

UPIA Study Course

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Course Overview

- Review materials
 - The UPIA Handbook
 - The Two UPIAs -- Uniform Prudent Investor Act and Uniform Principal and Income Act
 - Both UPIAs become effective January 1, 2004
 - Both UPIAs are default rules that can be overridden by trust terms
 - Both UPIAs **apply to new and existing trusts**
 - Exculpatory provisions
 - Trust accountings, trustee removal
 - Questions
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Uniform Prudent Investor Act

Chapter 1, Page 1; Chapter 2

- The bad news
 - Being a trustee just got tougher
 - Duty to investigate, monitor and make changes
 - The good news
 - Banks and trust companies are probably already doing most of the things required by the new act
 - But these are dangerous waters for individual trustees**
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Uniform Prudent Investor Act

Chapter 1, Pages 1 - 4; Chapter 2, Pages 9 - 14

- Old standard – based on the prudent man rule
 - Focused on individual investment decisions and preservation of principal
 - New standard – Trust Code §117.004
 - Invest and manage as a **prudent investor** would, *considering many factors*
 - Modern Portfolio Theory – evaluate portfolio as a whole
 - With few exceptions, trustee can invest in any type of property
 - **In many cases, new standard will encourage, if not require, investing for *total return* of the trust**
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Uniform Prudent Investor Act

Chapter 1, Page 5; Chapter 2, Pages 14 - 20

- Problems with concentrations
 - Affirmative duty to diversify
 - Trust Code §117.005
 - Duty to investigate and implement plan at inception of trusteeship
 - Trust Code §117.006
 - **The old Texas rule permitting retention of original trust property is gone**
 - Codification of duties of loyalty and impartiality
 - Trust Code §§117.007-8
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Uniform Prudent Investor Act

Chapter 1, Pages 4-6; Chapter 2, Pages 21-28; Chapter 7, Pages 1-3

- New rules regarding delegation
 - Trust Code §117.011
 - (a) Trustee must use care, skill and caution in selecting agent, establishing terms of delegation and monitoring agent
 - (c) Trustee who does so is *not liable for agent's actions* unless:
 - Agent is **affiliate** of trustee
 - Delegation agreement requires **arbitration**
 - Delegation agreement **shortens statute of limitations**
 - Language invoking the act
 - Trust Code §117.012
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Uniform Principal and Income Act

Chapter 1, Pages 6 - 8; Chapter 3

- Main reason the act was passed – the power to adjust
 - Trust Code §116.005
 - Act goes much further, however
 - A general reworking of all trust accounting rules
 - Biggest changes:
 - Deferred compensation plans inside trusts
 - Oil and gas properties
 - Timber
 - Trustee's fees, accounting expenses
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Uniform Principal and Income

Chapter 3, Pages 8 - 12

- Definitions
 - Trust Code §116.001
 - Some overlap with Trust Code §111.004
 - "Income beneficiaries" and "remainder beneficiaries"
 - "Fiduciary" includes trustee and executor, but not guardian or agent
 - "Income interest"
 - "Person"
 - "Terms of the trust"
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Uniform Principal and Income Act

Chapter 3, Pages 13 - 16

General Principles

- Trust Code §116.004
 - (a) Follow trust terms, then statute, but **if there's no rule, it's principal**
 - (b) When exercising discretion (including power to adjust), **trustee must act impartially**, unless trust terms provide otherwise
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Uniform Principal and Income Act

Chapter 1, Pages 5 - 8; Chapter 3, Page 16 - 28

Power to Adjust

- Trust Code §116.005
 - Necessary because of "total return" nature of prudent investor rule
 - (a) Prerequisites
 - Must be applying the prudent investor rule
 - What is "income" must be relevant to the distribution standard
 - Can, or should, one adjust an HEMS trust?
 - Trustee can't act impartially without making adjustment
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Uniform Principal and Income Act

Chapter 1, Pages 5–8; Chapter 3, Pages 16–28; Chapter 7, Page 4

- Power to adjust
 - (b) Factors to consider – similar to prudent investor rule factors in Trust Code §117.004(c)
 - (c) Trustee cannot make an adjustment:
 - That reduces income payable in marital deduction trust
 - If the trustee also is a beneficiary**
 - (d) Trustee may be able to appoint co-trustee
 - Consider adapting co-trustee provision
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Uniform Principal and Income Act

Chapter 1, Pages 5–8; Chapter 3, Pages 16–28; Chapter 7, Page 4

- Two-pronged analysis:
 - (1) **Can** the trustee adjust?
 - Must be investing as a prudent investor
 - Income must matter
 - Trustee cannot be beneficiary (independent trustee or co-trustee)
 - (2) **Should** the trustee adjust?
 - Decision probably must be made annually – can't just set it and forget it
 - Doing it, not doing it, or doing it wrong can be abuse of discretion
 - No percentages mentioned in statute, but 3-5% is likely
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Uniform Principal and Income Act

Chapter 1, Pages 8-9; Chapter 3, Pages 28-32; Chapter 7, Pages 4-7

- Judicial control of discretionary power
 - Trust Code §116.006
 - Applies to power to adjust decisions only
 - (a) Court can't substitute judgment
 - (c) Damage recovery the most favorable possible for trustee
 - (d) Advisory opinions
 - Must have "reasonable belief" that beneficiary "will object," which can't be based on refusal to sign release
 - Must make reasonable disclosure
 - Must "advance" attorneys' fees
 - Court may award fees and costs as "may seem equitable and just"
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Uniform Principal and Income Act

