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BILL  ANALYSIS

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Senate Bills 978, 979, and 980 (as introduced 2-23-12)
Sponsor: Senator Tonya Schuitmaker (S.B. 978 & 979)
Senator Rick Jones (S.B. 980)
Committee: Judiciary

(as enrolled)

Date Completed: 5-1-12

CONTENT

Senate Bill 978 would amend the Michigan Trust Code (Chapter 7 of the Estates and Protected Individuals Code) to do the following:

- Authorize the trustee of an irrevocable trust to distribute property to the trustee of a second trust, under certain circumstances.
- Specify that certain provisions regarding the revocability of a trust would not apply to a trust created by the power to distribute property from a first trust to a second trust.
- Specify that a trustee would not be liable to a beneficiary for failure to exercise the power to distribute property from a first trust to a second trust, unless the trust instrument expressly provided otherwise.

Senate Bill 979 would amend the Personal Property Trust Perpetuities Act to revise provisions regarding the determination of the period during which vesting of a future interest in property may be postponed.

Senate Bill 980 would amend the Powers of Appointment Act to do all of the following:

- Specify that the Michigan Trust Code (MTC) would govern the exercise of the power of multiple trustees.
- Authorize a trustee to appoint property in favor of the trustee of a second trust, under certain

circumstances; and express legislative intent about the codification of common law regarding this authorization.

- Specify the powers of trustees and terms of second trusts when property was appointed in favor of the trustee of a second trust.
- Revise provisions regarding when the vesting of a future interest may be suspended or postponed by the exercise of a power of appointment.

The bills are described in detail below.

Senate Bill 978

Distribution of Property to a Second Trust

Under the bill, if an irrevocable trust included a discretionary trust provision, the trustee could distribute by written instrument all or part of the property subject to that provision to the trustee of a second trust, unless the terms of the first trust expressly provided otherwise. The trustee could distribute the property if the terms of the second trust did not materially change the beneficial interests of the beneficiaries of the first trust. Also, if the governing instrument of the first trust expressly indicated an intention that the first trust qualified for a tax benefit or its terms were clearly designed to qualify it for a tax benefit and, if the first trust would qualify for the intended tax benefit, the governing instrument of the second trust could not be inconsistent with the tax planning that informed the first trust.

"First trust" would mean an irrevocable trust that has a discretionary trust provision that is exercised to distribute property to a second trust. "Tax benefit" would mean a Federal or State tax deduction, exemption, exclusion, or other particular tax attribute. The term would not include grantor trust status. A trust would have grantor trust status to the extent that its assets were treated, for Federal income tax purposes, as owned by the grantor or another person under the Internal Revenue Code.

A distribution of property to the trustee of a second trust could not result in any of the following:

- An increase in or a change in the method of determining the compensation of a trustee, unless all beneficiaries entitled to receive reports regarding the first trust had consented in writing to the increase or change.
- A charge of a fee or commission on the transfer of assets from the first trust to the second trust, unless all beneficiaries entitled to receive reports regarding the first trust had consented in writing to the fee or commission.
- A reduction in the standard of care applicable to the trustee's actions or an expansion of exonerations of the trustee.
- A diminution in the authority of a person who had a power exercisable in a fiduciary capacity to direct or remove the trustee.

An increase in the maximum period during which the vesting of a future interest could be suspended or postponed under applicable law would not constitute a material change in the interest of a beneficiary.

An increase in compensation arising solely because the duration of the second trust was longer than the duration of the first trust would not constitute an increase in or a change in the method of determining the compensation of the trustee.

In determining whether a trust was irrevocable, a settlor's lack of capacity to exercise a power of revocation would negate the power unless an agent of the settlor under a durable power of attorney, a conservator of the settlor, or a plenary guardian of the settlor were serving and the agent, conservator, or guardian were authorized to exercise the power of

revocation. The MTC defines "settlor" as a person, including a testator, who creates a trust. Under the bill, "settlor" also would include a trustee who creates a trust.

