Legislative Analysis

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UNITRUST ACT

House Bill 5110 as reported from committee
Sponsor: Rep. Douglas C. Wozniak
Committee: Judiciary
Complete to 6-12-24

SUMMARY:

House Bill 5110 would create a new act, the Unitrust Act, to allow certain fiduciaries to convert income trusts to unitrusts, convert express unitrusts to income trusts, and change the percentage or method used to calculate unitrust amounts. The bill is based on Article 3 of the Uniform Fiduciary Income and Principal Act, a model act drafted by the National Conference of Commissioners on Uniform State Laws, also known as the Uniform Law Commission (ULC).[1]

Authorized actions

The new act would allow a trustee[2] that complies with the requirements described below to do any of the following:

- Convert an income trust (a trust that is not a unitrust) to a ***unitrust*** if the trustee adopts in a ***record*** a unitrust policy for the trust providing both of the following:
  - That in administering the trust, the ***net income*** of the trust will be a ***unitrust amount*** rather than net income determined without regard to the new act.
  - The percentage and method used to calculate the unitrust amount.
- Change the percentage or method used to calculate a unitrust amount for a unitrust if the trustee adopts in a record a unitrust policy or an amendment or replacement of a unitrust policy providing those changes.
- Convert a unitrust to an income trust if the trustee adopts in a record a determination that, in administering the trust, the net income of the trust will be net income determined without regard to the new act rather than a unitrust amount.

Unitrust would mean a trust for which net income is a unitrust amount, and would include an ***express unitrust***.

Record would mean information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

Express unitrust would mean a trust for which, under the ***terms of the trust*** without regard to the provisions of the bill, ***income*** or net income must or may be calculated as a unitrust amount.

Terms of a trust would mean the manifestation of the intent of a settlor or decedent with respect to the trust, expressed in a manner that admits of its proof in a judicial proceeding, whether by written or spoken words or by conduct.

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[1] https://www.uniformlaws.org/committees/community-home?CommunityKey=1105f9bb-eb93-4d4d-a1ab-a535ef73de0c
[2] Including an original, additional, or successor trustee, regardless of whether appointed or confirmed by a court.

Income would mean, as defined in the Uniform Principal and Income Act,[3] money or property that a fiduciary receives as current return from a principal asset. It would include a portion of receipts from a sale, exchange, or liquidation of a principal asset, to the extent provided in Article 4 of the Uniform Principal and Income Act.[4]

Net income would mean, as defined in the Uniform Principal and Income Act, the total receipts allocated to income during an accounting period minus the disbursements made from income during the period, plus or minus transfers under the Uniform Principal and Income Act to or from income during the period.

Unitrust amount would mean an amount computed by multiplying a determined value of a trust by a determined percentage. For a unitrust administered under a unitrust policy, the unitrust amount would mean the ***applicable value***, multiplied by the ***unitrust rate***.

Applicable value would mean the measure of the ***net fair market value of a trust*** taken into account as described below.

Net fair market value of a trust would mean the fair market value of the assets of the trust less the noncontingent liabilities those assets are subject to in the hands of the trustee.

Unitrust rate would mean the rate used to compute the unitrust amount for a unitrust administered under a unitrust policy.

Action requirements

The trustee could take an action described above if all of the following are met:

- The trustee sends a notice in a record in the manner described below that describes the proposed action.
- At least one member of each class of the ***qualified trust beneficiaries*** receiving the notice is one of the following:
    - A legally competent individual.
    - An existing entity (a ***person*** other than an individual).
    - Represented as provided in Part 3 of Article VII of the Estates and Protected Individuals Code (EPIC).[5]
- The trustee does not receive, by the specified date, an objection in a record to the proposed action from a person the notice is sent to.

