Department of Legislative Services

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FISCAL AND POLICY NOTE
Revised

Senate Bill 787 (Senator Forehand)
Judicial Proceedings Judiciary

Estates and Trusts - Maryland Uniform Principal and Income Act - Certain Payments to and from Trusts

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This bill modifies specified provisions of the Maryland Uniform Principal and Income Act (MUPIA) by (1) establishing certain requirements regarding payments from a "separate fund" (*e.g.*, an individual retirement account) and their allocation between principal and income of a trust which qualifies, or for which an election has been made to qualify, for a marital deduction from the federal estate tax; and (2) amending provisions specifying how a tax on the trust's share of an entity's taxable income must be paid by the trustee. The bill clarifies when the provisions relating to payments from a "separate fund" first apply, based generally on when a trust is initially funded.

Fiscal Summary

State Effect: The bill is not expected to have a direct, material impact on State finances.

Local Effect: None.

Small Business Effect: None.

Analysis

Bill Summary: The bill modifies provisions of MUPIA that govern how certain payments to a trustee are allocated between income and principal of a trust and how certain tax payments paid by a trustee are allocated. The provisions under MUPIA apply where the terms of a trust or will do not contain a different provision and where a trustee does not otherwise exercise a discretionary power of administration under the terms of a trust or will that produces a result different from a result required or permitted under MUPIA.

Allocation of Payments from a "Separate Fund"

The bill establishes requirements for the allocation of payments from a "separate fund" to specified trusts that qualify for a marital deduction from the federal taxable estate (for purposes of the federal estate tax), or for which an election to qualify has been made, under specified sections of the federal Internal Revenue Code. A "separate fund" includes a private or commercial annuity; an individual retirement account; and a pension, profit-sharing, stock-bonus, or stock-ownership plan. "Payment" includes any payment from a separate fund, regardless of the reason for the payment.

For payments made to the trusts specified in the bill that qualify for a marital deduction, or for which an election to qualify has been made, the following requirements apply:

- a trustee must determine the internal income of each separate fund for the accounting period as if the separate fund were a trust subject to MUPIA;

- on request of the surviving spouse, the trustee must demand that the person administering the separate fund distribute the internal income to the trust;

- the trustee must allocate a payment from the separate fund to income to the extent of the amount of the internal income of the separate fund and distribute that amount to the surviving spouse and the balance of the payment to principal;

- on request of the surviving spouse, the trustee must allocate principal to income to the extent the internal income of the separate fund exceeds payments made from the separate fund to the trust during the accounting period;

- if a trustee cannot determine the internal income of a separate fund, but can determine the value of the separate fund, the internal income of the separate fund is deemed to equal 4% of the fund's value, according to the most recent statement of the value before the beginning of the accounting period; and

- if the trustee cannot determine both the internal income of the separate fund and the fund's value, the internal income of the fund is deemed to equal the product of the interest rate and the present value of the expected future payments, as determined under a specified section of the Internal Revenue Code for the month preceding the accounting period for which the computation is made.

Payment of Taxes by a Trustee

Existing provisions governing the payment of taxes by a trustee are amended to specify that a tax required to be paid by a trustee on the trust's share of an entity's taxable income must be paid:

- from income to the extent that receipts from the entity are allocated only to income;
- from principal to the extent that receipts from the entity are allocated only to principal;
- proportionately from principal and income to the extent that receipts from the entity are allocated to both income and principal; and
- from principal to the extent that the tax exceeds the total receipts from the entity.

Also, the trustee must adjust income or principal receipts to the extent that the trust's taxes are reduced because the trust receives a deduction for payments made to a beneficiary.

Current Law:

MUPIA Applicability

In allocating receipts and disbursements to or between principal and income, a fiduciary (personal representative or trustee) must administer a trust or estate in accordance with the terms of the trust or the will, even if there is a different provision in MUPIA. In addition, a fiduciary may administer a trust or estate by the exercise of a discretionary power of administration given to the fiduciary by the terms of the trust or the will, even if the exercise of the power produces a result different from a result required or permitted by MUPIA. Otherwise, in allocating receipts and disbursements to or between principal and income, a fiduciary must administer a trust or estate in accordance with MUPIA.

