

**HOUSE OF REPRESENTATIVES STAFF ANALYSIS**

**BILL #:** HB 379

Florida Uniform Principal and Income Act

**SPONSOR(S):** Wood

**TIED BILLS:** None

**IDEN./SIM. BILLS:** SB 1222

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	<b>REFERENCE</b>	<b>ACTION</b>	<b>ANALYST</b>	<b>STAFF DIRECTOR</b>
1)	Civil Justice & Courts Policy Committee	7 Y, 0 N	Bond	De La Paz
2)	Insurance, Business & Financial Affairs Policy Committee	20 Y, 0 N	Reilly	Cooper
3)	Criminal & Civil Justice Policy Council		Bond	Havlicak
4)				
5)				

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**SUMMARY ANALYSIS**

The Florida Uniform Principal and Income Act provides a means for allocating monies held in trust between principal and income where the terms of the trust do not provide for allocation. This bill amends the allocation under the Act for payments from deferred compensation plans, annuities, and retirement plans or accounts in order to allow marital deduction trusts to continue to receive favorable federal estate tax treatment.

This bill provides an effective date of July 1, 2009, and does not appear to have a fiscal impact on state or local governments.

## HOUSE PRINCIPLES

Members are encouraged to evaluate proposed legislation in light of the following guiding principles of the House of Representatives

- Balance the state budget.
- Create a legal and regulatory environment that fosters economic growth and job creation.
- Lower the tax burden on families and businesses.
- Reverse or restrain the growth of government.
- Promote public safety.
- Promote educational accountability, excellence, and choice.
- Foster respect for the family and for innocent human life.
- Protect Florida's natural beauty.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. EFFECT OF PROPOSED CHANGES:

##### **Background**

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. 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). The trustee and the personal representative satisfy their obligations by making the proper allocations of assets to either principal or to income. Generally, assets allocated to principal serve the interests of remainder beneficiaries of a trust, and the interests of the final distributees of the assets in an estate. Assets allocated to income meet the requirements of income beneficiaries during the life of a trust, and those beneficiaries who must be paid out of the income derived during administration of an estate.<sup>1</sup>

The Florida Uniform Principal and Income Act is modeled after the Uniform Principal and Income Act. Section 738.602, F.S., is a part of the Florida Uniform Principal and Income Act. This section allocates payments from deferred compensation plans, annuities, and retirement accounts between principal and income.

Section 738.602, F.S., provides that income is either any payment specifically characterized by the payor as interest or dividends or as a payment made in lieu of interest or dividends; or is any other payment to the extent that the trustee, reasonably and in good faith, determines that such payment represent interest, dividends, or their equivalent. Any receipt of monies not determined to be income must be allocated to principal. If a trustee cannot determine whether a payment is principal or income, and all or part of the payment is required to be made, the trustee must allocate 10 percent to income and the remainder to principal. This does not apply to a payment where the trustee requested the payment (i.e., to a withdrawal for the purpose of reinvesting in a different account). A trustee must allocate more to income if such additional amount is required for the trust to obtain an estate tax marital deduction (i.e., for a QTIP trust).

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<sup>1</sup> Summary of the Uniform Principal and Income Act, at [http://www.nccusl.org/Update/uniformact\\_summaries/uniformacts-s-upaia1997.asp](http://www.nccusl.org/Update/uniformact_summaries/uniformacts-s-upaia1997.asp) .

A qualified terminal interest property trust, commonly referred to as a "QTIP trust," is a popular device that allows an individual to provide a surviving spouse with the income from (or use of) property undiminished by estate taxes for life, while ensuring that the individual's wishes will be followed after the death of the spouse.<sup>2</sup> This is accomplished by qualifying the trust property for the estate tax marital deduction, even though a terminable interest exists. Many persons fund QTIP trusts with retirement assets remaining upon their death. Florida estate planning attorneys are concerned that some Florida trusts intended to be QTIP trusts may not qualify for QTIP treatment because of a conflict between federal tax law and the provisions of s. 738.602, F.S.<sup>3</sup>

## Effect of Bill

This bill amends and expands s. 738.602, F.S., to provide for favorable federal income tax treatment of marital deduction (QTIP) trusts. The allocation of a payment is either by the general rule at subsection (4), or the special rule applicable to marital trusts at subsection (5).

