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BILL



ANALYSIS

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Senate Bill 22 (as reported without amendment)
Senate Bill 23 (Substitute S-1 as reported)
Sponsor: Senator Tonya Schuitmaker
Committee: Judiciary

(as enacted)
(as enacted)

Date Completed: 1-27-11

RATIONALE

Since 1988, Michigan law has contained the Uniform Statutory Rule Against Perpetuities, which requires a nonvested interest in property or a power of appointment to vest within a prescribed number of years in order to be valid. (A property interest is "nonvested" if the transferee is not presently entitled to the interest, and might never become entitled to it. A power of appointment is the authority to create new ownership interests in assets or select the recipient of an interest in property.) Originally, the statutory rule applied to nonvested interests in both real and personal property, as well as powers of appointment.

Several years ago, it was suggested that the statutory rule should be eliminated with respect to personal property held in trust, in order to allow people to establish "dynasty trusts" in Michigan. A dynasty, or perpetual, trust essentially allows its creator, the settlor, to pass wealth from generation to generation without the burden of transfer taxes, including estate and gift taxes and the Federal generation-skipping transfer tax (subject to limitations on tax-exempt transfers). Because the rule against perpetuities limits the duration of trusts, dynasty trusts are created only in states that have eliminated the rule or modified it to permit trusts that continue for hundreds of years. Therefore, Public Act 148 of 2008 enacted Michigan's Personal Property Trust Perpetuities Act, and Public Act 149 of 2008 amended Uniform Statutory Rule Against

Perpetuities to make an exception for property subject to the new Act.

The present version of the generation-skipping transfer (GST) tax was enacted in 1986. Under U.S. Treasury regulations, the GST tax does not apply to a trust that was irrevocable and in existence on September 25, 1985, to the extent the trust's assets are not added to after that date. The regulations also contain various rules about what constitutes an addition to a grandfathered trust for this purpose. In particular, there is a rule that if the exercise of a nongeneral power of appointment extends, beyond a specified number of years, the period during which vesting of future interests in the assets of the trust may be postponed, the assets may lose their exempt status. (A power of appointment is "nongeneral" if the document creating it restricts the person or people who may be appointed to receive the interest. The term "future interest" basically refers to a legal right to receive property at some time in the future, on a particular date or upon the occurrence of an event.)

Concerns have been raised that people who are unfamiliar with these Federal regulations, or Michigan's new perpetuities law for personal property held in trust, may make trust arrangements that extend the period for vesting beyond what is allowed by this rule, making the trust assets subject to the GST tax. To prevent this from occurring, amendments to the perpetuities law have been suggested.

CONTENT

Senate Bill 22 would amend the Uniform Statutory Rule Against Perpetuities to revise an exception to provisions of that law for property subject to the Personal Property Trust Perpetuities Act.

Senate Bill 23 (S-1) would amend the Personal Property Trust Perpetuities Act to make the Act inapplicable to a trust to the extent it is a "special appointee trust".

The bills are described below.

Senate Bill 23 (S-1)

The Personal Property Trust Perpetuities Act applies only to a nonvested interest in, or power of appointment over, personal property held in a trust that is either revocable on, or created after, the Act's effective date (May 28, 2008).

The bill also specifies that the Act would apply only to the extent that the trust is not a special appointee trust. For this purpose, a trust would be a special appointee trust to the extent it includes assets that were held in a trust that was irrevocable on September 25, 1985, if both of the following apply:

- The assets have continuously been held in trust since September 25, 1985.
- The assets have not become subject to a general power of appointment since September 25, 1985.

(A power of appointment is "general" if the person who has the power may exercise it in favor of himself or herself, or his or her creditors, whether or not it may be exercised in favor of others.)

Senate Bill 22

Section 2 of the Uniform Statutory Rule Against Perpetuities contains the requirement that a nonvested property interest or power of appointment vest within a prescribed number of years in order to be valid. Section 2 does not apply, however, to an interest in, or power of appointment over, personal property held in a trust that is either revocable on or created after the effective date of the Personal Property Trust Perpetuities Act.

Under the bill, instead, Section 2 would not apply to an interest or power of appointment to which that Act applies.

MCL 554.75 (S.B. 22)
554.94 (S.B. 23)

BACKGROUND

Rule Against Perpetuities

The common law rule against perpetuities was designed to restrict the power of a landowner to tie up property in long-term or perpetual family trusts. (Under the common law rule, a nonvested property interest is invalid unless it must vest, if at all, within 21 years, plus the period of gestation, after some life or lives in being at the time the interest is created.) Because the common law rule could invalidate some property transfers that otherwise would be considered reasonable, Michigan enacted the Uniform Statutory Rule Against Perpetuities in 1988. Under this law, an interest that would be valid under the common law rule remains valid, but an interest that would violate the common law rule is invalid only if it does not actually vest or terminate within 90 years after its creation.

As discussed above, in order to allow people to establish dynasty trusts in Michigan, the Personal Property Trust Perpetuities Act was enacted in 2008 and the statutory rule was eliminated with respect to property subject to the Act.

Generation-Skipping Transfer Tax

The Federal GST tax applies to outright gifts and transfers in trust to grandchildren and others deemed to be two or more generations below that of the person making the transfer. The present rate of the GST tax is 35% of the value of the assets. The law also allows a lifetime exemption for each individual making a transfer or transfers. The amount of the exemption is presently \$5.0 million. If Congress does not act, the rate will rise to 55% and the exemption will drop to \$1.0 million after 2012.

As noted above, the GST tax does not apply to a trust that was irrevocable and in existence on September 25, 1985, to the extent the trust's assets are not added to after that date. Under U.S. Treasury regulations, the exercise of a power of

appointment (other than a general power of appointment) will not be considered an addition to the trust, and will not subject the assets to the GST tax, if it is exercised in a manner that will not postpone the vesting of an interest beyond what amounts to the 21-year common law rule against perpetuities or the 90-year uniform statutory rule.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The enactment of the Personal Property Trust Perpetuities Act added flexibility to trust arrangements and made it possible for someone with a power of appointment under a preexisting trust to appoint the assets to a new trust that will be governed by the new statute, and not be subject to the statutory rule against perpetuities. In some cases, the preexisting trust may be one that was grandfathered in under the U.S. Treasury regulations governing the GST tax exemption; that is, a trust that was irrevocable and in existence on September 25, 1985. In this situation, however, it is possible that the person exercising the power of appointment will do so in a way that extends the period during which the vesting of future interests in the assets can be postponed, well beyond the period allowed by the Treasury regulations, thereby creating what the regulations consider an addition to the trust. As a result, the grandfathered status will be forfeited and the assets will become taxable.

If estate planners are familiar with the GST tax regulations and understand the Personal Property Trust Perpetuities Act, they will be aware of the consequences of extending the period during which the vesting of future interests can be postponed beyond that permitted by the regulations, when they are considering the exercise of a nongeneral power of appointment over a grandfathered trust. Because of the complexity of the regulations and the newness of Michigan's law, however, not everyone will be aware of the risks and there may be situations in which trust assets inadvertently become subject to the GST tax. The proposed legislation would prevent this outcome by making the Personal Property Trust Perpetuities Act inapplicable to a trust to the

extent that it includes assets from a GST-tax grandfathered tax. In such a situation, the Uniform Statutory Rule Against Perpetuities would apply and the appointment of the assets to the new trust would conform to the Treasury regulations. To the extent that the trust includes personal property that was *not* from a grandfathered trust, it will remain subject to the Personal Property Trust Perpetuities Act.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

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

Fiscal Analyst: Matthew Grabowski

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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.