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**The Remarkable Power of Appointment Device:
Planning and Drafting Considerations**

By

Professor Ira Mark Bloom
Justice David Josiah Brewer
Distinguished Professor of Law
Albany Law School
80 New Scotland Avenue
Albany, NY 12208-3494
ibloo@albanylaw.edu

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The Remarkable Power of Appointment Device: Planning and Drafting Considerations

Ira Mark Bloom*

“The power of appointment is the most efficient dispositive device that the ingenuity of Anglo-American lawyers has ever worked out.”¹

I. Introduction

Consider how the power of appointment device can be used by contemporary estate planners to achieve important non-tax dispositive goals: flexibility, control and creditor protection. As an example, Client wants to create a testamentary trust for Client’s Child for life, and then to Client’s Grandchildren. Client does not like the rigidity of fixed remainders that would result if the remainder was simply left to his grandchildren. Rather he wants Child to decide up until his death how the trust principal will be enjoyed by Client’s Grandchildren.

One solution is to give Child a special (nongeneral), exclusive (exclusionary) testamentary power of appointment pursuant to which Child will name in his will who among the Client’s Grandchildren will take and in what proportions. In this way, the trust remains flexible until the Child dies and gives the Child control over the principal without subjecting the principal to the Child’s creditors.² In addition, the trust principal will not be subject to federal estate taxation on the Child’s death. Nor will federal GST tax be imposed on the trust principal when Child dies if Client’s GST exemption was allocated to produce a zero inclusion ratio.

Client could have given Child even greater control by permitting Child to appoint to anyone other than himself, his creditors, Child’s estate or estate creditors. Creditor and tax immunity would still result.

What are the rules for the power of appointment device? For example, what arrangements should be treated as a power of appointment? What are the rules for creating powers of appointment? For exercising powers? Is property subject to a power of appointment always insulated from creditors?

* Justice David Josiah Brewer Distinguished Professor of Law, Albany Law School. Professor Bloom served as a member of the Members Consultative Group, Restatement (Third) of Property: Wills and Other Donative Transfers. He is currently serving as an Observer for the Uniform Power of Appointment Act Project. Professor Bloom has authored an article on powers of appointment: Ira Mark Bloom, *Powers of Appointment Under The Restatement (Third) of Property*, 33 Ohio Northern L. Rev. 755 (2007).

¹ W. Barton Leach, *Powers of Appointment*, 24 A.B.A.J. 807 (1938).

² Client could have given Child greater control by allowing Child to exercise his power during lifetime as well as by will.

New York has had statutory rules for powers of appointment dating from 1830.³ In 1964 the Bennet Commission, in a report prepared by Professor Richard Powell, recommended that existing New York legislation be replaced by laws essentially codifying the common law of powers of appointment.⁴ The common law rules were set forth in the First Restatement of Property.⁵ Enacted in 1965 under New York's Article 5 of the Real Property Law,⁶ the 1964 revisions were then enacted without substantial change as part of Article 10 of the Estates, Powers and Trusts Law, which became effective in 1967.⁷ New York's current statutory treatment of powers of appointment continues substantially unchanged in Article 10 of the EPTL.⁸

Although New York law on powers of appointment remains essentially unchanged since 1967, the American Law Institute has produced two comprehensive updates. An entire volume was devoted to powers of appointment in the Second Restatement, which was published in 1986.⁹ As part of the latest Restatement of Property project in the last decade,¹⁰ the American Law Institute again undertook to update the law of powers of appointment.¹¹

The Institute's formulation process was explained in the Tentative Draft on powers of appointment¹²:

Each portion of an Institute project is submitted initially for review to the project's Consultants or Advisors as a Memorandum, Preliminary Draft, or Advisory Group Draft. As revised, it is then submitted to the Council of the Institute in the form of a Council Draft. After review by the Council, it is submitted as a Tentative Draft . . . for

³ 1 R.S., Part II, Chap. I, Art 3 (pp.731 et seq.) (1829) (effective Jan. 1, 1830).

⁴ See Report No. 6.9B in Third Report of the Temporary State Commission on the Modernization, Revision and Simplification of the Law of Estates 612 (1964).

⁵ Powers of appointment were covered in an extensive chapter of the first Restatement of Property. See 3 Restatement of the Law of Property ch. 25 (1940). Professor Powell was the Reporter.

⁶ See L. 1964, ch. 864, effective June 1, 1965.

⁷ See L. 1966, ch. 952, effective September 1, 1967.

⁸ There have been a few changes since 1967. For example, EPTL 10-6.9 was added in 1975 and EPTL 10-10.1 and 10-10.2 were amended in 2005.

⁹ See 2 Restatement of the Law Second Property (Donative Transfers) (1986).

¹⁰ “[Restatements] purport to state an authoritative or recommended view of the current American common law.” See Edward C. Halbach, Jr., *Symposium on Law in the Twentieth Century: Uniform Acts, Restatements, and Trends in American Trust Law at Century's End*, 88 Cal. L. Rev. 1877, 1881 (2000).

¹¹ Powers of appointment in relation to the Rule Against Perpetuities are treated in § 27.1 of the Restatement (Third) of Property: Wills and Other Donative Transfers. . . Other substantive and procedural rules that involve powers of appointment are properly treated elsewhere in the Restatement (Third) of Property: Wills and Other Donative Transfers. For example, under the slayer rule, the slayer will be precluded from taking a power of appointment that was conferred on the slayer in the victim's will. See Restatement (Third) of Property: Wills and Other Donative Transfers § 8.4, cmt. k (hereinafter 3d Rest. Prop.). For virtual representation purposes, the donee of a general testamentary power may bind objects and takers in default. See, e.g., UTC § 302. See also UPC § 1-403.

¹² See Tentative Draft No. 5, at x. (March 27, 2006), Restatement (Third) of Property: Wills and other Donative Transfers (hereinafter Tentative Draft).

consideration by the membership at the Institute's Annual Meeting. At each stage of the reviewing process, a Draft may be referred back for revision and resubmission.

Earlier drafts of the material contained in [the Tentative] Draft on powers of appointment are contained in:

Council Draft No. 5 (2005)

Preliminary Draft No. 11 (2005)

In May of 2006, the membership of the ALI approved the Tentative Draft on powers of appointment for publication in the Restatement (Third) of Property: Wills and Other Donative Transfers (hereinafter Restatement (Third) of Property).¹³ In late 2011, the powers of appointment topic was published in Volume 3 of the Restatement (Third) of Property.¹⁴

My paper will highlight decisions made in the Powers of Appointment Division of the Restatement (Third) of Property that affect planning and drafting. Of necessity, only selected issues will be addressed since the Powers of Appointment Division runs over 225 pages.¹⁵ My focus will be on issues that will confront estate planners,¹⁶ including to some extent issues that may arise for estate planners under powers that are created by non-lawyers and lawyers not well-versed in powers of appointment law. Also, consistent with the Restatement's treatment, my primary focus will be on powers of appointment in trusts.¹⁷

Overall, I believe that the latest Restatement's treatment of powers of appointment is a commendable and important piece of work that will provide significant guidance to lawyers and judges in all states.¹⁸ In addition, the latest Restatement's treatment of powers of appointment can serve as a basis to revise New York's law on powers, which is clearly in need of an update after almost 50 years. The latest Restatement's treatment of powers of appointment will also form the basis for a Uniform Power of Appointment Act that the National Conference of Commission on Uniform State Laws is presently working on.

¹³ Actions Taken with Respect to Submitted at 2006 Annual Meeting 8

<http://www.ali.org/doc/2006ActionsTaken.pdf>. As explained in the Tentative Draft at x:

The bylaws of The American Law Institute provide that "Publication of any work as representing the Institute's position requires authorization by the membership and approval by the Council."

¹⁴ 3 Restatement (Third) of Property: Wills and Other Donative Transfers Div. 6 (2011). In addition to powers of appointment, Volume 3 covers class gifts, future interests and perpetuities.

¹⁵ The Division includes §§ 17.1-23.1. Excluded from discussion are issues involving selective allocation (§ 19.19) contracts to appoint (§§ 21.1 and 21.2) and the surviving spouse's elective share (§ 23.1). Releases and disclaimers, which are found in §§ 20.1-20.4, are only briefly mentioned in the paper.

¹⁶ For estate planners, the tax consequences of powers of appointment will be critical. Unlike the treatment of powers of appointment under the Restatement (Second) of Property, the Restatement (Third) of Property does not provide Reporter's Tax Notes for powers of appointment.

¹⁷ In a few instances, the Powers of Appointment Division provides illustrations involving non-trust dispositions. *See, e.g.*, 3d Rest. Prop. § 17.1, Illust. 2, § 18.1, Illust. 10.

