NEBRASKA'S UPDATED PRINCIPAL AND INCOME ACT: APPORTIONING, ALLOCATING, AND ADJUSTING IN THE NEW TRUST WORLD

RONALD R. VOLKMER†

I. INTRODUCTION

Principal and income legislation came to Nebraska in 1980 when the Nebraska Unicameral adopted its version of the Revised Uniform Principal and Income Act.¹ The Nebraska Principal and Income Act, as it was officially titled,² became effective January 1, 1981.³ In an article published in this journal in 1980, I reviewed the major provisions of this legislation and concluded “There can be little doubt that the Nebraska Principal and Income Act will be of significant value in aiding a trustee in the administration of trusts.”⁴ Since 1980, the law of trusts, particularly in regard to the duties of a trustee in administering a trust, has been changing rapidly. The statutory trust law of Nebraska reflected the happenings nationally as the Unicameral adopted, in 1996 and 1997, three significant uniform acts: (1) the Uniform Management of Institutional Funds Act;⁵ (2) the Uniform Prudent Investor Act;⁶ and (3) the Uniform Custodial Trust Act.⁷ In an article published in this journal in 1997, I detailed the Nebraska versions of these acts and gave my personal stamp of approval on the legislative acceptance of these three uniform acts.⁸ In the conclusion of that article I predicted “more changes are undoubtedly in store,” citing the venerable maxim “tempora mutuantur.”⁹

† Professor of Law, Creighton University School of Law. The author gratefully acknowledges the assistance of William Marienau, Counsel to the Unicameral’s Banking, Commerce and Insurance Committee.

² Id.
⁴ Volkmer, 14 CREIGHTON L. REV. at 156.
⁶ NEB. REV. STAT. §§ 8-2201 to -2213 (Reissue 1997).
⁹ Volkmer, 31 CREIGHTON L. REV. at 255.
As predicted, the "ebb and flow of the law's development" continued apace in 2001 when the Nebraska Unicameral passed Legislative Bill 56 ("L.B. 56") as a replacement for the principal and income legislation passed in 1980. In the same vein as the articles previously referred to, I will review and highlight the major aspects of the new legislation, particularly noting the changes from the prior Nebraska law and the manner in which L.B. 56 departs from the national model upon which it was based. Finally, the article will conclude with some of my views on the new legislation's impact on drafting and, once again, give a look to the future.

II. THE ROAD TO ENACTMENT

The principal and income act enacted by the Nebraska Unicameral in 1980 was based upon the 1962 Revised Uniform Principal and Income Act ("1962 Revised Act"), promulgated by the National Conference of Commissioners on Uniform State Laws ("NCCUSL"). In the early to mid 1990's, NCCUSL drafters were hard at work preparing a new "third generation" principal and income act. In the summer of 1997, these efforts came to fruition when NCCUSL adopted a newly revised principal and income act ("1997 Uniform Act").

During the first session of the 96th Legislature, in January 1999, Senator David Landis introduced Legislative Bill 63 ("L.B. 63"), which would have adopted the 1997 Uniform Act into Nebraska law. L.B. 63 was reported out of the Banking, Commerce and Insurance Committee and placed on general file. No significant efforts were made to move the legislation forward; the prevailing sentiment at the time (among bar leadership and the bill's introducer) was to have the bill scrutinized by interested groups and leave the bill pending. When the second session of the 96th Legislative Session adjourned sine die on May 27, 1999, L.B. 63, like other pending legislation, disappeared into legislative oblivion.

10. Id.
On January 4, 2001, Senator Landis introduced L.B. 56 on the first day of the 97th Legislature, First Session. L.B. 56, the successor to the defunct L.B. 63 of the prior legislative session, became the vehicle by which the 1997 Uniform Act became part of Nebraska law. L.B. 56 was reported out favorably by the Banking, Commerce and Insurance Committee and, after having received approval through the three rounds of legislative consideration, was signed by the Governor on April 17, 2001. Because the bill did not carry an emergency clause, the legislation went into effect on September 1, 2001. The Revisor of Statutes placed the new legislation in Article 31 of Chapter 30 of the Nebraska Revised Statutes, in a sense “replacing” the Nebraska Principal and Income Act of 1980.

III. THE NEED TO UPDATE PRINCIPAL AND INCOME LEGISLATION

David Schaengold has written of the background accompanying the drafting of the 1931 and 1962 uniform acts. According to Schaengold, the impetus for the creation of the 1931 act and the revision of 1962 were in response to demands from trustees who were “troubled about discharging their fiduciary duties faced as they were by an ever increasing number of difficult and technical problems which arose in deciding principal and income issues.” The 1962 revision followed the organization and pattern of the 1931 act, with just a few new provisions being added.

In the “Prefatory Note” to the 1997 Uniform Principal and Income Act, NCCUSL outlined the two purposes of the 1997 Act:

One purpose is to revise the 1931 and the 1962 Acts. Revision is needed to support the now widespread use of the revocable living trust as a will substitute, to change the rules in

23. Neb. Rev. Stat. §§ 30-3116 to -3149 (2001). The 2001 Cumulative Supplement to the Nebraska Revised Statutes had not been distributed as of the date this article was written. This information was taken from the Nebraska Unicameral's website. See http://www.unicam.state.ne.us. The section numbers assigned to the new act pick up where the section numbers of the now repealed act left off. That will result in the anomaly of Chapter 30, Article 31, of the Nebraska Revised Statutes beginning with §30-3116 instead of §30-3101 if the numbering system contained on the web site finds its way into the official supplement.
those Acts that experience has shown need to be changed, and to establish new rules to cover situations not provided for in the old Acts, including rules that apply to financial instruments invented since 1962.

The other purpose is to provide a means for implementing the transition to an investment regime based on principles embodied in the Uniform Prudent Investor Act, 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.27

The above quotation reveals that in the traditionally sedate world of estate planning, several revolutions had and were taking place: the "nonprobate" revolution, featuring widespread utilization of the revocable inter vivos trust; the astonishing development and growth of new types of investments; and, most critically for purposes of this article, the changed world of trustee's investment duties, based on Modern Portfolio Theory, that emphasized the "total return" concept.28 These revolutionary developments were nationwide in scope and Nebraska principal and income law was fast becoming obsolete. Most pointedly, when the Nebraska Unicameral adopted the Uniform Prudent Investor Act in 1997,29 a new world of trustee investment duties descended upon the state. To deal with the new reality of "total return" investing, trustees needed an updated principal and income act that would take into consideration not only new forms of investment but also the new "prudent investor" standard pertaining to trustees' investments. As I stated in my 1997 article, commenting upon the effect of Nebraska's adoption of the Uniform Prudent Investor Act, "A new principal and income act is the next logical step."30

The logical nexus between the Uniform Prudent Investor Act and the 1997 Principal and Income Act can be illustrated in various ways, but perhaps the most compelling fact is that Nebraska has now joined twenty-two other states and the District of Columbia in enacting the 1997 Principal and Income Act.31 What this fact illustrates is that the 1931 and 1962 uniform acts, with their concentrated focus upon the distinction between "principal" and "income," are ill suited to today's world of "total return" investing. While corporate trustees may not

28. I referred to these "revolutions" in my 1997 article as well. See Volkmer, 31 CREIGHTON L. REV. at 222 n.7.
29. NEB. REV. STAT. §§ 8-2201 to -2213 (Reissue 1997).
have been clamoring for legislation of this type, once the shift to a "total return" concept of investing occurred, the die was cast. As stated by NCCUSL, in referring to coordinating the principal and income act with the prudent investor act, "A revision is necessary so that principal and income allocation rules can function with modern trust investment practices."

