



Sub. H.B. 522*

124th General Assembly

(As Reported by S. Finance & Financial Institutions)

Reps. Willamowski, Seitz, Reidelbach, Salerno, Schmidt, Setzer, Raga, Fessler, Gilb, Manning, Calvert, Coates, Patton, Womer Benjamin

BILL SUMMARY

- Eliminates certain provisions of the Fiduciary Law and modifies the Probate Fiduciary Law to adopt the Uniform Principal and Income Act of 1997, which provides standards for administering funds of a trust and circumstances and applicable accounting rules for allocations to or disbursements from income or principal of a trust.
- Specifies provisions relating to the liability of a trustee for making adjustments between income and principal of a trust.
- Eliminates provisions of the Probate Fiduciary Law relating to the determination of principal and income of a probate trust and the charging of expenses and distributions from income of probate trusts.
- Provides for application to existing trusts and estates.
- Modifies state bond law concerning obligations issued for local government infrastructure projects.
- Declares an emergency.

** This analysis was prepared before the report of the Senate Finance and Financial Institutions Committee appeared in the Senate Journal. Note that the list of co-sponsors and the legislative history may be incomplete.*

CONTENT AND OPERATION

Overview

The bill makes conforming changes in the Institutional Trust Funds Act and eliminates provisions of the current Fiduciary Law relating to standards for the allocation of receipts to and expenditures from income and principal of a trust. It replaces these provisions with the Uniform Principal and Income Act of 1997, which generally revises and updates these existing laws. The bill also relocates a provision of the Fiduciary Law providing that a qualified beneficiary or a legal representative of a qualified beneficiary periodically may request that an inter vivos trustee provide a report of the management of an inter vivos trust.

In the Probate Fiduciary Law, the bill eliminates provisions relating to the determination of principal and income of a probate trust and the charging of expenses and distributions from income of probate trusts, and modifies this Law to provide that certain allocations of receipts and expenditures are to be in accordance with the bill's provisions.

The bill states that all of these changes are effective on January 1, 2003.

The Uniform Principal and Income Act of 1997 is a model act developed by the National Conference of Commissioners on Uniform State Laws, while the existing Fiduciary Law is the Uniform Principal and Income Act approved by the National Conference of Commissioners on Uniform State Laws in 1962. According to the prefatory note accompanying the 1997 Act, its general purposes are (1) to replace provisions of the previous uniform act to provide for "revocable living trusts," which generally are revocable trusts made by living persons who transfer title to specified assets to the trust with instructions to apply the income in accordance with the terms of the trust, (2) to update and establish provisions, including those relating to financial instruments created since 1962, and (3) to provide for investment under principals contained in the Uniform Prudent Investor Act (secs. 1339.52 to 1339.61, not in the bill). (See **COMMENT 1.**)

Generally, the bill modifies the Fiduciary Law to provide standards for administering funds of a trust and circumstances and applicable accounting rules for allocations to or disbursements from income or principal of a trust (see **COMMENT 2.**) Specifically, the bill provides standards relating to decedents' estates or a terminating income interest, apportionment at the beginning and end of an income interest, allocation of receipts during administration of a trust, and allocation of disbursements during administration of a trust. The bill also includes definitions and provides for its construction and application, including its application to existing trusts and estates.

The analysis categorizes the changes to the Fiduciary Law (secs. 1340.01 to 1340.91) by subject matter as follows: (1) general provisions, application to existing trusts and estates, and the bill's specified effective date, (2) general fiduciary duties, (3) decedents' estates or a terminating income interest, including determining and distributing net income and distributions to residuary and remainder beneficiaries, (4) apportionment at the beginning and end of an income interest, (5) allocation of receipts during the administration of a trust, including receipts from entities and receipts normally and not normally apportioned, and (6) allocation of disbursements during administration of a trust. The analysis also discusses the relocation of a provision of the Fiduciary Law (sec. 1340.031) relating to reports of management of inter vivos trusts.

The analysis next discusses the elimination and modification of provisions in the Probate Fiduciary Law (secs. 2109.66 to 2109.68) to reflect enactment of the bill's provisions. Conforming changes that are made to a provision of the Institutional Trust Funds Act (sec. 1340.35) also are discussed.

The analysis concludes with a discussion of a modification the bill makes to state bond law.

General provisions; application to existing trusts and estates; effective date

- 1340.40 Includes definitions for terms used throughout the bill. These definitions include: accounting period, beneficiary, fiduciary, income, income beneficiary, income interest, mandatory income interest, net income, person, principal, remainder beneficiary, terms of a trust, and trustee.
- 1340.90 Specifies that the bill may be cited as the "Uniform Principal and Income Act (1997)." Also, requires consideration to be made for uniformity in the construction and application of the bill's provisions among states enacting it.
- 1340.91 Provides generally for the application to trusts or decedents' estates existing on the bill's effective date.