¹⁸ Apart from New York, only a few states, California, Michigan, Minnesota, and Wisconsin, have extensive statutory coverage for powers of appointment. *See, e.g.*, Cal. Prob. Code §§ 600-695.

II. Definitions

A. Black Letter Law

§ 17.1 POWER OF APPOINTMENT DEFINED

A power of appointment is a power that enables the donee of the power to designate recipients of beneficial ownership interests in or powers of appointment over the appointive property.

§ 17.2 TERMINOLOGY ASSOCIATED WITH A POWER OF APPOINTMENT

(a) “Donor.” The “donor” (“creator”) is the person who created or reserved the power of appointment. Before creating the power, the donor was either the owner of the appointive property or the donee of a power of appointment with respect to the appointive property.

(b) “Donee.” The “donee” (“power holder”) is the person on whom the power of appointment was conferred or in whom the power was reserved. If the donor reserved the power in himself or herself, the donor is also the donee, and the term “Donor-Donee” is sometimes used to refer to such a person.

(c) “Permissible Appointees.” The “permissible appointees” (“objects”) are the persons to whom an appointment is authorized.

(d) “Impermissible Appointee.” An impermissible appointee (“nonobject”) is anyone who is not a permissible appointee.

(e) “Appointee.” An “appointee” is a person to whom an appointment has been made.

(f) “Taker in default of appointment.” A “taker in default of appointment” (“taker-in-default”) is a person who takes the appointive property to the extent that the power is not effectively exercised. The clause that identifies the taker- or takers-in-default is called the gift-in-default clause. The gift-in-default clause often identifies the takers-in-default as a class (i.e., a class gift).

(g) “Appointive property.” The “appointive property” is the property or property interest that is subject to a power of appointment.

B. Illustration

Settlor creates a testamentary trust over stock with the income payable to Daughter for life, remainder as Daughter appoints other than to herself, her creditors, her estate or the creditors of her estate; in default of the exercise of the appointment to her children in equal shares.

Based on the Restatement (Third) of Property § 17.1, and accepting that the Daughter is the **donee** under the Restatement (Third) of Property § 17.2, Settlor has created a power of appointment because the donee has the power to designate who will receive the remainder interest in the trust property, the so-called **appointive property** under the Restatement (Third) of Property § 17.2.

Based on the Restatement (Third) of Property § 17.2, Settlor is the **donor**; Daughter is the **donee**; every person in the world is an **object** apart from the donee, her estate, and her and her estate creditors; daughter's children are the **takers in default**. The remainder interest is the **appointive property**.¹⁹

C. Arrangements Constituting Powers of Appointment²⁰

1. Powers in trust

a. Fiduciary powers

Although fiduciary powers were not powers of appointment under the Tentative Draft, Restatement (Third) of Property § 17.1, comment g explains that fiduciary powers are powers of appointment. However, the Comment also provides that basic trust rules will apply to such fiduciary powers. *See* Restatement (Third) of Trusts. Fiduciary powers are not powers of appointment in New York. *See* EPTL 10-3.1(b).

For tax purposes, fiduciary powers, other than reserved powers, are considered powers of appointment. *See, e.g.*, I.R.C. § 2041.

¹⁹ Although EPTL 10-2.2 defines donor and donee in a similar way, EPTL 10-2.2(c) erroneously defines appointee as an object instead of as the person in whose favor the power is exercised. No definition for taker in default is provided under current New York law.

²⁰ EPTL 10-3.1(a) defines a power of appointment as follows: "This article [Article 10] applies to powers of appointment. A power of appointment, as the term is used in this article, is an authority created or reserved by a person having property subject to his disposition, enabling the donee to designate, within such limits as may be prescribed by the donor, the appointees of the property or the shares or the manner in which such property shall be received."

b. Power to withdraw

A power to withdraw is treated as a power of appointment under the Restatement (Third) of Property § 17.1, comment e. What is a power of withdrawal? *Cf.* U.T.C. § 103(11) (Power of withdrawal means a presently exercisable power of appointment); 3d Rest. Trusts § 74(2) (To the extent a trust is subject to a presently exercisable general power of appointment or power of withdrawal, and the donee of the power is legally competent, the donee has authority similar . . . to the authority the settlor of a revocable trust has under Subsection (1).); 3d Rest. Trusts § 56, cmt. b (Trust property subject to a presently exercisable general power of appointment (a power by which the property may be appointed to the donee, including one in the form of a power of withdrawal), because the power's equivalence to ownership, is treated as property of the donee of the power.)

Common examples: 5/5 powers and *Crummey* demand powers.

c. Power to terminate

What is a power to terminate? If the power is only to accelerate interests, then Restatement (Third) of Property § 17.1, Reporter's Notes to comment e, treats the power as NOT a power of appointment, reversing the position in the Restatement (Second) of Property. But if a power to terminate could be in favor of others, then it should be treated as a power of appointment. For tax purposes, a retained power to terminate is taxable even if can only accelerate enjoyment. *See Lober v. United States*, 346 U.S. 355 (1953).

d. Power to amend

Power to amend, even by donor, is treated as a power of appointment under the Restatement (Third) of Property § 17.1, comment e. For tax purposes, a retained power to amend is not a power of appointment but property subject to the power may be subject to estate tax under Internal Revenue Code § 2038 unless subject to an ascertainable standard. *See, e.g., Jennings v. Smith*, 161 F.2d 74 (2d Cir. 1947).

e. Power to revoke

Despite the comprehensive treatment of the revocable trust device under the Restatement of Trusts, *see, e.g.*, 3d Rest. Trusts §§ 25, 74, the Restatement (Third) of Property § 17.1, comment e, treats the right as a power of appointment.²¹ *Consider* 3d Rest. Trusts § 56 cmt. b (Powers of revocation or appointment); 3d Rest. Trusts § 74 gen. cmt. a (“This Section deals with situations in which a person currently has, by reason of a power of revocation, appointment, or withdrawal, the equivalent of ownership of the trust property, even though the legal title to the property is held by the trustee.”). *See also* 3d Rest. Prop. § 22.2, cmt. a, set forth *in* Part VI, B2, *infra*, and Bogert, Bogert and Radford, *The Law of Trusts and Trustees* § 1001 at 396 (2006) (“A power to revoke a trust is not the equivalent of a power of appointment and should not be subjected to the statutory rules in some states regarding the formalities required for the execution of powers of appointment.”)

Although Uniform Probate Code § 2-201(b) defines a power to revoke as a power of appointment, this is for elective share purposes where it makes sense to combine. *See* UPC § 1-403(2) (holder of “power of revocation or a presently exercisable general power of appointment”), § 6-102, Comment (revocable trust subject to estate creditors but not property that was subject to a presently exercisable general power of appointment.) *See also* UPC § 2-902.

The revocable trust device is not treated as a power of appointment under the Uniform Trust Code; rather a power of appointment is treated as revocable trust. *See* UTC §§ 103(11) and (14) and comments thereunder, § 505 and § 603.

Can a third person have a unilateral power to revoke? *Cf.* 3d Rest. Trusts § 64 (referring to termination or modification).

For tax purposes, a reserved power to revoke is not a power of appointment but the power holder will be treated as the owner for tax purposes.

f. Power to direct trustee to distribute income or principal.

Includes beneficiary, settlor of revocable trust, person with

²¹ A power to revoke is not a power of appointment under New York law. EPTL 10-3.1(b).

power of withdrawal and trust protectors.

g. Management powers

Management powers, including trustee appointment and replacement powers, are properly NOT powers of appointment. *See* 3d Rest. Prop § 17.1, cmts. h and i.

2. Power of attorney is NOT a power of appointment. *See* 3d Rest. Prop § 17.1 cmt. j.

3. Other Arrangements?

Many arrangements that involve a power of revocation are broad enough to be powers of appointment under the Restatement (Third) of Property § 17.1. For example, gifts causa mortis, revocable deeds, life insurance and 529 plans. But should the power of revocation under these distinct arrangements be treated as powers of appointment subject to the rules under the Powers of Appointment Division? The comments to Restatement (Third) of Property § 17.1 provide no guidance.

D. Aspects of terminology

1. Persons

Can a corporation or other entity be a donor or a donee? *See* EPTL 1-2.12 (broadly defining person)

2. Donee issues

a. Deceased donee cannot take, but an unborn may be donee.

b. Donee cannot transfer power to another

c. Variations on only one donee

(1) Exercise by donee with consent of another. *See* EPTL 10-6.4.

(2) Joint donees. *See* EPTL 10-6.7.

