

State of South Dakota

SEVENTY-SEVENTH SESSION
LEGISLATIVE ASSEMBLY, 2002

439H0615

SENATE BILL NO. 141

Introduced by: Senator Whiting and Representative Brown (Jarvis)

1 FOR AN ACT ENTITLED, An Act to authorize total return unitrusts.

2 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF SOUTH DAKOTA:

3 Section 1. Terms used in this Act mean:

4 (1) "Disinterested person," any person who is not a related or subordinate party, as
5 defined in section 672(c) of the Internal Revenue Code (26 U.S.C. section 1, et seq.),
6 with respect to the person then acting as trustee of the trust and excludes the trustor
7 of the trust and any interested trustee;

8 (2) "Income trust," any trust, created by either an inter vivos or a testamentary
9 instrument, which directs or permits the trustee to distribute the net income of the
10 trust to one or more persons, either in fixed proportions or in amounts or proportions
11 determined by the trustee. However, no trust that otherwise is an income trust may
12 qualify pursuant to this subdivision, if it is subject to taxation under I.R.C. section
13 2001 or section 2501, until the expiration of the period for filing the return therefor
14 (including extensions);

15 (3) "Interested distributee," any person to whom distributions of income or principal can



1 currently be made who has the power to remove the existing trustee and designate as
2 successor a person who may be a related or subordinate party, as defined in I.R.C.
3 section 672(c), with respect to such distributee;

4 (4) "Interested trustee," (i) any individual trustee to whom the net income or principal of
5 the trust can currently be distributed or would be distributed if the trust were then to
6 terminate and be distributed, or (ii) any trustee who may be removed and replaced by
7 an interested distributee, or (iii) any individual trustee whose legal obligation to
8 support a beneficiary may be satisfied by distributions of income and principal of the
9 trust, or (iv) any of the above;

10 (5) "Total return unitrust," any income trust which has been converted under and meets
11 the provisions of this Act;

12 (6) "Trustee," all persons acting as trustee of the trust, except where expressly noted
13 otherwise, whether acting in their discretion or on the direction of one or more
14 persons acting in a fiduciary capacity;

15 (7) "Trustor," any individual who created an inter vivos or a testamentary trust;

16 (8) "Unitrust amount," an amount computed as a percentage of the fair market value of
17 the trust;

18 (9) "Current valuation year," the accounting period of the trust for which the unitrust
19 amount is being determined;

20 (10) "Prior valuation year," each of the two accounting periods of the trust immediately
21 preceding the current valuation year; and

22 (11) "I.R.C.," the Internal Revenue Code (26 U.S.C. section 1, et seq.).

23 Section 2. A trustee, other than an interested trustee, or, if two or more persons are acting
24 as trustee, a majority of the trustees who are not an interested trustee (in either case hereafter

1 "trustee"), may, in its sole discretion and without the approval of any court, (i) convert an income
2 trust to a total return unitrust, (ii) reconvert a total return unitrust to an income trust, or (iii)
3 change the percentage used to calculate the unitrust amount and the method used to determine
4 the fair market value of the trust if:

5 (1) The trustee adopts a written policy for the trust providing (i) in the case of a trust
6 being administered as an income trust, that future distributions from the trust will be
7 unitrust amounts rather than net income, (ii) in the case of a trust being administered
8 as a total return unitrust, that future distributions from the trust will be net income
9 rather than unitrust amounts, or (iii) that the percentage used to calculate the unitrust
10 amount or the method used to determine the fair market value of the trust will be
11 changed as stated in the policy;

12 (2) The trustee sends written notice of its intention to take such action, along with copies
13 of such written policy and this chapter, to (i) the trustor, if living, (ii) all living persons
14 who are currently receiving or eligible to receive distributions of income of the trust,
15 (iii) all living persons who would receive principal of the trust if the trust were to
16 terminate at the time of the giving of such notice (without regard to the exercise of
17 any power of appointment) or, if the trust does not provide for its termination, all
18 living persons who would receive or be eligible to receive distributions of income or
19 principal of the trust if the persons identified in subclause (ii) of this subdivision were
20 deceased, and (iv) all persons acting as adviser or protector of the trust;

21 (3) At least one person receiving notice under each of subclauses (ii) and (iii) of
22 subdivision (2) is, to the best information and belief of the trustee, legally competent;
23 and

24 (4) No person receiving such notice objects, by written instrument delivered to the

1 trustee, to the proposed action of the trustee within sixty days of receipt of such
2 notice.

