

BILL ANALYSIS

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S.B. 1197
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Jurisprudence
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AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

S.B. 1197 deals with several issues in the Property Code relating to trusts. The bill is endorsed by the Real Estate, Probate and Trust Law Section of the State Bar of Texas.

The bill amends Section 112.010(c-2)(2) (relating to disclaiming an interest), Property Code, to include a special extension of the deadline for disclaiming an interest in trust. Under current law, it is generally required that disclaimers be made within nine months of the date of the event creating the interest. This deadline was designed to mirror the identical deadline for "qualified disclaimers" under Section 2518 of the Internal Revenue Code. The recent federal tax bill that went into effect December 17, 2010, however, extends the deadline for making certain disclaimers of property passing as a result of a death occurring in 2010—for federal tax purposes—until nine months from the date of enactment (or September 17, 2011). This bill extends the deadline in these situations for state law purposes, as well.

The bill amends Section 112.038 (Forfeiture Clause), Property Code, to revise the forfeiture clause statute, also known as the no contest clause or interrorem clause statute, to correspond with the Probate Code. Under a Probate Code provision, one is allowed to defend a *will*—and make a forfeiture clause in such a will unenforceable—if "just cause" exists for bringing the action. Under the current Property Code, to defend a *trust*, "probable cause" is the standard. The bill then would make the two codes uniform by replacing "probable cause" in Section 112.038, Property Code, with "just cause" so the same standard will apply to both wills and trusts.

The bill amends Section 112.057 (Division and Combination of Trusts), Property Code, which currently allows trustees to divide and combine trusts when appropriate (usually to achieve beneficial tax results) *upon 30-days notice to the beneficiaries*. The bill adds two subsections to Section 112.057, Property Code. Subsection (e) allows waiver of notice by beneficiaries of a trust proposed to be divided or combined with another trust without a judicial proceeding if each beneficiary waives notice in a writing that is delivered to the trustee. Subsection (f) allows a guardian of the estate, guardian ad litem, or parent of a minor or incapacitated beneficiary to waive the notice on behalf of a beneficiary.

The bill amends Section 115.001(d) (relating to jurisdiction), Property Code, to expand the jurisdiction over trusts created by a decedent while administration of the decedent's estate is pending. Specifically, the bill will include statutory county courts on the list of courts on which jurisdiction is conferred, rather than provide that the exclusive jurisdiction still rests in the district court. This change is to conform the section to other recent changes to the Probate Code, which extend jurisdiction over trusts created by a decedent to statutory county courts (as opposed to just statutory probate courts) while administration of the decedent's estate is pending.

The bill amends Section 115.002 (Venue), Property Code, to extend permissive venue of trust proceedings while the estate is pending. Under current law, generally, venue for a trust proceeding is in the county of the trustee's residence. However, courts in which the administration of a deceased settlor's estate is pending currently have *jurisdiction* over such proceedings. The bill now also adds permissive venue in those counties for such proceedings.

The bill amends Section 115.011(b) (relating to necessary parties), Property Code, to clarify necessary parties to a trust proceeding. Under current law, necessary parties to a trust proceeding include any beneficiary designated by name in the instrument creating a trust. This

technically includes anyone named as a beneficiary in a will creating a testamentary trust, *even if the person is not a beneficiary of the trust*. It also includes persons whose interest in the trust may have previously terminated. The bill now limits necessary parties to persons designated by name as a beneficiary of the trust, and whose interests have not been previously distributed, extinguished, terminated, or paid.

The bill corrects cross referencing errors in the Texas Uniform Principal and Income Act created when a previous legislative change to the section pertaining to a Trustee's Power to Adjust modified subsection numbering.

Finally, the bill makes technical changes to Sections 116.205(c) (relating to income taxes) and (d) (relating to income taxes), Property Code, to adopt changes made by the Uniform Principal and Income Act, which address the potential for cash flow shortages caused when a trust holds an interest in a pass-through taxation entity (such as partnerships or S corporations). The cash flow problem often results when such an entity makes a distribution during the year, but does not distribute all of its taxable income. The problem is created by the current requirement that taxes be paid proportionately from income, to the extent the *entity's receipts* are allocated to income, and from principal, to the extent that *receipts from the entity* are allocated to principal, or to the extent that the trust's share of the *entity's taxable income* exceeds receipts from the entity. By deleting the requirement that taxes be charged to trust principal to the extent that the trust's share of the entity's taxable income exceeds receipts from the entity and requiring the trustee to 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, the trust is required to pay taxes on its share of an entity's taxable income from income or principal receipts to the extent that receipts from the entity are allocable to each of income and principal. This bill makes certain that the trust has a source of cash from which to pay some or all of the taxes on its share of the entity's taxable income as reduced by distributions to beneficiaries.