(3) Successive donees: Consider successive donees, including a mechanism for appointment.

d. Reserved power: Donor can be the donee. As noted in the comments under Restatement of Property § 319 (1940), comment b:

Reserved power. Where a person reserves a power in himself he is

both the donor and the donee. The linguistic difficulties attendant upon a person being both donor and donee are overcome by considerations of common usage and convenience.

The Restatement (Third) of Property often refers to a retained powerholder as donor-donee.

For tax purposes, a retained power is not a power of appointment. *See* Treas. Reg. § 20.2041-(b)(2).

e. Donee as beneficiary: Donee is considered a trust beneficiary under the Uniform Trust Code. *See* UTC § 103(3)(b).

f. Donee as donor: Donee can be a donor by exercising a power to create a power.

3. Objects

Objects can range from unlimited to only one.

- Example of one: T in trust to A for 20 years. D has the power to change the income beneficiary to B.
- Example of very broad class: To anyone other than the big 4 in tax world.

If appointment is in further trust, trustee would be a non-object. Might consider excluding certain persons as trustee if exercise in trust, e.g., certain relatives.

Exercise will be subject to applicable perpetuities rules. *See* EPTL 10-8.1-10-8.4.

4. Takers in default

The common situation involves a future interest subject to divestment on exercise of the power. Consider the statement in Restatement (Third) of Property § 19.25, comment a: “Takers in default of appointment take future interests that may be defeated by an exercise of the power.”

Can takers in default have a present interest?

Example: S in trust to A for 20 years, B has power to amend the trust by naming a different income beneficiary. A is taker (owner) in default.

Essential Drafting Point: Every well-drafted power should provide takers-in-default!

E. Other definitions

1. Powers appendant (power over owned interest)

The Restatement (Third) of Property § 17.1 recognizes as valid powers appendant in contrast with prior Restatements. *See also* 3d Rest. Prop. § 17.3, cmt. g. Powers appurtenant are synonymous with powers appendant. *See* Rest Prop. § 325, cmt. a.

Example: Donor gives donee a life estate in property and the power to decide who will enjoy the life estate. The power is not subsumed within the life estate. *See* 3d Rest. Prop§ 17.3, cmt. g (failure to recognize would create conceptual problems, *e.g.*, if trust income beneficiary had the power of withdrawal). *See* 3d Rest. Trusts § 58, cmt. (b)(1) (discussing invalidity of spendthrifted income interest if beneficiary has power to compel distribution of trust principal to self).

2. Power in gross

Power in gross is where donee also has an interest. *See* 3d Rest. Prop. § 17.3, cmt. f.

Example: Settlor creates a testamentary trust over stock with the income payable to Daughter for life, remainder as Daughter appoints other than to herself, her creditors, her estate or the creditors of her estate, in default of the exercise of the appointment to her children in equal shares.

Daughter has a power in gross.

3. Collateral power

Collateral power is where the donee has no owned interest. *See* 3d Rest. Prop. § 17.3, cmt. f. Example would be trust where a person has power to change remainder beneficiary but is not a trust beneficiary.

4. Imperative power

The term imperative power (mandatory power or power in trust) involving implied gifts in default of exercise is generally rejected by Restatement (Third) of Property § 17.1, comment k, in favor of an implied gift in default of exercise where there is no gift-in-default clause. *See* 3d Rest. Prop. § 19.23. Note that “imperative power” and the consequences thereof are employed in New York. *See* EPTL 10-3.4 (b) and 10-6.8.

Under the Restatement (Third) of Property, powers of appointment are discretionary. *See* 3d Rest. Prop § 17.1, cmt. k. But what about certain imperative powers in trust? *E.g.*, remainder interest in CRT if named charity fails.

III. Categories of Powers of Appointment

A. Black Letter Law

§ 17.3 GENERAL POWER; NONGENERAL POWER

(a) A power of appointment is general to the extent that the power is exercisable in favor of the donee, the donee’s estate, or the creditors of either, regardless of whether the power is also exercisable in favor of others.

(b) A power of appointment that is not general is a nongeneral power.

§ 17.4 POWER PRESENTLY EXERCISABLE; TESTAMENTARY POWER; POSTPONED POWER

(a) A power of appointment is presently exercisable if it is exercisable by the donee at the time in question, whether or not it is also exercisable by will.

(b) A power of appointment is testamentary if it is exercisable only in the donee’s will.

(c) A power of appointment is postponed if it is not exercisable until the occurrence of a specified event, the satisfaction of an ascertainable standard, or the passage of a specified period of time. A postponed power becomes presently exercisable upon the occurrence of the specified event, the satisfaction of the ascertainable standard, or the passage of the specified period of time.

§ 17.5 WHETHER POWER IS EXCLUSIONARY OR NONEXCLUSIONARY

A power of appointment whose permissible appointees are defined and limited is either exclusionary or nonexclusionary. An exclusionary power is one in which the donor has authorized the donee to appoint to any one or more of the permissible appointees, to the exclusion of the others. A nonexclusionary power is one in which the donor has specified that the donee cannot make an appointment that excludes any permissible appointee or one or more designated permissible appointees from a share of the appointive property. In determining whether a power is exclusionary or nonexclusionary, the power is exclusionary unless the terms of the power expressly provide that an appointment must benefit each permissible appointee or one or more designated permissible appointees.

B. Illustration

Settlor creates a testamentary trust over stock with the income payable to Daughter for life, remainder as Daughter appoints during lifetime or by will other than to herself, her creditors, her estate or the creditors of her estate; in default of the exercise of the appointment, to her children in equal shares.

Daughter has a **nongeneral power** under Restatement (Third) of Property § 17.3. Under Restatement (Third) of Property § 17.4, the power is **presently exercisable**. Since the class of objects is not defined and limited, Restatement (Third) of Property § 17.5 is not applicable.

C. General-Nongeneral Categories

1. General

a. Tax law coordination

Restatement (Third) of Property § 17.3 follows the general transfer tax law definition. *See* I.R.C. § 2041(b) and 2514(c). Accord EPTL 10-3.2(b). It also includes a tax exception under Internal Revenue Code § 2041(b)(1)(C)(ii) for a power exercisable with a person having a substantial adverse interest. How should substantial adverse interest be defined? *Cf.* Treas. Reg. § 20.2041-3(c) (“value [of interest] in relation to total value of property subject to the power is not insignificant.”)

The Restatement (Third) of Property § 17.3 does not use all of the transfer tax exceptions. Noteworthy departure is the

ascertainable standard exception under Internal Revenue Code § 2041(b)(1)(A), which can be treated as a general power under the Restatement (Third) of Property. *See* 3d Rest. Prop. § 20.1, cmt.i. New York does not have the ascertainable standard exception. *But cf.* EPTL 5-1.1-A(b)(1)(H) (exception applies for elective share issue) and 10-7.2 (exception applies for creditors' rights issue).

The Restatement (Third) of Property § 17.3 does not provide the tax law exception of Internal Revenue Code § 2041(b)(1)(C)(I) if donee's power is exercisable only in conjunction with donor. *Cf.* 3d § Rest. Prop. § 18.2, cmt. e.

b. Presumption that power is a general power

The Restatement (Third) of Property presumes that an ambiguous power is a general power. *See* 3d Rest. Prop., Intro. to Part B of ch. 17. *Cf.* EPTL 10-5.1. Since a general power classification will have adverse creditor and transfer tax consequences, should the presumption be otherwise? *Cf.* 3d Rest. Prop § 11.3(c)(4) (constructional preference that produces more favorable tax consequences than other constructions). If it is assumed that unsophisticated estate planner or lay person will use ambiguous language, maybe it is a good presumption as the presumption would result in step-up in basis under Internal Revenue Code § 1014.

2. Nongeneral

a. Nongeneral in lieu of special

For historical reasons, "nongeneral" is used instead of "special." *See* 3d Rest. Prop § 17.3, cmt. b. California and New York use "special." *See* Cal. Prob. Code § 611(d) and EPTL 10-3.2(c). Most lawyers use **special**, not nongeneral.

b. Drafting considerations

Restatement (Third) of Property § 19.15, which renders appointments to non-objects ineffective, provides some helpful drafting points in comment d:

d. Permissible appointees of nongeneral power. The donor may define the permissible appointees of a nongeneral power by exclusion, by inclusion, or by a combination of the two. If they are

defined by exclusion, the donor lists the persons to whom a valid appointment cannot be made. If they are defined by inclusion, the donor lists the persons to whom a valid appointment can be made.

