

BILL ANALYSIS

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S.B. 648
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AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

As part of its ongoing review of Texas probate, guardianship, and trust law, the Real Estate, Probate, and Trust Law Section of the State Bar of Texas has proposed several updates to the law regarding trusts. The changes include an updated definition of property, appointment of trusts, and title coverage. Each of these updates are intended to clean up the current law regarding trusts.

S.B. 648 amends Section 111.004(12) of the Property Code relating to the definition of “property” to include digital assets or electronic medium.

Texas law protects the beneficiary of a spendthrift trust property from creditors unless the settlor of the trust is also a beneficiary. A question arises as to when a settlor would be considered a beneficiary of a trust. The amendment to Section 112.035 further clarifies that a settlor is not a beneficiary solely because the settlor's interest was created by a power of appointment by a third party.

The bill amends the Property Code, by adding a Subchapter D (Distribution of Trust Principal in Further Trust) granting the power to a trustee to distribute trust principal from trusts under which the trustee has certain distributive powers to another trust with similar terms in limited situations, such as to correction of administrative problems without the necessity of court approval (sometimes called “decanting”).

The bill amends Section 113.029 (Discretionary Powers; Tax Savings) of the Property Code, extending protection to beneficiaries affiliated with their corporate trustee. The list of beneficiaries includes officers, directors, managers, or owners of a corporate trustee.

As proposed, S.B. 648 amends current law relating to trusts.

RULEMAKING AUTHORITY

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Section 111.004(12), Property Code, to redefine "property" for this section to include property held in any digital or electronic medium.

SECTION 2. Amends Section 112.035, Property Code, by amending Subsection (d) and adding Subsections (g) and (h), as follows:

(d) Provides that a settlor is not considered a beneficiary of a trust solely because a trustee who is not the settlor is authorized under the trust instrument to pay or reimburse the settlor for, or pay directly to the taxing authorities, any tax on trust income or principal that is payable by the settlor under the law imposing the tax, or the settlor's interest in the trust was created by the exercise of a power of appointment by a third party.

(g) Provides that, for the purposes of this section, property contributed to the following trusts is not considered to have been contributed by the settlor, and a person who would otherwise be treated as a settlor or a deemed settlor of the following trusts is prohibited from being treated as a settlor:

(1) an irrevocable inter vivos marital trust if the settlor is a beneficiary of the trust after the death of the settlor's spouse and the trust is treated as qualified terminable interest property under Section 2523(f), Internal Revenue Code of 1986 or a general power of appointment trust under Section 2523(e), Internal Revenue Code of 1986;

(2) an irrevocable inter vivos trust for the settlor's spouse if the settlor is a beneficiary of the trust after the death of the settlor's spouse; or

(3) an irrevocable trust for the benefit of a person if the settlor is the person's spouse, regardless of whether or when the person was the settlor of an irrevocable trust for the benefit of that spouse or to the extent that the property of the trust was subject to a general power of appointment in another person.

(h) Provides that, for the purposes of Subsection (g), a person is a beneficiary whether named a beneficiary under the initial trust instrument or through the exercise of a limited or general power of appointment by that person's spouse or another person.

SECTION 3. Amends Chapter 112, Property Code, by adding Subchapter D, as follows:

SUBCHAPTER D. DISTRIBUTION OF TRUST PRINCIPAL IN FURTHER TRUST

Sec. 112.071. DEFINITIONS. Defines "authorized trustee," "current beneficiary," "first trust," "full discretion," "limited discretion," "presumptive remainder beneficiary," "principal," "second trust," and "successor beneficiary" in this section.

Sec. 112.072. DISTRIBUTION TO SECOND TRUST: TRUSTEE WITH FULL DISCRETION. (a) Authorizes an authorized trustee who has the full discretion to distribute the principal of a trust to distribute all or part of the principal of that trust in favor of a trustee of a second trust for the benefit of one or more current beneficiaries of the first trust and for the benefit of one or more successor or presumptive remainder beneficiaries of the first trust.

(b) Authorizes the authorized trustee to, in connection with the exercise of a power of distribution under this section, grant a power of appointment, including a currently exercisable power of appointment, in the second trust to one or more of the current beneficiaries of the first trust who, at the time the power of appointment is granted, is eligible to receive the principal outright under the terms of the first trust.

(c) Authorizes the class of permissible appointees the beneficiary is authorized to appoint under that power, if the authorized trustee grants a power of appointment to a beneficiary under Subsection (b), to be broader or different than the current, successor, and presumptive remainder beneficiaries of the first trust.

