

Life's Third Certainty: Change, And How Powers Of Appointment May Help An Estate Plan To Accommodate For It

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They say that the two certainties in life are death and taxes, but change must be the third. People grow, or regress. Couples marry, and some divorce. Babies come into this world, while others leave it. Laws fluctuate depending on who is in power. The economy may thrive...or not. When establishing a trust as part of an estate plan, a material question is how to ensure that the trust is administered according to its creator's wishes while accounting for life's potential changes.

If you have ever met with an estate planning attorney, you have likely discussed trusts. A trust is a legal agreement allowing the creator (the "Settlor") to direct how assets are to be used by a third party (the "Trustee") for the benefit of certain individuals (the "Beneficiaries").



Some trusts may be amended or revoked during the Settlor's lifetime; these are called revocable trusts. Upon the Settlor's death, though, these trusts become irrevocable. Many times, irrevocable trusts are created during a Settlor's lifetime. In most cases, older generations create irrevocable trusts to benefit younger generations in a manner that protects the trust assets from certain creditors and minimizes certain taxes.

The attribute of these trusts that helps to protect their assets and provide tax savings is the very attribute that many people view as their biggest drawback: they are irrevocable; their terms may not be amended or revoked. This irrevocable nature may cause a Settlor to hesitate to establish a trust for fear of chiseling the wrong set of directions in the proverbial stone. For this reason, drafting irrevocable trusts with the flexibility to change with the times is important. This may be done by appointing Trustees whom a Settlor trusts to use discretion in carrying out the Settlor's wishes, ensuring – when appropriate - that documents are drafted in a manner to make them modifiable in the future, and/or including certain flexible provisions that allow for

certain decisions to be made by select individuals in the future. One such example of flexible trust provisions is the **power of appointment**.

A power of appointment is a provision within a Trust granting an individual (often, a Beneficiary) the authority to designate who will receive trust property, how it will be distributed, and under what conditions. This authority can be broad or narrow, depending on the Settlor's wishes and the language of the trust document. By granting this discretion to direct trust property, the power of appointments allow for adaptability of the trust in response to changing circumstances, unforeseen events, or changes in family dynamics.



For example, John and Jane create a trust for their son, Jim. The trust provides that income and principal may be distributed to Jim or for Jim's benefit during his lifetime and that, upon Jim's death, the remaining trust estate passes to or among John's and Jane's descendants and/or charity, as designated in Jim's last will and testament. Jim's power to direct the disposition of the trust in his will is his power of appointment.

Powers of appointment do not all resemble Jim's power; they come in different forms, for different purposes, with different provisions, with different consequences for the beneficiaries relating to estate taxation, income taxation, asset protection, and ownership, all of which should be discussed with and carefully designed by a qualified estate planning attorney. Here, we will focus on various family circumstances that may arise that powers of appointment may help to address. Please remember that the following examples require more planning than the simple inclusion of a power of appointment.

Base Facts: Assume John and Jane are married with three children, Peter, Paul, and Mary. John dies, leaving a trust for the benefit of Jane, requiring quarterly distributions of income to Jane and permissible distributions of principal for her support. The trust grants Jane a limited power of appointment to direct the trust property to be distributed outright or in further trust for any of John's descendants and/or charity. If Jane doesn't exercise her power of appointment, then upon her death, the trust will be distributed among John's descendants, per stirpes.

Successful Child Scenario

For this scenario, in addition to the Base Facts, let's assume Peter and Paul both earn middle-class salaries, but Mary invents the latest Silicon Valley success and has more money than she could spend in 1,000 lifetimes. If Mary inherits one-third of her parents' estates after they die, she will needlessly inherit funds that would be of more use to her brothers and will have an augmented estate, destined to be subject to more tax. Jane could fix the situation by exercising her power of appointment to direct the trust estate remaining at her death for the benefit of Peter and Paul, excluding Mary.

Substance Abuse Scenario

In addition to the Base Facts, assume that John's death sends Paul into a downward spiral, and his alcoholism surfaces in a major way. Paul loses his job, alienates his spouse, and depletes his personal funds. As difficult as it is to effectively disinherit Paul, Jane decides to use her power of appointment to provide that Paul's share of the trust will not be distributed to him upon her death; instead, it will be held in a trust for the benefit of Paul and his children, with the proviso that the only permissible distributions for Paul will be for healthcare and rehabilitation, unless a named, trusted individual determines that Paul has stopped drinking. Jane could use her power of appointment to affect the necessary planning to ensure that Paul doesn't deplete his part of the estate she and John worked so hard to amass at the liquor store, further damaging his health and well-being.

Special Needs Scenario

Here, along with the Base Facts, assume John and Jane have six wonderful grandchildren. One of Peter's children, Paxton, has severe multiple sclerosis and cannot see, write, speak, walk, or handle his own activities of daily living. After John's death, Jane becomes worried about a scenario in which Peter's share of the estate passes to Paxton (thereby disqualifying him from certain necessary public assistance) and decides that she would like to direct Peter's share of John's trust to provide for Paxton's benefit. Jane may exercise her power of appointment to direct what would have been Peter's share of the trust to a special needs trust for Paxton to supplement the goods and services provided by public assistance. Further, Jane could use her power of appointment to direct that any trust funds remaining upon Paxton's death will be distributed among her and John's then-living descendants, per stirpes.

Spendthrift Scenario

In addition to the Base Facts, assume here that Peter falls on difficult times, his loans and credit card bills are mounting, and his marriage is strained. Seeing this, Jane decides that it is a bad idea for Peter to receive one-third of the trust when she dies because the creditors (potentially including Peter's wife, in a divorce) would all take their part of Peter's inheritance. Therefore, Jane exercises her power of appointment to direct Peter's inheritance into a trust that allows a trustee to make distributions for Peter's benefit. Not only could the creation of the trust protect Peter's inheritance from susceptibility to his poor decisions, but it could also help to shield Peter's inheritance from certain creditors.

Changes in Wealth Goals

In addition to the Base Facts here, assume that Jane has significant personal funds apart from the trust John left for her and she makes large gifts to the children after John's death. With time, she decides that the children have already received plenty of money and she does not want to ruin the children by allowing them to receive additional funds from John's trust when she dies; so, Jane exercises her power of appointment to direct that, upon her death, the remaining trust estate will be distributed to charities she and John supported during their lives together.

These are just a few examples of the usefulness of powers of appointment, but powers of appointment may prove to be even more useful in scenarios we cannot contemplate now. Certainly, when meeting with a qualified estate planning attorney, a discussion relating to powers of appointment, if they are appropriate, for what purposes, and for whose benefit is worthwhile for any thorough estate plan.

If you have any questions or would like to discuss further, please reach out to your client service team, or call 404.264.1400. You can also visit us on the web at [HomrichBerg.com](https://www.HomrichBerg.com).

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