Indiana Law Review

Volume 45 **2012** **Number 3**

NOTES

NET INCOME WITH MAKE-UP CHARITABLE REMAINDER UNITRUSTS AND THE TRUSTEE'S POWER TO ADJUST UNDER INDIANA'S UNIFORM PRINCIPAL AND INCOME ACT

TED R. BATSON, JR.*

INTRODUCTION

In 1997, the National Conference of Commissioners on Uniform State Laws (Commissioners) promulgated a new version of the Uniform Principal and Income Act (UPAIA 1997).[1] Indiana adopted the UPAIA 1997 as the Indiana Uniform Principal and Income Act (the Indiana Act) in 2002.[2] Both the Indiana Act and the UPAIA 1997 provide in part that "[a] trustee may adjust between principal and income to the extent the trustee considers necessary" if certain conditions are met.[3] An adjustment under this provision is commonly referred to as the trustee's "power to adjust." One of the necessary conditions to an exercise of the power to adjust is that the trust's governing instrument "describe the amount that may or must be distributed to a beneficiary by referring to the trust's income."[4] A net income with make-up charitable remainder unitrust (NIMCRUT) is a type of split-interest trust defined in the Internal Revenue Code that, by definition, requires the distribution of the trust's income subject to a unitrust

---

* J.D. Candidate, 2012, Indiana University Robert H. McKinney School of Law; M.B.A., 1990, Indiana University; B.A., 1986, Asbury University, Wilmore, Kentucky.

I am grateful to the following colleagues and friends who unselfishly gave of their time and expertise during the preparation of this Note: Professor Peter A. Prescott, Gregory W. Baker, Steven R. Bone, Emanuel J. Kallina, Jonathan D. Ackerman, David W. Newman, and Frances D. Schafer. As with most significant endeavors, I am also deeply indebted to my wife Ruth and my two daughters, Kelsey and Mackenzie.

1. UNIF. PRINCIPAL & INCOME ACT (amended 2008), 7A pt. III U.L.A. 363 (Supp. 2010), *available at* http://www.law.upenn.edu/bll/archives/ulc/upaia/2000final.pdf. Previous versions were promulgated in 1931, UNIF. PRINCIPAL & INCOME ACT, 7A pt. III U.L.A. 589 (2006), and 1962, UNIF. PRINCIPAL & INCOME ACT, REVISED 1962 ACT, 7A pt. III U.L.A. 547 (2006).

2. Uniform Principal and Income Act, Pub. L. No. 84-2002, § 2, 2002 Ind. Acts 987 (codified at IND. CODE §§ 30-2-14-0.1 to -44 (2011), *available at* http://www.in.gov/legislative/ic/code/title30/ar2/ch14.html).

3. IND. CODE § 30-2-14-15(a) (2011); UNIF. PRINCIPAL & INCOME ACT § 104(a).

4. IND. CODE § 30-2-14-15(a)(2); UNIF. PRINCIPAL & INCOME ACT § 104(a).

limitation.[5]

The trustee's power to adjust is not a power of unfettered discretion. Both the Indiana Act and the UPAIA 1997 impose limitations on a trustee's ability to exercise the power to adjust. These limitations have special implications in the context of a NIMCRUT. In addition, the Internal Revenue Code grants certain federal tax benefits to the settlor of a NIMCRUT and exempts a NIMCRUT from income tax. Similar benefits are often conferred under state law. Therefore, an Indiana NIMCRUT trustee desiring to exercise the power to adjust must be aware of the limitations imposed by the Indiana Act, and federal and state tax authorities.

Part I of this Note provides contextual background describing the NIMCRUT and the policy rationale behind the power to adjust. Part II examines the power to adjust as found in the Indiana Act, focusing on the threshold conditions for exercising the power and the internal limitations the Indiana Act places on a trustee's exercise of the power. Part III advocates an amendment to the Indiana Act to clarify the availability of the power to adjust to Indiana NIMCRUT trustees.

I. SETTING THE STAGE

A. The Net Income with Make-Up Charitable Remainder Unitrust

The term "charitable remainder trust" (CRT) is used to denote a trust arrangement that creates two distinct classes of beneficiaries: (1) income beneficiaries[6] who are generally entitled to receive an income interest for life,[7] and (2) charitable remainder beneficiaries who are entitled to receive the remainder interest upon the expiration of the income interest.[8] In 1969, Congress enacted the Tax Reform Act of 1969[9] and prescribed rules such that a properly drafted, funded, and administered CRT (a qualified CRT) provides a number of tax benefits to the creator of the trust. The NIMCRUT is a special case of the CRT that is distinguished by the manner in which the income beneficiary's right to income is defined.

1. Charitable Remainder Trusts Generally.—CRTs are defined at I.R.C. § 664 and its supporting Treasury regulations. A qualified CRT is a trust arrangement that provides for the payment of a distribution at least annually to

---

5. *See* I.R.C. § 664(d)(3) (2006).

6. *Id.* § 664(d)(1)(A) (describing a charitable remainder annuity trust); *Id.* § 664(d)(2)(A) (describing a charitable remainder unitrust).

7. The term of a charitable remainder trust may be "for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals." *Id.* §§ 664(d)(1)(A), 664(d)(2)(A).

8. *Id.* § 664(d)(1)(C) (describing a charitable remainder annuity trust); *id.* § 664(d)(2)(C) (describing a charitable remainder unitrust).

9. Tax Reform Act of 1969, Pub. L. No. 91-172, § 201(e)(1), 83 Stat. 487, 562-64 (1969), (codified as amended at I.R.C. § 664).

one or more non-charitable income beneficiaries[10] with the trust remainder irrevocably designated to, or for the use of, one or more charitable organizations described in I.R.C. § 170(c).[11] CRTs are generally classified into two categories based upon the method used to compute the required payout to the income beneficiary. In the first category, the charitable remainder *annuity trust* (CRAT), the trust pays the income beneficiary a *fixed amount* of not less than five percent (and no more than fifty percent) of the trust's initial value (the annuity amount).[12] In the second category, the charitable remainder *unitrust* (CRUT), the trust pays the income beneficiary a *fixed percentage* of not less than five percent (and no more than fifty percent) of the trust's fair market value as redetermined annually (the annual unitrust amount).[13]

In either a CRAT or a CRUT, the trustee may pay the annuity amount or the annual unitrust amount from income or principal but must pay the income beneficiary the required distribution from principal if the trust's income is insufficient.[14] Trust income in excess of the stated annuity amount or the annual unitrust amount must be added to the trust's principal.[15]

A CRT created in conformity with I.R.C. § 664 is exempt from tax[16] unless it has unrelated business taxable income.[17] A transferor to an inter vivos CRT receives an income tax charitable deduction,[18] a gift tax charitable deduction,[19] and, if applicable, an estate tax charitable deduction[20] equal to the present value

---

10. I.R.C. §§ 664(d)(1)(A), 664(d)(2)(A); *see also* Treas. Reg. § 1.664-1(a)(1)(I) (1972). The Internal Revenue Code requires that the current income beneficiary(ies) of a charitable remainder trust be "one or more persons (at least one of which is not [a charitable organization])." I.R.C. §§ 664(d)(1)(A), 664(d)(2)(A). Accordingly, charitable income beneficiaries are permitted so long as there is at least one non-charitable beneficiary.

11. I.R.C. § 664(d)(2)(C). Provision is also made for the remainder interest to remain in trust for the use of an organization described in section 170(c). *Id.*; *see also* Treas. Reg. § 1.664-1(a)(1)(I).

12. I.R.C. § 664(d)(1)(A); *see also* Treas. Reg. § 1.664-1(a)(1)(I).

13. I.R.C. § 664(d)(2)(A); *see also* Treas. Reg. § 1.664-1(a)(1)(I).

14. Rev. Rul. 72-395 § 4.01, 1972-2 C.B. 340, 342 (describing the requirement for CRATs); *id.* § 6.01 (describing the requirement for CRUTs).

15. *Id.* § 7.01 (The sample trust provision illustrated states, "Any income of the trust in excess of such payments *shall* be added to principal." (emphasis added)). *But see id.* § 6.01(2) ("Any income of the trust in excess of the unitrust amount *may, but need not*, be added to principal. Care should be taken, however, *to assure that*, under applicable local law, *such excess income is retained by the trust*." (emphasis added)).

16. I.R.C. § 664(c)(1) (providing that a CRT is exempt from income taxation); *see also* Treas. Reg. § 1.664-1(a)(1)(I).

17. I.R.C. § 664(c)(2) (imposing an excise tax of one hundred percent on a CRT's unrelated business taxable income).

18. *Id.* § 170(f)(2)(A) (2006).

19. *Id.* § 2522(c)(2)(A) (2006).

