

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based only on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/SB 830

SPONSOR: Senator Grant

SUBJECT: Rule Against Perpetuities

DATE: February 2, 2000

REVISED: 2/24/00 _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Matthews</u>	<u>Johnson</u>	<u>JU</u>	<u>Favorable/CS</u>
2.	_____	_____	_____	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____

I. Summary:

The committee substitute revises Florida's statutory Rule Against Perpetuities by extending the time period within which a property interest in a trust must either vest or terminate from 90 years to 360 years as measured from the date the trust was created. Additionally, it amends Part IV of chapter 737, Florida Statutes, relating to the powers of a trustee, to provide procedures for judicial and non-judicial modifications of irrevocable trusts, for the representation of specified persons in modification proceedings, and for the award of attorney's fees, costs and guardian ad litem fees in modifications proceedings.

This bill substantially amends section 689.225 of the Florida Statutes. It also creates sections 737.4031, 737.4032, and 737.4033.

II. Present Situation:

Rule Against Perpetuities

The common law Rule Against Perpetuities originated from an English court rule in 1682. The rule provides that a nonvested (also known as contingent) interest ¹ in property or power of appointment in a trust is invalid unless it can be said, with absolute certainty, that it will either vest or terminate, no later than 21 years after the death of an individual alive at the creation of the trust interest. The primary objective of the rule is to prevent perpetual control and unreasonable restraints upon the alienation of property by invalidating, after a specific time, any future nonvested interest created either by a will, deed, or power of appointment².

¹Contingent remainders, executory interests, vested remainders subject to open (class gifts), options to purchase (not attached to a leasehold), and rights of first refusal are subject to the Rule Against Perpetuities. Vested interests, reversion, possibilities of reverter, charity to charity dispositions, and rights of entry are not subject to the rule.

²A power of appointment is power delegated to another to exercise prescribed powers on behalf of the person who delegated the powers.

In 1988, the Florida Legislature enacted the Florida Uniform Statutory Rule Against Perpetuities³ which essentially codified the common law Rule Against Perpetuities. *See* ch. 88-40, L.O.F.; s. 689.225, F.S. However, the statutory Rule Against Perpetuities also included a “wait and see” provision that essentially extends the valid duration of a future interest to 90 years⁴ from the date of the trust’s creation. Therefore, a property interest or the power of appointment must vest or terminate within a “life in being plus 21 years” or within the 90-year period in order to be valid.

Over the past several years, there has been a trend among states⁵ to eliminate or limit the rule against perpetuities in order to facilitate the establishment of long-term, multi-generational trusts (sometimes referred to as “dynasty trusts”) and to avoid the payment of federal estate and generation-skipping transfer taxes.⁶ However, Congress has often reacted accordingly.⁷ Although it is possible to shield a trust from federal estate and generation-skipping transfer taxes, as long as the interests of the trust are valid for an ascertainable period, there are limits on how much can be placed into these trusts and taxes may be owed upon transfer at some point or upon termination. Overall, the federal tax laws have been interpreted to mean that if a trust has no limit on its existence and the beneficiary exercises power in such a way to extend the trust forever, the exercise of the beneficiary could potentially and would immediately trigger the gift or estate tax.

Trust Administration

Chapter 737, Florida Statutes, relates to the creation and administration of trusts. A “trust” is generally the fiduciary obligation or relationship protected by the courts in which one person, the “trustee,” holds a property interest for the benefit or use of another, the “beneficiary.” John G. Grimsley, *Fla. Law of Trusts* § 1-1 (4th ed. 1993). Trusts are created for many purposes including, but not limited to, the protection of property and beneficiaries, tax planning and professional management of assets. However, a trust may not be created for any purpose in contravention of law or public policy. *Reid v. Barry*, 93 Fla. 849, 112 So. 846 (1927). Section 731.201(33), F.S., enumerates the various categories of trusts.

Under current case law, a trust may be terminated when the trust sets forth the term of termination, when the trust becomes passive or its purpose has been accomplished, when the

³Twenty-five states (including Florida) have adopted the National Conference of Commissioners on Uniform State Law’s Uniform Statutory Rule Against Perpetuities in its entirety or with slight variations.

⁴The 90-year period was intended to approximate an average time period that would apply in a 21-years plus a life in being situation. *See* USRAP comments, 8B ULA 342.

⁵E.g., Delaware, Illinois, Kentucky, Mississippi, Ohio, Pennsylvania, Rhode Island, Vermont and Virginia.

