

First Supplement to Memorandum 98-75

Uniform Principal and Income Act: Staff Draft Recommendation (Comments of State Bar)

Attached to this supplement are comments on the discussion draft of the *Uniform Principal and Income Act* from James Deeringer, on behalf of the State Bar Estate Planning, Trust and Probate Law Section Executive Committee.

§ 16340. Determination and distribution of net income and principal

Points 1 and 2 in the attached letter are directed to irrelevant language in subdivision (d) and in the quoted uniform act background material. The staff thinks these revisions should be made. In general, we have leaned toward keeping potentially relevant uniform act commentary, but in this case, discussions of pecuniary gifts in trust looks to be irrelevant and would be confusing.

The third point is more of a taste change and is under consideration. The staff does not feel strongly about the order of the subdivisions.

After further discussing these points with Jim Deeringer, the staff proposes to revise Section 16340 as follows:

1 16340. After the decedent's death, in the case of a decedent's estate, or
2 after an income interest in a trust ends, the following rules apply:

3 (a) If property is specifically given to a beneficiary, by will or trust, the
4 fiduciary of the estate or of the terminating income interest shall distribute
5 the net income and principal receipts to the beneficiary who is to receive
6 the property, subject to the following rules:

7 (1) The net income and principal receipts from the specifically given
8 property are determined by including all of the amounts the fiduciary
9 receives or pays with respect to the property, whether the amounts accrued
10 or became due before, on, or after the decedent's death or an income
11 interest in a trust ends, and by making a reasonable provision for amounts
12 the fiduciary believes the estate or terminating income interest may become
13 obligated to pay after the property is distributed.

14 (2) The fiduciary may not reduce income and principal receipts from the
15 specifically given property on account of a payment described in Section
16 16370 or 16371, to the extent that the will, the trust, or Section 12002

1 requires payment from other property or to the extent that the fiduciary
2 recovers the payment from a third person.

3 (b) The fiduciary shall distribute to a beneficiary who receives a
4 pecuniary amount, whether outright or in trust, the interest or any other
5 amount provided by the will, the trust, or Chapter 8 (commencing with
6 Section 12000) of Part 10 of Division 7, from the remaining net income
7 determined under subdivision (c) or from principal to the extent that net
8 income is insufficient. ~~For purposes of this subdivision, a reference in~~
9 ~~Chapter 8 (commencing with Section 12000) of Part 10 of Division 7 to the~~
10 ~~date of the testator's death means the date of the settlor's death or of the~~
11 ~~occurrence of some other event on which the distributee's right to receive~~
12 ~~the gift depends.~~

13 (c) The fiduciary shall determine the remaining net income of the
14 decedent's estate or terminating income interest as provided in this chapter
15 and by doing the following:

16 (1) Including in net income all income from property used to discharge
17 liabilities.

18 (2) Paying from income or principal, in the fiduciary's discretion, fees of
19 attorneys, accountants, and fiduciaries, court costs and other expenses of
20 administration, and interest on death taxes, except that the fiduciary may
21 pay these expenses from income of property passing to a trust for which the
22 fiduciary claims an estate tax marital or charitable deduction only to the
23 extent that the payment of these expenses from income will not cause the
24 reduction or loss of the deduction.

25 (3) Paying from principal all other disbursements made or incurred in
26 connection with the settlement of a decedent's estate or the winding up of a
27 terminating income interest, including debts, funeral expenses, disposition
28 of remains, family allowances, and death taxes and related penalties that are
29 apportioned to the estate or terminating income interest by the will, the
30 trust, or Division 10 (commencing with Section 20100).

31 (d) ~~The~~ After distributions required by subdivision (b), the fiduciary shall
32 distribute the remaining net income determined under subdivision (c) in the
33 manner provided in Section 16341 to all other beneficiaries, ~~including a~~
34 ~~beneficiary who receives a pecuniary amount in trust, even if the~~
35 ~~beneficiary holds an unqualified power to withdraw assets from the trust or~~
36 ~~other presently exercisable general power of appointment over the trust.~~

37 (e) For purposes of this section, a reference in Chapter 8 (commencing
38 with Section 12000) of Part 10 of Division 7 to the date of the testator's
39 death means the date of the settlor's death or of the occurrence of some
40 other event on which the distributee's right to receive the gift depends.

In addition to removing the unwanted language in subdivision (d), these revisions provide for better internal integration of the section. The language in

subdivision (e) is removed from subdivision (b) because it applies under both subdivision (a)(2) and (b). “Remaining” is added in subdivision (b) and the cross-reference to subdivision (c) is added in subdivision (d) to tie these subdivisions directly to the explanation of determining “Remaining net income” in subdivision (c).

§ 16361(c). Deferred compensation, annuities, and similar payments

Mr. Deeringer raises some substantive issues concerning the 90-10 rule under this section. (Exhibit p. 2.) The staff understands that the State Bar is still considering its viewpoint on the issue. The draft recommendation contains the uniform act rule and the staff has no viewpoint on whether the options discussed in the State Bar letter would be better.

Respectfully submitted,

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Assistant Executive Secretary

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December 4, 1998

Stan Ulrich
California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

Re: **UPIA Discussion Draft**

Dear Stan:

On behalf of the Executive Committee of the Estate Planning, Trust, and Probate Law Section of the State Bar, I would like to offer the following comments on the "September 1998 Discussion Draft" of the Uniform Principal and Income Act:

1. In section 16340, subsection (d), we suggest that everything after the words "all other beneficiaries" in the second line be deleted. The reference at the end of subsection (d) to pecuniary gifts in trust is a vestige of section 201 of the Uniform Act, which treats pecuniary gifts *in trust* as part of the residue for purposes of allocating net income. In California, as you know, we have always treated all pecuniary gifts in the same manner, regardless of whether they are made outright or in trust, and our RUPIA Working Group was inclined to preserve this approach. Earlier portions of section 16340 reflect that approach, but we neglected to delete this inappropriate reference in subsection (d).
2. Section 16340 is fundamentally different from section 201 of the Uniform Act in its treatment of pecuniary gifts in trust. Given this fact, I wonder whether we should still include all of the NCCUSL comments to this section of the Uniform Act, since some of them are now inappropriate and may confuse people more than they help.
3. Again with respect to section 16340, I believe it might be clearer if subsections (c) and (d) were reversed.

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4. Section 16361(c) provides that required minimum distributions from IRAs, qualified plans, and the like will be characterized as ten percent income and ninety percent principal. One California expert on employee benefits planning (Steve Trytten) has publicly criticized this rule on the ground that it will tend to trap income at the trust level, where it will generally be taxed at higher rates than it would be in the hands of the beneficiaries. As I understand it, he suggests that required minimum distributions should instead be characterized in the same way that they are treated in the hands of the trustee (generally, as entirely income except to the extent of employee contributions).

Those members of the Executive Committee who are knowledgeable enough to comment take a very different view. They believe that most settlors intend that proceeds of IRAs and qualified plans, including required minimum distributions, be preserved as part of corpus for as long as possible. To the extent IRA or qualified plan distributions are characterized as income, simple trusts will be required to pass them through to the income beneficiaries. The Executive Committee believes that required minimum distributions should be characterized as entirely principal so that the trustee of even a simple trust (i.e., a trust requiring current distribution of all net income) will have discretion to retain them in trust for later distribution. So long as the trust allows discretionary distributions of principal, trapping of income at the trust level can be avoided by making discretionary principal distributions, if making such distributions is deemed less damaging than trapping income.

Please let me know if you have any questions concerning these comments. I will be attending the December 11 CLRC meeting.

Very truly yours,

James L. Deeringer

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cc: Susan House