**A** **BILL**

TO ADD SECTION 62‑7‑816A, SOUTH CAROLINA CODE OF LAWS, 1976, RELATING TO THE POWERS OF A TRUSTEE, SO AS TO AUTHORIZE A TRUSTEE TO AMEND THE PROVISIONS OF AN IRREVOCABLE TRUST WHEN DOING SO IS IN THE BEST INTEREST OF THE BENEFICIARIES AND IN FURTHERANCE OF THE PURPOSE OF THE TRUST; TO AMEND SECTION 62‑7‑903, RELATING TO THE SOUTH CAROLINA UNIFORM PRINCIPAL AND INCOME ACT, SO AS TO CLARIFY THE TERMS OF THE PROVISION; TO AMEND SECTION 62‑7‑904, RELATING TO THE POWERS OF A TRUSTEE TO ADJUST, SO AS TO INCLUDE IN THESE POWERS FOR THE CONVERSION OF A TRUST TO A UNITRUST; AND TO ADD SECTIONS 62‑7‑904A THROUGH 62‑7‑904P, RELATING TO UNITRUSTS, SO AS TO PROVIDE FOR THE REQUIREMENTS TO ESTABLISH A UNITRUST AND ITS ADMINISTRATION.

Be it enacted by the General Assembly of the State of South Carolina:

SECTION 1. Article 7 of Title 62 is amended by adding:

“Section 62‑7‑816A. (a) Unless the terms of the instrument expressly provide otherwise, a trustee with the discretion to make distributions of principal or income to or for the benefit of one or more beneficiaries of a trust, the original trust, may exercise that discretion by appointing all or part of the property subject to that discretion in favor of another trust for the benefit of one or more of those beneficiaries, the second trust. This power may be exercised without the approval of a court, but court approval is necessary if the terms of the original trust expressly prohibit the exercise of such power or require court approval.

(b) The trustee of the original trust may exercise this power whether or not there is a current need to distribute principal or income under any standard provided in the original trust. The trustee’s special power to appoint trust principal or income in further trust under this section includes the power to create the second trust.

(c) The second trust may be a trust created under the same trust instrument as the original trust or under a different trust instrument, and the trustee of the second trust may be either the trustee of the original trust or another trustee.

(d) The terms of the second trust are subject to the following requirements:

(1) The beneficiaries of the second trust may include only beneficiaries of the original trust.

(2) A beneficiary who has only a future beneficial interest, vested or contingent, in the original trust cannot have the future beneficial interest accelerated to a present interest in the second trust.

(3) The terms of the second trust may not contain any provision nor reduce any fixed income, annuity, or unitrust interest of a beneficiary in the assets of an original trust document if the inclusion of the provision or reduction in the original trust document would have disqualified any assets of the original trust for any federal or state income, estate, or gift tax deduction received on account of any assets of the original trust, or if the inclusion of the provision or reduction in the original trust would have reduced the amount of any federal or state income, estate, or gift tax deduction received. In addition, the terms of the second trust may not reduce any retained interest of a beneficiary of the original trust if the interest is a qualified interest under Internal Revenue Code Section 2702.

(4) If contributions to the original trust have been excluded from the gift tax by the application of Internal Revenue Code Section 2503(b) and Section 2503(c), then the second trust shall provide that the beneficiary’s remainder interest in the contributions shall vest and become distributable no later than the date upon which the interest would have vested and become distributable under the terms of the original trust.

(5) If a beneficiary of the original trust has a power of withdrawal over trust property, then either:

(A) the terms of the second trust must provide a power of withdrawal in the second trust identical to the power of withdrawal in the original trust; or

(B) sufficient trust property must remain in the original trust to satisfy the outstanding power of withdrawal.

(6) If the power to distribute principal or income in the original trust is subject to an ascertainable standard, then the power to distribute income or principal in the second trust must be subject to the same ascertainable standard as in the original trust and must be exercisable in favor of the same beneficiaries as in the original trust.

(7) The second trust may confer a power of appointment upon a beneficiary of the original trust to whom or for the benefit of whom the trustee has the power to distribute principal or income of the original trust. The permissible appointees of the power of appointment conferred upon a beneficiary may include persons who are not beneficiaries of the original or second trust.

(e) A trustee may not exercise the power to appoint principal or income under subsection (a) of this section if the trustee is a beneficiary of the original trust, but the remaining cotrustee or a majority of the remaining cotrustees may act for the trust. If all the trustees are beneficiaries of the original trust, then the court may appoint a special fiduciary with authority to exercise the power to appoint principal or income under subsection (a) of this section.

(f) The exercise of the power to appoint principal or income under subsection (a) of this section:

(1) is considered the exercise of a power of appointment, other than a power to appoint to the trustee, the trustee’s creditors, the trustee’s estate or the creditors of the trustee’s estate;

(2) does not result in the trustee or cotrustees of the original trust being considered the settlor of the second trust;

(3) is not prohibited by a spendthrift provision or by a provision in the trust instrument that prohibits amendment or revocation of the trust.

(g) To effect the exercise of the power to appoint principal or income under subsection (a) of this section, all of the following apply:

(1) The exercise of the power to appoint must be made by an instrument in writing, signed and acknowledged by the trustee, setting forth the manner of the exercise of the power, including the terms of the second trust, and the effective date of the exercise of the power. The instrument must be filed with the records of the original trust.

(2) The trustee shall give written notice to all qualified beneficiaries of the original trust, at least ninety days prior to the effective date of the exercise of the power to appoint, of the trustee’s intention to exercise the power. The notice must include a copy of the instrument described in subitem (1) of this subsection.

(3) If all qualified beneficiaries waive the notice period by a signed written instrument delivered to the trustee, the trustee’s power to appoint principal or income is exercisable after notice is waived by all qualified beneficiaries, notwithstanding the effective date of the exercise of the power.

(h) The provisions of this section shall not be construed to create or imply a duty of the trustee to exercise the power to distribute principal or income, or to create an inference of impropriety made as a result of a trustee not exercising the power to appoint principal or income conferred under subsection (a) of this section. The provisions of this section shall not be construed to abridge the right of any trustee who has a power to appoint property in further trust that arises under the terms of the original trust or under any other section of this article or under another provision of law or under common law. The terms of an original trust may modify or waive the notice requirements under subsection (g), reduce or increase restrictions on altering the interests of beneficiaries under subsection (d), and may otherwise contain provisions that are inconsistent with the requirements of this section.

(i) A trustee or beneficiary may commence a proceeding to approve or disapprove a proposed exercise of the trustee’s special power to appoint to another trust pursuant to subsection (a) of this section.

(j) The provisions of Section 62‑7‑109 regarding notices and the sending of documents to persons under this article apply for the purposes of notices and the sending of documents under this section.”

REPORTER’S COMMENT

Providing decanting authority to a trustee, authority to appoint the property of an original trust to a second trust, provides a nonjudicial method for modifying an irrevocable trust when doing so would be in the best interests of the beneficiaries or in furtherance of the purposes of the trust. Some examples of how decanting authority might be used by a trustee include: modifying the administrative or substantive provisions of a trust to account for a change in law, combining trusts to reduce administrative costs, limiting the authority of interested trustees, correcting scrivener’s errors, and conforming the distribution provisions of a trust to the requirements of a special needs trust.

Subsection (a) authorizes a trustee with discretion to make distributions of principal or income to or for the benefit of one or more beneficiaries of the original trust to exercise that discretion by appointing all or part of such property to a second trust. This authority may be exercised whether the original trust grants the trustee absolute discretion over distributions or whether the trustee’s discretion is limited by an ascertainable standard.

Subsections (b) and (c) affirm the broad decanting authority intended to be afforded to trustees to eliminate the uncertainty that was faced by trustees exercising decanting authority in reliance solely on common law principles. Subsection (b) provides that the trustee may exercise the power to decant whether or not there is a current need to distribute property under any standard provided in the original trust, for example, by decanting property from an original trust that limits distributions to an ascertainable standard to a second trust to promote administration of the trust or preservation of trust property. But see subdivision (d)(6), which prevents a trustee from exercising decanting authority to eliminate an ascertainable standard limiting the trustee’s discretion in the original trust document.

Subsection (d) provides certain requirements for the terms of the second trust. Subdivisions (d)(1) and (d)(2) prevent a trustee from exercising decanting authority to add beneficiaries to the second trust who were not beneficiaries of the original trust or accelerate the interest of a beneficiary with only a future interest in the original trust to a present interest under the second trust. Subdivisions (d)(3) and (d)(4) restrict a trustee’s ability to modify terms of an original trust or a beneficiary’s fixed interest in the trust if the original trust qualified for certain tax benefits. Under subdivision (d)(5), a trustee is required to preserve a beneficiary’s power of withdrawal over trust property; the trustee may do so by either maintaining sufficient trust property in the original trust to satisfy the beneficiary’s power of withdrawal, or by providing the beneficiary with an identical power of withdrawal under the terms of the second trust. Subdivision (d)(6) prevents a trustee from modifying any ascertainable standard governing the trustee’s power to make distributions under the terms of the original trust. Subdivision (d)(7) provides that the terms of the second trust may grant a power of appointment to a beneficiary of the original trust exercisable in favor of persons who are not beneficiaries of the original or second trust.

The remaining provisions of the statute address procedural concerns, including notice requirements and the procedure for decanting if the trustee is a beneficiary of the original trust. Subsection (e) prevents a trustee with a beneficial interest in the original trust from exercising the authority to decant, while preserving the ability to decant in circumstances where all trustees have an interest in the trust. Subsection (f) provides that the trustee’s power to decant is considered the exercise of a special power of appointment, does not result in the trustee being treated as the settlor of the second trust, and is not prohibited by a spendthrift provision or a provision prohibiting amendment or revocation of the original trust. Subsection (g) provides the procedural requirements for effecting a decanting, including the requisite notice and the beneficiaries’ ability to waive the notice period. Subsection (h) affirms that the provisions of Section 62‑7‑816A do not create an affirmative duty in the trustee to exercise the special power to appoint, limit the trustee’s decanting authority derived from some other source, or nullify any decanting provisions included in an original trust that are inconsistent with the provisions of this section. Subsection (i) allows either a trustee or beneficiary to seek court approval or disapproval of a proposed exercise of the decanting power, and subsection (j) incorporates the notice provisions of SCTC section 62‑7‑109.