While one can quibble with the precise form that the new principal and income legislation should take, it can hardly be doubted that in Nebraska the need for a new principal and income act became critical once Nebraska joined the rest of the country in accepting the Modern Portfolio Theory of Investing embodied in the Uniform Prudent Investor Act.

IV. STRUCTURE AND HIGHLIGHTS OF THE 1997 UNIFORM ACT

In this section, the structure and highlights of the 1997 Uniform Principal and Income Act will be outlined. Before doing that, however, two caveats are in order: (1) the discussion in this section will be referencing the provisions of the 1997 Uniform Act as promulgated (not considering the modifications made by the Nebraska Unicameral); and (2) the discussion herein is not intended to be an in-depth discussion of the 1997 Act. For those who are interested in a more detailed analysis of the 1997 Act's provisions, it is recommended that the reader consult other published articles or go to the NCCUSL website to obtain copies of the voluminous official "Comments" accompanying the various sections.

To give the reader some idea of the greater complexity of the 1997 Uniform Act, I might point out that the 1962 Revised Principal and Income Act had thirteen substantive sections, twelve of which found their way into Nebraska law in 1980. By contrast the 1997 Uniform

---

32. See NCCUSL, A Few Facts About the Uniform Principal and Income Act, at http://www.nccusal.org/nccusl/uniformact_factsheets/uniformacts.fs.upia.asp (last visited 1/18/02).


34. NCCUSL, at http://www.nccusal.org (last visited 1/18/02).


36. See generally Volkmer, 14 CREIGHTON L. REV. at 134-56.
Act has twenty-nine substantive sections, all of which were adopted into Nebraska law. As it turned out, there were fewer and far less significant departures by the Unicameral from the 1997 Uniform Act than in the Unicameral’s adoption of the 1962 Revised Uniform Principal and Income Act.

A. Structure of the 1997 Uniform Act

The 1997 Uniform Act is divided into six “Articles,” five of which are substantive in nature. One of the articles, Article 4, is further broken down into four “Parts.” Listed below are the various Article, Section, and Part headings from the Uniform Act; the comparable Nebraska statutory reference\(^{37}\) (if any) appears next to the section number:

**Article 1. Definitions and Fiduciary Duties**

101. (§30-3116) Short Title.
102. (§30-3117) Definitions.
103. (§30-3118) Fiduciary duties; general principles.
104. (§30-3119) Trustee’s power to adjust.

**Article 2. Decedent’s Estate or Terminating Income Interest**

201. (§30-3122) Determination and distribution of net income.
202. (§30-3123) Distribution to residuary and remainder beneficiaries.

**Article 3. Apportionment at Beginning and End of Income Interest**

301. (§30-3124) When right to income begins and ends.
302. (§30-3125) Apportionment of receipts and disbursements when decedent dies or income interest begins.
303. (§30-3126) Apportionment when income interest ends.

**Article 4. Allocation of Receipts During Administration of Trust**

Part 1. Receipts From Entities

401. (§30-3127) Character of receipts.
402. (§30-3128) Distribution from trust or estate.
403. (§30-3129) Business and other activities conducted by trustee.

Part 2. Receipts Not Normally Apportioned

404. (§30-3130) Principal receipts.
405. (§30-3131) Rental property.
406. (§30-3132) Obligation to pay money.
407. (§30-3133) Insurance policies and similar contracts.

Part 3. Receipts Normally Apportioned

408. (§30-3134) Insubstantial allocations not required.

---

\(^{37}\) See supra note 23.
Article 5. Allocation of Disbursements During Administration of Trust

501. (§30-3142) Disbursements from income.
502. (§30-3143) Disbursements from principal.
503. (§30-3144) Transfers from income to principal for depreciation.
504. (§30-3145) Transfers from income to reimburse principal.
505. (§30-3146) Income taxes.
506. (§30-3147) Adjustments between principal and income because of taxes.


601. (§30-3148) Uniformity of application and construction.
602. Severability clause.
603. Repeal.
604. Effective date.
605. (§30-3149) Application of act to existing trusts and estates.

The astute observer will note that the Nebraska adoption of the 1997 Uniform Act contains obvious omissions and (by inference) additions. The uniform act sections not adopted in Nebraska (§§ 602-604) are not worthy of comment; the additions are important and will be discussed infra.

Before examining the highlights of the 1997 Uniform Act (the new and changed rules), I would like to set the stage for that discussion by quoting from the “Prefatory Note” written by the drafters of this act. The following language from the Prefatory Note presents, from the drafters’ perspectives, the basic issues addressed by the 1997 Uniform Act:

Revision of the 1931 and 1962 Acts

The prior Acts and this revision of those Acts deal with four questions affecting the rights of beneficiaries:

(1) How is income earned during the probate of an estate to be distributed to trusts and to persons who receive outright bequests of specific property, pecuniary gifts, and the residue?
(2) When an income interest in a trust begins (i.e., when a person who creates the trust dies or when she transfers property to a trust during life), what property is principal that will eventually go to the remainder beneficiaries and what is income?

(3) When an income interest ends, who gets the income that has been received but not distributed, or that is due but not yet collected, or that has accrued but is not yet due?

(4) After an income interest begins and before it ends, how should its receipts and disbursements be allocated to or between principal and income?38

It might be noted that the issues listed above are the traditional “principal and income” issues that have been recurrent and problematic over the years. To oversimplify the matter just a bit, the problem for the fiduciary, be it personal representative or trustee, has been one of “allocating” or “apportioning” receipts in a proper manner. A glance at the Article headings for the 1997 Uniform Act illustrates this basic point. Clearly then, the over-arching goal of the drafters of the 1997 Uniform Act was to provide guidance to fiduciaries facing the above questions in a changed world of non-probate transfers, new investment vehicles, and a new standard for trustee investment (“the total return” concept). New rules and revised rules were in order and not surprisingly, a new principal and income act—the “third generation” attempt—ended up being more complex and lengthier.

B. THE “NEW” RULES OF 1997 UNIFORM ACT

In the Prefatory Note, the drafters of the 1997 Uniform Act, under the heading of “New rules,” provided the following list:

Issues addressed by some of the more significant new rules include:

(1) The application of the probate administration rules to revocable living trusts after the settlor’s death and to other terminating trusts. Articles 2 and 3.

(2) The payment of interest or some other amount on the delayed payment of an outright pecuniary gift that is made pursuant to a trust agreement instead of a will when the agreement or state law does not provide for such a payment. Section 201(3).

