

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** CS/HB 1089 Trusts  
**SPONSOR(S):** Civil Justice Subcommittee, Caruso  
**TIED BILLS:** **IDEN./SIM. BILLS:** CS/SB 1366

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Civil Justice Subcommittee	13 Y, 0 N, As CS	Mawn	Luczynski
2) Ways & Means Committee	17 Y, 0 N	Keller	Langston
3) Judiciary Committee	15 Y, 0 N	Mawn	Luczynski

### SUMMARY ANALYSIS

A trust is a relationship in which one person (“settlor”) holds title to property under an obligation to keep or use the property for the benefit of another (“beneficiary”). In certain situations, a settlor, called in these cases a “grantor,” may be treated as a trust’s owner for federal income tax purposes. Such a trust is called a “grantor trust.” A grantor must report all of the grantor trust’s income, losses, deductions, and credits on his or her individual income tax return and pay any taxes on the grantor trust’s income even if the grantor has no beneficial interest in the trust.

Florida law currently allows a trustee to reimburse the grantor for income taxes attributable to grantor trust income if the trust instrument specifically provides for such reimbursement. However, such a provision is unlikely to appear in any grantor trust instrument created before Florida’s reimbursement statute took effect on July 1, 2007, given the state of Florida’s trust law before that date. Thus, the parties to a pre-2007 Florida grantor trust must decide between forcing a grantor to continue bearing the trust’s income tax burden or converting to a non-grantor trust and accepting the consequences.

In recent years, some states have enacted legislation empowering a trustee to reimburse a grantor for income taxes attributable to grantor trust income or pay such taxes directly on the grantor’s behalf without an express authorization in the trust instrument. In these states, a trustee not expressly prohibited from making such reimbursements by the trust instrument’s terms may choose to reimburse the grantor or to expressly opt out of doing so.

CS/HB 1089 modernizes Florida’s trust code by allowing, but not requiring, an independent trustee of a grantor trust to reimburse the grantor for all or part of the income tax paid by the grantor and attributable to trust income or to pay such taxes directly on the grantor’s behalf, provided the trust instrument does not explicitly prohibit such tax reimbursements or payments, unless:

- The trustee provides written notice to the grantor and any person who can remove and replace the trustee that he or she elects out of the tax reimbursement and payment provisions at least 60 days before the election takes effect; or
- Applying such provisions would prevent a contribution to a trust from qualifying for, or would reduce, a federal tax benefit under specified circumstances.

Further, the bill provides that if a trust’s terms require the trustee to act at the direction or with the consent of a trust advisor or any other person, or that tax reimbursements or payments be made directly by a trust advisor or any other person, the trustee’s powers granted by the bill must instead or also be granted to such person. Additionally, the bill specifies that a person may not be considered a grantor trust beneficiary due solely to implementation of the tax reimbursement or payment provision.

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

The bill provides an effective date of July 1, 2020.

# FULL ANALYSIS

## I. SUBSTANTIVE ANALYSIS

### A. EFFECT OF PROPOSED CHANGES:

#### Grantor Trusts

A trust is a relationship in which one person (“settlor”) holds title to property, subject to an obligation to keep or use the property for the benefit of another (“beneficiary”), formed under the laws of the state in which it is organized.<sup>1</sup> In certain situations, a settlor may be treated as the trust’s owner for federal income tax purposes. Specifically, a settlor is treated as the trust’s owner when:

- The settlor has a reversionary interest<sup>2</sup> in the trust corpus<sup>3</sup> or its income if, at the trust’s inception, the value of such interest<sup>4</sup> exceeded five percent of the trust’s value.<sup>5</sup>
- The beneficial enjoyment of the trust corpus or its income is subject to a power of disposition exercisable by the grantor or a non-adverse party,<sup>6</sup> or both, without any adverse party’s<sup>7</sup> consent.<sup>8</sup>
- A power exercisable by the grantor or a non-adverse party, or both, enables the settlor:
  - To purchase, exchange, or otherwise deal with or dispose of the corpus or its income for less than adequate consideration;<sup>9</sup> or
  - To borrow the corpus or income without adequate interest or security.<sup>10</sup>
- The settlor has directly or indirectly borrowed the corpus or income and has not completely repaid the loan, including any interest, before the beginning of the taxable year.<sup>11</sup>
- The power to re-vest title to the trust in the settlor is exercisable by the trust or a non-adverse party, or both.<sup>12</sup>
- The settlor’s income is, or in the discretion of the settlor or a non-adverse party, or both, may be:
  - Distributed to the settlor or the settlor’s spouse;
  - Held or accumulated for future distribution to the settlor or the settlor’s spouse; or
  - Applied to premium payments on life insurance policies on the life of the settlor or the settlor’s spouse.<sup>13</sup>

When a settlor is treated as a trust’s owner for federal income tax purposes, the settlor is referred to as the “grantor” and the trust is referred to as a “grantor trust.”<sup>14</sup> A grantor must report all of the grantor trust’s income, losses, deductions, and credits on his or her individual income tax return and must pay any taxes on the grantor trust’s income even if the grantor has no beneficial interest<sup>15</sup> in the trust.<sup>16</sup>

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<sup>1</sup> Internal Revenue Service, *Definition of a Trust*, <https://www.irs.gov/charities-non-profits/definition-of-a-trust> (last visited Feb. 19, 2020).

<sup>2</sup> A “reversionary interest” is an interest that a person has in the reversion of property, meaning a future interest under which a person retains a present right to a future interest in property that he or she conveys to another. Black’s Law Dictionary 916 (6th ed. 1991).

<sup>3</sup> The “trust corpus” is the property transferred into the trust. Corpus is the latin word for “body.” Legal Information Institute, *Trust Corpus*, [https://www.law.cornell.edu/wex/trust\\_corpus](https://www.law.cornell.edu/wex/trust_corpus) (last visited Feb. 19, 2020).

<sup>4</sup> The value of a settlor’s reversionary interest shall be determined by assuming the maximum exercise of discretion in favor of the settlor. 26 U.S.C. § 673c (2020).

<sup>5</sup> 26 U.S.C. § 673a (2020).

<sup>6</sup> A “non-adverse party” is any person without a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power he or she possesses over the trust. 26 U.S.C. § 672 (2020).

<sup>7</sup> An “adverse party” is any person with a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power he or she possesses over the trust. 26 U.S.C. § 672 (2020).

<sup>8</sup> 26 U.S.C. § 674a (2020).

<sup>9</sup> “Consideration,” necessary to form a contract, is something bargained for and received by a promisor from a promisee. Legal Information Institute, *Consideration*, <https://www.law.cornell.edu/wex/Consideration> (last visited Feb. 19, 2020).

<sup>10</sup> 26 U.S.C. § 675 (2020).

<sup>11</sup> *Id.*

<sup>12</sup> 26 U.S.C. § 676a (2020).

<sup>13</sup> 26 U.S.C. § 677a (2020).

<sup>14</sup> The Florida Coalition for Modern Laws (“FCML”), *White Paper* (2019).

<sup>15</sup> A “beneficial interest” is the right of a party to some profit, distribution, or benefit from a contract or trust. Legal Information Institute, *Beneficial Interest*, [https://www.law.cornell.edu/wex/beneficial\\_interest](https://www.law.cornell.edu/wex/beneficial_interest) (last visited Feb. 19, 2020).

<sup>16</sup> 26 U.S.C. § 671 (2020).

Where a grantor is unable or unwilling to bear the grantor trust's income tax burden, the trust may be converted into a non-grantor trust so that the trust or its beneficiaries bear the tax burden.<sup>17</sup> However, a conversion is not always desirable, as the conversion may make the trust ineligible to own stock in an S corporation<sup>18</sup> or to qualify for a federal capital gains tax exclusion<sup>19</sup> on the sale of the grantor's primary residence.<sup>20</sup> For these reasons, the parties to a grantor trust may want the trust to remain in its current form but relieve the grantor of the tax burden by allowing the trustee<sup>21</sup> to reimburse the grantor for income taxes paid by the grantor and attributable to the trust ("reimbursement").

