

3B:11-4.1

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LAWS OF: 1996 CHAPTER: 41

BILL NO: A1555

SPONSOR(S): Bagger

DATE INTRODUCED: February 15, 1996

COMMITTEE: ASSEMBLY: Judiciary
SENATE: Commerce

AMENDED DURING PASSAGE: Yes Amendments during passage denoted by
First reprint enacted Superscript numbers

DATE OF PASSAGE: ASSEMBLY: March 18, 1996
SENATE: May 16, 1996

DATE OF APPROVAL: July 27, 1996

FOLLOWING STATEMENTS ARE ATTACHED IF AVAILABLE:

SPONSOR STATEMENT: Yes

COMMITTEE STATEMENT: ASSEMBLY: Yes
SENATE: Yes

FISCAL NOTE: No

VETO MESSAGE: No

MESSAGE ON SIGNING: Yes

FOLLOWING WERE PRINTED:

REPORTS: No

HEARINGS: No

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P.L. 1996, CHAPTER 41, *approved June 26, 1996*
Assembly No. 1555 (*First Reprint*)

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

3

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

6

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, ¹**[in the trustee's individual**
13 **capacity,]**¹ unless either:

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

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

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

27 (2) The power to make discretionary distributions of either
28 principal or income to satisfy any of the trustee's ¹**personal**¹ legal
29 obligations ¹**[in the trustee's individual capacity]**¹ for support or other
30 purposes;

31 (3) The power to make discretionary allocations in the trustee's
32 ¹**personal**¹ favor of receipts or expenses as between income and
33 principal, unless such trustee ¹**[acts in a fiduciary capacity whereby**
34 **such trustee]**¹ has no power to enlarge or shift any beneficial interest
35 except as an incidental consequence of the discharge of such trustee's
36 fiduciary duties;

37 (4) The power to exercise any of the powers proscribed in this
38 subsection with regard to an individual other than the trustee to the
39 extent that such individual could exercise a similar prohibited power

EXPLANATION - Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and intended to be omitted in the law.

Matter underlined thus is new matter.

Matter enclosed in superscript numerals has been adopted as follows:

¹ Assembly AJU committee amendments adopted March 11, 1996.

1 in connection with a trust that benefits the trustee.

2 b. Unless otherwise prohibited by the provisions of subsection a.
3 of this section, a trustee may exercise a power described in that
4 subsection in favor of someone other than the trustee, the trustee's
5 estate, or the creditors of either.

6 c. If a governing instrument contains a power proscribed under
7 subsection a. of this section the following ¹~~may~~ shall¹ apply:

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

11 (2) If there is no trustee in office who can exercise such power
12 upon application of any interested party, a court of competent
13 jurisdiction shall appoint a trustee to exercise such power or, except
14 as provided in subsection d. of this section, a successor trustee who
15 would not be disqualified ¹~~may~~ shall¹ be appointed ¹to exercise the
16 power that the other trustees cannot exercise¹ in accordance with the
17 provisions of the trust instrument as if the office of trustee were vacant
18 ¹to exercise the power that the other trustees cannot exercise¹.

19 d. No beneficiary of a trust, in an individual, trustee or other
20 capacity, may appoint, or remove and appoint, a trustee ¹who is
21 related or subordinate to the beneficiary within the meaning of 26
22 U.S.C. § 672 (c)¹ unless:

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

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

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

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

39 ¹~~This subsection d. shall not apply if the trustee appointed by the~~
40 ~~beneficiary is not related or subordinate to the beneficiary within the~~
41 ~~meaning of 26 U.S.C. §672(c).~~¹

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

44 f. This section applies to:

45 (1) Any trust created under a governing instrument executed 90
46 days or more after the effective date of this act, unless the governing

1 instrument expressly provides that this act does not apply; and
2 (2) Any trust created under a governing instrument executed
3 before 90 days after the effective date of this act, unless all interested
4 parties affirmatively elect on or before three years after the effective
5 date by a written declaration signed by or on behalf of each interested
6 party and delivered to the trustee, not to be subject to the application
7 of this act. In the case of a testamentary trust, such declarations shall
8 be filed with the clerk of the court in which the will was admitted to
9 probate.

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

11 (1) Each trustee then serving; and

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

18

19 2. This act shall take effect immediately .

20

21

22

23

24 Limits certain trustees' powers of distribution.

[First Reprint]
ASSEMBLY, No. 1555

STATE OF NEW JERSEY

INTRODUCED FEBRUARY 15, 1996

By Assemblyman BAGGER

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

3

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

6

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, ¹[in the trustee's individual
13 capacity,]¹ unless either:

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

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

21 If a trustee is prohibited by paragraph (1) of this subsection from
22 exercising a power conferred upon the trustee, the ¹[trustee's]trustee
23 nevertheless may¹ exercise ¹[of]¹ that power ¹but¹ shall be limited to
24 distributions for the trustee's health, education, support or
25 maintenance to the extent otherwise permitted by the terms of the
26 trust.

27 (2) The power to make discretionary distributions of either
28 principal or income to satisfy any of the trustee's ¹personal¹ legal
29 obligations ¹[in the trustee's individual capacity]¹ for support or other
30 purposes;

EXPLANATION - Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and intended to be omitted in the law.

Matter underlined thus is new matter.

Matter enclosed in superscript numerals has been adopted as follows:

¹ Assembly AJU committee amendments adopted March 11, 1996.

