

The Two UPIAs

Glenn M. Karisch
Barnes & Karisch, P. C.
Austin, Texas
www.texasprobate.com

© 2003 by Glenn M. Karisch, All Rights Reserved.

Overview

- Review materials
 - Text of acts with comments available at <http://www.texasprobate.com>
 - 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 in Texas
-

Uniform Prudent Investor Act

Page 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**
-

Uniform Prudent Investor Act

Pages 2 - 4

- Old standard – based on the prudent man rule
 - 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***
-

Uniform Prudent Investor Act

Page 5

- Problem of 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
-

Uniform Prudent Investor Act

Pages 5-6; Pages 13 - 16

- 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
-

Uniform Principal and Income Act

Page 6

- 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
-

Uniform Principal and Income Act

Pages 6 - 7

- 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
-

Uniform Principal and Income Act

Pages 6 - 7

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 – HEMS trusts?
 - Trustee can’t act impartially without making adjustment
-

Uniform Principal and Income Act

Pages 6 - 7; Page 16

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
-

Uniform Principal and Income Act

Pages 7 – 8; Pages 16 - 19

- 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" and cannot base belief 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"
-

Uniform Principal and Income Act

Page 7

- Noncharitable Unitrusts
 - Trust Code §116.007
 - Not a conversion statute
-

Uniform Principal and Income Act

- Allocation Issues Involving Decedents' Estates
 - Trust Code §§ 116.051 -- 116.103
 - Similar to old law, except administration expenses are allocated at trustee's discretion (*Hubert* fix)
 - Pecuniary gifts in estates *and trusts* – interest at 6% starts accruing one year after death, not one year after letters testamentary are granted
-

Uniform Principal and Income Act

- Receipts from entities
 - Trust Code § 116.151
 - General rule: cash = income, noncash = principal
 - "Money received in partial liquidation"
 - Business conducted by trustee
 - Trust Code § 116.153
 - 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 are principal (different from old Trust Code §113.105(b))
 - Insubstantial allocations = principal
 - Trust Code § 116.171
-

Uniform Principal and Income Act

Page 9

- 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 official Bar comments
 - For existing trusts and estates with deferred payment assets, pay careful attention to the transition
-

Uniform Principal and Income Act

Pages 8 - 9

- 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
-

Uniform Principal and Income Act

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
-

Uniform Principal and Income Act

Pages 20 - 26

Allocation of disbursements

- Accountings now usually 1/2 income, 1/2 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 1/2 income, 1/2 principal, not discretionary as before
 - Judicial proceedings (other than actions just involving income or principal interest) are usually 1/2 income, 1/2 principal, not discretionary as before
 - "When in doubt, it's principal"
- Texas now has an equitable adjustment provision
- Trust Code §116.206
-

Exculpatory Clauses

Pages 10 – 11; Page 19

- The *Grizzle* case
 - HB 3503
 - Cannot exculpate for:
 - Bad faith
 - Intentional breaches
 - Reckless indifference
 - Profit from breach of trust
 - Effect on 867 and 142 Trusts
 - Drafting exculpatory clauses in light of HB 3503
-

Conclusion

- Drafting ideas, Page 13
 - Marketing ideas, Page 12
-

The Two UPIAs

Glenn M. Karisch
Barnes & Karisch, P. C.
Austin, Texas
www.texasprobate.com