

STATE OF ALABAMA



ALABAMA LAW INSTITUTE

ALABAMA UNITRUST ACT

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SYNOPSIS: Under federal Treasury Regulations Section 1.643(b)-1, a local law is allowed to provide that a trust may provide for an alternative for reasonable apportionment between the income and remainder beneficiaries of the total return of the trust. It offers as an example "a state statute providing that income is a unitrust amount of no less than 3% and no more than 5% of the fair market value of the trust assets, whether determined annually or averaged on a multiple year basis. . . ." This type of provisions is common referred to as a "unitrust."

This bill would update the Alabama Principal and Income Act to acknowledge trusts that are established initially as unitrusts and also to provide procedures for existing trusts to be converted into unitrusts. An additional provision

1 is added to make clear that the Alabama Trust Code
2 applies to the Alabama Principal and Income Act.

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6 A BILL
7 TO BE ENTITLED
8 AN ACT

9
10 Relating to trusts; to amend 19-3A-102, 19-3A-103,
11 19-3A-104, and 19-3A-409 of the Code of Alabama 1975, relating
12 to the Alabama Principal and Income Act, to make such
13 provisions consistent with new provisions authorizing
14 unitrusts; and to add 19-3A-105, 106 and 608 to the Code of
15 Alabama 1975, to address trusts created as express unitrusts,
16 to authorize the conversion of trusts to unitrusts and to
17 clarify that the Alabama Trust Code applies to the Alabama
18 Principal and Income Act.

19 BE IT ENACTED BY THE LEGISLATURE OF ALABAMA:

20 Section 1. Sections 19-3A-102, 19-3A-103, 19-3A-104,
21 and 19-3A-409 of the Code of Alabama 1975, are amended to read
22 as follows:

23 "§19-3A-102. Definitions.

1 As used in this chapter, the following terms are
2 defined as follows:

3 (1) ACCOUNTING PERIOD. A calendar year unless
4 another 12-month period is selected by a fiduciary. The term
5 includes a portion of a calendar year or other 12-month period
6 that begins when an income interest begins or ends when an
7 income interest ends.

8 (2) BENEFICIARY. Includes, in the case of a
9 decedent's estate, an heir, legatee, and devisee and, in the
10 case of a trust, an income beneficiary and a remainder
11 beneficiary.

12 (3) FIDUCIARY. A personal representative or a
13 trustee. The term includes an executor, administrator,
14 successor personal representative, special administrator, and
15 a person performing substantially the same function.

16 (4) INCOME. Money or property that a fiduciary
17 receives as current return from a principal asset. The term
18 also includes a portion of receipts from a sale, exchange, or
19 liquidation of a principal asset, to the extent provided in
20 Article 4.

21 (5) INCOME BENEFICIARY. A person to whom net income
22 of a trust is or may be payable.

23 (6) INCOME INTEREST. The right of an income
24 beneficiary to receive all or part of net income, whether the

1 terms of the trust require it to be distributed or authorize
2 it to be distributed in the trustee's discretion.

3 (7) INVENTORY VALUE. a. The cost of an asset that is
4 purchased by the fiduciary, or b. the market value of an asset
5 at the time the asset becomes subject to the trust; except
6 that in the case of a testamentary trust, the fiduciary may
7 use any value finally determined for the purposes of an estate
8 or inheritance tax.

9 (8) MANDATORY INCOME INTEREST. The right of an
10 income beneficiary to receive net income that the terms of the
11 trust require the fiduciary to distribute.

12 (9) NET INCOME. The total receipts allocated to
13 income during an accounting period minus the disbursements
14 made from income during the period, plus or minus transfers
15 under this chapter to or from income during the period.

16 (10) PERSON. An individual, corporation, business
17 trust, estate, trust, partnership, limited liability company,
18 association, joint venture, government, governmental
19 subdivision, agency, or instrumentality, public corporation,
20 or any other legal or commercial entity.

21 (11) PRESUMPTIVE REMAINDER BENEFICIARY. Those
22 persons who would be entitled to the principal of a trust if
23 the income interest were immediately terminated, and if a
24 trust contains a power of appointment, the holder of such

1 power of appointment shall also be a presumptive remainder
2 beneficiary.

3 (12) PRINCIPAL. Property transferred to or acquired
4 by a fiduciary and held in trust for distribution to a
5 remainder beneficiary when an income interest ends.

6 (13) REMAINDER BENEFICIARY. A person entitled to
7 receive principal when an income interest ends.

8 (14) TERMS OF A TRUST. The manifestation of the
9 intent of a settlor or decedent with respect to the trust,
10 expressed in a manner that admits of its proof in a judicial
11 proceeding, whether by written or spoken words or by conduct.

12 (15) TRUSTEE. An original, additional, or successor
13 trustee, whether or not appointed or confirmed by a court.

14 (16) UNITRUST AMOUNT. An amount determined annually
15 equal to a percentage (specified by the provisions of the
16 governing instrument, the written notice referenced in
17 subsection 106(a), the written instrument referenced in
18 subsection 106(b), or the order of the court referenced in
19 subsection 106(c), whichever is applicable) of the net fair
20 market value of the trust assets, whether determined annually
21 or averaged over a designated multiple year smoothing period.