General fiduciary duties

- 1340.41 Provides general rules for (1) the administration of a trust in allocating receipts and disbursements between principal and income, and (2) matters within the scope of the bill's provisions relating to decedents' estates, termination of an income interest, and apportionment at the beginning or end of an income interest. Also, provides for impartiality to beneficiaries and specifies rules to

prevent the reduction or loss of marital and charitable tax deductions.

- 1340.42 Authorizes a trustee to make adjustments between principal and income of a trust by providing for general authority to make adjustments, factors to consider in making an adjustment, prohibited adjustments, adjustments by cotrustees, the release of adjustment authority by a trustee, limitations on adjustment authority, liability of a trustee for making an adjustment, and a "safe-harbor" adjustment (see **COMMENT 3**).

Decedents' estates or a terminating income interest

Determining and distributing net income

- 1340.46 Specifies rules for determining and distributing net income that apply after a decedent dies, in the case of an estate, or after an income interest in a trust ends, including rules related to distributions to beneficiaries generally and beneficiaries receiving a "pecuniary amount outright," prohibited reductions in principal or income receipts, and determinations relevant to net income and principal receipts.

Distribution to residuary and remainder beneficiaries

- 1340.47 Provides for a beneficiary's entitlement to a portion of net income, considerations for determining a beneficiary's share of net income, recordkeeping requirements for undistributed net income, and considerations for applying gains or losses from the disposition of principal assets.

Apportionment at beginning and end of an income interest

- 1340.51 Specifies that an income beneficiary is entitled to net income when an income interest begins, specifies when an asset becomes subject to a trust or subject to a successive income interest, and specifies when an income interest ends.
- 1340.52 Provides for the apportionment of receipts and disbursements when a decedent dies or an income interest ends, including allocations between principal and income based on the due date of the obligation or income.
- 1340.53 Requires certain distributions to mandatory income beneficiaries when a mandatory income interest ends and specifies requirements

when a trustee's obligation to pay a fixed annuity or fixed fraction of the trust's assets ends.

Allocation of receipts during administration of trust

- 1340.57 Specifies allocations to income or principal for money or receipts received from "entities" (defined), including money received in partial liquidation of an entity. Also, provides for the reliance of a trustee upon an entity's representations about the source or characterization of distributions.
- 1340.58 Provides for the allocation to income or principal of disbursements received from other trusts or estates.
- 1340.59 Authorizes a trust that conducts a business or other activity to account separately for the business or activity, including providing for the allocation of net cash receipts to income or principal and for the allocation to principal if the trust sells the separate business or activity. Also, provides examples of activities for which a trustee may maintain separate accounting records.

Receipts not normally apportioned

- 1340.63 Requires allocations to principal of certain items received, including specified assets received that are not allocated to income, certain reimbursements received, proceeds from property taken by eminent domain, and net income received but not distributed to a known beneficiary.
- 1340.64 Specifies allocation to income of amounts received as rent of real or personal property, allocation to principal of amounts representing refundable deposits (including security deposits), and limits on the distribution of amounts representing refundable deposits.
- 1340.65 Requires, subject to specified exceptions, allocation to income of amounts received as interest on an obligation to pay money to the trustee and allocation to principal of described amounts received from the disposition of an obligation to pay money to the trustee.
- 1340.66 Provides, subject to a specified exception, for the allocation between principal and income of funds received from a life insurance policy, of dividends received from an insurance policy, and of proceeds of a contract that insures the trustee against specified losses.

Receipts normally apportioned

- 1340.70 Authorizes a trustee or cotrustee that determines an allocation between principal and income is insubstantial, under specified circumstances, to allocate the entire amount to principal and provides examples of allocations presumed to be insubstantial.
- 1340.71 Provides, subject to a specified exception, for the allocation between principal and income of fixed or future "payments" (defined) received by a trust that are or are not characterized as interest, dividends, or equivalent payments; are payments "required to be made" (defined); or are necessary to obtain an estate tax marital deduction.
- 1340.72 Provides for allocation between principal and income of receipts from a "liquidating asset" (defined).
- 1340.73 Allocates receipts received from interests in minerals, other natural resources, or water between principal and income, including providing allocation instructions based on when the interest is acquired by a trust.
- 1340.74 Allocates net receipts received from interests in timber and related products between principal and income, including recognizing amounts for depletion and providing allocation instructions based on when the interest is acquired by a trust or the harvesting occurs.
- 1340.75 &
Section 3 Authorizes a spouse, in situations where a marital deduction is allowed, to require a trustee to "make property productive of income," convert property, or make adjustments between principal and income in consideration of the sufficiency of income received by the spouse, and provides for allocation if the preceding does not apply regardless of whether an asset is income-producing. Specifies that this provision of the bill is intended to codify existing fiduciary and trust law principles.
- 1340.76 Provides for allocations to principal made in connection with receipts received from transactions in "derivatives" (defined) and upon the purchase or sale of an option on assets.
- 1340.77 Specifies allocations between income and principal of interest or other returns from "asset-backed securities" (defined) or proceeds received from collateral financial assets.

