THE ESTATE PLANNER'S SUPERPOWER

Powers of Appointment Explained

trustate

About me

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Founder and CEO, trustate

- Settled hundreds of estates, nationwide.
- Administered over $50B via estate administrations.
- 12+ years experience as estate attorney (JD & LLM) with multi-jurisdictional estate/trust admin practice.
- Learn more: trustate.com

Welcome!

Agenda

- What are Powers of Appointment?
- Estate Tax Refresher
- Income Tax Consequences
- Types of Powers of Appointment
- Drafting Considerations
- Practical Planning Applications
- Case Studies
- Q&A

What is a Power of Appointment?

A power of appointment is a legal authority granted to a person (the "powerholder") to designate who will receive certain property, typically held in trust.

Legal foundation:

- Restatement (Third) of Property: Wills and Other Donative Transfers §17.1: A power of appointment is a donative power that enables the powerholder to designate recipients of beneficial interests in the appointive property.
- Distinction between general and non-general (special/limited) powers is key to understanding tax consequences.
- Powers are classified based on the scope of discretion granted and who the permissible appointees are.

What is a Power of Appointment?

A power of appointment is a legal authority granted to a person (the “powerholder”) to designate who will receive certain property, typically held in trust.

Internal Revenue Code §2041:

A general power of appointment causes the value of the property subject to the power to be included in the powerholder’s gross estate.

- General = Power exercisable in favor of the decedent, their estate, their creditors, or the creditors of their estate.
- Limited = Power that excludes those categories — not included in gross estate.

Why it’s considered a "superpower" in estate planning

- Think of a power of appointment as the legal version of a “choose your own beneficiary” clause — it gives someone authority to redirect assets without needing to amend the original trust instrument.
- Used wisely, it becomes a superpower in flexible estate planning.

