
SENATE BILL 6267

State of Washington 57th Legislature

2002 Regular Session

By Senators Johnson and Kline

Read first time 01/14/2002. Referred to Committee on Judiciary.

1 AN ACT Relating to the principal and income act; adding new
2 sections to chapter 11.104 RCW; repealing RCW 11.104.010, 11.104.020,
3 11.104.030, 11.104.040, 11.104.050, 11.104.060, 11.104.070, 11.104.071,
4 11.104.080, 11.104.090, 11.104.100, 11.104.110, 11.104.120, 11.104.130,
5 11.104.900, 11.104.901, 11.104.910, 11.104.920, 11.104.930, and
6 11.104.940; and providing an effective date.

7 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

8 **ARTICLE 1**
9 **DEFINITIONS; FIDUCIARY DUTIES AND POWERS; REMEDIES**

10 NEW SECTION. **Sec. 101.** SHORT TITLE. This act may be cited as the
11 Washington uniform principal and income act of 2002.

12 NEW SECTION. **Sec. 102.** DEFINITIONS. In this act:

13 (1) "Accounting period" means a calendar year unless another
14 twelve-month period is selected by a fiduciary. The term includes a
15 portion of a calendar year or other twelve-month period that begins
16 when an income interest begins or ends when an income interest ends.

1 (2) "Beneficiary" includes, in the case of a decedent's estate, an
2 heir, legatee, and devisee and, in the case of a trust, an income
3 beneficiary and a remainder beneficiary.

4 (3) "Fiduciary" means a personal representative or a trustee. The
5 term includes an executor, administrator, successor personal
6 representative, special administrator, and a person performing
7 substantially the same function.

8 (4) "Income" means money or property that a fiduciary receives as
9 current return from a principal asset. The term includes a portion of
10 receipts from a sale, exchange, or liquidation of a principal asset, to
11 the extent provided in Article 4 of this act.

12 (5) "Income beneficiary" means a person to whom net income of a
13 trust is or may be payable.

14 (6) "Income interest" means the right of an income beneficiary to
15 receive all or part of net income, whether the terms of the trust
16 require it to be distributed or authorize it to be distributed in the
17 trustee's discretion.

18 (7) "Mandatory income interest" means the right of an income
19 beneficiary to receive net income that the terms of the trust require
20 the fiduciary to distribute.

21 (8) "Net income" means the total receipts allocated to income
22 during an accounting period minus the disbursements made from income
23 during the period, plus or minus transfers under this act to or from
24 income during the period.

25 (9) "Person" means an individual, corporation, business trust,
26 estate, trust, partnership, limited liability company, association,
27 joint venture, or government; governmental subdivision, agency, or
28 instrumentality; public corporation; or any other legal or commercial
29 entity.

30 (10) "Principal" means property held in trust for distribution to
31 a remainder beneficiary.

32 (11) "Remainder beneficiary" means a person entitled to receive
33 principal, including when an income interest ends.

34 (12) "Terms of a trust" means the manifestation of the intent of a
35 settlor or decedent with respect to the trust, expressed in a manner
36 that admits of its proof in a judicial proceeding. The "terms of a
37 trust" shall include without limitation such modifications as may be
38 made from time to time with respect to the trust under chapter 11.96A
39 RCW or otherwise under Washington or applicable federal laws.

1 (13) "Trustee" includes an original, additional, or successor
2 trustee, whether or not appointed or confirmed by a court.

3 NEW SECTION. **Sec. 103.** FIDUCIARY DUTIES; GENERAL PRINCIPLES. (a)
4 In allocating receipts and disbursements to or between principal and
5 income, and with respect to any matter within the scope of this act, a
6 fiduciary:

7 (1) Shall administer a trust or estate in accordance with the terms
8 of the trust or the will, even if there is a different provision in
9 this act;

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

15 (3) Shall administer a trust or estate in accordance with this act
16 if the terms of the trust or the will do not contain a different
17 provision or do not give the fiduciary a discretionary power of
18 administration; and

19 (4) Shall add a receipt or charge a disbursement to principal to
20 the extent that the terms of the trust and this act do not provide a
21 rule for allocating the receipt or disbursement to or between principal
22 and income.

