# POWERS OF APPOINTMENT

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Nearly thirty years ago a distinguished lawyer and teacher made the statement that the power of appointment is "the most efficient dispositive device that the ingenuity of Anglo-American lawyers has ever worked out."[1] To most practicing lawyers this was an amazing statement, for if the device was actually of such superlative excellence, how did it happen that there were so few guidelines available in regard to its use? There were very few cases on the subject and practically no legislation. To be sure, an examination of early English reports and treatises would have revealed that the power of appointment was used by English draftsmen more than 500 years ago in assisting clients to avoid burdensome feudal laws.[2] Moreover, the early treatises in this country suggested its use, when carefully drafted, for certain stated purposes,[3] but early English and American treatises are not readily available to many of our practicing lawyers.[4]

It is doubtful, therefore, if the high praise of powers of appointment would have made much impact upon the practicing bar if the Federal Revenue Act of 1942 had not made the use of special powers most attractive as a tax avoidance device, and if the Revenue Act of 1948

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[1] Leach, *Powers of Appointment*, 24 A.B.A.J. 807 (1938). This statement brings to mind Maitland's evaluation of the law of trusts. Maitland wrote, "If we were asked what is the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence, I cannot think that we should have any better answer to give than this, namely, the development from century to century of the trust idea." MAITLAND, SELECTED ESSAYS 129 (1936).

[2] See 7 HOLDSWORTH, HISTORY OF ENGLISH LAW 149-164 (1926).

[3] See such standard works as GRAY, RULE AGAINST PERPETUITIES (3d ed. 1915); KALES, ESTATES, FUTURE INTERESTS AND ILLEGAL CONDITIONS AND RESTRAINTS IN ILLINOIS (2d ed. 1920) [hereinafter cited as KALES].

[4] For general treatment of Powers of Appointment see 5 AMERICAN LAW OF PROPERTY §§ 23.1-66 (Casner ed. 1952); 3 POWELL, REAL PROPERTY §§ 385-403 (1952); RESTATEMENT, PROPERTY §§ 318-69 (1940). There are a number of excellent law review articles on Powers of Appointment. One that is highly recommended is Halbach, *The Use of Powers of Appointment in Estate Planning*, 45 IOWA L. REV. 691 (1960) [hereinafter cited as *Halbach*]. See also the recent report of the Subcommittee, Real Property, Probate and Trust Law, American Bar Association Report, *Use and Drafting of Powers of Appointment*, 1 REAL PROP. PROB. & TR. J. 307 (1966).

had not made the use of general powers an equally attractive tax savings device.[5] This does not mean to say that tax avoidance and tax savings are the main reasons for the use of powers of appointment, as we shall try to point out in this article, but they did furnish the impetus for their use in more recent times.[6]

Recently we asked a leading trust officer in one of the largest trust departments in Arizona if powers were extensively used in the trusts administered by his trust department. He replied that they were not used as often as they should be.[7]

An examination of the Arizona reports and statutes reveals that they are nearly barren of cases and statutory provisions involving powers of appointment. The only treatment in the statutes appears in the Arizona Estate Tax Act, a statute based upon the 1939 Internal Revenue Code.[8] Only one case on the subject was found in the Arizona reports and it sheds little light on the court's treatment of powers.[9] A careful examination of the forms issued by the various corporate fiduciaries for use by the practicing bar indicates that there are suggested clauses providing for the use of powers of appointment.[10] As one might expect, however, these forms are limited to the situations most commonly arising. They do not incorporate suggestions as to the ingenious use of powers in particular cases, nor do they point out how the use of powers can contribute to the flexibility of the dispositive instrument. They are in the main concerned with the marital deduction clauses in the Federal Internal Revenue Code. It is very interesting to compare them with Professor Leach's "The Will of J. Albert Thomas."[11]

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[5] See STEPHENSON, DRAFTING WILLS AND TRUST AGREEMENTS: DISPOSITIVE PROVISIONS 87 (1955).

[6] LOWNDES & KRAMER, FEDERAL ESTATE AND GIFT TAXES 253-270, 607-609, 648-655 (2d ed. 1962) [hereinafter cited as LOWNDES & KRAMER].

[7] See *Halbach* 691, "Despite the existence of many reasons which would seem to dictate an increased use of appointive powers today, it is generally recognized that such powers are not extensively used." In the 1966 Subcommittee report of the Section of Real Property, Probate and Trust Law, American Bar Association *Use and Drafting of Powers of Appointment*, 1 REAL PROP. PROB. & TR. J. 307 (1966) it is said, "The widespread use of trusts in modern estate planning has not been accompanied by a similarly widespread use of powers of appointment. . . . Partly because many lawyers are unaware of the advantages of this device and partly because of fears resulting from uncertainty and lack of familiarity with it, the power of appointment continues to be sadly neglected."

[8] See ARIZ. REV. STAT. ANN. §§ 42-1501.3, 42-1511(A)5, 42-1512(A)4 (1956).

[9] *In re* Rowlands' Estate, 73 Ariz. 337, 241 P.2d 781 (1952).

[10] See UNITED CALIF. BANK, SUGGESTED FORMS FOR WILLS AND TRUSTS (6th ed. 1963); see also THE ARIZ. BANK, SUGGESTED PROVISIONS FOR WILLS AND TRUSTS (1966).

