

DRAFT

FOR DISCUSSION ONLY

**UNIFORM FIDUCIARY INCOME AND PRINCIPAL ACT**  
**[FORMERLY REVISED UNIFORM PRINCIPAL AND**  
**INCOME ACT]**

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NATIONAL CONFERENCE OF COMMISSIONERS  
ON UNIFORM STATE LAWS

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*NOVEMBER 17-18, 2017 DRAFTING COMMITTEE MEETING*

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By

NATIONAL CONFERENCE OF COMMISSIONERS  
ON UNIFORM STATE LAWS

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November 5, 2017

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**UNIFORM FIDUCIARY INCOME AND PRINCIPAL ACT**

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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.





1 (2) “Beneficiary” includes:<sup>1</sup>  
2 (A) in the case of a trust, an income beneficiary, including a current income  
3 beneficiary, a remainder beneficiary, and any other successor beneficiary;  
4 (B) in the case of an estate, an heir[, legatee,] and devisee;  
5 (C) in the case of a life estate or term interest, a person that holds a life estate, a  
6 term interest, or a remainder or other interest following a life estate or term interest; and  
7 (D) in the case of another arrangement or relationship, a person that holds an  
8 interest in property or may succeed to an interest in property.  
9 (3) “Current income beneficiary” means a beneficiary<sup>2</sup> to which a fiduciary may distribute  
10 net income,<sup>3</sup> regardless of whether the fiduciary may also distribute principal to that beneficiary.  
11 (4) Except in Section 401, “distribution” means payment or transfer by a fiduciary to a  
12 beneficiary in the beneficiary’s capacity as a beneficiary, made pursuant to the terms of the trust,  
13 without consideration other than a beneficiary’s right to receive a distribution under the terms of  
14 the trust. “Distribute” has a corresponding meaning.<sup>4</sup>  
15 (5) “Estate” means a decedent’s estate. The term includes the property of the decedent as

---

<sup>1</sup> Paragraph (2) is broken into subparagraphs. Subparagraphs (C) and (D) are new.

<sup>2</sup> “Person” is changed to “beneficiary” to create a better flow.

<sup>3</sup> This is changed to the active voice. In addition, “net income of a trust” is changed to simply “net income.” This is the first of many rewrites to avoid the use of the word “trust,” in view of the expansion of the language throughout the Act from “trustee” to “fiduciary,” which includes personal representatives. It wasn’t possible in every case, and even this draft might go too far. The drafting committee should discuss this in the fall.

<sup>4</sup> The second sentence had been “In Section 401, the term also includes a payment or transfer from an entity to an owner of the entity or another person with an interest in the entity.” This made the following sentence (the former third sentence, now the second sentence) regarding the corresponding meaning of “distribute” ambiguous. Did that third sentence of the paragraph refer to the first sentence, the second sentence, or both? Moreover, the deleted former second sentence was unnecessary. The words “distribution” and “distribute” are not used in Section 401 in the meaning given them by the first sentence of this paragraph. Therefore, Section 401 can have its own definition, which is added as Section 401(a)(1), with a conforming addition of “Except in Section 401,” at the beginning of this paragraph.

1 originally constituted and as it exists from time to time during administration.<sup>5</sup>

2 (6) “Fiduciary” means a trustee, [trust director determined under [Section 2(9) of the  
3 Uniform Directed Trust Act,]]<sup>6</sup> personal representative, life tenant, holder of a term interest, or  
4 person acting under a legal delegation from a fiduciary. The term includes another person that  
5 holds property for a successor beneficiary whose interest may be affected by the allocation of  
6 receipts and expenditures between income and principal.<sup>7</sup> If there are two or more co-fiduciaries,  
7 the term means all co-fiduciaries acting in accordance with the terms of the trust and applicable  
8 law, including this [act].

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

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

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

17 (A) in the case of a trust:

---

<sup>5</sup> The definition of “estate” in paragraph (5) is adapted from the UPC.

<sup>6</sup> [NEW 11/1/17] In view of the ULC’s approval of UDTA, this reference to “trust director” in Section 102(6) is new, as well as the words “person acting under a legal delegation from a fiduciary” at the end of the sentence and the first sentence of the Legislative Note at the end of Section 102.

<sup>7</sup> The phrase “whether the [fiduciary] also has a beneficial interest in the property” is deleted from paragraph (6) as redundant.

<sup>8</sup> This sentence (“The term also includes the right of a current beneficiary to use property held by a fiduciary.”) is new and might be unnecessary and/or confusing. It is not a natural understanding of the term “income interest,” but something like this might be needed to complete the notion of “beneficiary” and “fiduciary” in paragraphs (2) and (6) and the intended scope for the Act we have described in Section 103.

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

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

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

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

9 (C) a parent, brother, sister, or issue of a person defined in subparagraph (A) or  
10 (B);

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

13 (E) an employee of a person defined in subparagraph (A), (B), (C), or (D).<sup>9</sup>

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

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

---

<sup>9</sup> [NEW 11/1/17] This new formulation in Section 102(9)(C), (D), and (E) replaces “a related or subordinate party with respect to a person defined in subparagraph (A) or (B)” that had been subparagraph (C). Generally, this tracks the definition of “related or subordinate party” in section 672(c) of the Internal Revenue Code, except that it uses the simpler term “voting control” instead of the more subjective “significant from the standpoint of voting control.” (The drafting committee might discuss whether that change leaves a gap that could create a tax trap for persons who rely on this provision.) With this change, the clunky definition of “related or subordinate party” that was Section 102(16) is deleted. That term, defined in Section 102(16), was not used in this draft anywhere else but in Section 102(9)(C) anyway.

As rewritten, in generalized and simplified terms, this Section 102(9) is a self-contained description of persons whom we don’t want to exercise powers to affect beneficial interests. That includes, for purposes of this Act, the general power to adjust in Section 203 and the specialized power to reallocate the apportionment of trust and estate

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

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

8 (13) “Personal representative” means an executor, administrator, successor personal  
9 representative, special administrator, and person who performs substantially the same function  
10 with respect to an estate under the law governing the person’s status.<sup>10</sup>

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

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

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

17 (17) “Terms of the trust”<sup>11</sup> means the manifestation of the intent of a settlor or decedent  
18 with respect to a trust, expressed in a manner that admits of its proof in a judicial proceeding,

---

expenses in Section 501(2). But it no longer limits the power to convert to a unitrust under Article 3, as discussed there.

<sup>10</sup> This definition of “personal representative” is adapted from the UPC. (“Personal representative,” not “executor,” is the term used in the UPC.) The words “with respect to an estate” (which is defined as “a decedent’s estate”) are added. The word “includes” is changed to “means,” to exclude other arrangements like “bankruptcy estates,” although the provisions of the Act could apply to a bankruptcy estate if it meets the requirements for “another arrangement or relationship” in Section 103.

1 whether by words in a record, by other written or spoken words, or by conduct. In the case of an  
2 estate,<sup>12</sup> the term includes a will. In the case of a life estate, term interest, or other arrangement or  
3 relationship, the term includes the corresponding manifestation of the rights of the beneficiaries.

4 (18) “Trust”:

5 (A) includes:

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

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

10 (B) excludes:

11 (i) a constructive trust;

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

16 (iii) an arrangement under which a person is a nominee, escrowee, or  
17 agent<sup>13</sup> for another.<sup>14</sup>

18 (19) “Trustee” includes an original, additional, or successor trustee, whether or not

---

<sup>11</sup> The defined term in paragraph (18) continues to be “terms of the trust,” which is used 20 times in the 2008 UPIA and 40 times in the UTC. “Terms of a trust” is used only four times in the 2008 UPIA, only 16 times in the UTC, and not at all in this draft.

<sup>12</sup> Here in paragraph (18), and in a few other places in the previous draft, the term “decedent’s estate” was used. “Estate” is defined as “a decedent’s estate” in Section 102(5), making the use of “decedent’s” redundant, and it has been removed throughout the draft.

<sup>13</sup> [NEW 11/1/17] the word “agent” is added to Section 102(18)(B)(iii) at Bill LaPiana’s suggestion.

<sup>14</sup> This definition is adapted from the UPC. (Ironically, the UTC does not have a definition of “trust.”) It seems appropriate and might allay some of the concerns that “fiduciary” is too broad a term.

1 appointed or confirmed by a court.

2 (20) “Will” means any testamentary instrument recognized by applicable law that makes a  
3 legally effective disposition of a person’s property effective at that person’s death. The term  
4 includes a codicil.<sup>15</sup>

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

9 **Comment**

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

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

17  
18 **Inventory value.** There is no definition for inventory value in this Act because the  
19 provisions in which that term was used in the 1962 Act have either been eliminated (in the case  
20 of the underproductive property provision) or changed in a way that eliminates the need for the  
21 term (in the case of bonds and other money obligations, property subject to depletion, and the  
22 method for determining entitlement to income distributed from a probate estate).

23  
24 **“Record.”** This addition in the current Act is copied from Section 2(22) of the Uniform  
25 Trust Decanting Act.

26  
27 **“Successor beneficiary.”** This term is used in the current Act rather than “remainder  
28 beneficiary,” the term in the 1997 Act, in recognition of the fact that modern trusts often last  
29 longer than the life of a single income beneficiary, and therefore the beneficiaries whose future  
30 interests are most often in need of balance and protection are beneficiaries who continue as  
31 income beneficiaries, not who succeed to the “remainder” interest as if the trust terminates. The  
32 term “successor beneficiary” includes “remainder beneficiaries.”

