



**KANSAS BAR
ASSOCIATION**

TO: The Honorable Tim Owens
And Members of the Senate Judiciary Committee

FROM: Tim O'Sullivan
On Behalf of the Kansas Bar Association

RE: SB 403, conversion of a unitrust into a trust

DATE: February 13, 2012

Chairman Owens and Members of the Senate Judiciary Committee:

I am Tim O'Sullivan. I am an attorney in Wichita specializing in probate and trust matters. I am appearing on behalf of the Kansas Bar Association (KBA) in support of SB 403, which amends K.S.A. 58-9-105. SB 403 was proposed by the KBA Real Property, Probate and Trust Section, approved by the KBA Legislative Committee and then subsequently approved by the KBA Board of Governors.

Modifications of Unitrust Provision of Kansas Uniform Principal and Income Act (KUPIA)

Kansas was the second state to adopt the 1997 version of the Uniform Principal and Income Act ("KUPIA" or "the Act"). The determination of the amount of income to be distributed to a beneficiary under the provisions of trust instruments which require the distribution of all income to trust beneficiaries is made under the provisions of the KUPIA unless the trust instrument provides otherwise.

After so determining the amount of income (generally interest, rents, royalties and dividends after deducting allocable expenses), Sections 103 and 104 of the Act give the trustee discretion, taking into account the Prudent Investor Act and its "total return" concepts, to make equitable adjustments between income and principal if required to do so out of its fiduciary responsibilities of fairness to both the income and remainder beneficiaries. For example, if the trust estate was invested heavily in equities due to it having a long term, which equities paid little in dividends but which had substantial appreciation beyond that necessary to preserve the value of the principal for the remainder beneficiaries, the trustee could periodically exercise such authority and allocate some of such appreciation to income.

Some trust administrators complained that because there was no "bright line" standard in determining the amount of such adjustment, ("KUPIA" or "the Act"), it engendered complexity and imposed administrative burdens in its application and administration. Moreover, the somewhat subjective nature of such adjustments raised the specter of beneficiary demands for frequent adjustments, perhaps even annually, thereby pitting current beneficiaries against remainder beneficiaries in a manner that did little to lessen the tension between them. In sum, the enactment of the adjustment provision may have

simply changed the nature of the argument from the type of investments the trustee should be investing in, and the income thereby generated, to the amount of the appropriate adjustment, if any.

The suggested alternative of many commentators and trust administrators, which was designed to interject simplicity and administrative ease to the foregoing problematic aspects of the adjustment provision while still attaining its overall objective, was to permit the trustee to elect to convert to a unitrust income payout while retaining the total return concept as to the investment of the trust estate. The unitrust option, simply speaking, involves adopting a fixed percentage payout of the value of the trust estate averaged over a period in determining the income of the trust estate. This concept had not been included in the 1997 Uniform Principal and Income Act, nor in any subsequent amendment, as the Uniform Commissioners favored the more flexible, situational specific, and what they considered more equitable, adjustment approach. As a consequence, with no proposal promulgated by the Uniform Commissioners to follow as a guide, the majority of states which have now enacted such unitrust election nonetheless have varied on such issues as the percentage payout, the factors to consider in selecting the option, and whether the adjustment provision is to be statutorily retained as an additional option.

In 2009, Kansas joined the majority of states which had adopted the unitrust option. In enacting the unitrust conversion option in that year, Kansas, unlike some other states, nonetheless retained the adjustment authority under Sections 103 and 104 in the absence of the adoption of the unitrust option. K.S.A. 58-9-105(h) makes it clear that converting to a unitrust has no effect on any provisions governing distributions of principal under the trust instrument.