(d) Authorizes the beneficiaries of the second trust, if the beneficiaries of the first trust are described as a class of persons, to include one or more persons who become includable in that class after the distribution to the second trust.

Sec. 112.073. DISTRIBUTION TO SECOND TRUST: TRUSTEE WITH LIMITED DISCRETION. (a) Authorizes an authorized trustee who has limited discretion to distribute the principal of a trust to distribute all or part of the principal of that trust in favor of a trustee of a second trust as provided by this section.

(b) Requires the current beneficiaries of the second trust to be the same as the current beneficiaries of the first trust, and the successor and remainder beneficiaries of the second trust are required to be the same as the successor and remainder beneficiaries of the first trust.

(c) Requires that the second trust include the same language authorizing the trustee to distribute the income or principal of the trust that was included in the first trust.

(d) Requires the beneficiaries of the second trust, if the beneficiaries of the first trust are described as a class of persons, to include all persons who become includable in that class after the distribution to the second trust.

(e) Requires that the second trust, if the first trust grants a power of appointment to a beneficiary of the trust, grant the power of appointment to the beneficiary in the second trust, and the class of permissible appointees under that power is required to be the same as the class of permissible appointees under the power granted by the first trust.

(f) Provides that the exercise of a power of distribution under this section is subject to Section 113.029 (Discretionary Powers; Tax Savings).

Sec. 112.074. NOTICE REQUIRED. (a) Authorizes an authorized trustee to exercise a power of distribution under Section 112.072 or 112.073 without the consent of the settlor or beneficiaries of the first trust and without court approval if there are one or more current beneficiaries who are not legally incapacitated, there are one or more presumptive remainder beneficiaries who are not legally incapacitated, and the authorized trustee provides to all of the current beneficiaries and presumptive remainder beneficiaries who are not legally incapacitated written notice of the trustee's decision to exercise the power, specifying the manner in which the trustee intends to exercise the power and the proposed effective date of the distribution.

(b) Provides that, for the purpose of determining who is entitled to the notice, a beneficiary is determined as of the date the notice is sent with the assumption that any existing power of appointment has not been exercised.

(c) Provides that a trustee is not required to provide a copy of the notice to a beneficiary who is known to the trustee and cannot be located by the trustee after reasonable diligence or is not known to the trustee.

(d) Requires the authorized trustee, if a charity is a current beneficiary or presumptive remainder beneficiary of the trust, to also give written notice of the trustee's decision to the attorney general.

Sec. 112.075. WRITTEN INSTRUMENT REQUIRED. Requires that a distribution under Section 112.072 or 112.073 be made by a written instrument that is signed and acknowledged by the trustee and filed with the records of the first trust and the second trust.

Sec. 112.076. REFERENCE TO TRUST TERMS. Provides that a reference to the governing instrument or terms of the governing instrument of a trust includes the terms of a second trust to which that trust's principal was distributed under this subchapter.

Sec. 112.077. SETTLOR OF SECOND TRUST. (a) Provides that except as provided by Subsection (b), the settlor of a first trust is considered to be the settlor of a second trust established under this subchapter.

(b) Provides that if a settlor of a first trust is not also the settlor of a second trust into which principal of that first trust is distributed, the settlor of the first trust is

considered the settlor of the portion of the second trust distributed to the second trust from that first trust under this subchapter.

Sec. 112.078. **COURT-ORDERED DISTRIBUTION.** (a) Authorizes the trustee to petition a court to order a distribution under this subchapter if the power to make a distribution under this subchapter is unavailable for any reason.

(b) Authorizes the trustee or the beneficiary, if the trustee receives a written objection to a distribution under this subchapter from a beneficiary before the proposed effective date of the distribution specified in the notice provided to the beneficiary under Section 112.074, to petition a court to approve, modify, or deny the exercise of the trustee's power to make a distribution under this subchapter. Provides that the trustee has the burden of proving that the proposed exercise of the power furthers the purposes of the trust.

(c) Authorizes the trustee, in a judicial proceeding under this section, to present the trustee's reasons for supporting or opposing a proposed distribution, including whether the trustee believes the distribution would enable the trustee to better carry out the purposes of the trust.

(d) Prohibits a trustee's actions under this subchapter from being considered improper or inconsistent with the trustee's duty of impartiality unless the court finds, based on all the evidence, that the trustee acted in bad faith.

Sec. 112.079. **TERM OF SECOND TRUST.** Authorizes a second trust to have a term that is longer than the term of a first trust whose principal was distributed to the trust, including a term that is measured by the lifetime of a current beneficiary.