33  
34 **“Terms of the trust.”** The term “terms of a trust” was chosen in the 1997 Act in  
35 preference to “terms of the trust instrument” (the phrase used in the 1962 Act) to make it clear

---

<sup>15</sup> [NEW 11/1/17] This definition of “will,” new in the last draft, is revised to avoid saying “‘Will’ means a ... will ...”

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

7  
8 **SECTION 103. SCOPE.** Except as otherwise provided in this [act] or in the terms of  
9 the trust, this [act] applies to:

10 (1) a trust or estate;

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

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

16 **SECTION 104. GOVERNING LAW.** Except as otherwise provided in this [act] or in  
17 the terms of the trust, this [act] applies when this state is the principal place of administration of  
18 an estate or trust or the situs of property not held in an estate or trust. By accepting the  
19 trusteeship of a trust having its principal place of administration in this state or by moving the  
20 principal place of administration of a trust to this state, the trustee submits to the application of  
21 this [act] to any matter within its scope involving the trust.<sup>16</sup>

---

<sup>16</sup> The first sentence of Section 104 formerly stated: “This [act] contains rules governing the administration of trusts within its scope, not rules of construction.” John Langbein pointed out that this is not true: income and principal allocations can determine who gets what, which is construction. The Comment to Section 104 acknowledges that Section 104 is written this way despite that fact. The words “or the situs of property not held in an estate or trust” are added to the first sentence to accommodate life estates and other relationships that are not trusts or estates.

The words “Except as otherwise provided in this [act] or in the terms of the trust,” are added at the beginning at the suggestion of a Commissioner at the San Diego meeting. The draft is silent, however, on subsidiary issues such as whether the governing instrument can designate the law of a jurisdiction with which the trust has little or no nexus or contact.

1 **Comment**

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

8 The question of the allocation of receipts and expenditures to principal or income  
9 presents a different problem. See Restatement of Trusts (Second), §§ 232-241. If a  
10 testator creates a trust to be administered in a state other than that of his domicile, the  
11 question is whether the allocation, as for instance of extraordinary dividends, is to be  
12 determined by the local law of his domicile or the local law of the place of administration.  
13 This could conceivably be treated as a question of administration and governed by the  
14 local law of the place of administration. On the other hand, it can be treated as a question  
15 of the distribution of the trust property and governed by the local law of the testator’s  
16 domicile. For the purposes of the choice of the applicable law, it is generally held that it is  
17 a question of construction and that the local law of the testator’s domicile is applicable.

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

29

---

A Commissioner also suggested that we deal with the case where a trust administered in one state owns property located in another state. That seems unnecessary. But the clause “which is not necessarily the place where all or most or any of the trust assets are located” is added at the end of the Comment to address that concern.



1 [ARTICLE] 2

2 FIDUCIARY DUTIES AND JUDICIAL REVIEW

3 SECTION 201. FIDUCIARY DUTIES; GENERAL PRINCIPLES.

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

6 (1) shall administer a trust or estate in good faith in accordance with the terms of  
7 the trust or the will,<sup>17</sup> even if there is a different provision in this [act];

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

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

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

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

20 (b) In exercising the power to adjust under Section 203(a), the power to convert to or  
21 from a unitrust or change the administration of a unitrust under [Article] 3, or another  
22 discretionary power of administration regarding a matter within the scope of this [act], whether

1 granted by the terms of the trust or this [act], a trustee shall administer a trust impartially,<sup>18</sup> based  
2 on what is fair and reasonable to all the beneficiaries, giving due regard to the beneficiaries’  
3 respective interests,<sup>19</sup> except to the extent the terms of the trust manifest an intention that the  
4 trustee shall or may favor one or more beneficiaries.<sup>20</sup>

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

8 (1) the terms of the trust;

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

10 (3) the intent of the settlor;

11 (4) the identity and circumstances of the beneficiaries;<sup>21</sup>

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

14 (6) the desirability of the preservation and appreciation of the capital of the trust,

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<sup>17</sup> [NEW 11/1/17] Throughout Section 201(a), the words “or the will” are added to make it less awkward.

<sup>18</sup> Although the use of “impartially” was questioned by the drafting committee, particularly by Carlyn, for being too subjective, section 803 of the UTC states simply that “[i]f a trust has two or more beneficiaries, the trustee shall act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries’ respective interests.”

<sup>19</sup> The phrase “relationships to each other” has been deleted from Section 201(b). To the extent those relationships – for example, the fact that a surviving spouse with a life income interest is (or is not) the parent of the decedent’s children – are relevant, they are incorporated in the phrase “the beneficiaries’ respective interests.”

<sup>20</sup> John Langbein believed that this exception was too restrictive. In response, “clearly manifest” (which seems redundant) is changed to simply “manifest,” which might help. John also suggested replacing “terms of the trust” with something like “logic of the trust” to pick up notions such as a preference for taking care of a surviving spouse. Section 102(17) defines “terms of the trust” with reference to “written or spoken words or by conduct,” which arguably is broad enough.

<sup>21</sup> [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?

1 including the reasonable maintenance of the value of capital with regard to indices<sup>22</sup> the fiduciary  
2 determines to be appropriate;<sup>23</sup>

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

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

10 (9) the net amount that would be allocated to income under [Articles] 4 through 7  
11 to the extent they apply;

12 (10) the suitability of the rules in [Articles] 4 through 7 in the context of all the  
13 relevant factors considered by the fiduciary, including the other factors in this subsection to the  
14 extent they are relevant;<sup>24</sup>

15 (11) the increase or decrease in the value of principal assets, which the fiduciary

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<sup>22</sup> [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.

<sup>23</sup> This factor in paragraph (6), relating to the preservation of capital, which the drafting committee seemed to view as paramount in Chicago last September, was changed to just one of many factors after the discussion in Washington in March. The concern that many expressed in March about the role of cost-of-living indices might be addressed somewhat by the replacement of “measured by” with “with regard to.” The most recent change of “need” to “desirability” at the beginning of paragraph (6) may further soften the articulation of this factor.

<sup>24</sup> [NEW 11/1/17] 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 may estimate as to an asset for which market value is not readily available;

2 (12) whether and to what extent the terms of the trust give the fiduciary power to  
3 accumulate income or invade principal or prohibit the fiduciary from accumulating income or  
4 invading principal;

5 (13) the extent to which the fiduciary has accumulated income or invaded  
6 principal;

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

9 (15) the anticipated tax consequences of exercising the powers.

10 **Comment**

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

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

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

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

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

1           **Factors.** The factors in Section 201(c) that a trustee should consider are adapted from  
2 Section 104(b) of the 1997 Act, which were written in the context of the power to adjust now  
3 found in Section 203.  
4

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

#### 14           **SECTION 202. JUDICIAL REVIEW OF DISCRETIONARY POWER.**<sup>25</sup>

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

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

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<sup>25</sup> [NEW 11/1/17] Many discussions, including past drafting committee meetings and recent conference calls, suggest that Section 202 needs more attention and, in particular, needs to be rationalized in comparison to Sections 201 (regarding general principles of fiduciary duty), 203(j) (regarding the power to adjust), and 310 (regarding the power to convert to a unitrust). Section 202 throughout uses a standard of “abuse of the fiduciary’s discretion,” whereas Sections 203(j) and 310, and even Section 201(a)(1) itself, as well as Section 801 of the Uniform Trust Code, cite “good faith.” Section 202(b) is uncharacteristically detailed (compared, for example, to the very general list in UTC Section 1001(b)(1) through (9), coupled with the “other appropriate relief” catch-all of Section 1001(b)(10)). But some might view Section 202(b) as uncharacteristically narrow in its focus on distributions. Perhaps distributions are the only things that could ever be affected by an abuse of discretion under UFIPA, but can we be sure? What if a trustee uses creative applications of the special default rules in Article 4 to cover up a failure to invest prudently for total return? Or what if improper distorted outcomes under Article 4 simply lull the trustee into even a good faith (to that extent) belief that its investments are prudent when they are not?

The drafting committee might also want to consider if there are any differences between Sections 203(j) and 310 themselves that need reconciling, such as the additional words “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” in Section 310.

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

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

10           (3) To the extent that the court is unable, after applying paragraphs (1) and (2), to  
11 place the beneficiaries, the trust, or both, in the positions they would have occupied if the  
12 discretion had not been abused, the court may order the fiduciary to pay an appropriate amount  
13 from the fiduciary's own funds to one or more of the beneficiaries, the trust, or both.<sup>26</sup>

14           (c) On [petition] by the fiduciary, the court having jurisdiction over a trust shall determine  
15 whether a proposed exercise or nonexercise by the fiduciary of a discretionary power conferred  
16 by this [act] will result in an abuse of the fiduciary's discretion. If the petition describes the  
17 proposed exercise or nonexercise of the power and contains sufficient information to inform the  
18 beneficiaries of the reasons for the proposal, the facts upon which the fiduciary relies, and an

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<sup>26</sup> This subsection (b) was reinstated at the request of the drafting committee in March. But the special rules in Section 203(j) for the power to adjust and Section 310(b) for unitrust conversions are narrower than this, especially in their protection of the fiduciary from personal liability, and may therefore conflict with this. In November the drafting committee should consider this possibility of a conflict and resolve the conflict if one exists.

In addition, a Commissioner in San Diego suggested adding a reference to lost interest or lost purchasing power to paragraph (1); Turney replied that he wouldn't want to presume to tell a court exactly what to do. In the context of subsection (c), a Commissioner asked us to think about attorney's fees – reimbursing a successful challenger or charging an unsuccessful challenger. These suggestions are also an invitation for us to consider whether subsections (b) and (c) either conflict or overlap with each other or with Sections 203(j) and 310(b), as well as to return to the question of whether there is too much micromanagement of the court's equitable power here.

