#L-640 sul

3/3/86

Third Supplement to Memorandum 86-16

Subject: Study L-640 - Probate Code (AB 2652--Comments of State Bar)

Attached to this memorandum is a copy of a letter from Kenneth M. Klug, on behalf of the State Bar Estate Planning, Trust and Probate Law Section Executive Committee, commenting on the proposed trust law, AB 2652. The staff has the following responses to the points raised by the Executive Committee; the paragraph numbers refer to the corresponding numbered paragraphs in the Executive Committee's letter:

1. Location of rule against perpetuities, Civil Code Section 771

The Executive Committee asks whether the rule against perpetuities, as applied to trusts, should be located in the new Trust Law rather than in the Civil Code.

Assembly Bill 2652 moves the perpetuities provision generally applicable to trusts, Section 771, to the location of other perpetuities sections, Section 715 *et seq*. This perpetuities section was mislocated at Section 771, being in the midst of provisions on estates in general. The staff would prefer keeping provisions on perpetuities in one place in the Civil Code.

2-3. Operative date of repeal of old trust statutes

The Executive Committee notes that the operative date of the repeal of old trust statutes under AB 2652 is not clear.

Clearly the old law should not be repealed before the new law becomes operative. Accordingly, AB 2652 should be amended to provide that the entire bill is delayed in its effect until July 1, 1987. To accomplish this end, the following amendment should be made in AB 2652:

Amendment __

On page 103, after line 38, insert:
SEC. 41. (a) Except as provided in subdivisions (b) and (c), this act becomes operative on July 1, 1987.

(b) After the effective date of this act, the Judicial Council may adopt any forms necessary so that the forms may be used when this act become operative.

(c) After the effective date of this act, the courts may adopt any rules necessary so that the rules will be effective when this act becomes operative.

4 & 9. Revocation of trust by attorney in fact under Civil Code Section 2467

The Executive Committee opposes the policy reflected in Civil Code Section 2467(a)(5), as it would be amended by AB 2652, and Probate Code Section 15401(b) in AB 2652 that requires authority in the trust instrument before the attorney in fact may exercise the principal's power to revoke a trust. The Executive Committee argues that principals who execute general powers of attorney intend to give the attorney in fact all the powers of the principal and that the warnings are sufficient protection.

These provisions represent specific Commission policy decisions. The restriction on revocation of trusts is based on the sense that this is a very serious power, analogous to revoking a will--a power that the attorney in fact does not have. Does the Commission wish to reconsider this policy?

5. Civil Code Section 5110.150. Community property in revocable trust

The Executive Committee questions the need for Civil Code Section 5110.150 (which would supersede Section 5113.5) in AB 2652.

Section 5110.150 and the repeal of Section 5113.5 should be deleted from AB 2652 until agreement can be reached on any needed revisions in this area. Section 5110.150 was included in the bill when it was submitted so that we could get it printed. Its retention was subject to further study. It appears that there is no agreement on whether Section 5113.5 needs revision or, if it does, whether Section 5110.150 is the way to do it. The staff would leave the law as it is for now, pending further study of this subject by the State Bar. This would be accomplished by the following amendments:

Amendment __

On page 16, strike out lines 34 to 40, inclusive

Amendment __

On page 17, strike out lines 1 to 40, inclusive

Amendment __

On page 18, strike out lines 1 to 9 inclusive

6. *Section 15305. Enforcement of support judgment against spendthrift trust*

The Executive Committee asks whether a person may enforce a judgment for child or spousal support against the amount payable to the trust beneficiary pursuant to an ascertainable standard of support, health, or education. The Executive Committee suggests language that would make the amount "necessary for the education and support of the beneficiary" immune from claims of support creditors.