Chapter 1, Page 8; Chapter 3, Pages 32 - 33

- Noncharitable Unitrusts
 - Trust Code §116.007
 - In marital trust, one still must use "greater of income or unitrust percentage" until Proposed Treasury Reg. §1.643(b) is made final
 - Not a conversion statute
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Uniform Principal and Income Act

Chapter 3, Pages 35 -- 47

- Allocation Issues Involving Decedents' Estates
 - Trust Code §§ 116.051 -- 116.103
 - Rules #1 through #4 – similar to old law, except administration expenses are allocated at trustee's discretion (*Hubert fix*) (pp. 35 – 36)
 - Pecuniary gifts in estates *and trusts* – interest at 6% starts accruing one year after death, not one year after letters testamentary are granted (pp. 36 – 37)
 - Rules change regarding receipt of periodic payments (pp. 43 - 44)
 - If the due date is not periodic or if there's no due date, accrue; otherwise, allocate to income
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Uniform Principal and Income Act

Chapter 1, Pages 10 – 11; Chapter 3, Pages 49 -- 54

- Receipts from entities
 - Trust Code § 116.151
 - General rule: cash = income, noncash = principal
 - "Money received in partial liquidation"
 - 20% of entity's gross assets
 - Entity may characterize payments
 - Business conducted by trustee
 - Trust Code § 116.153
 - Trustee may operate assets as a business, using GAAP
 - May be useful with minerals, timber
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Uniform Principal and Income Act

Chapter 3, Pages 56 -- 59

- Sale of discounted bonds and notes
 - Trust Code § 116.163
 - If maturity date at time of purchase is one year or more, all sales proceeds is principal (different from old Trust Code §113.105(b))
 - Insubstantial allocations = principal
 - Trust Code § 116.171
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Uniform Principal and Income Act

Chapter 1, Page 10; Chapter 3, Pages 59 - 67

- Receipts from deferred compensation plans
 - Trust Code § 116.172
 - Old rule was 5% of inventory value
 - New rule uses unitrust concepts – 4% of the FMV of the “deferred payment asset”
 - Only applies if part or all of payment was required to be made
 - This section was garbled in the legislative process – see Bar comments, Ch. 3, pp. 66--67
 - For existing trusts and estates with deferred payment assets, pay careful attention to the transition
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Uniform Principal and Income Act

Chapter 1, Page 10; Chapter 3, Pages 68 - 70

- Oil and gas receipts
 - Trust Code §116.174
 - Old rule
 - All delay rentals are income
 - Royalties, etc., are 27.5% principal, 72.5% income**
 - New rule
 - "Nominal" delay rentals are income, other delay rentals are allocated "equitably"
 - Royalties, etc., are allocated "equitably"**
 - Presumption: Following tax depletion deduction is "equitable"**
 - Grandfather provision: Trustee may continue to apply old rule to *existing properties* if trustee was correctly following the old law**
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Uniform Principal and Income Act

Chapter 1, Page 10; Chapter 3, Pages 71 - 73

- Timber
 - Trust Code §116.175
 - Old law: allocate reasonably and equitably
 - New law: complicated scheme based on rate of growth and rate of harvesting
 - Contains grandfather provision similar to that applicable to oil and gas properties
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Uniform Principal and Income Act

Chapter 3, Pages 73 - 75

Unproductive property

- Trust Code §116.176
 - Old law (Trust Code §113.110) – procedure for allocating some of sales proceeds to income
 - New law – No procedure for allocating sales proceeds to income
 - A real problem during the transition
 - Consider Section 116.005 power to adjust
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Uniform Principal and Income Act

Chapter 3, Pages 79 – 87; Chapter 8

- Allocation of disbursements – see Chapter 8 chart
 - Accountings now usually ½ income, ½ principal, not all income as before
 - Depreciation is now discretionary
 - Environmental expenses are principal
 - Trustee’s fees, custodial fees, investment advisor’s fees are usually ½ income, ½ principal, not discretionary as before
 - Judicial proceedings (other than actions just involving income or principal interest) are usually ½ income, ½ principal, not discretionary as before
 - “When in doubt, it’s principal”
 - Texas now has an equitable adjustment provision
 - Trust Code §116.206
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Exculpatory Clauses

Chapter 1, Pages 11 – 12; Chapter 4; Chapter 7, Page 7

- The *Grizzle* case
- HB 3503
 - (§113.059) Cannot exculpate for:
 - Bad faith
 - Intentional breaches
 - Reckless indifference
 - Profit from breach of trust
 - Special finding required for exculpation clauses in 867 and 142 Trusts
- Drafting exculpatory clauses in light

Trust Accountings; Trustee Removal

Chapter 1, Pages 12 - 13

- Trust Accountings (§113.151)
 - Trustee now has 90 days after demand to provide accounting, unless court otherwise orders
 - Court *may* order trustee to pay demanding beneficiary's attorneys' fees
 - Trustee Removal (§113.082)
 - "May" means "may, in its discretion"
 - Failure to provide accounting is specific grounds for removal
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Conclusion

- Drafting ideas – Chapter 7
 - Marketing ideas – Chapter 6
 - Questions
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