[3] https://www.legislature.mi.gov/Laws/MCL?objectName=mcl-Act-159-of-2004
[4] https://www.legislature.mi.gov/Laws/MCL?objectName=mcl-159-2004-4
[5] https://www.legislature.mi.gov/Laws/MCL?objectName=mcl-386-1998-VII-3

Qualified trust beneficiary would mean, as defined in EPIC, either of the following:

- A trust beneficiary[6] whom the ***settlor*** intends to benefit as a material purpose of the trust and to whom one or more of the following apply on the date the trust beneficiary's qualification is determined:
    - The trust beneficiary is a distributee or permissible distributee of trust income or principal.
    - The trust beneficiary would be a distributee or permissible distributee of trust income or principal if the interests of the distributees under the trust described above terminated on that date without causing the trust to terminate.
    - The trust beneficiary would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.
- If on the date a trust beneficiary's qualification is determined there is no trust beneficiary as described above, a trust beneficiary to whom one or more of the following apply on the date the trust beneficiary's qualification is determined:
    - The trust beneficiary is a distributee or permissible distributee of trust income or principal.
    - The trust beneficiary would be a distributee or permissible distributee of trust income or principal if the interests of the distributees under the trust described above terminated on that date without causing the trust to terminate.
    - The trust beneficiary would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.

Settlor would mean, as defined in EPIC, a person, including a testator or a trustee, who creates a trust. If more than one person creates a trust, each person would be a settlor of the portion of the trust property attributable to that person's contribution. The lapse, release, or waiver of a power of appointment would not cause the holder of a power of appointment to be treated as a settlor of the trust.

Person would mean an individual or corporation, including a fiduciary of an estate or trust, a business trust, partnership, limited liability company, association, joint venture, public corporation, government, governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

If, after sending a notice, the trustee decides not to take the action proposed in the notice, the trustee would have to notify in a record each person described above of the decision not to take the action and the reasons for that decision.

In deciding how to take an action authorized as described above, the trustee would have to consider all factors relevant to the purposes of the trust and the interests of the beneficiaries.

A trustee could release or delegate the power to take an action authorized as described above for reasons analogous to the reasons for releasing a power to adjust between ***principal*** and income described in section 104(6) of the Uniform Principal and Income Act.[7] The release

[6] A person who has a present or future beneficial interest in a trust, vested or contingent, or who holds a power of appointment over trust property in a capacity other than that of trustee or trust director, or both.

[7] https://www.legislature.mi.gov/Laws/MCL?objectName=mcl-555-504

could be permanent or for a specified period, including a period measured by the life of an individual.

> ***Principal*** would mean property held in trust for distribution to a remainder beneficiary when the trust terminates.

Although the new act would allow a trustee that is not an ***independent person*** to exercise certain discretionary powers, if a trust does not have a trustee that is an independent person, the trustee of that trust could appoint, without court approval, one or more special trustees that are independent persons to exercise discretionary powers under the act as long as the appointment complies with any limits imposed by the terms of the trust on who is eligible to serve as a cotrustee or successor trustee. Each such special trustee would serve as trustee for the purpose or purposes, according to the conditions and limitations, and for the duration specified by the appointing trustee.

> ***Independent person*** would mean a person that is *not* any of the following:
> - With respect to a trust, a qualified trust beneficiary, a nonfiduciary settlor of the trust, or an individual whose legal obligation to support a beneficiary may be satisfied by a distribution from the trust.
> - A spouse, parent, brother, sister, or descendant of an individual described in the above paragraph.
> - A corporation, partnership, limited liability company, or other entity in which persons described in the above two paragraphs, in the aggregate, have voting control.
> - An employee of a person described in the above three paragraphs.

Notice requirements

A notice required as described above would have to be sent in a manner authorized under section 7109 of EPIC[8] to all of the following:

- The qualified trust beneficiaries.
- Each person acting as a trust director as that term is defined in section 7703a of EPIC.[9]
- Each person that is not then a trustee or a person acting as a trust director but that has a then-exercisable power under the terms of the trust to appoint or remove a trustee or person acting as a trust director.

