

D R A F T

FOR DISCUSSION ONLY

UNIFORM TRUST ACT

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

MEETING IN ITS ONE-HUNDRED-AND-SEVENTH YEAR
CLEVELAND, OHIO

JULY 24 – 31, 1998

UNIFORM TRUST ACT

WITH PREFATORY NOTE AND COMMENTS

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NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

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UNIFORM TRUST ACT

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UNIFORM TRUST ACT

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PREFATORY NOTE

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The Uniform Trust Act is the first comprehensive attempt at the national level to codify the law of trusts. A Study Committee was appointed in 1993. The Drafting Committee was appointed in 1994, met once during the 1994-1995 year, and twice yearly during 1995-1996, 1996-1997, and 1997-1998.

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Reasons for Trust Act – There are several reasons why the drafting of a Uniform Trust Act is timely. The primary stimulus is the much greater use of trusts in recent years, particularly the revocable living trust, even among those of moderate wealth. This greater use of the trust, and consequent rise in the number of day-to-day questions involving trusts, has led to a recognition that the trust law in many States is quite thin – a few scattered statutes and even less in the way of reported cases. It has also led to a recognition that the existing Uniform Acts relating to trusts, while numerous, are incomplete. The primary source of trust law in most States is thus the Restatement (Second) of Trusts and the multivolume treatises by Scott and Bogert, sources which fail to address numerous practical issues and which on others provide insufficient guidance. While there are numerous Uniform Acts related to trusts, none is comprehensive. The Uniform Trust Act hopefully will provide States with precise answers to these trust law questions and in an easily findable place.

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Existing Uniform Laws on Trust Law Subjects – There are numerous Uniform Acts on trusts and related subjects, but none provide comprehensive coverage of trust law issues. Certain of these Acts are incorporated into the larger Uniform Trust Act. Others, addressing more specialized topics, will continue to be available for enactment in their free-standing form. The following are the most relevant Acts:

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Uniform Trustee Powers Act – approved in 1964, it has been enacted in 16 States. The Act, as its name implies, contains a list of specific trustee powers and deals with selected other issues, particularly rights of third parties. The Trustee Powers Act, at a minimum, needs to be updated to reflect the recently approved Uniform Prudent Investor Act. Revisions are also needed due to changes in commercial practice, such as the invention of the LLC. The substantive issues covered by the Trustee Powers Act, but with numerous updates, are fully incorporated into the draft of the Uniform Trust Act, principally at Sections 5-117 and 7-202.

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1 Uniform Prudent Investor Act – approved in 1994, this Act has been enacted in
2 over half of the States. This Act, and variant forms enacted in a number of other
3 States, will soon displace the obsolete “prudent man” concept. The Prudent
4 Investor Act is incorporated into the Uniform Trust Act as Article 5, Part 2.

5 Revised Uniform Principal and Income Act – a major revision of this widely
6 enacted Uniform Act was approved in 1997. The Act extensively revises the
7 accounting rules applicable to both trusts and estates. The Revised Uniform
8 Principal and Income Act (1997) is incorporated into the Uniform Trust Act as
9 Article 6.

10 Uniform Custodial Trust Act – approved in 1987, this Act has been enacted to
11 date in 13 jurisdictions. This Act, which allows standard trust provisions to be
12 automatically incorporated into the terms of the trust simply by referring to the
13 Act, is not displaced by the Uniform Trust Act but complements it.

14 Uniform Probate Code Article VII – approved in 1969, Article VII has been
15 enacted in about 15 jurisdictions. Article VII, although titled “Trust
16 Administration,” is a modest statute, addressing only a limited number of topics,
17 such as trust registration, jurisdiction, and trustee liability to third parties. The
18 substance of Article VII, other than its provisions on trust registration, are
19 absorbed into the Uniform Trust Act, the provisions on jurisdiction at Article 1,
20 Part 2, and the provisions on rights of third parties at Section 7-201.

21 Uniform Common Trust Fund Act – approved in 1938, this Act has been
22 enacted in 34 States. The drafters of the Uniform Trust Act have elected not to
23 address the subject of common trust funds and will leave this Act undisturbed.
24 Common trust funds have receded in importance in recent years and are being
25 replaced by proprietary mutual funds that may also be made available to non-
26 trust customers. The Uniform Trust Act addresses the use of proprietary funds,
27 principally at Section 5-103.

28 Uniform Trust Act (1937) – this largely overlooked Act of the same name was
29 enacted in only six States, none within the past several decades. Despite a title
30 suggesting comprehensive coverage of its topic, this Act addresses even less
31 topics than does Article VII of the UPC. This Act is not being used in the
32 drafting of the current Act and should be withdrawn as obsolete.

33 Uniform Supervision of Trustees for Charitable Purposes Act – approved in
34 1954, this Act has been enacted in four States. This Act is limited to
35 mechanisms for monitoring the actions of charitable trustees and does not
36 address the substantive law of charitable trusts, including the doctrine of cy pres.
37 Cy pres is dealt with in Article 2, Part 3 of the Uniform Trust Act.

1 Uniform Testamentary Additions to Trusts Act – this Act is available in two
2 versions: the 1960 Act, with 32 enactments; and the 1991 Act, with 15
3 enactments through 1996. This Act validates pourover devises to trusts. While
4 not incorporated into the Uniform Trust Act, the Testamentary Additions to
5 Trusts Act, like the Uniform Trust Act, is designed to facilitate the use of the
6 revocable living trust.

7 Uniform Probate Code – approved in 1969, and enacted in close to complete
8 form in about 20 States but influential in all, the UPC overlaps with trust topics
9 in several areas. One area of overlap, already mentioned, is UPC Article VII. A
10 second area of overlap are the rules of construction found in UPC Article II,
11 Part 7. These provisions extend to revocable trusts and other nonprobate
12 arrangements the rules of construction originally developed under the law of
13 wills. Because the Uniform Trust Act deals exclusively with the law of trusts,
14 the Drafting Committee has elected not to incorporate these rules of
15 construction into the draft. A third area of overlap between the UPC and the
16 Uniform Trust Act concerns representation of beneficiaries. UPC Section 1-403
17 provides principles of representation for achieving binding judicial settlements of
18 matters involving both estates and trusts. The Uniform Trust Act adopts these
19 representation principles, and extends them to nonjudicial settlements
20 concerning trusts and to notices and consents required by or which may be given
21 under the Act. See Uniform Trust Act, Article 7, Part 3.

22 **Role of Restatement of Trusts** – The Restatement (Second) of Trusts was
23 approved by the American Law Institute in 1957. But beginning in the late 1980s,
24 work on the Restatement Third began. The portion of Restatement Third relating to
25 the prudent investor rule and other investment topics was completed and approved
26 in 1992. A tentative draft of the portion of Restatement Third relating to the rules
27 on the creation and validity of trusts was approved in 1996. The Uniform Trust Act
28 is being drafted in close coordination with the writing of the Restatement Third. To
29 the extent feasible, the Trust Act follows the portions of the Restatement Third
30 which have been completed to date. Through close consultation with the other
31 project’s reporter, efforts are being made as well to coordinate the drafting of the
32 Uniform Act with the current best guess on the probable substance of the
33 uncompleted portions of the Restatement. Given the current pace of the
34 Restatement Third, the Uniform Trust Act will likely be completed several years
35 ahead of the other project.

36 **Models for Drafting** – While the Uniform Trust Act is the first
37 comprehensive *Uniform* Act on the subject of trusts, comprehensive trust statutes
38 are already in effect in several States. Notable examples include the statutes in
39 California, Georgia, Indiana, and Texas, all of which have been referred to in the
40 drafting process. Most influential has been the 1986 California statute, which was

1 used by the Drafting Committee as its initial model. The California statute is known
2 as the Trust Law and is found at Division 9 of the California Probate Code (Sections
3 15000 *et seq.*). There are several reasons why the California statute was selected.
4 First, the California statute addresses many more issues than do the statutes of the
5 other States. Second, the California law draws extensively from the other state
6 models. Most importantly, the California Law Revision Commission, which drafted
7 the California Trust Law, conformed its drafting with the text of the Restatement,
8 although of the Restatement Second, not Restatement Third. The California law
9 was only a starting point, however. The draft at this point is entirely the Drafting
10 Committee's work product. Since drafting began in 1995, each of the California
11 provisions had been discussed by the Drafting Committee and either accepted,
12 rejected or revised. The provisions which remain have also been reorganized.

13 **Act as Default Law** – The Act contains a series of default rules which may
14 be modified by the terms of a trust. But there are certain provisions not subject to
15 change by the settlor. These include the methods for creating a trust (Article 2, Part
16 1), the procedures for terminating of modifying a trust other than by its express
17 terms (Article 2, Part 2), the exceptions to enforcement of a spendthrift provision
18 (Article 2, Part 4), and the standard of capacity for creating a revocable trust
19 (Section 3-101). While the settlor is free to modify the powers and duties of a
20 trustee, a trustee must always act in good faith and with regard to the purposes of
21 the trust and the interest of the beneficiaries. See Sections 5-101 and 7-105.

22 **Overview of Act**

23 **Article 1 – General Provisions, Definitions, and Jurisdiction of Court** –
24 Besides supplying definitions which apply throughout the Act (Section 1-105), this
25 article addresses selected issues involving judicial proceedings concerning trusts,
26 particularly trusts with contacts to more than one State or country (Article 1, Part
27 2). The key concept is locating the trust's principal place of administration, which
28 determines where the trustee and beneficiaries have consented to jurisdiction and
29 which court has primary jurisdiction over proceedings involving the administration
30 of a trust. A procedure for changing the principal place of administration is also
31 provided.

32 **Article 2, Part 1 – Creation and Validity of Trust** – This part specifies the
33 requirements for the creation of a trust. Most of the requirements track traditional
34 doctrine, including intention, capacity, a requirement of property, and a purpose that
35 must be for the benefit of the trust's beneficiaries. This part develops a three-part
36 classification system for trusts. Noncharitable trusts ordinarily require an
37 ascertainable beneficiary, charitable trusts by their very nature are created to benefit
38 the public at large. Honorary trusts are trusts for noncharitable purposes which are
39 valid despite the absence of an ascertainable (i.e., human) beneficiary. These include

1 trusts for the care of an animal and trusts for other noncharitable purposes such as
2 the maintenance of a cemetery lot.

3 **Article 2, Part 2, Modification or Termination of Trust** – This part
4 provides a series of interrelated rules on when a trust may be terminated or modified
5 other than by its express terms. The overall objective of this part is to liberalize the
6 common law rules but without losing sight of the principle that preserving the
7 settlor’s intent is paramount. Termination or modification may be allowed upon
8 beneficiary consent if the trust no longer serves a material purpose or if the settlor
9 concurs (Section 2-202), by the court in response to unanticipated circumstances
10 (Section 2-203), or if continued administration under the trust’s existing terms
11 would be uneconomical (Section 2-204). Trusts may be reformed to correct a
12 mistake of law or fact (Section 2-205), or modified to achieve the settlor’s tax
13 objectives (Section 2-206). Trusts may be combined or divided (Section 2-207). A
14 settlor, trustee, or beneficiary has standing to petition the court with respect to a
15 proposed termination or modification (Section 2-208).

16 **Article 2, Part 3, Charitable Purposes** – This part does not
17 comprehensively address the topic of charitable giving. Instead, its focus is on the
18 doctrine of cy pres, which it attempts to restate by stating explicitly what courts tend
19 to do in actual practice. Unless the terms of the trust provide to the contrary, a
20 charitable trust does not fail if a specific charitable purpose becomes impracticable,
21 unlawful, impossible to fulfill, or wasteful. Rather, the court, applying cy pres, must
22 apply or distribute the trust property, in whole or in part, in a manner most closely
23 approximating the settlor’s charitable purpose.

24 **Article 2, Part 4 – Spendthrift Provisions and Claims by Creditors** –
25 This part addresses the validity of a spendthrift provision and other issues relating to
26 the rights of creditors, both of the settlor and beneficiaries, to reach the trust to
27 collect a debt. Section 2-401 specifies the requirements for a valid spendthrift
28 provision and, if valid, its effect. For trusts without valid spendthrift provisions,
29 Section 2-402 describes the circumstances under which a beneficiary’s creditors may
30 reach the beneficiary’s interest. Section 2-403 lists the categories of creditors
31 whose claims are not subject to a spendthrift bar, and the extent to which such a
32 creditor may reach the trust. Sections 2-404 to 2-406 address special categories
33 where the rights of a beneficiary’s creditors may not depend on whether the trust
34 contains a spendthrift provision. Section 2-404 deals with discretionary trusts and
35 trusts which provide for a standard of distribution. Section 2-405 addresses creditor
36 claims against a settlor, whether the trust is revocable or irrevocable, and if
37 revocable, whether the claim is made during the settlor’s lifetime or incident to the
38 settlor’s death. Section 2-406 provides a creditor with a remedy if a trustee fails to
39 make a required distribution within a reasonable time.

1 **Article 3, Revocable Trusts** – Because of the widespread use in recent
2 years of the revocable trust as an alternative to a will, this short article is one of the
3 more important articles of the Act. Each section of this article deals with issues of
4 significance not totally settled under current law. A general theme of this article and
5 of the other parts of the Act is to treat the revocable trust as the functional
6 equivalent of a will. The article specifies a standard of capacity, provides that a trust
7 is presumed revocable unless its terms provide otherwise, prescribes the procedure
8 for revocation or modification, and provides a statute of limitations on contests.

9 **Article 4, Office of Trustee** – This article contains a series of default rules
10 dealing with the office of trustee, all of which may be modified by the terms of the
11 trust. Sections 4-101 and 4-102 address the process for getting a trustee into office,
12 including the procedures for indicating an acceptance of office and whether bond
13 will be required. Section 4-103 covers the office of cotrustee, permitting cotrustees
14 to act by majority action, specifying the extent to which one trustee may delegate to
15 another, and describing the circumstances under which a cotrustee may be held
16 responsible for the actions of the other trustee or trustees. Sections 4-104 through
17 4-108 address changes in the office of trustee, specifying the circumstances when a
18 vacancy must be filled, the procedure for resignation, the grounds for removal, and
19 the process for appointing a successor. Sections 4-109 and 4-110 describe the
20 standard for determining trustee compensation and reimbursement for expenses
21 advanced.

22 **Article 5, Part 1, Duties and Powers of Trustee** – This part states the
23 fundamental duties of a trustee and lists the trustee’s powers. The duties listed are
24 not new, but how the particular duties are formulated and applied has changed over
25 the years. This part was drafted where possible to conform with the 1994 Uniform
26 Prudent Investor Act. The Uniform Prudent Investor Act prescribes a trustee’s
27 responsibilities with respect to the management and investment of trust property.
28 This Act also addresses a trustee’s duties with respect to distributions to
29 beneficiaries.

30 **Article 5, Part 2, Uniform Prudent Investor Act** – This part reproduces
31 the Uniform Prudent Investor Act as approved in 1994. Because of the widespread
32 adoption of the Uniform Prudent Investor Act, no effort has been made to
33 interweave the Prudent Investor Act into the preceding part of this Act. States
34 adopting this Act which have previously enacted the Prudent Investor Act are
35 encouraged to recodify their version of the Prudent Investor Act by reenacting it as
36 part of this Act. By enacting the Prudent Investor Act as a separate part of this Act,
37 uniformity with States which have enacted the Prudent Investor Act in its free-
38 standing form will be preserved.

1 **Article 6, Revised Uniform Principal and Income Act** – This article
2 reproduces the Revised Uniform Principal and Income Act as approved by the
3 Uniform Law Conference at its 1997 Annual Meeting.

4 **Article 7, Part 1, Liability of Trustees to Beneficiaries** – This part lists
5 the remedies for breach of trust, describes how money damages are to be
6 determined, provides a statute of limitations on claims against a trustee, and
7 specifies other defenses, including consent of a beneficiary and recognition of and
8 limitations on the effect of an exculpatory clause.

9 **Article 7, Part 2, Rights of Third Persons** – This part addresses trustee
10 relations with third parties. The emphasis is on encouraging trustees and third
11 parties to engage in commercial transactions to the same extent as would occur if
12 the property were not held in trust. This part, among other things, permits a trustee
13 to rely on a certification of trust, thereby hopefully reducing requests by third parties
14 for copies of the complete trust instrument.

15 **Article 7, Part 3, Representation of Beneficiaries and Settlement**
16 **Agreements** – This part deals with the important topic of representation of
17 beneficiaries, both representation by fiduciaries (personal representatives, guardians
18 and conservators), and what is known as virtual representation. The representation
19 principles of the part apply for purposes of settlement of disputes, whether by a
20 court or nonjudicially. They apply for the giving of required notices. They apply for
21 the giving of consents to certain actions.

22 **Article 8, Transitional and Miscellaneous Provisions** – The Act is
23 intended to have the widest possible application, consistent with constitutional
24 limitations. The Act applies not only to trusts created on or after the effective date,
25 but also to trusts in existence on the date of enactment.

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UNIFORM TRUST ACT

ARTICLE 1
GENERAL PROVISIONS, DEFINITIONS,
AND JURISDICTION OF COURT

PART 1
GENERAL PROVISIONS AND DEFINITIONS

SECTION 1-101. SHORT TITLE. This [Act] may be cited as the Uniform Trust Act.

SECTION 1-102. CONSTRUCTION AGAINST IMPLIED REPEAL.
This [Act] is a general act intended to provide unified coverage of its subject matter. No part of this [Act] may be construed as impliedly repealed by subsequent legislation if that construction can reasonably be avoided.

SECTION 1-103. COMMON LAW OF TRUSTS. The common law of trusts supplements this [Act] except to the extent that it is modified by this [Act] or another statute of this State.

Comment

The Act codifies those portions of the law of express trusts that are most amenable to codification. The Act is supplemented by the common law of trusts, including principles of equity, particularly as articulated in the Restatement of Trusts. The common law of trusts is not static but includes the contemporary and

1 **SECTION 1-105. DEFINITIONS.** In this [Act]:

2 (1) “Beneficiary” means a person who has any present or future beneficial
3 interest in a trust, whether vested or contingent, or a power of appointment.

4 (2) “Charitable trust” means a trust created for a charitable purpose as
5 described in Section 2-301. The term excludes the interests in the trust of a
6 noncharitable beneficiary.

7 (3) “Conservator” means a person appointed by a court to manage the
8 estate of a minor or adult individual.

9 (4) “Fiduciary,” used as a noun, includes a personal representative,
10 guardian, conservator, and trustee.

11 (5) “Good faith” means honesty in fact and, when used in reference to:

12 (A) a trustee, the observance of fiduciary principles; or

13 (B) a third party, the observance of reasonable standards of fair dealing.

14 (6) “Guardian” means a person appointed by a court [,parent, or spouse] to
15 make decisions regarding the support, care, education, health, and welfare of a
16 minor or adult individual. The term does not include a guardian ad litem.

17 (7) “Know,” with respect to a particular fact, means to have actual
18 knowledge of the fact or have reason to know, based upon all of the facts and
19 circumstances actually known to the person at the time, that the particular fact
20 exists.

1 (8) “Person” means an individual, corporation, business trust, estate, trust,
2 partnership, limited liability company, association, joint venture, government,
3 governmental subdivision, or agency, or any other legal or commercial entity.

4 (9) “Petition” includes a complaint and statement of claim.

5 (10) “Property” means anything that may be the subject of ownership,
6 whether real or personal, legal or equitable, or any interest therein. The term
7 includes a chose in action, claim, or beneficiary designation under a policy of
8 insurance, financial instrument, employees’ trust, or other arrangement, whether
9 revocable or irrevocable.

10 (11) “Qualified beneficiary” means a beneficiary who, on the date the
11 beneficiary’s qualification is determined, is entitled or eligible to receive a
12 distribution of trust income or principal or who would be entitled to receive a
13 distribution if the event causing the trust’s termination occurred.

14 (12) “Settlor” means a person who creates a trust. The term includes a
15 testator.

16 (13) “Spendthrift provision” means a term of a trust which restrains the
17 voluntary or involuntary transfer of a beneficiary’s interest.

18 (14) “State” means a State of the United States, the District of Columbia,
19 Puerto Rico, the United States Virgin Islands, or any territory or insular possession
20 subject to the jurisdiction of the United States.

21 (15) “Terms of a trust” means the manifestation of the intent of a settlor
22 regarding a trust’s provisions at the time of the trust’s creation or amendment which

1 is expressed in a manner admitting of its proof in a judicial proceeding, whether by
2 written or spoken words or by conduct.

3 (16) “Trust” means an express trust, charitable or noncharitable, with
4 additions thereto, wherever and however created, including a trust created pursuant
5 to a statute, judgment, or decree under which the trust is to be administered in the
6 manner of an express trust.

7 (17) “Trustee” includes an original, additional, or successor trustee, whether
8 or not appointed or confirmed by a court.

9 **Comment**

10 “Beneficiary” (paragraph (1)) refers only to a beneficiary of a trust as defined
11 in the Act. The term includes not only beneficiaries who received their interests
12 under the terms of the trust but also beneficiaries who received their interests by any
13 other means, including by an assignment, the exercise of a power of appointment, by
14 a resulting trust upon the failure of an interest or gap in a disposition, or through the
15 operation of an antilapse statute upon the predecease of a named beneficiary. The
16 fact that a person incidentally benefits from the trust does not mean that the person
17 is a beneficiary. For example, neither a trustee nor persons hired by the trustee
18 become beneficiaries merely because they receive compensation from the trust. See
19 Restatement (Third) of Trusts § 49 (Preliminary Draft No. 3, 1997).

20 Under the Act, only the charitable portion of a trust with both charitable and
21 noncharitable beneficiaries qualifies as a “charitable trust” (paragraph (2)).
22 Consequently, a split-interest trust will in certain instances be governed by two sets
23 of provisions, one applicable to the charitable interests, the other the noncharitable.
24 Compare, e.g., Section 2-204 (termination or modification of uneconomic
25 noncharitable trust) with Section 2-303 (termination or modification of uneconomic
26 charitable trust).

27 The definition of “fiduciary” (paragraph (4)) refers to the person holding a
28 fiduciary office as opposed to the duties or obligations of the office. A trustee may
29 engage in transactions with another trust, decedent’s estate or conservatorship
30 estate of which the trustee is the fiduciary. See Section 5-103(f)(3). A trustee has a
31 duty to redress a breach of trust committed by a former trustee or other fiduciary
32 from whom the trustee received trust property. See Section 5-113.

1 Under the Act, more is required than honesty of intent before a trustee, in
2 dealing with the beneficiaries, or a third party, in dealing with a trustee, can be said
3 to have been acting in “good faith” (paragraph (5)). The trustee or third party must
4 also have exhibited honesty in conduct. For a third party, this requires the
5 observance of reasonable standards of fair dealing, a requirement based on
6 comparable provisions of the Uniform Commercial Code. See Unif. Commercial
7 Code Section 3-103(4). For a trustee, honesty in conduct is exhibited by acting in
8 accordance with fiduciary principles, particularly the obligation not to place the
9 trustee’s own interests above those of the beneficiaries. See Section 5-103 (duty of
10 loyalty). The obligation of a trustee to act in good faith may not be waived in the
11 terms of the trust. See Section 5-101 (modification of duties and powers of settlor);
12 Section 5-115 (duty with regard to discretionary power). Nor is a term of a trust
13 which exculpates a trustee for not acting in good faith enforceable. See Section
14 7-105 (exculpation of trustee). With respect to a third person, good faith, and the
15 associated requirement of observance of reasonable standards of fair dealing, is
16 required before the third person may be protected in dealings with the trustee (see
17 Section 7-202), or for rejecting a certification of trust. See Section 7-203.

18 Under the Act, a “guardian” (paragraph (6)) makes decisions with respect to
19 personal care; a “conservator” (paragraph (3)) manages property. The terminology
20 used is that employed in Article V of the Uniform Probate Code, and in its free-
21 standing Uniform Guardianship and Protective Proceedings Act. Enacting
22 jurisdictions not using these terms in the defined sense may wish to substitute their
23 own terminology. The definition of “guardian” accommodates those jurisdictions
24 which allow appointment of a guardian by a parent or spouse in addition to
25 appointment by a court. Enacting jurisdictions which allow appointment of a
26 guardian solely by a court should delete the bracketed language.

27 The fact that a person does not have actual knowledge of a particular fact
28 does not mean that the person did not “know” the fact (paragraph (7)). But neither
29 is a person charged with knowledge of facts the person would have discovered upon
30 investigation. This definition takes an intermediate approach. A fact is known to a
31 person if the person had actual knowledge of the fact or had reason to know of the
32 fact’s existence based on all of the circumstances and other facts actually known to
33 the person. “Know” is used in its defined sense in Section 5-109 (trustee knows
34 holder of power to direct has violated fiduciary duty owes to beneficiaries), and
35 Section 7-202 (protection of persons dealing with trustee). But actual knowledge is
36 required if the knowledge requirement relates to a proceeding in court. See
37 Sections 3-104(b) (limitation on contest of revocable trust), 7-307 (notice of judicial
38 settlement), and 7-308 (appointment of guardian ad litem). And for certain actions,
39 a person is charged with knowledge of facts the person would have discovered upon
40 reasonable inquiry. See Sections 7-104 (limitation of action against trustee

1 following final report or other statement), and 7-106 (nonliability of trustee for
2 beneficiary's consent, release, or ratification).

3 The definition of "property" (paragraph (10)) removes any lingering
4 uncertainty that a revocable designation under an employee plan or life insurance
5 contract is not a sufficient property interest to activate a trust. See also Section
6 2-101 and Comment (methods of creating trust).

7 Because of the difficulty of identifying beneficiaries with remote contingent
8 interests and their probable lack of interest in the day-to-day affairs of the trust, the
9 Act uses the concept of "qualified beneficiary" (paragraph (11)) to limit the class of
10 beneficiaries to whom certain notices must be given or consents received. The
11 definition of qualified beneficiaries is used to define the class to whom notice must
12 be given of a trustee resignation. See Section 4-105. The qualified beneficiary must
13 receive the trustee's annual report and other notices required by Section 5-114.
14 Notice to the qualified beneficiaries is also required before a trust may be combined
15 or divided. See Section 2-207. Actions which may be accomplished by the consent
16 of the qualified beneficiaries include the transfer of a trust's jurisdiction and the
17 appointment of a successor trustee. See Sections 1-205 (transfer of jurisdiction) and
18 4-108 (filling vacancy).

19 The qualified beneficiaries are limited to the beneficiaries currently eligible to
20 receive a distribution from the trust as well as what might be termed the first line
21 remaindermen, that is, the beneficiaries who would receive the principal were the
22 event triggering the trust's termination to occur on the date in question. Such a
23 terminating event will typically be the death or deaths of the beneficiaries currently
24 eligible to receive the income. Should a qualified beneficiary be a minor,
25 incapacitated, unknown or unascertained, the representation and virtual
26 representation principles of Article 7, Part 3 may apply, including the possible
27 appointment of a guardian ad litem or special representative to represent the
28 beneficiary's interest.

29 Determining the identity of the "settlor" (paragraph (12)) is usually not an
30 issue. The same person will both sign the trust instrument and fund the trust.
31 Ascertaining the identity of the settlor becomes more difficult when more than one
32 person signs the trust instrument or funds the trust. The fact that a person is
33 designated as the "settlor" by the terms of the trust is not necessarily determinative.
34 For example, the person who executes the trust instrument may be acting as the
35 agent for the person who will be funding the trust. In that case, the person funding
36 the trust, and not the person signing the trust instrument, will be the settlor.
37 Similarly, should more than one person contribute to a trust, all of the contributors
38 will ordinarily be treated as settlors in proportion to their respective contributions,
39 regardless of which one signed the trust instrument. However, in the case of a

1 revocable trust, transfers made to the trust by a person who did not participate in the
2 trust's creation will frequently be intended as a donative transfer to the person who
3 originally created the trust. In that event, only the person who created the trust, and
4 not the later donor, will be the settlor.

5 Ascertaining the identity of the settlor is important for a variety of reasons.
6 It is important for determining rights in revocable trusts. See Sections
7 2-405(a)(2)-(3) (creditor claims against settlor of revocable trust), 3-102
8 (revocation or modification of revocable trust), and 3-104 (limitation on contest of
9 revocable trust). It is also important for determining rights of creditors in
10 irrevocable trusts. See Section 2-405(a)(1) (creditor can reach whatever trustee
11 could pay to settlor). While the settlor of an irrevocable trust traditionally has no
12 continuing rights over the trust except for a right to terminate the trust with the
13 beneficiaries' consent (see Section 2-202), under the Act the settlor of an
14 irrevocable trust may also petition for removal of the trustee or for a court order
15 relating to trust termination or modification. See Sections 2-208 (petitions for
16 approval or disapproval), and 4-106 (removal of trustee). Also, per Section
17 2-301(c), the settlor may maintain an action to enforce or modify a charitable trust.

18 “Spendthrift provision” (paragraph (13)) means a term of a trust which
19 restrains the transfer of a beneficiary's interest, either by a voluntary act of the
20 beneficiary or by an action by a beneficiary's creditor or assignee, which at least as
21 far as the beneficiary is concerned, would be involuntary. The effect of a spendthrift
22 provision is addressed in Article 2, Part 4. The presence of a spendthrift provision
23 may also constitute a material purpose sufficient to prevent the termination of a trust
24 by agreement of the beneficiaries, although the Act does not presume this result.
25 See Section 2-202.

26 “Terms of a trust” (paragraph (15)) is a defined term used with some
27 frequency in the Act. While the wording of a written trust instrument is almost
28 always the most important determinant of a trust's terms, the definition is not so
29 limited. Oral statements, the settlor's family circumstances, and, to the extent the
30 settlor was otherwise silent, rules of construction, all may have a bearing on
31 determining a trust's meaning. If a trust established by order of court is to be
32 administered as an express trust, the terms of the trust are determined from the court
33 order as interpreted in light of the general rules governing interpretation of
34 judgments. See Restatement (Third) of Trusts § 4 and cmt. f (Tentative Draft No.
35 1, 1996).

36 Not all evidence may necessarily be considered in determining the terms of a
37 trust. A manifestation of a settlor's intention does not constitute evidence of a
38 trust's terms if it would be inadmissible in a judicial proceeding in which the trust's
39 terms are in question. See Restatement (Third) of Trusts § 4 cmt. b (Tentative

1 Draft No. 1, 1996). See also Restatement (Third) Property: Donative Transfers
2 §§ 10.2, 11.1-11.3 (Tentative Draft No. 1, 1995). For example, in many States a
3 trust of real property is unenforceable unless evidenced by a writing, although this
4 Act does not so require, leaving this issue to be covered, if the enacting jurisdiction
5 so elects, by separate statute. See Section 2-103 (evidence of oral trust). Evidence
6 otherwise relevant to determining the terms of a trust may also be excluded under
7 other principles of law, such as the parol evidence rule.

8 Under the Act, a “trust” (paragraph (16)) means an express trust, whether
9 private or charitable, including a trust created by court judgment or decree which is
10 to be administered in the manner of an express trust. Excluded from the Act’s
11 coverage are constructive trusts, which are not express trusts but remedial devices
12 imposed by law. The Act is directed primarily at express trusts which arise in an
13 estate planning or other donative context, but the definition of “trust” is not so
14 limited. Trusts created pursuant to a divorce action would be included, even though
15 such a trust is not donative but is created pursuant to a bargained for exchange. The
16 extent to which even more commercially-oriented trusts are subject to the Act will
17 vary depending on the type of trust and the laws, other than this Act, under which
18 the trust was created. Commercial type trusts come in numerous different forms,
19 including trusts created pursuant to a state business trust act and trusts created for
20 special purposes, such as to pay a pension or managed pooled investments. See
21 John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of*
22 *Commerce*, 107 *Yale L.J.* 165 (1997).

23 **PART 2**
24 **JURISDICTION OF COURT**

25 **General Comment**

26 This part addresses selected issues involving judicial proceedings concerning
27 trusts, particularly trusts with contacts in more than one State or country. This part
28 is not intended as a comprehensive coverage of court jurisdiction or procedure with
29 respect to trusts, recognizing that many of these issues are better addressed
30 elsewhere, such as in the State’s rules of civil procedure or as provided by court
31 rule.

32 While the intervention of the court in the administration of a trust is not
33 encouraged, the jurisdiction of the court is available as invoked by persons
34 interested in the trust or as otherwise provided by law, such as on the direct
35 initiative of the court (Section 1-201). Proceedings involving the administration of a

1 trust will normally be brought in the court at the trust’s principal place of
2 administration, which is defined in Section 1-202. If not specified in the terms of the
3 trust, the principal place of administration will usually be the place where the day-to-
4 day activity of the trust is carried out. The trustee, by operation of law, is deemed
5 to have consented to the jurisdiction of the court at the principal place of
6 administration (Section 1-203), although courts in other places may also entertain
7 proceedings involving the administration of a trust if the parties consent or the
8 interests of justice so require (Section 1-204).

9 Changing a trust’s principal place of administration is sometimes desirable,
10 particularly to lower a trust’s state income tax. Many trust instruments expressly
11 authorize such a transfer, but for those which do not, Section 1-205 provides a
12 procedure for transfer, either with the consent of the “qualified” beneficiaries or
13 upon approval of court.

14 Sections 1-206 and 1-207 are optional, bracketed provisions relating to
15 subject-matter jurisdiction and venue.

16 The jurisdictional issues addressed in this part are also addressed in Article
17 VII of the Uniform Probate Code, but the Drafting Committee has elected not to
18 adopt the UPC provisions relating to trust registration. In this it is following the
19 example of a number of States which have enacted Article VII of the UPC without
20 the trust registration feature.

21 **SECTION 1-201. ROLE OF COURT IN ADMINISTRATION OF**

22 **TRUST.** The court may not intervene in the administration of a trust except to the
23 extent the jurisdiction of the court is invoked by persons interested in the trust or
24 otherwise exercised as provided by law.

25 **Comment**

26 The Act encourages the resolution of disputes without resort to the courts.
27 However, the court is always available to the extent its jurisdiction is invoked by
28 persons interested in the trust. Also, this section does not restrict the court’s
29 inherent and historical jurisdiction in trust matters, including the ability to provide
30 the trustee with instructions even in the absence of a dispute. A trustee should not
31 resort to the court as a matter of routine. Excessive resort to the court, with its
32 attendant costs, may constitute a breach of the duty to incur only reasonable costs of
33 administration. See Section 5-106.

1 This section prescribes rules for determining a trust’s principal place of
2 administration. Locating a trust’s principal place of administration will ordinarily
3 determine where the trustee and beneficiaries are subject to suit concerning the trust.
4 It may also be important for other matters, such as payment of state income tax.

5 Under the Act, once the principal place of administration is fixed, that
6 finding will determine where the trustee and beneficiaries have consented to suit
7 (Section 1-203), the circumstances when a proceeding may be entertained by a court
8 of another jurisdiction (Section 1-204), the procedure for transferring jurisdiction to
9 another State or country (Section 1-205), and the rules for locating venue within a
10 particular State (Section 1-207).

11 This section prescribes a priority list for ascertaining the principal place of
12 administration, but settlors who expect to name a trustee or cotrustees with
13 significant contacts in more than one State may wish to address this issue in the
14 terms of the trust. Pursuant to paragraph (2), a designation in the terms of the trust
15 is controlling absent a later transfer of jurisdiction to another place. Designating the
16 principal place of administration should be distinguished from designating the law to
17 determine the meaning and effect of the trust’s terms, as allowed by Section 1-104.
18 A settlor is free to designate one jurisdiction as the principal place of administration
19 and another to control the meaning of the dispositive provisions. Also, the law
20 governing the construction of the beneficial provisions of a trust does not change if
21 the principal place of administration is transferred to another State. See Section
22 1-205(e).

23 Most trusts will be controlled by paragraph (3), which fixes the principal
24 place of administration at the place where the day-to-day activity of the trust is
25 carried on. The place where the day-to-day activity is carried on will fix the
26 principal place of administration even if the trust is created by will or contains real
27 property. For financial-service institution trustees, the place where the day-to-day
28 activity is carried on will usually be the place where the personal trust officer is
29 located and not the place where the investments are safeguarded or records
30 processed.

31 Should the trust not be administered at a fixed location, and absent other
32 priority under this section, the principal place of administration will be determined
33 under paragraph (4), which looks to the trustee’s or cotrustees’ residence or usual
34 place of business. Under paragraph (4), it is possible that more than one jurisdiction
35 will qualify as the trust’s principal place of administration. This could occur, for
36 example, if cotrustees are located in more than one place. The practical result of
37 such dual residence or place of business may be to grant a beneficiary the choice of
38 forum in which to bring suit against a trustee.

1 to the Uniform Trust Act, the California statute lists the following as items relating
2 to the “internal affairs” of a trust:

- 3 (1) Determining questions of construction;
- 4 (2) Determining the existence or nonexistence of any immunity, power,
5 privilege, duty, or right;
- 6 (3) Determining the validity of a trust provision;
- 7 (4) Ascertaining beneficiaries and determining to whom property will pass
8 upon final or partial termination of the trust;
- 9 (5) Settling accounts and passing upon the acts of a trustee, including the
10 exercise of discretionary powers;
- 11 (6) Instructing the trustee;
- 12 (7) Compelling the trustee to report information about the trust or account
13 to the beneficiary;
- 14 (8) Granting powers to the trustee;
- 15 (9) Fixing or allowing payment of the trustee’s compensation or reviewing
16 the reasonableness of the compensation;
- 17 (10) Appointing or removing a trustee;
- 18 (11) Accepting the resignation of a trustee;
- 19 (12) Compelling redress of a breach of trust by any available remedy;
- 20 (13) Approving or directing the modification or termination of a trust;
- 21 (14) Approving or directing the combination or division of trusts; and
- 22 (15) Authorizing or directing transfer of a trust or trust property to or from
23 another jurisdiction.

24 To make certain that a court in the place of principal administration or
25 elsewhere may issue a binding order, subsection (b) allows the court to require a
26 party to consent to the jurisdiction of another court as a condition for a stay or
27 dismissal of proceedings brought under this section.

1 **SECTION 1-205. TRANSFER OF JURISDICTION.**

2 (a) A trustee may change a trust’s principal place of administration to
3 another State or country or transfer some or all of the trust property to a different
4 trustee outside this State:

5 (1) by substantially complying with a method specified in the terms of the
6 trust; or

7 (2) if the terms of the trust do not specify a method;

8 (A) with the consent of the qualified beneficiaries; or

9 (B) with the approval of the court, subject to such terms and
10 conditions as the court may order.

11 (b) The court may approve the transfer of a trust’s principal place of
12 administration to or from this State, or of the transfer of trust property to or from
13 this State to a new trustee, if it finds that:

14 (1) the transfer will promote the best interest of the trust and of its
15 beneficiaries, taking into account the economical and convenient administration of
16 the trust and the views of the beneficiaries;

17 (2) any new trustee to whom the trust property would be transferred is
18 willing and able to administer the trust or trust property under the terms of the trust;
19 and

1 of the courts in the former place, particularly if the former place is where the
2 beneficiaries are located.

3 This section validates the practice of specifying in the terms of the trust the
4 procedure for changing the principal place of administration to another place.
5 Subsection (a)(1) authorizes a trustee to change the principal place of administration
6 to another State or country, or transfer some or all of the trust property to a
7 different trustee outside of the State by substantially complying with a method
8 specified in the terms of the trust. For other examples where substantial and not
9 literal compliance with a procedure specified in the terms is permitted, see Sections
10 3-102 (revocation or modification of revocable trust), and 4-101 (acceptance or
11 rejection of trusteeship).

12 Should the terms of the trust not address transfer, subsection (a)(2)(A)
13 permits the trustee to change the place of administration upon approval of the
14 qualified beneficiaries. For the definition of qualified beneficiaries, see Section
15 1-105(11). Resort to the courts for approval of a transfer of jurisdiction is not
16 encouraged but is allowed under subsection (a)(2)(B). Per subsection (b), the court
17 must conclude that the transfer is in the best interest of the trust and its beneficiaries,
18 taking into account the economical and convenient administration of the trust and
19 the views of the beneficiaries. If appropriate to facilitate transfer of the trust
20 property or the place of administration of a trust to this State, the court may issue a
21 conditional order appointing a trustee to administer the trust in this State and
22 indicating that transfer to this State will be accepted if transfer is approved by the
23 proper court of the other jurisdiction. A trust that was subject to judicial
24 supervision in another State will not be subject to continuing court jurisdiction in
25 this State unless the terms of the trust so require or the court so determines in the
26 order accepting transfer to this State.

27 While transfer of the principal place of administration will normally change
28 the governing law with respect to administrative matters, subsection (e) clarifies that
29 such a change does not alter the controlling law with respect to the validity of the
30 trust and the construction of its beneficial provisions.

31 **[SECTION 1-206. SUBJECT MATTER JURISDICTION.]**

32 (a) The [designate] court has exclusive jurisdiction of proceedings brought
33 by a trustee or beneficiary concerning the administration of a trust.

1 (b) The [designate] court has concurrent jurisdiction with other courts of
2 this State of proceedings to determine the existence of a trust; proceedings by or
3 against creditors or debtors of trusts; and other judicial proceedings involving
4 trustees, beneficiaries, and third persons.]

5 **Comment**

6 This section, which is based on Section 7-201 of the Uniform Probate Code,
7 provides a means for distinguishing the jurisdiction of the court with primary
8 jurisdiction for trust matters from the jurisdiction of other courts, whether that court
9 be denominated the probate court, chancery court, or by some other name. The
10 section has been placed in brackets because subject-matter jurisdiction may already
11 be addressed by other statute or court rule and may be unnecessary to address in
12 States having unified court systems.