SECTION 2. Section 62‑7‑903 of the 1976 Code is amended to read:

“Section 62‑7‑903. (A) In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of Sections 62‑7‑905 through 62‑7‑909, a fiduciary:

(1) shall administer a trust or estate in accordance with the terms of the trust or the will, even if there is a different provision in ~~this part~~ the South Carolina Uniform Principal and Income Act;

(2) may administer a trust or estate by the exercise of a discretionary power of administration given to the fiduciary by the terms of the trust or the will, even if the exercise of the power produces a result different from a result required or permitted by ~~this part~~ the South Carolina Uniform Principal and Income Act;

(3) shall administer a trust or estate in accordance with ~~this part~~ the South Carolina Uniform Principal and Income Act if the terms of the trust or the will do not contain a different provision or do not give the fiduciary a discretionary power of administration; and

(4) shall add a receipt or charge a disbursement to principal to the extent that the terms of the trust and ~~this part~~ the South Carolina Uniform Principal and Income Act do not provide a rule for allocating the receipt or disbursement to or between principal and income.

(B) In exercising:

(1) the power to adjust pursuant to Section 62‑7‑904(A);

(2) a discretionary power in connection with the conversion or administration of a unitrust under Sections 62‑7‑904B through Section 62‑7‑904P; or

(3) a discretionary power of administration regarding a matter within the scope of ~~this part~~ the South Carolina Uniform Principal and Income Act, whether granted by the terms of a trust, a will, or ~~this part~~ the South Carolina Uniform Principal and Income Act,

a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with ~~this part~~ the South Carolina Uniform Principal and Income Act is presumed to be fair and reasonable to all of the beneficiaries.”

REPORTER’S COMMENT

Prior Act. The rule in Section 62‑7‑404(1) of the 1963 SC Act is restated in Section 62‑7‑903(a), without changing its substance, to emphasize that this Act contains only default rules and that provisions in the terms of the trust are paramount. However, Section 62‑7‑404(a) of the 1963 SC Act applied only to the allocation of receipts and disbursements to or between principal and income. In this Act, the first sentence of Section 62‑7‑903(A) states that it also applies to matters within the scope of Sections 62‑7‑905 through 62‑7‑909. Section 62‑7‑903(A)(2) incorporates the rule in Section 62‑7‑404(b) of the 1963 SC Act that a discretionary allocation made by the trustee that is contrary to a rule in the Act should not give rise to an inference of imprudence or partiality by the trustee.

The Act deletes the language that appears at the end of 1963 SC Act Section 62‑7‑404(a)(3) ‑ “and in view of the manner in which men of ordinary prudence, discretion and judgment would act in the management of their affairs” ‑ because persons of ordinary prudence, discretion and judgment, acting in the management of their own affairs do not normally think in terms of the interests of successive beneficiaries. If there is an analogy to an individual’s decision‑making process, it is probably the individual’s decision to spend or to save, but this is not a useful guideline for trust administration. No case has been found in which a court has relied on the “prudent man” rule of the 1963 SC Act.

Fiduciary discretion. The general rule is that if a discretionary power is conferred upon a trustee, the exercise of that power is not subject to control by a court except to prevent an abuse of discretion. Restatement (Second) of Trusts Sec 187. The situations in which a court will control will control the exercise of a trustee’s discretion are discussed in the comments to Sec 187. See also id. Sec 233 Comment p.

Questions for which there is no provision. Section 62‑7‑903(A)(4) allocates receipts and disbursements to principal when there is no provision for a different allocation in the terms of the trust, the will, or the Act. This may occur because money is received from a financial instrument not available at the present time (inflation‑indexed bonds might have fallen into this category had they been announced after the Uniform Act was approved by the Commissioners on Uniform State Laws) or because a transaction is of a type or occurs in a manner not anticipated by the Drafting Committee for the Uniform Act or the drafter of the trust instrument.

Allocating to principal a disbursement for which there is no provision in the Act or the terms of the trust preserves the income beneficiary’s level of income in the year it is allocated to principal, but thereafter will reduce the amount of income produced by the principal. Allocating to principal a receipt for which there is no provision will increase the income received by the income beneficiary in subsequent years, and will eventually, upon termination of the trust, also favor the remainder beneficiary. Allocating these items to principal implements the rule that requires a trustee to administer the trust impartially, based on what is fair and reasonable to both income and remainder beneficiaries. However, if the trustee decides that an adjustment between principal and income is needed to enable the trustee to comply with Section 62‑7‑903(B) after considering the return from the portfolio as a whole, the trustee may make an appropriate adjustment under Section 62‑7‑904(A).

Duty of impartiality. Whenever there are two or more beneficiaries, a trustee is under a duty to deal impartially with them. Restatement of Trusts 3d: Prudent Investor Rule Sec 183 (1992). This rule applies whether the beneficiaries’ interests in the trust are concurrent or successive. If the terms of the trust give the trustee discretion to favor one beneficiary over another, a court will not control the exercise of such discretion except to prevent the trustee from abusing it. Id. Sec 183, Comment a. “The precise meaning of the trustee’s duty of impartiality and the balancing of competing interests and objectives inevitably are matters of judgment and interpretation. Thus, the duty and balancing are affected by the purposes, terms, distribution requirements, and other circumstances of the trust, not only at the outset but as they may change from time to time.” Id. Sec 232, Comment c.

The terms of a trust may provide that the trustee, or an accountant engaged by the trustee, or a committee of persons who may be family members or business associates, shall have the power to determine what is income and what is principal. If the terms of a trust provide that this Act specifically or principal and income legislation in general does not apply to the trust but fail to provide a rule to deal with a matter provided for in this Act, the trustee has an implied grant of discretion to decide the question. Section 62‑7‑903(B) provides that the rule of impartiality applies in the exercise of such a discretionary power to the extent that the terms of the trust do not provide that one or more of the beneficiaries are to be favored. The fact that a person is named an income beneficiary or a remainder beneficiary is not by itself an indication of partiality for that beneficiary.

SECTION 3. Section 62‑7‑904 of the 1976 Code is amended to read:

“Section 62‑7‑904. (A) A trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust’s income, and the trustee determines, after applying the provisions in Section 62‑7‑903(A), that the trustee is unable to comply with Section 62‑7‑903(B). In lieu of exercising the power to adjust, the trustee may convert the trust to a unitrust as permitted under Sections 62‑7‑904A through 62‑7‑904P, in which case the unitrust amount becomes the net income of the trust.

(B) In deciding whether and to what extent to exercise the power ~~of adjustment~~ to adjust in subsection (A), a trustee shall consider all factors relevant to the trust and its beneficiaries, including, but not limited to:

(1) the nature, purpose, and expected duration of the trust;

(2) the intent of the settlor;

(3) the identity and circumstances of the beneficiaries;

(4) the needs for liquidity, regularity of income, and preservation and appreciation of capital;

(5) the assets held in the trust and the extent to which they consist of financial assets, interests in closely held enterprises, tangible and intangible personal property, or real property and the extent to which an asset is used by a beneficiary, and whether an asset was purchased by the trustee or received from the settlor;

(6) the net amount otherwise allocated to income under other sections of the South Carolina Uniform Principal and Income Act and the increase or decrease in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available;

(7) ~~terms of the trust and~~ whether and to what extent ~~they~~ the terms of the trust give the trustee the power to invade principal or accumulate income or prohibit the trustee from invading principal or accumulating income, and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income;

(8) the actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation; and

(9) the anticipated tax consequences of an adjustment.

(C) A trustee may not make an adjustment:

(1) that diminishes the income interest in a trust that requires all of the income to be paid at least annually to a surviving spouse and for which an estate tax or gift tax marital deduction is allowed, in whole or in part, if the trustee did not have the power to make the adjustment, but only to the extent that making such an adjustment would cause adverse tax consequences under applicable tax laws and regulations;

(2) that reduces the actuarial value of the income interest in a trust to which a person transfers property with the intent to qualify for a gift tax exclusion;

(3) that changes the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets;

(4) from any amount that is permanently set aside for charitable purposes under a will or the terms of a trust unless both income and principal are so set aside, but only to the extent that making such an adjustment would cause adverse tax consequences under applicable tax laws and regulations;

(5) if possessing or exercising the power to make an adjustment is determinative in causing an individual to be treated as the owner of all or part of the trust for income tax purposes and the individual would not be treated as the owner if the trustee did not possess the power to make an adjustment;

(6) if possessing or exercising the power to make an adjustment is determinative in causing all or part of the trust assets to be included for estate tax purposes in the estate of an individual who has the power to remove a trustee or appoint a trustee, or both, and the assets would not be included in the estate of the individual if the trustee did not possess the power to make an adjustment;

(7) if the trustee is a beneficiary of the trust; ~~or~~

(8) if the trustee is not a beneficiary, but the adjustment ~~benefits~~ would benefit the trustee directly or indirectly, except that a trustee may make an adjustment that also benefits a beneficiary even if the terms of the trust provide for trustee compensation as a percentage of the trust’s income; or

(9) if the trust has been converted to, and is then operating as a unitrust under Sections 62‑7‑904B through 62‑7‑904P.

(D) If subsection (C)(5), (6), (7), or (8) applies to a trustee and there is more than one trustee, a cotrustee to whom the provision does not apply may make the adjustment unless the exercise of the power by the remaining trustee or trustees is not permitted by the terms of the trust.

(E) A trustee may release the entire power of adjustment in subsection (A) or may release only the power to adjust from income to principal or the power to adjust from principal to income if the trustee is uncertain about whether possessing or exercising the power causes a result described in ~~subsection~~ subsections (C)(1) through (6) or subsection (C)(8) or if the trustee determines that possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax burden not contemplated in subsection (C). The release may be permanent or for a specified period, including a period measured by the life of an individual.

(F) Terms of a trust that limit the power of a trustee to make an adjustment between principal and income do not affect the application of this section unless it is clear from the terms of the trust that the terms are intended to deny the trustee the power ~~of adjustment~~ to adjust in subsection (A).”