A notice required as described above would have to include all of the following:

- A description of the proposed action.
- For a conversion of an income trust to a unitrust, a copy of the unitrust policy.
- For a change in the percentage or method used to calculate the unitrust amount, a copy of the unitrust policy or amendment or replacement of the unitrust policy.
- A statement that the person the notice is sent to may object to the proposed action by stating in a record the basis for the objection and sending or delivering the record to the trustee.
- The date by which an objection described above must be received by the trustee. This date would have to be at least 30 days after the date the notice is sent.

[8] https://www.legislature.mi.gov/Laws/MCL?objectName=mcl-700-7109
[9] https://www.legislature.mi.gov/Laws/MCL?objectName=mcl-700-7703a

- The date the action is proposed to be taken and the date it is proposed to take effect.
- The name and contact information of the trustee.

The representation provisions of Part 3 of Article VII of EPIC would apply with regard to notice and consent under these provisions.

A person could consent in a record at any time to a proposed action described above. A notice required as described above would not have to be sent to a person that consents in a record.

Unitrust policy

In administering a unitrust under the new act, the trustee would have to follow a unitrust policy adopted, amended, or replaced, as applicable, as described above. A unitrust policy would have to provide all of the following:

- The unitrust rate or the method for determining the unitrust rate as described below.
- The method for determining the applicable value as described below.
- The rules described below that apply in the administration of the unitrust, including both rules that are mandatory and optional rules that the trustee has elected to adopt.

Unitrust rate

Except as otherwise described below ("Special tax benefit"), a unitrust rate could be either of the following:

- A fixed unitrust rate.
- A unitrust rate that is determined for each period using either of the following:
    - A market index or other published data.
    - A mathematical blend of market indices or other published data over a stated number of preceding periods.

Except as otherwise described below ("Special tax benefit"), a unitrust policy could provide one or more of the following regarding a unitrust rate that is determined for each period as described above:

- A limit on how high the rate may rise.
- A limit on how low the rate may fall.
- A limit on how much the rate may increase over the unitrust rate for the preceding period or a mathematical blend of unitrust rates over a stated number of preceding periods.
- A limit on how much the rate may decrease below the unitrust rate for the preceding period or a mathematical blend of unitrust rates over a stated number of preceding periods.
- A mathematical blend of any of the unitrust rates determined as described above.

Determination of value

A unitrust policy would have to provide the method for determining the fair market value of an asset for the purpose of determining the unitrust amount, including both of the following:

- The frequency of valuing the asset, which would not need to require a valuation in every period.
- The date for valuing the asset in each period in which the asset is to be valued.

Except as otherwise described below ("Special tax benefit"), a unitrust policy could provide methods for determining the amount of the net fair market value of the trust to take into account in determining the applicable value, including one or more of the following:

- Obtaining an appraisal of an asset for which fair market value is not readily available.
- Exclusion of specific assets or groups or types of assets.
- Other exceptions or modifications of the treatment of specific assets or groups or types of assets.
- Identification and treatment of cash or property held for distribution.
- Use of either of the following:
    - An average of fair market values over a stated number of preceding periods.
    - Another mathematical blend of fair market values over a stated number of preceding periods.
- A limit on how much the applicable value of all assets, groups of assets, or individual assets may increase over either of the following:
    - The corresponding applicable value for the preceding period.
    - A mathematical blend of applicable values over a stated number of preceding periods.
- A limit on how much the applicable value of all assets, groups of assets, or individual assets may decrease below either of the following:
    - The corresponding applicable value for the preceding period.
    - A mathematical blend of applicable values over a stated number of preceding periods.
- The treatment of accrued income and other features of an asset that affect value.
- Determining the liabilities of the trust, including treatment of liabilities to conform with the treatment of assets under any or all of the above.

<u>Period used and standards for preceding periods or proration</u>

A unitrust policy would have to provide the period used for the unitrust rate and determinations of value as described above. Except as otherwise described below ("Special tax benefit"), the period could be any of the following:

- A calendar year.
- A 12-month period other than a calendar year.
- A calendar quarter.
- A three-month period other than a calendar quarter.
- Another period.

