

Trust Governing Law

Take-Away: There is much more to the settlor simply selecting the 'governing law' of his/her trust, when it comes to conflict-of-laws among various states.

Background: The Michigan Trust Code (MTC), following the Uniform Trust Code, uses a liberal approach to a trust's governing law to address conflict-of-law questions. Generally, a settlor is free to select the governing law, or laws, of their trust, so long as that selection does not violate public policy. The Michigan Trust Code provides: *'The meaning and effect of the terms of a trust are determined by:*

- *The law of the jurisdiction designated in the terms unless the designation of that jurisdiction's law is contrary to a **strong public policy of the jurisdiction** having the **most significant relationship** to the matter at issue; or*
- *In the absence of a controlling designation in the terms of the trust, the law of the jurisdiction having the **most significant relationship to the matter at issue.**" [MCL 700.7107.]*

While this MTC section is supposed to provide guidance as to identifying what law controls a trust, it also adds ambiguity as well, since no definitions are provided as to either what is a *strong public policy* or what constitutes a *most significant relationship*.

Restatement of Law-Conflicts: An additional source of ambiguity when looking at a trust's governing law is found in the Restatement (Second) Conflict of Laws (1971) which distinguishes the law applicable to real property held in trust from the law that applies to personal property (or *movables*) held in trust. [Restatement, Sections 267-282, addressing conflicts in trust law.]

Governing Law: Questions that pertain to the governing law of a trust tend to fall into three different categories: the trust's validity, the construction of the trust, and the administration of the trust.

- **Validity:** Ensuring the validity of the trust is always the first step to create a trust. Since the law of validity is 'tested' when the trust is first created, the law that governs its validity remains the same throughout the trust's duration. Usually, each

state has its own requirements for a trust to be treated as *valid*. MCL 700.7402 sets forth the basic requirements for the trust's creation in Michigan, including: (i) the settlor's capacity; (ii) the intention to create a trust; and (iii) the existence of a definite beneficiary. If a trust has contacts with several states, where one state would validate the trust, but another state's laws would deny its validity, the tendency of most courts will be to select the law that upholds the trust's validity. [Restatement, Section 270.]

- **Construction:** Construction generally refers to the principles that are applied to interpret the terms and provisions of a trust instrument. The settlor's intent is key to applying the law of *construction*. Often courts will not only look at the trust's terms, but also the circumstances under which the trust was created to better understand the settlor's intent. If the settlor designates a jurisdiction to govern his/her trust's *construction*, there is no requirement that there be a direct connection to that named jurisdiction. Since the purpose of the trust's construction is to interpret and clarify its terms in a way that reflects the settlor's intended meaning, the focus will be on implementing the settlor's intent as opposed to the location where the trust is administered. [Restatement, Section 268.]
- **Administration:** The governing law of trust administration is more of a 'moving target' since the trust's administration can shift and change where the trustee administers the trust, commonly called the trust's *situs*. The place of administration can change due to searching for more favorable tax laws, better legal protections for the beneficiaries, or more efficient administrative rules the trustee must follow. It is notable that while the transfer of a trust's principal place of business will normally result in a change to the governing law as it pertains to the trust's administration, that transfer will not impact that governing law that applies to the trust's validity or its construction. Accordingly, due to the variable situations, the MTC does not attempt to define the *principal place of business* (or residence) of a trustee. Thus, when a trust instrument lacks a choice-of-law provision, or a sufficient connection with a selected jurisdiction has not been established, the trust's principal place of administration will usually be deemed to be where the trustee is located.
- **MTC v. Restatement:** The *Restatement's* position on the law that governs trust administration notes that the law of the state designated in the trust instrument regarding *movables* may be designated by the settlor, but not for real estate. If no state is designated in the trust document, it is governed by the law of the state that is most closely connected with the trust's administration. [Restatement, Section 272.] However, the analysis for determining the law of trust administration under the

Restatement is different from that under the MTC. The MTC will look to the location of the trustee as the jurisdiction that governs the trust's administration, while the *Restatement* looks to the jurisdiction that has the *most substantial relation* with the trust [whatever that means!]

Drafting Choice-of-Law Provisions: When a trust instrument is drafted, the law regarding the validity and construction of the trust should be fixed, in contrast to the governing law of trust administration, which should remain flexible to allow the trustee to change the *situs* in the future for optimal changes and efficiency.

The Future: The topic of conflict-of-laws when it comes to a trust is admittedly fairly murky when principles of the *Restatement* at times seem to run counter to the MTC. Fortunately, the Uniform Law Commission is currently working on a proposed model act called the ***Conflict of Laws in Trusts and Estates Act***, along with a proposed updated *Restatement (Third) Conflict of Laws*, in an attempt to address current ambiguities in the law and to bring a greater consistency between these two 'sources.' Three areas which the ULC promises to address in these proposed changes include: (i) collapse the choice-of-law distinction between real and personal property held in trust; (ii) de-emphasize the distinction between a testamentary trust and an *inter vivos* trust in choice-of-law rules; and (iii) eliminate the application of different choice-of-law to matters of trust construction, and interpretation.

Conclusion: With new estate planning strategies seemingly appearing each month, a settlor should be able to choose the governing law for any aspect of his/her trust. Hopefully, with a new, model conflicts-of-law act and *Restatement* on the horizon a more streamlined approach will exist to reduce future conflict-of-law situations when dealing with trusts.

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