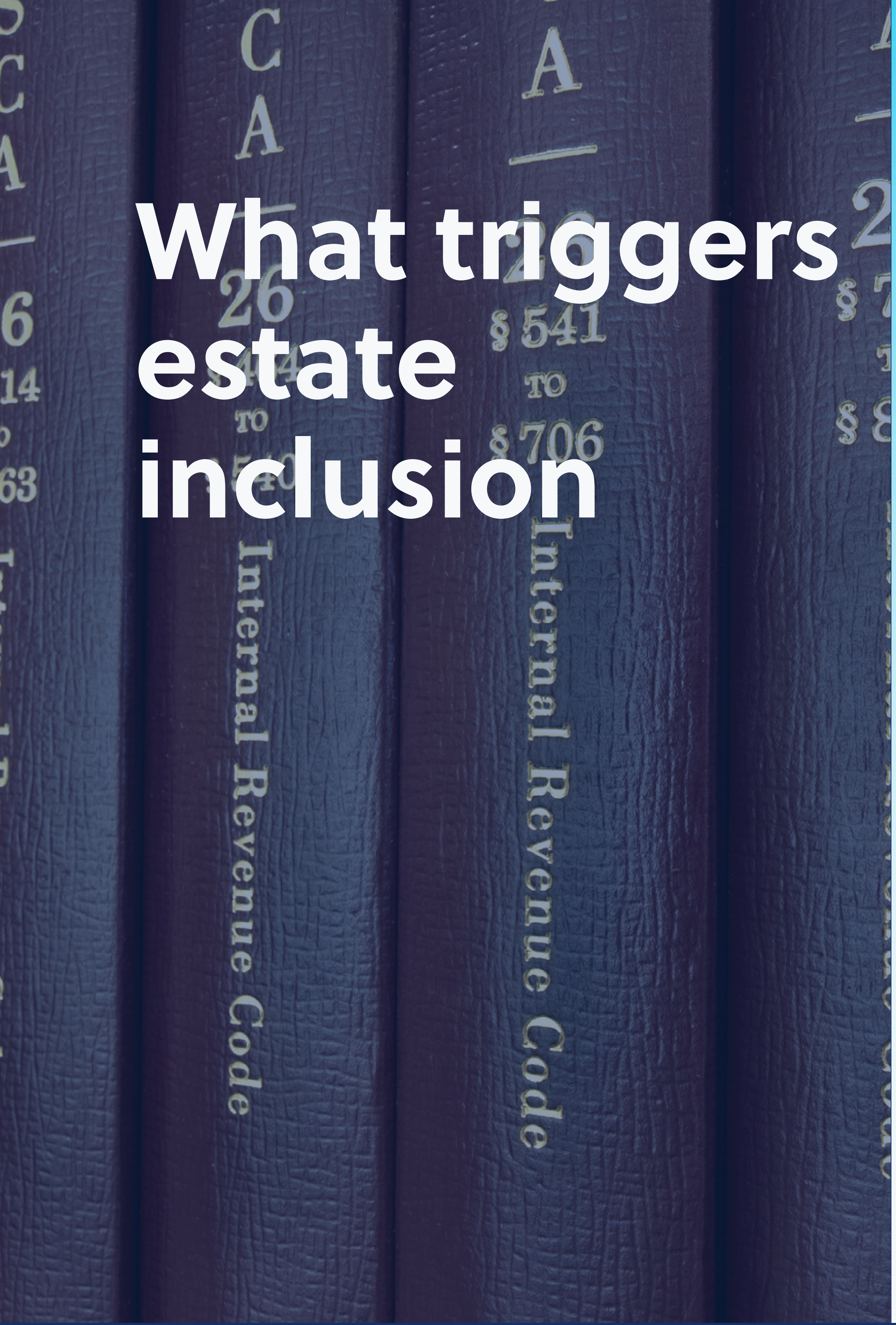
The role in modern estate planning

- **Flexibility**
- **Post-mortem control**
- **Coordination with changing family and tax circumstances**
- **Impacts whether trust assets are taxed at death**
- **Proper drafting can prevent unintentional estate inclusion**
    - General Power of Appointment → included in the estate
    - Limited (Special) Power of Appointment → excluded

Estate Tax Refresher

CURRENT FEDERAL EXEMPTION	EXEMPTION SCHEDULED TO SUNSET IN 2026	TOP ESTATE TAX RATE
$13.99M per person (2025)	To ~$7M	40%

