

**The Florida Senate**  
**BILL ANALYSIS AND FISCAL IMPACT STATEMENT**

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

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Prepared By: The Professional Staff of the Committee on Banking and Insurance

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BILL: CS/SB 1366

INTRODUCER: Judiciary Committee and Senator Gruters

SUBJECT: Trusts

DATE: February 18, 2020

REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Stallard</u>	<u>Cibula</u>	<u>JU</u>	<u>Fav/CS</u>
2.	<u>Palecki</u>	<u>Knudson</u>	<u>BI</u>	<u>Pre-meeting</u>
3.	_____	_____	<u>RC</u>	_____

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**Please see Section IX. for Additional Information:**

COMMITTEE SUBSTITUTE - Substantial Changes

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**I. Summary:**

CS/SB 1366 permits, but does not require, a trustee of certain trusts to use trust assets to pay directly on behalf of, or to reimburse, the person considered the owner of the trust for taxes attributable to the trust, subject to certain limitations.

The bill is applicable only to grantor trusts, a trust in which the grantor retains certain rights or powers over the trust such that federal tax law treats the grantor and the trust as one entity, thus making the grantor tax-liable for trust income. Under the bill, the trustee is authorized to make such a payment out of the trust assets unless the trust instrument prohibits such payment, or the trustee is:

- A qualified beneficiary of the trust.
- Treated as the owner of part or all of the trust under federal or state tax law.
- A “related or subordinate party” with respect to:
  - A person treated as the owner of all or part of the trust under federal or state tax law; or
  - A qualified beneficiary of the trust.

The bill expressly applies retroactively to trusts created before or after the effective date unless:

- The trustee gives the grantor and all others who may remove the trustee 60 days’ notice that the trustee intends to irrevocably opt out of the bill’s application to the trust; or
- Applying the bill would prevent a contribution to the trust from qualifying for, or would reduce, a federal tax benefit.

Life insurance policies held in the trust, the policy's cash value, or a loan secured by such policy may not be utilized to cover the grantor/settlor's tax liability.

The bill takes effect July 1, 2020.

## II. Present Situation:

### Trusts

Chapter 736, F.S., the Florida Trust Code, governs express trusts, and trusts created pursuant to a law, judgment, or decree that requires the trust to be administered in the manner of an express trust.<sup>1</sup> The common law of trusts and other principles of equity supplement the trust code, except to the extent modified by the trust code or another law of Florida.<sup>2</sup> An express trust arises from the express intent of the owner of property to create a trust, i.e., a fiduciary relationship in which one or more trustees is called upon to manage, protect, and invest certain property for the benefit of one or more beneficiaries.<sup>3</sup>

The settlor, who creates and contributes property to the trust,<sup>4</sup> may keep the trust revocable,<sup>5</sup> which allows the settlor to terminate or amend the trust at any time, or elect to make it irrevocable. Unless expressly stated in the trust instrument, a trust is presumed to be revocable.<sup>6</sup> While a trust is revocable, the duties of the trustee are owed exclusively to the settlor.<sup>7</sup> The property of a revocable trust is subject to the claims of a settlor's creditors during the settlor's lifetime to the extent the property is not otherwise exempted from such claims. However, the property of an irrevocable trust is only subject to the claims of a creditor or assignee of the settlor to the extent the property may be distributed for the settlor's benefit. Any discretionary power granted to the trustee to pay directly, or to reimburse the settlor for any tax on trust income or principal payable to the settlor does not further subject the assets of an irrevocable trust to claims of a settlor's creditors.<sup>8</sup>

### Taxation of Grantor Trusts

Federal tax law calls the settlor a "grantor." Sections 671-678 of the Internal Revenue Code ("IRC"), known as the grantor trust rules, provide that, if certain conditions are met, the grantor and the trust are treated as one entity, thus requiring the settlor to pay income tax on income generated by the trust, even if the grantor has no beneficial interest in the trust and cannot access its income.<sup>9</sup>

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<sup>1</sup> Section 736.0102, F.S. Chapter 736, F.S., does not apply to resulting or constructive trusts.

<sup>2</sup> Section 736.0106, F.S.

<sup>3</sup> "Beneficiary" means a person who has a present or future beneficial interest in a trust, vested or contingent, or who holds a power of appointment over trust property in a capacity other than that of trustee. Section 736.0103(4), F.S.

<sup>4</sup> Section 736.0103(18), F.S.

<sup>5</sup> "Revocable," as applied to a trust, means revocable by the settlor without the consent of the trustee or a person holding an adverse interest. Section 736.0103(17), F.S.

<sup>6</sup> Section 736.0602, F.S.

<sup>7</sup> Section 736.0603, F.S.

<sup>8</sup> Section 736.0505, F.S.

<sup>9</sup> 26 U.S.C. s. 671.