3 Section 3. If there is no trustee of the trust other than an interested trustee, the interested
4 trustee or, if two or more persons are acting as trustee and are interested trustees, a majority of
5 such interested trustees, may, in its sole discretion and without the approval of any court, take
6 such action as provided in section 2 of this Act so long as the trustee appoints a disinterested
7 person who, in its sole discretion but acting in a fiduciary capacity, determines for the trustee (i)
8 the percentage to be used to calculate the unitrust amount, (ii) the method to be used in
9 determining the fair market value of the trust, and (iii) which assets, if any, are to be excluded
10 in determining the unitrust amount; and complies with all of the provisions of subdivisions (1)
11 to (4), inclusive, of section 2 of this Act.

12 Section 4. If any trustee desires to (i) convert an income trust to a total return unitrust, (ii)
13 reconvert a total return unitrust to an income trust, or (iii) change the percentage used to
14 calculate the unitrust amount and the method used to determine the fair market value of the trust
15 but does not have the ability to or elects not to do it under the provisions of sections 2 and 3 of
16 this Act, or in the event the trustee receives a written objection within the applicable period, the
17 trustee may petition the court for such order as the trustee deems appropriate. In the event,
18 however, there is only one trustee of such trust and such trustee is an interested trustee or in the
19 event there are two or more trustees of such trust and a majority of them are interested trustees,
20 the court, in its own discretion or on the petition of such trustee or trustees or any person
21 interested in the trust, may appoint a disinterested person who, acting in a fiduciary capacity,
22 shall present such information to the court as shall be necessary to enable the court to make its
23 determination.

24 Section 5. The fair market value of the trust shall be determined at least annually, using such

1 valuation date or dates or averages of valuation dates as are deemed appropriate. Assets for
2 which a fair market value cannot be readily ascertained shall be valued using such valuation
3 methods as are deemed reasonable and appropriate. Such assets may be excluded from valuation,
4 if all income received with respect to such assets is distributed to the extent distributable in
5 accordance with the terms of the governing instrument.

6 Section 6. The unitrust amount shall be determined as follows:

7 (1) For the first three accounting periods of the trust, the unitrust amount for a current
8 valuation year of the trust shall be three percent, or such higher percentage specified
9 by the terms of the governing instrument or by the election of the trustee, the
10 disinterested person, or the court, of the net fair market value of the assets held in the
11 trust on the first business day of the current valuation year;

12 (2) Beginning with the fourth accounting period of the trust, the unitrust amount for a
13 current valuation year of the trust shall be three percent, or such higher percentage
14 specified by the terms of the governing instrument or by the election of the trustee,
15 the disinterested person, or the court, of the average of the net fair market value of
16 the assets held in the trust on the first business day of the current valuation year and
17 the net fair market value of the assets held in the trust on the first business day of each
18 prior valuation year;

19 (3) The percentage that may be elected in determining the unitrust amount shall be a
20 reasonable current return from the trust, taking into account the intentions of the
21 trustor of the trust as expressed in the governing instrument, the needs of the
22 beneficiaries, general economic conditions, projected current earnings and
23 appreciation for the trust, and projected inflation and its impact on the trust.
24 However, if such percentage is three percent or greater, or if no percentage is

1 specified, then that percentage shall be three percent;

2 (4) The unitrust amount for the current valuation year shall be proportionately reduced
3 for any distributions, in whole or in part, other than distributions of the unitrust
4 amount, and for any payments of expenses, including debts, disbursements and taxes,
5 from the trust within a current valuation year that the trustee determines to be
6 material and substantial, and shall be proportionately increased for the receipt, other
7 than a receipt that represents a return on investment, of any additional property into
8 the trust within a current valuation year;

9 (5) In the case of a short accounting period, the trustee shall prorate the unitrust amount
10 on a daily basis;

11 (6) If the net fair market value of an asset held in the trust has been incorrectly
12 determined either in a current valuation year or in a prior valuation year, the unitrust
13 amount shall be increased in the case of an undervaluation, or be decreased in the case
14 of an overvaluation, by an amount equal to the difference between the unitrust amount
15 determined based on the correct valuation of the asset and the unitrust amount
16 originally determined;

17 (7) In determining the net fair market value of the assets held in trust, the determination
18 may not include the value of any residential property or any tangible personal property
19 that, as of the first business day of the current valuation year, one or more income
20 beneficiaries of the trust have or had the right to occupy, or have or had the right to
21 possess or control, other than in a capacity as trustee, and instead the right of
22 occupancy or the right of possession or control shall be deemed to be the unitrust
23 amount with respect to the residential property or the tangible personal property; or
24 any asset specifically given to a beneficiary under the terms of the trust and the return

1 on investment on that asset, which return on investment shall be distributed to the
2 beneficiary.

