HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 1141 Conveyances of Land
SPONSOR(S): Stargel
TIED BILLS: None **IDEN./SIM. BILLS:** SB 1434

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) Civil Justice Committee	7 Y, 0 N	Shaddock	Bond
2) Economic Development, Trade & Banking Committee			
3) Justice Council			
4)			
5)			

SUMMARY ANALYSIS

An Individual Retirement Account ("IRA") is an investment tool that permits qualifying individuals to save and invest for retirement, with certain federal income tax advantages. Although IRAs have long been able to invest in real estate, it was not until recently that there has been significant interest in placing real estate investments into an IRA. Current Florida law is unclear as to how an IRA can take title to real property.

The bill specifies how retirement investment plans, such as IRAs and other qualified plans, may accept, hold, and transfer title to real property.

This bill does not appear to have a fiscal impact on state or local governments.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

Promote personal responsibility -- This bill will provide an individual with additional investment flexibility for administers of individual retirement accounts.

Safeguard individual liberty -- This bill increases the options of an individual regarding the conduct of his or her own affairs in the retirement arena.

B. EFFECT OF PROPOSED CHANGES:

Background[1]

The Employee Benefit Research Institute estimates there is in excess of $12 billion dollars in retirement assets currently in this country. Individual Retirement Accounts (IRAs) and other qualified plans are the second most popular type of account per household; behind the family checking account. Normally, IRAs and qualified plans are creatures of the Internal Revenue Code, and as such, are governed primarily by federal law and are only affected by state law within a limited scope. The interface between federal governance of IRAs and qualified plans, and state real property laws, creates an issue that falls within such a limited scope.

Investing an IRA in real estate is legal pursuant to the federal tax code. In the early days of IRAs, the only place that an IRA owner could go to invest an IRA in real estate or another type of alternative investment was a traditional trust company. If you could meet the minimum account size, which used to be at least $300,000 of investable assets, then the bank might be willing to accommodate the IRA owner's investment preferences. Now there is a proliferation of IRA providers who specialize in nothing but self-directed IRAs.[2] Many of them have minimum account sizes that are as low as the annual IRA contribution limits. These have become available to the average investor and, as such, are gaining a lot of press. There have always been rules to be followed and pitfalls for the unwary.

The IRS Rules

IRAs are created under ss. 408 and 408A of the Internal Revenue Code.[3] IRAs can be created by contribution subject to annual dollar limits, or by rollover from a qualified plan. Section 408 requires a written agreement containing certain required provisions.

The IRS has issued forms 5305 and 5305A as Model IRA Agreements. Form 5305A is clear that despite the fact that the IRA owner may direct investments and retain most "traditional" powers that might otherwise create a passive trust, such direction by the IRA owner will not cause the assets of the IRA to be treated as owned by the IRA owner. All IRAs are required to be held by a trustee or custodian approved by the IRS to hold IRA assets. The IRA owner cannot normally take out distributions prior to age 59 ½ without a penalty, and except in the case of a Roth IRA,[4] must start

[1] The bulk of this analysis is derived from materials graciously supplied by the Real Property Probate & Trust Law Section of the Florida Bar.

[2] "What is a self-directed IRA? It's simply an Individual Retirement Account established with a broker instead of a mutual fund or a bank. A self-directed IRA enables you to buy and sell individual stocks. As a result, you make the investment decisions instead of someone else, such as the manager of a mutual fund." *Self-Directed IRAs*, (last visited Mar. 9, 2006) <http://www.fool.com/foolu/askfoolu/1999/askfoolu990714.htm>.

[3] 26 U.S.C. ss. 408, 408A.

[4] "The Roth IRA provides no deduction for contributions, but instead provides a benefit that isn't available for any other form of retirement savings: if you meet certain requirements, all earnings are tax free when you or your beneficiary

taking distributions out by April 1st of the year after the year in which they turn 70½. No one has rights in an IRA during the lifetime of the IRA owner except the IRA owner, and there is no such thing as an irrevocable beneficiary designation during lifetime because the IRA must always belong to the individual it was established for during the lifetime of that individual.

Qualified plans[5] have rules that are basically the same as those for IRAs. There are penalties for withdrawal before the appropriate age, and in some cases withdrawals are prohibited until retirement or separation from service. All plans will have a written agreement, a trustee and a plan administrator; but it is important to note that some plans allow the participant to direct investments within their account.