This change would be contrary to the important policy reflected in Section 15305. The point of this section is to make clear that the court has the equitable power to invade what is "necessary" for the beneficiary in order to provide for the predetermined necessities of those persons the beneficiary is required by court order to support. While Section 15307 protects the amount necessary for education and support from the reach of general creditors, the whole point of Section 15305 is to provide greater rights to support creditors. This is consistent with distinctions made in other areas of the law, with distinctions made in existing law relating to enforcement against spendthrift trusts, and with the concept that the determination of the amount needed for the support of the beneficiary should take into account the needs of those the beneficiary is required to support. This is discussed in the Comment to Section 15305 as follows:

> Although a trust is a spendthrift trust or a trust for support, the interest of the beneficiary can be reached in satisfaction of a money judgment against the beneficiary for child or spousal support. In some cases a spendthrift clause may be construed as not intended to exclude the beneficiary's dependents. Even if the clause is construed as applicable to claims of the dependents for support, it is against public policy to give full effect to the provision. A provision in the trust is not effective to exempt the trust from enforcement of a judgment for support of a minor child or support of a spouse or former spouse. See subdivision (b).

> As a general rule, the beneficiary should not be permitted to have the enjoyment of the interest under the trust while neglecting to support his or her dependents. It is a matter for the exercise of discretion by the court as to how much of the amount payable to the beneficiary under the trust should be applied for such support and how much the beneficiary should receive. Even though the beneficiary's spouse has obtained an order directing the beneficiary to pay a specified amount for support, the spouse cannot compel the trustee to pay the full amount ordered unless the court determines that it is equitable and reasonable under the circumstances of the particular case to compel the trustee to make the payment. The result is much the same as though the trust were created not solely for the benefit of the beneficiary, but also for the benefit of the beneficiary's dependents. Cf. Estate of Johnston, 252 Cal. App. 2d 923, 927-30, 60 Cal. Rptr. 852 (1967) (discussion of public policy in light of former Civil Code § 859).

The staff believes that this section and its comment should remain unchanged.

7. Section 15307. Income in excess of amount for education and support subject to creditors' claims

The Executive Committee states that it is unclear whether or not Section 15307 permits the court to compel the trustee to exercise discretion.

This section applies to amounts to which the beneficiary is entitled regardless of whether the beneficiary becomes entitled to such amounts directly under provisions of the trust instrument or through exercise of the trustee's discretion. The references to the instrument and to discretion were added at a past meeting to make clear that the reason for entitlement to the payment was not relevant. The Comment to Section 15307 speaks to this issue in the following terms:

> If the trustee has discretion to determine the disposition of the trust income, the trustee may be able to defeat the creditor's attempt to reach the excess income under this section by reducing the amount to be paid to the beneficiary to the amount determined by the court to be necessary for the support and education of the beneficiary. See Estate of Canfield, 80 Cal. App. 2d 443, 450-52, 181 P.2d 732 (1947); E. Griswold, Spendthrift Trusts § 428 (2d ed. 1947).

If the statutory language is still confusing, notwithstanding the amplification in the comment, consideration should be given to revising the first sentence of this section to read as follows:

> Notwithstanding a restraint on transfer of a beneficiary's interest in the trust under Section 15300 or 15301, any amount to which the beneficiary is entitled under the trust instrument or ~~pursuant to the~~ that the trustee, in exercise of the trustee's discretion, has determined to pay to the beneficiary in excess of the amount that is or will be necessary for the education and support of the beneficiary may be applied to the satisfaction of a money judgment against the beneficiary.

It would also be useful to revise the comment to this section by adding a cross-reference to Section 15303 which provides that a transferee or creditor does not have the power to compel the trustee to exercise discretion.

8. Section 15400. Presumption of revocability

The Executive Committee asks whether a foreign trust that incorporates the law of California must expressly refer to revocability for the rule presuming revocability to apply.

The Executive Committee is questioning the language "where the instrument provides that the law of this state governs the revocability of the trust" in Section 15400. This language is intended to make clear that a general incorporation of the law of California does not pick up the revocability rule. This policy is based on the assumption that most settlors in other states will not be aware of the presumption of revocability, since 47 other states presume trusts to be irrevocable. If such a person creates a trust that is silent on the matter of irrevocability but that incorporates California law, it is reasonable to assume that the settlor is not looking to the presumption of revocability but rather the other aspects of California trust law. Does the Commission wish to reexamine this policy?

10. Section 15403. Modification or termination of irrevocable trust by all beneficiaries

The Executive Committee asks whether the court should be permitted to terminate a spendthrift trust with the consent of all beneficiaries.

