

MAINE STATE LEGISLATURE

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L.D. 1573

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14 STATE OF MAINE
16 HOUSE OF REPRESENTATIVES
18 120TH LEGISLATURE
20 FIRST REGULAR SESSION

22 COMMITTEE AMENDMENT "A" to H.P. 1173, L.D. 1573, Bill, "An
24 Act to Enact the Uniform Principal and Income Act of 1997"

26 Amend the bill on page 4 by inserting before section 1 the
28 following:

30 'Sec. 1. 18-A MRSA §7-402, sub-§(c), ¶(21), as enacted by PL
32 1979, c. 540, §1, is amended to read:

34 (21) To allocate items of income or expense to either trust
36 income or principal, as provided by law, ~~including creation
38 of reserves out of income for depreciation, obsolescence, or
amortization, or for depletion in mineral or timber
properties~~ Article VII, Part 7;

40 Further amend the bill in section 1 in Part 7 in Subpart 1
42 in that part designated "~~§7-702.~~" in subsection (b) in the 2nd
line (page 5, line 13 in L.D.) by striking out the following:
"heir, legatee" and inserting in its place the following 'heir'

Further amend the bill in section 1 in Part 7 in Subpart 1
by striking out all of that part designated "~~§7-704.~~" (page 9,
line 37 to page 11, line 50 in L.D.) and by striking out all of
that part designated "Uniform Comment" (page 12, line 3 to page
19, line 44 in L.D.) and inserting in their place the following:

RMS

2 '§7-704. Trustee's power to adjust

4 (a) A trustee may adjust between principal and income by
6 allocating an amount of income to principal or an amount of
8 principal to income to the extent the trustee considers
10 appropriate if the terms of the trust describe the amount that
12 may or must be distributed to a beneficiary by referring to the
14 trust's income and the trustee determines, after applying the
16 rules in section 7-703, subsection (a), that the trustee is
18 unable to comply with section 7-703, subsection (b).

20 (b) In deciding whether and to what extent to exercise the
22 power conferred by subsection (a), a trustee shall consider all
24 factors relevant to the trust and its beneficiaries, including
26 the following factors to the extent they are relevant:

28 (1) The nature, purpose and expected duration of the trust;

30 (2) The intent of the settlor;

32 (3) The identity and circumstances of the beneficiaries
34 and, to the extent reasonably known to the trustee, the
36 needs of the beneficiaries for present and future
38 distributions authorized or required by the terms of the
40 trust;

42 (4) The needs for liquidity, regularity of income and
44 preservation and appreciation of capital;

46 (5) The assets held in the trust; the extent to which they
48 consist of financial assets, interests in closely held
50 enterprises, tangible and intangible personal property or
real property; the extent to which an asset is used by a
beneficiary; and whether an asset was purchased by the
trustee or received from the settlor;

(6) The net amount allocated to income under the other
sections of this Part and the increase or decrease in the
value of the principal assets, which the trustee may
estimate as to assets for which market values are not
readily available;

(7) Whether and to what extent the terms of the trust give
the trustee the power to invade principal or accumulate
income or prohibit the trustee from invading principal or
accumulating income, and the extent to which the trustee has
exercised a power from time to time to invade principal or
accumulate income;

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2 (8) The actual and anticipated effect of economic
conditions on principal and income and effects of inflation
and deflation; and

4 (9) The anticipated tax consequences of an adjustment.

6 (c) A trustee may not make an adjustment under this section
8 if any of the following applies:

10 (1) The adjustment would diminish the income interest in a
12 trust that requires all of the income to be paid at least
14 annually to a spouse and for which an estate tax or gift tax
marital deduction would be allowed, in whole or in part, if
the trustee did not have the power to make the adjustment;

16 (2) The adjustment would reduce the actuarial value of the
18 income interest in a trust to which a person transfers
property with the intent to qualify for a gift tax exclusion;

20 (3) The adjustment would change the amount payable to a
22 beneficiary as a fixed annuity or a fixed fraction of the
value of the trust assets;

24 (4) The adjustment is from any amount that is permanently
26 set aside for charitable purposes under a will or the terms
of a trust unless both income and principal are so set aside;

28 (5) The trustee's possession or exercise of the power to
30 make an adjustment would cause an individual to be treated
32 as the owner of all or part of the trust for income tax
purposes and the individual would not be treated as the
owner if the trustee did not possess the power to make an
adjustment;

34 (6) The trustee's possession or exercise of the power to
36 make an adjustment would cause all or part of the trust
38 assets to be included for estate tax purposes in the estate
40 of an individual who has the power to remove a trustee or
appoint a trustee, or both, and the assets would not be
included in the estate of the individual if the trustee did
not possess the power to make an adjustment;

42 (7) The trustee is a beneficiary of the trust; or

44 (8) The trust has been converted to a unitrust under
46 section 7-705.

48 (d) If subsection (c), paragraph (5), (6) or (7) applies to
50 a trustee and there is more than one trustee, a cotrustee to whom
the provision does not apply may make the adjustment unless the

exercise of the power by the remaining trustee or trustees is prohibited by the terms of the trust. Terms of the trust requiring that if there are 2 or more trustees serving they must act by agreement or by any majority or percentage consensus may not be construed to prohibit the remaining trustee or trustees from possessing or exercising the power to make the adjustment.

(e) A trustee may release the entire power conferred by subsection (a) or may release only the power to adjust from income to principal or the power to adjust from principal to income, if the trustee is uncertain about whether possessing or exercising the power will cause a result described in subsection (c), paragraphs (1) to (6) or if the trustee determines that possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax burden not described in subsection (c). The release of the power to adjust may be permanent or for a specified period, including a period measured by the life of an individual.

(f) Terms of a trust that limit the power of a trustee to make an adjustment between principal and income do not affect the application of this section unless it is clear from the terms of the trust that the terms are intended to deny the trustee the power of adjustment conferred by subsection (a).

Uniform Comment

(This section is based on Section 104 of the Uniform Principal and Income Act (1997).)

Purpose and Scope of Provision. The purpose of Section 104 is to enable a trustee to select investments using the standards of a prudent investor without having to realize a particular portion of the portfolio's total return in the form of traditional trust accounting income such as interest, dividends, and rents. Section 104(a) authorizes a trustee to make adjustments between principal and income if three conditions are met: (1) the trustee must be managing the trust assets under the prudent investor rule; (2) the terms of the trust must express the income beneficiary's distribution rights in terms of the right to receive "income" in the sense of traditional trust accounting income; and (3) the trustee must determine, after applying the rules in Section 103(a), that he is unable to comply with Section 103(b). In deciding whether and to what extent to exercise the power to adjust, the trustee is required to consider the factors described in Section 104(b), but the trustee may not make an adjustment in circumstances described in Section 104(c).

Section 104 does not empower a trustee to increase or decrease the degree of beneficial enjoyment to which a

beneficiary is entitled under the terms of the trust; rather, it
2 authorizes the trustee to make adjustments between principal and
4 income that may be necessary if the income component of a
6 portfolio's total return is too small or too large because of
8 investment decisions made by the trustee under the prudent
10 investor rule. The paramount consideration in applying Section
12 104(a) is the requirement in Section 103(b) that "a fiduciary
14 must administer a trust or estate impartially, based on what is
16 fair and reasonable to all of the beneficiaries, except to the
18 extent that the terms of the trust or the will clearly manifest
20 an intention that the fiduciary shall or may favor one or more of
22 the beneficiaries." The power to adjust is subject to control by
24 the court to prevent an abuse of discretion. Restatement
26 (Second) of Trusts § 187 (1959). See also id. §§ 183, 232, 233,
28 Comment p (1959).