REPORTER’S COMMENTS

Purpose and Scope of Provision. The purpose of Section 62‑7‑904 is to enable a trustee to select investments using the standards of a prudent investor without having to realize a particular portion of the portfolio’s total return in the form of traditional trust accounting income such as interest, dividends, and rents. Section 62‑7‑904(A) authorizes a trustee to make adjustments between principal and income if three conditions are met: (1) the trustee must be managing the trust assets under the prudent investor rule; (2) the terms of the trust must express the income beneficiary’s distribution rights in terms of the right to receive “income” in the sense of traditional trust accounting income; and (3) the trustee must determine, after applying the rules in Section 62‑7‑903(A) that he is unable to comply with Section 62‑7‑903(B). In deciding whether and to what extent to exercise the power to adjust, the trustee is required to consider the factors described in Section 62‑7‑904(B) but the trustee may not make an adjustment in circumstances described in Section 62‑7‑904(C).

Section 62‑7‑904 does not empower a trustee to increase or decrease the degree of beneficial enjoyment to which a beneficiary is entitled under the terms of the trust; rather, it authorizes the trustee to make adjustments between principal and income that may be necessary if the income component of a portfolio’s total return is too small or too large because of investment decisions made by the trustee under the prudent investor rule. The paramount consideration in applying Section 62‑7‑904(A) is the requirement in Section 62‑7‑903(B) that “a fiduciary must administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries.” The power to adjust is subject to control by the court to prevent an abuse of discretion. Restatement (Second) of Trusts Sec.187 (1959). See also id. Sections 183, 232, 233, Comment p (1959).

Section 62‑7‑904 will be important for trusts that are irrevocable when a State adopts the prudent investor rule by statute or judicial approval of the rule in Restatement of Trusts 3d: Prudent Investor Rule. Wills and trust instruments executed after the rule is adopted can be drafted to describe a beneficiary’s distribution rights in terms that do not depend upon the amount of trust accounting income, but to the extent that drafters of trust documents continue to describe an income beneficiary’s distribution rights by referring to trust accounting income, Section 62‑7‑904 will be an important tool in trust administration.

Three conditions to the exercise of the power to adjust. The first of the three conditions that must be met before a trustee can exercise the power to adjust ‑ that the trustee invest and manage trust assets as a prudent investor ‑ is expressed in this Act by language derived from the Uniform Prudent Investor Act (UPIA), but the condition will be met whether the prudent investor rule applies because the UPIA or other prudent investor legislation has been enacted, the prudent investor rule has been approved by the courts, or the terms of the trust require it. Even if a State’s legislature or courts have not formally adopted the prudent investor rule, the Restatement establishes the prudent investor rule as an authoritative interpretation of the common law prudent man rule, referring to the prudent investor rule as a “modest reformulation of the Harvard College dictum and the basic rule of prior Restatements.” Restatement of Trusts 3d: Prudent Investor Rule, Introduction, at 5. As a result, there is a basis for concluding that the first condition is satisfied in virtually all States except those in which a trustee is permitted to invest only in assets set forth in a statutory “legal list.”

The second condition will be met when the terms of the trust require all of the “income” to be distributed at regular intervals; or when the terms of the trust require a trustee to distribute all of the income, but permit the trustee to decide how much to distribute to each member of a class of beneficiaries; or when the terms of a trust provide that the beneficiary shall receive the greater of the trust accounting income and a fixed dollar amount (an annuity), or of trust accounting income and a fractional share of the value of the trust assets (a unitrust amount). If the trust authorizes the trustee in its discretion to distribute the trust’s income to the beneficiary or to accumulate some or all of the income, the condition will be met because the terms of the trust do not permit the trustee to distribute more than the trust’s accounting income.

To meet the third condition, the trustee must first meet the requirements of Section 62‑7‑903(A), i.e., he must apply the terms of the trust, decide whether to exercise the discretionary powers given to the trustee under the terms of the trust, and must apply the provisions of the Act if the terms of the trust do not contain a different provision or give the trustee discretion. Second, the trustee must determine the extent to which the terms of the trust clearly manifest an intention by the settlor that the trustee may or must favor one or more of the beneficiaries. To the extent that the terms of the trust do not require partiality, the trustee must conclude that he is unable to comply with the duty to administer the trust impartially. To the extent that the terms of the trust do require or permit the trustee to favor the income beneficiary or the remainder beneficiary, the trustee must conclude that he is unable to achieve the degree of partiality required or permitted. If the trustee comes to either conclusion ‑ that he is unable to administer the trust impartially or that he is unable to achieve the degree of partiality required or permitted ‑ he may exercise the power to adjust under Section 62‑7‑904(A).

Impartiality and productivity of income. The duty of impartiality between income and remainder beneficiaries is linked to the trustee’s duty to make the portfolio productive of the trust’s accounting income whenever the distribution requirements are expressed in terms of distributing the trust’s “income.” The 1962 Act and the 1963 SC Act imply that the duty to produce income applies on an asset-by-asset basis because the right of an income beneficiary to receive “delayed income” from the sale proceeds of underproductive property under Section 62‑7‑415 of that Act arises if “any part of principal ... has not produced an average net income of a least one percent per year of its inventory value for more than a year ... .” Under the prudent investor rule, “[t]o whatever extent a requirement of income productivity exists, ... the requirement applies not investment by investment but to the portfolio as a whole.” Restatement of Trusts 3d: Prudent Investor Rule Sec 227, Comment i, at 34. The power to adjust under Section 62‑7‑904(A) is also to be exercised by considering net income from the portfolio as a whole and not investment by investment. Section 62‑7‑922(B) of this Act eliminates the underproductive property rule in all cases other than trusts for which a marital deduction is allowed; the rule applies to a marital deduction trust if the trust’s assets “consist substantially of property that does not provide the spouse with sufficient income from or use of the trust assets ...” ‑ in other words, the section applies by reference to the portfolio as a whole.

While the purpose of the power to adjust in Section 62‑7‑904(A) is to eliminate the need for a trustee who operates under the prudent investor rule to be concerned about the income component of the portfolio’s total return, the trustee must still determine the extent to which a distribution must be made to an income beneficiary and the adequacy of the portfolio’s liquidity as a whole to make that distribution.

For a discussion of investment considerations involving specific investments and techniques under the prudent investor rule, see Restatement of Trusts 3d: Prudent Investor Rule Sec 227, Comments k‑p.

Factors to consider in exercising the power to adjust. Section 62‑7‑904(B) requires a trustee to consider factors relevant to the trust and its beneficiaries in deciding whether and to what extent the power to adjust should be exercised. Section 62‑7‑933(C)(3) of the South Carolina Uniform Prudent Investor Act (SCUPIA) sets forth circumstances that a trustee is to consider in investing and managing trust assets. The circumstances in Section 62‑7‑933(C)(3) of the SCUPIA are the source of the factors in paragraphs (3) through (6) and (8) of Section 62‑7‑904(B) (modified where necessary to adapt them to the purposes of this Act) so that, to the extent possible, comparable factors will apply to investment decisions and decisions involving the power to adjust. If a trustee who is operating under the prudent investor rule decides that the portfolio should be composed of financial assets whose total return will result primarily from capital appreciation rather than dividends, interest, and rents, the trustee can decide at the same time the extent to which an adjustment from principal to income may be necessary under Section 62‑7‑904. On the other hand, if a trustee decides that the risk and return objectives for the trust are best achieved by a portfolio whose total return includes interest and dividend income that is sufficient to provide the income beneficiary with the beneficial interest to which the beneficiary is entitled under the terms of the trust, the trustee can decide that it is unnecessary to exercise the power to adjust.

Assets received from the settlor. Section 62‑7‑933(D) of SCUPIA provides that “[a] trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.” The special circumstances may include the wish to retain a family business, the benefit derived from deferring liquidation of the asset in order to defer payment of income taxes, or the anticipated capital appreciation from retaining an asset such as undeveloped real estate for a long period. To the extent the trustee retains assets received from the settlor because of special circumstances that overcome the duty to diversify, the trustee may take these circumstances into account in determining whether and to what extent the power to adjust should be exercised to change the results produced by other provisions of this Act that apply to the retained assets. See Section 62‑7‑904(B)(5); Uniform Prudent Investor Act Sec 3, Comment, 7B U.L.A. 18, at 25‑26 (Supp. 1997); Restatement of Trusts 3d: Prudent Investor Rule Sec 229 and Comments a‑e.

Limitations on Section 62‑7‑904 power to adjust. The purpose of subsections (C)(1) through (4) is to preserve tax benefits that may have been an important purpose for creating the trust. Subsections (C)(5), (6), and (8) deny the power to adjust in the circumstances described in those subsections in order to prevent adverse tax consequences, and subsection (C)(7) denies the power to adjust to any beneficiary, whether or not possession of the power may have adverse tax consequences.

Under subsection (C)(1), a trustee cannot make an adjustment that diminishes the income interest in a trust that requires all of the income to be paid at least annually to a spouse and for which an estate tax or gift tax marital deduction is allowed; but this subsection does not prevent the trustee from making an adjustment that increases the amount of income paid from a marital deduction trust to the spouse. Subsection (C)(1) applies to a trust that qualifies for the marital deduction because the spouse has a general power of appointment over the trust, but it applies to a qualified terminable interest property (QTIP) trust only if and to the extent that the fiduciary makes the election required to obtain the tax deduction. Subsection (C)(1) does not apply to a so‑called “estate” trust. This type of trust qualifies for the marital deduction because the terms of the trust require the principal and undistributed income to be paid to the surviving spouse’s estate when the spouse dies; it is not necessary for the terms of an estate trust to require the income to be distributed annually. Reg. Sec 20.2056(c)‑2(b)(1)(iii).

Subsection (C)(3) applies to annuity trusts and unitrusts with no charitable beneficiaries as well as to trusts with charitable income or remainder beneficiaries; its purpose is to make it clear that a beneficiary’s right to receive a fixed annuity or a fixed fraction of the value of a trust’s assets is not subject to adjustment under Section 62‑7‑904(A). Subsection (C)(3) does not apply to any additional amount to which the beneficiary may be entitled that is expressed in terms of a right to receive income from the trust. For example, if a beneficiary is to receive a fixed annuity or the trust’s income, whichever is greater, subsection (C)(3) does not prevent a trustee from making an adjustment under Section 62‑7‑904(A) in determining the amount of the trust’s income.