[11] See LEACH & LOGAN, CASES ON FUTURE INTERESTS AND ESTATE PLANNING 948-1011 (1961). This interesting hypothetical will first appeared in 27 B.U.L. REV. 157 (1947). It should be of particular interest to the practicing attorney. Professor Leach was Special Reporter for the Chapter on Powers of Appointment for the American Law Institute's Restatement of Property.

It is the purpose of this paper to examine the nature of powers of appointment; the basic technical terms or "words of art" which we must know, if we are called upon to advise the use of powers by our clients; the principal classifications of powers of appointment; the methods of creating powers and how they may be exercised, renounced, released, or disclaimed; gifts in default of the exercise of powers by the donee; the primary purposes fulfilled by the use of powers, *i.e.*, their use for non-tax purposes as well as for tax avoidance; and the inherent dangers in the use of powers, *i.e.*, the need for a thorough understanding of the law and rules applicable to their use.

It will be our endeavor to develop practical working concepts with some warning of tax and other hazards. Much of the discussion will be based upon the sample forms which are submitted, not as models, and certainly not for universal use or application, but more to assist in developing the points we wish to make.

*What is a power of appointment?* For our purpose the Restatement of Property satisfactorily describes it as:

> [A] power created or reserved by a person (the donor) having property subject to his disposition enabling the donee of the power to designate, within such limits as the donor may prescribe, the transferees of the property or the shares in which it shall be received.[12]

The basic terms in the application of this definition are *donor*— the person who is the creator of the power of appointment; *donee*— the person who receives the power; *object*— the person to or for whom the property may be appointed; *appointee*— the person to or for whom the property is actually appointed; *taker in default*—the person who is to receive the property in the event the donee fails effectively to appoint it; *appointive property*— the interest in property which the donee can create by exercising the power; and *exercise of the power of appointment*— the donee's act or method of making an appointment.[13]

*How are powers of appointment classified?* They are generally classified (1) as to objects; that is, to or for whom property may be appointed, and (2) as to methods of exercise. As to objects, for the purpose of this article we shall consider two types of powers, general and special (sometimes called limited or nongeneral) powers of appointment. A power of appointment is general if it can be exercised in favor of the donee, his estate, his creditors, or the creditors of his estate. It is general if it is exercisable in favor of any one of the four. A power of appointment is special if it can be exercised only in favor of persons,

[12] RESTATEMENT, PROPERTY § 318(1) (1940).

[13] *Id.* § 319.

not including the donee, who constitute a not unreasonably large group and the donor does not manifest an intent to create or reserve a power primarily for the benefit of the donee.[14]

*Methods of exercising powers.* Classified as to method of exercise, powers of appointment are presently exercisable, or exercisable by testamentary disposition. The usual method by which a power is presently exercisable is by *deed*, and the usual method by which a testamentary power is exercised is by *will*. It must be understood, however, that the terms "deed" and "will" are not limited, as those terms are generally understood.

A presently exercisable power may be exercised by a trust agreement, or other instrument, even though it does not have the formalities of a deed, if it would be sufficient under applicable state law to pass during the donee's lifetime an identical interest in the same things owned by the donee himself. A will for the purpose of exercising a power of appointment in a testamentary disposition is sufficient if under the applicable state law it can be probated as a will, even though, for example, it purports to do nothing more than exercise the power of appointment.[15]

Next, we shall consider generally the basic advantages accruing from the use of powers of appointment. Perhaps the greatest is that of adding flexibility in estate planning, not otherwise possible. It makes possible a later look, not by the donor of the power but by the donee. It may enable one to keep property in the family for the maximum period permitted under the Rule Against Perpetuities.

By leaving his estate to his wife in trust, with a power in her to appoint the corpus by will, a husband may protect his wife as life income beneficiary and yet leave her the power at her death to pass on his estate with the benefit of her knowledge of factors developing after the husband's death. Such an arrangement may also satisfy a wife who otherwise might oppose her husband "tying up his estate" in trust. Likewise, in some circumstances powers of appointment may be useful as tax savings or tax deferment devices. There may arise other occasions in which the benefits of flexibility and a later look may be helpful.

Now let us discuss some of the applied aspects of powers of appointment in certain circumstances, as illustrated by the sample forms which are placed on pages opposite the textual material. It is to be emphasized, first of all, that no technical nor express words are necessary to create a power of appointment. It is sufficient that the intent to create the power clearly appears. Good draftsmanship, however, is nowhere more

[14] *Id.* § 320.

[15] See Durand & Herterich, *Conflict of Laws and the Exercise of Powers of Appointment*, 12 CORNELL L.Q. 185, 187-90 (1957); 1 CASNER, ESTATE PLANNING 769 (3d ed., 1961).

important if uncertainties are to be avoided and if the projection of the "dead hand" of the donor far into the future is not to bring undesirable results.

Also, it should be recognized that a testator in a will or the settlor in a living trust has wide latitude with respect to the creation of general and special powers of appointment. He may make the donee of the power a distributee of his probate estate, a beneficiary of his testamentary trust or of his living trust, or he may make the donee a third person who has no interest in the donor's estate other than the power of appointment itself.