### Revenue Ruling 2004-64

Prior to 2004, uncertainty over the gift and estate tax consequences of reimbursement led to the omission of reimbursement provisions from many trust instruments.<sup>22</sup> Specifically, trust practitioners worried that such reimbursement may be considered a taxable gift from the trust beneficiaries to the grantor or that, due to a grantor's reimbursement eligibility, trust property may be included in the grantor's gross estate for estate tax purposes.<sup>23</sup> However, in 2004, the Internal Revenue Service issued Revenue Ruling 2004-64, holding that, when an independent trustee has discretionary reimbursement power under the terms of a trust agreement or applicable state law, the exercise of such power will not result in a taxable gift from the beneficiaries to the grantor or by itself cause the value of trust assets to be included in the grantor's gross estate for federal estate tax purposes.<sup>24</sup>

In 2006, the Legislature amended the Florida Trust Code to specifically authorize reimbursement if specifically provided for in the trust instruments.<sup>25</sup> However, such a provision is unlikely to appear in any grantor trust instrument created before Florida's reimbursement statute took effect on July 1, 2007, given the tax uncertainty and the state of Florida's trust law prior to that date.<sup>26</sup> Thus, the parties to a pre-2007 grantor trust organized in Florida must decide between forcing a grantor to continue bearing the trust's income tax burden or converting to a non-grantor trust and accepting the consequences.

### Recent Legislation

In recent years, some states, including Colorado,<sup>27</sup> Delaware,<sup>28</sup> New Hampshire,<sup>29</sup> and New York<sup>30</sup> have authorized a trustee to reimburse a grantor for income taxes attributable to grantor trust income or pay such taxes directly on the grantor's behalf without an express provision in the trust instrument. Instead, a trustee who does not wish to reimburse a grantor for or directly pay the taxes attributable to grantor trust income may opt out of such reimbursements.

### **Effect of Proposed Changes**

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<sup>17</sup> See FCML, *supra* note 14.

<sup>18</sup> An "S corporation" is a corporation that qualifies and elects to be an S corporation under the Internal Revenue Code. S Corporations typically do not pay taxes to the federal government. Instead, most S corporations are taxed indirectly through their shareholders. An S corporation must have a limited number of shareholders, giving rise to the statutory term "small business" or "S" corporation. Legal Information Institute, *S Corporation*, [https://www.law.cornell.edu/wex/s\\_corporation](https://www.law.cornell.edu/wex/s_corporation) (last visited Feb. 19, 2020).

<sup>19</sup> Capital gains are the profit on the sale of a capital asset, such as stock or real estate. If a person sells a primary residence, current tax law lets the seller exclude \$250,000 in profit from capital gains tax. A couple can exclude \$500,000. Legal Information Institute, *Capital Gains*, [https://www.law.cornell.edu/wex/capital\\_gains](https://www.law.cornell.edu/wex/capital_gains) (last visited Feb. 19, 2020).

<sup>20</sup> See FCML, *supra* note 14.

<sup>21</sup> A "trustee" is the person appointed, or required by law, to execute a trust. Black's Law Dictionary 1053 (6th ed. 1991).

<sup>22</sup> A "trust instrument" is an instrument executed by a settlor that contains the trust's terms, which are the manifestation of the settlor's intent regarding a trust. S. 736.0103(21) and (22), F.S.; see also FCML, *supra* note 14.

<sup>23</sup> *Id.*

<sup>24</sup> See Internal Revenue Service, Rev. Rule 2004-64, [https://www.irs.gov/irb/2004-27\\_IRB#RR-2004-64](https://www.irs.gov/irb/2004-27_IRB#RR-2004-64) (last visited Feb. 19, 2020).