The general rule for allocation of payments is similar to the allocation found under current law. Where the payor designates the portions of a payment as income and principal, that controls. Where the trustee can reasonably determine income and principal, that controls. If neither of these provisions apply, then a required payment is split 10% to income and the remainder to principal, and a non-required payment is 100% principal.

As to a marital deduction trust, the bill provides that that the general rule does not apply and instead the trustee must pay the spouse all of the income of the trust. The assets of the trust are broken into funds, which are defined as being either separate or nonseparate.

A "separate account" is defined by the bill as a fund holding assets exclusively for the benefit of a participant or account owner, and either the value of the account can be determined at any time or the fund maintains records that show receipts and disbursements regarding the assets of the fund. A "nonseparate account" is defined as a fund where the value can only be determined by the occurrence of a date or event defined by the fund.

This bill provides that the trustee of a trust may elect one of two methods of determining the income of a separate account. One method is by ordinary trust principles. The other method is by a unitrust<sup>4</sup> formula whereby the fair market value of the fund at the beginning of the trust period is multiplied by the percentage calculated under s. 738.1041(2)(b)2.a., F.S.<sup>5</sup> A trustee changing the method must notify the beneficiary.

This bill provides that income of a nonseparate account is calculated on a unitrust basis as follows: The value of the account is determined by calculating the present value of the future income stream, calculated pursuant to the present value formula in the Internal Revenue Code. The income is then

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<sup>2</sup> A common use of this trust is for the creator of the trust to provide that income from the trust will be distributed to the creator's spouse during the spouse's life, and the remainder paid to a child or children of the individual (who are not a child or children of the surviving spouse) after the death of the surviving spouse. In other words, the children from the first marriage get all of the remaining money, but only after their stepmother/stepfather dies.

<sup>3</sup> In Revenue Ruling 2006-26, the IRS denied QTIP treatment in a situation where the trustee was relying on the 10% default rule. The ruling was predicated on the IRS determination that the 10% was too arbitrary to be sufficient for qualifying a trust for QTIP treatment.

<sup>4</sup> A "unitrust" is a trust "from which a fixed percentage of the net fair market value of the trust's assets, valued annually, is paid each year to the beneficiary." Black's Law Dictionary, 6th edition. A trustee may convert a trust between traditional and unitrust forms of trust. Section 738.1041(2), F.S.

<sup>5</sup> Section 738.1041(2)(b)2.a., F.S., provides that the "percentage used to calculate the unitrust amount is 50 percent of the applicable federal rate as defined in the Internal Revenue Code, 26 U.S.C. s. 7520, in effect for the month the conversion under this section becomes effective and for each January thereafter; however, if the percentage calculated exceeds 5 percent, the unitrust percentage shall be 5 percent and if the percentage calculated is less than 3 percent, the unitrust percentage shall be 3 percent."

determined by multiplying the calculated present value by percentage calculated under s. 738.1041(2)(b)2.a., F.S.

The provisions of amended s. 738.602, F.S., do not apply to liquidating assets, which are governed by s. 738.603, F.S. A liquidating asset is an asset the value of which will diminish or terminate because the asset is expected to produce receipts for a period of limited duration.

**B. SECTION DIRECTORY:**

Section 1 amends s. 738.602, F.S., regarding payments from deferred compensation plans, annuities, and retirement plans or accounts.

Section 2 provides an effective date of July 1, 2009.

**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:**

Tax avoidance is a common theme in most trusts. This bill may help both current beneficiaries and future beneficiaries benefit from favorable tax treatment of a trust by minimizing federal tax burdens.

**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.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

**IV. AMENDMENTS/COUNCIL OR COMMITTEE SUBSTITUTE CHANGES**

None.