

**UNIFORM PRINCIPAL AND INCOME ACT
ISSUES LIST**

September 2016

1. In General: Broaden to fit a modern perpetual discretionary, possibly directed, trust.

Consider a re-ordered act as we discuss the issues.

Article 1 – definitions.

Article 2 – Statement of what principal and income are. Not exactly like the Restatement, but as a “This [act] applies to ...”?

Article 3 – power to allocate receipts and disbursements between income and principal.

Article 4 – unitrust conversion/creation provision. For the trustee who wants to make a decision once, or every so often, rather than constantly.

Article 5 – traditional default rules. Interest, dividends, rents, are income. Ignore more esoteric items? Perhaps describe as safe harbors?

Article 6 – tax sensitive rules to protect the marital and charitable deductions.

Article 7 – choice of law and construction/administration rules.

Article 8 – ULC boilerplate.

Would we have improved things or made changes to make changes?

2. Current Section 101. Short Title. Is it okay that it has the same acronym as the Uniform Prudent Investor Act? It may be hard to think of anything other than “Principal and Income” that would catch on.

3. Current Section 102. Definitions.

Add “current” beneficiary and “successive” beneficiary? Supplement and/or replace “income” and “remainder” beneficiary? Consider “successor income beneficiary”? As a subset of “successor” beneficiary?

Special treatment of perpetual trusts? Trusts that may be extended but are not perpetual from inception.

Add life tenant? Or co-tenant in possession? Do we need separate treatment for life estates?

Current Section 102(1). “Accounting period.” Clarify that months mean calendar months. Allow a 52-53-week year? Does precision like this help? Does this matter?

Current 102(3). “Fiduciary.” Add guardian and conservator? Add attorney-in-fact? (How do P&I rules apply to these persons?)

Current 102(5). “Income beneficiary.” Why “net” income?

4. Current Section 103. Fiduciary Duties: General Principles. Make this more general? Copy the UTC? Add, as many states do, an explicit disclaimer of any “negative inference” if a trustee acts contrary to the Act? Add an explicit disclaimer of any “negative inference” if a trustee departs from the standards in the Act? Better in Comments? Maybe unnecessary, or handled in some more direct way, if we change the approach to give all trustees more flexibility?

Current Section 103. Accommodate directed trusts? Revisit section 2041(b)(1)(C) of the Internal Revenue Code after we see what the UDTA does?

Current Section 103(a). Exotic financial instruments. Cover, ignore?

5. Current Section 104. Trustee’s Power To Adjust. Consider redesigning this so it is available to more modern (discretionary) trusts and not only to old-fashioned trusts. This could be done in part, for example, by moving the three conditions precedent in subsection (a) to the list of factors in subsection (b).

- But see paragraph (7).

We need to accommodate exempt assets and directed trusts, possibly in light of UDTA. Even if trustees are given greater discretion to determine what is income in the first place, a power of adjustment can still provide more flexibility in individual cases (permitting the trustee in effect to make exceptions from its own standards), perhaps with a higher level of responsibility. In other words, there is a lower standard of justification (and thus less “risk”) in reasonably defining income and distributing that income than in making a departure through an adjustment. Also consider “inception assets”?

- What should be the standards? Does it go to the range of impartiality? Put examples in Comments?

Current Section 104(c). Compare UTDA §19.

Current Section 104(d). Clarify. Distinguish between majority rule and unanimous consent trusteeships.

Section 104(e). Consider the purpose, need, and suitability of the power to release.

6. Current Section 105. Judicial Control of Discretionary Power. Does this need a special section? Anything special about this sort of control versus any other sort of court involvement? This may need to be coordinated better with the UTC and other relevant Acts. Or maybe, now that the power to adjust is better known and people are more comfortable with it, this kind of detail isn’t needed here; maybe it could be rolled into (or at least placed after) section 103.

Current Section 105(d). Do we need something for states that don't allow declaratory requests for aid and directions (or the like)? Perhaps a legislative note.

7. Current Section 201. Decedent's Estate or Terminating Income Interest: Determination and Distribution of Net Income. The section needs a lot of work. It is complex, tedious, and at points unclear.

8. Current Section 202. Distribution to Residuary and Remainder Beneficiaries. It may be necessary to reconcile notions of "statutory interest" on delayed distributions with the right of residuary beneficiaries to a proportionate share of estate (or trust) income. But do those scenarios ever really overlap? How many states provide for interest payments anyway?

- Also address recipients of "pecuniary" amounts.

Current Section 202(d). What does it mean to calculate interest "on the back end."

9. Current Section 301. When Right to Income Begins and Ends. There are lexical issues here – "entitled," "testator," "asset," "period," "successive income interest," etc. There is also the vexing issue of when death (or birth or any other event) changes the entitlement to income – *i.e.*, that day, the next day, the "moment of death," etc. (This is also a current topic of tax law discussion.)

- Is this a big deal?

10. Current Section 302. Apportionment of Receipts and Disbursements When Decedent Dies or Income Interest Begins. Same comment. Also a lexical issue with the word "apportionment."

11. Current Section 303. Apportionment When Income Interest Ends. Same comments. Do we understand the 5% rule, except under a use-it-or-lose-it view of powers of appointment (which may be okay).

12. Current Article 4. Allocation of Receipts During Administration of Trust. Consider an introductory section or subsection, providing, in effect, "for entities see section ____ and for accounting issues see section ____."

