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ALASKA STATE SENATE



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Senator Ralph Seekins
District D

SPONSOR STATEMENT-SB 87

Update of the Uniform Principal and Income Act

Statute 13.38 reflects the Alaska legislature's 1984 adoption of an early version of the Uniform Principal and Income Act. This Act provides rules for the determination of whether a trust's or estate's receipts should be considered income or principal. This distinction is often important because some beneficiaries may be entitled to income distributions, and others may be entitled to principal distributions. Senate Bill 87 updates the above-described statute to the most recent (1997) version of the Uniform Principal and Income Act. Articles 4 through 7 provide updated rules for determining whether receipts should be considered income or principal.

The drafters of the 1997 Uniform Principal and Income Act have recognized that there is a conflict between income and principal beneficiaries, and this conflict creates pressures on the fiduciary. The income beneficiaries want the fiduciary to invest so as to maximize annual income. The principal beneficiaries want the fiduciary to invest for long term equity growth. As a result, a trustee trying to satisfy both sets of beneficiaries will have to compromise with respect to the choice of investments. Consequently, the total return of the trust or estate will suffer. Two techniques have been adopted to avoid the need for such a compromise. These techniques allow the trustee to choose investment approaches which will maximize the total investment return of the trust or estate.

The first technique is provided by Article 1 of Senate Bill 87, which gives the trustee the discretionary power to adjust. This power allows the trustee to reallocate receipts from income to principal, or vice versa, when the trustee determines that it is fair and reasonable to do so. The second technique is provided by Article 2 of Senate Bill 87, which allows the trustee to convert a trust to a unitrust. This is a trust which provides that a certain percentage of its assets (often 4%) will be distributed each year to the income beneficiary.

Both of the above techniques will allow the trustee to choose investment approaches which will maximize the total return. As a result, both the income beneficiaries and the principal beneficiaries will receive greater distributions. Further, the trustee will not be struggling with the above-described conflict of interest in regard to investment approaches.

As of January, 2003, thirty states have adopted the 1997 Uniform Principal and Income Act. Of these, twelve states have included the unitrust provisions. Senate Bill 87 follows the legislation enacted by Pennsylvania, which includes both techniques which enable the trustee to maximize total returns. The State of Washington enacted this version in 2002. Georgia is presently considering it this year.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: SB 87
 () Publish Date: _____

Revision Date/Time (Note if correction): _____ Dept. Affected: Law
 Title "An Act relating to principal and income in the BRU Civil Division
administration of trusts and decedents' estates . . ." Component Commercial
 Sponsor Senator Seekins
 Requester Senate Judiciary Committee Component No. 2211

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()						
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
 Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

This bill would bring current the Uniform Principal and Income Act, which provides rules for the determination of whether a trust's or estate's receipts should be considered income or principal, by adopting the 1997 version of the Act.

Passage of this legislation will have no fiscal impact on the Department of Law.

Prepared by: Joan M. Kasson Phone (907) 465-5370
 Division Attorney General's Office Date/Time 4/14/03 12:57 PM
 Approved by: Joan M. Kasson for Gregg D. Renkes, Attorney General Date 4/14/2003
 Agency Department of Law

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MEMORANDUM

March 10, 2003

SUBJECT: Sectional summary of SB 87, relating to the Uniform Principal and Income Act (Work Order No. 23-LS0366I)

TO: Senator Ralph Seekins
Attn: Brian

FROM: *TLB*
Theresa L. Bannister
Legislative Counsel

You have requested a sectional summary of the above-described bill. As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents.

Section 1. Substitutes a reference to the new principal and income chapter for a reference to the current principal and income chapter.

Section 2. Adds the new Alaska Principal and Income Act. Article 1 is entitled "Preliminary Provisions; Power to Adjust" and consists of secs. 13.38.200 - 13.38.220.

Sec. 13.38.200 provides some general guidelines for fiduciaries (personal representatives of estates and trustees) for handling the interaction between the new chapter and the instrument (e.g., will or trust document) that governs the trust or estate, and for handling the situation where the new chapter and the instrument do not provide a rule for allocating receipts and disbursements between principal and income. Directs a fiduciary to act impartially based on what is fair and reasonable to all of the beneficiaries unless the governing instrument clearly manifests an intention that the fiduciary may or shall favor a beneficiary. States that a determination in accordance with the new provisions is presumed to be fair and reasonable to all of the beneficiaries.

Sec. 13.38.210 allows a trustee to adjust between principal and income by allocating income to principal or vice versa if certain conditions are met. Lists the factors that a trustee may consider when deciding whether and to what extent to use this adjustment power. Prohibits a trustee from making an adjustment under certain listed circumstances. Allows another trustee, if there is more than one trustee, to make certain adjustments that another trustee would not be allowed to make. Allows a trustee to release the power of adjustment permanently, or for a specified period, if the trustee is uncertain whether possessing or exercising the power will cause certain results. States how to deal with a governing instrument that limits the trustee's power to adjust.