The Commission has adopted a rule that would permit modification or termination of trusts notwithstanding the material purposes doctrine, except in the case of a spendthrift trust. Thus the court may permit modification or termination if the reason for doing so outweighs the interest in accomplishing a material purpose of the trust. Section 15403(b), however, makes the statutory judgment that the reason offered for termination does not outweigh the interest of the settlor in creating a spendthrift trust. Does the Commission wish to reexamine this policy?

The Executive Committee also asks about the need for obtaining the consent of contingent remainder beneficiaries. The consent of such beneficiaries is required under the proposed law as under existing law.

11. Section 15404. Modification or termination by settlor and all beneficiaries

The Executive Committee asks whether a court petition should be required under this section as under Section 15403.

The distinction is intentional. Section 15404 governs modification and termination by all interested parties, including the settlor, whereas Section 15403 governs modification and termination by consent of the beneficiaries, but not the settlor. The judgment has been made that court approval is required only where the consent of the settlor cannot be obtained. This distinction is recognized in the Comment to Section 15404: "A trust may be modified or terminated pursuant to this section without court approval, but a court order may be sought by petition under Section 17200."

12. Section 15407. Trustee's powers on termination

The Executive Committee suggests that the grant of powers "needed" to wind up the affairs of the trust may be too restrictive, and suggests substituting "reasonably necessary under the circumstances."

The staff recommends making this change. The language suggested by the Executive Committee is clearer and more precise.

13. Section 15803. Rights of holder of power of appointment

The Executive Committee suggests treating the holder of a

presently exercisable special power of appointment, to the extent of the power, the same as the holder of a general power under Section 15803.

Section 15803 recognizes that a holder of a presently exercisable general power of appointment is in essentially the same position as a settlor of a revocable trust as to the ability to dispose of the property for the benefit of the holder. The "to the extent" language relates to the particular property that is subject to the general power; it does not qualify the nature of the power itself. A power is general to the extent that it is exercisable in favor of one of the following: the donee, the donee's estate, the donee's creditors, or creditors of the donee's estate. See Civil Code § 1381.2 and the Comment thereto. If the power does not satisfy this requirement, it is a special power. Hence, if a power is general, the holder can exercise it in his or her own favor, and so is treated as equivalent to an owner. By parity of reasoning, under the proposed Trust Law, the holder of a general power is treated as a settlor under a revocable trust, who also has effective control of the property and may exercise that control in his or her own favor. If the power is special, it is not exercisable in favor of the holder, and so the logic of Section 15803 does not apply.

In addition, if holders of special powers of appointment were treated as settlors of revocable trusts "to the extent" of the power over the property, the effect would not be clear. The holder of a special power is subject to the limitations imposed by the creating instrument. See Civil Code §§ 1381.2, 1387.2. Given the variety of limitations that may be imposed on special powers, it does not appear advisable to adopt the Executive Committee's suggestion.

14. Section 16062(b). Transitional provision

The Executive Committee suggests that Section 16062(b) be revised as follows:

> (b) A trustee of a living trust created by an instrument executed before July 1, 1987, or of a trust created by a will executed before July 1, 1987, and not incorporated by reference in a will executed on or after July 1, 1987, is not subject to the duty to account provided in this section.

The staff would not make this change. The last "on or after" clause refers to the time of incorporation, not the time of execution of the will that incorporates the trust. If the suggested language were added, the provision would not cover the case where the will was executed before the operative date but the trust was incorporated by reference in a codicil after the operative date.

15. Sections 16200-16249. Trustees' powers

The Executive Committee argues that trustees' powers should be stated without any limitations in order to facilitate incorporation of statutory powers in trust instruments. Specifically the Executive Committee is concerned that references to the powers in existing Probate Code Section 1120.2 would, after the new law goes into effect, pick up the new limitations, such as the limitation on conducting a business.

The Commission has previously reaffirmed its policy of limiting the right to conduct a business as reflected in Section 16222(b) in AB 2652. It does not seem appropriate to eliminate all limitations on powers just to facilitate incorporation, particularly incorporations that have already been written.

