

DRAFT

FOR DISCUSSION ONLY

UNIFORM FIDUCIARY INCOME AND PRINCIPAL ACT

[FORMERLY REVISED UNIFORM PRINCIPAL AND INCOME ACT]

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

*Redline Comparison
November 2017 and February 2018 Committee Meeting Drafts*

Copyright © ~~2017~~2018

By

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

The ideas and conclusions set forth in this draft, including the proposed statutory language and any comments or reporter's notes, have not been passed upon by the National Conference of Commissioners on Uniform State Laws or the ~~drafting committee~~Drafting Committee. They do not necessarily reflect the views of the Conference and its ~~commissioners~~Commissioners and the ~~drafting committee~~Drafting Committee and its ~~members~~Members and ~~reporter~~Reporter. Proposed statutory language may not be used to ascertain the intent or meaning of any promulgated final statutory proposal.

~~November 5, 2017~~

January 22, 2018

DRAFTING COMMITTEE ON UNIFORM FIDUCIARY INCOME AND PRINCIPAL ACT

The Committee appointed by and representing the National Conference of Commissioners on Uniform State Laws in preparing this Act consists of the following individuals:

TURNEY P. BERRY, 500 W. Jefferson St., Suite 2800, Louisville, KY 40202, *Chair*
DAVID J. CLARK, 353 Bel Marin Keys Blvd., Suite 9, Novato, CA 94949, *Vice Chair*
MARY M. ACKERLY, 782 Bantam Rd., P.O. Box 815, Bantam, CT 06750-0815
JAMES W. DODGE, Legislative Reference Bureau, 112 State House, Springfield, IL 62706
DAVID M. ENGLISH, University of Missouri School of Law, 203 Hulston Hall,
Columbia, MO 65211
MARC S. FEINSTEIN, 431 N. Phillips Ave., Suite 301, Sioux Falls, SD 57104
BARRY C. HAWKINS, 300 Atlantic St., Stamford, CT 06901
JOHN H. LANGBEIN, Yale Law School, P.O. Box 208215, New Haven, CT 06520-8215
BRADLEY MYERS, University of North Dakota, 215 Centennial Dr. Stop 9003, Room 201
Grand Forks, ND 58202-9003
SUSAN D. SNYDER, 50 S. La Salle St., MB-09, Chicago, IL 60603
JAMES P. SPICA, 500 Woodward Ave., Suite 4000, Detroit, MI 48226-5403
LOUISE ELLEN TEITZ, Roger Williams University School of Law, 10 Metacom Ave., Bristol,
RI 02809-5103
CHARLES A. TROST, Nashville City Center, 511 Union St., Suite 2700, Nashville, TN 37219-
1760
RONALD D. AUCUTT, 1750 Tysons ~~Boulevard~~Bldv., Suite 1800, Tysons Corner, VA 22102-
4215, *Reporter*

AMERICAN BAR ASSOCIATION ADVISORS

WILLIAM P. LAPIANA, New York Law School, 185 W. Broadway, New York, NY 10013,
ABA Advisor
PAUL S. LEE, 38 E. 85th St., New York, NY 10028-0969, *ABA Section Advisor*

EX OFFICIO

ANITA RAMASASTRY, University of Washington School of Law, William H. Gates Hall, Box
353020, Seattle, WA 98195-3020, *President*
MARY M. ACKERLY, 782 Bantam Rd., P.O. Box 815, Bantam, CT 06750-0815, *Division Chair*

EXECUTIVE DIRECTOR

LIZA KARSAI, 111 N. Wabash Ave., Suite 1010, Chicago, IL 60602, *Executive Director*

Copies of this Act may be obtained from:
NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS
111 N. Wabash Ave., Suite 1010
Chicago, Illinois 60602
(312) 450-6600/www.uniformlaws.org

**UNIFORM FIDUCIARY INCOME AND PRINCIPAL ACT
TABLE OF CONTENTS**

PREFATORY NOTE.....	1
---------------------	---

**[ARTICLE] 1
SHORT TITLE, DEFINITIONS, SCOPE, AND GOVERNING LAW**

SECTION 101. SHORT TITLE.....	3
SECTION 102. DEFINITIONS	3
SECTION 103. SCOPE.	9
SECTION 104. GOVERNING LAW	9

**[ARTICLE] 2
FIDUCIARY DUTIES AND JUDICIAL REVIEW**

SECTION 201. FIDUCIARY DUTIES; GENERAL PRINCIPLES.	10
SECTION 202. JUDICIAL REVIEW OF DISCRETIONARY POWER	14
SECTION 203. FIDUCIARY’S POWER TO ADJUST	16

**[ARTICLE] 3
UNITRUST**

SECTION 301. DEFINITIONS.	21
SECTION 302. APPLICATION OF [ARTICLE]; DUTIES AND REMEDIES.	23
SECTION 303. AUTHORITY OF FIDUCIARY.....	25
SECTION 304. NOTICE.	27
SECTION 305. UNITRUST POLICY.....	32
SECTION 306. UNITRUST RATE.....	33
SECTION 307. APPLICABLE VALUE.	34
SECTION 308. PERIOD.	35
SECTION 309. OTHER RULES; SPECIAL TAX BENEFITS.....	36

**[ARTICLE] 4
ALLOCATION OF RECEIPTS DURING ADMINISTRATION**

**[PART 1
RECEIPTS FROM ENTITIES]**

SECTION 401. CHARACTER OF RECEIPTS FROM ENTITIES	40
SECTION 402. DISTRIBUTION FROM TRUST OR ESTATE.....	47
SECTION 403. BUSINESS AND OTHER ACTIVITIES CONDUCTED BY FIDUCIARY.....	47

**[PART 2
RECEIPTS NOT NORMALLY APPORTIONED]**

SECTION 404. PRINCIPAL RECEIPTS	49
SECTION 405. RENTAL PROPERTY	50
SECTION 406. RECEIPT ON AN OBLIGATION TO BE PAID IN MONEY	50
SECTION 407. INSURANCE POLICIES AND SIMILAR CONTRACTS	50

**[PART 3
RECEIPTS NORMALLY APPORTIONED]**

SECTION 408. DEFERRED COMPENSATION, ANNUITIES, AND SIMILAR PAYMENTS	51
SECTION 409. CERTAIN ILLIQUID ASSETS	54
SECTION 410. MINERALS, WATER, AND OTHER NATURAL RESOURCES	55
SECTION 411. TIMBER	56
SECTION 412. MARITAL DEDUCTION PROPERTY NOT PRODUCTIVE OF INCOME ...	58
SECTION 413. DERIVATIVES AND OPTIONS	58
SECTION 414. ASSET-BACKED SECURITIES	59
SECTION 415. OTHER FINANCIAL INSTRUMENTS AND ARRANGEMENTS	60
SECTION 416. INSUBSTANTIAL ALLOCATIONS NOT REQUIRED	60

**[ARTICLE] 5
ALLOCATION OF DISBURSEMENTS DURING ADMINISTRATION**

SECTION 501. DISBURSEMENTS FROM INCOME	61
SECTION 502. DISBURSEMENTS FROM PRINCIPAL	62
SECTION 503. TRANSFERS FROM INCOME TO PRINCIPAL FOR DEPRECIATION	63
SECTION 504. TRANSFERS FROM INCOME TO REIMBURSE PRINCIPAL	63
SECTION 505. TAXES ON INCOME	64
SECTION 506. ADJUSTMENTS BETWEEN INCOME AND PRINCIPAL BECAUSE OF TAXES	65

**[ARTICLE] 6
DEATH OF DECEDENT OR TERMINATION OF INCOME INTEREST**

SECTION 601. DETERMINATION AND DISTRIBUTION OF NET INCOME	68
SECTION 602. DISTRIBUTION TO RESIDUARY AND REMAINDER BENEFICIARIES ..	70

**[ARTICLE] 7
APPORTIONMENT AT BEGINNING AND END OF INCOME INTEREST**

SECTION 701. WHEN RIGHT TO INCOME BEGINS AND ENDS	72
SECTION 702. APPORTIONMENT OF RECEIPTS AND DISBURSEMENTS WHEN DECEDENT DIES OR INCOME INTEREST BEGINS	73

SECTION 703. APPORTIONMENT WHEN INCOME INTEREST ENDS	74
--	----

[ARTICLE] 8
MISCELLANEOUS PROVISIONS

SECTION 801. UNIFORMITY OF APPLICATION AND CONSTRUCTION	77
SECTION 802. APPLICATION OF [ACT] TO EXISTING TRUSTS AND ESTATES.....	77
SECTION 804. REPEALS; CONFORMING AMENDMENTS	78
SECTION 805. EFFECTIVE DATE	78

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
21

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 of
20 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 retrieved
23 (although prior over-distributions can sometimes be taken into account in determining the
24 amount of future distributions). This in turn highlights the bias toward principal that for practical
25 reasons has appeared in previous version of the Act and is made even more explicit in this
26 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 of 12 months or approximately 12 months that
31 begins when an income interest begins or ends when an income interest ends.

1 (2) “Beneficiary” includes:

2 (A) in the case of a trust, ~~an income;~~

3 (i) a current beneficiary, including a current income beneficiary; and a
4 beneficiary that may receive only principal;

5 (ii) a remainder beneficiary; and

6 (iii) any other successor beneficiary;

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

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

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

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

14 ~~——(4) Except in Section 401, “distribution~~ (4) “Distribution” means payment or transfer
15 by a fiduciary to a beneficiary in the beneficiary’s capacity as a beneficiary, made pursuant to the
16 terms of the trust, without consideration other than a beneficiary’s right to receive a distribution
17 under the terms of the trust. “Distribute” has a corresponding meaning.

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

21 (6) “Fiduciary” means a trustee, [trust director determined under [Section 2(9) of the
22 Uniform Directed Trust Act,]] personal representative, life tenant, holder of a term interest, or
23 person acting under a legal delegation from a fiduciary. The term includes another person that

holds property for a successor beneficiary whose interest may be affected by the allocation of receipts and expenditures between income and principal. If there are two or more co-fiduciaries, the term means all co-fiduciaries acting in accordance with the terms of the trust and applicable law, including this [act].

(7) “Income” means money or other property a fiduciary receives as current return from principal. The term includes a part of receipts from a sale, exchange, or liquidation of a principal asset, to the extent provided in [Article] 4.

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

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

(A) in the case of a trust:

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

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

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

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

(C) a spouse, parent, brother, sister, or issue of a person defined in subparagraph

(A) or (B);

(D) a ~~corporate~~corporation, partnership, or other entity in which persons defined in subparagraphs (A) through (C), in the aggregate, have voting control; or

(E) an employee of a person defined in subparagraph (A), (B), (C), or (D).

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

(11) “Net income” means the total allocations to income under this [act] and the terms of the trust during an accounting period minus the disbursements, other than distributions, allocated to income under this [act] and the terms of the trust during the period. The term includes adjustments from principal to income and excludes adjustments from income to principal under Section 203. ~~If~~To the extent the trust is a unitrust or has been converted to a unitrust, the term ~~includes~~means the unitrust amount determined under [Article] 3.

(12) “Person” means an individual, estate, trust, business or nonprofit entity, public corporation, government or governmental subdivision, agency, or instrumentality, or other legal entity.

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

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

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

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

1 (17) “Terms of ~~the~~a trust” means the manifestation of the intent of a settlor or decedent
2 with respect to a trust, expressed in a manner that admits of its proof in a judicial proceeding,
3 whether by words in a record, by other written or spoken words, or by conduct. In the case of an
4 estate, the term includes a will. In the case of a life estate, term interest, or other arrangement or
5 relationship, the term includes the corresponding manifestation of the rights of the beneficiaries.

6 (18) “Trust”:

7 (A) includes:

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

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

12 (B) excludes:

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

18 (iii) an arrangement under which a person is a nominee, escrowee, or agent
19 for another.

20 ~~———(19) “Trustee”~~ (19) “Trustee” means any person, other than a personal representative,
21 which owns or holds property for the benefit of beneficiaries. The term includes an original,
22 additional, or successor trustee, whether or not appointed or confirmed by a court.

23 (20) “Will” means any testamentary instrument recognized by applicable law that makes a

legally effective disposition of a person's property effective at that person's death. The term includes a codicil- or other amendment to a testamentary instrument.