<sup>25</sup> See s. 736.0505, F.S.

<sup>26</sup> See FCML, *supra* note 14.

<sup>27</sup> Colo. Rev. Stat. § 15-5-818 (2019).

<sup>28</sup> Del. Code Ann. tit. 12 § 3344 (2019).

<sup>29</sup> N.H. Rev. Stat. § 564-B:8-816(c) (2019).

<sup>30</sup> N.Y. Est. Powers & Trusts Law § 7-1.11(a) (2019).

CS/HB 1089 modernizes Florida's trust code by allowing, but not requiring, an independent trustee<sup>31</sup> of a grantor trust to reimburse the grantor for all or part of the income tax paid by the grantor and attributable to trust income or to pay such taxes directly on the grantor's behalf, provided the trust instrument does not explicitly prohibit such tax reimbursements or payments. The bill applies to all trusts, regardless of when they were created, unless:

- The trustee provides written notice to the grantor and any person who can remove and replace the trustee that he or she intends to irrevocably elect out of the tax reimbursement and payment provisions at least 60 days before the election takes effect.
- Applying the tax reimbursement and payment provisions would prevent a contribution to a trust from qualifying for, or would reduce, a federal tax benefit which was originally claimed, or could have been claimed, for the contribution.<sup>32</sup>

Further, the bill provides that, if a trust's terms require the trustee to act at the direction or with the consent of a trust advisor, a protector, or any other person, or that tax reimbursement or payment decisions be made directly by such a person, the powers granted by the bill to the trustee must instead or also be granted to such person if he or she meets the independence criteria established for trustees. Finally, the bill provides that a person may not be considered a grantor trust beneficiary due solely to implementation of the tax reimbursement or payment provision, including for purposes of determining the elective estate.<sup>33</sup> In other words, a grantor would not become a grantor trust beneficiary simply by receiving tax reimbursement or payment assistance from the trust.

The bill provides an effective date of July 1, 2020.

**B. SECTION DIRECTORY:**

**Section 1:** Creates s. 736.08145, F.S., relating to grantor trust reimbursement.

**Section 2:** Provides an effective date of July 1, 2020.

## **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.

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<sup>31</sup> To be independent under the bill, a trustee must not be treated as a grantor, a beneficiary of the trust, or a related or subordinate party with respect to a grantor or a beneficiary.

<sup>32</sup> Such federal tax benefits include: an exclusion under ss. 2503(b) or 2503(c)m, I.R.C.; a marital deduction under ss. 2506, 2056A, or 2523, I.R.C.; a charitable deduction under ss. 170(a), 642(c), 2055(a), or 2522(a), I.R.C.; direct skip treatment under s. 2642(c), I.R.C.

<sup>33</sup> An "elective estate" includes all probate and non-probate assets of a decedent. A surviving spouse may elect to receive at least 30 percent of the elective estate, i.e., an elective share. See generally ss. 732.201-732.2155, F.S.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill allows a trustee to reimburse or directly pay a grantor's trust-related income tax burden under specified circumstances without converting the trust and losing certain grantor-trust benefits. This may attract trust business to Florida and prevent existing grantor trusts from fleeing to states perceived to be more trust-friendly.

D. FISCAL COMMENTS:

None.

### III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. The bill does not appear to effect counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

### IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On February 4, 2020, the Civil Justice Subcommittee adopted an amendment and reported the bill favorably as a committee substitute. The amendment:

- Provided that specified trustee powers must be granted to a trust advisor, a protector, or any other person if the trust's terms require such a person to make tax payment decisions directly.
- Changed references from "qualified beneficiary" to "beneficiary."
- Clarified that a person may not be considered a grantor trust beneficiary for purposes of determining the elective share simply because he or she receives tax reimbursements or payment assistance from a trust.

This analysis is drafted to the committee substitute as passed by the Civil Justice Subcommittee.