

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

BILL: SB 2450

SPONSOR: Senator Atwater

SUBJECT: Florida Uniform Principal and Income Act

DATE: March 20, 2003      REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Matthews</u>	<u>Roberts</u>	<u>JU</u>	<u>Favorable</u>
2.	_____	_____	<u>BI</u>	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

**I. Summary:**

This bill amends various provisions of the Florida Uniform Principal and Income Act.

This bill substantially amends the following section of the Florida Statutes: 738.104, 738.1041, 738.202, and 738.401.

**II. Present Situation:**

Chapter 738, F.S., governs the identification of principal and income in or from a trust property through a trust instrument, will, or other governing instrument, the allocation of principal and income, and the apportionment of assets between income and principal. Last year, the Legislature substantially revised chapter 738, F.S. by enacting the Florida Uniform Principal And Income Act (1997) as modified.<sup>1</sup> See ch.2002-42. The intent of the Act was to:

<sup>1</sup> This Act is based the Uniform Principal and Income Act (1997) promulgated by the National Conference of Commissioners on Uniform State Laws. Florida’s Act also includes a number of provisions not found in the NCCUSL version of the uniform act. For example, chapter 738, F.S, provides that: 1) There is no express or implied duty to exercise a power to adjust between principal and income or vice versa (s. 738.104(7), F.S.); 2) Beneficiaries, by a super majority, have a right to object to a trustee’s discretionary power to adjust between principal and income (s. 738.104(8), F.S.); 3) A trustee has the discretionary power to convert an income trust to a total return unitrust or reconvert a total return unitrust to an income trust (s.738.1041, F.S.); 4) Value of trust assets is to be determined on an asset-by-asset basis and a challenge to such valuation must be made within 6 months of notice of such valuation (s. 738.202(5), F.S.); 5) State law on the apportionment of estate taxes trumps any apportionment provision in chapter 738, F.S. (s. 738.302(4),F.S.); 6) New shares of stock purchased from reinvested dividends retain their character as income (s. 738.401(4), F.S.); 7) additional provisions govern the sale and collection of interest from bonds and other obligations to pay were expanded (s. 738.503(3), F.S.); 8) A trustee must allocate to income payments received in the nature of interest or dividends under specified circumstances (s. 738.602(2)(a)2., F.S.); 9) An additional category of expenses for extraordinary repairs or expenses in capital improvements may be charged against the principal (s. 738.702(1)(h), F.S.); 10) The amount of depreciation taken for tax purpose is presumptively the correct depreciation for allocating between principal and income (s. 738.703(3), F.S.); 11) A formula for appointing expenses

- Provide more precise procedures for trustees and personal representatives in the administration of a trust or an estate, respectively.
- Specify more clearly what constitutes income and principal and the formulas for allocation of assets to principal and income.
- Ensure proper distribution to beneficiaries, heirs and devisees.
- Reflect changes in principal and allocation rules consistent with modern trust investment principles and practices.

There are numerous forms and types of trusts, and numerous forms and types of property held by trusts. A trustee of a trust and the personal representative of a decedent's estate are called fiduciaries. They have special duties toward those who benefit from their administration. The age and type of beneficiaries may warrant different distributions, and federal and state tax consequences must also be considered. A trustee of a trust has a fiduciary obligation to satisfy both the interests of the trust's income beneficiaries during the life of the trust, and the interests of the remainder beneficiaries at the trust's termination. A personal representative may be required to allocate net income to certain individuals during the administration of the estate and to assure that certain expenses are paid out of an appropriate category of interests before finally distributing the assets of the decedent's estate to the heirs or devisees (heirs if there is no will, devisees if there is a will).

A trustee's management of any trust involves an inherent conflict between the interests of current beneficiaries and future beneficiaries. Determining the proper balance between current beneficiaries, and future beneficiaries, necessarily entails policy considerations. In general, the current beneficiaries seek the largest possible payout given to them. The future beneficiaries seek as little as possible being paid to the present beneficiaries, in order to maximize the amount that the future beneficiary is to receive.

The grantor of a trust, in the document creating the trust, generally provides for a distribution plan that the grantor deems appropriate. There are many situations, however, where the terms of a trust do not clearly specify a distribution.

As applicable to the predecessor uniform principal and income acts and in accordance with well-established common law, the guiding principle under chapter 738, F.S., is to ensure that the trust's creator's intent governs the interpretation and construction of the trust or other governing instrument. Therefore, chapter 738, F.S., operates as the default, in the event a trust document, will or other governing instrument is silent.