Legislative Note: *Modify Section 102(6) to refer to Section 2(9) of the Uniform Directed Trust Act, or modify that provision appropriately if your state has not adopted the Uniform Directed Trust Act. Modify Section 102(9)(A)(i) to refer to Section 103(13) of the Uniform Trust Code, or modify that provision appropriately if your state has not adopted the Uniform Trust Code.*

Comment

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

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

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

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

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

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

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

(1) a trust or estate;

(2) a life estate or other term interest in which the interests of one or more persons will be succeeded by the interests of one or more other persons; and

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

SECTION 104. GOVERNING LAW. Except as otherwise provided in this [act] or in the terms of the trust, this [act] applies when this state is the principal place of administration of an estate or trust or the situs of property not held in an estate or trust. By accepting the trusteeship of a trust having its principal place of administration in this state or by moving the principal place of administration of a trust to this state, the trustee submits to the application of this [act] to any matter within its scope involving the trust.

Comment

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

The question of the allocation of receipts and expenditures to principal or income presents a different problem. See Restatement of Trusts (Second), §§ 232-241. If a testator creates a trust to be administered in a state other than that of his domicil, the question is whether the allocation, as for instance of extraordinary dividends, is to be determined by the local law of his domicil or the local law of the place of administration. This could conceivably be treated as a question of administration and governed by the local law of the place of administration. On the other hand, it can be treated as a question of the distribution of the trust property and governed by the local law of the testator's

1 domicil. For the purposes of the choice of the applicable law, it is generally held that it is
2 a question of construction and that the local law of the testator's domicil is applicable.

3 Despite the fact that income and principal allocations often do determine who gets what and
4 therefore have the effect of rules of construction, treating those allocations as governed by the
5 place of current administration seems to be the most workable approach and seems to be
6 contemplated, for example, by the change-of-situs examples in the 2003 amendments to the GST
7 tax regulations (Treasury Reg. § 26.2601-1(b)(4)(i)(E), Examples 11 & 12). Perhaps the biggest
8 burden of a rule of construction is determining the governing law not only *where* the trust was
9 originally created but also *when* the trust was originally created, a burden that gets greater as
10 longer-term trusts become more common and existing trusts therefore become older. Section 104
11 clarifies that the Uniform Fiduciary Income and Principal Act, like a rule of administration, is
12 governed by the law of the situs, or principal place of administration, of the trust, which is not
13 necessarily the place where all or most or any of the trust assets are located.

14 [ARTICLE] 2

15 FIDUCIARY DUTIES AND JUDICIAL REVIEW

16 SECTION 201. FIDUCIARY DUTIES; GENERAL PRINCIPLES.

17 (a) In ~~allocating a receipt~~making an allocation or ~~disbursement to income~~determination or
18 ~~principal or between income and principal, and with respect to any matter within the scope of~~
19 ~~[Articles] 6 and 7,~~exercising discretion under this [act], a fiduciary:

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

22 (2) may ~~administer the trust or estate by the~~ exercise ~~of~~ a discretionary power of
23 administration given to the fiduciary by the terms of the trust or the will, even if exercise of the
24 power produces a result different from a result required or permitted by this [act]; which shall
25 not create an inference that the fiduciary has improperly exercised the discretionary power;

26 (3) shall administer the trust or estate in accordance with this [act] ~~if~~to the extent
27 the terms of the trust or the will ~~do not either~~neither:

28 _____ (A) contain a different provision ~~or;~~ nor

29 _____ (B) give the fiduciary a discretionary power of administration;

(4) shall add a receipt to principal to the extent neither the terms of the trust or the will nor the other provisions of this [act] ~~allocates~~allocate the receipt ~~to income or principal or~~ between income and principal; and

(5) shall charge a disbursement to ~~income~~principal to the extent neither the terms of the trust or the will nor the other provisions of this [act] allocates the disbursement ~~to income or principal or~~ between income and principal.

(b) In exercising the power to adjust under Section 203(a), the power to convert to or from a unitrust or change the administration of a unitrust under [Article] 3, or another discretionary power of administration regarding a matter within the scope of this [act], whether granted by the terms of the trust or this [act], a ~~trustee~~fiduciary shall ~~administer a trust~~act impartially, based on what is fair and reasonable to all the beneficiaries, giving due regard to the beneficiaries' respective interests, except to the extent the terms of the trust manifest an intention that the ~~trustee~~fiduciary shall or may favor one or more beneficiaries.

(c) In ~~deciding~~determining whether ~~and~~, to what extent, and in what manner to exercise powers under Section 203 and [Article] 3, a fiduciary shall consider the effect of allocations between income and principal on the fiduciary's ability to comply with subsection (b) after applying the rules in subsection (a). In considering that effect, the fiduciary shall consider all other factors the fiduciary determines are relevant to the trust and its beneficiaries, including the following factors to the extent the fiduciary determines they are relevant:

(1) the terms of the trust;

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

(3) the ~~intent~~desirability of ~~the settlor~~;

1 ~~_____ (4) the identity and circumstances of the beneficiaries;¹~~
2 ~~_____ (5) the needs of the trust and the beneficiaries for liquidity and regularity of~~
3 ~~income;~~
4 ~~_____ (6) the desirability of the preservation and appreciation of the capital of the trust,~~
5 ~~including the reasonable maintenance of the value of capital with regard to indices² the fiduciary~~
6 ~~determines to be appropriate;:~~
7 ~~_____ (7) the role of allocations between income and principal in enabling the fiduciary~~
8 ~~to comply with subsection (b) after applying the rules in subsection (a);~~
9 ~~_____ (8) the assets held in the trust, the extent to which the assets consist of financial~~
10 ~~assets, interests in closely held enterprises, tangible and intangible personal property, real~~
11 ~~property, or assets for which specialized treatment is provided in [Articles] 4 through 7, the _____~~
12 ~~_____ (5) the extent to which an asset is used or may be used by a beneficiary; and;~~
13 ~~_____ (6) whether an asset was purchased by the fiduciary or received from the settlor;~~
14 ~~_____ (9) the net amount that would be allocated to income under [Articles] 4 through 7~~
15 ~~to the extent they apply;~~
16 ~~_____ (10) the suitability of the rules in [Articles] 4 through 7 in the context of all the~~
17 ~~relevant factors considered by the fiduciary, including the other factors in this subsection to the~~

¹ [NEW 11/1/17] With respect to “the identity and circumstances of the beneficiaries” identified as a potentially relevant factor in Section 201(c)(4), the drafting committee has discussed, for example, whether a fiduciary might or should be more comfortable with an adjustment between the current income interest of a surviving spouse and the successive interests of children if the spouse is also the parent of those children. Not dispositive, of course, but could it sometimes be at least relevant?

² [NEW 11/1/17] In the previous draft, what is now just “indices” in Section 201(c)(6) was “the cost of living and other indices.” Members of the drafting committee expressed uneasiness with the notion that a fiduciary is expected to match any specific index. But that is not necessarily the result from allowing the fiduciary to keep an eye on indices of its choosing. A fiduciary might conclude, for example, that if the growth of the principal in any year (or a smoothed average of more than one year) is less than one half of the growth in a given index or blend of indices, consideration should be given (not necessarily conclusively) to making an adjustment.

1 extent they are relevant;³

2 ~~_____ (11) the increase or decrease _____ (7) the volatility~~ in the value of principal
3 assets, which the fiduciary may estimate as to an asset for which market value is not readily
4 available;

5 ~~(128)~~ whether and to what extent the terms of the trust give the fiduciary power to
6 accumulate income or invade principal or prohibit the fiduciary from accumulating income or
7 invading principal;

8 ~~(139)~~ the extent to which the fiduciary has accumulated income or invaded
9 principal;

10 ~~(1410)~~ the actual and anticipated effect ~~of economic conditions~~ on income and
11 principal ~~and effects of~~ of economic conditions, including inflation and deflation; and

12 ~~(1511)~~ the anticipated tax consequences of exercising the powers.

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

15 Comment

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

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

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

³ [NEW 11/117] Members of the drafting committee discussed in a conference call the desirability of trying to distinguish between use of the power to adjust “generally” and use of the power to correct problems caused by the default rules. Because the adjustment itself is the same in either case, it could be complicating to attempt to carry out that desire in that way. But the new factor in Section 201(c)(10) is intended to address that concern.

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

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

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

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

26 27 **SECTION 202. JUDICIAL REVIEW OF DISCRETIONARY POWER.**

28 (a) In this section:

29 (1) A “fiduciary’s decision” means:

30 (A) a fiduciary’s allocation between income and principal or other
31 determination regarding income and principal required or authorized by the terms of the trust or
32 this [act];

33 (B) a fiduciary’s exercise or nonexercise of a discretionary power
34 regarding income and principal granted by the terms of the trust or this [act], including a power
35 under Section 203 or [Article] 3; and

1 (C) a fiduciary's implementation of a fiduciary's decision described in
2 subparagraph (A) or (B).

3 (2) "Trust" includes any arrangement or relationship described in Section 103.

4 (b) The court may not order a fiduciary to change a ~~decision to exercise or not to exercise~~
5 ~~a discretionary power conferred by this [act]~~ fiduciary's decision unless the court determines that
6 the fiduciary's decision was an abuse of the fiduciary's discretion.

7 (c) A fiduciary's decision is not an abuse of the fiduciary's discretion merely because the
8 court would have ~~exercised the power in~~ made a different ~~manner or would not have exercised~~
9 ~~the power~~ decision.

10 (b,d) If the court determines that a fiduciary has abused the fiduciary's discretion, in
11 addition to other remedies provided by this [act] or otherwise the court may place the ~~income and~~
12 ~~remainder~~ beneficiaries in the positions they would have occupied if the discretion had not been
13 abused, under the following rules:

14 (1) To the extent the abuse of discretion resulted in no distribution to a beneficiary
15 or in a distribution that is too small, the court ~~shall~~ may order the fiduciary to distribute to the
16 beneficiary an amount the court determines will ~~restore~~ replace the beneficiary, in whole or in part,
17 ~~to~~ in the ~~beneficiary's~~ appropriate position.

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

23 (3) To the extent that the court is unable, after applying paragraphs (1) and (2), to

1 place the beneficiaries, the trust, or both, in the positions they would have occupied if the
2 discretion had not been abused, the court may order the fiduciary to pay an appropriate amount
3 from the fiduciary's own funds to one or more of the beneficiaries, to the trust, or to both.

4 (ee) On [petition] by ~~the~~a fiduciary, the court having jurisdiction over a trust ~~shall~~may
5 determine whether a proposed ~~exercise or nonexercise by the fiduciary of a discretionary power~~
6 ~~conferred by this [act]~~fiduciary's decision will result in an abuse of the fiduciary's discretion. If
7 the petition describes the proposed ~~exercise or nonexercise of the power~~fiduciary's decision and
8 contains sufficient information to inform the beneficiaries of the reasons for the proposal, the
9 facts upon which the fiduciary relies, and an explanation of how the ~~income and remainder~~
10 beneficiaries will be affected by the proposed ~~exercise or nonexercise of the power~~fiduciary's
11 decision, a beneficiary who challenges the proposed ~~exercise or nonexercise~~fiduciary's decision
12 has the burden of establishing that it will result in an abuse of discretion.

13 ~~— (d) A determination under this [act] is presumed to be fair and reasonable to all the~~
14 ~~beneficiaries.~~ *Legislative Note: Modify this provision if your state does not permit what in effect*
15 *are declaratory judgments in such matters.*

16 SECTION 203. FIDUCIARY'S POWER TO ADJUST.

17 (a) ~~A fiduciary~~ Except as otherwise provided in the terms of the trust and this section, a
18 fiduciary may, without court approval, adjust between income and principal.

19 (b) This section does not create or imply a duty to exercise or consider the power to adjust
20 under subsection (a), or to inform beneficiaries about the applicability of this section.

21 (c) A fiduciary that in good faith takes or fails to take any action under this section is not
22 liable to a person affected by the action or inaction. The exclusive remedy of a person affected by
23 a fiduciary's good-faith action or inaction under this section is to obtain a court order directing
24 the fiduciary to exercise or refrain from exercising the power of adjustment under this section.

