

D R A F T

FOR DISCUSSION ONLY

UNIFORM FIDUCIARY INCOME AND PRINCIPAL ACT

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

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UNIFORM FIDUCIARY INCOME AND PRINCIPAL ACT

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NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

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June 7, 2017

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UNIFORM FIDUCIARY INCOME AND PRINCIPAL ACT

PREFATORY NOTE

The current revision of the former Uniform Principal and Income Acts, like the 1997 revision, is intended to reflect and address changes in the design and use of trusts. Very long-term trusts are more common, as are totally discretionary trusts – that is, trusts in which income, as well as principal, is distributable to beneficiaries during the term of the trust less as a matter of right and more only in the discretion of the trustee. Even where income distributions are mandatory, including occasions where income distributions are mandated by requirements of tax law (such as the estate tax marital deduction), discretion in the trustee to supplement income distributions by invasions of principal are common.

One result of these developments in the design, use, and role of trusts is to make historical distinctions between income and principal less important as a technical matter. Discretionary accumulation of income has the effect of treating income as principal to the extent of the accumulation. And discretionary invasion of principal has the effect of treating principal as income to the extent of the invasion. Even so, the difference between income and principal is important to impartial trustees and beneficiaries alike. If nothing else, the history of distinctions between the tree and its fruit and between the herd and the calf have created a dignity and discipline that are relevant in the administration of even a total discretionary modern trust. Thus, the Drafting Committee has chosen to retain the historical distinctions, including the historical technical rules that have evolved through changing legal and practical environments, while still allowing skilled and dedicated trustees the ability to respond and act appropriately in legal and practical environments that inevitably will continue to change.

The basic premise of the current revision is that a trustee that is aware of the current practical environment of trust administration and sensitive to the evolving demands of impartiality should be able to determine standards for adjusting between income and principal that are reasonable in the circumstances, and to update those standards from time to time. Authority to make adjustments between income and principal from year to year, introduced as Section 104 in 1997, is retained, and indeed significantly expanded, as new Section 203. The most important way in which the authority to adjust is expanded is by eliminating the precondition that trust distributions are constricted by the concept of “income” in a way that economic results from year to year could arbitrarily affect. In other words, while the trustee of a more modern trust with greater, if not total, flexibility to make distributions from income and/or principal would actually have been *denied* the flexibility intended by former Section 104, new Section 203 would ensure that designing a trust for greater flexibility would not ironically sacrifice the flexibility of adjustment.

That means that the technical structure of the current Act exhibits a certain amount of apparent redundancy. A trustee that could cope with the constraints of income and principal rules by merely accumulating income or invading principal now is given the alternative of making an adjustment under Section 203 instead, either from year to year, as under former Section 104, or for more than one year, under these expanded rules.

1 This is how the current Act respects, and permits a trustee to respect, the historical dignity
2 and discipline of the simple notion of “income.” Under Section 203, a trustee of a discretionary
3 trust can make adjustments, taking into account a nonexclusive list of factors provided in Section
4 201(c), and still achieve the comfortable outcome of “distributing income.” And when the
5 interests of beneficiaries under the terms of the trust are still not appropriately served within the
6 framework of “distributing income” – that is, when no reasonable adjustment would serve those
7 interests, or when significant non-pro rata distributions are justified – then invasions of principal
8 are still appropriate to the extent consistent with the terms of the trust.

9
10 A trustee that does not make adjustments under Section 203 still has the option of
11 following the more traditional rules, which are retained, with modest updates, in Articles 4
12 through 7.

13
14 As perhaps the “ultimate adjustment,” Article 3 adds the authority for a trustee to convert
15 a trust to a unitrust. This is discussed in the Comment to Article 3.

16
17 Finally, new Section 104 provides an important clarification that the income and principal
18 rules of the state that is the principal place of administration of the trust from time to time will be
19 the governing law.
20

1 **UNIFORM FIDUCIARY INCOME AND PRINCIPAL ACT**

2 **[ARTICLE] 1**

3 **SHORT TITLE, DEFINITIONS, SCOPE, AND GOVERNING LAW**

4 **SECTION 101. SHORT TITLE.** This [act] may be cited as the Uniform Fiduciary
5 Income and Principal Act.

6 **Comment**

7 **Name.** The change in the name of this Uniform Act has three purposes and effects.

8 First, this name will distinguish the Act from its 1931, 1962, and 1997 predecessors and
9 support an acronym that will not be confused with the Uniform Prudent Investor Act that was
10 closely associated with its 1997 predecessor.

11 Second, by using the word “Fiduciary,” the name emphasizes that the distinctions
12 between income and principal are most likely to be relevant in the context of trusts and
13 decedents’ estates, especially trusts that continue for a long time, perpetually in the case of some
14 modern trusts, and therefore present a greater possibility of competing interests between those
15 entitled to income currently and those who may be entitled to income and/or principal – that is,
16 entitled to “what’s left” – after the current interests terminate by death or otherwise. The Act is
17 intended to apply to arrangements other than just trusts and decedents’ estates, such as legal life
18 estates, where those arrangements share the long-term character and need for balancing of
19 successive interests that is most commonly associated with trusts. But the primary applications
20 of the Act will generally be in contexts marked by the role of a fiduciary.

21 Third, placing income first in the name emphasizes this fact that principal may be “what’s
22 left” after income is paid out. After income is paid out it is gone and normally cannot be
23 retrieved (although prior over-distributions can sometimes be taken into account in determining
24 the amount of future distributions). This in turn highlights the bias toward principal that for
25 practical reasons has appeared in previous version of the Act and is made even more explicit in
26 this version.

27 **SECTION 102. DEFINITIONS.** In this [act]:

28 (1) “Accounting period” means a calendar year unless another period of 12 calendar
29 months or approximately 12 calendar months is selected by a fiduciary. The term includes a part
30 of a calendar year or other 12-month period that begins when an income interest begins or ends
31 when an income interest ends.

1 (2) “Beneficiary” includes:

2 (A) in the case of a trust, an income beneficiary, including a current income
3 beneficiary, a remainder beneficiary, and any other successor beneficiary;

4 (B) in the case of an estate, an heir[, legatee,] and devisee;

5 (C) in the case of a life estate or term interest, a person that holds a life estate, a
6 term interest, or a remainder or other interest following a life estate or term interest; and

7 (D) in the case of another arrangement or relationship, a person that holds an
8 interest in property or may succeed to an interest in property.

9 (3) “Current income beneficiary” means a beneficiary to which a fiduciary may distribute
10 net income, regardless of whether the fiduciary may also distribute principal to that beneficiary.

11 (4) “Distribution” means payment or transfer by a fiduciary to a beneficiary in the
12 beneficiary’s capacity as a beneficiary, made pursuant to the terms of the trust, without
13 consideration other than a beneficiary’s right to receive a distribution under the terms of the trust.

14 In Section 401, the term also includes a payment or transfer from an entity to an owner of the
15 entity or another person with an interest in the entity. “Distribute” has a corresponding meaning.

16 (5) “Estate” means a decedent’s estate. The term includes the property of the decedent as
17 originally constituted and as it exists from time to time during administration.

18 (6) “Fiduciary” means a trustee, personal representative, life tenant, or holder of a term
19 interest. The term includes another person that holds property for a successor beneficiary whose
20 interest may be affected by the allocation of receipts and expenditures between income and
21 principal. If there are two or more co-fiduciaries, the term means all co-fiduciaries acting in
22 accordance with the terms of the trust and applicable law, including this [act].

23 (7) “Income” means money or other property a fiduciary receives as current return from

1 principal. The term includes a part of receipts from a sale, exchange, or liquidation of a principal
2 asset, to the extent provided in [Article] 4.

3 (8) “Income interest” means the right of a current income beneficiary to receive all or part
4 of net income, whether the terms of the trust require it to be distributed or authorize it to be
5 distributed in the fiduciary’s discretion. The term also includes the right of a current beneficiary
6 to use property held by a fiduciary.

7 (9) “Independent person” means a person that is not:

8 (A) in the case of a trust:

9 (i) [a qualified beneficiary determined under [Section 103(13) of the
10 Uniform Trust Code] [a beneficiary that receives or is entitled to receive income from the trust or
11 would be entitled to receive a distribution of principal if the trust were terminated, assuming no
12 power of appointment is exercised];

13 (ii) a settlor of the trust or the spouse of a settlor of the trust; or

14 (iii) an individual whose legal obligation to support a beneficiary may be
15 satisfied by distributions from the trust;

16 (B) in the case of an estate, a beneficiary; or

17 (C) a related or subordinate party, as that term is defined in Section 672(c) of the
18 Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section 672(c)][, as amended] with
19 respect to a person defined in subparagraph (A) or (B).

20 (10) “Mandatory income interest” means the right of a current income beneficiary to
21 receive net income that the terms of the trust require the fiduciary to distribute.

22 (11) “Net income” means the total allocations to income under this [act] and the terms of
23 the trust during an accounting period minus the disbursements, other than distributions, allocated

1 to income under this [act] and the terms of the trust during the period. The term includes
2 adjustments from principal to income and excludes adjustments from income to principal under
3 Section 203. If the trust is a unitrust or has been converted to a unitrust, the term includes the
4 unitrust amount determined under [Article] 3.

5 (12) “Person” means an individual, corporation, business trust, estate, trust, partnership,
6 limited liability company, association, joint venture, government or governmental subdivision,
7 agency, or instrumentality, public corporation, or any other legal or commercial entity.

8 **Drafting Note:** The UTC defines “person” as “an individual, corporation, business trust, estate,
9 trust, partnership, limited liability company, association, joint venture, government;
10 governmental subdivision, agency, or instrumentality; public corporation, or any other legal or
11 commercial entity,” but the Uniform Principal and Income Act currently uses this broader
12 definition.

13 (13) “Personal representative” means an executor, administrator, successor personal
14 representative, special administrator, and person who performs substantially the same function
15 with respect to an estate under the law governing the person’s status.

16 (14) “Principal” means property held in trust for distribution to, production of income for,
17 or use by a current or successor beneficiary.

18 (15) “Record” means information that is inscribed on a tangible medium or that is stored
19 in an electronic or other medium and is retrievable in perceivable form.

20 (16) “Successor beneficiary” means a person entitled to receive income or principal or
21 use property when an income interest or other current interest ends.

22 (17) “Terms of the trust” means the manifestation of the intent of a settlor or decedent
23 with respect to a trust, expressed in a manner that admits of its proof in a judicial proceeding,
24 whether by words in a record, by other written or spoken words, or by conduct. In the case of a
25 decedent’s estate, the term includes a will. In the case of a life estate, term interest, or other

1 arrangement or relationship, the term includes the corresponding manifestation of the rights of
2 the beneficiaries.

3 (18) “Trust”:

4 (A) includes

5 (i) an express trust, private or charitable, with additions to the trust,
6 wherever and however created; and

7 (ii) a trust created or determined by judgment or decree under which the
8 trust is to be administered in the manner of an express trust; and

9 (B) excludes

10 (i) a constructive trust;

11 (ii) a resulting trust, conservatorship, multi-party account, custodial
12 arrangement for a minor, business trust, common trust fund, voting trust, security arrangement,
13 liquidation trust, and trust for the primary purpose of paying debts, dividends, interest, salaries,
14 wages, profits, pensions, retirement benefits, or employee benefits of any kind; and

15 (iii) an arrangement under which a person is a nominee or escrowee for
16 another.

17 (19) “Trustee” includes an original, additional, or successor trustee, whether or not
18 appointed or confirmed by a court.

19 (20) “Will” means a decedent’s will, codicil, or any testamentary instrument recognized
20 by applicable law.

21 **Legislative Note:** *Modify Section 102(9)(A)(i) to refer to Section 103(13) of the Uniform Trust*
22 *Code, or modify that provision appropriately if your state has not adopted the Uniform Trust*
23 *Code.*

1 **Comment**

2 **“Accounting period.”** The change will clarify that a 52-53-week fiscal year,
3 contemplated, for example, by section 441(f) of the Internal Revenue Code, or any other
4 reasonable fiscal year, is not precluded.