Section 104 will be important for trusts that are
18 irrevocable when a State adopts the prudent investor rule by
20 statute or judicial approval of the rule in Restatement of Trusts
22 3d: Prudent Investor Rule. Wills and trust instruments executed
24 after the rule is adopted can be drafted to describe a
26 beneficiary's distribution rights in terms that do not depend
28 upon the amount of trust accounting income, but to the extent
that drafters of trust documents continue to describe an income
beneficiary's distribution rights by referring to trust
accounting income, Section 104 will be an important tool in trust
administration.

Three conditions to the exercise of the power to adjust.
The first of the three conditions that must be met before a
trustee can exercise the power to adjust - that the trustee
invest and manage trust assets as a prudent investor - is
expressed in this Act by language derived from the Uniform
Prudent Investor Act, but the condition will be met whether the
prudent investor rule applies because the Uniform Act or other
prudent investor legislation has been enacted, the prudent
investor rule has been approved by the courts, or the terms of
the trust require it. Even if a State's legislature or courts
have not formally adopted the rule, the Restatement establishes
the prudent investor rule as an authoritative interpretation of
the common law prudent man rule, referring to the prudent
investor rule as a "modest reformulation of the Harvard College
dictum and the basic rule of prior Restatements." Restatement of
Trusts 3d: Prudent Investor Rule, Introduction, at 5. As a
result, there is a basis for concluding that the first condition
is satisfied in virtually all States except those in which a
trustee is permitted to invest only in assets set forth in a
statutory "legal list."

2 The second condition will be met when the terms of the trust
3 require all of the "income" to be distributed at regular
4 intervals; or when the terms of the trust require a trustee to
5 distribute all of the income, but permit the trustee to decide
6 how much to distribute to each member of a class of
7 beneficiaries; or when the terms of a trust provide that the
8 beneficiary shall receive the greater of the trust accounting
9 income and a fixed dollar amount (an annuity), or of trust
10 accounting income and a fractional share of the value of the
11 trust assets (a unitrust amount). If the trust authorizes the
12 trustee in its discretion to distribute the trust's income to the
13 beneficiary or to accumulate some or all of the income, the
14 condition will be met because the terms of the trust do not
15 permit the trustee to distribute more than the trust accounting
16 income.

17 To meet the third condition, the trustee must first meet the
18 requirements of Section 103(a), i.e., she must apply the terms of
19 the trust, decide whether to exercise the discretionary powers
20 given to the trustee under the terms of the trust, and must apply
21 the provisions of the Act if the terms of the trust do not
22 contain a different provision or give the trustee discretion.
23 Second, the trustee must determine the extent to which the terms
24 of the trust clearly manifest an intention by the settlor that
25 the trustee may or must favor one or more of the beneficiaries.
26 To the extent that the terms of the trust do not require
27 partiality, the trustee must conclude that she is unable to
28 comply with the duty to administer the trust impartially. To the
29 extent that the terms of the trust do require or permit the
30 trustee to favor the income beneficiary or the remainder
31 beneficiary, the trustee must conclude that she is unable to
32 achieve the degree of partiality required or permitted. If the
33 trustee comes to either conclusion - that she is unable to
34 administer the trust impartially or that she is unable to achieve
35 the degree of partiality required or permitted - she may exercise
36 the power to adjust under Section 104(a).

37 **Impartiality and productivity of income.** The duty of
38 impartiality between income and remainder beneficiaries is linked
39 to the trustee's duty to make the portfolio productive of trust
40 accounting income whenever the distribution requirements are
41 expressed in terms of distributing the trust's "income." The
42 1962 Act implies that the duty to produce income applies on an
43 asset by asset basis because the right of an income beneficiary
44 to receive "delayed income" from the sale proceeds of
45 underproductive property under Section 12 of that Act arises if
46 "any part of principal ... has not produced an average net income
47 of a least 1% per year of its inventory value for more than a
48 year" Under the prudent investor rule, "[t]o whatever
49 extent a requirement of income productivity exists, ... the
50

requirement applies not investment by investment but to the portfolio as a whole." Restatement of Trusts 3d: Prudent Investor Rule § 227, Comment i, at 34. The power to adjust under Section 104(a) is also to be exercised by considering net income from the portfolio as a whole and not investment by investment. Section 413(b) of this Act eliminates the underproductive property rule in all cases other than trusts for which a marital deduction is allowed; the rule applies to a marital deduction trust if the trust's assets "consist substantially of property that does not provide the spouse with sufficient income from or use of the trust assets ..." - in other words, the section applies by reference to the portfolio as a whole.

While the purpose of the power to adjust in Section 104(a) is to eliminate the need for a trustee who operates under the prudent investor rule to be concerned about the income component of the portfolio's total return, the trustee must still determine the extent to which a distribution must be made to an income beneficiary and the adequacy of the portfolio's liquidity as a whole to make that distribution.

For a discussion of investment considerations involving specific investments and techniques under the prudent investor rule, see Restatement of Trusts 3d: Prudent Investor Rule § 227, Comments k-p.

Factors to consider in exercising the power to adjust. Section 104(b) requires a trustee to consider factors relevant to the trust and its beneficiaries in deciding whether and to what extent the power to adjust should be exercised. Section 2(c) of the Uniform Prudent Investor Act sets forth circumstances that a trustee is to consider in investing and managing trust assets. The circumstances in Section 2(c) of the Uniform Prudent Investor Act are the source of the factors in paragraphs (3) through (6) and (8) of Section 104(b) (modified where necessary to adapt them to the purposes of this Act) so that, to the extent possible, comparable factors will apply to investment decisions and decisions involving the power to adjust. If a trustee who is operating under the prudent investor rule decides that the portfolio should be composed of financial assets whose total return will result primarily from capital appreciation rather than dividends, interest, and rents, the trustee can decide at the same time the extent to which an adjustment from principal to income may be necessary under Section 104. On the other hand, if a trustee decides that the risk and return objectives for the trust are best achieved by a portfolio whose total return includes interest and dividend income that is sufficient to provide the income beneficiary with the beneficial interest to which the beneficiary is entitled under the terms of the trust,

the trustee can decide that it is unnecessary to exercise the power to adjust.

Assets received from the settlor. Section 3 of the Uniform Prudent Investor Act provides that "[a] trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying." The special circumstances may include the wish to retain a family business, the benefit derived from deferring liquidation of the asset in order to defer payment of income taxes, or the anticipated capital appreciation from retaining an asset such as undeveloped real estate for a long period. To the extent the trustee retains assets received from the settlor because of special circumstances that overcome the duty to diversify, the trustee may take these circumstances into account in determining whether and to what extent the power to adjust should be exercised to change the results produced by other provisions of this Act that apply to the retained assets. See Section 104(b)(5); Uniform Prudent Investor Act § 3, Comment, 7B U.L.A. 18, at 2526 (Supp. 1997); Restatement of Trusts 3d: Prudent Investor Rule § 229 and Comments *a-c*.

Limitations on the power to adjust. The purpose of subsections (c)(1) through (4) is to preserve tax benefits that may have been an important purpose for creating the trust. Subsections (c)(5), (6), and (8) deny the power to adjust in the circumstances described in those subsections in order to prevent adverse tax consequences, and subsection (c)(7) denies the power to adjust to any beneficiary, whether or not possession of the power may have adverse tax consequences.

Under subsection (c)(1), a trustee cannot make an adjustment that diminishes the income interest in a trust that requires all of the income to be paid at least annually to a spouse and for which an estate tax or gift tax marital deduction is allowed; but this subsection does not prevent the trustee from making an adjustment that increases the amount of income paid from a marital deduction trust to the spouse. Subsection (c)(1) applies to a trust that qualifies for the marital deduction because the spouse has a general power of appointment over the trust, but it applies to a qualified terminable interest property (QTIP) trust only if and to the extent that the fiduciary makes the election required to obtain the tax deduction. Subsection (c)(1) does not apply to a so-called "estate" trust. This type of trust qualifies for the marital deduction because the terms of the trust require the principal and undistributed income to be paid to the surviving spouse's estate when the spouse dies; it is not necessary for the terms of an estate trust to require the income to be distributed annually. Reg. § 20.2056(c)2(b)(1)(iii).

