POWER TO CONVERT TO UNITRUST
Under the Uniform Principal and Income Act of 1997 (NUPIA)
An Analysis of 18-A MRSA §§7-705 and 7-706

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I. INTRODUCTION

When Governor King signed into law Maine's version of the Uniform Principal and Income Act of 1997 (NUPIA) on March 22, 2002, with a unitrust option added in §7-705, Maine became the 4th state in the country to adopt legislation that gave trustees the power to convert a trust to a unitrust. Only Delaware, Missouri and New York had adopted true unitrust legislation before Maine. Since then, several other states have adopted unitrust legislation in one form or another, and it now seems likely that all states will eventually adopt some type of unitrust legislation. As of the end of May 2002, the list of other states that had adopted some version of unitrust legislation (in addition to Delaware, Missouri, New York and Maine) included Florida, Iowa, Louisiana, Maryland, New Hampshire, New Jersey, Ohio, Pennsylvania, South Dakota and Washington. Unitrust legislation was pending in Alaska, Illinois and Wisconsin. For a detailed analysis of the unitrust statutes (or "safe harbor" alternatives) adopted by the various states, see Wolf's *2002 Seminar Materials* (described in further detail below in this Section I), at pages 29-40.

At the time an *ad hoc* committee of the Maine State Bar Association's Trusts & Estate Section began looking at unitrust options for Maine, the committee didn't have many templates from which to choose. When the committee began its search of available options, the only states with unitrust legislation enacted or proposed were New York, Missouri, New Jersey, Delaware and Pennsylvania. After comparing the versions in those states, the committee chose to model Maine's unitrust legislation on Pennsylvania's then proposed legislation. Maine apparently wasn't the only state to be impressed with Pennsylvania's approach. Since Maine's enactment of NUPIA, New Hampshire and Washington have also enacted versions of Pennsylvania's unitrust legislation.

In recognition of the reality that it is always easier to edit than to create from scratch, the committee had a distinct benefit from being able to review the efforts of states that had ventured to the forefront of the unitrust debate. The committee was particularly fortunate to have the benefit of the insight of Robert B. Wolf, Esq. of Pittsburgh, who was active in the creation of the Pennsylvania legislation. Without question, Wolf has become the single most prolific and frequently cited advocate of unitrusts in the country. At the outset, I acknowledge that virtually everything I know about unitrusts comes from the many articles that Wolf has published in various legal journals over the years, particularly, *Defeating the Duty to Disappoint Equally – The Total Return Trust*, 32 Real Prop. Prob. & Tr. J. 46 (1997), *Total Return Trusts – Can Your Clients Afford Anything Less*, 33 Real Prop. Prob. & Tr. J. 131 (1998), and *Estate Planning with Total Return Trusts: Meeting Human Needs and Investment Goals Through Modern Trust Design*, 36 Real Prop. Prob. & Tr. J. 169 (2001). The culmination of those works and others by Wolf is a substantially revised, expanded and updated version of *Estate Planning with Total Return Trusts: Meeting Human Needs and Investment Goals Through Modern Trust Design*, written by Wolf in 2002 for use in the many seminars that he presents on the subject (subsequently referred to as "Wolf's *2002 Seminar Materials*"). Consistent with the generosity that Wolf displayed whenever the committee contacted him by telephone or e-mail throughout the time we were in the midst of our deliberative process, Wolf agreed to let us to reprint in full his *2002 Seminar Materials*.

I have used Wolf's *2002 Seminar Materials* throughout this piece to illustrate and explain Maine's unitrust legislation. If additional information is desired, you are likely to find it in Wolf's *2002 Seminar Materials,* or if not there, then almost certainly in one of the many references cited by Wolf in his *2002 Seminar Materials*. Wolf's explanation of Pennsylvania's unitrust legislation is equally applicable to Maine's legislation in all but a few minor respects, since Maine's legislation is a direct descendant of Pennsylvania's unitrust statute.

II. THE TOTAL RETURN UNITRUST

A. THE PROBLEM WITH TRADITIONAL TRUST DISTRIBUTION POWERS

A detailed explanation of total return unitrusts as an estate planning tool is beyond the scope of this presentation. The unitrust itself has been the subject of dozens of articles over the last several years. See, for example, footnote 11 on pages 3 and 4 of Wolf's *2002 Seminar Materials*.

As a summary however, the essence of the total return unitrust is directly tied to the recognition that the artificial distinction between investing for income versus growth of principal, as opposed to investing for total return, is frequently an unsuitable means of meeting the needs of income and remainder beneficiaries alike. This is especially true for trusts that direct the trustee to pay trust income to one or more current beneficiaries and preserve the principal for remainder beneficiaries. These trusts arise in many contexts, but probably most often in the context of a marital trust paying income to a surviving spouse for her lifetime, and then distributing the principal to children at the death of the surviving spouse. Trustees have a duty, as a matter of law, to be impartial in meeting the needs of the income beneficiary and the remaindermen. The duty of impartiality is codified in Maine's Uniform Prudent Investor Act at 18-A MRSA §7-302, which states in paragraph (f), "If a trust has 2 or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries."

One of the central tenets of the Prudent Investor Act is the diversification of the trust's investments. "A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying." 18-A MRSA §7-302(c). Diversification of investments, in turn, is the essence of modern portfolio theory, which suggests that through proper structuring of an investment portfolio, an investor is able to achieve desired investment results with controlled (*i.e.*, reduced) risk. The proper structure of an investment portfolio is diversification across a range of investments selected to match a blend of the desired investment returns and the amount of risk that is considered acceptable to achieve those returns.

The problem is that investing as a "prudent investor" may not always permit the trustee to achieve the purposes of the trust. Diversification over a broad range of investments will likely include investments in both bonds and stocks. With interest rates and dividend yields currently at or near historical lows, a beneficiary who is the recipient of all of the trust income (as defined by traditional standards) of a diversified investment portfolio, is certain to be disappointed. The Uniform Principal and Income Act, and particularly the power to adjust between principal and income, was intended to help resolve the incongruity between prudent investing and traditional trust obligations of distributing income to one class of beneficiaries and preserving principal for another class of beneficiaries. The Prefatory Note in the Uniform Comment to the Uniform Principal and Income Act includes the following explanation:

> The law of trust investment has been modernized. See Uniform Prudent Investor Act (1994); Restatement (Third) of Trusts: Prudent Investor Rule (1992) (hereinafter Restatement of Trusts 3d: Prudent Investor Rule). Now it is time to update the principal and income allocation rules so the two bodies of doctrine can work well together. This revision deals conservatively with the tension between modern investment theory and traditional income allocation. The starting point is to use the traditional system. If prudent investing of all the assets in a trust viewed as a portfolio and traditional allocation effectuate the intent of the settlor, then nothing need be done. The Act, however, helps the trustee who has made a prudent, modern portfolio-based investment decision that has the initial effect of skewing return from all the assets under management, viewed as a portfolio, as between income and principal beneficiaries. The Act gives that trustee a power to reallocate the portfolio return suitably. To leave a trustee constrained by the traditional system would inhibit the trustee's ability to fully implement modern portfolio theory.

