




Drafting Around the Michigan Trust Code

By Michael A. Shields



Generally, the Michigan Trust Code (MTC) is a set of default rules that apply when the terms of the trust instrument do not completely address the governance or administration of the trust for its intended purposes. Trust instruments may be drafted to override all of the MTC provisions except for certain mandatory provisions set forth in the MTC¹ involving issues such as powers of the court to modify or terminate trusts, limitations on commencing proceedings, jurisdiction, etc. This article focuses on certain MTC provisions that the settlor or practitioner may want to override.

Termination of Noncharitable Irrevocable Trust

The MTC permits the modification or termination of a non-charitable irrevocable trust under the following circumstances:

- (a) By the court upon the consent of the trustee and the qualified trust beneficiaries, if the court concludes that the modification or termination of the trust is consistent with the material purposes of the trust or that continuance of the trust is not necessary to achieve any material purpose of the trust.
- (b) Upon the consent of the qualified trust beneficiaries and a trust protector who is given the power under the terms of the trust to grant, veto, or withhold approval of termination or modification of the trust.
- (c) By a trustee or trust protector to whom a power to direct the termination or modification of the trust has been given by the terms of a trust.²

The settlor may want to address various circumstances for when to terminate the trust, such as when the continued separate existence of the trust is not necessary under the circumstances then existing for (1) a significant transfer tax or income tax benefit, (2) asset management assistance for a current beneficiary, or (3) achieving any other significant trust purpose. If the termination involves the credit shelter trust, the settlor may prefer that the trustee obtain the consent of all qualified trust beneficiaries to protect the remaining beneficiaries or to prevent possible inclusion of the credit shelter trust in the surviving spouse's estate if the surviving spouse is the income beneficiary and is serving as trustee.

The MTC provides that, upon termination, the trustee shall distribute the trust property as agreed by the qualified trust beneficiaries.³ The settlor may wish to dictate a different distribution, such as a distribution to the current income beneficiaries, as opposed to a distribution agreed to by the qualified trust beneficiaries.

Fast Facts:

Trust instruments may be drafted to override all of the Michigan Trust Code provisions except for certain mandatory provisions.

The settlor may want to eliminate the need to obtain court approval for removing a trustee.

The settlor may want to limit the dissemination of accountings to certain beneficiaries.

Termination of Small Trust

The MTC provides that after 63 days' notice to qualified trust beneficiaries, the trustee of a trust consisting of property having a value of less than \$50,000 (adjusted for inflation) may terminate the trust if the value of the trust is insufficient to justify the cost of administration⁴ and that, upon termination of the trust, the trustee shall distribute the trust property in the manner provided for in the terms of the trust, if any, and otherwise to current income beneficiaries, or, if there are no current income beneficiaries, in the manner directed by the court.⁵

The settlor may want to (1) change the 63-day notice period to a longer or shorter period, (2) increase or lower the dollar amount, (3) change the distribution from the current income beneficiaries to other beneficiaries, or (4) dictate a different method of distribution. For example, the settlor may want to increase the amount to at least \$100,000 since the annual income generated on assets under \$100,000 is usually not enough to cover the annual cost of administration. If the trust is not the marital trust, instead of distributing all the assets to the income beneficiaries, the settlor may want the assets divided among the qualified trust beneficiaries on the basis of their actuarial interests. If the trust is created for Medicaid planning purposes, the settlor may want the trustee to terminate the trust only after the trustee finds that the distribution does not adversely impact the trust beneficiaries' qualification for governmental benefits. If the income beneficiary is a minor or disabled person, it may be inappropriate to distribute money directly to that person. In such case, the settlor may prefer to make distributions upon termination subject to a special provision addressing payments to minors or disabled persons.

Amendment of Trust by Power of Attorney

The MTC provides that a settlor's powers with respect to revocation, amendment, or distribution of trust property may be exercised by an agent under a durable power of attorney only to the extent expressly authorized by the terms of the trust or the power of attorney.⁶ The settlor may want to prevent or limit the ability of an agent to revoke, amend, or change the distribution of trust property. This is particularly important since a power of attorney granting an agent the power to revoke, amend, or distribute trust property could be signed long after the trust was created, at a time when the settlor is less attentive to details, and

fails to appreciate the potential consequence of granting such a power. The settlor may wish to provide that the trust may not be amended or revoked if the settlor is disabled, as that term is defined in the trust.

Co-Trustees

The MTC provides that co-trustees must act by majority decision.⁷ The settlor may want to override this provision. Under certain circumstances, the settlor may want one co-trustee to act, a majority to act, or all to act. In a joint trust, for example, the settlors may want either of them to act. In a trust created by one settlor, the settlor may want the settlor and the settlor's spouse to serve as co-trustees and allow either of them to act.

The MTC provides that, by agreement of the trustees, a trustee may delegate to a co-trustee one or both of the following: (1) any power that is permitted to be delegated under the MTC to an agent who is not a trustee⁸ or (2) "[a]ny power that can only be performed by a trustee, if notice of the delegation is provided to the qualified trust beneficiaries within 28 days."⁹ The settlor may wish to give any trustee the power to delegate to a co-trustee, from time to time, any power given to the trustee without the necessity to notify all the qualified trust beneficiaries.