For the law relating to powers of appointment generally, we must look to the controlling state's statutes and to the common law. Arizona has no statutory law pertaining to powers of appointment generally,[16] and apparently only one adjudicated case, which will be discussed below. The Arizona Supreme Court has often said that where there is no statute and no applicable case law, it will give great weight to the Restatement by the American Law Institute.[17] Hence in many instances it is necessary to explore those parts of the Restatement of Property as pertain to powers of appointment.

For the federal estate tax treatment of powers of appointment, we must refer to section 2041 of the Internal Revenue Code and to the regulations thereunder. A somewhat similar treatment of powers of appointment appears in section 42-1511, Arizona Revised Statutes. The federal gift tax treatment of powers, section 2514 of the Internal Revenue Code, is the same as or similar to that found in the federal estate tax statute.

The only Arizona case to construe powers of appointment was *In re Rowlands' Estate.*[18] There Eva Rowland left a holographic will. In the will she made a number of specific bequests, after which there remained a residuary estate of approximately $38,000.00. After the specific bequests, the will provided:

> All things not mentioned in my will I leave it up to Mr. and Mrs. Hugh Cuthbert, Sr. to distribute to any of my close friends. Please give generously to Maria Discombe who has been a faithful maid. . . . If I have not mentioned anything I ought to have mentioned, I leave it to your judgments Mr. and Mrs. Hugh Cuthbert Senior . . .[19]

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[16] See ARIZ. REV. STAT. ANN. § 1-201 (1956). The Arizona Statute adopted the common law as part of the law of Arizona; that is, ". . . so far as it is consistent with and adapted to the natural and physical conditions of this state and the necessities of the people thereof. . . ."

[17] See Irwin v. Murphey, 81 Ariz. 148, 152, 302 P.2d 534, 537 (1956); Ehrenzweig, *The Restatement as a Source of Conflicts of Law in Arizona,* 2 ARIZ. L. REV. 177 (1960).

[18] 73 Ariz. 337, 241 P.2d 781 (1952).

[19] *Id.* at 339, 241 P.2d at 783.

The will nominated Lucy Cuthbert or Hugh Cuthbert, Sr. to serve as executor. Lucy declined and Hugh Cuthbert, Sr. qualified as executor.

The executor in his final account petitioned that the entire residue be distributed to himself and his wife. The maid, Maria Discombe, filed objections to the requested distribution. The trial court denied the objections, and decreed the entire residue to Hugh T. Cuthbert, Sr. and Lucy Cuthbert, his wife, whereupon Maria Discombe appealed. On appeal, the supreme court reversed and remanded the case with directions.

The Cuthberts on the appeal contended that the will provided a beneficial power in them which was tantamount to a general power of appointment. Justice De Concini, writing the opinion of the court, noted that under a general power of appointment, the donee of the power may exercise it in his own favor and name himself as sole beneficiary; and in this connection he pointed out that no special words are needed to create a power of appointment. The court reasoned, however, that all the language of the will must be given effect, if reasonably possible. Hence it could not agree that the Cuthberts had a general power of appointment.

The opinion stated that the language the testatrix had used created a power in trust;[20] and it was concluded that Maria Discombe could not be ignored, but must be treated generously as the testatrix had required, and that, as to close friends of the testatrix, including the Cuthberts themselves, the Cuthberts could make such distribution as they should choose, including giving to themselves everything not going to Maria Discombe. The case was thereupon remanded to the trial court with the directions that the Cuthberts treat Maria generously and for the trial court to decree distribution upon its approval of the donee's action.[21]

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[20] *Id.* at 340, 241 P.2d at 783. See KALES § 635; 2 SIMES & SMITH, FUTURE INTERESTS § 877 (2d ed. 1956) [hereinafter cited as SIMES & SMITH] who state that "the concept power in trust is recognized in the Restatement of Trusts but not in the Restatement of Property."

[21] The record of the Superior Court of Maricopa County in the Matter of the Estate of Eva Rowland, Probate No. 24543 discloses the following: After the mandate of the Arizona Supreme Court was returned, the Cuthberts, he as Executor, and he and she as trustees, took the position that giving Maria Discombe $4,000.00 would be "generous" to her. Mr. Cuthbert as Executor reported this and asked the trial court to so decree and to distribute $4,000.00 to Maria and the remainder of the $38,000.00 residuary estate in equal shares to Mr. and Mrs. Cuthbert. Maria objected and claimed she should receive at least $25,000.00. The trial court (Judge Donofrio) refused to determine what would be generous and disclaimed any right or power in the court to determine the amount of the appointment. All parties appealed to the Arizona Supreme Court, but on April 27, 1954, the parties, having worked out a settlement whereby Maria received $7,500.00 and Mr. and Mrs. Cuthbert were to receive the remainder of the residuary estate in equal shares, dismissed the appeals by stipulation and a Decree of Final Distribution so decreeing was entered. This case invites an interesting comparison with Jarndyce v. Jarndyce in DICKENS, BLEAK HOUSE.

Now let us examine some sample forms in order to illustrate some of the points we have made. Form No. 1 illustrates what a Testator may do in creating a general power of appointment to be exercised by will. This particular sample pertains to a marital deduction trust. This type of power came into extensive use following the enactment of the Internal Revenue Act of 1948.[22] In order to satisfy the marital deduction requirements, the power must be a general one, exercisable by the surviving spouse alone and in all events.[23] If the power is more limited, it will not qualify the trust for the marital deduction, as provided in the Federal Estate Tax and the Arizona Estate Tax Acts.

