

D R A F T

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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February 16-17, 2018 Drafting Committee Meeting

(Comments are included, but have not been updated.)

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By

NATIONAL CONFERENCE OF COMMISSIONERS  
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January 22, 2018

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# UNIFORM FIDUCIARY INCOME AND PRINCIPAL ACT

## PREFATORY NOTE

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

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

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

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

1           This is how the current Act respects, and permits a trustee to respect, the historical dignity  
2 and discipline of the simple notion of “income.” Under Section 203, a trustee of a discretionary  
3 trust can make adjustments, taking into account a nonexclusive list of factors provided in Section  
4 201(c), and still achieve the comfortable outcome of “distributing income.” And when the  
5 interests of beneficiaries under the terms of the trust are still not appropriately served within the  
6 framework of “distributing income” – that is, when no reasonable adjustment would serve those  
7 interests, or when significant non-pro rata distributions are justified – then invasions of principal  
8 are still appropriate to the extent consistent with the terms of the trust.  
9

10           A trustee that does not make adjustments under Section 203 still has the option of  
11 following the more traditional rules, which are retained, with modest updates, in Articles 4  
12 through 7.  
13

14           As perhaps the “ultimate adjustment,” Article 3 adds the authority for a trustee to convert  
15 a trust to a unitrust. This is discussed in the Comment to Article 3.  
16

17           Finally, new Section 104 provides an important clarification that the income and principal  
18 rules of the state that is the principal place of administration of the trust from time to time will be  
19 the governing law.  
20  
21

1                                   **UNIFORM FIDUCIARY INCOME AND PRINCIPAL ACT**

2   **[ARTICLE] 1**

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

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

6   **Comment**

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

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

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

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

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

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

1 (2) “Beneficiary” includes:

2 (A) in the case of a trust:

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

5 (ii) a remainder beneficiary; and

6 (iii) any other successor beneficiary;

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

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

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

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

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

17 “Distribute” has a corresponding meaning.

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

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

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

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

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

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

13 (A) in the case of a trust:

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

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

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

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

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

23 (A) or (B);

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

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

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

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

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

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

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

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

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

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

6           (18) “Trust”:

7                   (A) includes:

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

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

12                   (B) excludes:

13                           (i) a constructive trust;

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

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

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

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

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

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

7 **Comment**

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

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

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

21  
22 **“Record.”** This addition in the current Act is copied from Section 2(22) of the Uniform  
23 Trust Decanting Act.

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

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

40



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

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

## 14 [ARTICLE] 2

### 15 FIDUCIARY DUTIES AND JUDICIAL REVIEW

#### 16 SECTION 201. FIDUCIARY DUTIES; GENERAL PRINCIPLES.

17 (a) In making an allocation or determination or exercising discretion under this [act], a  
18 fiduciary:

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

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

25 (3) shall administer the trust or estate in accordance with this [act] to the extent  
26 the terms of the trust or the will neither:

27 (A) contain a different provision; nor

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

29 (4) shall add a receipt to principal to the extent neither the terms of the trust or the

1 will nor the other provisions of this [act] allocate the receipt between income and principal; and  
2 (5) shall charge a disbursement to principal to the extent neither the terms of the  
3 trust or the will nor the other provisions of this [act] allocates the disbursement between income  
4 and principal.

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

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

- 18 (1) the terms of the trust;
- 19 (2) the nature, purpose, distribution standards, and expected duration of the trust;
- 20 (3) the desirability of liquidity and regularity of income;
- 21 (4) the desirability of the preservation and appreciation of the capital of the trust;
- 22 (5) the extent to which an asset is used or may be used by a beneficiary;
- 23 (6) whether an asset was received from the settlor;

1 (7) the volatility in the value of principal assets, which the fiduciary may estimate  
2 as to an asset for which market value is not readily available;

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

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

7 (10) the actual and anticipated effect on income and principal of economic  
8 conditions, including inflation and deflation; and

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

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

12 **Comment**

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

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

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

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

28 The phrase “giving due regard to the beneficiaries’ respective interests” is copied from  
29 Section 803 of the Uniform Trust Code, relating to impartiality. Among other things, this could  
30 make relevant the relationships of beneficiaries to each other, for example, where the trustee

1 takes note of the fact that the successor beneficiaries following a life income interest of the  
2 settlor’s surviving spouse are descendants of that spouse, or not descendants of that spouse, or  
3 some who are the spouse’s descendants and some who are not.

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

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

16  
17 **SECTION 202. JUDICIAL REVIEW OF DISCRETIONARY POWER.**

18 (a) In this section:

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

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

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

26 (C) a fiduciary’s implementation of a fiduciary’s decision described in  
27 subparagraph (A) or (B).