5 **Income beneficiaries.** The definitions of current income beneficiary (Section 102(3))
6 and income interest (Section 102(8)) cover both mandatory and discretionary beneficiaries and
7 interests. There are no definitions for “discretionary income beneficiary” or “discretionary
8 income interest” because those terms are not used in the Act.
9

10 **Inventory value.** There is no definition for inventory value in this Act because the
11 provisions in which that term was used in the 1962 Act have either been eliminated (in the case
12 of the underproductive property provision) or changed in a way that eliminates the need for the
13 term (in the case of bonds and other money obligations, property subject to depletion, and the
14 method for determining entitlement to income distributed from a probate estate).
15

16 **“Record.”** This addition in the current Act is copied from Section 2(22) of the Uniform
17 Trust Decanting Act.
18

19 **“Successor beneficiary.”** This term is used in the current Act rather than “remainder
20 beneficiary,” the term in the 1997 Act, in recognition of the fact that modern trusts often last
21 longer than the life of a single income beneficiary, and therefore the beneficiaries whose future
22 interests are most often in need of balance and protection are beneficiaries who continue as
23 income beneficiaries, not who succeed to the “remainder” interest as if the trust terminates. The
24 term “successor beneficiary” includes “remainder beneficiaries.”
25

26 **“Terms of the trust.”** The term “terms of a trust” was chosen in the 1997 Act in
27 preference to “terms of the trust instrument” (the phrase used in the 1962 Act) to make it clear
28 that the Act applies to oral trusts as well as those whose terms are expressed in written
29 documents. The definition is based on the Restatement (Second) of Trusts § 4 (1959) and the
30 Restatement (Third) of Trusts § 4 (Tent. Draft No. 1, 1996). Constructional preferences or rules
31 would also apply, if necessary, to determine the terms of the trust. The phrase is changed to
32 “terms of the trust” (in contrast to “terms of a trust”) in the current Act because in context that
33 phrase is used much more often in the text of the Act.
34

35 **SECTION 103. SCOPE.** Except as otherwise provided in this [act] or in the terms of
36 the trust, this [act] applies to:

37 (1) a trust or estate;

38 (2) a life estate or other term interest in which the interests of one or more persons

39 will be succeeded by the interests of one or more other persons; and

1 (3) another arrangement or relationship to the extent a person holds property for
2 the benefit of a person that may succeed to an interest in the property, if the interests of the
3 successor may be affected by the allocation of receipts and disbursements between income and
4 principal.

5 **SECTION 104. GOVERNING LAW.** This [act] applies when this state is the principal
6 place of administration of an estate or trust or the situs of property not held in an estate or trust.
7 By accepting the trusteeship of a trust having its principal place of administration in this state or
8 by moving the principal place of administration of a trust to this state, the trustee submits to the
9 application of this [act] to any matter within its scope involving the trust.

10 **Comment**

11 A “rule of construction” is typically governed by the law of the place where the trust was
12 created or deemed created. A “rule of administration” is typically governed by the law of the
13 situs of the trust from time to time, often with appropriate savings provisions for tax benefits, etc.
14 if the situs is changed. Authorities seem to be divided, however, on which historical category
15 includes an income and principal act. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 268,
16 Comment h (1971):

17 The question of the allocation of receipts and expenditures to principal or income
18 presents a different problem. See Restatement of Trusts (Second), §§ 232-241. If a
19 testator creates a trust to be administered in a state other than that of his domicil, the
20 question is whether the allocation, as for instance of extraordinary dividends, is to be
21 determined by the local law of his domicil or the local law of the place of administration.
22 This could conceivably be treated as a question of administration and governed by the
23 local law of the place of administration. On the other hand, it can be treated as a question
24 of the distribution of the trust property and governed by the local law of the testator’s
25 domicil. For the purposes of the choice of the applicable law, it is generally held that it is
26 a question of construction and that the local law of the testator’s domicil is applicable.

27 Despite the fact that income and principal allocations often do determine who gets what and
28 therefore have the effect of rules of construction, treating those allocations as governed by the
29 place of current administration seems to be the most workable approach and seems to be
30 contemplated, for example, by the change-of-situs examples in the 2003 amendments to the GST
31 tax regulations (Reg. § 26.2601-1(b)(4)(i)(E), Examples 11 & 12). Perhaps the biggest burden of
32 a rule of construction is determining the governing law not only *where* the trust was originally
33 created but also *when* the trust was originally created, a burden that gets greater as longer-term
34 trusts become more common and existing trusts therefore become older. Section 104 clarifies

1 that the Uniform Fiduciary Income and Principal Act, like a rule of administration, is governed
2 by the law of the situs, or principal place of administration, of the trust.

3 **[ARTICLE] 2**

4 **FIDUCIARY DUTIES AND JUDICIAL REVIEW**

5 **SECTION 201. FIDUCIARY DUTIES; GENERAL PRINCIPLES.**

6 (a) In allocating a receipt or disbursement to or between income and principal, and with
7 respect to any matter within the scope of [Articles] 6 and 7, a fiduciary:

8 (1) shall administer a trust or estate in good faith in accordance with the terms of
9 the trust, even if there is a different provision in this [act];

10 (2) may administer the trust or estate by the exercise of a discretionary power of
11 administration given to the fiduciary by the terms of the trust, even if exercise of the power
12 produces a result different from a result required or permitted by this [act];

13 (3) shall administer the trust or estate in accordance with this [act] if the terms of
14 the trust do not either contain a different provision or give the fiduciary a discretionary power of
15 administration;

16 (4) shall add a receipt to principal to the extent neither the terms of the trust nor
17 this [act] allocates the receipt to or between income or principal; and

18 (5) shall charge a disbursement to income to the extent neither the terms of the
19 trust nor this [act] allocates the disbursement to or between income or principal.

20 (b) In exercising the power to adjust under Section 203(a), the power to convert to or
21 from a unitrust or change the administration of a unitrust under [Article 3], or another
22 discretionary power of administration regarding a matter within the scope of this [act], whether
23 granted by the terms of the trust or this [act], a trustee shall administer a trust impartially, based

1 on what is fair and reasonable to all the beneficiaries, giving due regard to the beneficiaries’
2 respective interests, except to the extent the terms of the trust manifest an intention that the
3 trustee shall or may favor one or more beneficiaries.

4 (c) In deciding whether and to what extent to exercise powers under Section 203 and
5 [Article] 3, a fiduciary shall consider all other factors relevant to the trust and its beneficiaries,
6 including the following factors to the extent they are relevant:

7 (1) the terms of the trust;

8 (2) the nature, purpose, and expected duration of the trust;

9 (3) the intent of the settlor;

10 (4) the identity and circumstances of the beneficiaries;

11 (5) the needs of the trust and the beneficiaries for liquidity and regularity of
12 income;

13 (6) the need for the preservation and appreciation of the capital of the trust,
14 including the reasonable maintenance of the value of capital with regard to the cost of living and
15 other indices the fiduciary determines to be appropriate;

16 (7) the role of allocations between income and principal in enabling the fiduciary
17 to comply with subsection (b) after applying the rules in subsection (a);

18 (8) the assets held in the trust, the extent to which the assets consist of financial
19 assets, interests in closely held enterprises, tangible and intangible personal property, real
20 property, or assets for which specialized treatment is provided in [Articles] 4 through 7, the
21 extent to which an asset is used or may be used by a beneficiary, and whether an asset was
22 purchased by the fiduciary or received from the settlor;

23 (9) the net amount that would be allocated to income under [Articles] 4 through 7

1 to the extent they apply;

2 (10) the increase or decrease in the value of principal assets, which the fiduciary
3 may estimate as to an asset for which market value is not readily available;

4 (11) whether and to what extent the terms of the trust give the trustee power to
5 invade principal or accumulate income or prohibit the trustee from invading principal or
6 accumulating income, and the extent to which the trustee has invaded principal or accumulated
7 income;

8 (12) the actual and anticipated effect of economic conditions on income and
9 principal and effects of inflation and deflation; and

10 (13) the anticipated tax consequences of the exercise.

11 **Drafting Note:** When the Uniform Directed Trust Act has been approved, this section should be
12 reviewed to ensure that it appropriately authorizes delegation to a co-trustee, special trustee,
13 protector, committee, accountant, or the like, particularly in light of how the Uniform Directed
14 Trust Act deals with section 2041(b)(1)(C) of the Internal Revenue Code.

15
16

Comment

17 No negative inference is intended if the trustee departs from the standards explicitly
18 provided in the Act.

19 Subsection (a)(5) is added, and subsection (a)(4) is changed, to favor principal (an
20 arguable purpose of the original subsection (a)(4)) with respect to both receipts and
21 disbursements. See also Section 501(2).

22 There are more ways to preserve and encourage impartiality than determining what is
23 income and what is principal. Examples include making investments prudently, making
24 distribution decisions thoughtfully, and explaining these actions transparently.

25 The terms of the trust may alter the degree or nature of impartiality without abandoning
26 the duty of impartiality. For example, the terms of the trust may permit or require a current
27 beneficiary to be preferred to meet needs for support in accordance with an accustomed standard
28 of living and for medical care, but in making determinations regarding that standard the trustee
29 owes a duty of impartiality to the current beneficiary and the successive beneficiaries. If such a
30 preference for support and health is expressed, this law preserves the duty of impartiality in
31 making discretionary distributions when that standard is satisfied.

1 The phrase “giving due regard to the beneficiaries’ respective interests” is copied from
2 Section 803 of the Uniform Trust Code, relating to impartiality. Among other things, this could
3 make relevant the relationships of beneficiaries to each other, for example, where the trustee
4 takes note of the fact that the successor beneficiaries following a life income interest of the
5 settlor’s surviving spouse are descendants of that spouse, or not descendants of that spouse, or
6 some who are the spouse’s descendants and some who are not.

7 **Factors.** The factors in Section 201(c) that a trustee should consider are adapted from
8 Section 104(b) of the 1997 Act, which were written in the context of the power to adjust now
9 found in Section 203.

10
11 Section 201(c)(8), based on former Section 104(b)(5), includes “whether an asset was
12 purchased by the fiduciary or received from the settlor” as a factor to consider. This
13 acknowledges the special status historically accorded to “inception assets” that are contributed to
14 a trust by the settlor as part of the initial funding, not acquired by the trustee as an investment or
15 reinvestment. The settlor’s decision to place an inception asset in trust is a tangible expression of
16 the settlor’s intent that deserves some weight, as appropriate. It may deserve more weight, of
17 course, to the extent the terms of the trust explicitly refer to inception assets and encourage or
18 require their holding or exonerate the trustee from continuing in good faith to hold them.

19
20 **SECTION 202. JUDICIAL REVIEW OF DISCRETIONARY POWER.**

21 (a) The court may not order a fiduciary to change a decision to exercise or not to exercise
22 a discretionary power conferred by this [act] unless the court determines that the decision was an
23 abuse of the fiduciary’s discretion. A fiduciary’s decision is not an abuse of discretion merely
24 because the court would have exercised the power in a different manner or would not have
25 exercised the power.

26 (b) If the court determines that a fiduciary has abused the fiduciary’s discretion, the court
27 may place the income and remainder beneficiaries in the positions they would have occupied if
28 the discretion had not been abused, under the following rules:

29 (1) To the extent the abuse of discretion resulted in no distribution to a beneficiary
30 or in a distribution that is too small, the court shall order the fiduciary to distribute to the
31 beneficiary an amount the court determines will restore the beneficiary, in whole or in part, to the
32 beneficiary’s appropriate position.

1 (2) To the extent the abuse of discretion resulted in a distribution to a beneficiary
2 that is too large, the court shall place the beneficiaries, the trust, or both, in whole or in part, in
3 their appropriate positions by ordering the fiduciary to withhold an amount from one or more
4 future distributions to the beneficiary who received the distribution that was too large or ordering
5 that beneficiary to return some or all of the distribution.

6 (3) To the extent that the court is unable, after applying paragraphs (1) and (2), to
7 place the beneficiaries, the trust, or both, in the positions they would have occupied if the
8 discretion had not been abused, the court may order the fiduciary to pay an appropriate amount
9 from its own funds to one or more of the beneficiaries, the trust, or both.

10 (c) On [petition] by the fiduciary, the court having jurisdiction over a trust shall determine
11 whether a proposed exercise or nonexercise by the fiduciary of a discretionary power conferred
12 by this [act] will result in an abuse of the fiduciary’s discretion. If the petition describes the
13 proposed exercise or nonexercise of the power and contains sufficient information to inform the
14 beneficiaries of the reasons for the proposal, the facts upon which the fiduciary relies, and an
15 explanation of how the income and remainder beneficiaries will be affected by the proposed
16 exercise or nonexercise of the power, a beneficiary who challenges the proposed exercise or
17 nonexercise has the burden of establishing that it will result in an abuse of discretion.

18 (d) A determination under this [act] is presumed to be fair and reasonable to all the
19 beneficiaries.

20 *Legislative Note: Modify this provision if your state does not permit what in effect are*
21 *declaratory judgments in such matters.*

22 **SECTION 203. FIDUCIARY’S POWER TO ADJUST.**

23 (a) A fiduciary may adjust between income and principal to the extent the fiduciary

1 considers the adjustment to be in the best interest of the beneficiaries.