23 (b) In exercising the power to adjust under section 104 (a) or (e)
24 of this act or another discretionary power of administration regarding
25 a matter within the scope of this act, whether granted by the terms of
26 a trust, a will, or this act, a fiduciary shall administer a trust or
27 estate impartially, based on what is fair and reasonable to all of the
28 beneficiaries, except to the extent that the terms of the trust or the
29 will clearly manifest an intention that the fiduciary shall or may
30 favor one or more of the beneficiaries. A determination in accordance
31 with this act is presumed to be fair and reasonable to all of the
32 beneficiaries.

33 NEW SECTION. **Sec. 104.** FIDUCIARY'S POWER TO ADJUST. (a) A
34 trustee may adjust between principal and income to the extent the
35 trustee considers necessary if the trustee invests and manages trust
36 assets as a prudent investor, the terms of the trust describe the
37 amount that may or must be distributed to a beneficiary by referring to

1 the trust's income, and the trustee determines, after applying the
2 rules in section 103(a) of this act, that the trustee is unable to
3 comply with section 103(b) of this act.

4 (b) In deciding whether and to what extent to exercise the power
5 conferred by subsection (a) of this section, a trustee shall consider
6 all factors relevant to the trust and its beneficiaries, including the
7 following factors to the extent they are relevant:

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

9 (2) The intent of the settlor;

10 (3) The identity and circumstances of the beneficiaries;

11 (4) The needs for liquidity, regularity of income, and preservation
12 and appreciation of capital;

13 (5) The assets held in the trust; the extent to which they consist
14 of financial assets, interests in closely held enterprises, tangible
15 and intangible personal property, or real property; the extent to which
16 an asset is used by a beneficiary; and whether an asset was purchased
17 by the trustee or received from the settlor;

18 (6) The net amount allocated to income under the other sections of
19 this act and the increase or decrease in the value of the principal
20 assets, which the trustee may estimate as to assets for which market
21 values are not readily available;

22 (7) Whether and to what extent the terms of the trust give the
23 trustee the power to invade principal or accumulate income or prohibit
24 the trustee from invading principal or accumulating income, and the
25 extent to which the trustee has exercised a power from time to time to
26 invade principal or accumulate income;

27 (8) The actual and anticipated effect of economic conditions on
28 principal and income and effects of inflation and deflation; and

29 (9) The anticipated tax consequences of an adjustment.

30 (c) A trustee may not make an adjustment:

31 (1) That diminishes the income interest in a trust that requires
32 all of the income to be paid at least annually to a spouse and for
33 which an estate tax or gift tax marital deduction would be allowed, in
34 whole or in part, if the trustee did not have the power to make the
35 adjustment;

36 (2) That reduces the actuarial value of the income interest in a
37 trust to which a person transfers property with the intent to qualify
38 for a gift tax exclusion;

1 (3) That changes the amount payable to a beneficiary as a fixed
2 annuity or a fixed fraction of the value of the trust assets;

3 (4) From any amount that is permanently set aside for charitable
4 purposes under a will or the terms of a trust unless both income and
5 principal are so set aside;

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

11 (6) If possessing or exercising the power to make an adjustment
12 causes all or part of the trust assets to be included for estate tax
13 purposes in the estate of an individual who has the power to remove a
14 trustee or appoint a trustee, or both, and the assets would not be
15 included in the estate of the individual if the trustee did not possess
16 the power to make an adjustment;

17 (7) If the trustee is a beneficiary of the trust; or

18 (8) If the trustee is not a beneficiary, but the adjustment would
19 benefit the trustee directly or indirectly.

20 (d) If subsection (c)(5), (6), (7), or (8) of this section applies
21 to a trustee and there is more than one trustee or an additional
22 trustee who is appointed by a court order, a binding agreement, or
23 otherwise under chapter 11.96A RCW, a cotrustee to whom the provision
24 does not apply may make the adjustment unless the exercise of the power
25 by the remaining trustee or trustees is not permitted by the terms of
26 the trust.

27 (e) A personal representative serving with nonintervention powers
28 under chapter 11.68 RCW may adjust between principal and income to the
29 extent the personal representative considers necessary, if the personal
30 representative invests and manages assets of the estate as a prudent
31 investor and the personal representative determines, after applying the
32 rules of section 103(a) of this act, that the personal representative
33 is unable to comply with section 103(b) of this act. In deciding
34 whether and to what extent to exercise the power conferred by this
35 subsection, the personal representative shall consider all factors
36 relevant to the estate and its beneficiaries, including factors
37 comparable to those a trustee would consider under subsection (b) of
38 this section if considering such an adjustment. A personal
39 representative may not make an adjustment under circumstances

1 comparable to those that are described in subsection (c) of this
2 section and that prohibit a trustee from making such an adjustment,
3 although a copersonal representative, or an additional personal
4 representative who is appointed by a court order, a binding agreement,
5 or otherwise under chapter 11.96A RCW, to whom such limitations do not
6 apply may make the adjustment unless the exercise of the power by the
7 remaining personal representative or personal representatives is not
8 permitted by the terms of a will.