Sec. 112.080. **DIVIDED DISCRETION.** Authorizes the authorized trustee having full discretion, if an authorized trustee has full discretion to distribute the principal of a trust and another trustee has limited discretion to distribute principal under the trust instrument, to exercise the power to distribute the trust's principal under Section 112.072.

Sec. 112.081. **LATER DISCOVERED ASSETS.** Provides that to the extent the authorized trustee does not provide otherwise the distribution of all of the principal of a first trust to a second trust includes subsequently discovered assets otherwise belonging to the first trust and principal paid to or acquired by the first trust after the distribution of the first trust's principal to the second trust and the distribution of part of the principal of a first trust to a second trust does not include subsequently discovered assets belonging to the first trust or principal paid to or acquired by the first trust after the distribution of principal from the first trust to the second trust, and those assets or that principal remain the assets or principal of the first trust.

Sec. 112.082. **OTHER AUTHORITY TO DISTRIBUTE IN FURTHER TRUST NOT LIMITED.** Prohibits this subchapter from being construed to limit the power of a trustee to distribute property in further trust under the terms of the governing instrument of a trust, other law, or a court order.

Sec. 112.083. **NEED FOR DISTRIBUTION NOT REQUIRED.** Authorizes an authorized trustee to exercise the power to distribute principal to a second trust under Section 112.072 or 112.073 regardless of whether there is a current need to distribute principal under the terms of the first trust.

Sec. 112.084. **DUTIES NOT CREATED.** (a) Provides that this subchapter does not create or imply a duty for an authorized trustee to exercise a power to distribute principal, and impropriety is prohibited from being inferred as a result of the trustee not exercising a power conferred by Section 112.072 or 112.073.

(b) Provides that a trustee does not have a duty to inform beneficiaries about the availability of the authority provided by this subchapter or a duty to review the trust to determine whether any action should be taken under this subchapter.

Sec. 112.085. CERTAIN DISTRIBUTIONS PROHIBITED. (a) Prohibits an authorized trustee, except as provided by Subsection (b), from exercising a power to distribute principal of a trust otherwise provided by Section 112.072 or 112.073 if the distribution is expressly prohibited by the terms of the governing instrument of the trust.

(b) Provides that a general prohibition of the amendment or revocation of a trust or a provision that constitutes a spendthrift clause does not preclude the exercise of a power to distribute principal of a trust under Section 112.072 or 112.073.

Sec. 112.086. EXCEPTIONS TO POWER OF DISTRIBUTION. Prohibits an authorized trustee from exercising a power to distribute principal of a trust under Section 112.072 or 112.073 to:

(1) reduce, limit, or modify a beneficiary's current, vested right to receive a mandatory distribution of income or principal, receive a mandatory annuity or unitrust interest, withdraw a percentage of the value of the trust, or withdraw a specified dollar amount from the trust;

(2) decrease or indemnify against a trustee's liability or exonerate a trustee from liability for failure to exercise reasonable care, diligence, and prudence;

(3) eliminate a provision granting another person the right to remove or replace the authorized trustee exercising the distribution power under Section 112.072 or 112.073; or

(4) reduce, limit, or modify in the second trust a perpetuities provision included in the first trust, unless expressly permitted by the terms of the first trust.

Sec. 112.087. TAX-RELATED LIMITATIONS. (a) Prohibits the authorized trustee from distributing the principal of a trust under Section 112.072 or 112.073 in a manner that would prevent a contribution to that trust from qualifying for or reducing the exclusion, deduction, or other federal tax benefit that was originally claimed for that contribution, including the annual exclusion under Section 2503(b), Internal Revenue Code of 1986, a marital deduction under Section 2056(a) or 2523(a), Internal Revenue Code of 1986, the charitable deduction under Section 170(a), 642(c), 2055(a), or 2522(a), Internal Revenue Code of 1986, direct skip treatment under Section 2642(c), Internal Revenue Code of 1986, or any other tax benefit for income, gift, estate, or generation-skipping transfer tax purposes under the Internal Revenue Code of 1986.

(b) Authorizes an authorized trustee, notwithstanding Subsection (a), to distribute the principal of a first trust to a second trust regardless of whether the settlor of the first trust is treated as the owner of the second trust under Sections 671-679, Internal Revenue Code of 1986.

(c) Prohibits an authorized trustee, if a trust owns Subchapter S Corporation stock, from distributing all or part of that stock under Section 112.072 or 112.073 to a second trust that is not a permitted shareholder under Section 1361(c)(2), Internal Revenue Code of 1986.