13 For an explanation of what types of matters are included in the phrase
14 “proceedings brought by a trustee or beneficiary concerning the administration of a
15 trust,” see the Comment to Section 1-204. Subsection (a) of this section is derived
16 from Section 7-201(a) of the Uniform Probate Code. Subsection (b) is based on
17 Section 7-204 of the Uniform Probate Code.

18 **[SECTION 1-207. VENUE.**

19 (a) A judicial proceeding concerning a trust may be commenced in the
20 [county] in which the trust’s principal place of administration is or is to be located
21 and, if the trust is created by will, in the [county] in which the decedent’s estate is
22 administered.

23 (b) If a trust created other than by will has no trustee, a judicial proceeding
24 for the appointment of a trustee must be commenced in the [county] in which a
25 beneficiary resides or the trust property, or some portion of the trust property, is
26 located.

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ARTICLE 2
CREATION, VALIDITY, MODIFICATION,
AND TERMINATION OF TRUST

PART 1
CREATION AND VALIDITY OF TRUST

General Comment

This part specifies the requirements for the creation of a trust. Most of the requirements track traditional doctrine. This part develops a three-part classification system for trusts. Noncharitable trusts ordinarily require an ascertainable beneficiary, charitable trusts by their very nature are created to benefit the public at large. Honorary trusts are trusts for noncharitable purposes which are valid despite the absence of an ascertainable (i.e., human) beneficiary. These include trusts for the care of an animal and trusts for other noncharitable purposes such as the maintenance of a cemetery lot.

Section 2-101 specifies the methods by which trusts are created, such as by transfer of property, self-declaration or exercise of a power of appointment. Section 2-102 lists the requirements for creation whatever method may have been employed, including intention, capacity and, if applicable, the necessity for an ascertainable beneficiary. Section 2-103 validates oral trusts, Section 2-104 enumerates the permitted purposes for which a trust may be created. The remaining sections address honorary trusts; Section 2-105 the trust for the care of an animal, and Section 2-106 the trust created for another noncharitable purpose.

SECTION 2-101. METHODS OF CREATING TRUST.

(a) A trust may be created by:

- (1) transfer of property to another person as trustee during the settlor's lifetime, or by will or other disposition taking effect upon the settlor's death;
- (2) declaration by the owner of property that the owner holds identifiable property as trustee; or

1 (3) exercise of a power of appointment in favor of another person as
2 trustee.

3 (b) Property subject to a declaration of trust may be identified in the terms
4 of the trust.

5 (c) Property may be transferred by means of the terms of a trust, which may
6 function as a deed of conveyance.

7 **Comment**

8 Subsection (a) follows Restatement (Second) of Trusts § 17 (1959) and
9 Restatement (Third) of Trusts § 10 (Tentative Draft No. 1, 1996). Under all three
10 methods specified in this section for creating a trust, the trust is not created until it
11 receives property. For what constitutes an adequate property interest, see
12 Restatement (Third) of Trusts § 41 (Preliminary Draft No. 3, 1997). The property
13 interest necessary to fund and create a trust need not be substantial. A revocable
14 designation of the trustee as beneficiary of a life insurance policy or employee
15 benefit plan is a property interest sufficient to create a trust. See Section 1-105(10)
16 (“property” defined). Furthermore, the property interest need not be transferred
17 contemporaneously with the signing of the trust instrument. A trust created by
18 means of an instrument signed during lifetime is not invalid simply because the
19 trustee does not receive property until a later date, including by will or contract at or
20 after the settlor’s death. A pourover devise to such a trust is also valid. See
21 Uniform Probate Code § 2-511 (pourover devise to trust valid regardless of
22 existence, size, or character of trust corpus).

23 While a trust created by will may come into existence immediately at the
24 testator’s death and not necessarily only upon the later transfer of title from the
25 personal representative, the nominated trustee does not have a duty to act until there
26 is an acceptance of the trusteeship, express or implied. See Section 4-101
27 (acceptance or rejection of trusteeship by trustee). To avoid an implied acceptance,
28 a nominated testamentary trustee who is monitoring the actions of the personal
29 representative but who has not yet made a final decision on acceptance should
30 inform the beneficiaries that it has assumed only a limited role. The failure to so
31 inform the beneficiaries could result in liability if the misleading conduct by the
32 nominated trustee causes harm to the trust beneficiaries. See Restatement (Third) of
33 Trusts § 36 comm. b (Preliminary Draft No. 3, 1997).

34 Consideration is not ordinarily required to create a trust, but a promise to
35 create a trust in the future is enforceable only if the requirements for an enforceable

1 contract are satisfied. See Restatement (Third) of Trusts § 15 (Tentative Draft No.
2 1, 1996). Should the right to enforce the contract be held by the trustee, however,
3 the chose in action thus created in the trustee is itself a property interest sufficient to
4 create a present trust. Otherwise, the enforceable right, if held by another, does not
5 create a present trust but may give rise to an action for breach of contract. A trust
6 created by means of a promise enforceable by the trustee is valid notwithstanding
7 that the trustee may resign or die before the promise is fulfilled. Unless expressly
8 made personal, the promise can be enforced by a successor trustee. For examples of
9 trusts created by means of promises enforceable by the trustee, see Restatement
10 (Third) of Trusts § 10 cmt. e (Tentative Draft No. 1, 1996).

11 While this section recognizes the established principle that a trust may be
12 created by means of the exercise of a power of appointment (see subsection (a)(3)),
13 this Act does not attempt to legislate comprehensively on the subject of powers of
14 appointment but addresses only selected issues. See Sections 2-405(b) (creditor
15 claims against holder of power to withdraw), 3-103(b) (rights of holder of power of
16 withdrawal), and 7-304 (representation by holder of general testamentary power of
17 appointment of persons subject to power). For the law on powers of appointment
18 generally, see Restatement (Second) of Property: Donative Transfers §§ 11.1-24.4
19 (1986).

20 While trusts are usually created by a transfer of property by the settlor or by
21 a self-declaration, trusts may also be created by the courts or by special statute.
22 See., e.g., Unif. Probate Code § 2-212 (elective share of incapacitated surviving
23 spouse to be held in trust on terms specified in statute); Unif. Probate Code § 5-407
24 (conservator may create trust with court approval); Restatement (Third) of Trusts
25 § 10 cmt. b (Tentative Draft No. 1, 1996).

26 Subsection (b) addresses some of the practical funding concerns that arise
27 with respect to self-declarations of trust. The very nature of the self-declaration of
28 trust negates a requirement that title to trust assets be reregistered and retransferred
29 into the name of the settlor as trustee. See, e.g., *In re Estate of Heggstad*, 20 Cal.
30 Rptr. 2d 43 (Ct. App. 1993) (citing relevant sections from Restatement (Second) of
31 Trusts). See also Restatement (Third) of Trusts § 10 cmt. e (Preliminary Draft No.
32 3, 1997). This subsection validates the practice of merely attaching a schedule
33 listing the assets that are to be subject to the trust without executing separate
34 instruments of transfer.

35 Subsection (b) confirms that separate documents of transfer are not required
36 to subject specific assets to a self-declaration of trust. To avoid possible later
37 problems with third party transferees and to better protect the interests of the
38 beneficiaries, it is recommended that settlors not rely on this subsection but instead
39 perfect title to the trust assets by executing separate instruments of transfer.

1 one or more beneficiaries other than the settlor. The doctrine of merger has been
2 inappropriately applied by the courts in some jurisdictions to invalidate self-
3 declarations of trust in which the settlor is the sole life beneficiary but other persons
4 are designated as beneficiaries of the remainder. The doctrine of merger, however,
5 is properly applicable only if all beneficial interests, both life interests and
6 remainders, are vested in the same person, whether in the settlor or someone else.
7 Under the Act, a beneficiary of a trust includes any person who has a present or
8 future interest, vested or contingent. See Section 1-105(1) (“beneficiary” defined).

9 Subsection (a)(3) requires that a trust, other than a charitable trust, a trust
10 for the care of an animal, or a trust for another valid noncharitable purpose, have a
11 definite or definitely ascertainable beneficiary. While the beneficiary will often be
12 definitely ascertained as of the trust’s creation, the beneficiary may also be
13 ascertained in the future. But a trust is not created if the beneficiary can only be
14 ascertained beyond the applicable perpetuities period. The definite beneficiary
15 requirement does not mean that a settlor cannot make a disposition in favor of a
16 class of persons, a designation which by its very nature is usually to a group whose
17 membership may change. Class designations are valid as long as the membership of
18 the class will be finally determined within the applicable perpetuities period. For
19 background on the definite beneficiary requirement, see Restatement (Third) of
20 Trusts §§ 46-48 (Preliminary Draft No. 3, 1997).

21 Subsection (b) allows a settlor to empower the trustee to select the
22 beneficiaries even if the class from whom the selection may be made is indefinite.
23 Such a provision would fail under traditional doctrine; it is an imperative power with
24 no designated beneficiary capable of enforcement. But such a provision is valid
25 under both this Act and the Restatement. Should the power not be exercised within
26 a reasonable time, the power will fail and the property pass by resulting trust. See
27 Restatement (Second) of Trusts § 122 (1959); Restatement (Second) of Property:
28 Donative Transfers § 12.1 cmt. e (1986).

29 **SECTION 2-103. EVIDENCE OF ORAL TRUST.** Except as required by a
30 statute other than this [Act], a trust need not be evidenced by a writing, but the
31 creation of an oral trust may be established only by clear and convincing evidence.

32 **Comment**

33 While it is always advisable for a settlor to reduce a trust to writing, the Act
34 validates oral trusts. Absent some specific statutory provision, such as a provision
35 requiring that transfers of real property be in writing, a writing is not required to
36 evidence a trust. States with statutes of frauds or other provisions requiring that the

1 creation of certain trusts must be evidenced by a writing may wish to specifically cite
2 such provisions.

3 For the Statute of Frauds generally, see Restatement (Second) of Trusts § 40
4 *et seq.* For a description of what the writing must contain, assuming that a writing
5 is required, see Restatement (Third) of Trusts § 22 (Tentative Draft No. 1, 1996).
6 For a discussion of when the writing must be signed, see Restatement (Third) of
7 Trusts § 23 (Tentative Draft No. 1, 1996). For a discussion of the law on oral
8 trusts, see Sarajane Love, *Imperfect Gifts as Declarations of Trust: An Unapologetic*
9 *Anomaly*, 67 Ky. L. J. 309 (1979).

10 **SECTION 2-104. TRUST PURPOSES.** A trust may be created only if its
11 purposes are lawful, do not violate public policy, and are possible to fulfill. A
12 charitable trust may be created only for a charitable purpose as specified in Section
13 2-301. Except as otherwise provided in Sections 2-105 or 2-106, the purpose of a
14 noncharitable trust must be to benefit its beneficiaries.

15 **Comment**

16 For an explication of the requirement that a trust must have a purpose that is
17 not unlawful or against public policy, see Restatement (Third) of Trusts §§ 28-29
18 (Preliminary Draft No. 3, 1997). A trust with a purpose that is unlawful or against
19 public policy is invalid. Depending on when the violation occurred, the trust may be
20 invalid at its inception or the invalidity may occur at a later date. The invalidity may
21 also be limited to particular provisions. Generally, a trust has a purpose which is
22 illegal or against public policy if: (1) its performance involves the commission of a
23 criminal or tortious act by the trustee; (2) its enforcement would otherwise be
24 against public policy even though not criminal or tortious; (3) the settlor's purpose
25 in creating the trust was to defraud creditors or others; or (4) the consideration for
26 the creation of the trust was illegal. See Restatement (Third) of Trusts § 28 cmt. a
27 (Preliminary Draft No. 3, 1997).

28 For the requirement that a trust must have a purpose which is for the benefit
29 of its beneficiaries, both in its terms and in how it is administered, see Restatement
30 (Third) of Trusts § 27 and cmt. b (Preliminary Draft No. 3, 1997). Although the
31 settlor is granted considerable latitude in defining the purposes of the trust, the
32 requirement that a trust have a purpose which is for the benefit of its beneficiaries
33 preclude purposes that are capricious and largely reflect personal whim. Individuals
34 may deal without restraint with their own property but not when impressed with a

1 trust for the benefit of others. See Restatement (Second) of Trusts § 124 cmt. g
2 (1959). Thus, attempts to impose unreasonable restrictions on the use of trust
3 property, such as a provision in a noncharitable trust severely impairing the use of
4 real property, will fail. See, e.g., *Colonial Trust v. Brown*, 135 A. 555 (Conn.
5 1926).

6 Trusts authorized by Sections 2-105 and 2-106, because they need not have
7 ascertainable beneficiaries, are exempt from the requirement that they have a
8 purpose which is of benefit to the beneficiaries. However, such trusts are subject to
9 the requirement that their purposes not be capricious. See, e.g., *McCaig v.*
10 *University of Glasgow*, Sess. Cases 231 (Scotland 1907), which invalidated a
11 provision requiring the trustee to erect statues of himself and various family
12 members.

13 For a provision which may allow reformation of trusts which fail to comply
14 with this section, see Section 2-205.

15 **SECTION 2-105. TRUST FOR CARE OF ANIMAL.**

16 (a) A trust for the care of an animal living at the settlor's death is valid. The
17 trust terminates upon the death of all animals covered by the terms of the trust. A
18 settlor's expressions of intent shall be liberally construed to bring the transfer within
19 this subsection and to presume against a merely precatory disposition.

20 (b) Property of a trust authorized by this section may not be applied to a use
21 other than its intended use except to the extent the court determines that the value
22 of the trust property exceeds the amount required for the intended use. Except as
23 otherwise directed by the terms of the trust, property not required for the intended
24 use must be distributed to those who would take the trust property if the trust were
25 to terminate on the date of the distribution.

26 (c) The intended use of a trust authorized by this section may be enforced
27 by a person designated for that purpose in the terms of the trust or, if none, by a

1 person appointed by the court. Persons with a demonstrated interest in the welfare
2 of the animal may petition for an order appointing or removing the person
3 designated to enforce the trust, who shall preferably be a person with such a
4 demonstrated interest.

5 **Comment**

6 This section and the next section of the Act validate so-called honorary
7 trusts. Unlike honorary trusts created pursuant to the common law of trusts, which
8 are arguably no more than unenforceable powers of appointment, the trusts created
9 by this and the next section are valid and enforceable and not dependent on whether
10 the trustee decides to honor the settlor's wishes. For a discussion of the common
11 law doctrine, see Restatement (Third) of Trusts § 48 (Preliminary Draft No. 3,
12 1997).

13 This section addresses a particular type of honorary trust, the trust for the
14 care of an animal. Section 2-106 specifies the requirements for trusts created for
15 other noncharitable purposes. A trust for the care of an animal may last for the life
16 of the animal. While the animal will ordinarily be alive on the date the trust is
17 created, an animal may be added as a beneficiary after that date as long as such
18 addition is made prior to the settlor's death. Animals in gestation but not yet born
19 at the time of the trust's creation may also be covered by its terms.

20 Subsection (b) addresses the problem of excess funds. Should the court
21 determine that the trust property exceeds the amount needed for the intended
22 purpose, the excess must be distributed to those who would take the trust property
23 if the trust were to terminate on the date of the distribution. Should the terms of the
24 trust not direct disposition upon termination, a resulting trust is ordinarily created in
25 the settlor unless the terms of the trust provide for a different disposition. See
26 Restatement (Third) of Trusts § 48 (Preliminary Draft No. 3, 1997). The settlor
27 may also anticipate the problem of excess funds by directing their disposition in the
28 terms of the trust. Absent the presence of excess funds, no portion of a trust
29 authorized by this or the next section may be applied other than for its intended use.

30 Subsection (c) covers enforcement. Noncharitable trusts ordinarily may be
31 enforced by their ascertainable beneficiaries. Charitable trusts may be enforced by
32 the state attorney general or by a person deemed to have a special interest. See
33 Restatement (Second) of Trusts § 391 (1959). But at common law, trusts for the
34 care of an animal or a trust without an ascertainable beneficiary created for another
35 noncharitable purpose were unenforceable because there was no person to enforce
36 the trustee's obligations.

1 This section and the next section close this gap. The intended use of a trust
2 authorized by either section may be enforced by a person designated for that
3 purpose in the terms of the trust or, if none, by a person appointed by the court.
4 Should the trust be created for the care of an animal, persons with a demonstrated
5 interest in the welfare of the animal have standing to petition for such an
6 appointment, either on their own behalf or on behalf of others. The person
7 appointed by the court to enforce the trust should also be a person who has
8 exhibited such a demonstrated interest. The concept of granting standing to a
9 person with a demonstrated interest in the animal's welfare is derived from the
10 Uniform Guardianship and Protective Proceedings Act, which allows a person
11 interested in the welfare of a ward or protected person to file petitions on the ward's
12 or protected person's behalf.

13 This section and the next section are originally derived from Section 2-907
14 of the Uniform Probate Code but much of this section is new.

15 **SECTION 2-106. TRUST FOR VALID NONCHARITABLE PURPOSE.**

16 (a) A trust for a noncharitable purpose without a definite or definitely
17 ascertainable beneficiary or for a noncharitable purpose to be selected by the trustee
18 is valid. The trust may not be enforced for more than 21 years.

19 (b) Property of a trust authorized by this section may not be applied to a use
20 other than its intended use except to the extent the court determines that the value
21 of the trust property exceeds the amount required for the intended use. Except as
22 otherwise directed by the terms of the trust, property not required for the intended
23 use must be distributed to those who would take the trust property if the trust were
24 to terminate on the date of the distribution.

25 (c) The intended use of a trust authorized by this section may be enforced
26 by a person designated for that purpose in the terms of the trust or, if none, by a
27 person appointed by the court.

1 **Comment**

2 This section authorizes two types of trusts without ascertainable
3 beneficiaries; trusts for general but noncharitable purposes, and trusts for a specific
4 noncharitable purpose other than the care of an animal, which is covered by Section
5 1-205. Examples of trusts for general noncharitable purposes would include a
6 bequest of money to be distributed to such objects of benevolence as the trustee
7 might select. At common law, such a trust was honorary but under this section such
8 a trust is enforceable for a period of up to 21 years, the maximum period allowed
9 under the rule against perpetuities for a disposition without lives in being.

10 The most common example of a trust for a specific noncharitable purpose is
11 a trust for the care of a cemetery plot. Trusts and other funding devices for the
12 perpetual care of cemetery plots is a topic frequently addressed by separate
13 legislation. Such legislation will typically endeavor to provide for truly perpetual
14 care as opposed to care limited for 21 years.

15 For the requirement that a trust, particularly the type of trust authorized by
16 this section, must have a purpose that is not capricious, see Section 2-104
17 Comment. For examples of the types of trusts authorized by this section, see
18 Restatement (Third) of Trusts § 48 (Preliminary Draft No. 3, 1997).

19 This section is similar to Section 2-105, although less detailed. Much of the
20 Comment to Section 2-105 also applies to this section.

21 **PART 2**

22 **MODIFICATION OR TERMINATION OF TRUST**

23 **General Comment**

24 This part provides a series of interrelated rules on when a trust may be
25 terminated or modified other than by its express terms. The overall objective of this
26 part is to liberalize the common law rules but without losing sight of the principle
27 that preserving the settlor's intent is paramount. Termination or modification may
28 be allowed upon beneficiary consent if the trust no longer serves a material purpose
29 or if the settlor concurs (Section 2-202), by the court in response to unanticipated
30 circumstances (Section 2-203), or if continued administration under the trust's
31 existing terms would be uneconomical (Section 2-204). Trusts may be reformed to
32 correct a mistake of law or fact (Section 2-205), or modified to achieve the settlor's
33 tax objectives (Section 2-206). Trusts may be combined or divided (Section 2-207).

1 A settlor, trustee, or beneficiary has standing to petition the court with respect to a
2 proposed termination or modification (Section 2-208).

3 **SECTION 2-201. TERMINATION OF TRUST.** In addition to the methods
4 specified in Sections 2-202 through 2-204, a trust terminates if the trust is revoked
5 or expires pursuant to its terms, or of the purpose of the trust is fulfilled or becomes
6 unlawful, impossible to fulfill, or violative of public policy.

7 **Comment**

8 This section lists the ways in which trusts typically terminate. In addition to
9 other powers granted under this Act or by the terms of the trust, upon termination
10 of a trust a trustee has the powers appropriate to wind up the affairs of the trust.
11 See Section 5-117(24).

12 For the requirement that a trust must have a purpose that is not illegal,
13 impossible to fulfill, or violative of public policy, see Section 2-104 and Comment.

14 **SECTION 2-202. MODIFICATION OR TERMINATION OF**
15 **IRREVOCABLE TRUST BY CONSENT.**

16 (a) An irrevocable trust may be modified or terminated upon the consent of
17 all of the beneficiaries if continuance of the trust on its existing terms is not
18 necessary to further a material purpose of the settlor. The inclusion of a spendthrift
19 provision in the terms of the trust shall not be presumed to constitute a material
20 purpose of the settlor.

21 (b) Whether or not continuance of the trust on its existing terms is necessary
22 to further a material purpose of the settlor, an irrevocable trust may be modified or
23 terminated upon the consent of the settlor and all of the beneficiaries.

1 (c) Upon termination of a trust pursuant to subsection (a) or (b), the trustee
2 shall distribute the trust property as agreed by the beneficiaries.

3 (d) If a beneficiary other than a qualified beneficiary does not consent to a
4 proposed modification or termination of a trust by the other beneficiaries or by the
5 settlor and other beneficiaries, the court shall approve the proposed modification or
6 termination if the court is satisfied that:

7 (1) if all beneficiaries had consented, the trust could have been
8 terminated or modified under this section; and

9 (2) the rights of a beneficiary who does not consent will be adequately
10 protected.

11 **Comment**

12 This section describes the circumstances under which an irrevocable trust
13 may be terminated or modified by the beneficiaries, with or without the concurrence
14 of the settlor. For provisions governing modification or termination of trusts
15 without the need to seek beneficiary consent, see Sections 2-203 (modification or
16 termination because of unanticipated circumstances) and 2-204 (termination or
17 modification of uneconomic noncharitable trust). If the trust is revocable by the
18 settlor, the method of revocation specified in Section 3-102 applies.

19 Subsection (a) states the test for termination or modification by unanimous
20 consent without the concurrence of the settlor. Subsection (b) states the test for
21 termination or modification by the beneficiaries with the concurrence of the settlor.
22 Subsection (c) directs how the trust property is to be distributed following a
23 termination under either subsection (a) or (b). Subsection (d) creates a procedure
24 for judicial approval of a proposed termination or modification when the consent of
25 less than all of the beneficiaries is available.

26 A trust may be modified or terminated pursuant to this section over a
27 trustee's objection and, except as provided in subsection (d), without court
28 approval. However, the court is available to indicate its approval or disapproval of
29 a proposed termination or modification upon petition of the settlor, beneficiary, or
30 trustee. See Section 2-208.

1 Subsection (a) of this section is based on Section 337 of the Restatement
2 (Second) of Trusts (1959), except that this subsection, unlike the Restatement, deals
3 expressly with the effect of a spendthrift provision. While the inquiry on whether
4 continuation of a trust is necessary to further a material purpose should focus on the
5 material purpose or purposes of the particular settlor, the courts have tended to
6 preclude termination based on whether the trust contains particular language
7 without examining its context. For the case law, see Austin W. Scott & William F.
8 Fratcher, *The Law of Trusts* § 337 (4th ed. 1988). The insertion of a spendthrift
9 provision, which is often added to instruments with little thought, has been a
10 particular problem. Subsection (a) does not negate the possibility that continuation
11 to assure spendthrift protection might be a material purpose of the particular settlor.
12 It instead calls attention to the issue by negating the inference that inserting a
13 spendthrift provision is always a bar to termination or modification.

14 Subsection (b), which is based on Restatement (Second) of Trusts § 338
15 (1959), permits termination upon the joint action of the settlor and beneficiaries.
16 While the beneficiaries alone cannot terminate a trust unless continuation of the trust
17 will no longer further the settlor's material purposes in creating the trust, such a
18 finding is not required if the settlor also consents. No finding of a lack of continuing
19 purpose for the trust is then required because all parties with a possible interest in
20 the trust's continuation, both the settlor and beneficiaries, are agreed there is no
21 further need for the trust.

22 The provisions of Article 7, Part 3 on representation, virtual representation
23 and the appointment and approval of guardians ad litem and special representatives
24 apply for purposes of determining whether all beneficiaries have signified consent
25 under this section. The authority to consent on behalf of another person, however,
26 does not include the authority to consent over the other person's objection. See
27 Section 7-303(c). For a listing of who may consent on behalf of a beneficiary, see
28 Sections 7-304, 7-305, and 7-306. A consent obtained by virtual representation is
29 valid only if there is no conflict of interest between the representative and the person
30 represented. Given this limitation, virtual representation will rarely be available in a
31 trust termination case, although its use will be frequent in cases involving trust
32 modification, such as a grant to the trustee of additional powers. If virtual
33 representation is unavailable, Sections 7-308 and 7-309 of the Act permit the court
34 to appoint either a guardian ad litem or special representative who may give the
35 necessary consent to the proposed modification or termination on behalf of the
36 minor, incapacitated, unborn, or unascertained beneficiary.

37 Subsection (c) recognizes that the power to terminate the trust includes the
38 right to direct how the trust property is to be distributed. While subsection (b)
39 requires the settlor's consent to terminate an irrevocable trust, such required consent
40 does not extend to the subsequent distribution of the trust property. Once a

1 termination has been approved, how the trust property is to be distributed is solely
2 for the beneficiaries to decide.

3 Subsection (d) addresses situations in which a termination or modification is
4 requested by less than all of the beneficiaries, either because a beneficiary objects,
5 the consent of a beneficiary cannot be obtained, or virtual representation is either
6 unavailable or its application uncertain. Subsection (d) allows the court to fashion
7 an appropriate order protecting the interests of the nonconsenting beneficiaries
8 while at the same time permitting the remainder of the trust property to be
9 distributed without restriction. The order of protection for the nonconsenting
10 beneficiaries might include continuation of the trust, the purchase of an annuity, or
11 the valuation and cashout of the interest.

12 **SECTION 2-203. MODIFICATION OR TERMINATION BECAUSE OF**
13 **UNANTICIPATED CIRCUMSTANCES.**

14 (a) The court shall modify the administrative or dispositive terms of a trust
15 or terminate the trust if, because of circumstances not anticipated by the settlor,
16 modification or termination would substantially further the settlor's purposes in
17 creating the trust.

18 (b) Upon termination of a trust under this section, the trust property must
19 be distributed in accordance with the settlor's probable intention.

20 **Comment**

21 This section permits modification or termination of a trust when there are
22 circumstances not anticipated by the settlor. This may include circumstances in
23 existence at the time of the trust's creation which were known to but not considered
24 by the settlor. Unlike Restatement (Second) of Trusts §§ 167 and 336 (1959), upon
25 which this section is partially based, this section allows a court to modify or
26 terminate a trust with respect to its beneficial provisions, not merely its
27 administrative terms. For example, modification of the beneficial provisions to
28 increase support of a beneficiary might be appropriate if the beneficiary has become
29 unable to provide for support due to poor health or serious injury.

30 While it is necessary there be circumstances not anticipated by the settlor
31 before the court may grant relief under this section, it is not essential that

1 circumstances have changed. The circumstances not anticipated by the settlor may
2 have been in existence when the trust was created. This section thus complements
3 Section 2-205, which allows for reformation of a trust based on mistake of fact or
4 law at the creation of the trust.

5 Relief under this section should not be lightly granted. Reasonable minds
6 can often disagree on the purposes of a trust and on whether the settlor chose the
7 appropriate means of implementation. The case for deviation should be compelling,
8 requiring that the petitioner show that the proposed termination or modification will
9 substantially further the settlor's objectives in creating the trust.

10 Upon termination under this section, subsection (b) requires that the trust be
11 distributed in accordance with the settlor's probable intent. This requirement, which
12 is similar to the doctrine of cy pres, will require an examination of what the settlor
13 probably would have done had the settlor been aware of the unanticipated
14 circumstances. Typically, such terminating distributions will be made to the
15 qualified beneficiaries, perhaps in proportion to the actuarial value of their interests,
16 although the section does not so prescribe. For the definition of qualified
17 beneficiaries, see Section 1-105(11).

18 **SECTION 2-204. UNECONOMIC NONCHARITABLE TRUST.**

19 (a) Except as otherwise provided by the terms of the trust, if the value of
20 the property of a noncharitable trust is less than [\$50,000], the trustee may
21 terminate the trust.

22 (b) Notwithstanding a term of the trust to the contrary, the court may
23 modify or terminate a noncharitable trust or appoint a new trustee if it determines
24 that the value of the trust property is insufficient to justify the cost of administration.

25 (c) Upon termination of a trust under this section, the trustee shall distribute
26 the trust property in accordance with the settlor's probable intention.

27 **Comment**

28 Subsection (a) assumes that a trust with a value of \$50,000 or less is
29 inherently uneconomical and may be terminated without court approval. This

1 provision is a default rule. The settlor is free to set a higher or lower figure or to
2 specify different procedures or to prohibit termination without a court order.

3 Subsection (b) allows a trust to be modified or terminated if the costs of
4 administration would otherwise be excessive. A court termination procedure may
5 be utilized for a trust of any size but most cases will involve smaller trusts although
6 ones greater than \$50,000 in value. For the comparable provision on charitable
7 trusts, see Section 2-303.

8 While this section is not principally directed a honorary trusts, it may be so
9 applied. See Sections 2-105, 2-106.

10 Compliance with this section is within the discretion of the trustee or, if
11 court approval is required, within the discretion of the court. When considering
12 whether to terminate a trust under this section, the trustee or court should consider
13 the protective function the trust is designed to serve. Termination under this section
14 is not always wise. Even if administrative costs may seem expensive in relation to
15 the size of the trust, protection of the asset base may indicate that the trust be
16 continued.

17 **SECTION 2-205. REFORMATION TO CORRECT MISTAKES.**

18 (a) The court may reform the terms of a trust, even if unambiguous, to
19 conform to the settlor's intention if the failure to conform was due to a mistake of
20 fact or law, whether in expression or inducement, and the settlor's intent can be
21 established by clear and convincing evidence.

22 (b) In determining the settlor's intent for purposes of this section or any
23 other purpose, direct evidence contradicting the plain meaning of the text as well as
24 other evidence may be considered.

25 **Comment**

26 Reformation of inter vivos instruments to correct for a mistake of law or fact
27 is a long-established remedy. The purpose of Restatement (Third) of Property:
28 Donative Transfers § 12.1 (Tentative Draft No. 1, 1995), upon which this section is
29 based, is to clarify that this doctrine also applies to wills.

1 might be interpreted differently in a way to achieve the desired tax objective. A tax
2 provision alone cannot create the essential terms of a tax-qualified trust. There must
3 already be language in the terms susceptible of the necessary interpretation.
4 Examples of tax provisions the meaning of which are sometimes in doubt include the
5 effect of administrative provisions on qualification for the federal estate tax marital
6 deduction, and whether a standard of distribution is sufficiently narrow to negate
7 what would otherwise be a taxable general power of appointment.

8 Subsection (a) is consistent with the Revised Uniform Principal and Income
9 Act (1997), which denies the trustee a power to equitably adjust the allocation of
10 income and principal receipts and disbursements if to do would endanger intended
11 tax benefits. See Section 6-104(c).

12 While subsection (a) is intended to function similar to a tax savings clause, it
13 is better practice to expressly include such a tax savings provision in the terms of the
14 trust. That way, there will be no doubt as to the settlor's intent.

15 Subsection (b) is based on Restatement (Third) of Property § 12.2
16 (Tentative Draft No. 1, 1995). "Modification" under this section is to be
17 distinguished from the "reformation" authorized by Section 2-205. Reformation
18 under Section 2-205 is available when the terms of a trust fail to reflect the donor's
19 original, particularized intention. The mistaken terms are then reformed to match
20 this specific intent. The modification authorized here is more general, allowing
21 documents to be changed to meet the settlor's tax-saving objective as long as the
22 resulting terms, particularly the beneficial provisions, are not inconsistent with the
23 settlor's probable intent. The modification allowed by this subsection is similar in
24 concept to the cy pres doctrine for charitable trusts (see Section 2-302), and the
25 deviation doctrine for unanticipated circumstances (see Section 2-203).

26 Whether a modification made by the court under subsection (b) will be
27 recognized for purposes of federal tax law is a matter of federal law, not this Act.
28 Among the modifications recognized under federal law have been the revision of
29 split-interest trusts to qualify for the charitable deduction, modification of a trust for
30 a noncitizen spouse to become eligible as a qualified domestic trust, and the splitting
31 of a trust to better utilize the exemption from generation-skipping tax.

32 Before proceeding to modify a trust under subsection (b), the advisor is
33 encouraged to determine whether modification utilizing some other section of this
34 part would assure a more certain federal tax result.

35 For further discussion of the issues raised by a desire to modify a trust to
36 achieve the settlor's tax objectives, see the Comments and Reporter's Notes to
37 Restatement (Third) of Property § 12.2 (Tentative Draft No. 1, 1995).

1 objectives, often invite such a division, although as in the case with a proposed
2 combination of trusts, the farther away the terms of the divided trusts are from the
3 original plan the less likely it is that the settlor's purposes will be achieved and the
4 division can be approved.

5 This section does not require that a combination or division be approved by
6 either the court or beneficiaries. Prudence may dictate, however, that court
7 approval under Section 2-208 be sought and beneficiary consent obtained whenever
8 the terms of the trusts to be combined or the trusts that will result from a division
9 differ substantially one from the other. For the provisions relating to beneficiary
10 consent or ratification of a transaction, or release of trustee from liability, see
11 Section 7-106.

12 While the consent of the beneficiaries is not necessary before a trustee may
13 combine or divide trusts under this section, advance notice to the qualified
14 beneficiaries of the proposed combination or division is required. This is consistent
15 with Section 5-114, which requires that the trustee keep the beneficiaries reasonably
16 informed of trust administration, including the giving of advance notice to the
17 qualified beneficiaries of several specified actions that may have a major impact on
18 their interests.

19 For a list of statutes authorizing division of trusts, either by the trustee or
20 court order, see Restatement (Third) Property: Donative Transfers § 12.2 statutory
21 note (Tentative Draft No. 1, 1995). For a provision authorizing a trustee, in
22 distributing the assets of the divided trust, to make non-pro-rata distributions, see
23 Section 5-117(20).

24 **SECTION 2-208. PETITION FOR APPROVAL OR DISAPPROVAL;**
25 **REPRESENTATION OF SETTLOR.**

26 (a) A petition to approve or disapprove a proposed action under this [part]
27 may be filed by the settlor, trustee, or beneficiary.

28 (b) A settlor's powers under this [part] may be exercised by:

29 (1) an agent under a power of attorney to the extent the power of
30 attorney or terms of the trust so authorize; or

1 (2) a conservator if approved by the court supervising the
2 conservatorship.

3 **Comment**

4 Subsection (a) clarifies that petitions for approval or disapproval of
5 proposed actions under this part may be filed by the settlor, trustee, or beneficiary.
6 The effect of this subsection is to make clear that a settlor is an interested person
7 with respect to any proposed action under this part, a considerably broader role than
8 that recognized under common law. See Section 2-202 Comment. A second effect
9 of this subsection is to make clear that court approval or disapproval may be sought
10 for an action which can be accomplished without court permission. This would
11 include petitions to approve or disapprove modification or termination by
12 beneficiary consent (Section 2-202), a petition questioning the trustee's distribution
13 upon termination of a trust under \$50,000 (Section 2-204), and a petition for
14 approval or disapproval of a proposed trust division or consolidation (Section
15 2-207).

16 Subsection (b) addresses the authority of an agent or conservator to act on a
17 settlor's behalf. Consistent with Section 3-102 on revocation or modification of a
18 revocable trust, the section assumes that a settlor, in granting an agent general
19 authority, did not intend for the agent to have authority to consent to the
20 termination or modification of a trust and possibly undo the settlor's estate plan. In
21 order for an agent to validly consent to a termination or modification, such authority
22 must be expressly conveyed either in the power or in the terms of the trust.

23 Similarly, subsection (b) assumes that the termination or modification of the
24 settlor's trust is a sufficiently important transaction that a conservator should not be
25 allowed to consent without first consulting with and obtaining the approval of the
26 court supervising the conservatorship. Many conservatorship statutes, in fact,
27 expressly require that the conservator obtain court approval to create, amend or
28 revoke a trust. See, e.g., Unif. Probate Code § 5-407.

29 **PART 3**
30 **CHARITABLE PURPOSES**

31 **General Comment**

32 A main purpose of this part is to substantially broaden the authority of courts
33 and trustees to make charitable gifts more effective. Many of the concepts

1 expressed in this article are not new, but have long been advocated by
2 commentators. See, e.g., Roger G. Sisson, *Relaxing the Dead Hand's Grip:*
3 *Charitable Efficiency and the Doctrine of Cy Pres*, 74 Va. L. Rev. 635 (1988);
4 Report, *Cy Pres and Deviation: Current Trends and Application*, 8 Real Prop. Prob.
5 & Trust J. 391 (1971); Joseph A. DiClerico, Jr., *Cy Pres: A Proposal for Change*,
6 47 B.U.L. Rev. 153 (1967); Kenneth L. Karst, *The Efficiency of the Charitable*
7 *Dollar: An Unfulfilled State Responsibility*, 73 Harv. L. Rev. 433 (1960). A
8 liberalizing trend is also apparent in a number of the state statutes, with the reforms
9 in Wisconsin being the most notable. See Wis. Stat. § 701.10.

10 **SECTION 2-301. CHARITABLE PURPOSES.**

11 (a) A charitable trust may be created for the relief of poverty, the
12 advancement of education or religion, the promotion of health, or any other purpose
13 the accomplishment of which is beneficial to the community.

14 (b) If the terms of a trust do not indicate a particular charitable purpose or
15 designate beneficiaries, the trustee may select one or more charitable purposes or
16 beneficiaries.

17 (c) A settlor may maintain an action to enforce or modify a charitable trust.

18 **Comment**

19 Subsection (a), unlike most of the remainder of the part, does not break
20 significant new ground. It merely restates the well-established categories of
21 charitable purposes listed in Restatement (Second) of Trusts § 368 and ultimately
22 derived from the Statute of Charitable Uses, 43 Eliz. I, c.4 (1601).

23 Subsection (b) ratifies a common estate planning technique under which the
24 trustee is permitted to select the charitable beneficiary or purposes for which
25 distributions are to be made. See Restatement (Second) of Trusts § 396 (1959).

26 Subsection (c), unlike Restatement (Second) of Trusts § 391 (1959),
27 authorizes the settlor to enforce or modify a charitable trust. This is consistent with
28 Section 2-208, which grants a settlor standing to participate in actions relating to
29 termination or modification of a trust, and with Section 4-106, which authorizes a
30 settlor to petition for removal of a trustee.

1 terms of the trust provide to the contrary, a charitable trust does not fail in whole or
2 in part if the particular purpose for which the trust was created becomes
3 impracticable, unlawful, impossible to fulfill, or wasteful. The court must instead
4 either modify the terms of the trust or direct that the property of the trust be
5 distributed in whole or in part in a manner best meeting the settlor's charitable
6 purposes.

7 The application of cy pres requires a balancing of the needs of society
8 against an assessment of the settlor's probable intent. In determining the settlor's
9 probable intent, the court may wish to consider the current and future community
10 needs in the general field of charity for which the trust was created, the settlor's
11 other charitable interests, and the value of the available trust property.

12 The doctrine of cy pres is not limited to charitable trusts, but applies as well
13 to other types of charitable dispositions, such as not-for-profit corporations. This
14 section, because it is part of a Uniform Trust Act, does not apply to charitable
15 dispositions made in nontrust form, but in formulating the rules for such dispositions
16 the courts are of course free to refer to the principles of this section.

17 **SECTION 2-303. UNECONOMIC CHARITABLE TRUST.**

18 (a) Except as otherwise provided by the terms of the trust, if the value of
19 the property of a charitable trust is less than [\$50,000], the trustee may terminate
20 the trust.

21 (b) Notwithstanding a term of the trust to the contrary, the court may
22 modify or terminate a charitable trust or appoint a new trustee if it determines that
23 the value of the trust property is insufficient to justify the cost of administration.

24 (c) Upon termination of a trust under this section, the trustee or the court
25 shall distribute the trust property in a manner consistent with the settlor's charitable
26 purpose.

27 **Comment**

28 Subsection (a) strives to make charitable giving more effective by permitting
29 the nonjudicial termination of small charitable trusts, thereby avoiding the expense

1 of a judicial termination proceeding. Nonjudicial termination is allowed if the value
2 of the trust property is less than \$50,000. While the creation of small charitable
3 trusts is not encouraged, subsection (a) does not interfere with the right of a settlor
4 to do so. The trustee may not modify or terminate a charitable trust with a value of
5 less than \$50,000 if such action is prohibited by the terms of the trust.

6 Subsection (b) authorizes the court to modify or terminate a charitable trust
7 even if the settlor has forbid such action. Unlike subsection (a), there is no dollar
8 limit. In order to reduce administrative costs in relation to the size of the trust, the
9 court, instead of terminating the trust, may appoint a new trustee. Upon termination
10 of the trust, the trust property is to be distributed pursuant to the cy pres principles
11 articulated in Section 2-302.