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

19 (g) Terms of a trust that limit the power of a fiduciary to make an
20 adjustment between principal and income do not affect the application
21 of this section unless it is clear from the terms of the trust that the
22 terms are intended to deny the fiduciary the power of adjustment
23 conferred by subsection (a) of this section.

24 (h) Unless a beneficiary has requested the fiduciary in writing
25 that the fiduciary consider an adjustment, nothing in this section
26 imposes a duty on the fiduciary to make an adjustment and the fiduciary
27 is not liable for not considering whether to make an adjustment under
28 this section.

29 NEW SECTION. **Sec. 105.** JUDICIAL CONTROL OF DISCRETIONARY POWERS.

30 (a) A court shall not change a fiduciary's decision to exercise or not
31 to exercise a discretionary power conferred by this act unless it
32 determines that the decision was an abuse of the fiduciary's
33 discretion. A court shall not determine that a fiduciary abused its
34 discretion merely because the court would have exercised the discretion
35 in a different manner or would not have exercised the discretion.

36 (b) The decisions to which subsection (a) of this section apply
37 include:

1 (1) A determination under section 104 (a) or (e) of this act of
2 whether and to what extent an amount should be transferred from
3 principal to income or from income to principal.

4 (2) A determination of: (i) The factors that are relevant to the
5 trust or estate and its beneficiaries; (ii) the extent to which they
6 are relevant; and (iii) the weight, if any, to be given to the relevant
7 factors, in deciding whether and to what extent to exercise the power
8 conferred by section 104 (a) or (e) of this act.

9 (c) If a court determines that a fiduciary has abused its
10 discretion, the remedy is to restore the income and remainder
11 beneficiaries to the positions they would have occupied if the
12 fiduciary had not abused its discretion, according to the following
13 principles:

14 (1) To the extent that the abuse of discretion has resulted in no
15 distribution to a beneficiary or a distribution that is too small, the
16 court may require the fiduciary to distribute from the trust to the
17 beneficiary an amount that the court determines will restore the
18 beneficiary, in whole or in part, to his or her appropriate position.

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

26 (3) To the extent that the court does not restore under (1) and (2)
27 of this subsection the beneficiaries, the trust, or both, to the
28 positions they would have occupied if the fiduciary had not abused its
29 discretion, the court may require the fiduciary to pay an appropriate
30 amount from its own funds to one or more of the beneficiaries or the
31 trust, or both. The fiduciary has no liability under this section
32 unless the beneficiary alleging the abuse of discretion establishes
33 that the fiduciary did not exercise its discretion in good faith and
34 with honest judgment.

35 (d) Upon a petition by the fiduciary, the court having jurisdiction
36 over the trust or estate shall determine whether a proposed exercise or
37 nonexercise by the fiduciary of a discretionary power conferred by the
38 act will result in an abuse of the fiduciary's discretion. If the
39 petition describes the proposed exercise or nonexercise of the power

1 and contains sufficient information to inform the beneficiaries of the
2 reasons for the proposal, the facts upon which the fiduciary relies,
3 and an explanation of how the income and remainder beneficiaries will
4 be affected by the proposed exercise or nonexercise of the power, a
5 beneficiary who challenges the proposed exercise or nonexercise has the
6 burden of establishing that it will result in an abuse of discretion.

7 (e) The fiduciary shall be reimbursed for any and all costs,
8 including without limitation all attorneys' fees and costs of defense,
9 and all liabilities that the fiduciary may incur in connection with any
10 claim or action relating in any way to the fiduciary's exercise of its
11 discretion under this act, except to the extent that the beneficiary
12 establishes that the fiduciary did not exercise its discretion in good
13 faith and with honest judgment. All attorneys' fees and costs shall be
14 advanced to the fiduciary as incurred and shall only be collected from
15 the fiduciary after it has been determined that the fiduciary did not
16 exercise its discretion in good faith and with honest judgment.

