

**HOUSE OF REPRESENTATIVES STAFF ANALYSIS**

**BILL #:** CS/HB 361 Trust Administration  
**SPONSOR(S):** Criminal & Civil Justice Policy Council; Wood  
**TIED BILLS:** None **IDEN./SIM. BILLS:** CS/SB 998

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	<b>REFERENCE</b>	<b>ACTION</b>	<b>ANALYST</b>	<b>STAFF DIRECTOR</b>
1)	Civil Justice & Courts Policy Committee	11 Y, 0 N	Bond	De La Paz
2)	Policy Council	15 Y, 0 N	Varn	Ciccone
3)	Criminal & Civil Justice Policy Council	12 Y, 0 N, As CS	Bond	Havlicak
4)				
5)				

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**SUMMARY ANALYSIS**

A trust is a legal entity created by a settlor for the benefit of one or more beneficiaries. Trusts are highly regulated, and are complicated by their relationship to federal tax laws and probate laws. This bill amends trust law, and probate law related to trusts, to:

- Specify how a trust may be assessed the expenses and obligations of the estate of the settlor.
- Provide that a court may deny compensation to an expert testifying as to reasonable compensation.
- Increase the amount of property that may be protected from creditors in certain trusts.
- Applicable to this year's temporary repeal of the federal estate tax, allow a court to modify the terms of a trust where the trust erroneously includes estate tax-related formulas.

This bill 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:

A trust is a legal entity created by a settlor<sup>1</sup> for the benefit of one or more beneficiaries. Trusts are highly regulated, and are complicated by their relationship to federal tax laws and probate laws. This bill amends trust law, and probate law related to trusts.

#### **Apportionment of Expenses and Obligations of an Estate**

Section 733.607(2), F.S., provides that, if a decedent's probate estate assets are insufficient to pay expenses of administering the estate and other obligations, the probate estate can request that the insufficiency be paid from the decedent's revocable trust, if one exists. Similarly, s. 733.707(3), F.S., provides that a probate estate may require a decedent's revocable trust to pay expenses and obligations of the probate estate. Section 736.05053, F.S., requires the trustee of a trust to comply with the requirement to pay expenses and obligations of the probate estate.

It is unclear from which portion of a revocable trust the payments required by ss. 733.607 and 733.707, F.S., are to be paid. The probate law, at s. 733.805, F.S., provides a means to determine which part of an estate is required to pay for the expenses and obligations of the probate estate (known as "abatement").

This bill amends ss. 733.607(2) and 733.707(3), F.S., to specifically reference the requirement in s. 736.05053, F.S., and to provide that the abatement provisions of the probate code at s. 733.805, F.S. apply to a revocable trust when that trust must pay expenses and obligations of a probate estate. This bill also amends s. 736.05053, F.S., to specifically provide that abatement applies to a revocable trust in the same manner as it applies to the probate estate. These changes conform to the provision in s. 733.805(4), F.S., that provides that a decedent's will and revocable trust be construed as one common instrument.

#### **Compensation of Trust Professionals**

The compensation of any person employed by a trust, including the trustee and professionals employed by the trustee (usually accountants and lawyers), is subject to court supervision and review. Section 736.0206(1), F.S., requires that all interested parties must be given notice of an application for

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<sup>1</sup> The settlor contributes the property to be managed and eventually distributed by the trust. The settlor also creates the trust instrument that names the beneficiaries of the trust and provides for management of the trust.

compensation. This bill removes the statutory requirement that all interested persons be given notice of an application for compensation. Current court rules require notice to all interested parties of all matters<sup>2</sup>, including an application for compensation of any person.<sup>3</sup> Unless the court rules are changed, this statutory change will have no effect.

In general, the court is not required to obtain expert testimony to justify a request for compensation. If a party objects to compensation, one or more of the parties may employ an expert witness to testify as to the reasonableness of the compensation. If an interested party objects to compensation of any person, s. 736.0206(5), F.S., requires the trust to pay an expert witness fee should an expert testify. This bill amends s. 736.0206(5), F.S., to provide that the court does not have to award compensation to an expert witness if the testimony did not assist the court.