(3) The allocation of net income from partnership interests acquired by the trustee other than from a decedent (the old Acts deal only with partnership interests acquired from a decedent). Section 401.

(4) An “unincorporated entity” concept has been introduced to deal with businesses operated by a trustee, including farming and livestock operations, and investment activities in rental real estate, natural resources, timber, and derivatives. Section 403.

(5) The allocation of receipts from discount obligations such as zero-coupon bonds. Section 406(b).

(6) The allocation of net income from harvesting and selling timber between principal and income. Section 412.

(7) The allocation between principal and income of receipts from derivatives, options, and asset-backed securities. Sections 414 and 415.

(8) Disbursements made because of environmental laws. Section 502(a)(7).

(9) Income tax obligations resulting from the ownership of S corporation stock and interests in partnerships. Section 505.

(10) The power to make adjustments between principal and income to correct inequities caused by tax elections or peculiarities in the way the fiduciary income tax rules apply. Section 506.

The surprising aspect of the above list is that section 104, the “Trustee’s Power to Adjust,” is not mentioned. The Prefatory Note, in a section entitled “Coordination with the Uniform Prudent Investor Act,” simply states, without referencing a section of the Act, “The Act gives [the] trustee a power to reallocate the portfolio return suitably.” Section 104 might be viewed as the very heart of the act and yet it goes unmentioned by specific reference in the Prefatory Note.

C. THE “CHANGED” OR “CLARIFIED” RULES OF THE 1997 UNIFORM ACT

The Prefatory Note also lists a “number of matters provided for in the prior Acts [that] have been changed or clarified in this revision” as follows:

(1) An income beneficiary’s estate will be entitled to receive only net income actually received by a trust before the beneficiary’s death and not items of accrued income. Section 303.

(2) Income from a partnership is based on actual distributions from the partnership, in the same manner as corporate distributions. Section 401.

(3) Distributions from corporations and partnerships that exceed 20% of the entity’s gross assets will be principal whether

---

40. Id. at 133.
or not intended by the entity to be a partial liquidation. Section 401(d)(2).

(4) Deferred compensation is dealt with in greater detail in a separate section. Section 409.

(5) The 1962 Act rule for “property subject to depletion,” (patents, copyrights, royalties, and the like), which provides that a trustee may allocate up to 5% of the asset’s inventory value to income and the balance to principal, has been replaced by a rule that allocates 90% of the amounts received to principal and the balance to income. Section 410.

(6) The percentage used to allocate amounts received from oil and gas has been changed – 90% of those receipts are allocated to principal and the balance to income. Section 411.

(7) The unproductive property rule has been eliminated for trusts other than marital deduction trusts. Section 413.

(8) Charging depreciation against income is no longer mandatory, and is left to the discretion of the trustee. Section 503.41

It should be recalled that the above quotations from the Prefatory Note to the 1997 Uniform Act were written in the context of comparing the 1997 Act with the 1931 and 1962 uniform acts. Nebraska did have a version of the 1962 Act in place before the new legislation became effective, but the Nebraska version contained significant departures from the language of the 1962 Act.

The focus will now shift to analyzing Nebraska law from two differing perspectives: (1) a comparison of the 1980 Nebraska Principal and Income Act with the 1997 Uniform Act as promulgated; and (2) a comparison of the 2001 Nebraska Uniform Principal and Income Act with the 1997 Uniform Act as promulgated by NCCUSL in 1997.

V. COMPARING NEBRASKA’S NEW LAW WITH ITS PRIOR LAW

The Prefatory Note to the 1997 Uniform Act, as noted above, listed “new rules” and “clarifications and changes in existing rules.” Had Nebraska, in 1980, adopted the 1962 Revised Uniform and Principal Act without any changes, the Prefatory Note’s listing of the “new rules” and the “clarifications and changes in existing rules” would accurately summarize the major changes in Nebraska law. My 1980 law review article on the Nebraska Principal and Income Act revealed a number of significant changes in Nebraska’s adoption of the 1962 act.42 Therefore, the quotations above from the Prefatory Note as to

41. Id.
42. Volkmer, 14 CREIGHTON L. REV. at 134-56.
"new rules" and "clarifications and changes in existing rules" cannot, from the perspective of Nebraska law be taken at face value. A more detailed examination is necessary because the "new" rules, which may not in fact be "new" to Nebraska law, and the "changes and clarifications" may not be accurately descriptive when comparing the now repealed Nebraska Principal and Income Act with the newly adopted Nebraska version of the 1997 Uniform Act.

In the same vein, a closer inspection of the rules denominated above as "new" and those denominated as "clarifications and changes in existing rules" is problematic because when it comes to the "allocating/apportioning" issues, the 1962 act might not have had a specific rule, but the generic definitions of what constituted "principal" and "income" ostensibly applied. On the other hand, there are clear examples in the 1997 Uniform Act where a deliberate change was made to the rule enunciated in the 1962 Act. When it comes to the topic of "adjusting," clearly the 1997 Uniform Act truly did enunciate new rules.

A. The "New" Rules Revisited

It is only with regard to the first two "new" rules listed above that further commentary is in order in light of the pre-existing Nebraska law. The first of the "new rules" listed above stated: "The application of the probate administration rules to revocable living trusts after the settlor's death and to other terminating trusts. Articles 2 and 3."43 As noted in my 1980 law review article, the Nebraska Principal and Income Act contained a provision that, while not directly referring to revocable trusts, had the effect of extending the application of net probate income rules to revocable trusts.44 Thus the first of the listed "new" rules is not really "new" to Nebraska law.

The following language is the second of the "new rules":
The payment of interest or some other amount on the delayed payment of an outright pecuniary gift that is made pursuant to a trust agreement instead of a will when the agreement or state law does not provide for such a payment. Section 201(3).45

The Comment to section 201 states, in pertinent part:

Gift of a pecuniary amount. Section 201(3) and (4) provide different rules for an outright gift of a pecuniary amount and

43. See supra note 39 and accompanying text.
44. See Volkmer, 14 CREIGHTON L. REV. at 146.
45. See supra note 39 and accompanying text.
a gift in trust of a pecuniary amount; this is the same approach used in Section 5(b)(2) of the 1962 Act.\textsuperscript{46}

When Nebraska adopted the 1962 Revised Principal and Income Act, the Unicameral changed the language of section (b)(2) of the 1962 Act and went further in adding a subsection that had the effect of distinguishing between pecuniary gifts determined by a formula and those not determined by a formula.\textsuperscript{47} Thus, for better or worse, the old Nebraska law made distinctions not based upon trust versus non-trust, but rather on the distinction between a devisee "of a specific amount of money not determined [by] a pecuniary formula" and a devisee "of a specific amount of money" determined by a formula.\textsuperscript{48} The Nebraska Unicameral adopted section 201 of the 1997 Uniform Act without change.\textsuperscript{49} Therefore, the distinction drawn by the now repealed Act no longer pertains.