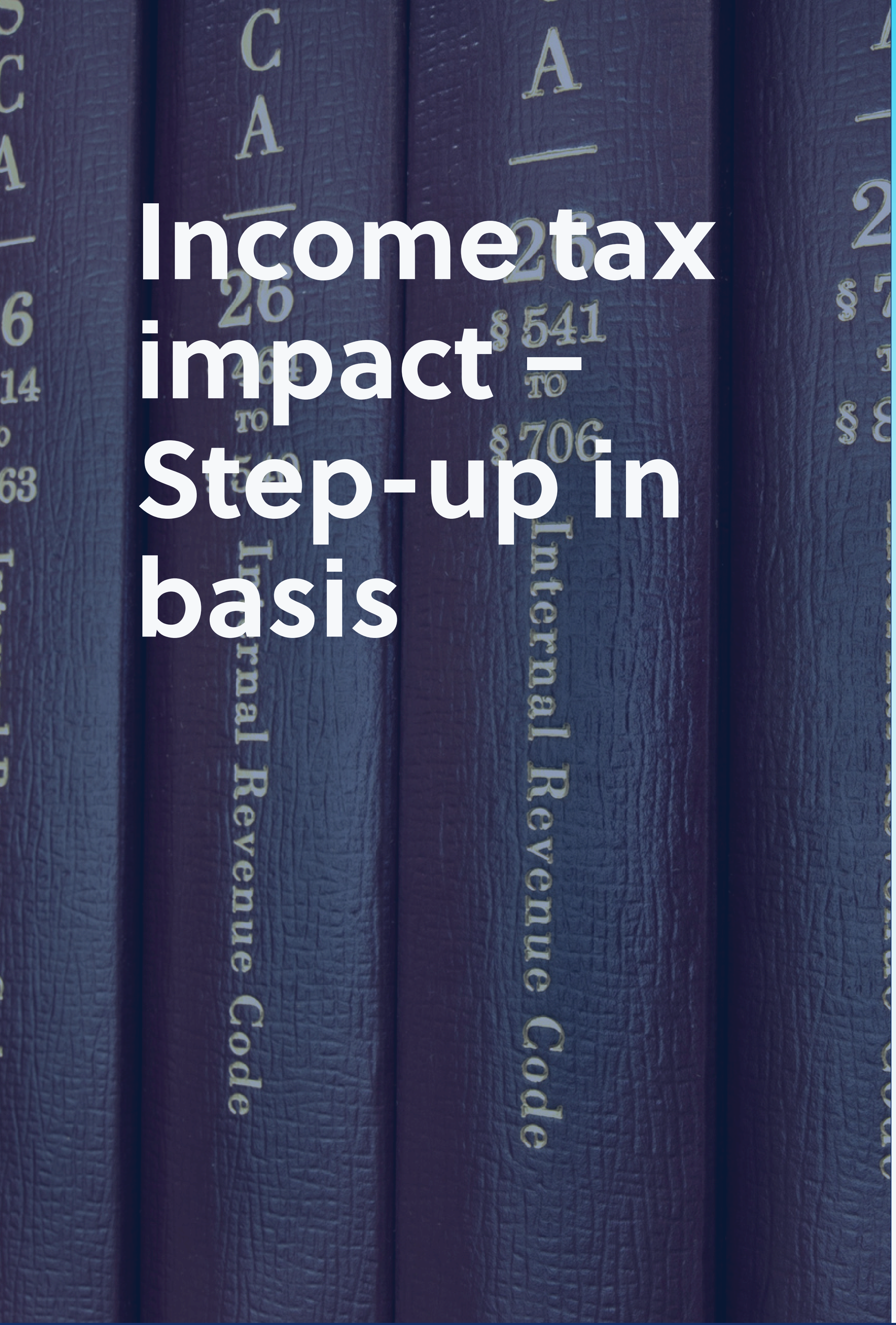
What triggers estate inclusion



IRC §§ 2033–2042

Internal Revenue Code §2041:

- **What's pulled into a decedent's taxable estate**
  - Property owned at death
  - Certain retained interests and powers
  - IRC §2041: Property subject to a general power of appointment
- **General Power of Appointment = inclusion (IRC §2041)**
- **Planning perspective: Inclusion is an opportunity or liability**