Sec. 13.28.220 prohibits a court from changing a fiduciary's decision about exercising a discretionary power under the new provisions, unless determined to be an abuse of discretion. When there is an abuse of discretion, provides for the restoration of income and remainder beneficiaries to positions they would have occupied if there hadn't been any abuse and establishes certain rules for handling the restoration.

Article 2 is entitled "Conversion to Unitrust" and consists of secs. 13.38.300 - 13.38.410.

Sec. 13.38.300 allows a trustee to release the power to adjust and convert a trust into a unitrust unless expressly prohibited by the governing instrument. Lists the conditions for when this may be done.

Sec. 13.38.310 allows a trustee to petition the court to approve a conversion of a trust to a unitrust under two conditions. Allows a beneficiary to request the conversion and to petition the court to order the conversion if the trustee does not convert. Directs a court to approve a conversion or to direct the requested conversion if court concludes the conversion will enable the trustee to better carry out the intent of the settlor or testator and the trust's purposes.

Sec. 13.38.320 lists certain factors that a trustee may consider when deciding whether to exercise the power to convert a trust to a unitrust.

Sec. 13.38.330 directs that after conversion, the trustee shall follow a specified investment policy and make certain distributions. Establishes a specific meaning for "income" in the governing instrument after conversion. Directs that after administration as a unitrust for three years, the four percent amount referred to in the meaning of "income" is to be averaged over the three preceding years.

Sec. 13.38.340 allows the trustee of a unitrust to determine certain listed items, including the effective date of the conversion, the frequency of distributions, and what valuation dates to use.

Sec. 13.38.350 provides for deduction from a unitrust distribution those expenses that would be deducted from income if the trust were not a unitrust. Unless the governing instrument provides otherwise, indicates what sources a unitrust distribution is considered to have been paid from.

Sec. 13.38.360 authorizes the trustee or a beneficiary, if the trustee declines, to petition the court to select a payout percentage, to provide for certain net income distributions, and to average the net asset valuation over a period other than three years.

Sec. 13.38.370 states that a conversion does not affect certain provisions in the governing instrument that relate to trustee distribution of principal or beneficiary withdrawal of principal.

Sec. 13.38.380 prohibits a trustee from converting a trust into a unitrust under certain described conditions.

Sec. 13.38.390 allows another trustee to make a conversion that one trustee may not, unless prohibited by the governing instrument. Allows the trustees to petition the court to direct a conversion if certain prohibitions apply to all of the trustees.

Sec. 13.38.400 authorizes a trustee to reconvert a unitrust back into a trust by following the procedures for conversion. Restores the trustee's power to adjust when there is a reconversion.

Sec. 13.38.410 allows, under certain circumstances, a trustee to release permanently or for a specified period the power to make a conversion.

Article 3 is entitled "Charitable Trust Election" and consists of secs. 13.38.440 - 13.38.490.

Sec. 13.38.440 allows a trustee of a trust held exclusively for charitable purposes to elect to be governed by this charitable trust election article unless the governing instrument expressly prohibits this election.

Sec. 13.38.450 requires that to make the election the trustee must adopt and follow an investment policy seeking a total return for the investments held by the trust. Establishes certain formalities for adopting the policy.

Sec. 13.38.460 directs a trustee, after making a charitable trust election, to select the percentage of the value of the trust that will be considered income and determine that it is consistent with the long-term preservation of the real value of the principal of the trust. Establishes certain limitations on what the percentage may be and how often it may be changed. Establishes that for charitable trusts required by the Internal Revenue Code to distribute a higher amount than otherwise selected under this section, the distribution amount required by the Internal Revenue Code controls over the percentage selected.

Sec. 13.38.470 authorizes a trustee to revoke a charitable trust election under certain conditions. Establishes certain formalities for establishing the revocation and an alternative investment policy.

Sec. 13.38.480 establishes what the value of the trust is for the purposes of applying the charitable election provisions. Allows for averaging the value of the trust over three or more preceding years when the trust has been administered as a unitrust under this section for at least three years.

Sec. 13.38.490 defines certain terms for the provisions dealing with the charitable trust election.

Article 4 is entitled "Decedent's Estate or Terminating Income Interest" and consists of secs. 13.38.500 - 13.38.510.

Sec. 13.38.500 gives a fiduciary certain directions regarding determinations, distributions, and reductions of principal and income receipts after a decedent dies, in the case of an estate, or after an income interest in a trust ends.