~~(b)~~

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

~~(e)~~ A fiduciary may not ~~make an adjustment; exercise the power to adjust under~~ subsection (a):

(1) that reduces the income interest in a trust that requires income to be paid at least annually to a spouse and for which a marital deduction for federal estate or gift tax purposes has been allowed, has been claimed, or could be claimed; except to the extent the adjustment is made to provide for a reasonable apportionment of the total return of the trust;

(2) that ~~reduces~~changes the actuarial value of a beneficiary's ~~income~~ interest in a trust to which a person transferred property if the value of the property for federal gift tax purposes or the qualification of the transfer ~~qualified or could qualify,~~ in whole or in part; for a federal gift tax annual exclusion was based on ~~the~~that actuarial value ~~of the income interest;~~ except to the extent the adjustment is made to provide for a reasonable apportionment of the total return of the trust;

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

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

(5) if possessing or exercising the power to make the adjustment causes a person to be treated as the owner of all or part of the trust for federal income tax purposes, ~~and the individual would not be treated as the owner if the fiduciary did not possess the power to make~~

1 ~~an adjustment;~~

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

7 ~~_____ (7) if possessing or exercising the power to make the adjustment~~
8 ~~causes a person to be treated as making a gift for federal gift tax purposes;~~

9 ~~_____ (8) if the trust is an irrevocable lifetime trust that provides income to be paid for~~
10 ~~life to the settlor, and possessing or exercising the power to make an adjustment would cause any~~
11 ~~public benefit program to consider the adjusted principal or income to be an available resource or~~
12 ~~available income and the principal or income or both would in each case not be considered as an~~
13 ~~available resource or income if the fiduciary did not possess the power to make an adjustment;~~

14 ~~_____ (8) if the fiduciary is a beneficiary of the trust whose interest would be materially~~
15 ~~affected by the adjustment;~~ (9) if the fiduciary is not an independent person; or

16 (10) if the trust is a unitrust under [Article] 3.

17 (df) If ~~subsection (e)(paragraph (5), (6), (7), (8), or (9) of subsection (e)~~ applies to a
18 fiduciary ~~and there is more than one fiduciary;~~

19 ~~_____ (1) a co-fiduciary to whom which the provision paragraph does not apply may~~
20 ~~make the adjustment unless the exercise of the power by the remaining co-fiduciary or co-~~
21 ~~fiduciaries is not permitted by the terms of the trust; or~~

22 ~~_____ (e) _____ (2) if there is no co-fiduciary to which the paragraph does not apply, the~~
23 ~~fiduciary may appoint a co-fiduciary to which the paragraph does not apply, and that appointed~~

1 do-fiduciary may make the adjustment.

2 (g) If subsection (e)(9) applies to a fiduciary and there is no co-fiduciary to which
3 subsection (e)(9) does not apply, the fiduciary may make the adjustment with the consent of
4 beneficiaries or in the absence of objection from beneficiaries, or by petitioning the court, in the
5 manner provided in Section 303 in the case of a conversion of a trust to a unitrust. In a court
6 proceeding under this subsection, Section 202(c) shall not apply.

7 (h) A fiduciary may release or delegate to a co-fiduciary the entire power conferred by
8 subsection (a) or ~~may release~~ only the power to adjust from income to principal or the power to
9 adjust from principal to income, if the fiduciary is uncertain about whether possessing or
10 exercising the power will cause a result described in subsection ~~(ee)~~(1) through ~~(6) or (e)(87)~~ or
11 if the fiduciary determines that possessing or exercising the power will or may deprive the trust
12 of a tax benefit or impose a tax burden not described in subsection ~~(e)-e)~~. The release or
13 delegation may be permanent or for a specified period, including a period measured by the life of
14 an individual or the lives ~~or of~~ more than one individual.

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

19 ~~(gi)~~ The power of adjustment under subsection (a):

20 (1) may be exercised at ~~or after~~any time before the end of the accounting period to
21 which it applies or ~~at or before~~ the beginning of the immediately subsequent accounting period;
22 and

23 (2) may apply to the ~~current~~ accounting period ~~or in which it is exercised~~, the

1 immediately past accounting period, and to one or more subsequent accounting periods.

2 ~~(hk)~~ A fiduciary's exercise of the power under subsection (a) must be:

3 (1) included in the report, if any, that is sent to beneficiaries under [Section
4 813(c)] of [the Uniform Trust Code]; or

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

10 ~~—— (i) This section does not create or imply a duty to exercise the power to adjust under~~
11 ~~subsection (a) or to inform beneficiaries about the applicability of this section.⁴~~

12 ~~—— (j) A fiduciary that in good faith takes or fails to take any action under this section is not~~
13 ~~liable to a person affected by the action or inaction. The exclusive remedy of a person affected~~
14 ~~by a fiduciary's good faith action or inaction under this section is to obtain a court order directing~~
15 ~~the fiduciary to exercise or refrain from exercising the power of adjustment under this~~
16 ~~section.~~ **Legislative Note:** *Modify Section 203(~~hf~~) if your state requires fiduciaries to act*
17 *unanimously. Modify Section 203(k)(1) to refer to Section 813(c) of the Uniform Trust Code and*
18 *modify Section 203(~~hk~~)(2) to refer to Section 103(13) of the Uniform Trust Code, or modify those*
19 *provisions appropriately if your state has not adopted the Uniform Trust Code.*

20 **Comment [NOT UP-TO-DATE]**

21 **Limitations on the power to adjust.** Section 203(~~ee~~) prohibits a trustee from exercising
22 the power to adjust where certain tax advantages might be jeopardized or the trustee might be
23 personally affected. In the latter case, the Drafting Committee does not intend that a trustee be
24 disqualified merely because of a remote interest in the principal of the trust – for example, if the
25 trustee is a remote contingent beneficiary in the unlikely event a number of younger-generation
26 beneficiaries all die before the trust terminates. Section 203(~~ee~~)(8) ~~uses formerly used~~ the word
27 “materially” for that reason.

28 Section 203 does not provide for the appointment of a disinterested person to exercise the

⁴ [NEW 11/1/17] The words “to exercise the power” are added to Section 203(i) to be consistent with the rest of the section.

1 power to adjust if no trustee is eligible, as Section 303(e) does in the case of converting the trust
2 to a unitrust, for example. Unlike a one-time conversion to a unitrust, the adjustment between
3 income and principal requires ongoing awareness of and attention to the particular characteristics
4 of the trust and its beneficiaries.

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

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

16 [ARTICLE] 3

17 UNITRUST

18 SECTION 301. DEFINITIONS. In this [article]:

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

21 ~~_____ (2) "Express unitrust" means a trust for which, under the terms of the trust without~~
22 ~~regard for this [article], income or net income must or may be calculated as a unitrust amount.~~

23 ~~_____ (3) "Net fair market value of the trust" means the fair market value of the assets of the~~
24 ~~trust, less the noncontingent liabilities of the trust.~~

25 (~~34~~) "Special tax benefit" means:

26 (A) eligibility of a transfer to a trust for the exclusion from gifts described in
27 Section 2503(b) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section
28 2503(b)][, as amended] because of the qualification of an income interest in the trust as a present
29 interest;

1 (B) qualification of a trust as a qualified subchapter S trust described in Section
2 1361(d) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section 1361(d)][, as
3 amended] at a time the trust holds stock of an S corporation as defined in Section 1361(a)(1) of
4 the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section 1361(a)(1)][, as amended];

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

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

12 if there is any possibility that:

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

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

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

22 (i) a taxable distribution as defined in Section 2612(b) of the Internal
23 Revenue Code of 1986[, as amended][, 26 U.S.C. Section 2612(b)][, as amended] could be made

1 from the trust; or

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

5 (45) “Unitrust” means a trust:

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

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

8 (56) “Unitrust amount” means an amount computed by multiplying the applicable value
9 by the unitrust rate.

10 (67) “Unitrust policy” means a policy described in Sections 305 through 309 and adopted
11 under Section 303.

12 (78) “Unitrust rate” means the rate used to compute the unitrust amount under paragraph
13 (56), determined pursuant to the unitrust policy.

14 **Legislative Note:** *In states in which the constitution, or other law, does not permit the phrase “as*
15 *amended” when federal statutes are incorporated into state law, the phrase should be omitted.*
16

17 **SECTION 302. APPLICATION OF [ARTICLE 1]; DUTIES AND REMEDIES.**

18 (a) This [article] applies to ~~an estate only to the extent~~ a trust that ~~is a beneficiary of the~~
19 ~~estate.~~⁵

20 ~~— (b) This [article] does not apply to a trust if:~~

21 ~~— (1) the terms of the trust expressly prohibit use of this [article] by a specific~~
22 ~~reference to this [article] or by an explicit expression of intent that income or⁶ net income not be~~
23 ~~calculated as a unitrust amount; or, unless:~~

⁵ Section 302(a) is revised from a prohibition on estates to this limited permission.

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

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

7 (b) This [article] applies to an express unitrust unless:

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

11 (2) the terms of the trust expressly prohibit use of this [article] by a specific
12 reference to this [article] or by an explicit expression of intent that net income be calculated as a
13 unitrust amount. If the terms of the trust expressly require that the trust be a unitrust, a fiduciary
14 may exercise the authority under section 303 to change the percentage or method used to
15 calculate the unitrust amount, to the extent consistent with the terms of the trust.

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

19 (d) This [article] applies to an estate only to the extent a trust is a beneficiary of the estate.
20 To the extent of the trust's interest in the estate, the estate may be administered like a unitrust,
21 the administration of the estate like a unitrust may be discontinued, or the percentage or method
22 used to calculate the unitrust amount may be changed, in the same manner as in the case of a trust

⁶ The words "income or" are added to "net income" in Section 302(b)(1).

under this [article].

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

(f) A fiduciary that in good faith takes or fails to take any action under this [article] is not liable to a person affected by the action or inaction, regardless of whether the affected person received notice in a record as provided in this [article] or the affected person was under a legal disability at the time of delivery of the notice. The exclusive remedy of a person affected by a fiduciary's good-faith action or inaction under this [article] is to obtain a court order directing the fiduciary to convert a trust to a unitrust, discontinue the status of a trust as a unitrust, or change the percentage or method used to calculate the unitrust amount.

Legislative Note: In states in which the constitution, or other law, does not permit the phrase "as amended" when federal statutes are incorporated into state law, the phrase should be omitted.

SECTION 303. AUTHORITY OF FIDUCIARY.

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

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

(A) if the trust is not a unitrust:

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

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

1 (B) if the trust is a unitrust:

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

5 (ii) that the percentage or method used to calculate the unitrust
6 amount ~~must~~will be changed as stated in the unitrust policy;

7 (2) the fiduciary sends a notice described in Section 304;

8 (3) if the settlor of the trust is living, the fiduciary sends a copy of the notice
9 required under paragraph (2) to the settlor;

10 (4) at least one member of each class[of qualified beneficiaries] receiving the
11 notice under paragraph (2) is:

12 (A) legally competent; [or]

13 (B) in the case of a charitable organization, then existing; [or]

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

15 (5) the fiduciary does not receive an objection in a record to the action proposed
16 under this subsection from a person to whom the notice under paragraph (2) is sent by the date
17 specified in the notice under Section 304(d)(4).

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

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

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

~~_____ (e) If~~ (c) If, after sending the notice under paragraph (2), a fiduciary decides not to take the action proposed under subsection (a), the fiduciary shall notify in a record each person described in Section 304(a) of the decision not to take the action and the reasons for the decision.

(d) If a beneficiary requests in a record that a fiduciary ~~to~~ take the action described in subsection (a) and the fiduciary declines to do so or does not do so within 90 days of the fiduciary's receipt of the request, the beneficiary may petition the court to direct the fiduciary to take the action requested.

~~_____ (1) [all~~ (e) In deciding whether and how to take an action authorized by this section, or whether and how to respond to a request by a beneficiary under subsection (d) or a petition by a beneficiary under subsection (d)(2), a fiduciary shall consider all factors relevant to the trust and its beneficiaries, including the relevant factors in Section 201(c).

~~_____ (f) The fiduciary may release or delegate the power under subsection (a) for the reasons and in the manner described in Section 203(h).~~

Legislative Note: In states in which the constitution, or other law, does not permit the phrase "as amended" when federal statutes are incorporated into state law, the phrase should be omitted. Modify Sections 303(a)(4) and 303(d)(1) to refer to Section 103(13) of the Uniform Trust Code, or modify those provisions appropriately if your state has not adopted the Uniform Trust Code.

Alternative A (UTC)

SECTION 304. NOTICE.