3 Section 7. The unitrust amount may not be less than the net income of the trust, determined
4 without regard to the provisions of section 8 of this Act, for (i) a trust for which a marital
5 deduction has been taken for federal tax purposes under I.R.C. section 2056 or 2523 (during the
6 lifetime of the spouse for whom the trust was created), or (ii) a trust to which the generation-
7 skipping transfer tax due under I.R.C. section 2601 does not apply by reason of any effective
8 date or transition rule.

9 Section 8. Following the conversion of an income trust to a total return unitrust, the trustee:

10 (1) Shall treat the unitrust amount as if it were net income of the trust for purposes of
11 determining the amount available, from time to time, for distributions from the trust;

12 and

13 (2) May allocate to trust income for each taxable year of the trust (or portions thereof)

14 (i) net short-term capital gain described in I.R.C. section 1222(5) for such year (or
15 portion thereof) but only to the extent that the amounts so allocated together with all
16 other amounts allocate to trust income for such year (or portion thereof) does not

17 exceed the unitrust amount for such year (or portion thereof); and (ii) net long-term
18 capital gain described in I.R.C. section 1222(7) for such year (or portion thereof) but

19 only to the extent that the amount so allocated together with all other amounts,
20 including amounts described in clause (i) above, allocated to trust income for such

21 year (or portion thereof) does not exceed the unitrust amount for such year (or
22 portion thereof).

23 Section 9. In administering a total return unitrust, the trustee may, in its sole discretion but
24 subject to the provisions of the governing instrument, determine:

- 1 (1) The effective date of the conversion;
- 2 (2) The timing of distributions (including provisions for prorating a distributions for a
3 short year in which a beneficiary' right to payments commences or ceases);
- 4 (3) Whether distributions are to be made in cash or in kind or partly in cash and partly in
5 kind;
- 6 (4) If the trust is reconverted to an income trust, the effective date of such reconversion;
7 and
- 8 (5) Such other administrative issues as may be necessary or appropriate to carry out the
9 purposes of this Act.

10 Section 10. Conversion to a total return unitrust under the provisions of this Act does not
11 affect any other provisions of the governing instrument, if any, regarding distributions of
12 principal.

13 Section 11. In the case of a trust for which a marital deduction has been taken for federal tax
14 purpose under I.R.C. section 2056 or 2523, the spouse otherwise entitled to receive the net
15 income of the trust has the right, by written instrument delivered to the trustee, to compel the
16 reconversion during his or her lifetime of the trust from a total return unitrust to an income trust,
17 notwithstanding anything in this Act to the contrary.

18 Section 12. This Act shall be construed as pertaining to the administration of a trust and shall
19 be available to any trust that is administered in South Dakota under South Dakota law unless (i)
20 the governing instrument reflects an intention that the current beneficiary or beneficiaries are to
21 receive an amount other than a reasonable current return from the trust, ii) the trust is a trust
22 described in I.R.C. section 170(f)(2)(B), 6664(d), 1361(d), 2702(a)(3), or 2702(b), (iii) one or
23 more persons to whom the trustee could distribute income have a power of withdrawal over the
24 trust that is not subject to an ascertainable standard under I.R.C. section 2041 or 2514 or that

1 can be exercised to discharge a duty of support he or she possesses, or (iv) the governing
2 instrument expressly prohibits use of this Act by specific reference to the chapter. A provision
3 in the governing instrument that "The provisions of this Act, or any corresponding provision of
4 future law, may not be used in the administration of this trust" or similar words reflecting such
5 intent are sufficient to preclude use of this Act.

6 Section 13. Any trustee or disinterested person who in good faith takes or fails to take any
7 action under this Act is not liable to any person affected by such action or inaction, regardless
8 of whether such person received written notice as provided in this Act and regardless of whether
9 such person was under a legal disability at the time of the delivery of such notice. Such person's
10 exclusive remedy shall be to obtain an order of the court directing the trustee to convert an
11 income trust to a total return unitrust, to reconvert from a total return unitrust to an income trust
12 or to change the percentage used to calculate the unitrust amount.

13 Section 14. Nothing in this Act is intended to create or imply a duty to take any action under
14 this Act, and no trustee is liable for not considering whether to take any action or for choosing
15 not to take any such action.

16 Section 15. This Act is effective upon enactment and is available to trusts in existence at the
17 date of enactment or created thereafter.