

SPECIAL REPORT

Trust and Estate Administration Acts

UNIFORM PRINCIPAL AND INCOME ACT

Effective January 1, 2000, Virginia has adopted the Uniform Principal and Income Act. This act is default legislation that deals with principal and income allocation issues left unresolved by a will or trust. The act makes the following changes:

- Probate administration rules are applied to revocable trusts after the grantor's death.
- Interest is payable on delayed pecuniary gifts in a revocable trust.
- Fiduciaries are given the power to make adjustments between principal and income to correct inequities caused by tax elections or fiduciary income tax rules.
- The most significant change authorizes a trustee, under certain circumstances, to make an "equitable adjustment" and re-characterize income as principal and principal as income, if the trustee determines that it is necessary to treat beneficiaries impartially.

Equitable adjustments will be frequently considered where one set of beneficiaries is given

income and another set of beneficiaries is given the principal upon the termination of the income interests. In the past, the trustee was forced to choose between investing for income or investing for capital gains. Under the new act the trustee can now invest for total return. The beneficiaries can be treated fairly by allocating income to principal or principal to income. For example, if the trustee invests 65% of the trust in stock and 35% in bonds, the trust's income will be diminished by the stock investments. If the trustee deems it necessary, he can adjust by treating some of the capital appreciation as income.

This power to make equitable adjustments will be particularly helpful where there are children by a prior marriage. In these cases, it is common for the decedent to create a trust that distributes income to his spouse. Upon the spouse's death, the trustee is directed to distribute the principal to the decedent's children. Previously, the spouse would demand that the trustee invest to generate income and the children would demand that the trustee invest to generate capital appreciation. With the power to make equitable adjustments, the trustee can invest for the best total return and make adjustments to treat the various beneficiaries equitably.

THE UNIFORM PRUDENT INVESTOR ACT

Effective January 1, 2000, Virginia has adopted the Uniform Prudent Investor Act. This act provides for a modern portfolio theory in investing and evaluating investment decisions.

The act provides that a fiduciary's investment and management decisions shall be evaluated not in isolation, but in the context of the entire portfolio and as a part of an overall investment strategy having risk and return objectives suited to the trust. The act imposes upon the fiduciary the duty to investigate investments, to diversify the investments, and to show loyalty and impartiality to the beneficiaries.

A significant change in the law, the act permits a fiduciary to delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. Previously, a fiduciary could only delegate investment authority if the underlying instrument expressly authorized the delegation.

The act applies not only to trustees, personal representatives and conservators, but also to an agent under a power of attorney.

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