1 explanation of how the income and remainder beneficiaries will be affected by the proposed  
2 exercise or nonexercise of the power, a beneficiary who challenges the proposed exercise or  
3 nonexercise has the burden of establishing that it will result in an abuse of discretion.

4 (d) A determination under this [act] is presumed to be fair and reasonable to all the  
5 beneficiaries.<sup>27</sup>

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

8 **SECTION 203. FIDUCIARY’S POWER TO ADJUST.**<sup>28</sup>

9 (a) A fiduciary may, without court approval, adjust between income and principal.<sup>29</sup>

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

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

14 (1) that reduces the income interest in a trust that requires income to be paid at  
15 least annually to a spouse and for which a marital deduction for federal estate or gift tax purposes  
16 has been allowed, has been claimed, or could be claimed;<sup>30</sup>

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<sup>27</sup> This subsection is moved here from Section 103, which is now Section 201. A Commissioner in San Diego asked whether “determination” should be changed to “decision by a trustee,” and commented that this should be a “presumption affecting the burden of going forward with the evidence, and not the burden of proof.” In any event, the reference to “[act]” may not make sense, and this subsection may need some work.

<sup>28</sup> In March this was expected to be Section 301, but dividing Article 3 into two parts just didn’t work very well.

<sup>29</sup> [NEW 11/1/17] Earlier drafts have intentionally discarded the narrow preconditions for adjustments in the 1997 Act, including distributions defined with reference to income. It was hard to understand that precondition anyway when one of the potential “factors” (Section 104(b)(7) of the 1997 Act, now reflected in Section 201(c)(12) and (13) of this draft) is “whether and to what extent the terms of the trust give the trustee the power to invade principal or accumulate income or prohibit the trustee from invading principal or accumulating income, and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income.” There is anecdotal evidence that as a precondition this provision is not strictly observed.

<sup>30</sup> [NEW 11/1/17] In Section 203(c)(1), relating to the federal estate or gift tax marital deduction, “has been allowed, has been claimed, or could be claimed” replaces “would be allowed, in whole or in part, if the fiduciary did not have the power to make the adjustment.” This is much more direct, objective, and, indeed, factual. The trustee should

1           (2) that reduces the actuarial value of a beneficiary’s income interest in a trust to  
2 which a person transferred property if the transfer qualified or could qualify, in whole or in part,  
3 for a federal gift tax exclusion based on the actuarial value of the income interest;<sup>31</sup>

4           (3) that changes the amount payable to a beneficiary as a fixed annuity or a fixed  
5 fraction of the value of the trust assets under the terms of the trust;<sup>32</sup>

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

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

12           (6) if possessing or exercising the power to make the adjustment causes all or part  
13 of the value of the trust assets to be included for federal estate tax purposes in the gross estate of

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know if a marital deduction has been allowed or claimed. This is not a long-term trust; the reference to income paid to the spouse limits the effect of this provision to the spouse’s life (although the drafting committee may wish to discuss whether that is too subtle and should be made more explicit). Both “allowed” and “claimed” are used to make it clear that this provision applies even if the estate tax or gift tax return has not been audited and/or the statute of limitation has not run. And “could be claimed” is added to make sure that the provision applies to any marital trust even before the return is filed.

<sup>31</sup> [NEW 11/1/17] In Section 203(c)(2), relating to the gift tax annual exclusion, “transfers” is changed to “transferred” and “would qualify” is changed to “qualified or could qualify.” The reasons are very much the same as those set forth in the preceding footnote. As a practical matter, while the allowance of an annual exclusion for the actuarial value of an income interest is still allowed (see Treasury Reg. §25.2503-3), the practice has probably become less common, as donors are more likely to elect to cover transfers to trusts with Crummey withdrawal powers or forgo the annual exclusion for large gifts. Finally, “the actuarial value of the income interest” is changed to “the actuarial value of *a beneficiary’s* income interest” to limit the application of this provision to the income beneficiary’s life, as in Section 203(c)(1).

<sup>32</sup> [NEW 11/1/17] It may not be self-evident how an exercise of the power to adjust could “[change] 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” as Section 203(c)(3) provides. But, as Jim Gamble wrote in the Comments to the 1997 Act, subsection (c)(3)’s “purpose is to make it clear that a beneficiary’s right to receive a fixed annuity or a fixed fraction of the value of a trust’s assets is not subject to adjustment under [then] Section 104(a).” The drafting committee may well decide not to second-guess Jim’s conservatism.



1 an individual who has the power to remove a fiduciary or appoint a fiduciary, or both, and the  
2 value of the assets would not be included in the gross estate of the individual if the fiduciary did  
3 not possess the power to make the adjustment;

4 (7) if the trust is an irrevocable lifetime trust that provides income to be paid for  
5 life to the settlor, and possessing or exercising the power to make an adjustment would cause any  
6 public benefit program to consider the adjusted principal or income to be an available resource or  
7 available income and the principal or income or both would in each case not be considered as an  
8 available resource or income if the fiduciary did not possess the power to make an adjustment;<sup>33</sup>

9 (8) if the fiduciary is a beneficiary of the trust whose interest would be materially  
10 affected by the adjustment;<sup>34</sup>

11 (9) if the fiduciary is not an independent person;<sup>35</sup> or

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

13 (d) If subsection (c)(5), (6), (7), (8), or (9) applies to a fiduciary and there is more than  
14 one fiduciary, a co-fiduciary to whom the provision does not apply may make the adjustment  
15 unless the exercise of the power by the remaining fiduciary or fiduciaries is not permitted by the  
16 terms of the trust.<sup>36</sup>

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<sup>33</sup> [NEW 11/1/17] New Section 203(c)(7) is an adaptation of New York's EPTL § 11-2.3(b)(5)(C)(viii). Questions are (1) whether it's a good idea; (2) whether it needs to be so detailed; (3) whether the wording is otherwise appropriate; and (4) whether it should be limited to trusts for settlors.

<sup>34</sup> [NEW 11/1/17] An "independent person" is defined in Section 102(9)(A)(i) and (B) to include a beneficiary. Thus, it is hard to tell what Section 203(c)(8) adds to Section 203(c)(9).

<sup>35</sup> The change to paragraph (9) eliminates the former subjective test of "whose interest would be materially affected" and also eliminates the dilemma that a trustee's compensation could be increased by an adjustment between income and principal. "Independent person" is defined in Section 102(9) as basically someone who is not either a qualified beneficiary or someone related or subordinate to a qualified beneficiary.

<sup>36</sup> [NEW 11/1/17] If Section 203(c)(5) or (6) applies because the fiduciary's possession or exercise of the power to adjust would have unwelcome tax consequences for the fiduciary (probably not very likely if the fiduciary must be an independent person to exercise that power), or if the fiduciary is not an independent person, then Section 203(d) provides for a qualified co-fiduciary to exercise the power. But there is no explicit provision for appointment of

1 (e) A fiduciary may release the entire power conferred by subsection (a) or may release  
2 only the power to adjust from income to principal or the power to adjust from principal to  
3 income if the fiduciary is uncertain about whether possessing or exercising the power will cause  
4 a result described in subsection (c)(1) through (6) or (c)(8) or if the fiduciary determines that  
5 possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax  
6 burden not described in subsection (c). The release may be permanent or for a specified period,  
7 including a period measured by the life of an individual or the lives or more than one  
8 individual.<sup>37</sup>

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

13 (g) The power of adjustment under subsection (a):

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

16 (2) may apply to the current accounting period or the immediately past accounting  
17 period and to one or more subsequent accounting periods.<sup>38</sup>

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

19 (1) included in the report, if any, that is sent to beneficiaries under [Section

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another person to exercise the power to adjust in that case (as Section 303 formerly did in the case of the power to convert to a unitrust). Should there be?

<sup>37</sup> A Commissioner in San Diego suggested adding these words "or the lives or more than one individual," which makes sense.

<sup>38</sup> [NEW 11/1/17] This revision of Section 203(g)(2) will prevent purported application to long closed accounting periods, which was not intended.

1 813(c)] of [the Uniform Trust Code]; or  
2 (2) reported at least annually to [the qualified beneficiaries determined under  
3 [Section 103(13)] of [the Uniform Trust Code], other than the [Attorney General]] [all  
4 beneficiaries that receive or are entitled to receive income from the trust or are entitled to receive  
5 a distribution of principal if the trust is terminated at the time the notice is sent, assuming no  
6 power of appointment is exercised].

7 (i) This section does not create or imply a duty to exercise the power to adjust under  
8 subsection (a) or to inform beneficiaries about the applicability of this section.<sup>39</sup>

9 (j) A fiduciary that in good faith takes or fails to take any action under this section is not  
10 liable to a person affected by the action or inaction. The exclusive remedy of a person affected  
11 by a fiduciary’s good-faith action or inaction under this section is to obtain a court order directing  
12 the fiduciary to exercise or refrain from exercising the power of adjustment under this section.<sup>40</sup>

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

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

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

24 Section 203 does not provide for the appointment of a disinterested person to exercise the  
25 power to adjust if no trustee is eligible, as Section 303(e) does in the case of converting the trust

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<sup>39</sup> [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.

<sup>40</sup> As stated in the footnote to Section 202(b), this narrower provision may conflict with Section 202(b). A Commissioner in San Diego asked how this applies to actions that are prohibited under subsection (c).