If the permissible appointees are defined by exclusion, the list must include the donee, the donee's estate, and the creditors of either; otherwise, the power would be a general power. The common way of identifying the permissible appointees by exclusion is to authorize the donee to appoint to "any person other than the donee, the donee's estate, and the creditors of either." A nongeneral power to appoint to "any person other than the donee, the donee's estate, and the creditors of either" gives the donee an almost unlimited choice of permissible appointees. The list of excluded persons may be expanded beyond just the donee, the donee's estate, and the creditors of either, however, and include other excluded persons. For example, the donee may be authorized to appoint to "any person other than the donee, the donee's estate, the creditors of either, my brother Bob, Bob's wife, Bob's descendants, and the XYZ Charity." An attempted appointment of a beneficial interest to any person that is excluded as a permissible appointee is ineffective.

If the permissible appointees are listed by inclusion, the list of permissible appointees must not include the donee, the donee's estate, and the creditors of either; otherwise the power would be a general power. A well-drafted list usually takes the form of a defined and limited class, such as "children," "grandchildren," "issue," "descendants," "brothers and sisters," "nieces and nephews," or "heirs." If, for example, the permissible appointees are the donee's descendants, an appointment to the donee's brother or sister is impermissible and ineffective...See also § 19.12(c) for the proposition that the descendants of a deceased permissible appointee of a nongeneral power are permissible appointees in certain circumstances.

3. Toggle mechanism

Depending on the situation, it may be appropriate for the trust protector or trustee to give donee a general power or take away a general power if authority so provided. Power status will depend on the actual situation at any given time. *See* 3d Rest. Prop. § 17.3, cmt. d.

4. Relation back theory

Restatement (Third) rejects use of relation back theory to explain all powers of appointment results. *See* 3d Rest. Prop. § 17.4, cmt. f. Relation back theory is applied for perpetuities purposes other than for presently exercisable general powers. *See* 3d Rest. Prop § 19.19, cmt. g and § 27.1, cmt. j(2). *Accord* UPC § 2-902, Comment a.

D. Time When Power Exercisable²²

1. Presently exercisable power

Exercise by last unrevoked document is a presently exercisable power. *See* 3d Rest. Prop. § 17.4, cmt. a.

2. Postponed power

Postponed power includes power subject to an ascertainable standard that can become presently exercisable once the standard is met. *See* 3d Rest. Prop. § 17.4, cmt. d.

Example: To A for life, A has power to demand principal for A's support taking into other resources. Assuming A does not need for support the power is a postponed power. What if A can demand support without taking into account other resources? Then the power would be a presently exercisable general power? *Cf.* Treas. Reg. § 20.2041-1(c)(2) (ascertainable exception applies even if beneficiary is not "required to exhaust his other income before the power can be exercised").

3. Testamentary power

Testamentary power is one exercisable only by the donee's will. *See* 3d Rest. Prop. § 17.4, cmt. c. *But cf.* 3d Rest. Prop. § 19.9, cmt. b. (will includes a revocable trust).

E. Exclusionary-nonexclusionary

1. Earlier Restatements used exclusive-nonexclusive terminology. *See, e.g.* 2d Rest. Prop §§ 21.1 and 21.2; see also Cal. Prob. Code § 652 and EPTL 10.3-2(a)(2).

2. Only applies when class is defined and limited. Could include a general

²² *See* EPTL 10-3.3.

power if limited to creditors.

3. Presumption in favor of exclusionary. For example, power to appoint “to” “among or between” is exclusionary. *See* Rest. of Prop. § 17.5, cmt. f.
4. If nonexclusionary, it is not necessary to specify share as under Restatement (Second) of Property § 21.2. Return to Restatement of Property § 361 (1940) position. *Contra* EPTL 10-6.5(2) (must be exercised equally in favor of all). Doctrine of illusory appointments based on reasonable benefit. *See* 3d Restatement of Property § 17.5 cmt. j.

IV. Selected Issues Involving the Creation of Powers of Appointment

A. How powers created

1. Black letter law

§ 18.1 POWER OF APPOINTMENT: HOW CREATED²³

A power of appointment is created by a transfer that manifests an intent to create a power of appointment.

2. Effective transfer required

An indispensable prerequisite for a person (donor) to create a power of appointment is that the property transfer must be effective. *See* 3d Rest. Prop. § 18.1, cmt. a. For example, a writing that complies with Statute of Frauds may be necessary to create power over real property. On the other hand, a writing may be unnecessary to create a power over personal property in a trust. *See, e.g.*, UTC § 40. *Contra* EPTL 7-1.17. Capacity and freedom from wrongdoing must also be satisfied.

A power can be created by a donee exercising a power but compliance with applicable perpetuities rules may be necessary. By exercising the power, the donee will be treated as the donor of the created power. *See* 3d Rest. Prop. § 17.2(a).

3. Manifestation of intention

Clearly, the most effective manner to manifest the intention to create a power is by an unambiguous written expression of intention. Unfortunately, not all powers are carefully drafted so that constructional

²³ *See* EPTL 10-4.1.

problems and litigation may result. The Restatement (Third) of Property § 18.11 provides extensive discussion and illustrations of constructional problems, including the use of predatory language. *See* 3d Rest. Prop. 18.11, cmts. b-g.

4. Objects dead

Restatement (Third) of Property § 18.1, comment h explains that a power of appointment is not created or will terminate if all objects are dead:

An intended power of appointment is not created if all the possible permissible appointees of the power are deceased when the transfer that is intended to create the power becomes legally operative. . . .
If all the possible permissible appointees of a power die after the power is created and before the donee exercises the power, the power terminates.

5. Effect of unascertainable objects

a. Power invalid if objects so indefinite that no one can be identified. *See* 3d Rest. Prop. § 18.1, cmt. i. Illustration 16: Donee to appoint to “the perfect persons in the world.”

b. Power valid if some of members of indefinite class can be identified. 3d Rest. Prop. § 18.1, cmt. i. Illustration 15: Donee to appoint among testator’s friends as donee selects. Suppose testator had no friends?

c. Power to appoint equally among members of indefinite class?
Example: Donee to appoint equally among testator’s friends. *Cf.* 3d Rest. Trusts § 46(1).

B. Donor’s authority to revoke or amend power

1. Black letter law

§ 18.2 DONOR’S AUTHORITY TO REVOKE OR AMEND POWER

The donor of a power of appointment lacks the authority to revoke or amend the power, except to the extent that the donor reserved a power of revocation or amendment when creating the power.

2. Discussion

The default rule is that a power once created is irrevocable. Accord EPTL 10-9.1(a). However, a power created under a revocable trust is by the nature of the trust revocable. However, if the donee has irrevocably exercised the power and as a result of the exercise the property is no longer in the trust, then the default rule is that the transferred property cannot be recovered by the donor. *See* 3d Rest. Prop. § 18.2, cmt. b.

V. Selected Issues Involving Exercise of Powers of Appointment

A. General Requisites²⁴

§ 19.1 GENERAL REQUISITES FOR EXERCISE OF A POWER OF APPOINTMENT

A power of appointment is exercised to the extent that:

(1) the donee manifests an intent to exercise the power in an otherwise effective document;

(2) the donee's expression of an intent to appoint satisfies the formal requirements of exercise imposed by the donor and by applicable law; and

(3) the donee's appointment constitutes a permissible exercise of the power.

Following the Institute's position under Restatement of Conflicts § 275, comment f, Restatement (Third) of Property § 19.1, comment e, provides that the law of the donee's domicile controls absent a contrary provision. *Cf.* EPTL 3-5.1(g).

B. Intent Issues

1. Capable drafting

Capable drafting is the best way to ensure that the donee's intent to exercise a power is expressed and carried out. Comments b-f under Restatement (Third) § 19.2, provide helpful insight:

b. Capable drafting. Capable drafting will leave no doubt regarding the donee's intent to appoint or not to appoint. Ideally,

²⁴ See EPTL 10-6.1

the donee or the donee's drafting agent will have the instrument creating the power at hand, and will formulate the language intended to express the donee's intent in light of the creating instrument.

Language expressing an intent to exercise a power is clearest if it makes specific reference to the creating instrument and exercises the power, if that is the intention, in unequivocal terms and with careful attention to the requirements of exercise that the donor has imposed.

c. Specific-exercise clause. The recommended method for exercising a power of appointment is by a specific-exercise clause, using language such as the following: "I hereby exercise the power of appointment conferred upon me by [my mother's will] as follows: I appoint [fill in details of appointment]."

d. Blanket-exercise clause. A blanket-exercise clause purports to exercise "any power of appointment" the donee may have, using language such as the following: "I hereby exercise any power of appointment I may have as follows: I appoint [fill in details of appointment]."