17 NEW SECTION. Sec. 106. POWER TO CONVERT TO UNITRUST. (a) In this
18 section, "beneficiary" means a person who has an interest in the trust
19 to be converted and who has the legal capacity to act in his, her, or
20 its own right with respect to all actions that such person may take
21 under this section.

22 (b) Unless expressly prohibited by the terms of the trust, a
23 trustee may release the power to make adjustments under section 104 of
24 this act and convert a trust into a unitrust as described in this
25 section if all of the following apply:

26 (1) The trustee determines that the conversion will enable the
27 trustee better to carry out the intent of the settlor or testator and
28 the purposes of the trust.

29 (2) The trustee gives written notice of the trustee's intention to
30 release the power to adjust and to convert the trust into a unitrust
31 and of how the unitrust will operate, including what initial decisions
32 the trustee will make under this section, to all beneficiaries:

33 (i) Who are currently eligible to receive income from the trust; or

34 (ii) Who would receive, if no powers of appointment were exercised,
35 a distribution of principal if the trust were to terminate immediately
36 before the notice is given.

1 (3) There is at least one beneficiary under (2)(i) of this
2 subsection and at least one other person who is a beneficiary under
3 (2)(ii) of this subsection.

4 (4) No beneficiary objects to the conversion to a unitrust in a
5 writing delivered to the trustee within sixty days after the notice is
6 given under (2) of this subsection.

7 (c) The parties, as defined by RCW 11.96A.030(4), may agree to
8 convert a trust to or from a unitrust by means of a binding agreement
9 under chapter 11.96A RCW.

10 (d)(1) The trustee may petition the court under chapter 11.96A RCW
11 to order a conversion to a unitrust if either of the following apply:

12 (i) A party, as defined by RCW 11.96A.030(4), timely objects to the
13 conversion to a unitrust; or

14 (ii) There are no beneficiaries under (2)(i) and (ii) of this
15 subsection.

16 (2) A party, as defined by RCW 11.96A.030(4), may request a trustee
17 to convert to a unitrust. If the trustee does not convert, the party,
18 as defined by RCW 11.96A.030(4), may petition the court to order the
19 conversion.

20 (3) The court shall approve the conversion or direct the requested
21 conversion if the court concludes that the conversion will enable the
22 trustee to better carry out the intent of the settlor or testator and
23 the purposes of the trust.

24 (e) In deciding whether to exercise a power to convert to a
25 unitrust under this section, a trustee may consider, among other
26 things, the factors set forth in section 104(b) of this act.

27 (f) After a trust is converted to a unitrust, all of the following
28 apply:

29 (1) The trustee shall follow an investment policy seeking a total
30 return for the investments held by the trust, whether the return is to
31 be derived:

32 (i) From appreciation of principal;

33 (ii) From earnings and distributions from principal; or

34 (iii) From both.

35 (2) The trustee shall make regular distributions in accordance with
36 the terms of the trust, or the terms of the will, as the case may be,
37 construed in accordance with the provisions of this section.

38 (3) The term "income" in the terms of a trust or a will means an
39 annual distribution, the "unitrust distribution", equal to four

1 percent, the "payout percentage", of the net fair market value of the
2 trust's assets, whether such assets would be considered income or
3 principal under other provisions of this act, averaged over the lesser
4 of:

5 (i) The three preceding years; or

6 (ii) The period during which the trust has been in existence.

7 (g) The trustee may in the trustee's discretion from time to time
8 determine all of the following:

9 (1) The effective date of a conversion to a unitrust.

10 (2) The provisions for prorating a unitrust distribution for a
11 short year in which a beneficiary's right to payments commences or
12 ceases.

13 (3) The frequency of unitrust distributions during the year.

14 (4) The effect of other payments from or contributions to the trust
15 on the trust's valuation.

16 (5) Whether to value the trust's assets annually or more
17 frequently.

18 (6) What valuation dates to use.

19 (7) How frequently to value nonliquid assets and whether to
20 estimate their value.

21 (8) Whether to omit from the calculations trust property occupied
22 or possessed by a beneficiary.

23 (9) Any other matters necessary for the proper functioning of the
24 unitrust.

25 (h)(1) Expenses which would be deducted from income if the trust
26 were not a unitrust may not be deducted from the unitrust distribution.