22
23 **Alabama Unitrust Comment**

24
25 Section 19-3A-102(16) is added to the Alabama Uniform
26 Principal and Income Act concurrently with Sections 105 and

1 106 that concern express unitrusts and converted unitrusts.
2 The unitrust amount is determined by applying a fixed unitrust
3 percentage to the net fair market value of the trust assets.
4 For this purpose, net fair market value is determined by
5 reducing the fair market value of the assets by the
6 liabilities of the trust. If personal use or hard to value
7 assets are not being considered in determining the unitrust
8 amount pursuant to the governing instrument or Sections 105 or
9 106, then they will also be excluded from the net fair market
10 value of the assets for this purpose.
11

12 §19-3A-103. Fiduciary duties; general principles.
13

14 (a) In allocating receipts and disbursements to or
15 between principal and income, and with respect to any matter
16 within the scope of Article 2 and Article 3, a fiduciary:

17 (1) Shall administer a trust or decedent's estate in
18 accordance with the terms of the trust or the will, even if
19 there is a different provision in this chapter;

20 (2) May administer a trust or decedent's estate by
21 the exercise of a discretionary power of administration given
22 to the fiduciary by the terms of the trust or the will, even
23 if the exercise of the power produces a result different from
24 a result required or permitted by this chapter;

25 (3) Subject to the provisions of Section 19-3A-104,
26 shall administer a trust or decedent's estate in accordance
27 with this chapter if the terms of the trust or the will do not
28 contain a different provision or do not give the fiduciary a
29 discretionary power of administration; and

1 (4) Shall add a receipt or charge a disbursement to
2 principal to the extent that the terms of the trust and this
3 chapter do not provide a rule for allocating the receipt or
4 disbursement to or between principal and income.

5 (b) In exercising the power to adjust under Section
6 19-3A-104(a) or the power to convert to unitrust under Section
7 19-3A-106, if applicable, or a discretionary power of
8 administration regarding a matter within the scope of this
9 chapter, whether granted by the terms of a trust, a will, or
10 this chapter, a fiduciary shall administer a trust or
11 decedent's estate impartially, based on what is fair and
12 reasonable to all of the beneficiaries, except to the extent
13 that the terms of the trust or the will clearly manifest an
14 intention that the fiduciary shall or may favor one or more of
15 the beneficiaries. The exercise of discretion in accordance
16 with this chapter is presumed to be fair and reasonable to all
17 of the beneficiaries.

18 §19-3A-104. Trustee's power to adjust.

19 (a) If the terms of the trust expressly provide by
20 specific reference to this section, then a trustee may have
21 the power to adjust between principal and income to the extent
22 the trustee considers necessary if (1) the trustee invests and
23 manages trust assets as a prudent investor; (2) the terms of
24 the trust describe the amount that may or must be distributed

1 to a beneficiary by referring to the trust's income, and (3)
2 the trustee determines, after applying the rules in Section
3 19-3A-103(a), that the trustee is unable to comply with
4 Section 19-3A-103(b).

5 (b) In deciding whether and to what extent to
6 exercise the power conferred by subsection (a), a trustee
7 shall consider all factors relevant to the trust and its
8 beneficiaries, including, but not limited to:

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

11 (2) The intent of the settlor;

12 (3) The identity and circumstances of the
13 beneficiaries;

14 (4) The needs for liquidity for the trust;

15 (5) The regularity of income to the trust;

16 (6) The need for preservation and appreciation of
17 capital;

18 (7) The nature of the assets held in the trust and
19 the extent to which they consist of financial assets,
20 interests in closely held enterprises, tangible and intangible
21 personal property, or real property;

22 (8) The extent to which an asset is used by a
23 beneficiary;

1 (9) Whether an asset was purchased by the trustee or
2 received from the settlor;

3 (10) The net amount allocated to income under the
4 other sections of this chapter and the increase or decrease in
5 the value of the principal assets, which the trustee may
6 estimate as to assets for which market values are not readily
7 available;

8 (11) Whether and to what extent the terms of the
9 trust a. give the trustee the power to invade principal or
10 accumulate income, or b. prohibit the trustee from invading
11 principal or accumulating income;

12 (12) The extent to which the trustee has exercised a
13 power from time to time to invade principal or accumulate
14 income;

15 (13) The actual and anticipated effect of economic
16 conditions, inflation, and deflation upon principal and
17 income; and

18 (14) The anticipated income and transfer tax
19 consequences of an adjustment.

