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IN SUPPORT OF SENATE BILL 1083

**AN ACT CONCERNING AMENDMENTS TO THE CONNECTICUT
UNIFORM PRINCIPAL AND INCOME ACT**

**Judiciary Committee
March 9, 2009**

Thank you for the opportunity to appear before the Committee to comment on Senate Bill 1083. My name is John Ivimey. I am a principal of Reid and Riege, PC in Hartford, Secretary of the Connecticut Bar Association Estates and Probate Section and a fellow of the American College Trust and Estate Counsel. Our Section proposed this bill regarding amendments to the Connecticut Uniform Principal and Income Act.

The Principal and Income Act governs how a trust allocates receipts and expenses as between income beneficiaries and remainder beneficiaries. While in many cases, creators of trusts are free to determine in the document how these items should be allocated, the Principal and Income Act is a "default" rule that governs in the absence of specific direction. Connecticut adopted this version of the Uniform Principal and Income Act in 1999. The change proposed in Senate Bill 1083 is quite technical in nature but can be quite important in certain circumstances.

The change has to do with how receipts from a deferred compensation plan, such as an IRA are treated when paid to a trust that is intended to qualify for the federal estate tax marital deduction. It is not uncommon for the owner of an IRA account to provide that the proceeds upon his or her death are paid to a trust for the surviving spouse.

This is particularly true in the case of second marriages. Oftentimes, the plan is that the payment to this trust will qualify for the federal and state marital deduction so that no estate tax is paid in the first estate but is postponed until the surviving spouse dies. The most typical way of providing for this outcome (called the "marital deduction") is through a "QTIP Marital Trust" where the surviving spouse must receive all of the trust income. In rulings that were issued a few years ago, the IRS provided that if the trust is properly structured, then the marital deduction would be available. However, those IRS rulings required that special provisions

be included in the trust document. The IRS found that the default provisions in statutes such as the Connecticut Uniform Principal and Income Act were not adequate to comply with the tax requirements.

Accordingly, the proposed amendment to the Connecticut statute provides that even where the trust agreement itself does not include the provisions required by IRS, a payment to a trust otherwise qualifying for the marital deduction will be eligible. The change in the statute provides that "internal income" of the IRA itself (meaning interest and dividends) may be withdrawn at all times by the surviving spouse.

Attached to this testimony I have included an additional change to the Uniform Principal and Income Act that we are requesting. This proposed change has to do with the allocation of income taxes for trusts that receive receipts from a "pass through entity" like a partnership, LLC or an S corporation. Under some interpretations of the existing statute, a problem can arise where a trust is required to distribute all of its income to a trust beneficiary and it receives a distribution from a pass through entity. In general, this cash distribution is treated as income and would pass through to the beneficiary. However, there can be instances where the taxable income attributable to the pass through entity that must be reported by the trust exceeds the cash distribution.

In other words, the trustee would have an income tax obligation but not have cash available with which to pay the tax. This change would, in effect, allow the trustee to withhold a portion of the cash in order to pay the income tax liability. I hope that you will accept this substitute language in SB 1083.

These are modest but important changes to our Uniform Principal and Income Act. On behalf of the Estates and Probate Section, I urge the Committee to approve Senate Bill 1083 and adopt the attached proposed additional change.

**PROPOSED AMENDMENT
TO
Raised Senate Bill 1083**

--- To be inserted between lines 80 and 81 ---

Section 45a-542bb of the general statutes is amended as follows (*Effective October 1, 2009*):

(a) A tax required to be paid by a trustee based on receipts allocated to income must be paid from income.

(b) 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 by the taxing authority.

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

(1) from income to the extent that receipts from the entity are allocated only to income; and

(2) from principal to the extent that:

(A) receipts from the entity are allocated only to principal; and

~~(B) the trust's share of the entity's taxable income exceeds the total receipts described in paragraphs (1) and 2(A).~~

(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.

~~(d) For purposes of this section, 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. After applying subsections (a) through (c), the trustee shall 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.~~