(d) Prohibits an authorized trustee, if a trust owns an interest in property that is subject to the minimum distribution rules of Section 401(a)(9), Internal Revenue Code of 1986, from distributing the trust's interest in the property to a second trust under Section 112.072 or 112.073 if the distribution would shorten the minimum distribution period applicable to the property.

Sec. 112.088. COMPENSATION OF TRUSTEE. (a) Prohibits an authorized trustee, except as provided by Subsection (b) and unless a court, on application of the trustee, directs otherwise, from exercising a power under Section 112.072 or 112.073 solely to change trust provisions regarding the determination of the compensation of any trustee.

(b) Authorizes an authorized trustee, in connection with the exercise of a power under Section 112.072 or 112.073 for another valid and reasonable purpose, to bring the trustee's compensation into conformance with reasonable limits authorized by state law.

(c) Authorizes the compensation payable to the trustee of the first trust to continue to be paid to the trustee of the second trust during the term of the second trust and is authorized to be determined in the same manner as the compensation would have been determined in the first trust.

(d) Prohibits a trustee from receiving a commission or other compensation for the distribution of a particular asset from a first trust to a second trust under Section 112.072 or 112.073.

Sec. 112.089. LIABILITY OF TRUSTEE FOR ACTS OR OMISSIONS. (a) Provides that a trustee who reasonably and in good faith takes or omits to take any action under this subchapter is not liable for the act or omission to any person interested in the trust. Provides that an act or omission by a trustee under this subchapter is rebuttably presumed to have been taken or omitted reasonably and in good faith.

(b) Provides that if a person interested in the trust opposes an act or omission of a trustee under this subchapter, the person's exclusive remedy is to obtain a court order directing the trustee to act as the court determines necessary or beneficial for the proper functioning of the trust, including to modify or reverse a previous action of the trustee.

(c) Requires a person interested in a trust to bring a suit claiming that an act or omission by a trustee under this subchapter was an abuse of discretion not later than two years after the date the trustee provided the person or the person's representative with a written notice or report that sufficiently discloses facts fundamental to the claim so that the person knew or reasonably should have known of the claim.

(d) Provides that if a person otherwise entitled to bring an action that is subject to the limitations period provided by Subsection (c) is, at the time the notice or report was provided, under a legal disability and does not at that time have a personal representative appointed by a court as the guardian of the person's estate, the time during which the person is under that disability and unrepresented is not included in the limitations period.

SECTION 4. Amends Section 113.029, Property Code, by amending Subsection (b) and adding Subsection (e), as follows:

(b) Provides that, subject to Subsection (d) (relating to Subsection (b) not applying to certain powers and certain trusts), and unless the terms of the trust expressly indicate that a requirement provided by this subsection does not apply:

(1) a person, other than a settlor, who is a beneficiary and trustee, trustee affiliate, or discretionary power holder of a trust that confers on the trustee a power to make discretionary distributions to or for the trustee's, the trustee affiliates, or discretionary power holder's personal benefit is authorized to exercise the power only in accordance with an ascertainable standard relating to the trustee's, the trustee affiliate's, or the discretionary power holder's individual health, education,

support, or maintenance within the meaning of Section 2041(b)(1)(A) or 2514(c)(1), Internal Revenue Code of 1986; and

(2) makes no changes to this subchapter.

(e) Defines "discretionary power holder" in this section.

SECTION 5. Amends Section 11.13(j), Tax Code, to redefine "residence homestead," "trustor," and "qualifying trust" in this section.

SECTION 6. Amends Section 152.025(a), Tax Code, as follows:

(a) Provides that a tax is imposed on the recipient of a gift of a motor vehicle. Provides that this section applies only if a person receiving the motor vehicle receives the vehicle from:

(1) a trust that was revocable by a decedent or that was jointly revocable by a decedent and the decedent's spouse or a trust that is revocable by the person receiving the motor vehicle or that is jointly revocable by the recipient and the recipient's spouse;

(2) is a trust that is revocable by the transferor of the motor vehicle or that is jointly revocable by the transferor and the transferor's spouse; or

(3) Creates this subdivision from existing text and makes no further change to this subdivision.

SECTION 7. (a) Provides that, except as otherwise expressly provided by a trust, a will creating a trust, or this section, the changes in law made by this Act apply to a trust existing or created on or after September 1, 2013.

(b) Provides that, for a trust existing on September 1, 2013, that was created before that date, the changes in law made by this Act apply only to an act or omission relating to the trust that occurs on or after September 1, 2013.

SECTION 8. Effective date: September 1, 2013.