The draftsman, in preparing a testamentary trust in which a marital deduction is desired, must choose whether to use such general power of appointment, or to give outright to the estate of the surviving spouse upon the death of such spouse. Many lawyers of our acquaintance have preferred to use the general power of appointment, with gift over in default of appointment, influenced greatly, no doubt, by the hope that the surviving spouse would not upset the estate planning made by the two living spouses.[24] Some lawyers prefer not to use powers, but give outright to the estate of the surviving spouse on the death of the latter. This may result from a feeling that it is a more simple and sure process than the creation and exercise of a power of appointment.[25]

In Form No. 1 the appointive property (or the alternative outright gift to the estate of the surviving spouse) will be included in the gross estate of the surviving spouse for federal and state estate taxes, that is, of course, what may be left of it on the date of his (or her) death. It is thus part of the program of keeping the marital deduction portion out of the taxable estate of the first spouse to die.

Form No. 2 illustrates a general power of appointment of broad application which may be exercised by will or by deed. In such circumstances the period of limitation established by the Rule Against Perpetuities is measured from the date of the exercise of the power. Where the exercise is by will, the date is that of the death of the donee of the power; and where the exercise is by deed, it is the date of the deed of the donee of the power.[26]

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[22] See the discussion in LOWNDES & KRAMER 252.

[23] INT. REV. CODE OF 1954, § 2056.

[24] See Johnson, *Powers of Appointment*, 29 TAXES 965 (1951).

[25] FARR, AN ESTATE PLANNER'S HANDBOOK 334 (1966) [hereinafter cited as FARR] says, "One of the reasons for the historic failure of estate planning draftsmen to use the power of appointment device has been a lively fear of offending the rule [perpetuities]. *There is ground for that fear.*" (Emphasis added.)

[26] See Mifflin's Appeal, 121 Pa. 205, 15 Atl. 525 (1888), a leading case on this point. See also GULLIVER, CASES ON FUTURE INTERESTS 518-20 (1959).

## *SAMPLE PROVISIONS RELATING TO POWERS*
## of
## *APPOINTMENT IN WILLS**

*FORM NO. 1*—Powers of Appointment, Applicable in Marital Deduction Trusts

My said wife is hereby given a general power of appointment, to appoint, by Will, the whole or any part or parts of said trust, to whomever she may choose, including her estate. To the extent, if any, that she does not effectively exercise such power of appointment, the trust estate remaining unappointed at her death shall be administered and distributed as follows: (here set out the gift over in event of default in appointment).

*NOTE*: This is about as simple as a power may be made to qualify a gift in trust for the marital deduction. It must be a general power, exercisable by the surviving spouse alone, and in all events.

*FORM NO. 2*—General Power, of Broader Application

I hereby give unto ———————————— (donee) power to appoint ———————————— (description of appointive interest or property) to whomever or whatever object he may specify, including himself, his creditors, his estate and the creditors of his estate. This power of appointment may be exercised either by Will or by Deed. In default of effective appointment, I direct that the property shall be disposed of or distributed as follows: (gifts over).

*NOTE*: This general power again is very simple, as general powers usually are. In fact, they may be created without the use of such terms as "appoint," "appointment," "power of appointment" and other words of art. But better draftsmanship suggests use of terms with established legal meaning.

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* These samples are not offered as model forms. They were prepared by William H. Messinger to illustrate and make more definite the discussion of Powers of Appointment at a session of the Arizona Law Institute.

Whenever, in these forms, the donee make further appointment in trust, it is to be stressed that care must be taken not to violate the Rule against Perpetuities. See Professor Powell's warning in text accompanying footnote 51.

Under Form No. 2, the appointive property, if the general power of appointment was created after October 21, 1942, will be included in the gross estate of the donee for federal and state estate tax purposes.[27] If the donee of the general power renounces it within a reasonable time after he has knowledge of its existence, the property covered by the power will not be subject to either estate or gift taxes.[28] If, on the other hand, the donee accepts a general power and then releases it, the release may be equivalent to a gift to the takers in default, and, therefore may subject the donee to a gift tax.[29] In such a situation the release could, if made in contemplation of death, subject the property to the estate tax.[30]

Although the subject of pre- and post 1942 general powers of appointment presents many difficulties, we cannot here treat them extensively. For our purposes, we shall simply repeat that, with respect to general powers created after October 21, 1942, the Internal Revenue Code, sections 2041(a)(2) and 2514(b), makes a distinction for tax purposes between release, which in the case of a general power may be taxable for gift tax purposes and may be included in the gross estate for estate tax purposes, and a disclaimer or renunciation, which under both cited sections of the Internal Revenue Code is not a taxable event.[31]

Forms Numbers 3 to 6, inclusive, create special powers of appointment. Such powers are equally desirable in the disposition of separate as well as community property. By careful draftsmanship, much can be accomplished by the use of special powers, and their use does not ordinarily impose estate or gift tax consequences upon the donee of the power.[32] Of course, with the granting of special as well as general powers, the Rule Against Perpetuities must be kept in mind.[33] If the donee of the power creates new powers in the appointees, there is the ever present danger that the latter may violate the Rule Against Per-

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[27] For general discussion see LOWNDES & KRAMER 267-68.

