

Out with the Old, in with the Updated – Arkansas Adopts the Uniform Fiduciary Income and Principal Act



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Is it principal or it is income? This question has plagued trust beneficiaries, trustees, accountants, and attorneys since trusts have been used. The answer to the question is important, because the answer generally controls how much money a beneficiary will receive from the trust. It may also be the difference between whether or not a disgruntled beneficiary brings suit against a trustee.

To help answer this question, every state has a principal and income act. Most are based on the Uniform Principal and Income Act promulgated by the Uniform Law Commission. The UPIA (as it's known) was first created in 1931 (UPIA-31), and then revised in 1962 (the Revised UPIA, or RUPIA-62), and then again in 1997 (RUPIA-97). Although the RUPIA-97 was updated with minor revisions in 2000 and 2008, the RUPIA-97 was the last major update, and it is the version Arkansas currently uses and will use up to December 31, 2021.

In 2018, the Uniform Law Commission came out with a new update (and a new acronym) for the old act. It's now the Uniform Fiduciary Income and Principal Act (UFIP or UFIPA). Arkansas adopted the UFIPA during the last legislative session as Act 1088, and it will become effective January 1, 2022. Once effective, the Arkansas UFIPA will apply to all trusts and estates existing on or created after January 1, 2022.

So what changes can practitioners expect as a result of the new law? Below, we have briefly summarized a few of the key differences between current law and the recently-adopted UFIPA.

Expanded Power to Adjust for Independent Fiduciaries; No Power to Adjust for Fiduciaries Who Are Not Independent

Under current law (RUPIA-97), a fiduciary has the power to adjust between principal and income to the extent necessary, but only if the following conditions are satisfied before any adjustment is made:

1. The fiduciary invests and manages assets as a prudent investor;
2. The terms of the trust or will describe the amount that may or must be distributed to a beneficiary by referring to the trust's income; and
3. The trustee determines that he or she is unable to administer the trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries.

This power to adjust is not available to a trustee who is also a beneficiary of the trust or where the adjustment would benefit the trustee directly or indirectly.

New Ark. Code Ann. § 28-77-203(a) abandons these three threshold hurdles and gives a fiduciary the power to adjust as between income and principal “if the fiduciary determines the exercise of the power to adjust will assist the fiduciary to administer the trust or estate impartially.” This power is not exercisable, however, unless the fiduciary is an “independent person” as defined in new Ark. Code Ann. § 28-77-102(11). The definition of “independent person” loosely tracks the definition of a “related or subordinate party” from § 672 of the Internal Revenue Code but expands its scope to exclude:

- A. for a trust:
 - i. a qualified beneficiary determined under § 28-73-103(14);
 - ii. a settlor of a trust; or
 - iii. an individual whose legal obligation to support a beneficiary may be satisfied by a distribution from the trust;
- B. for an estate, a beneficiary;
- C. a spouse, parent, brother, sister, or issue of an individual described in subdivision (11)(A) or (B);
- D. a corporation, partnership, limited liability company, or other entity in which persons described in subdivisions (11)(A) through (C) of this section, in the aggregate, have voting control;[\[1\]](#) or
- E. an employee of a person described in subdivisions (11)(A), (B), (C), or (D) of this section.

According to the Uniform Law Commission’s explanation, the thinking behind this liberalization of the power to adjust was that the trend in investing continues to move away from the traditional notions of “principal” and “income” in the situation of a trust. A trust that must first require or permit a beneficiary to receive “income” in order to trigger a trustee’s ability to adjust, was seen as placing an artificial limitation on a settlor in the drafting of the trust. According to the Commission’s thinking, settlors should be able to describe what a beneficiary will receive with as much flexibility as they wish, and the trustee should still possess the power to adjust to aid in impartial administration.

Also of note under the power to adjust are new provisions of Ark. Code Ann. § 28-77-203(j) and (k). Subsection (j) allows a power to adjust to be used in more than one accounting period (i.e. across a period of years), which is a liberalization from RUPA-97. Subsection (k) requires (presumably as a check on the much-broadened power to adjust) that an exercise of a power to adjust must be communicated to the beneficiaries by the trustee.

Power to Convert to a Unitrust

New Ark. Code Ann. § 28-77-302(c) provides that “[a]n income trust . . . may be converted to a unitrust . . . regardless of the terms of the trust concerning distributions” unless the terms of the trust expressly prohibit use of this subchapter by a specific reference to this subchapter or an explicit expression of intent that net income not be calculated as a unitrust amount. An “income trust” is defined as a trust that is not a unitrust. “Unitrust” means a trust for which net income is computed by multiplying a determined value of a trust by a determined percentage.

This power to convert an income trust to a unitrust permits a fiduciary to determine the amount of the periodic payments to the income beneficiary based on a percentage of the net value of the trust assets, regardless of how much income is actually produced by the trust assets or the growth of the assets.

Judicial Review of Exercise of Discretionary Power

New Ark. Code Ann. § 28-77-202 includes new guidance regarding judicial review of a fiduciary's exercise of his or her discretionary powers that was omitted from Arkansas's versions of RUIPA-97. Pursuant to new Ark. Code Ann. § 28-77-202(b), "[t]he court may not order a fiduciary to change a fiduciary decisions unless the court determines that the fiduciary decision was an abuse of the fiduciary's discretion." Upon finding that a fiduciary decision constitutes an abuse of discretion, however, the court may order any remedy authorized by law, including, but not limited to, the following:

1. Compel the fiduciary to exercise or refrain from exercising the power to adjust;
2. Compel the fiduciary to exercise or refrain from exercising the power to convert and income trust to a unitrust;
3. Compel the fiduciary to distribute an amount to a beneficiary;
4. Compel a beneficiary to return some or all of a distribution;
5. Compel the fiduciary to withhold an amount from one or more future distributions to a beneficiary;
6. Otherwise compel the fiduciary to perform the fiduciary's duties;
7. Enjoin the fiduciary from committing an abuse of discretion;
8. Compel the fiduciary to redress an abuse of discretion by paying money, restoring property, or other means;
9. Order the fiduciary to account;
10. Appoint a special fiduciary to take possession of trust property and administer the trust;
11. Suspend the fiduciary;
12. Remove the fiduciary;
13. Reduce or deny compensation to the fiduciary; or
14. Void an act of the fiduciary, impose a lien or a constructive trust on trust property, or trace trust property wrongfully disposed of and recover the property or its proceeds.

Also of note is subsection (d) of new Ark. Code Ann. § 28-77-202, where a trustee that adequately discloses the facts in a petition for instruction to the court shifts the burden to any opposing beneficiary to prove the contemplated decision is an abuse of the fiduciary's discretion.

Conclusion

UFIPA has definitely broadened the scope of what trustees are able to do with regard to answering the question posed at the beginning of this article. But, it has also made those same trustees more accountable to beneficiaries in the exercise of their powers under UFIPA. For this reason, it is important for trustees to familiarize themselves with this new law prior to its January 1, 2022 effective date.

^[1] The authors note that the definition of "independent person," although based on § 672 of the Internal Revenue Code and, in fact, intended by the uniform drafters to be broader than § 672, is more narrow with respect to this particular subsection because it does not exclude subordinate employees of a corporation in which the settlor is an executive if the family group of excluded individuals does not also have voting control of the corporation.