If subsection (C)(5), (6), (7), or (8), prevents a trustee from exercising the power to adjust, subsection (D) permits a cotrustee who is not subject to the provision to exercise the power unless the terms of the trust do not permit the cotrustee to do so.

Release of the power to adjust. Section 62‑7‑904(E) permits a trustee to release all or part of the power to adjust in circumstances in which the possession or exercise of the power might deprive the trust of a tax benefit or impose a tax burden. For example, if possessing the power would diminish the actuarial value of the income interest in a trust for which the income beneficiary’s estate may be eligible to claim a credit for property previously taxed if the beneficiary dies within ten years after the death of the person creating the trust, the trustee is permitted under subsection (E) to release just the power to adjust from income to principal.

Trust terms that limit a power to adjust. Section 62‑7‑904(F) applies to trust provisions that limit a trustee’s power to adjust. Since the power is intended to enable trustees to employ the prudent investor rule without being constrained by traditional principal and income rules, an instrument executed before the adoption of this Act whose terms describe the amount that may or must be distributed to a beneficiary by referring to the trust’s income or that prohibit the invasion of principal or that prohibit equitable adjustments in general should not be construed as forbidding the use of the power to adjust under Section 62‑7‑904(A) if the need for adjustment arises because the trustee is operating under the prudent investor rule. Instruments containing such provisions that are executed after the adoption of this Act should specifically refer to the power to adjust if the settlor intends to forbid its use. See generally, Joel C. Dobris, Limits on the Doctrine of Equitable Adjustment in Sophisticated Postmortem Tax Planning, 66 Iowa L. Rev. 273 (1981).

Examples. The following examples illustrate the application of Section 62‑7‑904:

Example (1) T is the successor trustee of a trust that provides income to A for life, remainder to B. T has received from the prior trustee a portfolio of financial assets invested 20% in stocks and 80% in bonds. Following the prudent investor rule, T determines that a strategy of investing the portfolio 50% in stocks and 50% in bonds has risk and return objectives that are reasonably suited to the trust, but T also determines that adopting this approach will cause the trust to receive a smaller amount of dividend and interest income. After considering the factors in Section 62‑7‑904(B) T may transfer cash from principal to income to the extent T considers it necessary to increase the amount distributed to the income beneficiary.

Example (2) T is the trustee of a trust that requires the income to be paid to the settlor’s son C for life, remainder to C’s daughter D. In a period of very high inflation, T purchases bonds that pay double‑digit interest and determines that a portion of the interest, which is allocated to income under Section 62‑7‑915 of this Act, is a return of capital. In consideration of the loss of value of principal due to inflation and other factors that T considers relevant, T may transfer part of the interest to principal.

Example (3) T is the trustee of a trust that requires the income to be paid to the settlor’s sister E for life, remainder to charity F. E is a retired schoolteacher who is single and has no children. E’s income from her social security, pension, and savings exceeds the amount required to provide for her accustomed standard of living. The terms of the trust permit T to invade principal to provide for E’s health and to support her in her accustomed manner of living, but do not otherwise indicate that T should favor E or F. Applying the prudent investor rule, T determines that the trust assets should be invested entirely in growth stocks that produce very little dividend income. Even though it is not necessary to invade principal to maintain E’s accustomed standard of living, she is entitled to receive from the trust the degree of beneficial enjoyment normally accorded a person who is the sole income beneficiary of a trust, and T may transfer cash from principal to income to provide her with that degree of enjoyment.

Example (4) T is the trustee of a trust that is governed by the law of State X. The trust became irrevocable before State X adopted the prudent investor rule. The terms of the trust require all of the income to be paid to G for life, remainder to H, and also give T the power to invade principal for the benefit of G for “dire emergencies only.” The terms of the trust limit the aggregate amount that T can distribute to G from principal during G’s life to 6% of the trust’s value at its inception. The trust’s portfolio is invested initially 50% in stocks and 50% in bonds, but after State X adopts the prudent investor rule T determines that, to achieve suitable risk and return objectives for the trust, the assets should be invested 90% in stocks and 10% in bonds. This change increases the total return from the portfolio and decreases the dividend and interest income. Thereafter, even though G does not experience a dire emergency, T may exercise the power to adjust under Section 62‑7‑904(A) to the extent that T determines that the adjustment is from only the capital appreciation resulting from the change in the portfolio’s asset allocation. If T is unable to determine the extent to which capital appreciation resulted from the change in asset allocation or is unable to maintain adequate records to determine the extent to which principal distributions to G for dire emergencies do not exceed the 6% limitation, T may not exercise the power to adjust. See Joel C. Dobris, Limits on the Doctrine of Equitable Adjustment in Sophisticated Postmortem Tax Planning, 66 Iowa L. Rev. 273 (1981).

Example (5) T is the trustee of a trust for the settlor’s child. The trust owns a diversified portfolio of marketable financial assets with a value of $600,000, and is also the sole beneficiary of the settlor’s IRA, which holds a diversified portfolio of marketable financial assets with a value of $900,000. The trust receives a distribution from the IRA that is the minimum amount required to be distributed under the Internal Revenue Code, and T allocates 10% of the distribution to income under Section 62‑7‑918(C) of this Act. The total return on the IRA’s assets exceeds the amount distributed to the trust, and the value of the IRA at the end of the year is more than its value at the beginning of the year. Relevant factors that T may consider in determining whether to exercise the power to adjust and the extent to which an adjustment should be made to comply with Section 62‑7‑903(B) include the total return from all of the trust’s assets, those owned directly as well as its interest in the IRA, the extent to which the trust will be subject to income tax on the portion of the IRA distribution that is allocated to principal, and the extent to which the income beneficiary will be subject to income tax on the amount that T distributes to the income beneficiary.

Example (6) T is the trustee of a trust whose portfolio includes a large parcel of undeveloped real estate. T pays real property taxes on the undeveloped parcel from income each year pursuant to Section 62‑7‑925(3). After considering the return from the trust’s portfolio as a whole and other relevant factors described in Section 62‑7‑904(B), T may exercise the power to adjust under Section 62‑7‑904(A) to transfer cash from principal to income in order to distribute to the income beneficiary an amount that T considers necessary to comply with Section 62‑7‑903(B).

Example (7) T is the trustee of a trust whose portfolio includes an interest in a mutual fund that is sponsored by T. As the manager of the mutual fund, T charges the fund a management fee that reduces the amount available to distribute to the trust by $2,000. If the fee had been paid directly by the trust, one‑half of the fee would have been paid from income under Section 62‑7‑925(1) and the other one‑half would have been paid from principal under Section 62‑7‑926(A)(1). After considering the total return from the portfolio as a whole and other relevant factors described in Section 62‑7‑904(B), T may exercise its power to adjust under Section 62‑7‑904(A) by transferring $1,000, or half of the trust’s proportionate share of the fee, from principal to income.

SECTION 4. Article 7 of Title 62 is amended by adding:

“Section 62‑7‑904A. (A) A court may not change a fiduciary’s decision, or order a fiduciary to change its decision, to exercise or not to exercise a discretionary power conferred by the South Carolina Uniform Principal and Income Act unless it determines that the decision was an abuse of the fiduciary’s discretion. A fiduciary’s decision is not an abuse of discretion merely because the court would have exercised the power in a different manner or would not have exercised the power.

(B) The decisions subject to subsection (A) include, but are not limited to, a determination:

(1) pursuant to Section 62‑7‑904(A) of whether and to what extent an amount should be transferred from principal to income or from income to principal; and

(2) of the factors that are relevant to the trust and its beneficiaries, the extent to which they are relevant, and the weight, if any, to be given to the relevant factors, in deciding whether and to what extent to exercise the power in Section 62‑7‑904(A).

(C) If a court determines that a fiduciary has abused its discretion, the court may place the income and remainder beneficiaries in the positions they would have occupied if the fiduciary had not abused its discretion, according to the following rules:

(1) to the extent that the abuse of discretion has resulted in no distribution to a beneficiary or in a distribution that is too small, the court must order the fiduciary to distribute from the trust to the beneficiary an amount that the court determines will restore the beneficiary, in whole or in part, to the beneficiary’s appropriate position;

(2) to the extent that the abuse of discretion has resulted in a distribution to a beneficiary that is too large, the court must place the beneficiaries, the trust, or both, in whole or in part, in their appropriate positions by ordering the fiduciary to withhold an amount from one or more future distributions to the beneficiary who received the distribution that was too large or ordering that beneficiary to return some or all of the distribution to the trust;

(3) to the extent that the court is unable, after applying items (1) and (2), to place the beneficiaries, the trust, or both, in the positions they would have occupied if the fiduciary had not abused its discretion, the court may order the fiduciary to pay an appropriate amount from its own funds to one or more of the beneficiaries or the trust, or both.

(D) Upon a petition by the fiduciary, the court having jurisdiction over the trust or estate must determine whether a proposed exercise or nonexercise by the fiduciary of a discretionary power in the South Carolina Uniform Principal and Income Act would result in an abuse of the fiduciary’s discretion. If the petition describes the proposed exercise or nonexercise of the power and contains sufficient information to inform the beneficiaries of the reasons for the proposal, the facts upon which the fiduciary relies, and an explanation of how the income and remainder beneficiaries would be affected by the proposed exercise or nonexercise of the power, a beneficiary who challenges the proposed exercise or nonexercise has the burden of establishing that it will result in an abuse of discretion.”

REPORTER’S COMMENTS

General. All of the discretionary powers in this 1997 Act are subject to the normal rules that govern a fiduciary’s exercise of discretion. Section 62‑7‑904A codifies those rules for purposes of the Act so that they will be readily apparent and accessible to fiduciaries, beneficiaries, their counsel and the courts if and when questions concerning such powers arise.

Section 62‑7‑904A also makes clear that the normal rules governing the exercise of a fiduciary’s powers apply to the discretionary power to adjust conferred upon a trustee by Section 62‑7‑904(A). Discretionary provisions authorizing trustees to determine what is income and what is principal have been used in governing instruments for years; Section 2 of the 1931 Uniform Principal and Income Act recognized that practice by providing that “the person establishing the principal may himself direct the manner of ascertainment of income and principal...or grant discretion to the trustee or other person to do so....” Section 62‑7‑903(A)(2) also recognizes the power of a settlor to grant such discretion to the trustee. Section 62‑7‑904A applies to a discretionary power granted by the terms of a trust or a will as well as the power to adjust in Section 62‑7‑904A.

