SENATE JUDICIARY COMMITTEE
Senator Thomas Umberg, Chair
2021-2022 Regular Session

SB 1159 (Jones)
Version: April 18, 2022
Hearing Date: May 3, 2022
Fiscal: No
Urgency: No
AM

SUBJECT

Uniform Fiduciary Income and Principal Act

DIGEST

This bill repeals the existing Uniform Principal and Income Act and recasts and updates those provisions under a new name, the Uniform Fiduciary Income and Principal Act.

EXECUTIVE SUMMARY

This bill would repeal the existing Uniform Principal and Income Act (UPIA) and enact the Uniform Fiduciary Income and Principal Act (UFIPA), an updated version of UPIA. UFIPA was approved by the National Conference of Commissioners on Uniform State Laws in 2018 and drafted with the advice and assistance of subject matter experts, such as practitioners, attorneys, and judges. The bill would recast and update existing law to support developments in modern trust practices, including allowing trustees to invest for the maximum total return regardless if the return is in the form of income or growth of principal. Additionally, trusts are increasingly being written with more flexible terms that give trustees discretion to accumulate income or invade principal when beneficial to furthering the purposes of the trust. This bill, in recognition of these changes, grants trustees additional flexibility in administering discretionary trusts. The bill also makes changes to the administration of unitrusts and provides a default rule that the situs of the trust applies unless the terms of the trust specify another jurisdiction.

The bill is sponsored by the National Conference of Commissioners on Uniform Law Commission. The bill is supported by the California Bankers Association and the Executive Committee of the Trusts and Estates Section of the California Lawyers Association. There is no known opposition.

PROPOSED CHANGES TO THE LAW

Existing law,

1) Governs the distribution of income, interest and principal under a trust, and the allocation of distributions to beneficiaries by a trustee or of payments received by a trust under the Uniform Principal and Income Act (UPIA). (Prob. Code § 16320 et. seq.)

2) Prohibits a court from authorizing conversion to a unitrust with a payout percentage of less than 3 percent of greater than 5 percent of the fair market value of the trust assets. (Prob. Code § 16336.5 (b)(1)(B).)

3) Authorizes a trustee to make an adjustment between principal and income, to the extent the trustee considers necessary, if all of the following conditions are satisfied:
   a) the trustee invests and manages trust assets under the prudent investor rule;
   b) the trust describes the amount that is required or may be distributed to a beneficiary by referring to the trust's income; and
   c) the trustee determines, after applying specified rules, that the trustee is unable to comply with the requirement that a trustee administer a trust or estate impartially, as specified. (Prob. Code § 16336 (a).)

This bill:

1) Recasts and updates these provisions under a new name, the Uniform Fiduciary Income and Principal Act (UFIPA), for similar purposes.

2) Provides expressly that UFIPA applies when this state is the principal place of administration of a trust or estate or the situs of property that is not held in a trust or estate, as specified, unless the terms of the trust or UFIPA provide otherwise.

3) Makes various changes to the administration of a unitrust, such as providing that a unitrust rate may not be less than 3 percent or greater than 5 percent, unless the unitrust plan has been approved by a court, as specified.

4) Authorizes a fiduciary to make an adjustment between principal and income if the fiduciary determines the exercise of the power to adjust will assist the fiduciary in administering the trust or estate impartially, as provided.
   a) A fiduciary that in good faith exercises or fails to exercise the power to adjust is not liable to a person affected by the exercise or failure to exercise.

5) Specifies factors a fiduciary is required to consider when adjusting between principal and income or making various changes related to a unitrust including, among others:
    a) the desirability of liquidity and regularity of income;
    b) the desirability of the preservation and appreciation of principal;
    c) the extent to which an asset is used or may be used by a beneficiary;
    d) the extent to which the fiduciary has accumulated income or invaded principal in preceding accounting periods; and
    e) the reasonably expected tax consequences of the exercise of the power.

COMMENTS

1. Author's statement

The author writes:

> The Uniform Principal and Income Act (UPIA) was originally approved by the Uniform Law Commission (ULC) in 1931 and revised twice in 1962 and 1997. Nearly every state has adopted a version.
>
> Traditionally, beneficiaries of trusts were either entitled to receive income earned by the trust investments, or to inherit a share of the trust principal. The trustee's allocation of receipts and expenditures to income or principal had a direct effect on the beneficial interests. The UPIA established accounting rules to guide trustees in making these allocations.
>
> In the last few decades, the distinction between income and principal has become less important for two reasons. First, the development of modern portfolio theory allows trustees to invest for the maximum total return, whether the return is in the form of income or growth of principal. Second, modern trusts are often drafted with more flexible terms giving trustees discretion to accumulate income or access principal when advantageous to further the purposes of the trust.
>
> The Uniform Fiduciary Income and Principal Act (UFIPA) recognizes these developments and gives trustees additional flexibility to administer discretionary trusts.