20 (c) Notwithstanding the power conferred by
21 subsection (a), a trustee may not make an adjustment:

22 (1) That diminishes the income interest in a trust
23 that requires all of the income to be paid at least annually
24 to a spouse and for which an estate tax or gift tax marital

1 deduction would be allowed, in whole or in part, if the
2 trustee did not have the power to make the adjustment;

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

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

9 (4) That changes the amount that is permanently set
10 aside for charitable purposes under a will or the terms of a
11 trust, unless both income and principal are so set aside;

12 (5) If possessing or exercising the power to make an
13 adjustment causes an individual to be treated as the owner of
14 all or part of the trust for income tax purposes, and the
15 individual would not be treated as the owner if the trustee
16 did not possess the power to make an adjustment;

17 (6) If possessing or exercising the power to make an
18 adjustment causes all or part of the trust assets to be
19 included for estate tax purposes in the estate of an
20 individual who has the power to remove a trustee or appoint a
21 trustee, or both, and the assets would not be included in the
22 estate of the individual if the trustee did not possess the
23 power to make an adjustment;

1 (7) If the trustee is not a beneficiary, but the
2 adjustment would benefit the trustee directly or indirectly;
3 ~~or~~

4 (8) If the trustee is a beneficiary of the trust~~;~~
5 or

6 (9) If the trust is an express unitrust under
7 Section 19-3A-105 (relating to express unitrusts) or is a
8 unitrust by reason of a conversion under Section 19-3A-106
9 (relating to power to convert to unitrust).

10 (d) If subsection (c) (5), subsection (c) (6),
11 subsection (c) (7), or subsection (c) (8) applies to a trustee
12 and there is more than one trustee, then the co-trustee to
13 whom the provision does not apply may make the adjustment,
14 unless the exercise of the power by the remaining trustee or
15 trustees is not permitted by the terms of the trust.

16 (e) A trustee may release the entire power conferred
17 by subsection (a) or may release only the power to adjust from
18 income to principal or the power to adjust from principal to
19 income if the trustee is uncertain about whether possessing or
20 exercising the power will cause a result described in
21 subsection (c) (1) through subsection (c) (7) or if the trustee
22 determines that possessing or exercising the power will or may
23 deprive the trust of a tax benefit or impose a tax burden not
24 described in subsection (c). The release may be permanent or

1 for a specified period, including a period measured by the
2 life of an individual.

3 (f) The trustee or any beneficiary of a trust
4 covered by this chapter (or a trust to be created from a
5 decedent's estate that is covered by this chapter) (1) may
6 seek approval from a court of competent jurisdiction to be
7 governed prospectively by this section, or (2) may at any time
8 affirmatively elect to be governed prospectively by this
9 section by obtaining the written consent of all of the current
10 income beneficiaries and the presumptive remainder
11 beneficiaries of the trust, and such written consent shall
12 conclusively bind all persons who may have any interest in the
13 affected trust, including all contingent remainder
14 beneficiaries and potential appointees of the trust.

15 §19-3A-409.

16 (a) In this section:

17 (1) "Payment" means a payment that a fiduciary may
18 receive over a fixed number of years or during the life of one
19 or more individuals because of services rendered or property
20 transferred to the payer in exchange for future payments. The
21 term includes a payment made in money or property from the
22 payer's general assets or from a separate fund created by the
23 payer. For purposes of subsections (d), (e), (f), and (g),

1 the term also includes any payment from any separate fund,
2 regardless of the reason for the payment.

3 (2) "Separate fund" includes a private or commercial
4 annuity, an individual retirement account, and a pension,
5 profit-sharing, stock-bonus, or stock-ownership plan.

6 (b) To the extent that a payment or portion thereof
7 is characterized by other sections of this chapter as income
8 in the hands of the payer, a fiduciary shall allocate such
9 payment or portion thereof to income. The fiduciary shall
10 allocate to principal the balance of the payment and any other
11 payment received in the same accounting period that is not
12 characterized as income to the payer by other sections of this
13 chapter.

14 (c) To the extent that a payment is not allocated
15 between income and principal pursuant to subsection (b), a
16 fiduciary shall allocate to income ten percent (10%) of the
17 part that is required to be made during the accounting period
18 and the balance to principal. If no part of a payment is
19 required to be made or if the payment received by the
20 fiduciary is the entire amount to which the fiduciary is
21 entitled, then the fiduciary shall allocate the entire payment
22 to principal. For purposes of this subsection, a payment is
23 not "required to be made" to the extent that it is made
24 because the fiduciary exercises a right of withdrawal.

1 (d) Except as otherwise provided in subsection (e),
2 subsections (f) and (g) apply, and subsections (b) and (c) do
3 not apply, in determining the allocation of a payment made
4 from a separate fund to:

5 (1) a trust to which an election to qualify for a
6 marital deduction under Section 2056(b)(7) of the Internal
7 Revenue Code of 1986, as amended, 26 U.S.C. Section
8 2056(b)(7), as amended, has been made; or

9 (2) a trust that qualifies for the marital deduction
10 under Section 2056(b)(5) of the Internal Revenue Code of 1986,
11 as amended, 26 U.S.C. Section 2056(b)(5), as amended.

12 (e) Subsections (d), (f), and (g) do not apply if
13 and to the extent that the series of payments would, without
14 the application of subsection (d), qualify for the marital
15 deduction under Section 2056(b)(7)(C) of the Internal Revenue
16 Code of 1986, as amended, 26 U.S.C. Section 2056(b)(7)(C), as
17 amended.

