

Memorandum 68-108

Subject: Study 69 - Powers of Appointment

The version of Section 1381.3 and the Comment thereto approved for printing is attached as Exhibit I. We have sent the Recommendation including this section and the Comment thereto, to the printer to be set in type.

You will recall that Section 1381.3 relates to the definition of "testamentary" and "presently exercisable" powers of appointment. After further review, the staff believes that this section is defective and requires further consideration by the Commission.

This section has had an interesting history. It has been revised by the Commission at every meeting at which it has been considered. Originally, the critical subdivision provided:

A power of appointment is presently exercisable whenever the donor has not manifested an intent that its exercise is postponed.

This is virtually identical to the comparable language of the Restatement, the Michigan statutes, and the 1964 version of the New York statute. (In 1967, the New York statute was revised to read in part:

(b) A power of appointment is presently exercisable if it may be exercised by the donee, during his lifetime or by his written will, at any time after its creation, and does not include a postponed power as described in paragraph (d).

(c) A power of appointment is testamentary if it is exercisable only by a written will of the donee.

(d) A power of appointment is postponed if it is exercisable by the donee only after the expiration of a stated time or after the occurrence or non-occurrence of a specified event.

The Revisers' Note states that the latter section re-enacts the earlier section without substantive change.)

After the first meeting, this subdivision was revised to read:

A power of appointment is presently exercisable whenever the creating instrument does not manifest an intent that its exercise shall be solely by will or otherwise postponed.

After the next meeting, in an attempt to make clear that a postponed power can become presently exercisable upon the occurrence of the condition or event, the subdivision was redrafted as follows:

A power of appointment is "presently exercisable" if it is not testamentary and its exercise is not otherwise postponed beyond the time in question by the terms of the creating instrument.

At the May 1968 meeting this was changed to read:

A power of appointment is "presently exercisable" if it is not testamentary and it was exercisable from the time of its creation, or if it was postponed, the period of postponement has expired.

In September, we became aware of the common use of an instrument on file with the trustee at the death of the donee exercising a power relating to the trust assets (appointive property). It was first suggested that this type power also be considered "testamentary" but finally decided that this was a "postponed" power and that the section should be revised to ~~accommodate~~ accommodate it. The section was revised to read as follows:

(b) A power of appointment is "presently exercisable" if it is not testamentary and:

(1) It is effectively exercisable from the time of its creation; or

(2) If its effective exercise was postponed, the period of postponement has expired.

This language was in turn revised as set forth in Exhibit I.

The term "presently exercisable" is important in three separate areas. (1) If the donee has a "presently exercisable" power he

can contract to make an appointment; if his power is not "presently exercisable" he can not. See Section 1388.1. (2) If the donee has a "presently exercisable" general power, his creditors can reach the appointive property (or more accurately, the interest in the property that can be presently appointed). See Section 1390.3. (3) Finally, Section 1391.1 provides:

The permissible period under the applicable rule against perpetuities with respect to interests sought to be created by an exercise of a power of appointment begins:

(a) In the case of an instrument exercising a general power of appointment presently exercisable by the donee alone, on the date the appointment becomes effective.

(b) In all other situations, at the time of the creation of the power.

It would seem that the essence of a "presently exercisable" power is that the donee can, at the time in question, effectively (or perhaps a better word would be "irrevocably") appoint an interest in the appointive property. Whether the interest is a present or future one seems irrelevant. The critical question is whether the donee can appoint and the appointee can receive a beneficial interest in the property in contrast to a mere expectancy.

In some cases, the donor (the creating instrument) will provide that the power simply cannot be exercised until a stated event has occurred or condition satisfied. Here the power is truly "postponed" until the event has occurred or condition been satisfied. Similarly, if the donor (or creating instrument) provides that any exercise shall be revocable until a stated event or condition, it seems that such a power is "postponed." (This in effect is what is accomplished by creation of a testamentary power.) However, clearly distinguishable is the situation where only distribution is postponed. In the latter

case, the donee can, if he can irrevocably appoint, presently exercise the power. Compare, for example, (1) A gives B a life estate in certain property, with the remainder to C; (2) A places the same property in trust, with income for life to B, gives C a general power to appoint remainder interest; (3) A places same property in trust, income for life to C, gives C a general power to appoint the remainder interest "by an instrument on file with the trustee at C's death." Inasmuch as C in example (3) can file an instrument which by its terms irrevocably appoints the remainder interest to himself or others, C has just as complete "ownership" of the remainder as he has under examples (1) and (2) and each situation should be treated identically.

We can perhaps achieve this result and clarify the intent of Section 1381.3 by redrafting this section and the Comment thereto as provided in Exhibit II.

If the staff recommendation with regard to Section 1381.3 is accepted, the only conforming change necessary in the remainder of the recommendation is in Section 1390.3. (See attached Exhibit III.) Subdivision (b) of that section should be revised to read: "(b) Upon the death of the donee, subdivision (a) applies to a general testamentary power of appointment." The Comment to this section would be revised by striking the last two sentences of the first full paragraph on page 55.

Respectfully submitted,

Jack Horton
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Section 1381.3. "Testamentary" and "presently exercisable" powers of appointment

1381.3. (a) A power of appointment is "testamentary" if it is exercisable only by a will.

(b) A power of appointment is "presently exercisable" if it is not testamentary and:

(1) There is no limitation as to the time when it may be exercised and the donee can make an appointment effective upon exercise; or

(2) If the time of its exercise or the effective date of an appointment was postponed, the period of postponement has expired.

Comment. Section 1381.3 differentiates among powers of appointment by focusing upon the time at which the power may be effectively exercised. It defines "testamentary" and "presently exercisable" powers. Note that a power of appointment that can be exercised by inter vivos instrument as well as by will is not one that can be exercised "only by a will" and hence is not a testamentary power.