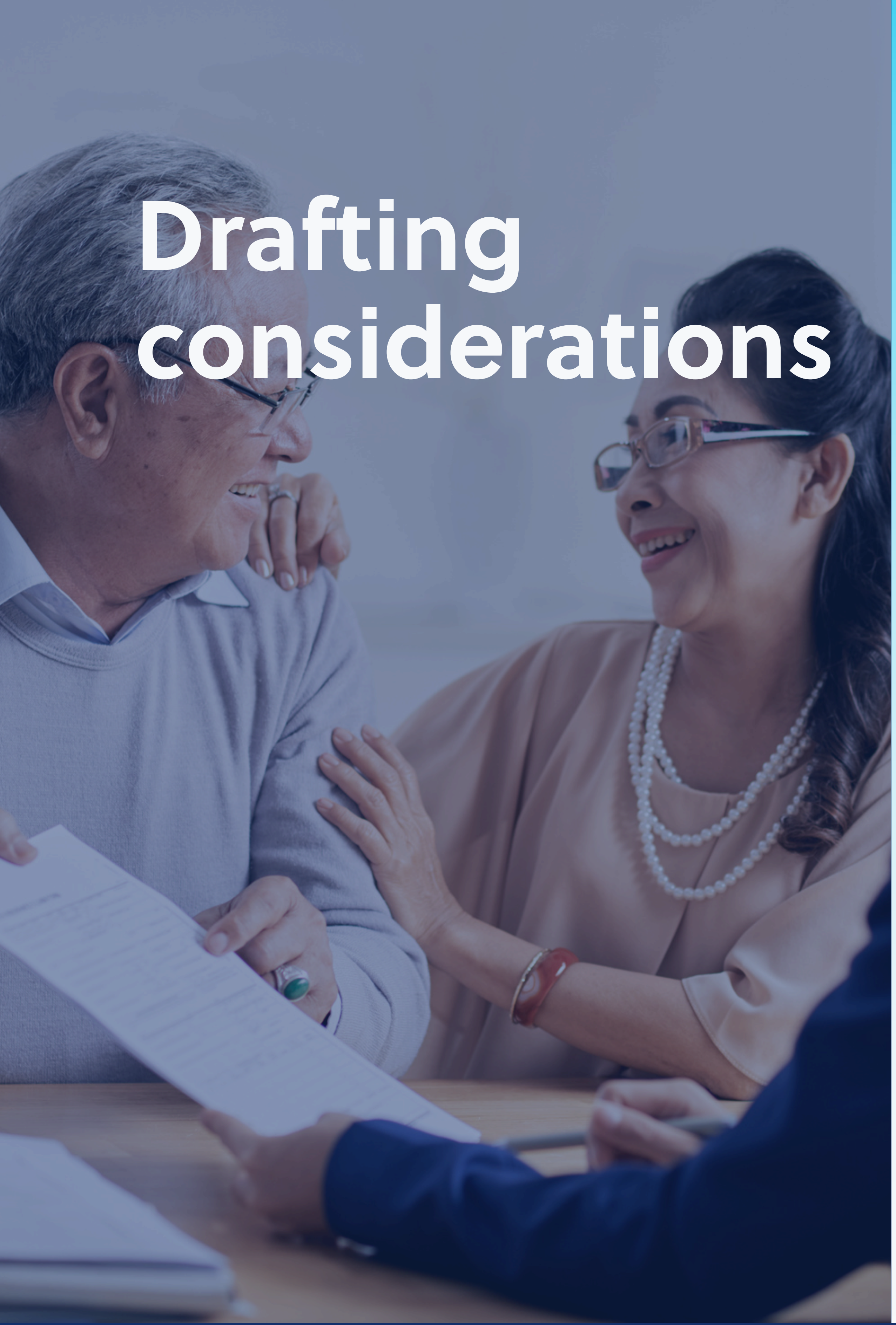
Income tax impact – Step-up in basis

IRC §1014

- Inclusion → Step-up benefit
- Exclusion → No step-up
- As of 2025, the highest federal income tax bracket for trusts and estates is: 37% on taxable income over $15,200
    - Examples: same asset, different basis outcomes
- Drafting powers to toggle tax results

Types of Powers of Appointment

TYPE	DEFINITION	TAX EFFECT	EXAMPLE
General	Can appoint to self, creditors, estate	Estate inclusion, basis step up	Upon the Beneficiary's death, the Trustees shall distribute the Descendant's Trust among such persons as the Beneficiary appoints by his or her will, in trust or outright.
Limited	Restricted class of appointees	No estate inclusion, no basis step up	Upon the Beneficiary's death, the Trustees shall distribute the Descendant's Trust among such persons, other than the Beneficiary's estate, his or her creditors and/or the creditors of his or her estate, as the Beneficiary appoints by his or her will, in trust or outright.
Testamentary	Exercisable at death	Depends on scope	Upon the Beneficiary's death, the Trustees shall distribute the Descendant's Trust among such persons, other than the Beneficiary's estate, his or her creditors and/or the creditors of his or her estate, as the Beneficiary appoints by his or her will, in trust or outright.
Inter Vivos	During lifetime	Rarely used	The Trustees shall distribute the Descendant's Trust among such persons, other than the Beneficiary's estate, his or her creditors and/or the creditors of his or her estate, as the Beneficiary appoints by written instrument, in trust or outright.



