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Exercising Powers of Appointment – A Simple Task or Tricky Business?

(Part I of a Two Part Article)

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In a deed, Brian gives his brother Jack the power to appoint certain property during Jack's lifetime to or among Brian's issue by an instrument in writing. Simple enough, but a number of questions can arise. Could Jack appoint only to one issue, excluding the others? Could Jack's attorney in fact under a durable power of attorney exercise the power on Jack's behalf? What if Jack's attorney in fact is one of Brian's issue – could he exercise the power for his own benefit? Could Jack delegate the power of appointment to someone else? Is there any type of property or conveyance over which a power of appointment could not be granted? And most importantly, what language must Jack (or his representative) use to properly exercise the power?

While many attorneys may see these as simple questions, the sad fact is that in many cases, the answers may not be so apparent. One case illustrating the point is Lucarelli v. Lucarelli¹. In that case, Lucille Lucarelli executed a durable power of attorney naming her son, Les, as attorney in fact. Lucille had three sons, Les, Leigh, and Robert. The document provided that Les was

prohibited from exercising any power (under the durable power of attorney) in favor of himself. Despite this prohibition, and motivated by a sudden down turn in Lucille's health, Les, acting under the durable power, executed a warranty deed on behalf of Lucille conveying her Wisconsin residence over to her three sons (including himself) as equal tenants in common, but reserving to Lucille a lifetime special power of appointment in favor of her issue². Sometime after that, Lucille recovered enough to execute and record a document intended to exercise her power in favor of her son, Les, thereby defeasing her other two sons of title and ownership.

Later, when Les tried to sell the home, he discovered he could not get title insurance because of Lucille's reserved power. To quiet title, Les brought an action in the Circuit Court. The Circuit Court held that the signed original transfer to the 3 sons by deed was invalid as to Les (because of the prohibition under the durable power) but valid as to the other brothers. It further held that the reserved power was void because the warranty deed itself constituted an outright gift, and there could not be an outright gift while a power to revest title (the reserved power of appointment) existed. An appeal was filed in the Court of Appeals.

Briefly, the Court of Appeals pointed out that under Wisconsin law, a warranty deed must convey indefeasible title to the grantees. The reserved power in Lucille to defease the title by exercising her special power was inconsistent with the terms of the warranty deed and was therefore void³. This is not to say that Lucille could not have reserved a power to appoint, but she could not do it in a warranty deed in Wisconsin. Therefore, her subsequent attempt to exercise the power in favor of one son to the exclusion of the two others was "equally futile". (Also significant was the fact that the durable power of attorney prohibited the attorney in fact from transferring the principal's property to himself.)

In addition to the conveyancing issue, another important question was posed at the early stages of the Lucarrelli case. The question was whether the language purporting to exercise the power constituted a valid exercise. For some reason, this is where many attorneys get confused. Lucille's exercise of the power was not clearly worded and this raised questions about the validity of the exercise.

For instance, Lucille's document of exercise stated, among other things, "*In that special power of appointment, I reserved the right to remove one or two of my sons from this deed*". In fact, Lucille reserved the power "*to appoint to or for the benefit of any one or more of [Lucille's] issue*". Does the exercise language, which improperly states the reserved power, work nevertheless, because it states a possible option that falls within the reserved power?

Louise' exercise went on to say, "*pursuant to that retained power, I do hereby exercise it, and I do hereby remove from this warranty deed and from ownership of the house, my son, Leigh and my son, Robert. Therefore, having exercised this power, only my son, Les, receives this property*".

Exercise of a power of this nature would normally be in the form of appointing the property, not "removing" a grantee. An appointment of the share of an existing grantee to a new party has the effect of removing the first grantee without any further expression of appointment. For instance, Lucille could have simply said, "*I hereby appoint the entire property subject to this power to my son, Les.*". This would have the effect of "removing" the other two sons by defeasing their title. A "removal", by itself, would not have been an effective exercise of the power, since there was no new grantee. In this case, however, Lucille followed that language with an expression of her intention by stating that she wanted her son, Les, to "receive" the property; does this "correct" the improper language? Another improper reference was the word "house". But shouldn't her reference in the exercise to "the house" be interpreted to mean "the property"? All of which leads to the essential question: with all these uncertainties raised by the unclear and imprecise language of the exercise, would it nevertheless be considered a valid exercise?

While, as discussed in further detail below, the requirements of the terms of exercise of a power will be governed by the language granting the power, which requirements must generally be strictly followed, the rule of substance over form will also apply, provided the donee's intent to exercise the power is clear. In this case, the only formal requirements were that Lucille's exercise be in writing and acknowledged, which it was. The fact that the language required some interpretation to come to the conclusion that she wanted the property to be owned solely by one

son was not fatal. Her intent was clear and there is little question that the court would see it that way.

What this case does illustrate, however, is the sometimes casual treatment that is given to powers of appointment, causing questions as to the grant as well as the exercise. So, what could or should Lucille have done to help eliminate these questions?

Some Observations on the Exercise of Powers

A power of appointment is a power to dispose of property⁴. The terms of the grant of the power usually dictate the manner and extent to which it may be exercised by the holder⁵.

