Legislative Analysis

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ABOLISH RULE AGAINST PERPETUITIES

House Bill 6365 as passed by the House
House Bill 6366 as passed by the House
Sponsor: Rep. Tonya Schuitmaker
Committee: Judiciary

First Analysis (11-28-06)

BRIEF SUMMARY: House Bill 6365 would repeal the Uniform Statutory Rule Against Perpetuities, abolish the common law rule against perpetuities, and restrict the application of Public Act 38 to nonvested property interests created between September 23, 1949 and December 27, 1988. House Bill 6366 would delete a provision within the Estates and Protected Individuals Code made obsolete by the repeal of the Uniform Statutory Rule Against Perpetuities Act.

FISCAL IMPACT: The bills would have no fiscal impact on state or local governments.

THE APPARENT PROBLEM:

Under the common law "rule against perpetuities," 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.) The purpose of the rule is said to be to prevent assets from being tied-up in long-term or even perpetual family trusts. Because the common law rule may invalidate what otherwise would be considered reasonable transfers of property, it is often noted for its harshness. That harshness led to a movement in the 1980s to modify the common law rule by adoption of a uniform statutory rule against perpetuities drafted by the National Conference of Commissions on Uniform State Laws.

The uniform rule allowed a so-called "wait and see" approach, based on actual events that occur within a 90-year post-creation period, instead of basing an interest's validity – 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 Information.) The Michigan Law Revision Commission recommended the adoption of the uniform rule, and in 1988, Public Act 418 enacted the Uniform Statutory Rule Against Perpetuities.

Almost 20 years later, there is now a national trend in favor of perpetuities. Reportedly, 21 states have taken action recently; some have repealed their statutes banning perpetuities, others have lengthened the time period for interests to vest (or not to vest and therefore become invalid) from the current 90-year period to 360 years (Florida), 365 years (Nevada), or even 1,000 years (Utah and Alaska). Legislation has been proposed in Michigan to repeal the Uniform Rule Against Perpetuities.

THE CONTENT OF THE BILLS:

The bills would amend two different laws to abolish the common law rule against perpetuities, repeal the Uniform Statutory Rule Against Perpetuities, and delete provisions in law referencing the rule against perpetuities. The bills are tie-barred to each other and would take effect January 1, 2007.

House Bill 6365 would amend Public Act 38 of 1949 (MCL 554.53), which concerns perpetuities and real and personal property. The bill would do the following:

- Beginning January 1, 2007, abolish the common law rule known as the Rule Against Perpetuities.
- Apply the provisions of Public Act 38 only to nonvested property interests created after September 23, 1949 but before December 27, 1988 (the effective date of the Uniform Statutory Rule Against Perpetuities, Public Act 418 of 1988).
- Repeal the Uniform Statutory Rule Against Perpetuities (MCL 554.71-554.78).
- Amend the title to conform to the bill's proposed revisions.

House Bill 6366 would amend the Estates and Protected Individuals Code (MCL 700.2702 and 700.2722) to delete a provision specifying that survival by 120 hours would not be required if it would invalidate a nonvested property interest or a power of appointment under provisions of the Uniform Statutory Rule Against Perpetuities (USRAP), which would be repealed by House Bill 6365.

The two bills are tie-barred to each other, meaning neither can take effect unless both do.

BACKGROUND INFORMATION:

The common law rule against perpetuities evolved over a 200-year period that culminated in the 17th 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 (i.e., being named a beneficiary of a trust) 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.