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between a life tenant and the remainder interests is provided. See s. 738.801, F.S. The following provisions were originally found in the Uniform Principal and Income Act (1997) but altered in Florida's version of the uniform act: 1) Section 738.503(2), F.S., does not include the provision in the uniform act which provides that the profit on the sale by a trustee of a note maturing within one year must be allocated to income. However, subsection (3) of this section expands upon the provisions regarding the sale of a bond. 2) Section 738.704(2), F.S., does not include the ability of a trustee to "borrow" principal to pay certain expenses chargeable against income, namely extraordinary repairs and capital improvements. Subsection (4) is added to provide that the principal may only be advanced for mortgage payments if necessary to avoid a default

### III. Effect of Proposed Changes:

**Section 1** amends s. 738.104, F.S., to clarify the scope of a trustee's power to adjust as follows:

- A trustee can only release a power to adjust if the trustee is doing so to convert an income trust to a total return unitrust.
- A trustee can release the power to adjust in its entirety, or portion thereof from income to principal or principal to income if the trustee is unsure about what may result if he or she has or exercises the power to adjust or knows that it would not benefit the trust.
- The release of the power to adjust is only effective as long as the trust is being administered as a unitrust.
- As to trusts in existence on January 1, 2003, a trustee has a power to adjust only if: 1) he or she sent a notice statement to beneficiaries regarding the right to object and the trustee's power to adjust, and 2) no objection is made or an objection is terminated by evidence of written consent of the supermajority of the trust beneficiaries or by court order resolving the objection.
- A notice statement of objection and power to adjust may be also served on the legal representative or guardian of the trust beneficiaries without formal court process.

**Section 2** amends s. 738.1041, F.S., to clarify the definition of an interested trustee as applied in the context of having the power to set the unitrust percentage under specified circumstances. Current language allows the definition to read "interested trustee" as including either a trustee whom an interested distributee may remove and replace, or a trustee who can be removed and an interested distributee replaces him or her. The bill clarifies that an interested trustee also includes any trustee who may be removed and replaced with a related or subordinate party provided the interested distributee has the power to remove and replace the trustee.

Additionally, it revises the provisions governing when a trustee without court approval can convert an income trust to a total return unitrust or vice versa and change the percentage used to calculate the unitrust amount or the methodology used to determine the fair market value of the trust. It clarifies the floor and ceiling limits of the unitrust percentage between 3 and 5 percent. It also provides that a notice statement of the trustee's intent to convert or change the percentage or methodology as aforementioned can be served upon the legal representative or natural guardian of specified interested persons without formal court process. The same ability applies to objections.

It also clarifies the application of this section to trusts administered by a trustee who has the power of withdrawal for a trust that is limited to amounts set forth in the federal Internal Revenue Code.

**Section 3** amends s. 738.202, F.S., relating to appraisals to establish the value of trust assets. The bill specifies that for purposes of distribution to residuary and remainder beneficiaries, the value of trust assets can be determined not only on appraisals within 2 years after the valuation date but also on appraisals within 2 years before the valuation date. Those determinations will be presumed reasonable.

**Section 4** amends s. 738.401, F.S., relating to the allocation of receipts from an entity to principal. It clarifies that distributions of gains from mutual funds are receipts that may be

allocated. This bill states that money received from an investment entity or real estate trust which represents a short-term or long-term capital gain realized with the entity in lieu of federal income tax purposes is a receipt that can be allocated.

Section 5 provides the Act is effective upon becoming law and is to be retroactively applied to January 1, 2003.

#### **IV. Constitutional Issues:**

**A. Municipality/County Mandates Restrictions:**

None.

**B. Public Records/Open Meetings Issues:**

None.

**C. Trust Funds Restrictions:**

None.

**D. Other Constitutional Issues:**

The bill expressly provides that it will apply retroactively to January 1, 2003. The general rule of statutory construction is that a substantive statute will not operate retrospectively absent clear legislative intent to the contrary, but a procedural or remedial statute can. *See Life Care Centers v. Sawgrass Care Center*, 683 So.2d 609, 613 (Fla. 1st DCA 1996), citing *State Farm Mutual Automobile Insurance Co. v. Laforest*, 658 So.2d 55, 61 (Fla. 1995). Substantive law either creates or imposes a new obligation or duty, or impairs or destroys existing rights. *See Alamo Renta-A-Car v. Mancusi*, 632 so.2d 1352, 1358 (Fla. 1994). The bill amends various provisions that may affect the duties or rights of individuals including trustees and beneficiaries which may implicate some constitutional considerations. However, proponents of the bill represent that the changes are primarily technical and for those that are not, it is represented that these changes are consistent with existing good accounting and trust administration principles and are necessary to avoid a loophole in the application of the Florida Uniform Principal and Income Act to trusts in existent on January 1, 2003.

As is the case with current provisions in chapter 738, F.S., this bill engrafts federal law requirements by new cross-references to the Internal Revenue Code. Although the Legislature may approve and adopt provisions of federal statutes, and all administrative rules made by a federal administrative body that are in existence and in effect at time the legislature acts, it constitutes an unconstitutional delegation of legislative power if the Legislature adopts in advance any federal act or ruling of any federal administrative body that Congress or such administrative body may adopt in the future. *See State ex rel. Orange State Oil Co.*, 21 So.2d 599, 603 (Fla. 1945). Since the amendment incorporates the specific and descriptive reference to those applicable federal statutes, the law under

chapter 738, F.S., will take the federal law as it exists at the time the state law is enacted without affect by any subsequent amendment or repeal to the federal law or regulations.

**V. Economic Impact and Fiscal Note:**

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Since the bill primarily clarifies existing language and facilitates procedural obligations, the bill may benefit practitioners in the field.

C. Government Sector Impact:

None.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Amendments:**

None.

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

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