[28] On renunciation see generally LOWNDES & KRAMER 269-70; SIMES & SMITH § 1061.

[29] LOWNDES & KRAMER 269-70.

[30] INT. REV. CODE OF 1954, § 2035.

[31] The draftsman quite often advises the use of general powers in wills and trusts in order to take advantage of the estate tax marital deduction. Otherwise he should be unusually cautious in advising their use, and then only after careful research has established that they should be used in the particular situation. Of course, the attorney should advise the use of powers only after he is reasonably certain that the donee's exercise of the powers do not run afoul of the Rule Against Perpetuities.

Many would profit by reading the interesting "A Tale of Four Families, Nine Million Dollars, and Fiduciaries," LEACH & LOGAN, CASES ON FUTURE INTERESTS AND ESTATE PLANNING 792-807 (1961). There the authors discuss the case of Sears v. Coolidge, 329 Mass. 340, 108 N.E. 2d 563 (1952), in their chapter on "Powers of Appointment Under the Rule."

[32] See *Halbach* at 694. See also FARR 162, 231.

[33] FARR 334-36; *Halbach* 703-10.

*FORM NO. 3*—Special Power of Appointment (Excluding only Estate and Creditors of Donee)

Upon the death of my said wife, I direct my Trustee to distribute the entire estate then remaining in the trust created by this, the SEVENTH paragraph of my Will, as my wife may appoint, in trust or otherwise, by her Will, in such portions as she may choose, to or among any person or persons other than her estate, her creditors, or the creditors of her estate. This power may be exercised by the Will of my said wife even though such Will was executed during my lifetime and before my own Will, and I direct that no specific or express language be required for its exercise. In default of effective appointment, I direct that said trust estate be disposed of and distributed as follows: (gifts over).

*FORM NO. 4*—Special Power of Appointment (Limited Class of Appointees)

Upon the death of my said son, life beneficiary of this trust, the Trustee shall distribute the principal of this trust in such shares as my said son may appoint by his Will. Such appointment, however, to be limited to and among such of the following persons as he may select and in such portions as he may designate, namely: wife of my said son, descendants of my said son, spouses of such descendants, or any corporation, person or organization to whom a bequest would be deductible for Federal Estate Tax purposes, at the time of the death of my said son, as a bequest for a religious, charitable, scientific, literary or educational purpose; provided, however, that this power shall not be exercisable to any extent or in any way for the benefit of my said son, his estate, his creditors, or the creditors of his estate. Any such appointment may be made in trust or otherwise. This power of appointment may be exercised by the Will of my said son even though such Will was executed during my lifetime and before my own Will. In default of effective appointment of said trust fund or any part thereof, said fund or such unappointed part thereof shall be distributed *per stirpes* among those of my descendants who are living at the death of my son.

petuities when he exercises his appointive power. For example, he may appoint to someone who was not a "life in being" when the original donor created the power.

Form No. 3 illustrates the situation in which the surviving wife is the beneficiary for life of a trust and is given a special power to appoint the remaining trust estate at her death by will, in trust or otherwise, in such portions as she may choose, to or among persons other than her estate, her creditors, or the creditors of her estate.[34] The appointment in this form must be by the donee's will, so there is no need to eliminate the donee as an object of the appointment.[35] The class of appointees is made broadly exclusive for the donee may appoint "in such portions as she may choose, to or among . . . ." Hence no questions may arise as to whom the objects of her appointment shall be or the portions to which any shall be entitled, so long, of course, as the appointees do not include her estate, her creditors, or the creditors of her estate.[36] By these conditions we are assured that the power will be special and not general.

In this and others of the forms, it is provided that where the exercise of the donee's power is by will, it can be executed in the lifetime of the donor and even before the donor's will.[37] This is fairly common and it is believed to be good practice.

Form No. 4 is more limited in the class of appointees in that the donee may appoint only to those designated. It again permits the appointment to be made in trust, which may be especially desirable in the case of the son's wife and descendants. On the supposition that there may be a failure of descendants, divorce between donor's son and wife, etc., alternative charitable appointments may be especially in order. In this form, the precaution is taken of negativing appointments which, by benefiting the son, his estate, his creditors, or the creditors of his estate, might make the power a general one.

Form No. 5 illustrates a special power of appointment which is contingent and limited in amount and in the class of appointees. It is contingent in that if son John survives the testator's wife, John takes outright and there is no power of appointment. If John does not survive the testator's wife, John may appoint by will one-half of the share apportioned

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[34] This illustrates a non-general power under INT. REV. CODE OF 1954, § 2041.

[35] In the circumstances there would be an avoidance of probate of the appointive property. See *Halbach* 699-700.

[36] Here the draftsman probably should follow the language of the Internal Revenue Code in designating the nature of the power. INT. REV. CODE OF 1954, § 2041(b)(1) provides, "The term 'general power of appointment' means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate. . . ."

[37] See 1 CASNER, ESTATE PLANNING 701 (3d ed. 1961); see also 5 AMERICAN LAW OF PROPERTY §§ 23.57, 23.58 (Casner ed. 1952).

