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Special Needs Trusts and Powers of Appointment

G. Mark Shalloway, Esq.

G. Mark Shalloway, Esq.
Shalloway & Shalloway, P.A.
West Palm Beach, FL

marks@shalloway.com
561.686.6200

A. What is a Power of Appointment?

A power of appointment is a power to name someone to receive a beneficial interest in property. The grantor of the power is called the *donor.* The person receiving the power is called the *holder* or *donee.* The parties to whom the holder may appoint (i.e., give) property by *exercising* the power are called the *permissible appointees,* and the parties whom the holder actually appoints are called the *appointees.*

A power of appointment can be exercisable either during the lifetime of the holder (an inter vivos power of appointment) or at the holder's death (testamentary power of appointment). The broadest powers allow the holder to exercise both during lifetime and death.

Comparing the relationship between the parties to a trust with the parties to a power of appointment, the donor of the power is usually the Grantor of the trust. The holder of the power is commonly the trustee or the beneficiary of the trust.

According to common law, property subject to a power of appointment is not considered legally owned by the holder, but rather, the holder is treated as merely a proxy for the donor. With regards to federal estate and gift tax however, some powers can cause the holder to be treated as if he or she owned the property, at least to the extent the holder has control over the property.

Powers of appointment can add great flexibility to a person's estate plan by enabling someone to direct trust dispositions after taking into account changes in circumstances that occur long after the person's death. With regard to special needs trusts in particular, a power of appointment can provide the trust beneficiary with a degree of dignity and control by allowing him or her to direct where any remaining assets should be distributed after death.

A.1. "General" Power of Appointment

For federal estate tax purposes, a general power of appointment is defined as a power to appoint property to any one or more of the power holder, the power holder's estate, the power holder's creditors, and the creditors of the power holder's estate. Reg. § 20.2041-1(c). Any one of these powers will cause the power of appointment to be a general power for federal estate tax purposes. Treas. Reg. § 20.2041-1(b).

It is important that the beneficiary of a SNT does not have a general power of appointment because that may cause the entire trust estate to be considered an available asset, thereby resulting in a reduction or loss of means-tested benefits, or allow a State Medicaid agency to utilize its estate recovery powers to force Medicaid payback for any benefits paid during the beneficiary's lifetime.

A beneficiary will also be found to hold a general power of appointment if he or she has the power to "remove and replace" another party (usually, the trustee) who has the right to exercise the power in favor of the beneficiary. However, the IRS has conceded that provided the replacement is a truly "independent" person defined as one who is neither "related" nor "subordinate" to the removing party as those terms are defined in Code Section 672, the power will not be imputed to the beneficiary with the removal power. (Rev. Rul. 95-58, 1995-2 C.B. 191).

A.2. "Limited" Power of Appointment

A limited power of appointment, also referred to as a "special" power of appointment, is any other power of appointment that is not considered a "general" power of appointment. A limited power of appointment provides the holder of the power with the right to decide who

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First appeared as part of the conference materials for the
16th Annual Changes and Trends Affecting Special Needs Trusts session
"Powers of Appointment in Special Needs Planning: Mystical Authority Made Magical!"