Allocation of Specified Payments Received by a Trustee

Under MUPIA, certain payments, including payments from a "separate fund," must be allocated between principal and income in a specified manner. The payments to which the specified allocation applies are payments that a trustee may receive over a fixed number of years or during the life of one or more individuals because of services rendered or property transferred to the payer in exchange for future payments. They include payments made in money or property from the payer's general assets or from a separate fund created by the payer, including a private or commercial annuity; an individual retirement account; and a pension, profit-sharing, stock-bonus, or stock-ownership plan.

To the extent a payment is characterized as interest, a dividend, or a payment made in lieu of interest or a dividend, a trustee must allocate it to income. The balance of the payment and any other payment received in the same accounting period that is not characterized as interest, a dividend, or an equivalent payment is allocated to principal.

If no part of a payment is characterized as interest, a dividend, or an equivalent payment, and all or part of the payment is required to be made, a trustee must allocate 10% of the part that is required to be made during the accounting period to income and the balance to principal. If no part of a payment is required to be made or the payment received is the entire amount to which the trustee is entitled, the entire payment must be allocated to principal. A payment is not "required to be made" to the extent it is made because the trustee exercises a right of withdrawal.

If a trustee must allocate more of a payment to income to obtain an estate tax marital deduction for a trust, the trustee must allocate to income the additional amount necessary to obtain the marital deduction.

Allocation of Tax Payments Made by a Trustee

A tax required to be paid by a trustee based on receipts allocated to income must be paid from income. A tax required to be paid by a trustee based on receipts allocated to principal must be paid from principal, even if the tax is called an income tax.

A tax required to be paid by a trustee on the trust's share of an entity's taxable income must be paid proportionately:

- from income to the extent that receipts from the entity are allocated to income; and
- from principal to the extent that receipts from the entity are allocated to principal and the trust's share of the entity's taxable income exceeds the total receipts.

Receipts allocated to principal or income must be reduced by the amount distributed to a beneficiary from principal or income for which the trust receives a deduction in calculating the tax.

Background: The changes made by the bill reflect amendments made by the National Conference of Commissioners on Uniform State Laws (NCCUSL) to its Uniform

Principal and Income Act in 2008. MUPIA was enacted in 2000 (Chapter 292), replacing a prior uniform act, and largely reflected the revised Uniform Principal and Income Act promulgated by NCCUSL in 1997. Additions and changes were made in 2002 (Chapter 478).

According to NCCUSL, the changes made in 2008 with respect to payments from a "separate fund" were in response to a 2006 Internal Revenue Service Revenue Ruling (No. 2006-26). Revenue Ruling 2006-26 indicated that existing provisions in the uniform law (equivalent to the provisions in MUPIA being amended by the bill) could cause a trust to not qualify for the marital deduction. The 2008 revisions were designed to address that concern.

For taxes paid by a trustee, the bill addresses instances where a trust owns an interest in a pass-through entity (where taxes on the entity's income are passed through to the entity's owners), such as a partnership or S-corporation. The trustee is responsible for taxes on the trust's share of the entity's income whether or not the income is distributed to the trust. The bill's changes are intended to provide clearer direction to a trustee in meeting that tax liability.

Additional Information

Prior Introductions: None.

Cross File: HB 772 (Delegate Waldstreicher) - Judiciary.

Information Source(s): Comptroller's Office, Judiciary (Administrative Office of the Courts), National Conference of Commissioners on Uniform State Laws, Maryland State Bar Association (Estate and Trust Law Section) Department of Legislative Services

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Analysis by: Scott D. Kennedy

Direct Inquiries to:
(410) 946-5510
(301) 970-5510