As pointed out above it is true that a failure to comply with the formal requirements set forth in the grant of the power may prevent an effective exercise of the power, but it is also true that “equity will aid the defective execution of a power” if the powerholder’s intent to exercise the power is clear, the defect is one of form rather than substance, and the donor’s purpose in imposing the requirement is not frustrated⁶.

For instance, say that X grants Y the power to appoint property after Y attains the age of 30 but not after Y has attained the age of 35. Y is aware of the power, though he is only age 28. At age 28, he executes an otherwise valid exercise of the power stating that the exercise is to take effect on the day after his 30th birthday. Will this act operate to exercise the power if Y lives to that date? It will not. Any exercise of the power by Y before he has attained age 30 or after age 35 will be ineffective, because under the terms of the power, the power does not become exercisable except within the prescribed period of time. The attainment of age 30 and the requirement that the power be exercised after that time are conditions precedent and must be satisfied to have an effective exercise of the power⁷.

The manner of the exercise, however, can pose a totally different question. For instance, in the foregoing example, say that, in addition to the requirement of attaining the prescribed age, the grant requires that Y must exercise the power by an “intervivos instrument”. Y exercises the

power in a Will duly executed while Y is age 32. Is the appointment effective? Since the Will is an instrument executed during Y's lifetime, is it not an intervivos instrument? Hasn't the substance, if not the form of the requirement set forth in the grant of the power been satisfied? Although we view a Will as a "testamentary" instrument, we do so because it serves to dispose of a person's property after his death in accordance with the applicable statute of Wills, but at the same time it is a legal document executed "intervivos" by the testator. Accordingly, it would satisfy the requirement of the terms of the power and the appointment would be effective⁸.

As can be seen, the answers to what sometimes appear to be simple questions are not always clear and the outcome could be quite uncertain, which leads us to the more important question: although we seem comfortable with drafting a grant of a power of appointment, why aren't we more careful and focused when drafting an exercise of a power?

Guidelines for Exercise

While there are no fixed rules other than those indicated above relating to careful compliance with the conditions set by the donor and establishing an intent to exercise the power, here are a few practical suggestions on drafting an exercise, which could help avoid litigation or a defective exercise:

1. Refer to the grant of the power in the exercise (when, by whom, the extent of the power, the property subject to the power, and in what instrument it was granted);
2. Express a clear intention to exercise the power, state the extent to which it is being exercised and in whose favor, and state the terms of the exercise (e.g. outright, in trust, whether a partial or full exercise, whether the exercise is revocable or irrevocable, etc.);
3. Use the right language. The powerholder does not convey her property. Since she is only a powerholder, it is not her property. She exercises a power. Therefore, she will simply state, "*I hereby exercise the (referenced) power in favor of _____*", etc.
4. Make sure any conditions precedent to the exercise of the power are satisfied;
5. Execute the document of exercise as required by the terms of the grant (e.g., signed and acknowledged, witnessed, delivered to someone, recorded, etc.); and

6. Review the exercise to ensure that it makes sense.

Here is how a simple exercise of a power may appear:

“I, Jack J. Bones, the donee of a power of appointment granted by Brian B. Bones
1. [under Article VI of the Brian B. Bones Trust dated June 30, 2000]; or 2. [in a deed
from Brian B. Bones dated June 30, 2000 and recorded in Coyote County Registry of
Deeds at book 666 page 777]; or 3. [under the Will of Brian B. Bones dated June 30,
2000 and admitted to probate in Coyote County Probate Court, docket/case no. CC-666],
hereby exercise the aforesaid power as follows:

I appoint [all/one-half/twenty percent/the sum of \$50,000] to Robert Bones, Barbara
Bones, and Alex Bones outright in equal shares, as [tenants in common, joint tenants,
etc.].

Witness my hand and seal

this ____ day of _____, 2000.

_____”

Jack J. Bones

[acknowledgment if necessary]

Note that the above exercise is unconditional and irrevocable. An exercise could be either or
both. If the exercise is to be revocable so that the powerholder could later revoke the exercise or
defeat the title by reappointing the property, it must so state, including the manner of revocation
or reappointment.

Exercising into a Trust

One circumstance that seems to give attorneys a lot of trouble is exercising a power in favor of a
trust. That is, most modern day powers allow the powerholder to appoint “on such trusts, terms,

and conditions as the powerholder may decide.” Just how is an appointment made to a trust? Must it be an existing trust? If it is an existing trust, how closely must the terms meet the terms of the power? For instance, say that the objects of the power are X’s children and the existing trust provides for X’s children in equal shares, but on a child’s death to his issue. Would an appointment to this trust be valid since it clearly benefit’s X’s children?

If the appointment is made to an existing trust, the trust must benefit only objects of the power and in a manner that does not breach the terms of the power (e.g., as to age requirements, etc.). In the example above, an appointment to a trust that provided a contingent benefit to a child’s issue would not be valid because a child’s issue are not permissible objects of the power. If the existing trust provided that on a child’s death his share would pass to his estate, for instance, the appointment would be valid, even though the child’s issue may be beneficiaries of the child’s estate. This is because such an arrangement is deemed to be an appointment to the child, who is the object of the power and who may arrange his estate in any manner he chooses.