18 (f) A fiduciary shall make a reasonable effort to
19 determine the internal income of each separate fund for the
20 accounting period as if the separate fund were a trust subject
21 to this chapter. Upon request of the surviving spouse, the
22 fiduciary shall make a demand on the person administering the
23 separate fund to distribute the internal income to the trust.
24 The fiduciary shall allocate a payment from the separate fund

1 to income to the extent of the internal income of the separate
2 fund and distribute that amount to the surviving spouse. The
3 fiduciary shall allocate the balance of the payment to
4 principal. Upon request of the surviving spouse, the
5 fiduciary shall allocate principal to income to the extent the
6 internal income of the separate fund exceeds payments made
7 from the separate fund to the trust during the accounting
8 period.

9 (g) If a fiduciary cannot determine the internal
10 income of a separate fund pursuant to subsection (f) but can
11 determine the value of the separate fund, the internal income
12 of the separate fund for the accounting period is deemed to
13 equal four percent of the fund's value, according to the most
14 recent statement of value preceding the beginning of the
15 accounting period. If the fiduciary can determine neither the
16 internal income of the separate fund nor the fund's value, the
17 internal income of the fund for the accounting period is
18 deemed to equal the product of the interest rate and the
19 present value of the expected future payments, as determined
20 under Section 7520 of the Internal Revenue Code of 1986, as
21 amended, 26 U.S.C. Section 7520, as amended, for the month
22 preceding the accounting period for which the computation is
23 made.

1 (h) This section does not apply to a payment to
2 which Section 19-3A-410 applies.

3 (i) If a trust holds one or more separate funds and
4 is an express unitrust under Section 105 or is a unitrust by
5 reason of conversion under Section 19-3A-106 (relating to
6 power to convert to unitrust), the following rules shall
7 apply.

8 (1) Income or net income from the separate
9 funds shall be determined as provided in the governing
10 instrument in the case of an express unitrust under Section
11 105 or the written notice referenced in Section 19-3A-106(a),
12 the written instrument referenced in Section 19-3A-106(b), or
13 the order of the court referenced in Section 19-3A-106(c) in
14 the case of a trust converted to a unitrust.

15 (2) If subparagraph (1) does not apply and the
16 fiduciary can determine the value of the separate fund, income
17 or net income with respect to such separate fund shall be an
18 amount equal to the unitrust percentage multiplied by said
19 value in the manner applied pursuant to the provisions of
20 Section 19-3A-105 or Section 19-3A-106, as the case may be.

21 (3) If subparagraph (1) does not apply and the
22 fiduciary cannot determine the value of the separate fund,
23 income or net income with respect to such separate fund shall

1 be determined in the manner provided in the foregoing
2 provisions of this section.

3 4 **Alabama Unitrust Comment** 5

6 Subparagraph (i) was added to address unitrusts. If the unitrust is a beneficiary of a
7 separate fund, as defined in Section 19-3A-409(a)(2), the determination of whether a receipt
8 is principal or income will be determined in the following order:
9

10 If the governing instrument, written notice, written instrument or court order
11 establishing the unitrust addresses the separate fund, the instrument, notice or order
12 will govern the determination of income with respect to the separate fund.
13

14 If the governing instrument, notice, instrument or court order is silent but the
15 fiduciary can determine the value of the separate fund (*e.g.*, it is an IRA or other
16 separate account fund), income with respect to the fund will equal the unitrust
17 percentage times the value of the separate fund. The other unitrust rules (*e.g.*,
18 smoothing) will also apply.
19

20 If neither of the above apply (*e.g.*, the separate fund is a pension or other
21 annuity), income with respect to the separate fund will be determined by applying the
22 other rules of Section 19-3A-409. As a result, the calculation will depend upon
23 whether the trust is a marital deduction trust. If the trust is not a marital deduction
24 trust, income is either based on what the payor characterizes as income [Section 19-
25 3A-409(b)] or if it is not characterized by the payor, 10% of the payment is income
26 [Section 19-3A-409(c)]. If it is a marital deduction trust, income is based upon the
27 internal income of the separate fund if it can be determined. Section 19-3A-409(f). If
28 not, it is determined by multiplying the IRC § 7520 interest rate times the IRC § 7520
29 value of the stream of payments to be received. Section 19-3A-409(g). Because of
30 the rule in Section 19-3A-409(i)(2), the 4% step in Section 19-3A-409(g) will not
31 apply.
32
33

34 Section 2. Sections 19-3A-105, 19-3A-106 and 19-3A-
35 608 are added to the Code of Alabama 1975 to read as follows:

36 "§19-3A-105. Express Unitrusts.

37 Except to the extent otherwise provided in the
38 governing instrument, the following provisions shall apply to
39 a trust which by its governing instrument requires

1 distribution of a unitrust amount (whether payable in a single
2 sum or in installments), such trust to be referred to as an
3 "express unitrust":

4 (a) The income and net income of an express unitrust
5 is the unitrust amount, but only if the unitrust amount is not
6 less than 3% and not more than 5% of the net fair market value
7 of the trust assets. If the unitrust amount is more than 5%
8 of the net fair market value of the trust assets, the income
9 and net income shall be 5% of the net fair market value of the
10 trust assets, and the excess over 5% shall be considered to be
11 principal of the trust.

12 (b) Expenses which would be deducted from income if
13 the trust were not an express unitrust shall not be deducted
14 from the unitrust amount.