Power to Adjust. The exercise of the power to adjust is governed by a trustee’s duty of impartiality, which requires the trustee to strike an appropriate balance between the interests of the income and remainder beneficiaries. Section 62‑7‑903(B) expresses this duty by requiring the trustee to “administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries.” Because this involves the exercise of judgment in circumstances rarely capable of perfect resolution, trustees are not expected to achieve perfection; they are, however, required to make conscious decisions in good faith and with proper motives.

In seeking the proper balance between the interests of the beneficiaries in matters involving principal and income, a trustee’s traditional approach has been to determine the settlor’s objectives from the terms of the trust, gather the information needed to ascertain the financial circumstances of the beneficiaries, determine the extent to which the settlor’s objectives can be achieved with the resources available in the trust, and then allocate the trust’s assets between stocks and fixed‑income securities in a way that will produce a particular level or range of income for the income beneficiary. The key element in this process has been to determine the appropriate level or range of income for the income beneficiary, and that will continue to be the key element in deciding whether and to what extent to exercise the discretionary power conferred by Section 62‑7‑904(A). If it becomes necessary for a court to determine whether an abuse of the discretionary power to adjust between principal and income has occurred, the criteria should be the same as those that courts have used in the past to determine whether a trustee has abused its discretion in allocating the trust’s assets between stocks and fixed‑income securities.

A fiduciary has broad latitude in choosing the methods and criteria to use in deciding whether and to what extent to exercise the power to adjust in order to achieve impartiality between income beneficiaries and remainder beneficiaries or the degree of partiality for one or the other that is provided for by the terms of the trust or the will. For example, in deciding what the appropriate level or range of income should be for the income beneficiary and whether to exercise the power, a trustee may use the methods employed prior to the enactment of SCUP&IA in 2001 in deciding how to allocate trust assets between stocks and fixed‑income securities; or may consider the amount that would be distributed each year based on a percentage of the portfolio’s value at the beginning or end of an accounting period, or the average portfolio value for several accounting periods, in a manner similar to a unitrust, and may select a percentage that the trustee believes is appropriate for this purpose and use the same percentage or different percentages in subsequent years. The trustee may also use hypothetical portfolios of marketable securities to determine an appropriate level or range of income within which a distribution might fall.

An adjustment may be made prospectively at the beginning of an accounting period, based on a projected return or range of returns for a trust’s portfolio, or retrospectively after the fiduciary knows the total realized or unrealized return for the period; and instead of an annual adjustment, the trustee may distribute a fixed dollar amount for several years, in a manner similar to an annuity, and may change the fixed dollar amount periodically. No inference of abuse is to be drawn if a fiduciary uses different methods or criteria for the same trust from time to time, or uses different methods or criteria for different trusts for the same accounting period.

While a trustee must consider the portfolio as a whole in deciding whether and to what extent to exercise the power to adjust, a trustee may apply different criteria in considering the portion of the portfolio that is composed of marketable securities and the portion whose market value cannot be determined readily, and may take into account a beneficiary’s use or possession of a trust asset.

Under the prudent investor rule, a trustee is to incur costs that are appropriate and reasonable in relation to the assets and the purposes of the trust, and the same consideration applies in determining whether and to what extent to exercise the power to adjust. In making investment decisions under the prudent investor rule, the trustee will have considered the purposes, terms, distribution requirements, and other circumstances of the trust for the purpose of adopting an overall investment strategy having risk and return objectives reasonably suited to the trust. A trustee is not required to duplicate that work for principal and income purposes, and in many cases the decision about whether and to what extent to exercise the power to adjust may be made at the same time as the investment decisions. To help achieve the objective of reasonable investment costs, a trustee may also adopt policies that apply to all trusts or to individual trusts or classes of trusts, based on their size or other criteria, stating whether and under what circumstances the power to adjust will be exercised and the method of making adjustments; no inference of abuse is to be drawn if a trustee adopts such policies.

General rule. The first sentence of Section 62‑7‑904A(A) is from Restatement (Second) of Trusts Sec 187 and Restatement (Third) of Trusts (Tentative Draft No. 2, 1999) Sec 50(1). The second sentence of Section 62‑7‑904A(A) derives from Comment e to Sec 187 of the Second Restatement and Comment b to Sec 50 of the Third Restatement.

The reference in Section 62‑7‑904A(A) to a fiduciary’s decision to exercise or not to exercise a discretionary power underscores a fundamental precept, which is that a fiduciary has a duty to make a conscious decision about exercising or not exercising a discretionary power. Comment b to Sec 50 of the Third Restatement states:

A court will intervene where the exercise of a power is left to the judgment of a trustee who improperly fails to exercise that judgment. Thus, even where a trustee has discretion whether or not to make any payments to a particular beneficiary, the court will interpose if the trustee, arbitrarily or without knowledge of or inquiry into relevant circumstances, fails to exercise the discretion.

Section 62‑7‑904A(B) makes clear that the rule of subsection (B) applies not only to the power conferred by Section 62‑7‑904A but also to the evaluation process required by Section 62‑7‑904A(B) in deciding whether and to what extent to exercise the power to adjust. Under Section 62‑7‑904A(B) a trustee is to consider all of the factors that are relevant to the trust and its beneficiaries, including, to the extent the trustee determines they are relevant, the nine factors enumerated in Section 62‑7‑904A(B). Section 62‑7‑904A(B) derives from Section 62‑7‑933(C)(3) of SCUPIA which lists eight circumstances that a trustee shall consider, to the extent they are relevant, in investing and managing assets. The trustee’s decisions about what factors are relevant for purposes of Section 62‑7‑904A(B) and the weight to be accorded each of the relevant factors are part of the discretionary decision‑making process. As such, these decisions are not subject to change for the purpose of changing the trustee’s ultimate decision unless the court determines that there has been an abuse of discretion in determining the relevancy and weight of these factors.

Remedy. The exercise or nonexercise of a discretionary power under the act normally affects the amount or timing of a distribution to the income or remainder beneficiaries. The primary remedy under Section 62‑7‑904A(C) for abuse of discretion is the restoration of the beneficiaries and the trust to the positions they would have occupied if the abuse had not occurred. It draws on a basic principle of restitution that if a person pays money to someone who is not intended to receive it (and in a case to which this act applies, not intended by the settlor to receive it in the absence of an abuse of discretion by the trustee), that person is entitled to restitution on the ground that the payee would be unjustly enriched if he were permitted to retain the payment. See Restatement of Restitution Sec 22 (1937). The objective is to accomplish the restoration initially by making adjustments between the beneficiaries and the trust to the extent possible; to the extent that restoration is not possible by such adjustments, a court may order the trustee to pay an amount to one or more of the beneficiaries, the trust, or both the beneficiaries and the trust. If the court determines that it is not possible in the circumstances to restore them to their appropriate positions, the court may provide other remedies appropriate to the circumstances. The approach of Section 105(c) is supported by Comment b to Sec 50 of the Third Restatement of Trusts:

When judicial intervention is required, a court may direct the trustee to make or refrain from making certain payments; issue instructions to clarify the standards or guidelines applicable to the exercise of the power; or rescind the trustee’s payment decisions, usually directing the trustee to recover amounts improperly distributed and holding the trustee liable for failure or inability to do so.

Advance determinations. Section 62‑7‑904A(D) employs the familiar remedy of the trustee’s petition to the court for instructions. It requires the court to determine, upon a petition by the fiduciary, whether a proposed exercise or nonexercise of a discretionary power by the fiduciary of a power conferred by the Act would be an abuse of discretion under the general rule of Section 62‑7‑904A. If the petition contains the information prescribed in the second sentence of subsection (D) the proposed action or inaction is presumed not to result in an abuse, and a beneficiary who challenges the proposal must establish that it will.

Subsection (D) is intended to provide a fiduciary the opportunity to obtain an assurance of finality in a judicial proceeding before proceeding with a proposed exercise or nonexercise of a discretionary power. Its purpose is not, however, to have the court instruct the fiduciary how to exercise the discretion.

A fiduciary may also obtain the consent of the beneficiaries to a proposed act or an omission to act, and a beneficiary cannot hold the fiduciary liable for that act or omission unless:

(a) the beneficiary was under an incapacity at the time of such consent or of such act or omission; or

(b) the beneficiary, when he gave his consent, did not know of his rights and of the material facts which the trustee knew or should have known and which the trustee did not reasonably believe that the beneficiary knew; or

(c) the consent of the beneficiary was induced by improper conduct of the trustee.

Restatement (Second) of Trusts Sec 216.

If there are many beneficiaries, including some who are incapacitated or unascertained, the fiduciary may prefer the greater assurance of finality provided by a judicial proceeding that will bind all persons who have an interest in the trust.

“Section 62‑7‑904B. The definitions in this section apply to Sections 62‑7‑904C through 62‑7‑904P.

(1) ‘Code’ means the Internal Revenue Code of 1986, as amended from time to time, and any statutory enactment successor to the Code; reference to a specific section of the code in Sections 62‑7‑904B through 62‑7‑904P are considered a reference also to any successor provision dealing with the subject matter of that section of the Code.

(2) ‘Disinterested person’ means a person who is not a related or subordinate party with respect to the person then acting as trustee of the trust and excludes the settlor of the trust and any interested trustee.

(3) ‘Express total return unitrust’ means a trust created by the terms of a governing instrument requiring the distribution at least annually of a unitrust amount equal to a fixed percentage of not less than three percent nor more than five percent a year of the net fair market value of the amounts of the trust, valued at least annually.

(4) ‘Income trust’ means a trust, created by either an inter vivos or a testamentary instrument, which directs or permits the trustee to distribute the net income of the trust to one or more persons, either in fixed proportions or in amounts or proportions determined by the trustee, and regardless of whether the trust directs or permits the trustee to distribute principal of the trust to one or more of those persons.