13. Current Section 401. Character of Receipts. Subsection (c)(1): Limit to non-trivial property. Also revisit the wisdom and need of tying these rules to the income tax treatment. And consider whether these rules need to be expanded in any event to deal with passthrough entities, pro rata and non-pro rata distributions, prearranged series of distributions.

14. Current Section 401(d)(2). Regarding the rule that "[m]oney is received in partial liquidation ... if the total amount of money and property received in a distribution or series of related distributions is greater than 20 percent of the entity's **gross assets**, as shown by the entity's year-end financial statements immediately preceding the initial receipt," Should it be gross or net? For example, if a business or other entity is highly leveraged, it might be possible that its debt is greater than 80% of its assets, meaning that its entire equity is less than 20% of its

gross assets, and it is impossible to responsibly distribute 20% of its gross assets. But that analysis may be an oversimplification.

- Whether “gross” or “net,” is it measured against all distributions from the entity? Or just distributions to this trust?
- What if there are no prior year’s financial statements? *E.g.*, a “new” spin-off entity.

15. Current Section 402. Distribution from Trust or Estate. There are a lot of problems with this. Isn’t it circular to in effect define “income” as a “distribution of income” or “principal” as a “distribution of principal,” or to refer to section 401 which refers to section 402? What is a “purchased interest”? Something other than a donated interest – *i.e.*, donated by the grantor? Will it always be easy to tell? And what difference does that make anyway? Is the reliance safe harbor (section 401(f)) robust enough?

16. Current Section 403. Business and Other Activities Conducted by Trustee. Consider whether some of the provisions are circular, such as the notion of accounting separately if the trustee accounts separately. Why do “businesses” need to be limited to a list (as in subsection (c))? Why does the activity for which the trustee separately accounts need to be a business in the first place?

17. Current Section 404. Principal Receipts. Check lexical issues, including “realized,” “an accounting period,” etc. Do we need to coordinate with GAAP/FASB?

18. Current Section 404(3). Why is this limited to Section 502(a)(7)?

19. Current Section 406. Obligation to Pay Money [an odd title]. What is the significance of “more than one year” in subsection (b)? Should it be beyond the current period? Is that feasible?

20. Current Section 407. Insurance Policies and Similar Contracts. Is the last sentence of subsection (a) circular? Can we leave this to the power to adjust?

21. Current Section 409. Deferred Compensation, Annuities, and Similar Payments. One question is whether payments are typically “characterized,” as stated in subsection (b). Can this be left to the power to adjust? What about the marital deduction in that instance?

22. Current Section 410. Liquidating Asset. Consider a different title and scope, such as application to “Hard-to-Value Assets” or “Illiquid Assets.” And shouldn’t the percentage be flexible and determined by the trustee? This needs some spreadsheet modeling.

23. Current Section 411. Minerals, Water, and Other Natural Resources. Can we leave this to the power to adjust?

24. Current Section 412. Timber. Can we leave this to the power to adjust?

25. Current Section 413. Property Not Productive of Income. Consider whether it makes sense to have a special provision like this just for the marital deduction. There no longer is a “minimum” amount of income required to be income producing. Is that ok?
26. Current Section 414. Derivatives and Options. Do we want special rules or just the power to adjust?
27. Current Section 415. Asset-Backed Securities. If we are going to have 414 and 415, we need to update for the latest financial products.
28. Current Section 501. Disbursements from Income. Again, a 50-50 apportionment in every case seems arbitrary. Fees attract attention so we need to be careful with our rule.
29. Current Section 504. Transfers from Income to Reimburse Principal. I don’t know what this is about, or why it has to be so complex. A simple statement authorizing trustees to “borrow” from principal or income seems sufficient.
30. Current Sections 505 and 506. Income Taxes [or “Taxes on Income”]. Do these rules work for, say, partnerships? Or ESBTs?
31. Current Section 601. Uniformity of Application and Construction. Is principal and income is a matter of construction (governing by the law where and when the trust was created) or a matter of administration (governed by the law of the current situs of the trust):

It may be desirable to specify whether these principal and income rules are to be considered rules of construction (that is, governed by the law of the place where the trust was created or deemed created) or rules of administration (that is, governed by the law of the situs of the trust from time to time, with appropriate savings provisions for tax benefits, etc. if the situs is changed). The latter seems to be the most workable clarification and seems to be contemplated by the change-of-situs examples in the 2003 amendments to the GST tax regulations (Reg. § 26.2601-1(b)(4)(i)(E), *Examples 11 & 12*). But authorities are divided. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 268, *Comment h* (1971):

The question of the allocation of receipts and expenditures to principal or income presents a different problem. See Restatement of Trusts (Second), §§ 232-241. If a testator creates a trust to be administered in a state other than that of his domicile, the question is whether the allocation, as for instance of extraordinary dividends, is to be determined by the local law of his domicile or the local law of the place of administration. This could conceivably be treated as a question of administration and governed by the local law of the place of administration. On the other hand, it can be treated as a question of the distribution of the trust property and governed by the local law of the testator’s domicile. For the purposes of the choice of the applicable law, it is generally held that it is a question of construction and that the local law of the testator’s domicile is applicable.

Arguably the biggest burden of a construction rule is determining the law not only where the trust was created but at the time the trust was created.