~~_____ (a) A notice required by Section 303(a)(2) must be sent in a manner authorized under [Section 109] of [the Uniform Trust Code] to:~~

~~_____ (1) the qualified beneficiaries determined under [Section 103(13)] of [the Uniform Trust Code], other than the [Attorney General]]-f]; and~~

~~_____ (2) [each person acting as [trust director] of the trust under [the Uniform Directed~~

Trust Act]]each person that is granted a power over a trust by the terms of the trust to the extent the power is exercisable while the person is not then serving as a trustee:

(A) including a power over the investment, management, or distribution of trust property or other matters of trust administration; and

(B) excluding a:

(i) power of appointment;

(ii) power to appoint or remove a trustee or person described in this paragraph;

(iii) power of a beneficiary over a trust to the extent the exercise or nonexercise of the power affects the beneficial interest of the beneficiary or another beneficiary represented by the beneficiary under [Uniform Trust Code] [Sections 301 through 305] with respect to the exercise or nonexercise of the power; and

(iv) power over a trust if the terms of the trust provide that the power is held in a nonfiduciary capacity and the power must be held in a nonfiduciary capacity to achieve the settlor's tax objectives under the Internal Revenue Code of 1986[, as amended][, and regulations issued thereunder]].

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

(c) A notice under Section 303(a)(2) need not be sent to a person that consents in a record to the action proposed under Section 303(a). The consent may be executed, and sent or delivered, at any time before, when, or after the proposed action is taken.

(d) A notice required by Section 303(a)(2) must include:

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

1 (2) a copy of the unitrust policy under Section 303(a)(1);
2 (3) a statement that the person to which the notice is sent may object to the
3 proposed action by stating the basis for the objection in a record and sending or delivering the
4 record to the fiduciary;
5 (4) the date by which an objection under paragraph (3) must be received by the
6 fiduciary, which must be at least 30 days after the date the notice is sent;
7 (5) the date on which the action is proposed to be taken and, if different, the date
8 on which the action is proposed to take effect;
9 (6) the name and contact information of the fiduciary; and
10 (7) the name and telephone number of a person that may be contacted for
11 additional information.

12 **Alternative B (no UTC)**

13 **SECTION 304. NOTICE.**

14 (a) A notice required by Section 303(a)(2) must be sent to:
15 (1) all beneficiaries that receive or are entitled to receive income from the trust or
16 are entitled to receive a distribution of principal if the trust is terminated at the time the notice is
17 sent, assuming no power of appointment is exercised; ~~may take the action described in~~
18 ~~subsection (a)(2); or; and~~
19 ~~(2) a beneficiary may petition the court to direct the fiduciary to take action under~~
20 ~~subsection (a)(2). ~~(e) In deciding whether and how to take an action authorized by this~~~~
21 ~~section, or whether and how to respond to a request by a beneficiary under subsection (d) or a~~
22 ~~petition by a beneficiary under subsection (d)(2), a fiduciary shall consider all factors relevant to~~
23 ~~the trust and its beneficiaries, including the relevant factors in Section 201(c).~~

~~_____ (f) The fiduciary may release the power under subsection (a) for the reasons and in the manner described in Section 203(e).~~

~~**Legislative Note:** In states in which the constitution, or other law, does not permit the phrase “as amended” when federal statutes are incorporated into state law, the phrase should be omitted. Modify Sections 303(a)(4) and 303(d)(1) to refer to Section 103(13) of the Uniform Trust Code, or modify those provisions appropriately if your state has not adopted the Uniform Trust Code.~~

~~**SECTION 304. NOTICE.**~~

~~_____ (a) A notice required by Section 303(a)(2) must be sent [in a manner authorized under [Section 109] of [the Uniform Trust Code]] to:~~

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

(2) [each person acting as [trust director] of the trust under [the Uniform Directed Trust Act]] [each person that is granted a power over a trust by the terms of the trust to the extent the power is exercisable while the person is not then serving as a trustee:

(A) including a power over the investment, management, or distribution of trust property or other matters of trust administration; and

(B) excluding a:

(i) power of appointment;

(ii) power to appoint or remove a trustee or person described in this paragraph;

(iii) power of a beneficiary over a trust to the extent the exercise or

1 nonexercise of the power affects the beneficial interest of the beneficiary or another beneficiary
2 represented by the beneficiary ~~under [Uniform Trust Code Sections 301 through 305]~~ with
3 respect to the exercise or nonexercise of the power; and

4 (iv) power over a trust if the terms of the trust provide that the
5 power is held in a nonfiduciary capacity and the power must be held in a nonfiduciary capacity to
6 achieve the settlor's tax objectives under the United States Internal Revenue Code of 1986[, as
7 amended][, and regulations issued thereunder]].

8 ~~[(b) The representation provisions of [Article 3] of [the Uniform Trust Code] apply to-~~
9 ~~notice under this section.]⁷~~

10 ~~——[(e)](b)~~ A notice under Section 303(a)(2) need not be sent to a person that consents in a
11 record to the action proposed under Section 303(a). The consent may be executed, and sent and
12 delivered, at any time before, when, or after the proposed action is taken.

13 ~~[(d)](c)~~ A notice required by Section 303(a)(2) must include:

- 14 (1) notice of the action proposed under Section 303(a);
- 15 (2) a copy of the unitrust policy under Section 303(a)(1);
- 16 (3) a statement that the person to which the notice is sent may object to the
17 proposed action by stating the basis for the objection in a record and mailingsending or
18 delivering the record to the fiduciary;
- 19 (4) the date by which an objection under paragraph (3) must be made received by
20 the fiduciary, which must be at least 30 days after the date the notice is sent;
- 21 (5) the date on which the action is proposed to be taken and, if different, the date

⁷ Section 304(a)(2) is adapted from Sections 2(5), 2(9), and 5(b) of the newly approved Uniform Directed Trust Act. Corresponding additions are made to the Legislative Note at the end of Section 304.

on which the action is proposed to take effect;

(6) the name and ~~mailing address~~contact information of the fiduciary; and

(7) the name and telephone number of a person that may be contacted for

additional information.

End of Alternatives

~~**Legislative Note:** In states in which the constitution, or other law, does not permit the phrase “as amended” when federal statutes are incorporated into state law, the phrase should be omitted.~~

~~Modify Section 304(a) to refer to Section 109 of the Uniform Trust Code or to appropriate general provisions for sending notice, modify Section 304(a)(1) to refer to Section 103(13) (defining “qualified beneficiary”) and related provisions of the Uniform Trust Code, modify Section 304(a)(2) to refer to Sections 301 through 305 of the Uniform Trust Code or replace it with a cross reference to the state’s law governing virtual representation, and modify the bracketed words in Section 304(b) to refer to Article 3 of the Uniform Trust Code; or modify those provisions appropriately if your state has not adopted the Uniform Trust Code. **Legislative Note:** Use Alternative A if your state has enacted the Uniform Trust Code. Use Alternative B if your state has not enacted the Uniform Trust Code.~~

~~*In states in which the constitution, or other law, does not permit the phrase “as amended” when federal statutes are incorporated into state law, the phrase should be omitted. Modify Section 304(a)(2) to refer to the Uniform Directed Trust Act or modify that provision appropriately if your state has not adopted the Uniform Directed Trust Act.*~~

SECTION 305. UNITRUST POLICY.

(a) In administering a unitrust under this [article], the fiduciary shall follow a unitrust policy adopted under Section 303(a)(1).

(b) A unitrust policy must provide for:

(1) the unitrust rate or the ~~determination of~~method for determining the unitrust rate under Section 306;~~and~~

(2) the ~~determination of~~method for determining the applicable value under Section 307~~;~~ and

(3) all rules identified in Sections 306 through 309 that will apply in the

administration of the unitrust, whether those rules are:

(A) mandatory, as prescribed in Sections 307(a) and 308(a); or

(B) optional, as set forth in Sections 306, 307(b) through (d), 308(b), and 309, to the extent that the fiduciary elects to adopt those rules.

SECTION 306. UNITRUST RATE.

(a) A unitrust rate may be:

(1) a fixed unitrust rate; or

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

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

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

(b) A unitrust policy may provide for:

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

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

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

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

(5) a mathematical blend of any of the unitrust rates determined under subsection

(a)(2) and paragraphs (1) through (4).

SECTION 307. APPLICABLE VALUE.

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

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

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

(b) A unitrust policy may prescribe standards for:

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

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

(3) how the net income attributable to an asset to which paragraph (1) or (2) applies ~~must be~~is determined and the effect of the net income on distributions;

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

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

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

(1) use of an average of ~~applicable~~fair market values over a stated number of previous periods;

(2) use of another mathematical blend of ~~applicable~~fair market values over a

1 stated number of previous periods;

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

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

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

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

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

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

12 (5) the treatment of accrued income and other ~~financial~~ features of an asset which
13 affect value.

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

17 **SECTION 308. PERIOD.**

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

20 (1) a calendar year;

21 (2) a 12-month period other than a calendar year;

22 (3) a calendar quarter;

23 (4) a three-month period other than a calendar quarter; or

1 (5) another period;

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

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

6 (2) using a fewer number of previous periods under Section 307(c)(1), (2), (3)(B),
7 or (4)(B) if:

8 (A) the trust has not been in existence for the previous periods; or

9 (B) fair market values are not available; or

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

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

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

15 (1) determining the timing of distributions;

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

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

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

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

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

(2) the only period that may be used under Section 308(a) is a calendar year under Section 308(a)(1); and

(3) no other provision of Sections 306 through 308 applies, except Sections 307(a)(1), (b)(4) and (5), (c)(1), and (d) and 308(b)(2)(A) and (3).

~~SECTION 310. DUTIES AND REMEDIES.~~

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

~~(b) A fiduciary that in good faith takes or fails to take any action under this [article] is not liable to a person affected by the action or inaction, regardless of whether the affected person received notice in a record as provided in this [article] or the affected person was under a legal disability at the time of delivery of the notice. The exclusive remedy of a person affected by a fiduciary's good faith action or inaction under this [article] is to obtain a court order directing the fiduciary to convert a trust to a unitrust, discontinue the status of a trust as a unitrust, or change the percentage or method used to calculate the unitrust amount.~~

~~**Legislative Note:** In states in which the constitution, or other law, does not permit the phrase “as amended” when federal statutes are incorporated into state law, the phrase should be omitted.~~

Comment

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

While the precise origin or intent of the word is not totally clear, it appears derived from the notion that the trust consists of a *unified* fund—“a single fund [in which] there would be no

1 distinction between income and principal,” only between “receipts” and “payouts.” Lovell, *supra*.
2 The “unitrust” can be thought of as a trust in which there is a “unity” of interest between the
3 current income beneficiary and the successor beneficiary, because both desire a higher value of
4 the trust assets.

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

10 Converting or reforming a trust to a unitrust can provide a partnership among the income
11 beneficiaries, the remainder beneficiaries, and the trustee that will enable the trustee to invest the
12 assets for long-term growth to the benefit of all beneficiaries. This will permit the mission of the
13 trustee and investment team to become more focused. Investment decisions can be based on the
14 needs and risk tolerances of the beneficiaries, and there is less likelihood of dissension between
15 the current and future beneficiaries over investment policy. In addition, to the extent that a
16 unitrust approach obviates discretionary invasions of principal, the trustee is protected against
17 challenges by the remainder beneficiaries that any discretionary principal distributions were
18 excessive. Similarly, a unitrust approach eliminates the need to make adjustments between
19 income and principal under Section 203 and thus avoids or minimizes controversy over whether
20 such adjustments are proper.

21 By the end of 2016, 36 states (Alabama, Alaska, Arizona, California, Colorado,
22 Delaware, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland,
23 Missouri, Nebraska, Nevada, New Hampshire, New Mexico, New York, North Carolina, Oregon,
24 Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont,
25 Virginia, Washington, West Virginia, Wisconsin, and Wyoming) had enacted statutes, some as
26 part of their Uniform Principal and Income Act and some separately, permitting a trustee to
27 convert a trust to a unitrust. Some of those statutes refer to unitrusts as “total return unitrusts” (a
28 term not used in Article 3).

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

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

40 To ensure that the income beneficiaries are not penalized if a trustee adopts a total

1 return investment strategy, many states have made, or are considering making, revisions
2 to the definitions of income and principal. Some state statutes permit the trustee to make
3 an equitable adjustment between income and principal if necessary to ensure that both the
4 income beneficiaries and the remainder beneficiaries are treated impartially, based on
5 what is fair and reasonable to all of the beneficiaries. Thus, a receipt of capital gains that
6 previously would have been allocated to principal may be allocated by the trustee to
7 income if necessary to treat both parties impartially. Conversely, a receipt of dividends or
8 interest that previously would have been allocated to income may be allocated by the
9 trustee to principal if necessary to treat both parties impartially.