12 For the comparable provision on termination of uneconomic noncharitable
13 trusts, see Section 2-204.

14 **PART 4**
15 **SPENDTHRIFT PROVISIONS AND CLAIMS BY CREDITORS**

16 **General Comment**

17 This part addresses the validity of a spendthrift provision and the rights of
18 creditors, both of the settlor and beneficiaries, to reach a trust to collect a debt.
19 Section 2-401 specifies the requirements for a valid spendthrift provision and, if
20 valid, its effect. For trusts without valid spendthrift provisions, Section 2-402
21 describes the circumstances under which a beneficiary's creditors may reach the
22 beneficiary's interest. Section 2-403 lists the categories of creditors whose claims
23 are not subject to a spendthrift bar, and the extent to which such a creditor may
24 reach the trust. Sections 2-404 to 2-406 address special categories where the rights
25 of a beneficiary's creditors may not depend on whether or not the trust contains a
26 spendthrift provision. Section 2-404 deals with discretionary trusts and trusts for
27 which distributions are subject to a standard. Section 2-405 covers creditor claims
28 against a settlor, whether the trust is revocable or irrevocable, and if revocable,
29 whether the claim is made during the settlor's lifetime or incident to the settlor's
30 death. Section 2-406 provides a creditor with a remedy if a trustee fails to make a
31 required payment within a reasonable time.

1 (b) A spendthrift provision is unenforceable against a state government or
2 the United States to the extent a statute of the State or federal law so provides.

3 **Comment**

4 For trusts with spendthrift provisions, the effect of this section is to enable
5 certain creditors to bypass a spendthrift restriction but only with respect to their
6 particular claims. Under this section, exceptions are recognized for court orders for
7 the support of a child or a current or former spouse and for certain governmental
8 claims.

9 The exception in subsection (a) for orders to support a beneficiary's child or
10 current or former spouse is in accord with Restatement (Second) of Trusts § 157
11 (1959) and numerous state statutes. It is also consistent with federal bankruptcy
12 law, which exempts such support orders from discharge. The effect of this
13 exception is to permit the claimant for unpaid support to attach present or future
14 distributions that would otherwise be made to the beneficiary. Distributions subject
15 to attachment include distributions required by the express terms of the trust, such
16 as mandatory payments of income, and distributions the trustee has otherwise
17 decided to make, such as through the exercise of discretion. Subsection (a), unlike
18 Section 2-402, does not authorize the spousal or child claimant to force a sale of the
19 beneficiary's interest. For the right of a spouse or child claimant to force a
20 distribution if the trustee has abused discretion or failed to comply with a standard
21 for distribution, see Section 2-404.

22 Subsection (b) exempts certain governmental claims from a spendthrift bar.
23 Federal preemption guarantees that certain federal claims, such as claims by the
24 Internal Revenue Service, may bypass a spendthrift provision no matter what this
25 Act might say. The case law and relevant Internal Revenue Code provisions on the
26 exception for federal tax claims are collected in 2A Austin W. Scott & William F.
27 Fratcher, *The Law of Trusts* § 157.4 (4th ed. 1987). As to claims by state
28 governments, this subsection recognizes that States take a variety of approaches
29 with respect to collection, depending on whether the claim is for unpaid taxes, for
30 care provided at an institution, or for other charges. Acknowledging this diversity,
31 subsection (b) does not prescribe a definite rule, but instead refers to other statutes
32 of the State on whether a particular claim would be barred or exempted from a
33 spendthrift provision. The other state statute might be a statute of the forum
34 jurisdiction or the statute of another State.

35 Unlike Restatement (Second) of Trusts § 157 (1959), this Act does not
36 provide that a spendthrift provision is unenforceable against creditors who have
37 furnished necessary services or supplies to the beneficiary, or creditors who have
38 furnished services or materials which have preserved or supposedly enhanced the

1 provision, or should the creditor fit within one of the exceptions created by Section
2 2-403, the creditor may attach a distribution the trustee is required to or has
3 otherwise decided to make to the beneficiary. Should the trust not contain a
4 spendthrift provision, the creditor may also conceivably force a sale of the
5 beneficiary's interest. See Section 2-402. But the mere power to attach an interest
6 does not mean that a creditor can force a trustee to exercise discretion or make a
7 distribution based on a standard.

8 Subsection (a), which establishes the general rule, forbids a creditor from
9 compelling a distribution from the trust, even if the trustee has failed to comply with
10 the standard of distribution or has abused a discretion. Per subsection (c), the
11 power to force a distribution due to an abuse of discretion or failure to comply with
12 a standard belongs solely to the beneficiary. Under Section 5-115, a trustee must
13 always exercise a discretionary power in good faith and with regard to the purposes
14 of the trust and the interest of the beneficiaries.

15 Subsection (b) creates an exception for support claims of a spouse, former
16 spouse, or child. While a creditor of a beneficiary may not in general assert that a
17 trustee has abused discretion or failed to comply with a standard of distribution,
18 such a claim may be asserted by the beneficiary's spouse, former spouse, or child,
19 but only if made in an appropriate judicial proceeding. The court must direct the
20 trustee to pay the spouse or child such amount as is equitable under the
21 circumstances but not in excess of the amount the trustee was otherwise required to
22 distribute to or for the benefit of the beneficiary. Before fixing this amount, the
23 court with jurisdiction over the trust should consider that in setting the respective
24 support award, an obligation on which the beneficiary has now defaulted, the family
25 court has already considered the respective needs and assets of the family. The Act
26 does not attempt to prescribe the particular procedural method for enforcing a
27 support judgment against the trust, leaving that matter to local collection law. For
28 an example, see Cal. Prob. Code § 15305.

29 **SECTION 2-405. CREDITOR'S CLAIM AGAINST SETTLOR.**

30 (a) Whether or not the terms of a trust contain a spendthrift provision, the
31 following rules apply:

32 (1) A creditor or assignee of the settlor may reach the maximum amount
33 that the trustee could pay to or for the settlor's benefit. If a trust has more than one
34 settlor, the amount the creditor or assignee of a particular settlor may reach may not

1 exceed the settlor's discretionary interest in the portion of the trust attributable to
2 that settlor's contribution;

3 (2) During the lifetime of the settlor, the property of a revocable trust is
4 subject to the claims of the settlor's creditors;

5 (3) After the death of a settlor, and subject to the settlor's right to direct
6 the source from which liabilities will be paid, the property of a revocable trust which
7 was subject to the settlor's power of revocation at the time of death is subject to
8 claims of the settlor's creditors, costs of administration of the settlor's estate, and
9 statutory allowances to a surviving spouse and children to the extent the settlor's
10 probate estate is inadequate to satisfy those claims, costs, and allowances.

11 (b) For purposes of this section, the holder of a presently exercisable power
12 of withdrawal shall be treated the same as the settlor of a revocable trust to the
13 extent of the property subject to the power.

14 **Comment**

15 Subsection (a)(1), which is based on Section 156 of the Restatement
16 (Second) of Trusts (1959), follows traditional doctrine in providing that a settlor
17 who is also a beneficiary may not use the trust as a shield against the settlor's
18 creditors. Whether the trust contains a spendthrift provision or not, a creditor of the
19 settlor may reach the maximum amount that the trustee could have paid to the
20 settlor-beneficiary. Should the trustee have discretion to distribute the entire income
21 and principal to the settlor, the effect of this subsection is to place the settlor's
22 creditors in the same position as if the trust had not been created. For the definition
23 of "settlor," see Section 1-105(12).

24 This section does not address possible rights against a settlor should the
25 settlor have been insolvent at the time of the trust's creation or was rendered
26 insolvent by the transfer of property to the trust. This subject is instead left to the
27 State's law on fraudulent conveyances. A transfer to the trust by an insolvent settlor
28 may also constitute a voidable preference under federal bankruptcy law.

1 Subsection (a)(2) states what is now a well accepted conclusion, that a
2 revocable trust is subject to the settlor's creditors while the settlor is living. Such
3 claims were not allowed at common law, however. See Restatement (Second) of
4 Trusts § 330, cmt. o (1959). Because a settlor usually also retains a beneficial
5 interest which a creditor may reach under subsection(a)(1), the common law rule is
6 normally of little significance. See Restatement (Second) of Trusts § 156(2) (1959).

7 Subsection (a)(3) recognizes that a revocable trust is usually employed as a
8 will substitute. As such, the trust assets, following the death of the settlor, should
9 be subject to the settlor's debts and other charges. However, in accordance with
10 traditional doctrine, the assets of the settlor's probate estate must normally first be
11 exhausted before the assets of the revocable trust can be reached.

12 This section does not attempt to address the procedural issues raised by the
13 need to first exhaust the decedent's probate estate to reach the assets of the
14 revocable trust. Nor does this section address the priority of the creditor claims or
15 the possible liability of the decedent's other nonprobate assets for the decedent's
16 debts and other charges. Subsection (a)(3), however, does ratify the typical
17 pourover will, revocable trust plan. Such a plan will usually shift a portion if not all
18 of the death-related liabilities from the probate estate to the revocable trust. As long
19 as the rights of the creditor or family member claiming a statutory allowance are not
20 impaired, the settlor is free to shift liability from the probate estate to the revocable
21 trust.

22 This section does not cover all creditor issues that may arise in connection
23 with revocable trusts, in particular the possible liability of other nonprobate assets
24 for unpaid claims. These issues, which extend well beyond the law of trusts, are
25 addressed in proposed Section 6-102 of the Uniform Probate Code, which will be
26 read at the Commissioners' 1998 Annual Meeting.

27 Subsection (b) treats a presently exercisable general power of appointment
28 as the functional equivalent of a power of revocation. Should the power be
29 unlimited, the property subject to the power will be fully subject to the claims of the
30 power holder's creditors, the same as the power holder's other assets. Should the
31 power holder retain the power until death, the property subject to the power may be
32 liable for claims and statutory allowances to the extent the power holder's probate
33 estate is insufficient to satisfy those claims and allowances. For powers limited
34 either in time or amount, such as a right to withdraw a \$10,000 annual exclusion
35 contribution within 30 days, this subsection would limit the creditor to the \$10,000
36 contribution and require the creditor to take action prior to the expiration of the
37 30-day period. However, subsection (b) does not negate the possibility that upon
38 the lapse of the power, the power holder would be deemed to have become the
39 settlor and thereby subject the contribution to creditor claims under subsection

1 (a)(1). For the definition of settlor and its possible interpretation, see Section
2 1-105(12) and Comment.

3 This Act does not address creditor issues with respect to property subject to
4 a special power of appointment or testamentary general power of appointment. For
5 creditor rights against such interests, see Restatement (Property) Second: Donative
6 Transfers §§ 13.1-13.7 (1986).

7 **SECTION 2-406. LATE PAYMENTS.** Whether or not a trust contains a
8 spendthrift provision, a creditor or assignee of a beneficiary may compel payment of
9 a distribution directed to be made to the beneficiary by the terms of the trust if the
10 trustee has failed to do so after a time reasonable for making the distribution.

11 **Comment**

12 The effect of a spendthrift provision is generally to totally insulate a
13 beneficiary's interest until a distribution is made and has been received by the
14 beneficiary. See Section 2-401. But this section, along with several other sections
15 in this part, recognize exceptions to this general rule. Whether a trust contains a
16 spendthrift provision or not, a trustee should not be able to avoid creditor claims
17 against a beneficiary by refusing to make a distribution required to be made by the
18 express terms of the trust. On the other hand, a spendthrift provision would become
19 largely a nullity were a beneficiary's creditors able to attach all required payments as
20 soon as they became due. This section reflects a compromise between these two
21 competing principles. A creditor can reach a distribution required to be made to the
22 beneficiary by the express terms of the trust only if the trustee has failed to make the
23 payment within a reasonable time after the required distribution date. Following this
24 reasonable period, payments required to be made by the express terms of the trust
25 are in effect being held by the trustee as agent for the beneficiary and should be
26 treated the same as any other of the beneficiary's personal assets.

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ARTICLE 3
REVOCABLE TRUSTS

General Comment

Because of the widespread use in recent years of the revocable trust as an alternative to a will, this short article is one of the more important articles of the Act. Each section of this article deals with issues of significance not totally settled under current law. A general theme of this article and of the other parts of this Act is to treat the revocable trust as the functional equivalent of a will. Section 3-101 provides that the capacity standard for wills is to apply in determining whether the settlor had capacity to create a revocable trust. Section 3-102, after providing that a trust is presumed revocable unless stated otherwise, prescribes the procedure for revocation or modification, whether the trust contains one or multiple settlors. Section 3-103 provides that while a trust is revocable and the settlor has capacity, the settlor has all rights that would otherwise be granted to the beneficiaries. Section 3-104 prescribes a statute of limitations on contest of a trust that was revocable at death.

SECTION 3-101. CAPACITY OF SETTLOR TO CREATE

REVOCABLE TRUST. An individual who has capacity to make a will has capacity to create a revocable trust.

Comment

The purpose of this section, which is patterned after Restatement (Third) of Trusts § 11 (Tentative Draft No. 1, 1996), is to provide some certainty to what has become a major issue in the law of trusts due to the recent and widespread use of the revocable trust as an alternative to a will.

This section recognizes that the revocable trust is used primarily as a will substitute, with its key provision being the determination of the persons to receive the trust property upon the settlor's death. To solidify the use of the revocable trust as a device for transferring property at death, the settlor usually also executes a pourover will under which following the settlor's death the property not transferred to the trust during life will be combined with the trust property which the settlor did manage to convey. Given this primary use of the revocable trust as a device for disposing of property at death, the capacity standard for wills, and not for lifetime gifts, should apply. If lifetime management issues implicating the standard of capacity arise, they may be dealt with by reformation or other appropriate remedies

1 that will not jeopardize the overall plan of disposition by making the standard for the
2 trust different or higher than that for making a will. Restatement (Third) of Trusts
3 § 11 cmt. b (Tentative Draft No. 1, 1996).

4 The application of the capacity standard for wills does not mean that the
5 revocable trust must be executed with the formalities of a will. There are no
6 execution requirements under this Act for a trust not created by will, and a trust, at
7 least one containing personal property, may be created by an oral statement. See
8 Section 2-103 and Comment. Nor does the application of the capacity standard for
9 wills, and the fact that most States prohibit a guardian or conservator from making a
10 will for the ward or protected person, mean that a guardian or conservator cannot
11 create a trust, if allowed under local guardianship or conservatorship law.

12 The Act does not explicitly spell out the standard of capacity necessary to
13 create other types of trusts, although Section 2-102 does require that the settlor
14 have capacity. This section expressly states a capacity standard for the creation of
15 revocable trusts because of the lack of clarity in the case law and the importance of
16 the issue in modern estate planning. No such uncertainty exists with respect to the
17 capacity standard for other types of trusts. To create a testamentary trust, the
18 settlor must have the capacity to make a will. To create an irrevocable trust, the
19 settlor must have the capacity during lifetime to transfer the property free of trust.
20 See generally Restatement (Third) of Trusts § 11 (Tentative Draft No. 1, 1996).

21 **SECTION 3-102. REVOCATION OR MODIFICATION OF**
22 **REVOCABLE TRUST.**

23 (a) Unless the terms of a trust expressly provide that the trust is irrevocable,
24 the settlor may revoke or modify the trust. This subsection does not affect trusts
25 created under instruments executed before [the effective date of this [Act]].

26 (b) Except as otherwise provided by the terms of a trust, if the trust is
27 created or funded by more than one settlor, each settlor may revoke or modify the
28 trust as to the portion of the trust contributed by that settlor.

1 **[ALTERNATIVE PROVISION FOR COMMUNITY PROPERTY STATES]**

2 (b) Except as otherwise provided by the terms of a trust, if the trust is
3 created or funded by more than one settlor:

4 (1) to the extent the trust consists of community property, the trust may
5 be revoked by either spouse acting alone but may be modified only by joint action of
6 both spouses;

7 (2) to the extent the trust consists of other property, each settlor may
8 revoke or modify the trust as to the portion of the trust contributed by that settlor.]

9 **[END OF ALTERNATIVE PROVISION]**

10 (c) A trust that is revocable by the settlor may be revoked or modified:

11 (1) by substantially complying with the method specified by the terms of
12 the trust; or

13 (2) unless the terms of the trust expressly make the specified method
14 exclusive, by any other method manifesting clear and convincing evidence of the
15 settlor's intent to revoke.

16 (d) Upon revocation of a revocable trust, the trustee shall distribute the trust
17 property as the settlor directs.

18 (e) The settlor's powers with respect to revocation or modification may be
19 exercised by an agent under a power of attorney only to the extent the terms of the
20 trust or the power of attorney expressly so authorizes.

1 (f) Except to the extent prohibited by the terms of the trust, a conservator
2 may revoke or modify a revocable trust with the approval of the court supervising
3 the conservatorship.

4 **Comment**

5 Subsection (a), which provides that a settlor may revoke or modify a trust
6 unless the terms of the trust expressly state that the trust is irrevocable, is contrary
7 to the common law of trusts. The common law presumes that a trust is irrevocable
8 absent evidence of contrary intent. See Restatement (Second) of Trusts § 330
9 (1959). This subsection does not govern trusts created in another State whose
10 validity, under choice of law rules, is governed by the law of a State following the
11 common law rule. In addition, this subsection does not prevent a trust from being
12 reformed to make it irrevocable if the settlor was proceeding under a mistake of law
13 at the time of its creation. See Section 2-205 (reformation of trust). But far easier
14 than relying on this statute, choice of law rules, or reformation is for the drafter to
15 simply express in the terms of the trust whether the trust is revocable or irrevocable.

16 A power of revocation includes the power to modify. See Restatement
17 (Second) of Trusts § 331 cmt. g (1959). An unrestricted power to modify may also
18 include the power to revoke a trust. See Restatement (Second) of Trusts § 331
19 cmt. h.

20 Subsection (b) provides default rules for revocation or modification of a
21 trust with multiple settlors. Alternate provisions are provided depending on whether
22 the enacting jurisdiction is a community or noncommunity property State. For
23 community property States, to the extent the trust consists of community property,
24 the trust may be revoked by either spouse acting alone but may be modified only by
25 joint action of both spouses. The purpose of this provision, and the reason for the
26 use of joint trusts in community property States, is to preserve the community
27 character of property transferred to the trust. For this reason, the requirement of
28 joint action to modify the trust does not apply to the extent the trust consists of
29 separate property.

30 The alternative provision for noncommunity property States provides that
31 each settlor may revoke or modify the trust as to the portion of the trust contributed
32 by that settlor. While the Act provides a rule for noncommunity property States, the
33 inclusion of this rule does not mean that the drafters of this Act concluded that the
34 use of joint trusts should be encouraged. The rule is included because of the
35 widespread use of joint trusts in noncommunity property States in recent years.
36 Joint trusts are a necessity in community property States due to the desire to

1 preserve the community character of the trust property. No such motivating reason
2 exists for their creation in noncommunity property States.

3 This section does not explicitly require that the other settlor or settlors be
4 notified if a joint trust is revoked by less than all of the settlors, but such notice
5 would be required under Section 5-114(f). While the trust is revocable and the
6 settlor has capacity, Section 5-114(f) provides that the duty to keep the beneficiaries
7 reasonably informed of developments is owed exclusively to the settlor. To avoid
8 an issue as to how this duty applies to a trust with multiple settlors, subsection (f)
9 further provides that in the case of a trust with multiple settlors, this duty to keep
10 the *settlor* informed extends to *all* of the settlors. Notifying the other settlor of
11 settlors of the revocation or modification will place them in a better position to
12 protect their interests. If the revocation or modification by less than all of the
13 settlors breaches an implied agreement not to revoke or modify the trust, those
14 harmed by the action could sue for breach of contract. If the trustee fails to notify
15 the other settlor or settlors of the revocation, the parties aggrieved by the trustee's
16 failure could sue the trustee for breach of trust.

17 Under subsection (c), the settlor may revoke a revocable trust by
18 substantially complying with the method specified in the terms of the trust or by any
19 other method manifesting clear and convincing evidence of the settlor's intent to
20 revoke. Only if the method specified in the terms of the trust is exclusive are use of
21 the other methods prohibited. Even then, a failure to comply with a technical
22 requirement, such as required notarization, may be excused as long as compliance
23 with the method specified in the terms of the trust is otherwise substantial.

24 While revocation of a trust is ordinarily accomplished by signing and
25 delivering a written document to the trustee, other methods, such as by oral
26 statement or by physical act coupled with a withdrawal of the property, may also
27 demonstrate the necessary intent. These less formal methods, because they provide
28 less reliable indicia of intent, are not to be encouraged.

29 Subsection (c) does not require that a trustee concur in a revocation or
30 modification of a trust. Such a concurrence would be necessary only if expressly
31 required by the terms of the trust. If the trustee concludes that a modification
32 unacceptably changes the trustee's duties, the trustee is free to resign. See Section
33 4-105.

34 Subsection (d), providing that upon revocation the trust property is to be
35 distributed as the settlor directs, codifies a provision commonly included in
36 revocable trust instruments.

1 Subsection (e) allows an agent under a power of attorney to revoke or
2 modify a revocable trust but only to the extent the terms of the trust or power of
3 attorney expressly so permit. An express provision is required because most settlors
4 usually intend the revocable trust, and not the power of attorney, to function as the
5 settlor's principal property management device. The power of attorney is usually
6 intended as a backup for assets not transferred to the revocable trust or to address
7 specific topics, such as the power to sign tax returns or apply for certain government
8 benefits, which are questionably beyond the authority of a trustee or which are not
9 customarily granted to a trustee.

10 Many States allow a conservator to exercise the settlor's power of
11 revocation with the prior approval of the court supervising the conservatorship.
12 See, e.g., Unif. Prob. Code § 5-407. Subsection (f) allows a settlor to direct in the
13 terms of the trust that this other law not apply. The fact that a conservator may be
14 prohibited from revoking the trust does not mean that the conservator is prohibited
15 from taking appropriate action to protect the settlor's interest if the settlor, now
16 under conservatorship, is also a beneficiary of the trust. For example, the
17 conservator could petition for removal of the trustee. See Section 4-106. The
18 conservator, acting on the settlor-beneficiary's behalf, could also bring an action to
19 enforce the trust according to its terms. Pursuant to Section 7-305, a conservator
20 may act on behalf of the beneficiary whose estate the conservator controls whenever
21 a consent or other action by the beneficiary is required or may be given under the
22 Act.

23 The settlor's power to revoke the trust under this section does not preclude
24 termination of the trust under another section.

25 **SECTION 3-103. OTHER RIGHTS OF SETTLOR; PRESENTLY**
26 **EXERCISABLE POWERS OF WITHDRAWAL.**

27 (a) Except as otherwise provided by the terms of a trust, while the trust is
28 revocable and the settlor has capacity to revoke the trust:

29 (1) rights of the beneficiaries are held by and the duties of the trustee are
30 owed exclusively to the settlor, and vest in the beneficiaries upon the settlor's death
31 or incapacity; and

1 **ARTICLE 4**
2 **OFFICE OF TRUSTEE**

3 **General Comment**

4 This article contains a series of default rules dealing with the office of
5 trustee, all of which may be superseded by the terms of the trust. Sections 4-101
6 and 4-102 address the process for getting a trustee into office, including the
7 procedures for indicating an acceptance and whether bond will be required. Section
8 4-103 address cotrustees, permitting the cotrustees to act by majority action and
9 specifying the extent to which one trustee may delegate to another. Sections 4-104
10 through 4-108 address changes in the office of trustee, specifying the circumstances
11 when a vacancy must be filled, the procedure for resignation, the grounds for
12 removal, and the process for appointing a successor. Sections 4-109 and 4-110
13 describe the standard for determining trustee compensation and reimbursement for
14 expenses advanced.

15 **SECTION 4-101. ACCEPTANCE OR REJECTION OF TRUSTEESHIP.**

16 (a) Except as otherwise provided in subsection (c), a person designated as
17 trustee accepts the trusteeship by:

18 (1) substantially complying with a method specified in the terms of the
19 trust; or

20 (2) unless the terms of the trust make the specified method exclusive,
21 accepting delivery of the trust property, exercising powers or performing duties as
22 trustee, or otherwise indicating an intention to accept the trusteeship.

23 (b) A person designated as trustee who has not yet accepted the trusteeship
24 may reject the trusteeship. A failure to accept the trusteeship within a reasonable
25 time after the person knows of the appointment is a rejection of the trusteeship.

1 (c) If there is an immediate risk of loss to the trust property, the person
2 named as trustee may act to preserve the trust property without accepting the
3 trusteeship, if within a reasonable time after acting the person delivers a written
4 rejection of the trusteeship to the settlor or, if the settlor is dead or lacks capacity, to
5 a qualified beneficiary.

6 **Comment**

7 This section, specifying the requirements for a valid acceptance of the
8 trusteeship, implicates many of the same issues as arise in determining whether a
9 trust has been revoked. Consequently, the two provisions track each other closely.
10 Compare Section 3-102(c) (procedure for revoking or modifying trust). Procedures
11 specified in the terms of the trust are recognized, but only substantial, not literal
12 compliance is required. A failure to meet technical requirements, such as
13 notarization of the trustee's signature, does not result in nonacceptance. Ordinarily,
14 the trustee will indicate an acceptance by signing the trust instrument or signing a
15 separate written instrument. However, this section recognizes any other method
16 indicating the necessary intent, such as an acceptance by oral statement or
17 knowingly exercising trustee powers, unless the terms of the trust make a specified
18 method exclusive. This section also does not preclude an acceptance by estoppel or
19 damages for an unreasonable delay in signifying a decision as to an acceptance or
20 rejection. For general background on issues relating to trustee acceptance and
21 rejection, see Restatement (Third) of Trusts § 36 (Preliminary Draft No. 3, 1997).
22 Consistent with Section 1-201, which encourages a court to intervene only when
23 called upon by an interested party or in other special circumstance, there is no
24 requirement that a trustee qualify in court.

25 To avoid the inaction that can result if the person designated as trustee fails
26 to communicate a decision to either accept or reject, subsection (b) provides that a
27 failure to accept within a reasonable time constitutes a rejection of the trusteeship.
28 A trustee's rejection of a trust normally precludes a later acceptance of the trust but
29 does not cause the trust to fail. See Restatement (Third) of Trusts § 36 cmt. c
30 (Preliminary Draft No. 3, 1997). As to filling vacancies in the event of a rejection,
31 see Section 4-108.

32 While a person designated as trustee who decides not to accept the
33 trusteeship need not give a formal rejection, a clear and early communication is
34 recommended. The appropriate recipient of the written rejection depends upon the
35 particular circumstances. Ordinarily, it would be appropriate to give the rejection to
36 the person who informs the person of the proposed trusteeship. If judicial

1 proceedings involving the trust are pending, the rejection could be filed with the
2 court. In the case of a person named as trustee of a revocable trust, it would be
3 appropriate to give the rejection to the settlor. In any event it would be best to give
4 notice of rejection to a beneficiary with a significant interest in the trust because that
5 beneficiary might be more motivated than others to seek appointment of a new
6 trustee.

7 Subsection (c) makes clear that the authority to act in an emergency does
8 not impose a duty to act. The person named as trustee may act in an emergency
9 without being considered to have accepted the trusteeship but upon conclusion of
10 the emergency the nominated trustee must clearly indicate to the settlor, if living and
11 competent, otherwise to the qualified beneficiaries entitled to approve a trustee's
12 report, that the person rejects the trusteeship.

13 **SECTION 4-102. TRUSTEE'S BOND.**

14 (a) A trustee is required to give a bond to secure performance of the
15 trustee's duties only if the court finds that a bond is needed to protect the interest of
16 beneficiaries or a bond is required by the terms of the trust and the court has not
17 dispensed with the requirement.

18 (b) If required, a bond must be in such amount and with such sureties and
19 liabilities as the court may specify. The court, by requiring bond, is not precluded
20 from later modifying or dispensing with the bond.

21 (c) Except as otherwise provided by the terms of trust or ordered by the
22 court, the cost of a bond is charged to the trust.

23 **Comment**

24 This provision is consistent with the Restatement and with the bonding
25 provisions of the Uniform Probate Code. See Restatement (Third) of Trusts § 35
26 cmt. a (Preliminary Draft No. 3, 1997); Unif. Probate Code §§ 3-604 (personal
27 representatives), 5-410 (conservators), and 7-304 (trustees). Because a bond is
28 required only if the terms of the trust require bond or a bond is found by the court to
29 be necessary to protect the interests of beneficiaries, bond will rarely be required
30 under the Act. This section does not specifically excuse bond for financial-service

1 institutions with trust powers, preferring instead to leave that topic to separate
2 legislation.

3 The amount of a bond otherwise required may be reduced by the value of
4 trust property deposited in a manner that prevents its unauthorized disposition, and
5 by the value of real property which the trustee, by express limitation of power, lacks
6 power to convey without court authorization.

7 The court may excuse or otherwise modify a requirement of a bond, reduce
8 or increase the amount of a bond, release a surety, or permit the substitution of
9 another bond with the same or different sureties.

10 **SECTION 4-103. COTRUSTEES.**

11 (a) Except as otherwise provided by the terms of a trust:

12 (1) a power held by cotrustees may be exercised by majority action;

13 (2) if a vacancy occurs in a cotrusteeship, the remaining cotrustee or
14 cotrustees may act for the trust; and

15 (3) if a cotrustee is unavailable to perform duties because of absence,
16 illness, or other temporary incapacity, and prompt action is necessary to accomplish
17 the purposes of the trust or to avoid irreparable injury to the trust property, the
18 remaining cotrustees may act for the trust as if they were the only trustees.

19 (b) If a trust has more than one trustee, each trustee shall:

20 (1) participate in the administration of the trust and not delegate to a
21 cotrustee the performance of functions that the settlor reasonably expected each
22 trustee to perform personally; and

23 (2) take reasonable steps to prevent a cotrustee from committing a
24 breach of trust and to compel a cotrustee to redress a breach of trust.

1 (c) A trustee who complies with subsection (b) is not liable for the actions
2 or failures to act of a cotrustee.

3 **Comment**

4 Subsection (a)(1) is in accord with Restatement (Third) of Trusts § 40
5 (Preliminary Draft No. 3, 1997), which rejects earlier Restatement formulations and
6 allows action by a majority of the trustees. This rule is subject to contrary provision
7 in the terms of the trust, as noted in the introductory clause. Should a cotrustee
8 resign or a vacancy occur by some other means, only a majority of the remaining
9 trustees need be counted, even though the number of trustees constituting a majority
10 would then be less than before the vacancy occurred.

11 Under subsection (a)(2), a vacancy in a cotrusteeship is disregarded if there
12 is at least one trustee remaining in office. This is consistent with Section 4-108,
13 which provides that unless the terms of the trust so require, a vacancy in a
14 cotrusteeship need be filled only if there is no cotrustee remaining in office.

15 By permitting the trustees to act by a majority, subsection (a) contemplates
16 that there may be a trustee or trustees who might dissent. A trustee who dissents is
17 not liable to a third party for failing to join in the majority's exercise of a power.
18 However, should the action by the majority constitute a breach of trust, the
19 dissenting trustee may be held liable under subsection (b) for failing to take action to
20 rectify the improper acts of the other cotrustees. The responsibility to monitor the
21 actions of the other cotrustees imposed by subsection (b) codifies the substance of
22 Sections 184 and 224 of the Restatement (Second) of Trusts (1959).

23 Subsection (b) also addresses the extent to which a trustee may delegate the
24 performance of functions to a cotrustee. A trustee may not delegate to a cotrustee
25 the performance of functions that the settlor expected the trustee to personally
26 perform. This is consistent with Restatement (Second) of Trusts § 171, although
27 that Restatement provision applied to all delegation, both to agents and to
28 cotrustees. For the provision of this Act on delegation to agents, see Section 5-108.
29 The exact extent to which a trustee may delegate functions to another trustee in a
30 particular case will vary depending on the reasons the settlor decided to appoint
31 cotrustees. The better practice is to address the division of functions in the terms of
32 the trust, as allowed by Section 5-101.

33 Delegation to a cotrustee is different than a cotrustee's assumption of duties
34 due to a trustee's inability to perform the trusteeship. Under subsection (a)(3), a
35 cotrustee, without a delegation, may assume all of the functions of another trustee
36 who is unavailable to perform duties because of absence, illness, or other temporary
37 incapacity.

1 (C) the qualified beneficiaries if the settlor lacks capacity and is not
2 represented by a conservator, guardian, or agent;

3 (3) in the case of an irrevocable trust, upon at least 30 days written
4 notice to the qualified beneficiaries; or

5 (4) with the approval of the court.

6 (b) A qualified beneficiary, by a written consent, may waive a notice
7 otherwise required under this section.

8 (c) In approving a resignation, the court may impose such orders and
9 conditions as are reasonably necessary for the protection of the trust property,
10 including the appointment of a receiver or temporary trustee.

11 (d) The liability for acts or omissions of a resigning trustee or of any sureties
12 on the trustee's bond is not released or affected by the trustee's resignation.

13 **Comment**

14 This section provides several alternative methods by which a trustee may
15 resign. As provided in subsection (a)(1), a trustee may always resign as provided in
16 the terms of the trust. Should the terms of the trust not provide a method for
17 resignation or should the method for whatever reason not be followed, a trustee may
18 resign by giving notice as provided in subsection (a)(2)-(3). Under subsection
19 (a)(4), court approval of a resignation is required only if none of the other
20 alternatives are available.

21 The persons to whom notice of a resignation must be given are generally the
22 same as those who must approve the appointment of a successor trustee to fill a
23 vacancy. See Section 4-108. For a revocable trust, notice to the settlor will
24 ordinarily be required, but should the settlor be incapacitated, subsection (a)(2)
25 makes provision for a substitute consent. For an irrevocable trust, subsection (a)(3)
26 requires that notice be given to the qualified beneficiaries.

27 Section 5-114 requires a trustee's report whenever there is a change of
28 trustees. See also Restatement (Third) of Trusts § 37 cmt. d (Preliminary Draft No.

1 3, 1997), which, like subsection (d), provides that resignation does not release the
2 resigning trustee from potential liabilities.

3 **SECTION 4-106. REMOVAL OF TRUSTEE.**

4 (a) A trustee may be removed in accordance with the terms of the trust or
5 by the court on its own initiative or on petition of a settlor, cotrustee, or beneficiary.

6 (b) The court may remove a trustee or order other appropriate relief as
7 specified in Section 7-102:

8 (1) if the trustee has committed a material breach of trust;

9 (2) if the trustee is unfit or unable to administer the trust;

10 (3) if lack of cooperation among cotrustees substantially impairs the
11 administration of the trust;

12 (4) if the investment decisions of the trustee, although not constituting a
13 breach of trust, have resulted in investment performance persistently and
14 substantially below those of comparable trusts;

15 (5) if, because of changed circumstances, removal of the trustee would
16 substantially further the settlor's purposes in creating the trust; or

17 (6) for other good cause shown.

18 (c) Pending a final decision on the petition to remove the trustee, the court
19 may order such appropriate relief under Section 7-102 as may be necessary to
20 protect the trust property or the interests of the beneficiaries.

21 **Comment**

22 Subsection (a) of this section is the same in substance as Section 38 of the
23 Restatement (Third) of Trusts (Preliminary Draft No. 3, 1997), except that it gives

1 the settlor of an irrevocable trust the right to petition for removal of a trustee. The
2 right to petition for removal does not give the settlor of an irrevocable trust any
3 other rights, such as the right to an annual report or to receive other information
4 concerning administration of the trust. The right of a beneficiary to petition for
5 removal does not apply to a revocable trust while the settlor has capacity. While the
6 trust is revocable and the settlor has capacity, the settlor holds all rights that would
7 otherwise be granted to the beneficiaries. See Section 3-103.

8 While removal is ordinarily ordered by a court, the topic may also be
9 addressed in the terms of the trust, as subsection (a) recognizes. In fashioning a
10 removal provision for an irrevocable trust, the drafter should remain cognizant of
11 the potential inclusion of the trust in the settlor's federal gross estate if the settlor
12 retains the power to be appointed as trustee.

13 The statement of grounds for removal by the court in subsection (b) is taken
14 in part from the Texas Trust Code and the Restatement. See Tex. Prop. Code Ann.
15 § 113.082(a); Restatement (Third) of Trusts § 38 cmt. e (Preliminary Draft No. 3,
16 1997). If a trustee is removed, another may be appointed to fill the vacancy as
17 provided in Section 4-108.

18 Subsection (b) allows removal for untoward action on the part of a trustee,
19 such as a material breach of trust, but the section is not so limited. The grounds
20 listed in subsection (b)(1)-(6) allow for removal under a variety of circumstances
21 where the trustee is not acting in the best interests of the beneficiaries or in line with
22 the expectations of the settlor.

23 Because of its importance to the long-term value of the beneficiaries'
24 interests, subsection (b)(4) specifically allows a trustee to be removed if the
25 investment decisions of the trustee, although not constituting a breach of trust, have
26 resulted in investment performance persistently and substantially below those of
27 comparable trusts.

28 To honor the settlor's reasonable expectations, subsection (b)(5) allows a
29 trustee to be removed because of changed circumstances. Changed circumstances
30 justifying removal of a trustee might include a substantial change in the character of
31 the trustee which has occurred between the date of the trust's creation and the date
32 the removal petition is filed.

33 Subsection (b)(6), instead of trying to catalog yet more grounds for removal,
34 allows for removal whenever there is good cause. Friction between cotrustees,
35 inability of the trustee and beneficiaries to get along through fault of the trustee,
36 indifference on the part of the trustee, and mediocre service may all justify removal

1 if in the best interests of the beneficiaries and not inconsistent with the purposes of
2 the trust.

3 A particularly appropriate circumstance justifying removal is the failure of a
4 trustee to keep the beneficiaries reasonably informed of the administration of the
5 trust or to comply with a beneficiary's request for information as required by
6 Section 5-114. Failure to comply with this duty may make it impossible for the
7 beneficiaries to protect their interests. It may also mask more serious violations by
8 the trustee. The failure to comply with the duties prescribed by Section 5-114 may
9 justify removal under subsection (b)(1), if it constitutes a material breach of trust, or
10 under subsection (b)(6), when determined to constitute good cause.

11 While the failure of a trustee to act in the beneficiaries' best interest is an
12 important factor in determining whether removal is appropriate, the settlor's
13 purposes in creating the trust should not be ignored. Complying with the
14 beneficiaries' wishes to the detriment of the settlor's purposes may also constitute
15 good cause for removal, justifying replacement with a trustee who will comply with
16 the fundamental responsibility to administer a trust in accordance with its terms.

17 **SECTION 4-107. DELIVERY OF PROPERTY BY FORMER TRUSTEE.**

18 Unless a cotrustee remains in office or the court otherwise orders, and until the trust
19 property is delivered to a successor trustee or to a person appointed by the court to
20 receive the property:

21 (1) a trustee who has resigned or been removed has the duties and powers of
22 the trusteeship; and

23 (2) a former trustee's personal representative, if the former trustee's
24 appointment terminated because of death, or a former trustee's conservator or
25 guardian, if the appointment terminated because of the former trustee's incapacity, is
26 responsible for and has the powers necessary to protect the trust property and
27 administer the trust.

28 **Comment**

1 This section addresses the continuing authority of a former trustee. Subject
2 to the power of the court to make other arrangements, a former trustee has
3 continuing authority until the property is delivered to a successor. However, if a
4 cotrustee remains in office, there is no reason to grant such continuing authority,
5 and none is granted. If the trustee has resigned or been removed, the continuing
6 authority is granted to the former trustee; if the former trustee has died, to the
7 former trustee's personal representative; if the former trustee has been adjudicated
8 incapacitated, to the former trustee's guardian or conservator. Whether a former
9 trustee remains in office or not, the former trustee remains liable for actions or
10 omissions during the trustee's term of office until liability is barred.

11 Section 5-114 requires a trustee's report whenever there is a change of
12 trustees. Section 7-202(c) protects third persons who deal in good faith with a
13 former trustee without knowledge that the person is no longer a trustee. See also
14 Section 7-102(4) (appointment of receiver or temporary trustee upon breach of
15 trust).

16 **SECTION 4-108. FILLING VACANCY.**

17 (a) A trustee must be appointed to fill a vacancy in a trusteeship if the trust
18 has no remaining trustee or the terms of the trust require a vacancy in the trusteeship
19 to be filled.

20 (b) A vacancy in a trusteeship required to be filled must be filled:

21 (1) by the person named in or nominated pursuant to the method
22 specified by the terms of the trust;

23 (2) if the terms of the trust do not name a person or specify a method for
24 filling the vacancy, or the person named or nominated pursuant to the method
25 specified does not accept, by a person:

26 (A) designated by the unanimous agreement of the qualified
27 beneficiaries; or

28 (B) appointed by the court.

1 **Comment**

2 This section addresses only circumstances when a vacancy in the trusteeship
3 *must* be filled. The court, exercising its inherent equity authority, may always
4 appoint additional trustees if the appointment would promote better administration
5 of the trust. See Restatement (Third) of Trusts § 35 cmt. e (Preliminary Draft No.
6 3, 1997).

7 Good drafting practice suggests that the terms of the trust deal expressly
8 with the problem of vacancies, naming successors and addressing the procedure for
9 filling a vacancy in the absence of a named successor. For this reason, subsection
10 (b)(1) provides that the first choice for filling the vacancy is the person named in or
11 nominated pursuant to the method specified in the terms of the trust. Furthermore,
12 subsection (a) clarifies that a vacancy in the cotrusteeship need be filled only if the
13 trust so requires. If a vacancy in the cotrusteeship is not filled, Section 4-103
14 authorizes the remaining cotrustees to continue to administer the trust. For a listing
15 of the circumstances when a vacancy in a cotrusteeship may occur, see Section
16 4-104.

17 Absent an effective provision in the terms of the trust, subsection (b)(2)(A)
18 permits a vacancy in the trusteeship to be filled, without the need for court approval,
19 by a person selected by unanimous agreement of the qualified beneficiaries, who, per
20 Section 4-105(a)(3), may also receive the trustee’s resignation. If a trustee resigns
21 pursuant to Section 4-105(a)(3), the trust may be transferred to a successor
22 appointed pursuant to subsection (b)(2)(A), all without court involvement.