This bill also repeals the attorney's fees provisions at ss. 736.1007(7), and 736.1007(9), F.S., that are duplicative of the provisions regarding compensation of any person at s. 736.0206, F.S.

### **Creditor Claims Against Trust Assets**

Traditionally, self-settled trusts have been treated harshly when it comes to creditors' rights. This follows from a widely accepted public policy maxim that an individual should not be permitted to put property in a trust for his or her own benefit and thereby escape creditor claims. Section 736.0505(1), F.S., provides that, whether or not a trust includes a spendthrift provision<sup>4</sup>:

- While the trust is revocable, the trust property is subject to the claims of the settlor's creditors; and
- In the case of an irrevocable trust, a settlor's creditor or assignee may reach the maximum that can be distributed to or for the benefit of the settlor. Notwithstanding this ability, the assets of the trust are not subject to the creditor's or assignee's claims merely because the trustee possesses the power to pay tax liabilities of the settlor.

Additionally, s. 736.0505(2)(a), F.S., provides that a person holding a power of withdrawal (the right to demand money from the trust) is treated the same as a settlor of the trust for purposes of the claims of creditors of the person holding that power. While the power of withdrawal is available, the full amount subject to withdrawal may be garnished by a creditor of a person holding the power. Upon the lapse, release, or waiver of the power of withdrawal, however, s. 736.0505(2)(b), F.S., provides that a creditor may only claim the amount that could have been withdrawn that was in excess of the greater of the federal gift tax exclusions.

#### *Increase in Protected Amount Related to Gift Tax Exclusion*

The United States tax code imposes an estate tax on transfers of property upon the death of an individual. The most obvious tax avoidance scheme to an estate tax is for a person to, while alive, give his or her property as gifts to the future beneficiaries. The intent of the gift tax law is to impose a tax on such gifts that is roughly equal to the future estate tax, thereby discouraging tax avoidance behavior.

The creation and funding of a trust is a gift to the beneficiaries. Trusts are commonly used in estate planning, and persons of sufficient wealth craft such trusts in a manner intended to minimize tax consequences. Section 736.0505(2)(b)2., F.S., references 26 U.S.C. s. 2503(b), which contains the most commonly used and commonly know exclusion to the gift tax law. That section excludes from the gift tax gifts to any one individual in a calendar year that are less than the exclusion amount. For a long

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<sup>2</sup> Florida Probate Rule 5.041(a).

<sup>3</sup> Florida Probate Rule 5.355.

<sup>4</sup> A spendthrift provision in a trust instrument is a provision by which a beneficiary has no control over trust distributions and distributions to the beneficiary are only made at the discretion of the trustee. Creditors of a beneficiary subject to a spendthrift provision may not attach the assets of the trust, although they may be able to garnish a distribution should the trustee elect to make a distribution to the beneficiary.

time, that amount was fixed at \$10,000. The sum has been inflation adjusted, and is currently \$13,000. It applies to a gift from one individual to another.

This bill amends the reference to the gift tax exclusion at 26 U.S.C. s. 2503(b) to provide that, where the donor was married at the time of the transfer to which the power of withdrawal applies, the assumption is that both spouses made a gift and the protected amount is twice that of an individual donor.

### *Protected Amounts Related to Spousal Trusts*

It is common in estate tax planning to create certain trusts between spouses to minimize tax consequences. The bill references 26 U.S.C. s. 2523(e) and 26 U.S.C. s. 2523(f). 26 U.S.C. s. 2523 relates to gift tax deductions applicable to transfers between spouses. A trust described under s. 2523(e) is a trust that is a life estate with a power of appointment in the donee spouse. The trust must pay all of the interest or earnings to the donee spouse to apply. Section 2523(f) relates to an election to treat a trust as a QTIP trust (qualified terminable interest property trust). A QTIP trust is a means by which a spouse can make a lifetime gift to the other spouse made for the purpose of maximizing marital deductions applicable to the estate and gift taxes, yet still maintain control of the assets in the trust, provided the donee spouse is entitled to the earnings of the trust.