Except as otherwise described below ("Special tax benefit"), a unitrust policy could provide standards for any of the following:

- Using fewer preceding periods in the applicable provisions described above under "Unitrust rate" in either of the following situations:
    - The trust was not in existence in a preceding period.
    - Market indices or other published data are not available for a preceding period.
- Using fewer preceding periods in the applicable provisions described above under "Determination of value" in either of the following situations:
    - The trust was not in existence in a preceding period.
    - Fair market values are not available for a preceding period.

- Prorating the unitrust amount on a daily basis for a part of a period in which the trust or the administration of the trust as a unitrust or the interest of any beneficiary commences or terminates.

<u>Other unitrust policy provisions</u>
Except as otherwise described below ("Special tax benefit"), a unitrust policy could do one or more of the following:

- Provide methods and standards for one or more of the following:
    - Determining the timing of distributions.
    - Making distributions in cash or in kind or partly in cash and partly in kind.
    - Correcting an underpayment or overpayment to a beneficiary based on the unitrust amount if there is an error in calculating the unitrust amount.
- Specify sources and the order of sources, including categories of income for federal income tax purposes, from which distributions of a unitrust amount are paid.
- Provide other standards and rules that the trustee determines serve the interests of the beneficiaries.

<u>Special tax benefit</u>
If a trust qualifies for a ***special tax benefit*** or has no trustee that is an independent person, all of the following would apply:

- The unitrust rate must not be less than 3% or more than 5%.
- A unitrust policy may provide methods for determining the amount of the net fair market value as described above only for the following:
    - Obtaining an appraisal of any asset for which fair market value is not readily available.
    - Identification and treatment of cash or property held for distribution.
    - Use of an average of fair market values over a stated number of preceding periods.
    - Determining the liabilities of the trust, including treatment of liabilities to conform with the treatment of assets under the above.
- The only period that may be selected as described above is the calendar year.
- A unitrust policy may provide standards for use of preceding periods or proration as described above only for one or more of the following:
    - Using fewer preceding periods in determining an average of fair market values over a stated number of preceding periods if the trust was not in existence in a preceding period.
    - Prorating the unitrust amount on a daily basis for a part of a period in which the trust or the administration of the trust as a unitrust or the interest of any beneficiary commences or terminates.
- The trustee of a trust that qualifies for a given special tax benefit may provide methods and standards for determining the timing of distributions as described above only to the extent consistent with the trust's qualification for that benefit.

Special tax benefit would mean any of the following:

- Exclusion of a transfer to a trust from gifts described in section 2503(b) of the Internal Revenue Code because of the qualification of an income interest in the trust as a present interest in property.[10]
- Status as a qualified subchapter S trust described in section 1361(d)(3) of the Internal Revenue Code at a time the trust holds stock of an S corporation described in section 1361(a)(1) of the Internal Revenue Code.[11]
- An estate or gift tax marital deduction for a transfer to a trust under section 2056 or 2523 of the Internal Revenue Code that depends or depended in whole or part on the right of the settlor's spouse to receive the net income of the trust.[12]
- Exemption in whole or in part of a trust from the federal generation-skipping transfer tax imposed by section 2601 of the Internal Revenue Code[13] because the trust was irrevocable on September 25, 1985, if there is any possibility that either of the following could happen:
  - A distribution under the terms of the trust that would be a taxable distribution as defined in section 2612(b) of the Internal Revenue Code[14] if the trust were not exempt in whole or in part from the federal generation-skipping transfer tax.
  - A termination under the terms of the trust that would be a taxable distribution as defined in section 2612(a) of the Internal Revenue Code if the trust were not exempt in whole or in part from the federal generation-skipping transfer tax.
- An inclusion ratio, as defined in section 2642(a) of the Internal Revenue Code of the trust that is less than one, if there is any possibility that either of the following could happen:
  - A taxable distribution, as defined in section 2612(b) of the Internal Revenue Code, could be made from the trust.
  - A taxable termination, as defined in section 2612(a) of the Internal Revenue Code, could occur with respect to the trust.

If a trust that does not qualify for any special tax benefit has cotrustees, and one or more of the cotrustees is an independent person, a majority of the cotrustees that are independent persons may exercise discretionary powers under the new act on behalf of the trust without regard to the above limitations.