2 Subsection (c)(3) applies to annuity trusts and unitrusts
4 with no charitable beneficiaries as well as to trusts with
6 charitable income or remainder beneficiaries; its purpose is to
8 make it clear that a beneficiary's right to receive a fixed
10 annuity or a fixed fraction of the value of a trust's assets is
12 not subject to adjustment under Section 104(a). Subsection
14 (c)(3) does not apply to any additional amount to which the
beneficiary may be entitled that is expressed in terms of a right
to receive income from the trust. For example, if a beneficiary
is to receive a fixed annuity or the trust's income, whichever is
greater, subsection (c)(3) does not prevent a trustee from making
an adjustment under Section 104(a) in determining the amount of
the trust's income.

16 If subsection (c)(5), (6), (7), or (8), prevents a trustee
18 from exercising the power to adjust, subsection (d) permits a
20 cotrustee who is not subject to the provision to exercise the
power unless the terms of the trust do not permit the cotrustee
to do so.

22 **Release of the power to adjust.** Section 104(e) permits a
24 trustee to release all or part of the power to adjust in
26 circumstances in which the possession or exercise of the power
might deprive the trust of a tax benefit or impose a tax burden.
28 For example, if possessing the power would diminish the actuarial
30 value of the income interest in a trust for which the income
32 beneficiary's estate may be eligible to claim a credit for
property previously taxed if the beneficiary dies within ten
years after the death of the person creating the trust, the
trustee is permitted under subsection (e) to release just the
power to adjust from income to principal.

34 **Trust terms that limit a power to adjust.** Section 104(f)
36 applies to trust provisions that limit a trustee's power to
38 adjust. Since the power is intended to enable trustees to employ
40 the prudent investor rule without being constrained by
42 traditional principal and income rules, an instrument executed
44 before the adoption of this Act whose terms describe the amount
46 that may or must be distributed to a beneficiary by referring to
the trust's income or that prohibit the invasion of principal or
that prohibit equitable adjustments in general should not be
construed as forbidding the use of the power to adjust under
Section 104(a) if the need for adjustment arises because the
trustee is operating under the prudent investor rule.
Instruments containing such provisions that are executed after
the adoption of this Act should specifically refer to the power
to adjust if the settlor intends to forbid its use. See
generally, Joel C. Dobris, Limits on the Doctrine of Equitable

Adjustment in Sophisticated Postmortem Tax Planning, 66 Iowa L. Rev. 273 (1981).

Examples. The following examples illustrate the application of Section 104:

Example (1) - T is the successor trustee of a trust that provides income to A for life, remainder to B. T has received from the prior trustee a portfolio of financial assets invested 20% in stocks and 80% in bonds. Following the prudent investor rule, T determines that a strategy of investing the portfolio 50% in stocks and 50% in bonds has risk and return objectives that are reasonably suited to the trust, but T also determines that adopting this approach will cause the trust to receive a smaller amount of dividend and interest income. After considering the factors in Section 104(b), T may transfer cash from principal to income to the extent T considers it necessary to increase the amount distributed to the income beneficiary.

Example (2) - T is the trustee of a trust that requires the income to be paid to the settlor's son C for life, remainder to C's daughter D. In a period of very high inflation, T purchases bonds that pay double-digit interest and determines that a portion of the interest, which is allocated to income under Section 406 of this Act, is a return of capital. In consideration of the loss of value of principal due to inflation and other factors that T considers relevant, T may transfer part of the interest to principal.

Example (3) - T is the trustee of a trust that requires the income to be paid to the settlor's sister E for life, remainder to charity F. E is a retired schoolteacher who is single and has no children. E's income from her social security, pension, and savings exceeds the amount required to provide for her accustomed standard of living. The terms of the trust permit T to invade principal to provide for E's health and to support her in her accustomed manner of living, but do not otherwise indicate that T should favor E or F. Applying the prudent investor rule, T determines that the trust assets should be invested entirely in growth stocks that produce very little dividend income. Even though it is not necessary to invade principal to maintain E's accustomed standard of living, she is entitled to receive from the trust the degree of beneficial enjoyment normally accorded a person who is the sole income beneficiary of a trust, and T may transfer cash from principal to income to provide her with that degree of enjoyment.

Example (4) - T is the trustee of a trust that is governed by the law of State X. The trust became irrevocable before State X adopted the prudent investor rule. The terms of the trust

require all of the income to be paid to G for life, remainder to H, and also give T the power to invade principal for the benefit of G for "dire emergencies only." The terms of the trust limit the aggregate amount that T can distribute to G from principal during G's life to 6% of the trust's value at its inception. The trust's portfolio is invested initially 50% in stocks and 50% in bonds, but after State X adopts the prudent investor rule T determines that, to achieve suitable risk and return objectives for the trust, the assets should be invested 90% in stocks and 10% in bonds. This change increases the total return from the portfolio and decreases the dividend and interest income. Thereafter, even though G does not experience a dire emergency, T may exercise the power to adjust under Section 104(a) to the extent that T determines that the adjustment is from only the capital appreciation resulting from the change in the portfolio's asset allocation. If T is unable to determine the extent to which capital appreciation resulted from the change in asset allocation or is unable to maintain adequate records to determine the extent to which principal distributions to G for dire emergencies do not exceed the 6% limitation, T may not exercise the power to adjust. See Joel C. Dobris, Limits on the Doctrine of Equitable Adjustment in Sophisticated Postmortem Tax Planning, 66 Iowa L. Rev. 273 (1981).

Example (5) - T is the trustee of a trust for the settlor's child. The trust owns a diversified portfolio of marketable financial assets with a value of \$600,000, and is also the sole beneficiary of the settlor's IRA, which holds a diversified portfolio of marketable financial assets with a value of \$900,000. The trust receives a distribution from the IRA that is the minimum amount required to be distributed under the Internal Revenue Code, and T allocates 10% of the distribution to income under Section 409(c) of this Act. The total return on the IRA's assets exceeds the amount distributed to the trust, and the value of the IRA at the end of the year is more than its value at the beginning of the year. Relevant factors that T may consider in determining whether to exercise the power to adjust and the extent to which an adjustment should be made to comply with Section 103(b) include the total return from all of the trust's assets, those owned directly as well as its interest in the IRA, the extent to which the trust will be subject to income tax on the portion of the IRA distribution that is allocated to principal, and the extent to which the income beneficiary will be subject to income tax on the amount that T distributes to the income beneficiary.

Example (6) - T is the trustee of a trust whose portfolio includes a large parcel of undeveloped real estate. T pays real property taxes on the undeveloped parcel from income each year pursuant to Section 501(3). After considering the return from

the trust's portfolio as a whole and other relevant factors described in Section 104(b), T may exercise the power to adjust under Section 104(a) to transfer cash from principal to income in order to distribute to the income beneficiary an amount that T considers necessary to comply with Section 103(b).

Example (7) - T is the trustee of a trust whose portfolio includes an interest in a mutual fund that is sponsored by T. As the manager of the mutual fund, T charges the fund a management fee that reduces the amount available to distribute to the trust by \$2,000. If the fee had been paid directly by the trust, one-half of the fee would have been paid from income under Section 501(l) and the other one-half would have been paid from principal under Section 502(a)(1). After considering the total return from the portfolio as a whole and other relevant factors described in Section 104(b), T may exercise its power to adjust under Section 104(a) by transferring \$1,000, or half of the trust's proportionate share of the fee, from principal to income.

