

Kentucky's New Narrower Inheritance Tax Statute on Powers of Appointment

John Cummins and Thomas Monarch

The Kentucky Legislature has reduced the scope of the Kentucky statute governing the inheritance taxation of trust property subject to a power of appointment. Only general powers of appointment will be subject to Kentucky inheritance tax now. No longer will the more limited special powers of appointment be subject to this tax.

The taxation of appointive property under Kentucky's inheritance tax scheme has been a cause of great confusion amongst practitioners and taxpayers throughout its history. The tax issue arises in trusts which give the beneficiary a power to "appoint" the trust property to others at the beneficiary's death. This most recent update brings Kentucky's taxation of appointive property much closer in line with the federal estate tax scheme and should resolve much of that confusion.

Effective July 15, 2024, Kentucky Revised Statutes (KRS) Section 140.040 expressly limits the definition of "power of appointment" to mean a general power of appointment, which is a power exercisable in favor of the powerholder, the

powerholder's estate, the powerholder's creditors and/or the creditors of the powerholder's estate. It also now expressly excludes from the definition of "power of appointment" limited or special powers of appointment that are limited to the health, education, maintenance and support ascertainable standards or that are exercisable only in conjunction with another person having a substantial interest in the appointive property that is adverse to the exercise in favor of the powerholder, the powerholder's estate, the powerholder's creditors and/or the creditors of the powerholder's estate. While not exactly the same, this updated Kentucky definition is substantially similar to the definition of "general power of appointment" which is subject to federal estate tax under Internal Revenue Code Section 2041.

Prior to this update, Kentucky law was unclear as to whether the term "power of appointment" was limited to only general powers, or whether the term was all encompassing to include any power of appointment regardless of any limitations thereon. This confusion led to uncertainty in estate tax planning and

inconsistencies in the preparation and acceptance of Kentucky inheritance tax returns.

Now, for decedents dying on or after July 15, 2024, the Kentucky Department of Revenue is required to administer this new KRS § 140.040 as nearly as practicably identical to the federal taxation of general powers of appointment under Internal Revenue Code Section 2041. With this clarification, it is better understood that limited or special powers of appointment specifically excepted from the term "power of appointment" will not cause the subject trust to be subject to Kentucky inheritance tax.

Nonetheless, there are still uncertainties as to how this new statute will affect how the beneficiaries' distributive shares subject to Kentucky inheritance tax are determined. It is unclear whether the Kentucky Department of Revenue will seek to levy tax on the transfer of trust property based upon the most probable appointee of a limited or special power of appointment over a trust, or if the Department will ignore the limited or special power and tax the named trust remainder beneficiaries.

Moving forward, practitioners and taxpayers should tread carefully when dealing with any power of appointment until the Kentucky Department of Revenue has issued clear guidance as to how this new tax scheme will be administered. That being said, this new Kentucky statute certainly seems to be a step in the right direction in narrowing the class of powers subject to Kentucky inheritance tax and conforming to the federal estate tax approach. It also eliminates the confusing statutory power of appointment regime that has been in effect for many years.



Partner John R. Cummins and Managing Associate Thomas H. Monarch are based in Dentons' Louisville office and are members of the firm's Trusts, Estates, and Wealth Preservation group. ■

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