The Prohibited Transaction Rules

There are additional rules for alternative investing with IRAs. Section 4975 of the Internal Revenue Code deals with prohibited transactions, and the main focus of this section is self-dealing.[6] If a transaction within an IRA is deemed prohibited, it can result in the disqualification of the entire account as of the first day of the tax year within the year that the transaction occurred. This can result in unexpected income tax liability, as well as penalties for early distribution if the IRA owner is under 59½. Although there is no place in the Internal Revenue Code that defines permissible investments, s. 4975 addresses what is prohibited, subject to exceptions:[7]

- the sale, exchange, or leasing of any property between an IRA and any disqualified person;
- the lending of money or other extensions of credit between an IRA and any disqualified person;
- the furnishing of goods, services, or facilities between any disqualified person and an IRA;
- the transfer to any disqualified person or use by any disqualified person (or for the disqualified person's benefit) of the income or assets of an IRA; or
- the receipt by any Disqualified Person of any consideration in connection with a transaction involving my IRA.

A “Disqualified Person” as defined under Internal Revenue Code s. 4975 includes, but is not limited to, the following:[8]

- the IRA owner;
- the IRA owner’s spouse;
- the IRA beneficiary;
- the IRA owner’s ancestors and lineal descendants;
- spouses of the IRA owner’s lineal descendants;
- anyone providing services to the IRA, including the IRA Custodian and any investment managers or advisors;
- any corporation, partnership, trust or estate in which the IRA owner individually has a 50% or greater interest.

Provided that an IRA does not engage in a prohibited transaction, alternative types of investments will not disqualify the account and will allow the IRA owner to enjoy tax-deferred growth.

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withdraw them. Other benefits include avoiding the early distribution penalty on certain withdrawals, and avoiding the need to take minimum distributions after age 70½." *Roth IRA 101*, (last visited Mar. 9, 2006) <http://www.fairmark.com/rothira/roth101.htm>.

[5] A qualified plan is established by an employer to provide retirement benefits for employees and their beneficiaries." *401(k) and Qualified Plans: Introduction*, (last visited Mar. 9, 2006) <http://www.investopedia.com/university/retirementplans/qualifiedplan/>.

[6] 26 U.S.C. s. 4975.

[7] 26 U.S.C. s. 4975(c)(1).

[8] 26 U.S.C. s. 4975(e)(2).

There are additional pitfalls which involve possible Unrelated Business Income Tax ("UBTI"). Retirement plan income that is generated from a trade or business regularly carried on by such account that is not substantially related to its tax-exempt purpose could be subject to UBTI, which is ordinary income at the trust tax rate, payable by the IRA account. Leveraging of real estate can create Unrelated Debt-Financed Income ("UDFI").

Current law

Under common law, an IRA meets the simplest definition of a trust, insofar as it is required that one person hold property for the benefit of another. The trustee or custodian must generally be a financial institution, unless the trustee can demonstrate to the IRS that it is capable of administering an IRA. Although the IRS considers all IRA custodians to be trustees as well, most IRA agreements offer a choice of some sort of institutionally managed product ("bank-managed") or what is referred to as a "self-directed" account. In the bank-managed product, the IRA owner is asked to select an investment objective and then allows the institution to make investment decisions and trade on the account based upon the investment objective established by the IRA owner. In contrast, a self-directed account will have all of the investments chosen by the IRA owner. Sometimes self-directed IRA accounts will be invested in traditional stocks and bonds because perhaps the IRA owner has the skill and experience to pick and choose the investments of the account. In other situations, these accounts are invested in alternative types of investments, such as LLCs, limited partnerships, mortgage receivables, promissory notes, or real property. On rare occasions, it is possible to find an alternative investment within a bank-managed IRA because the IRA owner has instructed the trustee or custodian to purchase and/or retain the asset, but it is important to note that alternative investments are not products traditionally sold to IRA owners within the context of a bank-managed IRA relationship.

Section 408(h) of the Internal Revenue Code expressly states that IRA custodial accounts are treated as IRA trusts so long as the assets of the account are held by a bank, trust company or other specified entity, and that an IRA custodian is treated as a trustee for all Code purposes. In the event that federal taxes (UBIT or UDFI) are imposed on an IRA, the IRA is taxed at the trust tax rate.

The bill seeks to clarify how title is taken in regard to self-directed IRAs. Several title companies have taken the position that if the IRA has a custodian as opposed to a trustee, the IRA is no more than a passive trust under the Statute of Uses,[9] and therefore the title cannot vest in the custodian or the

[9] "The Statute of Uses was enacted in 1535 to remedy the problems caused by dual legal and equitable ownership of land. Equitable ownership had arisen as a means of avoiding the legal requirements of land transfer and the feudal incidents of legal land ownership. The statute provided that anyone with beneficial ownership of land should henceforth be deemed to be the legal owner." *Chase Fed. Sav. And Loan Ass'n. v. Schreiber*, 479 So. 2d 90, 97 (Fla. 1986).