Maine Comment

Section 7-704(a) deletes the requirement in the Uniform Act that in order to adjust, the trustee must invest and manage the trust assets as a prudent investor. Investing as a prudent investor does not improve the trustee's ability to effectively or efficiently adjust between principal and income. Also, the requirement of the Uniform Act unnecessarily provides a potential basis for a beneficiary to contest the trustee's adjustment between principal and income by contending that the trustee failed to fully adhere to the principles of the prudent investor rule.

Section 7-704(c)(8) has been changed to recognize the addition of the power to convert to a unitrust under Section 7-705. The trustee may not exercise the power to adjust if the trust has been converted to a unitrust. The Uniform Act's paragraph (c)(8), prohibiting adjustments if the trustee is not a beneficiary but would be directly or indirectly benefited by the adjustment has been deleted, because it might prohibit a corporate trustee, whose fees are based on the amount of principal assets under management, from making an adjustment from income to principal and thereby increasing its future fees. Section 7-704(c)(7) appears to be sufficient protection from conflicts of interest.

Section 7-704(d) has been changed to avoid having the terms of the trust inadvertently undermine the Uniform Act's intent to permit an independent cotrustee to make the adjustment. Under the Uniform Act, if making an adjustment would cause trust income to be taxed to the trustee, or cause estate tax inclusion in the

estate of the trustee, or if the trustee is a beneficiary of the trust, then a cotrustee may make the adjustment "unless the exercise of the power by the remaining trustee or trustees is prohibited by the terms of the trust." Without the added language in subsection (d), a trust provision that requires 2 cotrustees to act by agreement, or by majority vote, might be construed to be such a prohibition.

§7-705. Power to convert to unitrust

(a) Unless expressly prohibited by the terms of the trust, a trustee may release the power to adjust under section 7-704 and convert a trust into a unitrust as described in this section if all of the following apply.

(1) The trustee determines that the conversion will improve the ability of the trustee to carry out the intent of the settlor and the purposes of the trust.

(2) The trustee gives written notice of the trustee's intention to release the power to adjust and to convert the trust into a unitrust and of how the unitrust will operate, including what initial decisions the trustee will make under this section, to the following beneficiaries:

(i) All beneficiaries who are currently eligible to receive income from the trust; and

(ii) All beneficiaries who would receive, if no power of appointment were exercised, a distribution of principal if the trust were to terminate immediately prior to the giving of notice.

(3) There is at least one beneficiary eligible to receive income and at least one beneficiary who would receive principal as described in paragraph (2).

(4) No beneficiary objects to the conversion to a unitrust in a writing delivered to the trustee within 60 days of the mailing of the notice required under paragraph (2).

(b) If a beneficiary timely objects to the conversion to a unitrust or if the requirements of subsection (a), paragraph (3) are not met, the trustee may petition the court to approve the conversion to a unitrust. A beneficiary may request a trustee to convert to a unitrust and, if the trustee does not convert, the beneficiary may petition the court to order the conversion. Upon receipt of a petition by the trustee or a beneficiary, the court shall approve the conversion or direct the requested conversion if the court concludes that the conversion will better enable the

Page

2 trustee to carry out the intent of the settlor and the purposes
3 of the trust.

4 (c) In deciding whether to exercise the power conferred by
5 subsection (a), a trustee shall consider the following factors to
6 the extent they are relevant:

8 (1) The nature, purpose and expected duration of the trust;

10 (2) The identity and circumstances of the beneficiaries
11 and, to the extent reasonably known to the trustee, the
12 needs of the beneficiaries for present and future
13 distributions authorized or required by the terms of the
14 trust;

16 (3) The needs for liquidity, regularity of income and
17 preservation and appreciation of capital;

18 (4) The assets held in the trust; the extent to which they
19 consist of financial assets, interests in closely held
20 enterprises, tangible and intangible personal property or
21 real property; and the extent to which an asset is used by a
22 beneficiary;

24 (5) Whether and to what extent the terms of the trust give
25 the trustee the power to invade principal or accumulate
26 income or prohibit the trustee from invading principal or
27 accumulating income, and the extent to which the trustee has
28 exercised a power from time to time to invade principal or
29 accumulate income;

32 (6) The actual and anticipated effect of economic
33 conditions on principal and income and effects of inflation
34 and deflation; and

36 (7) The anticipated tax consequences of the conversion.

38 (d) After a trust is converted to a unitrust, all of the
39 following apply.

40 (1) The trustee shall follow an investment policy seeking a
41 total return for the investments held by the trust, whether
42 the return is to be derived from appreciation of capital,
43 from earnings and distributions from capital or from both.

46 (2) The trustee shall make regular distributions in
47 accordance with the terms of the trust construed in
48 accordance with the provisions of this section.

2 (3) The term "income" in the terms of the trust means an
3 annual distribution, known as the "unitrust distribution,"
4 equal to 4%, known as the "payout percentage," of the net
5 fair market value of the trust's assets, whether such assets
6 would be considered income or principal under other
7 provisions of this Part, averaged over the lesser of the 3
8 preceding years or the period during which the trust has
9 been in existence.

10 (e) The trustee may in the trustee's discretion from time
11 to time determine all of the following:

12 (1) The effective date of a conversion to a unitrust;

13 (2) The provisions for prorating a unitrust distribution
14 for a short year in which a beneficiary's right to payment
15 commences or ceases;

16 (3) The frequency of unitrust distributions during the year;

17 (4) The effect of other payments from or contributions to
18 the trust on the trust's valuation;

19 (5) Whether to value the trust's assets annually or more
20 frequently;

21 (6) What valuation dates to use;

22 (7) How frequently to value nonliquid assets and whether to
23 estimate their value;

24 (8) Whether to omit from the calculation of the unitrust
25 distribution trust property occupied or possessed by a
26 beneficiary; and

27 (9) Any other matters necessary for the proper functioning
28 of the unitrust.

29 (f) After a trust is converted to a unitrust, the following
30 allocation rules apply to the trust.

31 (1) Expenses that would be deducted from income if the
32 trust were not a unitrust may not be deducted from the
33 unitrust distribution.

34 (2) Unless otherwise provided by the terms of the trust,
35 the unitrust distribution must be paid from net income, as
36 net income would be determined if the trust were not a
37 unitrust. To the extent net income is insufficient, the
38 unitrust distribution must be paid from net realized
39 income.

short-term capital gains. To the extent net income and net realized short-term capital gains are insufficient, the unitrust distribution must be paid from net realized long-term capital gains. To the extent net income and net realized short-term and long-term capital gains are insufficient, the unitrust distribution must be paid from the principal of the trust.

(g) The trustee or, if the trustee declines to do so, a beneficiary may petition the court to do any of the following:

(1) Select a payout percentage other than 4%;

(2) Provide for a distribution of net income, as would be determined if the trust were not a unitrust, in excess of the unitrust distribution if such distribution is necessary to preserve a tax benefit;

(3) Average the valuation of the trust's net assets over a period other than 3 years; or

(4) Reconvert from a unitrust. Upon a reconversion, the power to adjust under section 7-704 is revived.

(h) A conversion to a unitrust does not affect a provision in the terms of the trust directing or authorizing the trustee to distribute principal or authorizing a beneficiary to withdraw a portion or all of the principal.

(i) A trustee may not convert a trust into a unitrust if any of the following applies:

(1) Payment of the unitrust distribution would change the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets;

(2) The unitrust distribution would be made from any amount that is permanently set aside for charitable purposes under a will or the terms of the trust unless both income and principal are so set aside;

(3) The trustee's possession or exercise of the power to convert would cause an individual to be treated as the owner of all or part of the trust for income tax purposes, and the individual would not be treated as the owner if the trustee did not possess the power to convert;

(4) The trustee's possession or exercise of the power to convert would cause all or part of the trust assets to be included for estate tax purposes in the estate of an

Page

2 individual who has the power to remove a trustee or appoint
3 a trustee, or both, and the assets would not be included in
4 the estate of the individual if the trustee did not possess
5 the power to convert;

6 (5) The conversion would result in the disallowance of an
7 estate tax or gift tax marital deduction that would be
8 allowed if the trustee did not have the power to convert; or

10 (6) The trustee is a beneficiary of the trust.