10 Other states are proposing legislation that would allow the trustee to pay a unitrust
11 amount to an income beneficiary in satisfaction of that beneficiary's right to the income
12 from the trust. This unitrust amount will be a fixed percentage, sometimes required to be
13 within a range set by state statute, of the fair market value of the trust assets determined
14 annually.

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

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

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

26 [A]n allocation of amounts between income and principal pursuant to applicable local
27 law will be respected if local law provides for a reasonable apportionment between the
28 income and remainder beneficiaries of the total return of the trust for the year, including
29 ordinary and tax-exempt income, capital gains, and appreciation. For example, a state
30 statute providing that income is a unitrust amount of no less than 3% and no more than
31 5% of the fair market value of the trust assets, whether determined annually or averaged
32 on a multiple year basis, is a reasonable apportionment of the total return of the trust.

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

beneficiaries.

One such refinement is to provide that the trust distribute a percentage of its market value determined on the basis of a rolling average of values for periods other than years. Twelve quarters is an example. This can reduce potential fluctuations in distributions caused by short-swing movements in the stock market. Although the rate of increase in the unitrust distribution to the current income beneficiary will lag the performance of the portfolio, the current income beneficiary will benefit in down years. Another similar refinement designed to reduce risk to all the beneficiaries is to place a ceiling and/or a floor on the unitrust payout amount, or on the size of fluctuation of the unitrust amount from year to year or period to period. More fundamental refinements include a variable unitrust rate itself, perhaps drawn from specified market data, and different treatment for different types of assets, including the total exclusion of certain assets and the income therefrom. Sections 305-308 allow all variations of that kind. To afford a trustee the benefit of the safe harbor in the Treasury regulations in situations where it applies, Section 309(c) limits the parameters in those situations to the parameters specified in that safe harbor. The situations where Section 309(c) applies, described as situations in which the trust offers a “special tax benefit” defined in Section 301(34), are limited to the situations addressed in the 2003 Treasury Regulations.

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

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

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

[ARTICLE] 4

ALLOCATION OF RECEIPTS DURING ADMINISTRATION

[PART 1

RECEIPTS FROM ENTITIES]

SECTION 401. CHARACTER OF RECEIPTS FROM ENTITIES.

(a) In this section:

~~(1) “Distribution” means a payment or transfer from an entity to an owner of the~~

1 ~~entity or another person with an interest in the entity. “Distribute” has a corresponding meaning.~~⁸

2 ~~_____ (2) _____~~ (1) “Entity” means a corporation, partnership, limited liability
3 company, regulated investment company, real estate investment trust, common trust fund, or any
4 other organization or arrangement in which a fiduciary ~~has~~owns or holds an interest, regardless of
5 whether the entity is a taxpayer for federal income tax purposes, other than a trust or estate to
6 which Section 402 applies, a business or other activity to which Section 403 applies, an asset-
7 backed security to which Section 414 applies, or an instrument or arrangement to which Section
8 415 applies. An attribute or action attributed to an entity in this section includes an attribute or
9 action of any other entity in which the entity owns or holds an interest, including an interest
10 owned indirectly through another entity or entities.

11 ~~_____~~ (2) “Entity distribution” means a payment or transfer from an entity to a person
12 that owns or holds an interest in the entity, made to the person in the person’s capacity as an
13 owner or holder of the interest in the entity.

14 (b) Except as otherwise provided in this section, a fiduciary shall allocate to income
15 money received ~~from~~in an entity distribution.

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

17 (1) property; received in an entity distribution which is not:

18 ~~_____~~ (A) money; or

19 ~~_____~~ (B) personal property of ~~more than insubstantial or immaterial~~nominal
20 value, ~~other than money;~~

21 (2) money received in one entity distribution or ~~a~~in an entity distribution that

⁸ Subsection (a)(1) is new and is explained in the footnote to Section 102(4). It may be that a better fix would have been to find a different word or term altogether to replace “distribution,” but none came easily to mind.

1 information known to the fiduciary or provided to the fiduciary by or on behalf of the entity
2 indicates is part of a series of related entity distributions:

3 (A) in exchange for part or all of ~~at~~the fiduciary's interest in the entity; or

4 (B) which the fiduciary determines to be a return of capital; and

5 (3) money received in ~~total or partial liquidation of the~~an entity; ~~and~~

6 ~~(4) money received~~ distribution from an entity that is:

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

10 (B) an entity or arrangement treated ~~comparably~~ for federal income tax
11 purposes comparably to the treatment described in subparagraph (A)).

12 (d) ~~In determining whether a distribution of~~ A fiduciary may determine that money
13 ~~is received in partial liquidation of the~~an entity, ~~the following rules apply:~~

14 ~~(1) Money~~ distribution is ~~not received in partial liquidation and is income~~ a return
15 of capital to the extent it ~~does not exceed~~ exceeds the sum of the amounts the fiduciary
16 determines or estimates are:

17 (1) the amount of the entity's operating income; and

18 (2) the amount of income tax ~~at~~the fiduciary and the beneficiaries have paid or
19 ~~beneficiary~~ must pay on the taxable income of the entity.

20 (e) A fiduciary may determine that ~~distributes the money~~ received in an entity distribution
21 is a return of capital to the extent it represents the proceeds of the entity's sale or other
22 disposition of:

1 ~~_____ (2) If paragraph (1) does not apply,⁹ money is presumed to be received in partial~~
2 ~~liquidation to the extent the entity, not later than the date on which the entity files a federal~~
3 ~~income tax return for the year in which the distribution was made, indicates that it is a~~
4 ~~distribution in partial liquidation.¹⁰~~

5 ~~_____ (3) If paragraph (1) does not apply and either paragraph (2) does not apply or the~~
6 ~~fiduciary does not know if paragraph (2) applies, money is presumed to be received in partial~~
7 ~~liquidation to the extent the distribution is attributable to the proceeds from a sale of a capital~~
8 ~~asset by the entity or by a subsidiary or affiliate of the entity.¹¹~~

9 ~~_____ (4) If paragraph (1) does not apply and either paragraphs (2) and (3) do not apply~~
10 ~~or the fiduciary does not know if paragraph (2) or (3) applies, money is presumed to be received~~
11 ~~in partial liquidation to the extent _____ (1) all or part of the business or other activity~~
12 ~~conducted by the entity;~~

13 ~~_____ (2) one or more business assets that are not sold to customers in the ordinary~~
14 ~~course of the business or other activity conducted by the entity; or~~

15 ~~_____ (3) one or more assets other than business assets, unless the entity's primary~~
16 ~~activity is to invest in assets for the purpose of realizing gain on the disposition of all or some of~~
17 ~~those assets.~~

18 ~~_____ (f) If the entity's primary activity is to invest in assets for the purpose of realizing gain on~~

⁹ [NEW 11/1/17] Paragraphs (2), (3), and (4) recite the condition "If paragraph (1) does not apply." With reference to the application of paragraphs (2) and (3), paragraphs (3) and (4) add the alternative condition "the fiduciary does not know." The reason for this difference is that presumably the fiduciary should know if paragraph (1) applies and should not be given the option of ignorance. But is that always true of a *beneficiary's* income tax.

¹⁰ The clause "not later than the date on which the entity files a federal income tax return for the year in which the distribution was made" in Section 401(d)(2) replaces the less specific reference to "at or near the time of a distribution."

1 the disposition of all or some of those assets, a fiduciary may determine that money received in
2 an entity distribution is a return of capital to the extent it represents the excess of the proceeds of
3 the entity's sale or other disposition of one or more assets over the gain realized on the sale or
4 other disposition.

5 (g) If subsections (d) through (f) do not apply, a fiduciary may determine that money
6 received in an entity distribution is a return of capital if the total amount of money and property
7 ~~distributed~~received in a one entity distribution or in an entity distribution that information known
8 to the fiduciary or provided to the fiduciary by or on behalf of the entity indicates is part of a
9 series of related entity distributions ~~to all owners or distributees~~ is greater than 20 percent of the
10 fair market value ~~of the entity's assets, as shown by the entity's year-end financial statements~~
11 ~~immediately preceding the initial distribution.~~ of the entity.

12 ~~—————(5) In applying paragraphs (2) through (4);~~ (h) In determining if and to what
13 extent an entity distribution not described in subsections (c) through (g) is a return of capital, a
14 fiduciary may ~~rely on information~~ consider:

15 (1) the characterization of the entity distribution provided to the fiduciary by or on
16 behalf of the entity;

17 (2) the amount of the entity distribution compared to the amount of the entity's
18 regular, periodic distributions, if any, during the fiduciary's accounting period in which the entity
19 distribution is made and the three prior accounting periods;

20 (3) the amount of money the entity has accumulated during the fiduciary's
21 accounting period in which the entity distribution is made and the three prior accounting periods.

¹¹ [NEW 11/1/17] Section 401(d)(3), adapted from Section 16350(d) of the California Probate Code, was commended to the chairman and the reporter as a test that has proven workable in the context of sophisticated financial entities.

to the extent that the governing body of the entity has decided the money is no longer needed for the business or investment needs of the entity;

(4) the amount of income tax that the fiduciary and the beneficiaries have paid from income and from principal on the undistributed income of the entity received from an entity and does not have a duty to inquiry or investigate unless during the fiduciary's three accounting periods before the accounting period in which the entity distribution is made;

(A) other (5) the amount of money the entity has borrowed during the fiduciary's accounting period in which the entity distribution is made and the three prior accounting periods, whether or not repayment of the loan is secured to any extent by one or more of the entity's assets;

(6) the amount of money the entity has received from the sources described in Sections 407 and 409 through 411 during the fiduciary's accounting period in which the entity distribution is made and the three prior accounting periods; and

(7) the amount of money the entity has received from a source not described in this subsection during the fiduciary's accounting period in which the entity distribution is made and the three prior accounting periods.

(i) If, after applying subsections (b) through (h), a fiduciary determines that a portion of an entity distribution is a return of capital but is in doubt about the amount of the entity distribution that is a return of capital, the fiduciary shall allocate to principal the amount of the entity distribution which is in doubt.

(j) In applying subsections (b) through (i), unless subsection (k) applies, a fiduciary may rely without inquiry or investigation on information provided to the fiduciary by or on behalf of an entity on or before the date that is one month after the later of:

1 (1) if the fiduciary knows the entity's accounting period, the last day of the
2 fiduciary's accounting period that includes the last day of the entity's accounting period in which
3 the entity distribution is made; or

4 (2) if the fiduciary does not know the entity's accounting period, the last day of
5 the fiduciary's accounting period in which the entity distribution is made.

6 (k) Subsection (j) does not apply if:

7 (1) information in the fiduciary's possession indicates that the information
8 received from provided by or on behalf of the entity is or may be false, incorrect, or

9 ——(B(2) the fiduciary owns at least more than 50 percent of the voting interest
10 in the entity.

11 ——(6) (l) If a fiduciary receives additional information about the application of
12 this section to an entity distribution after the time described in subsection (j) but before the
13 fiduciary has paid part of the entity distribution to a beneficiary, the fiduciary shall consider the
14 additional information before making the payment to the beneficiary and may change a decision
15 to make the payment to the beneficiary.

16 (m) If the fiduciary receives additional information about the application of this section to
17 an entity distribution after the fiduciary has paid part of the entity distribution to a beneficiary,
18 the fiduciary is not required to change or recover the payment to the beneficiary, but may take
19 that information into account in determining whether to make an adjustment under Section 203.

20 **Comment**

21 **Additional flexibility.** The references to Section 415 at the end of Section 401(a) and to
22 entities comparably treated for federal income tax purposes in Section 401(c)(4)(B) provide
23 necessary guidance that may stay up-to-date even as new entities and arrangements are developed
24 to serve various tax needs and objectives.
25

1 **SECTION 402. DISTRIBUTION FROM TRUST OR ESTATE.** A fiduciary shall

2 allocate to income an amount received as a distribution of income, including a unitrust
3 distribution under [Article] 3, from a trust or an estate in which the ~~trust~~fiduciary has an interest
4 other than ~~an interest the fiduciary~~ purchased ~~interest~~, and shall allocate to principal an amount
5 received as a distribution of principal from such a trust or estate. If a fiduciary purchases an
6 interest in a trust that is an investment entity, or a decedent or donor transfers an interest in such a
7 trust to a fiduciary, Section 401, 414, or ~~414~~415 applies to a receipt from the trust.