B. THE BENEFIT OF A TOTAL RETURN UNITRUST

The addition of the power to convert to a unitrust, in §7-705, is intended to increase the trustee's ability to accomplish the purposes of the trust, without constraining the trustee's investment choices.

With the recent drop in interest rates and corporate dividends to miserly figures, it is virtually impossible for a trustee, utilizing traditional trust language that permits or requires distribution of income (and not principal) to the current beneficiaries, to satisfy the trustee's duty of impartiality. "With a thirty-year U.S. Treasury bond selling at about 5.51% and the Standard & Poor's (S&P) 500 dividend yield at 1.62% as of July 1, 2002, a trustee cannot structure a portfolio reasonably designed to produce both adequate growth and income. True impartiality will only allow a trustee to disappoint the income and remainder beneficiaries equally." Wolf's *2002 Seminar Materials*, p. 3. Traditional definitions of income limit income to interest and dividends in most trust portfolios. Under those traditional definitions, if the trustee diversifies the investment portfolio 50% to income producing assets (bonds and commercial paper) and 50% to equities, the income beneficiary will be greatly disappointed. Many of the best performing stocks of the last decade pay no dividend at all (*e.g.*, Microsoft). "With an even mix of stocks and bonds, one is currently able to generate only a net 3.20% return." See, Wolf's *2002 Seminar Materials*, p. 5. The only way to increase the distributions available to the income beneficiary under traditional trust law has been to increase the percentage of trust assets invested in bonds as opposed to stocks. At current interest rates and dividend yields, to achieve a 5% payout to the income beneficiary, a trust portfolio would need to be invested 96.15% in fixed income and 3.85% in stocks. *Id.* That investment mix is sure to create a disappointed class of remainder beneficiaries.

The solution is to permit the trustee to invest for total return, rather than requiring that the trustee concern itself with whether the dollars generated by investment come from income or from growth of principal. The generally accepted mantra is that "a dollar is a dollar" and it really shouldn't matter how the trustee generates the dollars that are needed to meet the goals of the settlor. The reality is that from the income beneficiary's standpoint, once income tax is paid, a dollar isn't a dollar and it does matter how the trustee generates the dollars that are distributed to the income beneficiary. This is especially true with long-term capital gain rates now as low as

18% (or in certain circumstances as low as 8%, depending on the type of asset sold, the holding period and the taxpayer's marginal tax rate). Therefore, with the ordering rule available with a unitrust distribution (see §7-705(f)(2) discussed below) the income beneficiary will potentially save substantial income taxes from a unitrust payment that includes long-term capital gains as part of distributable net income.

Thus, is born the concept of the total return unitrust - - freeing the trustee from the artificial bonds of income and principal, and permitting the trustee to freely diversify the trust portfolio with the goal of growing the trust property for the benefit of both the income beneficiaries and the remainder beneficiaries. The total return unitrust (TRU) "is a private non-charitable unitrust that provides a trust partnership between the current beneficiary and the remaindermen, facilitates total return investing and creates expectations in the income beneficiaries that are likely to be fulfilled. By directing the trustee to pay out a specific percentage of the trust set forth by the grantor or testator, this type of instrument removes the great difficulty in fulfilling the duty of impartiality. Trustees are able to invest in any type of asset, whether it is over-productive or under-productive of accounting income, and to make the payments as needed from those investment returns. One of the noted advantages of charitable remainder unitrusts is freedom from conflicts between the interests of beneficiaries. The trustee is not required to balance the interests of one beneficiary against the other. The trustee need only to consider the risk tolerance of the beneficiaries and the likely duration of the trust. The trustee then may invest as the trustee thinks best. Automatically, the life beneficiary profits in lock step with the remaindermen because what is good for one is good for the other." Wolf's *2002 Seminar Materials*, p. 41.

III. MAINE'S UNITRUST STATUTE - - §7-705

Following, is the text of the entire Maine unitrust statute - - §7-705. The text of the statute is in bold typeface. Explanatory comments are inserted throughout as an aid to understanding the provisions of the statute. To differentiate my own comments from Wolf's, text inserted from Wolf's *2002 Seminar Materials* is in arial font.

§7-705. Power to convert to unitrust

(a) Unless expressly prohibited by the terms of the trust, a trustee may release the power to adjust under section 7-704 and convert a trust into a unitrust as described in this section if all of the following apply:

COMMENT: A trustee cannot use the power to adjust after the trust has been converted to a unitrust. The choices are mutually exclusive; however, once the trust has converted to a unitrust, the trustee may reconvert from a unitrust, in which event the power to adjust under §7-704 is revived. See paragraph (g)(4) below.

This paragraph of the statute describes the "private" conversion process - - *i.e.*, conversion without any court involvement. If the private conversion process fails, either the trustee or a beneficiary may seek the "public" conversion process and petition the court to approve the conversion. See paragraph (b) below.

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

(2) The trustee gives written notice of the trustee's intention to release the power to adjust and to convert the trust into a unitrust and of how the unitrust will operate, including what initial decisions the trustee will make under this section, to all beneficiaries who are currently eligible to receive income from the trust and all beneficiaries who would receive, if no power of appointment were exercised, a distribution of principal if the trust were to terminate immediately prior to the giving of notice.

(3) There is at least one such beneficiary eligible to receive income and at least one such beneficiary who would receive principal as described in paragraph (2) of this subsection.

(4) No beneficiary objects to the conversion to a unitrust in a writing delivered to the trustee within 60 days of the mailing of the notice required under paragraph (2) of this subsection.