Sec. 13.38.510 indicates the distributions to which certain beneficiaries identified in the previous section are entitled. Establishes certain rules for determining a beneficiary's share of net income. Requires the fiduciary to maintain certain records regarding a beneficiary's interest, if the fiduciary doesn't distribute all of the collected but undistributed net income to each person as of a distribution date. Allows the fiduciary under certain conditions to apply this section's rules to certain net gains or losses from the disposition of a principal asset. Provides for using a distribution date that is when the fiduciary calculates the value of the assets.

Article 5 is entitled "Apportionment at Beginning and End of Income Interest" and consists of secs. 13.38.550 - 13.38.570.

Sec. 13.38.550 states that an income beneficiary is entitled to net income from the date when the income interest begins and establishes when an income interest begins. States when an asset becomes subject to a trust. States when an asset becomes subject to a successive income interest. Establishes when an income interest ends.

Sec. 13.38.560 indicates when a trustee is to allocate an income receipt or disbursement to principal and when to income. Indicates when an item of income or an obligation is considered to be due.

Sec. 13.38.570 gives directions on how to proceed when a mandatory income interest ends. Gives direction to a trustee on how to handle the final payment when the trustee's obligation to pay a fixed annuity or a fixed fraction of the trust's assets' value ends.

Article 6 is entitled "Allocation of Receipts during Administration of trust" and consists of secs. 13.38.600 - 13.38.740.

Sec. 13.38.600 directs the trustee when to allocate to income money received from an entity and when to allocate entity receipts from an entity to principal. States when money is considered to have been received in partial liquidation. Indicates when a trustee may rely on an entity's statement about the source or character of a distribution. Defines "entity" for the section.

Sec. 13.38.610 indicates when the trustee is to allocate to principal or income the income from a trust or an estate in which the trust has an interest other than a purchased interest. Indicates which sections apply to receipts from certain purchased interests.

Sec. 13.38.620 allows a trustee to maintain separate accounting records for activity conducted by the trust that is in the best interest of all the beneficiaries, whether or not the assets of the activity are segregated from other trust assets. Allows the trustee who accounts separately to make certain determinations relating to its net cash receipts. Under certain circumstances directs the trustee to account in the trust's general accounting records for the net amount received as principal from a sale of the activity's assets not made in the ordinary course of the activity. Lists the activities for which a trustee may maintain separate accounting records.

Sec. 13.38.630 directs the trustee to allocate to principal certain listed receipts.

Sec. 13.38.640 directs the trustee to allocate to income certain receipts from rental property. Indicates how to handle amounts received as refundable deposits.

Sec. 13.38.650 directs the trustee to allocate to income certain money received as interest. Requires the trustee to allocate to principal certain amounts received from the sale, redemption, or other disposition of an obligation to pay money to the trustee. Indicates how to allocate certain amounts received from short-term obligations to pay money to the trustee. Indicates that this section does not apply to obligations covered by certain listed sections.

Sec. 13.38.660 provides directions to the trustee on how to allocate to principal and income certain proceeds of and certain dividends from a life insurance policy or other contract in which the trust or its trustee is named as beneficiary. Directs a trustee to allocate to income the proceeds of certain other insurance contracts.

Sec. 13.38.670 provides direction to the trustee on how to handle allocations that are insubstantial. Indicates when an allocation is presumed to be insubstantial.

Sec. 13.38.680 provides directions to the trustee on how to allocate to income and principal certain payments that a trustee may receive over a fixed period of time or during the life of one or more individuals because of services rendered or property transferred to the payor in exchange for future payments, including annuities, deferred compensation agreements, employee death benefits, individual retirement accounts, and pension plans.

Sec. 13.38.690 indicates how a trustee is to allocate between principal and income receipts from liquidating assets. Defines "liquidating asset" for the section.

Sec. 13.38.700 indicates, to the extent that a trustee accounts for receipts from an interest in minerals or other natural resources under this section, how a trustee is to allocate between principal and income receipts from minerals and other natural resources. Indicates how a trustee is to allocate between principal and income amounts received on account of an interest in renewable and nonrenewable water. States that this chapter

Senator Ralph Seekins

March 10, 2003

Page 6

applies whether or not a decedent or a donor was extracting minerals, water, or other natural resources before the interest became subject to the trust.

Sec. 13.38.710 indicates, to the extent that a trustee accounts for receipts from the sale of timber and related products under this section, how the trustee is to allocate between principal and income net receipts from the sale of timber and related products. States that this chapter applies whether or not a decedent or transferor was harvesting timber from the property before it became subject to the trust.