*FORM NO. 5*—Special Power of Appointment (Contingent and Limited in Amount and in Class of Appointees)

Upon the death of my said wife, the share apportioned to my son, John, shall be distributed to him if he is then living; and in the event he is not then living, I hereby give and grant to him the power to give and appoint, by his Will, whether or not made in my lifetime and before my own Will, outright or in trust, one-half of said share apportioned for him, to any or all herein mentioned and in such portions as he may designate, namely: his wife, his children, his brother, his sister, descendants of his children, and descendants of his brother and sister; and the remainder of such share apportioned for my said son, John, together with all or any part of said share not effectively appointed (but I require no specific language for the testamentary exercise of the special power of appointment herein created) shall be distributed *per stirpes* to the descendants of my said son, John; and if he leaves no descendants then living, the same shall be distributed *per capita* to the descendants then living of his brother and sister.

*FORM NO. 6*—Special Power of Appointment (Power in other than Trust Beneficiary)

Upon the death of my said wife, the entire trust estate then remaining in the trust created by this, the EIGHTH paragraph of my Will, shall be divided by my Trustee into two equal parts. One part shall be distributed as my brother, George, may appoint, the other as my sister, Mary, may appoint, among those of their respective descendants who are living at the death of my said wife. Any appointment under these powers may be by Will, or by an instrument acknowledged and delivered to my Trustee. Any appointment within such class may be in trust or otherwise, and may be to such members of the class and in such portions as the donee of the power may designate. Any exercise of these powers by Will shall be valid even though such Will was executed during my lifetime and before my own Will, but no exercise by an instrument other

for him if he had survived the testator's wife. The power is special, limited to John's wife, his children, his brother, his sister, descendants of his children and of his brother and sister; and, as to one-half, and within such classes, it is exclusive and John may appoint among them as he sees fit all or any part of the said one-half. The other one-half of John's share, and any part of the one-half not effectively appointed, shall be distributed *per stirpes* to John's descendants, and if he leaves no descendants, then *per capita* to the descendants of John's brother and sister. This illustrates a more complex situation for which the testator may make provision by a contingent special power of appointment limited to the one-half which the donee may appoint.

Form No. 6 illustrates a situation in which the donees of the powers of appointment have no interest in the estate or trust other than the power to appoint. Here a trust has been set up by the testator's will for his wife for life, with provision that upon her death the trustee shall divide the entire trust estate then remaining into two equal parts. Special powers of appointment are given to the testator's brother George, and his sister Mary, each to appoint one of such equal parts among their respective descendants, living at the death of the testator's wife.

The exercise of the power here may be by will or by an instrument acknowledged and delivered to testator's trustee. It is provided that a will exercising the power may be made in the testator's lifetime and even before the testator's will, but that an instrument, other than a will, exercising a power must be made after the testator's death. This last requirement may or may not be justified. It may be, from practical considerations. Again, provisions are made for takers in default of appointment, and since experience indicates that corporate trustees often feel the need of definite, express notice of the exercise of powers of appointment, provision for notice is included in this form.

In none of the forms numbered 4 to 6 is reference to the power required in making appointment. If reference is required, it may be overlooked and the power may be lost.[38] If the power may be exercised generally and without reference, it may be exercised inadvertently. There is no one right way; the draftsman will have to choose.

Form No. 7 may serve as a hotchpot clause.[39] Without such a clause an inequity may arise where appointment does not fail as to some appointees, and yet they likewise share as takers in default.[40]

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[38] See STEPHENSON, *op. cit. supra* note 5, at 110-111.
[39] *Id.* at 102; *Halbach* 714-15.
[40] See LEACH & LOGAN, CASES ON FUTURE INTERESTS AND ESTATE PLANNING 976-77 (1961) (Will of Joseph Albert Thomas). See also 5 AMERICAN LAW OF PROPERTY §§ 23.48, 23.49 (Casner ed. 1952).

*FORM NO. 6* — (continued)

than a Will shall be valid unless made after my death. If either holder of these powers shall fail in whole or in part to make effective exercise of his or her powers, including notice thereof, delivered within six months following the death of my wife, to the Trustee named in my will or qualified and acting in my Estate, then all property over which such effective exercise was not made shall be distributed *per stirpes* among the descendants, living at the death of my said wife, of the person failing to exercise completely the power of appointment over such property.

*NOTE*: Forms 4 to 6, inclusive, illustrate only generally what may be done by Special Powers of Appointment. They present much more of a challenge to the draftsman than do General Powers of Appointment.

In these samples the Testator has not required the exercise to be by reference to the power. If reference is required, it may be overlooked and the power may be lost. If the power can be exercised generally and without reference, it may be exercised inadvertently.

*FORM NO. 7*—Hotchpot Clause

Under any power of appointment created in this Will, no person to whom an appointment is made shall share in the gift in default of appointment unless he contributes the property appointed to him to the funds to be distributed in default of appointment.

*NOTE*: Without such a clause, an inequity would arise where appointment did not fail as to one appointee and he took his appointed share, and, except for such a clause, also would take as a member of a class to whom distribution is made as takers in default.

