

SFA



BILL ANALYSIS

Senate Fiscal Agency

Lansing, Michigan 48909

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Senate Bill 78 (as reported without amendment)

Senate Bill 79 (as reported with amendments)

Sponsor: Senator John F. Kelly

Committee: Judiciary

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RATIONALE

Under the common law "rule against perpetuities", which Michigan law incorporates, a nonvested interest in property is not good unless it must vest, if at all, not later than 21 years, plus the period of gestation, after some life or lives in being at the time of the creation of the interest. (A "nonvested property interest" refers to an interest to which the transferee is not presently entitled and might never become entitled.) Because the common law rule may invalidate what otherwise would be considered reasonable transfers of property, it is often noted for its harshness. Thus, the Michigan Law Revision Commission has recommended the adoption of the Uniform Statutory Rule Against Perpetuities, drafted by the National Conference of Commissioners on Uniform State Laws. The uniform rule allows a so-called "wait and see" approach, based on actual events that occur within a 90-year post-creation period, to determining the validity of a nonvested property interest, instead of basing the validity of an interest solely on the certainty — at the time of creation — of vesting or failing to vest within the 21-year period. (For more information on the common law and uniform rules, see BACKGROUND.)

CONTENT

Senate Bill 78 would replace Michigan's common law "rule against perpetuities" with the Uniform Statutory Rule Against Perpetuities for nonvested property interests created on or after the effective date of the uniform statutory rule.

Senate Bill 79 would create a new law to enact the Uniform Statutory Rule Against Perpetuities to provide an alternative rule under which an interest that would be valid under the common law rule against perpetuities would continue to be valid; but also to provide that an interest that would have violated the common law rule would be invalid only if it did not actually vest or terminate within 90 years after its creation. The new act would cover nonvested property interests and powers of appointment, describe when a nonvested property interest or power or appointment would be created, and authorize a court to "reform" a disposition in a manner that approximated the transferor's plan and was within the 90 years allowed. The bill also specifies exceptions that would apply to the uniform rule.

The bills are tie-barred.

Senate Bill 79Nonvested Property Interest

The bill provides that a nonvested property interest would be invalid unless one or both of the following applied to the interest:

- When the interest is created, it is certain to vest or terminate no later than 21 years after the death of an individual alive at the time interest is created.

- The interest either vests or terminates within 90 years after its creation.

General Power of Appointment

A general power of appointment "not presently exercisable because of a condition precedent" would be invalid unless one or both of the following applied to the power:

- When the power is created, the condition precedent is certain either to be satisfied or become impossible to satisfy no later than 21 years after the death of an individual alive at the time the power is created.
- The condition precedent either is satisfied or becomes impossible to satisfy within 90 years after its creation.

("Power of appointment" refers to authority conferred upon a person to select the recipient of an interest in property. "General power" means that the person may select whomever he or she pleases. "Condition precedent" refers to a condition or event that must happen or be performed before a right may be exercised — in this case, the right to exercise the power of appointment.)

Nongeneral Power/General Testamentary Power of Appointment

A nongeneral power of appointment or a general testamentary (pursuant to a will) power of appointment would be invalid unless one or both of the following applied to the power:

- When the power is created, it is certain to be irrevocably exercised or otherwise to terminate no later than 21 years after the death of an individual alive at the time the power is created.
- The power is irrevocably exercised or otherwise terminates within 90 years after its creation.

("Nongeneral power of appointment" means that the instrument creating the power restricts the persons who may be appointed to receive the interest.)

In determining whether a nonvested property interest or a power of appointment was valid under the conditions pertaining to 21 years after the death of an individual, the possibility that a child would be born to an individual after the individual's death would be disregarded.

Time of Creation

Except as provided below, the time of creation of a nonvested property interest or a power of appointment would have to be determined by statutory or common law.

For purposes of the proposed act, if there were a person who alone could exercise a power created by a governing instrument to become the unqualified beneficial owner of a nonvested property interest or an interest subject to a power of appointment, the interest or power would be created when the power to become the unqualified beneficial owner terminated.

OVER

S.B. 78 & 79 (5-12-87)

S.B. 78 & 79 (5-12-87)

A nonvested property interest or a power of appointment arising from a transfer of property to a previously funded trust or other existing property arrangement would be created when the interest or power in the original contribution was created.

A nonvested property interest or power of appointment created by the exercise of a power of appointment would be created when the power had been irrevocably exercised or when a revocable exercise became irrevocable.

Reformation

Upon the petition of an interested person, a court would be required to reform a disposition in the manner that most closely approximated the transferor's manifested plan of distribution and that was within the allowable 90-year period, and one or more of the following applied:

- A nonvested property interest or a power of appointment became invalid under the statutory rule.
- A class gift was not but could become invalid under the statutory rule, and the time had arrived when the share of any class member was to take effect in possession or enjoyment.
- A nonvested property interest that was not invalidated by the 21-year rule could vest but not within 90 years after its creation.