ARGUMENTS:

For:

The bills would abolish the common law rule against perpetual trusts, thus allowing people to create trusts that could go on forever. A person could, therefore, have more options available in regards to what happens to his or her assets after death than are available now. When all states followed the common law or uniform statutory rule against perpetuities, the ban on perpetual trusts did not result in an economic disadvantage to businesses. However, a recent trend to abolish the common law rule against perpetuities (RAP) has resulted in at least 21 states reforming their laws: either by repealing the uniform statute or by increasing the period in which a non-vested interest would be permitted to vest, or not vest, from 90 years to up to 1,000 years. At least one study has shown that between 1986, when the federal generation skipping tax was established, and 2003, those states that abolished the RAP did experience a substantial increase in trust business (by allowing perpetual trusts, some wealthy individuals can avoid, in whole or in part, the costly generation skipping transfer [GST] tax in favor of lower gift or estate transfer taxes). In fact, some states have abolished the RAP and repealed their uniform statute as a means to grow their trust industry. Unless Michigan follows suit, people may choose to do business with trust companies in other states. And, if assets left the state, then tax revenues to the state could be lost and profits to Michigan trust companies and financial institutions would also be lost.

Against:

In general, the purpose of repealing the Uniform Statutory Rule Against Perpetuities (USRAP) and abolishing the common law rule against perpetuities (RAP) is to allow wealthy individuals to create perpetual trusts, known as dynasty trusts, to transfer property to successive generations without federal or state taxes. However, this area of law is very complicated; some states that repealed their uniform rule and abolished the RAP had to go back and reenact portions because the repeal triggered unintended federal tax consequences. Several law review articles on the subject identified the following concerns:

- Depending on the method used to eliminate the rule against perpetuities (RAP), a state could inadvertently subject certain trusts to the "Delaware Tax Trap," essentially triggering federal estate or gift taxes. (The Delaware Tax Trap applies to the exercise of a special power of appointment.) Just repealing the uniform statute and abolishing the RAP can, in some situations, subject a person who exercised his or her special power of appointment to transfer taxes, even though he or she actually never owned the property in question. This could be a serious disadvantage, according to one author, if, by being susceptible to the Delaware Tax Trap, future generations were denied the dispositive flexibility provided by trusts utilizing special powers of appointment.)
- It would be cheaper for the ultra-wealthy to have the Delaware Tax Trap triggered because federal and state transfer taxes are much lower than the tax generated by the generation skipping tax (GST), but those who are moderately wealthy could be subjected to federal and state transfer taxes that they are not currently required to pay. Therefore, if the RAP were abolished and the USRAP repealed, it should be done in such a way as to not favor the ultra-wealthy over the moderately wealthy.
- Repeal of the RAP could place increasing amounts of wealth in the hands of trust companies. With the ever increasing trend to consolidate financial institutions, huge amounts of wealth could eventually be concentrated in a handful of companies worldwide.
- Some predict that over time, the administration of so-called dynasty trusts will likely become very unwieldy and very costly; for example, under the assumption that the average married couple has 2.1 children, after 150 years, the average trust is likely to have more than 100 descendants (who would be beneficiaries of the trusts), about 2,500 beneficiaries 250 years after the trust was created, and about 45,000 beneficiaries 350 years after the trust was created. As time went on, the number of beneficiaries would continue to expand.
- According to Lewis Simes, a respected 20th century legal scholar, "it is desirable that the wealth of the world be controlled by its living members and not by the dead"; repeal of the USRAP and elimination of the RAP would, in essence, allow the dead to control assets for hundreds of years and for many generations after their deaths. In support of the RAP, Simes believed the RAP to strike a "fair balance between the desires of members of the present generation, and similar desires of succeeding generations, to do what they wish with the property they enjoy. . ."

In a nutshell, the rule against perpetuities is not just an archaic law from the 17th century. It has served societies well for over 400 years and should not be lightly abolished. First, careful scrutiny should be given to determine if it would be prudent for Michigan residents and businesses to repeal the USRAP and abolish the RAP; secondly, if the USRAP is repealed and the RAP abolished, then these actions should be done so properly to avoid any unintended consequences.

POSITIONS:

Greenleaf Trust supports the bills. (11-8-06)

The Probate and Estate Planning Section of the State Bar of Michigan has not yet taken a formal position on the bills, but is studying the issue. (11-15-16)

The Michigan Bankers Association has not taken a formal position on the bill but is in the process of studying the issue. (11-27-06)

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.