23 Subsection (b)(2)(B) authorizes the court to fill a vacancy if the trust does
24 not name a successor who is willing to accept the trust or if the trust does not
25 provide another method of appointment. The appointment of a successor by the
26 court is an alternative to an appointment by the beneficiaries under subsection
27 (b)(2)(A). The petition may be brought by any beneficiary of the trust. Per Section
28 4-106, a beneficiary without authority to join in a beneficiary appointment may also
29 petition the court for removal of the trustee appointed by the qualified beneficiaries.
30 For a list of factors for the court to consider in making its selection, see Restatement
31 (Third) of Trusts § 35 cmt. f (Preliminary Draft No. 3, 1997).

32 In the case of a revocable trust, the appointment of a successor will normally
33 be made directly by the settlor. As to the duties of a successor trustee, see Section
34 5-113.

35 **SECTION 4-109. COMPENSATION OF TRUSTEE.**

1 (a) If the terms of a trust do not specify the trustee's compensation, a
2 trustee or cotrustee is entitled to compensation that is reasonable under the
3 circumstances.

4 (b) If the terms of a trust specify the trustee's compensation, the trustee is
5 entitled to be compensated as provided, but the court may allow more or less
6 compensation:

7 (1) if the duties of the trustee are substantially different from those
8 contemplated when the trust was created;

9 (2) if the compensation specified by the terms of the trust would be
10 unreasonably low or high; or

11 (3) in extraordinary circumstances calling for equitable relief.

12 **Comment**

13 Subsection (a) establishes a standard of reasonable compensation. For a list
14 of factors relevant in determining reasonable compensation, see Restatement (Third)
15 of Trusts § 39 cmt. c (Preliminary Draft No. 3, 1997). In setting compensation, the
16 services actually performed and responsibilities assumed by the trustee should be
17 closely examined. For example, an adjustment in compensation may be appropriate
18 if the trustee has delegated significant duties, such as the delegation of investment
19 authority to outside managers in the form of the purchase of proprietary or other
20 mutual funds. See Sections 5-103(e) (duty of loyalty with respect to proprietary
21 funds), 5-108 (delegation by trustee), and Section 5-209 Comment (delegation of
22 investment and management authority under Uniform Prudent Investor Act). On the
23 other hand, a trustee with special skills, such as those of a real estate agent, may be
24 entitled to extra compensation for performing services that would ordinarily be
25 delegated. See Restatement (Third) of Trusts § 39 cmt. f (Preliminary Draft No. 3,
26 1997).

27 Subsection (b) permits the reasonable compensation standard to be
28 overridden or clarified by the terms of the trust, subject to the court's inherent
29 equity power to make adjustments downward or upward in appropriate
30 circumstances. Whether a provision in the terms of the trust setting the amount of
31 the trustee's compensation is binding on a successor trustee is a matter for

1 interpretation. Also a question for interpretation is whether a beneficial provision
2 for the trustee in the terms of the trust is in addition to or in lieu of the trustee's
3 regular compensation. Another possible uncertainty is whether the discharge of the
4 beneficial provision is conditional on the person performing services as trustee. See
5 Restatement (Third) of Trusts § 39 cmt. e (Preliminary Draft No.3, 1997).

6 Compensation may be set by agreement. A trustee may enter into an
7 agreement with the beneficiaries for lesser or increased compensation, although an
8 agreement increasing compensation is not binding on a nonconsenting beneficiary.
9 A trustee may agree to waive compensation and should do so prior to rendering
10 significant services if concerned about possible gift and income tax liability on the
11 compensation accrued prior to the waiver. See Rev. Rul. 66-167, 1966-1 C.B. 20.
12 See also Restatement (Third) of Trusts § 39 cmt. f (Preliminary Draft No. 3, 1997).

13 The standard of reasonable compensation also applies to a trust with
14 multiple trustees. The mere fact that a trust has more than one trustee does not
15 mean that the trustees together are entitled to more compensation than had either
16 acted alone. Nor does the appointment of multiple trustees mean that the trustees
17 are eligible to receive the compensation in equal shares. The total amount of the
18 compensation to be paid and how it will be divided depend on the totality of the
19 circumstances. Factors to be considered include the settlor's reasons for naming
20 multiple trustees and the level of responsibility assumed and exact services
21 performed by each trustee.

22 Section 5-117(15) grants the trustee authority to fix and pay its
23 compensation without the necessity of prior court review, but without precluding
24 the right of a beneficiary to object to the compensation in a later judicial proceeding.
25 Allowing the trustee to pay its compensation without prior court approval promotes
26 efficient trust administration but does place a significant burden on a beneficiary
27 who believes the compensation is unreasonable. To provide a beneficiary with time
28 to take action, if the beneficiary believes that action is appropriate, and because of
29 the importance of trustee's fees to the beneficiaries' interests, Section 5-114(b)(4)
30 requires a trustee to provide the qualified beneficiaries with advance notice of any
31 change in the method or rate of the trustee's compensation. Failure to provide such
32 advance notice constitutes a breach of trust, possibly justifying removal under
33 Section 4-106.

34 **SECTION 4-110. REPAYMENT FOR EXPENDITURES.** A trustee is
35 entitled to be reimbursed out of the trust property, with interest as appropriate, for:

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ARTICLE 5

FIDUCIARY ADMINISTRATION

PART 1

DUTIES AND POWERS OF TRUSTEE

General Comment

This part states the fundamental duties of a trustee and lists the trustee's powers. The duties listed are not new, but how the particular duties are formulated and applied has changed over the years. This part was drafted where possible to conform with the 1994 Uniform Prudent Investor Act, which has been enacted in over half the States. The Uniform Prudent Investor Act prescribes a trustee's responsibilities with respect to the management and investment of trust property. This Act also addresses a trustee's duties with respect to distribution to beneficiaries.

Because of the widespread adoption of the Uniform Prudent Investor Act, no effort has been made to interweave the Prudent Investor Act into this part of the Act. Instead, the Prudent Investor Act is reproduced separately as Part 2 of this article. States adopting this Act which have previously enacted the Prudent Investor Act are encouraged to recodify their version of the Prudent Investor Act by reenacting it as Part 2 of this article instead of leaving it elsewhere in their codes. Where the two Acts overlap, States should enact the provisions of this part and not the duplicative provisions of the Prudent Investor Act. To facilitate this process, the Uniform Prudent Investor Act is reproduced in full in Part 2 but provisions of that Act which duplicate provisions of this part are placed in brackets. Sections of this part which overlap with the Prudent Investor Act are Sections 5-103 (duty of loyalty), 5-104 (impartiality), 5-106 (costs of administration), trustee's skills (5-107), and delegation (5-108). For a list of the sections of the Prudent Investor Act which have been placed in brackets, see the General Comment to Part 2 of this article.

SECTION 5-101. MODIFICATION OF DUTIES AND POWERS BY

SETTLOR. The terms of a trust may expand, restrict, eliminate, or otherwise alter the duties prescribed by and powers provided in this [article], and the trustee may

1 reasonably rely on those terms, but this [Act] does not authorize a trustee to act
2 other than in good faith and with regard to the purposes of the trust and the interest
3 of the beneficiaries.

4 **Comment**

5 A settlor is free to vary the duties prescribed by and powers listed in this part
6 but not without limit. A trustee must always act in good faith and in accordance
7 with the purposes of the trust and the interests of the beneficiaries. The obligation
8 to act in good faith and in light of fiduciary principles is a fundamental concept that
9 applies throughout this Act. See Sections 5-115 (duties with regard to discretionary
10 power), 7-105 (exculpation of trustee). See also Sections 5-103 (duty of loyalty),
11 and 5-105 (duty to act with prudence). In addition and perhaps stating the obvious,
12 the trustee is not required to perform a duty prescribed by the terms of the trust if
13 performance would be impossible, invalid, illegal or violative of public policy. See
14 Section 2-104 (purposes for which trust can be created).

15 While a trustee generally must administer a trust in accordance with its terms
16 and purposes, the purposes and particular terms of the trust will on occasion
17 conflict. Should such a conflict occur because of circumstances not anticipated by
18 the settlor, it may be appropriate for the trustee to petition under Section 2-203 to
19 modify or terminate the trust.

20 Section 2(b) of the Uniform Prudent Investor Act, codified at Section
21 5-201(b), is similar, although unlike this section it places no express limit on the
22 ability of a settlor to vary the terms of the trust. However, a requirement that the
23 trustee must always act in good faith and with regard to the purposes of the trust
24 and the interests of the beneficiaries would seem to be implied.

25 **SECTION 5-102. DUTY TO ADMINISTER TRUST.** Upon acceptance of a
26 trust, the trustee shall administer the trust in good faith, according to its terms and
27 purposes and, except to the extent the terms of the trust otherwise provide,
28 according to this [Act].

29 **Comment**

30 This section confirms that the primary duty of a trustee, above all others, is
31 to follow the terms and purposes of the trust. Only if the terms of a trust are silent

1 or for some reason invalid on a particular issue are the trustee's duties derived
2 exclusively from this Act. This section also confirms that a trustee does not have a
3 duty to act until the trustee has accepted the trusteeship. See Section 4-101 and
4 Comment (acceptance or rejection of trusteeship).

5 For background on the trustee's duty to administer the trust, see
6 Restatement (Second) of Trusts §§ 164-169 (1959). For the provision of the
7 Uniform Prudent Investor Act protecting a trustee in relying on the terms of the
8 trust, see Section 5-201(b).

9 **SECTION 5-103. DUTY OF LOYALTY.**

10 (a) A trustee shall administer the trust solely in the interest of the
11 beneficiaries.

12 (b) A transaction involving the trust property which is affected by a
13 substantial conflict between the trustee's fiduciary and personal interests is voidable
14 by a beneficiary affected by the transaction unless the transaction was authorized by
15 the terms of the trust or approved by the court, or the beneficiary has consented to
16 the trustee's conduct, ratified the transaction, or released the trustee as provided in
17 Section 7-106.

18 (c) A transaction is presumed to involve a substantial conflict between
19 personal and fiduciary interests if it involves a sale, encumbrance, or other
20 transaction concerning the trust property entered into by the trustee with the spouse,
21 descendants, siblings, parents, agent, or attorney of a trustee, or with a corporation
22 or other enterprise in which the trustee has a substantial beneficial interest.

23 (d) A transaction between a trustee and a beneficiary which occurs during
24 the existence of the trust or while the trustee retains significant influence over the

1 beneficiary and from which the trustee obtains an advantage is voidable unless the
2 trustee establishes that the transaction was fair to the beneficiary.

3 (e) A trustee may invest in securities of an investment company or trust to
4 which the trustee, or its affiliates, provides services, and receive compensation from
5 the trust for those services, if the decision to invest satisfies the prudent investor rule
6 of [Article] 5, [Part] 2 and the trustee discloses at least annually to the persons
7 entitled under Section 5-114 to receive a copy of the trustee's annual report the rate
8 and method by which the compensation was determined.

9 (f) This section does not restrict the following transactions, if fair to the
10 beneficiaries:

11 (1) an agreement relating to the appointment of the trustee;

12 (2) the payment of reasonable compensation to the trustee, whether by
13 agreement, the terms of the trust, or this [Act]; and

14 (3) a transaction between a trust and another trust, decedent's estate, or
15 conservatorship of which the trustee is a fiduciary or a beneficiary has an interest.

16 **Comment**

17 This section addresses the duty of loyalty, perhaps the most fundamental
18 duty of the trustee. Subsection (a) states the general principle. A trustee owes a
19 duty of loyalty to the beneficiaries, a principle which is sometimes expressed as the
20 obligation by the trustee not to place the trustee's own interests over those of the
21 beneficiaries. Most but not all violations of the duty of loyalty concern transactions
22 involving the trust property, but breaches of the duty can take a myriad of other
23 forms. For a discussion of the different types of violations, see 2A Austin W. Scott
24 § William F. Fratcher, The Law of Trusts §§ 170-170.24 (4th ed. 1987).

25 Subsection (b) states the general rule with respect to transactions involving
26 trust property. A transaction involving the trust property which is affected by a
27 substantial conflict between the trustee's fiduciary and personal interests is voidable

1 by a beneficiary affected by the transaction. Transactions involving trust property
2 entered into by a trustee individually are voidable without further proof under the
3 “no further inquiry” rule. Such transactions are irrebuttably presumed to involve a
4 substantial conflict between personal and fiduciary interests. The appropriate result
5 is less clear with respect to transactions entered into with persons with close
6 business or personal ties to the trustee. Depending on the particular circumstances,
7 such transactions may or may not be tainted by conflict of interest. Subsection (c)
8 resolves the issue by requiring the trustee to prove the propriety of such
9 transactions. Transactions between a trustee and certain relatives, business
10 associates, or enterprises in which the trustee has a substantial beneficial interest are
11 presumptively voidable. Transactions involving trust property with parties not on
12 the list are not necessarily valid, however. While a presumption does not apply, a
13 transaction may still be voided if the beneficiary proves that a substantial conflict
14 between personal and fiduciary interests exists and that the transaction was affected
15 by the conflict.

16 The right of a beneficiary to void a transaction involving a substantial
17 conflict of interest is elective. Should the transaction prove unprofitable, the
18 beneficiary will likely allow the transaction to stand. Also, as provided in subsection
19 (b), the beneficiary may be precluded from acting if the transaction was expressly
20 authorized by the terms of the trust or approved by the court. In addition, a
21 beneficiary may be precluded from acting by statute of limitations or laches, or by
22 choosing to ratify the transaction, either prior to or subsequent to its occurrence.
23 See Sections 7-104, 7-106. In determining whether a beneficiary has consented to a
24 transaction, the principles of fiduciary and virtual representation from Article 7, Part
25 3 may be applied.

26 Subsection (d) creates a presumption that certain transactions between a
27 trustee and beneficiary outside of trust are an abuse by the trustee of a confidential
28 relationship with the beneficiary. This section has a limited scope. If the trust has
29 terminated, there must be proof that the trustee’s influence with the beneficiary
30 remains. Furthermore, whether or not the trust has terminated, there must be proof
31 that the trustee obtained an advantage from the relationship. The fact the trustee
32 profited is insufficient to show an abuse if a third party would have similarly profited
33 in an arm’s length transaction.

34 Subsection (e) creates a special exception for a “proprietary fund,” a mutual
35 fund investment offered to customers of a financial-service institution trustee.
36 Under such an arrangement, the mutual fund company will typically pay an annual
37 fee based on a percentage of the fund’s value to the financial-service institution
38 trustee for providing administrative shareholder services that would otherwise be
39 provided by agents of the fund. Subsection (e) provides that it is not a violation of
40 the duty of loyalty for a trustee, or its affiliates, to receive compensation for

1 providing such services as long as the trustee discloses at least annually to the
2 beneficiaries entitled to receive a copy of the trustee's annual report the rate and
3 method by which the compensation was determined. However, the mutual fund
4 investment selected must be prudent and the selection of a mutual fund, and the
5 resulting delegation of certain of the trustee's functions, may be taken into account
6 in setting the trustee's regular compensation. See Section 4-109 (trustee's
7 compensation), and Article 5, Part 2 (Uniform Prudent Investor Act).

8 Subsection (f) contains several exceptions to the general duty of loyalty,
9 which apply if the transaction was fair to the beneficiaries. A trustee is allowed to
10 negotiate in freedom about the terms of appointment and rate of compensation.
11 Consistent with Restatement (Second) of Trusts § 170, cmt. r (1959), a trustee may
12 also engage in a transaction involving another trust of which the trustee is also
13 trustee, or a transaction with a decedent's or conservatorship estate of which the
14 trustee is personal representative or conservator. With respect to a transaction
15 involving another fiduciary role, the trustee need not give advance notice of the
16 transaction to the beneficiaries unless required by some other provision. See, e.g.,
17 Section 5-114(b)(5).

18 Because it overlaps with subsection (a) of this section, Section 5-205, the
19 section of the Uniform Prudent Investor Act pertaining to the duty of loyalty, has
20 been placed in brackets.

21 **SECTION 5-104. IMPARTIALITY.** If a trust has two or more beneficiaries,
22 the trustee shall act impartially in investing and managing the trust property, taking
23 into account any differing interests of the beneficiaries.

24 **Comment**

25 The duty of impartiality is an important aspect of the duty of loyalty. This
26 section is identical to Section 6 of the Uniform Prudent Investor Act, codified at
27 Section 5-206, except that this section also applies to decisions by the trustee with
28 respect to distributions. The Prudent Investor Act is limited to duties with respect
29 to the investment and management of trust property. The differing beneficial
30 interests for which the trustee must act impartially include those of the current
31 beneficiaries versus those holding interests in the remainder, and among those
32 currently eligible for distributions, the interests of those entitled or eligible to receive
33 distributions of income versus those eligible to receive distributions of principal. In
34 effectuating the duty to act impartially, the trustee should be particularly sensitive to
35 allocation of receipts and disbursements between income and principal and should
36 consider, in an appropriate case, a reallocation of income to the principal account

1 and vice versa, if allowable under local law. For an example of such a provision,
2 taken from the Uniform Principal and Income Act (1997), see Section 6-104.

3 Placed in brackets is Section 5-206, the portion of the Uniform Prudent
4 Investor Act which overlaps with this section.

5 **SECTION 5-105. PRUDENT ADMINISTRATION.** A trustee shall
6 administer the trust as a prudent person would, by considering the purposes, terms,
7 distribution requirements, and other circumstances of the trust. In satisfying this
8 standard, the trustee shall exercise reasonable care, skill, and caution.

9 **Comment**

10 The duty to administer a trust with prudence is a fundamental duty of the
11 trustee. This duty is not affected by whether the trustee receives compensation but
12 may be altered by the terms of the trust. See Section 5-101 (modification of trustee
13 duties and powers by settlor). For a more detailed statement of the duty of
14 prudence with respect to trustee investment, including a list of factors to be taken
15 into account in determining whether the standard has been met, see Section 2 of the
16 Uniform Prudent Investor Act, codified at Section 5-202 (prudent investor rule).

17 **SECTION 5-106. COSTS OF ADMINISTRATION.** In administering the
18 trust, a trustee may only incur costs that are reasonable in relation to the trust
19 property, the purposes of the trust, and the skills of the trustee.

20 **Comment**

21 This section is consistent with the rules concerning costs in Section
22 227(c)(3) of the Restatement (Third) of Trusts: Prudent Investor Rule (1992). For
23 related rules concerning compensation and reimbursement of trustees, see Sections
24 4-109 and 4-110. The duty to minimize costs applies to delegation to agents as well
25 as to other aspects of trust administration. In deciding whether and how to
26 delegate, the trustee must be alert to balancing projected benefits against the likely
27 costs. The trustee must also be alert to adjusting compensation for functions which
28 the trustee has delegated to others in order to protect the beneficiary against “double
29 dipping.” The obligation to incur only necessary costs of administration has long

1 This section applies only to delegation to agents and not to delegation to a
2 cotrustee. For the provision authorizing but at the same time limiting the ability to
3 delegate to a cotrustee, see Section 4-103(b)(1).

4 Under subsection (a)(3), the duty to review the agent’s performance includes
5 the periodic evaluation of the continued need for and appropriateness of the
6 delegation of authority. In particular circumstances, the trustee may need to
7 terminate the delegation to comply with the duty under subsection (a)(1) (duty to
8 use reasonable care, skill, and caution in selecting agent).

9 Placed in brackets is Section 5-209, the portion of the Uniform Prudent
10 Investor Act which overlaps with this section.

11 **SECTION 5-109. POWERS TO DIRECT.**

12 (a) If the terms of a trust grant a person other than the trustee power to
13 direct certain actions of the trustee, the trustee shall act in accordance with the
14 exercise of the power unless an attempted exercise manifestly violates the terms of
15 the trust or the trustee knows that the attempted exercise violates a fiduciary duty
16 that the person holding the power owes the beneficiaries of the trust.

17 (b) The holder of a power to direct is presumptively a fiduciary who, as
18 such, is required to act in good faith, with regard to the purposes of the trust and the
19 interest of the beneficiaries, and is liable for any loss that results from breach of a
20 fiduciary duty.

21 **Comment**

22 This section is derived from Restatement (Second) of Trusts § 185 (1959).
23 Powers to direct in the terms of a trust usually relate either to choice of investment
24 or management of closely-held business interests. A power to direct must be
25 distinguished from a veto power. A power to direct involves action initiated and
26 within the control of a third party. The trustee usually has no responsibility other
27 than to carry out the direction when made. But if a third party holds a veto power,
28 the trustee is responsible for initiating the decision, subject to the third party’s
29 approval. A trustee who administers a trust subject to a veto power occupies a

1 position akin to that of a cotrustee and is responsible for taking appropriate action if
2 the third party's refusal to consent would result in a breach of trust. See
3 Restatement (Second) of Trusts § 185 cmt. g (1959); Section 4-103(b)(2)(duties of
4 cotrustees).

5 Powers to direct take a variety of forms. Frequently, the person holding the
6 power is directing the investment of the holder's own beneficial interest. Such self-
7 directed accounts are particularly prevalent among trusts holding interests in
8 employee benefit plans or individual retirement accounts. But for the type of
9 donative trust which is the primary focus of this Act, the holder of the power to
10 direct is frequently acting on behalf of others and may not even be a beneficiary of
11 the trust. In that event, the holder, as provided in subsection (b), is presumptively
12 acting in a fiduciary capacity and can be held liable should the power holder's
13 conduct constitute a breach of trust.

14 Powers to direct are most effective when the trustee is not deterred from
15 honoring the exercise of the power due to concerns about possible liability. On the
16 other hand, the trustee does bear overall responsibility for seeing that the terms of
17 the trust are honored. For this reason, subsection (a) provides that the trustee need
18 not honor an attempted exercise of a power to direct if the attempted exercise
19 manifestly violates the terms of the trust or the trustee knows the attempted exercise
20 violates a fiduciary duty that the holder of the power owes to the beneficiaries of the
21 trust. For the definition of "know," see Section 1-105(7).

22 **SECTION 5-110. CONTROL AND SAFEGUARDING OF TRUST**

23 **PROPERTY.** A trustee shall take steps reasonable under the circumstances to take
24 control of and to safeguard the trust property.

25 **Comment**

26 This section codifies the substance of Sections 175 and 176 of the
27 Restatement (Second) of Trusts (1959). The duty to take control of and safeguard
28 trust property is an aspect of the trustee's duty to act with prudence. See Section
29 5-105. See also Sections 5-117(1) (power to collect trust property), 5-117(11)
30 (power to insure trust property), and 5-117(12) (power to abandon trust property),
31 This section, like the other sections in this part, is subject to limitation in the terms
32 of the trust. For example, the settlor may provide that the spouse or other
33 beneficiary may occupy the settlor's former residence rent free, in which event the
34 trustee will be specifically precluded by the terms of the trust from taking complete
35 control.

1 (a) A trustee shall keep the beneficiaries of the trust reasonably informed
2 about the administration of the trust and, unless unreasonable under the
3 circumstances, promptly respond to a beneficiary's request for information.

4 (b) A trustee shall:

5 (1) upon request of a beneficiary, promptly provide the beneficiary with a
6 copy of the trust instrument;

7 (2) within 30 days after accepting a trusteeship, inform the beneficiaries
8 of the acceptance;

9 (3) within 30 days after the death of the settlor of a revocable trust,
10 inform the beneficiaries of their respective interests in the trust;

11 (4) inform the beneficiaries in advance of any change in the method or
12 rate of the trustee's compensation; and

13 (5) inform the beneficiaries in advance of a transaction affecting trust
14 property that comprises a significant portion of the value of the trust property and
15 whose fair market value is not readily ascertainable.

16 (c) A trustee shall prepare and send to the beneficiaries at least annually, at
17 the termination of the trust, and upon a change of trustee a report of the trust
18 property, liabilities, receipts, and disbursements, including the source and amount of
19 the trustee's compensation. A report of a former trustee must be prepared by the
20 former trustee or, if the trusteeship terminated by reason of death or incapacity, by
21 the former trustee's personal representative, conservator, or guardian.

1 (d) Copies of a trustee's report and other information required to be
2 provided under subsections (b) and (c) must be sent to:

3 (1) the qualified beneficiaries; and

4 (2) each beneficiary who has delivered to the trustee or other fiduciary a
5 written request for a copy of the report or other information.

6 (e) A beneficiary, by a written consent, may waive the right to a trustee's
7 report or other information otherwise required to be provided under this section.

8 The terms of a trust may not dispense with the requirements of this section except as
9 to a trustee's report or other information required to be furnished to a beneficiary
10 who is also a settlor.

11 (f) Except as otherwise provided by the terms of a trust, while the trust is
12 revocable and the settlor has capacity to revoke the trust, the duties of the trustee
13 under this section are owed exclusively to the settlor, and vest in the beneficiaries
14 upon the settlor's death or incapacity. If a trust has more than one settlor, the duties
15 under this section are owed to all settlors.

16 **Comment**

17 The duty to keep the beneficiaries informed of the administration of the trust
18 is one of the fundamental duties of a trustee. The trustee is under a duty to
19 communicate to the beneficiary information about the administration of the trust that
20 is reasonably necessary to enable the beneficiary to enforce the beneficiary's rights
21 under the trust or to prevent or redress a breach of trust. See Restatement (Second)
22 of Trusts § 173, cmt. c (1959). Ordinarily, the trustee is not under a duty to furnish
23 information to the beneficiary in the absence of a specific request for the
24 information. See *id.*, cmt. d. Thus, the general duty provided in subsection (a) is
25 ordinarily satisfied by complying with the annual report mandated by subsection (c)
26 unless there are special circumstances requiring particular information to be reported
27 to beneficiaries. However, if the trustee is dealing with the beneficiary on the

1 trustee's own account, the trustee has a duty to communicate material facts relating
2 to the transaction that the trustee knows or should know. See *id.*

3 The standard is different if the beneficiary makes a specific request for
4 information. In that event, subsection (a) requires the trustee to promptly comply
5 with the beneficiary's request unless unreasonable under the circumstances. Further
6 supporting the principle that a beneficiary should be allowed to make an independent
7 assessment of what information is relevant to protecting the beneficiary's interest,
8 subsection (b)(1) requires the trustee to on request furnish a beneficiary with a
9 complete copy of the trust instrument.

10 Subsections (a) and (b)(1) and the other provisions of this section have only
11 limited application to revocable trusts. Subsection (f) provides that during the time
12 that a trust is revocable and the settlor has capacity, the right to request information
13 or a copy of the trust instrument pursuant to this section belongs exclusively to the
14 settlor. In the case of a trust with multiple settlors, subsection (f) clarifies that the
15 beneficiaries' right to information extends to all of the settlors. Should less than all
16 of the settlor revoke or modify the trust, the trustee must notify the other settlor or
17 settlors of this fact. See Section 3-102 Comment.

18 To effectively protect their interests, it is essential that the beneficiaries at
19 least know the identity of the trustee. Subsection (b)(2) requires that a trustee
20 inform the beneficiaries of the trustee's assumption of office within 30 days of
21 acceptance. Similar to the obligation imposed on a personal representative
22 following admission of the will to probate, subsection (b)(3) requires the trustee of a
23 revocable trust to inform the beneficiaries, within 30 days after the settlor's death, of
24 their respective interests in the trust. These two duties can overlap. If the death of
25 the settlor happens to also be the occasion for the appointment of a successor
26 trustee, the new trustee of the now formerly revocable trust would need to inform
27 the beneficiaries both of the trustee's acceptance and of the beneficiaries' respective
28 interests.

29 Subsection (b)(4) deals with the sensitive issue of changes, usually increases,
30 in trustee compensation. Consistent with the requirement that the beneficiaries
31 receive advance notice of major transactions affecting their interests, subsection
32 (b)(4) requires that the beneficiaries be told in advance of changes in the method or
33 rate of the trustee's compensation. This might include a change in a periodic base
34 fee, rate of percentage compensation, hourly rate, termination fee or transaction
35 charge. For the standard for setting trustee compensation, see Section 4-109
36 Comment.

37 Absent a specific request by a beneficiary for information, the duty to keep
38 the beneficiaries reasonably informed is ordinarily satisfied by providing the

1 beneficiaries with a copy of the trustee’s annual report, but subsection (b)(5)
2 requires that the beneficiaries be given advance notice of certain proposed
3 transactions. This subsection, which is based on a provision drawn from South
4 Dakota law, is designed to codify but make more precise the fiduciary duty
5 delineated in such cases as *Allard v. Pacific National Bank*, 663 P.2d 104 (Wash.
6 1983), in which the court surcharged a trustee for failing to give the beneficiaries
7 advance notice of the proposed sale of a parcel of real estate that was the sole asset
8 of the trust. Cases subsequent to *Allard* have extended this duty to the sale of an
9 interest in a closely-held business, and this subsection extends the duty to sales of
10 tangible personal property.

11 Subsection (c) requires the trustee to furnish the beneficiaries with a copy of
12 a trustee’s report at least annually, at the termination of the trust, and upon a change
13 of trustee. The term “report” instead of “accounting” is used to negate the inference
14 that the report must be prepared in any particular format. The key factor is not the
15 format chosen but whether the report provides the beneficiaries with the information
16 necessary to protect their interests. Subsection (c) also addresses the responsibility
17 for the preparation of the report upon a trustee’s death or incapacity. Consistent
18 with Section 4-107, the report must be prepared by the trustee’s personal
19 representative, in the event of the trustee’s death, or the trustee’s conservator or
20 guardian, in the event of the trustee’s incapacity.

21 The principle that the trustee must keep the beneficiaries reasonably
22 informed is well established. Less certain is who among the many different types of
23 beneficiaries must be given the required notices. Subsection (d) provides that
24 required notices under subsections (b)-(c) be given to the qualified beneficiaries as
25 well as other beneficiaries who have requested a copy of the report or other
26 information. For the definition of qualified beneficiaries, see Section 1-105(11).
27 The result of this limitation is that the information need not be furnished to
28 beneficiaries with remote remainder interests unless they have filed a specific request
29 with the trustee.

30 Subsection (e), which allows trustee reports and other required information
31 to be waived upon written consent, is derived from South Dakota law. However, a
32 waiver of a trustee’s report or other information is not a waiver of the trustee’s
33 accountability and potential liability for items that the report or other information
34 would have disclosed. Subsection (e) also authorizes the creation of a “blind” trust.
35 While the terms of the trust may not prohibit the trustee from furnishing the
36 beneficiaries with the information required under this section, such a prohibition is
37 valid with respect to a beneficiary who is also a settlor.

1 (B) any other powers appropriate to accomplish the proper
2 management, investment, and distribution of the trust property; and

3 (C) any other powers conferred by this [Act].

4 (b) Except as modified by the terms of a trust, the exercise of a power is subject
5 to fiduciary duties as prescribed by this [article].

6 **Comment**

7 This section is intended to grant trustees the broadest possible powers, but
8 to be exercised always in accordance with the terms of the trust and duties of the
9 trustee. The powers conferred elsewhere in this Act which are subsumed by this
10 section include all of the specific powers listed in Section 5-117 as well as others
11 listed in the Comment to that section. The powers conferred by this Act may be
12 exercised without court approval. Should court approval of the exercise of a power
13 be desired, a petition for court approval may be filed.

14 A power differs from a duty. A duty imposes either a mandatory obligation
15 or mandatory prohibition. A power, on the other hand, is a discretion, the exercise
16 of which is not obligatory. The existence of a power, however created or granted,
17 does not speak to the question of whether it is prudent under the circumstances to
18 exercise the power.

19 **SECTION 5-117. SPECIFIC POWERS OF TRUSTEE.** Without limiting
20 the authority conferred by Section 5-116, a trustee may:

21 (1) collect trust property and receive additions to the trust property from a
22 settlor or any other person;

23 (2) acquire property for the trust, for cash or on credit;

24 (3) sell property, for cash or on credit, at public or private sale, or exchange
25 property;

26 (4) deposit trust funds in an account in a financial-service institution,
27 including an institution operated by the trustee;

1 (5) borrow money, with or without security, and mortgage or pledge trust
2 property for a period within or extending beyond the term of the trust;

3 (6) advance money for the protection of the trust, for which advances the
4 trustee has a lien on the trust property as against a beneficiary;

5 (7) with respect to an interest in a proprietorship, partnership, limited
6 liability company, business trust, corporation or other form of business or enterprise,
7 continue the business or enterprise and take any action that may be taken by
8 shareholders, members, or property owners, including changing the form of business
9 organization, voting, or giving proxies to vote, shares of stock or membership
10 interests, and holding a security in the name of a nominee or in other form without
11 disclosure of the trust so that title may pass by delivery;

12 (8) with respect to an interest in real property, make ordinary or
13 extraordinary repairs, alterations, or improvements in buildings or other structures,
14 demolish improvements, raze existing or erect new party walls or buildings,
15 subdivide or develop land, dedicate land or easements to public use, and make or
16 vacate plats and adjust boundaries;

17 (9) enter into a lease for any purpose as lessor or lessee, including a lease or
18 other arrangement for exploration and removal of natural resources, with or without
19 the option to purchase or renew, for a period within or extending beyond the term
20 of the trust;

1 (10) grant an option involving a sale, lease, or other disposition of trust
2 property or take an option for the acquisition of property, including an option
3 exercisable beyond the term of the trust;

4 (11) insure the property of the trust against damage or loss and insure the
5 trustee, the trustee's agents, and beneficiaries against liability to third persons arising
6 from the administration of the trust;

7 (12) abandon or decline to administer property which the trustee reasonably
8 believes is of little or no value;

9 (13) inspect or investigate property the trustee holds or has been asked to
10 hold, or property owned or operated by an entity in which the trustee holds or has
11 been asked to hold an interest, for the purpose of determining the application of
12 environmental law with respect to the property; take action to prevent, abate, or
13 otherwise remedy any actual or potential violation of any environmental law
14 affecting property held directly or indirectly by the trustee; and decline to accept
15 property into trust or to disclaim any power with respect to property that has or may
16 have environmental liability attached;

17 (14) pay or contest any claim, settle a claim by or against the trust by
18 compromise, arbitration, or otherwise, and release, in whole or in part, a claim
19 belonging to the trust;

20 (15) pay taxes, assessments, compensation of the trustee and of employees
21 and agents of the trust, and other expenses incurred in the administration of the
22 trust;

1 (16) exercise elections with respect to federal, state, and local taxes;

2 (17) select a mode of payment under any employee benefit or retirement
3 plan, annuity or life insurance payable to the trustee, exercise rights thereunder, and
4 take appropriate action to collect the proceeds, including exercise of the right to
5 indemnification against expenses and liabilities;

6 (18) make loans out of trust property, including loans to a beneficiary on
7 terms and conditions the trustee considers to be fair and reasonable under the
8 circumstances, and guarantee loans to the beneficiary by encumbrances on trust
9 property;

10 (19) pay an amount distributable to a beneficiary under a legal disability or
11 who the trustee otherwise believes is incapacitated, by applying it directly for the
12 beneficiary's benefit, or by paying the amount to:

13 (A) the beneficiary's conservator or, if the beneficiary does not have a
14 conservator, the beneficiary's guardian;

15 (B) the beneficiary's custodian under [the Uniform Transfers to Minors
16 Act] or custodial trustee under [the Uniform Custodial Trust Act]; or

17 (C) if there is no conservator, guardian, custodian, or custodial trustee, a
18 relative or other person having physical custody of the beneficiary;

19 (20) make a distribution of property and money in divided or undivided
20 interests, pro rata or non-pro-rata, and adjust resulting differences in valuation;

1 Paragraph (7) authorizes the trustee to continue, incorporate or otherwise
2 change the form of a business. Any such decision by the trustee must be made in
3 light of the standards of prudent investment stated in Part 2 of this article. The
4 authority under this paragraph is broader than that granted under Section 3(c)(3) of
5 the Uniform Trustees' Powers Act. Under the Trustees' Powers Act, a trustee may
6 continue a business only if authorized by the terms of the trust or court order.

7 Paragraph (13), which addresses possible liability for violations of
8 environmental law, is drawn primarily from the Texas Trust Code. See Tex. Prop.
9 Code § 113.025.

10 Paragraph (14) authorizes a trustee to release claims. The determination of
11 when to release a claim depends upon the duties imposed on the trustee. As a
12 general matter, the trustee should be able to release a claim not only when it is
13 uncollectible, but also when collection would be uneconomical. See also Section
14 5-112 (duty to enforce claims and defend actions).

15 Paragraph (15) authorizes a trustee to pay compensation without prior court
16 approval. For the standard for setting the compensation, see Section 4-109. See
17 also Section 4-110 (repayment for expenses).

18 Paragraph (18) allows a trustee to make loans to or guarantee loans of a
19 beneficiary upon such terms and conditions the trustee considers fair and reasonable.
20 The determination of what is fair and reasonable must be made in light of the
21 fiduciary duties of the trustee and purposes of the trust. If the trustee requires
22 security for the loan to the beneficiary, adequate security under this paragraph may
23 consist of a charge on the beneficiary's interest in the trust. See Restatement
24 (Second) of Trusts § 255 (1959). The interest of a beneficiary that is subject to a
25 spendthrift restraint may not be used for security for a loan under this paragraph.
26 See Article 2, Part 4 (spendthrift protection and claims of creditors).

27 Paragraph (19) allows a trustee to make payments to another person for the
28 use or benefit of the beneficiary, including to a custodian under the Uniform
29 Transfers to Minor Act.

30 Paragraph (20) allows a trustee to make non-pro-rata distributions and
31 distribute undivided interests. The trustee also has the power to sell property in
32 order to make the distribution. This paragraph recognizes the authority to take
33 gains and losses into account for tax purposes when making distributions. This
34 power provides needed flexibility and lessens the risk that the non-pro-rata
35 distribution will be treated as a taxable sale.

1 Paragraph (22) authorizes a trustee to prosecute or defend an action. As to
2 the propriety of reimbursement for attorney's fees and other expenses of an action
3 or judicial proceeding, see Section 4-110 and Comment. See also Section 5-112
4 (duty to defend actions).

5 Paragraph (24), which is similar to Section 344 of the Restatement (Second)
6 of Trusts (1959), clarifies that even though the trust has terminated, the trustee
7 retains the powers needed to wind up the affairs of the trust and distribute the
8 remaining trust property. While such terminations should not be delayed, neither
9 should they be hasty or ill-considered. By anticipating the termination prior to the
10 terminating event, many of the problems that typically arise can be avoided.

11 **PART 2**
12 **UNIFORM PRUDENT INVESTOR ACT**

13 **General Comment**

14 Reproduced below in its entirety is the Uniform Prudent Investor Act as
15 approved in 1994. The text reproduced below is identical to that of the free-
16 standing Act except for minor revisions to conform terminology. Because of the
17 widespread adoption of the Uniform Prudent Investor Act, no effort has been made
18 to interweave the Prudent Investor Act into Part 1 of this article. States adopting
19 this Act which have previously enacted the Prudent Investor Act are encouraged to
20 recodify their version of the Prudent Investor Act as part of this Act. Enacting the
21 Prudent Investor Act in a unit as a separate part of this Act preserves uniformity
22 with States which have enacted the Prudent Investor Act in its free-standing form..

23 The Prudent Investor Act prescribes a series of duties relevant to the
24 *investment* and *management* of trust property. The Uniform Trust Act, Article 5,
25 Part 1, lists the duties and powers of a trustee relevant to the *investment*,
26 *management*, and *distribution* of trust property. Because of this overlap between
27 the two Acts, provisions of the Prudent Investor Act which duplicate Article 5, Part
28 1 have been placed in brackets. They should not be enacted but are included here
29 for the sake of completeness and to preserve the Comments. The provisions of the
30 Prudent Investor Act placed in brackets and the corresponding provisions of Article
31 5, Part 1 of this Act are as follows:

	Prudent Investor Act	Article 5, Part 1
32		
33	Special skills	5-202(f)
34	Loyalty	5-205

1 reporter's notes by Edward C. Halbach, Jr., in Restatement of Trusts 3d: Prudent
2 Investor Rule (1992); see also Edward C. Halbach, Jr., Trust Investment Law in the
3 Third Restatement, 27 Real Property, Probate & Trust J. 407 (1992); Bevis
4 Longstreth, Modern Investment Management and the Prudent Man Rule (1986);
5 Jeffrey N. Gordon, The Puzzling Persistence of the Constrained Prudent Man Rule,
6 62 N.Y.U.L. Rev. 52 (1987); John H. Langbein & Richard A. Posner, The
7 Revolution in Trust Investment Law, 62 A.B.A.J. 887 (1976); Note, The Regulation
8 of Risky Investments, 83 Harvard L. Rev. 603 (1970). A succinct account of the
9 main findings of modern portfolio theory, written for lawyers, is Jonathan R. Macey,
10 An Introduction to Modern Financial Theory (1991) (American College of Trust &
11 Estate Counsel Foundation). A leading introductory text on modern portfolio
12 theory is R.A. Brealey, An Introduction to Risk and Return from Common Stocks
13 (2d ed. 1983).

14 **Legislation.** Most States have legislation governing trust-investment law.
15 This Act promotes uniformity of state law on the basis of the new consensus
16 reflected in the Restatement of Trusts 3d: Prudent Investor Rule. Some States have
17 already acted. California, Delaware, Georgia, Minnesota, Tennessee, and
18 Washington revised their prudent investor legislation to emphasize the total-
19 portfolio standard of care in advance of the 1992 Restatement. These statutes are
20 extracted and discussed in Restatement of Trusts 3d: Prudent Investor Rule § 227,
21 reporter's note, at 60-66 (1992).