12 (j) If subsection (i), paragraph (3), (4) or (6) applies to
13 a trustee and there is more than one trustee, a cotrustee to whom
14 the provision does not apply may convert the trust unless the
15 exercise of the power by the remaining trustee or trustees is
16 prohibited by the terms of the trust. Terms of the trust
17 requiring that if there are 2 or more trustees serving they must
18 act by agreement or by any majority or percentage consensus may
19 not be construed to prohibit the remaining trustee or trustees
20 from exercising the power to convert. If subsection (i),
21 paragraph (3), (4) or (6) applies to all the trustees, the
22 trustees may petition the court to direct a conversion.

24 (k) A trustee may release the power conferred by subsection
25 (a) to convert to a unitrust if the trustee is uncertain about
26 whether possessing or exercising the power will cause a result
27 described in subsection (i), paragraph (3), (4) or (5) or if the
28 trustee determines that possessing or exercising the power will
29 or may deprive the trust of a tax benefit or impose a tax burden
30 not described in subsection (i). The release of the power to
31 convert to a unitrust may be permanent or for a specified period,
32 including a period measured by the life of an individual.

34 **Maine Comment**

36 This section is modeled after Pennsylvania's unitrust
37 provision, 20 Pa. Cons. Stat. Ann. §8105.

38 This section allows conversion to a unitrust, in which case
39 the question of how to allocate receipts and disbursements
40 between income and principal becomes irrelevant in determining
41 the unitrust distribution amount. The 4% unitrust is an
42 alternative to using the power to adjust under section 7-704 to
43 determine the appropriate distribution to the current
44 beneficiary. Caveat: The federal income, gift and estate tax
45 treatment of unitrusts is presently uncertain. On February 15,
46 2001, the Internal Revenue Service issued proposed regulations
47 that, when finalized, will provide certainty to many questions
48 about the federal tax treatment of unitrusts. The proposed
49 regulations are applicable to trusts and estates for taxable
50

years that begin on or after the date that the final regulations are published in the Federal Register. Until then, certain tax treatment of unitrusts, e.g., the effect of converting certain trusts exempt from generation-skipping tax into a unitrust, and the ability to qualify a trust for the gift or estate tax marital deduction, is uncertain. Subsection (g) is designed in part to allow the trustee, by petition to the court, to preserve the exemption from generation-skipping tax that might otherwise be jeopardized for certain trusts as a result of conversion to a unitrust. Practitioners should determine the status of the proposed regulations in order to evaluate the federal income, gift and estate (including generation-skipping) tax treatment that will result from conversion to a unitrust.

Under Section 7-705(a)(2), because the unitrust may not be familiar to most beneficiaries, the trustee is required to notify them and can not convert to a unitrust in the face of an objection from a beneficiary without a court order. In the case of a minor or incapacitated beneficiary, the required notice may, as in other similar instances, be given to the beneficiary's court-appointed conservator or, in the case of an incapacitated adult, the beneficiary's attorney-in-fact acting under an appropriate durable power of attorney.

Under Section 7-705(c), the list of factors to consider is similar to the list of factors to be considered by the trustee when investing and managing trust assets under the prudent investor rule as described in the Maine Revised Statutes, Title 18-A, section 7-302.

Giving the trustee discretion under Section 7-705(e) seems preferable to creating a statutory straightjacket.

Section 7-705(f) provides an ordering rule that directs how the unitrust distribution should be paid: first from net income, 2nd from net-realized short-term capital gain, 3rd from net-realized long-term capital gain and 4th from principal.

Section 7-705(i), (j) and (k) parallel similar provisions in Section 7-704 regarding the power to adjust.

§7-706. Judicial review of discretionary powers

(a) A court may not change a fiduciary's decision to exercise or not to exercise a discretionary power conferred by this Part unless it determines that the decision was an abuse of the fiduciary's discretion. A court may not determine that a fiduciary abused the fiduciary's discretion merely because the court would have exercised the discretion in a different manner or would not have exercised the discretion.

2 (b) If a court determines that a fiduciary has abused the
3 fiduciary's discretion in exercising a discretionary power
4 conferred by this Part, the remedy is to restore the income and
5 remainder beneficiaries to the positions they would have occupied
6 if the fiduciary had not abused the fiduciary's discretion,
7 according to the following rules.

8
9 (1) To the extent that the abuse of discretion has resulted
10 in no distribution to a beneficiary or a distribution that
11 is too small, the court shall require the fiduciary to
12 distribute from the trust to the beneficiary an amount that
13 the court determines will restore the beneficiary, in whole
14 or in part, to the beneficiary's appropriate position.

15 (2) To the extent that the abuse of discretion has resulted
16 in a distribution to a beneficiary that is too large, the
17 court shall restore the beneficiaries or the trust, or both,
18 in whole or in part, to their appropriate positions by
19 requiring the fiduciary to withhold an amount from one or
20 more future distributions to the beneficiary who received
21 the distribution that was too large or requiring that
22 beneficiary or that beneficiary's estate to return some or
23 all of the distribution to the trust, notwithstanding a
24 spendthrift or similar provision.

25 (3) If the abuse of discretion concerns the power to
26 convert a trust into a unitrust, the court shall require the
27 trustee either to convert the trust to a unitrust or to
28 reconvert from a unitrust.

29 (4) To the extent that the court is unable, after applying
30 paragraphs (1), (2) and (3), to restore the beneficiaries or
31 the trust, or both, to the positions they would have
32 occupied if the fiduciary had not abused the fiduciary's
33 discretion, the court may require the fiduciary to pay an
34 appropriate amount from the fiduciary's own funds to one or
35 more of the beneficiaries or the trust, or both.

36 (c) Upon a petition by the fiduciary, a court having
37 jurisdiction over the trust or estate shall determine whether a
38 proposed exercise or nonexercise by the fiduciary of a
39 discretionary power conferred by this Part will result in an
40 abuse of the fiduciary's discretion. If the petition describes
41 the proposed exercise or nonexercise of the power and contains
42 sufficient information to inform the beneficiaries of the reasons
43 for the proposal, the facts upon which the fiduciary relies and
44 an explanation of how the income and remainder beneficiaries will
45 be affected by the proposed exercise or nonexercise of the power,
46 a beneficiary who challenges the proposed exercise or nonexercise

has the burden of establishing that it will result in an abuse of discretion.

Uniform Comment

(This is based on Section 105 of the Uniform Principal and Income Act (1997).)

General. All the discretionary powers in the 1997 Act are subject to the normal rules that govern a fiduciary's exercise of discretion. Section 105 codifies those rules for purposes of the Act so that they will be readily apparent and accessible to fiduciaries, beneficiaries, their counsel and the courts if and when questions concerning such powers arise.

Section 105 also makes clear that the normal rules governing the exercise of a fiduciary's powers apply to the discretionary power to adjust conferred upon a trustee by section 104(a). Discretionary provisions authorizing trustees to determine what is income and what is principal have been used in governing instruments for years; section 2 of the 1931 Uniform Principal and Income Act recognized that practice by providing that "the person establishing the principal may himself direct the manner of ascertainment of income and principal. . . or grant discretion to the trustee or other person to do so..." Section 103(a)(2) recognizes the power of a settlor to grant such discretion to the trustee; section 105 applies to a discretionary power granted by the terms of a trust or a will and to the power to adjust in section 104(a).