A power may be neither "testamentary" nor "presently exercisable." A power is not "presently exercisable" if it is "postponed." A power is "postponed" if: (1) The creating instrument provides that the power may be exercised only after a specified act or event occurs or condition is met (for example, that the donee reach the age of 25), and such act or event has not occurred or the condition has not been met; or (2) the creating instrument provides that an exercise of the power is effective, (for example, the appointive property is distributable pursuant to an exercise of the power) only after a specified act or event occurs or condition is met, and such act or event has not occurred or the condition has not been met. Examples of a power that is

"postponed" are: (1) The creating instrument provides that a wife's power of appointment over certain property held in trust by a bank is exercisable "only by a written instrument other than a will on file with the trustee at the death of my wife" and, although the wife has filed a written instrument with the trustee designating the appointees, she is still alive. (2) The appointive property is held in trust by a bank, the creating instrument provides that "any distribution of the appointive property in accordance with an exercise of the power of appointment by written instrument delivered to the trustee during the donee's lifetime shall be made after the donee's death," and, although the donee has delivered a written instrument to the trustee designating the appointees, the donee is still alive. When the term "power not presently exercisable" is used in this title, it includes both testamentary powers and powers that are otherwise postponed.

Section 1381.3 follows the common law embodied in the Restatement of Property Section 321. For comparable sections in other recently enacted statutes, see Michigan Statutes Annotated Section 26.155(102)(1)

(Supp. 1967); New York Estates, Powers and Trusts Law Section 10-3.3 (1967).

EXHIBIT II

§ 1381.3

Section 1381.3. "Testamentary" and "presently exercisable" powers of appointment

1381.3. (a) A power of appointment is "testamentary" if it is exercisable only by a will.

(b) A power of appointment is "presently exercisable" at the time in question to the extent that the donee can irrevocably appoint an interest in the appointive property.

Comment. Section 1381.3 differentiates among powers of appointment by focusing upon the time at which the power may be effectively exercised. It defines "testamentary" and "presently exercisable" powers. Note that a power of appointment that can be exercised by inter vivos instrument as well as by will is not one that can be exercised "only by a will" and hence is not a testamentary power.

A power may be neither "testamentary" nor "presently exercisable." A power is not "presently exercisable" if it is "postponed." A power is "postponed" if: (1) The creating instrument provides that the power may be exercised only after a specified act or event occurs or condition is met (for example, that the donee reach the age of 25), and such act or event has not occurred or the condition has not been met; or (2) the creating instrument provides that an exercise of the power is revocable until a specified act or event occurs or condition is met, and such act or event has not occurred or the condition has not been met. An example of a power that is "postponed" is: The creating instrument provides that a wife's power of appointment over certain property held in trust by a

bank is exercisable "only by a written instrument other than a will on file with the trustee at the death of my wife" and, to insure that the wife retains unlimited discretion throughout her lifetime, the creating instrument further provides that any instrument of appointment shall be revocable during the donee's lifetime. Although the wife has filed a written instrument with the trustee designating the appointees, she is still alive. When the term "power not presently exercisable" is used in this title, it includes both testamentary powers and powers that are otherwise postponed.

Section 1381:3 follows the common law embodied in the Restatement of Property Section 321. For comparable sections in other recently enacted statutes, see Mich. Stat. Ann. § 26.155(102)(1)(Supp. 1967); N.Y. Estates, Powers and Trusts Law § 10-3.3 (1967).

Section 1390.3. General power

1390.3. (a) To the extent that the property owned by the donee is inadequate to satisfy the claims of his creditors or the creditors of his estate and the expenses of the administration of his estate, property subject to a general power of appointment that is presently exercisable is subject to such claims to the same extent that it would be subject to such claims if the property were owned by the donee.

(b) Upon the death of the donee, subdivision (a) applies to:

(1) A general testamentary power of appointment.

(2) A general power of appointment the exercise of which can take effect only upon the death of the donee.

(c) This section applies whether or not the power of appointment has been exercised.

Comment. Section 1390.3 states the rule with respect to the availability of property subject to a general power of appointment to satisfy the debts of the donee. It is intended to make appointive property available to satisfy creditors' claims when the donee has the equivalent of full ownership of the property. See Comment to Section 1381.2.

Subdivision (a) provides that the creditors of a donee possessing a power of appointment that is both general and presently exercisable can reach the appointive property for the satisfaction of their claims. However, these creditors must first exhaust the remainder of the donee's assets before resorting to the appointive property. Subject to this

limitation, if the property has been appointed by an inter vivos instrument, the property is liable to the same extent that the donee's owned property would be liable. Thus, it would be liable if, had it been the donee's owned property, the transfer could have been subjected to the rules relating to fraudulent conveyances. See Restatement of Property § 330 (1940).

Subdivision (b) provides that the same rule applies to property which is covered by a general testamentary power (or the equivalent) which has, in effect, become presently exercisable because of the death of the donee. In such case, the appointive assets have come under the power of disposition by the debtor donee and hence are treated the same as other assets of the decedent. Paragraph (2) of subdivision (b) is not strictly necessary since the power of appointment there described becomes "presently exercisable" upon the death of the donee. Nevertheless, to make this clear, the paragraph has been included in subdivision (b).

Subdivision (c) provides that the rights of creditors are not dependent upon the exercise of the power. Unlike the common law rule, which requires the exercise of the power, the mere existence of the power is the operative fact essential to the right of creditors. In addition, it does not matter what the interest of the donee is in the property; the property available to creditors can be either a present or a future interest.