The distribution power authorized by the bill could not be exercised over any portion of the first trust as to which the exercising trustee was the settlor, unless the exercising trustee were acting in a fiduciary capacity when he or she created the first trust.

The trustee of the second trust could be the trustee of the first trust; the second trust could be a trust under the governing instrument of the first trust or another governing instrument; the governing instrument could be created by the trustee of the first trust; and the governing instrument could be the instrument that exercised the power to distribute property in the first trust to a second trust.

The second trust instrument could provide that assets of the first trust discovered after exercise of the power to distribute property to a second trust would be property of the first trust, if that trust were to continue in existence after exercise of the power, or that assets of the first trust discovered after exercise of the power would be property of the second trust if the first trust terminated upon exercise of the power.

The second trust instrument also could provide for indemnification of the trustee of the first trust, except as limited by Section 7908 of the MTC. (That section provides that a term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent the term relieves the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the trust beneficiaries; or the term was inserted as the result of the trustee's abuse of a fiduciary or confidential relationship to the settlor.)

A trustee of the first trust could exercise the power to distribute property to a second trust without the consent of that trust's settlor, any beneficiary, or a court. Within 63 days before exercising the power, however, the trustee would have to give written notice of an intended exercise of the power to the settlors of the first trust, if living, and qualified trust beneficiaries. The notice would have to include a copy of the

proposed instrument of exercise. If the living settlors and qualified trust beneficiaries waived the 63-day notice period in writing, a distribution could be made before the notice period expired.

The period during which the vesting of a future interest could be suspended or postponed by the exercise of the power to distribute property to a second trust would be determined under the Powers of Appointment Act (as it would be amended by Senate Bill 980), treating the power to distribute as a power of appointment. (A power of appointment is the authority conferred upon a person to create new ownership interests in assets or select the recipient of an interest in property.)

The bill would not abridge the right of a trustee who had a power to distribute trust property in further trust under the terms of a trust instrument, any other statute, or the common law. The bill would not abridge any right of a trustee who had a power to amend or terminate a trust.

The bill would include exercise of a power to distribute property from a first trust to a second trust in the MTC's list of ways a trust may be created.

Trust Amendment/Revocation; Duties to Settlor

The MTC provides that, unless the terms of a trust expressly provide that it is irrevocable, the settlor may revoke or amend the trust. Also, while a trust is revocable, rights of the trust beneficiaries are subject to the control of, and the duties of the trustee are owed exclusively to, the settlor. Under the bill, these provisions would not apply to either of the following:

- A trust created by the exercise of a power to distribute property from a first trust to a second trust.
- A trust created by the exercise of a power of appointment held by a trustee in a fiduciary capacity.

Trustee Liability

The bill specifies that, unless the trust instrument expressly provided otherwise, a trustee would not be liable to a beneficiary for failure to exercise the power to distribute property from a first trust to a second trust

or the power described in the Powers of Appointment Act (under Senate Bill 980).

Senate Bill 979

The Personal Property Trust Perpetuities Act excludes certain personal property held in trust from the rule against perpetuities and similar rules that potentially affect the duration of trusts.

The Act states that, if a first power is exercised so as to subject the property to, or to create, a second power, the period during which the exercise of the second power may postpone the vesting of a future interest in the property must be determined under the Uniform Statutory Rule Against Perpetuities by reference to the time the first power was created. Under the bill, instead, the period during which the vesting of a future interest in property could be postponed by the exercise of a second power would have to be determined under the Uniform Statutory Rule Against Perpetuities by reference to the time of the creation of the power or appointment that subjected property to, or created the second power. (Generally speaking, the term "future interest" refers to a legal right to receive real or personal property at some time in the future, on a particular date or upon the occurrence of an event.)