28 (2) “Trust” includes any arrangement or relationship described in Section 103.

29 (b) The court may not order a fiduciary to change a fiduciary’s decision unless the court  
30 determines that the fiduciary’s decision was an abuse of the fiduciary’s discretion.

1 (c) A fiduciary's decision is not an abuse of the fiduciary's discretion merely because the  
2 court would have made a different decision.

3 (d) If the court determines that a fiduciary has abused the fiduciary's discretion, in  
4 addition to other remedies provided by this [act] or otherwise the court may place the  
5 beneficiaries in the positions they would have occupied if the discretion had not been abused,  
6 under the following rules:

7 (1) To the extent the abuse of discretion resulted in no distribution to a beneficiary  
8 or in a distribution that is too small, the court may order the fiduciary to distribute to the  
9 beneficiary an amount the court determines will place the beneficiary, in whole or in part, in the  
10 appropriate position.

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

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

20 (e) On [petition] by a fiduciary, the court having jurisdiction over a trust may determine  
21 whether a proposed fiduciary's decision will result in an abuse of the fiduciary's discretion. If the  
22 petition describes the proposed fiduciary's decision and contains sufficient information to inform  
23 the beneficiaries of the reasons for the proposal, the facts upon which the fiduciary relies, and an

1 explanation of how the beneficiaries will be affected by the proposed fiduciary's decision, a  
2 beneficiary who challenges the proposed fiduciary's decision has the burden of establishing that  
3 it will result in an abuse of discretion.

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

6 **SECTION 203. FIDUCIARY'S POWER TO ADJUST.**

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

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

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

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

18 (e) A fiduciary may not exercise the power to adjust under subsection (a):

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

23 (2) that changes the actuarial value of a beneficiary's interest in a trust to which a

1 person transferred property if the value of the property for federal gift tax purposes or the  
2 qualification of the transfer in whole or in part for a federal gift tax annual exclusion was based  
3 on that actuarial value, except to the extent the adjustment is made to provide for a reasonable  
4 apportionment of the total return of the trust;

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

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

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

11 (6) if possessing or exercising the power to make the adjustment causes all or part  
12 of the value of the trust assets to be included for federal estate tax purposes in the gross estate of  
13 an individual who has the power to remove a fiduciary or appoint a fiduciary, or both;

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

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

21 (9) if the fiduciary is not an independent person; or

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

23 (f) If paragraph (5), (6), (7), (8), or (9) of subsection (e) applies to a fiduciary:

1           (1) a co-fiduciary to which the paragraph does not apply may make the adjustment  
2 unless the exercise of the power by the remaining co-fiduciary or co-fiduciaries is not permitted  
3 by the terms of the trust; or

4           (2) if there is no co-fiduciary to which the paragraph does not apply, the fiduciary  
5 may appoint a co-fiduciary to which the paragraph does not apply, and that appointed do-  
6 fiduciary may make the adjustment.

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

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

20           (i) Terms of the trust that limit the power of a fiduciary to make an adjustment between  
21 income and principal do not affect the application of this section unless the terms of the trust  
22 expressly deny the fiduciary the power of adjustment under subsection (a).

23           (j) The power of adjustment under subsection (a):

1 (1) may be exercised at any time before the end of the accounting period to which  
2 it applies or the immediately subsequent accounting period; and

3 (2) may apply to the accounting period in which it is exercised, the immediately  
4 past accounting period, and to one or more subsequent accounting periods.

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

6 (1) included in the report, if any, that is sent to beneficiaries under [Section  
7 813(c)] of [the Uniform Trust Code]; or

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

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

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

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

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

30 In any event, Section 203(f) allows an adjustment to be made by a qualified co-trustee or

1 co-trustees when the other co-trustee or co-trustees is or are disqualified. Whether two or more  
2 qualified co-trustees must act unanimously or by majority vote or in some other way is left to  
3 general rules of trust law or the particular governing instrument.

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

11 **[ARTICLE] 3**

12 **UNITRUST**

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

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

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

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

20 (4) "Special tax benefit" means:

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

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

1 the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section 1361(a)(1)][, as amended];

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

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

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

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

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

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

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

1 with respect to the trust.