WOLF COMMENT:

(a) The Private Conversion Requirements. The private conversion process is fairly simple, once the trustee decides that the trust is not excluded for tax reasons as discussed previously [the tax reasons to which Wolf alludes are all discussed below in this outline, and include preventing the loss of a charitable deduction, see §7-705(i)(2); preventing someone from being treated as the owner of all or part of the trust for income tax purposes under the grantor trust rules, see §7-705(i)(3); preventing someone from being treated as the owner of all or part of the trust for estate tax purposes, see §7-705(i)(4); and preventing the loss of a marital deduction, see §7-705(i)(5)], and that the conversion is a good idea.

(1) Is it a good idea? The statutory phrasing for the conversion being a good idea is as follows:

> "The trustee determines that the conversion will enable the trustee to better carry out the intent of the settlor or testator and the purposes of the trust."

(2) Give Notice of Substance of Conversion Decision. Once having decided this central question, the trustee is required to give written notice that he intends to release the power to adjust and convert the trust into a unitrust. And not just that the trustee wishes to convert to a unitrust, but how the unitrust will operate, which would presumably include the unitrust rate (always 4% in a private conversion), the dates for distributions, the method and

dates used to value trust property, any assets to be excluded from the valuation computation, and any other decisions pertinent to the operating of the trust. This is important so that the beneficiary really understands the way the trust will operate if converted.

(3) [The Maine Comment, omitted from the legislation as enacted, includes the following statement in reference to the requirement that notice be given to at least one income beneficiary and one remainder beneficiary: "In the case of a minor or incapacitated beneficiary, the required notice may, as in other similar instances, be given to the beneficiary's court-appointed conservator or, in the case of an incapacitated adult, the beneficiary's attorney-in-fact acting under an appropriate durable power of attorney." In other words, the notice is not effective if it is given directly to a minor or incapacitated beneficiary. Notice should be given to the minor or incapacitated beneficiary's legal representative.]

(4) No one objects within 60 days. If no one objects within 60 days of the notice, then the conversion is complete.

A fairly simple process for conversion in most cases.

. . .

Whom to notify, and what to say in the notification. The statute reads well enough in defining the current and remainder beneficiaries. In the situation where the trust is to A for life, and then to B, the application is simple enough. But there are lots of trusts that may present a more difficult situation for application of the above notice rule. For example, if the trust is multigenerational, to Mom for life, and then to children for life and then to grandchildren outright, then if the trust were to terminate in the expected way, the grandchildren would be the remaindermen and the children would neither be current beneficiaries nor remainder beneficiaries, yet the author believes that they should receive notice. If advising a trustee, it is unlikely that there is a good reason for excluding anyone who has a vested interest in the trust, and it is likely that the statutory language may be refined to include at least those beneficiaries who would be eligible to receive distributions if those beneficiaries who are currently eligible were to die. This seems all the more compelling where the statute requires court approval.

The notification should spell out the conversion decision contemplated, and that the conversion will require the release of the power to adjust, as well as the details of the unitrust operating decisions on valuation and distribution. It should note that as required by the statute, once a conversion is accomplished the trustee must invest the trust for total return, rather than separately for income and principal. And if this author were to be drafting such a notice for a trustee, it would likely contain broad language noting that while investing for total return allows the trustee to do the best it can to invest the trust prudently, there is no guarantee that a total return strategy, or any strategy, will be effective to preserve the real or even nominal value of the trust, or to make it grow. That should be easy enough to remember in the midst of a bear market, but it should be included in the notice in this author's opinion.

The statute is short enough that it could be included in the notice to the beneficiary. Wolf, *2002 Seminar Materials*, pgs. 156-157.

(b) If a beneficiary timely objects to the conversion to a unitrust, or if the requirements of paragraph (3) of subsection (a) of this section are not met, the trustee may petition the court to approve the conversion to a unitrust. A beneficiary may request a trustee to convert to a unitrust, and if the trustee does not convert, the beneficiary may petition the court to order the conversion. In either case, a petition by the trustee or petition by a beneficiary, the court shall approve the conversion or direct the requested conversion if the court concludes that the conversion will better enable the trustee to carry out the intent of the settlor and the purposes of the trust.

COMMENT: A trustee cannot convert to a unitrust in the face of a timely objection from a beneficiary, without a court order.

Either the trustee or a beneficiary must seek judicial approval for the conversion if:

i. One of the beneficiaries objects within 60 days;

ii. There are no current beneficiaries or no remainder beneficiaries who have a legal representative who can be given notice; or

iii. A beneficiary requests a conversion and the trustee does not convert.

In addition, judicial approval is needed by petition from the trustee or a beneficiary if:

i. Either the trustee or a beneficiary wants to use a unitrust rate other than 4% (see paragraph (g)(1));

ii. Either the trustee or a beneficiary requests that net income, determined as if the trust were not a unitrust, be distributed if greater than the unitrust amount, if needed to preserve a tax benefit (see paragraph (g)(2));

iii. Either the trustee or a beneficiary wants to use a smoothing rule other than 3 years (see paragraph (g)(3)); or

iv. Either the trustee or a beneficiary wants to reconvert from a unitrust, and revive the power to adjust (see paragraph (g)(4)).

WOLF COMMENT:

Judge Drayer of the Montgomery [County] Pennsylvania Orphans' Court Division issued a preliminary memorandum to the Bar of that county as to what he might expect in a petition to convert. As one of the most highly respected Pennsylvania jurists in this field, his suggestions may be instructive, though they are obviously preliminary:

1. How and when the trust was created (a copy should be attached)
2. Facts supporting venue.
3. How funds received (gift, award by prior adjudication etc.)
4. Description of dispositive provisions of the trust.
5. Term of the trust.
6. Beneficiaries currently eligible to receive income, and those who would be eligible if current beneficiaries were to die, and those, in the absence of the exercise of any power of appointment, who would receive any principal if the trust were to terminate and distribution were to occur as of the time of the filing of the petition.
7. Current market value of the principal

8. Current accounting income and yield without the application of the power to adjust.

9. Asset allocation percentages.

10. Averments of facts in support of proposition that the conversion will enable the trustee to better carry out the purposes of the trust.

11. Copies of notices sent to beneficiaries should be attached.

12. The reason or reasons why court approval is necessary.

Wolf, *2002 Seminar Materials*, p. 159.

ADDITIONAL COMMENT: Wolf also suggests that even if a beneficiary has a legal representative (parent, court appointed conservator or attorney in fact under a power of attorney) who can be provided notice on behalf of the beneficiary, unless there is a beneficiary of the same class who is competent to receive notice directly, the trustee might be well advised to obtain court approval for the conversion. This is especially true where the beneficiary's legal representative may have a conflict of interest.