Drafting considerations

- Importance of clear language
- Avoiding unintentional general powers
- Safe harbors and restrictive language
- Coordination with trust protectors or advisors

Sample Drafting Language

Good clause for an LPOA:

the Trustees shall distribute the Descendant's Trust among such of the Grantor's descendants as the Beneficiary appoints by his or her will, in trust or outright.

Problematic clause: Causes a general power! ⬇️

"The beneficiary may appoint to any person she chooses."

Practical applications in planning

- **Add post-mortem flexibility for changing needs**
- **Preserve asset protection while giving some control**
- **Use in:**
  - Revocable Trust Plans
  - Third Party SNTs
  - Spousal trusts (SLATs)
  - Multigenerational/dynasty trusts (IDGTs, ILITs)
- **Where is it in Trustate's Documents?**
  - Narrow LPOA (Leah's personal preference in most situations)
    - Appointee Class: ONLY the Trust creator's descendants
  - Broad LPOA (the "standard")
    - Appointee Class: Everyone other than self, estate, creditors, creditors of estate
  - Broadest LPOA
    - Appointee Class: Everyone other than self, estate, creditors, creditors of estate AND specific language that allows a surviving spouse to have an income interest. (Technically also present in the Broad LPOA)
  - Trustee Power to Confer a GPOA
    - B-14 of the UTPs
    - B-14 of the UWPs

Case Study #1

Limited Power of Appointment – No Step-Up, No Estate Inclusion

<u>Key Fact:</u> The trust includes a LPOA exercisable at death → no step-up under IRC §1014.

The trust sells the asset during the lifetime of the powerholder.

- **Facts**
  - Trust has an LPOA — not includable in the estate
  - Trust owns appreciated real estate:
    - **FMV = $2,000,000**
    - **Basis = $200,000**
  - Trust sells asset after death of powerholder
  - Capital gains realized by the trust
  - Powerholder's estate is well below the exemption → no estate tax would have been due

Case Study #1

Limited Power of Appointment – No Step-Up, No Estate Inclusion

- **Result**
  - Capital Gain = $1.8M
  - Capital Gains Tax = 23.8%
  - $1.8M × 23.8% = $428,400
- **Key Point**
  - Because the LPOA kept the asset out of the estate, no step-up
  - But that estate exclusion had no real benefit, since the estate was well under the exemption
  - Result: Avoided estate tax that wouldn't have applied anyway, but paid high income tax

Case Study #2

General Power of Appointment – Step-Up + Estate Inclusion = Net Tax Loss

GPOA allows for step up but causes estate tax hit

- **Facts**
  - Trust creator gives the beneficiary a GPOA exercisable at death
  - Same asset:
    - **FMV = $2,000,000**
    - **Basis = $200,000**
  - Step-up in basis applies → new basis = $2,000,000
  - Estate exceeds the federal exemption by $2M → taxable estate