15 (c) The trustee may, in the trustee's discretion
16 from time to time, determine the following:

17 (1) The frequency of payment of the unitrust
18 amount during the year;

19 (2) Any adjustments to be made to the unitrust
20 amount due to other payments from or contributions to the
21 trust;

22 (3) The valuation dates to use;

1 (4) How nonliquid or hard to value assets shall
2 be valued, how frequently to value them and whether to
3 estimate their value;

4 (5) Whether to omit from the calculations the
5 value of trust property occupied, used or possessed by a
6 beneficiary; and

7 (6) Any other matters necessary for the proper
8 functioning of the unitrust that are not inconsistent with the
9 governing instrument.

10 **Alabama Unitrust Comment**

11
12
13 Section 19-3A-105 has been added to the Alabama Principal and Income Act to be an
14 “applicable local law” that complies with Treas. Reg. § 1.643(b)-1. The regulation states in
15 part the following:

16
17 However, an allocation of amounts between income and prin-
18 cipal pursuant to applicable local law will be respected if local
19 law provides for a reasonable apportionment between the
20 income and remainder beneficiaries of the total return of the
21 trust for the year, including ordinary and tax-exempt income,
22 capital gains, and appreciation. For example, a state statute
23 providing that income is a unitrust amount of no less than 3%
24 and no more than 5% of the fair market value of the trust
25 assets, whether determined annually or averaged on a multiple
26 year basis, is a reasonable apportionment of the total return of
27 the trust.

28
29 Typically, this section will be relied upon by trusts that are intended to satisfy the
30 “pay all income” requirement of marital deduction trusts. It does not prohibit the creation of
31 trusts that fail to satisfy the requirements of this section. However, a trust that does not
32 satisfy the requirements of this section might fail to meet the requirements to qualify for the
33 marital deduction.

34
35 To be consistent with the example in the above Treasury Regulation, an express
36 unitrust should require that the trustee distribute a unitrust amount each year equal to a fixed
37 percentage of not less than 3 nor more than 5 percent per year of the net fair market value of
38 the trust assets. The trust, of course, can provide for distributions in addition to the annual
39 unitrust amount.

1
2 This section contains default provisions that address matters that are not addressed in
3 the governing instrument.
4

5
6 §19-3A-106. Conversion to unitrust.

7 (a) NONJUDICIAL CONVERSION UPON NOTICE BY TRUSTEE.--

8 Unless expressly prohibited by the governing instrument, a
9 trustee may convert a trust into a unitrust as described in
10 this section if all of the following apply:

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

14 (2) The trustee gives written notice of the
15 trustee's intention to convert the trust into a unitrust,
16 including the trustee's initial decisions as set forth below,
17 to all the qualified beneficiaries. The written notice shall
18 include the following:

19 (i) An explanation of how the unitrust
20 will operate;

21 (ii) The effective date of the conversion
22 to a unitrust;

23 (iii) The unitrust percentage to be used;

24 (iv) The provisions for prorating a
25 unitrust distribution for a short year in which a
26 beneficiary's right to payments commences or ceases;

1 (v) Whether the net fair market value of
2 the trust assets will be determined annually or averaged over
3 a designated multiple year smoothing period; and

4 (vi) Such other matters as the trustee
5 deems appropriate for the proper functioning of the unitrust,
6 which may include such matters as—

7 (A) Whether to omit from the
8 calculations trust property occupied, used or possessed by a
9 beneficiary,

10 (B) How nonliquid or hard to value
11 assets shall be valued, how frequently to value them and
12 whether to estimate their value, or

13 (C) Whether the trust assets will be
14 valued annually or more frequently;

15 (3) There is at least one sui juris income
16 beneficiary and at least one sui juris presumptive remainder
17 beneficiary.

18 (4) No beneficiary, or a person who may
19 represent and bind a beneficiary who is not sui juris, objects
20 to the conversion to a unitrust in a writing delivered to the
21 trustee within 60 days of the mailing of the notice under
22 paragraph (2).

1 (5) If the trustee requests, the trustee
2 receives consents from such beneficiaries as determined by the
3 trustee.

4 (b) NONJUDICIAL CONVERSION BY CONSENT OF QUALIFIED
5 BENEFICIARIES.

6 (1) Unless expressly prohibited by the
7 governing instrument, the qualified beneficiaries of a trust
8 may convert the trust into a unitrust as described in this
9 section by a written instrument delivered to the trustee that
10 sets forth all of the following:

11 (i) A representation by the qualified
12 beneficiaries that the conversion will enable the trustee to
13 better carry out the intent of the settlor or testator and the
14 purposes of the trust;

15 (ii) The effective date of the conversion
16 to a unitrust, which shall not be earlier than 60 days after
17 the date the written instrument is delivered to the trustee,
18 unless the trustee consents to an earlier date, provided that
19 such earlier date is not earlier than the date the written
20 instrument is delivered to the trustee;

21 (iii) The unitrust percentage to be used;

22 (iv) The provisions for prorating a
23 unitrust distribution for a short year in which a
24 beneficiary's right to payments commences or ceases;

1 (v) Whether the net fair market value of
2 the trust assets will be determined annually or averaged over
3 a designated multiple year smoothing period; and

4 (vi) Such other matters as the
5 beneficiaries deem appropriate for the proper functioning of
6 the unitrust, which may include such matters as-

7 (A) Whether to omit from the
8 calculations trust property occupied, used or possessed by a
9 beneficiary,

10 (B) How nonliquid or hard to value
11 assets shall be valued, how frequently to value them and
12 whether to estimate their value, or.