20. *Id.* § 2055(e)(2)(A) (2006). The estate tax charitable deduction is only available if the settlor retains an income interest. If the settlor names someone other than himself or herself as an

of the charitable remainder interest.[21] Similarly, a transferor to a testamentary CRT receives an estate tax charitable deduction.[22]

2. *The NIMCRUT, a Special Case*.—A NIMCRUT is a special case of a CRUT. Internal Revenue Code section 664(d)(3)(A) adds a twist to the standard CRUT definition by providing that a CRUT agreement may define the payment to the income beneficiary to be the *lesser* of the CRUT's annual unitrust amount *and* the trust's accounting income.[23] Internal Revenue Code section 664(d)(3)(B) adds a further twist by permitting the payment of trust accounting income in excess of the annual unitrust amount to the extent of any accumulated prior year deficiencies to "make-up" for those prior year shortfalls.[24] Prior year deficiencies are measured as the excess of the CRUT's annual unitrust amount over the CRUT's trust accounting income each year.[25] The combination of the trust income provision and the deficiency "make-up" provision gives rise to the name commonly associated with this type of CRUT, the *n*et *i*ncome with *m*ake-up *c*haritable *r*emainder *u*ni*t*rust, or NIMCRUT.[26] Despite the difference in payout structure between a standard CRUT and a NIMCRUT, the computation of the present value of the charitable remainder interest (i.e., the deductible amount) is exactly the same for both types of CRUT.[27]

3. *Use of NIMCRUTs in Charitable Planning*.—Donors wishing to make charitable contributions of illiquid assets in exchange for an income stream commonly use the NIMCRUT.[28] The NIMCRUT is particularly suited for this

---

income beneficiary, then there is no estate inclusion of the CRT corpus and, as a result, no charitable estate tax deduction. *See id.*

21. Treas. Reg. § 1.664-3(d) (1972); *see also* Treas. Reg. § 1.664-4(a) (1972).

22. I.R.C. § 2055(e)(2)(A).

23. "Trust accounting income" is the term used to describe that portion of a trust portfolio's total return realized in the form of interest, dividends, rents, and other statutorily defined categories. UNIF. PRINCIPAL & INCOME ACT (amended 2008) § 104 cmt., 7A pt. III U.L.A. 363 (Supp. 2010). Trust accounting income is the amount to which an income beneficiary is entitled when a trust agreement "express[es] the income beneficiary's distribution rights in terms of the right to receive 'income.'" *Id.*

24. I.R.C. § 664(d)(3)(B).

25. *Id.*

26. The make-up provision is optional. I.R.C. § 664(d)(3) ("[T]he trust instrument *may* provide that the trustee shall pay the income beneficiary for any year – . . . (B) any amount of the trust income which is in excess of [the annual unitrust amount]." (emphasis added)); *see also* Rev. Rul. 72-395 § 7.01 cmt. 1, 1972-2 C.B. 340, 350 (explaining that "[m]akeup of deficiencies [is] not required" (emphasis omitted)). In rare cases this provision is omitted and the resulting trust is typically called a "net income charitable remainder unitrust," or NICRUT.

27. *See* Rev. Rul. 72-395 § 7.01 cmt. 2, 1972-2 C.B. 340, 350 ("[N]otwithstanding the [net income limitation], the computation of the charitable deduction will be determined on the basis that the regular unitrust amount will be distributed in each taxable year of the trust.").

28. *See* B. Howard Pearson, *Charitable Remainder Trusts and Other Charitable Techniques*, *in* 30TH ANNUAL ESTATE PLANNING INSTITUTE, at 967, 976-77 (PLI Tax Law & Est. Plan., Course Handbook Series No. D-283, 1999).

type of contribution because, unlike a CRAT or a standard CRUT, a NIMCRUT is not required to make a distribution to an income beneficiary unless the trust receives trust accounting income. Thus, for example, the NIMCRUT trustee in possession of an illiquid asset, such as raw land, is not required to make a distribution until the land is sold and the proceeds are invested in an income-producing portfolio. Were this property contributed to a CRAT or a standard CRUT, the trustee would be required to make a distribution according to the distribution schedule defined in the trust agreement. Failure to make distributions when required will generally cause a charitable remainder trust to lose its tax-qualified status, potentially resulting in catastrophic results to the donor.[29]

NIMCRUTs are used much less frequently than CRATs or standard CRUTs. This is most likely because income distributions from a NIMCRUT are limited to the trust's net income instead of a more predictable (and, in many cases, larger) annuity or unitrust amount. In 2007, for example, 21,475 NIMCRUT returns were filed compared with 74,773 returns filed by standard CRUTs.[30] Based on these statistics, NIMCRUTs represented 22.3% of all charitable remainder unitrusts filing returns in 2007.[31]

4. The Intersection of Federal Income Tax Law and State Principal and Income Law.—Treasury Regulation section 1.664-3(a)(1)(i)(b)(3) states that "trust income generally means income as defined under [I.R.C. §] 643(b) and the applicable regulations."[32] Internal Revenue Code section 643(b) specifies that "the term 'income,' when not preceded by the words 'taxable,' 'distributable net,' 'undistributed net,' or 'gross,' means the amount of income of the estate or trust for the taxable year *determined under the terms of the governing instrument and applicable local law*."[33] The applicable local law in Indiana is the Indiana Act.[34]

B. The Modernization of Principal and Income Accounting: A Play in Two Acts

In administering a trust, a trustee is bound by a duty of impartiality to balance

---

29. *See, e.g.*, Estate of Atkinson v. Comm'r, 309 F.3d 1290, 1295-96 (11th Cir. 2002) (denying an estate tax charitable deduction where the trustee of a CRAT failed to make the required annual annuity payments to the income beneficiary).

30. *See* Lisa Schreiber Rosenmerkel, *Changing Times: An Analysis of the 2007 Revision of the Split-Interest Trust Information Return*, 29 I.R.S. STAT. INCOME BULL., Mar. 2010, at 130, 135, *available at* http://www.irs.gov/pub/irs-soi/10winbul.pdf. For purposes of this analysis, the number of NIMCRUT returns filed was computed as the sum of "Net Income CRUTs," 4,628, and "Net Income with makeup CRUTs," 16,847. *See id.*

31. *See id.* For purposes of this analysis, the percentage of NIMCRUT returns filed was computed by dividing the sum of "Net Income CRUTs," 4,628, and "Net Income with makeup CRUTs," 16,847, or 21,475, by the total number of returns filed, 96,248. *See id.*

32. Treas. Reg. § 1.664-3(a)(1)(i)(b)(3) (as amended in 2004).

33. I.R.C. § 643(b) (2006) (emphasis added).

34. IND. CODE § 30-2-14-14(a) (2011) ("The following applies to a fiduciary in allocating receipts and disbursements to or between principal and income . . . .").

the competing interests of various classes of trust beneficiaries.[35] In the context of principal and income accounting, these competing interests are illustrated, on the one hand, by the interest of income beneficiaries that the trust's investment portfolio be productive of income for distribution, and, on the other hand, by the interest of remainder beneficiaries in the preservation and growth of the trust's principal. To strike this balance, trustees have traditionally invested trust portfolios according to a prudence standard and allocated the resulting investment receipts and disbursements between the income account (payable to the income beneficiaries) and principal account (payable to the remainder beneficiaries at the expiration of the trust's term).[36]

In the thirty-five years between the promulgation of the Revised Uniform Principal and Income Act[37] and the promulgation of UPAIA 1997, both investment practice and scholarship about the behavior of the investment markets changed significantly.[38] The Commissioners first responded to these changes in 1994 by promulgating the Uniform Prudent Investor Act (UPIA).[39] The UPIA set aside the "prudent man rule" of *Harvard College v. Amory*[40] in favor of the "prudent investor rule" of the *Restatement (Third) of Trusts*.[41] The Commissioners followed the UPIA with the UPAIA 1997 to harmonize the adoption of the prudent investor rule in the UPIA with the rules relating to the allocation of receipts and disbursements to the income and principal accounts.[42]

1. Act 1: The Uniform Prudent Investor Act.—The UPIA modernized trust investment law in light of the widespread acceptance of modern portfolio theory.[43] Under modern portfolio theory, a trustee invests a trust's portfolio as a whole to maximize total return given an acceptable level of risk.[44] In the language of the UPIA, "[a] trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy

---

35. *See* RESTATEMENT (THIRD) OF TRUSTS § 79 (2007).

36. *See* Robert B. Wolf, *Defeating the Duty to Disappoint Equally—The Total Return Trust*, 32 REAL PROP. PROB. & TR. J. 45, 50-51 (1997).

37. UNIF. PRINCIPAL & INCOME ACT, REVISED 1962 ACT, 7A pt. III U.L.A. 547 (2006).

38. *See* UNIF. PRINCIPAL & INCOME ACT (amended 2008) prefatory n., 7A pt. III U.L.A. 363, 366-67 (Supp. 2010); UNIF. PRUDENT INVESTOR ACT, prefatory n., 7B U.L.A. 1, 3 (2006); RESTATEMENT (THIRD) OF TRUSTS, ch. 17 intro. n. (2007).

39. UNIF. PRUDENT INVESTOR ACT, 7B U.L.A. 1.

40. 26 Mass. (9 Pick.) 446, 469 (1830) ("[Trustees should] observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.").

41. RESTATEMENT (THIRD) OF TRUSTS § 90.

42. *See* UNIF. PRINCIPAL & INCOME ACT prefatory n.

43. *See* UNIF. PRUDENT INVESTOR ACT prefatory n.