*FORM NO. 8*—Exercise of Power in Residuary Clause

All of the rest, residue and remainder of my estate, real, personal and mixed, of which I shall die seized or possessed, and all property and estate over which I hold power of appointment, I give, devise and bequeath as follows:

Form No. 8 provides for exercising the power by the residuary clause. This shows the donee's intent and should be effective where no express reference to the power is required in the donor's instrument creating the power. There is a division of authority as to whether a residuary clause, with no mention of power of appointment, will act as an exercise of an existing power.[41] In some jurisdictions the rule is that a general residuary clause is sufficient unless a contrary intention appears from the will.[42] In other jurisdictions a power of appointment is held not to be exercised by a residuary clause unless an intent to exercise the power appears from the will. The Restatement of Property adopts the latter rule.[43] It is sound practice, in any event, to make clear in the donee's will whether or not powers of appointment are being exercised.

Form No. 9 illustrates a partial and contingent exercise of a special power of appointment by express reference to the power. In this instance the husband of Mary Smith concluded that the family fortunes were such that if she survived him, she might well need one-half of what Mr. Smith's father had given him a special power to appoint to her, so, contingent upon Mary surviving him, he appointed to her the one-half.

Form No. 10 illustrates the express exclusion in the residuary clause of any appointive property and expressly declares that the testator has no intention of exercising any power of appointment which the testator may have, then or at the time of his death.[44]

Form No. 11 illustrates a very strong disavowal of the exercise of any power of appointment and a positive and unequivocal refusal to exercise any power or powers of appointment which the testator then had or which he might acquire before his death.[45] In an estate already in high estate tax brackets, it may be exceedingly important that a special power of appointment not be exercised, particularly if the takers in default also are those whom the donee of the power would want benefited.

Care also must be taken to be sure that powers of appointment are not created where none are intended or desired. We have already seen that no particular or even express language is required for the creation of a power of appointment. Administrative clauses may be such that, unintentionally, powers are created. One of the most common errors occurs when husbands and wives, owning community property, respec-

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[41] See 1 CASNER, ESTATE PLANNING 695; (3d ed. 1961) 3 RESTATEMENT, PROPERTY § 343 (1940); 2 SIMES & SMITH § 975.

[42] Boston Safe Deposit & Trust Co. v. Painter, 322 Mass. 362, 77 N.E.2d 409 (1948). See FARR 358 (Residuary Clauses, Form 1); 5 PAGE, WILLS § 45.21 (Bowe & Parker ed. 1962).

[43] RESTATEMENT, PROPERTY § 343 (1940).

[44] See *Halbach* 710-12.

[45] *Id.* at 712.

*FORM NO. 9*—Partial and Contingent Exercise by Express Reference

My father, RICHARD SMITH, by Deed of Trust dated ————— ————————————, having given to me a special power of appointment to appoint by Will, to my widow or my descendants, the whole or any part of the principal of a certain trust therein created, with the further provisions that if I fail to appoint, then any principal remaining should be paid over to my children and their descendants *per stirpes;* and it being my desire and intent to exercise said power of appointment in part, and under the circumstances hereinafter provided, therefore, I now exercise, in part, under such circumstances, said power of appointment, as follows:

> I give, devise and bequeath and appoint to my wife, MARY SMITH, if she survives me, one-half of the principal of said trust estate.

## *NEGATIVING IN WILL THE EXERCISE OF POWER OF APPOINTMENT*

*FORM NO. 10*—Expressly Excluding Exercise of Power by Residuary Clause

All of the rest, residue and remainder of my estate, real, personal and mixed, of which I shall die seized or possessed, and any estate over which I shall have testamentary control at my death, excluding, however, any appointive property (it being my intent, which I hereby expressly declare, to exercise no power of appointment which now or at the time of my death, I may have) I give, devise and bequeath as follows:

*FORM NO. 11*—Strong Disavowal of Exercise of Power

Except as I expressly hereinafter exercise, directly or contingently, any power or powers of appointment, I hereby positively and unequivocally declare that I refuse to exercise any power or powers of appointment which I now have or which I may acquire before my death; and no general provision of this Will shall be deemed or construed to be an exercise of such power or powers of appointment.

> *NOTE:* Since in some cases it is held that a general residuary clause is sufficient to constitute an exercise of a power of appointment, it is well to negative in some positive way an election to exercise, if that is the need and desire of the Testator.

tively set up a trust of his or her community half for the benefit of the other spouse for life, with remainder over to their children, and in the trust give to the trustee power to invade the corpus, and name as trustee the surviving spouse.[46] Such a power to invade corpus which is not limited by an ascertainable standard relating to the health, education, support, or maintenance of the surviving spouse, in compliance with the provisions of section 2041(b) of the Internal Revenue Code, creates in the surviving spouse a general power of appointment and causes the trust estate to be in the estate of the surviving spouse for federal estate tax purposes.[47]

Good practice dictates that, in order to avoid the tax difficulties in such a will, the draftsman expressly spell out that no invasion of corpus may be made by the trustee while the surviving spouse is serving as trustee. The draftsman may provide in the will for a successor trustee, and if the surviving spouse finds that there is a need to invade the corpus, he or she may resign and the independent successor trustee may qualify, and thereafter such successor trustee, in the exercise of its discretion and judgment, may invade the corpus.[48]

Another instance where a general power may be created without any intent or desire to do so is where power is given to a trustee to invade the corpus, and a right is given to a named person to remove the trustee and appoint a new trustee, and this right is broad enough to permit the named person to appoint himself as trustee.[49] In such circumstances, the rights so created give such person a general power of appointment. This situation again illustrates graphically the care which must be exercised in drafting wills and trusts.