⁶The federal generation-skipping transfer tax was designed to diminish the ability to avoid successive transfer taxes. *See* s. 2601 et seq. Internal Revenue Code

⁷For example, Delaware enacted law that allowed trust beneficiaries to avoid federal estate taxes through a manipulation of the rule against perpetuities and essentially create a trust in perpetual existence. As long as the beneficiaries of each generation took the necessary action to extend the period in the rule against perpetuities and the assets remained inside the trust, no estate taxes would be due. In response, Congress enacted sections 2041(a)(3) and 2514(d) of the Internal Revenue Code, also known as the “Delaware tax trap,” to counter the Delaware law. The “Delaware tax trap” states that if a beneficiary exercises a power that allows vesting of the trust property to be postponed “for a period ascertainable without regard to the date of the creation of the [beneficiary’s] power,” the exercise of the beneficiary’s power triggers a gift tax or estate tax.

performance of the trust has become impossible, or when the legal and equitable estates in the same property have merged. Under a reserved power of amendment, an irrevocable trust may be amended if the settlor and beneficiaries agree as long as the rights of no other persons are affected. *See also* 56 Fla.Jur.2d, Trusts ss.79-84. Additionally, statutory law expressly allows a trustee to terminate a trust if the market value of the trust is less than \$50,000 and if relative to the costs of administering the trust, compliance with the trust will defeat or substantially impair the accomplishment of the trust purposes. *See* s. 737.402(3), F.S.

Spendthrift Clauses

A spendthrift clause or trust imposes a restraint upon the beneficiary from voluntarily alienating his or her interest or upon the creditor from reaching a beneficiary's interest before the interest is paid out. *See* Waterbury v. Munn, 32 So.2d 603 (Fla. 1947). Florida gives full effect to spendthrift clauses or trusts subject to a few exceptions and then only as a last resort. *See e.g.*, Bacardi v. White, 463 So.2d 218 (Fla. 1985)(spendthrift trusts can be garnished for collection of both alimony arrearage and attorney fees awarded incident to a divorce).

Attorney's Fees and Costs in Trust Proceedings

There are provisions for awarding attorney's fees and costs in trust proceedings. *See* s. 737.627, F.S. (an award of attorney's fees in actions challenging the exercise of trustee powers) and s. 737.2041, F.S. (entitlement for trustee to reasonable compensation for ordinary and extraordinary services as described in statute).

In 1999, the Florida Legislature enacted another provision to permit costs and attorney's fees incurred in a trust proceeding to be paid out of a trust if the court determined that the attorney rendered services to the trust on or after July 1, 1999. *See* ch. 99-352, L.O.F., s. 737.2035, F.S. The provision was modeled after a similar provision in the Florida Probate Code, which states that costs in probate proceedings may be awarded as in chancery actions, that any attorney who renders services to an estate may apply for an order awarding attorney fees, and that the court may, in its discretion, direct from what part of the estate costs and attorney's fees will be paid. *See* s. 733.106, F.S.

III. Effect of Proposed Changes:

Section 1 amends section 689.225, Florida Statutes, relating to the statutory Rule Against Perpetuities. For those trusts created after December 31, 2000, it allows nonvested property interest or power of appointment in a trust to vest or terminate in 360 years in lieu of the current 90 year maximum period. This section also abolishes the common-law rule against perpetuities and rule against remoteness in vesting.⁸

Section 2 creates section 737.4031, 737.4032, and 737.4033, Florida Statutes, within Part IV of chapter 737, Florida Statutes, relating to the powers of trustees. These sections are created to provide a mechanism for modifying trusts created in accordance with the proposed 360-year period under the statutory Rule Against Perpetuities, based on inevitable changes in circumstances

⁸The common law rule against remoteness in vesting is another term for the rule against perpetuities. *See* Van Roy v. Hoover, 117 So.887 (Fla. 1928).

unforeseen under the circumstances in existence at the creation of the trusts. Trusts may be modified through judicial or non-judicial procedures as discussed below.

