



Welcome to *Trust Connection*, our monthly newsletter highlighting Trust news and information. Each month we will feature timely articles of interest.

About Us

At Halliday Private Trust, it is our mission to assist our clients in the process of providing solutions, specifically through a wide range of financial advice.

Since 1982, we have utilized a full spectrum of financial services to help our clients navigate every major hurdle in their financial lives. Because we are an independent financial services firm, we utilize an open architecture approach to locating the most suitable investment options for our clients.

Our role is to help clients make smart decisions about their money. We understand that each client has unique needs and requires personalized solutions based on their goals, objectives and concerns.

Powers of Appointment: Six Rules to Encode or Decode Every Trust

Powers of appointment are the secret ingredient to the major advantages of irrevocable trusts and the formula that makes them work. Knowing this makes it easier to decode documents, or design them in the first place, and also to communicate the advantages to the client and beneficiaries.

When drafting a trust the attorney must match the desires of the client with the design of the internal revenue code. A proper alignment between these two areas enables clients to control their money in the manner that they wish after death, while achieving the tax and asset protection desired for their heirs. As one might imagine, if you give too much power or access to the funds, the IRS will say they belong to the beneficiary, thus losing the estate tax protection and asset protection. Fortunately, the internal revenue code provides a “bright line” test to determine whether the beneficiary is the owner of the trust property or not — it is called a power of appointment.

There are five powers of appointment — add the right to income to make six. Technically, powers of appointment are over the assets of the trust, not the income those assets produce. The right to the income does not make one the owner of the underlying asset. Below are explanations of each of the five powers and the right to income. When creating powers of attorney, the attorney drafting the document will use technical language, the accountant determining the tax implications will read that language carefully, and the trustee will read and interpret distribution decisions based on that language. This is central to the operation of the trust in carrying out the intent of the client.

Powers of Appointment and Explanations

1. Lifetime General Power of Appointment – The ability for a beneficiary to take any or all of the assets of the trust at any time and for any reason. This makes an irrevocable trust work very much like a revocable trust; full control and no tax or asset protection benefits. Generally used only in marital trusts.
2. Testamentary General Power of Appointment – The ability for a beneficiary to change the beneficiaries to whomever they choose. By itself this power gives no access during life, but may be combined with other powers. Whether the power is exercised or not, the assets are included in the power holder’s estate. Also used primarily in marital trusts.
3. Five by Five Power – The ability for the beneficiary to take the greater of \$5000 or five percent of the trust each calendar year, a five percent version of the Lifetime General Power. Some access translates to five percent of the income being taxable to the beneficiary, and five percent being included in the power holder’s estate.

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A LOCAL TRUST SOLUTION

Call us today at (800) 786-1598 to learn more about working with Halliday Private Trust.

For information and assistance, please feel free to contact one of our Trust Advisors:

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4. Ascertainable Standard – The ability of beneficiaries to request any amount of the assets, subject to specific language, such as “health, education, and support” or “to support their accustomed manner of living.” Because these distributions are subject to specific language, or subject to the judgment of an independent or adverse person, this power is NOT a general power and thus creates no estate tax inclusion for beneficiaries.

5. Specified Class – The ability to alter the beneficiaries of the trust, yet only within a predefined class or group of beneficiaries, such as “among the grantor’s descendants.” Since this power does not give unrestricted authority to change and the power holder cannot appoint to him/herself, this is NOT a general power and thus creates no estate tax inclusion for beneficiaries.

6. Income – The ability to get all of the income automatically, or have access to the income for anything or for predefined reasons. Again, the right to the income does not make you the owner of the underlying asset, so this is NOT a general power and thus creates no estate tax inclusion for beneficiaries.

In general when considering the language in a trust, one should answer the question, “If I were to leave instructions on how I wanted this money to be used, what would I say?” That response, when matched up with the six powers above, should make it fairly clear which powers to include. Keep in mind, the greater the power given, the greater the inclusion in the estate. Powers 1 and 2 create 100 percent estate inclusion and thus are best saved for marital trusts. Power 3 creates a nice balance of access without discretion, yet does cause some estate inclusion. Inclusion in the estate is not just a tax issue; it can also eliminate creditor protection, which in the world of high estate tax exempt values is more important to most clients.

Non-marital trusts, that is, trusts for other family members, will generally include Powers 4 and 6 on a discretionary basis. This grants access to 100 percent of the money, but only if needed for some identified use such as “maintaining one’s accustomed manner of living,” or “for support in reasonable comfort.” On the other hand, the language may be much more restrictive for a Special Needs Trust or a Supplemental Needs Trust, such as, “no distribution shall be made which would disqualify her from state or federal aid programs which are available to her” or “to pay for such supplemental support not provided by state or federal aid programs.” These examples are simplified to demonstrate the meaning of the language and grantors’ ability to design it as they wish. With broad discretion over the use of both income and principal, it can create the greatest balance of access and availability to the beneficiaries without breaching the tax protection and asset protection features of the trust. Power 5 can likewise maintain this protection and yet still give the beneficiaries a say in the future of the trust to be flexible to family needs and wealth dynamics.

Summary

It should go without saying that having experienced partners design and implement the language you desire in your trust is paramount to achieving what you desire with your life savings and for the people most precious to you. Be sure to utilize an attorney to draft precise language to reflect your wishes, an accountant to accurately interpret the tax consequences, and a professional trustee to properly and independently exercise the discretion you provide in the document for benefit of your heirs.

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