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Empower Your Loved Ones with a 'Power of Appointment'

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Preparing an estate plan means having a say in what happens to your wealth after you are gone. Through a Last Will and Testament, you can name the important people in your life who will inherit your assets.

You can also specify whether they should receive these assets immediately upon your death or over time through a trust. Looking even farther ahead, you can give your loved ones a "power of appointment," enabling them to say where any remaining trust assets should go when they themselves are out of the picture.

With a power of appointment at their disposal, your loved ones can direct their inheritance to subsequent generations wisely and effectively.

Trusts — A Primer

First, a little explanation. A trust is an arrangement under which money or other property is managed by one person, called the "trustee," for the benefit of another person, called the "beneficiary." Trusts can be especially useful if your loved ones include a young person, someone with special needs, or anyone who has trouble managing money.

In placing their inheritance into a trust, you create a gatekeeper—the trustee. This person is a fiduciary who manages the trust assets and makes distributions only in your beneficiary's best interests.

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Some distributions could be discretionary. For example, the trustee could be authorized to cover expenses related to your loved one's health, education, and support as the trustee deems advisable. This authority could be broadly defined to include things like paying for a wedding, buying a house, purchasing a business, or entering a trade or profession.

Other distributions from the trust could be mandatory. A trust for a young person might say the beneficiary is entitled to withdraw half of the principal upon reaching the age of 25 and the balance when he or she turns 30.

Some people like to include provisions that encourage the beneficiary to achieve certain life goals. The trust could state, for example, that the beneficiary is to receive a large distribution upon graduating from college. Trusts can also discourage harmful behavior by pausing distributions if the beneficiary falls prey to addiction or alcoholism—apart from payments for rehabilitative treatment.

By including a “spendthrift clause” in the trust, you can prevent a creditor from placing on lien on the principal to satisfy your child’s unpaid debts. If your children are adopted, placing their inheritance into a trust can ward off possible intrusions from their birth family. Unscrupulous “friends” seeking a loan can also be kept at bay.

Powers of Appointment

In addition to protecting a loved one’s inheritance, a trust can say what happens upon the death of the beneficiary. Many trusts simply state that any remaining trust property goes to the beneficiary’s children in equal shares. With a power of appointment, however, you can give the beneficiary greater flexibility and control.

A power of appointment is the legal right to designate the new owner of property. How can this be useful? Consider a beneficiary who has two children, one with special needs. The beneficiary could exercise the power by appointing half of the trust property in a special-needs trust for the disabled child and half to the other child, outright and free of any trust.

In different circumstances, the beneficiary could effectively disinherit an estranged child. Or multiple children could be left different amounts of the trust property, based on their financial needs or how close they have been to the beneficiary.

Under a “special power of appointment,” the potential appointees could be limited to a select group of people, such as the beneficiary’s spouse and children. Or the power could be “general,” meaning there are no restrictions on the beneficiary’s power to appoint (think unmarried partners, friends, or charities). Either way, the power could be exercised under the beneficiary’s own Will, which should specifically reference the power of appointment and name the new owners.

A power of appointment has been called estate planning’s secret weapon. Consider including one in a trust for your loved ones. It will help them adjust your estate plan to their circumstances long after you are gone. To get started, call an Estates & Trusts lawyer for help.