13 (C) Whether the trust's assets will
14 be valued annually or more frequently;

15 (2) A trust will not convert into a unitrust
16 unless the written instrument is executed by all qualified
17 beneficiaries, whether directly or by representation.

18 (3) Notwithstanding the foregoing, a trustee
19 may, prior to the effective date of the conversion, seek court
20 confirmation that the foregoing requirements have been
21 satisfied, in which case the conversion will not be effective
22 before the conversion is confirmed by the court.

23 (c) JUDICIALLY APPROVED CONVERSION.-

1 (1) The trustee or a qualified beneficiary may
2 petition the court to order the conversion to a unitrust, even
3 if any of the following apply:

4 (i) A beneficiary timely objects to the
5 conversion to a unitrust, or

6 (ii) There are no sui juris income
7 beneficiaries or sui juris presumptive remainder
8 beneficiaries.

9 (2) Unless expressly prohibited by the
10 governing instrument, the court shall order the conversion if
11 the court concludes (i) that the conversion will enable the
12 trustee to better carry out the intent of the settlor or
13 testator and the purposes of the trust or (ii) all qualified
14 beneficiaries have consented to the conversion.

15 (3) The court shall make the following
16 decisions which shall be set forth in the order of the court
17 approving the conversion:

18 (i) The effective date of the conversion
19 to a unitrust;

20 (ii) The unitrust percentage to be used;

21 (iii) The provisions for prorating a
22 unitrust distribution for a short year in which a
23 beneficiary's right to payments commences or ceases;

1 (iv) Whether the net fair market value of
2 the trust assets will be determined annually or averaged over
3 a designated multiple year smoothing period; and

4 (v) Such other matters as the court deems
5 appropriate for the proper functioning of the unitrust, which
6 may include such matters as-

7 (A) Whether to omit from the
8 calculations trust property occupied, used or possessed by a
9 beneficiary,

10 (B) How nonliquid or hard to value
11 assets shall be valued, how frequently to value them and
12 whether to estimate their value, or

13 (C) Whether the trust assets will be
14 valued annually or more frequently.

15 (4) Court costs shall be charged to the trust
16 or as otherwise determined by the court.

17 (d) UNITRUST PERCENTAGE. The unitrust percentage
18 with respect to a converted unitrust to be used in determining
19 the unitrust amount shall be not less than 3 percent nor more
20 than 5 percent, unless otherwise ordered by the court.

21 (e) POST CONVERSION. During the period of time that
22 the trust is a converted unitrust, all of the following apply:

1 (1) Notwithstanding any provision of this
2 chapter to the contrary, the term "income" or "net income" in
3 the governing instrument shall mean the unitrust amount.

4 (2) The frequency of distributions shall be
5 determined in accordance with the governing instrument.

6 (3) If the written notice referenced in
7 subsection (a), the written instrument referenced in
8 subsection (b), or the order of the court referenced in
9 subsection (c) provides that the net fair market value of the
10 trust assets will be averaged over a designated smoothing
11 period, the net fair market value of the trust assets for
12 purposes of determining the unitrust amount shall be the
13 average of the net fair market value of the trust assets over
14 the designated smoothing period.

15 (4) Any distribution in excess of the unitrust
16 amount shall be deemed to have been paid out of the principal
17 of the trust.

18 (5) Expenses which would be deducted from
19 income if the trust were not a unitrust may not be deducted
20 from the unitrust amount.

21 (f) PRINCIPAL DISTRIBUTIONS.--A conversion to a
22 unitrust does not affect a provision in the governing
23 instrument directing or authorizing the trustee to distribute

1 principal or authorizing a beneficiary to withdraw a portion
2 or all of the principal.

3 (g) DISCRETION OF TRUSTEE.-- Except to the extent
4 otherwise provided in the governing instrument, the written
5 notice referenced in subsection (a), the written agreement
6 referenced in subsection (b), or the order of the court
7 referenced in subsection (c), the trustee may, in the
8 trustee's discretion from time to time, determine the
9 following:

10 (1) The frequency of payment of the unitrust
11 amount during the year;

12 (2) Any adjustments to be made to the unitrust
13 amount due to other payments from or contributions to the
14 trust;

15 (3) The valuation dates to use;

16 (4) How nonliquid or hard to value assets shall
17 be valued, how frequently to value them and whether to
18 estimate their value;

19 (5) Whether to omit from the calculations the
20 value of trust property occupied, used or possessed by a
21 beneficiary; and

22 (6) Any other matters necessary for the proper
23 functioning of the unitrust that are not inconsistent with the
24 written notice referenced in subsection (a), the written

1 agreement referenced in subsection (b), or the order of the
2 court referenced in subsection (c).

