Build flexibility into your estate plan with powers of appointment

Published on May 14, 2020

There are several tools you can use to build flexibility into your estate plan. Flexibility is especially important now because of an uncertain estate planning environment.

The federal gift and estate tax exemption currently is an inflation-adjusted $11.58 million (the highest it's ever been) but it's scheduled to drop to its pre-2018 level of $5 million (indexed for inflation) on January 1, 2026. This window of opportunity could close sooner, however, depending on the results of this fall's election. One of the most versatile tools available to add flexibility to your estate plan is the power of appointment.

How does it work?

A power of appointment is simply a provision in your estate plan that permits another person — a beneficiary, family member or trusted advisor, for example — to determine how, when and to whom certain assets in your estate or trust will be distributed. The person who receives a power of appointment is called the "holder."

These powers come in several forms. A testamentary power of appointment allows the holder to direct the distribution of assets at death through his or her will or trust. An *inter vivos* power of appointment allows the holder to determine the disposition of assets during his or her lifetime.

Powers may be general or limited. A general power of appointment allows the holder to distribute assets to anyone, including himself or herself. A limited power has one or more restrictions. In most cases, limited powers don't allow holders to distribute assets for their own benefit (unless distributions are strictly based on "ascertainable standards" related to the holder's health, education or support). Typically, limited powers authorize the holder to distribute assets among a specific class of people. For example, you might give your daughter a limited power of appointment to distribute assets among her children.

The distinction between general and limited powers has significant tax implications. Assets subject to a general power are included in the *holder's* taxable estate, even if the holder doesn't execute the power, and such assets will receive a step-up (or step-down) in basis to fair market value at the holder's date of death for income tax purposes. Limited powers generally don't expose the holder to gift or estate tax liability, and the assets subject to a limited power of appointment won't get a step-up (or step-down) in basis to fair market value at the holder's date of death for income tax purposes (in other words, carry-over basis applies to those assets).

Dealing with uncertainty

Powers of appointment provide flexibility and enhance the chances that you'll achieve your estate planning goals. They allow you to postpone the determination of how your wealth will be distributed until the holder has all the relevant facts. If you'd like to build more certainty into your estate plan, please contact us.

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