Study L-649 September 23, 1998

First Supplement to Memorandum 98-64

Uniform Principal and Income Act: Staff Draft Tentative Recommendation (Additional Comments)

Attached to this memorandum is a letter from Luther J. Avery, commenting on principal and income issues. We will consider this letter in connection with the staff draft tentative recommendation at the meeting.

Respectfully submitted,

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Assistant Executive Secretary

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Our File No. 9911.81-35

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**Re: Uniform Principal and Income Act: Memorandum 98-64
Staff Draft Tentative Recommendation 9/11/98**

Ladies and Gentlemen:

The proposed new UP&IA fails adequately to deal with the following problems:

1. The treatment of losses from partnership interests and LLP and similar entities.

2. The power to make adjustments between principal and income without consent of the beneficiaries.

3. The concept that income is to be reported and accounted for on a cash basis rather than an accrual basis. For example, an income beneficiary's estate is to receive only net income "actually received" and not items of accrued income; thus dividends declared and payable but not yet received will be taken from the income beneficiary who dies before payment.

4. Income from a partnership; is based on actual distributions, yet the fact is most partnerships do not make actual distribution; the partners are notified of an accounting entry. Rarely are payments made.

5. The concept that depreciation is no longer mandatory is contrary to the Supreme Court decision in *Estate of Kelley* (1965) 63 Cal.2d 679. Moreover, depreciation is required under generally accepted accounting principles. The problem with leaving depreciation to the discretion of the trustee leaves upon the real question. Usually depreciation is claimed as a tax deduction deducted by the income beneficiary even though the trustee has not withheld income to fund a depreciation reserve to protect the remainderman.

The purported justification for revision of UPIA is to coordinate with the Uniform Prudent Investor Act. However, nothing in the UPA requires change of the UPIA. The UPIA needs change, but not to justify the Prudent Investor Act. The alleged tension between investment performance and the accounting treatment of principal and income arises out of the fact that lawyers and trustees draft inadequate documents as well as the fact trustees ignore Probate Code §16060, the Duty to Inform, and act as if discharge of the Duty to Account under Probate Code §16061 is fully discharged by the present inadequate accountings by trustees, particularly including the computerized monstrosities generated by banks as trustees.

The UPIA is being justified for the wrong reason. The UPIA, and particularly the proposed ability of trustees to reallocate between income and principal, is simply an attempt to protect banks and other trustees who disregard the duty of impartiality between or among beneficiaries. Who says it is undesirable to constrain trustees' ability to implement modern portfolio theory? Who says the UPIA as proposed will accomplish the objectives of the trustor? The remedy that should be used rather than the UPIA is an amendment to the Probate Code Division 9, Chapter 3, to make the process of accommodation of the investment policies of the trustee subject to review and approval by the trust beneficiaries.

In short, I recommend the Commission address the issues from the standpoint of protecting the beneficiaries instead of from the standpoint of "(3) eliminating or restraining elements in the uniform act that would unfairly expose trustees to liability for breach of trust." It seems to me the entire project is for the benefit of trustees and ignores the interests of beneficiaries.

Yours sincerely,

Luther Avery

Luther J. Avery

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