As proposed, S.B. 1197 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 112.010(c-2)(2), Property Code, as follows:

(2) Authorizes a person authorized to disclaim an interest in a trust under Subsection (c) of this section (relating to who can disclaim an interest in a trust created in any manner other than by will) to disclaim an interest in whole or in part by certain means, including delivering the memorandum to the trustee or, if there is not a trustee, to the transferor of the interest or his legal representative not later than the date that is nine months after the later of:

- (A) Makes no changes to this paragraph;
- (B) and (C) Makes nonsubstantive changes; or
- (D) in the case of an interest in a trust created by reason of the death of a decedent dying before December 17, 2010, but after December 31, 2009, and to which Texas Probate Code Section 37A (Means of Evidencing Disclaimer or Renunciation of Property or Interest Receivable From A Decedent) does not apply, then December 17, 2010.

SECTION 2. Amends Section 112.038, Property Code, as follows:

Sec. 112.038. FORFEITURE CLAUSE. Provides that a provision in a trust that would cause a forfeiture of or void an interest for bringing any court action, including contesting a trust, is unenforceable if:

- (1) just cause existed for bringing the action, rather than probable cause exists for bringing the action; and
- (2) Makes no changes to this subdivision.

SECTION 3. Amends Section 112.057, Property Code, by adding Subsections (e) and (f), as follows:

(e) Authorizes a beneficiary to whom written notice is required to be given under this section to waive the notice requirement in a writing delivered to the trustee. Provides that notice is not required if all beneficiaries to whom notice would otherwise be required to be given under this section waive the notice requirement.

(f) Requires notice required under this section to be given to a guardian of the estate, guardian ad litem, or parent of a minor or incapacitated beneficiary. Authorizes a guardian of the estate, guardian ad litem, or parent of a minor or incapacitated beneficiary to waive the notice requirement in accordance with this section on behalf of the minor or incapacitated beneficiary.

SECTION 4. Amends Section 115.001(d), Property Code, to provide that the jurisdiction of the district court is exclusive except for jurisdiction conferred by law on certain courts, including a county court at law.

SECTION 5. Amends Section 115.002, Property Code, by adding Subsection (c-1), as follows:

(c-1) Authorizes an action involving the interpretation and administration of an inter vivos trust created by the settlor or a testamentary trust created by the settlor's will, if the settlor is deceased and an administration of the settlor's estate is pending in this state, to be brought, notwithstanding Subsections (b) (relating to dictating venue if there is a single, noncorporate trustee) and (c) (relating to dictating venue if there are multiple trustees or a corporate trustee):

- (1) in a county in which venue is proper under Subsection (b) or (c); or
- (2) in the county in which the administration of the settlor's estate is pending.

SECTION 6. Amends Section 115.011(b), Property Code, as follows:

(b) Provides that the only necessary parties to action under Section 115.001 (Jurisdiction) are:

- (1) a beneficiary of the trust on whose act or obligation the action is predicated;
- (2) a beneficiary of the trust designated by name, other than a beneficiary whose interest has been distributed, extinguished, terminated, or paid, rather than a beneficiary designated by name in the instrument creating the trust is a necessary party to action under Section 115.001; and
- (3) and (4) Makes no changes to these subdivisions.

SECTION 7. Amends Sections 116.005(d) and (e), Property Code, to make conforming changes.

SECTION 8. Amends Sections 116.205(c) and (d), Property Code, as follows:

(c) Requires that a tax required to be paid by a trustee on the trust's share of an entity's taxable income be paid, rather than paid proportionately:

- (1) Makes a nonsubstantive change;
- (2) from principal to the extent that receipts from the entity are allocated only to principal;
- (3) proportionately from principal and income to the extent that receipts from the entity are allocated to both income and principal; and
- (4) from principal to the extent that the tax exceeds the total receipts from the entity.

Deletes existing Subdivision (2)(B) requiring that a tax required to be paid by a trustee on the trust's share of an entity's taxable income be paid proportionately 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 described in Subdivisions (1) and (2)(A). Makes nonsubstantive changes.

(d) Requires the trustee, after applying Subsections (a) (relating to requiring that a tax required to be paid by a trustee based on receipts allocated to income be paid from income), (b) (relating to requiring a tax required to be paid by a trustee based on receipts allocated to principal be paid from principal, even if the tax is called an income tax by the taxing authority), and (c), to 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. Deletes existing text requiring receipts allocated to principal or income to be reduced by the amount distributed to a beneficiary from principal or income for which the trust receives a deduction in calculating the tax for purposes of this section.

SECTION 9. (a) Provides that, except as otherwise expressly provided by the will, the trust, or this Act, the changes in law made by this Act apply to:

- (1) a trust existing or created on or after September 1, 2011;
 - (2) the estate of a decedent who dies before September 1, 2011, if the probate or administration of the estate is pending as of September 1, 2011; and
 - (3) the estate of a decedent who dies on or after September 1, 2011.
- (b) Provides that for a trust existing on September 1, 2011, 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, 2011.
- (c) Makes application of Sections 112.038, 115.002, and 115.011, Property Code, as amended by this Act, prospective.
- (d) Provides that the amendment by this Act of Section 115.001, Property Code, is intended to clarify rather than change existing law.

SECTION 10. Effective date: September 1, 2011.