22 Drafters in Illinois in 1991 worked from the April 1990 "Proposed Final
23 Draft" of the Restatement of Trusts 3d: Prudent Investor Rule and enacted
24 legislation that is closely modeled on the new Restatement. 760 ILCS § 5/5
25 (prudent investing); and § 5/5.1 (delegation) (1992). As the Comments to this
26 Uniform Prudent Investor Act reflect, the Act draws upon the Illinois statute in
27 several sections. Virginia revised its prudent investor act in a similar vein in 1992.
28 Virginia Code § 26-45.1 (prudent investing) (1992). Florida revised its statute in
29 1993. Florida Laws, ch. 93-257, amending Florida Statutes § 518.11 (prudent
30 investing) and creating § 518.112 (delegation). New York legislation drawing on
31 the new Restatement and on a preliminary version of this Uniform Prudent Investor
32 Act was enacted in 1994. N.Y. Assembly Bill 11683-B, Ch. 609 (1994), adding
33 Estates, Powers and Trusts Law § 11-2.3 (Prudent Investor Act).

34 **Remedies.** This Act does not undertake to address issues of remedy law or
35 the computation of damages in trust matters. Remedies are the subject of a
36 reasonably distinct body of doctrine. See generally Restatement (Second) of Trusts
37 §§ 197-226A (1959) [hereinafter cited as Restatement of Trusts 2d; also referred to
38 as 1959 Restatement].

1 **Implications for charitable and pension trusts.** This Act is centrally
2 concerned with the investment responsibilities arising under the private gratuitous
3 trust, which is the common vehicle for conditioned wealth transfer within the family.
4 Nevertheless, the prudent investor rule also bears on charitable and pension trusts,
5 among others. “In making investments of trust funds the trustee of a charitable trust
6 is under a duty similar to that of the trustee of a private trust.” Restatement of
7 Trusts 2d § 389 (1959). The Employee Retirement Income Security Act (ERISA),
8 the federal regulatory scheme for pension trusts enacted in 1974, absorbs trust-
9 investment law through the prudence standard of ERISA § 404(a)(1)(B), 29 U.S.C.
10 § 1104(a). The Supreme Court has said: “ERISA’s legislative history confirms that
11 the Act’s fiduciary responsibility provisions ‘codif[y] and mak[e] applicable to
12 [ERISA] fiduciaries certain principles developed in the evolution of the law of
13 trusts.’” *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110-11 (1989)
14 (footnote omitted).

15 **Other fiduciary relationships.** The Uniform Prudent Investor Act
16 regulates the investment responsibilities of trustees. Other fiduciaries – such as
17 executors, conservators, and guardians of the property – sometimes have
18 responsibilities over assets that are governed by the standards of prudent investment.
19 It will often be appropriate for States to adapt the law governing investment by
20 trustees under this Act to these other fiduciary regimes, taking account of such
21 changed circumstances as the relatively short duration of most executorships and the
22 intensity of court supervision of conservators and guardians in some jurisdictions.
23 The present Act does not undertake to adjust trust-investment law to the special
24 circumstances of the state schemes for administering decedents’ estates or
25 conducting the affairs of protected persons.

26 Although the Uniform Prudent Investor Act by its terms applies to trusts and
27 not to charitable corporations, the standards of the Act can be expected to inform
28 the investment responsibilities of directors and officers of charitable corporations.
29 As the 1992 Restatement observes, “the duties of the members of the governing
30 board of a charitable corporation are generally similar to the duties of the trustee of
31 a charitable trust.” Restatement of Trusts 3d: Prudent Investor Rule § 379,
32 Comment *b*, at 190 (1992). See also *id.* § 389, Comment *b*, at 190-91 (absent
33 contrary statute or other provision, prudent investor rule applies to investment of
34 funds held for charitable corporations).

1 prudence, and diligence under the circumstances then prevailing that a prudent man
2 acting in a like capacity and familiar with such matters would use in the conduct of
3 an enterprise of like character and with like aims”

4 **Prior Restatement.** The Restatement of Trusts 2d (1959) also tracked the
5 language of the *Amory* case: “In making investments of trust funds the trustee is
6 under a duty to the beneficiary . . . to make such investments and only such
7 investments as a prudent man would make of his own property having in view the
8 preservation of the estate and the amount and regularity of the income to be derived
9” Restatement of Trusts 2d § 227 (1959).

10 **Objective standard.** The concept of prudence in the judicial opinions and
11 legislation is essentially relational or comparative. It resembles in this respect the
12 “reasonable person” rule of tort law. A prudent trustee behaves as other trustees
13 similarly situated would behave. The standard is, therefore, objective rather than
14 subjective. Sections 5-202 through 5-209 identify the main factors that bear on
15 prudent investment behavior.

16 **Variation.** Almost all of the rules of trust law are default rules, that is, rules
17 that the settlor may alter or abrogate. Subsection (b) carries forward this traditional
18 attribute of trust law. Traditional trust law also allows the beneficiaries of the trust
19 to excuse its performance, when they are all capable and not misinformed.
20 Restatement of Trusts 2d § 216 (1959).

21 **SECTION 5-202. STANDARD OF CARE; PORTFOLIO STRATEGY;**
22 **RISK AND RETURN OBJECTIVES.**

23 (a) A trustee shall invest and manage trust property as a prudent investor
24 would, by considering the purposes, terms, distribution requirements, and other
25 circumstances of the trust. In satisfying this standard, the trustee shall exercise
26 reasonable care, skill, and caution.

27 (b) A trustee’s investment and management decisions respecting individual
28 assets must be evaluated not in isolation but in the context of the trust portfolio as a

1 whole and as a part of an overall investment strategy having risk and return
2 objectives reasonably suited to the trust.

3 (c) Among circumstances that a trustee shall consider in investing and
4 managing trust property are such of the following as are relevant to the trust or its
5 beneficiaries:

6 (1) general economic conditions;

7 (2) the possible effect of inflation or deflation;

8 (3) the expected tax consequences of investment decisions or strategies;

9 (4) the role that each investment or course of action plays within the
10 overall trust portfolio, which may include financial assets, interests in closely held
11 enterprises, tangible and intangible personal property, and real property;

12 (5) the expected total return from income and the appreciation of capital;

13 (6) other resources of the beneficiaries;

14 (7) needs for liquidity, regularity of income, and preservation or
15 appreciation of capital; and

16 (8) an asset's special relationship or special value, if any, to the purposes
17 of the trust or to one or more of the beneficiaries.

18 (d) A trustee shall make a reasonable effort to verify facts relevant to the
19 investment and management of trust property.

20 (e) A trustee may invest in any kind of property or type of investment
21 consistent with the standards of this [Act].

1 **Factors affecting investment.** Subsection (c) points to certain of the
2 factors that commonly bear on risk/return preferences in fiduciary investing. This
3 listing is nonexclusive. Tax considerations, such as preserving the stepped up basis
4 on death under Internal Revenue Code § 1014 for low-basis assets, have
5 traditionally been exceptionally important in estate planning for affluent persons.
6 Under the present recognition rules of the federal income tax, taxable investors,
7 including trust beneficiaries, are in general best served by an investment strategy that
8 minimizes the taxation incident to portfolio turnover. See generally Robert H.
9 Jeffrey & Robert D. Arnott, *Is Your Alpha Big Enough to Cover Its Taxes?*, *Journal*
10 *of Portfolio Management* 15 (Spring 1993).

11 Another familiar example of how tax considerations bear upon trust
12 investing: In a regime of pass-through taxation, it may be prudent for the trust to
13 buy lower yielding tax-exempt securities for high-bracket taxpayers, whereas it
14 would ordinarily be imprudent for the trustees of a charitable trust, whose income is
15 tax exempt, to accept the lowered yields associated with tax-exempt securities.

16 When tax considerations affect beneficiaries differently, the trustee’s duty of
17 impartiality requires attention to the competing interests of each of them.

18 Subsection (c)(8), allowing the trustee to take into account any preferences
19 of the beneficiaries respecting heirlooms or other prized assets, derives from the
20 Illinois act, 760 ILCS § 5/5(a)(4) (1992).

21 **Duty to monitor.** Subsections (a) through (d) apply both to investing and
22 managing trust assets. “Managing” embraces monitoring, that is, the trustee’s
23 continuing responsibility for oversight of the suitability of investments already made
24 as well as the trustee’s decisions respecting new investments.

25 **Duty to investigate.** Subsection (d) carries forward the traditional
26 responsibility of the fiduciary investor to examine information likely to bear
27 importantly on the value or the security of an investment for example, audit reports
28 or records of title. E.g., *Estate of Collins*, 72 Cal. App. 3d 663, 139 Cal. Rptr. 644
29 (1977) (trustees lent on a junior mortgage on unimproved real estate, failed to have
30 land appraised, and accepted an unaudited financial statement; held liable for losses).

31 **Abrogating categoric restrictions.** Subsection (e) clarifies that no
32 particular kind of property or type of investment is inherently imprudent.
33 Traditional trust law was encumbered with a variety of categoric exclusions, such as
34 prohibitions on junior mortgages or new ventures. In some States legislation
35 created so-called “legal lists” of approved trust investments. The universe of
36 investment products changes incessantly. Investments that were at one time thought
37 too risky, such as equities, or more recently, futures, are now used in fiduciary

1 portfolios. By contrast, the investment that was at one time thought ideal for trusts,
2 the long-term bond, has been discovered to import a level of risk and volatility – in
3 this case, inflation risk – that had not been anticipated. Accordingly, subsection (e)
4 follows Restatement of Trusts 3d: Prudent Investor Rule in abrogating categoric
5 restrictions. The Restatement says: “Specific investments or techniques are not per
6 se prudent or imprudent. The riskiness of a specific property, and thus the propriety
7 of its inclusion in the trust estate, is not judged in the abstract but in terms of its
8 anticipated effect on the particular trust’s portfolio.” Restatement of Trusts 3d:
9 Prudent Investor Rule § 227, Comment *f*, at 24 (1992). The premise of subsection
10 (e) is that trust beneficiaries are better protected by the emphasis on close attention
11 to risk/return objectives as prescribed in subsection (b) than in attempts to identify
12 categories of investment that are per se prudent or imprudent.

13 The Act impliedly disavows the emphasis in older law on avoiding
14 “speculative” or “risky” investments. Low levels of risk may be appropriate in some
15 trust settings but inappropriate in others. It is the trustee’s task to invest at a risk
16 level that is suitable to the purposes of the trust.

17 The abolition of categoric restrictions against types of investment in no way
18 alters the trustee’s conventional duty of loyalty, which is reiterated in Section 5-205.
19 For example, were the trustee to invest in a second mortgage on a piece of real
20 property owned by the trustee, the investment would be wrongful on account of the
21 trustee’s breach of the duty to abstain from self-dealing, even though the investment
22 would no longer automatically offend the former categoric restriction against
23 fiduciary investments in junior mortgages.

24 **Professional fiduciaries.** The distinction taken in subsection (f) between
25 amateur and professional trustees is familiar law. The prudent investor standard
26 applies to a range of fiduciaries, from the most sophisticated professional investment
27 management firms and corporate fiduciaries, to family members of minimal
28 experience. Because the standard of prudence is relational, it follows that the
29 standard for professional trustees is the standard of prudent professionals; for
30 amateurs, it is the standard of prudent amateurs. Restatement of Trusts 2d § 174
31 (1959) provides: “The trustee is under a duty to the beneficiary in administering the
32 trust to exercise such care and skill as a man of ordinary prudence would exercise in
33 dealing with his own property; and if the trustee has or procures his appointment as
34 trustee by representing that he has greater skill than that of a man of ordinary
35 prudence, he is under a duty to exercise such skill.” Case law strongly supports the
36 concept of the higher standard of care for the trustee representing itself to be expert
37 or professional. See Annot., Standard of Care Required of Trustee Representing
38 Itself to Have Expert Knowledge or Skill, 91 A.L.R. 3d 904 (1979) and 1992 Supp.
39 at 48-49.

1 Circumstances can, however, overcome the duty to diversify. For example,
2 if a tax-sensitive trust owns an underdiversified block of low-basis securities, the tax
3 costs of recognizing the gain may outweigh the advantages of diversifying the
4 holding. The wish to retain a family business is another situation in which the
5 purposes of the trust sometimes override the conventional duty to diversify.

6 **Rationale for diversification.** “Diversification reduces risk . . . [because]
7 stock price movements are not uniform. They are imperfectly correlated. This
8 means that if one holds a well diversified portfolio, the gains in one investment will
9 cancel out the losses in another.” Jonathan R. Macey, *An Introduction to Modern*
10 *Financial Theory* 20 (American College of Trust and Estate Counsel Foundation,
11 1991). For example, during the Arab oil embargo of 1973, international oil stocks
12 suffered declines, but the shares of domestic oil producers and coal companies
13 benefitted. Holding a broad enough portfolio allowed the investor to set off, to
14 some extent, the losses associated with the embargo.

15 Modern portfolio theory divides risk into the categories of “compensated”
16 and “uncompensated” risk. The risk of owning shares in a mature and well-
17 managed company in a settled industry is less than the risk of owning shares in a
18 start-up high-technology venture. The investor requires a higher expected return to
19 induce the investor to bear the greater risk of disappointment associated with the
20 start-up firm. This is compensated risk – the firm pays the investor for bearing the
21 risk. By contrast, nobody pays the investor for owning too few stocks. The
22 investor who owned only international oils in 1973 was running a risk that could
23 have been reduced by having configured the portfolio differently – to include
24 investments in different industries. This is uncompensated risk – nobody pays the
25 investor for owning shares in too few industries and too few companies. Risk that
26 can be eliminated by adding different stocks (or bonds) is uncompensated risk. The
27 object of diversification is to minimize this uncompensated risk of having too few
28 investments. “As long as stock prices do not move exactly together, the risk of a
29 diversified portfolio will be less than the average risk of the separate holdings.”
30 R.A. Brealey, *An Introduction to Risk and Return from Common Stocks* 103 (2d
31 ed. 1983).

32 There is no automatic rule for identifying how much diversification is
33 enough. The 1992 Restatement says: “Significant diversification advantages can be
34 achieved with a small number of well-selected securities representing different
35 industries Broader diversification is usually to be preferred in trust investing,”
36 and pooled investment vehicles “make thorough diversification practical for most
37 trustees.” Restatement of Trusts 3d: Prudent Investor Rule § 227, General Note on
38 Comments *e-h*, at 77 (1992). See also Macey, *supra*, at 23-24; Brealey, *supra*, at
39 111-13.

1 Rule § 229 (1992), lightly revising Restatement of Trusts 2d § 230 (1959). The
2 duty extends as well to investments that were proper when purchased but
3 subsequently become improper. Restatement of Trusts 2d § 231 (1959). The same
4 standards apply to successor trustees, see Restatement of Trusts 2d § 196 (1959).

5 The question of what period of time is reasonable turns on the totality of
6 factors affecting the asset and the trust. The 1959 Restatement took the view that
7 “[o]rdinarily any time within a year is reasonable, but under some circumstances a
8 year may be too long a time and under other circumstances a trustee is not liable
9 although he fails to effect the conversion for more than a year.” Restatement of
10 Trusts 2d § 230, comment *b* (1959). The 1992 Restatement retreated from this rule
11 of thumb, saying, “No positive rule can be stated with respect to what constitutes a
12 reasonable time for the sale or exchange of securities.” Restatement of Trusts 3d:
13 Prudent Investor Rule § 229, comment *b* (1992).

14 The criteria and circumstances identified in Section 5-202 as bearing upon
15 the prudence of decisions to invest and manage trust assets also pertain to the
16 prudence of decisions to retain or dispose of inception assets under this section.

17 **[SECTION 5-205. LOYALTY.** A trustee shall invest and manage the trust
18 property solely in the interest of the beneficiaries.]

19 **Comment**

20 The duty of loyalty is perhaps the most characteristic rule of trust law,
21 requiring the trustee to act exclusively for the beneficiaries, as opposed to acting for
22 the trustee’s own interest or that of third parties. The language of Section 4 of this
23 Act derives from Restatement of Trusts 3d: Prudent Investor Rule § 170 (1992),
24 which makes minute changes in Restatement of Trusts 2d § 170 (1959).

25 The concept that the duty of prudence in trust administration, especially in
26 investing and managing trust assets, entails adherence to the duty of loyalty is
27 familiar. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B), extracted in the
28 Comment to Section 1 of this Act, effectively merges the requirements of prudence
29 and loyalty. A fiduciary cannot be prudent in the conduct of investment functions if
30 the fiduciary is sacrificing the interests of the beneficiaries.

31 The duty of loyalty is not limited to settings entailing self-dealing or conflict
32 of interest in which the trustee would benefit personally from the trust. “The trustee
33 is under a duty to the beneficiary in administering the trust not to be guided by the
34 interest of any third person. Thus, it is improper for the trustee to sell trust property

1 to a third person for the purpose of benefitting the third person rather than the
2 trust.” Restatement of Trusts 2d § 170, comment *q*, at 371 (1959).

3 No form of so-called “social investing” is consistent with the duty of loyalty
4 if the investment activity entails sacrificing the interests of trust beneficiaries – for
5 example, by accepting below-market returns – in favor of the interests of the
6 persons supposedly benefitted by pursuing the particular social cause. See, e.g.,
7 John H. Langbein & Richard Posner, *Social Investing and the Law of Trusts*, 79
8 *Michigan L. Rev.* 72, 96-97 (1980) (collecting authority). For pension trust assets,
9 see generally Ian D. Lanoff, *The Social Investment of Private Pension Plan Assets:
10 May it Be Done Lawfully under ERISA?*, 31 *Labor L.J.* 387 (1980). Commentators
11 supporting social investing tend to concede the overriding force of the duty of
12 loyalty. They argue instead that particular schemes of social investing may not
13 result in below-market returns. See, e.g., Marcia O’Brien Hylton, “Socially
14 Responsible” Investing: Doing Good Versus Doing Well in an Inefficient Market, 42
15 *American U.L. Rev.* 1 (1992). In 1994 the Department of Labor issued an
16 Interpretive Bulletin reviewing its prior analysis of social investing questions and
17 reiterating that pension trust fiduciaries may invest only in conformity with the
18 prudence and loyalty standards of ERISA §§ 403-404. Interpretive Bulletin 94-1,
19 59 *Fed. Regis.* 32606 (Jun. 22, 1994), to be codified as 29 CFR § 2509.94-1. The
20 Bulletin reminds fiduciary investors that they are prohibited from “subordinat[ing]
21 the interests of participants and beneficiaries in their retirement income to unrelated
22 objectives.”

23 **[SECTION 5-206. IMPARTIALITY.** If a trust has two or more
24 beneficiaries, the trustee shall act impartially in investing and managing the trust
25 property, taking into account any differing interests of the beneficiaries.]

26 **Comment**

27 The duty of impartiality derives from the duty of loyalty. When the trustee
28 owes duties to more than one beneficiary, loyalty requires the trustee to respect the
29 interests of all the beneficiaries. Prudence in investing and administration requires
30 the trustee to take account of the interests of all the beneficiaries for whom the
31 trustee is acting, especially the conflicts between the interests of beneficiaries
32 interested in income and those interested in principal.

33 The language of Section 6 derives from Restatement of Trusts 2d § 183
34 (1959); see also *id.*, § 232. Multiple beneficiaries may be beneficiaries in succession
35 (such as life and remainder interests) or beneficiaries with simultaneous interests (as
36 when the income interest in a trust is being divided among several beneficiaries).

1 **Former law.** The former nondelegation rule survived into the 1959
2 Restatement: “The trustee is under a duty to the beneficiary not to delegate to
3 others the doing of acts which the trustee can reasonably be required personally to
4 perform.” The rule put a premium on the frequently arbitrary task of distinguishing
5 discretionary functions that were thought to be nondelegable from supposedly
6 ministerial functions that the trustee was allowed to delegate. Restatement of Trusts
7 2d § 171 (1959).

8 The Restatement of Trusts 2d admitted in a comment that “There is not a
9 clear-cut line dividing the acts which a trustee can properly delegate from those
10 which he cannot properly delegate.” Instead, the comment directed attention to a
11 list of factors that “may be of importance: (1) the amount of discretion involved; (2)
12 the value and character of the property involved; (3) whether the property is
13 principal or income; (4) the proximity or remoteness of the subject matter of the
14 trust; (5) the character of the act as one involving professional skill or facilities
15 possessed or not possessed by the trustee himself.” Restatement of Trusts 2d § 171,
16 comment *d* (1959). The 1959 Restatement further said: “A trustee cannot properly
17 delegate to another power to select investments.” Restatement of Trusts 2d § 171,
18 comment *h* (1959).

19 For discussion and criticism of the former rule see William L. Cary & Craig
20 B. Bright, *The Delegation of Investment Responsibility for Endowment Funds*, 74
21 *Columbia L. Rev.* 207 (1974); John H. Langbein & Richard A. Posner, *Market*
22 *Funds and Trust-Investment Law*, 1976 *American Bar Foundation Research J.* 1,
23 18-24.

24 **The modern trend to favor delegation.** The trend of subsequent
25 legislation, culminating in the Restatement of Trusts 3d: Prudent Investor Rule, has
26 been strongly hostile to the nondelegation rule. See John H. Langbein, *Reversing*
27 *the Nondelegation Rule of Trust-Investment Law*, 59 *Missouri L. Rev.* 105 (1994).

28 **The delegation rule of the Uniform Trustee Powers Act.** The Uniform
29 Trustee Powers Act (1964) effectively abrogates the nondelegation rule. It
30 authorizes trustees “to employ persons, including attorneys, auditors, investment
31 advisors, or agents, even if they are associated with the trustee, to advise or assist
32 the trustee in the performance of his administrative duties; to act without
33 independent investigation upon their recommendations; and instead of acting
34 personally, to employ one or more agents to perform any act of administration,
35 whether or not discretionary” Uniform Trustee Powers Act § 3(24), 7B
36 *Uniform Laws Ann.* 743 (1985). The Act has been enacted in 16 States, see
37 “Record of Passage of Uniform and Model Acts as of September 30, 1993,”
38 1993-94 *Reference Book of Uniform Law Commissioners* (unpaginated, following
39 page 111) (1993).

1 **UMIFA’s delegation rule.** The Uniform Management of Institutional
2 Funds Act (1972) (UMIFA), authorizes the governing boards of eleemosynary
3 institutions, who are trustee-like fiduciaries, to delegate investment matters either to
4 a committee of the board or to outside investment advisors, investment counsel,
5 managers, banks, or trust companies. UMIFA § 5, 7A Uniform Laws Ann. 705
6 (1985). UMIFA has been enacted in 38 States, see “Record of Passage of Uniform
7 and Model Acts as of September 30, 1993,” 1993-94 Reference Book of Uniform
8 Law Commissioners (unpaginated, following page 111) (1993).

9 **ERISA’s delegation rule.** The Employee Retirement Income Security Act
10 of 1974, the federal statute that prescribes fiduciary standards for investing the
11 assets of pension and employee benefit plans, allows a pension or employee benefit
12 plan to provide that “authority to manage, acquire or dispose of assets of the plan is
13 delegated to one or more investment managers” ERISA § 403(a)(2), 29
14 U.S.C. § 1103(a)(2). Commentators have explained the rationale for ERISA’s
15 encouragement of delegation:

16 ERISA . . . invites the dissolution of unitary trusteeship. . . . ERISA’s
17 fractionation of traditional trusteeship reflects the complexity of the modern
18 pension trust. Because millions, even billions of dollars can be involved, great
19 care is required in investing and safekeeping plan assets. Administering such
20 plans—computing and honoring benefit entitlements across decades of
21 employment and retirement—is also a complex business. . . . Since, however,
22 neither the sponsor nor any other single entity has a comparative advantage in
23 performing all these functions, the tendency has been for pension plans to use a
24 variety of specialized providers. A consulting actuary, a plan administration
25 firm, or an insurance company may oversee the design of a plan and arrange for
26 processing benefit claims. Investment industry professionals manage the
27 portfolio (the largest plans spread their pension investments among dozens of
28 money management firms).

29 John H. Langbein & Bruce A. Wolk, *Pension and Employee Benefit Law* 496
30 (1990).

31 **The delegation rule of the 1992 Restatement.** The Restatement of Trusts
32 3d: Prudent Investor Rule (1992) repeals the nondelegation rule of Restatement of
33 Trusts 2d § 171 (1959), extracted supra, and replaces it with substitute text that
34 reads:

35 § 171. Duty with Respect to Delegation. A trustee has a duty personally to
36 perform the responsibilities of trusteeship except as a prudent person might
37 delegate those responsibilities to others. In deciding whether, to whom, and in
38 what manner to delegate fiduciary authority in the administration of a trust, and

1 thereafter in supervising agents, the trustee is under a duty to the beneficiaries to
2 exercise fiduciary discretion and to act as a prudent person would act in similar
3 circumstances.

4 Restatement of Trusts 3d: Prudent Investor Rule § 171 (1992). The 1992
5 Restatement integrates this delegation standard into the prudent investor rule of
6 section 227, providing that “the trustee must . . . act with prudence in deciding
7 whether and how to delegate to others” Restatement of Trusts 3d: Prudent
8 Investor Rule § 227(c)(1992).

9 **Protecting the beneficiary against unreasonable delegation.** There is an
10 intrinsic tension in trust law between granting trustees broad powers that facilitate
11 flexible and efficient trust administration, on the one hand, and protecting trust
12 beneficiaries from the misuse of such powers on the other hand. A broad set of
13 trustees’ powers, such as those found in most lawyer-drafted instruments and
14 exemplified in the Uniform Trustees’ Powers Act, permits the trustee to act
15 vigorously and expeditiously to maximize the interests of the beneficiaries in a
16 variety of transactions and administrative settings. Trust law relies upon the duties
17 of loyalty and prudent administration, and upon procedural safeguards such as
18 periodic reports and the availability of judicial oversight, to prevent the misuse of
19 these powers. Delegation, which is a species of trustee power, raises the same
20 tension. If the trustee delegates effectively, the beneficiaries obtain the advantage of
21 the agent’s specialized investment skills or whatever other attributes induced the
22 trustee to delegate. But if the trustee delegates to a knave or an incompetent, the
23 delegation can work harm upon the beneficiaries.

24 This section is designed to strike the appropriate balance between the
25 advantages and the hazards of delegation. This section authorizes delegation under
26 the limitations of subsections (a) and (b). Subsection (a) imposes duties of care,
27 skill, and caution on the trustee in selecting the agent, in establishing the terms of
28 the delegation, and in reviewing the agent’s compliance.

29 The trustee’s duties of care, skill, and caution in framing the terms of the
30 delegation should protect the beneficiary against overbroad delegation. For
31 example, a trustee could not prudently agree to an investment management
32 agreement containing an exculpation clause that leaves the trust without recourse
33 against reckless mismanagement. Leaving one’s beneficiaries remediless against
34 willful wrongdoing is inconsistent with the duty to use care and caution in
35 formulating the terms of the delegation. This sense that it is imprudent to expose
36 beneficiaries to broad exculpation clauses underlies both federal and state legislation
37 restricting exculpation clauses, e.g., ERISA §§ 404(a)(1)(D), 410(a), 29 U.S.C.
38 §§ 1104(a)(1)(D), 1110(a); New York Est. Powers Trusts Law § 11-1.7 (McKinney
39 1967).

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ARTICLE 6
UNIFORM PRINCIPAL AND INCOME ACT (1997)

PREFATORY NOTE

This revision of the 1931 Uniform Principal and Income Act and the 1962 Revised Uniform Principal and Income Act has two purposes.

One purpose is to revise the 1931 and the 1962 Acts. Revision is needed to support the now widespread use of the revocable living trust as a will substitute, to change the rules in those Acts that experience has shown need to be changed, and to establish new rules to cover situations not provided for in the old Acts, including rules that apply to financial instruments invented since 1962.

The other purpose is to provide a means for implementing the transition to an investment regime based on principles embodied in the Uniform Prudent Investor Act, especially the principle of investing for total return rather than a certain level of “income” as traditionally perceived in terms of interest, dividends, and rents.

Revision of the 1931 and 1962 Acts

The prior Acts and this revision of those Acts deal with four questions affecting the rights of beneficiaries:

(1) How is income earned during the probate of an estate to be distributed to trusts and to persons who receive outright bequests of specific property, pecuniary gifts, and the residue?

(2) When an income interest in a trust begins (i.e., when a person who creates the trust dies or when she transfers property to a trust during life), what property is principal that will eventually go to the remainder beneficiaries and what is income?

(3) When an income interest ends, who gets the income that has been received but not distributed, or that is due but not yet collected, or that has accrued but is not yet due?

(4) After an income interest begins and before it ends, how should its receipts and disbursements be allocated to or between principal and income?

Changes in the traditional sections are of three types: new rules that deal with situations not covered by the prior Acts, clarification of provisions in the 1962 Act, and changes to rules in the prior Acts.

1 **New rules.** Issues addressed by some of the more significant new rules
2 include:

3 (1) The application of the probate administration rules to revocable living
4 trusts after the settlor's death and to other terminating trusts. Article 6, Parts 2 and
5 3.

6 (2) The payment of interest or some other amount on the delayed payment
7 of an outright pecuniary gift that is made pursuant to a trust agreement instead of a
8 will when the agreement or state law does not provide for such a payment. Section
9 6-201(3).

10 (3) The allocation of net income from partnership interests acquired by the
11 trustee other than from a decedent (the old Acts deal only with partnership interests
12 acquired from a decedent). Section 6-401.

13 (4) An "unincorporated entity" concept has been introduced to deal with
14 businesses operated by a trustee, including farming and livestock operations, and
15 investment activities in rental real estate, natural resources, timber, and derivatives.
16 Section 6-403.

17 (5) The allocation of receipts from discount obligations such as zero-coupon
18 bonds. Section 6-406(b).

19 (6) The allocation of net income from harvesting and selling timber between
20 principal and income. Section 6-412.

21 (7) The allocation between principal and income of receipts from
22 derivatives, options, and asset-backed securities. Sections 6-414 and 6-415.

23 (8) Disbursements made because of environmental laws. Section
24 6-502(a)(7).

25 (9) Income tax obligations resulting from the ownership of S corporation
26 stock and interests in partnerships. Section 6-505.

27 (10) The power to make adjustments between principal and income to
28 correct inequities caused by tax elections or peculiarities in the way the fiduciary
29 income tax rules apply. Section 6-506.

30 **Clarifications and changes in existing rules.** A number of matters
31 provided for in the prior Acts have been changed or clarified in this revision,
32 including the following:

1 (1) An income beneficiary’s estate will be entitled to receive only net
2 income actually received by a trust before the beneficiary’s death and not items of
3 accrued income. Section 6-303.

4 (2) Income from a partnership is based on actual distributions from the
5 partnership, in the same manner as corporate distributions. Section 6-401.

6 (3) Distributions from corporations and partnerships that exceed 20% of the
7 entity’s gross assets will be principal whether or not intended by the entity to be a
8 partial liquidation. Section 6-401(d)(2).

9 (4) Deferred compensation is dealt with in greater detail in a separate
10 section. Section 6-409.

11 (5) The 1962 Act rule for “property subject to depletion,” (patents,
12 copyrights, royalties, and the like), which provides that a trustee may allocate up to
13 5% of the asset’s inventory value to income and the balance to principal, has been
14 replaced by a rule that allocates 90% of the amounts received to principal and the
15 balance to income. Section 6-410.

16 (6) The percentage used to allocate amounts received from oil and gas has
17 been changed – 90% of those receipts are allocated to principal and the balance to
18 income. Section 6-411.

19 (7) The unproductive property rule has been eliminated for trusts other than
20 marital deduction trusts. Section 6-413.

21 (8) Charging depreciation against income is no longer mandatory, and is left
22 to the discretion of the trustee. Section 6-503.

23 **Coordination with the Uniform Prudent Investor Act**

24 The law of trust investment has been modernized. See Uniform Prudent
25 Investor Act (1994); Restatement (Third) of Trusts: Prudent Investor Rule (1992)
26 (hereinafter Restatement of Trusts 3d: Prudent Investor Rule). Now it is time to
27 update the principal and income allocation rules so the two bodies of doctrine can
28 work well together. This revision deals conservatively with the tension between
29 modern investment theory and traditional income allocation. The starting point is to
30 use the traditional system. If prudent investing of all the assets in a trust viewed as a
31 portfolio and traditional allocation effectuate the intent of the settlor, then nothing
32 need be done. The Act, however, helps the trustee who has made a prudent,
33 modern portfolio-based investment decision that has the initial effect of skewing
34 return from all the assets under management, viewed as a portfolio, as between

1 income and principal beneficiaries. The Act gives that trustee a power to reallocate
2 the portfolio return suitably. To leave a trustee constrained by the traditional system
3 would inhibit the trustee’s ability to fully implement modern portfolio theory.

4 As to modern investing see, e.g., the Preface to, terms of, and Comments to
5 the Uniform Prudent Investor Act (1994); the discussion and reporter’s note by
6 Edward C. Halbach, Jr. in Restatement of Trusts 3d: Prudent Investor Rule; John H.
7 Langbein, The Uniform Prudent Investor Act and the Future of Trust Investing, 81
8 Iowa L. Rev. 641 (1996); Bevis Longstreth, Modern Investment Management and
9 the Prudent Man Rule (1986); John H. Langbein & Richard A. Posner, The
10 Revolution in Trust Investment Law, 62 A.B.A.J. 887 (1976); and Jeffrey N.
11 Gordon, The Puzzling Persistence of the Constrained Prudent Man Rule, 62 N.Y.U.
12 L. Rev. 52 (1987). See also R.A. Brearly, An Introduction to Risk and Return from
13 Common Stocks (2d ed. 1983); Jonathan R. Macey, An Introduction to Modern
14 Financial Theory (1991). As to the need for principal and income reform see, e.g.,
15 Joel C. Dobris, Real Return, Modern Portfolio Theory and College, University and
16 Foundation Decisions on Annual Spending From Endowments: A Visit to the World
17 of Spending Rules, 28 Real Prop., Prob., & Tr. J. 49 (1993); Joel C. Dobris, The
18 Probate World at the End of the Century: Is a New Principal and Income Act in
19 Your Future?, 28 Real Prop., Prob., & Tr. J. 393 (1993); and Kenneth L. Hirsch,
20 Inflation and the Law of Trusts, 18 Real Prop., Prob., & Tr. J. 601 (1983). See
21 also, Jerold I. Horn, The Prudent Investor Rule – Impact on Drafting and
22 Administration of Trusts, 20 ACTEC Notes 26 (Summer 1994).

23 **PART 1**

24 **DEFINITIONS AND FIDUCIARY DUTIES**

25 **SECTION 6-101. SHORT TITLE.** This [article] may be cited as the Uniform
26 Principal and Income Act (1997).

27 **SECTION 6-102. DEFINITIONS.** In this [article]:

28 (1) “Accounting period” means a calendar year unless another 12-month
29 period is selected by a fiduciary. The term includes a portion of a calendar year or

1 other 12-month period that begins when an income interest begins or ends when an
2 income interest ends.

3 (2) “Beneficiary” includes, in the case of a decedent’s estate, an heir [,
4 legatee,] and devisee and, in the case of a trust, an income beneficiary and a
5 remainder beneficiary.

6 (3) “Fiduciary” means a personal representative or a trustee. The term
7 includes an executor, administrator, successor personal representative, special
8 administrator, and a person performing substantially the same function.

9 (4) “Income” means money or property that a fiduciary receives as current
10 return from a principal asset. The term includes a portion of receipts from a sale,
11 exchange, or liquidation of a principal asset, to the extent provided in [Part] 4.

12 (5) “Income beneficiary” means a person to whom net income of a trust is
13 or may be payable.

14 (6) “Income interest” means the right of an income beneficiary to receive all
15 or part of net income, whether the terms of the trust require it to be distributed or
16 authorize it to be distributed in the trustee’s discretion.

17 (7) “Mandatory income interest” means the right of an income beneficiary to
18 receive net income that the terms of the trust require the fiduciary to distribute.

19 (8) “Net income” means the total receipts allocated to income during an
20 accounting period minus the disbursements made from income during the period,
21 plus or minus transfers under this [article] to or from income during the period.

1 (a) In allocating receipts and disbursements to or between principal and
2 income, and with respect to any matter within the scope of [Parts] 2 and 3, a
3 fiduciary:

4 (1) shall administer a trust or estate in accordance with the terms of the
5 trust or the will, even if there is a different provision in this [article];

6 (2) may administer a trust or estate by the exercise of a discretionary
7 power of administration given to the fiduciary by the terms of the trust or the will,
8 even if the exercise of the power produces a result different from a result required or
9 permitted by this [article];

10 (3) shall administer a trust or estate in accordance with this [article] if the
11 terms of the trust or the will do not contain a different provision or do not give the
12 fiduciary a discretionary power of administration; and

13 (4) shall add a receipt or charge a disbursement to principal to the extent
14 that the terms of the trust and this [article] do not provide a rule for allocating the
15 receipt or disbursement to or between principal and income.

16 (b) In exercising the power to adjust under Section 6-104(a) or a
17 discretionary power of administration regarding a matter within the scope of this
18 [article], whether granted by the terms of a trust, a will, or this [article], a fiduciary
19 shall administer a trust or estate impartially, based on what is fair and reasonable to
20 all of the beneficiaries, except to the extent that the terms of the trust or the will
21 clearly manifest an intention that the fiduciary shall or may favor one or more of the

1 beneficiaries. A determination in accordance with this [article] is presumed to be
2 fair and reasonable to all of the beneficiaries.

3 **Comment**

4 **Prior Act.** The rule in Section 2(a) of the 1962 Act is restated in Section
5 6-103(a), without changing its substance, to emphasize that the Act contains only
6 default rules and that provisions in the terms of the trust are paramount. However,
7 Section 2(a) of the 1962 Act applies only to the allocation of receipts and
8 disbursements to or between principal and income. In this Act, the first sentence of
9 Section 6-103(a) states that it also applies to matters within the scope of Articles 2
10 and 3. Section 6-103(a)(2) incorporates the rule in Section 2(b) of the 1962 Act
11 that a discretionary allocation made by the trustee that is contrary to a rule in the
12 Act should not give rise to an inference of imprudence or partiality by the trustee.

13 The Act deletes the language that appears at the end of 1962 Act Section
14 2(a)(3) – “and in view of the manner in which men of ordinary prudence, discretion
15 and judgment would act in the management of their affairs” – because persons of
16 ordinary prudence, discretion and judgment, acting in the management of their own
17 affairs do not normally think in terms of the interests of successive beneficiaries. If
18 there is an analogy to an individual’s decision-making process, it is probably the
19 individual’s decision to spend or to save, but this is not a useful guideline for trust
20 administration. No case has been found in which a court has relied on the “prudent
21 man” rule of the 1962 Act.

22 **Fiduciary discretion.** The general rule is that if a discretionary power is
23 conferred upon a trustee, the exercise of that power is not subject to control by a
24 court except to prevent an abuse of discretion. Restatement (Second) of Trusts
25 § 187. The situations in which a court will control the exercise of a trustee’s
26 discretion are discussed in the comments to § 187. See also *id.* § 233 Comment *p.*

27 **Questions for which there is no provision.** Section 6-103(a)(4) allocates
28 receipts and disbursements to principal when there is no provision for a different
29 allocation in the terms of the trust, the will, or the Act. This may occur because
30 money is received from a financial instrument not available at the present time
31 (inflation-indexed bonds might have fallen into this category had they been
32 announced after this Act was approved by the Commissioners on Uniform State
33 Laws) or because a transaction is of a type or occurs in a manner not anticipated by
34 the Drafting Committee for this Act or the drafter of the trust instrument.

35 Allocating to principal a disbursement for which there is no provision in the
36 Act or the terms of the trust preserves the income beneficiary’s level of income in
37 the year it is allocated to principal, but thereafter will reduce the amount of income

1 produced by the principal. Allocating to principal a receipt for which there is no
2 provision will increase the income received by the income beneficiary in subsequent
3 years, and will eventually, upon termination of the trust, also favor the remainder
4 beneficiary. Allocating these items to principal implements the rule that requires a
5 trustee to administer the trust impartially, based on what is fair and reasonable to
6 both income and remainder beneficiaries. However, if the trustee decides that an
7 adjustment between principal and income is needed to enable the trustee to comply
8 with Section 6-103(b), after considering the return from the portfolio as a whole, the
9 trustee may make an appropriate adjustment under Section 6-104(a).

10 **Duty of impartiality.** Whenever there are two or more beneficiaries, a
11 trustee is under a duty to deal impartially with them. Restatement of Trusts 3d:
12 Prudent Investor Rule § 183 (1992). This rule applies whether the beneficiaries’
13 interests in the trust are concurrent or successive. If the terms of the trust give the
14 trustee discretion to favor one beneficiary over another, a court will not control the
15 exercise of such discretion except to prevent the trustee from abusing it. Id. § 183,
16 Comment *a*. “The precise meaning of the trustee’s duty of impartiality and the
17 balancing of competing interests and objectives inevitably are matters of judgment
18 and interpretation. Thus, the duty and balancing are affected by the purposes,
19 terms, distribution requirements, and other circumstances of the trust, not only at
20 the outset but as they may change from time to time.” Id. § 232, Comment *c*.

21 The terms of a trust may provide that the trustee, or an accountant engaged
22 by the trustee, or a committee of persons who may be family members or business
23 associates, shall have the power to determine what is income and what is principal.
24 If the terms of a trust provide that this Act specifically or principal and income
25 legislation in general does not apply to the trust but fail to provide a rule to deal
26 with a matter provided for in this Act, the trustee has an implied grant of discretion
27 to decide the question. Section 6-103(b) provides that the rule of impartiality
28 applies in the exercise of such a discretionary power to the extent that the terms of
29 the trust do not provide that one or more of the beneficiaries are to be favored.
30 The fact that a person is named an income beneficiary or a remainder beneficiary is
31 not by itself an indication of partiality for that beneficiary

32 **SECTION 6-104. TRUSTEE’S POWER TO ADJUST.**

33 (a) A trustee may adjust between principal and income to the extent the
34 trustee considers necessary if the trustee invests and manages trust assets as a
35 prudent investor, the terms of the trust describe the amount that may or must be

1 distributed to a beneficiary by referring to the trust's income, and the trustee
2 determines, after applying the rules in Section 6-103(a), that the trustee is unable to
3 comply with Section 6-103(b).