44. *See* S. Alan Medlin, *Limitations on the Trustee's Power to Adjust*, 42 REAL PROP. PROB. & TR. J. 717, 719, 736 (2008).

having *risk and return objectives reasonably suited to the trust*."[45] This is distinguishable from the prior rule of *Amory*, which over time came to treat certain classes of assets as per se imprudent as well as to focus on the prudence or imprudence of the selection of individual assets in a trust's portfolio.[46]

Inherent in the UPIA's approach is the absence of any concern about the *categories* of returns generated by an investment portfolio.[47] However, under traditional notions of trust accounting income, the categories of returns generated by an investment portfolio are important because only investment returns from specific categories (e.g., interest, dividends, rents, and royalties) are considered allocable to income[48] and, therefore, payable to income beneficiaries. Similarly, absent language to the contrary in the trust agreement, capital appreciation, realized or unrealized, has been traditionally allocable to the trust principal[49] and, therefore, retained for the benefit of the trust's remainder beneficiaries. As a result, in states that adopted the UPIA, trustees were potentially placed in a bind. Those trustees were duty-bound to invest according to the modern portfolio theory principles of the UPIA.[50] At the same time, those trustees were duty-bound to impartially balance the interests of both income and remainder beneficiaries with respect to the production of income under the traditional income categories while adding to trust principal through capital appreciation. This balance was complicated by the fact that, in general, the greater the proportion of a trust portfolio invested in equity securities, the smaller the proportion of the overall expected investment return that will come from one of the traditional categories of income distributable to a trust's income beneficiaries.[51] Conversely, the greater the proportion of a portfolio invested in fixed-income securities, the smaller the proportion of the overall expected investment return that will result from capital appreciation that increases the trust's principal.[52] In other words, under the traditional model, to achieve a targeted amount of income to distribute to the trust's income beneficiaries, the trustee was necessarily required to sacrifice some overall investment return potential in order to generate returns from categories that were distributable to the trust's income beneficiaries.

This dilemma can be illustrated as follows[53]:

45. UNIF. PRUDENT INVESTOR ACT § 2(b) (emphasis added).

46. *See* RESTATEMENT (THIRD) OF TRUSTS, Ch. 17 intro. n.

47. *See* UNIF. PRINCIPAL & INCOME ACT prefatory n.; Medlin, *supra* note 44, at 719.

48. *See* UNIF. PRINCIPAL & INCOME ACT prefatory n.; Christopher P. Cline, *The Uniform Prudent Investor and Principal and Income Acts: Changing the Trust Landscape*, 42 REAL PROP. PROB. & TR. J. 611, 647 (2008).

49. *See* Cline, *supra* note 48, at 647.

50. *See, e.g.*, IND. CODE § 30-4-3.5-1(a) (2011) ("Except as otherwise provided [by the terms of the trust agreement], a trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule set forth in this chapter.").

51. *See* Wolf, *supra* note 36, at 59.

52. *See id.*

53. This example is patterned after an example found in Medlin, *supra* note 44, at 721.

Assume that for the current year, a trustee can choose between Portfolio A invested solely in the stock market (a one hundred percent equity allocation) and Portfolio B invested solely in fixed-income securities[54] (a one hundred percent fixed-income allocation). Further assume Portfolio A will earn a fifteen percent return, all in the form of unrealized capital appreciation, while Portfolio B will earn a four percent return, all in the form of interest income. Assuming (1) an initial value of $1,000,000 and (2) that all trust accounting income is distributed to the trust's income beneficiaries, then the trust's investment and distribution activity can be summarized as follows:

	Portfolio A 100% Equity	Portfolio B 100% Fixed-Income
Beginning of Year Value	$1,000,000	$1,000,000
Capital Appreciation	$150,000	$0
Trust Accounting Income	$0	$40,000
Distribution to Income Beneficiaries	$0	($40,000)
End of Year Value	$1,150,000	$1,000,000

Assuming that the returns illustrated represent the maximum possible returns for each portfolio given an equally acceptable degree of risk,[55] one can see that Portfolio A maximizes the trust's investment performance but generates no income to pay to the income beneficiaries; all of the investment return inures to the benefit of the remainder beneficiaries. But, if the trustee selects Portfolio B to generate income to distribute to the income beneficiaries, then the trustee will clearly favor the interests of the income beneficiaries over the remainder beneficiaries because the portfolio generates no growth in the trust portfolio. Thus, the trustee is placed in a position of conflict between the two classes of beneficiaries, each desiring that the trustee invest with their best interests in mind.

Trustees have traditionally managed this conflict in Solomon-like fashion by devising portfolios, composed in part of equity securities and in part of fixed-income securities, expected to generate blended returns comprised of interest, dividends, and capital appreciation. Returning to the previous example, if the trustee invested instead in Portfolio C, which invests forty percent in equity

54. Fixed-income securities, generally corporate bonds and other similar corporate debt instruments, produce fixed rates of return in the form of interest. *See* Medlin, *supra* note 44 at 719. While the rate of return from fixed-income securities is subject to adjustment for inflation, deflation, and other economic conditions, the rate of return on fixed-income securities is generally more stable than the rate of return on equity securities (e.g., corporate stocks). *See id.* at 720.

55. Because equity securities are generally more risky than fixed income securities, this assumption is unlikely to hold in a real-world investment scenario. *See* Wolf, *supra* note 36, at 52-60.

securities and sixty percent in fixed-income securities, the resulting activity can be summarized as follows[56]:

	Portfolio A 100% Equity	Portfolio B 100% Fixed-Income	Portfolio C 40% Equity/ 60% Fixed-Income
Beginning of Year Value	$1,000,000	$1,000,000	$1,000,000
Capital Appreciation	$150,000	$0	$60,000
Trust Accounting Income	$0	$40,000	$24,000
Distribution to Income Beneficiaries	$0	($40,000)	($24,000)
End of Year Value	$1,150,000	$1,000,000	$1,060,000

While Portfolio C does generate income that is distributable to the trust's income beneficiaries, it is only sixty percent of the amount they would receive under Portfolio B. Similarly, the remainder beneficiaries would receive some capital appreciation, but only forty percent of the amount they would receive under Portfolio A. One commentator has characterized this result as the trustee's duty to disappoint equally.[57]

2. *Act 2: The Uniform Principal and Income Act.*—The Commissioners' response to the potential conflict between an investment standard that is indifferent to the categories of returns generated and a trust accounting income regime principally based on categories of returns, was the introduction of an equitable power of adjustment in the UPAIA 1997. UPAIA 1997 section 104(a) states:

> A trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income, and the trustee determines, after applying the rules in Section 103(a), that the trustee is unable to comply with Section 103(b).[58]

The comments to section 104 (Comments) explicitly state that "[t]he purpose of [the power to adjust] is to enable a trustee to select investments using the standards of a prudent investor without having to realize a particular portion of

56. This example is an extension of an example found in Medlin, *supra* note 44, at 721.

57. *See* Wolf, *supra* note 36, at 72 ("All the trustee can do is to try to fulfill their duty of impartiality by disappointing income and remainder beneficiaries equally!").

58. UNIF. PRINCIPAL & INCOME ACT § 104(a) (amended 2008), 7A pt. III U.L.A. 363, 434 (Supp. 2010).

the portfolio's total return in the form of traditional trust accounting income such as interest, dividends, and rents."[59]

To guide trustees in determining whether and to what extent to exercise the power to adjust, UPAIA 1997 section 104(b) provides the following nine factors for consideration:

(1) the nature, purpose, and expected duration of the trust;
(2) the intent of the settlor;
(3) the identity and circumstances of the beneficiaries;
(4) the needs for liquidity, regularity of income, and preservation and appreciation of capital;
(5) 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; the extent to which an asset is used by a beneficiary; and whether an asset was purchased by the trustee or received from the settlor;
(6) the net amount allocated to income under the other sections of this [Act] and the increase or decrease in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available;
(7) 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;
(8) the actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation; and
(9) the anticipated tax consequences of an adjustment.[60]

The Comments state that these factors are intended to be consistent with a similar list of factors in the UPIA "so that, to the extent possible, comparable factors will apply to investment decisions and decisions involving the power to adjust."[61]

The Comments provide several examples illustrating the interplay between the trustee's investment decisions and the exercise of the power to adjust. For example, in Example 1 from the Comments, a newly appointed trustee determines that a shift in the trust's investment allocation from a portfolio invested twenty percent in stocks (i.e., equity securities) and eighty percent in bonds (i.e., fixed-income securities) to a portfolio equally weighted between the two asset classes is appropriate because this alternative portfolio "has risk and return objectives that are reasonably suited to the trust."[62] However, having made this decision, the

59. *Id.* § 104 cmt.

60. *Id.* § 104(b) (alteration in original).

61. *Id.* § 104 cmt.

62. *Id.* Note that the phrase "risk and return objectives that are reasonably suited to the trust" is from section 2(b) of the UPIA. UNIF. PRUDENT INVESTOR ACT § 2(b).

trustee also determines that this new portfolio allocation will result in the receipt of less dividend and interest income.[63] After considering the factors listed in UPAIA 1997 section 104(b), the "[trustee] may transfer cash from principal to income to the extent [the trustee] considers it necessary to increase the amount distributed to the income beneficiary."[64]

II. INDIANA'S POWER TO ADJUST

The power to adjust is codified in the Indiana Act as follows:

> (a) A trustee may adjust between principal and income to the extent the trustee considers necessary if:
> (1) the trustee invests and manages trust assets as a prudent investor;
> (2) the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income; and
> (3) the trustee determines:
> (A) after applying the rules in section 14(a) of this chapter; and
> (B) considering any power the trustee may have under the trust or the will to invade principal or accumulate income;
> that the trustee is unable to comply with section 14(b) of this chapter.[65]

As adopted, Indiana's power to adjust statute is substantially the same as UPAIA 1997 section 104. The only substantive change was the insertion of the phrase "considering any power the trustee may have under the trust or the will to invade principal or accumulate income" in Indiana Code section 30-2-14-15(a)(3).[66] This phrase does not substantively alter the meaning of the power to adjust as embodied in the UPAIA 1997, but rather serves to highlight the requirement that the trustee first administer a trust according to its terms as required by Indiana Code section 30-2-14-14(a)(1).