2 (5) “Unitrust” means a trust:

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

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

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

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

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

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

13

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

15 (a) This [article] applies to a trust that is not a unitrust, unless:

16 (1) the trust is a trust described in Section 170(f)(2)(B), 642(c)(5), 664(d),  
17 2702(a)(3), or 2702(b) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section  
18 170(f)(2)(B), 642(c)(5), 664(d), 2702(a)(3), or 2702(b)][, as amended]; or

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

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

23 (1) the trust is a trust described in Section 170(f)(2)(B), 642(c)(5), 664(d),  
24 2702(a)(3), or 2702(b) of the Internal Revenue Code of 1986[, as amended][, 26 U.S.C. Section

1 170(f)(2)(B), 642(c)(5), 664(d), 2702(a)(3), or 2702(b)][, as amended]; or

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

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

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

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

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

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

3  
4 **SECTION 303. AUTHORITY OF FIDUCIARY.**

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

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

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

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

12 and

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

15 (B) if the trust is a unitrust:

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

18 or

19 (ii) that the percentage or method used to calculate the unitrust  
20 amount will be changed as stated in the unitrust policy;

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

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

24 (4) at least one member of each class[ of qualified beneficiaries] receiving the

1 notice under paragraph (2) is:

2 (A) legally competent; [or]

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

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

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

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

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

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

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

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

22 (e) In deciding whether and how to take an action authorized by this section, or whether  
23 and how to respond to a request by a beneficiary under subsection (d) or a petition by a

1 beneficiary under subsection (d)(2), a fiduciary shall consider all factors relevant to the trust and  
2 its beneficiaries, including the relevant factors in Section 201(c).

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

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

9 **Alternative A (UTC)**

10 **SECTION 304. NOTICE.**

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

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

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

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

20 (B) excluding a:

21 (i) power of appointment;

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

24 (iii) power of a beneficiary over a trust to the extent the exercise or  
25 nonexercise of the power affects the beneficial interest of the beneficiary or another beneficiary

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

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

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

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

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

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

14 (2) a copy of the unitrust policy under Section 303(a)(1);

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

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

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

22 (6) the name and contact information of the fiduciary; and

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

1 additional information.

2 **Alternative B (no UTC)**

3 **SECTION 304. NOTICE.**

4 (a) A notice required by Section 303(a)(2) must be sent to:

5 (1) all beneficiaries that receive or are entitled to receive income from the trust or  
6 are entitled to receive a distribution of principal if the trust is terminated at the time the notice is  
7 sent, assuming no power of appointment is exercised; and

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

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

13 (B) excluding a:

14 (i) power of appointment;

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

17 (iii) power of a beneficiary over a trust to the extent the exercise or  
18 nonexercise of the power affects the beneficial interest of the beneficiary or another beneficiary  
19 represented by the beneficiary with respect to the exercise or nonexercise of the power; and

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

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

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

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

6 (2) a copy of the unitrust policy under Section 303(a)(1);

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

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

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

14 (6) the name and contact information of the fiduciary; and

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

17 **End of Alternatives**

18 **Legislative Note:** Use Alternative A if your state has enacted the Uniform Trust Code. Use  
19 Alternative B if your state has not enacted the Uniform Trust Code.

20  
21 *In states in which the constitution, or other law, does not permit the phrase “as*  
22 *amended” when federal statutes are incorporated into state law, the phrase should be omitted.*  
23 *Modify Section 304(a)(2) to refer to the Uniform Directed Trust Act or modify that provision*  
24 *appropriately if your state has not adopted the Uniform Directed Trust Act.*

25 **SECTION 305. UNITRUST POLICY.**

26 (a) In administering a unitrust under this [article], the fiduciary shall follow a unitrust

1 policy adopted under Section 303(a)(1).

2 (b) A unitrust policy must provide for:

3 (1) the unitrust rate or the method for determining the unitrust rate under Section  
4 306;

5 (2) the method for determining the applicable value under Section 307; and

6 (3) all rules identified in Sections 306 through 309 that will apply in the  
7 administration of the unitrust, whether those rules are:

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

9 (B) optional, as set forth in Sections 306, 307(b) through (d), 308(b), and  
10 309, to the extent that the fiduciary elects to adopt those rules.

11 **SECTION 306. UNITRUST RATE.**

12 (a) A unitrust rate may be:

13 (1) a fixed unitrust rate; or

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

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

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

18 (b) A unitrust policy may provide for:

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

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

23 (3) a limit on how much the unitrust rate determined under subsection (a)(2) may

1 increase over the unitrust rate for the previous period or a mathematical blend of unitrust rates  
2 over a stated number of previous periods;

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

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

8 **SECTION 307. APPLICABLE VALUE.**

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

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

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

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

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

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

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

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

23 (5) identification and treatment of cash or property held for distribution in

1 determining the fair market value of the assets of the trust.