Florida's version of the Statute of Uses, in s. 689.09, F.S., provides:

> By deed of bargain and sale, or by deed of lease and release, or of covenant to stand seized to the use of any other person, or by deed operating by way of covenant to stand seized to the use of another person, of or in any lands or tenements in this state, the possession of the bargainor, releasor or covenantor shall be deemed and adjudged to be transferred to the bargainee, releasee or person entitled to the use as perfectly as if such bargainee, releasee or person entitled to the use had been enfeoffed by livery of seizin of the land conveyed by such deed of bargain and sale, release or covenant to stand seized; provided, that livery of seizin can be lawfully made of the lands or tenements at the time of the execution of the said deeds or any of them.

In other words,

> In Florida, a modified version of the early English common-law statute of uses is in effect. The statute operates, when a conveyance of land to a trustee merely creates a dry, naked, passive trust, no active duties being imposed on the trustee, to vest both legal and equitable title in the beneficiary. The beneficiary becomes seised of the legal estate, and the statute of uses is said to "execute the trust." Similarly, when no intention to the contrary appears, an active trust will not be continued beyond the

account and would vest in the IRA owner. Such a position could have a negative impact in certain retirement investors.

On the surface one would assume that qualified plans would not be potentially impacted by this interpretation because they require a trust agreement; however, depending upon the document, if the plan allows the participant to direct the investments, there is the potential that a similar result might occur under current state law within a plan context.

Currently the only exception to the Statute of Uses that allows a custodian to take title is found in the Florida Uniform Gift to Minors Act (s. 710.111(1)(e), F.S.). There has never been a proper method for taking title to real estate in IRAs or qualified plans prescribed in the Florida Statutes, and similarly there is not currently an exception for same under the Statute of Uses.

Effect of bill

The bill would carve out an exception for IRAs and Qualified Plans and prescribe the correct manner in which title should be taken to real property purchased within these accounts. The bill is not determinative as to whether an IRA is considered a trust under state law, but rather provides a manner for taking title by creating an exception to the Statute of Uses.

The bill provides clarification as to taking title to real property in IRAs and qualified plans by covering all title taken in a manner consistent with the Statute of Uses, whether previously recorded or not, setting forth a template for vesting title to IRA custodians and trustees as well as Qualified Plan custodians and trustees. The bill grants powers to the custodian or trustee and allows further disposition of the property by the custodian or trustee without the joinder of the beneficiary, except in the case of a revocation or termination.[10] This presumes that the custodian or trustee will obtain whatever type of authorization they need from the IRA owner or qualified plan participant subject to the terms of the contractual agreement between the parties.

The bill allows third parties to rely on the powers of the custodian or trustee regardless of whether the powers clause is recorded on the deed, and third parties have no duty to inquire as to the qualifications of the trustee or custodian.[11] Title conveyed under this section by a custodian or trustee will be taken free and clear of the claims of the IRA owner, plan participant or beneficiary.[12] The bill also provides that if notice of revocation or termination of an IRA or qualified plan is recorded, any disposition or encumbrance of such property will be executed by the custodian or trustee and will require the joinder of the IRA owner or plan participant, provides that the standard of care for a custodian or trustee will be that observed by a prudent person dealing with property of another and does not impose fiduciary duties on a custodian that they would not otherwise bear, but despite the remedial nature of the statute will not relieve a custodian or trustee for breach of a contractual agreement with the IRA owner or plan participant.[13]

Further, the bill provides that when a provision is recorded that declares the interest to be personal property, that provision will be controlling for state law purposes, defines IRAs and qualified plans pursuant to the Internal Revenue Code, and defines beneficiaries to only be applicable when the IRA owner or qualified plan participant is deceased. It specifically excludes transfers under this section

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purposes of its creation as set forth in the trust instrument. When these purposes are accomplished, the trust estate ceases to exist and the trustee's title becomes extinct. The interest given by the operation of the statute of uses will be as effective as that which would be passed by the trustee's deed, except that the latter may make the grantee's chain of title clearer.

55A Fla. Jur. 2d, Trusts, s. 6.

[10] Section 689.072(2).
[11] Section 689.072(3).
[12] Section 689.072(4).
[13] Section 689.072(6).

from the Statute of Uses,[14] and proposes that this section will be remedial in nature and should be given liberal interpretation.[15]

C. SECTION DIRECTORY:

Section 1, creates s. 689.072, which carves out an exception for IRAs and Qualified Plans and prescribes the correct manner in which title should be taken to real property purchased within these accounts.

Section 2, provides an effective date of July 1, 2006.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

None.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

This bill does not appear to require counties or municipalities to take an action requiring the expenditure of funds, reduce the authority that counties or municipalities have to raise revenue in the aggregate, nor reduce the percentage of state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

[14] Section 689.072(9)(b).
[15] Section 689.072(10).

C. DRAFTING ISSUES OR OTHER COMMENTS:

It appears the language on line 54 is unclear. Possibly the first "the" in that line should be changed to a "that."

IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES

None.