The Executive Committee really seems to be questioning whether the new powers should be picked up by a reference to the older statement of powers in Section 1120.2. The consensus of the advisory group that considered this issue in May and June last year was that the new powers provisions should apply to all trusts, except to the extent that the trust provided otherwise, and the Commission adopted this policy. The benefit of this approach is that one body of general law applies to all trusts and trustees are thus not required to worry about which law applies. This policy was adopted with the understanding that the old and new statements of powers were substantially the same in substance. While the limitation on the conduct of a business under Section 16222(b) was noted, the consensus of the advisory group was that the interest in one body of powers outweighed any detriment from specific limitations on powers. The Commission agreed with this position and thus Section 16203 provides that a reference to Section 1120.2 means a reference to the powers in Sections 16220-16249. An earlier draft had

provided that an incorporation of Section 1120.2 powers had the effect of adopting the same powers to the extent they are provided in the new law.

The staff would not alter AB 2652 in response to this suggestion of the Executive Committee. As a matter of policy, it seems best that those who incorporate sets of powers without analyzing them be protected by the few limitations that apply. The more skillful drafter would presumably not be incorporating a whole set of powers by number in any event. A drafter who considers issues such as those raised by the Executive Committee could easily reject the limitation on deposits in uninsured accounts or on the power to conduct a business.

16. Section 16305. Income earned during administration of decedent's estate

The Executive Committee states that this section is unclear and asks whether it allows income during probate to be used to discharge liabilities of the decedent.

This section could probably be clearer, but as it stands it continues prior law without change. As far as the staff is aware, this provision has not caused problems during its 20-year existence. It does not appear that this section has any effect on the use of income to discharge liabilities of the decedent.

17. Section 16308(b). Accounting principles in farming operations

The Executive Committee states that "generally accepted accounting principles" is a term of art and that its application in farming and agricultural operations would normally be inappropriate. The Executive Committee suggests adopting the accounting method that is "utilized by the business or operation for federal income tax purposes" or "by the accounting method on which the business or operation keeps its books."

The staff wonders whether this language has been a problem during the past 20 years, because Section 16308(b) continues existing language in this regard without change. It should also be noted that subdivision (a) provides that "net profits and losses of the business shall be computed in accordance with generally accepted accounting principles for a comparable business." (Emphasis added.) On its face,

this language counters the suggestion that farms would be denied use of traditional accounting methods. However, the emphasis in subdivision (b) on applying generally accepted accounting principles to agricultural and farming operations raises doubts about the intent of the section. In other words, the reference to generally accepted accounting principles in subdivision (b) seems to take away what the "comparable business" language gives.

At least four states have discovered problems with the reference to "generally accepted accounting principles." Florida omits the words "generally accepted." Nebraska determined that this was a term of art that did not necessarily apply to certain types of businesses operated by a fiduciary and refers instead to "recognized methods of accounting for a comparable business." Volkmer, Nebraska's Trustees' Powers Act and Principal and Income Act: The New Look in Nebraska Trust Law, 14 Creighton L. Rev. 121, 149 (1980). Arkansas and Washington substitute a "reasonable and equitable" standard.

The staff has no particular objection to the language proposed by the Executive Committee, but we are concerned that it may cause a new set of problems. We would prefer a more conservative revision, such as by taking the Nebraska approach of eliminating the word "generally." We could also delete subdivision (b). This would eliminate the conflicting signals emanating from subdivisions (a) and (b).

18. Section 16312(b)(1). Interest on trust indebtedness as charge against income

The Executive Committee recommends that "interest on trust indebtedness" be added to items that are charged against income.

This seems to be covered already in Section 16312(b)(1) which provides that "interest paid by the trustee" is charged against income.

19. Section 16312(d)(5). Interest on estate tax as charge against principal

The Executive Committee suggests that it may be inappropriate to charge interest on estate tax against principal if an election has been made to claim a deduction for interest on deferred estate tax. The Executive Committee suggests that the reference to interest in Section

16312(d)(5) be deleted and that language be added to the Comment. (See the first full paragraph on page 6 of Exhibit 1.)