(c) In deciding whether to exercise the power conferred by subsection (a) of this section, a trustee shall consider the following factors to the extent they are relevant:

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

(2) The identity and circumstances of the beneficiaries and, to the extent reasonably known to the trustee, the needs of the beneficiaries for present and future distributions authorized or required by the terms of the trust;

(3) The needs for liquidity, regularity of income and preservation and appreciation of capital;

(4) The assets held in the trust; the extent to which they consist of financial assets, interests in closely held enterprises, tangible and intangible personal property or real property; and the extent to which an asset is used by a beneficiary;

(5) Whether and to what extent the terms of the trust give the trustee the power to invade principal or accumulate income or prohibit the trustee from invading principal or accumulating income, and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income;

(6) The actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation; and

(7) The anticipated tax consequences of the conversion.

COMMENT: The above list is extensive, but it is by no means intended to be an exclusive list of what the trustee may consider in deciding whether there is a benefit to a conversion. This list of factors will have to be considered by the trustee at the outset - - before a decision is made to give notice to the beneficiaries as provided under paragraph (a). Therefore, this paragraph (c) should be the trustee's starting point in weighing whether or not to convert to a unitrust.

All of the considerations listed in this paragraph (c) are also listed as considerations for the trustee in deciding whether to exercise the power to adjust under §7-704(b) and is similar to the list of factors to be considered by the trustee when investing and managing trust assets under the prudent investor rule. See 18-A MRSA §7-302(b)(3).

All factors will not be relevant in all trusts. All too often the trustee is left to guess as to what the settlor's intent was in creating the trust. Are distributions to be made based on need or are they to be made liberally to support a certain lifestyle? A discretionary trust, exempt from generation skipping transfer tax, for the lifetime of a high income earning child, which then distributes to grandchildren as the remaindermen, would be a poor choice to convert to a unitrust. It would be inconsistent with the tax planning purpose of a trust that is exempt from generation skipping transfer tax to make distributions to a non-skip person if the distributions aren't needed. Are there business assets, real estate and partnership interests in the trust? If so, unless there are also substantial liquid assets in the trust, conversion may require that the trustee sell the illiquid assets or distribute fractional ownership interests in the illiquid assets. Once a trust is converted to a unitrust the trustee is required to invest for total return (see paragraph (d) below), which by definition contemplates a broad range of financial investments. A trust that holds substantial business assets, real estate and partnership interests is not likely to be a trust that is invested for total return.

WOLF COMMENT:

Factors Favoring the Unitrust – Factors favoring the unitrust might include the following:

(a) Where there is a need for more income on a continuing basis than can be satisfied by the income, without the continuing exercise of discretionary distribution powers under the instrument, if available. The most obvious place where the unitrust would be the most desirable would be where the income need is significantly in excess of what can be satisfied with accounting income. If a 4% or 5% income need is anticipated for the indefinite future, the power to adjust may be the tough way to go, since it would require a virtually continuous exercise of the power, and while the statute allows the needs of the beneficiary to be taken into account, it may be easier to simply convert to a unitrust.

(b) Where the beneficiaries do not get along well. The classic case here is the second family and a QTIP trust, with remainder to the children by a first marriage. While one can use the power to adjust to address the conflict, it simply puts the trustee more directly into the conflict, rather than as a sideshow to the choice of asset allocation. In these situations, and indeed in situations where there is little conflict, but the trustee would prefer to keep it that way, the unitrust would be the best answer.

(c) Where the unitrust is more desirable as the simpler, more straightforward process. In many cases, the unitrust may just be simpler than deciding when and how to use the power to adjust, and where the trustee is more inclined to a method that everyone will understand more easily, the unitrust may be the better answer. In trusts which are not of the multi-million dollar variety, the trustee may not feel as though they have the time and resources to devote to the power to adjust.

(d) Where the unitrust will allow the trust beneficiaries to plan their finances better. One real advantage with the unitrust is that it brings with it a sense of stability and understandability greater than the power to adjust. There are those who think that the power to adjust really can't be employed until the end of an accounting period, although it is probably an unduly narrow reading of the power. The unitrust distribution will likely be used so that at the beginning of a year, the beneficiary will know her trust "salary" for the entire year. It can easily be made payable quarterly or even monthly, and this may be of significant benefit to the trust beneficiary in her financial planning. In fact, it may encourage financial maturity in the beneficiary if the beneficiary can budget a certain amount coming in at the beginning of the year, as opposed to simply asking the trustee for the exercise of its discretion, which may encourage trust dependency.

Wolf, *2002 Seminar Materials*, pgs. 155-156.

ADDITIONAL COMMENT: For factors favoring use of the power to adjust in lieu of converting to a unitrust, see Wolf, *2002 Seminar Materials*, p. 155.

(d) After a trust is converted to a unitrust, all of the following shall apply:

(1) The trustee shall follow an investment policy seeking a total return for the investments held by the trust, whether the return is to be derived from appreciation of capital, from earnings and distributions from capital, or from both;

COMMENT: This is the essence of the "total return unitrust". The trustee's investment policy shifts from a traditional one based on the distinctions between income and principal, to one that is based on total return. With long-term capital gain rates substantially lower than the top income tax rate of 39.1%, it makes economic sense for the trustee, as well as for both the current and remainder beneficiaries, to be able to seek return through long-term growth rather than from traditional income sources of income, dividends and rents.

(2) The trustee shall make regular distributions in accordance with the terms of the trust construed in accordance with the provisions of this section;

(3) The term "income" in the terms of the trust shall mean an annual distribution (the unitrust distribution) equal to 4% (the payout percentage) of the net fair market value of the trust's assets, whether such assets would be considered income or principal under other provisions of this Part, averaged over the lesser of the three preceding years, or the period during which the trust has been in existence.

COMMENT: After conversion, the income beneficiary will receive a 4% unitrust payout (unless either the trustee or a beneficiary has sought court approval for a unitrust payout other than 4% under paragraph (g)(1)). The distinction between income and principal becomes irrelevant for the purpose of making the unitrust payment.

The three year averaging is a "smoothing rule" that reduces fluctuations in the unitrust payout due to volatility of the investment markets. A substantial up or down year in the value of the trust's investments will have little effect on a unitrust distribution that is computed based upon three years of market performance.

