

Department of Legislative Services  
Maryland General Assembly  
2000 Session

**FISCAL NOTE**

Senate Bill 637 (Senator Baker)

Judicial Proceedings

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**Trusts - Allocation of Capital Gains Distributions by Investment Funds**

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This bill authorizes the trustee of a trust to elect to treat a portion of distributions by an investment fund from realized capital gains as income. "Investment fund" is defined as an entity that is treated as a partnership for federal income tax purposes, has 50 or more investors, and more than half the assets of which consist of cash and marketable securities, including its proportionate share of these assets owned by any entity in which it owns an interest.

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**Fiscal Summary**

**State Effect:** None. The bill would not directly affect governmental operations or finances.

**Local Effect:** None.

**Small Business Effect:** Minimal

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**Analysis**

**Current Law:** The current law governing the allocation of distributions by corporations, regulated investment companies, and real estate investment trusts provides that distributions are income if they are made from ordinary income by a regulated investment company or by a trust qualifying and electing to be taxed under federal law as a real estate investment trust. All other distributions made by the company or trust are principal, including distributions from capital gains, depreciation, or depletion, whether in the form of cash or an option to take new stock, or cash or an option to purchase additional shares.

In 1989, however, the General Assembly enacted "non-uniform" language that provided an exception to this general rule. The exception gives a trustee the option to elect to treat a portion of distributions by a mutual fund from realized capital gains as income and was

apparently intended to encourage trustees to invest in growth-oriented mutual funds, which produce little or no ordinary income.

**Bill Summary:** The bill adds limited market investment funds to this exception. Under the bill, the portion of a capital gain distribution subject to this election would be limited so that the total distribution to income beneficiaries could not exceed the annual federal mid-term rate. The federal mid-term rate is the rate of interest established by the Secretary of the Treasury on debt instruments issued by United States (i.e., treasury bonds) with a term of more than three years but less than nine years. The rate for such bonds is currently 6.56%.

**Background:** A trustee of a trust and the personal representative of a decedent's estate are fiduciaries and 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 legatees (heirs if there is no will, legatees 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 are distributed to the remainder beneficiaries of a trust and the final distributees of the assets in an estate. Income is the current return received from an asset that is principal. Assets allocated to income are distributed to 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.

The identification of principal and income, their allocation, and apportionment of assets between income and principal is not always clear. The Uniform Law Commissioners promulgated the first Uniform Principal and Income Act in 1931 to provide statutory guidance to trustees. A revision was promulgated in 1962. Maryland adopted the 1962 revised uniform act in 1965, with the exception discussed above.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** HB 938 (Delegate Dembrow) - Judiciary.

**Information Source(s):** Judiciary (Administrative Office of the Courts); Registers of

Wills, Uniform Law Commissioners, Department of Legislative Services

**Fiscal Note History:** First Reader - March 1, 2000  
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