8 **SECTION 403. BUSINESS AND OTHER ACTIVITIES CONDUCTED BY**
9 **FIDUCIARY.**

10 (a) This section applies to a business or other activity conducted by a fiduciary if the
11 fiduciary determines that it is in the best interest of the beneficiaries to account separately for the
12 business or other activity instead of:

13 (1) accounting for the business or other activity as part of the fiduciary's general
14 accounting records; or

15 (2) conducting the business or other activity through an entity described in Section
16 401, whether or not the entity is a taxpayer for federal income tax purposes.

17 (b) A fiduciary that accounts separately for a business or other activity under this section
18 ~~may~~shall maintain separate accounting records for the transactions of the business or other
19 activity, whether or not assets of the business or other activity are segregated from other assets
20 held by the fiduciary.

21 (c) A fiduciary that accounts separately for a business or other activity under this section:

22 (1) may determine:

23 (A) the extent to which the net cash receipts of the business must be

1 retained for:

2 (i) working capital,

3 (ii) the acquisition or replacement of fixed assets, and

4 (iii) other reasonably foreseeable needs of the business or other

5 activity; and

6 (B) the extent to which the remaining net cash receipts are accounted for
7 as principal or income in the trust's general accounting records;

8 (2) may make the determinations under paragraph (1) separately and differently
9 from the fiduciary's decisions concerning distributions of income or principal; and

10 (3) shall account for the net amount received from the sale of assets of the
11 business or other activity, other than a sale in the ordinary course of the business or other activity,
12 as principal in the trust's general accounting records to the extent the fiduciary determines that
13 the net amount received is no longer required in the conduct of the business or other activity.

14 (d) Activities for which a fiduciary may maintain separate accounting records include:

15 (1) retail, manufacturing, service, and other traditional business activities;

16 (2) farming;

17 (3) raising and selling livestock and other animals;

18 (4) management of rental properties;

19 (5) extraction of minerals and other natural resources;

20 (6) timber operations;

21 (7) activities to which Section 413 applies; and

22 (8) other operating businesses.

23 **Comment**

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

[PART 2

RECEIPTS NOT NORMALLY ~~ALLOCATED~~APPORTIONED]

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

(1) to the extent not allocated to income under this [act], assets received from:

(A) a transferor during the transferor's lifetime;

(B) an estate;

(C) a trust with a terminating income interest; or

(D) a payor under a contract naming the fiduciary as beneficiary;

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

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

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

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

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

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

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

(a) This section does not apply to an obligation to which Section 408, 409, 410, 411, 413, 414, or 414415 applies.

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

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

SECTION 407. INSURANCE POLICIES AND SIMILAR CONTRACTS.

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

(b) Except as otherwise provided in subsection (c), a fiduciary shall allocate to principal the proceeds of a life insurance policy or other contract received by the fiduciary as beneficiary, including a contract that insures against loss for damage to, destruction of, or loss of title to an asset. The fiduciary shall allocate dividends on an insurance policy to income if the premiums on the policy are paid from income, and to principal if the premiums are paid from principal.

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

[PART 3

RECEIPTS NORMALLY APPORTIONED]

SECTION 408. DEFERRED COMPENSATION, ANNUITIES, AND SIMILAR PAYMENTS.

~~———— (a) This section does not apply to a payment to which Section 409 applies.¹²~~

~~———— (b)~~ (a) In this section:

(1) “Payment” means an amount a fiduciary may receive over a fixed number of years or during the life of one or more individuals because of services rendered or property transferred to the payor in exchange for future receipts. The term includes an amount drawn in money or property from the payor’s general assets or from a separate fund created by the payor.

~~For purposes of subsections (f), (g), (h), and (i), the~~The term also includes an amount drawn from any separate fund, regardless of the reason for the withdrawal.

(2) “Separate fund” includes a private or commercial annuity, an individual

¹² [NEW 11/1/17] This subsection (a) is moved from the end to the beginning, consistently with other Style Committee suggestions.

1 retirement account, and a pension, profit-sharing, stock-bonus, or stock-ownership plan.

2 ~~—— (c) To the extent a payment is characterized by the payor as interest, a dividend, or a~~
3 ~~payment made instead of interest or a dividend, a fiduciary shall allocate the payment to income.~~
4 ~~The fiduciary shall allocate to principal the balance of the payment and any other payment~~
5 ~~received in the same accounting period that is not characterized as interest, a dividend, or a~~
6 ~~payment made instead of interest or a dividend.¹³~~

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

14 ~~(e) The percentage used under subsection (d) must be 10 percent, unless the fiduciary~~
15 ~~selects a different percentage in a record.~~

16 ~~—— (f)¹⁴ Except as otherwise provided in subsection (g), subsections (h) and (i) apply, and~~
17 ~~subsections (c) and (d) do not apply, in determining the allocation of a payment made from a~~
18 ~~separate fund to:~~

19 ~~—— (1) a trust to which an election to qualify for a marital deduction under Section~~
20 ~~2056(b)(7) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section~~
21 ~~2056(b)(7)][, as amended], has been made; or~~

¹³ This change makes the two sentences parallel.

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

3 ~~_____ (g) Subsections (f), (h), and (i) do not apply if and to the extent the series of payments~~
4 ~~would, without the application of subsection (f), qualify for the marital deduction under Section~~
5 ~~2056(b)(7)(C) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section~~
6 ~~2056(b)(7)(C)][, as amended].~~

7 ~~_____ (h) A trustee~~ (b) A fiduciary shall determine the internal income of each separate fund
8 for the accounting period as if the separate fund were a trust subject to this [act~~]-~~] and shall
9 allocate the amount of that internal income to income.

10 (c) If a separate fund is a retirement account or other plan derived from the employment
11 of an individual who created or added assets to a trust, and the sole current income beneficiary of
12 the trust is the surviving spouse of that individual, the following rules apply:

13 (1) Upon request of the surviving spouse, the ~~trustee~~fiduciary shall demand that
14 the person administering the separate fund distribute the internal income to the ~~trust-~~fiduciary.

15 (2) The ~~trustee~~fiduciary shall allocate a payment from the separate fund to income
16 to the extent of the internal income of the separate fund and distribute that amount to the
17 surviving spouse. The ~~trustee~~fiduciary shall allocate the balance of the payment to principal.

18 (3) Upon request of the surviving spouse, the ~~trustee~~fiduciary shall allocate
19 principal to income to the extent the internal income of the separate fund exceeds payments made
20 from the separate fund to the trust during the accounting period.

21 (id) If a ~~trustee~~fiduciary cannot determine the internal income of a separate fund but can

¹⁴ This subsection might be reviewed in light of the discussion at the ACTEC Employee Benefits Committee meeting in Seattle.

determine the value of the separate fund, the internal income of the separate fund is deemed to equal [insert number at least three percent and not more than five percent] of the fund's value, according to the most recent statement of value preceding the beginning of the accounting period.

(e) If the ~~trustee~~ fiduciary can determine neither the internal income of the separate fund nor the fund's value, the internal income of the fund is deemed to equal the product of the interest rate and the present value of the expected future payments, as determined under Section 7520 of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section 7520][, as amended], for the month preceding the accounting period for which the computation is made.

SECTION 409. CERTAIN ILLIQUID ASSETS.

~~(a)~~ (a) This section does not apply to a payment to which Section 408 applies.

(b) In this section, "illiquid asset" means an asset whose value is volatile or difficult to determine or will diminish or terminate because the asset is expected to produce receipts for a period of limited duration. The term includes a leasehold, patent, copyright, royalty right, and right to receive payments during a period of more than one year under an arrangement that does not provide for the payment of interest on the unpaid balance. The term does not include a payment subject to Section 408, natural resources subject to Section 410, timber subject to Section 411, an activity or asset subject to Section 413, an asset subject to Section 414 or 415, or any asset for which the fiduciary establishes a reserve for depreciation under Section 503.

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

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

Comment

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

18 19 **SECTION 410. MINERALS, WATER, AND OTHER NATURAL RESOURCES.**

20 (a) To the extent a fiduciary ~~accounts pursuant to this section~~does not account for receipts
21 from an interest in minerals, water, or other natural resources ~~not accounted for~~ as a business
22 under Section 403, the fiduciary shall allocate the receipts as follows:

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

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

28 (3) If ~~an amount~~ received as a royalty, shut-in-well payment, take-or-pay payment,
29 or bonus, ~~or delay rental is more than nominal,~~ a percentage receipt must be allocated ~~to~~between
30 income and ~~the balance to~~ principal equitably.

31 (4) If an amount is received from a working interest or any other interest not
32 provided for in ~~paragraph~~subsection (1), (2), or (3), a ~~percentage of the net amount~~

1 ~~received~~receipt must be allocated ~~to~~between income and ~~the balance to~~ principal equitably.

2 (b) An amount received on account of an interest in water that is renewable must be
3 allocated to income. If the water is not renewable, ~~a percentage of the~~ amount~~receipt~~ must be
4 allocated ~~to~~between income and ~~the balance to~~ principal equitably.

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

7 ~~—(d~~ (c) This [act] applies whether or not a decedent or transferor was extracting
8 minerals, water, or other natural resources before the interest ~~became subject to a trust~~was owned
9 or held by a fiduciary.

10 (d) An allocation of a receipt under this section is presumed to be equitable if the amount
11 allocated to principal is equal to the amount allowed by the United States Internal Revenue Code
12 of 1986[, as amended,] as a deduction for depletion of the interest.

13 (e) If a fiduciary owns or holds an interest in minerals, water, or other natural resources
14 on [the effective date of this [act]], the fiduciary may allocate receipts from the interest as
15 provided in this [act] or in the manner used by the fiduciary before [the effective date of this
16 [act]]. If the fiduciary acquires an interest in minerals, water, or other natural resources after [the
17 effective date of this [act]], the fiduciary shall allocate receipts from the interest as provided in
18 this [act].

19 **SECTION 411. TIMBER.**

20 (a) To the extent a fiduciary ~~accounts~~does not account for receipts from the sale of timber
21 and related products ~~pursuant to this section~~as a business under Section 403, the fiduciary shall
22 allocate the net receipts:

23 (1) to income to the extent the amount of timber removed from the land does not

1 exceed the rate of growth of the timber during the accounting periods in which a beneficiary has
2 a mandatory income interest;

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

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

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

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

13 (c) This [act] applies whether or not a decedent or transferor was harvesting timber from
14 the property before it ~~became subject to the trust~~was owned or held by a fiduciary.

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

18 (e) If a fiduciary owns an interest in land used for growing and cutting timber on [the
19 effective date of this [act]], the fiduciary may allocate net receipts from the sale of timber and
20 related products as provided in this [act] or in the manner used by the fiduciary on or before [the
21 effective date of this [act]]. If the fiduciary acquires an interest in timberland after [the effective
22 date of this [act]], the fiduciary shall allocate net receipts from the sale of timber and related
23 products as provided in this [act].

1 **SECTION 412. MARITAL DEDUCTION PROPERTY NOT PRODUCTIVE OF**
2 **INCOME.**

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

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

12 **SECTION 413. DERIVATIVES AND OPTIONS.**

13 (a) In this section, "derivative" means a contract ~~or financial~~ instrument, other
14 arrangement, or ~~a combination of contracts and financial~~ instruments which gives a trust, or
15 other arrangements, the ~~right~~ value, rights, and obligations of which are, in whole or obligation to
16 participate in some in part, dependent on or ~~all changes in the price of a~~ derived from an
17 underlying tangible or intangible asset ~~or,~~ group of tangible or intangible assets, ~~or changes in a~~
18 rate, an index, or occurrence of ~~prices or an event.~~ The term includes stocks, fixed income
19 securities, other financial instruments, and arrangement based on indices, commodities, interest
20 rates, or other market indicator for an asset or group of assets weather-related events, and credit
21 default events.

22 (b) To the extent a fiduciary does not account ~~under Section 403~~ for a transaction in
23 derivatives as a business under Section 403, the fiduciary shall allocate ~~to principal~~ 10 percent of

1 receipts from the transaction and disbursements made in connection with the transaction to
2 income, and the balance to principal.