WOLF COMMENT:

By using a three-year rolling average of market values to determine the annual payout, the trust can provide much smoother streams of distributions. . . .

While one can make an argument for the four- and five-year smoothing rules, the three-year rule gets most of the smoothing without diminishing the important partnership between the current and remainder beneficiaries and the trustee. The longer smoothing periods allow the distribution to continue to go up and down long after the market is pointing the other way. . . .

Because of these results generally favoring the selection of the three-year smoothing rule, it is used in our model document. It appears to represent the best compromise between the need for smoothness in the distributions and the need to increase or decrease distributions along with market performance quickly enough to preserve the trustee-life beneficiary-remaindermen partnership. . . .

. . . What it does on the positive side is that it takes the short-term pressure off the trustee in the event of a bad market because the three year averaging dampens the effects on the current beneficiary's cash flow stream. This is probably the most important effect, because it allows the trustee to think about the trust's asset allocation in the longer, rather than shorter, term. And this author submits that thinking longer term in asset allocation is the more productive and safer in the long run. Designing a trust that would be extremely sensitive to the changes in total return would be unwise because of its likelihood that it will engender costly short term management moves that in the longer term will work against the best interests of the trust and its beneficiaries.

Wolf, *2002 Seminar Materials*, pgs. 42-45.

(e) The trustee may in the trustee's discretion from time to time determine all of the following:

(1) The effective date of a conversion to a unitrust;

(2) The provisions for prorating a unitrust distribution for a short year in which a beneficiary's right to payment commences or ceases;

WOLF COMMENT:

Simply using the unitrust rate times the fair market value of the trust assets at the time of conversion may be an attractive alternative, particularly if the unitrust conversion occurs during a bear market such as the market at the present time. The statute requires the use of a 3-year smoothing rule, but one would expect that this discretionary power for a short year might allow the distribution to be based on the initial starting value at the time of conversion. This would have the advantage of not using historical values which are not there anymore in the trust. The smoothing rule is not as helpful at the beginning of a unitrust regimen, through conversion, where the current beneficiary's income stream is being increased anyway, though it would work well enough during a bull market period. Wolf, *2002 Seminar Materials*, p. 159.

(3) The frequency of unitrust distributions during the year;

WOLF COMMENT:

The trustee can chose whatever is most comfortable for the trustee and the beneficiaries, whether quarterly or monthly. Liquidity and cost considerations aside, monthly distributions are often favored by beneficiaries. Wolf, *2002 Seminar Materials*, p. 160

(4) The effect of other payments from or contributions to the trust on the trust's valuation.

WOLF COMMENT:

The forms set forth in these materials have adjustment language that allows the three-year smoothing apparatus to operate reasonably in light of additional contributions to the trust or material distributions. Other approaches could deal with only such contributions or distributions which are material to the calculations. Wolf, *2002 Seminar Materials*, p. 160.

(5) Whether to value the trust's assets annually or more frequently;

WOLF COMMENT:

The calculations in these materials assume an annual valuation, though rolling valuations on a quarterly basis would make the distributions smoother in theory, if less predicable. Most beneficiaries would prefer to know their income in advance for an entire year, rather than having it vary quarter to quarter. Wolf, *2002 Seminar Materials*, p. 160

(6) What valuation dates to use;

WOLF COMMENT:

We have used the end of the year or the beginning of the year as the valuation dates on the theory that it is nice to know where one stands at the beginning of the year. If the first date of conversion is one date used, and then the first date of the next year is the next date used, it accelerates obtaining multiple valuation dates for smoothing purposes. In the context of conversion, particularly in a bear market, it will help by providing reasonably current values as quickly as possible, so as not to over distribute during a down market. Wolf, *2002 Seminar Materials*, p. 160

(7) How frequently to value non-liquid assets and whether to estimate their value.

WOLF COMMENT:

If non-liquid assets are included in a unitrust, it is important to be practical in the valuation method and process. That is the reason for the reference to an estimate of value. It would be unduly burdensome to require an appraisal of real estate every year just to compute the unitrust distribution in most cases, unless the value were to be ascertained frequently for some other purpose. If there are many non-liquid assets in the trust, the unitrust may be less than ideal in any case. Wolf, *2002 Seminar Materials*, p. 160

(8) Whether to omit from the calculation of the unitrust distribution trust property occupied or possessed by a beneficiary.

WOLF COMMENT:

Where the beneficiary is able to get the use of the property as for example living in a piece of residential property, it may make the most sense to simply exclude that property from the unitrust calculation, since the use of the property may be the equivalent of the income or unitrust interest within the context of such "use" property. This could be the case with tangible personal property as well, but the variety of the circumstances led the drafters not to require a particular method, but to give the trustee discretion as to how to treat these "use" type assets. Wolf, *2002 Seminar Materials*, p. 160

(9) Any other matters necessary for the proper functioning of the unitrust.

COMMENT: Giving the trustee discretion over all of the above listed items as well as any other items that the trustee deems relevant to the functioning of the trust seems preferable to creating a statutory straightjacket.

(f) After a trust is converted to a unitrust, the following allocation rules shall apply to the trust:

(1) Expenses which would be deducted from income if the trust were not a unitrust may not be deducted from the unitrust distribution.

COMMENT: The conversion to a unitrust requires that the trustee abandon the traditional distinction between income and principal for purposes of distributions to the current beneficiary. It therefore makes sense that once the trust has been converted, the trustee should not treat the unitrust distribution as if it were traditional "income" for purposes of accounting deductions. However, conversion does not result in the trustee abandoning traditional trust accounting practices when it comes time to prepare the Form 1041, fiduciary income tax return. The same deductions that the trustee has always been entitled to deduct against income will continue to be deducted against income. Don't confuse deductions against income with deductions from the unitrust payment. Traditional deductions against income aren't lost because the trust has been converted to a unitrust. Traditional deductions are still deducted from traditional income for income tax purposes; they simply aren't deducted from the unitrust distribution.

(2) Unless otherwise provided by the terms of the trust, the unitrust distribution shall be paid from net income, as such term would be determined if the trust were not a unitrust. To the extent net income is insufficient, the unitrust distribution shall be paid from net realized short-term capital gains. To the extent income and net realized short-term capital gains are insufficient, the unitrust distribution shall be paid from net realized long-term capital gains. To the extent income and net realized short-term and long-term capital gains are insufficient, the unitrust distribution shall be paid from the principal of the trust.

