

SENATE BILL REPORT

SB 5066

AS REPORTED BY COMMITTEE ON LAW & JUSTICE, JANUARY 27, 1993

Brief Description: Limiting powers of trustees.

SPONSORS: Senators A. Smith, McCaslin and Nelson

SENATE COMMITTEE ON LAW & JUSTICE

Majority Report: That Substitute Senate Bill No. 5066 be substituted therefor, and the substitute bill do pass.

Signed by Senators A. Smith, Chairman; Quigley, Vice Chairman; Hargrove, McCaslin, Nelson, Niemi, Rinehart, Roach, and Spanel.

Staff: Alan Caplan (786-7465)

Hearing Dates: January 19, 1993; January 27, 1993

BACKGROUND:

If an individual has an unrestricted legal power to appropriate someone else's property for his or her own benefit, that person may possess a "general power of appointment." General powers of appointment often arise when a person is a trustee and a beneficiary of the same trust, or when a child administering an incompetent parent's living gift plan is entitled to transfer the parent's property to himself or herself.

Under some circumstances, holders of general powers of appointment (or their estates) may become liable for federal gift or estate taxes. According to the Internal Revenue Code of 1986, these taxes can be avoided if the power-holder's abilities are limited by an "ascertainable standard" relating to that person's "health, education, support, or maintenance."

The Washington State Bar Association has noted that Washington citizens sometimes fall into federal tax "traps" when their agreements do not contain the exact language of the statutory exception. In such cases, a power of appointment intended to be limited by an ascertainable standard may be construed to be general, and a power-holder inadvertently may become subject to federal estate or gift taxes. It has been recommended that legislative action be taken to eliminate this problem.

SUMMARY:

Holders of powers of appointment are prohibited from making discretionary distributions of property for their own benefit, except to provide for their health, education, maintenance or support. An exception is provided when the terms of an

agreement granting a power of appointment expressly state that this prohibition shall not apply.

Powers of appointment must be exercised in a reasonable manner, regardless of language purporting to grant absolute discretion to the power-holder.

Trustees who are also trust beneficiaries are prohibited from taking certain discretionary actions with respect to trust property. Provisions are made to confer prohibited powers on non-interested trustees.

A person entitled to remove or replace a trustee shall not be deemed, by virtue of that power, to possess the powers of the trustee subject to removal or replacement.

To avoid creating releases that would be subject to federal gift taxes, this bill generally is not applicable to powers of appointment created prior to its effectiveness.

EFFECT OF PROPOSED SUBSTITUTE:

Technical changes are made to further the intent of the bill.

Appropriation: none

Revenue: none

Fiscal Note: available

TESTIMONY FOR:

This bill would prevent some people from unnecessarily incurring federal tax liability because they are unaware of federal laws governing gift and estate taxes.

TESTIMONY AGAINST: None

TESTIFIED: Noreen Nearn, Washington State Bar Association (pro)