1 to a unitrust, for example. Unlike a one-time conversion to a unitrust, the adjustment between  
2 income and principal requires ongoing awareness of and attention to the particular characteristics  
3 of the trust and its beneficiaries.

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

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

15 **[ARTICLE] 3**

16 **UNITRUST<sup>41</sup>**

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

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

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

22 (3) "Special<sup>42</sup> tax benefit" means:

23 (A) eligibility of a transfer to a trust for the exclusion from gifts described in  
24 Section 2503(b) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section

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<sup>41</sup> [NEW 11/1/17] Article 3 generally addresses conversions of income trusts to unitrusts. Several states – apparently including Alabama, Alaska, Arizona, Colorado, Delaware, Florida, North Carolina, Pennsylvania, South Carolina, Tennessee, Vermont, West Virginia, and Wisconsin – have statutory provisions dealing with "express unitrusts" or "express total return unitrusts," which are trusts established to be either mandatory or elective unitrusts under the terms of the trust. Should the uniform act do so as well? (It should not require a very elaborate addition.)

<sup>42</sup> The word "Special" is added to "tax benefit" in paragraph (3).

1 2503(b)][, as amended] because of the qualification of an income interest in the trust as a present  
2 interest;

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

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

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

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

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

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

23 (4) “Unitrust” means a trust:

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

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

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

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

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

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

11

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

13 (a) This [article] applies to an estate only to the extent a trust is a beneficiary of the  
14 estate.<sup>43</sup>

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

16 (1) the terms of the trust expressly prohibit use of this [article] by a specific  
17 reference to this [article] or by an explicit expression of intent that income or<sup>44</sup> net income not be  
18 calculated as a unitrust amount; or

19 (2) the trust is a trust described in Section 170(f)(2)(B), 642(c)(5), 664(d),  
20 2702(a)(3), or 2702(b) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section  
21 170(f)(2)(B), 642(c)(5), 664(d), 2702(a)(3), or 2702(b)][, as amended].<sup>45</sup>

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<sup>43</sup> Section 302(a) is revised from a prohibition on estates to this limited permission.

<sup>44</sup> The words “income or” are added to “net income” in Section 302(b)(1).

<sup>45</sup> Section 302(b) formerly had an additional exception if a distributee had a power of withdrawal or a power to appoint trust funds to discharge his or her duty of support. The drafting committee criticized the general power (“5 and 5”) limitations, and perhaps no purpose is served by this exception at all. So it is removed from this draft.

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

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

6

7 **SECTION 303. AUTHORITY OF FIDUCIARY.**

8 (a) A fiduciary may, without court approval, convert a trust to a unitrust, discontinue the  
9 status of a trust as a unitrust,<sup>46</sup> or change the percentage or method used to calculate the unitrust  
10 amount if:<sup>47</sup>

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

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

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

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<sup>46</sup> The description in Section 303(a) of the actions a trustee may take under this provision has been revised to eliminate any reference to “an income trust.”

<sup>47</sup> [NEW 11/1/17] The former paragraph (1) of this Section 303(a) required the fiduciary to be an “independent person.” There seems to be no consensus reason for that limitation, and that paragraph is deleted from this draft. There is no consistency on this issue among states that have enacted unitrust statutes – some require the fiduciary to be independent with respect to the beneficiaries, while some even allow the beneficiaries themselves to convert to a unitrust without consent of the fiduciary. The plan is to provide a chart comparing the states at the November 17 drafting committee meeting. The revisions in this draft reflect the assumption that the drafting committee would ordinarily not want to prevent a conversion that some states now allow, including a conversion by the beneficiaries rather than the trustee. It is true that states that allow beneficiaries to convert to a unitrust generally require unanimous action of the beneficiaries – typically all the qualified beneficiaries – whereas the removal of the independent person requirement will appear to permit a fiduciary who is a beneficiary to unilaterally convert to a unitrust. But because the fiduciary under Section 304 must give notice to all qualified beneficiaries and under Section 303(a)(5) cannot proceed if any of them objects, the effect is equivalent to a requirement of unanimous consent. And in light of the removal of the requirement that the fiduciary be an independent person and the addition of the alternative authority in beneficiaries to convert to a unitrust, former subsections (d), (e), and (f), providing for options if the fiduciary is not an independent person, are deleted.

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

3 (B) if the trust is a unitrust:

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

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

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

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

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

14 (A) legally competent; [or]

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

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

17 (5) the fiduciary does not receive an objection in a record to the action proposed  
18 under this subsection from a person to whom the notice under paragraph (2) is sent<sup>48</sup> by the date  
19 specified in the notice under Section 304(d)(4).

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<sup>48</sup> This reference in Section 303(a)(5) to receiving “an objection in a record to the action proposed under this subsection from a person to whom the notice under paragraph (2) is sent” no longer includes the settlor, who now gets notice under the separate provisions of paragraph (3), not under paragraph (2). This is intended to eliminate any implication that the settlor must approve, or can veto, a unitrust conversion, which could create unwelcome tax results for the settlor, such as inclusion of the value of the trust assets in the settlor’s gross estate for estate tax purposes.



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

- 6 (1) consented under Section 304(c); or
- 7 (2) objected under Section 304(d)(3).

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

11 (d) If a beneficiary requests a fiduciary to take the action described in subsection (a) and  
12 the fiduciary declines to do so or does not do so within 90 days of the fiduciary's receipt of the  
13 request:

14 (1) [all the qualified beneficiaries determined under [Section 103(13)] of [the  
15 Uniform Trust Code], other than the [Attorney General]] [all beneficiaries that receive or are  
16 entitled to receive income from the trust or are entitled to receive a distribution of principal if the  
17 trust is terminated at the time the notice is sent, assuming no power of appointment is exercised]  
18 may take the action described in subsection (a)(2); or

19 (2) a beneficiary may petition the court to direct the fiduciary to take action under  
20 subsection (a)(2).<sup>49</sup>

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<sup>49</sup> [NEW 11/1/17] Section 303(d) now gives the power to convert, alternatively, to qualified beneficiaries, and also confirms that any beneficiary can petition the court to convert. The selection of 90 days is arbitrary for now.

1 (e) In deciding whether and how to take an action authorized by this section, or whether  
2 and how to respond to a request by a beneficiary under subsection (d) or a petition by a  
3 beneficiary under subsection (d)(2), a fiduciary shall consider all factors relevant to the trust and  
4 its beneficiaries, including the relevant factors in Section 201(c).<sup>50</sup>

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

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

11 **SECTION 304. NOTICE.**

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

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

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

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<sup>50</sup> [NEW 11/1/17] The words “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)” are added to Section 303(e) (Section 303(g) in the previous draft). Although beneficiaries are authorized under this draft to convert to a unitrust, it seems harsh to require persons who are not fiduciaries to consider factors that are designed to inform the exercise of fiduciary duty. Yet it seems appropriate that those factors be considered, and these additional words are intended to accomplish that.

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

3 (B) excluding a:

4 (i) power of appointment;

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

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

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

15 [(b) The representation provisions of [Article 3] of [the Uniform Trust Code] apply to  
16 notice under this section.]<sup>51</sup>

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

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

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

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<sup>51</sup> 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.

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 mailing or delivering the  
4 record to the fiduciary;<sup>52</sup>

5 (4) the date by which an objection under paragraph (3) must be made, which must  
6 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;<sup>53</sup>

9 (6) the name and mailing address<sup>54</sup> of the fiduciary; and

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

12 **Legislative Note:** *In states in which the constitution, or other law, does not permit the phrase “as*  
13 *amended” when federal statutes are incorporated into state law, the phrase should be omitted.*  
14 *Modify Section 304(a) to refer to Section 109 of the Uniform Trust Code or to appropriate*  
15 *general provisions for sending notice, modify Section 304(a)(1) to refer to Section 103(13)*  
16 *(defining “qualified beneficiary”) and related provisions of the Uniform Trust Code, modify*  
17 *Section 304(a)(2) to refer to Sections 301 through 305 of the Uniform Trust Code or replace it*  
18 *with a cross reference to the state’s law governing virtual representation, and modify the*  
19 *bracketed words in Section 304(b) to refer to Article 3 of the Uniform Trust Code; or modify*  
20 *those provisions appropriately if your state has not adopted the Uniform Trust Code. Modify*  
21 *Section 304(a)(2) to refer to the Uniform Directed Trust Act or modify that provision*  
22 *appropriately if your state has not adopted the Uniform Directed Trust Act.*

23 **SECTION 305. UNITRUST POLICY.**

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

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<sup>52</sup> This is revised in response to John Langbein’s urging that we “make it make sense.”

<sup>53</sup> A Commissioner asked if we should require that the conversion or other change should be prospective only.

<sup>54</sup> A Commissioner asked if we should accommodate email or other electronic “addresses,” pointing to the reference in paragraph (3) to “a record,” which is defined in Section 102(15) to include electronic media.

1 (b) A unitrust policy must provide for:

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

3 and

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

5 **SECTION 306. UNITRUST RATE.**

6 (a) A unitrust rate may be:

7 (1) a fixed unitrust rate; or

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

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

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

12 (b) A unitrust policy may provide for:

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

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

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

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

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

3 **SECTION 307. APPLICABLE VALUE.**

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

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

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

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

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

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

14 (3) how the net income attributable to an asset to which paragraph (1) or (2)  
15 applies must be determined and the effect of the net income on distributions;<sup>55</sup>

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

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

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

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<sup>55</sup> Paragraph (3) formerly stated: “how the net income attributable to an asset excluded under paragraph (1) or given special treatment under paragraph (2) must be determined and the effect of the net income on distributions”. A

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

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

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

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

8 (B) a mathematical blend of applicable values over a stated number of  
9 previous periods;

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

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

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

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

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

19 **SECTION 308. PERIOD.**

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

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Commissioner in San Diego expressed concern with the word “special” because it is not used in paragraph (2). The result was the simpler articulation in paragraph (4) in this draft.