2 (b) In deciding whether and to what extent to exercise the power conferred by subsection
3 (a), a fiduciary shall consider all factors relevant to the trust and its beneficiaries, including the
4 relevant factors in Section 201(c).

5 (c) A fiduciary may not make an adjustment:

6 (1) that reduces the income interest in a trust that requires income to be paid at
7 least annually to a spouse and for which a marital deduction for federal estate or gift tax purposes
8 would be allowed, in whole or in part, if the fiduciary did not have the power to make the
9 adjustment;

10 (2) that reduces the actuarial value of the income interest in a trust to which a
11 person transfers property if the transfer would qualify, in whole or in part, for a federal gift tax
12 exclusion based on the actuarial value of the income interest;

13 (3) that changes the amount payable to a beneficiary as a fixed annuity or a fixed
14 fraction of the value of the trust assets;

15 (4) from any amount that is permanently set aside for charitable purposes under
16 the terms of the trust unless both income and principal are so set aside;

17 (5) if possessing or exercising the power to make an adjustment causes a person to
18 be treated as the owner of all or part of the trust for federal income tax purposes;

19 (6) if possessing or exercising the power to make an adjustment causes all or part
20 of the value of the trust assets to be included for federal estate tax purposes in the gross estate of
21 an individual who has the power to remove a fiduciary or appoint a fiduciary, or both, and the
22 value of the assets would not be included in the gross estate of the individual if the fiduciary did
23 not possess the power to make an adjustment;

1 (7) if the fiduciary is a beneficiary of the trust whose interest would be materially
2 affected by the adjustment;

3 (8) if the trustee is not an independent person; or

4 (9) if the trust is a unitrust under [Article] 3.

5 (d) If subsection (c)(5), (6), (7), or (8) applies to a fiduciary and there is more than one
6 fiduciary, a co-fiduciary to whom the provision does not apply may make the adjustment unless
7 the exercise of the power by the remaining fiduciary or fiduciaries is not permitted by the terms
8 of the trust.

9 (e) A fiduciary may release the entire power conferred by subsection (a) or may release
10 only the power to adjust from income to principal or the power to adjust from principal to
11 income if the fiduciary is uncertain about whether possessing or exercising the power will cause
12 a result described in subsection (c)(1) through (6) or (c)(8) or if the fiduciary determines that
13 possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax
14 burden not described in subsection (c). The release may be permanent or for a specified period,
15 including a period measured by the life of an individual.

16 (f) Terms of the trust that limit the power of a fiduciary to make an adjustment between
17 income and principal do not affect the application of this section unless it is clear from the terms
18 of the trust that the terms are intended to deny the fiduciary the power of adjustment under
19 subsection (a).

20 (g) The power under subsection (a):

21 (1) may be exercised at or after the end of the accounting period or at or before the
22 beginning of the accounting period; and

23 (2) may apply to one or more accounting periods.

1 (h) A fiduciary’s exercise of the power under subsection (a) must be:

2 (1) included in the report, if any, that is sent to beneficiaries under [Section
3 813(c)] of [the Uniform Trust Code]; or

4 (2) otherwise reported at least annually to [the qualified beneficiaries determined
5 under [Section 103(13)] of [the Uniform Trust Code], other than the Attorney General] [all
6 beneficiaries that receive or are entitled to receive income from the trust or are entitled to receive
7 a distribution of principal if the trust is terminated at the time the notice is sent, assuming no
8 power of appointment is exercised].

9 (i) This section does not create or imply a duty to adjust under subsection (a) or to inform
10 beneficiaries about the applicability of this section.

11 (j) A fiduciary that in good faith takes or fails to take any action under this section is not
12 liable to a person affected by the action or inaction. The exclusive remedy of a person affected
13 by a fiduciary’s good-faith action or inaction under this section is to obtain a court order directing
14 the fiduciary to exercise or refrain from exercising the power under subsection (a).

15 *Legislative Note: Modify Section 203(h)(1) to refer to Section 813(c) of the Uniform Trust Code*
16 *and modify Section 203(h)(2) to refer to Section 103(13) of the Uniform Trust Code, or modify*
17 *those provisions appropriately if your state has not adopted the Uniform Trust Code.*

18 **Comment**

19 **Limitations on the power to adjust.** Section 203(c) prohibits a trustee from exercising
20 the power to adjust where certain tax advantages might be jeopardized or the trustee might be
21 personally affected. In the latter case, the Drafting Committee does not intend that a trustee be
22 disqualified merely because of a remote interest in the principal of the trust – for example, if the
23 trustee is a remote contingent beneficiary in the unlikely event a number of younger-generation
24 beneficiaries all die before the trust terminates. Section 203(c)(7) uses the word “materially” for
25 that reason.

26 Section 203 does not provide for the appointment of a disinterested person to exercise the
27 power to adjust if no trustee is eligible, as Section 303(e) does in the case of converting the trust
28 to a unitrust, for example. Unlike a one-time conversion to a unitrust, the adjustment between
29 income and principal requires ongoing awareness of and attention to the particular characteristics

1 of the trust and its beneficiaries.

2 In any event, Section 203(d) allows an adjustment to be made by a qualified co-trustee or
3 co-trustees when the other co-trustee or co-trustees is or are disqualified. Whether two or more
4 qualified co-trustees must act unanimously or by majority vote or in some other way is left to
5 general rules of trust law or the particular governing instrument.

6 Even in a case where Section 203(c) does not prohibit a trustee from adjusting between
7 income and principal because certain tax advantages might be jeopardized, the trustee's
8 adjustment between income and principal does not necessarily determine or affect the amount of
9 income that will be subject to federal income tax. Income for federal tax purposes is different
10 from income for purposes of trust administration. As Treasury Reg. §1.643(b)-1 warns, "[t]rust
11 provisions that depart fundamentally from traditional principles of income and principal will
12 generally not be recognized" for income tax purposes.

13 **[ARTICLE] 3**

14 **UNITRUST**

15 **SECTION 301. DEFINITIONS.** In this [article]:

16 (1) "Applicable value" means the amount of the net fair market value of the trust taken
17 into account under Section 307.

18 (2) "Net fair market value of the trust" means the fair market value of the assets of the
19 trust, less the liabilities of the trust.

20 (3) "Special tax benefit" means:

21 (A) eligibility of a transfer to a trust for the exclusion from gifts described in
22 Section 2503(b) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section
23 2503(b)][, as amended] because of the qualification of an income interest in the trust as a present
24 interest;

25 (B) qualification of a trust as a qualified subchapter S trust described in Section
26 1361(d) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section 1361(d)][, as
27 amended] at a time the trust holds stock of an S corporation defined in Section 1361(a)(1) of the
28 Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section 1361(a)(1)][, as amended];

1 (C) qualification of a transfer to a trust for an estate tax or gift tax marital
2 deduction under Section 2056 or 2523 of the Internal Revenue Code of 1986[, as amended][, 26
3 U.S.C. Section 2056 or 2523][, as amended] that depends or depended in whole or in part on the
4 right of the transferor’s spouse to receive the net income of the trust;

5 (D) exemption in whole or in part of a trust from the federal generation-skipping
6 transfer tax imposed by Section 2601 of the Internal Revenue Code of 1986[, as amended][, 26
7 U.S.C. Section 2601][, as amended] because the trust was irrevocable on September 25, 1985; or

8 (E) an inclusion ratio, as defined in Section 2642(a) of the Internal Revenue Code
9 of 1986[, as amended][, 26 U.S.C. Section 2642(a)][, as amended], of the trust that is less than
10 one, if there is any possibility that:

11 (i) a taxable distribution as defined in Section 2612(b) of the Internal
12 Revenue Code of 1986[, as amended][, 26 U.S.C. Section 2612(b)][, as amended] could be made
13 from the trust; or

14 (ii) a taxable termination as defined in Section 2612(a) of the Internal
15 Revenue Code of 1986[, as amended][, 26 U.S.C. Section 2612(a)][, as amended] could occur
16 with respect to the trust.

17 (4) “Unitrust” means a trust:

18 (A) for which net income is a unitrust amount; and

19 (B) that meets the requirements of a unitrust policy.

20 (5) “Unitrust amount” means an amount computed by multiplying the applicable value by
21 the unitrust rate.

22 (6) “Unitrust policy” means the policy described in Sections 305 through 309 and adopted
23 under Section 303.

1 (7) “Unitrust rate” means the rate used to compute the unitrust amount under paragraph
2 (5), determined pursuant to the unitrust policy.

3 **SECTION 302. APPLICATION OF [ARTICLE].**

4 (a) This [article] applies to an estate only to the extent a trust is a beneficiary of the estate.

5 (b) This [article] does not apply to a trust if:

6 (1) the terms of the trust expressly prohibit use of this [article] by a specific
7 reference to this [article] or by an explicit expression of intent that income or net income not be
8 calculated as a unitrust amount; or

9 (2) the trust is a trust described in Section 170(f)(2)(B), 642(c)(5), 664(d),
10 2702(a)(3), or 2702(b) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section
11 170(f)(2)(B), 642(c)(5), 664(d), 2702(a)(3), or 2702(b)][, as amended].

12 (c) A trust may be converted to a unitrust under this [article] regardless of the terms of the
13 trust concerning distributions. Conversion to a unitrust under this [article] does not affect other
14 terms of the trust concerning distributions of income or principal.

15 **SECTION 303. AUTHORITY OF FIDUCIARY.**

16 (a) A fiduciary may, without court approval, convert a trust to a unitrust, discontinue the
17 status of a trust as a unitrust, or change the percentage or method used to calculate the unitrust
18 amount if:

19 (1) the fiduciary is an independent person;

20 (2) the fiduciary adopts in a record a unitrust policy for the trust providing:

21 (A) if the trust is not a unitrust:

1 (i) that in administering the trust in the future the net income of the
2 trust must be a unitrust amount rather than net income determined without regard to this [article];

3 and

4 (ii) the percentage and method used to calculate the unitrust
5 amount; or

6 (B) if the trust is a unitrust:

7 (i) that in administering the trust in the future the net income of the
8 trust must be net income determined without regard to this [article] rather than a unitrust amount;

9 or

10 (ii) that the percentage or method used to calculate the unitrust
11 amount must be changed as stated in the unitrust policy;

12 (3) the fiduciary sends a notice described in Section 304;

13 (4) if the settlor of the trust is living, the fiduciary sends a copy of the notice
14 required under paragraph (3) to the settlor;

15 (5) at least one member of each class[of qualified beneficiaries] receiving the
16 notice under paragraph (3) is:

17 (A) legally competent;

18 (B) in the case of a charitable organization, then existing; or

19 [(C) represented in the manner provided in Section 304(b)]; and

20 (6) the fiduciary does not receive an objection in a record to the action proposed
21 under this subsection from a person to whom the notice under paragraph (3) is sent by the date
22 specified in the notice under Section 304(d)(4).

1 (b) If a fiduciary receives an objection in a record described in Section 304(d)(3) not later
2 than the date stated in the notice under Section 304(d)(4), the fiduciary or a beneficiary may
3 petition the court to have the proposed action taken as proposed, taken with modifications, or
4 denied. A person described in Section 304(a) may oppose the action proposed under subsection
5 (a) in the proceeding under this subsection, regardless of whether the person has:

6 (1) consented under Section 304(c); or

7 (2) objected under Section 304(d)(3).

8 (c) If a fiduciary decides not to take the action proposed under subsection (a), the
9 fiduciary shall notify each person described in Section 304(a) of the decision not to take the
10 action and the reasons for the decision.

11 (d) If a fiduciary is not an independent person and one or more fiduciaries are
12 independent persons, the fiduciaries that are independent persons may take the action described
13 in subsection (a), (b), or (c).

14 (e) If no fiduciary is an independent person, the fiduciary may appoint an independent
15 person to take an action described in subsection (a), (b), or (c) in the independent person's sole
16 discretion exercised in a fiduciary capacity.

17 (f) If no fiduciary is an independent person, or if the fiduciary chooses not to take an
18 action under subsection (a), (b), or (e), the fiduciary or a beneficiary may petition the court for
19 approval of any of the actions described in subsection (a) or (b).

20 (g) In deciding whether and how to take an action authorized by this section, a fiduciary
21 shall consider all factors relevant to the trust and its beneficiaries, including the relevant factors
22 in Section 201(c).

1 (h) The fiduciary may release the power under subsection (a) for the reasons and in the
2 manner described in Section 203(e).