The Comment to section 201 further states:

**Interest on pecuniary amounts.** Section 201(3) provides that the beneficiary of an outright pecuniary amount is to receive the interest or other amount provided by applicable law if there is no provision in the will or the terms of the trust. Many states have no applicable law that provides for interest or some other amount to be paid on an outright pecuniary gift under an inter vivos trust; this section provides that in such case the interest or other amount to be paid shall be the same as the interest or other amount required to be paid on testamentary pecuniary gifts. This provision is intended to accord gifts under inter vivos instruments the same treatment as testamentary gifts. . . .\textsuperscript{50}

As noted above, the Nebraska Unicameral did amend section 5 of the 1962 Act in an attempt to engraft the probate income rules applicable to wills and devisees to beneficiaries of revocable trusts.\textsuperscript{51} But that is a difficult fit and the language utilized was far from crystal clear. Subsection (3) of section 201 of the 1997 Uniform Act is now part of the statutory law of Nebraska and it remains to be seen whether this language will prove problematic. I believe that interpretation of this particular provision will prove difficult as it invokes a legal fiction (treating the distribution from an inter vivos trust as if it

\textsuperscript{47} See Volkmer, 14 Creighton L. Rev. at 144-46.
\textsuperscript{48} Id. at 146.
\textsuperscript{51} Volkmer, 14 Creighton L. Rev. at 146.
were testamentary) whereas the sub silentio reference is to a legal rule based upon fact.\footnote{52}

One other note on the “new” rules as applied to distributions from income from an estate: section 202 of the 1997 Uniform Act, as stated in the Comment thereto, “changes the basis for determining [the residuary legatees’] proportionate interests by using asset values as of a date reasonably near the time of distribution instead of inventory values [as provided in Section 5(b)(2) of the 1962 Act].”\footnote{53} The Nebraska version of section 5(b)(2), in the 1980 legislation, did not use the term “inventory value,” but instead opted for “value of the property at the date of death.”\footnote{54} Although this new rule was not showcased in the above listing of new rules in the Prefatory Note, the change is noteworthy in light of a gyrating stock market.\footnote{55}

B. THE “CLARIFICATIONS AND CHANGES” IN EXISTING RULES

REVISITED

Of the listing above from the Prefatory Note as to the “clarifications and changes in existing rules,” the topics listed in categories four through eight are deserving of comment in light of what had been the statutory rules under the Nebraska Principal and Income Act.\footnote{56}

According to the Prefatory Note,

The 1962 Act rule for “property subject to depletion,” (patents, copyrights, royalties, and the like), which provides that a trustee may allocate up to 5% of the asset’s inventory value to income and the balance to principal, has been replaced by a rule that allocates 90% of the amounts received to principal and the balance to income. Section 410.\footnote{57}

The 1962 Act rule reference was to section 11, which was changed by the Nebraska Unicameral when it was enacted in 1980. Rejecting the approach of the drafters of the 1962 Revised Act, the Nebraska

\footnote{52. The language of section 201(3) (“The pecuniary amount . . . required to be paid under a will”), inferentially, under the Nebraska statutory scheme, refers to Neb. Rev. Stat. § 30-24,102 (Reissue 1995). This section, in turn, refers to a critical date: “one year after the first appointment of a personal representative until payment . . . .” In attempting to apply this rule to a distribution by a trustee of a revocable trust, the “appointment of a personal representative” language does not fit. Neb. Rev. Stat. § 30-24,102 (Reissue 1995).


55. Consider, as many must with great sorrow, the valuation of Enron stock, which, admittedly (and thankfully), is an abnormal case.


approach was to mandate a “reasonable and equitable” standard.\textsuperscript{58} As noted in the quotation, section 410 of the 1997 Uniform Act, which utilizes the term “liquidating asset,” mandates an allocation of the receipts to principal.\textsuperscript{59} In adopting this provision, Nebraska law has taken a turn away from a “mud rule” and opted for a “crystal rule.”

The Prefatory Note further states that:

The percentage used to allocate amounts received from oil and gas has been changed—90% of those receipts are allocated to principal and the balance to income. Section 411.\textsuperscript{60}

The 1962 Revised Act, in section 9, entitled “Disposition of Natural Resources,” allocated to principal as a depletion allowance, twenty-seven and one-half percent of the gross receipts, but not more than 50% of the net receipts after paying expenses.\textsuperscript{61} The 1980 Nebraska version of this section keyed the depletion allowance to the amount permitted under federal income tax law.\textsuperscript{62} Section 411 takes a different approach, as explained in the Comment, that “[a] depletion provision that is tied to past or present [Internal Revenue] Code provisions is undesirable because it causes a large portion of the oil and gas receipts to be paid out as income.”\textsuperscript{63} With the adoption of section 411 of the 1997 Uniform Act,\textsuperscript{64} Nebraska law has changed course as the link to federal tax law has been severed.

As to the topic of “unproductive property,” the Prefatory Note says that “The unproductive property rule has been eliminated for trusts other than marital deduction trusts. Section 413.”\textsuperscript{65} The 1962 Revised Act, in section 12, addressed the topic of what it labeled “underproductive property.”\textsuperscript{66} In 1980, the Nebraska Unicameral omitted this section in adopting the 1962 Revised Act.\textsuperscript{67} Thus in Nebraska, there was no rule to be “eliminated,” unless one were to refer to the substantive law relating to the trustee’s duty to make the trust property productive.\textsuperscript{68} Section 413 thus brings into Nebraska statutory law a topic not previously addressed.\textsuperscript{69}

Next is the topic of depreciation. According to the Prefatory Note, under the 1997 Uniform Act, “Charging depreciation against income is

\begin{flushleft}
\textsuperscript{58} Volkmer, 14 CREIGHTON L. REV. at 150.
\textsuperscript{62} Volkmer, 14 CREIGHTON L. REV. at 150.
\textsuperscript{64} NEB. REV. STAT. § 30-3137 (2001).
\textsuperscript{67} Volkmer, 14 CREIGHTON L. REV. at 155.
\textsuperscript{68} See generally RESTATEMENT (SECOND) TRUSTS § 181 (1959).
\textsuperscript{69} NEB. REV. STAT. § 30-3139 (2001).
\end{flushleft}
no longer mandatory, and is left to the discretion of the trustee. Section 503.\textsuperscript{70} In the 1962 Revised Act, the mandatory charge against income for depreciation was contained in section 13.\textsuperscript{71} In Nebraska's enactment of section 13, the subsection relating to depreciation was omitted and Nebraska had no statutory rule.\textsuperscript{72} Under section 503 of the 1972 Uniform Act, the drafters deferred to the trustee's discretion the decision to make a charge for depreciation and how that would be allocated.\textsuperscript{73} The Nebraska Unicameral adopted section 503 verbatim.\textsuperscript{74}

In terms of change in Nebraska law, the final topic to be considered is that of the trustee's compensation. Whereas the 1962 Revised Act allocated the trustee's "regular compensation" on equal basis between the holders of the income and principal interests,\textsuperscript{75} the Nebraska Principal and Income Act enacted in 1980 allocated all of the trustee's "regular compensation" to the income beneficiary.\textsuperscript{76} Sections 501 and 502 of the 1997 Uniform Act allocate the trustee's regular compensation equally between the holders of the income and principal beneficiaries.\textsuperscript{77} With the enactment of the 1997 Uniform Act, the Nebraska statutory rule\textsuperscript{78} as to allocation of the trustee's compensation changes fairly dramatically.