Although a blanket-exercise clause does manifest the donee's intent to exercise any power of appointment that the donee may have, such a clause raises the often-litigated question of whether it satisfies the requirement of specific reference frequently imposed by the donor in the document creating the power. See § 19.10.

e. Blending clause. A blending clause purports to blend the appointive property with the donee's own property in a common disposition. The exercise portion of a blending clause can take the form of a specific exercise or, more commonly, a blanket exercise. For example, a clause providing "All the rest, residue, and remainder of my estate, including the property over which I have a power of appointment under my mother's will, I give, devise, and bequeath as follows" is a blending clause with a specific reference. A clause providing "All the rest, residue, and remainder of my estate, including any property over which I have a power of appointment, I give, devise, and bequeath as follows" is a blending clause with a blanket exercise.

This Restatement seeks to eliminate any significance heretofore attached to the use of a blending clause. A blending clause has

traditionally been regarded as significant in the application of the doctrines of “selective allocation” and “capture.” This Restatement eliminates the significance of such a clause under those doctrines. See §§ 19.19 and 19.21. The use of a blending clause is more likely to be the product of the forms used by the donee’s lawyer than a deliberate decision by the donee to facilitate the application of the doctrines of selective allocation or capture.

f. Nonexercise clause. If the donee decides not to exercise a specific power or any power that the donee might have, it is important for the donee to consider whether to depend on mere silence to produce a nonexercise or to take definitive action to assure a nonexercise. Definitive action can be by a release during life (see Chapter 20) or by a nonexercise clause in the donee’s will or other relevant document. A nonexercise clause can take the form of a specific-nonexercise clause (for example, “I hereby do not exercise the power of appointment conferred on me by my uncle’s trust”) or the form of a blanket-nonexercise clause (for example, “I hereby do not exercise any power of appointment I might have”).

Absent clear drafting, issues and litigation may arise whether and how the donee intended to exercise the power.

2. Donee’s residuary clause

§ 19.4 DONEE’S RESIDUARY CLAUSE

A residuary clause in the donee’s will or revocable trust does not manifest an intent to exercise any of the donee’s power(s) of appointment, unless the power in question is a general power and the donor did not provide for takers in default or the gift-in-default clause is ineffective.

By capable drafting, the issue whether a residuary clause exercises a general power should never arise because the residuary clause should expressly address the matter. Even if not addressed, a residuary clause will not exercise a general power if the donor required that the donee use language that specifically refers to the power. Nor should the issue arise if the donor provided for effective takers in default.

Assuming there was no effective taker in default clause and no requirement that the donee use language referring to the power, Restatement (Third) of Property § 19.4, in a departure from Restatement

(Second) of Property § 17.3, seeks to carry out the donee's probable intent that the property pass pursuant to the donee's residuary clause. *Cf.* 3d Rest. Prop. § 19.22(b) (property would otherwise pass through the donee's estate).

The rule of Restatement (Third) § 19.4 also applies to residuary clauses in revocable trusts.

The default rule in New York law is significantly different! *See* EPTL 10-6.1(a)(4). *Cf.* EPTL 10-6.1(b) (no exercise if specific reference required).

3. After-acquired powers

§ 19.6 TESTAMENTARY EXERCISE OF AFTER-ACQUIRED POWERS

Unless the language or circumstances indicate that the donee had a different intention, a blanket-exercise clause extends to a power of appointment acquired by the donee after the donee executed the document that contains the blanket-exercise clause.

Consider some of the comments:

a. Scope. Nothing in law prevents a donee from exercising a power of appointment in a document that the donee executed before the donee acquired the power. The only question is one of construction—whether the donee intended to exercise the after-acquired power. If the donee's exercising document specifically identifies the power that the donee is exercising, the donee's exercise clause unambiguously expresses an intent to exercise that power, whether the power is an after-acquired power or not (see Comment *e*). A blanket-exercise clause, however, raises a question of construction. The rule of this section is that, unless the language or circumstances indicate that the donee had a different intention, a blanket-exercise clause extends to a power of appointment acquired by the donee after the donee executed the document that contains the blanket-exercise clause. Reference to then-present circumstances, such as "all the powers I have" or like expressions, is not a sufficient indication of an intent to exclude after-acquired powers.

b. Donee's exercising document. The donee's exercising document is any document that the donee executes that contains an exercise

clause. Thus, the donee's exercising document could be the donee's will, a testamentary trust, a revocable or irrevocable inter vivos trust, or any other document that contains an exercise clause.

c. After-acquired power. A power of appointment is an after-acquired power if the instrument creating the power becomes effective after the donee executed the exercising document.

If, for example, the power is created in the donor's will and the donor dies after the execution of the donee's will, the power is an after-acquired power, whether or not the donor's will antedates that of the donee. If the donee executes a codicil, the doctrine of republication by codicil may be applied to treat the date of the codicil as the date that the will is executed for purposes of determining whether a power is an after-acquired power. . . .

Illustration:

1. Donee's will contains a blanket-exercise clause. Before Donee executed her will, Donee's father, Donor-1, died. Donor-1's will created a trust, directing the trustee to pay the income to Donee for life, then to such persons as Donee shall appoint. After Donee executed her will but before she died, Donee's mother, Donor-2, died. Donor-2's will created a trust, directing the trustee to pay the income to Donee for life, then to such persons as Donee shall appoint. The blanket-exercise clause in Donee's will manifests an intent to exercise the powers granted to her by Donor-1's will and by Donor-2's will.

d. Language or circumstances indicating that the donee did not intend to exercise an after-acquired power. Although reference to then-present circumstances, such as "all the powers I have" or like expressions, is not a sufficient indication of an intent to exclude after-acquired powers, more precise language, such as "all powers I have at the date of execution of this will," does indicate an intent to exclude after-acquired powers.

If the donee subsequently executes a codicil, the doctrine of republication by codicil . . . could be invoked to exercise any power acquired by the donee after execution of the will but before execution of the codicil.

If the donor and donee is the same person, a blanket-exercise clause in the donor-donee's preexisting will is rebuttably presumed

not to manifest an intent to exercise a power that the donor later reserved to himself or herself in another donative transfer, unless the donor did not provide for takers in default or the gift-in-default clause is ineffective.

4. Donee's authority to revoke or amend exercise

§ 19.7 DONEE'S AUTHORITY TO REVOKE OR AMEND EXERCISE²⁵

The donee of a power of appointment lacks the authority to revoke or amend an exercise of the power, except to the extent that the donee reserved a power of revocation or amendment when exercising the power, and the terms of the power do not prohibit the reservation.

Would an exercise over a remainder interest by donee in a revocable trust remain revocable unless donee makes irrevocable? What about other exercises? Example: Income to A for 20 years; Donee has power to change income beneficiary by a revocable trust and names B as beneficiary. After B receives income for 2 years, can Donee change beneficiary back to A?

C. Effectiveness Issues

1. Capacity and freedom from wrongdoing

§ 19.8 CAPACITY OF DONEE TO EXERCISE A POWER OF APPOINTMENT; FREEDOM FROM WRONGDOING

(a) In order for an attempted exercise of a power of appointment to be effective, the donee must have capacity to exercise the power. The donee has capacity to exercise the power if the donee has capacity to make a similar transfer of owned property.

(b) In order for an attempted exercise of a power of appointment to be effective, the donee must be free from undue influence and other wrongdoing.

Comment d to Restatement (Third) of Property § 19.8, provides for the exercise of powers for an incapacitated donee:

d. Inter vivos exercise of presently exercisable general power

²⁵ See EPTL 10-9.1(b) and (c).

by or on behalf of mentally incapacitated donee. Unless the donor has manifested a contrary intent, it is assumed that the donor intends that the legal representative or agent under the authority of a durable power of attorney of the incapacitated donee of a presently exercisable general power is to be permitted to exercise the power for the benefit of the donee to the same extent the legal representative or agent could make an effective transfer of similar owned property for the benefit of the donee.

Uniform Durable Power of Attorney Act § 211(b)(3) allows agent to exercise for the benefit of principal. *Cf.* GOL 5-1502G(2). Specific authority is necessary to make gifts. *See* Unif. Durable Power of Attorney Act § 217. *Cf.* GOL § 5-1514(3) (both general and special powers presently exercisable) (agent authorized to make gift can exercise).

2. Formal requirements

§ 19.9 FORMAL REQUIREMENTS OF AN APPOINTMENT

In order for an attempted exercise of a power of appointment to be effective, the document purporting to exercise the power must be executed in compliance with (i) the formalities required by law for the transfer by the donee of owned property of a similar type²⁶ and (ii), except as provided in § 19.10, any additional formalities required by the donor.

