Feb 3, 2017 via email

Ben –

I urge you and the drafting committee to abolish the 20% rule in section 401 of the Uniform Principal and Income Act. In my experience, it is unworkable, arbitrary, and unrealistic. It provides that if an entity distributes more than 20 percent of the gross assets shown on its financial statements for the preceding year, the distribution is in "partial liquidation" of the entity and is considered principal to the trust. The rule is unworkable because most entities do not have financial statements. And even if they did, the assets are presented at historical cost basis, which usually bears no resemblance to the assets' real value and is therefore a meaningless standard. Most trusts cannot simply fix the problem by exercising the power to adjust because the trustees are also beneficiaries (sec. 104(c)). Or they are corporate trustees and refuse to exercise the power because they don't want to be sued.

For example, in 2004 Microsoft declared a dividend that was 30% of the gross assets on its prior year financial statements. No one thought that was a liquidating distribution or treated it that way. Yet it passed the 20% mark. Another example is an entity that owns a fully depreciated apartment complex with substantial cash flow. If the entity distributes that annual cash flow, it could easily exceed the 20% mark, but merely represent a distribution of the entity's annual profits. Classification as principal or income also impacts whether the distributions from the trust to the beneficiaries are community property in 9 states.

While we know the UPIA can't solve all the problems, we need to either abolish the 20% rule altogether, or make it more flexible by allowing the trustee to decide how a distribution is classified based all on the facts and circumstances. I am happy to discuss this further with you. I hope you are enjoying the book I sent you last year - "The Fiduciary Accounting Answer Book."

Thank you for you attention.

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