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.)

Prepared By: Judiciary Committee

BILL:	SB 1434
INTRODUCER:	Senator Atwater
SUBJECT:	Conveyances of Land
DATE:	March 21, 2006
REVISED:	03/23/06

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Chinn	Maclure	JU	**Fav/1 amendment**
2.			BI	
3.				
4.				
5.				
6.				

Please see last section for Summary of Amendments

- [ ] Technical amendments were recommended
- [X] Amendments were recommended
- [ ] Significant amendments were recommended

I. Summary:

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 creates section 689.072, Florida Statutes.

II. Present Situation:

Background[1]

The Employee Benefit Research Institute estimates there is in excess of $12 trillion dollars in retirement assets currently in this country. Individual retirement accounts (IRAs) and other qualified plans[2] are the second most popular type of account per household, behind the family checking account.

An IRA is a trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries, but only comes into existence if the written governing instrument meets the requirements set forth in the Internal Revenue Code.[3] Usually, IRAs and qualified plans are developed with the code in mind and, as such, are governed primarily by federal law. An exception to the blanket application of federal law to IRAs is found within the limited context of state real property law.

Internal Revenue Rules

IRAs are created under s. 408 of the Internal Revenue Code (IRC).[4] IRAs can be created by contribution, subject to annual dollar limits, or by rollover from a qualified plan; the written governing instrument creating the IRA must contain certain provisions under s. 408 of the IRC that vary based upon whether the plan is created by contribution or by rollover.

The Internal Revenue Service (IRS) has issued forms 5305[5] and 5305A[6] 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.[7] The IRA owner cannot normally take out distributions prior to age 59½ without a penalty, and except in the case of a Roth IRA,[8] must start taking distributions out by

[1] The bulk of this analysis is derived from materials supplied by the Real Property, Probate, and Trust Law Section of the Florida Bar.
[2] E.g., individual retirement annuity, simplified employee pension (SEP), and employer and employee association trust accounts. See United States Department of the Treasury, Internal Revenue Service, *Publication 590 (2005), Individual Retirement Arrangements*, ch. 1, *available at* http://www.irs.gov/publications/p590/ch01.html.
[3] 26 U.S.C. s. 408(a).
[4] 26 U.S.C. s. 408.
[5] See United States Department of the Treasury, Internal Revenue Service, *Form 5305, available at http://www.irs.gov/pub/irs-pdf/f5305.pdf.*
[6] See United States Department of the Treasury, Internal Revenue Service, *Form 5305A, available at http://www.irs.gov/pub/irs-pdf/f5305a.pdf.*
[7] See United States Department of the Treasury, Internal Revenue Service, *Publication 590 (2005), Individual Retirement Arrangements*, ch. 1, *available at* http://www.irs.gov/publications/p590/ch01.html.
[8] "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 withdraw them. Other benefits include avoiding the early distribution penalty on certain withdrawals, and eliminating the need to take minimum distributions after age 70½." Roth IRA 101, http://www.fairmark.com/rothira/roth101.htm (last visited Mar. 21, 2006).

April 1st of the year after the year in which they turn 70½.[9] 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[10] 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 (IRC) deals with prohibited transactions, and the main focus of this section is self-dealing.[11] 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 of the IRC addresses what is prohibited, subject to exceptions, including:[12]

- 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 an IRA.

A "Disqualified Person" as defined under Internal Revenue Code s. 4975 includes, but is not limited to, the following:[13]

- a fiduciary;
- the IRA owner;
- the IRA owner's spouse;

[9] Id.
[10] "A qualified plan is established by an employer to provide retirement benefits for employees and their beneficiaries." *401(k) and Qualified Plans: Introduction*, http://www.investopedia.com/university/retirementplans/qualifiedplan/ (last visited Mar. 21, 2006). See, e.g., *supra* note 2.
[11] 26 U.S.C. s. 4975.
[12] 26 U.S.C. s. 4975(c)(1). Exceptions to the prohibited transactions are provided in 26 U.S.C. s. 4975(c)(2).
[13] 26 U.S.C. s. 4975(e)(2). See this section for a listing of all disqualified persons under the code.

- 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; and
- any corporation, partnership, trust or estate in which the IRA owner individually has a 50 percent 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 achieve tax-deferred growth.

Apart from the prohibited transactions listed above, 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

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. 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. In the event that federal taxes (UBIT or UDFI) are imposed on an IRA, the IRA is taxed at the trust tax rate.