The exercise of the power to adjust is governed by a trustee's duty of impartiality, which requires the trustee to strike an appropriate balance between the interests of the income and remainder beneficiaries. Section 103(b) expresses this duty by requiring the trustee to "administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries." Because this involves the exercise of judgment in circumstances rarely capable of perfect resolution, trustees are not expected to achieve perfection; they are, however, required to make conscious decisions in good faith and with proper motives.

In seeking the proper balance between the interests of the beneficiaries in matters involving principal and income, a trustee's traditional approach has been to determine the settlor's objectives from the terms of the trust, gather the information needed to ascertain the financial circumstances of the beneficiaries, determine the extent to which the settlor's

2 objectives can be achieved with the resources available in the
3 trust, and then allocate the trust's assets between stocks and
4 fixed-income securities in a way that will produce a particular
5 level or range of income for the income beneficiary. The key
6 element in this process has been to determine the appropriate
7 level or range of income for the income beneficiary, and that
8 will continue to be the key element in deciding whether and to
9 what extent to exercise the discretionary power conferred by
10 section 104(a). If it becomes necessary for a court to determine
11 whether an abuse of the discretionary power to adjust between
12 principal and income has occurred, the criteria should be the
13 same as those that courts have used in the past to determine
14 whether a trustee has abused its discretion in allocating the
15 trust's assets between stocks and fixed-income securities.

16 **General rule.** The first sentence of section 105(a) is from
17 Restatement (Second) of Trusts § 187 and Restatement (Third) of
18 Trusts (Tentative Draft No. 2, 1999), § 50(1). The second
19 sentence of section 105(a) derives from Comment *e* to § 187 of the
20 Second Restatement and Comment *b* to § 50 of the Third Restatement.

22 The reference in section 105(a) to a fiduciary's decision to
23 exercise or not to exercise a discretionary power underscores a
24 fundamental precept, which is that a fiduciary has a duty to make
25 a conscious decision about exercising or not exercising a
26 discretionary power. Comment *b* to § 50 of the Third Restatement
27 states:

28 [A] court will intervene where the exercise of a power is
29 left to the judgment of a trustee who improperly fails to
30 exercise that judgment. Thus, even where a trustee has
31 discretion whether or not to make any payments to a
32 particular beneficiary, the court will interpose if the
33 trustee, arbitrarily or without knowledge of or inquiry into
34 relevant circumstances, fails to exercise the discretion.

36 Section 105(b) makes clear that the rule of subsection (a)
37 applies not only to the power conferred by section 104(a) but
38 also to the evaluation process required by section 104(b) in
39 deciding whether and to what extent to exercise the power to
40 adjust. Under section 104(b), a trustee is to consider all of
41 the factors that are relevant to the trust and its beneficiaries,
42 including, to the extent the trustee determines they are
43 relevant, the nine factors enumerated in section 104(b). Section
44 104(b) derives from section 2(c) of the Uniform Prudent Investor
45 Act, which lists eight circumstances that a trustee shall
46 consider, to the extent they are relevant, in investing and
47 managing assets. The trustee's decisions about what factors are
48 relevant for purposes of section 104(b) and the weight to be
49 accorded each of the relevant factors are part of the
50

discretionary decision-making process. As such, these decisions are not subject to change for the purpose of changing the trustee's ultimate decision unless the court determines that there has been an abuse of discretion in determining the relevancy and weight of these factors.

Remedy. The exercise or nonexercise of a discretionary power under the Act normally affects the amount or timing of a distribution to the income or remainder beneficiaries. The primary remedy under section 105(c) for abuse of discretion is the restoration of the beneficiaries and the trust to the positions they would have occupied if the abuse had not occurred. It draws on a basic principle of restitution that if a person pays money to someone who is not intended to receive it (and in a case to which this Act applies, not intended by the settlor to receive it in the absence of an abuse of discretion by the trustee), that person is entitled to restitution on the ground that the payee would be unjustly enriched if he were permitted to retain the payment. See Restatement of Restitution § 22 (1937). The objective is to accomplish the restoration initially by making adjustments between the beneficiaries and the trust to the extent possible; to the extent that restoration is not possible by such adjustments, a court may order the trustee to pay an amount to one or more of the beneficiaries, the trust, or both the beneficiaries and the trust. If the court determines that it is not possible in the circumstances to restore them to their appropriate positions, the court may provide other remedies appropriate to the circumstances. The approach of section 105(c) is supported by Comment b to § 50 of the Third Restatement of Trusts:

When judicial intervention is required, a court may direct the trustee to make or refrain from making certain payments; issue instructions to clarify the standards or guidelines applicable to the exercise of the power; or rescind the trustee's payment decisions, usually directing the trustee to recover amounts improperly distributed and holding the trustee liable for failure or inability to do so...

Advance determinations. Section 105(d) employs the familiar remedy of the trustee's petition to the court for instructions. It requires the court to determine, upon a petition by the fiduciary, whether a proposed exercise or nonexercise of a discretionary power by the fiduciary of a power conferred by the Act would be an abuse of discretion under the general rule of section 105(a). If the petition contains the information prescribed in the second sentence of subsection (d), the proposed action or inaction is presumed not to result in an abuse, and a beneficiary who challenges the proposal must establish that it will.

2 Subsection (d) is intended to provide a fiduciary the
3 opportunity to obtain an assurance of finality in a judicial
4 proceeding before proceeding with a proposed exercise or
5 nonexercise of a discretionary power. Its purpose is not,
6 however, to have the court instruct the fiduciary how to exercise
7 the discretion.

8
9 A fiduciary may also obtain the consent of the beneficiaries
10 to a proposed act or an omission to act, and a beneficiary cannot
11 hold the fiduciary liable for that act or omission unless:

12 (a) the beneficiary was under an incapacity at the time of
13 such consent or of such act or omission; or

14 (b) the beneficiary, when he gave his consent, did not know
15 of his rights and of the material facts which the trustee knew or
16 should have known and which the trustee did not reasonably
17 believe that the beneficiary knew; or

18 (c) the consent of the beneficiary was induced by improper
19 conduct of the trustee.

20
21 Restatement (Second) of Trusts § 216.

22
23 If there are many beneficiaries, including some who are
24 incapacitated or unascertained, the fiduciary may prefer the
25 greater assurance of finality provided by a judicial proceeding
26 that will bind all persons who have an interest in the trust.

27
28 **Maine Comment**

29 Subsection (b) of Section 105 of the Uniform Act lists the
30 determinations to which subsection (a) applies. This has been
31 omitted as unnecessary.'

32 Further amend the bill in section 1 in Part 7 in Subpart 2
33 in that part designated "~~§7-721.~~" in subsection (b) in paragraph
34 (3) in the 5th line (page 20, line 35 in L.D.) by striking out
35 the following: "family allowances" and inserting in its place the
36 following: 'exempt property and allowances distributable
37 pursuant to Article II, Part 4'

38 Further amend the bill in section 1 in Part 7 in Subpart 2
39 in that part designated "~~§7-721.~~" in subsection (c) in the last
40 line (page 20, line 49 in L.D.) by inserting after the
41 following: "under a will" the following: 'under section 3-904'

42 Further amend the bill in section 1 in Part 7 in Subpart 2
43 in that part designated "~~§7-721.~~" under that part relating to

"Uniform Comment" by inserting at the end on page 23 the following:

'Maine Comment

Subsection (c) of this section has been altered from the uniform version only by the insertion of the cross-reference to section 3-904, which is the section controlling the payment of interest on pecuniary devises, to avoid confusion.