4 (b) In deciding whether and to what extent to exercise the power conferred
5 by subsection (a), a trustee shall consider all factors relevant to the trust and its
6 beneficiaries, including the following factors to the extent they are relevant:

7 (1) the nature, purpose, and expected duration of the trust;
8 (2) the intent of the settlor;
9 (3) the identity and circumstances of the beneficiaries;
10 (4) the needs for liquidity, regularity of income, and preservation and
11 appreciation of capital;

12 (5) the assets held in the trust; the extent to which they consist of
13 financial assets, interests in closely held enterprises, tangible and intangible personal
14 property, or real property; the extent to which an asset is used by a beneficiary; and
15 whether an asset was purchased by the trustee or received from the settlor;

16 (6) the net amount allocated to income under the other sections of this
17 [article] and the increase or decrease in the value of the principal assets, which the
18 trustee may estimate as to assets for which market values are not readily available;

19 (7) whether and to what extent the terms of the trust give the trustee the
20 power to invade principal or accumulate income or prohibit the trustee from
21 invading principal or accumulating income, and the extent to which the trustee has
22 exercised a power from time to time to invade principal or accumulate income;

1 (8) the actual and anticipated effect of economic conditions on principal
2 and income and effects of inflation and deflation; and

3 (9) the anticipated tax consequences of an adjustment.

4 (c) A trustee may not make an adjustment:

5 (1) that diminishes the income interest in a trust that requires all of the
6 income to be paid at least annually to a surviving spouse and for which an estate tax
7 or gift tax marital deduction would be allowed, in whole or in part, if the trustee did
8 not have the power to make the adjustment;

9 (2) that reduces the actuarial value of the income interest in a trust to
10 which a person transfers property with the intent to qualify for a gift tax exclusion;

11 (3) that changes the amount payable to a beneficiary as a fixed annuity or
12 a fixed fraction of the value of the trust assets;

13 (4) from any amount that is permanently set aside for charitable purposes
14 under a will or the terms of a trust unless both income and principal are so set aside;

15 (5) if possessing or exercising the power to make an adjustment causes
16 an individual to be treated as the owner of all or part of the trust for income tax
17 purposes, and the individual would not be treated as the owner if the trustee did not
18 possess the power to make an adjustment;

19 (6) if possessing or exercising the power to make an adjustment causes
20 all or part of the trust assets to be included for estate tax purposes in the estate of an
21 individual who has the power to remove a trustee or appoint a trustee, or both, and

1 the assets would not be included in the estate of the individual if the trustee did not
2 possess the power to make an adjustment;

3 (7) if the trustee is a beneficiary of the trust; or

4 (8) if the trustee is not a beneficiary, but the adjustment would benefit
5 the trustee directly or indirectly.

6 (d) If subsection (c)(5), (6), (7), or (8) applies to a trustee and there is more
7 than one trustee, a cotrustee to whom the provision does not apply may make the
8 adjustment unless the exercise of the power by the remaining trustee or trustees is
9 not permitted by the terms of the trust.

10 (e) A trustee may release the entire power conferred by subsection (a) or
11 may release only the power to adjust from income to principal or the power to
12 adjust from principal to income if the trustee is uncertain about whether possessing
13 or exercising the power will cause a result described in subsection (c)(1) through (6)
14 or (c)(8) or if the trustee determines that possessing or exercising the power will or
15 may deprive the trust of a tax benefit or impose a tax burden not described in
16 subsection (c). The release may be permanent or for a specified period, including a
17 period measured by the life of an individual.

18 (f) Terms of a trust that limit the power of a trustee to make an adjustment
19 between principal and income do not affect the application of this section unless it is
20 clear from the terms of the trust that the terms are intended to deny the trustee the
21 power of adjustment conferred by subsection (a).

22

Comment

1 **Purpose and Scope of Provision.** The purpose of Section 6-104 is to
2 enable a trustee to select investments using the standards of a prudent investor
3 without having to realize a particular portion of the portfolio’s total return in the
4 form of traditional trust accounting income such as interest, dividends, and rents.
5 Section 6-104(a) authorizes a trustee to make adjustments between principal and
6 income if three conditions are met: (1) the trustee must be managing the trust assets
7 under the prudent investor rule; (2) the terms of the trust must express the income
8 beneficiary’s distribution rights in terms of the right to receive “income” in the sense
9 of traditional trust accounting income; and (3) the trustee must determine, after
10 applying the rules in Section 6-103(a), that he is unable to comply with Section
11 6-103(b). In deciding whether and to what extent to exercise the power to adjust,
12 the trustee is required to consider the factors described in Section 6-104(b), but the
13 trustee may not make an adjustment in circumstances described in Section 6-104(c).

14 Section 6-104 does not empower a trustee to increase or decrease the degree
15 of beneficial enjoyment to which a beneficiary is entitled under the terms of the trust;
16 rather, it authorizes the trustee to make adjustments between principal and income
17 that may be necessary if the income component of a portfolio’s total return is too
18 small or too large because of investment decisions made by the trustee under the
19 prudent investor rule. The paramount consideration in applying Section 6-104(a) is
20 the requirement in Section 6-103(b) that “a fiduciary must administer a trust or
21 estate impartially, based on what is fair and reasonable to all of the beneficiaries,
22 except to the extent that the terms of the trust or the will clearly manifest an
23 intention that the fiduciary shall or may favor one or more of the beneficiaries.” The
24 power to adjust is subject to control by the court to prevent an abuse of discretion.
25 Restatement (Second) of Trusts § 187 (1959). See also *id.* §§ 183, 232, 233,
26 Comment *p* (1959).

27 Section 6-104 will be important for trusts that are irrevocable when a State
28 adopts the prudent investor rule by statute or judicial approval of the rule in
29 Restatement of Trusts 3d: Prudent Investor Rule. Wills and trust instruments
30 executed after the rule is adopted can be drafted to describe a beneficiary’s
31 distribution rights in terms that do not depend upon the amount of trust accounting
32 income, but to the extent that drafters of trust documents continue to describe an
33 income beneficiary’s distribution rights by referring to trust accounting income,
34 Section 6-104 will be an important tool in trust administration.

35 **Three conditions to the exercise of the power to adjust.** The first of the
36 three conditions that must be met before a trustee can exercise the power to adjust –
37 that the trustee invest and manage trust assets as a prudent investor – is expressed in
38 this Act by language derived from the Uniform Prudent Investor Act, but the
39 condition will be met whether the prudent investor rule applies because the Uniform
40 Act or other prudent investor legislation has been enacted, the prudent investor rule

1 has been approved by the courts, or the terms of the trust require it. Even if a
2 State’s legislature or courts have not formally adopted the rule, the Restatement
3 establishes the prudent investor rule as an authoritative interpretation of the
4 common law prudent man rule, referring to the prudent investor rule as a “modest
5 reformulation of the Harvard College dictum and the basic rule of prior
6 Restatements.” Restatement of Trusts 3d: Prudent Investor Rule, Introduction, at
7 5. As a result, there is a basis for concluding that the first condition is satisfied in
8 virtually all States except those in which a trustee is permitted to invest only in
9 assets set forth in a statutory “legal list.”

10 The second condition will be met when the terms of the trust require all of
11 the “income” to be distributed at regular intervals; or when the terms of the trust
12 require a trustee to distribute all of the income, but permit the trustee to decide how
13 much to distribute to each member of a class of beneficiaries; or when the terms of a
14 trust provide that the beneficiary shall receive the greater of the trust accounting
15 income and a fixed dollar amount (an annuity), or of trust accounting income and a
16 fractional share of the value of the trust assets (a unitrust amount). If the trust
17 authorizes the trustee in its discretion to distribute the trust’s income to the
18 beneficiary or to accumulate some or all of the income, the condition will be met
19 because the terms of the trust do not permit the trustee to distribute more than the
20 trust accounting income.

21 To meet the third condition, the trustee must first meet the requirements of
22 Section 6-103(a), i.e., she must apply the terms of the trust, decide whether to
23 exercise the discretionary powers given to the trustee under the terms of the trust,
24 and must apply the provisions of the Act if the terms of the trust do not contain a
25 different provision or give the trustee discretion. Second, the trustee must
26 determine the extent to which the terms of the trust clearly manifest an intention by
27 the settlor that the trustee may or must favor one or more of the beneficiaries. To
28 the extent that the terms of the trust do not require partiality, the trustee must
29 conclude that she is unable to comply with the duty to administer the trust
30 impartially. To the extent that the terms of the trust do require or permit the trustee
31 to favor the income beneficiary or the remainder beneficiary, the trustee must
32 conclude that she is unable to achieve the degree of partiality required or permitted.
33 If the trustee comes to either conclusion – that she is unable to administer the trust
34 impartially or that she is unable to achieve the degree of partiality required or
35 permitted – she may exercise the power to adjust under Section 6-104(a).

36 **Impartiality and productivity of income.** The duty of impartiality
37 between income and remainder beneficiaries is linked to the trustee’s duty to make
38 the portfolio productive of trust accounting income whenever the distribution
39 requirements are expressed in terms of distributing the trust’s “income.” The 1962
40 Act implies that the duty to produce income applies on an asset by asset basis

1 because the right of an income beneficiary to receive “delayed income” from the sale
2 proceeds of underproductive property under Section 12 of that Act arises if “any
3 part of principal . . . has not produced an average net income of a least 1% per year
4 of its inventory value for more than a year” Under the prudent investor rule,
5 “[t]o whatever extent a requirement of income productivity exists, . . . the
6 requirement applies not investment by investment but to the portfolio as a whole.”
7 Restatement of Trusts 3d: Prudent Investor Rule § 227, Comment *i*, at 34. The
8 power to adjust under Section 6-104(a) is also to be exercised by considering net
9 income from the portfolio as a whole and not investment by investment. Section
10 6-413(b) of this Act eliminates the underproductive property rule in all cases other
11 than trusts for which a marital deduction is allowed, and it applies to a marital
12 deduction trust if the trust’s assets “consist substantially of property that does not
13 provide the surviving spouse with sufficient income from or use of the trust assets
14 . . .” – in other words, the section applies by reference to the portfolio as a whole.

15 While the purpose of the power to adjust in Section 6-104(a) is to eliminate
16 the need for a trustee who operates under the prudent investor rule to be concerned
17 about the income component of the portfolio’s total return, the trustee must still
18 determine the extent to which a distribution must be made to an income beneficiary
19 and the adequacy of the portfolio’s liquidity as a whole to make that distribution.

20 For a discussion of investment considerations involving specific investments
21 and techniques under the prudent investor rule, see Restatement of Trusts 3d:
22 Prudent Investor Rule § 227, Comments *k-p*.

23 **Factors to consider in exercising the power to adjust.** Section 6-104(b)
24 requires a trustee to consider factors relevant to the trust and its beneficiaries in
25 deciding whether and to what extent the power to adjust should be exercised.
26 Section 2(c) of the Uniform Prudent Investor Act sets forth circumstances that a
27 trustee is to consider in investing and managing trust assets. The circumstances in
28 Section 2(c) of the Uniform Prudent Investor Act are the source of the factors in
29 paragraphs (3) through (6) and (8) of Section 6-104(b) (modified where necessary
30 to adapt them to the purposes of this Act) so that, to the extent possible,
31 comparable factors will apply to investment decisions and decisions involving the
32 power to adjust. If a trustee who is operating under the prudent investor rule
33 decides that the portfolio should be composed of financial assets whose total return
34 will result primarily from capital appreciation rather than dividends, interest, and
35 rents, the trustee can decide at the same time the extent to which an adjustment from
36 principal to income may be necessary under Section 6-104. On the other hand, if a
37 trustee decides that the risk and return objectives for the trust are best achieved by a
38 portfolio whose total return includes interest and dividend income that is sufficient
39 to provide the income beneficiary with the beneficial interest to which the

1 beneficiary is entitled under the terms of the trust, the trustee can decide that it is
2 unnecessary to exercise the power to adjust.

3 **Assets received from the settlor.** Section 5-203 provides that “[a] trustee
4 shall diversify the investments of the trust unless the trustee reasonably determines
5 that, because of special circumstances, the purposes of the trust are better served
6 without diversifying.” The special circumstances may include the wish to retain a
7 family business, the benefit derived from deferring liquidation of the asset in order to
8 defer payment of income taxes, or the anticipated capital appreciation from retaining
9 an asset such as undeveloped real estate for a long period. To the extent the trustee
10 retains assets received from the settlor because of special circumstances that
11 overcome the duty to diversify, the trustee may take these circumstances into
12 account in determining whether and to what extent the power to adjust should be
13 exercised to change the results produced by other provisions of this Act that apply
14 to the retained assets. See Section 6-104(b)(5); Section 5-203 Comment;
15 Restatement of Trusts 3d: Prudent Investor Rule § 229 and Comments *a-e*.

16 **Limitations on the power to adjust.** The purpose of subsections (c)(1)
17 through (4) is to preserve tax benefits that may have been an important purpose for
18 creating the trust. Subsections (c)(5), (6), and (8) deny the power to adjust in the
19 circumstances described in those subsections in order to prevent adverse tax
20 consequences, and subsection (c)(7) denies the power to adjust to any beneficiary,
21 whether or not possession of the power may have adverse tax consequences.

22 Under subsection (c)(1), a trustee cannot make an adjustment that diminishes
23 the income interest in a trust that requires all of the income to be paid at least
24 annually to a surviving spouse and for which an estate tax or gift tax marital
25 deduction is allowed; but this subsection does not prevent the trustee from making
26 an adjustment that increases the amount of income paid from a marital deduction
27 trust to the surviving spouse. Subsection (c)(1) applies to a trust that qualifies for
28 the marital deduction because the surviving spouse has a general power of
29 appointment over the trust, but it applies to a qualified terminable interest property
30 (QTIP) trust only if and to the extent that the fiduciary makes the election required
31 to obtain the tax deduction. Subsection (c)(1) does not apply to a so-called “estate”
32 trust. This type of trust qualifies for the marital deduction because the terms of the
33 trust require the principal and undistributed income to be paid to the surviving
34 spouse’s estate when the spouse dies; it is not necessary for the terms of an estate
35 trust to require the income to be distributed annually. Reg.
36 § 20.2056(c)-2(b)(1)(iii).

37 Subsection (c)(3) applies to annuity trusts and unitrusts with no charitable
38 beneficiaries as well as to trusts with charitable income or remainder beneficiaries;
39 its purpose is to make it clear that a beneficiary’s right to receive a fixed annuity or a

1 fixed fraction of the value of a trust's assets is not subject to adjustment under
2 Section 6-104(a). Subsection (c)(3) does not apply to any additional amount to
3 which the beneficiary may be entitled that is expressed in terms of a right to receive
4 income from the trust. For example, if a beneficiary is to receive a fixed annuity or
5 the trust's income, whichever is greater, subsection (c)(3) does not prevent a trustee
6 from making an adjustment under Section 6-104(a) in determining the amount of the
7 trust's income.

8 If subsection (c)(5), (6), (7), or (8), prevents a trustee from exercising the
9 power to adjust, subsection (d) permits a cotrustee who is not subject to the
10 provision to exercise the power unless the terms of the trust do not permit the
11 cotrustee to do so.

12 **Release of the power to adjust.** Section 6-104(e) permits a trustee to
13 release all or part of the power to adjust in circumstances in which the possession or
14 exercise of the power might deprive the trust of a tax benefit or impose a tax
15 burden. For example, if possessing the power would diminish the actuarial value of
16 the income interest in a trust for which the income beneficiary's estate may be
17 eligible to claim a credit for property previously taxed if the beneficiary dies within
18 ten years after the death of the person creating the trust, the trustee is permitted
19 under subsection (e) to release just the power to adjust from income to principal.

20 **Trust terms that limit a power to adjust.** Section 6-104(f) applies to trust
21 provisions that limit a trustee's power to adjust. Since the power is intended to
22 enable trustees to employ the prudent investor rule without being constrained by
23 traditional principal and income rules, an instrument executed before the adoption of
24 this Act whose terms describe the amount that may or must be distributed to a
25 beneficiary by referring to the trust's income or that prohibit the invasion of
26 principal or that prohibit equitable adjustments in general should not be construed as
27 forbidding the use of the power to adjust under Section 6-104(a) if the need for
28 adjustment arises because the trustee is operating under the prudent investor rule.
29 Instruments containing such provisions that are executed after the adoption of this
30 Act should specifically refer to the power to adjust if the settlor intends to forbid its
31 use. See generally, Joel C. Dobris, *Limits on the Doctrine of Equitable Adjustment*
32 *in Sophisticated Postmortem Tax Planning*, 66 Iowa L. Rev. 273 (1981).

33 **Examples.** The following examples illustrate the application of Section
34 6-104:

35 **Example (1)** – T is the successor trustee of a trust that provides income to
36 A for life, remainder to B. T has received from the prior trustee a portfolio of
37 financial assets invested 20% in stocks and 80% in bonds. Following the
38 prudent investor rule, T determines that a strategy of investing the portfolio 50%

1 in stocks and 50% in bonds has risk and return objectives that are reasonably
2 suited to the trust, but T also determines that adopting this approach will cause
3 the trust to receive a smaller amount of dividend and interest income. After
4 considering the factors in Section 6-104(b), T may transfer cash from principal
5 to income to the extent T considers it necessary to increase the amount
6 distributed to the income beneficiary.

7 **Example (2)** – T is the trustee of a trust that requires the income to be paid
8 to the settlor’s son C for life, remainder to C’s daughter D. In a period of very
9 high inflation, T purchases bonds that pay double-digit interest and determines
10 that a portion of the interest, which is allocated to income under Section 6-406
11 of this Act, is a return of capital. In consideration of the loss of value of
12 principal due to inflation and other factors that T considers relevant, T may
13 transfer part of the interest to principal.

14 **Example (3)** – T is the trustee of a trust that requires the income to be paid
15 to the settlor’s sister E for life, remainder to charity F. E is a retired
16 schoolteacher who is single and has no children. E’s income from her social
17 security, pension, and savings exceeds the amount required to provide for her
18 accustomed standard of living. The terms of the trust permit T to invade
19 principal to provide for E’s health and to support her in her accustomed manner
20 of living, but do not otherwise indicate that T should favor E or F. Applying the
21 prudent investor rule, T determines that the trust assets should be invested
22 entirely in growth stocks that produce very little dividend income. Even though
23 it is not necessary to invade principal to maintain E’s accustomed standard of
24 living, she is entitled to receive from the trust the degree of beneficial enjoyment
25 normally accorded a person who is the sole income beneficiary of a trust, and T
26 may transfer cash from principal to income to provide her with that degree of
27 enjoyment.

28 **Example (4)** – T is the trustee of a trust that is governed by the law of State
29 X. The trust became irrevocable before State X adopted the prudent investor
30 rule. The terms of the trust require all of the income to be paid to G for life,
31 remainder to H, and also give T the power to invade principal for the benefit of
32 G for “dire emergencies only.” The terms of the trust limit the aggregate
33 amount that T can distribute to G from principal during G’s life to 6% of the
34 trust’s value at its inception. The trust’s portfolio is invested initially 50% in
35 stocks and 50% in bonds, but after State X adopts the prudent investor rule T
36 determines that, to achieve suitable risk and return objectives for the trust, the
37 assets should be invested 90% in stocks and 10% in bonds. This change
38 increases the total return from the portfolio and decreases the dividend and
39 interest income. Thereafter, even though G does not experience a dire
40 emergency, T may exercise the power to adjust under Section 6-104(a) to the

1 extent that T determines that the adjustment is from only the capital appreciation
2 resulting from the change in the portfolio's asset allocation. If T is unable to
3 determine the extent to which capital appreciation resulted from the change in
4 asset allocation or is unable to maintain adequate records to determine the extent
5 to which principal distributions to G for dire emergencies do not exceed the 6%
6 limitation, T may not exercise the power to adjust. See Joel C. Dobris, Limits
7 on the Doctrine of Equitable Adjustment in Sophisticated Postmortem Tax
8 Planning, 66 Iowa L. Rev. 273 (1981).

9 **Example (5)** – T is the trustee of a trust for the settlor's child. The trust
10 owns a diversified portfolio of marketable financial assets with a value of
11 \$600,000, and is also the sole beneficiary of the settlor's IRA, which holds a
12 diversified portfolio of marketable financial assets with a value of \$900,000.
13 The trust receives a distribution from the IRA that is the minimum amount
14 required to be distributed under the Internal Revenue Code, and T allocates 10%
15 of the distribution to income under Section 6-409(c) of this Act. The total
16 return on the IRA's assets exceeds the amount distributed to the trust, and the
17 value of the IRA at the end of the year is more than its value at the beginning of
18 the year. Relevant factors that T may consider in determining whether to
19 exercise the power to adjust and the extent to which an adjustment should be
20 made to comply with Section 6-103(b) include the total return from all of the
21 trust's assets, those owned directly as well as its interest in the IRA, the extent
22 to which the trust will be subject to income tax on the portion of the IRA
23 distribution that is allocated to principal, and the extent to which the income
24 beneficiary will be subject to income tax on the amount that T distributes to the
25 income beneficiary.

26 **Example (6)** – T is the trustee of a trust whose portfolio includes a large
27 parcel of undeveloped real estate. T pays real property taxes on the
28 undeveloped parcel from income each year pursuant to Section 6-501(3). After
29 considering the return from the trust's portfolio as a whole and other relevant
30 factors described in Section 6-104(b), T may exercise the power to adjust under
31 Section 104(a) to transfer cash from principal to income in order to distribute to
32 the income beneficiary an amount that T considers necessary to comply with
33 Section 6-103(b).

34 **Example (7)** – T is the trustee of a trust whose portfolio includes an interest
35 in a mutual fund that is sponsored by T. As the manager of the mutual fund, T
36 charges the fund a management fee that reduces the amount available to
37 distribute to the trust by \$2,000. If the fee had been paid directly by the trust,
38 one-half of the fee would have been paid from income under Section 6-501(1)
39 and the other one-half would have been paid from principal under Section
40 6-502(a)(1). After considering the total return from the portfolio as a whole and

1 other relevant factors described in Section 6-104(b), T may exercise its power to
2 adjust under Section 6-104(a) by transferring \$1,000, or half of the trust's
3 proportionate share of the fee, from principal to income.

4 **PART 2**
5 **DECEDENT'S ESTATE OR TERMINATING INCOME INTEREST**

6 **SECTION 6-201. DETERMINATION AND DISTRIBUTION OF NET**

7 **INCOME.** After a decedent dies, in the case of an estate, or after an income
8 interest in a trust ends, the following rules apply:

9 (1) A fiduciary of an estate or of a terminating income interest shall
10 determine the amount of net income and net principal receipts received from
11 property specifically given to a beneficiary under the rules in [Parts] 3 through 5
12 which apply to trustees and the rules in paragraph (5). The fiduciary shall distribute
13 the net income and net principal receipts to the beneficiary who is to receive the
14 specific property.

15 (2) A fiduciary shall determine the remaining net income of a decedent's
16 estate or a terminating income interest under the rules in [Parts] 3 through 5 which
17 apply to trustees and by:

18 (A) including in net income all income from property used to discharge
19 liabilities;

20 (B) paying from income or principal, in the fiduciary's discretion, fees of
21 attorneys, accountants, and fiduciaries; court costs and other expenses of
22 administration; and interest on death taxes, but the fiduciary may pay those expenses

1 from income of property passing to a trust for which the fiduciary claims an estate
2 tax marital or charitable deduction only to the extent that the payment of those
3 expenses from income will not cause the reduction or loss of the deduction; and

4 (C) paying from principal all other disbursements made or incurred in
5 connection with the settlement of a decedent's estate or the winding up of a
6 terminating income interest, including debts, funeral expenses, disposition of
7 remains, family allowances, and death taxes and related penalties that are
8 apportioned to the estate or terminating income interest by the will, the terms of the
9 trust, or applicable law.

10 (3) A fiduciary shall distribute to a beneficiary who receives a pecuniary
11 amount outright the interest or any other amount provided by the will, the terms of
12 the trust, or applicable law from net income determined under paragraph (2) or from
13 principal to the extent that net income is insufficient. If a beneficiary is to receive a
14 pecuniary amount outright from a trust after an income interest ends and no interest
15 or other amount is provided for by the terms of the trust or applicable law, the
16 fiduciary shall distribute the interest or other amount to which the beneficiary would
17 be entitled under applicable law if the pecuniary amount were required to be paid
18 under a will.

19 (4) A fiduciary shall distribute the net income remaining after distributions
20 required by paragraph (3) in the manner described in Section 6-202 to all other
21 beneficiaries, including a beneficiary who receives a pecuniary amount in trust, even

1 if the beneficiary holds an unqualified power to withdraw assets from the trust or
2 other presently exercisable general power of appointment over the trust.

3 (5) A fiduciary may not reduce principal or income receipts from property
4 described in paragraph (1) because of a payment described in Section 6-501 or
5 6-502 to the extent that the will, the terms of the trust, or applicable law requires the
6 fiduciary to make the payment from assets other than the property or to the extent
7 that the fiduciary recovers or expects to recover the payment from a third party.
8 The net income and principal receipts from the property are determined by including
9 all of the amounts the fiduciary receives or pays with respect to the property,
10 whether those amounts accrued or became due before, on, or after the date of a
11 decedent's death or an income interest's terminating event, and by making a
12 reasonable provision for amounts that the fiduciary believes the estate or terminating
13 income interest may become obligated to pay after the property is distributed.

14 **Comment**

15 **Terminating income interests and successive income interests.** A trust
16 that provides for a single income beneficiary and an outright distribution of the
17 remainder ends when the income interest ends. A more complex trust may have a
18 number of income interests, either concurrent or successive, and the trust will not
19 necessarily end when one of the income interests ends. For that reason, the Act
20 speaks in terms of income interests ending and beginning rather than trusts ending
21 and beginning. When an income interest in a trust ends, the trustee's powers
22 continue during the winding up period required to complete its administration. A
23 terminating income interest is one that has ended but whose administration is not
24 complete.

25 If two or more people are given the right to receive specified percentages or
26 fractions of the income from a trust concurrently and one of the concurrent interests
27 ends, e.g., when a beneficiary dies, the beneficiary's income interest ends but the
28 trust does not. Similarly, when a trust with only one income beneficiary ends upon
29 the beneficiary's death, the trust instrument may provide that part or all of the trust

1 assets shall continue in trust for another income beneficiary. While it is common to
2 think and speak of this (and even to characterize it in a trust instrument) as a “new”
3 trust, it is a continuation of the original trust for a remainder beneficiary who has an
4 income interest in the trust assets instead of the right to receive them outright. For
5 purposes of this Act, this is a successive income interest in the same trust. The fact
6 that a trust may or may not end when an income interest ends is not significant for
7 purposes of this Act.

8 If the assets that are subject to a terminating income interest pass to another
9 trust because the income beneficiary exercises a general power of appointment over
10 the trust assets, the recipient trust would be a new trust; and if they pass to another
11 trust because the beneficiary exercises a nongeneral power of appointment over the
12 trust assets, the recipient trust might be a new trust in some States (see 5A Austin
13 W. Scott & William F. Fratcher, *The Law of Trusts* § 640, at 483 (4th ed. 1989));
14 but for purposes of this Act a new trust created in these circumstances is also a
15 successive income interest.

16 **Gift of a pecuniary amount.** Section 6-201(3) and (4) provide different
17 rules for an outright gift of a pecuniary amount and a gift in trust of a pecuniary
18 amount; this is the same approach used in Section 5(b)(2) of the 1962 Act.

19 **Interest on pecuniary amounts.** Section 6-201(3) provides that the
20 beneficiary of an outright pecuniary amount is to receive the interest or other
21 amount provided by applicable law if there is no provision in the will or the terms of
22 the trust. Many States have no applicable law that provides for interest or some
23 other amount to be paid on an outright pecuniary gift under an inter vivos trust; this
24 section provides that in such a case the interest or other amount to be paid shall be
25 the same as the interest or other amount required to be paid on testamentary
26 pecuniary gifts. This provision is intended to accord gifts under inter vivos
27 instruments the same treatment as testamentary gifts. The various state authorities
28 that provide for the amount that a beneficiary of an outright pecuniary amount is
29 entitled to receive are collected in Richard B. Covey, *Marital Deduction and Credit*
30 *Shelter Dispositions and the Use of Formula Provisions*, App. B (Supp. 1997).

31 **Administration expenses and interest on death taxes.** Under Section
32 6-201(2)(B) a fiduciary may pay administration expenses and interest on death taxes
33 from either income or principal. An advantage of permitting the fiduciary to choose
34 the source of the payment is that, if the fiduciary’s decision is consistent with the
35 decision to deduct these expenses for income tax purposes or estate tax purposes, it
36 eliminates the need to adjust between principal and income that may arise when, for
37 example, an expense that is paid from principal is deducted for income tax purposes
38 or an expense that is paid from income is deducted for estate tax purposes.

1 The United States Supreme Court has considered the question of whether an
2 estate tax marital deduction or charitable deduction should be reduced when
3 administration expenses are paid from income produced by property passing in trust
4 for a surviving spouse or for charity and deducted for income tax purposes. The
5 Court rejected the IRS position that administration expenses properly paid from
6 income under the terms of the trust or state law must reduce the amount of a marital
7 or charitable transfer, and held that the value of the transferred property is not
8 reduced for estate tax purposes unless the administration expenses are material in
9 light of the income the trust corpus could have been expected to generate.
10 *Commissioner v. Estate of Otis C. Hubert*, 117 S.Ct. 1124 (1997). The provision in
11 Section 6-201(2)(B) permits a fiduciary to pay and deduct administration expenses
12 from income only to the extent that it will not cause the reduction or loss of an
13 estate tax marital or charitable contributions deduction, which means that the limit
14 on the amount payable from income will be established eventually by Treasury
15 Regulations.

16 **Interest on estate taxes.** The IRS agrees that interest on estate and
17 inheritance taxes may be deducted for income tax purposes without having to
18 reduce the estate tax deduction for amounts passing to a charity or surviving spouse,
19 whether the interest is paid from principal or income. Rev. Rul. 93-48, 93-2 C.B.
20 270. For estates of persons who died before 1998, a fiduciary may not want to
21 deduct for income tax purposes interest on estate tax that is deferred under Section
22 6166 or 6163 because deducting that interest for estate tax purposes may produce
23 more beneficial results, especially if the estate has little or no income or the income
24 tax bracket is significantly lower than the estate tax bracket. For estates of persons
25 who die after 1997, no estate tax or income tax deduction will be allowed for
26 interest paid on estate tax that is deferred under Section 6166. However, interest on
27 estate tax deferred under Section 6163 will continue to be deductible for both
28 purposes, and interest on estate tax deficiencies will continue to be deductible for
29 estate tax purposes if an election under Section 6166 is not in effect.

30 Under the 1962 Act, Section 13(c)(5) charges interest on estate and
31 inheritance taxes to principal. The 1931 Act has no provision. Section 6-501(3) of
32 this Act provides that, except to the extent provided in Section 6-201(2)(B) or (C),
33 all interest must be paid from income.

34 **SECTION 6-202. DISTRIBUTION TO RESIDUARY AND REMAINDER**
35 **BENEFICIARIES.**

1 (a) Each beneficiary described in Section 6-201(4) is entitled to receive a
2 portion of the net income equal to the beneficiary's fractional interest in
3 undistributed principal assets, using values as of the distribution date. If a fiduciary
4 makes more than one distribution of assets to beneficiaries to whom this section
5 applies, each beneficiary, including one who does not receive part of the
6 distribution, is entitled, as of each distribution date, to the net income the fiduciary
7 has received after the date of death or terminating event or earlier distribution date
8 but has not distributed as of the current distribution date.

9 (b) In determining a beneficiary's share of net income, the following rules
10 apply:

11 (1) The beneficiary is entitled to receive a portion of the net income
12 equal to the beneficiary's fractional interest in the undistributed principal assets
13 immediately before the distribution date, including assets that later may be sold to
14 meet principal obligations.

15 (2) The beneficiary's fractional interest in the undistributed principal
16 assets must be calculated without regard to property specifically given to a
17 beneficiary and property required to pay pecuniary amounts not in trust.

18 (3) The beneficiary's fractional interest in the undistributed principal
19 assets must be calculated on the basis of the aggregate value of those assets as of the
20 distribution date without reducing the value by any unpaid principal obligation.

1 provision would apply, for example, if a settlor creates a trust for grandchildren
2 before any grandchildren are born. When the first grandchild is born, the period
3 preceding the date of birth is treated as having ended, followed by a successive
4 income interest, and the apportionment rules in Sections 6-302 and 6-303 apply
5 accordingly if the terms of the trust do not contain different provisions.

6 **SECTION 6-302. APPORTIONMENT OF RECEIPTS AND**
7 **DISBURSEMENTS WHEN DECEDENT DIES OR INCOME INTEREST**
8 **BEGINS.**

9 (a) A trustee shall allocate an income receipt or disbursement other than one
10 to which Section 6-201(1) applies to principal if its due date occurs before a
11 decedent dies in the case of an estate or before an income interest begins in the case
12 of a trust or successive income interest.

13 (b) A trustee shall allocate an income receipt or disbursement to income if
14 its due date occurs on or after the date on which a decedent dies or an income
15 interest begins and it is a periodic due date. An income receipt or disbursement
16 must be treated as accruing from day to day if its due date is not periodic or it has
17 no due date. The portion of the receipt or disbursement accruing before the date on
18 which a decedent dies or an income interest begins must be allocated to principal
19 and the balance must be allocated to income.

20 (c) An item of income or an obligation is due on the date the payer is
21 required to make a payment. If a payment date is not stated, there is no due date for
22 the purposes of this [article]. Distributions to shareholders or other owners from an
23 entity to which Section 6-401 applies are deemed to be due on the date fixed by the

1 entity for determining who is entitled to receive the distribution or, if no date is
2 fixed, on the declaration date for the distribution. A due date is periodic for receipts
3 or disbursements that must be paid at regular intervals under a lease or an obligation
4 to pay interest or if an entity customarily makes distributions at regular intervals.

5 **Comment**

6 **Prior Acts.** Professor Bogert stated that “Section 4 of the [1962] Act
7 makes a change with respect to the apportionment of the income of trust property
8 not due until after the trust began but which accrued in part before the
9 commencement of the trust. It treats such income as to be credited entirely to the
10 income account in the case of a living trust, but to be apportioned between capital
11 and income in the case of a testamentary trust. The [1931] Act apportions such
12 income in the case of both types of trusts, except in the case of corporate
13 dividends.” George G. Bogert, *The Revised Uniform Principal and Income Act*, 38
14 *Notre Dame Law. 50, 52* (1962). The 1962 Act also provides that an asset passing
15 to an inter vivos trust by a bequest in the settlor’s will is governed by the rule that
16 applies to a testamentary trust, so that different rules apply to assets passing to an
17 inter vivos trust depending upon whether they were transferred to the trust during
18 the settlor’s life or by his will.

19 Having several different rules that apply to similar transactions is confusing.
20 In order to simplify administration, Section 6-302 applies the same rule to inter
21 vivos trusts (revocable and irrevocable), testamentary trusts, and assets that become
22 subject to an inter vivos trust by a testamentary bequest.

23 **Periodic payments.** Under Section 6-302, a periodic payment is principal if
24 it is due but unpaid before a decedent dies or before an asset becomes subject to a
25 trust, but the next payment is allocated entirely to income and is not apportioned.
26 Thus, periodic receipts such as rents, dividends, interest, and annuities, and
27 disbursements such as the interest portion of a mortgage payment, are not
28 apportioned. This is the original common law rule. Edwin A. Howes, Jr., *The*
29 *American Law Relating to Income and Principal* 70 (1905). In trusts in which a
30 surviving spouse is dependent upon a regular flow of cash from the decedent’s
31 securities portfolio, this rule will help to maintain payments to the spouse at the
32 same level as before the settlor’s death. Under the 1962 Act, the pre-death portion
33 of the first periodic payment due after death is apportioned to principal in the case of
34 a testamentary trust or securities bequeathed by will to an inter vivos trust.

35 **Nonperiodic payments.** Under the second sentence of Section 6-302(b),
36 interest on an obligation that does not provide a due date for the interest payment,

1 such as interest on an income tax refund, would be apportioned to principal to the
2 extent it accrues before a person dies or an income interest begins unless the
3 obligation is specifically given to a devisee or remainder beneficiary, in which case
4 all of the accrued interest passes under Section 6-201(1) to the person who receives
5 the obligation. The same rule applies to interest on an obligation that has a due date
6 but does not provide for periodic payments. If there is no stated interest on the
7 obligation, such as a zero coupon bond, and the proceeds from the obligation are
8 received more than one year after it is purchased or acquired by the trustee, the
9 entire amount received is principal under Section 6-406.

10 **SECTION 6-303. APPORTIONMENT WHEN INCOME INTEREST**

11 **ENDS.**

12 (a) In this section, “undistributed income” means net income received before
13 the date on which an income interest ends. The term does not include an item of
14 income or expense that is due or accrued or net income that has been added or is
15 required to be added to principal under the terms of the trust.

16 (b) When a mandatory income interest ends, the trustee shall pay to a
17 mandatory income beneficiary who survives that date, or the estate of a deceased
18 mandatory income beneficiary whose death causes the interest to end, the
19 beneficiary’s share of the undistributed income that is not disposed of under the
20 terms of the trust unless the beneficiary has an unqualified power to revoke more
21 than five percent of the trust immediately before the income interest ends. In the
22 latter case, the undistributed income from the portion of the trust that may be
23 revoked must be added to principal.

24 (c) When a trustee’s obligation to pay a fixed annuity or a fixed fraction of
25 the value of the trust’s assets ends, the trustee shall prorate the final payment if and

1 to the extent required by applicable law to accomplish a purpose of the trust or its
2 settlor relating to income, gift, estate, or other tax requirements.

3 **Comment**

4 **Prior Acts.** Both the 1931 Act (Section 4) and the 1962 Act (Section 4(d))
5 provide that a deceased income beneficiary's estate is entitled to the undistributed
6 income. The Drafting Committee concluded that this is probably not what most
7 settlors would want, and that, with respect to undistributed income, most settlors
8 would favor the income beneficiary first, the remainder beneficiaries second, and the
9 income beneficiary's heirs last, if at all. However, it decided not to eliminate this
10 provision to avoid causing disputes about whether the trustee should have
11 distributed collected cash before the income beneficiary died.

12 **Accrued periodic payments.** Under the prior Acts, an income beneficiary
13 or his estate is entitled to receive a portion of any payments, other than dividends,
14 that are due or that have accrued when the income interest terminates. The last
15 sentence of subsection (a) changes that rule by providing that such items are not
16 included in undistributed income. The items affected include periodic payments of
17 interest, rent, and dividends, as well as items of income that accrue over a longer
18 period of time; the rule also applies to expenses that are due or accrued.

19 **Example – accrued periodic payments.** The rules in Section 6-302 and
20 Section 6-303 work in the following manner: Assume that a periodic payment
21 of rent that is due on July 20 has not been paid when an income interest ends on
22 July 30; the successive income interest begins on July 31, and the rent payment
23 that was due on July 20 is paid on August 3. Under Section 6-302(a), the July
24 20 payment is added to the principal of the successive income interest when
25 received. Under Section 6-302(b), the entire periodic payment of rent that is
26 due on August 20 is income when received by the successive income interest.
27 Under Section 6-303, neither the income beneficiary of the terminated income
28 interest nor the beneficiary's estate is entitled to any part of either the July 20 or
29 the August 20 payments because neither one was received before the income
30 interest ended on July 30. The same principles apply to expenses of the trust.

31 **Beneficiary with an unqualified power to revoke.** The requirement in
32 subsection (b) to pay undistributed income to a mandatory income beneficiary or her
33 estate does not apply to the extent the beneficiary has an unqualified power to
34 revoke more than five percent of the trust immediately before the income interest
35 ends. Without this exception, subsection (b) would apply to a revocable living trust
36 whose settlor is the mandatory income beneficiary during her lifetime, even if her
37 will provides that all of the assets in the probate estate are to be distributed to the
38 trust.

1 (4) money received from an entity that is a regulated investment
2 company or a real estate investment trust if the money distributed is a capital gain
3 dividend for federal income tax purposes.

4 (d) Money is received in partial liquidation:

5 (1) to the extent that the entity, at or near the time of a distribution,
6 indicates that it is a distribution in partial liquidation; or

7 (2) if the total amount of money and property received in a distribution
8 or series of related distributions is greater than 20 percent of the entity's gross
9 assets, as shown by the entity's year-end financial statements immediately preceding
10 the initial receipt.

11 (e) Money is not received in partial liquidation, nor may it be taken into
12 account under subsection (d)(2), to the extent that it does not exceed the amount of
13 income tax that a trustee or beneficiary must pay on taxable income of the entity that
14 distributes the money.

15 (f) A trustee may rely upon a statement made by an entity about the source
16 or character of a distribution if the statement is made at or near the time of
17 distribution by the entity's board of directors or other person or group of persons
18 authorized to exercise powers to pay money or transfer property comparable to
19 those of a corporation's board of directors.

20 **Comment**

21 **Entities to which Section 6-401 applies.** The reference to partnerships in
22 Section 6-401(a) is intended to include all forms of partnerships, including limited
23 partnerships, limited liability partnerships, and variants that have slightly different
24 names and characteristics from State to State. The section does not apply, however,

1 to receipts from an interest in property that a trust owns as a tenant in common with
2 one or more co-owners, nor would it apply to an interest in a joint venture if, under
3 applicable law, the trust's interest is regarded as that of a tenant in common.