- 1 (1) a calendar year;
- 2 (2) a 12-month period other than a calendar year;
- 3 (3) a calendar quarter;
- 4 (4) a three-month period other than a calendar quarter; or
- 5 (5) another period;<sup>56</sup>

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

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

- 10 (2) using a fewer number of previous periods under Section 307(c)(1), (2), (3)(B),
- 11 or (4)(B) if:<sup>57</sup>

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

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

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

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<sup>56</sup> This clause in Section 308(a) formerly stated (with appropriate spacing and indenting): “which may be: (1) a calendar year or quarter; (2) a 12-month or three-month period other than a calendar year or quarter; or (3) another period.” Some Commissioners in San Diego, including a member of the Style Committee, suggested just saying “prescribe the period,” without specifically citing selected (perhaps arbitrarily selected) examples of a “period,” while acknowledging that setting forth the conventional periods might be helpful. But such a change might leave it ambiguous as to whether other than conventional periods are allowed, as well as sacrifice a bias for a conventional period unless there is a reason for the fiduciary to use a nonconventional period. The change in the current draft arguably goes in the opposite direction, converting three paragraphs into five. But that change may strengthen the protection against negative tax consequences, which should be a high priority of this draft in view of the Treasury Regulations already issued on this subject and described in the Comment after Section 310. See, for example, the change made to Section 309(c)(2). When a future draft is circulated to the Style Committee or the entire Commission, maybe more elaboration of the tax concerns would be a good idea.

<sup>57</sup> A change from the previous draft is to break the second half of Section 308(b)(2) into two subparagraphs (A) and (B). This also may strengthen the tax protection. See the change to Section 309(c)(3).



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

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

3                   (1) determining the timing of distributions;

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

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

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

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

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

12                   (2) the only period that may be used under Section 308(a) is a calendar year under  
13 Section 308(a)(1);<sup>58</sup> and

14                   (3) no other provision of Sections 306 through 308 applies, except Sections  
15 307(a)(1), (b)(4) and (5), and (d) and 308(b)(2)(A) and (3).<sup>59</sup>

16           **SECTION 310. DUTIES AND REMEDIES.**

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

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<sup>58</sup> The words “under Section 308(a)(1)” are added to Section 309(c)(2) to make the tax protection even stronger. See the footnote to Section 308(a).

<sup>59</sup> Section 309(c)(3) is cluttered, but it is the natural result of breaking up the former all-inclusive Section 501(o). In the previous draft Section 309(v)(3) stated: “no other provision of Sections 305 through 308 applies, except Sections 305(a), 307(a)(1), (b)(4) and (5), and (d), and 308(b)(2) and (3).” This draft removes Section 305, which doesn’t seem to fit, and limits the reference to Section 308(b)(2) to the newly bifurcated Section 308(b)(2)(A). See the footnote to Section 308(b)(2).

1 (b) A fiduciary that in good faith takes or fails to take any action under this [article] is not  
2 liable to a person affected by the action or inaction, regardless of whether the affected person  
3 received notice in a record as provided in this [article] or the affected person was under a legal  
4 disability at the time of delivery of the notice. The exclusive remedy of a person affected by a  
5 fiduciary’s good-faith action or inaction under this [article] is to obtain a court order directing the  
6 fiduciary to convert a trust to a unitrust, discontinue the status of a trust as a unitrust, or change  
7 the percentage or method used to calculate the unitrust amount.<sup>60</sup>

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

#### 10 11 **Comment**

12 **Background.** The word “unitrust” can be traced at least to the literature of the mid-  
13 1960s. Lovell, “The Unitrust: A New Concept to Meet an Old Problem,” 105 TRUSTS &  
14 ESTATES 215 (1966); Del Cotto & Joyce, “Taxation of the Trust Annuity: The Unitrust Under the  
15 Constitution and the Internal Revenue Code,” 23 TAX L. REV. 257 (1968). For many estate  
16 planners and charitable giving planners, the first introduction to the word may be in the term  
17 “charitable remainder unitrust” introduced by Congress in section 664, added to the Internal  
18 Revenue Code by the Tax Reform Act of 1969. The word was reprised following the enactment  
19 of section 2702 in Treasury Reg. § 25.2702-3(c), governing “qualified unitrust interests” in  
20 grantor retained unitrusts (“GRUTs”) (which are hardly ever used, if they are used at all).

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

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

32 Converting or reforming a trust to a unitrust can provide a partnership among the income

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<sup>60</sup> As stated in the footnote to Section 202(b), this narrower provision may conflict with Section 202(b).

1 beneficiaries, the remainder beneficiaries, and the trustee that will enable the trustee to invest the  
2 assets for long-term growth to the benefit of all beneficiaries. This will permit the mission of the  
3 trustee and investment team to become more focused. Investment decisions can be based on the  
4 needs and risk tolerances of the beneficiaries, and there is less likelihood of dissension between  
5 the current and future beneficiaries over investment policy. In addition, to the extent that a  
6 unitrust approach obviates discretionary invasions of principal, the trustee is protected against  
7 challenges by the remainder beneficiaries that any discretionary principal distributions were  
8 excessive. Similarly, a unitrust approach eliminates the need to make adjustments between  
9 income and principal under Section 203 and thus avoids or minimizes controversy over whether  
10 such adjustments are proper.

11 By the end of 2016, 36 states<sup>61</sup> (Alabama, Alaska, Arizona, California, Colorado,  
12 Delaware, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland,  
13 Missouri, Nebraska, Nevada, New Hampshire, New Mexico, New York, North Carolina, Oregon,  
14 Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont,  
15 Virginia, Washington, West Virginia, Wisconsin, and Wyoming) had enacted statutes, some as  
16 part of their Uniform Principal and Income Act and some separately, permitting a trustee to  
17 convert a trust to a unitrust. Some of those statutes refer to unitrusts as “total return unitrusts” (a  
18 term not used in Article 3).

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

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

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

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<sup>61</sup> [NEW 11/1/17] The number of states (36) and list of those states are updated.

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

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

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

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

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

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

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

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

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

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

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

## 20 [ARTICLE] 4

### 21 ALLOCATION OF RECEIPTS DURING ADMINISTRATION

#### 22 [PART 1

#### 23 RECEIPTS FROM ENTITIES]

#### 24 SECTION 401. CHARACTER OF RECEIPTS.

25 (a) In this section:

26 (1) “Distribution” means a payment or transfer from an entity to an owner of the  
27 entity or another person with an interest in the entity. “Distribute” has a corresponding  
28 meaning.<sup>62</sup>

29 (2) “Entity” means a corporation, partnership, limited liability company, regulated

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<sup>62</sup> 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 investment company, real estate investment trust, common trust fund, or any other organization  
2 or arrangement in which a fiduciary has an interest, regardless of whether the entity is a taxpayer  
3 for federal income tax purposes,<sup>63</sup> other than a trust or estate to which Section 402 applies, a  
4 business or activity to which Section 403 applies, an asset-backed security to which Section 414  
5 applies, or an instrument or arrangement to which Section 415 applies.

6 (b) Except as otherwise provided in this section, a fiduciary shall allocate to income  
7 money received from an entity.

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

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

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

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

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

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

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

18 (d) In determining whether a distribution of money is received in partial liquidation of the  
19 entity, the following rules apply:

20 (1) Money is not received in partial liquidation and is income to the extent it does  
21 not exceed the amount of income tax a fiduciary or beneficiary must pay on taxable income of

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<sup>63</sup> This clause clarifies that “disregarded entities” (for tax purposes) are still entities under section 401, not under section 403. Maybe that policy choice should be discussed, but if a trustee who owns, say, a tree farm, wants to drop

1 the entity that distributes the money.

2 (2) If paragraph (1) does not apply,<sup>64</sup> money is presumed to be received in partial  
3 liquidation to the extent the entity, not later than the date on which the entity files a federal  
4 income tax return for the year in which the distribution was made, indicates that it is a  
5 distribution in partial liquidation.<sup>65</sup>

6 (3) If paragraph (1) does not apply and either paragraph (2) does not apply or the  
7 fiduciary does not know if paragraph (2) applies, money is presumed to be received in partial  
8 liquidation to the extent the distribution is attributable to the proceeds from a sale of a capital  
9 asset by the entity or by a subsidiary or affiliate of the entity.<sup>66</sup>

10 (4) If paragraph (1) does not apply and either paragraphs (2) and (3) do not apply  
11 or the fiduciary does not know if paragraph (2) or (3) applies, money is presumed to be received  
12 in partial liquidation to the extent the total amount of money and property distributed in a  
13 distribution or series of related distributions to all owners or distributees is greater than 20  
14 percent of the fair market value<sup>67</sup> of the entity's assets, as shown by the entity's year-end financial  
15 statements immediately preceding the initial distribution.<sup>68</sup>

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the farm into a single member LLC for liability or management purposes it seems odd that doing so would affect income/principal allocations.

<sup>64</sup> [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.

<sup>65</sup> 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."

<sup>66</sup> [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.

<sup>67</sup> [NEW 11/1/17] In Section 401(d)(4), "fair market value" replaces "net value." The drafting committee has discussed whether this standard is workable, but there has been no consensus about a replacement.