3 (h) PROCEDURE TO MODIFY.--Modifications of the
4 unitrust provisions of a converted unitrust may be implemented;
5 (A) by the trustee following the same procedures as in
6 subsection (a) for converting a trust into a unitrust with the
7 exception that the written notice shall state the
8 modifications; (B) by the qualified beneficiaries following the
9 same procedures as in subsection (b) for converting a trust
10 into a unitrust with the exception that the written instrument
11 shall state the modifications; or (C) by the court pursuant to
12 the petition of a beneficiary or the trustee. The modifications
13 shall be set forth in the notice, written instrument or court
14 order, as the case may be, that makes the modifications. The
15 modifications may include any of the following:

16 (1) Changes or additions to any of the matters
17 set forth in, or that could have been set forth in, the
18 original notice, written instrument or court order, as the
19 case may be, or any subsequent modifications thereto;

20 (2) Provisions for a distribution of net
21 income, as would be determined if the trust were not a
22 unitrust, in excess of the unitrust distribution if such
23 distribution is necessary to preserve a tax benefit; or

1 (3) Reversions from a unitrust, in which case
2 the trust shall be administered in accordance with its
3 provisions prior to its conversion to a unitrust. Upon
4 reconversion, the power to adjust under Section 19-3A-104, if
5 any, shall be revived.

6 (i) PROHIBITED CONVERSIONS.--A trust may not be
7 converted into a unitrust in any of the following
8 circumstances:

9 (1) If payment of the unitrust amount would
10 change the aggregate annual amount payable to a beneficiary as
11 a fixed annuity;

12 (2) If the trust is an "Institutional Fund"
13 governed by the provisions of Section 19-3C-1, *et seq.*;

14 (3) If the conversion would reduce any amount
15 permanently set aside for charitable purposes under the
16 governing instrument which is not expressed under the
17 governing instrument as "income" or "net income" or determined
18 pursuant to the terms of the governing instrument by reference
19 to "income" or "net income";

20 (4) If the conversion would reduce the value of
21 any interest for which a Federal estate or gift tax charitable
22 deduction has been taken, or would cause the reduction of an
23 amount being disbursed or to be disbursed to a charity for
24 which an income, estate or gift tax deduction has been taken;

1 (5) If possessing or exercising the power to
2 convert would cause an individual to be treated as the owner
3 of all or part of the trust for Federal income tax purposes,
4 and the individual would not be treated as the owner if the
5 trustee did not possess the power to convert;

6 (6) If possessing or exercising the power to
7 convert would cause all or part of the trust assets to be
8 subject to Federal estate or gift tax with respect to an
9 individual, and the assets would not be subject to Federal
10 estate or gift tax with respect to the individual if the
11 trustee did not possess the power to convert; or

12 (7) If the conversion would result in the
13 disallowance of a Federal estate or gift tax marital or
14 charitable deduction which would be allowed if the trustee did
15 not have the power to convert.

16 (j) PERMISSIBLE CONVERSION WHEN OTHERWISE
17 PROHIBITED.—

18 (1) If subsection (i) (5) or (6) applies because
19 a trustee is a beneficiary and there is more than one trustee,
20 a co-trustee to whom the provision does not apply may convert
21 the trust unless the exercise of the power by the remaining
22 trustee or trustees is prohibited by the governing instrument.

23 (2) If subsection (i) (5) or (6) applies to all
24 the trustees, the trustees may petition the court to direct a

1 conversion or the beneficiaries may convert under subsection
2 (b).

3 (1) RELEASE OF THE POWER TO CONVERT.—

4 (1) A trustee may release the power conferred
5 by subsection (a) to convert to a unitrust if any of the
6 following apply:

7 (i) The trustee is uncertain about whether
8 possessing or exercising the power will cause a result
9 described in subsection (i) (5), (6) or (7).

10 (ii) The trustee determines that
11 possessing or exercising the power will or may deprive the
12 trust of a tax benefit or impose a tax burden not described in
13 subsection (i).

14 (2) The release may be permanent or for a
15 specified period, including a period measured by the life of
16 an individual.

17
18 **Alabama Unitrust Comment**
19

20 Section 19-3A-106 has been added to the Alabama Principal and Income Act to
21 provide procedures for the conversion of an existing trust into a unitrust. There are three
22 conversion methods: nonjudicial conversion upon notice, nonjudicial conversion by consent,
23 and judicially approved conversion.
24

25 A nonjudicial conversion upon notice is initiated by the trustee. To make the
26 conversion, the trustee will give written notice of the trustee's intention to convert the trust
27 into a unitrust to the qualified beneficiaries (within the meaning of Section 19-3B-103(14)).
28 The written notice must include an explanation of how the unitrust will operate; the effective
29 date of the conversion to a unitrust; the unitrust percentage to be used; the provisions for
30 prorating a unitrust distribution for a short year in which a beneficiary's right to payments
31 commences or ceases; whether the trust assets will be valued annually or more frequently;
32 and whether the net fair market value of the trust's assets will be averaged over a designated

1 multiple year smoothing period. It can, but is not required, to include other matters for the
2 proper functioning of the unitrust, such as whether to omit from the calculations trust
3 property occupied, used or possessed by a beneficiary, how nonliquid or hard to value assets
4 shall be valued, how frequently to value nonliquid or hard to value assets and whether to
5 estimate the value of nonliquid or hard to value assets.
6