(5) ‘Interested distributee’ means a living beneficiary who is a distributee or permissible distributee of trust income or principal who has the power to remove the existing trustee and designate as successor a person who may be a related or subordinate party with respect to that distributee.

(6) ‘Interested trustee’ means any of the following:

(a) an individual trustee who is a qualified beneficiary;

(b) a trustee who may be removed and replaced by an interested distributee;

(c) an individual trustee whose legal obligation to support a beneficiary may be satisfied by distributions of income and principal of the trust.

(7) ‘Legal disability’ means a person under a legal disability who is a minor, an incompetent or incapacitated person, or an unborn individual, or whose identity or location is unknown.

(8) ‘Qualified beneficiary’ means a qualified beneficiary as defined in Section 62‑7‑103(12).

(9) ‘Related or subordinate party’ means a related or subordinate party as defined in Section 672(c) of the Code.

(10) ‘Representative’ means a person who may represent and bind another as provided in Part 3 of this article, the provisions of which apply for purposes of this section and Sections 62‑7‑904C through 62‑7‑904P.

(11) ‘Settlor’ means an individual, including a testator, who creates a trust.

(12) ‘Total return unitrust’ means an income trust that has been converted under and meets the provisions of this section and Section 62‑7‑904C through 62‑7‑904P.

(13) ‘Treasury regulations’ means the regulations, rulings, procedures, notices, or other administrative pronouncements issued by the Internal Revenue Service, as amended from time to time.

(14) ‘Trustee’ means a person acting as trustee of the trust, except as otherwise expressly provided in this section and Sections 62‑7‑904C through 62‑7‑904P whether acting in that person’s discretion or on the direction of one or more persons acting in a fiduciary capacity.

(15) ‘Unitrust amount’ means an amount computed as a percentage of the fair market value of the assets of the trust.”

REPORTER’S COMMENTS

See comments after Section 62‑7‑904P.

“Section 62‑7‑904C. (A) A trustee, other than an interested trustee, or, where two or more persons are acting as trustees, a majority of the trustees who are not interested trustees (in either case hereafter ‘trustee’) in the trustee’s sole discretion and without court approval, may:

(1) convert an income trust to a total return unitrust;

(2) reconvert a total return unitrust to an income trust; or

(3) change the percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust if all of the following apply:

(a) The trustee adopts a written policy for the trust providing:

( i) in the case of a trust being administered as an income trust, that future distributions from the trust will be unitrust amounts rather than net income as determined pursuant to the South Carolina Uniform Principal and Income Act;

(ii) in the case of a trust being administered as a total return unitrust, that future distributions from the trust will be net income rather than unitrust amounts; or

(iii) that the percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust will be changed as stated in the policy.

(b) The trustee gives written notice of its intention to take the action, including copies of the written policy and Sections 62‑7‑904B through 62‑7‑904P, to:

( i) the settlor of the trust, if living; and

(ii) all persons who are the qualified beneficiaries of the trust at the time the notice is given. If a qualified beneficiary is under a legal disability, notice shall be given to the representative of the qualified beneficiary if a representative is available without court order.

(c) There is at least:

( i) one qualified beneficiary described in Section 62‑7‑103(12)(A) or (B) who is not under a legal disability or a representative of a qualified beneficiary so described; or

(ii) one qualified beneficiary described in Section 62‑7‑103(12)(C) who is not under a legal disability or a representative of a qualified beneficiary so described.

(d) No person receiving notice of the trustee’s intention to take the proposed action objects to the action within ninety days after notice has been given. The objection must be by written notice to the trustee.

(B) If there is no trustee of the trust other than an interested trustee, the interested trustee or, where two or more persons are acting as trustee and are interested trustees, a majority of the interested trustees may, in its sole discretion and without court approval:

(1) convert an income trust to a total return unitrust;

(2) reconvert a total return unitrust to an income trust; or

(3) change the percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust if all of the following apply:

(a) The trustee adopts a written policy for the trust providing:

( i) in the case of a trust being administered as an income trust, that future distributions from the trust will be unitrust amounts rather than net income as determined pursuant to the South Carolina Uniform Principal and Income Act;

(ii) in the case of a trust being administered as a total return unitrust, that future distributions from the trust will be net income as determined pursuant to the South Carolina Uniform Principal and Income Act rather than unitrust amounts, or

(iii) that the percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust will be changed as stated in the policy.

(b) The trustee appoints a disinterested person who, in its sole discretion but acting in a fiduciary capacity, determines for the trustee:

( i) the percentage to be used to calculate the unitrust amount;

(ii) the method to be used in determining the fair market value of the trust; and

(iii) which assets, if any, are to be excluded in determining the unitrust amount.

(c) The trustee gives written notice of its intention to take the action, including copies of the written policy and Sections 62‑7‑904B through 62‑7‑904P and the determinations of the disinterested person to:

( i) the settlor of the trust, if living; and

(ii) all persons who are the qualified beneficiaries of the trust at the time of the giving of the notice. If a qualified beneficiary is under a legal disability, notice must be given to the representative of the qualified beneficiary if a representative is available without court order.

(d) There is at least:

( i) one qualified beneficiary described in Section 62‑7‑103(12)(A) or (B) or a representative of a beneficiary so described; or

(ii) one qualified beneficiary described in Section 62‑7‑103(12)(C) or a representative of a qualified beneficiary so described.

(e) No person receiving notice of the trustee’s intention to take the proposed action of the trustee objects to the action or to the determination of the disinterested person within ninety days after notice has been given. The objection must be by written instrument delivered to the trustee.

(C) A trustee may act under subsection (A) or (B) of this section with respect to a trust for which both income and principal have been set aside permanently for charitable purposes under the governing instrument and for which a federal estate or gift tax deduction has been taken, if all of the following apply:

(1) Instead of sending written notice to the persons described in subsection (A)(3)(b) or subsection (B)(3)(b), as the case may be, the trustee shall send written notice to each charitable organization expressly designated to receive the income of the trust under the governing instrument and, if no charitable organization is expressly designated to receive all of the income of the trust under the governing instrument, to the Attorney General of this State.

(2) Subsection (A)(3)(d) or subsection (B)(3)(d) of this subsection, as the case may be, does not apply to this action.

(3) In each taxable year, the trustee shall distribute the greater of the unitrust amount or the amount required by Section 4942 of the Code.

(D) The provisions of Section 62‑7‑109 regarding notices and the sending of documents to persons under this article shall apply for purposes of notices and the sending of documents under this section.”

REPORTER’S COMMENTS

See comments after Section 62‑7‑904P.

“Section 62‑7‑904D. (A) If a trustee desires to:

(1) convert an income trust to a total return unitrust;

(2) reconvert a total return unitrust to an income trust; or

(3) change the percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust assets but does not have the ability to or elects not to do it under Section 62‑7‑904C, the trustee may petition the court for an order as the trustee considers appropriate. If there is only one trustee of the trust and the trustee is an interested trustee or if there are two or more trustees of the trust and a majority of them are interested trustees, the court, in its own discretion or on the petition of the trustee or trustees or any person interested in the trust, may appoint a disinterested person who, acting in a fiduciary capacity, shall present information to the court as necessary to enable the court to make its determinations under Sections 62‑7‑904B through 62‑7‑904P.

(B) A qualified beneficiary or a representative of a qualified beneficiary may request the trustee to:

(1) convert an income trust to a total return unitrust;

(2) reconvert a total return unitrust to an income trust; or

(3) change the percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust. If the trustee does not take the action requested, the qualified beneficiary or a representative of the qualified beneficiary may petition the court to order the trustee to take the action.

(C) All proceedings under this section must be conducted as provided in Part 2 of this article.”

REPORTER’S COMMENTS

See comments after Section 62‑7‑904P.

“Section 62‑7‑904E. (A) The fair market value of the trust assets must be determined at least annually, using a valuation date selected by the trustee in its discretion. The trustee, in its discretion, may use an average of the fair market value on the same valuation date for the current fiscal year and not more than three preceding fiscal years, if the use of this average appears desirable to the trustee to reduce the impact of fluctuations in market value on the unitrust amount. Assets for which a fair market value cannot be readily ascertained must be valued using valuation methods as are considered reasonable and appropriate by the trustee. Assets, such as a residence or tangible personal property, used by the trust beneficiary may be excluded by the trustee from the fair market value for computing the unitrust amount.

(B) The percentage to be used by the trustee in determining the unitrust amount must be a reasonable current return from the trust, but not less than three percent nor more than five percent, taking into account the intentions of the settlor of the trust as expressed in the terms of the trust, the needs of the beneficiaries, general economic conditions, projected current earnings and appreciation for the trust assets, and projected inflation and its impact on the trust.

(C) Following the conversion of an income trust to a total return unitrust, the trustee:

(1) shall consider the unitrust amount as paid from net accounting income determined as if the trust were not a unitrust;

(2) shall then consider the unitrust amount as paid from ordinary income not allocable to net accounting income;

(3) may, in the trustee’s discretion, consider the unitrust amount as paid from net short‑term gain described in Section 1222(5) of the Code and then from net long‑term capital gain described in Section 1222(7) of the Code so long as the discretionary power is exercised consistently and in a reasonable and impartial manner, but the amount so paid from net capital gains may not be greater than the excess of the unitrust amount over the amount of distributable net income as defined in Section 643(a) of the Code without regard to Section 1.643(a)‑3(b) of the Treasury Regulations, as amended from time to time; and

(4) shall then consider the unitrust amount as coming from the principal of the trust.”

REPORTER’S COMMENTS

See comments after Section 62‑7‑904P.

“Section 62‑7‑904F. In administering a total return unitrust, the trustee may, in its sole discretion but subject to the terms of the trust, determine:

(1) the effective date of the conversion;

(2) the timing of distributions, including provisions for prorating a distribution for a short year in which a beneficiary’s right to payments commences or ceases;

(3) whether distributions are to be made in cash or in kind or partly in cash and partly in kind;

(4) if the trust is reconverted to an income trust, the effective date of the reconversion; and

(5) any other administrative issues as may be necessary or appropriate to carry out the purposes of Sections 62‑7‑904B through 62‑7‑904P.”

REPORTER’S COMMENTS

See comments after Section 62‑7‑904P.