<sup>68</sup> [NEW 11/1/17] The word "distribution" at the end of Section 401(d)(4) replaces the word "receipt."

1 (5) In applying paragraphs (2) through (4), a fiduciary may rely on information  
2 received from an entity and does not have a duty to inquiry or investigate unless:

3 (A) other information in the fiduciary’s possession indicates that the  
4 information received from the entity is or may be false,<sup>69</sup> or

5 (B) the fiduciary owns at least 50 percent of the voting interest in the  
6 entity.

7 (6)<sup>70</sup>

8 **Comment**

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

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<sup>69</sup> [NEW 11/1/17] Section 401(d)(5)(A) is intended to include John Langbein’s standard that “if something is smelly enough, the trustee should be able to use his nose.”

<sup>70</sup> [NEW 11/1/17] It seems that one more paragraph or subsection is needed to provide an answer if none of the previous rules provide an answer. Letting a fiduciary just decide, with or without guidance such as a list of factors to consider, may put too much pressure on fiduciaries.

In the previous draft, subsections (d) through (g) stated:

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

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

(f) Money is not received in partial liquidation and is income to the extent it does not exceed the amount of income tax a fiduciary or beneficiary must pay on taxable income of the entity that distributes the money.

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



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,<sup>71</sup> from a trust or an estate in which the trust has an interest other  
4 than a purchased interest, and shall allocate to principal an amount received as a distribution of  
5 principal from such a trust or estate. If a fiduciary purchases an interest in a trust that is an  
6 investment entity, or a decedent or donor transfers an interest in such a trust to a fiduciary,  
7 Section 401 or 414 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<sup>72</sup> maintain separate accounting records for the transactions of the business or other activity,  
19 whether or not assets of the business or other activity are segregated from other assets held by the  
20 fiduciary.

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<sup>71</sup> The reference to a unitrust distribution is added to Section 402, in view of the new unitrust provision.

<sup>72</sup> [NEW 11/1/17] There is still the question of whether the word “may” in Section 403(b) should be “shall.”

1 (c)<sup>73</sup> A fiduciary that accounts separately for a business or other activity under this section:

2 (1) may determine:

3 (A) the extent to which the net cash receipts of the business must be  
4 retained for:

5 (i) working capital,

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

7 (iii) other reasonably foreseeable needs of the business or activity;

8 and

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

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

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

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

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

19 (2) farming;

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

21 (4) management of rental properties;

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

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<sup>73</sup> [NEW 11/1/17] Section 403(c) has been broken up.

- 1 (6) timber operations;
- 2 (7) activities to which Section 413 applies; and
- 3 (8) other operating businesses.

4 **Comment**

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

15  
16 **[PART 2**

17 **RECEIPTS NOT NORMALLY ALLOCATED]**

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

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

- 20 (A) a transferor during the transferor’s lifetime;
- 21 (B) an estate;
- 22 (C) a trust with a terminating income interest; or
- 23 (D) a payor under a contract naming the fiduciary as beneficiary;

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

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

28 (4) proceeds of property taken by eminent domain, except that proceeds awarded for a

1 loss of income for a period are income if a current income beneficiary had a mandatory income  
2 interest during the period;

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

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

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

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

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

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

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

1 is acquired by the fiduciary, an amount received that exceeds its purchase price or its value when  
2 acquired by the fiduciary must be allocated to income.<sup>74</sup>

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

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

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

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

13 **[PART 3**

14 **RECEIPTS NORMALLY APPORTIONED]**

15 **SECTION 408. DEFERRED COMPENSATION, ANNUITIES, AND SIMILAR**  
16 **PAYMENTS.**<sup>75</sup>

17 (a) This section does not apply to a payment to which Section 409 applies.<sup>76</sup>

18 (b) In this section:

19 (1) “Payment” means an amount a fiduciary may receive over a fixed number of

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<sup>74</sup> In the previous draft (and in the current UPIA) the first and third occurrences of the word “acquired” in Section 406(c) were stated as “purchased or acquired.” The use of the word “purchased” begs the question “purchased by whom?” The only reasonable answer is purchased by the fiduciary, but then it means the same as “acquired” anyway.

<sup>75</sup> Section 408 is still under review, possibly with help from Susan Porter and a group she chairs.

<sup>76</sup> [NEW 11/1/17] This subsection (a) is moved from the end to the beginning, consistently with other Style Committee suggestions.

1 years or during the life of one or more individuals because of services rendered or property  
2 transferred to the payor in exchange for future receipts. The term includes an amount drawn in  
3 money or property from the payor's general assets or from a separate fund created by the payor.  
4 For purposes of subsections (f), (g), (h), and (i), the term also includes an amount drawn from  
5 any separate fund, regardless of the reason for the withdrawal.

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

8 (c) To the extent a payment is characterized by the payor as interest, a dividend, or a  
9 payment made instead of interest or a dividend, a fiduciary shall allocate the payment to income.  
10 The fiduciary shall allocate to principal the balance of the payment and any other payment  
11 received in the same accounting period that is not characterized as interest, a dividend, or a  
12 payment made instead of interest or a dividend.<sup>77</sup>

13 (d) If no part of a payment is characterized as interest, a dividend, or an equivalent  
14 payment, and all or part of the payment is required to be made, a fiduciary shall allocate to  
15 income a percentage of the part that is required to be made during the accounting period and shall  
16 allocate the balance to principal. If no part of a payment is required to be made or the payment  
17 received is the entire amount to which the fiduciary is entitled, the fiduciary shall allocate the  
18 entire payment to principal. For purposes of this subsection, a payment is not required to be  
19 made to the extent it is made because the fiduciary exercises a right of withdrawal.

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

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<sup>77</sup> This change makes the two sentences parallel.

1 (f)<sup>78</sup> Except as otherwise provided in subsection (g), subsections (h) and (i) apply, and  
2 subsections (c) and (d) do not apply, in determining the allocation of a payment made from a  
3 separate fund to:

4 (1) a trust to which an election to qualify for a marital deduction under Section  
5 2056(b)(7) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section  
6 2056(b)(7)][, as amended], has been made; or

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

9 (g) Subsections (f), (h), and (i) do not apply if and to the extent the series of payments  
10 would, without the application of subsection (f), qualify for the marital deduction under Section  
11 2056(b)(7)(C) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section  
12 2056(b)(7)(C)][, as amended].

13 (h) A trustee shall determine the internal income of each separate fund for the accounting  
14 period as if the separate fund were a trust subject to this [act]. Upon request of the surviving  
15 spouse, the trustee shall demand that the person administering the separate fund distribute the  
16 internal income to the trust. The trustee shall allocate a payment from the separate fund to  
17 income to the extent of the internal income of the separate fund and distribute that amount to the  
18 surviving spouse. The trustee shall allocate the balance of the payment to principal. Upon  
19 request of the surviving spouse, the trustee shall allocate principal to income to the extent the  
20 internal income of the separate fund exceeds payments made from the separate fund to the trust  
21 during the accounting period.

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<sup>78</sup> This subsection might be reviewed in light of the discussion at the ACTEC Employee Benefits Committee meeting in Seattle.

1 (i) If a trustee cannot determine the internal income of a separate fund but can determine  
2 the value of the separate fund, the internal income of the separate fund is deemed to equal [insert  
3 number at least three percent and not more than five percent] of the fund's value, according to  
4 the most recent statement of value preceding the beginning of the accounting period. If the  
5 trustee can determine neither the internal income of the separate fund nor the fund's value, the  
6 internal income of the fund is deemed to equal the product of the interest rate and the present  
7 value of the expected future payments, as determined under Section 7520 of the Internal Revenue  
8 Code of 1986[, as amended][, 26 U.S.C. Section 7520][, as amended], for the month preceding  
9 the accounting period for which the computation is made.

10 **SECTION 409. CERTAIN ILLIQUID ASSETS.**

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

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

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



1 **Comment**

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

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

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

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

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

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

32 (4) If an amount is received from a working interest or any other interest not

1 provided for in paragraph (1), (2), or (3), a percentage of the net amount received must be  
2 allocated to income and the balance to principal.

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

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

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

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

15 **SECTION 411. TIMBER.**

16 (a) To the extent a fiduciary accounts for receipts from the sale of timber and related  
17 products pursuant to this section, the fiduciary shall allocate the net receipts:<sup>79</sup>

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

21 (2) to principal to the extent the amount of timber removed from the land exceeds

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<sup>79</sup> A question was raised at the March drafting committee about the clarity of “net receipts” in Section 411(a), and perhaps that will be discussed further.

1 the rate of growth of the timber or the net receipts are from the sale of standing timber;

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

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

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

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

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

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

21 **SECTION 412. MARITAL DEDUCTION PROPERTY NOT PRODUCTIVE OF**  
22 **INCOME.**

23 (a) The transferor's spouse may require the trustee of a trust for which a gift or estate tax

1 marital deduction was allowed to make property productive of income, convert property to  
2 productive property within a reasonable time, or exercise the power conferred by Section 203 if  
3 the trust assets otherwise do not provide the transferor’s spouse with sufficient income from or  
4 use of the trust assets to qualify for the deduction. The trustee may decide which action or  
5 combination of actions to take.<sup>80</sup>

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

9 **SECTION 413. DERIVATIVES AND OPTIONS.**<sup>81</sup>

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

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

17 (c) If a fiduciary grants an option to buy property from the trust, whether or not the trust  
18 owns the property when the option is granted, grants an option that permits another person to sell

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<sup>80</sup> Section 412(a) is rewritten. Previously it stated: “If property is transferred in a trust whose assets consist substantially of property that does not provide the transferor’s spouse with sufficient income from or use of the trust assets and a marital deduction for estate or gift tax purposes that is dependent on providing the transferor’s spouse with sufficient income from or use of the trust assets is allowed for all or part of the transfer, and if the amounts the trustee transfers from principal to income under Section 401 and distributes to the spouse from principal pursuant to the terms of the trust are insufficient to provide the spouse with the beneficial enjoyment required to obtain the marital deduction, the spouse may require the trustee to make property productive of income, convert property within a reasonable time, or exercise the power conferred by Section 401(a). The trustee may decide which action or combination of actions to take.”