Under the Indiana Act, a number of threshold conditions must be satisfied prior to an exercise of the power to adjust.[67] These threshold conditions can be divided into those that are external to the power to adjust (embodied in the references to section 14(a) and section 14(b) in the text of the statute) and those that are internal to the power to adjust's statutory text. Assuming the threshold conditions are met, the trustee must then determine whether any of the statutory prohibitions limiting the exercise of the power to adjust found in Indiana Code section 30-2-14-15(c) are applicable. If, after reviewing the prohibitions on the exercise of the power to adjust found in Indiana Code section 30-2-14-15(c), the trustee is still not prevented from pursuing the power to adjust, then the trustee

63. *See* UNIF. PRINCIPAL & INCOME ACT § 104 cmt.
64. *Id*.
65. IND. CODE § 30-2-14-15(a) (2011).
66. *Id.* § 30-2-14-15(a)(3).
67. *See* Medlin, *supra* note 44, at 726-36 (discussing these threshold conditions in the context of the UPAIA 1997).

should assess the factors found at Indiana Code section 30-2-14-15(b)[68] to determine whether and to what extent to exercise the power to adjust.

A. External Threshold Conditions

As an initial matter, a trustee *must* administer a trust according to the terms of the trust agreement, even if an applicable trust provision differs from the Indiana Act.[69] The Comments[70] explain that this rule "emphasize[s] . . . that provisions in the terms of the trust are paramount"; the UPAIA 1997 is a set of default rules that only have effect when the document is silent.[71] Second, a trustee *may* exercise any discretionary powers of administration given the trustee under the terms of the trust agreement.[72] Third, a trustee *must* administer the trust in accordance with the applicable principal and income act in matters that are not addressed in the trust agreement or covered by a discretionary power of administration granted the trustee by the terms of the trust agreement.[73] Finally, "[i]n exercising the power to adjust . . . a fiduciary shall administer a trust . . . impartially . . . ."[74] The Comments describe this requirement of impartiality as the "paramount consideration in applying [the power to adjust]."[75]

In sum, before a trustee considers the appropriateness of an exercise of the power to adjust, the trustee must first administer the trust using all principal and income rules contained in the trust agreement and all the discretionary and non-discretionary powers granted to the trustee under the terms of the trust agreement. Next, the trustee must apply all of the provisions of the Indiana Act *other than the power to adjust*. Having taken into account powers granted by the trust agreement and having applied the Indiana Act, the trustee must then determine whether the trustee has impartially administered the trust as between the income and remainder beneficiaries before proceeding to the power to adjust. If, in the trustee's assessment, the trustee has impartially administered the trust as between

---

68. The list of factors in IND. CODE § 30-2-14-15(b) corresponds to the list of factors found at UNIF. PRINCIPAL & INCOME ACT § 104(b). *See supra* note 60 and accompanying text.

69. IND. CODE § 30-2-14-14(a)(1) (2011).

70. Indiana did not create its own explanatory comments when it enacted the Indiana Act. However, where a statute is based on a uniform act, "[t]he comments to [the] uniform act are indicative of the Legislature's intent." Basileh v. Alghusain, 912 N.E.2d 814, 821 (Ind. 2009) (addressing the Uniform Interstate Family Support Act).

71. UNIF. PRINCIPAL & INCOME ACT § 103 cmt.

72. IND. CODE § 30-2-14-14(a)(2).

73. *Id.* § 30-2-14-14(a)(3).

74. *Id.* § 30-2-14-14(b).

75. UNIF. PRINCIPAL & INCOME ACT § 104 cmt.; *see also* RESTATEMENT (THIRD) OF TRUSTS § 79 gen. cmt. a (2007) (A trustee has a duty to impartially administer a trust "in balancing the naturally conflicting concerns of life and remainder beneficiaries . . . . The duty of impartiality is applicable to . . . . the allocation of receipts and expenditures between principal and income accounts . . . , especially as fiduciary discretion, or the making of adjustments . . . , may be involved . . . .").

the income and remainder beneficiaries after satisfying these external threshold conditions, then the inquiry stops. However, if, after satisfying the external conditions, the trustee determines that partiality is being shown to one class of beneficiary over another, then the trustee must determine whether the internal threshold conditions of the Indiana Act are met.

In general, a NIMCRUT trustee should be able to satisfy the external threshold conditions. A trustee prudently overseeing the every day administration of a NIMCRUT will, as a matter of course, apply any discretionary and non-discretionary powers in the administration of the trust. Similarly, where the trust agreement is silent as to the proper allocation of receipts and disbursements between principal and income, the Indiana Act is the standard that guides the decisions of a prudent trustee with regard to the administration of principal and income matters.[76] The more difficult question is whether the trustee has, in fact, impartially administered the trust. What is "fair and reasonable" is a highly fact-sensitive determination that is likely to be colored by one's perspective. An income beneficiary whose trust distributions are less than expected will almost certainly have a different perspective from that of a charitable remainder beneficiary with its own expectancy of what it should receive when the trust's term expires.

B. Internal Threshold Conditions

In addition to the external threshold conditions described above, Indiana Code section 30-2-14-15(a) imposes two internal threshold conditions that must be met before an exercise of the power to adjust is proper. First, the trustee must "invest[] and manage[] [the] trust assets as a prudent investor."[77] The Comments state that this "condition will be met [where] the prudent investor rule applies because the Uniform [Prudent Investor] Act . . . has been enacted."[78] For a NIMCRUT administered under Indiana law, this condition is met by virtue of Indiana's adoption of the Indiana Uniform Prudent Investor Act.[79]

Second, by its terms, the trust agreement must "describe the amount that may or must be distributed to a beneficiary by referring to the trust's income."[80] The Comments state that this requirement is met

> when the terms of the trust require all of the "income" to be distributed at regular intervals; or when the terms of the trust require a trustee to distribute all of the income, but permit the trustee to decide how much to distribute to each member of a class of beneficiaries; or when the terms

---

76. *See* IND. CODE § 30-2-14-14(a)(1).

77. *Id.* § 30-2-14-15(a)(1).

78. UNIF. PRINCIPAL & INCOME ACT § 104 cmt.

79. Ind. Unif. Prudent Investor Act, Pub. L. No. 137-1999, § 3, 1999 Ind. Acts 756 (codified at IND. CODE §§ 30-4-3.5-1 to -13). Note that Indiana's adoption of UPIA may satisfy this condition in an objective sense, but whether the trustee is actually investing as a prudent investor is an individualized determination based on the trustee's actions in a particular case.

80. IND. CODE § 30-2-14-15(a)(2).

> of a trust provide that the beneficiary shall receive the greater of the trust accounting income and a fixed dollar amount (an annuity), or of trust accounting income and a fractional share of the value of the trust assets (a unitrust amount). If the trust authorizes the trustee in its discretion to distribute the trust's income to the beneficiary or to accumulate some or all of the income, the condition will be met *because the terms of the trust do not permit the trustee to distribute more than the trust accounting income*.[81]

While this Comment does not specifically describe a NIMCRUT, it does not preclude a NIMCRUT from meeting the condition. The Comment clearly states that the condition is satisfied where a beneficiary is entitled to the *greater* of trust accounting income or an annuity or unitrust amount. But, a NIMCRUT income beneficiary is entitled to the *lesser* of trust accounting income *and* the annual unitrust amount. The resolution of this distinction is found in the last clause of the last sentence of the Comment: "because the terms of the trust do not permit the trustee to distribute more than the trust accounting income."[82] The implication of this clause is that a trust term permitting the distribution of more than trust accounting income does not "describe the amount that may or must be distributed to a beneficiary by referring to the trust's income"[83] and, therefore, the power to adjust is not available. Conversely, a trust term that "describes the amount that may or must be distributed" in terms of trust income, but does not permit the distribution of trust income in excess of a stated unitrust amount, still meets the requirement of the statute because it does not permit the distribution of *more* than the trust's accounting income. This latter condition is clearly the case with a NIMCRUT where trust accounting income, up to the annual unitrust amount, must be distributed.[84] Even if there is a make-up amount, no more than trust accounting income may be distributed.[85]

Furthermore, in the case of a NIMCRUT, if trust accounting income exceeds the annual unitrust amount, such excess must be retained and added to trust principal.[86] The Comment does not address the case where such retention is mandatory, but the last sentence of the Comment does speak approvingly of a discretionary power to retain income so long as "the terms of the trust do not permit the trustee to distribute more than the trust accounting income."[87] Following the same rationale stated in the last clause of the Comment, there is little reason to distinguish between a NIMCRUT's mandatory retention of income and a discretionary retention of income coupled with a requirement that no more than trust accounting income be distributed. In neither case may a trustee

81. UNIF. PRINCIPAL & INCOME ACT § 104 cmt. (emphasis added).
82. *Id.*
83. IND. CODE § 30-2-14-15(a)(2).
84. *See supra* Part I.A.2.
85. *See supra* Part I.A.2.
86. *See supra* Part I.A.2. and note 15.
87. UNIF. PRINCIPAL & INCOME ACT § 104 cmt.

distribute more than the trust accounting income. Therefore, a qualified NIMCRUT should satisfy the requirement that the trust agreement "describe the amount that may or must be distributed to a beneficiary by referring to the trust's income."[88]