“Section 62‑7‑904G. Conversion to a total return unitrust under Sections 62‑7‑904B through 62‑7‑904P does not affect any other provision of the terms of the trust, if any, regarding distributions of principal. For purposes of Sections 62‑7‑904B through 62‑7‑904P, the distribution of a unitrust amount is considered a distribution of income and not of principal.”

REPORTER’S COMMENTS

See comments after Section 62‑7‑904P.

“Section 62‑7‑904H. No trustee or disinterested person who in good faith takes or fails to take any action under Sections 62‑7‑904B through 62‑7‑904P is liable to any person affected by the action or inaction, regardless of whether the person received written notice as provided in Sections 62‑7‑904B through 62‑7‑904P and regardless of whether the person was under a legal disability at the time of the delivery of the notice. The exclusive remedy for any person affected by such action or inaction is to obtain an order of the court directing the trustee to:

(1) convert an income trust to a total return unitrust;

(2) reconvert from a total return unitrust to an income trust; or

(3) change the percentage used to calculate the unitrust amount.”

REPORTER’S COMMENTS

See comments after Section 62‑7‑904P.

“Section 62‑7‑904I. Sections 62‑7‑904B through 62‑7‑904P apply to all trusts in existence on, or created after the effective date of Sections 62‑7‑904A through 62‑7‑904P unless:

(1) the governing instrument contains a provision clearly expressing the settlor’s intention that the current beneficiary or beneficiaries are to receive an amount other than a reasonable current return from the trust;

(2) the trust is a trust described in Section 170(f)(2)(B), Section 664(d), Section 2702(a)(3), or Section 2702(b) of the Code;

(3) the trust is a trust under which any amount is, or has been in the past, set aside permanently for charitable purposes unless the income from the trust also is devoted permanently to charitable purposes; or

(4) the governing instrument expressly prohibits use of Sections 62‑7‑904B through 62‑7‑904P by specific reference to Sections 62‑7‑904B through 62‑7‑904P or expressly states the settlor’s intent that net income not be calculated as a unitrust amount.

A provision in the terms of the trust that ‘the provisions of Sections 62‑7‑904B through 62‑7‑904P of this part or any corresponding provision of future law, must not be used in the administration of this trust,’ or ‘the trustee shall not determine the distributions to the income beneficiary as a unitrust amount,’ or similar words reflecting that intent is sufficient to preclude the use of Sections 62‑7‑904B through 62‑7‑904P.”

REPORTER’S COMMENTS

See comments after Section 62‑7‑904P.

Section 62‑7‑904J. RESERVED

Section 62‑7‑904K. RESERVED

Section 62‑7‑904L. RESERVED

“Section 62‑7‑904M. (A) The unitrust amount to be distributed by the express total return unitrust may be determined by the terms of the unitrust governing instrument by reference to the net fair market value of the trust’s assets determined annually or averaged on a multiple‑year basis.

(B) The terms of an express total return unitrust governing instrument may provide that:

(1) any assets of such a unitrust for which a fair market value cannot be readily ascertained must be valued using valuation methods that the trustee considers reasonable and appropriate;

(2) any assets of such a unitrust, such as a residence property or tangible personal property, used by the trust beneficiary entitled to the unitrust amount may be excluded by the trustee from the net fair market value for computing the unitrust amount.”

REPORTER’S COMMENTS

See comments after Section 62‑7‑904P.

“Section 62‑7‑904N. The distribution from an express total return unitrust of a unitrust amount equal to a fixed percentage of not less than three percent nor more than five percent reasonably apportions between the income beneficiaries and the remainder of the total return of an express total return unitrust.”

REPORTER’S COMMENTS

See comments after Section 62‑7‑904P.

“Section 62‑7‑904O. (A) The terms of an express total return unitrust governing instrument may provide the method similar to the method provided under Section 62‑7‑904C for changing the unitrust percentage or for converting from a unitrust to an income trust or for a reconversion of an income trust to a unitrust, or for all of these actions.

(B) If the terms of an express total return unitrust governing instrument do not specifically or by reference to Section 62‑7‑904C grant a power to the trustee to change the unitrust percentage or change to an income trust, the trustee shall not have that power.”

REPORTER’S COMMENTS

See comments after Section 62‑7‑904P.

“Section 62‑7‑904P. Unless the terms of the express total return unitrust governing instrument specifically provide otherwise, the trustee:

(A) shall consider the unitrust amount as paid from net accounting income determined as if the trust were not a unitrust;

(B) shall then consider the unitrust amount as paid from ordinary income not allocable to net accounting income;

(C) may, in the trustee’s discretion, consider the unitrust amount as paid from net short‑term gain described in Section 1222(5) of the Code and then from net long‑term capital gain described in Section 1222(7) of the Code so long as this discretionary power is exercised consistently and in a reasonable and impartial manner, but the amount so paid from net capital gains may not be greater than the excess of the unitrust amount over the amount of distributable net income as defined in Section 643(a) of the Code without regard to Section 1.643(a)‑3(b) of the Treasury Regulations; and

(D) shall then consider the unitrust amount as coming from the principal of the trust.”

REPORTER’S COMMENTS

Background. The Uniform Prudent Investor Act (UPIA), enacted in 1994 by the Uniform Law Commission (ULC), embodies basic principles for an investment regime, “especially the principle of investing for total return rather than a certain level of ‘income’ as traditionally perceived in terms of interest, dividends, and rents,” based on categories of receipts Total return investing is established by the ULC as the investment regime of a “prudent investor”, and UPIA provides that trustees “shall invest and manage trust assets as a prudent investor would” in default of contrary provisions in the terms of the trust. There is a fundamental distinction, however, between needs of trust income beneficiaries and those of trust principal or remainder beneficiaries, which affects the duty of trustees to administer trusts “impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or will clearly manifest an intention that the fiduciary [trustee] shall or may favor one or more of the beneficiaries.” These inherent conflicts could in any given situation make it problematic for the trustee to comply with the duty of impartiality. For example, in a low interest/low dividend environment, a prudent investor investing for total return would normally invest less for interest/dividend return and more for capital gains return. The result: an income beneficiary receives, for example, only a one percent return for the year while the remainder beneficiary reaps the rewards of the capital gains. Of course, the opposite would be true in a double‑digit high interest/high dividend environment. In neither case would the trustee’s conduct comply with its duty of impartiality, nor would the results be fair and reasonable for the respective beneficiaries affected. Realizing this dilemma for trustees, the ULC addressed this issue in its work on amending its 1962 Revised Uniform Principal and Income Act. This work produced ULC’s 1997 Uniform Principal and Income Act (UP&IA) which includes ULC’s approach to providing assistance to trustees: the power to adjust. South Carolina enacted versions of both UPIA (as SCUPIA) and UP&IA (as SCUP&IA), effective on the same date, July 18, 2001.

Alternate Approach. The power to adjust was not the only approach considered to provide assistance to trustees. During the late 1990s and early 2000s, some states began working independently of the ULC on various versions of unitrust powers for trustees. In the early 2000s, some states enacted unitrust versions with no power to adjust or other ULC provisions. Other states enacted versions of the UP&IA incorporating their respective unitrust versions, thereby having both the power to adjust and their respective unitrust powers as options. No unitrust approach has ever been included in the UP&IA. South Carolina did not include any such unitrust option in 2001 when it enacted SCUP&IA. In the years since 2001, however, the unitrust approach has become increasingly recognized among the states as an established alternative to the power to adjust. The 2013 South Carolina amendments adopted a unitust option, in subsections 904A through 904P.

Purpose and Scope of Unitrust Option. The purpose of Sections 62‑7‑904B through 62‑7‑904P is similar to that of Section 62‑7‑904 (power to adjust): to enable a trustee to select investments using the standards of a prudent investor without having to realize a particular portion of the portfolio’s total return in the form of traditional trust accounting income categories such as interest, dividends, and rents.

Section 62‑7‑904C(A) authorizes a trustee who meets the qualifications set forth in this section to: (1) convert an income trust to a total return unitrust; (2) convert a total return unitrust to an income trust; or (3) change the percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust if all of the following apply: (a) The trustee adopts a written policy for the trust that contains the three provisions that follow numbered (i), (ii), and (iii); (b) The trustee gives written notice of its intention to take the action, including copies of the written policy and Sections 62‑7‑904B through 62‑7‑904P, to those persons described in the two provisions that follow numbered (i) and (ii); (c) There is at least one qualified beneficiary or a representative described in the two provisions that follow numbered (i) and (ii); (d) No person receiving notice of the trustee’s intention to take the proposed action objects to the proposed action within ninety days after notice has been given. An objection must be by written notice to the trustee. Section 62‑7‑904C(B) authorizes an interested trustee or a majority of interested trustees (if there is no trustee of the trust other than an interested trustee) in its or their sole discretion and without court approval to: (1) convert an income trust to a total return unitrust; (2) convert a total return unitrust to an income trust; or (3) change the percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust if all of the following apply: (a) The trustee adopts a written policy for the trust that contains the three provisions that follow numbered (i), (ii), and (iii); (b) The trustee appoints a disinterested person who, in its sole discretion but acting in its fiduciary capacity, determines for the trustee the three items that follow numbered (i), (ii), and (iii); (c) The trustee gives written notice of its intention to take the action, include copies of the written policy and Sections 62‑7‑904B through 62‑7‑904P and the determinations of the disinterested person to those persons described in the two provisions that follow numbered (i) and (ii); (d) There is at least one qualified beneficiary or a representative described in the two provisions that follow numbered (i) and (ii); (e) No person receiving notice of the trustee’s intention to take the proposed action of the trustee objects to the action or to the determinations of the disinterested person within ninety days after notice has been given. The objection must be by written instrument delivered to the trustee. Section 62‑7‑904C(C) authorizes a trustee to act under subsection (A) or (B) of this section with respect to a trust for which both income and principal have been set aside permanently for charitable purposes under the governing instrument and for which a federal estate or gift tax deduction has been taken, if all of the provisions in the three subsections that follow numbered (1), (2), and (3) apply. Section 62‑7‑904C(D) provides that the provisions of Section 62‑7‑109 regarding notices and the sending of documents to persons under this article shall apply for purposes of notices and the sending of documents under this section.