COMMENT: This paragraph provides an "ordering rule" that directs how the unitrust distribution should be paid - - first from net income, second from net realized short-term capital gain, third from net realized long-term capital gain, and fourth from principal. The ordering rule is consistent with Proposed Reg §1.643(a)(3)(e), Example 9, which states:

> State law provides that a trustee may make an election to pay an income beneficiary an amount equal to four percent of the annual fair market value of the trust assets in full satisfaction of that beneficiary's right to income. State law provides that this unitrust amount shall be considered paid first

> from ordinary income, then from net short-term capital gain, then from net long-term capital gain, and finally from return of principal. Trust's governing instrument provides that A is to receive each year income as defined under State law. Trustee makes the unitrust election under State law. At the beginning of the taxable year, trust assets are valued at $500,000. During the year, Trust receives $5,000 of dividend income and realizes $80,000 of net long-term gain from the sale of capital assets. Trustee distributes to A $20,000 (4% of $500,000) in satisfaction of A's right to income. Net long-term capital gain in the amount of $15,000 is allocated to income pursuant to the State law ordering rule and is included in distributable net income for the taxable year.

The beneficiary who receives the unitrust distribution will be taxed accordingly, based on the taxable composition of the unitrust payment - - ordinary income, short-term gain, long-term gain and/or principal.

WOLF COMMENT:

Until very recently, the question of whether capital gains will be taxed to the current beneficiary as a part of distributable net income has been an open one, despite the income allocation provisions in the TRU model set forth previously in these materials. The issue is whether the IRS will treat a total return unitrust like a charitable remainder unitrust that has an ordering rule for the taxation of the trust beneficiary. A CRUT acts as a conduit for ordinary income, then short-term capital gain, then long-term capital gain, then nontaxable income and finally a nontaxable return of capital. . . . In other words, the TRU uses a pure conduit approach draining off the highest taxation progressively to the lowest, with the exception of tax free accounting income, which should come out first just like in an income rule trust. . . . The entire thrust of the TRU is to allow the trust beneficiary to participate in the benefits of both the increase in value and capital gains enjoyed by the trust. Given this background, it seems less than sensible to tax all of the capital gains to the trust. Wolf, *2002 Seminar Materials*, p. 56

(g) The trustee or, if the trustee declines to do so, a beneficiary may petition the court to do any of the following:

(1) Select a payout percentage different than 4%.

COMMENT: Wolf has done extensive computer modeling of different payout rates under different market conditions, and has factored in the effects of taxes and expenses. See, for example, pages 64 to 85 of his *2002 Seminar Materials*. His bottom line: "[T]he data and model suggest that if in designing a long-term trust the goals are to protect both the current beneficiary and the remaindermen from inflation, then 5% is probably the most the trustee can distribute and still have a reasonable chance of fulfilling these objectives. And remember this is with an all-equity portfolio, which a relatively small proportion of trustees may be able to tolerate. For most trust portfolios, a 3% or 4% distribution rate is more sensible." pgs. 81 – 82. In Wolf's Table 6, on page 82, for example, he illustrates that after 27 years a 3% unitrust payout will exceed a 6% unitrust payout, and after 38 years, the value of the trust assets remaining in a 3% unitrust are almost 3 times the value of the assets remaining in a 6% unitrust. The assumptions for his computer modeling are described on pages 64 – 66. What's the right unitrust rate? The answer depends on the settlor's intent. The longer the trust is intended to remain in existence, the lower the unitrust payout will have to be to increase the statistical odds that the trust will be able to continue to operate over a long period of time and not cannibalize itself.

WOLF COMMENT:

A 4% rate was selected because it represents a reasonable proxy for the traditional notion of "income" without tying the trustee's hands on the investment of the trust portfolio, but that is not to imply that it is best for all situations. Clearly there are situations where the need may be higher than 4%, as for example in a trust for an elderly surviving spouse, where the discretionary powers are not adequate. At the same time, the trustee of a long term GST exempt or grandfathered trust may be best advised to use a lower rate, if adequate to meet the needs of the beneficiaries. In such cases, a court petition will be required, but as long as the lower or higher rate is acceptable to all of the sui juris beneficiaries, the court should not have a hard time with the request. Obviously, though, a long term trust where a high rate such as 7 or 8% were requested might well be dangerous to all concerned, since the probabilities of maintaining the real value of the trust with that rate of payout is less sanguine. Wolf, *2002 Seminar Materials*, p. 158.

(2) Provide for a distribution of net income, as would be determined if the trust were not a unitrust, in excess of the unitrust distribution if such distribution is necessary to preserve a tax benefit.

COMMENT: It should not be necessary to petition the court for this power once the Proposed Regs become effective. Until the Proposed Regs are effective, this appears to be an issue in two circumstances:

- Trusts for which there was a gift or estate tax marital deduction. A marital trust is required to distribute all income to the spousal beneficiary for life. IRC §§2523 (e) and (f) and 2056(b)(5) and (b)(7). The problem, in the context of a marital trust that has been converted to a unitrust is this: What happens if the income earned in the trust is **more than** the unitrust distribution? Does the trust continue to qualify for the marital deduction? Proposed Reg 1.643(b)(1) makes it clear that a unitrust payment of between 3% and 5% will qualify as a distribution of all the trust income, regardless of the amount of the actual trust accounting income. But, until the Proposed Regs become effective, if the trustee intends to convert the trust to a unitrust, then in order to preserve the marital deduction, the trustee must petition the court pursuant to this paragraph for the right to distribute the greater of all income or the unitrust payment. Without petitioning the court for the right to distribute the greater of all income or the unitrust payment before the Proposed Regs become effective, the trustee will be prohibited from converting to a unitrust. See paragraph (i)(5) below and the accompanying Wolf Comment. In essence, paragraph (i)(5) is a "savings clause" that protects existing marital trusts from possible disqualification for the marital deduction between the time NUPIA becomes effective (1/1/03) and the date the Proposed Regs become effective. If the trustee were to have the power to convert the trust after NUPIA becomes effective and before the date the Proposed Regs become effective, without having court approval to distribute the greater of all income or the unitrust payment, then the spouse would no longer be entitled to all trust income. If any person other than the surviving spouse has the power to alter the terms of the trust so as to deprive her of her right to the income, then the trust fails to meet a critical element required to qualify for the marital deduction. Treas. Reg. §20.2056(b)-5(f)(7).