C. Statutory Prohibitions on the Exercise of the Power to Adjust

Indiana Code section 30-2-14-15(c) contains seven statutory prohibitions that limit a fiduciary's exercise of the power to adjust. Of these seven, four are relevant to a NIMCRUT.[89]

1. Prohibition on Exercise Where Trustee Is a Beneficiary.—Indiana Code section 30-2-14-15(c)(7) states that the power to adjust may not be exercised "if the trustee is a beneficiary of the trust."[90] Thus, if a NIMCRUT trustee is also a beneficiary of the trust (including a charitable remainder beneficiary) then that beneficiary-trustee is prohibited from exercising the power to adjust. However, the Indiana Act provides that a co-trustee who is not a beneficiary may exercise the power unless prohibited from doing so by the terms of the trust.[91] Thus, if the limitation of Indiana Code section 30-2-14-15(c)(7) applies, it may be possible to appoint a co-trustee who is not a beneficiary to exercise the power to adjust.[92]

2. Grantor Trust Prohibition.—Indiana Code section 30-2-14-15(c)(5) prohibits a trustee from

> possessing or exercising the power to make an adjustment [if this] causes 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 make an adjustment.[93]

This prohibition is intended to prevent the availability or exercise of the power to adjust from causing a trust that is otherwise a non-grantor trust from becoming

---

88. IND. CODE § 30-2-14-15(a)(2).

89. The three that are not relevant are IND. CODE § 30-2-14-15(c)(1) (prohibiting an exercise of the power to adjust that would adversely impact a claimed marital deduction); IND. CODE § 30-2-14-15(c)(2) (prohibiting an exercise of the power to adjust that would adversely impact a claimed gift tax exclusion); and IND. CODE § 30-2-14-15(c)(6) (prohibiting an exercise of the power to adjust that would cause the corpus of the trust to be included in an individual's estate).

90. IND. CODE § 30-2-14-15(c)(7).

91. *Id.* § 30-2-14-15(d).

92. Indiana did not adopt the provision in the UPAIA 1997 that prohibited an exercise of the power to adjust by a non-beneficiary trustee where the adjustment would benefit the trustee indirectly. This raises the question of whether a non-beneficiary co-trustee could be the spouse or child of a beneficiary. If such a person is appointed co-trustee, the trustee's duty of loyalty, described in the *Restatement (Third) of Trusts* § 78 as the "duty to administer the trust solely in the interest of the beneficiaries," probably precludes such a co-trustee from acting improperly to his or her own benefit. RESTATEMENT (THIRD) OF TRUSTS § 78.

93. IND. CODE § 30-2-14-15(c)(5).

a grantor trust.[94]

A qualified NIMCRUT is not a grantor trust.[95] For example, notwithstanding the general rule that a retained right to income from a trust will cause the grantor to be treated as the owner of the trust,[96] by rule a NIMCRUT is not a grantor trust simply because the grantor or the grantor's spouse are income beneficiaries of the trust.[97] However, a trust, including a NIMCRUT, is a grantor trust where "the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party."[98]

Where the power to adjust is exercisable by the grantor or a nonadverse party, or both, it is likely that the power to adjust is a power of disposition over trust income that would cause the trust to be a grantor trust. The power to adjust can only be exercised where the amount to be distributed to income beneficiaries is described by reference to trust income. Moreover, any adjustment between income and principal necessarily has a direct effect on the amount of income to be distributed. As a power that necessarily affects the disposition of trust income, it is probable that the IRS would characterize the power to adjust as a "power of disposition" controlling the "beneficial enjoyment" of the income of the trust. Therefore, even if the terms of the trust agreement do not limit the grantor's exercise of the power to adjust, a grantor who is the trustee of a NIMCRUT should not exercise the power to adjust, but rather should defer such an exercise to a co-trustee who is neither a grantor nor a beneficiary.

3. Prohibition on Changing a Fixed Annuity or Unitrust Amount.—Indiana Code section 30-2-14-15(c)(3) prohibits an exercise of the power to adjust "that changes the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets."[99] Referring to this provision, the Comments state that "a beneficiary's right to receive a fixed annuity or a fixed fraction of the value of a trust's assets is not subject to [the power to adjust]."[100] One commentator suggests that this Comment "seem[s] to indicate that [UPAIA 1997

---

94. The term "grantor trust" is derived from I.R.C. § 671 which provides that "[w]here . . . the *grantor* . . . [is] treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor . . . those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust . . . ." (emphasis added). I.R.C. § 671 (2006).

95. *See* Treas. Reg. § 1.664-1(a)(4) (1972).

96. I.R.C. § 677(a) (2006) ("The grantor shall be treated as the owner of any portion of a trust . . . whose income . . . is, or . . . may be-- (1) distributed to the grantor or the grantor's spouse . . . .").

97. Treas. Reg. § 1.664-1(a)(4) ("[N]either the grantor nor his spouse shall be treated as the owner of the trust . . . merely because the grantor or his spouse is named as a recipient.").

98. I.R.C. § 674(a) (2006).

99. IND. CODE § 30-2-14-15(c)(3) (2011).

100. UNIF. PRINCIPAL & INCOME ACT § 104 cmt. (amended 2008), 7A pt. III U.L.A. 363, 438 (Supp. 2010).

section] 104(c)(3)[101] governs charitable remainder trusts, *including the net-income-with-makeup charitable remainder unitrust*."[102]

It seems clear that this section works to prohibit an exercise of the power to adjust in the case of a CRAT or standard CRUT which describe the amount due to the income beneficiary as a fixed annuity or fixed fraction (or percentage) of the value of the trust assets, respectively. However, it is less clear whether this prohibition should apply to a NIMCRUT. A NIMCRUT requires that a trustee distribute to the income beneficiary the *lesser* of the trust's accounting income *and* an annual unitrust amount.[103] An exercise of the power to adjust by a NIMCRUT trustee is not a change to the annual unitrust amount, but rather a change to the amount of the trust accounting income. For this reason, it seems unlikely that the prohibition applies to NIMCRUTs.

4. Prohibition on Adjustments from Amounts Permanently Set Aside for Charitable Purposes.—It is the fourth prohibition that poses the greatest test to the propriety of the exercise of the power to adjust in the case of a NIMCRUT. Indiana Code section 30-2-14-15(c)(4) prohibits an adjustment "from any amount that is permanently set aside for charitable purposes under a will or the terms of a trust unless both income and principal are so set aside."[104] Of specific concern is whether an exercise of the power to adjust in the context of a NIMCRUT is "an adjustment . . . from [an] amount . . . permanently set aside for charitable purposes."[105]

a. In a NIMCRUT, is there an amount permanently set aside for charitable purposes?—As previously noted, a transferor who transfers property to a qualified NIMCRUT receives a charitable income tax deduction and charitable transfer tax deduction equal to the present value of the remainder interest in the trust.[106] To qualify for the income and transfer tax deductions, the remainder interest must be irrevocably designated to, or for the use of, one or more charitable organizations.[107] Therefore, at least facially, a NIMCRUT's charitable remainder interest is an amount permanently set aside for charitable purposes. Further, because a NIMCRUT defines the interest of the income beneficiaries in terms of income and the only other available interest is the right to the trust principal, at any given point in time, a NIMCRUT's charitable remainder is, at least theoretically, equivalent to the NIMCRUT's principal. Under this analytical framework, an adjustment from principal to income would therefore be an adjustment from an amount permanently set aside for charitable purposes.

However, this conclusion is arguably incorrect for at least three reasons. First, the computation of the present value of the remainder interest (the

---

101. UPAIA 1997 § 104(c)(3) corresponds to IND. CODE § 30-2-14-15(c)(3).

102. CHRISTOPHER P. CLINE, THE LAW OF TRUSTEE INVESTMENTS 82 (2009) (emphasis added).

103. *See supra* Part I.A.2.

104. IND. CODE § 30-2-14-15(c)(4).

105. *Id.*

106. *See supra* notes 18-21 and accompanying text.

107. *See* I.R.C. § 664(d)(1)(C) (2006) (describing a charitable remainder annuity trust); I.R.C. § 664(d)(2)(C) (describing a charitable remainder unitrust).

deductible amount) casts doubt on the assumption that the amount a NIMCRUT donor intended to permanently set aside for charitable purposes is always equal to the NIMCRUT's principal. Second, an appropriate exercise of the power to adjust probably will not cause a NIMCRUT to lose tax benefits obtained when it was created. Finally, denying NIMCRUT trustees access to the power to adjust is contrary to the policy underlying the power.

b. The computation of the present value of the remainder interest and its relationship to the amount permanently set aside for charitable purposes.—The prescribed method for computing the present value of the remainder interest of a standard CRUT and a NIMCRUT are the same.[108] The computation requires seven inputs: (1) the date of transfer;[109] (2) the age of each beneficiary;[110] (3) the unitrust percentage;[111] (4) the applicable I.R.C. § 7520 rate;[112] (5) the frequency of the required unitrust distributions (e.g., monthly, quarterly, semi-annual, or annual distribution periods);[113] (6) the timing of distributions within the distribution period (e.g., whether distributions occur at the beginning or end of the distribution period);[114] and (7) the date on which trust property is to be valued relative to the distribution year (e.g., at the beginning or the end of the period).[115]

As discussed above, the computation of the present value of the remainder interest for a standard CRUT and a NIMCRUT is the same.[116] The computation assumes that the annual unitrust amount is distributed in full each year; it makes no adjustment for the possibility that, in the case of a NIMCRUT, trust accounting income may be less than the annual unitrust amount. The computed amount is the basis of the charitable income tax and transfer tax deductions. As such, it is arguable that this amount reflects the amount permanently set aside for charitable purposes.