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

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

6 (2) use of another mathematical blend of fair market values over a stated number  
7 of previous periods;

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

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

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

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

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

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

18 (5) the treatment of accrued income and other features of an asset which affect  
19 value.

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

1           **SECTION 308. PERIOD.**

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

- 4                   (1) a calendar year;
- 5                   (2) a 12-month period other than a calendar year;
- 6                   (3) a calendar quarter;
- 7                   (4) a three-month period other than a calendar quarter; or
- 8                   (5) another period;

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

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

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

- 15                               (A) the trust has not been in existence for the previous periods; or
- 16                               (B) fair market values are not available; or

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

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

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

- 22                   (1) determining the timing of distributions;
- 23                   (2) making distributions in cash or in kind or partly in cash and partly in kind; or

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

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

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

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

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

10 (3) no other provision of Sections 306 through 308 applies, except Sections  
11 307(a), (b)(4) and (5), (c)(1), and (d) and 308(b)(2)(A) and (3).

## 12 Comment

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## 19 [ARTICLE] 4

### 20 ALLOCATION OF RECEIPTS DURING ADMINISTRATION

#### 21 [PART 1

#### 22 RECEIPTS FROM ENTITIES]

#### 23 SECTION 401. CHARACTER OF RECEIPTS FROM ENTITIES.

24 (a) In this section:

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

1 attribute or action attributed to an entity in this section includes an attribute or action of any other  
2 entity in which the entity owns or holds an interest, including an interest owned indirectly  
3 through another entity or entities.

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

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

9 (c) A fiduciary shall allocate to principal:

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

11 (A) money; or

12 (B) personal property of nominal value;

13 (2) money received in one entity distribution or in an entity distribution that  
14 information known to the fiduciary or provided to the fiduciary by or on behalf of the entity  
15 indicates is part of a series of related entity distributions:

16 (A) in exchange for part or all of the fiduciary’s interest in the entity; or

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

18 (3) money received in an entity distribution from an entity that is:

19 (A) a regulated investment company or a real estate investment trust if the  
20 money received in the entity distribution is a capital gain dividend for federal income tax  
21 purposes; or

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

1 (d) A fiduciary may determine that money received in an entity distribution is a return of  
2 capital to the extent it exceeds the sum of the amounts the fiduciary determines or estimates are:

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

4 (2) the amount of income tax the fiduciary and the beneficiaries have paid or must  
5 pay on the taxable income of the entity.

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

8 (1) all or part of the business or other activity conducted by the entity;

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

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

14 (f) If the entity's primary activity is to invest in assets for the purpose of realizing gain on  
15 the disposition of all or some of those assets, a fiduciary may determine that money received in  
16 an entity distribution is a return of capital to the extent it represents the excess of the proceeds of  
17 the entity's sale or other disposition of one or more assets over the gain realized on the sale or  
18 other disposition.

19 (g) If subsections (d) through (f) do not apply, a fiduciary may determine that money  
20 received in an entity distribution is a return of capital if the total amount of money and property  
21 received in one entity distribution or in an entity distribution that information known to the  
22 fiduciary or provided to the fiduciary by or on behalf of the entity indicates is part of a series of  
23 related entity distributions is greater than 20 percent of the fair market value of the entity.

1 (h) In determining if and to what extent an entity distribution not described in subsections  
2 (c) through (g) is a return of capital, a fiduciary may consider:

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

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

8 (3) the amount of money the entity has accumulated during the fiduciary's  
9 accounting period in which the entity distribution is made and the three prior accounting periods,  
10 to the extent that the governing body of the entity has decided the money is no longer needed for  
11 the business or investment needs of the entity;

12 (4) the amount of income tax that the fiduciary and the beneficiaries have paid  
13 from income and from principal on the undistributed income of the entity received during the  
14 fiduciary's three accounting periods before the accounting period in which the entity distribution  
15 is made;

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

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

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

1 and the three prior accounting periods.

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

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

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

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

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

15 (1) information in the fiduciary's possession indicates that the information  
16 provided by or on behalf of the entity is or may be incorrect, or

17 (2) the fiduciary owns more than 50 percent of the voting interest in the entity.

18 (l) If a fiduciary receives additional information about the application of this section to an  
19 entity distribution after the time described in subsection (j) but before the fiduciary has paid part  
20 of the entity distribution to a beneficiary, the fiduciary shall consider the additional information  
21 before making the payment to the beneficiary and may change a decision to make the payment to  
22 the beneficiary.

23 (m) If the fiduciary receives additional information about the application of this section to

1 an entity distribution after the fiduciary has paid part of the entity distribution to a beneficiary,  
2 the fiduciary is not required to change or recover the payment to the beneficiary, but may take  
3 that information into account in determining whether to make an adjustment under Section 203.