Vacancies in Trusteeship

The MTC provides that if one or more co-trustees remain in office, a vacancy in a trusteeship need not be filled.¹⁰ The settlor may want to address the vacancy. In a second-marriage situation, for example, the settlor may want to have a co-trustee from each side of the marriage acting at all times to ensure that the trust is administered fairly or at least perceived to be administered fairly for both sides of the family.

There are several MTC provisions the settlor or practitioner may want to override or take advantage of.

Resignation of Trustees

Under the MTC, a trustee may resign upon at least 28 days' notice to qualified trust beneficiaries, the holders of powers of appointment, and all co-trustees; or with approval of the court.¹¹ The settlor may wish to increase or shorten the 28-day period or limit the notice to certain beneficiaries such as the income beneficiaries. The settlor should consider keeping the requirement that a trustee who is resigning must notify the holder of a power of appointment so that the holder knows the identity of the acting trustee(s) for giving notice of his or her exercise of power. Also, the settlor should consider imposing certain conditions on the resigning trustee that help protect the trust property.

Removal of Trustees

The MTC provides that the settlor, co-trustee, or qualified trust beneficiary may request the court to remove a trustee, or a trustee may be removed by the court on its own initiative.¹² The MTC sets forth the circumstances under which the court may remove the trustee, such as a serious breach of trust, lack of cooperation that impairs administration of the trust, unfitness or failure to administer the trust effectively, or a substantial change of circumstances.¹³ The settlor may want to override this provision and eliminate the need to obtain court approval for removing a trustee. The settlor may decide to establish guidelines for removal of trustees or give certain beneficiaries the power and discretion to remove trustees. For example, the settlor may give certain beneficiaries (such as the then adult income beneficiaries) the power to remove a corporate trustee and to appoint another corporate trustee without seeking court approval.

Self-Dealing

The MTC provides that a sale of trust property entered into by the trustee for the trustee's own personal account is voidable by a trust beneficiary unless (1) the transaction is authorized by the terms of the trust; (2) the transaction was approved by a court after notice to interested persons; (3) the trust beneficiary did not commence a proceeding within the time allowed by the MTC (generally one year after disclosure if the matter is adequately disclosed, and if the matter is not adequately disclosed, five years after the earlier of removal, resignation, or death of the trustee or the termination of the trust);¹⁴ (4) the trust beneficiary consented to the trustee's conduct; (5) the transaction involves a contract entered into or acquired by the trust before the person became a trustee; or (6) the transaction is otherwise permitted by statute.¹⁵ The settlor may want to authorize the trustee to deal with himself or herself on a fair, arms-length basis provided any potential benefit from the transaction inures to the trust and not to the trustee individually. Or, for example, if the trustee is one of the settlor's children, the settlor may wish to provide that the trustee is authorized to purchase certain trust property, provided the property is purchased at its appraised value on fair payment terms.

Accountings

The MTC requires the trustee to keep qualified trust beneficiaries reasonably informed about the administration of the trust¹⁶ and to send accountings to distributees of income or principal and other qualified or nonqualified trust beneficiaries who request it.¹⁷ The settlor may want to override this provision and limit the dissemination of accountings to certain beneficiaries. For example, the settlor may want to restrict disclosure of information to the surviving spouse

with respect to the credit shelter trust or marital trust during the surviving spouse's lifetime. The court, however, has the power to require the trustee to provide information to other trust beneficiaries.¹⁸ Accordingly, it would be helpful to the court to explain why the settlor wants to limit the disclosure of information. For example, the trust could provide that the settlor and settlor's spouse have always kept their financial matters to themselves and not disclosed such information to their children, partly for privacy, but also to encourage their children to make it on their own.

Retention and Diversification of Assets

The MTC provides that a trust may relieve "a trustee of liability for breach of trust for the acquisition or retention of a particular asset or asset class or failure to diversify investments."¹⁹ The settlor may wish to take advantage of this provision and give the trustee this protection or grant the trustee authority to retain certain assets, particularly if the settlor owns closely held businesses that the settlor wants to pass on to certain beneficiaries or if the settlor has low-basis securities that the settlor does not want to sell during his or her lifetime.

Conclusion

There are several MTC provisions the settlor or practitioner may want to override or take advantage of. It is recommended that the practitioner explain the settlor's intentions in the trust to provide guidance to the trustee and the court in administering and interpreting the trust. ■

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FOOTNOTES

1. MCL 700.7105(2).
2. MCL 700.7411(1).
3. MCL 700.7411(4).
4. MCL 700.7414(1).
5. MCL 700.7414(3).
6. MCL 700.7602(5).
7. MCL 700.7703(1).
8. MCL 700.7817(v).
9. MCL 700.7703(5).
10. MCL 700.7704(2).
11. MCL 700.7705(1).
12. MCL 700.7706(1).
13. MCL 700.7706(2).
14. MCL 700.7905.
15. MCL 700.7802(2).
16. MCL 700.7814(1).
17. MCL 700.7814(3).
18. MCL 700.7814(4).
19. MCL 700.7908(2).