- Trusts that became irrevocable by September 25, 1985 and are exempt from generation skipping transfer (GST) tax. The Treasury's summary of Proposed Reg 1.643(b)-1(a) contains the following explanation:

> In general under the effective date rules accompanying the generation-skipping transfer (GST) tax statutory provisions, a trust that was irrevocable on September 25, 1985, is not subject to the GST tax provisions, unless a GST transfer is made out of corpus added to the trust after that date. . . . The regulations provide guidance on when certain changes made to the terms of an exempt trust will not be treated as causing the trust to lose its exempt or grandfathered status. One safe-harbor in section 26.2601-1(b)(4)(i)(D) is for modifications that will not shift a beneficial interest in the trust to a lower generation beneficiary or increase the amount of a GST transfer.
>
> Under the proposed regulations, the administration of a pre-September 25, 1985 trust in conformance with a state law that defines income as a unitrust amount, or permits equitable adjustments between income and principal to ensure impartiality, and that meets the requirements of section 1.643(b)-1(a) will not be treated as a modification that shifts a beneficial interest to a lower generation beneficiary, or increases the amount of a generation-skipping transfer.

In other words, assume a GST tax exempt trust requires that the trustee pay all income to settlor's children for their lifetime, and then distribute principal to the settlor's grandchildren. What is the effect of the trustee converting the trust to a unitrust if the income earned in the trust is **more than** the unitrust distribution? Similar to the way the Proposed Regs protect a gift or estate tax marital deduction, the Proposed Regs make it clear that a unitrust payment, even if it is less than all of the trust accounting income, will not be considered a shift of a beneficial interest in the trust to a lower generation beneficiary that will expose the trust to GST tax. Similar to the issues discussed above related to protection of the marital deduction, until the Proposed Regs become effective, in order to preserve the GST tax exempt status of a pre-September 25, 1985 trust that is converted to a unitrust, a trustee should petition the court for the right to distribute income, in addition to the unitrust payment, if the trust accounting income exceeds the unitrust payment. Although NUPIA contains a "savings clause" (paragraph (i)(5)) to prevent the mere existence of the power to convert from disqualifying a trust for the marital deduction, no such savings clause exists to preserve the GST tax exempt status of a pre-September 25, 1985 trust. No such savings clause is needed. Unlike a marital trust, where the mere power of a third party (*e.g.*, a trustee) to alter the terms of the trust so as to deprive the spouse/beneficiary of her right to receive all of the trust income could disqualify the trust for the marital deduction, there is only concern over a trust losing its GST exempt status if an actual modification (as opposed to the power to cause a modification) shifts a beneficial interest to a lower generation beneficiary or increases the amount of a generation-skipping transfer. Therefore, until the Proposed Regs become effective, if the trustee intends to modify (*i.e.*, convert) a pre-September 25, 1985 GST exempt trust, then in order to preserve the GST exempt status, the trustee should petition the court pursuant to this paragraph for the right to distribute the greater of all income or the unitrust payment. The trustee may still convert the trust in the absence of such a petition, but conversion without such a petition, before the Proposed Regs become effective, may cause the trust to lose its GST exempt status.

(3) Average the valuation of the trust's net assets over a period other than three years.

(4) Reconvert from a unitrust. Upon a reconversion, the power to adjust under section 7-704 shall be revived.

COMMENT: The trustee's power to adjust and the payment of a unitrust amount are mutually exclusive. A trustee may not use the power to adjust if a unitrust payout is being made. If the trustee or a beneficiary wants to have the trust reconverted from a unitrust, the reconversion must be done by court approval. Reconverting from a unitrust will automatically revive the power to adjust, assuming that the trust otherwise satisfies the criteria for a trustee to be able to use the power to adjust.

(h) A conversion to a unitrust does not affect a provision in the terms of the trust directing or authorizing the trustee to distribute principal or authorizing a beneficiary to withdraw a portion or all of the principal.

COMMENT: In other words, a unitrust payment may co-exist in tandem with (i) the trustee's discretionary power to distribute principal to the beneficiary, (ii) the trustee's obligation to distribute principal to the beneficiary for certain purposes or at certain times or ages, and (iii) the beneficiary's right to withdraw all or any part of the principal (for example, the annual power to withdraw an amount that does not exceed the greater of $5,000 or 5% of the trust assets).

(i) A trustee may not convert a trust into a unitrust if any of the following applies:

(1) Payment of the unitrust distribution would change the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets.

COMMENT: A similar restriction exists in the power to adjust. See §7-704(c)(3).

WOLF COMMENT:

Where the instrument describes what the beneficiary is to receive as a fixed annuity or a fixed fraction of the trust, the granting of the power to adjust would be a clear contravention of what the grantor had in mind, since the distributable amount was a definite sum, in the case of a fixed annuity, or what amounts to a unitrust, in the case of a fixed fraction of the trust. As a result, this situation is excluded from both the power to adjust and the power to convert to a unitrust. This is the only exclusion that is not based upon tax considerations. Wolf, *2002 Seminar Materials*, p. 152.

(2) The unitrust distribution would be made from any amount that is permanently set aside for charitable purposes under a will or the terms of the trust unless both income and principal are so set aside.

COMMENT: A similar restriction exists in the power to adjust and is based on the language of the Uniform Principal and Income Act. See §7-704(c)(4). The comment in the Uniform Act, describing this restriction with regard to the power to adjust, somewhat cryptically states that the purpose of the restriction "is to preserve tax benefits that may have been an important purpose for creating the trust." Since the restriction against conversion described in (i)(1) covers charitable remainder annuity trusts and charitable remainder unitrusts, it is difficult to know what the drafters of the Uniform Act had in mind with this restriction (to the extent they added it with regard to the power to adjust). It seems reasonable to conclude under any reading of the provision, that amounts “permanently set aside” would be amounts for which a federal gift or estate charitable deduction was taken, and that the purpose of the provision is to protect the charitable deduction.

(3) Possessing or exercising the power to convert would cause an individual to be treated as the owner of all or part of the trust for income tax purposes, and the individual would not be treated as the owner if the trustee did not possess the power to convert.

COMMENT: A similar restriction exists in the power to adjust. See §7-704(c)(5). This is presumably intended to be a safeguard in those instances in which a trustee is a beneficiary. However, in light of the blanket restriction in subparagraph (6) below of this paragraph (i), it is not clear how the existence of the power would cause someone to be treated as the owner of all or part of the trust for income tax purposes under the grantor trust rules. Paragraph (j) below permits an independent/disinterested trustee to exercise the power to convert.