3 (c) If a fiduciary grants an option to buy property from the trust, whether or not the trust
4 owns the property when the option is granted, grants an option that permits another person to sell
5 property to the trust, or acquires an option to buy property for the trust or an option to sell an
6 asset owned by the trust, and the fiduciary or other owner of the asset is required to deliver the
7 asset if the option is exercised, ~~an amount received for granting the option must be allocated to~~
8 ~~principal. An amount paid to acquire the option must be paid from principal. A gain or loss~~
9 ~~realized upon the exercise of an option, including an option granted to a settlor of the trust for~~
10 ~~services rendered, must be allocated to principal.~~ the fiduciary shall allocate the following
11 amounts 10 percent to income and the balance to principal:

12 (1) an amount received for granting the option;

13 (2) an amount paid to acquire the option; and

14 (3) gain or loss realized upon the exercise, exchange, settlement, offset, closing, or
15 expiration of the option.

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

17 (a) In this section, “asset-backed security” means an asset whose value is based on the
18 right it gives the owner to receive distributions from the proceeds of financial assets that provide
19 collateral for the security. The term includes an asset that gives the owner the right to receive
20 from the collateral financial assets only the interest or other current return or only the proceeds
21 other than interest or current return. The term does not include an asset to which Section 401 or
22 408 applies.

23 (b) If a ~~trust~~fiduciary receives a payment from interest or other current return and from

1 other proceeds of the collateral financial assets, the fiduciary shall allocate to income the part of
2 the payment the payor identifies as being from interest or other current return and shall allocate
3 the balance of the payment to principal.

4 (c) If a ~~trust~~fiduciary receives one or more payments in exchange for the ~~trust's~~fiduciary's
5 entire interest in an asset-backed security in one accounting period, the fiduciary shall allocate
6 the payments to principal. If a payment is one of a series of payments that will result in the
7 liquidation of the ~~trust's~~fiduciary's interest in the security over more than one accounting period,
8 the fiduciary shall allocate a percentage of the payment to income and the balance to principal.

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

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

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

15 **Comment**

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

19 **SECTION 416. INSUBSTANTIAL ALLOCATIONS NOT REQUIRED.** If a

20
21 fiduciary determines that an allocation between income and principal required by Section 408,
22 409, 410, 411, or 414 is insubstantial, the fiduciary may allocate the entire amount to principal,
23 unless Section 203(~~ee~~) applies to the allocation. This power may be exercised by a co-fiduciary in
24 the circumstances described in Section 203(~~df~~) and may be released or delegated for the reasons
25 and in the manner described in Section 203(~~e~~-h). An allocation is presumed to be insubstantial

1 if:

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

4 (2) the asset producing the receipt to be allocated has a fair market value less than 10
5 percent of the total fair market value of ~~a trust's~~the assets owned or held by the fiduciary at the
6 beginning of the accounting period.

7 [ARTICLE] 5

8 ALLOCATION OF DISBURSEMENTS DURING ADMINISTRATION

9 **SECTION 501. DISBURSEMENTS FROM INCOME.** A fiduciary shall make the
10 following disbursements from income to the extent they are not disbursements to which Section
11 601(~~c~~)(2)(~~B~~) or (~~C~~3) applies:

12 (1) one-half of:

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

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

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

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

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

Comment

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

SECTION 502. DISBURSEMENTS FROM PRINCIPAL.

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

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

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

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

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

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

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

(7) disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the costs of those

activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or regulations, statutory or common law claims by third parties, and defending claims based on environmental matters.

(b) If a principal asset is encumbered with an obligation that requires income from that asset to be paid directly to the creditor, the fiduciary shall transfer from principal to income an amount equal to the income paid to the creditor in reduction of the principal balance of the obligation.

SECTION 503. TRANSFERS FROM INCOME TO PRINCIPAL FOR DEPRECIATION.

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

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

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

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

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

SECTION 504. TRANSFERS FROM INCOME TO REIMBURSE PRINCIPAL.

(a) If a fiduciary makes or expects to make a principal disbursement described in this section, the fiduciary may transfer an appropriate amount from income to principal in one or

1 more accounting periods to reimburse principal or to provide a reserve for future principal
2 disbursements.

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

6 (1) an amount chargeable to income but paid from principal because it is
7 unusually large, including extraordinary repairs;

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

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

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

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

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

19 **SECTION 505. TAXES ON INCOME-TAXES.**

20 (a) A tax required to be paid by a fiduciary which is based on receipts allocated to income
21 must be paid from income.

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

1 authority.

2 (c) A tax required to be paid by a ~~trustee~~fiduciary on the ~~trust's~~fiduciary's share of an
3 entity's taxable income must be paid:

4 (1) from income and principal proportionately to the ~~extent that~~allocation of
5 receipts from the entity ~~are allocated only to~~income; and principal; and

6 (2) from principal to the extent that ~~receipts from the entity are allocated only to~~
7 principal;

8 ~~—————(3) proportionately from principal and income to the extent that receipts from the~~
9 ~~entity are allocated to both income and principal; and~~

10 ~~—————(4) from principal to the extent that~~ the tax exceeds the total receipts from the
11 entity.

12 (d) After applying subsections (a) through (c), the ~~trustee~~fiduciary shall adjust income or
13 principal receipts to the extent that the ~~trust's~~fiduciary's taxes are reduced because ~~the trust~~
14 ~~receives~~of a deduction for payments made to a beneficiary.

15 Comment

16
17 **Marital deduction issues.** Any payment of income tax from income could raise issues of
18 the estate or gift tax marital deduction, especially if the income on which that income tax is paid
19 is not fully distributed, as in the case of income retained in an entity owned in whole or in part by
20 the trust. The Drafting Committee found these issues to be similar to the issues raised by Rev.
21 Rul. 2006-26 in the context of defined contribution qualified retirement plans and individual
22 retirement accounts (IRAs). The committee concluded that no change needs to be made to the
23 Act because it understands that the power in the spouse to cause the trust assets to be made
24 reasonably productive of income cures any marital deduction issue.

25 26 SECTION 506. ADJUSTMENTS BETWEEN INCOME AND PRINCIPAL 27 BECAUSE OF TAXES.

28 (a) A fiduciary may make adjustments between income and principal to offset the shifting

1 of economic interests or tax benefits between current income beneficiaries and successor
2 beneficiaries that arise from:

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

5 (2) an income tax or any other tax that is imposed upon the fiduciary or a
6 beneficiary as a result of a transaction involving the fiduciary or a distribution ~~from~~made by the
7 ~~trust~~fiduciary; or

8 (3) the ownership by a ~~trust~~fiduciary of an interest in an entity whose taxable
9 income, whether or not distributed, is includable in the taxable income of the ~~trust~~fiduciary or a
10 beneficiary.

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

22 ~~——(c) After applying Section 505, the fiduciary shall adjust income or principal receipts to~~
23 ~~the extent the trust's taxes are reduced because the trust receives a deduction for payments made~~

2 **Discretionary adjustments.** Section 506(a) permits the fiduciary to make adjustments
3 between income and principal because of tax law provisions. It would permit discretionary
4 adjustments in situations like these: (1) A fiduciary elects to deduct administration expenses that
5 are paid from principal on an income tax return instead of on the estate tax return; (2) a
6 distribution of a principal asset to a trust or other beneficiary causes the taxable income of an
7 estate or trust to be carried out to the distributee and relieves the persons who receive the income
8 of any obligation to pay income tax on the income; or (3) a trustee realizes a capital gain on the
9 sale of a principal asset and pays a large state income tax on the gain, but under applicable
10 federal income tax rules the trustee may not deduct the state income tax payment from the capital
11 gain in calculating the trust's federal capital gain tax, and the income beneficiary receives the
12 benefit of the deduction for state income tax paid on the capital gain. See generally Joel C.
13 Dobris, Limits on the Doctrine of Equitable Adjustment in Sophisticated Postmortem Tax
14 Planning, 66 Iowa L. Rev. 273 (1981).

15
16 Section 506(a)(3) applies to a qualified Subchapter S trust (QSST) whose income
17 beneficiary is required to include a pro rata share of the S corporation's taxable income in his
18 return. If the QSST does not receive a cash distribution from the corporation that is large enough
19 to cover the income beneficiary's tax liability, the trustee may distribute additional cash from
20 principal to the income beneficiary. In this case the retention of cash by the corporation benefits
21 the trust principal. This situation could occur if the corporation's taxable income includes capital
22 gain from the sale of a business asset and the sale proceeds are reinvested in the business instead
23 of being distributed to shareholders.

24
25 **Mandatory adjustment.** Subsection (b) provides for a mandatory adjustment from
26 income to principal to the extent needed to preserve an estate tax marital deduction or charitable
27 contributions deduction. It is derived from New York's EPTL § 11-1.2(A), which requires
28 principal to be reimbursed by those who benefit when a fiduciary elects to deduct administration
29 expenses on an income tax return instead of the estate tax return. Unlike the New York provision,
30 subsection (b) limits a mandatory reimbursement to cases in which a marital deduction or a
31 charitable contributions deduction is reduced by the payment of additional estate taxes because of
32 the fiduciary's income tax election. It is intended to preserve the result reached in *Estate of*
33 *Britenstool v. Commissioner*, 46 T.C. 711 (1966), in which the Tax Court held that a
34 reimbursement required by the predecessor of EPTL § 11-1.2(A) resulted in the estate receiving
35 the same charitable contributions deduction it would have received if the administration expenses
36 had been deducted for estate tax purposes instead of for income tax purposes. Because a fiduciary
37 will elect to deduct administration expenses for income tax purposes only when the income tax
38 reduction exceeds the estate tax reduction, the effect of this adjustment is that the principal is
39 placed in the same position it would have occupied if the fiduciary had deducted the expenses for
40 estate tax purposes, but the income beneficiaries receive an additional benefit. For example, if
41 the income tax benefit from the deduction is \$30,000 and the estate tax benefit would have been
42 \$20,000, principal will be reimbursed \$20,000 and the net benefit to the income beneficiaries
43 will be \$10,000.

44 **Irrevocable grantor trusts.** Under Sections 671-679 of the Internal Revenue Code (the
45 "grantor trust" provisions), a person who creates an irrevocable trust for the benefit of another

1 person may be subject to tax on the trust's income or capital gains, or both, even though the
2 settlor is not entitled to receive any income or principal from the trust. Because this is now a
3 well-known tax result, many trusts have been created to produce this result, but there are also
4 trusts that are unintentionally subject to this rule. The Act does not require or authorize a trustee
5 to distribute funds from the trust to the settlor in these cases because it is difficult to establish a
6 rule that applies only to trusts where this tax result is unintended and does not apply to trusts
7 where the tax result is intended. Settlers who intend this tax result rarely state it as an objective
8 in the terms of the trust, but instead rely on the operation of the tax law to produce the desired
9 result. As a result it may not be possible to determine from the terms of the trust if the result was
10 intentional or unintentional. If the drafter of such a trust wants the trustee to have the authority to
11 distribute principal or income to the settlor to reimburse the settlor for taxes paid on the trust's
12 income or capital gains, such a provision should be placed in the terms of the trust. In some
13 situations the Internal Revenue Service may require that such a provision be placed in the terms
14 of the trust as a condition to issuing a private letter ruling.

15 [ARTICLE] 6

17 DEATH OF DECEDENT OR TERMINATION OF INCOME INTEREST

18 SECTION 601. DETERMINATION AND DISTRIBUTION OF NET INCOME.

19 (a) The rules in this section apply:

20 (1) after a decedent dies ~~in the case of~~ an estate or ~~trust is created~~; or

21 (2) after an income interest in a trust ends ~~and the trust continues or is distributed~~.

22 (b) A fiduciary of an estate or a terminating income interest shall determine the amount of
23 net income and net principal receipts received from property specifically given to a beneficiary
24 under the rules in [Articles] 4, 5, and 7 and the rules in subsection (f). The fiduciary shall
25 distribute the net income and net principal receipts to the beneficiary ~~who~~that is to receive the
26 specific property.