4 **Comment**

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

9  
10 **SECTION 402. DISTRIBUTION FROM TRUST OR ESTATE.** A fiduciary shall  
11 allocate to income an amount received as a distribution of income, including a unitrust  
12 distribution under [Article] 3, from a trust or an estate in which the fiduciary has an interest other  
13 than an interest the fiduciary purchased, and shall allocate to principal an amount received as a  
14 distribution of principal from such a trust or estate. If a fiduciary purchases an interest in a trust  
15 that is an investment entity, or a decedent or donor transfers an interest in such a trust to a  
16 fiduciary, Section 401, 414, or 415 applies to a receipt from the trust.

17 **SECTION 403. BUSINESS AND OTHER ACTIVITIES CONDUCTED BY**  
18 **FIDUCIARY.**

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

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

24 (2) conducting the business or other activity through an entity described in Section  
25 401, whether or not the entity is a taxpayer for federal income tax purposes.

1 (b) A fiduciary that accounts separately for a business or other activity under this section  
2 shall maintain separate accounting records for the transactions of the business or other activity,  
3 whether or not assets of the business or other activity are segregated from other assets held by the  
4 fiduciary.

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

6 (1) may determine:

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

9 (i) working capital,

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

11 (iii) other reasonably foreseeable needs of the business or other  
12 activity; and

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

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

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

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

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

23 (2) farming;

- 1 (3) raising and selling livestock and other animals;
- 2 (4) management of rental properties;
- 3 (5) extraction of minerals and other natural resources;
- 4 (6) timber operations;
- 5 (7) activities to which Section 413 applies; and
- 6 (8) other operating businesses.

7 **Comment**

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

18  
19 **[PART 2**

20 **RECEIPTS NOT NORMALLY APPORTIONED]**

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

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

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

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

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

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

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

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

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

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

18 (a) This section does not apply to an obligation to which Section 408, 409, 410, 411, 413,  
19 414, or 415 applies.

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

23 (c) A fiduciary shall allocate to principal an amount received from the sale, redemption, or

1 other disposition of an obligation to pay money to the fiduciary more than one year after it is  
2 acquired by the fiduciary, including an obligation whose purchase price or value when it is  
3 acquired is less than its value at maturity. If the obligation matures not later than one year after it  
4 is acquired by the fiduciary, an amount received that exceeds its purchase price or its value when  
5 acquired by the fiduciary must be allocated to income.

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

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

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

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

16 **[PART 3**

17 **RECEIPTS NORMALLY APPORTIONED]**

18 **SECTION 408. DEFERRED COMPENSATION, ANNUITIES, AND SIMILAR**  
19 **PAYMENTS.**

20 (a) In this section:

21 (1) "Payment" means an amount a fiduciary may receive over a fixed number of  
22 years or during the life of one or more individuals because of services rendered or property  
23 transferred to the payor in exchange for future receipts. The term includes an amount drawn in

1 money or property from the payor's general assets or from a separate fund created by the payor.  
2 The term also includes an amount drawn from any separate fund, regardless of the reason for the  
3 withdrawal.

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

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

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

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

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

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

20 (d) If a fiduciary cannot determine the internal income of a separate fund but can  
21 determine the value of the separate fund, the internal income of the separate fund is deemed to  
22 equal [insert number at least three percent and not more than five percent] of the fund's value,  
23 according to the most recent statement of value preceding the beginning of the accounting period.

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

6 **SECTION 409. CERTAIN ILLIQUID ASSETS.**

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

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

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

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

20 **Comment**

21 **Prior Acts.** As stated in a Comment to the 1997 Act, Section 11 of the 1962 Act allocates  
22 receipts from "property subject to depletion" to income in an amount "not in excess of 5%" of  
23 the asset's inventory value. The 1931 Act has a similar 5% rule that applies when the trustee is  
24 under a duty to change the form of the investment. The 5% rule imposes on a trust the obligation  
25 to pay a fixed annuity to the current income beneficiary until the asset is exhausted. Under both

1 the 1931 and 1962 Acts the balance of each year's receipts is added to principal. A fixed payment  
2 can produce unfair results. The remainder beneficiary receives all of the receipts from unexpected  
3 growth in the asset, e.g., if royalties on a patent or copyright increase significantly. Conversely, if  
4 the receipts diminish more rapidly than expected, most of the amount received by the trust will  
5 be allocated to income and little to principal. Moreover, if the annual payments remain the same  
6 for the life of the asset, the amount allocated to principal will usually be less than the original  
7 inventory value. For these reasons, Section 810 of the 1997 Act abandoned the annuity approach  
8 under the 5% rule, but required that 10% of the receipts from a "liquidating asset" be allocated to  
9 income and the balance to principal. Section 409 generally expands this treatment to any volatile  
10 or otherwise "illiquid" asset, as defined, but allows the trustee to select a percentage other than  
11 10% under subsection (c). This is consistent with the greater flexibility contemplated by the  
12 current act and recognizes that a fixed percentage can be arbitrary.