In view of the problems that are raised, the staff agrees that the reference to interest be deleted. This would then invoke the fallback rule of Section 16302(a)(3) which applies the general standard of care to trustee decisions regarding allocation to principal and income, if the trust does not provide a special rule covering the situation.

20. Section 17005(a)(2). Venue for testamentary trusts

The Executive Committee suggests that describing the court having venue over a testamentary trust as the court in the county "where the decedent's estate is administered" may be misleading. The Executive Committee suggests referring to the court "which has jurisdiction over the administration of the estate pursuant to Section 301."

The staff does not object strongly to the Executive Committee's proposed language, but we would not refer to "superior" court since that matter is covered in Section 17000(a). However, it is not at all clear that the suggested language answers the objection raised by the Executive Committee. The Executive Committee states that the language in the bill may be misleading where the estate is closed. But the recommended language may also be misleading in such a situation. If the estate is closed, what court has jurisdiction over administration of the estate? It should also be noted that, if the difficulty in the language is caused by the tense of the verb "is", the problem is solved by Probate Code Section 9: "The present tense includes the past and future tenses, and the future, the present."

21. Section 17104(b). Conclusiveness of order

The Executive Committee questions the purpose of the provision that the court's orders are conclusive if the court finds that notice has been regularly given, and suggests the deletion of the first sentence of Section 17104(b).

Section 17104(b) continues a provision in Probate Code Section 1138.6 (proceedings concerning living trusts and most testamentary trusts). Proposed Section 17104 was drafted based on an analogous provision in the guardianship-conservatorship statute, Probate Code

Section 1468(b). This language also appears in Probate Code Section 1200(b) and in Probate Code Section 1200.5(c) (notice in probate proceedings). Since this language has been applied throughout the Probate Code for years, the staff does not think it is appropriate to alter it at this point without further study. This issue should be considered in the course of revising the Probate Code as a whole.

22. Typographical error

The Executive Committee notes a typographical error. This error and several others would be corrected by amendments proposed in material attached to Memorandum 86-16.

Respectfully submitted,

Stan G. Ulrich
Staff Counsel

EXHIBIT 1

ESTATE PLANNING, TRUST AND PROBATE LAW SECTION

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Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, CA 94307-4739

February 26, 1986

Re: AB 2652

Dear John:

The Executive Committee of the Estate Planning, Trust and Probate Law Section has the following comments on AB 2652:

1. Present Civil Code §771 (rule against perpetuities) is relocated to Civil Code §716.5 dealing with restraints on alienation. Query: Should this be included in the Probate Code provisions of the new Trust Law, rather than in the Civil Code?

2. Civil Code §852 et seq are repealed and superseded by new Trust Code §15000 et seq. Sections 15000 et seq do not become effective until 7/1/87; it is not clear that Civil Code §852 is effective until then.

3. Civil Code §2215 et seq and Civil Code §2255-2290.12 are deleted. Same question as No. 2.

4. The proposed amendment to Civil Code §2467(a)(5) would take away the authority of an attorney-in-fact under a statutory short form power of attorney to revoke a trust created by the principal. We are strongly opposed to the amendment. Principals who execute general powers of attorney intend to give the attorney-in-fact all powers of the principal. The warnings provided under Civil Code §2450 are an adequate protection for the principal, and there is no justification for depriving the principal of the very valuable right to authorize an attorney-in-fact to revoke a trust.

5. New CC §5110.150 deals with community property held in a revocable living trust. The Executive Committee is uncertain of the perceived need in making the change.

The comment to the proposed redraft of Civil Code §5110.150 (per Nat Sterling's letter to me dated Feb. 6, 1986) states that one consequence of retention of its community property character is that the trust property is subject to claims of creditors. This would also be the effect of proposed Probate Code §15304.

We recommend that Sections 14 and 15 of AB2652 be deleted, so that present Civil Code §5113.5 will remain law without change, pending further study of the need for change and of the effects of any proposed change.