4 **Capital gain dividends.** Under the Internal Revenue Code and the Income
5 Tax Regulations, a "capital gain dividend" from a mutual fund or real estate
6 investment trust is the excess of the fund's or trust's net long-term capital gain over
7 its net short-term capital loss. As a result, a capital gain dividend does not include
8 any net short-term capital gain, and cash received by a trust because of a net short-
9 term capital gain is income under this Act.

10 **Reinvested dividends.** If a trustee elects (or continues an election made by
11 its predecessor) to reinvest dividends in shares of stock of a distributing corporation
12 or fund, whether evidenced by new certificates or entries on the books of the
13 distributing entity, the new shares would be principal, but the trustee may determine,
14 after considering the return from the portfolio as a whole, whether an adjustment
15 under Section 6-104 is necessary as a result.

16 **Distribution of property.** The 1962 Act describes a number of types of
17 property that would be principal if distributed by a corporation. This becomes
18 unwieldy in a section that applies to both corporations and all other entities. By
19 stating that principal includes the distribution of any property other than money,
20 Section 6-401 embraces all of the items enumerated in Section 6 of the 1962 Act as
21 well as any other form of nonmonetary distribution not specifically mentioned in that
22 Act.

23 **Partial liquidations.** Under subsection (d)(1), any distribution designated
24 by the entity as a partial liquidating distribution is principal regardless of the
25 percentage of total assets that it represents. If a distribution exceeds 20% of the
26 entity's gross assets, the entire distribution is a partial liquidation under subsection
27 (d)(2) whether or not the entity describes it as a partial liquidation. In determining
28 whether a distribution is greater than 20% of the gross assets, the portion of the
29 distribution that does not exceed the amount of income tax that the trustee or a
30 beneficiary must pay on the entity's taxable income is ignored.

31 **Other large distributions.** A cash distribution may be quite large (for
32 example, more than 10% but not more than 20% of the entity's gross assets) and
33 have characteristics that suggest it should be treated as principal rather than income.
34 For example, an entity may have received cash from a source other than the conduct
35 of its normal business operations because it sold an investment asset; or because it
36 sold a business asset other than one held for sale to customers in the normal course
37 of its business and did not replace it; or it borrowed a large sum of money and
38 secured the repayment of the loan with a substantial asset; or a principal source of

1 its cash was from assets such as mineral interests, 90% of which would have been
2 allocated to principal if the trust had owned the assets directly. In such a case the
3 trustee, after considering the total return from the portfolio as a whole and the
4 income component of that return, may decide to exercise the power under Section
5 6-104(a) to make an adjustment between income and principal, subject to the
6 limitations in Section 6-104(c).

7 **SECTION 6-402. DISTRIBUTION FROM TRUST OR ESTATE. A**

8 trustee shall allocate to income an amount received as a distribution of income from
9 a trust or an estate in which the trust has an interest other than a purchased interest,
10 and shall allocate to principal an amount received as a distribution of principal from
11 such a trust or estate. If a trustee purchases an interest in a trust that is an
12 investment entity, or a decedent or donor transfers an interest in such a trust to a
13 trustee, Section 6-401 or 6-415 applies to a receipt from the trust.

14 **Comment**

15 **Terms of the distributing trust or estate.** Under Section 6-103(a), a
16 trustee is to allocate receipts in accordance with the terms of the recipient trust or, if
17 there is no provision, in accordance with this Act. However, in determining whether
18 a distribution from another trust or an estate is income or principal, the trustee
19 should also determine what the terms of the distributing trust or estate say about the
20 distribution – for example, whether they direct that the distribution, even though
21 made from the income of the distributing trust or estate, is to be added to principal
22 of the recipient trust. Such a provision should override the terms of this Act, but if
23 the terms of the recipient trust contain a provision requiring such a distribution to be
24 allocated to income, the trustee may have to obtain a judicial resolution of the
25 conflict between the terms of the two documents.

26 **Investment trusts.** An investment entity to which the second sentence of
27 this section applies includes a mutual fund, a common trust fund, a business trust or
28 other entity organized as a trust for the purpose of receiving capital contributed by
29 investors, investing that capital, and managing investment assets, including
30 asset-backed security arrangements to which Section 415 applies. See John H.
31 Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*,
32 107 *Yale L.J.* 165 (1997).

1 **SECTION 6-403. BUSINESS AND OTHER ACTIVITIES CONDUCTED**
2 **BY TRUSTEE.**

3 (a) If a trustee who conducts a business or other activity determines that it
4 is in the best interest of all the beneficiaries to account separately for the business or
5 activity instead of accounting for it as part of the trust's general accounting records,
6 the trustee may maintain separate accounting records for its transactions, whether or
7 not its assets are segregated from other trust assets.

8 (b) A trustee who accounts separately for a business or other activity may
9 determine the extent to which its net cash receipts must be retained for working
10 capital, the acquisition or replacement of fixed assets, and other reasonably
11 foreseeable needs of the business or activity, and the extent to which the remaining
12 net cash receipts are accounted for as principal or income in the trust's general
13 accounting records. If a trustee sells assets of the business or other activity, other
14 than in the ordinary course of the business or activity, the trustee shall account for
15 the net amount received as principal in the trust's general accounting records to the
16 extent the trustee determines that the amount received is no longer required in the
17 conduct of the business.

18 (c) Activities for which a trustee may maintain separate accounting records
19 include:

- 20 (1) retail, manufacturing, service, and other traditional business activities;
- 21 (2) farming;
- 22 (3) raising and selling livestock and other animals;

- 1 (4) management of rental properties;
- 2 (5) extraction of minerals and other natural resources;
- 3 (6) timber operations; and
- 4 (7) activities to which Section 6-414 applies.

5 **Comment**

6 **Purpose and scope.** The provisions in Section 6-403 are intended to give
7 greater flexibility to a trustee who operates a business or other activity in
8 proprietorship form rather than in a wholly-owned corporation (or, where permitted
9 by state law, a single-member limited liability company), and to facilitate the
10 trustee’s ability to decide the extent to which the net receipts from the activity
11 should be allocated to income, just as the board of directors of a corporation owned
12 entirely by the trust would decide the amount of the annual dividend to be paid to
13 the trust. It permits a trustee to account for farming or livestock operations, rental
14 properties, oil and gas properties, timber operations, and activities in derivatives and
15 options as though they were held by a separate entity. It is not intended, however,
16 to permit a trustee to account separately for a traditional securities portfolio to
17 avoid the provisions of this Act that apply to such securities.

18 Section 6-403 permits the trustee to account separately for each business or
19 activity for which the trustee determines separate accounting is appropriate. A
20 trustee with a computerized accounting system may account for these activities in a
21 “subtrust”; an individual trustee may continue to use the business and record-
22 keeping methods employed by the decedent or transferor who may have conducted
23 the business under an assumed name. The intent of this section is to give the trustee
24 broad authority to select business record-keeping methods that best suit the activity
25 in which the trustee is engaged.

26 If a fiduciary liquidates a sole proprietorship or other activity to which
27 Section 6-403 applies, the proceeds would be added to principal, even though
28 derived from the liquidation of accounts receivable, because the proceeds would no
29 longer be needed in the conduct of the business. If the liquidation occurs during
30 probate or during an income interest’s winding up period, none of the proceeds
31 would be income for purposes of Section 6-201.

32 **Separate accounts.** A trustee may or may not maintain separate bank
33 accounts for business activities that are accounted for under Section 6-403. A
34 professional trustee may decide not to maintain separate bank accounts, but an
35 individual trustee, especially one who has continued a decedent’s business practices,
36 may continue the same banking arrangements that were used during the decedent’s

1 lifetime. In either case, the trustee is authorized to decide to what extent cash is to
2 be retained as part of the business assets and to what extent it is to be transferred to
3 the trust's general accounts, either as income or principal.

4 **SECTION 6-404. PRINCIPAL RECEIPTS.** A trustee shall allocate to
5 principal:

6 (1) to the extent not allocated to income under this [article], assets received
7 from a transferor during the transferor's lifetime, a decedent's estate, a trust with a
8 terminating income interest, or a payer under a contract naming the trust or its
9 trustee as beneficiary;

10 (2) money or other property received from the sale, exchange, liquidation, or
11 change in form of a principal asset, including realized profit, subject to this [article];

12 (3) amounts recovered from third parties to reimburse the trust because of
13 disbursements described in Section 6-502(a)(7) or for other reasons to the extent
14 not based on the loss of income;

15 (4) proceeds of property taken by eminent domain, but a separate award
16 made for the loss of income with respect to an accounting period during which a
17 current income beneficiary had a mandatory income interest is income;

18 (5) net income received in an accounting period during which there is no
19 beneficiary to whom a trustee may or must distribute income; and

20 (6) other receipts as provided in [Part 3].

21 **Comment**

22 **Eminent domain awards.** Even though the award in an eminent domain
23 proceeding may include an amount for the loss of future rent on a lease, if that

1 received as consideration for prepaying principal, must be allocated to income
2 without any provision for amortization of premium.

3 (b) A trustee shall allocate to principal an amount received from the sale,
4 redemption, or other disposition of an obligation to pay money to the trustee more
5 than one year after it is purchased or acquired by the trustee, including an obligation
6 whose purchase price or value when it is acquired is less than its value at maturity.
7 If the obligation matures within one year after it is purchased or acquired by the
8 trustee, an amount received in excess of its purchase price or its value when
9 acquired by the trust must be allocated to income.

10 (c) This section does not apply to an obligation to which Section 6-409,
11 6-410, 6-411, 6-412, 6-414, or 6-415 applies.

12 **Comment**

13 **Variable or floating interest rates.** The reference in subsection (a) to
14 variable or floating interest rate obligations is intended to clarify that, even though
15 an obligation's interest rate may change from time to time based upon changes in an
16 index or other market indicator, an obligation to pay money containing a variable or
17 floating rate provision is subject to this section and is not to be treated as a
18 derivative financial instrument under Section 6-414.

19 **Discount obligations.** Subsection (b) applies to all obligations acquired at a
20 discount, including short-term obligations such as U.S. Treasury Bills, long-term
21 obligations such as U.S. Savings Bonds, zero-coupon bonds, and discount bonds
22 that pay interest during part, but not all, of the period before maturity. Under
23 subsection (b), the entire increase in value of these obligations is principal when the
24 trustee receives the proceeds from the disposition unless the obligation, when
25 acquired, has a maturity of less than one year. In order to have one rule that applies
26 to all discount obligations, the Act eliminates the provision in the 1962 Act for the
27 payment from principal of an amount equal to the increase in the value of U.S.
28 Series E bonds. The provision for bonds that mature within one year after
29 acquisition by the trustee is derived from the Illinois act. 760 ILCS 15/8 (1996).

1 Subsection (b) also applies to inflation-indexed bonds – any increase in
2 principal due to inflation after issuance is principal upon redemption if the bond
3 matures more than one year after the trustee acquires it; if it matures within one
4 year, all of the increase, including any attributable to an inflation adjustment, is
5 income.

6 **Effect of Section 6-104.** In deciding whether and to what extent to exercise
7 the power to adjust between principal and income granted by Section 6-104(a), a
8 relevant factor for the trustee to consider is the effect on the portfolio as a whole of
9 having a portion of the assets invested in bonds that do not pay interest currently.

10 **SECTION 6-407. INSURANCE POLICIES AND SIMILAR**

11 **CONTRACTS.**

12 (a) Except as otherwise provided in subsection (b), a trustee shall allocate to
13 principal the proceeds of a life insurance policy or other contract in which the trust
14 or its trustee is named as beneficiary, including a contract that insures the trust or its
15 trustee against loss for damage to, destruction of, or loss of title to a trust asset.

16 The trustee shall allocate dividends on an insurance policy to income if the premiums
17 on the policy are paid from income, and to principal if the premiums are paid from
18 principal.

19 (b) A trustee shall allocate to income proceeds of a contract that insures the
20 trustee against loss of occupancy or other use by an income beneficiary, loss of
21 income, or, subject to Section 6-403, loss of profits from a business.

22 (c) This section does not apply to a contract to which Section 6-409 applies.

23 **SECTION 6-408. INSUBSTANTIAL ALLOCATIONS NOT REQUIRED.**

24 If a trustee determines that an allocation between principal and income required by

1 Section 6-409, 6-410, 6-411, 6-412, or 6-415 is insubstantial, the trustee may
2 allocate the entire amount to principal unless one of the circumstances described in
3 Section 6-104(c) applies to the allocation. This power may be exercised by a
4 cotrustee in the circumstances described in Section 6-104(d) and may be released
5 for the reasons and in the manner described in Section 6-104(e). An allocation is
6 presumed to be insubstantial if:

7 (1) the amount of the allocation would increase or decrease net income in an
8 accounting period, as determined before the allocation, by less than 10 percent; or

9 (2) the value of the asset producing the receipt for which the allocation
10 would be made is less than 10 percent of the total value of the trust's assets at the
11 beginning of the accounting period.

12 **Comment**

13 This section is intended to relieve a trustee from making relatively small
14 allocations while preserving the trustee's right to do so if an allocation is large in
15 terms of absolute dollars.

16 For example, assume that a trust's assets, which include a working interest in
17 an oil well, have a value of \$1,000,000; the net income from the assets other than
18 the working interest is \$40,000; and the net receipts from the working interest are
19 \$400. The trustee may allocate all of the net receipts from the working interest to
20 principal instead of allocating 10%, or \$40, to income under Section 6-411. If the
21 net receipts from the working interest are \$35,000, so that the amount allocated to
22 income under Section 6-411 would be \$3,500, the trustee may decide that this
23 amount is sufficiently significant to the income beneficiary that the allocation
24 provided for by Section 411 should be made, even though the trustee is still
25 permitted under Section 6-408 to allocate all of the net receipts to principal because
26 the \$3,500 would increase the net income of \$40,000, as determined before making
27 an allocation under Section 6-411, by less than 10%. Section 6-408 will also relieve
28 a trustee from having to allocate net receipts from the sale of trees in a small
29 woodlot between principal and income.

1 While the allocation to principal of small amounts under this section should
2 not be a cause for concern for tax purposes, allocations are not permitted under this
3 section in circumstances described in Section 6-104(c) to eliminate claims that the
4 power in this section has adverse tax consequences.

5 **SECTION 6-409. DEFERRED COMPENSATION, ANNUITIES, AND**
6 **SIMILAR PAYMENTS.**

7 (a) In this section, “payment” means a payment that a trustee may receive
8 over a fixed number of years or during the life of one or more individuals because of
9 services rendered or property transferred to the payer in exchange for future
10 payments. The term includes a payment made in money or property from the
11 payer’s general assets or from a separate fund created by the payer, including a
12 private or commercial annuity, an individual retirement account, and a pension,
13 profit-sharing, stock-bonus, or stock-ownership plan.

14 (b) To the extent that a payment is characterized as interest or a dividend or
15 a payment made in lieu of interest or a dividend, a trustee shall allocate it to income.
16 The trustee shall allocate to principal the balance of the payment and any other
17 payment received in the same accounting period that is not characterized as interest,
18 a dividend, or an equivalent payment.

19 (c) If no part of a payment is characterized as interest, a dividend, or an
20 equivalent payment, and all or part of the payment is required to be made, a trustee
21 shall allocate to income 10 percent of the part that is required to be made during the
22 accounting period and the balance to principal. If no part of a payment is required
23 to be made or the payment received is the entire amount to which the trustee is

1 entitled, the trustee shall allocate the entire payment to principal. For purposes of
2 this subsection, a payment is not “required to be made” to the extent that it is made
3 because the trustee exercises a right of withdrawal.

4 (d) If, to obtain an estate tax marital deduction for a trust, a trustee must
5 allocate more of a payment to income than provided for by this section, the trustee
6 shall allocate to income the additional amount necessary to obtain the marital
7 deduction.

8 (e) This section does not apply to payments to which Section 5-410 applies.

9 **Comment**

10 **Scope.** Section 6-409 applies to amounts received under contractual
11 arrangements that provide for payments to a third party beneficiary as a result of
12 services rendered or property transferred to the payer. While the right to receive
13 such payments is a liquidating asset of the kind described in Section 6-410 (i.e., “an
14 asset whose value will diminish or terminate because the asset is expected to
15 produce receipts for a period of limited duration”), these payment rights are covered
16 separately in Section 6-409 because of their special characteristics.

17 Section 6-409 applies to receipts from all forms of annuities and deferred
18 compensation arrangements, whether the payment will be received by the trust in a
19 lump sum or in installments over a period of years. It applies to bonuses that may
20 be received over two or three years and payments that may last for much longer
21 periods, including payments from an individual retirement account (IRA), deferred
22 compensation plan (whether qualified or not qualified for special federal income tax
23 treatment), and insurance renewal commissions. It applies to a retirement plan to
24 which the settlor has made contributions, just as it applies to an annuity policy that
25 the settlor may have purchased individually, and it applies to variable annuities,
26 deferred annuities, annuities issued by commercial insurance companies, and
27 “private annuities” arising from the sale of property to another individual or entity in
28 exchange for payments that are to be made for the life of one or more individuals.
29 The section applies whether the payments begin when the payment right becomes
30 subject to the trust or are deferred until a future date, and it applies whether
31 payments are made in cash or in kind, such as employer stock (in-kind payments
32 usually will be made in a single distribution that will be allocated to principal under
33 the second sentence of subsection (c)).

1 **The 1962 Act.** Under Section 12 of the 1962 Act, receipts from “rights to
2 receive payments on a contract for deferred compensation” are allocated to income
3 each year in an amount “not in excess of 5% per year” of the property’s inventory
4 value. While “not in excess of 5%” suggests that the annual allocation may range
5 from zero to 5% of the inventory value, in practice the rule is usually treated as
6 prescribing a 5% allocation. The inventory value is usually the present value of all
7 the future payments, and since the inventory value is determined as of the date on
8 which the payment right becomes subject to the trust, the inventory value, and thus
9 the amount of the annual income allocation, depends significantly on the applicable
10 interest rate on the decedent’s date of death. That rate may be much higher or
11 lower than the average long-term interest rate. The amount determined under the
12 5% formula tends to become fixed and remain unchanged even though the amount
13 received by the trust increases or decreases.

14 **Allocations Under Section 6-409(b).** Section 6-409(b) applies to plans
15 whose terms characterize payments made under the plan as dividends, interest, or
16 payments in lieu of dividends or interest. For example, some deferred compensation
17 plans that hold debt obligations or stock of the plan’s sponsor in an account for
18 future delivery to the person rendering the services provide for the annual payment
19 to that person of dividends received on the stock or interest received on the debt
20 obligations. Other plans provide that the account of the person rendering the
21 services shall be credited with “phantom” shares of stock and require an annual
22 payment that is equivalent to the dividends that would be received on that number of
23 shares if they were actually issued; or a plan may entitle the person rendering the
24 services to receive a fixed dollar amount in the future and provide for the annual
25 payment of interest on the deferred amount during the period prior to its payment.
26 Under Section 6-409(b), payments of dividends, interest or payments in lieu of
27 dividends or interest under plans of this type are allocated to income; all other
28 payments received under these plans are allocated to principal.

29 Section 6-409(b) does not apply to an IRA or an arrangement with payment
30 provisions similar to an IRA. IRAs and similar arrangements are subject to the
31 provisions in Section 6-409(c).

32 **Allocations Under Section 6-409(c).** The focus of Section 6-409, for
33 purposes of allocating payments received by a trust to or between principal and
34 income, is on the payment right rather than on assets that may be held in a fund from
35 which the payments are made. Thus, if an IRA holds a portfolio of marketable
36 stocks and bonds, the amount received by the IRA as dividends and interest is not
37 taken into account in determining the principal and income allocation except to the
38 extent that the Internal Revenue Service may require them to be taken into account
39 when the payment is received by a trust that qualifies for the estate tax marital
40 deduction (a situation that is provided for in Section 6-409(d)). An IRA is subject

1 to federal income tax rules that require payments to begin by a particular date and be
2 made over a specific number of years or a period measured by the lives of one or
3 more persons. The payment right of a trust that is named as a beneficiary of an IRA
4 is not a right to receive particular items that are paid to the IRA, but is instead the
5 right to receive an amount determined by dividing the value of the IRA by the
6 remaining number of years in the payment period. This payment right is similar to
7 the right to receive a unitrust amount, which is normally expressed as an amount
8 equal to a percentage of the value of the unitrust assets without regard to dividends
9 or interest that may be received by the unitrust.

10 An amount received from an IRA or a plan with a payment provision similar
11 to that of an IRA is allocated under Section 6-409(c), which differentiates between
12 payments that are required to be made and all other payments. To the extent that a
13 payment is required to be made (either under federal income tax rules or, in the case
14 of a plan that is not subject to those rules, under the terms of the plan), 10% of the
15 amount received is allocated to income and the balance is allocated to principal. All
16 other payments are allocated to principal because they represent a change in the
17 form of a principal asset; Section 6-409 follows the rule in Section 6-404(2), which
18 provides that money or property received from a change in the form of a principal
19 asset be allocated to principal.

20 Section 6-409(c) produces an allocation to income that is similar to the
21 allocation under the 1962 Act formula if the annual payments are the same
22 throughout the payment period, and it is simpler to administer. The amount
23 allocated to income under Section 6-409 is not dependent upon the interest rate that
24 is used for valuation purposes when the decedent dies, and if the payments received
25 by the trust increase or decrease from year to year because the fund from which the
26 payment is made increases or decreases in value, the amount allocated to income
27 will also increase or decrease.

28 **Marital deduction requirements.** When an IRA is payable to a QTIP
29 marital deduction trust, the IRS treats the IRA as separate terminable interest
30 property and requires that a QTIP election be made for it. In order to qualify for
31 QTIP treatment, an IRS ruling states that all of the IRA's income must be
32 distributed annually to the QTIP marital deduction trust and then must be allocated
33 to trust income for distribution to the spouse. Rev. Rul. 89-89, 1989-2 C.B. 231. If
34 an allocation to income under this Act of 10% of the required distribution from the
35 IRA does not meet the requirement that all of the IRA's income be distributed from
36 the trust to the spouse, the provision in subsection (d) requires the trustee to make a
37 larger allocation to income to the extent necessary to qualify for the marital
38 deduction. The requirement of Rev. Rul. 89-89 should also be satisfied if the IRA
39 beneficiary designation permits the spouse to require the trustee to withdraw the
40 necessary amount from the IRA and distribute it to her, even though the spouse

1 royalties on a patent or copyright increase significantly. Conversely, if the receipts
2 diminish more rapidly than expected, most of the amount received by the trust will
3 be allocated to income and little to principal. Moreover, if the annual payments
4 remain the same for the life of the asset, the amount allocated to principal will
5 usually be less than the original inventory value. For these reasons, Section 6-410
6 abandons the annuity approach under the 5% rule.

7 **Lottery payments.** The reference in subsection (a) to rights to receive
8 payments under an arrangement that does not provide for the payment of interest
9 includes state lottery prizes and similar fixed amounts payable over time that are not
10 deferred compensation arrangements covered by Section 6-409.

11 **SECTION 6-411. MINERALS, WATER, AND OTHER NATURAL**
12 **RESOURCES.**

13 (a) To the extent that a trustee accounts for receipts from an interest in
14 minerals or other natural resources pursuant to this section, the trustee shall allocate
15 them as follows:

16 (1) If received as nominal delay rental or nominal annual rent on a lease,
17 a receipt must be allocated to income.

18 (2) If received from a production payment, a receipt must be allocated
19 to income if and to the extent that the agreement creating the production payment
20 provides a factor for interest or its equivalent. The balance must be allocated to
21 principal.

22 (3) If an amount received as a royalty, shut-in-well payment, take-or-
23 pay payment, bonus, or delay rental is more than nominal, 90 percent must be
24 allocated to principal and the balance to income.

1 out as income. As wells are depleted, the amount received by the income
2 beneficiary falls drastically. Allocating a larger portion of the receipts to principal
3 enables the trustee to acquire other income producing assets that will continue to
4 produce income when the mineral reserves are exhausted.

5 **Application of Sections 6-403 and 6-408.** This section applies to the
6 extent that the trustee does not account separately for receipts from minerals and
7 other natural resources under Section 403 or allocate all of the receipts to principal
8 under Section 6-408.

9 **Open mine doctrine.** The purpose of Section 6-411(c) is to abolish the
10 “open mine doctrine” as it may apply to the rights of an income beneficiary and a
11 remainder beneficiary in receipts from the production of minerals from land owned
12 or leased by a trust. Instead, such receipts are to be allocated to or between
13 principal and income in accordance with the provisions of this Act. For a discussion
14 of the open mine doctrine, see generally 3A Austin W. Scott & William F. Fratcher,
15 The Law of Trusts § 239.3 (4th ed. 1988), and *Nutter v. Stockton*, 626 P.2d 861
16 (Okla. 1981).

17 **Effective date provision.** Section 9(b) of the 1962 Act provides that the
18 natural resources provision does not apply to property interests held by the trust on
19 the effective date of the Act, which reflects concerns about the constitutionality of
20 applying a retroactive administrative provision to interests in real estate, based on
21 the opinion in the Oklahoma case of *Franklin v. Margay Oil Corporation*, 153 P.2d
22 486, 501 (Okla. 1944). Section 6-411(d) permits a trustee to use either the method
23 provided for in this Act or the method used before the Act takes effect. Lawyers in
24 jurisdictions other than Oklahoma may conclude that retroactivity is not a problem
25 as to property situated in their States, and this provision permits trustees to decide,
26 based on advice from counsel in States whose law may be different from that of
27 Oklahoma, whether they may apply this provision retroactively if they conclude that
28 to do so is in the best interests of the beneficiaries.

29 If the property is in a State other than the State where the trust is
30 administered, the trustee must be aware that the law of the property’s situs may
31 control this question. The outcome turns on a variety of questions: whether the
32 terms of the trust specify that the law of a State other than the situs of the property
33 shall govern the administration of the trust, and whether the courts will follow the
34 terms of the trust; whether the trust’s asset is the land itself or a leasehold interest in
35 the land (as it frequently is with oil and gas property); whether a leasehold interest
36 or its proceeds should be classified as real property or personal property, and if as
37 personal property, whether applicable state law treats it as a movable or an
38 immovable for conflict of laws purposes. See 5A Austin W. Scott & William F.
39 Fratcher, The Law of Trusts §§ 648, at 531, 533-534; § 657, at 600 (4th ed. 1989).

1 **SECTION 6-412. TIMBER.**

2 (a) To the extent that a trustee accounts for receipts from the sale of timber
3 and related products pursuant to this section, the trustee shall allocate the net
4 receipts:

5 (1) to income to the extent that the amount of timber removed from the
6 land does not exceed the rate of growth of the timber during the accounting periods
7 in which a beneficiary has a mandatory income interest;

8 (2) to principal to the extent that the amount of timber removed from the
9 land exceeds the rate of growth of the timber or the net receipts are from the sale of
10 standing timber;

11 (3) to or between income and principal if the net receipts are from the
12 lease of timberland or from a contract to cut timber from land owned by a trust, by
13 determining the amount of timber removed from the land under the lease or contract
14 and applying the rules in paragraphs (1) and (2); or

15 (4) to principal to the extent that advance payments, bonuses, and other
16 payments are not allocated pursuant to paragraph (1), (2), or (3).

17 (b) In determining net receipts to be allocated pursuant to subsection (a), a
18 trustee shall deduct and transfer to principal a reasonable amount for depletion.

19 (c) This [article] applies whether or not a decedent or transferor was
20 harvesting timber from the property before it became subject to the trust.

1 (d) If a trust owns an interest in timberland on [the effective date of this
2 [Act]], the trustee may allocate net receipts from the sale of timber and related
3 products as provided in this [article] or in the manner used by the trustee before [the
4 effective date of this [Act]]. If the trust acquires an interest in timberland after [the
5 effective date of this [Act]], the trustee shall allocate net receipts from the sale of
6 timber and related products as provided in this [article].

7 **Comment**

8 **Scope of section.** The rules in Section 6-412 are intended to apply to net
9 receipts from the sale of trees and by-products from harvesting and processing trees
10 without regard to the kind of trees that are cut or whether the trees are cut before or
11 after a particular number of years of growth. The rules apply to the sale of trees
12 that are expected to produce lumber for building purposes, trees sold as pulpwood,
13 and Christmas and other ornamental trees. Subsection (a) applies to net receipts
14 from property owned by the trustee and property leased by the trustee. The Act is
15 not intended to prevent a tenant in possession of the property from using wood that
16 he cuts on the property for personal, noncommercial purposes, such as a Christmas
17 tree, firewood, mending old fences or building new fences, or making repairs to
18 structures on the property.

19 Under subsection (a), the amount of net receipts allocated to income
20 depends upon whether the amount of timber removed is more or less than the rate of
21 growth. The method of determining the amount of timber removed and the rate of
22 growth is up to the trustee, based on methods customarily used for the kind of
23 timber involved.

24 **Application of Sections 6-403 and 6-408.** This section applies to the
25 extent that the trustee does not account separately for net receipts from the sale of
26 timber and related products under Section 6-403 or allocate all of the receipts to
27 principal under Section 6-408. The option to account for net receipts separately
28 under Section 6-403 takes into consideration the possibility that timber harvesting
29 operations may have been conducted before the timber property became subject to
30 the trust, and that it may make sense to continue using accounting methods
31 previously established for the property. It also permits a trustee to use customary
32 accounting practices for timber operations even if no harvesting occurred on the
33 property before it became subject to the trust.

1 **Duty to make property productive of income.** In order to implement the
2 Uniform Prudent Investor Act, this Act abolishes the right to receive delayed income
3 from the sale proceeds of an asset that produces little or no income, but it does not
4 alter existing state law regarding the income beneficiary’s right to compel the trustee
5 to make property productive of income. As the law continues to develop in this
6 area, the duty to make property productive of current income in a particular
7 situation should be determined by taking into consideration the performance of the
8 portfolio as a whole and the extent to which a trustee makes principal distributions
9 to the income beneficiary under the terms of the trust and adjustments between
10 principal and income under Section 6-104 of this Act.

11 Trusts for which the value of the right to receive income is important for tax
12 reasons may be affected by Reg. § 1.7520-3(b)(2)(v) *Example (1)*,
13 § 20.7520-3(b)(2)(v) *Examples (1) and (2)*, and § 25.7520-3(b)(2)(v) *Examples (1)*
14 and (2), which provide that if the income beneficiary does not have the right to
15 compel the trustee to make the property productive, the income interest is
16 considered unproductive and may not be valued actuarially under those sections.

17 **Marital deduction trusts.** Subsection (a) draws on language in Reg.
18 § 20.2056(b)-5(f)(4) and (5) to enable a trust for a surviving spouse to qualify for a
19 marital deduction if applicable state law is unclear about the surviving spouse’s right
20 to compel the trustee to make property productive of income. The trustee should
21 also consider the application of Section 104 of this Act and the provisions of
22 Restatement of Trusts 3d: Prudent Investor Rule § 240, at 186, app. § 240, at 252
23 (1992). Example (6) in the Comment to Section 104 describes a situation involving
24 the payment from income of carrying charges on unproductive real estate in which
25 Section 6-104 may apply.

26 Once the two conditions have occurred – insufficient beneficial enjoyment
27 from the property and the spouse’s demand that the trustee take action under this
28 section – the trustee must act; but instead of the formulaic approach of the 1962
29 Act, which is triggered only if the trustee sells the property, this Act permits the
30 trustee to decide whether to make the property productive of income, convert it,
31 transfer funds from principal to income, or to take some combination of those
32 actions. The trustee may rely on the power conferred by Section 6-104(a) to adjust
33 from principal to income if the trustee decides that it is not feasible or appropriate to
34 make the property productive of income or to convert the property. Given the
35 purpose of Section 6-413, the power under Section 6-104(a) would be exercised to
36 transfer principal to income and not to transfer income to principal.

37 Section 6-413 does not apply to a so-called “estate” trust, which will qualify
38 for the marital deduction, even though the income may be accumulated for a term of
39 years or for the life of the surviving spouse, if the terms of the trust require the

1 principal and undistributed income to be paid to the surviving spouse's estate when
2 the spouse dies. Reg. § 20.2056(c)-2(b)(1)(iii).

3 **SECTION 6-414. DERIVATIVES AND OPTIONS.**

4 (a) In this section, "derivative" means a contract or financial instrument or a
5 combination of contracts and financial instruments which gives a trust the right or
6 obligation to participate in some or all changes in the price of a tangible or intangible
7 asset or group of assets, or changes in a rate, an index of prices or rates, or other
8 market indicator for an asset or a group of assets.

9 (b) To the extent that a trustee accounts for transactions in derivatives
10 pursuant to this section, the trustee shall allocate to principal receipts from and
11 disbursements made in connection with those transactions.

12 (c) If a trustee grants an option to buy property from the trust, whether or
13 not the trust owns the property when the option is granted, grants an option that
14 permits another person to sell property to the trust, or acquires an option to buy
15 property for the trust or an option to sell an asset owned by the trust, and the trustee
16 or other owner of the asset is required to deliver the asset if the option is exercised,
17 an amount received for granting the option must be allocated to principal. An
18 amount paid to acquire the option must be paid from principal. A gain or loss
19 realized upon the exercise of an option, including an option granted to a settlor of
20 the trust for services rendered, must be allocated to principal.

21 **Comment**

22 **Scope and application.** It is difficult to predict how frequently and to what
23 extent trustees will invest directly in derivative financial instruments rather than

1 participating indirectly through investment entities that may utilize these instruments
2 in varying degrees. If the trust participates in derivatives indirectly through an
3 entity, an amount received from the entity will be allocated under Section 6-401 and
4 not Section 6-414. If a trustee invests directly in derivatives to a significant extent,
5 the expectation is that receipts and disbursements related to derivatives will be
6 accounted for under Section 6-403; if a trustee chooses not to account under
7 Section 6-403, Section 6-414(b) provides the default rule. Certain types of option
8 transactions in which trustees may engage are dealt with in subsection (c) to
9 distinguish those transactions from ones involving options that are embedded in
10 derivative financial instruments.

11 **Definition of “derivative.”** “Derivative” is a difficult term to define
12 because new derivatives are invented daily as dealers tailor their terms to achieve
13 specific financial objectives for particular clients. Since derivatives are typically
14 contract-based, a derivative can probably be devised for almost any set of objectives
15 if another party can be found who is willing to assume the obligations required to
16 meet those objectives.

17 The most comprehensive definition of derivative is in the Exposure Draft of
18 a Proposed Statement of Financial Accounting Standards titled “Accounting for
19 Derivative and Similar Financial Instruments and for Hedging Activities,” which was
20 released by the Financial Accounting Standards Board (FASB) on June 20, 1996
21 (No. 162-B). The definition in Section 6-414(a) is derived in part from the FASB
22 definition. The purpose of the definition in subsection (a) is to implement the
23 substantive rule in subsection (b) that provides for all receipts and disbursements to
24 be allocated to principal to the extent the trustee elects not to account for
25 transactions in derivatives under Section 6-403. As a result, it is much shorter than
26 the FASB definition, which serves much more ambitious objectives.

27 A derivative is frequently described as including futures, forwards, swaps
28 and options, terms that also require definition, and the definition in this Act avoids
29 these terms. FASB used the same approach, explaining in paragraph 65 of the
30 Exposure Draft:

31 The definition of *derivative financial instrument* in this Statement includes those
32 financial instruments generally considered to be derivatives, such as forwards,
33 futures, swaps, options, and similar instruments. The Board considered defining
34 a derivative financial instrument by merely referencing those commonly
35 understood instruments, similar to paragraph 5 of Statement 119, which says
36 that “. . . a derivative financial instrument is a futures, forward, swap, or option
37 contract, or other financial instrument with similar characteristics.” However,
38 the continued development of financial markets and innovative financial
39 instruments could ultimately render a definition based on examples inadequate

1 and obsolete. The Board, therefore, decided to base the definition of a
2 derivative financial instrument on a description of the common characteristics of
3 those instruments in order to accommodate the accounting for newly developed
4 derivatives. (Footnote omitted.)

5 **Marking to market.** A gain or loss that occurs because the trustee marks
6 securities to market or to another value during an accounting period is not a
7 transaction in a derivative financial instrument that is income or principal under the
8 Act – only cash receipts and disbursements, and the receipt of property in exchange
9 for a principal asset, affect a trust’s principal and income accounts.

10 **Receipt of property other than cash.** If a trustee receives property other
11 than cash upon the settlement of a derivatives transaction, that property would be
12 principal under Section 6-404(2).

13 **Options.** Options to which subsection (c) applies include an option to
14 purchase real estate owned by the trustee and a put option purchased by a trustee to
15 guard against a drop in value of a large block of marketable stock that must be
16 liquidated to pay estate taxes. Subsection (c) would also apply to a continuing and
17 regular practice of selling call options on securities owned by the trust if the terms of
18 the option require delivery of the securities. It does not apply if the consideration
19 received or given for the option is something other than cash or property, such as
20 cross-options granted in a buy-sell agreement between owners of an entity.

21 **SECTION 6-415. ASSET-BACKED SECURITIES.**

22 (a) In this section, “asset-backed security” means an asset whose value is
23 based upon the right it gives the owner to receive distributions from the proceeds of
24 financial assets that provide collateral for the security. The term includes an asset
25 that gives the owner the right to receive from the collateral financial assets only the
26 interest or other current return or only the proceeds other than interest or current
27 return. The term does not include an asset to which Section 6-401 or 6-409 applies.

28 (b) If a trust receives a payment from interest or other current return and
29 from other proceeds of the collateral financial assets, the trustee shall allocate to

1 income the portion of the payment which the payer identifies as being from interest
2 or other current return and shall allocate the balance of the payment to principal.

3 (c) If a trust receives one or more payments in exchange for the trust's
4 entire interest in an asset-backed security in one accounting period, the trustee shall
5 allocate the payments to principal. If a payment is one of a series of payments that
6 will result in the liquidation of the trust's interest in the security over more than one
7 accounting period, the trustee shall allocate 10 percent of the payment to income
8 and the balance to principal.

9 **Comment**

10 **Scope of section.** Typical asset-backed securities include arrangements in
11 which debt obligations such as real estate mortgages, credit card receivables and
12 auto loans are acquired by an investment trust and interests in the trust are sold to
13 investors. The source for payments to an investor is the money received from
14 principal and interest payments on the underlying debt. An asset-backed security
15 includes an "interest only" or a "principal only" security that permits the investor to
16 receive only the interest payments received from the bonds, mortgages or other
17 assets that are the collateral for the asset-backed security, or only the principal
18 payments made on those collateral assets. An asset-backed security also includes a
19 security that permits the investor to participate in either the capital appreciation of
20 an underlying security or in the interest or dividend return from such a security, such
21 as the "Primes" and "Scores" issued by Americus Trust. An asset-backed security
22 does not include an interest in a corporation, partnership, or an investment trust
23 described in the Comment to Section 6-402, whose assets consist significantly or
24 entirely of investment assets. Receipts from an instrument that do not come within
25 the scope of this section or any other section of the Act would be allocated entirely
26 to principal under the rule in Section 6-103(a)(4), and the trustee may then consider
27 whether and to what extent to exercise the power to adjust in Section 6-104, taking
28 into account the return from the portfolio as whole and other relevant factors.

29 **PART 5**

30 **ALLOCATION OF DISBURSEMENTS DURING**
31 **ADMINISTRATION OF TRUST**

- 1 (a) A trustee shall make the following disbursements from principal:
- 2 (1) the remaining one-half of the disbursements described in Section
- 3 6-501(1) and (2);
- 4 (2) all of the trustee's compensation calculated on principal as a fee for
- 5 acceptance, distribution, or termination, and disbursements made to prepare
- 6 property for sale;
- 7 (3) payments on the principal of a trust debt;
- 8 (4) expenses of a proceeding that concerns primarily principal, including
- 9 a proceeding to construe the trust or to protect the trust or its property;
- 10 (5) premiums paid on a policy of insurance not described in Section
- 11 6-501(4) of which the trust is the owner and beneficiary;
- 12 (6) estate, inheritance, and other transfer taxes, including penalties,
- 13 apportioned to the trust; and
- 14 (7) disbursements related to environmental matters, including
- 15 reclamation, assessing environmental conditions, remedying and removing
- 16 environmental contamination, monitoring remedial activities and the release of
- 17 substances, preventing future releases of substances, collecting amounts from
- 18 persons liable or potentially liable for the costs of those activities, penalties imposed
- 19 under environmental laws or regulations and other payments made to comply with
- 20 those laws or regulations, statutory or common law claims by third parties, and
- 21 defending claims based on environmental matters.

1 (b) If a principal asset is encumbered with an obligation that requires income
2 from that asset to be paid directly to the creditor, the trustee shall transfer from
3 principal to income an amount equal to the income paid to the creditor in reduction
4 of the principal balance of the obligation.

5 **Comment**

6 **Environmental expenses.** All environmental expenses are payable from
7 principal, subject to the power of the trustee to transfer funds to principal from
8 income under Section 6-504. However, the Drafting Committee decided that it was
9 not necessary to broaden this provision to cover other expenditures made under
10 compulsion of governmental authority. See generally the annotation at 43 A.L.R.
11 4th 1012 (Duty as Between Life Tenant and Remainderman with Respect to Cost of
12 Improvements or Repairs Made Under Compulsion of Governmental Authority).

13 Environmental expenses paid by a trust are to be paid from principal under
14 Section 6-502(a)(7) on the assumption that they will usually be extraordinary in
15 nature. Environmental expenses might be paid from income if the trustee is carrying
16 on a business that uses or sells toxic substances, in which case environmental
17 cleanup costs would be a normal cost of doing business and would be accounted for
18 under Section 6-403. In accounting under that section, environmental costs will be
19 a factor in determining how much of the net receipts from the business is trust
20 income. Paying all other environmental expenses from principal is consistent with
21 this Act's approach regarding receipts – when a receipt is not clearly a current
22 return on a principal asset, it should be added to principal because over time both
23 the income and remainder beneficiaries benefit from this treatment. Here, allocating
24 payments required by environmental laws to principal imposes the detriment of
25 those payments over time on both the income and remainder beneficiaries.