13

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

15 (a) To the extent a fiduciary does not account for receipts from an interest in minerals,  
16 water, or other natural resources as a business under Section 403, the fiduciary shall allocate the  
17 receipts as follows:

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

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

23 (3) If received as a royalty, shut-in-well payment, take-or-pay payment, or bonus, a  
24 receipt must be allocated between income and principal equitably.

25 (4) If an amount is received from a working interest or any other interest not  
26 provided for in subsection (1), (2), or (3), a receipt must be allocated between income and  
27 principal equitably.

28 (b) An amount received on account of an interest in water that is renewable must be  
29 allocated to income. If the water is not renewable, the receipt must be allocated between income

1 and principal equitably.

2 (c) This [act] applies whether or not a decedent or transferor was extracting minerals,  
3 water, or other natural resources before the interest was owned or held by a fiduciary.

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

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

13 **SECTION 411. TIMBER.**

14 (a) To the extent a fiduciary does not account for receipts from the sale of timber and  
15 related products as a business under Section 403, the fiduciary shall allocate the net receipts:

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

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

21 (3) between income and principal if the net receipts are from the lease of land  
22 used for growing or cutting timber or from a contract to cut timber from land, by determining the  
23 amount of timber removed from the land under the lease or contract and applying the rules in

1 paragraphs (1) and (2); or

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

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

6 (c) This [act] applies whether or not a decedent or transferor was harvesting timber from  
7 the property before it was owned or held by a fiduciary.

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

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

17 **SECTION 412. MARITAL DEDUCTION PROPERTY NOT PRODUCTIVE OF**  
18 **INCOME.**

19 (a) The transferor's spouse may require the trustee of a trust for which a gift or estate tax  
20 marital deduction was allowed to make property productive of income, convert property to  
21 productive property within a reasonable time, or exercise the power conferred by Section 203 to  
22 the extent the trust assets otherwise do not provide the transferor's spouse with sufficient income  
23 from or use of the trust assets to qualify for the deduction. The trustee may decide which action

1 or combination of actions to take.

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

5 **SECTION 413. DERIVATIVES AND OPTIONS.**

6 (a) In this section, “derivative” means a contract, instrument, other arrangement, or  
7 combination of contracts, instruments, or other arrangements, the value, rights, and obligations of  
8 which are, in whole or in part, dependent on or derived from an underlying tangible or intangible  
9 asset, group of tangible or intangible assets, index, or occurrence of an event. The term includes  
10 stocks, fixed income securities, other financial instruments, and arrangement based on indices,  
11 commodities, interest rates, weather-related events, and credit default events.

12 (b) To the extent a fiduciary does not account for a transaction in derivatives as a business  
13 under Section 403, the fiduciary shall allocate 10 percent of receipts from the transaction and  
14 disbursements made in connection with the transaction to income, and the balance to principal.

15 (c) If a fiduciary grants an option to buy property from the trust, whether or not the trust  
16 owns the property when the option is granted, grants an option that permits another person to sell  
17 property to the trust, or acquires an option to buy property for the trust or an option to sell an  
18 asset owned by the trust, and the fiduciary or other owner of the asset is required to deliver the  
19 asset if the option is exercised, the fiduciary shall allocate the following amounts 10 percent to  
20 income and the balance to principal:

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

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

23 (3) gain or loss realized upon the exercise, exchange, settlement, offset, closing, or

1 expiration of the option.

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

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

9 (b) If a fiduciary receives a payment from interest or other current return and from other  
10 proceeds of the collateral financial assets, the fiduciary shall allocate to income the part of the  
11 payment the payor identifies as being from interest or other current return and shall allocate the  
12 balance of the payment to principal.

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

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

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

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

1 **Comment**

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

5  
6 **SECTION 416. INSUBSTANTIAL ALLOCATIONS NOT REQUIRED.** If a

7 fiduciary determines that an allocation between income and principal required by Section 408,  
8 409, 410, 411, or 414 is insubstantial, the fiduciary may allocate the entire amount to principal,  
9 unless Section 203(e) applies to the allocation. This power may be exercised by a co-fiduciary in  
10 the circumstances described in Section 203(f) and may be released or delegated for the reasons  
11 and in the manner described in Section 203(h). An allocation is presumed to be insubstantial if:

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

14 (2) the asset producing the receipt to be allocated has a fair market value less than 10  
15 percent of the total fair market value of the assets owned or held by the fiduciary at the beginning  
16 of the accounting period.