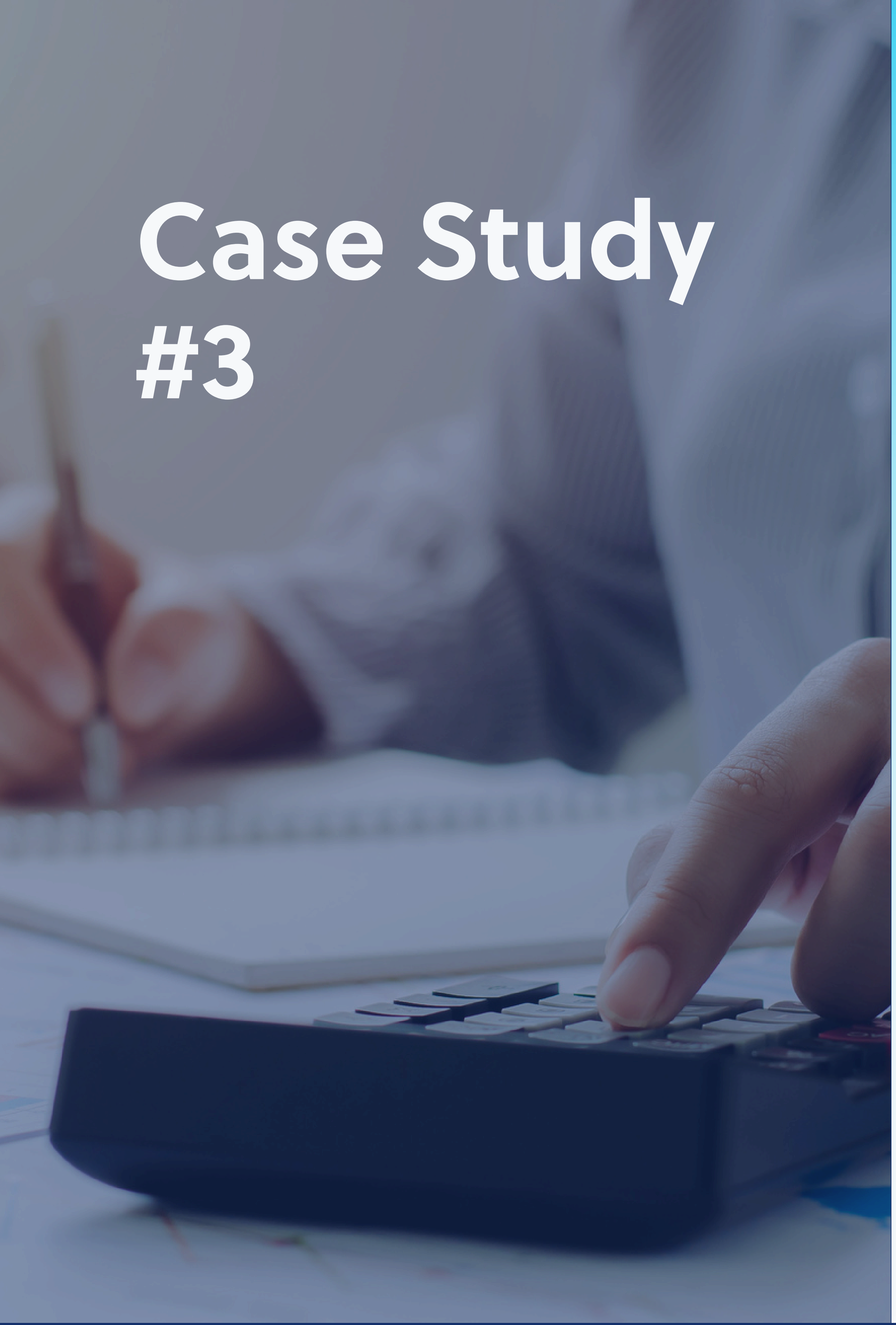
Case Study #2

General Power of Appointment – Step-Up + Estate Inclusion = Net Tax Loss

GPOA allows for step up but causes estate tax hit

Key Point

- Yes, step-up eliminated capital gains tax
- But the cost of estate inclusion far outweighed the benefit
- Result: Big tax bill could've been avoided by excluding the asset