Section 62‑7‑904D(A) provides that if a trustee desires to: (1) convert an income trust to a total return unitrust; (2) convert a total return unitrust to an income trust; or (3) change the percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust assets, but does not have the ability to or elects not to do it under Section 62‑7‑904C, the trustee may petition the court for an order as the trustee considers appropriate. If there is only one trustee of the trust and the trustee is an interested trustee or if there are two or more trustees of the trust and a majority of them are interested trustees, the court, in its own discretion or on the petition of the trustee or trustees or any person interested in the trust, may appoint a disinterested person who, acting in a fiduciary capacity, shall present information to the court as necessary to enable the court to make its determinations under Sections 62‑7‑904B through 62‑7‑904P. Section 62‑7‑904D(B) authorizes a qualified beneficiary or a representative of a qualified beneficiary to request the trustee to: (1) convert an income trust to a total return unitrust; (2) convert a total return unitrust to an income trust; or (3) change the percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust assets. If the trustee does not take the action requested, the qualified beneficiary or a representative of a qualified beneficiary may petition the court to order the trustee to take the action. Section 62‑7‑904D(C) provides that all proceedings under this section must be conducted as provided in Part 2 of this article.

Section 62‑7‑904E(A) requires that the fair market value of the trust assets be determined at least annually, using a valuation date selected by the trustee in its discretion, and that assets for which a fair market value cannot be readily ascertained be valued using valuation methods considered reasonable and appropriate by the trustee. This section authorizes the trustee, in its discretion, to use an average of the fair market value on the same valuation date for the current fiscal year and not more than three preceding fiscal years, if the use of this average appears desirable to the trustee to reduce the impact of fluctuations in market value on the unitrust amount and to exclude from the fair market value for computing the unitrust amount assets such as a residence or tangible personal property used by the trust beneficiary. Section 62‑7‑904E(B) requires that the percentage used in determining the unitrust amount be a reasonable current return from the trust, in any event not less than three percent nor more than five percent, taking into account the intentions of the settlor of the trust as expressed in the terms of the trust, the needs of the beneficiaries, general economic conditions, projected current earnings and appreciation for the trust assets, and projected inflation and its impact on the trust. Section 62‑7‑904E(C) provides that, following the conversion of an income trust to a total return unitrust, the trustee: (1) must consider the unitrust amount as paid from net accounting income determined as if the trust were not a unitrust; (2) must then consider the unitrust amount as paid from ordinary income not allocable to net accounting income; (3) may, in the trustee’s discretion, consider the unitrust amount as paid from net short‑term gain described in section 1222(5) of the Code and then from net long‑term capital gain described in section 1222(7) of the Code so long as the discretionary power is exercised consistently and in a reasonable and impartial manner, but the amount so paid from net capital gains may not be greater than the excess of the unitrust amount over the amount of distributable net income as defined in section 643(a) of the Code without regard to section 1.643(a)‑3(b) of the Treasury Regulations, as amended from time to time; and (4) must then consider the unitrust amount as coming from the principal of the trust.

Section 62‑7‑904F authorizes the trustee, in administering a total return unitrust, to determine in its sole discretion but subject to the provisions of the terms of the trust: (1) the effective date of the conversion; (2) the timing of distributions, including provisions for prorating a distribution for a short year in which a beneficiary’s right to payments commences or ceases; (3) whether distributions are to be made in cash or in kind or partly in cash and partly in kind; (4) if the trust is reconverted to an income trust, the effective date of the reconversion; and (5) any other administrative issues as may be necessary or appropriate to carry out the purposes of Sections 62‑7‑904B through 62‑7‑904P.

Section 62‑7‑904G clearly establishes that conversion to a total return unitrust under Sections 62‑7‑904B through 62‑7‑904P shall not affect any other provision of the terms of the trust, if any, regarding distributions of principal. For purposes of Sections 62‑7‑904B through 62‑7‑904P, the distribution of a unitrust amount is considered a distribution of income and not of principal.

Section 62‑7‑904H purports to establish evidence of good faith by the trustee or any disinterested person who takes or fails to take any action under Sections 62‑7‑904B through 62‑7‑904P as a complete defense against liability to any person affected by such action or inaction, regardless of whether the person received written notice as provided in Sections 62‑7‑904B through 62‑7‑904P and regardless of whether the person was under a legal disability at the time of the delivery of the notice. The exclusive remedy for any person affected by an action or inaction shall be to obtain an order of the court directing the trustee (1) to convert an income trust to a total return unitrust, (2) to reconvert from a total return unitrust to an income trust, or (3) to change the percentage used to calculate the unitrust amount.

Section 62‑7‑904I addresses certain types of trusts and trust provisions or other default circumstances which cause Sections 62‑7‑904B through 62‑7‑904P not to apply to such trusts.

Section 62‑7‑904M(A) is the first of the four final sections that address the express total return unitrust as distinguished from the total return unitrust and the income trust. Each of these trusts is included in the definitions section, 62‑7‑904B where subsection (3) provides: ‘Express total return unitrust’ means a trust created by the terms of a governing instrument requiring the distribution at least annually of a unitrust amount equal to a fixed percentage of not less than three percent nor more than five percent a year of the net fair market value of the assets of the trust, valued at least annually. Note that this Section 62‑7‑904M(A) provides in addition to “annually”: “or averaged on a multiple year basis.” Section 62‑7‑904M(B) authorizes the terms of such governing instrument to provide that: (1) any assets of such a unitrust for which a fair market value cannot be readily ascertained must be valued using valuation methods that the trustee considers reasonable and appropriate; and (2) any assets of such a unitrust, such as a residence property or tangible personal property, used by the trust beneficiary entitled to the unitrust amount may be excluded from the net fair market value for computing the unitrust amount.

Section 62‑7‑904N establishes South Carolina’s critically important position on the effect of the distribution of such a unitrust amount: “The distribution from an express total return unitrust of a unitrust amount equal to a fixed percentage of not less than three percent nor more than five percent reasonably apportions between the income beneficiaries and the remaindermen the total return of an express total return unitrust” (emphasis added).

Section 62‑7‑904O(A) authorizes the terms of an express total return unitrust governing instrument to provide the method similar to the method provided under Section 62‑7‑904C for changing the unitrust percentage or for converting from a unitrust to an income trust or for a reconversion of an income trust to a unitrust, or for all of these actions. Section 62‑7‑904O(B) denies a trustee the power to change the unitrust percentage or change to an income trust if the terms of an express total return unitrust governing instrument do not specifically or by reference to Section 62‑7‑904C grant such power to that trustee.

Section 62‑7‑904P provides that, unless the terms of the express total return unitrust governing instrument specifically provide otherwise, the trustee: (A) must consider the unitrust amount as paid from net accounting income determined as if the trust were not a unitrust; (B) must then consider the unitrust amount as paid from ordinary income not allocable to net accounting income; (C) may, in the trustee’s discretion, consider the unitrust amount as paid from net short‑term gain described in section 1222(5) of the Code and then from net long‑term capital gain described in section 1222(7) of the Code so long as this discretionary power is exercised consistently and in a reasonable and impartial manner, but the amount so paid from net capital gains may not be greater than the excess of the unitrust amount over the amount of distributable net income as defined in section 643(a) of the Code without regard to section 1.643(a)‑3(b) of the Treasury Regulations, as amended from time to time; and (D) must then consider the unitrust amount as coming from the principal of the trust.

Treasury Department and Internal Revenue Service (Treasury and Service). The promulgation by the ULC of its 1994 UPIA and 1997 UP&IA and the developing interest of the states in these two uniform laws, the 1997 UP&IA’s power to adjust, and the alternative unitrust approach garnered Treasury and Internal Revenue Service interest in the late 1990s. During that period, there was a recognition that “state statutes are in the process of changing traditional concepts of income and principal in response to investment strategies that seek total positive return on trust assets”. Considerable time and resources were devoted to addressing the various tax issues raised which culminated in the Treasury and the Service adopting 15 Treasury Regulations amendments. The effect of these amendments was to conform the regulations to the changes referred to above. These amendments were issued as final regulations generally effective January 2, 2004, and were published in 69 Federal Register No. 1, January 2, 2004, pp. 13‑22, 26 CFR Parts 1, 20, 25, and 26 [TD 9102] RIN 1545‑AX96.

The prefatory Summary, Background, and Explanation materials published with the final regulations referred to above are instructive, particularly the Service responses to many of the comments on the original proposed regulations that were published on February 15, 2001. Of the many Treasury and Service positions expressed in these materials on various issues that arose during this process, one of the more instructive of these appears on page 16 under the heading “Trusts Qualifying for Gift and Estate Tax Marital Deductions”:

The proposed regulations provide that a spouse will be treated as entitled to receive all net income from a trust, as required for the trust to qualify for the gift and estate tax marital deductions under Sec. 20.2056(b)‑5(a)(1) of the Estate Tax Regulations and Sec. 25.2523(e)‑1(f)(1) of the Gift Tax Regulations, if the trust is administered under applicable state law that provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and that meets the requirements of Sec. 1.643(b)‑1. Thus, a spouse who, as the income beneficiary, is entitled in accordance with the state statute and the governing instrument to a unitrust amount of no less than 3% and no more than 5% would be entitled to all the income from the trust for purposes of qualifying the trust for the marital deduction.

Several commentators suggested that a trust that provides for a unitrust payment to the spouse should satisfy the income standard even in states that have not enacted legislation defining income as a unitrust amount or providing that a right to income may be satisfied by such a payment. The income distribution requirement that must be satisfied for a trust to qualify for the gift and estate tax marital deductions ensures that the spouse receives what is traditionally considered to be income from the assets held in trust. As previously discussed, the IRS and the Treasury Department believe that only if applicable state law has authorized a departure from traditional concepts of income and principal should such a departure be respected for Federal tax purposes. A state statute specifically authorizing certain unitrust amounts in satisfaction of an income interest or certain powers to adjust in conformance with the provisions of Sec.1.643(b)-1 would meet this standard. However, in the absence of a state statute, or, for example, a decision of the highest court of the state applicable to all trusts administered under that state’s law, the applicable state law requirement will not be satisfied.

SECTION 5. This act takes effect on January 1, 2014.

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