Specifically section 737.4031, Florida Statutes, creates the procedure and requirements for judicial modification of irrevocable trusts as follows:

- Allows a trustee or beneficiary to request judicial modification of an irrevocable trust under either of these two scenarios:
 - ▶ If the purpose of the trust has been fulfilled, is impossible to fulfill, has become illegal, no longer exists, or would be defeated or substantially impaired by complying with the terms, the court may either amend the terms of the trust, terminate the trust partially or entirely, direct the trustee to perform acts not originally authorized by the trust, or prohibit the trustee from performing acts originally authorized by the trust. [Note: this is essentially codification of existing law]
 - ▶ If compliance with the trust would not be in the best interest of the beneficiary, the court can modify the trust in a manner that conforms to the extent possible with the settlor's intent while taking into account the current circumstances and the best interests of the beneficiaries. Judicial modification under this subsection is not applicable to a trust created after December 31, 2000 if the trust requires the interest of the trust to vest or terminate within the time period under the old statutory rule against perpetuities, and if the trust expressly prohibits judicial modification.
- Requires the court to consider the trust's terms and purposes, the facts and circumstances surrounding the creation of the trust and relevant extrinsic evidence regarding the proposed judicial modification.
- Requires representation by a legal guardian or alternatively, a court-appointed guardian ad litem (upon the court's own motion or upon the request of the trustee or a beneficiary) for the interests of unborn or unascertained beneficiaries, unidentified or unknown beneficiaries, or beneficiaries who are minor or under legal disability, when those interests are not represented by another beneficiary.
- Provides that spendthrift provisions must be considered, but are not determinative in the decision to modify a trust.
- Defines the term "beneficiary" distinctly from the definition of "beneficiary" provided in the Florida Probate Code (s. 731.201(2), F.S.) although it retains the definition of "trust" as provided in the Florida Probate Code (s. 731.201(33), F.S.).
- States that trusts are not deemed revocable for purposes of judicial modifications when consent of all the beneficiaries is required for the settlor to be able to revoke the trust.
- States that irrevocable trusts are created for purposes of this act when the right of revocation terminates.

Section 737.4032, Florida Statutes, creates the procedure and requirements for non-judicial modification of irrevocable trusts only when based on the unanimous agreement of the trustee and all beneficiaries and after the death of the settlor:

- Provides that a non-judicial modification agreement may amend the terms of the trust, terminate the trust partially or entirely, direct the trustee to perform acts not originally authorized by the trust, or prohibit the trustee from performing acts originally authorized by the trust.
- Prohibits an agreement to modify a trust until all charitable interests, if any, are terminated.
- Binds unborn and unascertained beneficiaries, unidentified and unknown beneficiaries, and beneficiaries who are minor or under legal disability, to the modification agreement, if the interests of these persons are represented by another beneficiary under the trust and to the extent that their interests are not in conflict with those of the beneficiary.
- Requires representation by a legal guardian or alternatively, a court-appointed guardian ad litem (upon request of the trustee or a beneficiary) for the interests of unborn or unascertained beneficiaries, unidentified or unknown beneficiaries, or beneficiaries who are minor or under legal disability, when those interests are not represented by another beneficiary.
- Provides that the provisions for non-judicial modification are not applicable to a trust created after December 31, 2000 if the trust requires the interest of the trust to vest or terminate within the time period under the old statutory rule against perpetuities, and if the trust expressly prohibits non-judicial modification.
- Establishes that spendthrift provisions do not preclude non-judicial modification of a trust.
- Contains the same provisions as contained in the section on judicial modification as pertains to the definitions of “beneficiary” and “trust”, the irrevocability of trusts in which all beneficiaries must consent, and the creation of irrevocable trust when the right of revocation terminates.

Section 737.4033, Florida Statutes, provides for a court-award of attorney’s fees and taxable costs, including guardian ad litem’s costs in judicial and non-judicial modification proceedings, payable from the trust or as otherwise directed by the court.

Section 3 provides that the act shall take effect December 31, 2000, except that the sections on judicial and non-judicial modification of trusts shall not apply to trusts created prior to January 1, 2001, or to trusts created after December 31, 2000, if specific conditions are met.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

The provisions of this bill are consistent with proposed legislation arising from the 1999 Report of the Rules Against Perpetuities Committee which the Florida Bar's Real Property, Probate, and Trust Law Section supports.

The bill may encourage persons to keep and preserve capital wealth in trusts in Florida without the risk of subjecting the trust to federal estate and generation-skipping transfer taxes. It may also encourage more development of trust management companies.

The bill may deter the use of spendthrift clauses in trusts given that their protective effect may be overridden in judicial and nonjudicial modification proceedings.

C. Government Sector Impact:

Although this Act does not appear to have a significant fiscal impact on state or local government, there may be an indeterminate fiscal impact on the collection of federal estate taxes on trust assets in a decedent's estate. The Department of Revenue has reported that there is no fiscal impact on the collection of taxes.

This bill may have an indeterminate impact on the state courts dependent on the number of proceedings filed arising from any matter relating to judicial and non-judicial modification of irrevocable trusts.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Amendments:

None.

This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.