The comments under Restatement (Third) of Property § 19.9 are most instructive (emphasis added):

b. Power exercisable “by will.” A power of appointment that is exercisable “by will” (as in “to such persons as the donee shall by will appoint”) is a testamentary power and is exercisable by an instrument that is formally sufficient to be admitted to probate under applicable law. Although the power is exercised even if the will is not submitted for admission to probate, the power is not exercised if the will is submitted for admission to probate and probate is denied. The applicable law is the law that would apply with respect to the formalities for a will if the appointive assets were the owned assets of the donee. *See* §§ 3.1 (Attested Wills), 3.2 (Holographic Wills), and 3.3 (Excusing Harmless Errors). **Because a revocable trust operates in substance as a will, a power of appointment exercisable “by will” can be exercised in**

²⁶ Accord EPTL 10-6.3.

a revocable-trust document, as long as the revocable trust remained revocable at the donee's death.

A power of appointment that is exercisable “by will admitted to probate” is exercisable only by a will that is actually admitted to probate.

....

d. Power exercisable “by deed.” A power that is exercisable “by deed” (as in “to such persons as the donee shall by deed appoint”) is exercisable by an instrument that would be formally sufficient under applicable law to be legally operative in the donee’s lifetime to transfer an interest to the appointee if the donee owned the appointive assets. At one time, “deed” required the use of seal, but seal is now archaic and is no longer required. The exercise of a power of appointment by a revocable trust would be an exercise “by deed.” A power to revoke a revocable trust is effectively exercised by the methods provided in Restatement Third, Trusts § 63. See UTC § 602(c).

e. Power exercisable “by deed or will.” A power that is exercisable “by deed or will” (as in “to such persons as the donee shall by deed or will appoint”) is a presently exercisable power and is exercisable by an instrument of appointment that is formally sufficient under applicable law to be either (i) legally operative in the donee’s lifetime to transfer an interest to the appointee if the donee owned the appointive assets or (ii) formally sufficient to be admitted to probate under applicable law.

f. Power exercisable “by written instrument” or by “last unrevoked written instrument.” A power exercisable “by written instrument” or by “last unrevoked written instrument” is exercisable by deed or will (see Comment *e*). *Cf.* EPTL 10-6.2(3) (“where the donor has made the power exercisable only by deed, it is also exercisable by a written will unless exercise by will is expressly excluded.”)

g. Document of exercise not specified. A power in which the document of exercise is not specified (as in “to such persons as the donee shall appoint”) is exercisable by deed or will (see Comment *e*).

Based on foregoing, an exercise by will can be made by a

revocable trust but the exercise should still be considered testamentary. On the other hand, if the power can be exercised by deed a revocable trust can be used in which case the power would appear to be presently exercisable.

3. Substantial compliance

§ 19.10 SUBSTANTIAL COMPLIANCE WITH DONOR-IMPOSED FORMAL REQUIREMENTS

Substantial compliance with formal requirements of an appointment imposed by the donor, including a requirement that the instrument of exercise make reference or specific reference to the power, is sufficient if (i) the donee knew of and intended to exercise the power, and (ii) the donee's manner of attempted exercise did not impair a material purpose of the donor in imposing the requirement.

Restatement (Third) of Property § 19.10 employs a more lenient approach in contrast with the Restatement (Second) of Property § 18.3, which followed the less flexible historical approach.

4. Death of donee before power created

§ 19.11 DEATH OF DONEE BEFORE POWER CREATED

If the donee dies before the effective date of a document purporting to confer on the donee a power of appointment, the power is not created, and any attempted exercise of the power is ineffective.

As the following comments make clear, a power created under a donor's revocable trust can be immediately effective, but not a power under a donor's will while the donor is alive. If the donee dies before the donor in the case of a power under the will, the power is not validly created in the donee.

b. Power created in donor's will. A power of appointment created in the donor's will is created when the donor dies, not when the donor executes the will. If the donee does not survive the donor, any attempt by the donee to exercise the power is ineffective.

If the donee survives the donor, the power is created, and can be exercised by a document executed before or after the donor's death (see § 19.6). If the document exercising the power is the donee's will, the exercise is revocable until the donee dies. If the document

exercising the power is an inter vivos document of exercise, the exercise is revocable until the donor's death, unless the exercise is expressly revocable, in which case it is revocable beyond the donor's death as provided in § 19.7.

c. Power created in donor's inter vivos trust. A power of appointment created in the donor's inter vivos trust is created when the trust is established, even if the trust is a revocable trust. (For principles controlling when a trust is established, see Restatement Third, Trusts § 10.) If the donee does not survive the establishment of the trust, any attempt by the donee to exercise the power is ineffective.

If the donee survives the establishment of the trust, the power is created, and can be exercised by a document executed before or after the establishment of the trust. If the document exercising the power is the donee's will, the exercise is revocable until the donee dies. If the document exercising the power is an inter vivos document of exercise, the exercise is revocable until the establishment of the trust, unless the exercise is expressly revocable, in which case it is revocable beyond the establishment of the trust as provided in § 19.7.

If the inter vivos trust is revocable, an exercise by the donee after the trust is established that does not remove the appointed property from the trust remains subject to the donor's power to revoke or amend the trust, which includes the authority to revoke or amend the power created in the trust. See § 18.2, Comment *b*.

5. Deceased appointees

§ 19.12 APPOINTMENT TO DECEASED APPOINTEE OR PERMISSIBLE APPOINTEE'S DESCENDANTS; APPLICATION OF ANTILAPSE STATUTE

(a) An appointment to a deceased appointee is ineffective, but an antilapse statute may apply to pass the appointed property to the deceased appointee's descendants or other substitute takers.

(b) Even when the antilapse statute does not expressly address an appointment to a deceased appointee, its purpose and policy should apply to an appointment to a deceased appointee (i) as if the appointed property were owned by either the donor or the donee, and (ii) so that the substituted takers are treated as permissible appointees

of the power.

(c) The donee of a nongeneral power is authorized to appoint to the descendants of a deceased permissible appointee, whether or not the permissible appointee's descendants are included within the description of the permissible appointees, but not if the deceased permissible appointee died before the execution of the instrument that created the power.. This subsection does not apply if the donor specifically prohibited an appointment to the descendants of a deceased permissible appointee.

Cal. Prob. Code § 673 was basis for Restatement (Third) of Property § 19.12(a) and Cal. Prob. Code § 674 was basis for Restatement (Third) of Property § 19.12(c). New York has no statutory provisions. *But cf.* Matter of Goodman, 155 N.Y.S.2d 424 (Sup. Ct. 1956) (antilapse statute applied to general powers).

6. Permissible appointments

§ 19.13 GENERAL POWER—PERMISSIBLE APPOINTMENTS

(a) The donee of a general power that permits appointment to the donee or to the donee's estate is authorized to make any appointment, including one in trust and one that creates a power of appointment in another, that the donee could make by appointing to the donee or to the donee's estate and then disposing of the appointive assets as owned property.²⁷

(b) The donee of a general power that permits appointment only to the donee's creditors or to the creditors of the donee's estate is restricted to appointing to those creditors.

Consider the following comments and illustrations (3d Rest. Prop. § 19.13, cmts. a and b, and Illustrations 1 and 2):

a. Rationale. When the donor creates a general power under which an appointment can be made outright to the donee or outright to the donee's estate, the necessary implication is that the donee can accomplish by an appointment to others whatever that the donee could accomplish by first making the appointive assets owned property and then disposing of the owned property.

²⁷ See EPTL 10-6.6(a).

b. Variations in terms of general power. A general power as defined in § 17.3 is one that permits appointment to the donee, the donee's estate, or the creditors of either. A power that restricts appointment to just the donee or to just the donee's estate or to just the creditors of the donee or to just the creditors of the donee's estate is a general power.

A general power to appoint only to the donee (even though it says "and to no one else") does not prevent the donee from exercising the power directly in favor of others. There is no reason to require the donee to transform the appointive assets into owned property and then in a second step to dispose of the owned property. Likewise, a general power to appoint only to the donee's estate (even though it says "and to no one else") does not prevent an exercise of the power by will directly in favor of others. There is no reason to require the donee to transform the appointive assets into estate property and then in a second step to dispose of the estate property by will.

A general power to appoint only to the donee's creditors or to appoint only to the creditors of the donee's estate permits only an appointment to the donee's creditors or the creditors of the donee's estate, as the case may be.

Illustrations:

1. Donor dies, leaving a will that devises property to T in trust. T is directed to pay the income to Donee, Donor's daughter, for life, "with power in Donee to withdraw from time to time any or all of the trust corpus." On Donee's death, the remaining trust property is disposed of by the terms of the trust. Donee directs T to pay \$50,000 out of the trust property to her daughter Jane. The direction given to T is a permissible exercise of Donee's power of withdrawal.