VI. THE POWER TO ADJUST

A. INTRODUCTION

As mentioned previously, in most discussions of the 1997 Uniform Act, section 104, the "Trustee's Power to Adjust," has produced the most commentary and debate.\textsuperscript{79} Given the controversial nature of section 104, it is not surprising that it received the most attention in the bill-drafting process and became the subject of numerous amendments. Some of the amendments occurred before the bill was introduced while others occurred after the bill was reported out of committee. As a result, Nebraska's version of section 104 is an eclectic mix of additions and omissions borrowed from the language found in comparable statutes enacted in California, Connecticut, and Virginia.

\textsuperscript{72} Volkmer, 14 Creighton L. Rev. at 152-53.
\textsuperscript{76} Volkmer, 14 Creighton L. Rev. at 153-54.
\textsuperscript{79} See, e.g., David Schaengold, New Principal and Income Act Being Promulgated, Tr. & Est., Dec. 1999, at 42-44; see supra note 23 and accompanying text.
B. Trustee Investment Duties

Before going into some of the particulars of the Nebraska changes to section 104, I would like to review briefly the underlying reasons why the trustee's power to adjust became a focal point in the drafting of the 1997 Uniform Act. David W. Keister and William J. McCarthy, Jr. have outlined the rationale for section 104 as follows:

The most often discussed—and debated— provision of the 1997 Act is section 104, which gives trustees a new power to make adjustments between income and principal. This new power was added to the Act, in large part, to enable the trustee to treat income and remainder beneficiaries fairly under an investment regime that conforms to the principles of modern portfolio theory and seeks total return. The power also allows a trustee to adjust income and principal where strict allocation requirements under other provisions of the Act may lead to inequitable results.

Spurred by events and reforms of recent years, modern portfolio theory has been gaining acceptance as the foundation of trust investment law. The Restatement of Trusts (Third): Prudent Investor Rule (completed in 1992) and the Uniform Prudent Investor Act (approved in 1994), which incorporate the tenets of this theory, have helped shift the focus away from the suitability of each separate investment to the modern approach of considering the portfolio as a whole.

Under the prudent investor rule, the various stocks, bonds, and other trust assets that together form the portfolio are viewed as interrelated pieces of the entire investment program. The total return (i.e., income and capital appreciation) of the whole portfolio at an appropriate risk level—instead of the isolated performance of each investment—is paramount.

The unfortunate reality is that the modern investment approach clashes with the traditional way of structuring trusts. The familiar design of a trust is to give the current beneficiary a right to the net income earned by the trust, and to give the future remainder beneficiary what is left when the income interest ends. The interests of the beneficiaries are dependent on what is considered income and what is considered principal. Under the old investment standards, where the trustee could focus on each investment in isolation, the trustee felt free to invest in "safe" vehicles that produced a reasonable flow of income, but relatively little capital appreciation. Although the total return of the overall portfolio may have suffered, the trustee was able to point to the propriety of each investment.
Now, with the shift in emphasis to the performance of the whole portfolio, there is a tension between investing for total return and meeting the traditional income and principal allocations. In periods of moderate-to-low interest rates (such as we are in now), a strategy of investing for total return may not generate income on an amount that traditionally has been accorded an income beneficiary.

For example, a large allocation of assets in low-yielding stocks or stock mutual funds in order to boost total return may skew the return away from income towards principal growth, shortchanging the income beneficiary. On the other hand, if the trustee lowers equity exposure and invests heavily in vehicles with greater income yields, the total return may be diminished.

Section 104 of the 1997 Act would give the trustee the ability to move principal to income and income to principal in order to make up insufficiencies in either resulting from investment choices made pursuant to the prudent investor rule. In the previous example, assuming the requirements of section 104 are met, the trustee could transfer principal to income to provide a reasonable current return for the income beneficiary. If no such power existed, the trustee would be torn in two directions, and would likely be forced to invest substantially in higher-yielding, lower-total-return investments in order to pay a reasonable amount to the income beneficiary.80

Recall that Nebraska adopted the Uniform Prudent Investor Act in 1997 and that the standards for prudent investment specified therein apply to "decisions or actions" of trustees occurring after September 13, 1997.81

C. CONDITIONS FOR EXERCISING THE POWER TO ADJUST

In the above quotation the authors stated that "assumining the requirements of section 104 are met," the trustee could decide to adjust. In discussing the requirements of section 104, the Comment to section 104 states:

Section 104(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 account-

81. NEB. REV. STAT. § 8-2212 (Reissue 1997).
ing income; and (3) the trustee must determine, after applying the rules in Section 103(a), that he is unable to comply with Section 103(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 104(b), but the trustee may not make an adjustment in circumstances described in Section 104(c).\textsuperscript{82}

Subsections (a), (b) and (c) are key provisions and understanding their interplay is critical. However, in considering the Nebraska version of these subsections, the reader should be aware that the Nebraska Unicameral did depart from the 1997 Uniform Act language. These changes will be detailed \textit{infra}.

D. CO-TRUSTEES; RELEASE; LIMITATIONS ON THE POWER TO ADJUST

Subsection (d) of section 104 covers the situation involving cotrustees; it was changed by the Nebraska Unicameral as was subsection (e) dealing with the topic of a trustee's release of the power to adjust. Subsection (f), relating to limitations on the power to adjust imposed by the terms of a trust, was the only subsection of section 104 that was unchanged by the Nebraska Unicameral.

E. NEBRASKA CHANGES TO SECTION 104

The Nebraska version of section 104 is Nebraska Revised Statutes section 30-3119.\textsuperscript{83} In addition to the changes adverted to above, section 30-3119 contains an additional subsection not found in section 104: "(g) Nothing in the Uniform Principal and Income Act shall give rise to liability for any exercise or failure to exercise a discretionary power under this section unless such exercise or failure to exercise constitutes an abuse of the trustee's discretion."\textsuperscript{84}

The following is a general description of the changes made by the Nebraska Unicameral to the various subsections of section 104 (\textit{Neb. Rev. Stat.} § 30-3119):

\textbf{Subsection (a):} The following language appearing in section 30-3119 was added: "and considering any power the trustee may have under the trust to invade principal or accumulate interest . . . ."\textsuperscript{85}

\textbf{Subsection (b):} The portion of the first sentence up to the colon was borrowed from Connecticut and the Uniform

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{83} \textit{Neb. Rev. Stat.} § 30-3119 (2001).
\item \textsuperscript{84} \textit{Neb. Rev. Stat.} § 30-3119.
\item \textsuperscript{85} \textit{Neb. Rev. Stat.} § 30-3119(a). This was an amendment added to the bill once it reached the floor. \textit{Neb. Leg. J.}, 97th Leg., 1st Sess. 673, 1206 (2001).
\end{itemize}
\end{footnotesize}
Principal and Income Act (1997) § 104(b). Section 30-3119 uses the verb “may,” rather than the verb “shall” as contained in the 1997 Uniform Act.