Sec. 13.38.720 allows a spouse to require a trustee to make certain trust property productive of income, convert the property within a reasonable time, or to exercise the power of adjustment under sec. 13.38.210(a) under certain circumstances related to federal estate or gift tax marital deductions. Indicates that for cases not governed by (a) of this section, proceeds from the sale or other disposition of an asset are principal without regard to the amount of income the asset produces during any accounting period.

Sec. 13.38.730 indicates that, to the extent that a trustee does not account under sec. 13.38.620 for transactions in derivatives, the trustee is to allocate to principal receipts from, and disbursements made, in connection with transactions in derivatives. Allocates to principal certain amounts related to options. Defines "derivative" for the section.

Sec. 13.38.740. Directs the trustee on how to allocate between principal and income payments from interest, or other current return, and from other proceeds of collateral financial assets. Directs the trustee on how to allocate between principal and income those payments received in exchange for the trust's entire interest in an asset-backed security. Defines "asset-backed security" for the section.

Article 7 is entitled "Allocation of Disbursements During Administration of Trust" and consists of secs. 13.38.800 - 13.38.860.

Sec. 13.38.800 requires a trustee to make certain listed disbursements from income.

Sec. 13.38.810 requires a trustee to make certain listed disbursements from principal.

Sec. 13.38.820 allows the trustee, in the trustee's discretion, to allocate, subject to AS 13.38.800 - 13.38.810, to income or principal ordinary expenses incurred in the administration, management, or preservation of trust property and the distribution of income.

Sec. 13.38.830 authorizes a trustee to transfer to principal a reasonable amount of the net cash receipts from a principal asset that is subject to depreciation. Lists certain exceptions. States that an amount transferred to principal is not required to be held as a separate fund.

Senator Ralph Seekins
March 10, 2003
Page 7

Sec. 13.38.840 authorizes a trustee to transfer an appropriate amount from income to principal in order to reimburse principal or to provide a reserve for future disbursements under certain conditions. Allows for continuing the transfers from income to principal under certain conditions. States that this section does not apply to the extent the trustee has been or expects to be reimbursed by a third party.

Sec. 13.38.850 directs that a tax required to be paid by a trustee based on receipts allocated to income is to be paid from income. Directs that a tax required to be paid by a trustee based on receipts allocated to principal is to be paid from principal. Indicates how the payment of a tax required to be paid on the trust's share of an entity's taxable income is to be allocated between principal and income.

Sec. 13.38.860 allows a trustee to make adjustments between principal and income to offset the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries arising from certain listed factors.

Sec. 13.38.900 requires that when applying these new provisions consideration be given to the need to promote uniformity among the state enacting these provisions.

Sec. 13.38.980 defines certain terms for the new provisions.

Sec. 13.38.990 gives the new provisions the name of "Alaska Principal and Income Act."

Section 3. Repeals the current chapter entitled "Principal and Income of Trusts."

Section 4. States to which trusts and estates, the new principal and income provisions apply.

Section 5. Makes this Act effective September 1, 2003.

If I may be of further assistance, please advise.

TLB:mdr
03-028.mdr

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December 31, 2002

Senator Ralph Seekins
Seekins Ford Lincoln
1625 Old Steese Highway
Fairbanks, AK 99709

Re: Introduction of the Uniform Principal and Income Act

Dear Senator Seekins:

I am a member of an informal group of trust and estate attorneys who annually review legislation that would be advantageous for the State of Alaska in this area. We recommend that the Alaska Legislature consider and adopt the Pennsylvania version of the 1997 Uniform Principal and Income Act.

In 2002, Pennsylvania adopted the 1997 Uniform Principal and Income Act, with some significant changes. These include a power to convert to a unitrust and a number of other significant provisions. Also in 2002 the State of Washington adopted Pennsylvania's version of the Uniform Principal and Income Act.

Enclosed is the full report of the Advisory Committee on the Pennsylvania version of the Uniform Principal and Income Act. This report includes the various sections of the Uniform Act, the Uniform Commission's comments and, where Pennsylvania has changed the Act, additional Pennsylvania comments describing these changes.

I have conferred with several of the attorneys who participated in the Advisory Committee for the Pennsylvania version of the Act. They have recommended the following additional changes.

1. Section 8102, relating to definitions.
2. Section 8105(a)(2) and (3), relating to notice.
3. Section 8105(d)(3), relating to calculation of the unitrust amount.
4. Section 8105 [new letter subsection], relating to reconversion.

I have included all of the above changes.

Senator Ralph Seekins
December 31, 2002
Page 2

Thank you very much for agreeing to sponsor this Act. This updating of the Uniform Principal and Income Act will facilitate the administration of Alaska trusts, and therefore provide significant benefits to the residents of our state.

Sincerely,



David G. Shaftel

Enclosures: As stated

Terry Kerty ?