Determinations of abuse of discretion

The court could not order a trustee to change a decision to exercise or not exercise a discretionary power conferred by the new act unless the court determines that the decision was an abuse of the trustee's discretion. A trustee's decision would not be an abuse of discretion merely because the court would not have exercised the power or would have exercised it in a different manner. If the court determines that a trustee has abused their discretion, the court could, by following the rules provided in section 105(3) of the Uniform Principal and Income

[10] https://www.law.cornell.edu/uscode/text/26/2503
[11] https://www.law.cornell.edu/uscode/text/26/1361
[12] https://www.law.cornell.edu/uscode/text/26/2056 and https://www.law.cornell.edu/uscode/text/26/2523
[13] https://www.law.cornell.edu/uscode/text/26/2601
[14] https://www.law.cornell.edu/uscode/text/26/2612

Act,[15] place the beneficiaries in the positions they would have occupied if the discretion had not been abused. Upon petition by the trustee, the court having jurisdiction over a trust would have to determine whether a proposed exercise or nonexercise by the trustee of a discretionary power conferred by the new act will result in an abuse of the trustee's discretion.

Other provisions

A person receiving the notice as described above could oppose the proposed action in a court proceeding regardless of whether the person either consented or objected as described above.

Substituting a unitrust amount for net income, or net income for a unitrust amount, under the new act would not otherwise affect terms of the trust concerning distributions, including discretionary terms.

The new act would not create a duty to take or consider action under the act or to inform a beneficiary about the applicability of the act, apart from the notice conditionally required as described above.

A trustee that in good faith takes an action that is authorized by the new act would not be liable to a person affected by the action.

In applying and construing the act, consideration should be given to the need to promote uniformity of the law with respect to its subject matter among states that enact the uniform law on which it is based, Article 3 of the Uniform Fiduciary Income and Principal Act.

The new act would modify, limit, or supersede the federal Electronic Signatures in Global and National Commerce Act,[16] but would not modify, limit, or supersede section 101(c) of that act[17] or authorize electronic delivery of notices described in section 103(b) of that act.[18]

The act would define, but nowhere use, the term *income beneficiary*.

Applicability

The new act would apply to a trust, except as otherwise provided in the terms of the trust or as described below, if Michigan is the trust's principal place of administration as described in section 7108 of the Estates and Protected Individuals Code.[19]

Except as otherwise described below, the new act would apply to both of the following:[20]

- An income trust, unless the terms of the trust expressly prohibit use of the act by either a specific reference to the act or an explicit expression of intent that net income is not to be calculated as a unitrust amount.
- A unitrust, except to the extent the terms of the trust explicitly do any of the following:
    - Prohibit use of the act by a specific reference to the act.

[15] https://www.legislature.mi.gov/Laws/MCL?objectName=mcl-555-505
[16] https://www.law.cornell.edu/uscode/text/15/chapter-96/subchapter-I
[17] https://www.law.cornell.edu/uscode/text/15/7001
[18] https://www.law.cornell.edu/uscode/text/15/7003
[19] https://www.legislature.mi.gov/Laws/MCL?objectName=MCL-700-7108
[20] For purposes of these provisions, references in the terms of a trust to income, net income, unitrust amounts, or the trustee's discretion in distributing any of these would not be, in the absence of additional evidence, a sufficient indication of an intent contrary to the application of the new act or to the doing of anything that the new act would authorize a trustee to do.

- Prohibit conversion to an income trust.
- Limit changes to the method of calculating the unitrust amount.

The new act would not apply to a trust described in section 170(f)(2)(B), 642(c)(5), 664(d), 2702(a)(3)(A)(ii) or (iii) or (b) of the Internal Revenue Code.[21]

The terms of a trust would prevail over any provision of the new act.[22]

Effectiveness
The new act would apply to a trust existing or created on or after the bill's effective date.