Subsection (b)(2): The language in section 30-3119 after “the intent of the settlor” was added.\(^\text{87}\)

Subsection (c): Section 30-3119 omits subsection (c)(8) of section 104.\(^\text{88}\)

Subsection (d): Section 30-3119 departs significantly from subsection (d) of section 104. Since there is no subsection (c)(8) in section 30-3119, the reference to it in subsection (d) was stricken. Section 30-3119 keeps the section 104 language after “applies,” but inserts “(i)” to indicate that an additional proviso has been added at the end:

or (ii) to the trustee and there is not more than one trustee, or to all trustees, any trustee or beneficiary may petition the court pursuant to section 30-2806 for appointment of a cotrustee to whom the provision does not apply who may make the adjustment unless the exercise of the power by the appointed trustee is not permitted by the terms of the trust.\(^\text{89}\)

Subsection (e): Once again, since there is no subsection (c)(8) in section 30-3119, the reference to it has been stricken.

VII. ADDITIONAL SECTIONS “ADDED” TO THE NEBRASKA ACT

A. INTRODUCTION

In the listing above (in section IV(A)) of the sections of the Uniform Act and the comparable Nebraska statutory provisions, the careful reader might have noted that the Nebraska statutory citations contain a gap from Nebraska Revised Statutes section 30-3119 to section 30-3122. Yet, sections 30-3120 and 30-3121 are part of the Ne-

\(^{86}\) CONN. GEN. STAT. ANN. § 45a-542c(b) (West 2001). The language of 1997 Uniform Act, section 104(b) is:

In deciding whether and to what extent to exercise the power conferred by subsection (a), a trustee shall consider all factors relevant to the trust and its beneficiaries, including the following factors to the extent they are relevant: . . .


\(^{88}\) The omitted language: “(8) if the trustee is not a beneficiary, but the adjustment would benefit the trustee directly or indirectly.” Unif. Principal & Income Act (1997) § 104(c)(8), 7B U.L.A. 143 (2000).

braska Uniform Principal and Income Act. The story of how sections 30-3120 and 30-3121 came to be a part of the Act and the content of these sections will now be recounted.


The story behind the enactment of Nebraska Revised Statutes section 30-3120 is, in essence, the story of how an additional section, section 105, was added to the 1997 Uniform Act. The text Uniform Laws Annotated, published in 2000, and the 2001 Cumulative Annual Pocket Part, in reprinting the provisions of the 1997 Uniform Principal and Income Act, do not contain a section 105. As of the time of the writing of this article the version of the 1997 Uniform Act on the NCCUSL web site does not, at first glance, reveal the existence of a new section 105.90 However, further searching on the NCCUSL web site indicates that on August 3, 2000, an amendment to the Principal and Income Act, section 105, was approved by NCCUSL.91

When Senator Landis introduced L.B. 63 in January of 1999, that bill tracked the language of the 1997 Uniform Act, as it then existed, without a section relating to judicial control of discretionary powers.92 When Senator Landis introduced L.B. 56 in January 2001, that bill added a new section, section 5, dealing with judicial control of discretionary powers.93 Section 5 of L.B. 56 embodied what later became, in August of that year, section 105 of the 1997 Uniform Act. When L.B. 56 became law, section 5 became Nebraska Revised Statutes section 30-3120,94 and that is the story of how the 1997 Uniform Act got amended and how Nebraska picked up that amendment and enacted it without change.

The official Comment to section 105 has yet to be written and the current literature discussing the 1997 Uniform Act makes no mention of it. As a matter of first impression, it would appear that Nebraska Revised Statutes section 30-3120 simply reiterates a black letter rule that has been part of fiduciary administration law for a long time. That rule, according to the Restatement (Second) Trusts, section 187, is: “Where discretion is conferred upon the trustee with respect to the

exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion."95 If one reads the Comments to section 187, one gets the distinct impression that the scope of review by a court is extremely limited and that one who has the burden of proof on this issue (which presumably would ordinarily be the person challenging the trustee’s action) has a very difficult and exacting evidentiary burden to satisfy.96

Subsections (a), (b) and (c) of section 30-3120 address the issue of post hoc review of the trustee’s decision by the court. Subsection (c) addresses the question of the appropriate remedy if the trustee is found to have abused its discretion.

Subsection (d) of section 30-3120 sets forth a procedure whereby a trustee may petition the court for instructions as to whether a proposed action by the trustee will result in an abuse of discretion:

Upon petition by the fiduciary, the court having jurisdiction over the trust or estate shall determine whether a proposed exercise or nonexercise by the fiduciary of a discretionary power conferred by the act will 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 will 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.97

Without delving into the niceties of evidence law as to the distinction between the burden of going forward with the evidence and the burden of jury persuasion, section 30-3120 is consistent in assigning the burden of proof to the person claiming abuse of discretion in situations involving both ex ante (subsection (d)) and post hoc (subsection (a)) proceedings.98 Subsection (d), which provides the trustee with a method for securing advance judicial approval of contemplated deci-


96. Perhaps the most revelatory of the Comments is Comment e (“No abuse of discretion”). The tenor of this comment is basically a “hands off” approach by the court. RESTATEMENT (SECOND) TRUSTS §187, cmt. e (1959). The tenor of the comments in the Tentative Draft to the Restatement (Third) do not seem to be very much different. RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. on Subsection (1) (Tentative Draft No. 2, 1999).

97. NEB. REV. STAT. § 30-3120(d) (2001).

sions, is not the only method by which a trustee can place the onus on the beneficiaries to object. The next section discusses that method.

C. **Notice of Proposed Action to Beneficiaries (Neb. Rev. Stat. § 30-3121)**

Legislative Bill 63, the first attempt to adopt the 1997 Uniform Act in 1999, did not contain a provision that would have allowed the trustee to give notice to beneficiaries in advance of a proposed action by the trustee to allocate or adjust. In 1999, the California legislature enacted a version of the 1997 Uniform Act that provided for such a procedure. The statutory provision providing for such a procedure in California is section 16337 of the California Probate Code. Californian's version of the 1997 Uniform Act included a version of the 1997 Uniform Act section 104—the controversial "power to adjust" provision—in Probate Code section 16336. Here is one commentary on the California procedure authorized by Probate Code section 16337:

Trustees concerned about the propriety of their adjustment decisions may wish to utilize the advance notice procedure available under the California but not Uniform Act. Probate Code § 16337. The trustee may notify the beneficiaries in advance of a proposed course of action or decision not to take action. The notice must be mailed to all adult beneficiaries receiving or eligible to receive trust income or who would be entitled to receive trust income or a distribution of principal were the trust to terminate. In addition to spelling out the trustee's plan, the notice must inform the beneficiaries of the time period in which to object and when the proposed action may be taken or is otherwise effective. In no event may the time for objection be less than 30 days from the date the notice was mailed. A trustee may proceed with the proposed action if the trustee does not receive an objection within the specified time period. Provision is also made for court review in the event an objection is made.