For example, assume that Fred, age 68, and Jane, age 62, transfer $1,000,000 to a NIMCRUT on January 15, 2011. Further assume that the trust's stated unitrust percentage is five percent. Based on a transfer date of January 15, 2011,

---

108. *See supra* Part I.A.2. and note 27 and accompanying text; *see also* Treas. Reg. § 1.664-4 (2009) (describing the computation of the remainder interest in a charitable remainder unitrust).

109. The date of transfer establishes the "valuation date" used to determine the applicable life table as required by Treas. Reg. § 1.664-4(a)(1) (2011) and the I.R.C. § 7520 rate to be used as required by Treas. Reg. § 1.664-4(a)(2) (2009).

110. The age of each beneficiary is an indirect input in computation. A beneficiary's age is relevant to the selection of the remainder factor from the appropriate table as described in IRS Publ'n 1457, Actuarial Valuations (5-2009), *available at* http://www.irs.gov/pub/irs-pdf/p1457.pdf.

111. *See* Treas. Reg. § 1.664-4(e)(3) (2009).

112. Each month the IRS publishes an interest rate used to determine "the value of any annuity, any interest for life or a term of years, or any remainder or reversionary interest." I.R.C. § 7520(a) (2006); *see also* Rev. Rul. 2011-6, 2011-10 I.R.B. 537, 538 tbl. 4 (providing an example of the monthly publication of the I.R.C. § 7520 rate).

113. *See* Treas. Reg. § 1.664-4(e)(3).

114. *See id.* § 1.664-4(a)(3).

115. *See id.* § 1.664-4(e)(3).

116. *See supra* Part I.A.2. and note 27 and accompanying text.

the best[117] section 7520 rate allowed is 2.4%. Under these facts, the present value of the remainder interest (and the putative amount permanently set aside for charitable purposes) is $365,700.[118] As previously explained, this computed amount is the same regardless of whether Fred and Jane's trust is a standard CRUT or a NIMCRUT.

What is the effect if the NIMCRUT's investment portfolio fails to produce trust accounting income greater than or equal to the annual unitrust amount but the overall investment return is greater than or equal to the annual unitrust amount?[119] Under this scenario, each year the income beneficiaries will receive less than the annual unitrust amount while, at the expiration of the trust's term, the charitable remainder beneficiaries will receive a larger charitable remainder—more than the putative amount permanently set aside for charitable purposes. This increase in the charitable remainder would be reflected in an increase in the value of the trust's principal over time. Assuming the amount originally computed as the present value of the remainder interest represents the amount permanently set aside for charitable purposes, the difference between the trust principal and the computed present value represents an amount *not* permanently set aside for charitable purposes, an amount from which adjustments could be made.

It is possible to illustrate this difference by substituting in the present value computation, in place of the unitrust percentage, an estimate of the real rate of return the trust will receive in the form of trust accounting income while holding all other factors constant. Assuming that Fred and Jane's NIMCRUT will receive a real rate of return of trust accounting income of three percent, the resulting estimate of the present value of the remainder interest is $541,824, a difference of $176,124. It is from this difference that an adjustment between principal and income would be made under the power to adjust. Assuming this difference is over and above the amount permanently set aside for charitable purposes (as measured by the computed present value of the remainder interest), an adjustment

---

117. Internal Revenue Code section 7520(a) provides in part that "[i]f an income, estate, or gift tax charitable contribution is allowable for any part of the property transferred, the taxpayer may elect to use such Federal midterm rate *for either of the [two] months preceding the month in which the valuation date falls* . . . ." I.R.C. § 7520(a) (emphasis added). When computing the present value of the remainder interest for unitrusts requiring distributions more frequently than annually, a higher I.R.C. § 7520 rate will produce a slightly larger result.

118. Further assume that income beneficiary distributions are paid at the end of each calendar quarter and that the trust property is valued on the first day of each year.

119. If the trust accounting income rate of return exceeds the stated unitrust percentage, then there is no distinction between the expected results of a standard CRUT and a NIMCRUT. This is because, in either case, the required distributions are exactly equal to the annual unitrust amount and the income in excess of the annual unitrust amount is retained in the trust for the benefit of the charitable remainder beneficiary. Conversely, if the trust accounting income rate of return *and* the overall rate of return are less than the stated unitrust percentage, or perhaps even reflect a negative return, there is little or no amount from which to make an adjustment and the question of the propriety of an adjustment is in all probability moot.

from this amount would not be subject to the limitation of Indiana Code section 30-2-14-15(c)(4).

In short, the computed present value of the remainder interest used to substantiate the charitable income tax and transfer tax deductions is a reasonable estimate of the amount the donor intended to "permanently set aside for charitable purposes." In Indiana, "[t]he primary goal in construing a trust document is to ascertain and effectuate the intent of the settlor."[120] The charitable tax deductions a donor receives upon the transfer of property to a charitable remainder trust suggests that it was the donor's intent to permanently set aside for charitable purposes a specific amount that, depending on the performance of the trust's investment portfolio, may be less than the trust principal. Therefore, an adjustment from principal amounts in excess of the amount permanently set aside for charitable purposes should not be treated as an adjustment from an amount permanently set aside for charitable purposes. A contrary interpretation is that altruistic donors create NIMCRUTs with the expectation that the charitable remainder beneficiary will receive the excess described above.

An additional consideration in this analysis is the role of the unitrust amount in limiting the potential for adjustment. Because a NIMCRUT trustee can never distribute more than the annual unitrust amount plus the makeup amount,[121] there is an upper bound to the amount of an adjustment from principal to income that will be payable to the NIMCRUT's income beneficiaries. This upper bound serves to limit a trustee's ability to adjust from an amount permanently set aside for charitable purposes. Consequently the potential for abuse is significantly diminished.

c. An appropriate exercise of the power to adjust will not cause the loss of federal or state tax benefits obtained when the trust was created.—The Comments provide that "[t]he purpose of [UPAIA 1997 sections 104(c)(1)] through (4) is to preserve tax benefits that may have been an important purpose for creating the trust."[122] The implication is that, if upon enactment of the UPAIA 1997 by a state, the availability of the power to adjust could cause a trust to lose a tax benefit obtained when the trust was created, then, to preserve that tax benefit, the trustee of that trust is denied access to the power to adjust. In the case of a NIMCRUT, three such tax benefits are relevant: (1) the donor's charitable income tax deduction, (2) the charitable transfer tax deduction, and (3) tax-exempt status during the administration of the trust.

With respect to federal tax benefits, the IRS has approved the use of the power to adjust. As noted above, the starting point in computing trust accounting income is the I.R.C. § 643(b) and its applicable regulations.[123] In response to the publication of the UPAIA 1997 and its subsequent adoption by several states, on January 2, 2004 the IRS released final regulations (the 2004 Regulations),

---

120. Malachowski v. Bank One, Indianapolis, 590 N.E.2d 559, 565 (Ind. 1992).

121. *See supra* Part I.A.2.

122. UNIF. PRINCIPAL & INCOME ACT § 104 cmt. (amended 2008), 7A pt. III U.L.A. 363, 438 (Supp. 2010).

123. *See supra* Part I.A.4.

amending the existing regulations under I.R.C. § 643(b), designed to

> recognize that state statutes are in the process of changing traditional concepts of income and principal in response to investment strategies that seek total positive return on trust assets. These statutes are designed to ensure that, when a trust invests in assets that may generate little traditional income (including dividends, interest, and rents), the income and remainder beneficiaries are allocated reasonable amounts of the total return of the trust (including both traditional income and capital appreciation of trust assets) so that both classes of beneficiaries are treated impartially.[124]

Consistent with this purpose, Treasury Regulation section 1.643(b)-1 was amended by adding the following language:

> Allocations pursuant to methods prescribed by [state principal and income] statutes for apportioning the total return of a trust between income and principal *will be respected* regardless of whether the trust provides that the income must be distributed to one or more beneficiaries or may be accumulated in whole or in part . . . .[125]

However, the 2004 Regulations included an express provision permitting a NIMCRUT trustee to possess a discretionary power to apportion realized capital gains between income and principal "under the terms of the governing instrument but only to the extent that the state statute permits the trustee to make adjustments between income and principal to treat beneficiaries impartially."[126] Because this language appears in the regulation, is couched in language similar to the UPAIA 1997's power to adjust, and is the only such language that appears in the charitable remainder trust regulations, it is tempting to interpret this regulation as the extent of the IRS's permissive attitude toward the power to adjust.[127] That is, to assume that the IRS recognizes the valid existence of such a power *only* for realized capital gains and *only* if the power is granted in the governing instrument and *only* if there is a state statute permitting adjustments between income and principal under a duty of impartiality. This narrow view is contrary to the express language of Treasury Regulation section 1.643(b)-1 recited above, which imposes no limitation on the use of the power to adjust.

Furthermore, a careful reading of the preamble to the 2004 Regulations indicates that it is unlikely that this language from the charitable remainder trust regulations circumscribes the availability of the power to adjust. Speaking in the context of a discretionary power to apportion realized capital gains between

124. T.D. 9102, 2004-1 C.B. 366, 366-67.

125. *Id.* at 373-74 (emphasis added).

