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F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 2/13/09
SPONSOR Irwin **LAST UPDATED** ___ **HB** 462

SHORT TITLE Revise Property Interest Perpetuity Rule **SB** ___

ANALYST Hoffmann

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY09	FY10		
	See Narrative		

(Parenthesis ( ) Indicate Expenditure Decreases)

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY09	FY10	FY11		
	(Indeterminate)			

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From
Administrative Office of the Courts (AOC)
Attorney General's Office (AGO)
Aging and Long-term Services Department (ALTSD)

No Response
Administrative Office of the District Attorneys (AODA)
Taxation and Revenue Department (TRD)

SUMMARY

Synopsis of Bill

House Bill 462 adds an additional exception to the Statutory Rules Against Perpetuities which would permit a trust to hold personal property in perpetuity. Under the common law "rule against perpetuities", a nonvested interest in property is not valid 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. (A nonvested property interest is an interest to which the transferee is not

presently entitled and might never become entitled.) The rule was designed to restrain the power of a landowner to tie up property in long-term or perpetual family trusts. The Bill's exception would provide that real property interests must be distributed within 110 years, either to those who at that time would be entitled to receive distributions as if the trust was terminated; or, if no provisions for distribution upon termination exist, then to those beneficiaries entitled to receive trust income; or if there are no distribution upon termination instructions and no income beneficiaries, then to the heirs of the settler through the intestacy provisions of probate law. Personal property is not so limited. Perpetual trusts of the type the House Bill 462 would permit are sometimes referred to as "dynasty trusts".

The Statutory Rules Against Perpetuities as adopted in 1992 was promulgated as a uniform law by the National Conference of Commissioners on Uniform State Laws.

FISCAL IMPLICATIONS

House Bill 462 makes no appropriations.

The AGO[1] explains that House Bill 462 as proposed would have an impact on tax collections under the New Mexico Estate Tax, §7-7-1 –§7-7-20, NMSA 1978 by permitting property, other than real property, to be held indefinitely by a trust. The Bill would likely also impact income tax revenues, by permitting capital assets, such as securities, to be held indefinitely by a trust, rather than being distributed to individuals. The AGO further notes that House Bill 462 would create business opportunities in dynasty trusts for New Mexico financial planners and institutions, and generate taxable gross receipts associated with establishing and administering such trusts. The extent of the impact is not known at this time.

SIGNIFICANT ISSUES

According to the AGO, there is a philosophical question as to whether it is in the public interest to permit property to be accumulated indefinitely by a dynasty trust, potentially amassing economic power to itself, and shielding a favored few from taxation by the State of New Mexico. Vesting of future interests, satisfaction of conditions precedent to the exercise of a general power of appointment, exercise of non-general or testamentary powers of appointment, absolute ownership, and the power of alienation could be indefinitely suspended, postponed, or allowed to go on indefinitely with respect to personal property held in trust.

However, by exempting personal property held in trust from the rule against perpetuities and similar rules, the Bill would enable this State's financial planners and institutions to set up tax avoiding dynasty trusts for their clients. Because financial institutions in New Mexico cannot offer this type of estate-planning service, they have a disadvantage compared to those in states that have abolished the rule against perpetuities, or made it long enough to be irrelevant. Reportedly, 21 states have abolished the Rule in this regard. Currently, if a New Mexico resident wishes to establish a dynasty trust, the resident must establish it in one of those 21 states. Apart from residents perhaps preferring to deal with local institutions, local bankers and estate planners would prefer to retain the business and earn the fees assessed for administering trusts.

Eliminating the rule against perpetuities completely for personal property held in trust, could trigger a section of the Internal Revenue Code that causes assets subject to a decedent's power of

appointment to be included in the gross estate of the decedent, if he or she exercises that power by creating another (second) power that, "under the applicable local law" [the rule against perpetuities] can be validly exercised so as to postpone the vesting of any estate or interest in such property...for a period ascertainable without regard to the date of creation of the first power" (26 U.S.C. 2041(a)(3)). U.S. Senate Bill 296 was introduced January 22, 2009, and if enacted, would reportedly repeal this provision.