In addition, under the Act, a nonvested interest, general power of appointment not presently exercisable because of a condition precedent, or nongeneral or testamentary power of appointment created, or to which property is subjected, by the exercise of the second power is invalid, to the extent of the exercise of the second power, unless the interest or power satisfies the Uniform Statutory Rule Against Perpetuities measured from the time of the creation of the first power. Under the bill, the interest or power would have to satisfy the Uniform Statutory Rule Against Perpetuities measured from the time of the creation of the power of appointment that subjected property to, or created, the second power.

The Act defines "first power" as a nonfiduciary, nongeneral power of appointment over personal property held in trust that is exercised so as to subject the property, or to create, another power of appointment.

"Second power" means a nonfiduciary power of appointment over personal property held in trust that is created or to which property is subjected by the exercise of a first power and that is not a presently exercisable general power. Under the bill, "second power" would mean a power of appointment over personal property held in trust, other than a presently exercisable general power, that is created or to which property is subjected by the exercise of either a first power or a second-order fiduciary power.

The bill would define "second-order fiduciary power" as a fiduciary power of appointment that is created or has property subjected to it by the exercise of one of the following:

- A first power.
- A fiduciary power of appointment that was created or had property subjected to it by the exercise of a first power.
- A fiduciary power of appointment whose creation or control over property subject to the power is traceable through a succession of previous exercises of fiduciary powers to the exercise of a fiduciary power that was created or had property subjected to it by the exercise of a first power.

Senate Bill 980

Power Vested in Multiple Trustees

The Powers of Appointment Act governs the creation and exercise of powers of appointment, the release of powers, contracts to appoint, the rights of creditors of donees of powers, and other related matters. Under the Act, "power" means a power of appointment over property.

The bill specifies that when a power was vested in two or more trustees, the trustees' coordination in the exercise of the power would be governed by Sections 7703 and 7815(3) of the MTC, unless the trust instrument manifested a contrary intent. (Section 7703 of the MTC outlines the powers and duties of cotrustees; Section 7815(3), as it would be amended by Senate Bill 798, outlines rules applicable to a trustee's exercise of a power.)

Appointing Property in Favor of a Second Trust

Authorization. The bill would add Section 5a to provide that a trustee with a presently exercisable discretionary power to make distributions of income or principal of an irrevocable trust to or for the benefit of one or more beneficiaries of the trust, could exercise the power by appointing all or part of the property subject to the power in favor of the trustee of a second trust, unless the terms of the first trust expressly provided otherwise. This power could be exercised if the conditions described below were satisfied. ("First trust" would mean an irrevocable trust over which a trustee has a presently exercisable discretionary power to make distributions that is exercised by appointing property in favor of the trustee of a second trust.)

The beneficiaries of the second trust could include only permissible appointees of the trustee's discretionary distribution power as of the time the power was exercised, even if fewer than all permissible appointees.

If contributions to a trust had been excluded from gift tax under the Internal Revenue Code, the trust instrument of the second trust would have to provide that the beneficiary's remainder interest would pass or be payable no later than the date on which the interest would have passed or been payable under the terms of the first trust instrument.

The exercise of the discretionary power could not reduce the income, annuity, or unitrust interest or general power of appointment of a beneficiary of a trust that was intended to qualify for a marital or charitable deduction under Federal or State law by virtue of that beneficiary's interest in the trust, whether or not that deduction was actually taken.

The exercise of the discretionary power could not reduce a presently exercisable general power to withdraw a specified percentage or amount of trust property in a trust beneficiary who was the only trust beneficiary to or for the benefit of whom the trustee had the power to make discretionary distributions.

Second Trust Instrument. A second trust instrument could provide for a special or general power of appointment, including a power to appoint trust property to people who were not beneficiaries of the first trust, to one or more of the beneficiaries of the second trust. It also could provide that, at a time or upon the occurrence of an event specified in the second trust instrument, the remaining trust assets would thereafter be held for the benefit of beneficiaries who were or who would have been beneficiaries of the first trust on terms and conditions substantially identical to the terms and conditions of the first trust, with respect to the interest of those beneficiaries.