126. Treas. Reg. § 1.664-3(a)(1)(i)(b)(3) (as amended in 2004); *see also* T.D. 9102, 2004-1 C.B. 366, 374.

127. *See, e.g.*, Medlin, *supra* note 44, at 743-44 ("The revised Treasury regulations allow the allocation of capital gains, traditionally principal, to income for charitable remainder unitrusts, but only if both the trust instrument and applicable state law allow such an equitable adjustment.").

income and principal, the IRS stated, "The provision in the . . . regulations [that describes the apportionment of capital gains between income and principal] *has no effect on the determination of trust accounting income under applicable state law that grants the trustee a power to reasonably apportion the total return of the trust*."[128] This statement from the preamble, coupled with the express language of Treasury Regulation section 1.643(b)-1, clearly indicates that, as long as a NIMCRUT trustee observes the formalities imposed by the applicable state's principal and income statute, the IRS will respect the trustee's exercise of the power to adjust. As a result, a reasonable exercise of the power to adjust under a state-law-imposed duty of impartiality should not cause a NIMCRUT to lose any federal tax benefits obtained when the trust was created or to lose the trust's exempt status during the trust term.

The same result is obtained when considering the impact on state tax benefits. The starting point for computing the tax benefits conferred by the State of Indiana on a qualified NIMCRUT is federal adjusted gross income as modified by state statute.[129] Indiana does not allow a taxpayer to claim a charitable deduction in arriving at taxable income.[130] Therefore, there is no direct Indiana tax benefit to a donor who creates and transfers property to a NIMCRUT.[131] Because a qualified charitable remainder trust is exempt from federal income tax,[132] its federal adjusted gross income is zero dollars. As a result, a charitable remainder trust is effectively exempt from income tax in Indiana so long as its federal tax exemption is preserved. Furthermore, the charitable remainder interest in a qualifying charitable remainder trust is exempt from Indiana's inheritance tax.[133] Therefore, an exercise of the power to adjust that does not cause an otherwise qualified charitable remainder trust to lose its exemption from federal income tax granted by I.R.C. § 664(a), or to lose the estate tax deduction granted by I.R.C. § 2055(a), will not cause the trust to lose any state tax benefits obtained when the trust was created or to lose the trust's exempt status during the trust term.

One commentator has noted a potential problem with applying this tax-benefit-preservation rationale to circumvent the limitation of UPAIA 1997 section 104(c) (and its Indiana counterpart Indiana Code section 30-2-14-15(c)(4)): The plain language of the statute fails to incorporate the tax-benefit-preservation rationale.[134] Absent a reference to the tax benefits to be preserved in the statute,

---

128. T.D. 9102, 2004-1 C.B. 366, 369 (emphasis added).

129. *See* IND. CODE §§ 6-3-2-1, 6-3-1-3.5 (2011); *see also id.* § 6-3-1-14 ("The term 'person' means an individual, trust, or estate.").

130. *See id.* §§ 6-3-2-1 to -21.7 (describing amounts includible in taxable income and amounts deductible in arriving at taxable income).

131. However, because the excess of the value over the adjusted tax basis (i.e., the unrealized capital gain) of property transferred to a NIMCRUT is excluded from federal adjusted gross income and consequently excluded from Indiana taxable income, there is an indirect tax avoidance benefit.

132. *See supra* note 16.

133. IND. CODE § 6-4.1-3-1 (2011) ("Each transfer described in section 2055(a) of the Internal Revenue Code is exempt from the inheritance tax."); *see also supra* note 20.

134. *See* Medlin, *supra* note 44, at 744 ("[I]t is arguable that state law, based on the UPAIA

it is uncertain that a court interpreting the statute would look beyond the plain language of the statute to the Comments.[135] Had the drafters of the UPAIA 1997 had the benefit of the IRS's commentary accompanying the 2004 Regulations when the UPAIA 1997 was promulgated, perhaps the prohibition on the exercise of the power to adjust in the case of amounts permanently set aside for charitable purposes would have been tempered to make it clear that the power to adjust should be exercisable by NIMCRUT trustees.

d. Denying NIMCRUT trustees access to the power to adjust is contrary to the policy underlying the power.—As discussed above, the UPIA and the UPAIA 1997 are two halves of a whole.[136] The UPIA creates a duty to invest as a prudent investor, seeking total return without regard to the categories of income that make up the return, while the UPAIA 1997, through the mechanism of the power to adjust, empowers a trustee to ensure impartial treatment of income and remainder beneficiaries should inequities arise in the pursuit of optimal returns.[137] If the prohibition of Indiana Code section 30-2-14-15(c)(4) includes NIMCRUTs, then the statutory scheme arguably creates a direct conflict between the trustee's duty to invest as a prudent investor and the trustee's duty of impartiality; a conflict that is not diminished by the fact that one class of beneficiary is made up of one or more charitable organizations.

An Indiana NIMCRUT trustee has a duty to invest as a prudent investor.[138] Further, a trustee is also required to invest impartially, "taking into account any differing interest of the beneficiaries."[139] The trustee's investment decisions are "evaluated . . . in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to

---

[1997], . . . prohibits a reallocation from principal to income because section 104(c)(4) does not use tax terms.").

135. In Indiana, statutes that are "clear and unambiguous . . . [are construed by taking] words and phrases . . . in their plain, ordinary, and usual sense." Basileh v. Alghusain, 912 N.E.2d 814, 821 (Ind. 2009). If a "statute is susceptible to more than one interpretation it is deemed ambiguous and thus open to judicial construction." *Id*. When construing an ambiguous statute, a primary rule of statutory construction "is to determine, give effect to, and implement the intent of the Legislature." *Id*. Where the statute in question is based on a uniform act, "[t]he comments to [the] uniform act are indicative of the Legislature's intent." *Id*. However, "[i]t is always presumed, in regard to a statute, that no absurd or unreasonable result was intended by the legislature." Simmons v. State, 129 N.E.2d 121, 125 (Ind. 1955) (quoting Marks v. State, 40 N.E.2d 108, 111 (Ind. 1942)). Finally, when "applying and construing [the Indiana Act], consideration must be given to the need to promote uniformity of the law . . . among states that enact [the UPAIA 1997]." IND. CODE § 30-2-14-44 (2011); *see also* 2A NORMAN J. SINGER & J.D. SHAMBIE SINGER, STATUTES AND STATUTORY CONSTRUCTION § 48:11 (7th ed. 2007) ("Legislation adopted from a Uniform Act should be construed in a manner which makes it operate uniformly with other states that have adopted the Uniform Act.").

136. *See* discussion *supra* Part I.B.

137. *See supra* Part I.B.

138. IND. CODE § 30-4-3.5-1(a) (2011); *see also id.* § 30-4-3-6(b)(1) (2011).

139. *Id.* § 30-4-3.5-6.

the trust."[140] However, as previously noted, such an investment strategy is indifferent to the categories of income that make up the returns produced.[141] In fact, the pursuit of total return using "an overall investment strategy having risk and return objectives reasonably suited to the trust"[142] may result in a portfolio that produces no trust accounting income and all capital appreciation (or loss), or vice versa.

Under a scenario where the trustee's compliance with the duty to invest as a prudent investor produces minimal trust accounting income under the traditional categories of income while producing significant capital appreciation, the result is a windfall to one class of beneficiary at the expense of the other. In the alternative, if a NIMCRUT trustee, considering the prohibition on the exercise of the power to adjust imposed by Indiana Code section 30-2-14-15(c)(4), determines that "risk and return objectives reasonably suited to" a NIMCRUT requires investing in a fashion that sacrifices total return in favor of an allocation which necessarily disappoints equally,[143] then neither class of beneficiary is served and the amount that ultimately passes to the charitable remainder beneficiaries would, in all likelihood, be diminished. This diminishment may even be greater than the effect of an adjustment between principal and income under the power to adjust.

In summary, a NIMCRUT trustee's adjustment from principal to income is not barred per se by Indiana Code section 30-2-14-15(c)(4). If the present value of the charitable remainder interest when a NIMCRUT is funded defines the amount permanently set aside for charitable purposes, then, if the total return from the trust's investment portfolio exceeds the annual unitrust amount, and the trust accounting income is less than the annual unitrust amount, the value of the trust principal will exceed the amount permanently set aside for charitable purposes. An adjustment from this excess, up to the annual unitrust amount, is an adjustment from an amount that is *not* permanently set aside from charitable purposes. In addition, an exercise of the power to adjust will not result in the loss of federal or state tax benefits. Finally, a NIMCRUT trustee denied access to the power to adjust may be forced to invest in less productive investment portfolios to the mutual detriment of both the income and remainder beneficiaries.

III. WHAT IS NEEDED TO BREATHE LIFE INTO THE POWER TO ADJUST FOR NIMCRUTS?: LEGISLATIVE INTERVENTION

The foregoing analysis notwithstanding, the lack of explicit statutory authority or case law (in Indiana or any other state) supporting an exercise of the power to adjust by a NIMCRUT trustee will give many trustees pause. Therefore, to breathe life into the power to adjust, a legislative change may be necessary to give Indiana NIMCRUT trustees the confidence to exercise the power to adjust.

140. *Id.* § 30-4-3.5-2(b).
141. *See supra* Part I.B.1.
142. UNIF. PRUDENT INVESTOR ACT § 2(b), 7B U.L.A. 1, 20 (2006).
143. *See supra* note 57 and accompanying text.