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,[14] and therefore the title

[14] "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

cannot vest in the custodian and would vest in the IRA owner. Such a position could have a negative impact on certain retirement investors. It would seem that qualified plans would not be affected by this interpretation because they require a trust agreement; however, if the plan allows the participant to direct the investments, similar to a passive trust, there is the potential that a similar result might occur[15] 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.[16] There is no explicit 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 the same under the Statute of Uses.

III. Effect of Proposed Changes:

The bill would carve out an exception to the Statute of Uses for individual retirement accounts (IRAs) and qualified plans and prescribe the correct manner in which title should be taken to real property purchased within these accounts. The bill does not address whether an IRA is considered a trust under state law, but rather it provides a manner for custodians and trustees to take title for property held in IRAs and qualified plans.

The bill provides clarification as to taking title to real property in IRAs and qualified plans by 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 of the IRA, qualified plan, or custodianship.[17] 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.

> 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 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.

[15] I.e., the title stays vested with the plan investor.

[16] Section 710.111(1)(e), F.S.

[17] Section 689.072(2).

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.[18] In addition, the grantee, mortgagee, lessee, transferee, assignee, or person obtaining a satisfaction or release or otherwise dealing with the custodian or trustee is not required to inquire into:

- The identification or status of any named IRA owner, plan participant, or beneficiary of the IRA or plan or his or her heirs or assigns to whom the custodian or trustee may be accountable under the IRA agreement or qualified plan document;
- The authority of the custodian or trustee to act within and exercise powers granted under the IRA agreement or qualified plan document;
- The adequacy or disposition or any consideration provided to the custodian or trustee in connection with any interest acquired from such custodian or trustee; or
- Any provision of an IRA or qualified plan document.

Any title conveyed under the new section by a custodian or trustee will be taken free and clear of the claims of the IRA owner, plan participant, or beneficiary.[19]

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 must be executed by the custodian or trustee and will require the joinder of the IRA owner or plan participant

The standard of care that must be observed by a custodian or trustee of an IRA or qualifying plan is that of a prudent person dealing with property of another and does not impose fiduciary duties on a custodian or trustee that one would not otherwise bear. In the same vein, custodians and trustees are subject to liability for breach of the IRA agreement, custodial agreement, or qualified plan document.[20]

With respect to the applicability of certain provisions to transactions under the newly created section, the bill provides the following:

- When a provision is recorded that declares the interest to be personal property, that provision will be controlling if it is necessary for a court proceeding;[21]
- When the term "beneficiary" is used with relation to the provisions of this section, it applies only when the individual account owner or qualified plan participant is deceased;[22] and
- When a transfer of real property interests to a custodian or trustee occurs under this section, it is not subject to the provisions of the Statute of Uses.[23]

[18] Section 689.072(3).
[19] Section 689.072(4).
[20] Section 689.072(6).
[21] For favorable federal income tax treatment, it is assumed that the IRA or plan owner would not want to hold title to the property.
[22] Section 689.072(8).
[23] Section 689.072(9).

There is no explicit provision that provides for retroactivity in applying the new section to transfers involving existing IRAs or qualifying plans. There is, however, language that provides that the newly created section is "remedial in nature." [24] A law that is remedial in nature is a law that is "passed to correct or modify an existing law; esp., a law that gives a party a new or different remedy when the existing remedy, if any, is inadequate."[25] This language, combined with the statement that the new section be "liberally construed to effectively carry out its purposes,"[26] could be interpreted by a court to provide an implicit direction for retroactive application, should the matter ever be challenged.

The bill provides an effective date of July 1, 2006.

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 bill codifies what has already been an investment practice of some individual retirement account owners and beneficiaries of qualified plans. Thus, the bill would provide a safe harbor for investors already conducting practices outlined in the bill. With more clarity in the law relating to investment of individual retirement account and qualified plan funds, it may encourage more private investment of these funds.

C. Government Sector Impact:

None.

[24] Section 689.072(10).
[25] Black's Law Dictionary (8th ed. 2004).
[26] Section 689.072(10).

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

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

VIII. Summary of Amendments:

Barcode 092110 by Judiciary:
Provides that new s. 689.072, F.S., does not apply to any deed, mortgage, or instrument to which existing s. 689.071, F.S., applies. (WITH TITLE AMENDMENT)

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