<sup>81</sup> Sections 413 and 414 are still under review, with help from Paul Lee.

1 property to the trust, or acquires an option to buy property for the trust or an option to sell an  
2 asset owned by the trust, and the fiduciary or other owner of the asset is required to deliver the  
3 asset if the option is exercised, an amount received for granting the option must be allocated to  
4 principal. An amount paid to acquire the option must be paid from principal. A gain or loss  
5 realized upon the exercise of an option, including an option granted to a settlor of the trust for  
6 services rendered, must be allocated to principal.

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

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

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

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

23 (d) The percentage used under subsection (c) must be 10 percent, unless the fiduciary

1 selects a different percentage in a record.

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

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

6 **Comment**

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

10  
11 **SECTION 416. INSUBSTANTIAL ALLOCATIONS NOT REQUIRED.** If a  
12 fiduciary determines that an allocation between income and principal required by Section 408,  
13 409, 410, 411, or 414 is insubstantial, the fiduciary may allocate the entire amount to principal,  
14 unless Section 203(c) applies to the allocation. This power may be exercised by a co-fiduciary in  
15 the circumstances described in Section 203(d) and may be released for the reasons and in the  
16 manner described in Section 203(e). An allocation is presumed to be insubstantial if:

17 (1) the amount of the allocation would increase or decrease net income in an accounting  
18 period, as determined before the allocation, by less than 10 percent; and<sup>82</sup>

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

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<sup>82</sup> The word "or" is changed to "and" here to narrowly apply the Section 416 exception to cases where both tests are satisfied.

1 [ARTICLE] 5

2 ALLOCATION OF DISBURSEMENTS DURING ADMINISTRATION

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

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

6 (1) one-half of:

7 (A) the regular compensation of the fiduciary and of any person providing  
8 investment advisory, custodial, or other<sup>83</sup> services to the fiduciary; and

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

11 (2) the balance of the disbursements described in paragraph (1) to the extent a fiduciary  
12 that is an independent person<sup>84</sup> determines that making those disbursements from income would  
13 be in the interests of the beneficiaries because principal is illiquid or otherwise;<sup>85</sup>

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

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

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<sup>83</sup> [NEW 11/1/17] The word “fiduciary” had been added to Section 501(1)(A) as a modifier of “services” to cover trust directors under the UDTA. Because the now-approved UTDA treats trust directors as fiduciaries, that addition is unnecessary and is deleted from this draft. (It was awkward anyway to envision the trust director “providing fiduciary ... services to the fiduciary.”) But the word “other” is added to be safe.

<sup>84</sup> [NEW 11/1/17] the reference to an “independent person” is retained in Section 501(2).

<sup>85</sup> The new reference to an “independent person” in Section 501(2) picks up the new definition of “independent person” in Section 102(9). See also Section 201(a)(4) and (5) and the Comment to Section 201.

1 **Comment**

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

6 **SECTION 502. DISBURSEMENTS FROM PRINCIPAL.**

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

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

10 (2) all the fiduciary’s compensation calculated on principal as a fee for acceptance,  
11 distribution, or termination, and disbursements made to prepare for or execute a sale or other  
12 disposition of the property;<sup>86</sup>

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

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

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

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

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

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<sup>86</sup> This reference in Section 502(a)(2) to “prepare for or execute a sale or other disposition of the property” replaces “prepare property for sale” and is intended to more clearly cover the cost of appraisals, land use appraisals, remediation, and the like, which will be noted in a Comment.



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

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

8 **SECTION 503. TRANSFERS FROM INCOME TO PRINCIPAL FOR**  
9 **DEPRECIATION.**

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

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

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

17 (2) under this section if the fiduciary is accounting under Section 403 for the  
18 business or activity in which the asset is used.<sup>87</sup>

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

---

<sup>87</sup> The former paragraph (2) of Section 503(b) “(during the administration of a decedent’s estate”) has been deleted as redundant in view of the current broadening of the explicit wording throughout the Act to “fiduciaries,” including personal representatives.

1           **SECTION 504. TRANSFERS FROM INCOME TO REIMBURSE PRINCIPAL.**<sup>88</sup>

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

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

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

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

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

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

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

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

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<sup>88</sup> The drafting committee might discuss whether a reciprocal provision for reimbursing income from principal is needed.



1 is not fully distributed, as in the case of income retained in an entity owned in whole or in part by  
2 the trust. The Drafting Committee found these issues to be similar to the issues raised by Rev.  
3 Rul. 2006-26 in the context of defined contribution qualified retirement plans and individual  
4 retirement accounts (IRAs). The committee concluded that no change needs to be made to the  
5 Act because it understands that the power in the spouse to cause the trust assets to be made  
6 reasonably productive of income cures any marital deduction issue.

7  
8 **SECTION 506. ADJUSTMENTS BETWEEN INCOME AND PRINCIPAL**

9 **BECAUSE OF TAXES.<sup>90</sup>**

10 (a) A fiduciary may make adjustments between income and principal to offset the shifting  
11 of economic interests or tax benefits between current income beneficiaries and successor  
12 beneficiaries that arise from:<sup>91</sup>

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

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

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

19 (b) If the amount of an estate-tax marital deduction or charitable-contribution deduction is  
20 reduced because a fiduciary deducts an amount paid from principal for income tax purposes  
21 instead of deducting it for estate-tax purposes, and as a result estate taxes paid from principal are

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<sup>90</sup> [NEW 11/1/17] There has been considerable discussion about Section 506, including whether the third word of subsection (a) – “may” – should be “shall,” making the adjustments mandatory, not discretionary, especially because subsection (c) uses the word “shall.” (In a previous draft, subsection (c) was copied into Section 506 from Section 505, which generally uses the word “must.”) Concerns have been expressed about the *Heller* case. The point has also been made that there should be a comment about the scope of Section 506. For purposes of this draft, although Comments have generally not been updated, the Comment on Section 506 in the 1997 Act has been restored. We have made no changes to the 1997 version of Section 506 except generic changes in wording (deleting “estate,” changing “remainder” to “successor,” placing “income” before “principal, etc.) and the addition of subsection (c).

The drafting committee might also consider why subsection (c) is now used in both Sections 505 and 506.

<sup>91</sup> This enumeration might be further clarified.

1 increased and income taxes paid by a trust or beneficiary are decreased, each trust or beneficiary  
2 that benefits from the decrease in income tax shall reimburse the principal from which the  
3 increase in estate tax is paid. The total reimbursement must equal the increase in the estate tax to  
4 the extent the principal used to pay the increase would have qualified for a marital deduction or  
5 charitable contribution deduction but for the payment. The proportionate share of the  
6 reimbursement for each trust or beneficiary whose income taxes are reduced must be the same as  
7 its proportionate share of the total decrease in income tax. A trust shall reimburse principal from  
8 income.

9 (c) After applying Section 505, the fiduciary shall adjust income or principal receipts to  
10 the extent the trust's taxes are reduced because the trust receives a deduction for payments made  
11 to a beneficiary.<sup>92</sup>

#### 12 **Comment to 1997 Act**

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

27  
28 Section 506(a)(3) applies to a qualified Subchapter S trust (QSST) whose income  
29 beneficiary is required to include a pro rata share of the S corporation's taxable income in his  
30 return. If the QSST does not receive a cash distribution from the corporation that is large enough  
31 to cover the income beneficiary's tax liability, the trustee may distribute additional cash from  
32 principal to the income beneficiary. In this case the retention of cash by the corporation benefits

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<sup>92</sup> This Section 506(c) has been moved here from Section 505.