Many estate planners recommend QTIP trusts to allow for the full use of the donee spouse's estate tax exemption without compromising the ability of the donor to control the disposition of the trust assets after the death of the donee spouse. However, it is argued that retaining that power of appointment makes the trust subject to continuing claims of creditors of the donor. For this reason, some donors have been unwilling to create a QTIP trust under Florida law, preferring to move such trusts to states where creditor protection has been created by statute.<sup>5</sup>

This bill adds subsection (3) to s. 736.0505, F.S., related to spousal trusts. It provides that, as to trusts under 26 U.S.C. s. 2523(e) and 26 U.S.C. s. 2523(f), upon the death of the settlor's spouse, the assets are considered to have been contributed by the settlor's spouse and not by the settlor. As the form of such trusts make them non-revocable as of the death of a spouse, this appears to have the effect of allowing certain self-settled trusts to protect assets from creditors upon the death of a spouse. The bill further provides, however, that this protection does not apply if the funding of the trust was a fraudulent conveyance, as such is defined in the fraudulent conveyance law at s. 726.105, F.S.

### **Trust Interpretation Related to the Federal Estate Tax**

Wills and trust agreements (both revocable and irrevocable) frequently contain provisions designed to eliminate, minimize or defer payment of the federal estate tax and the federal generation-skipping transfer tax. These provisions are usually phrased not in terms of fixed-dollar amounts but, instead, in terms of a formula intended to produce the optimal result under the law prevailing at the time for application of the formula (usually, but not always, at the death of the testator, testatrix or trust settlor).

In 2001, Congress enacted a general phase-out of the estate tax (and related taxes such as the gift tax and the generation skipping tax), although the phase out is only applicable for 2010, with such taxes returning (with different rates and exemptions) in 2011. For poorly drafted trusts that do not take into account the suspension of the taxes, it is unclear how such formulas in trusts will be interpreted. For example, a formula phrased in terms of "the most I can pass free from estate taxes at my death" can result in an unintended disinheriting of the surviving spouse if the decedent's children are to receive the formula amount (in 2010, everything) and the surviving spouse is to receive the balance (in 2010, nothing). A probate court can, under current law, modify the terms of an existing trust to conform to a settlor's intent, s. 736.04113, F.S., when modification is in the best interests of the beneficiaries, s. 736.04115, F.S., to correct a mistake, s. 736.0415, F.S., or to achieve a settlor's tax objectives, s.

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<sup>5</sup> Real Property, Probate and Trust Law Section of the Florida Bar, *White Paper on Proposed Revision to Florida Statutes Section 736.0505*, undated, received on December 30, 2009. On file with committee staff.

736.0416, F.S. It is likely that one or more affected beneficiaries under these poorly drafted trusts would file an action for modification of the trust.

This bill creates s. 736.04114, F.S., to create a means for judicial construction of an irrevocable trust that includes federal tax provisions. If an irrevocable trust contains a formula-based distribution where the formula is based on federal estate tax provisions, the court may modify the trust to reflect the settlor's probable intent. This section only applies from January 1, 2010 through December 31, 2010, or through the date that the federal government reinstates the estate tax, whichever comes first. A trustee that withholds distributions pending a determination under this section is not liable to any beneficiary for damages related to the delay in distribution. This provision is specifically retroactive to January 1, 2010.

**B. SECTION DIRECTORY:**

Section 1 amends s. 733.607, F.S., related to possession of an estate.

Section 2 amends s. 733.707, F.S., related to the order of payment of expenses and obligations of an estate.

Section 3 amends s. 736.0206, F.S., related to compensation of professionals employed by a trust.

Section 4 creates s. 736.04114, F.S., related to judicial interpretation of trusts with federal tax provisions.

Section 5 amends s. 736.0505, F.S., related to creditor claims against the settlor of a trust.

Section 6 amends s. 736.05053, F.S., related to a trustee's duty to pay expenses and obligations of a settlor's estate.

Section 7 amends s. 736.1007, F.S., related to trustee's attorney's fees.

Section 8 provides an effective date of July 1, 2010.

**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.

#### **C. DRAFTING ISSUES OR OTHER COMMENTS:**

None.

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

On February 2, 2010, the Criminal & Civil Justice Policy Council adopted one amendment to this bill. The amendment added the provisions regarding interpretation of trusts in light of the short-term repeal of the federal estate tax. The bill was then reported favorably as a council substitute.