SENATE JUDICIARY COMMITTEE
Senator Thomas Umberg, Chair
2023-2024 Regular Session

SB 522 (Niello)
Version: February 14, 2023
Hearing Date: April 11, 2023
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. This bill is substantially similar to last year's SB 1159 (Jones, 2022), which passed this Committee on a vote of 11 to 0, but was not set for a hearing in the Assembly Judiciary Committee.

The bill is sponsored by the California Bankers Association, the California Commission on Uniform State Laws, 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.
   a) A fiduciary that in good faith takes or fails to take an action under the provisions governing unitrusts is not liable to a person affected by the action or inaction.

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. Stated need for the bill

The author writes:

> SB 522 seeks to provide increased flexibility to administer discretionary trusts. The bill replaces the Uniform Principal and Income Act (UPIA) with the Uniform Fiduciary Income and Principal Act (UFIPA) to recognize the development of modern portfolio theory that allows trustees to invest for the maximum total return, whether the return is in the form of income or growth of principal. The bill additionally permits flexible terms giving trustees discretion to accumulate income or access principal when advantageous to further the purposes of the trust.

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 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. <u>This bill is substantially similar to last year's SB 1159 (Jones, 2022)</u>

This bill is substantially similar to last year's SB 1159 (Jones, 2022), which passed this Committee on a vote of 11 to 0, but was ultimately never set for a hearing in the Assembly Judiciary Committee. Many of the changes this bill makes are technical and nonsubstantive. However, there are a few differences that are substantive. The author

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[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. 3, 2023).

and sponsor state that these additions were inadvertently left out of last year's bill and that they are included in the uniform law.[2] These changes include:

- Providing a definition for "unitrust plan," which is identical to the definition for "unitrust policy" in the model law.
- Authorizing an income trust to be converted to a unitrust regardless of the terms of the trust concerning distributions, and provides that conversion to a unitrust does not affect other terms of the trust concerning distributions of income or principal.
- Providing that the provisions applying to unitrusts apply to an estate only to the extent a trust is a beneficiary of the estate. To the extent of the trust's interest in the estate, the estate may be administered as a unitrust, the administration of the estate as a unitrust may be discontinued, or the percentage or method used to calculate the unitrust amount may be changed, in the same manner as for a trust under these provisions.
- Providing that the provisions applying to unitrusts do not create a duty to take or consider action or to inform a beneficiary about the applicability of these provisions.
- Specifies that a fiduciary that in good faith takes or fails to take an action under the provisions applying to unitrusts is not liable to a person affected by the action or inaction.

4. Proposed amendments

The author may wish to amend the bill to remove a lone reference to the "act" and instead replace it with the "chapter" to be consistent. Additionally, the author may wish to amend the bill to explicitly require the fiduciary to act in good faith, based on what is fair and reasonable to all beneficiaries, when making an allocation or determination or exercising discretion under UFIPA. This language is included in the model act and the comment to the model act specifically notes that it is included to complement and support the exoneration for a fiduciary's action or inaction in good faith.

The specific amendments are as follows:

Amendment 1

On page 7, between lines 33 and 34, insert:
(1) A fiduciary shall act in good faith, based on what is fair and reasonable to all beneficiaries.

[2] A copy of the uniform law can be found here https://www.uniformlaws.org/viewdocument/enactment-kit-74?CommunityKey=1105f9bb-eb93-4d4d-a1ab-a535ef73de0c&tab=librarydocuments.

Amendment 2

On page 7, in line 34, strike out "(1)" and insert:
(2)

Amendment 3

On page 7, in line 37, strike out "(2)" and insert:
(3)

Amendment 4

On page 8, in line 5, strike out "(3)" and insert:
(4)

Amendment 5

On page 8, in line 10, strike out "act" and insert"
chapter

5. Statements in support

The California Commission on Uniform State Laws (CCUSL), one of the sponsors of the bill, writes:

> UFIPA is an updated version of the Uniform Principal and Income Act (UPIA). For this latest revision, the title was changed to differentiate the act from its predecessors, and also to avoid confusion with the closely related Uniform Prudent Investor Act, which shared the UPIA acronym. The Uniform Principal and Income Act was originally approved by the ULC in 1931 and revised in 1962 and 1997. Nearly every state, including California, has adopted a version.
>
> The Uniform Principal and Income Act provided a set of accounting rules to guide trustees in making allocations between principal and income. Since the Act's revision in 1997, the distinction between income and principal has become less important, in part because modern portfolio theory allows trustees to invest for maximum total return, whether in the form of income or growth of principal. UFIPA recognizes this change and gives trustees additional flexibility to administer discretionary trusts.
>
> UFIPA Section 104 provides a new default rule on governing law. The law of the situs of the trust will apply, unless the terms of the trust specify a different jurisdiction. This rule is consistent with other uniform trust and estate acts and will help prevent multi-state disputes.

> The CCUSL has worked closely with the California Bankers Association and the California Lawyers Association, Trusts and Estates Section Executive Committee, both co-sponsors, in "fine tuning" UFIPA to meet California's needs. We are pleased with the result.

SUPPORT

California Bankers Association (sponsor)
California Commission on Uniform State Laws (sponsor)
California Lawyers Association, Trusts and Estates Section Executive Committee (TEXCOM) (sponsor)

OPPOSITION

None known

RELATED LEGISLATION

Pending Legislation: SB 801 (Allen, 2023) enacts the California Uniform Directed Trust Act to provide a method for regulating trusts where a person who is not a trustee has been given a role in directing the trust by, among other things, setting forth the duties and responsibilities of the trust director and the duties and responsibilities of the directed trustee. SB 801 is currently pending in this Committee.

Prior Legislation:

SB 1157 (Jones, 2022), would have repealed the existing Uniform Principal and Income Act and revised and updated those provisions under a new name, the Uniform Fiduciary Income and Principal Act. SB 1157 was never set for a hearing in the Assembly Judiciary Committee.

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.

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