When L.B. 56 was introduced in 2001, section 6 of that bill mirrored the provisions of California Probate Code section 16337, with one exception. Section 6 ultimately became Nebraska Revised Statutes section 30-3121 and the heading for the section reads: "Proposed action; notice; objections." The change to this section that was made during the legislative process was in subsection (f), with the italicized portion being added:

---

A trustee is not liable to a beneficiary for an action regarding a matter governed by the act if the trustee does not receive a written objection to the proposed action from the beneficiary within the applicable period and the other requirements of this section are satisfied. If no beneficiary entitled to notice objects under this section, the provisions of section 30-3120 shall not apply and the trustee is not liable to any current or future beneficiary with respect to the proposed action.102

It is understandable that trustees (and particularly corporate trustees) would be searching for every possible legal method of insulating themselves from legal liability. In the past, trustees have attempted to enforce exculpatory clauses in trust agreements with mixed results; nonjudicial settlements of accounts have also had somewhat of a checkered history.103 To close the court house door based upon a beneficiary’s failure to object is problematic for, among other things, it is likely that the notice given will not inform the beneficiary of the consequences of failing to respond.104 The Nebraska amendment seems unnecessarily restrictive in precluding the trustee from switching gears and opting for the procedure specified in subsection (d) of Nebraska Revised Statutes section 30-3120.

VIII. DRAFTING CONSIDERATIONS

The Comment to section 103 of the 1997 Uniform Act provides the proper context in which to consider the topic of drafting:

Prior Act. The rule in Section (2)(a) of the 1962 Act is re-stated in Section 103(a), without changing its substance, to emphasize that the Act contains only default rules and that provisions in the terms of the trust are paramount. However, Section 2(a) of the 1962 Act applies only to the allocation of receipts and disbursements to or between principal and income. In this Act, the first sentence of Section 103(a) states that it also applies to matters within the scope of Articles 2 and 3. Section 103(a)(2) incorporates the rule in Section 2(b) of the 1962 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.105

103. For general discussion of these topics, see Jesse Dukeminier & Stanley Johnson, Wills, Trusts and Estates 629, 948-49 (6th ed. 2000).
104. A requirement that a beneficiary arbitrate the dispute at least preserves the right to contest the action; whether such a provision in a trust is enforceable is dubious.
The comparable section in the Nebraska statutory scheme to section 103(a) of the 1997 Uniform Act is section 30-3118(a).\textsuperscript{106} Despite a minor change in the language of section 103(a)(2),\textsuperscript{107} there is no question but that the Nebraska Uniform Principal and Income Act contains "only"\textsuperscript{108} default rules and that, indeed, the provisions of the trust are "paramount." In short, this means that the intention of the settlor, as expressed in the trust, reigns supreme as to matters covered by the Act. The drafter can effectively "trump" any or all of the Act's "rules." The language of Nebraska Revised Statute section 30-3118(a)(2) clearly contemplates and authorizes language in a trust granting to a trustee a discretionary power over allocation and apportionment decisions and it is clear that in exercising such a power the trustee receives protection unless there is an abuse of discretion by the trustee.\textsuperscript{109}

What about language in a trust that goes beyond granting discretionary authority to the trustee and purports to make such decision final and binding upon the beneficiaries? As a general rule, the Restatement (Second) Trusts has this to say:

The settlor cannot confer upon the trustee such an unlimited power that the court will not entertain a suit by the beneficiary to prevent the trustee from acting dishonestly. It is against public policy to permit the settlor to relieve the trustee of all accountability.\textsuperscript{110}

With respect to allocation issues, the Restatement (Second) Trusts has a more specific and intriguing statement as to the limits on the power of a settlor to confer discretion:

By the terms of a trust a discretionary power may be conferred on the trustee to determine questions relating to the distribution of trust property. There is no public policy that prevents the avoidance of litigation by committing the determination with finality to the trustee. Thus it may be pro-

\begin{enumerate}
\item 106. \textit{NEB. REV. STAT.} § 30-3118 (2001).
\item 107. This language was added: "and no inference that the fiduciary has abused its discretion arises solely from the fact that the fiduciary has exercised an express power given to the fiduciary by the terms of the trust or the will." \textit{NEB. REV. STAT.} § 30-3118 (2001).
\item 108. I have a problem with the word "only." Rules of construction are, in the world of the drafter, at least as important as "rules of law." Former students of mine might recall that I have had a similar problem with the manner in which the drafters of the Uniform Probate Code have similarly denominated the rules of construction in the Uniform Probate Code as "merely presumptions."
\item 109. \textit{NEB. REV. STAT.} § 30-3118 (2001) ("A fiduciary ... (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 ...") (emphasis added).
\item 110. \textit{RESTATEMENT (SECOND) TRUSTS} § 187 cmt. k (1959). As to Nebraska law, the relevant case is \textit{In re Will of Sullivan}, 144 Neb. 36, 12 N.W.2d 148 (1943).
\end{enumerate}
vided that in determining what is income and what is principal the trustee's decision shall be final.\textsuperscript{111}

As challenging and as interesting as the drafting questions are in regard to allocation and apportionment topics, I would respectfully reiterate the theme that I outlined at the end of my article discussing the Uniform Prudent Investor Rule: In the post "total return" world of trust investing, the drafter of the trust may need to consider abandoning the traditional notions of principal and income. While this topic is beyond the scope of this article I would like to leave the readers with a flavor of the type of discussion that is current in the literature:

Under certain types of governing instruments, traditional notions of principal and income need not interfere with fiduciary administration. For example, if the governing instrument confers discretion on the fiduciary to distribute either income or principal to current beneficiaries, defining principal and income is much less important. Similarly, if the governing instrument requires periodic distribution of a fixed amount (possibly subject to readjustment by formula) to current beneficiaries, rather than distribution of "all income," traditional notions of principal and income lose much of their capacity to distort investment policy.\textsuperscript{112}

IX. FUTURE TRUST LEGISLATION FOR NEBRASKA?

In January 2001, Senator Dave Landis introduced L.B. 361 at the beginning of the First Session of the Ninety-Seventh Legislature.\textsuperscript{113} L.B. 361 would enact into Nebraska law the Uniform Trust Code, a NCCUSL project that received approval in the summer of 2000.\textsuperscript{114} The Uniform Trust Code is an ambitious attempt by its drafters to "provide States with precise, comprehensive, and easily accessible guidance on trust law questions."\textsuperscript{115} One article of this Code\textsuperscript{116} deals with revocable trusts, a popular form of nonprobate transfer. Despite the fact that Nebraska has a fair amount of legislation dealing with trusts and estates, revocable trusts are basically outside the scope of all of these statutes. The enactment by the Nebraska Unicameral of