17 **[ARTICLE] 5**

18 **ALLOCATION OF DISBURSEMENTS DURING ADMINISTRATION**

19 **SECTION 501. DISBURSEMENTS FROM INCOME.** A fiduciary shall make the

20 following disbursements from income to the extent they are not disbursements to which Section  
21 601(c)(2) or (3) applies:

22 (1) one-half of:

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

25 (B) all expenses for accountings, judicial and nonjudicial proceedings, or

- 1 other matters that involve both the income and remainder interests;
- 2 (2) the balance of the disbursements described in paragraph (1) to the extent a  
3 fiduciary that is an independent person determines that making those disbursements from income  
4 would be in the interests of the beneficiaries because principal is illiquid or otherwise;
- 5 (3) all the other ordinary expenses incurred in connection with the administration,  
6 management, or preservation of property and the distribution of income, including interest,  
7 ordinary repairs, regularly recurring taxes assessed against principal, and expenses of a  
8 proceeding or other matter that concerns primarily the income interest; and
- 9 (4) premiums on insurance covering the loss of a principal asset or the loss of  
10 income from or use of the asset.

11 **Comment**

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

15  
16 **SECTION 502. DISBURSEMENTS FROM PRINCIPAL.**

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

- 18 (1) the remaining one-half of the disbursements described in Section 501(1) after  
19 application of Section 501(2);
- 20 (2) all the fiduciary's compensation calculated on principal as a fee for acceptance,  
21 distribution, or termination, and disbursements made to prepare for or execute a sale or other  
22 disposition of the property;
- 23 (3) payments on the principal of a trust debt;
- 24 (4) expenses of a proceeding that concerns primarily principal, including a  
25 proceeding to construe the trust or to protect the trust or its property;

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

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

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

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

16 **SECTION 503. TRANSFERS FROM INCOME TO PRINCIPAL FOR**  
17 **DEPRECIATION.**

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

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

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

1 enjoyment of a beneficiary; or

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

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

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

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

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

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

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

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

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

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

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

4 **SECTION 505. TAXES ON INCOME.**

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

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

10 (c) A tax required to be paid by a fiduciary on the fiduciary's share of an entity's taxable  
11 income must be paid:

12 (1) from income and principal proportionately to the allocation of receipts from  
13 the entity between income and principal; and

14 (2) from principal to the extent that the tax exceeds the total receipts from the  
15 entity.

16 (d) After applying subsections (a) through (c), the fiduciary shall adjust income or  
17 principal receipts to the extent that the fiduciary's taxes are reduced because of a deduction for  
18 payments made to a beneficiary.

19 **Comment**

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

1 reasonably productive of income cures any marital deduction issue.

2

3

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

4

**BECAUSE OF TAXES.**

5

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

6

of economic interests or tax benefits between current income beneficiaries and successor

7

beneficiaries that arise from:

8

(1) elections and decisions, other than those described in subsection (b), the

9

fiduciary makes from time to time regarding tax matters;

10

(2) an income tax or any other tax that is imposed upon the fiduciary or a

11

beneficiary as a result of a transaction involving the fiduciary or a distribution made by the

12

fiduciary; or

13

(3) the ownership by a fiduciary of an interest in an entity whose taxable income,

14

whether or not distributed, is includable in the taxable income of the fiduciary or a beneficiary.

15

(b) If the amount of an estate tax marital deduction or charitable contribution deduction is

16

reduced because a fiduciary deducts an amount paid from principal for income tax purposes

17

instead of deducting it for estate tax purposes, and as a result estate taxes paid from principal are

18

increased and income taxes paid by a fiduciary or beneficiary are decreased, each fiduciary or

19

beneficiary that benefits from the decrease in income tax shall reimburse the principal from

20

which the increase in estate tax is paid. The total reimbursement must equal the increase in the

21

estate tax to the extent the principal used to pay the increase would have qualified for a marital

22

deduction or charitable contribution deduction but for the payment. The proportionate share of

23

the reimbursement for each fiduciary or beneficiary whose income taxes are reduced must be the

24

same as its proportionate share of the total decrease in income tax. A fiduciary shall reimburse

1 principal from income.

## 2 **Comment to 1997 Act**

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

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

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



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

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

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

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

1 required to be paid under a will.