6. Proposed Prob C. §15305(b) deals with spendthrift trusts and support judgments. The proposal allows a court to order a trustee to pay amounts to a beneficiary's creditor where the "beneficiary has a right under the trust to compel the trustee to pay income or principal or both." Query: Does this apply to power of invasion limited by an ascertainable standard of support, health or education? We note that proposed §15307 limits the amount to be applied to satisfy a judgment against a beneficiary to the amount in excess of that required for the beneficiary's education and support. Proposed §15305(b) does not have that limitation insofar as a support judgment is concerned. We recommend that the limitation be expressly included in §15305(b) to avoid the cart and horse problem: e.g., the beneficiary needs $10,000 for his support; he is authorized to compel the trustee to pay him $10,000 for support; under §15305(b) that $10,000 is paid to satisfy a support judgment against the beneficiary; the beneficiary still needs $10,000 to pay his support; again, that $10,000 is paid to satisfy the support judgment....etc. This problem can be solved by adding the following language at page 43, line 18, following the word "both:" "in excess of the amount that is or will be necessary for the education and support of the beneficiary."

7. Proposed §15307 allows the Court to order a trustee of a spendthrift trust to satisfy all or part of a money judgment against the beneficiary out of amounts which the trustee may distribute pursuant to the "exercise of the trustee's discretion." It is not clear whether or not the proposal authorizes the Court to compel the trustee to exercise that discretion, but the language can be read to create such authority. We do not believe that the Court should have authority to compel the exercise of the trustee's discretion in order to satisfy a money judgment, and we recommend that the statutory language make that clear.

8. Proposed §15400 provides that a trust is revocable unless expressly irrevocable. The section applies only where, among other things, the trust instrument provides that the law of this state governs the revocability of the trust. Query: Should the application be more general; i.e., if the trust instrument provides that the law of this state governs the trust, need it expressly refer to revocability?

9. Section 15401(b) prohibits revocation of a trust by an attorney-in-fact unless revocation by an attorney-in-fact is expressly permitted by the trust instrument. We are strongly opposed to Section 15401(b). A general power of attorney is intended to authorize the attorney-in-fact to perform all acts which could be done by the principal. It is bad public policy to restrict the actions that can be undertaken pursuant to a general power of attorney. Limited powers of attorney are already available for principals who wish to restrict the authorization of an attorney-in-fact. No purpose is served by adding an automatic restriction.

We concur with the position of the California Bankers Association as expressed in Paulette Leahy's letter to you of September 6, 1985: to wit, that the attorney-in-fact should be authorized to revoke a trust unless the trust instrument provides otherwise.

10. Section 15403(b). Should the court have jurisdiction to terminate a spendthrift trust with consent of all beneficiaries? What about the consent of contingent remainder beneficiaries? Note that §15804, etc. deals with notices and not consents.

11. Section 15404(a). Should "upon petition to the court" be added to be parallel to §15403(a), or is it intentional that the court not be involved?

12. Section 15407(b). On termination of the trust, the trustee continues to have the powers "needed" to wind up the affairs of the trust. We believe that "reasonably necessary under the circumstances" is a better standard. I handled a matter several years ago where the sole asset of the living trust was the settlor's residence. The trust "terminated" on the settlor's death and was distributable to 24 nieces and nephews, some of whom were minors. The trustee sold the residence following the death of the settlor and distributed cash to the beneficiaries. I wonder if a title company would be concerned about the ability of a trustee to sell real property after "termination" if a standard of need is imposed.

13. Section 15803 provides that a holder of a presently exercisable general power of appointment has the rights of a settlor to the extent of the property covered by the power. We suggest including a holder of a presently exercisable special power of appointment to the same extent.

14. Page 61, line 8 - insert "executed" after "will".

15. Sections 16220 et seq restate the substance of existing §1120.2 (trustee powers) but not verbatim. This may present problems where the trust instrument incorporates the powers under existing Probate Code §1120.2.

For example, existing §1120.2(17) authorizes the trustee to continue or participate in any business. Proposed §16222(b) permits continuation of a business only if authorized by the trust instrument or by the court. It would appear that if a trust instrument refers to Probate Code §1120.2, it would incorporate the limitation of proposed §16222(b). Similarly, §16224 is limited to where the trust instrument directs or permits investment in obligations of the United States government. Does incorporating §16224 permit the investment? Section 16225(d) authorizes the court to authorize deposit of trust funds in an amount greater than the government insurance. Does incorporating §16225(d) constitute an authorization to exceed deposit insurance? In each case it is not clear whether a mere incorporation by the trust instrument of the statutory powers includes the power to undertake the act, or limits the power and requires court authorization to undertake the act.