2. Background

The National Conference of Commissioners on Uniform State Laws approved UFIPA in 2018 with the intent of modernizing and updating the provisions of UPIA. The legislation was drafted with the advice and assistance of subject matter experts, such as practitioners, attorneys, and judges. According to the author and sponsors, the historical distinction between income and principal has become less important in the last few decades for two reasons. First, under modern portfolio theory trustees are allowed to invest for maximum total return, whether that return is in income or growth of principal. Second, trusts are often drafted with more flexibility contemporarily allowing trustees discretion to accumulate income or invade principal when beneficial to furthering the purposes of the trust. In recognition of these current developments, UFIPA provides trustees more flexibility to administer discretionary trusts. For example, the bill removes the restrictions on when a trustee is authorized to make an adjustment between principal and income and instead authorizes a trustee to make an adjustment between principal and income if the fiduciary determines the exercise of the power to adjust will assist the fiduciary in administering the trust or estate impartially. (Prob. Code § 16336 (a).) The bill requires a fiduciary to consider various factors when adjusting between principal and income including, among others: the desirability of liquidity and regularity of income; the desirability of the preservation and appreciation of principal; the extent to which an asset is used or may be used by a beneficiary; the extent to which the fiduciary has accumulated income or invaded principal in preceding accounting periods; and the reasonably expected tax consequences of the exercise of the power.

The bill also makes various changes to the administration of unitrusts. When UPIA was enacted by California in 1999 it did not include provisions related to the conversion of a traditional trust into a unitrust, which allows for total-return investing. (AB 846 Ackerman (Ch. 846, Stats. 1999).) In 2003, the Internal Revenue Service published regulations regarding unitrust conversions under certain conditions if authorized by state law. In 2005, California amended UPIA to allow for unitrust conversions. (SB 754, Poochigian (Ch. 100; Stats. 2005).) This bill makes various change to the provisions governing unitrusts by allowing "flexible and innovative unitrust provisions" that allow a trustee to "establish a unitrust policy with a variable or adjustable rate of return based on market conditions or the needs of individual beneficiaries."[1] Specifically, the bill provides that a unitrust rate may be less than 3 percent or greater than 5 percent if the unitrust plan has been approved by a court. Existing law prohibits a court from authorizing conversion to a unitrust with a payout percentage of less than 3 percent of greater than 5 percent of the fair market value of the trust assets. (Prob. Code § 16336.5 (b)(1)(B).) The bill further states that, if the unitrust plan has been approved by court order, any unitrust rate may be used. The bill specifies that a unitrust rate may be either a fixed unitrust rate or a unitrust rate that is determined for each period using a market index or other published data or a mathematical blend of market indices or other published data over a stated number of preceding periods.

The bill also includes a governing law provision. The bill expressly provides that UFIPA applies when this state is the principal place of administration of a trust or estate or the

[1] *The Uniform Fiduciary Income and Principal Act: A Summary*, Uniform Law Commission, available at https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=0cbc14e5-8053-c4b0-b3bf-7ae9dca2a95b&forceDialog=0 (as of Apr. 24, 2022).

situs of property that is not held in a trust or estate and is subject to a life estate or other term interest, unless the terms of the trust or UFIPA provide otherwise.

3. Statements in support

The National Conference of Commissioners on Uniform Law Commission, sponsor of the bill, writes:

> The Uniform Law Commission is pleased to sponsor your SB 1159, the Uniform Fiduciary Income and Principal Act (UFIPA). UFIPA updates California's existing law (based on the ULC's prior Uniform Principal and Income Act) to keep pace with developments in trust and estate practice.
>
> Three of the most important provisions of UFIPA are the following:
>
> - UFIPA allows total-return investing. Trustees should invest for the greatest total return, regardless of whether that return takes the form of income or growth in principal. UFIPA facilitates such investing by overcoming historic technical distinctions between income and principal.
> - UFIPA contains flexible and innovative unitrust rules. Popularized by modern portfolio theory, unitrusts help maximize investment return and minimize administrative expenses. UFIPA provides the first uniform rules for converting older trusts into unitrusts, providing flexibility while still abiding by federal tax regulations.
> - UFIPA facilitates individualized estate planning. UFIPA's flexible rules enable estate planners to tailor the terms of a trust to fit a client's individual needs and allow flexibility to adapt to unforeseen future events.

SUPPORT

National Conference of Commissioners on Uniform Law Commission (sponsor)
California Bankers Association
Executive Committee of the Trusts and Estates Section of the California Lawyers Association (TEXCOM)

OPPOSITION

None known

RELATED LEGISLATION

Pending Legislation: None known.

Prior Legislation:

SB 754 (Poochigian, Ch. 100; Stats. 2005) authorized a trustee, unless prohibited by the governing instrument, to convert a trust into a unitrust, pursuant to specified procedures and requirements.

AB 846 (Ackerman, Ch. 846, Stats. 1999) repealed the Revised Uniform Principal and Income Act and enacted the Uniform Principal and Income Act.

****