Conditions for Conversion

K.S.A. 58-9-105(a) provides three conditions be present for the trustee to elect the unitrust option, which permits an income payout option between 3% and 5% of the trust estate, determined annually:

(1) The trustee determines that the conversion will enable the trustee to better carry out the intent of the settlor or testator and the purposes of the trust;

(2) The trustee gives each “qualified beneficiary” (the term “beneficiary” is defined in the Kansas UPIA, the same being an income or remainder beneficiary under K.S.A. 58-9-102(2); however, the term “qualified beneficiary” is defined in 105(a) by reference to the definition of such term under provisions of the Kansas Uniform Trust Code, i.e., K.S.A. 58a-103, which under subsection (12) thereof defines the term “qualified beneficiaries” as those beneficiaries then entitled to a trust distribution, whether in the discretion of the trustee or otherwise, or who would be so entitled if the trust terminated) written notice of the trustee’s intention to release the adjustment power and to convert the trust into a unitrust and how the unitrust will operate, including what initial decisions the trustee will make in that regard; and

(3) No qualified beneficiary timely objects to the conversion to a unitrust, timely being within 60 days of the mailing of the notice under provision (2).

Petitioning District Court to Reconvert Unitrust or Go Beyond Normal Unitrust Provisions

K.S.A. 58-9-105(g) permits the trustee, or a qualified beneficiary if the trustee refuses to do so, to petition the district court to vary provisions which otherwise would be applicable upon conversion to a

unitrust. The first variance is to reconvert out of the unitrust option. No guidelines are indicated for such reconversion. One would assume that the pleadings would assert that the elements that were present in favor of the conversion are no longer present. In the event such reconversion is granted, the ability to adjust income under K.S.A. 58-9-104 is specifically restored under the statutory provisions. However, there are no statutory provisions which delineate considerations for the court in determining whether to authorize a reconversion. One would assume that they would be the same considerations and factors which merited the conversion, only in reverse.

In addition to a reconversion, the petition can request the court to modify three other administrative provisions that would otherwise be applicable. First, the court may be petitioned to order a unitrust percentage of less than 3% or greater than 5%. Second, the court may be requested to require a distribution of any income amount that would have been determined in the absence of the unitrust conversion that is in excess of the unitrust amount. Finally, the petitioner may ask the court to “average the valuation of the trust’s net assets over a period other than three years.” It would appear that this would only be necessary to extend the averaging period, for the default provision discussed above is an averaging period “up to three years.” As with the reconversion, no guidelines or considerations are statutorily delineated in determining under the subject circumstances whether any such foregoing modifications would be appropriate.

Recommended Legislative Modifications

The modifications in the Bill which are proposed by the Kansas Bar Association and its Real Property, Probate and Trust Section are to permit the trustee to both elect out of the unitrust option and return to the adjustment provision, as well as to change the unitrust percentage payout within the prescribed 3% to 5% range, without necessity of an expensive and unnecessary court proceeding. It is important to note in this regard that there is no specific current statutory provision for making such adjustment within the prescribed range following the unitrust election, either with or without judicial approval. It is thus inherently ambiguous in this regard and in need of the clarification provided in the Bill.

It would seem reasonable, as provided in the Bill, that the same procedure for electing into the unitrust option and choice of percentage payout would be appropriate to either elect out of the option or change the initial determined unitrust percentage within the prescribed statutory range. Retained without modification would be the judicial procedure that is always required for electing an averaging period of more than three years or determining a unitrust payout percentage of less than 3% or more than 5%.

To elect out of the unitrust percentage, the trustee would simply follow the same foregoing non-judicial procedure under K.S.A. 58-9-105(a) that was required to initiate it, save that the trustee would inform the beneficiaries of the trustee’s intent to elect out of the unitrust conversion, the effect on the beneficiaries in terms of returning to the determination of income under the KUPIA outside of the unitrust provision, and the rationale that such election out is due to the fact that the unitrust option is no longer necessary or desirable to carry out the intent of the settlor or testator after considering all of the factors under K.S.A. 58-9-105(c) which had merited its invocation. Such non-judicial reconversion would retain the same right of a beneficiary to seek judicial redress under K.S.A. 58-9-105(b).

To make a subsequent unitrust adjustment within the 3%-5% range, the same procedure would be followed as was required in initially electing the unitrust option, similarly having the identical beneficiary right of judicial redress.

We respectfully ask that you give it SB 403 your support.

On behalf of the Kansas Bar Association, I thank you for your time this morning and would be available to respond to questions.

About the Kansas Bar Association:

The Kansas Bar Association (KBA) was founded in 1882 as a voluntary association for dedicated legal professionals and has more than 7,200 members, including lawyers, judges, law students, and paralegals.
www.ksbar.org