Exceptions

The bill's provisions containing the 21-year and 90-year rules would not apply to any of the following:

- A nonvested property interest or a power of appointment arising out of a "nondonative transfer" (a transfer that is not a gift), except a nonvested property interest or a power of appointment arising out of a premarital or postmarital agreement; a separation or divorce settlement; a spouse's election; a similar arrangement arising out of a prospective, existing, or previous marital relationship between the parties; a contract to make or not to revoke a will or trust; a contract to exercise or not to exercise a power of appointment; a transfer in satisfaction of a duty of support; or a reciprocal transfer.
- A fiduciary's power relative to the administration or management of assets, including the power of a fiduciary to sell, lease, or mortgage property, and the power of a fiduciary to determine principal and income.
- A power to appoint a fiduciary.
- A discretionary power of a trustee to distribute principal before termination of a trust to a beneficiary having an indefeasibly vested (irrevocable) interest in the income and principal.
- A property interest, power of appointment, or any other arrangement that was not subject to the common-law rule against perpetuities or is excluded by another statute.

Application/Construction

The proposed act would apply to a nonvested property interest or a power of appointment that was created on or after the act's effective date. Upon the petition of an interested person, if a nonvested property interest or a power of appointment created before that date were determined in a judicial proceeding, begun on or after the effective date, to violate the rule against perpetuities as it existed before that date, a court could reform the disposition in the manner that most closely approximated the transferor's manifested plan of distribution and was within the limits of the rule against perpetuities applicable when the interest or power was created.

The act would have to be "applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this act among states enacting it".

The bill would amend Public Act 38 of 1949, which incorporates the common law rule against perpetuities, to specify that, unless otherwise provided by statute, the Act would not apply to nonvested property interests created on or after the effective date of the Uniform Statutory Rule Against Perpetuities.

The bill also would repeal a provision under which no estate for life may be limited as a remainder on a term of years, except to a person in being at the creation of the estate (MCL 554.21). (That is, a life estate cannot be granted as a remainder interest after a term of years. A "life estate" is an interest in property that terminates upon the death of the person having the interest. A "remainder" is a property interest that takes effect after the termination of an interest in the same property held by another person.)

MCL 554.53

BACKGROUND

The common law rule against perpetuities evolved over a 200-year period that culminated in the seventeenth century with the 21-years-plus-lives-in-being rule. The rule was designed as a restraint on the power of a landowner to create nonvested interests in property; that is, to tie up property in long-term or even perpetual family trusts. Under the rule, a nonvested property interest is void unless it is certain at the time of the interest's creation that the interest will either vest or fail to vest during the permitted period. As a result, because actual post-creation events are irrelevant, even an interest that was likely to vest and actually would have vested (if allowed) well within the period of a life in being plus 21 years is nevertheless invalid if, at the time of the interest's creation, there was even a remote possibility that it would not have done so. Consequently, reasonable dispositions are invalidated because of such unlikely possibilities as the following:

- That a woman who has passed menopause would give birth to, or a "fertile octogenarian" would father, additional children.
- That the probate of an estate would take more than 21 years to complete.
- That a middle-aged or older married man or woman would become remarried to a person born after the testator's death.

The prospect of striking down interests on such a basis led to a movement to reform the common law rule, by shifting the criterion for validity from possible post-creation events to actual post-creation events; that is, instead of invalidating an interest because of what might happen, wait and see what does happen following the interest's creation. As a result, both the Restatement (second) of Property and the uniform statutory rule validate interests that would be valid under common law, take a "wait-and-see" approach to interests that would be invalid under common law, and allow judicial reformation of an instrument that would be invalid. The Restatement, however, specifies the applicable "measuring lives", while the uniform rule adopts a flat 90-year post-creation period. The 90-year rule approximates the period that would be derived by taking the youngest measuring life allowed under the Restatement (six years), and adding the average life expectancy, plus the 21 years allowed under common law.

FISCAL IMPACT

The bills would have no fiscal impact on State or local government.

ARGUMENTS

Supporting Argument

The uniform statutory rule drafted by the National Conference of Commissioners on Uniform State Laws serves to ensure the validity of reasonable dispositions that otherwise would be struck down under common law. The rule not only continues to validate interests that are valid under the common law rule, but also gives a second chance to otherwise invalid interests. Further, in addition to providing an alternative 90-year wait-and-see period, the uniform rule authorizes the judicial reformation of dispositions that were made before the rule's adoption and would fail under common law, or made after the rule's adoption and would also fail the wait-and-see test. By using a flat 90 years, the rule provides an unmistakable termination of the permitted period, thus avoiding the need to identify and trace measuring lives.

Adoption of the uniform rule would not necessarily change the practice followed in drafting dispositions, however. Competent drafters already include a savings clause, specifying that if an interest did not vest within the permitted period, the interest would go to someone else. Adopting the uniform rule simply would add a statutory savings clause, providing an alternative period in the event that an interest failed under the common law rule.

Supporting Argument

Unlike the common law rule, the uniform rule does not apply to commercial transactions. While it may be desirable to regulate the vesting of such transactions, it is not appropriate to do so by the use of criteria that were originally designed for family transactions and are based on the lifetime of an individual.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.