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F I S C A L   I M P A C T   R E P O R T

SPONSOR:	Martinez	DATE TYPED:	03/6/01	HB	109/aSJC
SHORT TITLE:	Uniform Principal and Income Act			SB	
			ANALYST:		Rael

APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY01	**FY02**	**FY01**	**FY02**		
		See Narrative			

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to HB111 Uniform Trust Code

SOURCES OF INFORMATION

Administrative Office of the Courts (AOC)

SUMMARY

Synopsis of SJC Amendment

The amendment replaces the 90% allocation to principal for working interest, royalty, shut-in well, take-or-pay, bonus or delay rental payments with the equivalent of the amount that is allowed as a deduction from gross income for depletion purposes under federal income tax law.

The Uniform Law Commissioners comment to the section notes that a depletion provision that is tied to past or present Internal Revenue Code (IRC) provisions is undesirable because it causes a large portion of the oil and gas receipts to be paid out as income. (At one time, the IRC provided a 27.5% depletion allowance.) As wells are depleted, the amount received by the income beneficiary falls drastically. Allocating a larger portion of the receipts to principal enables the trustee to acquire other income producing assets that will continue to produce income when the mineral reserves are exhausted.

Synopsis of Original Bill

This bill repeals Sections 46-3-1 through 46-3-15. The purpose of the new and revised act is to provide procedures for trustees administering an estate in separating principal from income, and to ensure that the intent of the trust creator is the guiding principle for trustees. The bill will allow principal and income allocation rule to function with modern trust investment practices. The effective date of the provisions of this act is July 1, 2001.

Significant Issues

The Administrative Office of the Courts reports the following:

Distinguishing income from principal is not always self-evident. Therefore, the law has provided trustees with statutory help for a long period of time. In the 1990's and especially since the promulgation of the Uniform Prudent Investor Act in 1994, a trustee's obligation to invest the assets of a trust as a prudent investor would invest them, has substantially altered the fiduciary obligation of a trustee. There is a strong relationship between the obligation to invest as a prudent investor and the obligation to satisfy income and remainder beneficiaries. The current Uniform and Principal Income Act does not accommodate prudent investor rules. This bill does.

There are certain kinds of assets that this revised act provides for that are just not within the scope of consideration in the current act. One of them is derivatives. Another is asset-based securities. Receipts from derivatives, unless a trustee exercises powers available in the conduct of a business held in trust, are principal. Receipts from asset-based securities are either income or principal, depending upon the categorization of the asset backed security's payor. This revised act provides, generally, that an income receipt is principal if it is due before a decedent dies in the case of an estate or before an income interest begins in the case of a trust. After death or after an income interest begins, it is classified as income. If there is income that is not distributed at the time the income interest ends, generally it is paid to income beneficiaries. But if the trust is revocable by an income beneficiary at an amount more than five percent of the trust's corpus immediately before the income interest ends, the undistributed income allocable to the revocable part, must be added to principal.

This revised act provides rules that assure orderly distribution of income when the decedent dies or an income interest ends. The current act makes no attempt to deal with this distribution problem.

This revised act allows the trustee to adjust principal and income to the extent made necessary by prudent investment when a trust provides for a fixed income for the income beneficiary. The current act does not deal with adjustment as a result of prudent investment. The whole notion of prudent investment, modern portfolio theory and total return came later in time than what is in the act now.

Expenses and taxes must be paid during the administration of a trust. Under the revised act, a trustee who conducts a business held in a trust may separate out the accounting for the business from that for other trust assets. The trustee, also, has the power to allocate net cash receipts to working capital, the acquisition or replacement of fixed assets, and other reasonably foreseeable needs of the business or activity, and the extent to which the remaining net cash receipts are accounted for as principal or income in the trust's general accounting records. The current uniform act treats net profit from a business as income, and losses as principal. There is no flexibility.

This revised act allows a fiduciary to make adjustments between principal and income for tax purposes. The current uniform act does not provide such discretion to the fiduciary.

FISCAL IMPLICATIONS

See Administrative Implications below.

ADMINISTRATIVE IMPLICATIONS

Greater litigation may result in increased court expenses.

The Administrative Office of the Courts notes the following:
Drafting and administration of wills and trusts becomes considerably more difficult without a modern set of rules that, among other things, allows adjustment because of prudent investment decisions and because of tax laws. If wills and trusts are not adequately drafted, trustees will not be able to meet fiduciary obligations. The result will be, higher costs for setting up trusts, more conflict between trustees and beneficiaries and excessive litigation in the courts.

MFV/njw