2. Donor dies, leaving a will that devises property to T in trust. T is given discretion to pay the income from time to time to Donee, Donor's son, and Donee's issue as T may determine. "On Donee's death, the trust property shall pass to Donee's estate if Donee so provides in his will; and if Donee does not so provide in his will, the trust property shall be paid to Donee's issue then living, such issue to take by representation; and if no issue of Donee is then living, the same shall pass to the X charity." Donee in his will directs that the trust property be paid to Donee's wife.

The direction given in Donee's will is a permissible exercise of Donee's power to appoint to his estate.

§ 19.14 NONGENERAL POWER—PERMISSIBLE APPOINTMENTS

Except to the extent that the donor has manifested a contrary intention, the donee of a nongeneral power is authorized to make an appointment in any form, including one in trust and one that creates a power of appointment in another, that only benefits permissible appointees of the power.²⁸

Exercise in further trust and creating powers in another must be in conformity with applicable perpetuities rules. Also, possible gift and estate tax issues arise. *See, e.g.* I.R.C. § 2041(a)(3).

Trustee with power to invade may have power to decant, which is treated as the exercise of a special power of appointment. *See* 3d Rest. Prop. § 19.14, cmt f. New York has the most comprehensive decanting statute based on extensive 2011 amendments. *See* EPTL 10-6.6(b)-(q).

§ 19.15 APPOINTMENT TO IMPERMISSIBLE APPOINTEE—“FRAUD ON THE POWER”

An appointment that benefits an impermissible appointee is ineffective.

If an appointment is made in trust, the trustee need not be a permissible appointee, since the trustee does not take a beneficial interest by the appointment. *See* 3d Rest. Prop. § 19.15, cmt. e. An appointment to a charity that is not an object is not valid, but a court may apply the *cy pres* doctrine to select a charity that is an object. *See* 3d Rest. Prop. § 19.15, cmt. h.

7. Disposition of unappointed property

The following provisions all recognize the primacy of gift-in-default clauses. In the absence of an effective gift-in-default clause, interesting issues arise regarding the ultimate taker.

²⁸ *See* EPTL 10-6.6(a).

§ 19.21 DISPOSITION OF INEFFECTIVELY APPOINTED PROPERTY UNDER GENERAL POWER

(a) To the extent that the donee of a general power makes an ineffective appointment, the gift-in-default clause controls the disposition of the ineffectively appointed property to the extent that the gift-in-default clause is effective.

(b) To the extent that the donor did not provide for takers in default or the gift-in-default is ineffective, the ineffectively appointed property passes to the donee or to the donee's estate rather than under a reversionary interest to the donor or to the donor's transferees or successors in interest.

As explained in Andersen and Bloom, *FUNDAMENTALS OF TRUSTS AND ESTATES* ____ (4th ed. 2012):

Under traditional doctrine, an ineffectively exercised general power raised the question whether the donee intended to assume control over the property for more than the limited purpose of exercising the power. If so, the donee may have “captured” the property for his own estate. *See Hochberg v. Proctor*, 805 N.E.2d 979 (Mass. 2004) The most common indicator of an intention to capture property is a general blending clause, one which mixes the donee's own property and the property subject to the power.

The Restatement (Third) of Property § 19.21 wisely departs from the capture doctrine if the donee ineffectively exercises a general power of appointment, for example, because the exercise violates the Rule Against Perpetuities. If the donor provided for takers by a takers in default clause, the property will pass to the takers. If there are no takers in default, the property ineffectively appointed passes to the donee or the donee's estate without having to determine if the donee intended to capture the property. In effect, the Restatement (Third) of Property § 19.21 repudiates the capture doctrine in favor of a modern approach to the problem of ineffectively exercised powers.

Restatement (Third) of Property § 19.21, comment f, purports to provide a separate rule for powers of revocation, amendment and withdrawal that are not ineffectively exercised—the property remains in the trust.

§ 19.22 DISPOSITION OF UNAPPOINTED PROPERTY UNDER LAPSED GENERAL POWER

(a) To the extent that the donee of a general power to appoint a future interest fails to exercise the power, completely releases the power, or expressly refrains from exercising the power, the gift-in-default clause controls the disposition of the unappointed property to the extent that the gift-in-default clause is effective.

(b) To the extent that the donor did not provide for takers in default or the gift-in-default clause is ineffective, the unappointed property passes to the donee or to the donee's estate if the donee merely failed to exercise the power, but if the donee released the power or expressly refrained from exercising the power, the unappointed property passes under a reversionary interest to the donor or to the donor's transferees or successors in interest.

Restatement (Third) of Property § 19.22(b) wisely departs from Restatement (Second) of Property § 24.1, which returned the property to the donor or the donor's estate if the power was not exercised and the gift-in-default clause was not effective. The same result occurs under Restatement (Third) of Property § 19.21(b) when a general power is ineffectively exercised and there is no effective taker in default.

Comment f to Restatement (Third) § 19.22, provides for when powers of revocation, amendment and withdrawal are not exercised:

If the donee...dies without exercising a power of revocation or amendment, the power to revoke expires and, unless someone else continues to have a power of revocation or amendment, the trust becomes irrevocable and unamendable at the donee's death. If the donee...dies without exercising a power to withdraw principal of a trust, the principal that the donee could have but did not withdraw remains part of the trust.

§ 19.23 DISPOSITION OF UNAPPOINTED PROPERTY UNDER LAPSED NONGENERAL POWER

(a) To the extent that the donee of a nongeneral power fails to exercise the power, completely releases the power, or expressly refrains from exercising the power, the gift-in-default clause controls the disposition of unappointed property to the extent that the gift-in-default clause is effective.

(b) To the extent that the donor did not provide for takers in default or the gift-in-default clause is ineffective, the unappointed property passes under an implied gift in default to the permissible appointees of the power (including those who are substituted for permissible appointees under an antilapse statute) living when the power lapses, if:

(1) the permissible appointees are a defined and limited class and

(2) the donor has not manifested an intent that the permissible appointees shall receive the appointive property only so far as the donee elects to appoint it to them.

(c) If subsection (b) is inapplicable, the unappointed property passes under a reversionary interest to the donor or to the donor's transferees or successors in interest.

Restatement (Third) of Property § 19.23(b) produces the traditional results, but does so on the basis of an implied gift among the class members rather than as an imperative power.

Due to the passage of time, problems may arise with returning the property to the donor, transferees or successors under Restatement (Third) of Property § 19.23(c). The likely nongeneral power involved will be the power to appoint to anyone other than the donee, donee's estate or applicable creditors. Since the donor wanted the donee to have virtual ownership, a different default rule might have been to have the unappointed property pass to the donee's heirs, avoiding unwarranted estate tax problems that would result if the property passed to the donee's estate.

8. Effect of appointment to taker in default

**§ 19.24 PARTIAL APPOINTMENT TO TAKE IN DEFAULT—
DISPOSITION OF UNAPPOINTED PROPERTY**

If the donee of a power of appointment makes a valid partial appointment to a taker in default, the taker in default-appointee also takes his or her full share of any unappointed property as taker in default, unless the donor or the donee manifests a contrary intent.

§ 19.25 APPOINTMENT TO TAKER IN DEFAULT—APPOINTEE TAKES AS TAKER IN DEFAULT RATHER THAN AS APPOINTEE

To the extent that an appointee would have taken the appointed property as a taker in default of appointment had the appointment not been made, the appointee takes under the gift in default of appointment and not under the appointment.

Prior to the Revenue Act of 1942, unexercised general powers were not taxable. Since then, taxation does not depend on whether a general power is exercised. *See* I.R.C. § 2041(a)(2).

VI. Creditors' Rights

A. Creditors of the Donee—Nongeneral Power

1. Black Letter Law

§ 22.1 CREDITORS OF THE DONEE—NONGENERAL POWER

Property subject to a nongeneral power of appointment is exempt from claims of the donee's creditors and from liability for expenses of administering the donee's estate.

2. Discussion

As explained in Restatement (Third) of Property § 22.1, comment a:

Rationale: Because a nongeneral power of appointment is not an ownership-equivalent power, the donee's creditors have no claim to the appointive assets, irrespective of whether or not the donee exercises the power.

Donee of a nongeneral power is not considered to have an ownership-equivalent because the power cannot be exercised for the economic benefit of donee. *See* Rest. Trusts § 56 cmt. b. Nonetheless, a broad nongeneral power effectively allows donee to make virtually anyone the owner. Under Revenue Act of 1942, broad special powers (hybrid powers) were subject to tax as were certain other special powers but the Revenue Act of 1951 repealed these rules.

3. Planning considerations

The fundamental decision to allow a donee to have extensive control over property, without allowing creditors to reach the property, makes broad special powers extremely attractive. For donees who have sufficient wealth, a nongeneral power gives them virtual ownership without the responsibilities. However, if the donee's estate is the taker in default, then donee is treated as possessing a general power. *See* 3d Rest. Prop. § 22.1, cmt. c.