1 (3) The power to make discretionary allocations in the trustee's
2 'personal' favor of receipts or expenses as between income and
3 principal, unless such trustee '[acts in a fiduciary capacity whereby
4 such trustee]' has no power to enlarge or shift any beneficial interest
5 except as an incidental consequence of the discharge of such trustee's
6 fiduciary duties;

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

11 b. Unless otherwise prohibited by the provisions of subsection a.
12 of this section, a trustee may exercise a power described in that
13 subsection in favor of someone other than the trustee, the trustee's
14 estate, or the creditors of either.

15 c. If a governing instrument contains a power proscribed under
16 subsection a. of this section the following '[may] shall' apply:

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

20 (2) If there is no trustee in office who can exercise such power
21 upon application of any interested party, a court of competent
22 jurisdiction shall appoint a trustee to exercise such power or, except
23 as provided in subsection d. of this section, a successor trustee who
24 would not be disqualified '[may]shall' be appointed 'to exercise the
25 power that the other trustees cannot exercise' in accordance with the
26 provisions of the trust instrument as if the office of trustee were vacant
27 '[to exercise the power that the other trustees cannot exercise]'.

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

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

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

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

43 This subsection d. shall not apply if the appointment of the trustee
44 by the beneficiary may be made only in conjunction with another
45 person having a substantial interest in the property of the trust, subject
46 to the power, which is adverse to the exercise of the power in favor of

1 the beneficiary within the meaning of 26 U.S.C. §2041(b) (1) (C) (ii).

2 ¹【This subsection d. shall not apply if the trustee appointed by the
3 beneficiary is not related or subordinate to the beneficiary within the
4 meaning of 26 U.S.C. §672(c).】¹

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

7 f. This section applies to:

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

11 (2) Any trust created under a governing instrument executed
12 before 90 days after the effective date of this act, unless all interested
13 parties affirmatively elect on or before three years after the effective
14 date by a written declaration signed by or on behalf of each interested
15 party and delivered to the trustee, not to be subject to the application
16 of this act. In the case of a testamentary trust, such declarations shall
17 be filed with the clerk of the court in which the will was admitted to
18 probate.

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

20 (1) Each trustee then serving; and

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

27

28 2. This act shall take effect immediately .

29

30

31

32

33 Limits certain trustees' powers of distribution.

1 before 90 days after the effective date of this act, unless all interested
2 parties affirmatively elect on or before three years after the effective
3 date by a written declaration signed by or on behalf of each interested
4 party and delivered to the trustee, not to be subject to the application
5 of this act. In the case of a testamentary trust, such declarations shall
6 be filed with the clerk of the court in which the will was admitted to
7 probate.

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

9 (1) Each trustee then serving; and

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

16

17 2. This act shall take effect immediately .

18

19

20 *SPONSOR'S* STATEMENT

21

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

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

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

46 State law determines the limits on a trustee's power of distribution.

1 Therefore, whether a trustee's distribution powers are limited by an
2 ascertainable standard related to health, education, support or
3 maintenance is a matter of state law. This bill addresses these limits.

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

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

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

23

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27 _____
Limits certain trustees' powers of distribution.

ASSEMBLY JUDICIARY COMMITTEE

STATEMENT TO

ASSEMBLY, No. 1555

with committee amendments

STATE OF NEW JERSEY

DATED: MARCH 11, 1996

The Assembly Judiciary Committee reports favorably and with committee amendments Assembly Bill No. 1555.

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

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

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

The committee amendments generally are technical in nature except that in subsection c. "may" is changed to "shall" concerning the appointment of successor trustees.

SENATE COMMERCE COMMITTEE

STATEMENT TO

[First Reprint]

ASSEMBLY, No. 1555

STATE OF NEW JERSEY

DATED: MAY 2, 1995

The Senate Commerce Committee reports favorably Assembly Bill No. 1555 (1R).

This bill supplements New Jersey's probate code and addresses situations in which trustees are also beneficiaries of the trust.

The bill prohibits a trustee/beneficiary from:

- a. making discretionary distributions of either principal or income for his own benefit unless the power is limited by an ascertainable standard relating to the trustee's health, education, support or maintenance, or the power is exercisable only with the consent of a person having a substantial interest in the trust;
- b. making discretionary allocations in the trustee's personal favor of receipts or expenses as between income and principal;
- c. making distributions of either principal or income to discharge his personal legal obligations; and
- d. exercising powers for a beneficiary other than the trustee to the extent that such beneficiary could exercise a similar power for the trustee.

The bill does not affect the power given to an independent trustee. The bill provides if there is no trustee who can exercise the power of invasion, a court can appoint a special trustee. The provisions of the bill do not apply while a trust is revocable or amendable by the grantor. The provisions of the bill apply to any trust created under a governing instrument executed 90 days or more after the effective date of the bill, unless the governing instrument expressly provides that the bill does not apply, and does apply to governing instruments executed prior to that time, unless all interested parties affirmatively elect on or before three years after the effective date of the bill not to be subject to the application of the provisions of the bill.



OFFICE OF THE GOVERNOR NEWS RELEASE

CN-001

TRENTON, NJ 08625

CONTACT: Becky Taylor
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(609)777-2600

RELEASE: Thurs., June 27, 1996

Gov. Christie Whitman has signed legislation to prevent adverse tax consequences for certain beneficiaries of trusts.

The legislation is designed to prevent unintended tax consequences in situations where family beneficiaries are also trustees and possess powers over the property. When these individuals' powers over the property are not properly limited by tax law, unintended adverse tax consequences may result.

Federal tax law recognizes that states may determine the limitations on the trustee's power of distribution. This legislation provides for the limits on a trustee's powers of distribution which will prevent unintended tax consequences.

A-1555/S-982, was sponsored by Assemblyman Rich Bagger (R-Middlesex/Morris/Somerset/Union) and Senate President Donald DiFrancesco (R-Middlesex/Morris/Somerset/Union).