

SENATE, No. 982

STATE OF NEW JERSEY

INTRODUCED MARCH 18, 1996

By Senator DiFRANCESCO

1 AN ACT concerning the limits on certain trustees' powers of  
2 distribution and supplementing Title 3B of the New Jersey Statutes.

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4 **BE IT ENACTED** by the Senate and General Assembly of the State  
5 of New Jersey:

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7 1. a. The following powers conferred by a governing instrument  
8 upon a trustee in his or her capacity as a trustee shall not be exercised  
9 by that trustee:

10 (1) The power to make discretionary distributions of either  
11 principal or income to or for the benefit of the trustee, the trustee's  
12 estate, or the creditors of either, unless either:

13 (a) limited by an ascertainable standard relating to the trustee's  
14 health, education, support or maintenance, within the meaning of  
15 26 U.S.C. §§ 2041 and 2514; or

16 (b) exercisable by the trustee only in conjunction with another  
17 person having a substantial interest in the property subject to the  
18 power which is adverse to the interest of the trustee within the  
19 meaning of 26 U.S.C. 2041(b) and (1) (C) (ii);

20 If a trustee is prohibited by paragraph (1) of this subsection from  
21 exercising a power conferred upon the trustee, the trustee nevertheless  
22 may exercise that power but shall be limited to distributions for the  
23 trustee's health, education, support or maintenance to the extent  
24 otherwise permitted by the terms of the trust.

25 (2) The power to make discretionary distributions of either  
26 principal or income to satisfy any of the trustee's personal legal  
27 obligations for support or other purposes;

28 (3) The power to make discretionary allocations in the trustee's  
29 personal favor of receipts or expenses as between income and  
30 principal, unless such trustee has no power to enlarge or shift any  
31 beneficial interest except as an incidental consequence of the discharge  
32 of such trustee's fiduciary duties;

33 (4) The power to exercise any of the powers proscribed in this  
34 subsection with regard to an individual other than the trustee to the  
35 extent that such individual could exercise a similar prohibited power  
36 in connection with a trust that benefits the trustee.

37 b. Unless otherwise prohibited by the provisions of subsection a.

1 of this section, a trustee may exercise a power described in that  
2 subsection in favor of someone other than the trustee, the trustee's  
3 estate, or the creditors of either.

4 c. If a governing instrument contains a power proscribed under  
5 subsection a. of this section the following shall apply:

6 (1) If the power is conferred on two or more trustees, it may be  
7 exercised by the trustee or trustees who are not so prohibited as if they  
8 were the only trustee or trustees; or

9 (2) If there is no trustee in office who can exercise such power  
10 upon application of any interested party, a court of competent  
11 jurisdiction shall appoint a trustee to exercise such power or, except  
12 as provided in subsection d. of this section, a successor trustee who  
13 would not be disqualified shall be appointed to exercise the power  
14 that the other trustees cannot exercise in accordance with the  
15 provisions of the trust instrument as if the office of trustee were  
16 vacant.

17 d. No beneficiary of a trust, in an individual, trustee or other  
18 capacity, may appoint, or remove and appoint, a trustee who is related  
19 or subordinate to the beneficiary within the meaning of 26 U.S.C.  
20 §672 (c) unless:

21 (1) the trustee's discretionary power to make distributions to or for  
22 such beneficiary is limited by an ascertainable standard relating to the  
23 beneficiary's health, education, support or maintenance as set forth in  
24 subsection a. of this section;

25 (2) the trustee's discretionary power may not be exercised to  
26 satisfy any of such beneficiary's legal obligations for support or other  
27 purposes; and

28 (3) the trustee's discretionary power may not be exercised to grant  
29 to such beneficiary a general power to appoint property of the trust to  
30 the beneficiary, the beneficiary's estate or the creditors thereof within  
31 the meaning of 26 U.S.C. §2041.

32 This subsection d. shall not apply if the appointment of the trustee  
33 by the beneficiary may be made only in conjunction with another  
34 person having a substantial interest in the property of the trust,  
35 subject to the power, which is adverse to the exercise of the power in  
36 favor of the beneficiary within the meaning of 26 U.S.C. §2041(b) (1)  
37 (C) (ii).