3 **Legislative Note:** *Modify Section 303(a)(5) to refer to Section 103(13) of the Uniform Trust*
4 *Code, or modify that provision appropriately if your state has not adopted the Uniform Trust*
5 *Code.*

6 **SECTION 304. NOTICE.**

7 (a) The notice required by Section 303(a)(3) must be sent[, in a manner authorized under
8 [Section 109] of [the Uniform Trust Code],] to:

9 (1) [the qualified beneficiaries determined under [Section 103(13)] of [the
10 Uniform Trust Code], other than the Attorney General] [all beneficiaries that receive or are
11 entitled to receive income from the trust or are entitled to receive a distribution of principal if the
12 trust is terminated at the time the notice is sent, assuming no power of appointment is exercised];
13 and

14 (2) each person acting as[advisor or protector] of the trust.

15 [(b) The representation provisions of [Article 3] of [the Uniform Trust Code] apply to
16 notice under this section.]

17 [(c)] The notice under Section 303(a)(3) need not be sent to a person that consents in a
18 record to the action proposed under Section 303(a). The consent may be executed and delivered
19 at any time before, when, or after the proposed action is taken.

20 [(d)] The notice required by Section 303(a)(3) must include:

21 (1) notice of the action proposed under Section 303(a);

22 (2) a copy of the unitrust policy under Section 303(a)(2);

1 (3) a statement that the person to which the notice is sent may object to the
2 proposed action by stating the basis for the objection in a record and mailing or delivering the
3 record to the fiduciary;

4 (4) the date by which an objection under paragraph (3) must be made, which must
5 be at least 30 days after the date the notice is sent;

6 (5) the date on which the action is proposed to be taken and, if different, the date
7 on which the action is proposed to take effect;

8 (6) the name and mailing address of the fiduciary; and

9 (7) the name and telephone number of a person that may be contacted for
10 additional information.

11 *Legislative Note: Modify Section 304(a) to refer to Section 109 of the Uniform Trust Code,*
12 *modify Section 304(a)(1) to refer to Section 103(13) of the Uniform Trust Code, and modify the*
13 *bracketed words in Section 304(b) to refer to Article 3 of the Uniform Trust Code; or modify*
14 *those provisions appropriately if your state has not adopted the Uniform Trust Code.*

15 **SECTION 305. UNITRUST POLICY.**

16 (a) In administering a unitrust under this [article], the fiduciary shall follow the unitrust
17 policy adopted under Section 303(a)(2).

18 (b) A unitrust policy must provide for:

19 (1) the unitrust rate or the determination of the unitrust rate under Section 306;

20 and

21 (2) the determination of the applicable value under Section 307.

22 **SECTION 306. UNITRUST RATE.**

23 (a) A unitrust rate may be:

24 (1) a fixed unitrust rate; or

1 (2) a unitrust rate that is determined for each period using:

2 (A) a market index or other published data; or

3 (B) a mathematical blend of market indices or other published data over a
4 stated number of previous periods.

5 (b) A unitrust policy may provide for:

6 (1) a limit on how high the unitrust rate determined under subsection (a)(2) may
7 rise;

8 (2) a limit on how low the unitrust rate determined under subsection (a)(2) may
9 fall;

10 (3) a limit on how much the unitrust rate determined under subsection (a)(2) may
11 increase over the unitrust rate for the previous period or a mathematical blend of unitrust rates
12 over a stated number of previous periods;

13 (4) a limit on how much the unitrust rate determined under subsection (a)(2) may
14 decrease below the unitrust rate for the previous period or a mathematical blend of unitrust rates
15 over a stated number of previous periods; or

16 (5) a mathematical blend of any of the unitrust rates determined under subsection
17 (a)(2) and paragraphs (1) through (4).

18 **SECTION 307. APPLICABLE VALUE.**

19 (a) A unitrust policy must state the method for determining the fair market value of an
20 asset for purposes of determining the unitrust amount, including:

21 (1) the frequency of valuing an asset, which need not require a valuation in every
22 period; and

23 (2) the date for valuing an asset in each period in which the asset is valued.

1 (b) A unitrust policy may prescribe standards for:

2 (1) the exclusion of specific assets or groups or types of assets from the
3 calculation of the unitrust amount;

4 (2) other exceptions or modifications of the treatment of specific assets or groups
5 or types of assets in the calculation of the unitrust amount;

6 (3) how the net income attributable to an asset excluded under paragraph (1) or
7 given special treatment under paragraph (2) must be determined and the effect of the net income
8 on distributions;

9 (4) obtaining an appraisal of an asset for which market value is not readily
10 available; and

11 (5) identification and treatment of cash or property held for distribution to
12 determine the fair market value of the assets of the trust.

13 (c) A unitrust policy may prescribe methods for determining the amount of the fair market
14 value to take into account in determining the applicable value, including:

15 (1) use of an average of applicable values over a stated number of previous
16 periods;

17 (2) use of another mathematical blend of applicable values over a stated number
18 of previous periods;

19 (3) a limit on how much the applicable value of all assets, groups of assets, or
20 individual assets, may increase over:

21 (A) the corresponding applicable value for the previous period; or

22 (B) a mathematical blend of applicable values over a stated number of
23 previous periods;

1 (4) a limit on how much the applicable value of all assets, groups of assets, or
2 individual assets may decrease below:

3 (A) the corresponding applicable value for the previous period; or

4 (B) a mathematical blend of applicable values over a stated number of
5 previous periods; or

6 (5) the treatment of accrued income and other financial features of an asset.

7 (d) A unitrust policy may prescribe methods for determining the liabilities of the trust,
8 including treatment of liabilities to conform with the treatment of assets under subsections (a)
9 through (c).

10 **SECTION 308. PERIOD.**

11 (a) A unitrust policy must prescribe the period used under Section 306(a)(2), 306(b)(3) or
12 (4), or 307(a), which may be:

13 (1) a calendar year or quarter;

14 (2) a 12-month or three-month period other than a calendar year or quarter; or

15 (3) another period;

16 (b) A unitrust policy may prescribe standards for:

17 (1) using a fewer number of previous periods under Section 306(a)(2) or 306(b)(3)
18 or (4) if the trust has not been in existence for the previous periods or market indices or other
19 published data are not available;

20 (2) using a fewer number of previous periods under Section 307(a) if the trust has
21 not been in existence for the previous periods or fair market values are not available; or

1 (3) prorating the unitrust amount[on a daily basis] for a part of a period in which
2 the trust or the administration of the trust as a unitrust or the interest of any beneficiary
3 commences or terminates.

4 **SECTION 309. OTHER RULES; SPECIAL TAX BENEFITS.**

5 (a) A unitrust policy may prescribe methods and standards for:

6 (1) determining the timing of distributions;

7 (2) making distributions in cash or in kind or partly in cash and partly in kind; or

8 (3) correcting an underpayment or overpayment to a beneficiary based on the
9 unitrust amount if there is an error in calculating the unitrust amount.

10 (b) A unitrust policy may prescribe other standards and rules the fiduciary determines
11 serve the interests of the beneficiaries.

12 (c) If a trust qualifies for any special tax benefit:

13 (1) the unitrust rate established under Section 306(a)(1) may not be less than three
14 percent or more than five percent;

15 (2) the only period that may be used under Section 308(a) is a calendar year; and

16 (3) no other provision of Sections 305 through 308 applies, except Sections
17 305(a), 307(a)(1), (b)(4) and (5), and (d), and 308(b)(2) and (3).

18 **SECTION 310. DUTIES AND REMEDIES.**

19 (a) This [article] does not create or imply a duty to take action or to inform beneficiaries
20 about the applicability of this [article].

21 (b) A fiduciary or independent person that in good faith takes or fails to take any action
22 under this [article] is not liable to a person affected by the action or inaction, regardless of
23 whether the affected person received notice in a record as provided in this [article] or the affected

1 person was under a legal disability at the time of delivery of the notice. The exclusive remedy of
2 a person affected by the good-faith action or inaction under this [article] of a fiduciary or
3 independent person is to obtain a court order directing the fiduciary to convert a trust to a
4 unitrust, discontinue the status of a trust as a unitrust, or change the percentage or method used to
5 calculate the unitrust amount.

6 **Legislative Note:** *In states in which the constitution, or other law, does not permit the phrase “as*
7 *amended” when federal statutes are incorporated into state law, the phrase should be omitted.*
8 *Modify Section 304(a) to refer to appropriate general provisions for sending notice. Modify*
9 *Sections 304(a)(1) and 303(a)(5) to refer to Section 103(13) (defining “qualified beneficiary”)*
10 *and related provisions of the Uniform Trust Code, or modify those provisions appropriately if*
11 *your state has not adopted the Uniform Trust Code. Modify Section 304(a)(2) to refer to*
12 *appropriate provisions defining and addressing trust advisors and trust protectors, perhaps in*
13 *light of the Uniform Directed Trust Act, or modify or delete Section 304(a)(2) as appropriate if*
14 *your state law has no such provisions. Modify Section 304(b) to refer to Article 3 and other*
15 *provisions of the Uniform Trust Code defining and addressing representation, or modify or*
16 *delete Section 304(b) as appropriate if your state has not adopted the Uniform Trust Code.*

17

18

Comment

19 **Background.** The word “unitrust” can be traced at least to the literature of the mid-
20 1960s. Lovell, “The Unitrust: A New Concept to Meet an Old Problem,” 105 TRUSTS &
21 ESTATES 215 (1966); Del Cotto & Joyce, “Taxation of the Trust Annuity: The Unitrust Under the
22 Constitution and the Internal Revenue Code,” 23 TAX L. REV. 257 (1968). For many estate
23 planners and charitable giving planners, the first introduction to the word may be in the term
24 “charitable remainder unitrust” introduced by Congress in section 664, added to the Internal
25 Revenue Code by the Tax Reform Act of 1969. The word was reprised following the enactment
26 of section 2702 in Treasury Reg. § 25.2702-3(c), governing “qualified unitrust interests” in
27 grantor retained unitrusts (“GRUTs”) (which are hardly ever used, if they are used at all).

28 While the precise origin or intent of the word is not totally clear, it appears derived from
29 the notion that the trust consists of a *unified* fund—“a single fund [in which] there would be no
30 distinction between income and principal,” only between “receipts” and “payouts.” Lovell,
31 *supra*. The “unitrust” can be thought of as a trust in which there is a “unity” of interest between
32 the current income beneficiary and the successor beneficiary, because both desire a higher value
33 of the trust assets.

34 Thus, in today’s legal usage, a “unitrust” is simply a trust in which the periodic payout to
35 the current income beneficiary is determined with reference to a percentage of the net value of
36 the trust assets, determined from time to time, regardless of how much income is produced by the
37 trust assets or the growth of the trust assets. As the value of the trust assets increases, the unitrust
38 amount increases. As the value decreases, the unitrust amount decreases.

1 Converting or reforming a trust to a unitrust can provide a partnership among the income
2 beneficiaries, the remainder beneficiaries, and the trustee that will enable the trustee to invest the
3 assets for long-term growth to the benefit of all beneficiaries. This will permit the mission of the
4 trustee and investment team to become more focused. Investment decisions can be based on the
5 needs and risk tolerances of the beneficiaries, and there is less likelihood of dissension between
6 the current and future beneficiaries over investment policy. In addition, to the extent that a
7 unitrust approach obviates discretionary invasions of principal, the trustee is protected against
8 challenges by the remainder beneficiaries that any discretionary principal distributions were
9 excessive. Similarly, a unitrust approach eliminates the need to make adjustments between
10 income and principal under Section 401 and thus avoids or minimizes controversy over whether
11 such adjustments are proper.

12 By the end of 2016, 34 states (Alabama, Alaska, Arizona, California, Colorado,
13 Delaware, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland,
14 Missouri, Nebraska, Nevada, New Hampshire, New York, North Carolina, Oregon,
15 Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Virginia,
16 Washington, West Virginia, Wisconsin, and Wyoming) had enacted statutes, some as part of
17 their Uniform Principal and Income Act and some separately, permitting a trustee to convert a
18 trust to a unitrust. Some of those statutes refer to unitrusts as “total return unitrusts” (a term not
19 used in Section 501).

20 **Response by the Internal Revenue Service.** In February 2001, the Internal Revenue
21 Service published proposed regulations it described in part as follows: “This document contains
22 proposed regulations revising the definition of income under section 643(b) of the Internal
23 Revenue Code to take into account changes in the definition of trust accounting income under
24 state laws.” The preamble to the proposed regulations noted:

25 These [then current] statutory and regulatory provisions [under section 643] date
26 back to a time when, under state statutes, dividends and interest were considered income
27 and were allocated to the income beneficiaries while capital gains were allocated to the
28 principal of the trust. Changes in the types of available investments and in investment
29 philosophies have caused states to revise, or to consider revising, these traditional
30 concepts of income and principal....