To that end, the author proposes that the Indiana legislature amend Indiana Code section 30-2-14-15(c)(4) to read:

> (c) A trustee may not make an adjustment: . . . (4) from any amount that is permanently set aside for charitable purposes under a will or the terms of a trust *(A) for which a deduction or exemption from tax would be allowed under Title 6 of the Indiana Code or sections 170, 664, 2055, or 2522 of the Internal Revenue Code if the trustee did not have the power to make the adjustment; or (B)* unless both the income and principal are so set aside. (Proposed change appears in italicized text)

The proposed change is appropriate for four reasons. First, it is consistent with the tax-benefit-preservation rationale articulated by the Commissioners in the Comments. Second, it is consistent with the IRS's current position with respect to the power to adjust. Third, it resolves the conflict between a trustee's duty to administer a NIMCRUT impartially between income beneficiaries and remainder beneficiaries and the trustee's duty to invest the trust prudently. Finally, it is consistent with the favorable stance Indiana has taken toward NIMCRUTs in other modifications made when the Indiana Act was adopted.

A. The Proposed Change Is Consistent with the Tax-Benefit-Preservation Rationale Found in the Comments

As discussed above, the Comments state that "[t]he purpose of subsection[] [104(c)](4) is to preserve tax benefits that may have been an important purpose for creating the trust."[144] The drafters of the UPAIA 1997 explicitly included language incorporating this tax-benefit rationale into two other subsections under UPAIA 1997 section 104(c). UPAIA 1997 section 104(c)(1) states that

> (c) A trustee may not make an adjustment:
> (1) that diminishes the income interest in a trust that requires all of the income to be paid at least annually to a spouse *and for which an estate tax or gift tax marital deduction would be allowed, in whole or in part, if the trustee did not have the power to make the adjustment*.[145]

The highlighted text precludes the use of the power to adjust only if a specific tax benefit, e.g., the estate tax or gift tax marital deduction, would be lost if the trustee possesses the power to adjust.[146] By drafting the statute in this manner, the drafters left open the possibility that the power to adjust would be available in the context of a marital deduction trust if the IRS ruled that such an exercise would not result in the loss of the marital deduction.

Similarly, UPAIA 1997 section 104(c)(2) states that "(c) A trustee may not

---

144. UNIF. PRINCIPAL & INCOME ACT § 104 cmt. (amended 2008), 7A pt. III U.L.A. 363, 438 (Supp. 2010); *see* discussion *supra* at Part II.C.4.(a)(2).

145. UNIF. PRINCIPAL & INCOME ACT § 104(c)(1) (emphasis added); *see also* IND. CODE § 30-2-14-15(c)(1) (2011).

146. *See* Medlin, *supra* note 44, at 744.

make an adjustment: . . . (2) that reduces the actuarial value of the income interest in a trust to which a person transfers property with *the intent to qualify for a gift tax exclusion*."[147] In this case, the statute only precludes the exercise of the power to adjust if the creator of the trust intended for the transfer of property to qualify for a gift tax exclusion. Once again the drafters of the UPAIA 1997 anchored the prohibition on the exercise of the power to adjust to the preservation of an expected tax benefit. For example, in the case where a settlor transferred property to a trust with no intent to qualify for a gift tax exclusion (perhaps because the settlor had already exhausted all available gift tax exclusions), the use of the power to adjust would not be precluded.

The proposed amendment explicitly imports the tax-benefit-preservation rationale that underlies UPAIA 1997 sections 104(c)(1) and (2) into Indiana Code section 30-2-14-15(c)(4). The proposed amendment precludes the exercise of the power to adjust only if the authorities that grant a tax benefit to be preserved determine that the availability of the power to adjust would result in the loss of the tax benefit.

B. The Proposed Change Is Consistent with the IRS's Current Position with Respect to the Power to Adjust

As discussed above, the IRS has approved the exercise of the power to adjust by NIMCRUT trustees.[148] However, some commentators have suggested that this permissive stance is limited to situations involving a discretionary power to apportion realized capital gains between income and principal, and then only when the discretionary power is "granted to the trustee under the terms of the governing instrument but only to the extent that the state statute permits the trustee to make adjustments between income and principal to treat beneficiaries impartially."[149] But this narrow view is at odds with the language of Treasury Regulation section 1.643(b)-1 and the broad pronouncement in the preamble to the 2004 Regulations that the provision limiting the apportionment of realized capital gains "has no effect on the determination of trust accounting income under applicable state law that grants the trustee a power to reasonably apportion the total return of the trust."[150]

Both the narrow interpretation of Treasury Regulation section 1.664-3(a)(1)(i)(b)(3) and the broader statement of Treasury Regulation section 1.643(b)-1 are currently at odds with a facial reading of the limitation imposed by Indiana Code section 30-2-14-15(c)(4). By tying the availability of the power to adjust to the IRS's determination of the effect of the power to adjust on tax benefits, the proposed amendment to Indiana Code section 30-2-14-15(c)(4)

---

147. UNIF. PRINCIPAL & INCOME ACT § 104(c)(2) (emphasis added); *see also* IND. CODE § 30-2-14-15(c)(2).

148. *See supra* Part II.C.4.(a)(2).

149. Treas. Reg. § 1.664-3(a)(1)(i)(b)(3) (as amended in 2004); *see supra* note 127 and the accompanying text.

150. T.D. 9102, 2004-1 C.B. 366, 369; *see also supra* notes 124-26 and accompanying text.

would permit the use of the power to adjust within the boundaries described by either the narrow interpretation or the broad interpretation.

C. The Proposed Change Resolves the Conflict Between a Trustee's Duty of Impartiality and the Trustee's Duty to Invest the Trust Prudently

As discussed above, Indiana Code section 30-2-14-15(c)(4) as currently written creates a facial conflict between a trustee's duty to treat the income and remainder beneficiaries of a NIMCRUT impartially and the trustee's duty to invest the trust prudently.[151] The proposed amendment eliminates this conflict by making the power to adjust available to NIMCRUT trustees until federal or state tax authorities (or legislatures) assert the preeminence of a tax policy favoring the protection of all of a NIMCRUT's principal.

D. The Proposed Change Is Consistent with Indiana's Favorable Stance Toward NIMCRUTs

The proposed amendment to Indiana Code section 30-2-14-15(c)(4) is consistent with the beneficial treatment Indiana has afforded NIMCRUTs historically. Indiana made two NIMCRUT-friendly changes to UPAIA 1997 when it enacted the Indiana Act in 2002.[152] The Indiana General Assembly amended UPAIA 1997 section 406 (relating to debt instruments) by adding the following subsection:

> (c) Notwithstanding any other provision of this section, when an obligation described in this section is held as an asset of a *charitable remainder trust*, an increase in the value of the obligation over the value of the obligation at the time of acquisition by the trust is distributable as income. For purposes of this subsection, the increase in value is available for distribution only when the trustee receives cash on account of the obligation.[153]

This provision ensures that the increase in value of an obligation, such as an original issue discount bond (e.g., a zero-coupon bond), is allocable to income, but only when the trustee receives cash on account of the obligation, typically as a result of the sale or maturity of the bond.

Similarly, the Indiana General Assembly amended UPAIA 1997 section 409 by adding the following subsection:

---

151. *See supra* Part II.C.4.(a)(3).

152. The author's employer, Renaissance Administration LLC (but not the author) played a role in recommending these changes to the Indiana General Assembly through the participation of its in-house counsel as a member of the Probate, Trust, and Real Property Section of the Indiana State Bar Association.

153. IND. CODE § 30-2-14-28(c) (emphasis added). The statute refers to "charitable remainder trusts" and not specifically to NIMCRUTs. However, because NIMCRUTs are the only variety of charitable remainder trust that determines income beneficiary payments by reference to trust income, this provision is effectively targeted at NIMCRUTs.

> (g) Notwithstanding any other provision of this section, when a private or commercial deferred annuity is held as an asset of a *charitable remainder trust*, an increase in the value of the obligation over the value of the obligation at the time of the acquisition by the trust is distributable as income. For purposes of this subsection, the increase in value is available for distribution only when the trustee exercises a right of withdrawal or otherwise receives cash on account of the obligation.[154]

This provision ensures that the increase in value of an obligation, such as a commercial deferred annuity, is allocable to income, but only when the trustee receives cash on account of the obligation. The proposed amendment is in line with the type of incremental benefits accorded charitable remainder trusts by these two enacted amendments.

In summary, the proposed amendment to Indiana Code section 30-2-14-15(c)(4) is consistent with the policies underlying the prohibition on adjustments from amounts permanently set aside for charitable purposes. Moreover the proposed amendment is in harmony with the IRS's position on an exercise of the power to adjust by a NIMCRUT trustee. Furthermore, the proposed amendment resolves a conflict in the duties a NIMCRUT trustee owes trust beneficiaries. Finally, the proposed amendment is consistent with Indiana's historically favorable treatment of NIMCRUTs.

CONCLUSION

Based on the foregoing analysis, an Indiana NIMCRUT trustee can exercise the power to adjust. However, the lack of explicit statutory authority or case law that explicitly addresses the use of the power to adjust by NIMCRUT trustees is likely to cause trustees to hesitate to exercise the power to adjust. The Indiana General Assembly should amend Indiana Code section 30-2-14-15(c)(4) to explicitly authorize the exercise of the power to adjust by NIMCRUT trustees. Indiana has historically shown leadership in effecting positive change in principal and income law as it relates to NIMCRUTs. The proposed amendment furthers Indiana's leadership in this arena. It is now up to the Indiana legislature to make it clear that the power to adjust is alive and well for Indiana's NIMCRUT trustees.

154. *Id.* § 30-2-14-31(g) (emphasis added).