In addition, a second trust could provide that assets of the first trust discovered after exercise of the power to appoint property in favor of the trustee of a second trust would be property of the first trust if that trust continued in existence, or that assets of the first trust discovered after exercise of the power would be property of the second trust if the first trust terminated upon exercise of the power. A second trust also could provide for indemnification of the trustee of the first trust, except as limited by the MTC.

Powers of Trustees. A discretionary power to make distributions to a given trust beneficiary would be presently exercisable when the timeliness of a present distribution to or for the benefit of that beneficiary depended, under the terms of the trust instrument, only on the trustee's judgment as to what was in the beneficiary's best interests.

A power to make distributions would not be discretionary if it were limited by a definite and ascertainable standard, but instructions for the trustee to consider such things as a beneficiary's best interests, welfare, comfort, happiness, or general development would not in themselves constitute definite and ascertainable standards, regardless of whether the trustee also was instructed or permitted to consider resources outside the trust that could be available to the beneficiary.

A general power annually to withdraw a specified percentage or amount of trust property would be presently exercisable with respect to any year for which the beneficiary who held the power was entitled, under the terms of the governing instrument, to

exercise the power, and each subsequent year for which the beneficiary would be entitled to exercise the power assuming only the beneficiary's survival and the continuation of the trust.

General Terms. The trustee of the second trust could be the trustee of the first trust; the second trust could be a trust under the governing instrument of the first trust or another governing instrument; the governing instrument could be one created by the trustee of the first trust; and the governing instrument could be the instrument that exercised the power to appoint property in favor of the trustee of a second trust.

A second trust would have to be treated as a new irrevocable trust for purposes of the notice requirements of the MTC. A second trust also would have to be treated as a continuation of the first trust for purposes of the MTC's notice requirements, and the charge of any fee or commission on the transfer of assets from the first trust to the second trust would have to be treated as a change in the rate of the trustee's compensation.

A discretionary power to appoint property in favor of the trustee of a second trust would be a power of appointment and a discretionary power for purposes of the MTC.

Section 5a could not abridge the right of a trustee who had a power to distribute trust property in further trust under the Act, any other statute, or the common law, and could not abridge the right of a trustee who had a power to amend or revoke a trust.

The bill states, "It is the intent of the legislature that this section be a codification of the common law of this state in effect before the effective date" of the bill.

Vesting of a Future Interest

Under the Act, the period during which the vesting of a future interest may be postponed or suspended by an instrument exercising a power begins on the effective date of the instrument in the case of a general power presently exercisable, and at the time of the creation of the power in all other situations.

Under the bill, in determining the period during which the vesting of a future interest may be suspended or postponed by the exercise of a power of appointment, if a second power were created by the exercise of a first power, and the first power were a presently exercisable general power, the second power would be considered to have been created on the effective date of the instrument of exercise. In all other situations, the second power would be considered to have been created at the time of the creation of the first power.

The length of the period, whether finite or infinite, during which the vesting of a future interest could be suspended or postponed by exercise of a power would be determined, from the beginning date specified in the Act (described above), under the Personal Property Trust Perpetuities Act, or under the Uniform Statutory Rule Against Perpetuities, to the extent that all of the following conditions were satisfied:

- An instrument exercised a power of appointment so as to subject property to or to create a trust that was either revocable on or created after May 28, 2008.
- The appointive property was personal property.
- The trust was not a special appointee trust.

As used in these provisions, "first power" would mean a power of appointment, an exercise of which has created another power of appointment. "Second power would mean a power of appointment created by the exercise of a first power.

MCL 700.7103 et al. (S.B. 978)
554.92 & 554.93 (S.B. 979)
556.112 et al. (S.B. 980)

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

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

Fiscal Analyst: Dan O'Connor

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