31 To ensure that the income beneficiaries are not penalized if a trustee adopts a total
32 return investment strategy, many states have made, or are considering making, revisions
33 to the definitions of income and principal. Some state statutes permit the trustee to make
34 an equitable adjustment between income and principal if necessary to ensure that both the
35 income beneficiaries and the remainder beneficiaries are treated impartially, based on
36 what is fair and reasonable to all of the beneficiaries. Thus, a receipt of capital gains that
37 previously would have been allocated to principal may be allocated by the trustee to
38 income if necessary to treat both parties impartially. Conversely, a receipt of dividends or
39 interest that previously would have been allocated to income may be allocated by the
40 trustee to principal if necessary to treat both parties impartially.

41 Other states are proposing legislation that would allow the trustee to pay a unitrust

1 amount to an income beneficiary in satisfaction of that beneficiary’s right to the income
2 from the trust. This unitrust amount will be a fixed percentage, sometimes required to be
3 within a range set by state statute, of the fair market value of the trust assets determined
4 annually.

5 Questions have arisen concerning how these state statutory changes affect the
6 definition of income provided in section 643(b) and the other Code provisions that rely on
7 the section 643(b) definition of income. This definition of income affects trusts
8 including, but not limited to, ordinary trusts, charitable remainder trusts, pooled income
9 funds, and qualified subchapter S trusts.

10 In short, amendment of the regulations was proposed to respond to changes in circumstances,
11 including changes in the pressures on a trustee faced with an obligation to invest for total return
12 under the prudent investor rule and faced with the remedies of principal-income adjustments
13 under the Revised Uniform Principal and Income Act and of conversion to a total return unitrust.

14 The final regulations were released on December 30, 2003. Treasury Reg. §1.643(b)-1
15 states, in part:

16 [A]n allocation of amounts between income and principal pursuant to applicable local
17 law will be respected if local law provides for a reasonable apportionment between the
18 income and remainder beneficiaries of the total return of the trust for the year, including
19 ordinary and tax-exempt income, capital gains, and appreciation. For example, a state
20 statute providing that income is a unitrust amount of no less than 3% and no more than
21 5% of the fair market value of the trust assets, whether determined annually or averaged
22 on a multiple year basis, is a reasonable apportionment of the total return of the trust.

23 **Article 3.** The typical state unitrust statute limits unitrust conversions to the parameters
24 in the Treasury Regulations – “a unitrust amount of no less than 3% and no more than 5% of the
25 fair market value of the trust assets, whether determined annually or averaged on a multiple year
26 basis.” Article 3 borrows heavily from that existing state legislation, but it is broader and more
27 flexible than the laws of most states. The Drafting Committee decided that state law should not
28 be limited by specialized federal regulations and have included in Article 3 many more features
29 and refinements than only a 3-5% range and the potential for annual averaging, to permit a
30 unitrust to even better serve the objective of achieving more stability and predictability for
31 beneficiaries.

32 One such refinement is to provide that the trust distribute a percentage of its market value
33 determined on the basis of a rolling average of values for periods other than years. Twelve
34 quarters is an example. This can reduce potential fluctuations in distributions caused by short-
35 swing movements in the stock market. Although the rate of increase in the unitrust distribution
36 to the current income beneficiary will lag the performance of the portfolio, the current income
37 beneficiary will benefit in down years. Another similar refinement designed to reduce risk to all
38 the beneficiaries is to place a ceiling and/or a floor on the unitrust payout amount, or on the size
39 of fluctuation of the unitrust amount from year to year or period to period. More fundamental
40 refinements include a variable unitrust rate itself, perhaps drawn from specified market data, and

1 different treatment for different types of assets, including the total exclusion of certain assets and
2 the income therefrom. Sections 305-308 allow all variations of that kind. To afford a trustee the
3 benefit of the safe harbor in the Treasury regulations in situations where it applies, Section 309(c)
4 limits the parameters in those situations to the parameters specified in that safe harbor. The
5 situations where Section 309(c) applies, described as situations in which the trust offers a
6 “special tax benefit” defined in Section 301(3), are limited to the situations addressed in the 2003
7 Treasury Regulations.

8 Because of the broad flexibility Article 3 allows, it is not necessary to provide specific
9 fixes for specific identified challenges, including computational challenges like the treatment of
10 accrued but unpaid income and the treatment of property that is personally used and not invested.

11 In addition to the requirements in Section 304(d), some state statutes also require the
12 trustee to send a copy of the state unitrust statute. If the other, somewhat more detailed,
13 requirements of this Article 3 are followed, that seems unnecessary, although any state that
14 chooses may still add it.

15 Section 302(c) provides that a trust may be converted to a unitrust regardless of the terms
16 of the trust governing distributions – that is, even though distributions are not defined or limited
17 by the amount of net income of the trust. This is a departure from current state laws, but it
18 reflects the overall commitment to flexibility that is a theme of the current revision of the Act.

19 **[ARTICLE] 4**

20 **ALLOCATION OF RECEIPTS DURING ADMINISTRATION**

21 **[PART 1**

22 **RECEIPTS FROM ENTITIES]**

23 **SECTION 401. CHARACTER OF RECEIPTS.**

24 (a) In this section, “entity” means a corporation, partnership, limited liability company,
25 regulated investment company, real estate investment trust, common trust fund, or any other
26 organization or arrangement in which a fiduciary has an interest, regardless of whether the entity
27 is a taxpayer for federal income tax purposes, other than a trust or estate to which Section 402
28 applies, a business or activity to which Section 403 applies, an asset-backed security to which
29 Section 414 applies, or an instrument or arrangement to which Section 415 applies.

30 (b) Except as otherwise provided in this section, a fiduciary shall allocate to income

1 money received from an entity.

2 (c) A fiduciary shall allocate the following receipts from an entity to principal:

3 (1) property, of more than insubstantial or immaterial value, other than money;

4 (2) money received in one distribution or a series of related distributions in
5 exchange for part or all of a trust's interest in the entity;

6 (3) money received in total or partial liquidation of the entity; and

7 (4) money received from an entity that is:

8 (A) a regulated investment company or a real estate investment trust if the
9 money distributed is a capital gain dividend for federal income tax purposes; or

10 (B) an entity or arrangement treated comparably for federal income tax
11 purposes to the treatment describe in paragraph (4)(A).

12 (d) Money is presumed to be received in partial liquidation to the extent the entity, not
13 later than the date on which the entity files a federal income tax return for the year in which the
14 distribution was made, indicates that it is a distribution in partial liquidation. The fiduciary may
15 determine that the circumstances require an allocation different from this presumption.

16 (e) If an entity does not indicate that a distribution is in partial liquidation and the total
17 amount of money and property distributed in a distribution or series of related distributions to all
18 owners or distributees is greater than 20 percent of the fair market value of the entity's assets, as
19 shown by the entity's year-end financial statements immediately preceding the initial receipt, the
20 distribution shall be treated as a distribution in partial liquidation except to the extent the
21 fiduciary determines the distribution is substantially equivalent to income previously
22 undistributed.

23 (f) Money is not received in partial liquidation and is income to the extent it does not

1 exceed the amount of income tax a fiduciary or beneficiary must pay on taxable income of the
2 entity that distributes the money.

3 (g) A fiduciary may rely on a statement made by an entity about the source or character of
4 a distribution if the statement is made not later than the date on which the entity files a federal
5 income tax return for the year in which the distribution was made by the entity's board of
6 directors or other person or group of persons authorized to exercise powers to pay money or
7 transfer property comparable to those of a corporation's board of directors, including the manager
8 of a limited liability company and general partner of a partnership

9 **Comment**

10 **Additional flexibility.** The references to Section 415 at the end of Section 401(a) and to
11 entities comparably treated for federal income tax purposes in Section 401(c)(4)(B) provide
12 necessary guidance that may stay up-to-date even as new entities and arrangements are developed
13 to serve various tax needs and objectives.

14
15 **SECTION 402. DISTRIBUTION FROM TRUST OR ESTATE.** A fiduciary shall
16 allocate to income an amount received as a distribution of income, including a unitrust
17 distribution under [Article] 3, from a trust or an estate in which the trust has an interest other than
18 a purchased interest, and shall allocate to principal an amount received as a distribution of
19 principal from such a trust or estate. If a fiduciary purchases an interest in a trust that is an
20 investment entity, or a decedent or donor transfers an interest in such a trust to a fiduciary,
21 Section 401 or 414 applies to a receipt from the trust.

22 **SECTION 403. BUSINESS AND OTHER ACTIVITIES CONDUCTED BY**
23 **FIDUCIARY.**

24 (a) If a fiduciary that conducts a business or other activity determines that it is in the best
25 interest of all the beneficiaries to account separately for the business or activity instead of

1 accounting for it as part of the trust's general accounting records rather than through an entity
2 described in Section 401 whether or not the entity is a taxpayer for federal income tax purposes,
3 the fiduciary may maintain separate accounting records for its transactions, whether or not its
4 assets are segregated from other trust assets.

5 (b) A fiduciary that accounts separately for a business or other activity may determine the
6 extent to which the net cash receipts of the business must be retained for working capital, the
7 acquisition or replacement of fixed assets, and other reasonably foreseeable needs of the business
8 or activity, and the extent to which the remaining net cash receipts are accounted for as principal
9 or income in the trust's general accounting records. The fiduciary may make those
10 determinations separately and differently from the fiduciary's decisions concerning distributions
11 of income or principal. If a fiduciary sells assets of the business or other activity, other than in
12 the ordinary course of the business or activity, the fiduciary shall account for the net amount
13 received as principal in the trust's general accounting records to the extent the fiduciary
14 determines that the amount received is no longer required in the conduct of the business.

15 (c) Activities for which a fiduciary may maintain separate accounting records include:

- 16 (1) retail, manufacturing, service, and other traditional business activities;
- 17 (2) farming;
- 18 (3) raising and selling livestock and other animals;
- 19 (4) management of rental properties;
- 20 (5) extraction of minerals and other natural resources;
- 21 (6) timber operations;
- 22 (7) activities to which Section 413 applies; and
- 23 (8) other operating businesses.

1 **Comment**

2 **Separate accounting.** The second sentence of subsection (b) is added to accommodate
3 the concept of “separate accounting” in a trust the only activity of which (other than making
4 distributions to beneficiaries) is the conduct of a business. It may not be reasonable to assume
5 that receipts not distributed to beneficiaries have been “retained” for use in the business, if that
6 permits discretionary distributions to beneficiaries, in effect, to define trust income. That might
7 be especially awkward if discretionary distributions of either income or principal or both to
8 multiple beneficiaries are not made pro rata. In such a case, the trustee is permitted to designate
9 which distributions in effect define trust income, and which distributions are discretionary
10 distributions under the terms of the trust not intended to be a standard or precedent for defining
11 income.
12

13 **[PART 2**

14 **RECEIPTS NOT NORMALLY ALLOCATED]**

15 **SECTION 404. PRINCIPAL RECEIPTS.** A fiduciary shall allocate to principal:

16 (1) to the extent not allocated to income under this [act], assets received from a transferor
17 during the transferor’s lifetime, a decedent’s estate, a trust with a terminating income interest, or
18 a payor under a contract naming the fiduciary as beneficiary;

19 (2) money or other property received from the sale, exchange, liquidation, or change in
20 form of a principal asset, subject to this [article];

21 (3) amounts recovered from third parties to reimburse the trust because of disbursements
22 described in Section 502(a)(7) or for other reasons to the extent not based on the loss of income;

23 (4) proceeds of property taken by eminent domain, except that proceeds awarded for a
24 loss of income for a period are income if a current income beneficiary had a mandatory income
25 interest during the period;

26 (5) net income received in an accounting period during which there is no beneficiary to
27 whom a fiduciary may or must distribute income; and

28 (6) other receipts as provided in [Part 3].

1 **SECTION 405. RENTAL PROPERTY.** To the extent the fiduciary does not account
2 separately under Section 403 for the management of rental properties, the fiduciary shall allocate
3 to income an amount received as rent of real or personal property, including an amount received
4 for cancellation or renewal of a lease. An amount received as a refundable deposit, including a
5 security deposit or a deposit that is to be applied as rent for future periods, must be added to
6 principal and held subject to the terms of the lease, except as otherwise provided by law, and is
7 not available for distribution to a beneficiary until the fiduciary's contractual obligations have
8 been satisfied with respect to that amount.

9 **SECTION 406. RECEIPT ON AN OBLIGATION TO BE PAID IN MONEY .**

10 (a) This section does not apply to an obligation to which Section 408, 409, 410, 411, 413,
11 or 414 applies.