7 For a trustee to use nonjudicial conversion upon notice, there must be at least one sui
8 juris income beneficiary and at least one sui juris presumptive remainder beneficiary. The
9 conversion will be made if no beneficiary, or person who may represent and bind a
10 beneficiary who is not sui juris, objects to the conversion within 60 days of the mailing of the
11 notice. At the option of the trustee, the trustee can also require that specific beneficiaries
12 provide consents to the conversion as opposed to merely not objecting.
13

14 A nonjudicial conversion by consent is initiated by the qualified beneficiaries
15 delivering a written instrument to the trustee that sets forth substantially the same
16 information required for the notice that would be used for a nonjudicial conversion upon
17 notice. The written instrument must be executed by all qualified beneficiaries, whether
18 directly or by representation.
19

20 A judicially approved conversion is initiated by the trustee or a qualified beneficiary
21 petitioning the court. The criteria for the court to consider are whether the conversion will
22 enable the trustee to better carry out the intent of the settlor or testator and the purposes of the
23 trust or whether all qualified beneficiaries have consented to the conversion. An order
24 approving the conversion must set forth decisions that are substantially the same as the
25 information required for the notice that would be used for a nonjudicial conversion upon
26 notice.
27

28 Unless otherwise ordered by a court, the unitrust percentage for a converted unitrust
29 distribution is to be not less than 3 percent or more than 5 percent.
30

31 The effect of the conversion is to substitute the unitrust amount for the terms
32 "income" and "net income" in the governing instrument. Other provisions concerning
33 distributions remain unchanged. For example, directions to make discretionary distributions
34 subject to a standard such as health, education, maintenance and support or distributions
35 upon the occurrence of an event such as the attainment of a designated age continue to apply.
36 A provision to sprinkle income or net income among beneficiaries will become a provision to
37 sprinkle the unitrust amount among beneficiaries. If the governing instrument provides for
38 monthly payments of net income, the unitrust amount will be paid monthly.
39

40 Except to the extent provided in the governing instrument or the instrument effecting
41 the conversion (*i.e.*, the written notice, written agreement or court order), the trustee will
42 have the discretion to determine the frequency of payment of the unitrust distribution during
43 the year; the effect on the unitrust amount of other payments from or contributions to the
44 trust; what valuation dates to use; how nonliquid or hard to value assets will be valued, how
45 frequently to value them and whether to estimate their value; whether to omit from the
46 calculations trust property occupied, used or possessed by a beneficiary; and other matters

1 necessary for the proper functioning of the unitrust that are not inconsistent with the written
2 notice, the written agreement, or the court's order.

3
4 The unitrust provisions of a converted unitrust may be modified using procedures
5 similar to those used to convert the trust into a unitrust. The modifications may include
6 changes or additions to any of the matters set forth in, or that could have been set forth in, the
7 original notice, written instrument or court order, that converted the trust, provide for a
8 distribution of net income in excess of the unitrust distribution if the distribution is necessary
9 to preserve a tax benefit, or revert from a unitrust.

10
11 A trust cannot be converted into a unitrust if payment of the unitrust distribution
12 would change any amount payable as a fixed annuity payment (such as pay \$10,000.00 per
13 year) into a unitrust payment, or if the trust is an Institutional Fund. Similarly, a trust cannot
14 be converted into a unitrust if payment of the unitrust distribution would provide that the
15 unitrust distribution would be made from trust funds which are permanently set aside for
16 charitable purposes and for which a Federal estate or gift tax charitable deduction has been
17 taken, , if possessing or exercising the power to convert would cause an individual to be
18 treated as the owner of all or part of the trust for Federal income tax purposes; and the
19 individual would not be treated as the owner if the trustee did not possess the power to
20 convert, if possessing or exercising the power to convert would cause all or part of the trust
21 assets to be subject to Federal estate or gift tax with respect to an individual and the assets
22 would not be subject to Federal estate or gift tax with respect to the individual if the trustee
23 did not possess the power to convert, or if the conversion would result in the disallowance of
24 a Federal estate tax or gift tax marital or charitable deduction which would be allowed if the
25 trustee did not have the power to convert.

26
27
28 §19-3A-608. Application of Alabama Uniform Trust

29 Code.

30 The provisions of the Alabama Uniform Trust Code
31 apply to the Alabama Principal and Income Act, except to the
32 extent the provisions are inconsistent with the provisions of
33 this chapter.

34
35 **Alabama Unitrust Comment**
36

37 Section 608 makes clear that the Alabama Uniform Trust Code applies to the
38 Alabama Principal and Income Act. For example, provisions relating to judicial proceedings
39 and representation apply when addressing principal and income matters. Section 608 is not
40 intended to imply that the Alabama Uniform Trust Code did not apply to the Alabama

1 Principal and Income Act prior to its addition to the Alabama Principal and Income Act or
2 that it does not apply to other statutes involving trusts, it is merely included for clarification.

3

4

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Section 3. This act shall become effective upon its
passage and approval by the Governor, or it otherwise becoming
law.