1 the trust principal. This situation could occur if the corporation's taxable income includes capital  
2 gain from the sale of a business asset and the sale proceeds are reinvested in the business instead  
3 of being distributed to shareholders.  
4

5 **Mandatory adjustment.** Subsection (b) provides for a mandatory adjustment from  
6 income to principal to the extent needed to preserve an estate tax marital deduction or charitable  
7 contributions deduction. It is derived from New York's EPTL § 11-1.2(A), which requires  
8 principal to be reimbursed by those who benefit when a fiduciary elects to deduct administration  
9 expenses on an income tax return instead of the estate tax return. Unlike the New York  
10 provision, subsection (b) limits a mandatory reimbursement to cases in which a marital deduction  
11 or a charitable contributions deduction is reduced by the payment of additional estate taxes  
12 because of the fiduciary's income tax election. It is intended to preserve the result reached in  
13 *Estate of Britenstool v. Commissioner*, 46 T.C. 711 (1966), in which the Tax Court held that a  
14 reimbursement required by the predecessor of EPTL § 11-1.2(A) resulted in the estate receiving  
15 the same charitable contributions deduction it would have received if the administration expenses  
16 had been deducted for estate tax purposes instead of for income tax purposes. Because a  
17 fiduciary will elect to deduct administration expenses for income tax purposes only when the  
18 income tax reduction exceeds the estate tax reduction, the effect of this adjustment is that the  
19 principal is placed in the same position it would have occupied if the fiduciary had deducted the  
20 expenses for estate tax purposes, but the income beneficiaries receive an additional benefit. For  
21 example, if the income tax benefit from the deduction is \$30,000 and the estate tax benefit would  
22 have been \$20,000, principal will be reimbursed \$20,000 and the net benefit to the income  
23 beneficiaries will be \$10,000.  
24

25 **Irrevocable grantor trusts.** Under Sections 671-679 of the Internal Revenue Code (the  
26 "grantor trust" provisions), a person who creates an irrevocable trust for the benefit of another  
27 person may be subject to tax on the trust's income or capital gains, or both, even though the  
28 settlor is not entitled to receive any income or principal from the trust. Because this is now a  
29 well-known tax result, many trusts have been created to produce this result, but there are also  
30 trusts that are unintentionally subject to this rule. The Act does not require or authorize a trustee  
31 to distribute funds from the trust to the settlor in these cases because it is difficult to establish a  
32 rule that applies only to trusts where this tax result is unintended and does not apply to trusts  
33 where the tax result is intended. Settlers who intend this tax result rarely state it as an objective  
34 in the terms of the trust, but instead rely on the operation of the tax law to produce the desired  
35 result. As a result it may not be possible to determine from the terms of the trust if the result was  
36 intentional or unintentional. If the drafter of such a trust wants the trustee to have the authority to  
37 distribute principal or income to the settlor to reimburse the settlor for taxes paid on the trust's  
38 income or capital gains, such a provision should be placed in the terms of the trust. In some  
39 situations the Internal Revenue Service may require that such a provision be placed in the terms  
40 of the trust as a condition to issuing a private letter ruling.  
41

42

1 [ARTICLE] 6

2 DEATH OF DECEDENT OR TERMINATION OF INCOME INTEREST<sup>93</sup>

3 SECTION 601. DETERMINATION AND DISTRIBUTION OF NET INCOME.

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

6 (b) A fiduciary of an estate or a terminating income interest shall determine the amount of  
7 net income and net principal receipts received from property specifically given to a beneficiary  
8 under the rules in [Articles] 4, 5, and 7<sup>94</sup> and the rules in subsection (f). The fiduciary shall  
9 distribute the net income and net principal receipts to the beneficiary who is to receive the  
10 specific property.

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

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

16 (2) paying from income or principal, in the fiduciary's discretion, fees of  
17 attorneys, accountants, and fiduciaries, court costs and other expenses of administration, and  
18 interest on estate and inheritance taxes and other taxes imposed by reason of the death of a

---

<sup>93</sup> This title was formerly "DECEDENT'S ESTATE OR TERMINATING INCOME INTEREST." The terms were flagrantly unparallel: the "decedent's estate" is something that is beginning and the "terminating income interest" is something that is ending. Moreover, the word "decedent's" in reference to an "estate" has been uniformly deleted from this draft as redundant. See the footnote to Section 102(17) on the use of "decedent's estate."

<sup>94</sup> Here and in subsection (c) there had been the clause "which apply to trustees." That is deleted because the general term throughout the Act is now "fiduciary."

1 decedent,<sup>95</sup> but the fiduciary may pay those expenses from income of property passing to a trust  
2 for which the fiduciary claims a federal estate tax marital or charitable deduction only to the  
3 extent the payment of those expenses from income will not cause the reduction or loss of the  
4 deduction; and

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

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

20 (e) A fiduciary shall distribute the net income remaining after distributions required by  
21 subsection (d) in the manner described in Section 602 to all other beneficiaries, including a

---

<sup>95</sup> [NEW 11/1/17] In the previous draft the politicized term “death taxes” was changed in Section 601(c)(2) and (3) to “estate and inheritance taxes.” To be sure that no “death tax” is omitted, the words “and other taxes imposed by reason of the death of a decedent” are now added to those provisions.



1 beneficiary who receives a pecuniary amount in trust, even if the beneficiary holds an unqualified  
2 power to withdraw assets from the trust or other presently exercisable general power of  
3 appointment over the trust.

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

14 **SECTION 602. DISTRIBUTION TO RESIDUARY AND REMAINDER**  
15 **BENEFICIARIES.**

16 (a) Except to the extent [Article] 3 applies in the case of a beneficiary that is a trust,<sup>96</sup>  
17 each beneficiary described in Section 601(e) is entitled to receive a part of the net income equal  
18 to the beneficiary's fractional interest in undistributed principal assets, using values as of the  
19 distribution date. If a fiduciary makes more than one distribution of assets to beneficiaries to  
20 whom this section applies, each beneficiary, including one who does not receive part of the  
21 distribution, is entitled, as of each distribution date, to the net income the fiduciary has received

---

<sup>96</sup> [NEW 11/1/17] Bill LaPiana asked: "In light of § 302(a), if the residuary clause is ½ outright to X, ½ in trust, could the 'net income' of the first ½ be the income as traditionally determined and the 'net income' of the other half a unitrust amount?" Because the answer appears to be yes, the first clause has been added to Section 602(a).

1 after the date of the decedent’s death or an income interest’s terminating event or previous  
2 distribution date.<sup>97</sup>

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<sup>98</sup> calculated without regard to:

9 (A) property specifically given to a beneficiary under the decedent’s will  
10 or the terms of the trust;<sup>99</sup> 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

---

<sup>97</sup> Instead of changing “current distribution date” to “given date” at the end of Section 602(a) as John Langbein suggested, this draft simply deletes “but has not distributed as of the current distribution date” as surplus. The word “earlier” (now the third-from-last word of the subsection) is changed to the more precise word “previous.”

<sup>98</sup> In March, the drafting committee suggested changing “must be” to “is” in Section 602(b)(2). The term “must be” is used 39 times in the current draft, and almost all of those references could conveniently be changed to “is.” Likewise with phrases such as “shall be,” “shall be allocated,” and “the fiduciary shall allocate.” Those changes have not been made yet, either here or elsewhere. Should they be?

1 person as of a distribution date, the fiduciary shall maintain appropriate records showing the  
2 interest of each beneficiary in the net income.

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

7 **Comment**

8 Section 602(b)(2) excludes specific bequests in kind and pecuniary bequests from the  
9 calculation of a beneficiary’s fractional interest of undistributed principal assets for purposes of  
10 allocating income to that beneficiary. If the beneficiary is entitled to statutory interest on any  
11 such bequest, that interest is not income subject to allocation under this section, and that bequest  
12 does not share in the income earned by the other assets.<sup>100</sup>

13 **[ARTICLE] 7**

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

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

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

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

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

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

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<sup>99</sup> The words “under the decedent’s will or the terms of the trust” are added in Section 602(b)(2)(A). Section 102(17), defining “terms of the trust,” states: “In the case of an estate, the term includes a will.” Here, however, a will is so clearly the point of the provision that it seems awkward to merely insert a reference to “terms of the trust.”

<sup>100</sup> Is it clear from the text of the Act that a specific bequest does not share in the income earned by other assets?

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

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

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

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

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

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

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

20 (b) A fiduciary shall allocate a periodic income receipt or disbursement to income if its  
21 due date occurs on or after the date on which a decedent dies or an income interest begins. A  
22 receipt or disbursement is periodic if it must be paid at regular intervals under an obligation to

1 make payments or if a payor customarily makes payments at regular intervals.<sup>101</sup> An income  
2 receipt or disbursement must be treated as accruing<sup>102</sup> from day to day if it is not periodic or it has  
3 no due date. The part of the receipt or disbursement accruing before the date on which a  
4 decedent dies or an income interest begins must be allocated to principal, and the balance must  
5 be allocated to income.

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

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

#### 11 **Comment**

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

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<sup>101</sup> 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 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.”

<sup>102</sup> Here in Section 702(b) is an example of where the phrase “must be treated as accruing” could be changed to simply “accrues.” See Section 602(b)(2) and the corresponding footnote.



1 most settlors would want, and that, with respect to undistributed income, most settlors would  
2 favor the income beneficiary first, the remainder beneficiaries second, and the income  
3 beneficiary's heirs last, if at all. It decided not to eliminate this provision, however, to avoid  
4 causing disputes about whether the trustee should have distributed collected cash before the  
5 income beneficiary died.

6  
7 The current Drafting Committee is not as sure that the estate rule is not what most settlors  
8 would want. The estate rule may actually fit best with the paradigm of a beneficiary who incurs  
9 bills, like credit card charges and unreimbursed medical expenses, that are paid in arrears from  
10 trust distributions. At the other end of the wealth spectrum, payment to the estate might create an  
11 avoidable increment of estate tax as well as an administrative burden, but those situations would  
12 typically entail more sophisticated estate planning that can draft around that. Moreover, the  
13 estate rule would avoid the pressure to make or demand income distributions at more frequent  
14 intervals in order to keep the distributions more current up to the date of death. The payment of  
15 "stub income" to the income beneficiary's estate also provides better protection in cases where  
16 tax rules require a beneficiary to receive income "for life."

## 17 18 [ARTICLE] 8

### 19 MISCELLANEOUS PROVISIONS

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

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

### 26 **Alternative A**

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

29 (1) if the trust is not funded as of [the effective date of this [act]], the date of the  
30 decedent's death;

31 (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 **Alternative B**

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

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

9 (2) if the trust is initially funded in the calendar year beginning January 1, \_\_\_\_\_ [insert  
10 year in which this [act] takes effect], the date of the decedent’s death; or

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

13 **End of Alternatives**

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

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

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

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



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

2           (a) . . . .

3           (b) . . . .

4           (c) . . . .

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