



Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL



ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986

House Bill 5154 (as passed by the House)
Sponsor: Representative John Walsh
House Committee: Tax Policy
Senate Committee: Finance

Date Completed: 6-8-12

CONTENT

The bill would amend the Uniform Principal and Income Act (which governs the way in which receipts and expenditures of a trust or estate must be allocated between principal and income) to do the following:

- Rewrite a provision that requires a trustee to allocate to income an additional amount of payments from a retirement fund, in order to obtain an estate tax marital deduction for the trust.
- Require a trustee, after allocating payments between income and principal when paying the trust's share of an entity's taxable income, to adjust receipts to the extent the trust's taxes were reduced because the trust received a deduction for payments made to a beneficiary.

Marital Tax Deduction

Section 409 governs the allocation of a payment between income and principal in situations involving a series of payments received by a trust because of services rendered or property transferred to the payer, including payments from a separate fund created by the payer, such as an annuity, individual retirement account, or pension plan.

If a trustee must allocate more of a payment to income than provided for in this section, in order to obtain an estate tax marital deduction for the trust, the trustee is required to allocate the additional amount necessary. The bill would delete this requirement.

The bill would add new requirements for a trustee in determining the allocation of a payment made from a separate fund to either of the following (except to the extent the series of payments otherwise would qualify for the marital deduction):

- A trust to which an election to qualify for a marital deduction under a section of the Internal Revenue Code (IRC) had been made.
- A trust that qualified for a marital deduction under that section.

The trustee would have to determine the internal income of each separate fund for the accounting period as if the fund were a trust subject to the Act. Upon request of the surviving spouse, the trustee would have to demand that the person administering the separate fund distribute the internal income to the trust. The trustee would have to allocate a payment from the fund to income to the extent of the internal income of the fund, distribute that amount to the surviving spouse, and allocate the balance to principal. Upon request of the surviving spouse, the trustee would have to allocate principal to income to the extent the internal income of the separate fund exceeded payments made from the separate fund to the trust during the accounting period.

If the trustee could not determine the internal income of a separate fund but could determine its value, the internal income of the fund would be deemed to equal 3.5% of the

fund's value, according to the most recent statement of value before the accounting period began. If the trustee could not determine the internal income or value of a fund, the internal income would be deemed to equal the product of the interest rate and the present value of the expected future payments, as determined under a section of the IRC, for the month preceding the accounting period for which the computation was made.

Tax on Entity's Taxable Income

Section 505 requires a trustee to pay from income or from principal a tax based on receipts allocated to income or allocated to principal, respectively. If the tax is on the trust's share of an entity's taxable income, the trustee must pay the tax as follows:

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

The bill, instead, would require a trustee to pay the tax on an entity's taxable income as follows:

- From income to the extent that receipts from the entity were allocated only to income.
- From principal to the extent that receipts from the entity were allocated only to principal.
- Proportionately from principal and income to the extent that receipts from the entity were allocated to both income and principal.
- From principal to the extent that the tax exceeded the total receipts from the entity.

The bill would require the trustee, after applying the required allocations, to adjust income or principal receipts to the extent that the trust's taxes were reduced because the trust received a deduction for payments to a beneficiary.

MCL 555.809 et al.

BACKGROUND

The Uniform Principal and Income Act was enacted in 2004 and replaced an earlier principal and income act that Michigan had enacted in 1965. The different versions were promulgated by the National Conference of Commissioners on Uniform State Laws (the Uniform Law Commission). The more recent version was promulgated in 1997 to reflect modern investment theory, accommodate prudent investor rules, clarify the allocation of acquired assets, provide for types of investments that did not previously exist, and empower trustees to make adjustments between principal and income to correct certain inequities.

In 2008, the Uniform Law Commission finalized amendments to Sections 409 and 505 of the Uniform Principal and Income Act. According to a summary of the amendments prepared by the Uniform Law Commission, "The section 409 amendments should serve to resolve issues brought about by IRS Revenue Ruling 2006-26 and assist separate funds within a trust in qualifying for the IRS estate tax marital deduction safe harbors. The section 505 amendments should allow mandatory income trusts that own an entity to retain the proper amount of funds from distributions to meet their existing tax obligations."

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: Dan O'Connor

S1112\5154sa.

This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.