There is no doubt as to the value of the use of powers of appointment in the drafting of inter vivos and testamentary trusts. This is true in regard to community as well as to separate property. The use of general and special powers, depending upon the circumstances, is one of the most valuable tools of the estate planner. The statement made by Mr. Furman Smith, a leading Atlanta probate attorney, is well worth repeating. Soon after the enactment of the 1951 powers of appointment act (Federal Internal Revenue Code) he stated, in an address to a group of Georgia estate planners:

> I am a very firm believer in powers of appointment. I use them in almost every instrument I draw, and there are several reasons

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[46] LOWNDES & KRAMER 254-57.
[47] *Id.* at 262-3.
[48] See UNITED CALIF. BANK, SUGGESTED FORMS FOR WILLS AND TRUSTS 117-18 (6th ed. 1963).
[49] See SIMES, FUTURE INTERESTS 182 (1951), citing and quoting from *In re* Clark, 274 App. Div. 49, 80 N.Y.S.2d 1 (1945).

for that. In the first place my experience is that under modern conditions parents need all the control they can have over their children. . . . I think the parents ought to have the right, and the children ought to know the parents have the right, to say when those children and how those children and which of those children are going to get the property.

In the second place a parent making provision for a 16- or 18-year-old child is certainly in a better position to judge what is best for that child than was the grandparent of the child making a will or creating a trust before that grandchild was even born.

In the third place I personally feel quite strongly that a son should be left in a position where he can take care of his wife. If a man is worth his salt, his first concern is, and should be, that his wife be properly taken care of if he dies prematurely. . . . And by giving the son a power of appointment you can permit him to take care of his wife, but you don't force him to do so, which is an advantage because conceivably when the son dies he and his wife may be separated, or they may be getting a divorce. So give the son a power by his will to appoint the property to his wife, if he thinks it desirable, but don't force him to.

Finally, the tax laws are so important and they're changing so fast that in my opinion it's desirable to leave property in as flexible a condition as possible by giving the children power of appointment over it, so that they can determine the disposition of it at the time of their death in the way that's most desirable in light of the tax laws as they then exist. Property dispositions which seem desirable now might be highly undesirable twenty years hence.[50]

Obviously, this statement, made by one of the leading practitioners in this field of law, indicates the tremendous value of powers of appointment to a client.

In commenting upon Mr. Smith's talk, Joseph Trachtman, the distinguished New York practitioner, made this statement:

> As to powers of appointment . . . I think that they ought to be granted as frequently as you say they ought to be, but I would suggest that perhaps you can go one step further . . . to expressly provide that the power may be exercised not only to make outright appointments, but to appoint further trusts and to grant further powers to appoint.[51]

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[50] Proceedings of the Second Annual Institute of Estate Planning, Georgia, 1952, 59-60.

[51] *Id.* at 81.

In commenting upon Mr. Smith's and Mr. Trachtman's statement, Professor Richard R. Powell added this word of caution:

> There are advantages in the increased elasticity. There are disadvantages. In the first place there is a rather strict regulation of how long you can tie up the property if the power of appointment is exercised in the creation of a new power. The rule against perpetuities is rather nasty when it deals with exercise of powers of appointment, many cases insisting that you read back the exercise into the instrument creating the power. Now that could well lead to invalidation in the exercise of the new powers that are proposed under the exercise of the family powers . . . *you've got to have an awfully good lawyer supervising the exercise of those powers, or you may well get a violation of the rule against perpetuities.*[52] (Emphasis added.)

Professor Powell's warning deserves our most careful attention.[53] Professor Leach and Dean Logan, "after many conferences with experienced estate planners," have prepared a suggested saving clause which they assert "should be included in any will or trust, for it is all too apparent that anyone can slip into a perpetuities error, or at least create the possibility of wasteful litigation. . . ."[54]

We can only add our agreement to the glowing praise of the use of powers of appointment, coupled with a warning that there are pitfalls which must be avoided. It is a device that the draftsman must take extreme care in phrasing when it is placed in an inter vivos or testamentary trust. Moreover, the draftsman should be in a position to explain in clear and understandable terms the nature of the powers to his client so that he and the client can both understand how the client's wishes are being met.

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[52] *Id.* at 84.

[53] In 1963 Arizona restored the common law Rule Against Perpetuities, ARIZ. REV. STAT. ANN. § 33-261.01 (Supp. 1966), added by Ariz. Laws 1963, ch. 25, § 2. This enactment followed the recommendation made by Professor Powell. See Powell, *Perpetuities in Arizona,* 1 ARIZ. L. REV. 225 (1959).

[54] Leach & Logan, *Perpetuities: A Standard Saving Clause to Avoid Violations of the Rule,* 74 HARV. L. REV. 1141, 1144 (1961). The authors pose the question: "Will this Clause work? We are convinced that it will, in all common law jurisdictions *except where Arizona law is applicable;* Arizona alone still keeps the two-life rule (plus twenty-one years). . . ." *Id.* at 1144-45. As Leach & Logan anticipated, Arizona repealed the two-life rule in 1963.