(4) Possessing or exercising the power to convert would cause all or part of the trust assets to be included for estate tax purposes in the estate of an individual who has the power to remove a trustee or appoint a trustee, or both, and the assets would not be included in the estate of the individual if the trustee did not possess the power to convert.

COMMENT: A similar restriction exists in the power to adjust. See §7-704(c)(6). This is presumably intended to be a safeguard in those instances in which a trustee is a beneficiary. However, in light of the blanket restriction in subparagraph (6) below of this paragraph (i), it is not clear how the existence of the power would cause estate tax inclusion for all or part of the trust assets. Paragraph (j) below permits an independent/disinterested trustee to exercise the power to convert.

(5) The conversion would result in the disallowance of an estate tax or gift tax marital deduction which would be allowed if the trustee did not have the power to convert.

WOLF COMMENT:

This is intended to preclude a conversion to a unitrust until the Proposed Regulations are made final and in effect, unless an "income if greater" interest is included as provided in Section [7-705(g)(2)]. This is important since a power in a third party to effect a change in a marital trust which would disqualify the trust, may itself disqualify the trust for marital deduction purposes. Wolf, *2002 Seminar Materials*, p. 153.

(6) The trustee is a beneficiary of the trust.

COMMENT: A similar restriction exists in the power to adjust. See §7-704(c)(7). In addition to preventing what might be a conflict of interest, this restriction protects the trustee/beneficiary from being treated as the owner of trust assets for income tax purposes and protects against having the trust assets included in the estate of the trustee/beneficiary.

(j) If paragraph (3), (4) or (6) of subsection (i) of this section applies to a trustee and there is more than one trustee, a co-trustee to whom the provision does not apply may convert the trust unless the exercise of the power by the remaining trustee or trustees is prohibited by the terms of the trust. Terms of the trust requiring that if there are two or more trustees serving, they must act by agreement or by any majority or percentage consensus, shall not be construed to prohibit the remaining trustee or trustees from exercising the power to convert. If paragraph (3), (4) or (6) of subsection (i) of this section applies to all the trustees, the trustees may petition the court to direct a conversion.

COMMENT: A similar provision exists in the power to adjust. See §7-704(d).

WOLF COMMENT:

. . . if one of the tax problems noted above [paragraph (i)(3) or (4)] would apply to one of the trustees, but not another, then the other trustees, presumably the disinterested trustee or trustees, may exercise the power to adjust or the power to convert.

. . . If the concern is that the power may cause grantor trust status, inclusion for estate tax purposes, if the only trustee is a beneficiary, the trustee may still petition the court for conversion to a unitrust. For the power to adjust, there is no court process that will cleanse the discretionary power, and of course one would not want to go to court every time an adjustment was desirable anyway, whereas a petition for the court to decide on a unitrust conversion issue should cleanse the process from a tax point of view for the trustee, since it is the court, rather than the trustee, that is making the decision. Even without the court process, the requirement that current and remainder beneficiaries be given notice and may block the conversion without court action should provide in most situations an "adverse party" helpful for some situations, as in a Section 2041 power of appointment concern. Wolf, *2002 Seminar Materials,* p. 153.

(k) A trustee may release the power conferred by subsection (a) of this section to convert to a unitrust if the trustee is uncertain about whether possessing or exercising the power will cause a result described in paragraph (3), (4) or (5) of subsection (i) of this section, or if the trustee determines that possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax burden not described in subsection (i). The release of the power to convert to a unitrust may be permanent or for a specified period, including a period measured by the life of an individual.

COMMENT: A similar provision exists in the power to adjust. See §7-704(e).

WOLF COMMENT:

> Perhaps in an excess of caution, the drafters of the Uniform Act provided that if any of the tax problems described above would, or even might apply, then the power to adjust may be released, either permanently or for a period of time, and such a release may be only the power to adjust principal to income or income to principal. They further broadened the application not only to the tax problems feared and listed in the statute, but also any concern that the power might deprive the trust of a tax benefit or impose a tax burden. This broadening was copied in the Pennsylvania statute for the unitrust as well, so that the trustee can release either of these powers for virtually any tax concern. Wolf, *2002 Seminar Materials*, p. 153.

IV. JUDICIAL REVIEW OF DISCRETIONARY POWER

§7-706 makes it clear that all of the discretionary decisions made by a trustee with regard to the power to adjust or to convert to a unitrust are reviewable for abuse of discretion. However, a court may not find that the trustee abused its discretion merely because the court would have exercised the discretion in a different manner or would not have exercised the discretion. §7-706(a).

If the court does find that the trustee abused its discretion, the remedy is to put the parties (*i.e.*, the beneficiaries and the trust) where they would have been had the trustee not abused its discretion. The statute sets out four rules for putting the parties where they would have been:

1) If a beneficiary received too small of a distribution (or no distribution) as a result of the abuse, then the trustee is obligated to make an appropriate distribution to the beneficiary. §7-706(b)(1).

2) If a beneficiary received too large of a distribution as a result of the abuse, then the trustee is obligated to withhold an appropriate amount from future distributions to the beneficiary, or the beneficiary (or the beneficiary's estate) may be ordered to make restitution of the overpayment. The order to withhold an appropriate amount from future distributions may be made in spite of spendthrift provisions in the trust. §7-706(b)(2).
3) If the abuse concerns the power to convert to a unitrust, the court shall require the trustee to convert to a unitrust or to reconvert from a unitrust. §7-706(b)(3).
4) If the court is unable, after using the above three rules, to restore the parties to the position they would have been in but for the abuse of discretion, then the trustee may be surcharged from its own funds and ordered to make appropriate payment to one or more beneficiaries or to the trust. §7-706(b)(4).

The trustee is also permitted to file a petition for instructions with the court before exercising any discretion if the trustee wants an advance determination as to whether the proposed exercise (or non-exercise) of discretion will be considered an abuse of discretion. Assuming that the trustee's petition sets forth sufficient facts to fully inform the affected beneficiaries of the consequences of the trustee's proposed exercise (or non-exercise), a beneficiary who challenges the trustee's petition for instructions has the burden of establishing that the trustee's proposed exercise or non-exercise will be an abuse of discretion. §7-706(c).