12 (b) An amount received as interest on an obligation to pay money to a fiduciary, including
13 an amount received as consideration for prepaying principal, must be allocated to income without
14 any provision for amortization of premium.

15 (c) A fiduciary shall allocate to principal an amount received from the sale, redemption, or
16 other disposition of an obligation to pay money to the fiduciary more than one year after it is
17 purchased or acquired by the fiduciary, including an obligation whose purchase price or value
18 when it is acquired is less than its value at maturity. If the obligation matures not later than one
19 year after it is purchased or acquired by the fiduciary, an amount received that exceeds its
20 purchase price or its value when acquired by the fiduciary must be allocated to income.

21 **SECTION 407. INSURANCE POLICIES AND SIMILAR CONTRACTS.**

22 (a) This section does not apply to a contract to which Section 408 applies.

23 (b) Except as otherwise provided in subsection (c), a fiduciary shall allocate to principal

1 the proceeds of a life insurance policy or other contract received by the fiduciary as beneficiary,
2 including a contract that insures against loss for damage to, destruction of, or loss of title to an
3 asset. The fiduciary shall allocate dividends on an insurance policy to income if the premiums on
4 the policy are paid from income, and to principal if the premiums are paid from principal.

5 (c) A fiduciary shall allocate to income proceeds of a contract that insures the fiduciary
6 against loss of occupancy or other use by a current income beneficiary, loss of income, or, subject
7 to Section 403, loss of profits from a business.

8 **[PART 3**

9 **RECEIPTS NORMALLY APPORTIONED]**

10 **SECTION 408. DEFERRED COMPENSATION, ANNUITIES, AND SIMILAR**
11 **PAYMENTS.**

12 (a) In this section:

13 (1) "Payment" means an amount a fiduciary may receive over a fixed number of
14 years or during the life of one or more individuals because of services rendered or property
15 transferred to the payor in exchange for future receipts. The term includes an amount drawn in
16 money or property from the payor's general assets or from a separate fund created by the payor.
17 For purposes of subsections (e), (f), (g), and (h), the term also includes an amount drawn from
18 any separate fund, regardless of the reason for the withdrawal.

19 (2) "Separate fund" includes a private or commercial annuity, an individual
20 retirement account, and a pension, profit-sharing, stock-bonus, or stock-ownership plan.

21 (b) To the extent a payment is characterized by the payor as interest, a dividend, or a
22 payment made in lieu of interest or a dividend, a fiduciary shall allocate the payment to income.
23 The fiduciary shall allocate to principal the balance of the payment and any other payment

1 received in the same accounting period that is not characterized as interest, a dividend, or an
2 equivalent payment.

3 (c) If no part of a payment is characterized as interest, a dividend, or an equivalent
4 payment, and all or part of the payment is required to be made, a fiduciary shall allocate to
5 income a percentage of the part that is required to be made during the accounting period and shall
6 allocate the balance to principal. If no part of a payment is required to be made or the payment
7 received is the entire amount to which the fiduciary is entitled, the fiduciary shall allocate the
8 entire payment to principal. For purposes of this subsection, a payment is not required to be
9 made to the extent it is made because the fiduciary exercises a right of withdrawal.

10 (d) The percentage used under subsection (c) must be 10 percent, unless the fiduciary
11 selects a different percentage in a record.

12 (e) Except as otherwise provided in subsection (f), subsections (g) and (h) apply, and
13 subsections (b) and (c) do not apply, in determining the allocation of a payment made from a
14 separate fund to:

15 (1) a trust to which an election to qualify for a marital deduction under Section
16 2056(b)(7) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section
17 2056(b)(7)][, as amended], has been made; or

18 (2) a trust that qualifies for the marital deduction under Section 2056(b)(5) of the
19 Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section 2056(b)(5)][, as amended].

20 (f) Subsections (e), (g), and (h) do not apply if and to the extent the series of payments
21 would, without the application of subsection (e), qualify for the marital deduction under Section
22 2056(b)(7)(C) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section
23 2056(b)(7)(C)][, as amended].

1 (g) A trustee shall determine the internal income of each separate fund for the accounting
2 period as if the separate fund were a trust subject to this [act]. Upon request of the surviving
3 spouse, the trustee shall demand that the person administering the separate fund distribute the
4 internal income to the trust. The trustee shall allocate a payment from the separate fund to
5 income to the extent of the internal income of the separate fund and distribute that amount to the
6 surviving spouse. The trustee shall allocate the balance of the payment to principal. Upon
7 request of the surviving spouse, the trustee shall allocate principal to income to the extent the
8 internal income of the separate fund exceeds payments made from the separate fund to the trust
9 during the accounting period.

10 (h) If a trustee cannot determine the internal income of a separate fund but can determine
11 the value of the separate fund, the internal income of the separate fund is deemed to equal [insert
12 number at least three percent and not more than five percent] of the fund's value, according to
13 the most recent statement of value preceding the beginning of the accounting period. If the
14 trustee can determine neither the internal income of the separate fund nor the fund's value, the
15 internal income of the fund is deemed to equal the product of the interest rate and the present
16 value of the expected future payments, as determined under Section 7520 of the Internal Revenue
17 Code of 1986[, as amended][, 26 U.S.C. Section 7520][, as amended], for the month preceding
18 the accounting period for which the computation is made.

19 (i) This section does not apply to a payment to which Section 409 applies.

20 **SECTION 409. CERTAIN ILLIQUID ASSETS.**

21 (a) In this section, "illiquid asset" means an asset whose value is volatile or difficult to
22 determine or will diminish or terminate because the asset is expected to produce receipts for a
23 period of limited duration. The term includes a leasehold, patent, copyright, royalty right, and

1 right to receive payments during a period of more than one year under an arrangement that does
2 not provide for the payment of interest on the unpaid balance. The term does not include a
3 payment subject to Section 408, resources subject to Section 410, timber subject to Section 411,
4 an activity subject to Section 413, an asset subject to Section 414, or any asset for which the
5 fiduciary establishes a reserve for depreciation under Section 503.

6 (b) A fiduciary shall allocate a percentage of the receipts from an illiquid asset to income
7 and the balance to principal.

8 (c) The percentage used under subsection (b) must be 10 percent, unless the fiduciary
9 selects a different percentage in a record.

10 **Comment**

11 **Prior Acts.** As stated in a Comment to the 1997 Act, Section 11 of the 1962 Act allocates
12 receipts from “property subject to depletion” to income in an amount “not in excess of 5%” of
13 the asset’s inventory value. The 1931 Act has a similar 5% rule that applies when the trustee is
14 under a duty to change the form of the investment. The 5% rule imposes on a trust the obligation
15 to pay a fixed annuity to the current income beneficiary until the asset is exhausted. Under both
16 the 1931 and 1962 Acts the balance of each year’s receipts is added to principal. A fixed
17 payment can produce unfair results. The remainder beneficiary receives all of the receipts from
18 unexpected growth in the asset, e.g., if royalties on a patent or copyright increase significantly.
19 Conversely, if the receipts diminish more rapidly than expected, most of the amount received by
20 the trust will be allocated to income and little to principal. Moreover, if the annual payments
21 remain the same for the life of the asset, the amount allocated to principal will usually be less
22 than the original inventory value. For these reasons, Section 810 of the 1997 Act abandoned the
23 annuity approach under the 5% rule, but required that 10% of the receipts from a “liquidating
24 asset” be allocated to income and the balance to principal. Section 409 generally expands this
25 treatment to any volatile or otherwise “illiquid” asset, as defined, but allows the trustee to select a
26 percentage other than 10% under subsection (c). This is consistent with the greater flexibility
27 contemplated by the current act and recognizes that a fixed percentage can be arbitrary.

28

29 **SECTION 410. MINERALS, WATER, AND OTHER NATURAL RESOURCES.**

30 (a) To the extent a fiduciary accounts pursuant to this section for receipts from an interest
31 in minerals or other natural resources not accounted for as a business under Section 403, the
32 fiduciary shall allocate the receipts as follows:

1 (1) If received as nominal delay rental or nominal annual rent on a lease, a receipt
2 must be allocated to income.

3 (2) If received from a production payment, a receipt must be allocated to income
4 if and to the extent the agreement creating the production payment provides a factor for interest
5 or its equivalent. The balance must be allocated to principal.

6 (3) If an amount received as a royalty, shut-in-well payment, take-or-pay payment,
7 bonus, or delay rental is more than nominal, a percentage must be allocated to income and the
8 balance to principal.

9 (4) If an amount is received from a working interest or any other interest not
10 provided for in paragraph (1), (2), or (3), a percentage of the net amount received must be
11 allocated to income and the balance to principal.

12 (b) An amount received on account of an interest in water that is renewable must be
13 allocated to income. If the water is not renewable, a percentage of the amount must be allocated
14 to income and the balance to principal.

15 (c) The percentage used under subsection (a)(3), (a)(4), or (b) must be 10 percent, unless
16 the fiduciary selects a different percentage in a record.

17 (d) This [act] applies whether or not a decedent or transferor was extracting minerals,
18 water, or other natural resources before the interest became subject to the trust.

19 (e) If a fiduciary owns an interest in minerals, water, or other natural resources on [the
20 effective date of this [act]], the fiduciary may allocate receipts from the interest as provided in
21 this [act] or in the manner used by the fiduciary before [the effective date of this [act]]. If the
22 fiduciary acquires an interest in minerals, water, or other natural resources after [the effective
23 date of this [act]], the fiduciary shall allocate receipts from the interest as provided in this [act].

1 **SECTION 411. TIMBER.**

2 (a) To the extent a fiduciary accounts for receipts from the sale of timber and related
3 products pursuant to this section, the fiduciary shall allocate the net receipts:

4 (1) to income to the extent the amount of timber removed from the land does not
5 exceed the rate of growth of the timber during the accounting periods in which a beneficiary has
6 a mandatory income interest;

7 (2) to principal to the extent the amount of timber removed from the land exceeds
8 the rate of growth of the timber or the net receipts are from the sale of standing timber;

9 (3) to or between income and principal if the net receipts are from the lease of
10 land used for growing or cutting timber or from a contract to cut timber from land, by
11 determining the amount of timber removed from the land under the lease or contract and
12 applying the rules in paragraphs (1) and (2); or

13 (4) to principal to the extent advance payments, bonuses, and other payments are
14 not allocated pursuant to paragraph (1), (2), or (3).

15 (b) In determining net receipts to be allocated pursuant to subsection (a), a fiduciary shall
16 deduct and transfer to principal a reasonable amount for depletion.

17 (c) This [act] applies whether or not a decedent or transferor was harvesting timber from
18 the property before it became subject to the trust.

19 (d) This section does not prevent a tenant in possession of property from using wood the
20 tenant cuts on the property for personal purposes, such as indoor or outdoor ornamentation,
21 firewood, mending fences or building new fences, or making repairs to structures on the property.

22 (e) If a fiduciary owns an interest in land used for growing and cutting timber on [the
23 effective date of this [act]], the fiduciary may allocate net receipts from the sale of timber and

1 related products as provided in this [act] or in the manner used by the fiduciary before [the
2 effective date of this [act]]. If the fiduciary acquires an interest in timberland after [the effective
3 date of this [act]], the fiduciary shall allocate net receipts from the sale of timber and related
4 products as provided in this [act].

5 **SECTION 412. MARITAL DEDUCTION PROPERTY NOT PRODUCTIVE OF**
6 **INCOME.**

7 (a) The transferor’s spouse may require the trustee of a trust for which a gift or estate tax
8 marital deduction was allowed to make property productive of income, convert property to
9 productive property within a reasonable time, or exercise the power conferred by Section 203 if
10 the trust assets otherwise do not provide the transferor’s spouse with sufficient income from or
11 use of the trust assets to qualify for the deduction. The trustee may decide which action or
12 combination of actions to take.

13 (b) In a case not governed by subsection (a), proceeds from the sale or other disposition of
14 an asset are principal without regard to the amount of income the asset produces during any
15 accounting period.

16 **SECTION 413. DERIVATIVES AND OPTIONS.**

17 (a) In this section, “derivative” means a contract or financial instrument or a combination
18 of contracts and financial instruments that gives a trust the right or obligation to participate in
19 some or all changes in the price of a tangible or intangible asset or group of assets, or changes in
20 a rate, an index of prices or rates, or other market indicator for an asset or group of assets.

21 (b) To the extent a fiduciary does not account under Section 403 for a transaction in
22 derivatives, the fiduciary shall allocate to principal receipts from and disbursements made in
23 connection with the transaction.