\textsuperscript{111} Restatement (Second) Trusts § 187cmt. k. The tentative draft of the Restatement Third Trusts is currently silent upon this topic.
\textsuperscript{112} Elias Clark, et al., Cases and Materials on Gratuitous Transfers 735 (4th ed. 1999).
\textsuperscript{114} See NCCUSL, NCCUSL Publications and Drafts, at http://www.nccusl.org (last visited 1/20/2002).
\textsuperscript{116} Unif. Trust Code Article 6 (2000).
the Uniform Trust Code would, I believe, be a step forward and continue the trend of Nebraska statutory law in the trust and estate area being up to date and comprehensive.\textsuperscript{117}

The very latest discussion about changes in state trust law that might be considered in the future revolves around the concept of a "total return unitrust,"\textsuperscript{118} a topic that has been addressed by some authors from the drafting standpoint.\textsuperscript{119} One commentator has written about the latest statutory proposal in the context of a "possible alternative" to the adjustment power authorized by section 104 of the 1997 Uniform Principal and Income Act. According to Judith McCue,

A possible alternative to the Section 104 adjustment power, designed to respond to the impact that investing as a "prudent investor" has had on traditional trust concepts of "principal" and "income," would be to permit a trustee to convert a trust to a unitrust. As a unitrust would provide for payment to the "income beneficiary" of a fixed percentage of the value of the assets of the trust, valued annually, allocation of receipts and disbursements between income or principal has no impact on the relative rights of the beneficiaries.\textsuperscript{120}

A recent article by Robert B. Wolf and Stephan Leimberg\textsuperscript{121} provides an overview of the first "Total Return Unitrust" ("TRU") statutes. These statutes were \emph{not} based upon a model prepared and approved by NCCUSL, so, as might be expected, these gentlemen report that these path-breaking TRU statutes are different in the details of what they permit. In general, however, it may be safely stated that these statutes generally authorize the conversion of income trusts to total return unitrusts.

Interestingly enough one of these pioneering states is Missouri, which enacted the 1997 Uniform Principal and Income Act in 2001 with section 104.\textsuperscript{122} What this suggests is that the "power to adjust"

\textsuperscript{117} For further information on the proposal to enact the Uniform Trust Code in Nebraska, see Ronald R. Volkmer, \textit{Is There a Trust Code in Your Future?}, \textit{The Nebraska Lawyer}, Oct. 2001, at 18.

\textsuperscript{118} A fairly straight-forward and easy to read introduction to total return unitrusts is contained in a recent article in the \textit{Maine Bar Journal}. See Barry L. Kohler, \textit{TRU OR FALSE—An Introduction to the Total Return Unitrust}, 16 ME. B.J. 94 (2001).


\textsuperscript{122} Mo. REV. STAT. § 469.405 (2001).
under section 104 of the 1997 Uniform Act does not go far enough in that it provides an avenue for a yearly adjustment, not a “conversion” of the trust’s distributive terms. To be very much up to date, the Nebraska Unicameral might consider adding a TRU statute. According to the Wolf and Leimberg article, tax motivated considerations “have kick started statutory reform across the country because no-forward thinking state wants its trust businesses to be at a competitive disadvantage.”123 Wolf and Leimberg conclude by prophesying that “It is likely that TRU statutes will be considered in one variety or another in many other states very soon.”124

X. CONCLUSION

It is difficult to study the topic of principal and income legislation without becoming overwhelmed with the complexity of the topic. Even starting with a fairly simply question, the topic gets complicated very quickly. To illustrate: In one recently published casebook, the authors begin the study of principal and income by asking the question “What is income?” According to these authors,

Principal and income accounting involves three differing concepts of income: (1) fiduciary or trust accounting income; (2) federal income tax accounting income; and (3) generally accepted accounting principles (GAAP) income.

In the casebook authors’ focus on fiduciary or trust accounting income, the authors note that,

These accounting concepts are determined by reference to state law, e.g., a Principal and Income Act. They determine the net amount that a trustee has available for distribution to the “income” beneficiaries (NAI), generally calculated by subtracting total trust expenditures that are charged to income from the total trust receipts that are credited to income.

For federal income tax purposes, the key concept is that of “distributable net income” (DNI). This is the fundamental tax concept of Subchapter J of the Internal Revenue Code and is used in determining whether an amount of income is ultimately taxable to distributees or to the trust. . . .

Another key concept is “generally accepted accounting principles” (GAAP). For some purposes, what is income or not for business accounting purposes may or may not be treated as having the same character for trust accounting purposes—and properly so. After all, should business purposes necessarily be the same as trust accounting purposes? Business accounting purposes do not even control for tax pur-

123. Wolf & Leimberg, 28 EST. PLAN. at 474.
124. Id. at 477.
poses—thus, the legitimate and essential maintaining of a “double set of books.” Fiduciary accounting principles, however, are for the most part honored in determining DNI.

As one gets more deeply into the topics covered by the 1997 Uniform Act—distributions of various types from assorted forms of business entities, obligations to pay money, derivatives and options, asset backed securities—one begins to realize that trustees operate in a far more complicated world than they did in 1962 and that a more complicated principal and income act was all but inevitable. One can argue endlessly about the details of legislation of this type but, in the end, decisions have to be made as to the shape of legislation. Like other uniform acts enacted by the Nebraska Unicameral in the past twenty-five years (going back to Nebraska’s enactment of the Uniform Probate Code), I believe that the Nebraska Uniform and Principal Income Act is a positive step forward. I salute those whose energy and leadership made it a reality.

It may well be that, as the current discussion on the total return unitrust might suggest, the “principal-income” distinction is becoming obsolete when it comes to drafting the distributive provisions of trusts. But existing trusts, following a historical pattern, are likely to have contained within them dispositive provisions based on the “principal-income” distinction. With the advent of the total return concept of investing ushered in by adoption of the Uniform Prudent Investor Act, Nebraska trustees need the flexibility that section 104 of the 1997 Uniform Act provides. Enactment of the Nebraska Principal and Income Act without section 104 would, in my opinion, have left Nebraska law in the position of having moved one step forward and two steps backward. While I am sensitive to the concerns of corporate trustees that they might find themselves being “second guessed” (at best) and sued (at worst) in exercising the power to adjust, I believe that more than adequate safeguards exist in the Act to provide protection before the power to adjust is exercised.

In sum, I agree with the conclusion of David W. Keister and William J. McCarthy, Jr., who declared that “Trustees operating under the new Act will be able to apply rules that in large measure bring consistency, clarity, innovation, and common sense to trust adminis-

126. Special commendations to Senator David Landis for his tireless efforts (not only in the field of trust and estate legislation, but also for his efforts in supporting mediation.) His remarkable record of public service best illustrates, to me, the folly of term limits legislation. That topic, however, I will leave for another day.
The Nebraska Principal and Income Act is not perfect, but it is an improvement over what previously existed. To the extent that provisions of the new Act prove unworkable or unwise, then, by all means, let us work in the spirit which has characterized the relationship between the bar leadership and the legislature in the past twenty-five years: inviting and listening to all interested and affected parties; working cooperatively together to address issues of common concern; and let us be willing to make compromises as appropriate.