Case Study #3

Income Tax Planning with a Formula Power

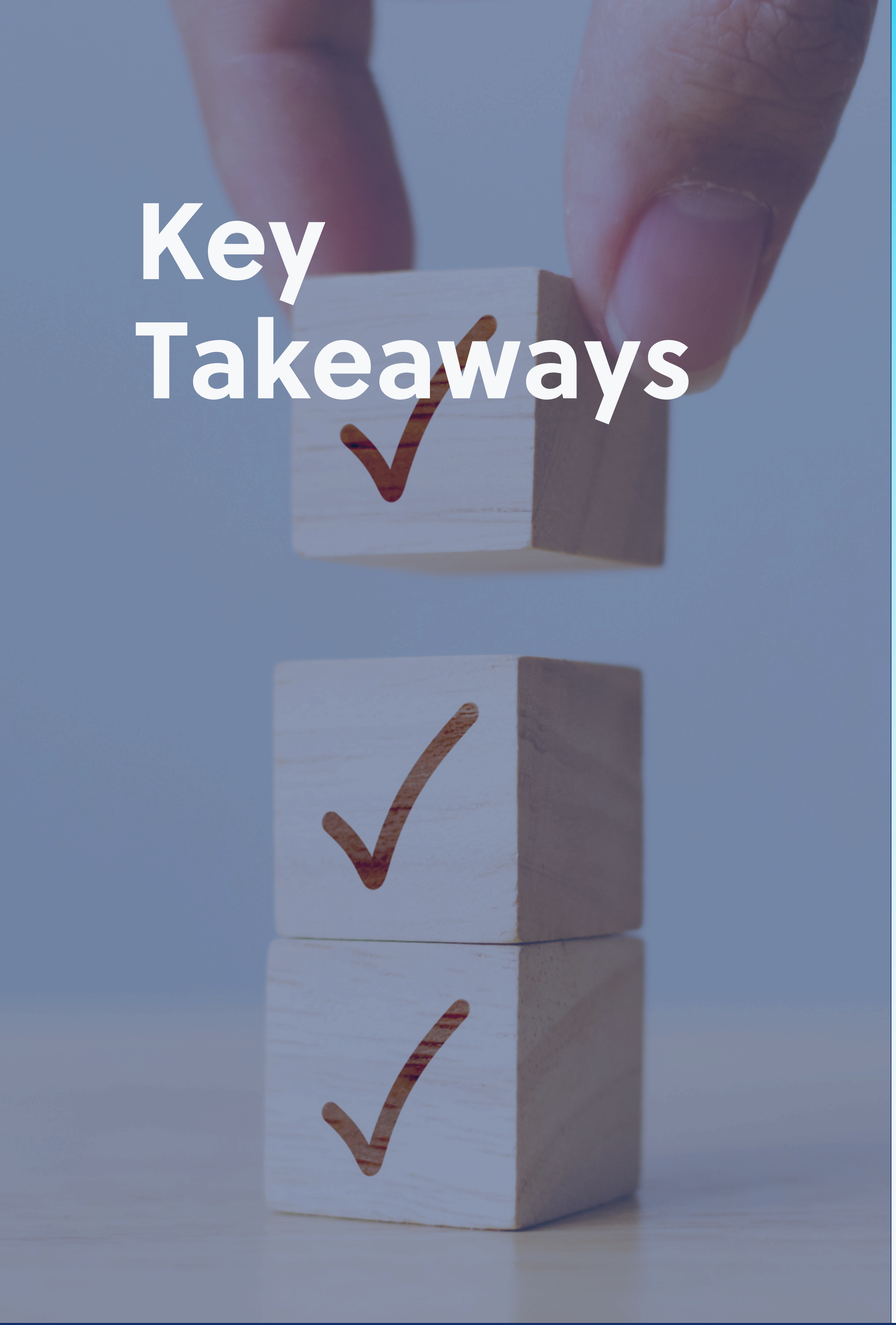
- Include formula clause that only creates general power if inclusion lowers total tax burden
- Strategic use in large taxable estates

Case Study #4

Limited Power in a Special Needs Trust

- Maintaining benefit eligibility
- Using power to allow flexible reallocation among descendants
- Avoiding any risk of beneficiary being deemed owner
- Does not work in a First Party d4a SNT

Key Takeaways



- Powers of appointment = control + flexibility
- Draft with precision to avoid unintended consequences
- Inclusion isn’t always bad—can optimize tax results
- Coordinate powers with other planning tools

Resources

Follow Trustate on LinkedIn for tips and updates.

Visit Trustate's website to explore subscription options and start streamlining estate planning, trust funding, and administration for all your estates today.

Email info@trustate.com with questions.