1 (c) If a fiduciary grants an option to buy property from the trust, whether or not the trust
2 owns the property when the option is granted, grants an option that permits another person to sell
3 property to the trust, or acquires an option to buy property for the trust or an option to sell an
4 asset owned by the trust, and the fiduciary or other owner of the asset is required to deliver the
5 asset if the option is exercised, an amount received for granting the option must be allocated to
6 principal. An amount paid to acquire the option must be paid from principal. A gain or loss
7 realized upon the exercise of an option, including an option granted to a settlor of the trust for
8 services rendered, must be allocated to principal.

9 **SECTION 414. ASSET-BACKED SECURITIES.**

10 (a) In this section, “asset-backed security” means an asset whose value is based on the
11 right it gives the owner to receive distributions from the proceeds of financial assets that provide
12 collateral for the security. The term includes an asset that gives the owner the right to receive
13 from the collateral financial assets only the interest or other current return or only the proceeds
14 other than interest or current return. The term does not include an asset to which Section 401 or
15 408 applies.

16 (b) If a trust receives a payment from interest or other current return and from other
17 proceeds of the collateral financial assets, the fiduciary shall allocate to income the part of the
18 payment the payor identifies as being from interest or other current return and shall allocate the
19 balance of the payment to principal.

20 (c) If a trust receives one or more payments in exchange for the trust’s entire interest in an
21 asset-backed security in one accounting period, the fiduciary shall allocate the payments to
22 principal. If a payment is one of a series of payments that will result in the liquidation of the
23 trust’s interest in the security over more than one accounting period, the fiduciary shall allocate a

1 percentage of the payment to income and the balance to principal.

2 (d) The percentage used under subsection (c) must be 10 percent, unless the fiduciary
3 selects a different percentage in a record.

4 **SECTION 415. OTHER FINANCIAL INSTRUMENTS AND ARRANGEMENTS.**

5 A fiduciary shall allocate receipts from or related to financial instruments and arrangements not
6 explicitly addressed by this [act] in a manner consistent with the rules prescribed and the
7 principles reflected in Sections 413 and 414.

8 **Comment**

9 Section 415 is added to the current Act to provide guidance for financial instruments and
10 arrangements designed in the future, which the Drafting Committee could not have anticipated
11 and addressed explicitly.

12 **SECTION 416. INSUBSTANTIAL ALLOCATIONS NOT REQUIRED.** If a
13 fiduciary determines that an allocation between income and principal required by Section 408,
14 409, 410, 411, or 414 is insubstantial, the fiduciary may allocate the entire amount to principal
15 unless Section 203(c) applies to the allocation. This power may be exercised by a co-fiduciary in
16 the circumstances described in Section 203(d) and may be released for the reasons and in the
17 manner described in Section 203(e). An allocation is presumed to be insubstantial if:
18

19 (1) the amount of the allocation would increase or decrease net income in an accounting
20 period, as determined before the allocation, by less than 10 percent; and

21 (2) the asset producing the receipt to be allocated has a fair market value less than 10
22 percent of the total fair market value of the trust's assets at the beginning of the accounting
23 period.

1 [ARTICLE] 5

2 ALLOCATION OF DISBURSEMENTS DURING ADMINISTRATION

3 SECTION 501. DISBURSEMENTS FROM INCOME. A fiduciary shall make the

4 following disbursements from income to the extent they are not disbursements to which Section
5 601(2)(B) or (C) applies:

6 (1) one-half of:

7 (A) the regular compensation of the fiduciary and of any person providing
8 fiduciary, investment advisory, or custodial services to the fiduciary; and

9 (B) all expenses for accountings, judicial and nonjudicial proceedings, or other
10 matters that involve both the income and remainder interests;

11 (2) the balance of the disbursements described in paragraph (1) to the extent a fiduciary
12 that is an independent person determines that making those disbursements from income would be
13 in the interests of the beneficiaries because principal is illiquid or otherwise;

14 (3) all the other ordinary expenses incurred in connection with the administration,
15 management, or preservation of property and the distribution of income, including interest,
16 ordinary repairs, regularly recurring taxes assessed against principal, and expenses of a
17 proceeding or other matter that concerns primarily the income interest; and

18 (4) recurring premiums on insurance covering the loss of a principal asset or the loss of
19 income from or use of the asset.

20 **Comment**

21 **Paying more than half of certain disbursements from income.** Section 501(2) is
22 added to be consistent with other parts of the Act, such as Section 201(a)(4) and (5), that favor
23 principal when appropriate.
24

1 **SECTION 502. DISBURSEMENTS FROM PRINCIPAL.**

2 (a) A fiduciary shall make the following disbursements from principal:

3 (1) the remaining one-half of the disbursements described in Section 501(1) after
4 application of Section 501(2);

5 (2) all the fiduciary's compensation calculated on principal as a fee for acceptance,
6 distribution, or termination, and disbursements made to prepare for or execute a sale or other
7 disposition of the property.

8 (3) payments on the principal of a trust debt;

9 (4) expenses of a proceeding that concerns primarily principal, including a
10 proceeding to construe the trust or to protect the trust or its property;

11 (5) premiums paid on a policy of insurance not described in Section 501(4) of
12 which the fiduciary is the owner and beneficiary;

13 (6) estate, inheritance, and other transfer taxes, including penalties, apportioned to
14 the trust; and

15 (7) disbursements related to environmental matters, including reclamation,
16 assessing environmental conditions, remedying and removing environmental contamination,
17 monitoring remedial activities and the release of substances, preventing future releases of
18 substances, collecting amounts from persons liable or potentially liable for the costs of those
19 activities, penalties imposed under environmental laws or regulations and other payments made
20 to comply with those laws or regulations, statutory or common law claims by third parties, and
21 defending claims based on environmental matters.

22 (b) If a principal asset is encumbered with an obligation that requires income from that
23 asset to be paid directly to the creditor, the fiduciary shall transfer from principal to income an

1 amount equal to the income paid to the creditor in reduction of the principal balance of the
2 obligation.

3 **SECTION 503. TRANSFERS FROM INCOME TO PRINCIPAL FOR**
4 **DEPRECIATION.**

5 (a) In this section, “depreciation” means a reduction in value due to wear, tear, decay,
6 corrosion, or gradual obsolescence of a fixed asset having a useful life of more than one year.

7 (b) A fiduciary may transfer to principal a reasonable amount of the net cash receipts from
8 a principal asset that is subject to depreciation, but may not transfer any amount for depreciation:

9 (1) of the part of real property used or available for use by a beneficiary as a
10 residence or of tangible personal property held or made available for the personal use or
11 enjoyment of a beneficiary; or

12 (2) under this section if the fiduciary is accounting under Section 403 for the
13 business or activity in which the asset is used.

14 (c) An amount transferred to principal need not be held as a separate fund.

15 **SECTION 504. TRANSFERS FROM INCOME TO REIMBURSE PRINCIPAL.**

16 (a) If a fiduciary makes or expects to make a principal disbursement described in this
17 section, the fiduciary may transfer an appropriate amount from income to principal in one or
18 more accounting periods to reimburse principal or to provide a reserve for future principal
19 disbursements.

20 (b) Principal disbursements to which subsection (a) applies include the following, but
21 only to the extent the fiduciary has not been and does not expect to be reimbursed by a third
22 party:

23 (1) an amount chargeable to income but paid from principal because it is

1 unusually large, including extraordinary repairs;

2 (2) a capital improvement to a principal asset, whether in the form of changes to
3 an existing asset or the construction of a new asset, including special assessments;

4 (3) disbursements made to prepare property for rental, including tenant
5 allowances, leasehold improvements, and broker's commissions;

6 (4) periodic payments on an obligation secured by a principal asset to the extent
7 the amount transferred from income to principal for depreciation is less than the periodic
8 payments; and

9 (5) disbursements described in Section 502(a)(7).

10 (c) If an asset whose ownership gives rise to the disbursements becomes subject to a
11 successive income interest after an income interest ends, a fiduciary may continue to transfer
12 amounts from income to principal as provided in subsection (a).

13 **SECTION 505. INCOME TAXES.**

14 (a) A tax required to be paid by a fiduciary based on receipts allocated to income must be
15 paid from income.

16 (b) A tax required to be paid by a fiduciary based on receipts allocated to principal must
17 be paid from principal, even if the tax is called an income tax by the taxing authority.

18 (c) A tax required to be paid by a fiduciary on the trust's share of an entity's taxable
19 income must be paid from principal to the extent the tax exceeds the total receipts from the
20 entity.

21 **Comment**

22
23 **Marital deduction issues.** Any payment of income tax from income could raise issues of
24 the estate or gift tax marital deduction, especially if the income on which that income tax is paid
25 is not fully distributed, as in the case of income retained in an entity owned in whole or in part by

1 the trust. The Drafting Committee found these issues to be similar to the issues raised by Rev.
2 Rul. 2006-26 in the context of defined contribution qualified retirement plans and individual
3 retirement accounts (IRAs). The committee concluded that no change needs to be made to the
4 Act because it understands that the power in the spouse to cause the trust assets to be made
5 reasonably productive of income cures any marital deduction issue.

6
7 **SECTION 506. ADJUSTMENTS BETWEEN INCOME AND PRINCIPAL**
8 **BECAUSE OF TAXES.**

9 (a) A fiduciary may make adjustments between income and principal to offset the shifting
10 of economic interests or tax benefits between current income beneficiaries and successor
11 beneficiaries that arise from:

12 (1) elections and decisions, other than those described in subsection (b), the
13 fiduciary makes from time to time regarding tax matters;

14 (2) an income tax or any other tax that is imposed upon the fiduciary or a
15 beneficiary as a result of a transaction involving or a distribution from the trust; or

16 (3) the ownership by a trust of an interest in an entity whose taxable income,
17 whether or not distributed, is includable in the taxable income of the trust or a beneficiary.

18 (b) If the amount of an estate-tax marital deduction or charitable-contribution deduction is
19 reduced because a fiduciary deducts an amount paid from principal for income tax purposes
20 instead of deducting it for estate-tax purposes, and as a result estate taxes paid from principal are
21 increased and income taxes paid by a trust or beneficiary are decreased, each trust or beneficiary
22 that benefits from the decrease in income tax shall reimburse the principal from which the
23 increase in estate tax is paid. The total reimbursement must equal the increase in the estate tax to
24 the extent the principal used to pay the increase would have qualified for a marital deduction or
25 charitable contribution deduction but for the payment. The proportionate share of the
26 reimbursement for each trust or beneficiary whose income taxes are reduced must be the same as

1 its proportionate share of the total decrease in income tax. A trust shall reimburse principal from
2 income.

3 (c) After applying Section 505, the fiduciary shall adjust income or principal receipts to
4 the extent the trust's taxes are reduced because the trust receives a deduction for payments made
5 to a beneficiary.

6 **[ARTICLE] 6**

7 **DECEDENT'S ESTATE OR TERMINATING INCOME INTEREST**

8 **SECTION 601. DETERMINATION AND DISTRIBUTION OF NET INCOME.**

9 (a) The rules in this section apply after a decedent dies in the case of an estate or after an
10 income interest in a trust ends.

11 (b) A fiduciary of an estate or a terminating income interest shall determine the amount of
12 net income and net principal receipts received from property specifically given to a beneficiary
13 under the rules in [Articles] 4, 5, and 7 and the rules in subsection (f). The fiduciary shall
14 distribute the net income and net principal receipts to the beneficiary who is to receive the
15 specific property.

16 (c) A fiduciary shall determine the income and net income of a decedent's estate or a
17 terminating income interest, other than the amount of net income determined under subsection

18 (b), under the rules in [Articles] 4, 5, and 7 and by:

19 (1) including in net income all income from property used or sold to discharge
20 liabilities;

21 (2) paying from income or principal, in the fiduciary's discretion, fees of
22 attorneys, accountants, and fiduciaries, court costs and other expenses of administration, and
23 interest on estate and inheritance taxes, but the fiduciary may pay those expenses from income of

1 property passing to a trust for which the fiduciary claims a federal estate tax marital or charitable
2 deduction only to the extent the payment of those expenses from income will not cause the
3 reduction or loss of the deduction; and

4 (3) paying from principal all other disbursements made or incurred in connection
5 with the settlement of a decedent's estate or the winding up of a terminating income interest,
6 including, to the extent authorized by the decedent's will, the terms of the trust, or applicable law,
7 debts, funeral expenses, disposition of remains, family allowances, and estate and inheritance
8 taxes and related penalties that are apportioned to the estate or terminating income interest by the
9 decedent's will, the terms of the trust, or applicable law.