Under the IRC, a grantor will be treated as the owner of a trust if the settlor retains certain rights to or powers over the trust, including:

- The “power to revoke,” that is, the power to revest title to trust property in the grantor;<sup>10</sup>
- A revisionary interest that exceeded 5 percent of the value of the income or corpus at the trust’s inception;<sup>11</sup>
- The “power to control beneficial enjoyment” of the corpus or income without the approval of an “adverse party,” which is a person, such as a beneficiary, whose substantial interest in the trust will be adversely affected by the exercise of power;<sup>12</sup>
- Certain “administrative powers,” such as the power to borrow from the corpus at low or no interest, or to sell the trust assets for below market value, without the approval of an adverse party;<sup>13</sup> or
- The right to income for the grantor or spouse without approval of an adverse party.<sup>14</sup>

### **Revenue Ruling 2004-64**

Until 2004, it was unclear whether federal gift and estate tax consequences would result from an independent trustee holding a discretionary power under a trust to reimburse the grantor for taxes paid attributable to trust income. The Internal Revenue Service resolved these uncertainties with Revenue Ruling 2004-64, when it held that when an independent trustee holds a discretionary power under a trust to reimburse the grantor for taxes paid attributable to trust income, the exercise of such power does not result in a taxable gift from the trust beneficiaries to the grantor, and the existence of such power does not by itself cause the value of the trust assets to be includable in the grantor’s gross estate for federal estate tax purposes. The ruling suggests that outcomes may vary where there is a pre-arranged understanding between the grantor and trustee regarding how the trustee would exercise the trustee’s discretion to reimburse the grantor for income taxes, the grantor could remove the trustee and name himself or herself as trustee, or local law would cause the trust assets to be subject to claims of the grantor’s creditors.

Following Revenue Ruling 2004-64, several states, including Florida, amended their laws to provide that the existence of a power in a trust document authorizing the trustee to reimburse the grantor for income taxes attributable to trust income does not subject the assets of the trust to claims of the grantor’s creditors.<sup>15</sup>

### **Legislation in Other States**

Several states, including Colorado,<sup>16</sup> Delaware,<sup>17</sup> New Hampshire,<sup>18</sup> and New York,<sup>19</sup> permit a trustee to pay a settlor’s taxes on trust income unless the trust instrument expressly prohibits it.

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<sup>10</sup> 26 U.S.C. s. 676.

<sup>11</sup> 26 U.S.C. s. 673.

<sup>12</sup> 26 U.S.C. s. 674.

<sup>13</sup> 26 U.S.C. s. 675.

<sup>14</sup> 26 U.S.C. s. 677.

<sup>15</sup> See ch. 2006-217, s. 5, Laws of Florida; s. 736.0505(1)(c), F.S.

<sup>16</sup> Colo. Rev. Stat. s. 15-5-818 (2019).

<sup>17</sup> Del. Code 12 s. 3344 (2019).

<sup>18</sup> N.H. Rev. Stat s. 564-B:8-816(c) (2019).

<sup>19</sup> N.Y. Est. Powers and Trusts Law s. 7-1.11(a) (2019).

### III. Effect of Proposed Changes:

The bill permits a trustee to, in its sole discretion, to utilize trust assets, with certain exceptions, to reimburse the person being treated as owner of the trust under the Internal Revenue Code or similar law for income tax liability attributable to the trust, or to pay such amount directly to the appropriate taxing authority. Life insurance policies held in the trust, the cash value of any such policy, or the proceeds of any loan secured by an interest in such policy may not be utilized for such reimbursement or payment.

The bill applies to trusts created before or after the effective date of the bill unless:

- The trustee provides written notification to the grantor and all others who may remove the trustee at least 60 days' notice that the trustee intends to irrevocably opt out of the bill's application to the trust; or
- Application would prevent a contribution to the trust from qualifying for, or would reduce, a federal tax benefit that was originally claimed or could have been claimed for the contribution, including:
  - An exclusion under s. 2503(b) or s. 2504(c) of the IRC;
  - A marital deduction under s. 2056, s. 2056A, or s. 2523 of the IRC;
  - A charitable deduction under s. 170(a), s. 642(c), s. 2055(a), or s. 2522(a) of the IRC; or
  - Skip direct treatment under s. 2642(c) of the IRC.

Trustees may not exercise or participate in the exercise of reimbursing the grantor or paying the taxing authority on the grantor's behalf if the trustee is treated as the owner of the trust, is the beneficiary of such trust, or is a related or subordinate party.

In the event that the terms of the trust require the trustee to act at the direction or with the consent of a trust advisor, a protector, or any other person, or that the decision to reimburse the grantor or pay the taxing authority directly be made directly by such person, the powers granted to a trustee under the bill extend to such trust advisor, protector, or other person.

The bill does not create a beneficiary status for any person, including for the purposes of determining an elective estate.

The bill takes effect July 1, 2020.

### IV. Constitutional Issues:

#### A. Municipality/County Mandates Restrictions:

None.

#### B. Public Records/Open Meetings Issues:

None.

#### C. Trust Funds Restrictions:

None.

D. State Tax or Fee Increases:

None.

E. Other Constitutional Issues:

None.

**V. Fiscal Impact Statement:**

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

This bill may attract more trust business to Florida, and will have an indeterminate impact.

C. Government Sector Impact:

None.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Statutes Affected:**

This bill creates section 736.08145 of the Florida Statutes.

**IX. Additional Information:**

A. Committee Substitute – Statement of Substantial Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

**CS by Judiciary Committee on February 11, 2020:**

The committee substitute:

- Prohibits a trustee from choosing to pay the grantor's trust-income taxes if the trustee is a beneficiary or is a related or subordinate party to a beneficiary;
- Provides that if a trust advisor, protector, or other person is authorized to act in place of a trustee by the trust's terms, that person may also choose to pay the grantor's trust-income taxes; and
- Provides that the bill does not, of itself, make anyone a beneficiary of a trust, including for the purposes of determining the elective estate.

B. Amendments:

None.

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

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