BACKGROUND:

According to committee testimony, unitrusts (also known as total return trusts) are designed to balance the interests of current income beneficiaries in returns such as dividends and the interests of successor beneficiaries in the appreciation of the trust assets they will inherit. As noted above, the bill is based on a model law drafted by the Uniform Law Commission, which describes a unitrust generally as follows:[23]

> While the precise origin or intent of the word ["unitrust"] is not totally clear, it appears derived from the notion that the trust consists of a *unified* fund—"a single fund [in which] there would be no distinction between income and principal," only between "receipts" and "payouts." Lovell, *supra*. The "unitrust" can be thought of as a trust in which there is a "unity" of interest between the current income beneficiary and the successor beneficiary, because both benefit from a higher value of the trust assets.
>
> Thus, in current legal usage, a "unitrust" is simply a trust in which the periodic payout to the current income beneficiary is determined with reference to a percentage of the net value of the trust assets, determined from time to time, regardless of how much income is produced by the trust assets or the growth of the trust assets. As the value of the trust assets increases, the unitrust amount increases. As the value decreases, the unitrust amount decreases.
>
> The "unity" of interest between the current income beneficiaries and the remainder or successor beneficiaries will enable the trustee to invest the assets for long-term growth to the benefit of all beneficiaries. This will permit the mission of the trustee and investment team to be more focused. Investment decisions can be based on the needs and risk tolerances of the beneficiaries, and there is less likelihood of dissension between the current and future beneficiaries over investment policy. In addition, to the extent that a unitrust approach obviates discretionary invasions of principal, the trustee is protected against challenges by the remainder beneficiaries that any discretionary

[21] https://www.law.cornell.edu/uscode/text/26/170, https://www.law.cornell.edu/uscode/text/26/642, https://www.law.cornell.edu/uscode/text/26/664, and https://www.law.cornell.edu/uscode/text/26/2702
[22] For purposes of these provisions, references in the terms of a trust to income, net income, unitrust amounts, or the trustee's discretion in distributing any of these would not be, in the absence of additional evidence, a sufficient indication of an intent contrary to the application of the new act or to the doing of anything that the new act would authorize a trustee to do.
[23] Page 29 of the pdf available here: https://www.uniformlaws.org/viewdocument/final-act-73?CommunityKey=1105f9bb-eb93-4d4d-a1ab-a535ef73de0c&tab=librarydocuments

principal distributions were excessive. Similarly, a unitrust approach eliminates the need to make adjustments between income and principal under Section 203 [of the Uniform Fiduciary Income and Principal Act, equivalent to section 104 of Michigan's Uniform Principal and Income Act[24]] and thus avoids or minimizes controversy over whether such adjustments are proper.

The ULC reported that by the end of 2016, 36 states had enacted laws to allow a trustee to convert a trust to a unitrust. The ULC's Uniform Fiduciary Income and Principal Act is a 2018 revision of previous model acts, notable for its inclusion of provisions (Article 3) regarding unitrusts.[25] As of June 2024, eight states have enacted its specific provisions.[26]

FISCAL IMPACT:

House Bill 5110 would have an indeterminate fiscal impact on local court funding units. Costs would be incurred depending on how provisions of the bill affect court caseloads and related administrative costs. It is difficult to project the actual fiscal impact to courts due to variables such as law enforcement practices, prosecutorial practices, judicial discretion, case types, and complexity of cases.

POSITIONS:

A representative of the Probate and Estate Planning Section of the State Bar of Michigan testified in support of the bill. (5-22-24)

The Department of Attorney General indicated a neutral position on the bill. (5-22-24)

Legislative Analyst: Rick Yuille
Fiscal Analyst: Robin Risko

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

[24] https://www.legislature.mi.gov/Laws/MCL?objectName=mcl-555-504
[25] Summary available here: https://www.uniformlaws.org/viewdocument/enactment-kit-74?CommunityKey=1105f9bb-eb93-4d4d-a1ab-a535ef73de0c&tab=librarydocuments
[26] https://www.uniformlaws.org/committees/community-home?communitykey=1105f9bb-eb93-4d4d-a1ab-a535ef73de0c