

REVISED UNIFORM PRINCIPAL AND INCOME ACT
UNITRUST ISSUES PREPARED FOR THE DRAFTING COMMITTEE
SEPTEMBER 23-24, 2016

1. Review: A unitrust is a trust that pays out a *percentage* of the value of the trust assets each year, without regard for whether “income” is equal to, greater than, or less than that amount.
2. How to convert an income trust to a total return unitrust
 - 2.1. Who may convert?
 - 2.1.1. Trustee(s) if disinterested. (Without court approval?)
 - 2.1.2. Disinterested cotrustee(s), if not all trustees are disinterested.
 - 2.1.3. Interested trustee(s), if no trustee is disinterested?
 - 2.1.3.1. With what additional safeguards?
 - 2.1.3.2. Is it enough that the trustee(s) *appoint* a disinterested actor?
 - 2.1.4. Court?
 - 2.1.4.1. On whose application?
 - 2.1.5. Beneficiaries?
 - 2.1.5.1. With what additional safeguards?
 - 2.2. What kind of trust may be converted?
 - 2.2.1. Must this be limited to cases where distributions are defined by “income”?
 - 2.2.1.1. Pay all income, no principal.
 - 2.2.1.2. Pay all income, and principal in the trustee’s discretion.
 - 2.2.1.2.1. Limited to an ascertainable standard.
 - 2.2.1.2.2. “Absolute” [not really] discretion.
 - 2.2.1.3. Discretion over income, no principal.
 - 2.2.1.4. Income (all or some) to some beneficiaries, principal to others.
 - 2.2.1.5. Discretion over both income and principal? (What’s the point?)
 - 2.2.2. What if the trust instrument prohibits use of a unitrust?
 - 2.2.2.1. How explicit must the prohibition be? (Must it cite the statute?)
 - 2.2.2.2. When can such a prohibition be overridden, if at all?
 - 2.2.3. May a unitrust be converted back to an income trust?
 - 2.2.3.1. Why not?
 - 2.2.3.2. Same for modifying the percentage or other terms of the unitrust.
 - 2.2.3.3. What if it was originally created as a unitrust?

- 2.2.4. Should frequency of actions under this statute be limited?
 - 2.2.4.1. *E.g.*, no more frequently than every two years, as in some statutes.
 - 2.2.4.1.1. Encourages predictability (which after all is the point).
 - 2.2.4.1.2. Allows opportunity to observe the results.
 - 2.2.4.1.3. Avoids the appearance of *ad hoc* manipulation.
 - 2.2.4.2. Is two years the right term?
 - 2.2.4.3. Should it apply to the time from creation of the trust to the first action too?
 - 2.2.4.4. Does it matter who has the power?
 - 2.2.4.5. Presumably a court could approve exceptions.
- 2.3. Should there ever be a *duty* to convert?
 - 2.3.1. If not, should the act explicitly deny the existence of any duty?
- 2.4. Should there ever be a duty to inform the beneficiaries of the unitrust option?
 - 2.4.1. If not, should the act explicitly deny the existence of any duty?
- 2.5. How is conversion accomplished?
 - 2.5.1. Factors to be considered?
 - 2.5.2. Trustee's adoption of a "policy"?
 - 2.5.2.1. Containing what?
 - 2.5.2.2. Statutes seem to require just a matter-of-fact conclusion.
 - 2.5.3. Must beneficiaries be notified? (Why not?)
 - 2.5.3.1. What should the notice include?
 - 2.5.3.2. When (*i.e.*, how long before the conversion) must notice be given?
 - 2.5.3.3. What if a beneficiary objects?
 - 2.5.3.4. What is trustee's duty to answer questions or provide information?
 - 2.5.3.5. Should a beneficiary who does not timely object be estopped?
 - 2.5.3.6. How should virtual representation work?
 - 2.5.3.6.1. The issue is balancing interests of successive beneficiaries.
 - 2.5.4. Again, is court approval always needed? If not, when is it required?
 - 2.5.5. Can the power to convert to a unitrust be released? Why? Or why not?
 - 2.5.5.1.1. Section 104(e) allows release of the power to adjust. Why?
 - 2.5.6. Must the trustee release the power to adjust if converting to a unitrust?