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

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

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

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

1 distribution, is entitled, as of each distribution date, to the net income the fiduciary has received  
2 after the date of the decedent's death or an income interest's terminating event or previous  
3 distribution date.

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

5 (1) The beneficiary is entitled to receive a part of the net income equal to the  
6 beneficiary's fractional interest in the undistributed principal assets immediately before the  
7 distribution date.

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

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

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

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

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

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

22 (d) A fiduciary may apply the rules in this section, to the extent the fiduciary considers it  
23 appropriate, to net gain or loss realized after the date of the decedent's death or an income

1 interest's terminating event or earlier distribution date from the disposition of a principal asset if  
2 this section applies to the income from the asset.

3 **Comment**

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

9 **[ARTICLE] 7**

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

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

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

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

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

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

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

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

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

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

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

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

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

10 (a) A fiduciary shall allocate an income receipt or disbursement, other than one to which  
11 Section 601(b) applies, to principal if its due date occurs:

12 (1) before the date on which a decedent dies in the case of an estate; or

13 (2) before the date on which an income interest begins in the case of a trust or  
14 successive income interest.

15 (b) If the due date of a periodic income receipt or disbursement occurs on or after the date  
16 on which a decedent dies or an income interest begins, the receipt or disbursement must be  
17 allocated to income.

18 (c) If an income receipt or disbursement is not periodic or has no due date, it must be  
19 treated as accruing from day to day. The part of the receipt or disbursement accruing before the  
20 date on which a decedent dies or an income interest begins must be allocated to principal, and the  
21 balance must be allocated to income.

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

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

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

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

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

7 **Comment**

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

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

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

24 (b) When a mandatory income interest of a beneficiary ends, the fiduciary shall pay the  
25 beneficiary’s share of the undistributed income that is not disposed of under the terms of the trust  
26 to:

27 (1) a mandatory income beneficiary who survives that date; or

28 (2) the estate of the deceased mandatory income beneficiary whose death causes

1 the interest to end.

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

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

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

7 (c) When a fiduciary's obligation to pay a fixed annuity or a fixed fraction of the value of  
8 assets ends, the fiduciary shall prorate the final payment as required to preserve an income tax,  
9 gift tax, estate tax, or other tax benefit.

10 **Comment**

11 **Prior Acts.** Both the 1931 Act (Section 4) and the 1962 Act (Section 4(d)) provide that a  
12 deceased income beneficiary's estate is entitled to the undistributed income. In a Comment to  
13 Section 303 of the 1997 Act, the 1997 Drafting Committee stated that this is probably not what  
14 most settlors would want, and that, with respect to undistributed income, most settlors would  
15 favor the income beneficiary first, the remainder beneficiaries second, and the income  
16 beneficiary's heirs last, if at all. It decided not to eliminate this provision, however, to avoid  
17 causing disputes about whether the trustee should have distributed collected cash before the  
18 income beneficiary died.

19  
20 The current Drafting Committee is not as sure that the estate rule is not what most settlors  
21 would want. The estate rule may actually fit best with the paradigm of a beneficiary who incurs  
22 bills, like credit card charges and unreimbursed medical expenses, that are paid in arrears from  
23 trust distributions. At the other end of the wealth spectrum, payment to the estate might create an  
24 avoidable increment of estate tax as well as an administrative burden, but those situations would  
25 typically entail more sophisticated estate planning that can draft around that. Moreover, the estate  
26 rule would avoid the pressure to make or demand income distributions at more frequent intervals  
27 in order to keep the distributions more current up to the date of death. The payment of "stub  
28 income" to the income beneficiary's estate also provides better protection in cases where tax  
29 rules require a beneficiary to receive income "for life."  
30  
31

1 [ARTICLE] 8

2 MISCELLANEOUS PROVISIONS

3 SECTION 801. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In

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

6 SECTION 802. APPLICATION OF [ACT] TO EXISTING TRUSTS AND

7 ESTATES. This [act] applies to a trust or estate existing on [the effective date of this [act]],  
8 except as otherwise expressly provided in the terms of the trust or in this [act].

9 [SECTION 803. SEVERABILITY CLAUSE. If any provision of this [act] or its

10 application to any person or circumstance is held invalid, the invalidity does not affect other  
11 provisions or applications of this [act] which can be given effect without the invalid provision or  
12 application, and to this end the provisions of this [act] are severable.]

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

15 SECTION 804. REPEALS; CONFORMING AMENDMENTS.

16 (a) . . . .

17 (b) . . . .

18 (c) . . . .

19 SECTION 805. EFFECTIVE DATE. This act takes effect . . .