26 Under Sections 6-504(a) and 6-504(b)(5), a trustee who makes or expects to
27 make a principal disbursement for an environmental expense described in Section
28 6-502(a)(7) is authorized to transfer an appropriate amount from income to
29 principal to reimburse principal for disbursements made or to provide a reserve for
30 future principal disbursements.

31 The first part of Section 6-502(a)(7) is based upon the definition of an
32 “environmental remediation trust” in Treas. Reg. § 301.7701-4(e)(as amended in
33 1996). This is not because the Act applies to an environmental remediation trust,
34 but because the definition is a useful and thoroughly vetted description of the kinds
35 of expenses that a trustee owning contaminated property might incur. Expenses
36 incurred to comply with environmental laws include the cost of environmental

1 consultants, administrative proceedings and burdens of every kind imposed as the
2 result of an administrative or judicial proceeding, even though the burden is not
3 formally characterized as a penalty.

4 **Title proceedings.** Disbursements that are made to protect a trust's
5 property, referred to in Section 6-502(a)(4), include an "action to assure title" that is
6 mentioned in Section 13(c)(2) of the 1962 Act.

7 **Insurance premiums.** Insurance premiums referred to in Section
8 6-502(a)(5) include title insurance premiums. They also include premiums on life
9 insurance policies owned by the trust, which represent the trust's periodic
10 investment in the insurance policy. There is no provision in the 1962 Act for life
11 insurance premiums.

12 **Taxes.** Generation-skipping transfer taxes are payable from principal under
13 subsection (a)(6).

14 **SECTION 6-503. TRANSFERS FROM INCOME TO PRINCIPAL FOR**
15 **DEPRECIATION.**

16 (a) In this section, "depreciation" means a reduction in value due to wear,
17 tear, decay, corrosion, or gradual obsolescence of a fixed asset having a useful life
18 of more than one year.

19 (b) A trustee may transfer to principal a reasonable amount of the net cash
20 receipts from a principal asset that is subject to depreciation, but may not transfer
21 any amount for depreciation:

22 (1) of that portion of real property used or available for use by a
23 beneficiary as a residence or of tangible personal property held or made available for
24 the personal use or enjoyment of a beneficiary;

25 (2) during the administration of a decedent's estate; or

1 (3) under this section if the trustee is accounting under Section 6-403 for
2 the business or activity in which the asset is used.

3 (c) An amount transferred to principal need not be held as a separate fund.

4 **Comment**

5 **Prior Acts.** The 1931 Act has no provision for depreciation. Section
6 13(a)(2) of the 1962 Act provides that a charge shall be made against income for
7 “. . . a reasonable allowance for depreciation on property subject to depreciation
8 under generally accepted accounting principles” That provision has been
9 resisted by many trustees, who do not provide for any depreciation for a variety of
10 reasons. One reason relied upon is that a charge for depreciation is not needed to
11 protect the remainder beneficiaries if the value of the land is increasing; another is
12 that generally accepted accounting principles may not require depreciation to be
13 taken if the property is not part of a business. The Drafting Committee concluded
14 that the decision to provide for depreciation should be discretionary with the trustee.
15 The power to transfer funds from income to principal that is granted by this section
16 is a discretionary power of administration referred to in Section 6-103(b), and in
17 exercising the power a trustee must comply with Section 6-103(b).

18 One purpose served by transferring cash from income to principal for
19 depreciation is to provide funds to pay the principal of an indebtedness secured by
20 the depreciable property. Section 6-504(b)(4) permits the trustee to transfer
21 additional cash from income to principal for this purpose to the extent that the
22 amount transferred from income to principal for depreciation is less than the amount
23 of the principal payments.

24 **SECTION 6-504. TRANSFERS FROM INCOME TO REIMBURSE**

25 **PRINCIPAL.**

26 (a) If a trustee makes or expects to make a principal disbursement described
27 in this section, the trustee may transfer an appropriate amount from income to
28 principal in one or more accounting periods to reimburse principal or to provide a
29 reserve for future principal disbursements.

1 (b) Principal disbursements to which subsection (a) applies include the
2 following, but only to the extent that the trustee has not been and does not expect to
3 be reimbursed by a third party:

4 (1) an amount chargeable to income but paid from principal because it is
5 unusually large, including extraordinary repairs;

6 (2) a capital improvement to a principal asset, whether in the form of
7 changes to an existing asset or the construction of a new asset, including special
8 assessments;

9 (3) disbursements made to prepare property for rental, including tenant
10 allowances, leasehold improvements, and broker's commissions;

11 (4) periodic payments on an obligation secured by a principal asset to the
12 extent that the amount transferred from income to principal for depreciation is less
13 than the periodic payments; and

14 (5) disbursements described in Section 6-502(a)(7).

15 (c) If the asset whose ownership gives rise to the disbursements becomes
16 subject to a successive income interest after an income interest ends, a trustee may
17 continue to transfer amounts from income to principal as provided in subsection (a).

18 **Comment**

19 **Prior Acts.** The sources of Section 6-504 are Section 13(b) of the 1962
20 Act, which permits a trustee to "regularize distributions," if charges against income
21 are unusually large, by using "reserves or other reasonable means" to withhold sums
22 from income distributions; Section 13(c)(3) of the 1962 Act, which authorizes a
23 trustee to establish an allowance for depreciation out of income if principal is used
24 for extraordinary repairs, capital improvements and special assessments; and Section
25 12(3) of the 1931 Act, which permits the trustee to spread income expenses of
26 unusual amount "throughout a series of years." Section 6-504 contains a more

1 detailed enumeration of the circumstances in which this authority may be used, and
2 includes in subsection (b)(4) the express authority to use income to make principal
3 payments on a mortgage if the depreciation charge against income is less than the
4 principal payments on the mortgage.

5 **SECTION 6-505. INCOME TAXES.**

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

8 (b) A tax required to be paid by a trustee based on receipts allocated to
9 principal must be paid from principal, even if the tax is called an income tax by the
10 taxing authority.

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

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

15 (2) from principal to the extent that:

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

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

19 (d) For purposes of this section, receipts allocated to principal or income
20 must be reduced by the amount distributed to a beneficiary from principal or income
21 for which the trust receives a deduction in calculating the tax.

22 **Comment**

23 **Electing Small Business Trusts.** An Electing Small Business Trust (ESBT)
24 is a creature created by Congress in the Small Business Job Protection Act of 1996

1 (P.L. 104-188). For years beginning after 1996, an ESBT may qualify as an S
2 corporation stockholder even if the trustee does not distribute all of the trust's
3 income annually to its beneficiaries. The portion of an ESBT that consists of the S
4 corporation stock is treated as a separate trust for tax purposes (but not for trust
5 accounting purposes), and the S corporation income is taxed directly to that portion
6 of the trust even if some or all of that income is distributed to the beneficiaries.

7 A trust normally receives a deduction for distributions it makes to its
8 beneficiaries. Subsection (d) takes into account the possibility that an ESBT may
9 not receive a deduction for trust accounting income that is distributed to the
10 beneficiaries. Only limited guidance has been issued by the Internal Revenue
11 Service, and it is too early to anticipate all of the technical questions that may arise,
12 but the powers granted to a trustee in Sections 6-506 and 6-104 to make
13 adjustments are probably sufficient to enable a trustee to correct inequities that may
14 arise because of technical problems.

15 **SECTION 6-506. ADJUSTMENTS BETWEEN PRINCIPAL AND**
16 **INCOME BECAUSE OF TAXES.**

17 (a) A fiduciary may make adjustments between principal and income to
18 offset the shifting of economic interests or tax benefits between income beneficiaries
19 and remainder beneficiaries which arise from:

20 (1) elections and decisions, other than those described in subsection (b),
21 that the fiduciary makes from time to time regarding tax matters;

22 (2) an income tax or any other tax that is imposed upon the fiduciary or a
23 beneficiary as a result of a transaction involving or a distribution from the estate or
24 trust; or

25 (3) the ownership by an estate or trust of an interest in an entity whose
26 taxable income, whether or not distributed, is includable in the taxable income of the
27 estate, trust, or a beneficiary.

1 (b) If the amount of an estate tax marital deduction or charitable
2 contribution deduction is reduced because a fiduciary deducts an amount paid from
3 principal for income tax purposes instead of deducting it for estate tax purposes, and
4 as a result estate taxes paid from principal are increased and income taxes paid by an
5 estate, trust, or beneficiary are decreased, each estate, trust, or beneficiary that
6 benefits from the decrease in income tax shall reimburse the principal from which the
7 increase in estate tax is paid. The total reimbursement must equal the increase in the
8 estate tax to the extent that the principal used to pay the increase would have
9 qualified for a marital deduction or charitable contribution deduction but for the
10 payment. The proportionate share of the reimbursement for each estate, trust, or
11 beneficiary whose income taxes are reduced must be the same as its proportionate
12 share of the total decrease in income tax. An estate or trust shall reimburse principal
13 from income.

14 **Comment**

15 **Discretionary adjustments.** Section 6-506(a) permits the fiduciary to make
16 adjustments between income and principal because of tax law provisions. It would
17 permit discretionary adjustments in situations like these: (1) A fiduciary elects to
18 deduct administration expenses that are paid from principal on an income tax return
19 instead of on the estate tax return; (2) a distribution of a principal asset to a trust or
20 other beneficiary causes the taxable income of an estate or trust to be carried out to
21 the distributee and relieves the persons who receive the income of any obligation to
22 pay income tax on the income; or (3) a trustee realizes a capital gain on the sale of a
23 principal asset and pays a large state income tax on the gain, but under applicable
24 federal income tax rules the trustee may not deduct the state income tax payment
25 from the capital gain in calculating the trust's federal capital gain tax, and the
26 income beneficiary receives the benefit of the deduction for state income tax paid on
27 the capital gain. See generally Joel C. Dobris, Limits on the Doctrine of Equitable
28 Adjustment in Sophisticated Postmortem Tax Planning, 66 Iowa L. Rev. 273
29 (1981).

1 Section 6-506(a)(3) applies to a qualified Subchapter S trust (QSST) whose
2 income beneficiary is required to include a pro rata share of the S corporation's
3 taxable income in his return. If the QSST does not receive a cash distribution from
4 the corporation that is large enough to cover the income beneficiary's tax liability,
5 the trustee may distribute additional cash from principal to the income beneficiary.
6 In this case the retention of cash by the corporation benefits the trust principal. This
7 situation could occur if the corporation's taxable income includes capital gain from
8 the sale of a business asset and the sale proceeds are reinvested in the business
9 instead of being distributed to shareholders.

10 **Mandatory adjustment.** Subsection (b) provides for a mandatory
11 adjustment from income to principal to the extent needed to preserve an estate tax
12 marital deduction or charitable contributions deduction. It is derived from New
13 York's EPTL § 11-1.2(A), which requires principal to be reimbursed by those who
14 benefit when a fiduciary elects to deduct administration expenses on an income tax
15 return instead of the estate tax return. Unlike the New York provision, subsection
16 (b) limits a mandatory reimbursement to cases in which a marital deduction or a
17 charitable contributions deduction is reduced by the payment of additional estate
18 taxes because of the fiduciary's income tax election. It is intended to preserve the
19 result reached in *Estate of Britenstool v. Commissioner*, 46 T.C. 711 (1966), in
20 which the Tax Court held that a reimbursement required by the predecessor of
21 EPTL § 11-1.2(A) resulted in the estate receiving the same charitable contributions
22 deduction it would have received if the administration expenses had been deducted
23 for estate tax purposes instead of for income tax purposes. Because a fiduciary will
24 elect to deduct administration expenses for income tax purposes only when the
25 income tax reduction exceeds the estate tax reduction, the effect of this adjustment
26 is that the principal is placed in the same position it would have occupied if the
27 fiduciary had deducted the expenses for estate tax purposes, but the income
28 beneficiaries receive an additional benefit. For example, if the income tax benefit
29 from the deduction is \$30,000 and the estate tax benefit would have been \$20,000,
30 principal will be reimbursed \$20,000 and the net benefit to the income beneficiaries
31 will be \$10,000.

32 **Irrevocable grantor trusts.** Under Sections 671-679 of the Internal
33 Revenue Code (the "grantor trust" provisions), a person who creates an irrevocable
34 trust for the benefit of another person may be subject to tax on the trust's income or
35 capital gains, or both, even though the settlor is not entitled to receive any income
36 or principal from the trust. Because this is now a well-known tax result, many trusts
37 have been created to produce this result, but there are also trusts that are
38 unintentionally subject to this rule. The Act does not require or authorize a trustee
39 to distribute funds from the trust to the settlor in these cases because it is difficult to
40 establish a rule that applies only to trusts where this tax result is unintended and
41 does not apply to trusts where the tax result is intended. Settlers who intend this

1 tax result rarely state it as an objective in the terms of the trust, but instead rely on
2 the operation of the tax law to produce the desired result. As a result it may not be
3 possible to determine from the terms of the trust if the result was intentional or
4 unintentional. If the drafter of such a trust wants the trustee to have the authority to
5 distribute principal or income to the settlor to reimburse the settlor for taxes paid on
6 the trust's income or capital gains, such a provision should be placed in the terms of
7 the trust. In some situations the Internal Revenue Service may require that such a
8 provision be placed in the terms of the trust as a condition to issuing a private letter
9 ruling.

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ARTICLE 7
LIABILITY OF TRUSTEES; RIGHTS OF
THIRD PERSONS; SETTLEMENT AGREEMENTS

PART 1
LIABILITY OF TRUSTEES TO BENEFICIARIES

General Comment

This part lists the remedies for breach of trust, describes how money damages are to be determined, and specifies some potential defenses. The remedies for breach of trust are listed in Section 7-102. The remedies provided are both broad and flexible. The method for determining money damages provided in Section 7-103 is based on two principles: (1) the trust should be restored to the position it would have been in had the harm not occurred; and (2) the trustee should not be permitted to profit from the trustee’s own wrong. Section 7-104 through 7-106 specify potential defenses. Section 7-104 provides a statute of limitations on actions against a trustee, Section 7-105 describes the effect of and potential limits on use of an exculpatory clause, and Section 7-106 deals with the requirements for beneficiary approval of acts of the trustee that might otherwise constitute a breach of trust.

SECTION 7-101. BREACH OF TRUST FOR VIOLATION OF DUTY. A

violation by a trustee of a duty the trustee owes a beneficiary is a breach of trust.
The remedies of a beneficiary for breach of trust are exclusively equitable.

Comment

This section is drawn from Section 201 of the Restatement (Second) of Trusts (1959). The remedies of a beneficiary are exclusively equitable and, as such, do not include either punitive damages or jury trial. The purpose of equity is to make one whole, not penalize.

For the list of remedies, see Section 7-102. For the method for determining money damages, see Section 7-103.

1 If a trustee commits a breach of trust, the beneficiaries may either affirm the
2 transaction or, if a loss has occurred, hold the trustee liable for the amount necessary
3 to fully compensate for the consequences of the breach. This may include lost
4 income, capital gain, or appreciation that would have resulted from proper
5 administration. Even if a loss has not occurred, the trustee may not be allowed to
6 benefit by reason of the trustee’s improper action, and is thus accountable for any
7 profit that the trustee may have made by reason of the breach.

8 For extensive commentary on the determination of damages, with numerous
9 specific applications, see Restatement (Third) of Trusts: Prudent Investor Rule
10 §§ 204-213 (1992).

11 The court is not precluded from reducing or excusing damages if appropriate
12 to do so. See Restatement (Second) of Trusts § 205, cmt. g (1959).

13 The remedies provided in this section do not preclude resort to other
14 remedies provided by this Act or available under the common law of trusts. See
15 Sections 1-103 (common law of trusts) and 7-102 (remedies for breach of trust). As
16 to defenses of the trustee, see Sections 7-104 to 7-106.

17 **SECTION 7-104. LIMITATION OF ACTION AGAINST TRUSTEE**
18 **AFTER FINAL REPORT OR OTHER STATEMENT.**

19 (a) Unless previously barred by adjudication, consent, or other limitation, a
20 claim against a trustee for breach of trust is barred as to a beneficiary who has
21 received from the trustee a report or other statement adequately disclosing the
22 existence of the claim unless a judicial proceeding to assert the claim is commenced
23 within two years after the later of the receipt of the report or statement or the
24 termination of the trust relationship between the beneficiary and that particular
25 trustee. A report or statement adequately discloses the existence of a claim if it
26 provides sufficient information so that the beneficiary knows of the claim or
27 reasonably should have inquired into its existence.

1 (b) For the purpose of subsection (a), a beneficiary is deemed to have
2 received a report or other statement:

3 (1) in the case of an adult, if it is received by the adult personally, or if
4 the adult lacks capacity, if it is received by the adult's conservator, guardian, or
5 agent with authority; or

6 (3) in the case of a minor, if it is received by the minor's guardian or
7 conservator or, if the minor does not have a guardian or conservator, if it is received
8 by a parent of the minor who does not have a conflict of interest.

9 **Comment**

10 This section is based in part on Section 7-307 of the Uniform Probate Code.
11 For provisions governing consent, release, and ratification by beneficiaries to relieve
12 the trustee of liability, see Section 7-106. The reference in the introductory clause
13 to claims previously barred also includes principles such as estoppel and laches that
14 apply under the common law of trusts. See Section 1-103. During the time that a
15 trust is revocable, the person holding the power to revoke is the one who must
16 receive the report or other statement in order to commence the running of the
17 limitations period provided in this section. See Section 3-103 (rights of settlor).

18 Subsection (b) provides special rules concerning who must receive the report
19 or other statement for it to have the effect of later barring claims based on the
20 information disclosed. This subsection addresses only the issue of when the clock
21 will start to run for purposes of the statute of limitations. Should the trustee wish to
22 immediately foreclose possible claims based on the information disclosed, a consent
23 to the report or other information may be obtained pursuant to Section 7-106.

24 For the provisions relating to the duty to report information to beneficiaries,
25 see Section 5-114.

26 **SECTION 7-105. EXCULPATION OF TRUSTEE.**

27 (a) A term of the trust relieving a trustee of liability for breach of trust is
28 unenforceable to the extent that it:

1 (1) relieves a trustee of liability for breach of trust committed
2 intentionally, in bad faith, or with reckless indifference to the purposes of the trust
3 or the interest of the beneficiaries; or

4 (2) was inserted as the result of an abuse by the trustee of a fiduciary or
5 confidential relationship to the settlor.

6 (b) An exculpatory term drafted by or on behalf of the trustee is presumed
7 to have been inserted as a result of an abuse of a fiduciary or confidential
8 relationship unless the trustee proves that the exculpatory term is fair under the
9 circumstances and that its existence and contents were adequately communicated to
10 the settlor.

11 **Comment**

12 Subsection (a) is the same in substance as Section 222 of the Restatement
13 (Second) of Trusts (1959). It is also consistent with the standards expressed in
14 Sections 5-101 and 5-115 relating to the extent to which a settlor may negate a duty
15 in the terms of the trust. There is a minimum standard of conduct to which a trustee
16 must comply, whether stated as a negation of a duty or in the form of an exculpatory
17 provision. A trustee must always act in good faith and with regard to the purposes
18 of the trust and the interest of the beneficiaries.

19 Subsection (b) disapproves cases such as *Marsman v. Nasca*, 573 N.E.2d
20 1025 (Mass. App. Ct. 1991), which hold that an exculpatory clause in a trust
21 instrument drafted by the trustee is valid absent proof that it was inserted as a result
22 of an abuse of a fiduciary relationship. Subsection (b) presumes that such an
23 insertion constitutes an abuse of a prior fiduciary or confidential relationship
24 between the settlor and trustee, often that of client and attorney. To overcome this
25 presumption, the trustee must establish that the clause was fair and that its existence
26 and contents were adequately communicated to the settlor. In determining whether
27 the clause was fair, the court may wish to examine: (1) the extent of the prior
28 relationship between the settlor and trustee; (2) whether the settlor received
29 independent advice; (3) the sophistication of the settlor with respect to business and
30 fiduciary matters; (4) the trustee's reasons for inserting the clause; and (5) the scope
31 of the particular provision inserted. See Restatement (Second) of Trusts § 222 cmt.
32 d (1959).

1 **General Comment**

2 This part addresses trustee relations with third parties. The emphasis is on
3 encouraging trustees and third parties to engage in commercial transactions to the
4 same extent as if the property was not held in trust. Section 7-201 negates personal
5 liability on contracts entered into by the trustee if the fiduciary relationship or
6 identity of the trust was properly disclosed. The trustee is also relieved from liability
7 for torts committed in the course of administration unless the trustee was personally
8 at fault. Section 7-202 protects third persons who deal with a trustee in good faith
9 and without knowledge that the trustee is exceeding a power. Section 7-203
10 permits a trustee to rely on a certification of trust, thereby hopefully reducing
11 requests by third parties for copies of the complete trust instrument.

12 **SECTION 7-201. LIMITATION ON PERSONAL LIABILITY OF**
13 **TRUSTEE.**

14 (a) Except as otherwise agreed, a trustee is not personally liable on a
15 contract properly entered into in the trustee's fiduciary capacity in the course of
16 administration of the trust if the trustee in the contract discloses either the fiduciary
17 capacity or identifies the trust.

18 (b) A trustee is personally liable for obligations arising from ownership or
19 control of trust property, or for torts committed in the course of administering a
20 trust, only if the trustee is personally at fault, whether negligently or intentionally.

21 (c) A claim based on a contract entered into by a trustee in the trustee's
22 fiduciary capacity, on an obligation arising from ownership or control of trust
23 property, or on a tort committed in the course of administering a trust, may be
24 asserted against the trust by a judicial proceeding against the trustee in the trustee's
25 fiduciary capacity, whether or not the trustee is personally liable on the claim.

26 **Comment**

1 This section is based on Section 7-306 of the Uniform Probate Code.
2 However, unlike the Uniform Probate Code, subsection (a) excuses the trustee from
3 personal liability on a contract if *either* the trustee’s representative capacity *or* the
4 identity of the trust is disclosed in the contract. Under this section, it is assumed
5 that either one of these statements in a contract puts the other contracting party on
6 notice that a trust is involved. The protection afforded the trustee by this section
7 applies only to contracts that are properly entered into in the trustee’s fiduciary
8 capacity, meaning that the trustee is exercising an available power and is not
9 violating a duty. This section does not excuse any liability the trustee may have for
10 breach of trust.

11 Subsection (b) addresses liability arising from ownership or control of trust
12 property and for torts occurring incident to the administration of the trust. Liability
13 in such situations is imposed on the trustee personally only if the trustee was
14 personally at fault, either intentionally or negligently. This is contrary to
15 Restatement (Second) of Trusts § 264 (1959), which imposes liability on a trustee
16 regardless of fault, including liability for acts of agents under respondeat superior.

17 Subsection (c) alters the case law rule that a trustee could not be sued in a
18 representative capacity if the trust estate was not liable.

19 **SECTION 7-202. PROTECTION OF PERSON DEALING WITH**
20 **TRUSTEE.**

21 (a) A person who in good faith assists a trustee or who in good faith and for
22 value deals with a trustee without knowledge that the trustee is exceeding or
23 improperly exercising the trustee’s powers is protected from liability as though the
24 trustee properly exercised the power.

25 (b) A person who in good faith deals with another person with knowledge
26 that the other person is a trustee is not solely on that account placed on notice to
27 inquire into the extent of the trustee’s powers or the propriety of their exercise or to
28 see to the proper application of assets of the trust paid or delivered to a trustee.

1 (c) A person who in good faith assists a former trustee or who for value and
2 in good faith deals with a former trustee without knowledge that the person is no
3 longer a trustee is protected from liability as if the former trustee were still a trustee.

4 (d) The protection provided by this section to persons assisting or dealing
5 with a trustee is secondary to that provided under comparable provisions of other
6 laws relating to commercial transactions or to the transfer of securities by
7 fiduciaries.

8 **Comment**

9 This section is originally derived from Section 7 of the Uniform Trustees'
10 Powers Act, but with several important changes. The key to understanding the
11 section are the definitions of "good faith" and "know," codified at Section 1-105(5)
12 and (7). The definition of "good faith," with respect to third persons, requires not
13 only honesty of intention but also observance of reasonable standards of fair dealing.
14 The definition of "know" refers to more than actual knowledge. While a person is
15 not charged with knowledge of facts discoverable upon reasonable inquiry, the third
16 party is charged with knowledge of facts the person had reason to know based on
17 the facts and circumstances actually known to the person at the time in question. In
18 other words, if the person should have been aware of a particular fact based on the
19 circumstances and other facts of which the person was actually aware, the person is
20 charged with knowledge of that fact. The Uniform Trustees' Powers Act, on the
21 other hand, by failing to define good faith, left open the issue of whether its
22 requirement that a trustee act in good faith was totally subjective or instead
23 contained an objective element.

24 Subsection (a) protects two different classes; persons who assist a trustee
25 with a transaction, and persons who deal with the trustee for value. The third
26 person is protected in the transaction despite the fact the trustee was exceeding or
27 improperly exercising the power as long as the assistance was provided or
28 transaction was entered into in "good faith" and without "knowledge" as defined in
29 Section 1-105(5) and (7).

30 Subsection (b) performs two functions. First, it negates the common law
31 rule that a third party does not receive credit if the trustee misapplies assets paid or
32 delivered to the trustee which are properly part of the trust. To receive the
33 protection provided by this subsection, the third person must have been acting in
34 good faith and without knowledge of the misapplication. Second, subsection (b)

1 confirms that a third party acting in good faith and without knowledge is not
2 charged with a duty to inquire into the extent of a trustee's powers or the propriety
3 of their exercise.

4 Subsection (c) extends the protections afforded by the section to assistance
5 provided to or dealings for value with a former trustee. The third party is protected
6 the same as if the former trustee still held the office.

7 Subsection (d) clarifies that the protections provided by this section will in
8 many cases be superseded by protections provided by other statutes, in particular
9 the statutes relating to commercial transactions or to transfers of securities by
10 fiduciaries. The principal statutes in question are the various articles of the Uniform
11 Commercial Code, including Article 8 on the transfer of securities, as well as the
12 Uniform Simplification of Transfer of Securities by Fiduciaries Act.

13 **SECTION 7-203. CERTIFICATION OF TRUST.**

14 (a) To establish the existence or terms of a trust, a trustee may present a
15 certification of trust to any person in lieu of providing a copy of the trust instrument.

16 (b) A certification of trust must contain a statement that the trust has not
17 been revoked or modified in any manner that would cause the representations
18 contained in the certification of trust to be incorrect and must contain a statement
19 that it is being signed by all of the currently acting trustees of the trust.

20 (c) A certification of trust need not contain the dispositive terms of a trust.

21 (d) A person may require that the trustee offering a certification of trust
22 provide copies of those excerpts from the original trust instrument and later
23 modifications that designate the trustee and confer upon the trustee the power to act
24 in the pending transaction.

25 (e) A person who acts in reliance upon a certification of trust without
26 knowledge that the representations contained therein are incorrect is not liable to

1 any person for so acting and may assume without inquiry the existence of the facts
2 contained in the certification. Knowledge may not be inferred solely from the fact
3 that a copy of all or part of the trust instrument is held by the person relying upon
4 the certification. A transaction, and a lien created thereby, entered into by the
5 trustee and a person acting in reliance upon a certification of trust is enforceable
6 against the trust property.

7 (f) A person making a demand for the trust instrument in addition to a
8 certification of trust or excerpts is liable for damages, including reasonable
9 attorney's fees, incurred as a result of the refusal to accept the certification of trust
10 or excerpts in lieu of the trust instrument if the court determines that the person did
11 not act in good faith in requesting the trust instrument.

12 (g) This section does not limit the rights of beneficiaries to obtain copies of
13 the trust instrument or rights of others to obtain copies in a judicial proceeding
14 concerning the trust.

15 **Comment**

16 This section, based on California Probate Code § 18100.5, is designed to
17 protect the privacy of a trust instrument by reducing requests by third parties for
18 complete copies of the instrument when verifying a trustee's authority. Third parties
19 frequently insist on receiving a copy of the complete trust instrument solely to verify
20 a specific and narrow authority of the trustee to engage in a particular transaction.
21 While a testamentary trust, because it is created under a will, is a matter of public
22 record, an inter vivos trust instrument is private. Such privacy is compromised,
23 however, if the trust instrument must be widely distributed among third parties. A
24 certification of trust is a document signed by all currently acting trustees that may
25 include excerpts from the trust instrument necessary to facilitate the particular
26 transaction. The benefit of a certification is that it will enable the transaction to
27 proceed without disclosure of the trust's beneficial provisions. Nor is there a need
28 for third parties who may already have a copy of the instrument to pry into its
29 provisions. Persons acting in reliance on a certification may assume the truth of the

1 certification even if they have a complete copy of the trust instrument in their
2 possession. To encourage compliance with this section, persons demanding a trust
3 instrument despite having already been offered a certification may be liable for
4 damages, including reasonable attorney's fees, if their refusal is determined not to
5 have been in good faith.

6 **PART 3**
7 **REPRESENTATION OF BENEFICIARIES**
8 **AND SETTLEMENT AGREEMENTS**

9 **General Comment**

10 This part deals with the important topic of representation of beneficiaries,
11 both representation by fiduciaries (personal representatives, guardians and
12 conservators), and what is known as virtual representation. Virtual representation is
13 a doctrine which allows binding representation by others of beneficiaries who are
14 unborn or unascertained, and under more modern versions, beneficiaries who may
15 be alive and known but who are legally incapacitated.

16 Section 7-301 is the general and introductory section, laying out the scope of
17 the part. The representation principles of this part have numerous applications
18 under this Act. The representation principles of the part apply for purposes of
19 settlement of disputes, whether by a court or nonjudicially. They apply for the
20 giving of required notices. They apply for the giving of consents to certain actions.
21 The representation principles of this part may be used to facilitate:

22 (1) Approval of a transfer of jurisdiction by the qualified beneficiaries
23 (Section 1-205);

24 (2) Modification or termination of a trust upon the consent of the
25 beneficiaries, with or without the consent of the settlor (Section 2-202);

26 (3) Notice to qualified beneficiaries of a proposed trust combination or
27 division (Section 2-207);

28 (4) Notice to qualified beneficiary of emergency assumption of duties
29 without accepting trusteeship (Section 4-101(c));

30 (5) Appointment of successor trustee upon agreement of qualified
31 beneficiaries (Section 4-108(b)(2));

1 (6) Notice to qualified beneficiaries of resignation of trustee (Section
2 4-105);

3 (7) Notice of trustee's report (Section 5-114);

4 (8) Nonliability of trustee upon consent, release, or affirmation of beneficiary
5 (Section 7-106).

6 Section 7-302 addresses settlement agreements, both judicial and
7 nonjudicial. While the judicial settlement procedures may be used in all court
8 proceedings relating to the trust, the nonjudicial settlement procedures will not
9 always be available. First, the terms of the trust may direct that the procedures not
10 be used, or settlors may negate or modify them by specifying their own methods for
11 obtaining consents. Second, a nonjudicial settlement may not be used to approve
12 actions that would otherwise be illegal, such as to improperly terminate a trust.
13 Only such matters as a court could properly approve may be made the subject of a
14 nonjudicial settlement.

15 Section 7-303 deals with the effect of a consent, whether by actual or virtual
16 representation. A consent bars a later objection by the person represented, but a
17 consent is not binding if the person represented raises an objection prior to the date
18 the consent would otherwise become effective. The possibility that a beneficiary
19 might object to a consent given on the beneficiary's behalf will not be germane in
20 many cases because the person represented will be unborn or unascertained. But
21 there are situations where the representation principles of this part can apply to adult
22 and competent beneficiaries. For example, while the trustee of a revocable trust
23 entitled to a pourover devise has authority under Section 7-305 to approve the
24 personal representative's account on behalf of the trust beneficiaries, such consent
25 would not be binding on a trust beneficiary who registers an objection.

26 Section 7-304 deals with the effect of a consent by the holder of a general
27 testamentary powers of appointment. (Revocable trusts and presently exercisable
28 general powers of appointment are covered by Section 3-103, which grant the
29 settlor or holder of the power all rights of the beneficiaries or persons whose
30 interests are subject to the power). Absent a conflict of interest, the holder of a
31 testamentary general power of appointment may bind those whose interests are
32 subject to the power.

33 Section 7-305 provides that a fiduciary, absent conflict of interest, may
34 represent and bind the beneficiary or beneficiaries of the respective fiduciary
35 relationship, whether of an estate, trust, conservatorship, or guardianship. Drawing
36 from Section 1-403 of the Uniform Probate Code, the section also allows a parent
37 without a conflict of interest to represent and bind a minor child. A typical example

1 of conflict of interest is a trustee seeking to approve an accounting for an estate for
2 which the trustee is also acting as personal representative.

3 Section 7-306 is the virtual representation provision. It provides for
4 representation of and the giving of a binding consent on behalf of a minor,
5 incapacitated, unborn, or unascertained person by another beneficiary with a
6 substantially identical interest with respect to the particular issue. Also, the minor,
7 incapacitated, unborn, or unascertained beneficiary is bound only to the extent (1)
8 the other beneficiary adequately represents the person's interest, (2) the person is
9 not otherwise represented under one of the other sections of this part, and (3) there
10 is no conflict of interest between the representative and the person represented.

11 Section 7-307 specifies the persons who must be notified to bind a
12 beneficiary represented under this part in connection with a judicial settlement.

13 Sections 7-308 and 7-309 authorize the court to appoint persons to
14 represent the interests of beneficiaries not otherwise able to represent themselves.
15 Such appointments may be made whether or not the person might otherwise be
16 represented as provided in this part. Section 7-308 authorizes the appointment of a
17 guardian ad litem at any point in a judicial proceeding but to encourage such
18 appointments only when really needed, the court must first find that representation
19 of the beneficiary might otherwise be inadequate. Also, to encourage some
20 flexibility in how the guardian ad litem approaches the job, the guardian ad litem, in
21 approving a settlement, may consider general family benefit. Section 7-309
22 authorizes the court, in connection with a nonjudicial settlement, to appoint a special
23 representative to represent the interests of one or more beneficiaries. The
24 distinction between a guardian ad litem and a special representative has more to do
25 with the nature of the proceeding than the function served.

26 **SECTION 7-301. REPRESENTATION OF BENEFICIARIES.**

27 (a) Whenever under this [Act] a notice is required to be given to a
28 beneficiary, notice to a person who may represent and bind the beneficiary under this
29 [part] is considered notice to the beneficiary.

30 (b) Whenever under this [Act] a consent may be given by a beneficiary, the
31 consent of a person who may represent and bind the beneficiary under this [part] is
32 considered the consent of the beneficiary.

1 **SECTION 7-302. SETTLEMENT AGREEMENTS.**

2 (a) Except to the extent that the terms of a trust indicate that the procedures
3 specified in this [part] do not apply, persons interested in a trust may be represented
4 and bound as provided in this [part], whether or not the settlement is approved by
5 the court.

6 (b) Nonjudicial settlements may include only terms and conditions a court
7 could properly approve.

8 (c) Settlement agreements may extend to any question or dispute involving
9 a trust, including:

- 10 (1) the determination of the persons interested in the trust;
11 (2) the interpretation or construction of the terms of the trust;
12 (3) the direction to a trustee to refrain from performing a particular act
13 or the grant to the trustee of any necessary or desirable power;
14 (4) a change of trustee or determination of a trustee's compensation;
15 (5) a change in the principal place of administration of a trust; and
16 (6) the modification of the trust to comply with statutes and regulations
17 of the United States to achieve qualification for deductions, elections, or other tax
18 provisions.

19 **SECTION 7-303. EFFECT OF CONSENT.** The consent of a person who
20 may represent another under this [part] is binding on the person represented unless

1 the person represented objects to the representation prior to the date the consent
2 would otherwise have become effective.

3 **SECTION 7-304. GENERAL TESTAMENTARY POWER OF**
4 **APPOINTMENT.** To the extent there is no conflict of interest between the holder
5 of a general testamentary power of appointment and the persons represented with
6 respect to the particular question or dispute, the holder may represent and bind the
7 persons whose interests, as objects, takers in default, or otherwise, are subject to the
8 power.

9 **SECTION 7-305. REPRESENTATION BY FIDUCIARIES AND**
10 **PARENTS.** To the extent there is no conflict of interest between the representative
11 and the person represented:

12 (1) a conservator may represent and bind the person whose estate the
13 conservator controls;

14 (2) a guardian may represent and bind the ward if a conservator of the
15 ward's estate has not been appointed;

16 (3) an agent with authority may represent and bind the principal;

17 (4) a trustee may represent and bind the beneficiaries of the trust;

18 (5) a personal representative of a decedent's estate may represent and bind
19 the persons interested in the estate; and

1 (6) if a conservator or guardian has not been appointed, a parent may
2 represent and bind a minor child.

3 **SECTION 7-306. REPRESENTATION BY PERSON WITH**
4 **SUBSTANTIALLY IDENTICAL INTEREST.** Unless otherwise represented, a
5 minor or an incapacitated, unborn, or unascertained person may be represented by
6 and bound by another having a substantially identical interest with respect to the
7 particular question or dispute, but only to the extent that:

- 8 (1) the person's interest is adequately represented; and
9 (2) there is no conflict of interest between the representative and those
10 represented.

11 **SECTION 7-307. NOTICE OF JUDICIAL SETTLEMENT.**

12 (a) Notice of a proposed judicial settlement to a person who may be
13 represented and bound under Section 7-304 or 7-305 must be given either directly
14 to the person or to one who may bind the person.

15 (b) Notice is given to minor, incapacitated, unborn, or unascertained
16 persons who are not represented under Sections 7-304 and 7-305 and who may be
17 bound under Section 7-306 by giving notice to all persons whose interests in the
18 judicial proceedings are substantially identical and whose identities are actually
19 known.

1 **SECTION 7-308. APPOINTMENT OF GUARDIAN AD LITEM.**

2 Notwithstanding representation under Section 7-304, 7-305, or 7-306, at any point
3 in a judicial proceeding, if the court determines that representation of the interest
4 might otherwise be inadequate, the court may appoint a guardian ad litem to
5 represent the interest of and approve a judicial settlement on behalf of a minor,
6 incapacitated, unborn, or unascertained person, or a person whose identity or
7 address is not actually known. If not precluded by conflict of interest, a guardian ad
8 litem may be appointed to represent several persons or interests. In approving a
9 judicially supervised settlement, a guardian ad litem may consider general family
10 benefit.

11 **SECTION 7-309. APPOINTMENT OF SPECIAL REPRESENTATIVE.**

12 Notwithstanding representation under Section 7-304, 7-305, or 7-306, the court
13 may appoint a special representative to represent the interests of and approve a
14 nonjudicial settlement on behalf of designated persons. If not precluded by conflict
15 of interest, a special representative may be appointed to represent several persons or
16 interests. In approving the settlement, a special representative may consider general
17 family benefit.

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ARTICLE 8
TRANSITIONAL AND MISCELLANEOUS PROVISIONS

SECTION 8-101. APPLICATION OF [ACT].

(a) This [Act] takes effect on _____.

(b) Except as provided elsewhere in this [Act], on [the effective date of this [Act]]:

(1) this [Act] applies to all trusts created before, on, or after [its effective date];

(2) this [Act] applies to all judicial proceedings concerning trusts commenced on or after [its effective date];

(3) this [Act] applies to judicial proceedings concerning trusts commenced before [its effective date] unless the court finds that application of a particular provision of this [Act] would substantially interfere with the effective conduct of the judicial proceedings or the rights of the parties, in which case the particular provision of this [Act] does not apply and the superseded law applies;

(4) any rule of construction or presumption provided in this [Act] applies to trust instruments executed before [the effective date of the [Act]] unless there is a clear indication of a contrary intent in the terms of the trust; and

(5) an act done before [the effective date of the [Act]] in any proceeding and any accrued right is not impaired by this [Act].

1 (c) If a right is acquired, extinguished, or barred upon the expiration of a
2 prescribed period that has commenced to run under any other statute before [the
3 effective date of the [Act]], that statute remains in force with respect to that right.

4 **Comment**

5 This section addresses the applicability of the Act, including application to
6 pending judicial proceedings and the administration of existing trusts. The Act is
7 intended to receive the widest possible application. The Act applies to all trusts
8 subject to the jurisdiction of the enacting State, whether created before or after the
9 date of enactment. But recognizing constitutional concerns, excluded from
10 coverage are trusts created prior to the Act's effective date if such application
11 would impair a vested right. For such an impairment to occur, however, the trust
12 would have to be irrevocable as of the effective date and the particular provision of
13 the Act would have to actually reduce or otherwise threaten a beneficial interest.

14 **SECTION 8-102. UNIFORMITY OF APPLICATION AND**

15 **CONSTRUCTION.** In applying and construing this Uniform Act, consideration
16 must be given to the need to promote uniformity of the law with respect to its
17 subject matter among States that enact it.

18 **SECTION 8-103. SEVERABILITY CLAUSE.** If any provision of this [Act]
19 or its application to any person or circumstances is held invalid, the invalidity does
20 not affect other provisions or applications of the [Act] which can be given effect
21 without the invalid provision or application, and to this end the provisions of this
22 [Act] are severable.

1 **SECTION 8-104. SPECIFIC REPEALER AND AMENDMENTS.**

2 [(a)] The following Acts and parts of Acts are repealed:

3 (1)

4 (2)

5 (3)

6 [(b)] The following Acts and parts of Acts are amended:

7 (1)

8 (2)

9 (3)]