3. Should there be lower or upper limits on the unitrust percentage, and what should they be?
 - 3.1. Is 1% a logical lower limit?
 - 3.1.1. 1962 Act, §12, made 1% the standard of “underproductive”.
 - 3.2. Is 10% a logical upper limit? Compare provisions of the current act:
 - 3.2.1. Section 410(b) (10% of proceeds of a liquidating asset is income).
 - 3.2.2. Section 411(a)(3) (90% of royalty, etc. is principal).
 - 3.2.3. Section 415(c) (10% of asset-backed security proceeds is income).
 - 3.3. Should these limits be tied to an index or AFR and, if so, how?
 - 3.4. Should “smoothing” be allowed? Or encouraged?
 - 3.4.1. One objective is predictability and certainty for the beneficiary.
 - 3.4.2. *E.g.*, use average of last 2 or 3 years. Or 8 or 12 quarters.
 - 3.4.3. Maybe a percentage or fractional floor or cap on annual changes.
 - 3.4.4. Should such a floor be more important, or more restrictive, than a cap?
 - 3.4.4.1. Serving the objective of predictability for the beneficiary?
 - 3.4.5. For tax considerations, see item 9.1.
4. Should it be possible to blend percentage and income approaches?
 - 4.1. *E.g.*, net income or 5% of value, whichever is lesser – or greater.
 - 4.2. Should there be less flexibility for a trustee’s conversion than for grantors?
5. What, if anything, should the act say about hard-to-value assets?
 - 5.1. Should the act get into details of valuation estimates and other conventions?
 - 5.2. Should it simply affirm the trustee’s discretion?
6. Should some trust assets be excluded from the unitrust calculation?
 - 6.1. Such as –
 - 6.1.1. Hard-to-value assets?
 - 6.1.2. Assets personally occupied or used by one or more beneficiaries?
 - 6.1.2.1. Limited to residential or tangible personal property?
 - 6.1.3. Other kinds of assets?
 - 6.1.4. Any assets the trustee determines in its “policy”?
 - 6.2. Presumably the non-unitrust principal-and-income rules will apply to such assets?

7. Other unitrust calculation issues:
 - 7.1. Income accruals, like rent and interest.
 - 7.1.1. Would including these items of income be a kind of double-counting?
 - 7.2. Retirement benefits or annuity payments receivable by the trust.
 - 7.2.1. Same question.
 - 7.3. Proration when an income interest ends.
 - 7.4. What expenses, if any, are deductible from the unitrust amount?
 - 7.5. Should there be an explicit provision for correction of miscalculations?
8. What about total or partial payment of the unitrust amount in kind? Any issues?
9. “Tax-related limitations” (*cf.* section 19 of UTDA).
 - 9.1. *E.g.*, limit to 3-5% with only annual smoothing *if* Reg. §1.643(b)-1 matters.
 - 9.1.1. Is that enough? (That is the approach of section 19 of UTDA.)
 - 9.1.2. Or must *all* unitrusts be so limited? (That’s harsh.)
 - 9.2. What about special allocations to trust income for income tax purposes?
 - 9.2.1. Net short-term capital gains?
 - 9.2.2. Net long-term capital gains?
10. Exclusions?
 - 10.1. Charitable lead trusts (I.R.C. §170(f)(2)(B))?
 - 10.2. Pooled income fund (I.R.C. §642(c)(5))?
 - 10.3. Charitable remainder trusts (I.R.C. §664(d))?
 - 10.4. (Qualified) personal residence trusts (I.R.C. §2702(a)(3)(A)(ii))?
 - 10.5. Grantor retained annuity trusts (GRATs) and unitrusts (I.R.C. §2702(b))?
 - 10.6. State law special needs trusts?
 - 10.7. Others?
11. Trustee’s compensation:
 - 11.1. To the extent based on “income,” should the unitrust amount be used?
 - 11.1.1. Would that, in effect, base compensation entirely on the value of assets?
 - 11.2. What incentive does the trustee have to actually produce total return?
 - 11.2.1. Or is that any business of a principal and income act?
12. Special statute of limitations?
13. Effective date?
 - 13.1. Should the provision apply to trusts in existence when it is enacted?