The AOC[2] offers the following additional technical explanations of some of the issues.

The Uniform Statutory Rule Against Perpetuities (USRAP) was drafted and approved by the National Conference of Commissioners on Uniform State Laws, with amendments, in 1990. The commissioners provide the following summary:

The Uniform Statutory Rule adopts what has become known as the "wait-and-see" approach. This is the principal reform of the common-law Rule. Rather than invalidating future interests based on hypothetical possibilities, the Uniform Statutory Rule provides a period of time within which an interest can actually vest. If it does, it is saved. If it does not, then it is invalid. We wait and see, in other words, if an interest will, in fact, vest.

The basic statement of the Rule in the Uniform Statutory Rule is as follows:
"A nonvested property interest is invalid unless:

> (1) when the interest is created, it is certain to vest or to terminate within the lifetime of an individual then alive or within 21 years after the death of that individual; or
>
> (2) the interest either vests or terminates within 90 years after its creation." The initial part of the Rule restates the common law and validates interests that meet the basic test. The second part of the Uniform Statutory Rule deals with invalidation. It sets a period of time, 90 years, within which actual vesting validates an interest. Invalidation can occur only if the future interest has not vested 90 years after its creation. We "wait and see" 90 years.

Why a fixed number of years? It is the simplest and least capricious way to measure time. Why 90 years? To give ample time; that is, it should be within the lifetimes involved in measuring these interests, for a nonvested future interest to vest. Ninety years represents an estimate of the actual time most extended future interests will take, at the outside, to vest. If they do not vest, 90 years is a sufficient time to justify invalidating such interests.

Powers of appointment are given separate treatment in the statement of the basic Rule in Section 1. A "power of appointment" leaves to another person the opportunity to designate who takes nonvested future interests. They are traditionally subject to the "Rule Against Perpetuities." The Uniform Statutory Rule deals with them separately from other property interests because of particular distinctions made between general and non-general powers, testamentary and non-testamentary powers. But the Rule is fundamentally the same. If a delegation of a power vests within the common-law time for vesting, it is absolutely valid. Otherwise, "wait and see," the 90-year period, applies to the question of invalidity.

Beyond the "wait-and-see" approach to invalidity, the Uniform Statutory Rule gives invalid future interests a second chance. Section 3 permits a court to reform an invalid interest or power of appointment "in the manner that most closely approximates the transferor's manifested plan of

distribution..." The court can reform interests by vesting them within 90 years of their creation. So, even if 90 years pass and there is no vesting of an interest, the appropriate court can save it from extinction.

The remainder of the Uniform Statutory Rule copes with issues inherent in the basic application of the "Rule Against Perpetuities." Section 2 settles questions of the creation of nonvested property interests because the Rule begins to run at the time an interest is created. And there are some kinds of interests to which the Rule should not apply. These are the subject of Section 4 [Section 45-2-904 NMSA 1978]. An example is a fiduciary's power relating to the administration or management of assets. Fiduciary powers are technically nonvested in character, but are no threat to the ultimate determination of property ownership. It would, therefore, be inappropriate to apply the Rule against fiduciary powers.

CH/mt

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[1] The Attorney General's Office analysis and comments include the following disclaimer. "*This analysis is neither a formal Attorney General's Opinion nor an Attorney General's Advisory Opinion letter.*
This is a staff analysis in response to the agency's, committee's or legislator's request."

[2] The Administrative Office of the Courts analysis includes the following disclaimer: "THIS BILL ANALYSIS IS SUBMITTED BY THE AOC AND SHALL NOT BE CONSTRUED AS A SUBMISSION BY THE SUPREME COURT OR ANY OTHER COURT."