38 e. The provisions of this section shall not apply during the time that  
39 a trust remains revocable or amendable by the grantor.

40 f. This section applies to:

41 (1) Any trust created under a governing instrument executed 90  
42 days or more after the effective date of this act, unless the governing  
43 instrument expressly provides that this act does not apply; and

44 (2) Any trust created under a governing instrument executed  
45 before 90 days after the effective date of this act, unless all interested  
46 parties affirmatively elect on or before three years after the effective

1 date by a written declaration signed by or on behalf of each interested  
2 party and delivered to the trustee, not to be subject to the application  
3 of this act. In the case of a testamentary trust, such declarations shall  
4 be filed with the clerk of the court in which the will was admitted to  
5 probate.

6 g. In this section the term "interested party" means:

7 (1) Each trustee then serving; and

8 (2) Each person having an interest in income or principal whom it  
9 would be necessary to join as a party in a proceeding for the judicial  
10 settlement of a trustee's account or, if such a person has not attained  
11 majority or is otherwise incapacitated, the person's legal representative  
12 under applicable law or the person's agent under a durable power of  
13 attorney that is sufficient to grant such authority.

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15 2. This act shall take effect immediately.

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## 18 STATEMENT

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20 This bill supplements New Jersey's probate code by addressing  
21 situations in which trustees named to serve also may be beneficiaries  
22 of the trust. This situation is common with trusts where a family  
23 member may serve as trustee with discretion as to payments of income  
24 and principal among family members. However, this situation presents  
25 the problem of the inherent conflict of interest between a trustee who  
26 could favor himself and the balance of the beneficiaries. Moreover,  
27 due to the increased complexity of the Internal Revenue Code and the  
28 aggressive positions taken by the Internal Revenue Service, certain  
29 powers held by a trustee can have the unintended consequences of  
30 causing a trustee who also happens to be a beneficiary of the trust to  
31 have the entire trust fund included in the trustee/beneficiary's estate,  
32 to cause some or all of the trust income to be taxable to the trustee  
33 and be charged with a taxable gift in the exercise of his or her fiduciary  
34 powers.

35 The tax issue is whether the fiduciary powers granted to a trustee  
36 under a will or trust agreement will be deemed to confer upon the  
37 trustee a general power of appointment under Section 2041 of the  
38 Internal Revenue Code thus causing the trust property to be included  
39 in the trustee's estate for Federal estate tax purposes.

40 In this determination, the Internal Revenue Service focuses on two  
41 questions: (1) whether the trustee's distribution powers are subject to  
42 an enforceable, ascertainable standard and (2) whether the trustee can  
43 make distributions to discharge a legal obligation of the trustee.

44 State law determines the limits on a trustee's power of distribution.  
45 Therefore, whether a trustee's distribution powers are limited by an  
46 ascertainable standard related to health, education, support or

1 maintenance is a matter of state law. This bill addresses these limits.

2 The bill deals with the problem by prohibiting a trustee/beneficiary  
3 from making discretionary payments of principal and income for his  
4 own benefit unless the power is limited by an ascertainable standard or  
5 the power is exercisable only with the consent of a person having a  
6 substantial interest in the trust. The bill would not affect such a power  
7 given to an independent trustee and the bill provides if there is no  
8 trustee who can exercise the power of invasion, a court can appoint a  
9 special trustee.

10 In addition, the bill prevents unintended taxation by prohibiting a  
11 trustee/beneficiary (a) from making discretionary allocations in the  
12 trustee's favor of receipts or expenses as between income and  
13 principal, (b) from making distributions to discharge his legal  
14 obligations and (c) from exercising powers for a beneficiary other than  
15 the trustee to the extent that such beneficiary could exercise a similar  
16 power for the instant trustee.

17 The sponsor hopes that this bill may leave family members free to  
18 select one of their own to act as the fiduciary and retain the discretion  
19 to make discretionary payments to all the beneficiaries including the  
20 trustee.

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25 Limits certain trustees' powers of distribution.