Subsection (d) of this section replaces former section 8-202 and, like it, has the effect of allocating income earned during estate administration to residuary devisees and devisees of pecuniary interests in trust. The former section 8-202 required that residuary devisees receive their "pro rata" share of income earned during administration, while devisees of pecuniary devises in trust received an allocation determined to a separate formula, colloquially referred to as a "fixed fraction" formula, mandated under former section 8-203.

The combined effect of this section and section 7-722, to which this section refers, will be to require proration of income earned during administration among both residuary devisees and recipients of pecuniary devises in trust in the same fashion: according to what is colloquially known as the "changing fraction" method. This method is fairer and more accurate than former section 8-203 "fixed fraction" method.

This section and section 7-722, taken together, will also require for the first time that pecuniary dispositions in trust and remainder dispositions under inter vivos trust documents receive the same income entitlement as pecuniary devises in trust and residuary dispositions under will. Maine law has heretofore been silent on the question of how income should be allocated among takers from an inter vivos trust.'

Further amend the bill in section 1 in Part 7 in Subpart 2 in that part designated "~~§7-722.~~" under that part relating to "Uniform Comment" by inserting at the end of the comment on page 25 the following:

'Maine Comment

This section requires proration of income received during estate administration or before division of an inter vivos trust into separate shares among devisees who take pecuniary dispositions in trust or who take a share of the residue (if under a will) or among beneficiaries who take pecuniary dispositions in trust or a share of the remainder (if under an inter vivos trust document). It also requires that the "changing

fraction" method be used to accomplish the proration. For a comparison of the "changing fraction" and "fixed fraction" methods, see Covey, op. cit. supra in the Uniform Comment; Cantrill, op. cit. supra in the Uniform Comment; Kurtz, Allocation of Increases and Decreases to Fractional Share Marital Deduction Bequests, 8 R. Prop. Prob & Tr. J. 450 (1973). For a discussion of the treatment of income allocation in Maine under the former law, see Hunt, Fractional or Pecuniary: Who Cares and Why? 8 Me. B. J. 280 (1993). Former section 8-203 required a fixed fraction allocation of income to pecuniary devisees in trust, while former section 8-202 required a "pro rata" allocation among residuary devisees. Neither section 8-202 nor section 8-203 applied, as this section does, to takers under inter vivos trusts.'

Further amend the bill in section 1 in Part 7 in Subpart 4 in that part designated "§7-741." under that part relating to "Uniform Comment" by inserting at the end of the comment on page 33 the following:

'Maine Comment

Section 7-741, subsection (c), paragraph (4) replaces former section 8-204 and is to the same effect, except that the new section applies to real estate investment trusts ("REITs") as well as mutual fund companies. Section 8-204 was facially ambiguous about whether it applied to REITs.'

Further amend the bill in section 1 in Part 7 in Subpart 4 in that part designated "§7-746." under that part relating to "Uniform Comment" by inserting at the end of the comment on page 38 the following:

'Maine Comment

This section replaces the Maine Revised Statutes, Title 18-A, section 8-201, a nonuniform provision relating to nonamortization of bond premiums, that was added to the Uniform Probate Code as adopted in Maine at the time of its original adoption in 1979. Although this section is largely to the same effect as former section 8-201, subsection (b) of this section provides instruction on the treatment proceeds of the sale or redemption of an obligation (such as a United States Treasury Bill) that matures within one year after its acquisition date. Former section 8-201 was silent on this issue. This section treats appreciation on zero-coupon obligations as principal (as long as the obligations are held by the fiduciary for more than one year); former section 8-201 would have allocated appreciation on a noninterest-bearing obligation (such as a zero-coupon bond) to income.'

R/S

2 Further amend the bill in section 1 in Part 7 in Subpart 4
3 by striking out all of that part designated "~~§7-752.~~" (page 48,
4 line 1 to page 48, line 41 in L.D.) and by striking out all of
5 that part designated "**Uniform Comment**" (page 48, line 44 to page
6 49, line 32 in L.D.) and inserting in their place the following:

8 '§7-752. Timber

10 (a) To the extent that a trustee accounts for receipts from
11 the sale of timber and related products pursuant to this section,
12 the trustee shall allocate the net receipts:

14 (1) To income to the extent the net receipts do not exceed
15 the product of (i) mean annual growth multiplied by the
16 number of years since the last timber sale, or, if more
17 recent, the date the timber became a part of the trust,
18 multiplied by (ii) the stumpage rates obtained, after
19 netting against the stumpage rates obtained the expenses
20 associated with the conduct of the sale;

22 (2) To principal to the extent that the proceeds received
23 exceed the amount determined in paragraph (1);

24 (3) To or between income and principal if the net receipts
25 are from the lease of timberland or from a contract to cut
26 timber from land owned by a trust, by determining the amount
27 of timber removed from the land under the lease or contract
28 and applying the rules in paragraphs (1) and (2); or

30 (4) To principal to the extent that advance payments,
31 bonuses and other payments are not allocated pursuant to
32 paragraph (1), (2) or (3).

34 (b) In determining net receipts to be allocated pursuant to
35 subsection (a), a trustee may deduct and transfer to principal a
36 reasonable amount for depletion.

38 (c) This section applies whether or not a decedent or
39 transferor was harvesting timber from the property before it
40 became subject to the trust.

42 (d) If a trust owns an interest in timberland on January 1,
43 2003, the trustee may allocate net receipts from the sale of
44 timber and related products as provided in this section or in the
45 manner used by the trustee before January 1, 2003. If the trust
46 acquires an interest in timberland after January 1, 2003, the
47 trustee shall allocate net receipts from the sale of timber and
48 related products as provided in this section.

50

(e) For purposes of this section, the term "mean annual growth" means, at the trustee's option, either:

(1) The mean annual increment of growth of the timber involved as determined by a licensed professional forester; or

(2) Forty-five hundredths of a cord per acre of woodland.

Uniform Comment

(This section is based on Section 412 of the Uniform Principal and Income Act (1997).)

Scope of section. The rules in Section 412 are intended to apply to net receipts from the sale of trees and by-products from harvesting and processing trees without regard to the kind of trees that are cut or whether the trees are cut before or after a particular number of years of growth. The rules apply to the sale of trees that are expected to produce lumber for building purposes, trees sold as pulpwood, and Christmas and other ornamental trees. Subsection (a) applies to net receipts from property owned by the trustee and property leased by the trustee. The Act is not intended to prevent a tenant in possession of the property from using wood that he cuts on the property for personal, noncommercial purposes, such as a Christmas tree, firewood, mending old fences or building new fences, or making repairs to structures on the property.

Under subsection (a), the amount of net receipts allocated to income depends upon whether the amount of timber removed is more or less than the rate of growth. The method of determining the amount of timber removed and the rate of growth is up to the trustee, based on methods customarily used for the kind of timber involved.

Application of Sections 403 and 408. This section applies to the extent that the trustee does not account separately for net receipts from the sale of timber and related products under Section 403 or allocate all of the receipts to principal under Section 408. The option to account for net receipts separately under Section 403 takes into consideration the possibility that timber harvesting operations may have been conducted before the timber property became subject to the trust, and that it may make sense to continue using accounting methods previously established for the property. It also permits a trustee to use customary accounting practices for timber operations even if no harvesting occurred on the property before it became subject to the trust.

Maine Comment

Paragraphs (1) and (2) of subsection (a) have been changed from the versions contained in the Uniform Act, and subsection (e) is new.

The changes in paragraph (1) and new subsection (e) are intended to make clear that several years may pass in which no timber is harvested. When a harvest does occur after a multiyear hiatus, the income portion of the sales proceeds will be the annual growth multiplied by the number of years since the last harvest (or since the addition of the woodland to the trust, which is a time for a fresh start). While the rate of actual annual growth can vary between less than zero (even without a harvest) and 1.00 cord per acre, and can always be measured by a forester, a growth rate of .45 cords per acre is provided as an alternative. This represents an industrywide rule-of-thumb average, which will be more or less accurate depending on the types of trees and the silvicultural practices employed. It is intended to provide a reasonable growth assumption (and thus avoid either overallocation or underallocation to income) while allowing the trustee (especially in cases of small lots) to avoid the costs associated with obtaining a determination of the actual growth rate from a professional forester.