The current federal transfer tax law is also generous—property subject to a special power is generally not subject to estate or gift taxation, although GST tax may be involved. Exceptions are for special powers exercised beyond the perpetuities period and the exercise of a lifetime power where donee was the income beneficiary. Under the Revenue Act of 1942, many special powers were taxable on the theory that donee is practically the owner.

Property law and tax law are not the same if the donor retains a power to appoint property. Under Restatement (Third) of Property § 22.1, a retained power does not subject to creditors unless a fraudulent transfer is involved. *See* 3d § Rest. Prop. § 22.1, cmt. b. For tax purposes, a retained power is not a power of appointment, but can be subject to tax. *See* I.R.C. § 2038. In *Commissioner v. Chase Nat'l Bank* (82 F.2d 157 (2d Cir. 1936), *cert. denied*, 299 U.S. 552 (1936)), which was decided under the forerunner of Internal Revenue Code § 2038, a reserved power to appoint by will among the decedent's issue was held taxable.

B. Creditors of the Donee—General Power Created by Donee

1. Black Letter Law

**§ 22.2 CREDITORS OF THE DONEE—GENERAL POWER
CREATED BY DONEE**

Property subject to a general power of appointment that was created by the donee is subject to the payment of the claims of the donee's creditors to the same extent that it would be subject to those claims if the property were owned by the donee.

2. Discussion

As explained in Restatement (Third) of Property § 22.2, comment a:

Rationale. If a person makes a transfer but retains a general power of appointment over the transferred property, public policy does not allow this formal change in the control of the transferred property to put the property beyond the reach of the donor-donee's creditors. The Restatement Third of Trusts adheres to the same position with respect to a revocable inter vivos trust. See Restatement Third, Trusts § 25, Comment *e*.

Similar tax results. Donor still treated as effective owner.

3. Planning

Asset protection approach: Wyo. Stat. § 4-10-510(a)(iv)(B) (creditors cannot reach trust property over which settlor retains a general power).

Non-asset protection jurisdictions: Donor as income beneficiary with donee having power to appoint to another trust if creditor problems. *See generally, Alexander Bove, Using the Power of Appointment to Protect Assets—More Power than You Ever Imagined, 36 ACTEC L. J. 333 (2010) (discussing techniques).*

C. Creditors of the Donee—General Power Created by Someone Other than the Donee

1. Black Letter Law

§ 22.3 CREDITORS OF THE DONEE—GENERAL POWER CREATED BY SOMEONE OTHER THAN THE DONEE

(a) To the extent that the property owned by the donee is insufficient to satisfy the claims of the donee's creditors, property subject to a presently exercisable general power of appointment that was created by someone other than the donee is subject to those claims to the same extent that it would be subject to those claims if the property were owned by the donee.

(b) Upon the death of the donee, to the extent that the donee's estate is insufficient to satisfy the claims of creditors of the donee's estate, property subject to a general power of appointment that was created by someone other than the donee and that was exercisable by

the donee's will is subject to those claims and expenses to the same extent that it would be subject to those claims and expenses if the property had been owned by the donee.

2. Discussion

The rationale for allowing creditor access to a presently exercisable general power is found in Restatement (Third) of Property § 22.3, comment a:

A presently exercisable general power of appointment is an ownership-equivalent power. See § 17.4, Comment *f(1)*; accord Restatement Third, Trusts § 74, Comment *a*. As noted in the first Restatement of Property: “The power to become the owner at will is in essence ownership The general power presently exercisable is the practical equivalent of ownership, since it gives to the donee the power to acquire ownership at any time by appointing to himself.” 3 Restatement of Property, Introductory Note to Chapter 25 (Powers of Appointment) at pp. 1812-1813.

Consequently, property subject to a presently exercisable general power of appointment is subject to the claims of the donee's creditors, to the extent that the property owned by the donee is insufficient to satisfy those claims. Furthermore, upon the donee's death, property subject to a general power of appointment that was presently exercisable by the donee's will is subject to creditors' claims to the extent that the donee's estate is insufficient to satisfy the claims of creditors of the estate and the expenses of administration of the estate.

Whether the donee has or has not purported to exercise the power is immaterial.

Prior Restatements allowed creditors to reach exercised general testamentary powers on the theory that the exercise was the assumption of ownership. See 2d § Rest. Prop § 13.4. Restatement (Third) of Property § 22.3 goes beyond prior positions and extends creditors' rights to property that was subject to an unexercised testamentary general power. As explained in comment c to Restatement (Third) of Property § 22.3:

The Restatement Third of Trusts has now diverged from the common-law rule. See Restatement Third, Trusts § 56, Comments *b* and *c*. The Restatement Third of Trusts represents the

current position of the Institute, and is the rule adopted in this § 22.3.

Restatement (Third) of Property § 22.3 on unexercised general powers is the position taken by California law. *See* Cal. Prob. Code § 682(c). *Contra* Alaska Stat. § 34.40.115 (creditors can reach only if the donee of a general power “effectively exercises the power of appointment in favor of the donee, the creditors of the donee, the donee’s estate, or the creditors of the donee’s estate.”). *See also Rhode Island Trust Co. v. Anthony*, 142 A. 531 (R.I. 1928) (general testamentary power exercised in favor of family members not reachable by creditors).

In New York, neither exercised nor unexercised general testamentary powers are reachable if donee was not the donor. *See* EPTL 10.7-4.

Note: UPC § 6-102 permits estate creditors to reach property in a revocable trust but not property that was subject to a presently exercisable general power of appointment. UTC § 505 provides creditors’ rights in revocable trusts.

3. Planning

Crummey powers could be subject to creditors’ claims, as would 5/5 withdrawal powers in credit shelter and other trusts. Other general powers, for example under previously-created (b)(5) trusts, could also be subject to creditors’ claims under Restatement (Third) of Property § 22.3.

However, principled the decision to subject property subject to a general power to the claims of creditors during lifetime and at death, rule will encourage reliance on trust haven rules, e.g., Alaska. Presumably, the principled rule reflects strong public policy. Thus, one might not be successful if one tries to use the law of tax haven, rather than creating a trust in safe haven.

Estate tax law treats exercised or unexercised general testamentary power as taxable. Gift tax applies on the exercise of a general power.

A major issue involves a power subject to an ascertainable standard that is not a general power for transfer tax purposes (but might be under Internal Revenue Code § 678). This issue arose in New York, which subjects property subject to a presently exercisable general power to creditors’ claims.

In *In re Flood*, N.Y.L.J., Mar. 11, 1998, at 32, col. 3 (Sur. Ct., Nassau County), *aff'd* 262 A.D. 2d 643, 691 N.Y.S.2d 354 (2d Dep't. 1999), beneficiary had the power to demand trust property based on an ascertainable standard. Courts held that this was a presently exercisable general power causing the property to be subject to the claims of creditors. In response to *Flood*, EPTL 10-7.2 was amended to add the ascertainable exception.

Under the Restatement (Third) of Property § 17.4, a power subject to an ascertainable standard is not a presently exercisable power until the standard is met. As a result, there should not be a problem if the standard has not been met. But what if it has? For example, the standard could be immediately met if other resources of the donee do not have to be taken into account; or, if taking into account other resources, the trust property could be demanded. In such cases, the property would be a presently exercisable general power that would entitle creditors to reach under Restatement (Third) of Property § 22.3. *Cf.* 3d Rest. Trusts § 60, cmt. g.

Note: UTC §§ 103(11) and 504(e) were added in 2004 to ensure that creditors could not reach trust property that a trustee could distribute trust to himself or herself if discretion was limited by an ascertainable standard. *Contra* 3d Rest. Trusts § 60, cmt. g. Could creditors reach under UTC for demand power subject to ascertainable standard if powerholder was not a trustee but power was or became presently exercisable? *See* UTC § 505(b).

4. Creditor procedure

Comment e to Restatement (Third) of Property § 22.3 continues the position under Restatement (Second) of Property § 13.4 that an exercised power does not become part of the probate estate, leaving it to donee's executor to reach property in the hands of appointees. Clarification might be helpful if there is not an executor. For example, donee's property passes under a revocable trust and indeed the exercise is by the revocable trust, which is a sanctioned method under Restatement (Third) of Property § 19.9, comment b.

D. Releases and Disclaimers

Donee could possibly avoid creditor and tax issues by disclaiming power. *See* 3d Rest. Prop. § 20.4. Alternatively, where Uniform Disclaimer Act not enacted, donee could wholly or partially release power. *See* EPTL 10-9.2.