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OPINION	:	No. 81-1001
of	:	NOVEMBER 25, 1981
GEORGE DEUKMEJIAN Attorney General	:	
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THE HONORABLE CAROL HALLETT, MEMBER OF THE ASSEMBLY, has requested an opinion on the following question:

What is the effect of the limited power of appointment exception in section 13805 of the Revenue and Taxation Code upon a bypass trust estate plan?

CONCLUSION

The limited power of appointment exception in section 13805 of the Revenue and Taxation Code has no effect upon a bypass trust estate plan.

ANALYSIS

A state inheritance tax is imposed upon every transfer subject to the provisions of part 8 of division 2 of the Revenue and Taxation Code. (Rev. & Tax. Code,

§ 13401.)[1] "Transfer" includes the passage of any property, or any interest therein or income therefrom, in possession or enjoyment, present or future, in trust or otherwise. (§ 13304.) A transfer by will or the laws of succession is subject to the provisions of part 8 of division 2. (§ 13601.) Under this statutory scheme (prior to the enactment of section 13805, *infra*), the transfer by a predecedent spouse of his estate to the surviving spouse would be subject to inheritance tax. Ordinarily, the transfer of the remainder of the estate upon the death of the surviving spouse to the children would again be subject to tax.

The "bypass trust estate plan" is an arrangement designed to avoid the second tax in the estate of a surviving spouse on property that had been taxed in the estate of the predecedent spouse. By this commonly employed mechanism, the predecedent spouse may effectively provide for the care and support of the surviving spouse, and transfer the remainder of the estate to the children without incurring a double tax. Typically, the plan consists of an "A-B" marital deduction trust. The "A" trust, which is the marital deduction trust,[2] is combined with the "bypassing" or "B" trust consisting of the residue (the portion in excess of that which qualifies for the marital deduction) in favor of the children, in which the surviving spouse has a "limited power of appointment," usually for life.

A "power of appointment" is defined generally as a power or authority conferred by one person ("donor") by deed or will upon another ("donee") to appoint, that is, to select and nominate, the person or persons who are to receive and enjoy an estate or an income therefrom or from a fund, after the testator's death or the donee's death, or after the termination of an existing right or interest. (*Estate of Conroy* (1977) 67 Cal. App. 3d 734, 738) In the specific context of this analysis, a power of appointment is a power conferred by the predecedent spouse by will upon the surviving spouse to appoint the person or persons who are to enjoy the property or income of a certain portion of the estate during the life of the surviving spouse. Such a power, depending upon the terms of its creation, is either general or limited. Based on common law and recent statutory enactment (§§ 13692, 13693; Civ. Code, § 1381.2) a general power of appointment is one which may be exercised in favor of anyone, including the donee, and is, therefore, equivalent to a grant of absolute ownership, while a limited (or "special") power is one which may be exercised in favor of certain specified individuals or to a class of designated persons, not including the donee or the estate of the donee. (*Estate of Conroy*, *supra*, at pp 738–739)

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[1]Hereinafter, all section references are to the Revenue and Taxation Code.

[2]For purposes of federal estate tax, see title 26, United States Code, section 2056 *et seq*. Since interspousal transfers, except in the case of a limited power of appointment, are not taxed (§ 13805, *infra*), California no longer provides for any marital deduction.

Nevertheless, for purposes of inheritance tax law, "[a] power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent," is a limited power of appointment. (§ 13692, subd. (a).) It is clear that the "decedent" in this context refers to the donee of the power, i.e., the survivor of the predeceased Spouse Thus, the value of the "B" trust in which the surviving spouse has a limited interest of invasion subject to an ascertainable standard, is taxed in the estate of the predecedent spouse[3] but not in that of the surviving spouse (*Cf. Estate of Stober* (1980) 108 Cal. App. 3d 591.)

We now turn to the effect upon the foregoing analysis of a recent amendment of the inheritance tax law. Specifically, the present inquiry concerns the applicability of section 1 3805 to a bypass trust estate plan. By the Statutes of 1980, chapter 634, section 15 (Assembly Bill 2092), effective July 20, 1980, the Legislature enacted section 13805 concerning inheritance taxes with respect to a death occurring after December 31, 1980:

> "None of the property transferred to the spouse of the decedent is subject to this part, except that if a limited power of appointment over any portion or all of the decedent's property is given to the spouse of the decedent, the value of such property is subject to this part; provided, however, that the value of any interest, other than the power itself given to the spouse of the decedent in such property is not subject to this part."[4]

The first segment ("None of the property transferred to the spouse of the decedent is subject to this part") is unambiguous. As stated in the Legislative Counsel's Digest to Assembly Bill 2092, section 13805 "would generally exempt all property transferred to a spouse from inheritance . . . taxes . . . ." Thus, property passing *from the decedent to the surviving spouse* is generally not subject to Inheritance tax.

The second segment ("except that if a limited power of appointment over any portion or all of the decedent's property is given to the spouse of the decedent, the value of such property is subject to this part") provides the principal exception to the general rule. The value of property *subject to a limited power of appointment* is taxable. The purpose of this exception is immediately apparent. Since, as we have seen, a limited power of appointment is not taxed in the estate of the surviving spouse, section 13805 would, in the

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[3]The creation of powers, whether general or limited, is usually deemed a taxable transfer from the donor to the dunce as of the date of the donor's death (§ 13694(a).)

[4]A similar provision with respect to interspousal gifts (Stats. 1980, ch. 634, § 40) was added as section 15310.

absence of the exception, result in the transfer of, property of the predecedent spouse through two estates to the children without incurring any tax. The effect of the exception is to retain preexisting law as it applies to the bypass trust estate plan by exempting the limited power of appointment from the interspousal transfer exclusion otherwise provided by section 13805. Both before and after the enactment of section 13805, property subject to a limited power of appointment is taxed in the estate of the predecedent spouse but not in the estate of the surviving spouse.

The third segment ("provided, however, that the value of any interest, other than the power itself, given to the spouse of the decedent in such property is not subject to this part") is a limitation upon the exception. The value of the right of invasion by, and usually during the life of, the surviving spouse, is not subject to tax. Hence, the value of the property subject to a limited power is taxed[5] *only* to the extent that it *exceeds* the value of the interest therein (excluding the value of any right to appoint others) of the surviving spouse. The force and effect of section 13805, then, is to tax only that part or share of the estate of a predecedent spouse which is transferred to the children

Section 13805 pertains exclusively to the transfer by the decedent to the surviving spouse, and bears no impact upon the estate of the surviving spouse. Specifically, the limited power of appointment exception in section 13805 does not affect the tax status of the bypass trust upon the transfer by the surviving spouse of the remaining corpus.

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[5]The tax is not paid by the transferee, but from the corpus of the trust. (§ 14124.)