Paragraph (2) has been altered to eliminate the implication in the uniform provision that the proceeds of sale of standing timber must be allocated to principal. Whether timber is standing or down when a sale occurs has no relevance to the characterization of its proceeds.

Subsection (b) also varies from the Uniform Act by permitting, rather than requiring, a reserve for depletion. Most well-drafted trust documents are permissive on this issue. Trustees may choose to conform their practice on the issue to the depletion allowance available for federal income tax purposes (which may vary from time to time) or may have nontax-related rationales for their decisions on maintenance of reserves.'

Further amend the bill in section 1 in Part 7 in Subpart 4 in that part designated "§7-753." under that part relating to "**Uniform Comment**" by striking out all of the 4th indented paragraph (page 50, lines 47 to 50 and page 51, lines 1 to 4 in L.D.) and inserting in its place the following:

'Trusts for which the value of the right to receive income is important for tax reasons may be affected by Reg. § 1.7520-3(b)(2)(v) *Example (1)*, § 20.7520-3(b)(2)(v) *Examples (1) and (2)*, and § 25.7520-3(b)(2)(v) *Examples (1) and (2)*, which provide that if the income beneficiary does not have the right to compel the trustee to make the property productive, the income

AMS

interest is considered unproductive and may not be valued actuarially under those sections.'

Further amend the bill in section 1 in Part 7 in Subpart 6 by striking out all of those parts designated "~~§7-772.~~" and "~~§7-773.~~" (page 65, lines 13 to 27 in L.D.) and inserting in their place the following:

§7-772. Effective date

This Part takes effect January 1, 2003.

§7-773. Application of Part to all trusts and estates

This Part applies to every trust or decedent's estate, including those in existence on January 1, 2003, beginning with the first fiscal year of the trust or decedent's estate that begins on or after January 1, 2003, except as otherwise expressly provided in the will or terms of the trust or in this Part.

Uniform Comment

(This is Section 605 of the Uniform Principal and Income Act (1997).)

Further amend the bill by inserting at the end before the summary the following:

'Sec. 2. 18-A MRSA Art. VIII, Pt. 2, as enacted by PL 1979, c. 540, §1, is repealed.'

Further amend the bill by relettering or renumbering any nonconsecutive Part letter or section number to read consecutively.

Further amend the bill by inserting at the end before the summary the following:

SUMMARY

This bill, as amended by this committee amendment, adopts the Uniform Principal and Income Act of 1997, referred to as the "New Principal and Income Act" or "NUPIA," as promulgated by the National Conference of Commissions on Uniform State Laws with one minor addition to Maine's existing version of the Uniform Probate Code, UPC, the Maine Revised Statutes, Title 18-A. It also repeals 4 existing nonuniform provisions of Title 18-A, sections 8-201 to 8-204. The 4 repealed provisions are replaced by sections of NUPIA that are largely to the same effect, except as

otherwise pointed out in the Maine Comments to NUPIA sections 7-721, 7-722, 7-741 and 7-746.

In 1995, effective January 1, 1997, Maine adopted the Uniform Prudent Investor Act, UPIA, Title 18-A, section 7-302. UPIA changed slightly the standard of prudence to which fiduciaries, including personal representatives, conservators and trustees, are held. Under the former "Prudent Person Rule," each asset in a fiduciary's portfolio had to constitute, standing alone, a prudent investment. Some investments, such as pork belly futures, would be imprudent investments for fiduciaries under just about any circumstances. Under UPIA's new "Prudent Investor Rule," there are no investments that are imprudent per se for a fiduciary; instead, prudence is determined by reference to the portfolio as a whole, taking into account the goals of the fiduciary's account and the needs of the affected beneficiary or beneficiaries.

UPIA's change in the standard of fiduciary prudence reflected changes in the theory of portfolio management that have taken place since the 1960's. Most investment managers now invest to maximize a portfolio's total return; i.e., to produce the highest number of dollars in investment return, without regard to whether those dollars are in the form of ordinary income from interest and dividends or in the form of capital gains.

In this investment environment, governed by the Prudent Investor Rule of UPIA, a legislative response to the manner in which most trusts have historically been drafted is necessary. Most trust documents require that "income" be paid to one beneficiary or set of beneficiaries, while "principal" may only be distributed under different circumstances or to different beneficiaries. When fiduciaries are investing for total return and without regard to whether the return is in the form of income or capital gain, which is traditionally regarded as principal, income beneficiaries may end up with no income at all.

NUPIA addresses this issue in its section 104, which is Title 18-A, section 7-704, by allowing a trustee to make adjustments between principal and income so that the trust is operated with fairness to both income and principal beneficiaries and so that the trustee discharges the trustee's fiduciary duty to be impartial as between the interests of income beneficiaries and the interests of principal beneficiaries. This is one major reason for this new legislation.

There is, however, a 2nd reason. At least since the UPC became effective in Maine in 1981, the State has had no statute describing how fiduciaries should apportion receipts and

2 disbursements between principal and income except Title 18-A,
3 section 3-916, which tells personal representatives how to
4 apportion estate taxes, and the nonuniform provisions of Title
5 18-A, sections 8-201 to 8-204, which are repealed by this
6 legislation. Two of these 4 sections apply only to estates and
7 not to trusts or conservatorships. Further, the issues addressed
8 by the 4 sections represent a tiny subset of the principal and
9 income allocation issues fiduciaries face every day. Among the
10 common issues addressed by fiduciaries on which Maine has had no
11 law, for example, are as follows.

12 1. Is a dividend paid in stock, rather than in money,
13 income or principal?

14 2. Is a distribution in liquidation of the value of an
15 asset, such as a partnership interest, all principal or allocable
16 in some part to income?

17 3. Are retirement plan assets payable to a decedent's
18 estate, which are treated as taxable income for federal tax
19 purposes, to be treated as principal or income?

20 4. Should an income tax imposed as a result of a trust's
21 capital gains be paid out of income or principal?

22 5. Should a trustee's commission be charged against income
23 or principal or partly to each?

24 This legislation will answer these, and many other, everyday
25 questions. It will always remain possible for a testator or
26 settlor to provide for a different set of rules in a will or
27 trust, but NUPIA will provide a clear and comprehensive set of
28 default rules when, as is usually the case, the governing
29 instrument is silent. NUPIA therefore fills a gaping void in the
30 Maine statutes.

31 This amendment, in Title 18-A, section 7-752, sets out
32 specific rules for allocating income from harvesting timber.

33 NUPIA has been adopted in 25 states, including California,
34 Connecticut, Colorado, Hawaii, Minnesota, Missouri, Pennsylvania,
35 New York and Virginia, and is currently pending before or has
36 been considered by the legislatures of at least 5 other states,
37 including Rhode Island and Vermont. Like Maine, Colorado,
38 Arizona, Hawaii, Minnesota and New Mexico have adopted the
39 Uniform Probate Code and the Uniform Prudent Investor Act.

40 This amendment includes Maine Comments to explain deviations
41 from NUPIA.

COMMITTEE AMENDMENT "A" to H.P. 1173, L.D. 1573

"Legatee" is removed from the definition of "beneficiary" in Title 18-A, section 7-702 to conform with the existing definition of "devisee."

This amendment makes Title 18-A, Part 7 take effect on January 1, 2003. It applies to trusts and decedent's estates starting with the first fiscal year of the trust or decedent's estate that begins on or after January 1, 2003, unless the terms of the trust or will expressly provide otherwise.