We recommend that each power be stated without limitations so that practitioners can readily incorporate the statutory powers without also incorporating the limitations.

16. Section 16305 dealing with the Principal and Income Law is unclear. Does this allow income during probate to be used to discharge liabilities of the decedent?

17. Section 16308(b) requires that income from an agricultural operation be determined by generally accepted accounting principles. Using generally accepted accounting principles is contrary to farm method of accounting. Generally accepted accounting principles require an accrual method of accounting. Most farmers utilize the cash method rather than the accrual method. Requiring farmers to switch accounting methods where a trust is involved is too expensive.

Furthermore, it is impractical to accrue a value for growing crops or for crops delivered to a co-op. Crops delivered to cooperatives are frequently credited to the farmer by quantity (tonnage, bushels, lugs, etc.) rather than by dollar value. It is not until the co-op sells the commodity that the price is determined. With some commodities, such as raisins, the price may not be determined or paid for several years. Attempting to accrue income based on value at delivery is impossible. Congress has refused attempts by the Treasury Department to require farmers to determine taxable income on the accrual method for those very reasons.

There may also be a constitutional problem with the use of the terminology "generally accepted accounting principles." It is my understanding that "generally accepted accounting principles" is a term of art defining standards promulgated by the American Institute of CPA's. The principles are revised from time to time. I wonder if a statutory incorporation of principles established by a non-government agency might be an unconstitutional delegation of legislative power. We recommend that §16308(b) be revised to provide: Income from a business or from an agricultural or farming operation, including the raising of animals or the operation of a nursery, shall be determined by the accounting method which is utilized by the business or operation for federal income tax purposes [or by the accounting method on which the business or operation keeps its books.]

18. Section 16312(b)(1). We recommend that you add "interest on trust indebtedness" to the list of items to be charged against income, especially in view of (d)(2) which might create an impression that interest is a principal charge. Interest paid on trust property is deductible for income tax purposes. Since the income beneficiary receives the tax benefit from the deduction, the income beneficiary should bear the burden of the expense. Further, by carrying the indebtedness the trust has a larger gross principal from which to generate more income.

19. Section 16312(d)(5). This section provides that interest on estate tax is to be charged to principal, and presents a slightly different issue from that discussed above. (Proposed Section 20113 of AB2625 deals with interest on estate tax deficiencies. Section 16312(d)(5) would be limited to interest on deferred estate taxes.) Present federal law allows an election to claim a deduction for interest on deferred estate tax on either the estate tax return or the income tax return. If an election is made to

deduct the deferred interest on the estate tax return, the estate tax is reduced, and the income tax is increased. We believe that a Bixby-type adjustment is required to compensate the income beneficiary for the extra income tax resulting from the election. If the income beneficiary receives the benefit of a compensating adjustment, then the interest on deferred estate tax ought to be charged to income.

Accordingly, we recommend that the words "interest and" be deleted from page 80 at line 10, and that the following language be added to the Official Comment: "Although interest on a deficiency is charged to trust corpus under §20113, interest on deferred estate tax is charged to income. Charging income with the interest does not foreclose a Bixby- type adjustment where an election is made to deduct interest against the estate tax."

20. Section 17005(a)(2) deals with venue of testamentary trusts. The clause "county where the decedent's estate is administered" may be misleading if the estate is closed. We recommend utilizing the existing language of §1138.3(b): "in the superior court which has jurisdiction over the administration of the estate pursuant to Section 301.

21. Section 17104(b) requires the court to find in its order that notice has been regularly given. If the court fails to find that notice has been regularly given, is the order void? Is any purpose served by the requirement? We believe that the first sentence of §17104(b) be deleted.

22. Page 92, line 11 - "inadequate" is misspelled.

Very truly yours,

Kenneth M. Klug

cc: James D. Devine
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