10 (d) A fiduciary shall distribute to a beneficiary who receives a pecuniary amount outright
11 the interest or any other amount provided by the decedent's will, the terms of the trust, or
12 applicable law from net income determined under paragraph (2) or from principal to the extent
13 net income is insufficient. If a beneficiary is to receive a pecuniary amount outright from a trust
14 after an income interest ends and no interest or other amount is provided for by the terms of the
15 trust or applicable law, the fiduciary shall distribute the interest or other amount to which the
16 beneficiary would be entitled under applicable law if the pecuniary amount were required to be
17 paid under a will.

18 (e) A fiduciary shall distribute the net income remaining after distributions required by
19 subsection (d) in the manner described in Section 602 to all other beneficiaries, including a
20 beneficiary who receives a pecuniary amount in trust, even if the beneficiary holds an unqualified
21 power to withdraw assets from the trust or other presently exercisable general power of
22 appointment over the trust.

23 (f) A fiduciary may not reduce principal or income receipts from property described in

1 subsection (b) because of a payment described in Section 501 or 502 to the extent the decedent's
2 will, the terms of the trust, or applicable law requires the fiduciary to make the payment from
3 assets other than the property or to the extent the fiduciary recovers or expects to recover the
4 payment from a third party. The net income and principal receipts from the property are
5 determined by including all amounts the fiduciary receives or pays with respect to the property,
6 whether those amounts accrued or became due before, on, or after the date of a decedent's death
7 or an income interest's terminating event, and by making a reasonable provision for amounts the
8 fiduciary believes the estate or terminating income interest may become obligated to pay after the
9 property is distributed.

10 **SECTION 602. DISTRIBUTION TO RESIDUARY AND REMAINDER**
11 **BENEFICIARIES.**

12 (a) Each beneficiary described in Section 601(e) is entitled to receive a part of the net
13 income equal to the beneficiary's fractional interest in undistributed principal assets, using values
14 as of the distribution date. If a fiduciary makes more than one distribution of assets to
15 beneficiaries to whom this section applies, each beneficiary, including one who does not receive
16 part of the distribution, is entitled, as of each distribution date, to the net income the fiduciary has
17 received after the date of the decedent's death or an income interest's terminating event or
18 previous distribution date.

19 (b) In determining a beneficiary's share of net income, the following rules apply:

20 (1) The beneficiary is entitled to receive a part of the net income equal to the
21 beneficiary's fractional interest in the undistributed principal assets immediately before the
22 distribution date, including assets that later may be sold to meet principal obligations.

23 (2) The beneficiary's fractional interest in the undistributed principal assets must

1 be calculated without regard to:

2 (A) property specifically given to a beneficiary under the decedent's will
3 or the terms of the trust; and

4 (B) property required to pay pecuniary amounts not in trust.

5 (3) The beneficiary's fractional interest in the undistributed principal assets must
6 be calculated on the basis of the aggregate value of those assets as of the distribution date without
7 reducing the value by any unpaid principal obligation.

8 (4) The distribution date for purposes of this section may be the date as of which
9 the fiduciary calculates the value of the assets if that date is reasonably near the date on which the
10 assets are actually distributed.

11 (c) If a fiduciary does not distribute all the collected but undistributed net income to each
12 person as of a distribution date, the fiduciary shall maintain appropriate records showing the
13 interest of each beneficiary in the net income.

14 (d) A fiduciary may apply the rules in this section, to the extent the fiduciary considers it
15 appropriate, to net gain or loss realized after the date of the decedent's death or an income
16 interest's terminating event or earlier distribution date from the disposition of a principal asset if
17 this section applies to the income from the asset.

18 **Comment**

19 Section 602(b)(2) excludes specific bequests in kind and pecuniary bequests from the
20 calculation of a beneficiary's fractional interest of undistributed principal assets for purposes of
21 allocating income to that beneficiary. If the beneficiary is entitled to statutory interest on any
22 such bequest, that interest is not income subject to allocation under this section, and that bequest
23 does not share in the income earned by the other assets.

1 [ARTICLE] 7

2 APPORTIONMENT AT BEGINNING AND END OF INCOME INTEREST

3 SECTION 701. WHEN RIGHT TO INCOME BEGINS AND ENDS.

4 (a) A current income beneficiary or successor beneficiary is entitled to net income from
5 the date on which the income interest begins. An income interest begins on the date specified in
6 the terms of the trust or, if no date is specified, on the date an asset:

7 (1) becomes subject to the trust in the case of the current income beneficiary; or

8 (2) becomes subject to a successive income interest in the case of a successor
9 beneficiary.

10 (b) An asset becomes subject to a trust:

11 (1) on the date the asset is transferred to the trust in the case of an asset that is
12 transferred to a trust during the transferor's life;

13 (2) on the date of a testator's death in the case of an asset that becomes subject to
14 a trust by reason of a will, even if there is an intervening period of administration of the testator's
15 estate; or

16 (3) on the date of an individual's death in the case of an asset that is transferred to
17 a fiduciary by a third party because of the individual's death.

18 (c) An asset becomes subject to a successive income interest on the day after the
19 preceding income interest ends, as determined under subsection (d), even if there is an
20 intervening period of administration to wind up the preceding income interest.

21 (d) An income interest ends on the day before an income beneficiary dies or another
22 terminating event occurs, or on the last day of a period during which there is no beneficiary to
23 whom a fiduciary may distribute income.

1 **SECTION 702. APPORTIONMENT OF RECEIPTS AND DISBURSEMENTS**

2 **WHEN DECEDENT DIES OR INCOME INTEREST BEGINS.**

3 (a) A fiduciary shall allocate an income receipt or disbursement other than one to which
4 Section 601(1) applies to principal if its due date occurs before the date on which a decedent dies
5 in the case of an estate or before the date on which an income interest begins in the case of a trust
6 or successive income interest.

7 (b) A fiduciary shall allocate a periodic income receipt or disbursement to income if its
8 due date occurs on or after the date on which a decedent dies or an income interest begins. A
9 receipt or disbursement is periodic if it must be paid at regular intervals under an obligation to
10 make payments or if a payor customarily makes payments at regular intervals. An income receipt
11 or disbursement must be treated as accruing from day to day if it is not periodic or it has no due
12 date. The part of the receipt or disbursement accruing before the date on which a decedent dies
13 or an income interest begins must be allocated to principal, and the balance must be allocated to
14 income.

15 (c) An item of income or an obligation is due on the date the payor is required to make a
16 payment. If a payment date is not stated, there is no due date for purposes of this [act].
17 Distributions to shareholders or other owners from an entity to which Section 401 applies are
18 deemed to be due on the date fixed by the entity for determining who is entitled to receive the
19 distribution or, if no date is fixed, on the declaration date for the distribution.

20 **Comment**

21 The change to “before the date on which a decedent dies” and “before the date on which
22 an income interest begins” in Section 702(a) makes this provision consistent with the reference to
23 “the date of a testator’s death” in Section 701(b)(2) and consistent with the reference to “on or
24 after the date on which a decedent dies” in Section 702(b). It means that the time of day at which
25 the moment of death occurs is less relevant and therefore less important to determine. In effect,

1 the decedent's income interest ends with the day before the date of death, and the estate's income
2 interest begins with the date of death. Accounting periods based on a single day are easiest to
3 administer in a global economy where the actual time of death might otherwise appear to be
4 affected by arbitrary time zones. This rule in a uniform act does not purport to directly address
5 related income tax uncertainties, although it may contribute in the long term to uniformity in that
6 context as well.

7 **SECTION 703. APPORTIONMENT WHEN INCOME INTEREST ENDS.**

8 (a) In this section, "undistributed income" means net income received on or before the
9 date on which an income interest ends. The term does not include an item of income or expense
10 that is due or accrued or net income that has been added or is required to be added to principal
11 under the terms of the trust.

12 (b) When a mandatory income interest ends, the fiduciary shall pay to a mandatory
13 income beneficiary who survives that date, or the estate of a deceased mandatory income
14 beneficiary whose death causes the interest to end, the beneficiary's share of the undistributed
15 income that is not disposed of under the terms of the trust unless the beneficiary has an
16 unqualified power to withdraw more than five percent of the trust immediately before the income
17 interest ends. If the beneficiary has an unqualified power to withdraw more than five percent of
18 the trust immediately before the income interest ends, the undistributed income from the part of
19 the trust that may be withdrawn must be added to principal.

20 (c) When a fiduciary's obligation to pay a fixed annuity or a fixed fraction of the value of
21 the trust's assets ends, the fiduciary shall prorate the final payment if and to the extent required
22 by applicable law to accomplish a purpose of the trust or its settlor relating to income, gift, estate,
23 or other tax requirements.

24 **Comment**

25 **Prior Acts.** Both the 1931 Act (Section 4) and the 1962 Act (Section 4(d)) provide that a
26 deceased income beneficiary's estate is entitled to the undistributed income. In a Comment to

1 Section 303 of the 1997 Act, the 1997 Drafting Committee stated that this is probably not what
2 most settlors would want, and that, with respect to undistributed income, most settlors would
3 favor the income beneficiary first, the remainder beneficiaries second, and the income
4 beneficiary’s heirs last, if at all. It decided not to eliminate this provision, however, to avoid
5 causing disputes about whether the trustee should have distributed collected cash before the
6 income beneficiary died.

7
8 The current Drafting Committee is not as sure that the estate rule is not what most settlors
9 would want. The estate rule may actually fit best with the paradigm of a beneficiary who incurs
10 bills, like credit card charges and unreimbursed medical expenses, that are paid in arrears from
11 trust distributions. At the other end of the wealth spectrum, payment to the estate might create an
12 avoidable increment of estate tax as well as an administrative burden, but those situations would
13 typically entail more sophisticated estate planning that can draft around that. Moreover, the
14 estate rule would avoid the pressure to make or demand income distributions at more frequent
15 intervals in order to keep the distributions more current up to the date of death. The payment of
16 “stub income” to the income beneficiary’s estate also provides better protection in cases where
17 tax rules require a beneficiary to receive income “for life.”

18
19 **[ARTICLE] 8**

20 **MISCELLANEOUS PROVISIONS**

21 **SECTION 801. UNIFORMITY OF APPLICATION AND CONSTRUCTION.** In

22 applying and construing this uniform act, consideration must be given to the need to promote
23 uniformity of the law with respect to its subject matter among states that enact it.

24 **SECTION 802. APPLICATION OF [ACT] TO EXISTING TRUSTS AND**
25 **ESTATES.** This [act] applies to a trust or decedent’s estate existing on [the effective date of this
26 [act]] except as otherwise expressly provided in the terms of the trust or in this [act].

27 **Alternative A**

28 **SECTION 803. TRANSITIONAL MATTERS.** Section 408, as amended by this
29 [amendment], applies to a trust described in Section 408(e) on and after the following date:

30 (1) If the trust is not funded as of [the effective date of this [amendment]], the date of the
31 decedent’s death.

32 (2) If the trust is initially funded in the calendar year beginning January 1, _____ [insert

1 year in which this [amendment] takes effect], the date of the decedent’s death.

2 (3) If the trust is not described in paragraph (1) or (2), January 1, _____ [insert year in
3 which this [amendment] take effect].

4 **Alternative B**

5 **SECTION 803. TRANSITIONAL MATTERS.** Section 408 applies to a trust
6 described in Section 408(e) on and after the following date:

7 (1) If the trust is not funded as of [the effective date of this [act]], the date of the
8 decedent’s death.

9 (2) If the trust is initially funded in the calendar year beginning January 1, _____ [insert
10 year in which this [act] takes effect], the date of the decedent’s death.

11 (3) If the trust is not described in paragraph (1) or (2), January 1, _____ [insert year in
12 which this [act] takes effect].

13 **End of Alternatives**

14 **Legislative Note:** Use Alternative A if your state has enacted the Uniform Principal and Income
15 Act. Use Alternative B if your state has not enacted the Uniform Principal and Income Act.

16
17 *If your state has not adopted the Uniform Principal and Income Act, use the text of Sections 408
18 and 505, as amended by these amendments, instead of the text of the previous version of those
19 Sections.*

20
21 **[SECTION 804. SEVERABILITY CLAUSE.** If any provision of this [act] or its
22 application to any person or circumstance is held invalid, the invalidity does not affect other
23 provisions or applications of this [act] which can be given effect without the invalid provision or
24 application, and to this end the provisions of this [act] are severable.]

25 **Legislative Note:** Include this section only if your state lacks a general severability statute or a
26 decision by your state’s highest court stating a general rule of severability.

1 **SECTION 805. REPEALS; CONFORMING AMENDMENTS.**

2 (a)

3 (b)

4 (c)

5 **SECTION 806. EFFECTIVE DATE.** This act takes effect