Allocation of disbursements during administration of trust

- 1340.81 Provides for disbursements from income of amounts representing certain expenses and payments.
- 1340.82 Provides for disbursements from principal of amounts representing certain expenses, payments, taxes, disbursements relating to environmental matters, and obligations against principal assets.
- 1340.83 Authorizes, under specified circumstances, a trustee to allocate for depreciation, including by transferring to principal amounts received from depreciable principal assets.
- 1340.84 Authorizes, under specified circumstances, a trustee in making a "principal disbursement" to reimburse principal from income or to transfer funds from income to principal to provide a reserve for future principal disbursements.
- 1340.85 Allocates specified tax payments between income and principal.
- 1340.86 Authorizes a fiduciary, under specified circumstances, to make adjustments between income and principal for amounts representing "the shifting of economic interests or tax benefits" between specified beneficiaries and to reimburse principal for estate tax increases related to marital or charitable contribution deductions.

Relocation of Fiduciary Law about management reports of inter vivos trusts

(sec. 1340.031 (1339.69))

The Fiduciary Law provides that a qualified beneficiary or a legal representative of a qualified beneficiary periodically may request that an inter vivos trustee provide a report of the management of an inter vivos trust. This Law also specifies conditions for requesting a report, the general content of the report, the consequences of failure to make a report, the legal effect of a report on specified persons, and the effect of making a report upon any liability of an inter vivos trustee to specified persons. The bill retains this law, but relocates it to miscellaneous provisions of the Fiduciary Law (sec. 1339.69) and also relocates applicable definitions of "qualified beneficiary" and "legal representative" (sec. 1340.01(E) and (F) of current law).

Modifications to Probate Fiduciary Law

(secs. 2109.66 and 2109.67 (repealed), and 2109.68)

The bill eliminates provisions of the Probate Fiduciary Law relating to the determination of principal and income of a probate trust and the charging of expenses and distributions from income of probate trusts. Instead, the bill specifies that under the Probate Fiduciary Law, allocations of receipts and expenditures by an executor, administrator, or testamentary trustee are to be in accordance with the "Uniform Principal and Income Act."

Conforming changes

(sec. 1340.35)

The bill makes conforming changes in the Institutional Trust Funds Act to reflect the repeal and reenactment of the "Uniform Principal and Income Act" and the repeal of Probate Fiduciary Law relating to the charging of expenses and distributions from income of probate trusts.

State bond law modification

(R.C. 151.01)

The state General Obligation Bond Law (R.C. 151.01 to 151.09) allows for the issuance and refunding of a number of different kinds of state obligations authorized by the Ohio Constitution. These include obligations for natural resources projects (under Section 2l of Article VIII), local government infrastructure projects (Section 2m), public school and higher education facilities (Section 2n), and "Clean Ohio" conservation projects (Section 2o). Obligations for local government infrastructure projects also are authorized under Section 2k of Article VIII, but that section includes a \$1.2 billion cap on the total amount of new obligations that can be issued under it, and the cap has been reached.

The bill specifically lists the constitutional sections that the use of the term "obligations" applies to under the General Obligation Bond Law (including Section 2k), and specifies that the authority to issue bond anticipation notes or to refund existing bonds is subject to Section 2k in addition to the other constitutional provisions.

COMMENT

1. Generally, the Ohio Uniform Prudent Investor Act provides that if a trustee invests and manages trust assets under the Act, that trustee must invest and

manage the trust's assets as a prudent investor would, by considering the purposes, distribution requirements, and other circumstances of the trust. The Act, in addition to other provisions, specifies standards and requirements applicable to the management of trust assets, rather than specifying a list of permissible investments by a trustee.

2. The bill defines "income" (in part) to mean money or property that a fiduciary receives as current return from a principal asset of a trust. The bill defines "principal" to mean property held in a trust for distribution to certain beneficiaries when a trust terminates. (For additional definitions used in the bill, see sec. 1340.40.) Thus, by specifying receipts or disbursements as either affecting trust income or principal, one function of the bill is to establish standards for allocating a trust's funds between beneficiaries (e.g., a beneficiary entitled to income during the trust and a beneficiary entitled to principal which generally is distributed only when a trust terminates).

3. Generally, a "safe harbor" is a provision of law that removes liability upon an actor if the action is done in good faith. Presumably, for purposes of this provision of the bill, it describes an adjustment that a trustee may make and avoid liability.

HISTORY

ACTION	DATE	JOURNAL ENTRY
Introduced	02-26-02	p. 1454
Reported, H. Financial Institutions	05-30-02	pp. 1891-1892
Passed House (87-0)	06-19-02	pp. 1961-1962
Reported, S. Finance & Financial Institutions	---	---

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