If we are appointing to a new trust, who would be the settlor of the new trust? What would be the terms? Could the trust be revocable or amendable? If so, by whom?

When one thinks about these questions, they should not be so confusing. If the grant allows the powerholder to appoint under “such trusts, terms, and conditions”, it clearly means any legal arrangement that the powerholder desires, so long as he complies with the other terms of the power (i.e., conditions precedent, benefitting only objects of the power, etc.), and so long as the appointment terms are not illegal or against public policy, and, unless the power was granted in a state that has abrogated the rule against perpetuities, so long as the power does not cause the rule to be violated⁹.

In fact, even if there is no reference to trusts (although it certainly is better to provide one if there is an opportunity), there is nevertheless a basis for appointing to a trust on the reasoning that when a donor gives the donee (powerholder) the power to dispose of the appointive property, he is giving the powerholder the same rights of disposal as the powerholder would have if she owned the property herself and were giving it to the objects of the power¹⁰. In such a case, there

is no question that the donee of the power could transfer the property to a trust of her choosing for the benefit of the objects. Therefore, if, for example, a powerholder wishes to place the appointive property in a trust for the benefit of the objects of the power, providing for discretionary distributions for a period of years and outright distributions of various percentages at various ages, etc., etc., the powerholder or anyone acting at the powerholder's direction, could be the settlor of the trust, which would be drafted according to the powerholder's desired terms. These terms would include all of the terms normally found in well-drafted trusts, including selection of trustees and successors, spendthrift provisions, tax considerations, etc. Of course, the trust could not benefit anyone other than the objects of the power, as this would violate the terms of the power and the exercise would then be ineffective¹¹. Accordingly, there should be no "gifts over" on the death of an object, except to other objects of the power, or, if none, to the deceased object's estate.

After the trust was settled, the powerholder would then exercise the power in favor of the trust, preferably naming the beneficiaries in the document of exercise so as to make clear on its face that the exercise complies with the terms of the power.

Note that the trust could be revocable by the powerholder, or even amendable, having always in mind the objects of the power. For instance, if the trust originally provided for four objects of the power but the powerholder subsequently decided to exclude one or more or add one or more permissible objects, this could easily be done through an amendment to the trust. In fact, unless the donor of the power indicated a contrary intent, the powerholder could even grant someone else the power to do this (such as the trustee, or even a third party) so long as only permissible objects of the power could benefit by the exercise or amendment¹².

Power Exercised by a Legal Representative

It is interesting that delegation of the power to another by the powerholder is generally permitted, while exercise of the power by the powerholder's legal representative is not. If the powerholder becomes incapacitated the laws vary from state to state as to whether the powerholder's legal representative may exercise the power¹³. If this is a concern, it can of course be easily remedied

by drafting the power to include the statement that the power may be exercised by the donee's legal representative, including the donee's attorney in fact under a durable power of attorney.

Conclusion

Most advisors focus so much on the tax ramifications of powers of appointment that they often lose sight of the many administrative and property law issues involved, including the proper exercise of a power. It might be wise for all of us to re-examine the non-tax issues, so that, together with the tax issues¹⁴, we will be able to creatively and correctly make use of the many planning opportunities available with powers of appointment.

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¹ Wisconsin Court of Appeals No 99-1679, 2000 WL631090. It should also be noted that the Court of Appeals further decided that the original deed (by the attorney in fact) was itself ineffective and therefore void. Accordingly, the property reverted to the grantor's estate. The author expresses his appreciation to Wisconsin Attorney John Wargo for his assistance in reviewing the facts of this case.

² The apparent reason for the transfer of the home with the reserved power was to establish the date of the transfer for Medicaid eligibility purposes, yet retain ownership for tax purposes. For a detailed discussion of this idea, see Alexander A. Bove, Jr., *Creative Use of Special Power of Appointment to Protect the Home*, Estate Planning, January 1997

³ 23 Am. Jur. 2nd §78 (Deeds)

⁴ Restatement Second Property, §11.1

⁵ Restatement Second Property, §12.2

⁶ Restatement Second Property, §17.1, 18.3

⁷ Restatement Second Property, §18.4

⁸ Restatement Second Property, §18.3; comment c; illustration 5

⁹ Restatement Second Property, §1.4, comment 1

¹⁰ Restatement Second Property, section 19.3

¹¹ *Estate of Du Pont*, 379 A 2nd 570 (Pa. 1977)

¹² Restatement Second Property, §19.4 (2) and comment (a)

¹³ See e.g., Colorado Rev. Stat. §15-14-408 (5); Michigan Comp. Laws §700.468 (d); New Jersey Stat. Ann. §3B:12-5; Mass Gen Laws Ch. 201 §38; Texas Prob. Code Ann. §230(b)(i)

¹⁴ A discussion of the numerous tax issues related to powers of appointment is conspicuously omitted from this article. The author intends to cover these in a subsequent article