27 (c) A fiduciary shall determine the income and net income of an estate or a terminating
28 income interest, other than the amount of net income determined under subsection (b), under the
29 rules in [Articles] 4, 5, and 7 and by:

30 (1) including in net income all income from property used or sold to discharge

1 liabilities;

2 (2) paying from income or principal, in the fiduciary's discretion, fees of
3 attorneys, accountants, and fiduciaries, court costs and other expenses of administration, and
4 interest on estate and inheritance taxes and other taxes imposed by reason of the death of a
5 decedent, but the fiduciary may pay those expenses from income of property passing to a trust for
6 which the fiduciary claims a federal estate tax marital or charitable deduction only to the extent
7 the payment of those expenses from income will not cause the reduction or loss of the deduction;
8 and

9 (3) paying from principal all other disbursements made or incurred in connection
10 with the settlement of an estate or the winding up of a terminating income interest, including, to
11 the extent authorized by the decedent's will, the terms of the trust, or applicable law, debts,
12 funeral expenses, disposition of remains, family allowances, estate and inheritance taxes, and
13 other taxes imposed by reason of the death of a decedent and related penalties that are
14 apportioned to the estate or terminating income interest by the decedent's will, the terms of the
15 trust, or applicable law.

16 (d) A fiduciary shall distribute to a beneficiary who receives a pecuniary amount outright
17 the interest or any other amount provided by the decedent's will, the terms of the trust, or
18 applicable law from net income determined under subsection (c) or from principal to the extent
19 net income is insufficient. If a beneficiary is to receive a pecuniary amount outright from a trust
20 after an income interest ends and no payment of interest or other amount is provided for by the
21 terms of the trust or applicable law, the fiduciary shall distribute the interest or other amount to
22 which the beneficiary would be entitled under applicable law if the pecuniary amount were
23 required to be paid under a will.

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

6 (f) A fiduciary may not reduce principal or income receipts from property described in
7 subsection (b) because of a payment described in Section 501 or 502 to the extent the decedent's
8 will, the terms of the trust, or applicable law requires the fiduciary to make the payment from
9 assets other than the property or to the extent the fiduciary recovers or expects to recover the
10 payment from a third party. The net income and principal receipts from the property are
11 determined by including all amounts the fiduciary receives or pays with respect to the property,
12 whether those amounts accrued or became due before, on, or after the date of a decedent's death
13 or an income interest's terminating event, and by making a reasonable provision for amounts the
14 fiduciary believes the estate or terminating income interest may become obligated to pay after the
15 property is distributed.

16 **SECTION 602. DISTRIBUTION TO RESIDUARY AND REMAINDER**
17 **BENEFICIARIES.**

18 (a) Except to the extent [Article] 3 applies in the case of a beneficiary that is a trust, each
19 beneficiary described in Section 601(e) is entitled to receive a part of the net income equal to the
20 beneficiary's fractional interest in undistributed principal assets, using values as of the
21 distribution date. If a fiduciary makes more than one distribution of assets to beneficiaries to
22 whom this section applies, each beneficiary, including one who does not receive part of the
23 distribution, is entitled, as of each distribution date, to the net income the fiduciary has received

1 after the date of the decedent's death or an income interest's terminating event or previous
2 distribution date.

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

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

7 (2) The beneficiary's fractional interest in the undistributed principal assets must
8 be calculated without regard to:

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

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

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

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

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

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

1 this section applies to the income from the asset.

2 **Comment**

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

8 **[ARTICLE] 7**

9 **APPORTIONMENT AT BEGINNING AND END OF INCOME INTEREST**

10 **SECTION 701. WHEN RIGHT TO INCOME BEGINS AND ENDS.**

11 (a) ~~A current~~An income beneficiary ~~or successor beneficiary~~ is entitled to net income in
12 accordance with the terms of the trust from the date on which the income interest begins. An
13 income interest begins on the date specified in the terms of the trust or, if no date is specified, on
14 the date an asset:

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

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

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

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

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

25 (3) on the date of an individual's death in the case of an asset that is transferred to

1 a fiduciary by a third party because of the individual's death.

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

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

8 **SECTION 702. APPORTIONMENT OF RECEIPTS AND DISBURSEMENTS**
9 **WHEN DECEDENT DIES OR INCOME INTEREST BEGINS.**

10 (a) A fiduciary shall allocate an income receipt or disbursement, other than one to which
11 Section 601(~~4b~~) applies, to principal if its due date occurs:
12 (1) before the date on which a decedent dies in the case of an estate; or
13 (2) before the date on which an income interest begins in the case of a trust or
14 successive income interest.

15 (b) ~~A fiduciary shall allocate~~If the due date of a periodic income receipt or disbursement
16 ~~to income if its due date~~ occurs on or after the date on which a decedent dies or an income
17 interest begins. ~~A, the receipt or disbursement is periodic if it must be paid at regular intervals~~
18 ~~underallocated to income.~~

19 (c) If an ~~obligation to make payments or if a payor customarily makes payments at regular~~
20 ~~intervals.~~¹⁵ ~~An~~ income receipt or disbursement is not periodic or has no due date, it must be

¹⁵ This sentence is moved here in subsection (b) of Section 702 from the end of subsection (c) at John Langbein's suggestion, to demystify the use of the term "periodic" earlier. In addition, "periodic" now modifies the "receipt or disbursement," not the "due date," making it consistent with Section 504(b)(4), the only other place "periodic" is used. Conforming changes are made in the previous sentence, where "periodic" is moved up before "income receipt or disbursement," and the following sentence, where "its due date" is changed to simply "it." Finally, "an entity" is

1 treated as accruing from day to day ~~if it is not periodic or it has no due date.~~ The part of the
2 receipt or disbursement accruing before the date on which a decedent dies or an income interest
3 begins must be allocated to principal, and the balance must be allocated to income.

4 (d) For purposes of subsections (b) and (c), a receipt or disbursement is periodic if:

5 (1) it must be paid at regular intervals under an obligation to make payments; or

6 (2) a payor customarily makes payments at regular intervals.

7 (e) An item of income or an obligation is due on the date the payor is required to make a
8 payment. If a payment date is not stated, there is no due date for purposes of this [act].

9 (f) Distributions to shareholders or other owners from an entity to which Section 401
10 applies are deemed to be due on the date fixed by the entity for determining who is entitled to
11 receive the distribution or, if no date is fixed, on the declaration date for the distribution.

12 **Comment**

13 The change to “before the date on which a decedent dies” and “before the date on which
14 an income interest begins” in Section 702(a) makes this provision consistent with the reference to
15 “the date of a testator’s death” in Section 701(b)(2) and consistent with the reference to “on or
16 after the date on which a decedent dies” in Section 702(b). It means that the time of day at which
17 the moment of death occurs is less relevant and therefore less important to determine. In effect,
18 the decedent’s income interest ends with the day before the date of death, and the estate’s income
19 interest begins with the date of death. Accounting periods based on a single day are easiest to
20 administer in a global economy where the actual time of death might otherwise appear to be
21 affected by arbitrary time zones. This rule in a uniform act does not purport to directly address
22 related income tax uncertainties, although it may contribute in the long term to uniformity in that
23 context as well.

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

25 (a) In this section, “undistributed income” means net income received on or before the
26 date on which an income interest ends. The term does not include an item of income or expense

changed to “a payor” in this sentence because there seems to be no reason to distinguish entities for this purpose, and subsection (c) uses “payor.”

1 that is due or accrued or net income that has been added or is required to be added to principal
2 under the terms of the trust.

3 (b) When a mandatory income interest of a beneficiary ends, the fiduciary shall pay ~~to a~~
4 ~~mandatory income beneficiary who survives that date, or the estate of a deceased mandatory~~
5 ~~income beneficiary whose death causes the interest to end,~~ the beneficiary's share of the
6 undistributed income that is not disposed of under the terms of the trust ~~unless the~~ to:

7 (1) a mandatory income beneficiary ~~has an unqualified power to withdraw¹⁶ more~~
8 ~~than five percent~~ who survives that date; or

9 (2) the estate of the ~~trust immediately before the~~ deceased mandatory income
10 beneficiary whose death causes the interest ~~ends. to end.~~

11 (c) If the beneficiary has an unqualified power to withdraw more than five percent of the
12 value of the trust immediately before the income interest ends~~;~~ :

13 (1) the undistributed income from the part of the trust that may be withdrawn must
14 be added to principal~~;~~ and

15 (2) subparagraph (b) shall apply only to the balance of the undistributed income.

16 (c) When a fiduciary's obligation to pay a fixed annuity or a fixed fraction of the value of
17 ~~the trust's~~ assets ends, the fiduciary shall prorate the final payment ~~if and to the extent~~ as required
18 ~~by applicable law to accomplish a purpose of the trust or its settlor relating to income~~ preserve an
19 income tax, gift tax, estate tax, or other tax ~~requirements~~ benefit.

20 Comment

21 **Prior Acts.** Both the 1931 Act (Section 4) and the 1962 Act (Section 4(d)) provide that a

¹⁶ Here in Section 703(b) the word "revoke" is changed to "withdraw," as the drafting committee suggested. Similar changes are made in the next sentence. The word "revoke" or its variations does not appear anywhere else in the Act.

1 deceased income beneficiary's estate is entitled to the undistributed income. In a Comment to
2 Section 303 of the 1997 Act, the 1997 Drafting Committee stated that this is probably not what
3 most settlors would want, and that, with respect to undistributed income, most settlors would
4 favor the income beneficiary first, the remainder beneficiaries second, and the income
5 beneficiary's heirs last, if at all. It decided not to eliminate this provision, however, to avoid
6 causing disputes about whether the trustee should have distributed collected cash before the
7 income beneficiary died.
8

9 The current Drafting Committee is not as sure that the estate rule is not what most settlors
10 would want. The estate rule may actually fit best with the paradigm of a beneficiary who incurs
11 bills, like credit card charges and unreimbursed medical expenses, that are paid in arrears from
12 trust distributions. At the other end of the wealth spectrum, payment to the estate might create an
13 avoidable increment of estate tax as well as an administrative burden, but those situations would
14 typically entail more sophisticated estate planning that can draft around that. Moreover, the estate
15 rule would avoid the pressure to make or demand income distributions at more frequent intervals
16 in order to keep the distributions more current up to the date of death. The payment of "stub
17 income" to the income beneficiary's estate also provides better protection in cases where tax
18 rules require a beneficiary to receive income "for life."
19
20

1 [ARTICLE] 8

2 MISCELLANEOUS PROVISIONS

3 SECTION 801. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In
4 applying and construing this uniform act, consideration must be given to the need to promote
5 uniformity of the law with respect to its subject matter among states that enact it.

6 SECTION 802. APPLICATION OF [ACT] TO EXISTING TRUSTS AND
7 ESTATES. This [act] applies to a trust or estate existing on [the effective date of this [act]],
8 except as otherwise expressly provided in the terms of the trust or in this [act].

9 **Alternative A**

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

12 ~~_____ (1) if the trust is not funded as of [the effective date of this [act]], the date of the~~
13 ~~decedent's death;~~

14 ~~_____ (2) if the trust is initially funded in the calendar year beginning January 1, _____ [insert~~
15 ~~year in which this [act] takes effect], the date of the decedent's death; or~~

16 ~~_____ (3) if the trust is not described in paragraph (1) or (2), January 1, _____ [insert year in~~
17 ~~which this [act] takes effect].~~

18 **Alternative B**

19 ~~_____ SECTION 803. TRANSITIONAL MATTERS. Section 408 applies to a trust~~
20 ~~described in Section 408(e) on and after the following date:~~

21 ~~_____ (1) if the trust is not funded as of [the effective date of this [act]], the date of the~~
22 ~~decedent's death;~~

23 ~~_____ (2) if the trust is initially funded in the calendar year beginning January 1, _____ [insert~~

1 ~~year in which this [act] takes effect], the date of the decedent's death; or~~

2 ~~—— (3) if the trust is not described in paragraph (1) or (2), January 1, —— [insert year in~~

3 ~~which this [act] takes effect].~~

4 **~~End of Alternatives~~**

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

7
8 ~~—— If your state has not adopted the Uniform Principal and Income Act, use the text of~~
9 ~~Sections 408 and 505, as amended by these amendments, instead of the text of the previous~~
10 ~~version of those Sections.~~

11
12 ~~——~~ **[SECTION 804. SEVERABILITY CLAUSE.** If any provision of this [act] or its
13 application to any person or circumstance is held invalid, the invalidity does not affect other
14 provisions or applications of this [act] which can be given effect without the invalid provision or
15 application, and to this end the provisions of this [act] are severable.]

16 ~~**Legislative Note:** Include this section only if your state lacks a general severability statute or a~~
17 ~~decision by your state's highest court stating a general rule of severability.~~

18 **SECTION ~~805.~~ 804. REPEALS; CONFORMING AMENDMENTS.**

19 (a)

20 (b)

21 (c)

22 **SECTION ~~806.~~ 805. EFFECTIVE DATE.** This act takes effect