27 (2) Unless otherwise provided by the terms of the trust, the
28 unitrust distribution shall be paid from net income, as such term would
29 be determined if the trust were not a unitrust. To the extent net
30 income is insufficient, the unitrust distribution shall be paid from
31 net realized short-term capital gains. To the extent net income and
32 net realized short-term capital gains are insufficient, the unitrust
33 distribution shall be paid from net realized long-term capital gains.
34 To the extent net income and net realized short-term and long-term
35 capital gains are insufficient, the unitrust distribution shall be paid
36 from the principal of the trust.

37 (i) The trustee or, if the trustee declines to do so, a beneficiary
38 may petition the court:

39 (1) To select a payout percentage different than four percent.

1 (2) To provide for a distribution of net income, as would be
2 determined if the trust were not a unitrust, in excess of the unitrust
3 distribution if such distribution is necessary to preserve a tax
4 benefit.

5 (3) To average the valuation of the trust's net assets over a
6 period other than three years.

7 (4) To reconvert from a unitrust.

8 (j) Upon a reconversion, the power to adjust under section 104 of
9 this act is revived.

10 (k) A conversion to a unitrust does not affect a provision in the
11 terms of a trust directing or authorizing the trustee to distribute
12 principal or authorizing a beneficiary to withdraw a portion or all of
13 the principal.

14 (l) A trustee may not possess or exercise any power under this
15 section in any of the following circumstances:

16 (1) The unitrust distribution would be made from any amount that is
17 permanently set aside for charitable purposes under the terms of a
18 trust and for which a charitable deduction from a federal gift or
19 estate tax has been taken.

20 (2) The possession or exercise of the power would cause an
21 individual to be treated as the owner of all or part of the trust for
22 federal income tax purposes and the individual would not be treated as
23 the owner if the trustee did not possess or exercise the power.

24 (3) The possession or exercise of the power would cause all or any
25 part of the trust estate to be subject to any federal gift or estate
26 tax with respect to the individual and the trust estate would not be
27 subject to such taxation if the trustee did not possess or exercise the
28 power.

29 (4) The possession or exercise of the power would result in the
30 disallowance of a federal gift or estate tax marital deduction which
31 would be allowed if the trustee did not have the power.

32 (5) The trustee is a beneficiary of the trust.

33 (m) If subsection (1)(2), (3), or (5) of this section applies to a
34 trustee and there is more than one trustee or an additional trustee who
35 is appointed by a court order, a binding agreement, or otherwise under
36 chapter 11.96A RCW, a cotrustee to whom subsection (1)(2), (3), or (5)
37 of this section does not apply may possess and exercise the power
38 unless the possession or exercise of the power by the remaining trustee
39 or trustees is not permitted by the terms of the trust. If subsection

1 (1)(2), (3), or (5) of this section restricts all trustees from
2 possessing or exercising a power under this section, the trustee may
3 petition a court under chapter 11.96A RCW for the court to effect the
4 intended conversion or action.

5 (n) A trustee may release any power conferred by this section if
6 any of the following applies:

7 (1) The trustee is uncertain about whether possessing or exercising
8 the power will cause a result described in subsection (1)(2), (3), or
9 (4) of this section.

10 (2) The trustee determines that possessing or exercising the power
11 will or may deprive the trust of a tax benefit or impose a tax burden
12 not described in subsection (1) of this section.

13 The release may be permanent or for a specified period, including
14 a period measured by the life of an individual.

15 ARTICLE 2

16 DECEDENT'S ESTATE OR TERMINATING INCOME INTEREST

17 NEW SECTION. **Sec. 201.** DETERMINATION AND DISTRIBUTION OF NET
18 INCOME. After a decedent dies, in the case of an estate, or after an
19 income interest in a trust ends, the following rules apply:

20 (1) A fiduciary of an estate or of a terminating income interest
21 shall determine the amount of net income and net principal receipts
22 received from property specifically given to a beneficiary under the
23 rules in Articles 3 through 5 of this act which apply to trustees and
24 the rules in subsection (5) of this section. The fiduciary shall
25 distribute the net income and net principal receipts to the beneficiary
26 who is to receive the specific property.

27 (2) A fiduciary shall determine the remaining net income of a
28 decedent's estate or a terminating income interest under the rules in
29 Articles 3 through 5 of this act which apply to trustees, except to the
30 extent that the following apply:

31 (i) The fiduciary shall include in net income all income from
32 property used to discharge liabilities;

33 (ii) The fiduciary shall pay from income or principal, in the
34 fiduciary's discretion, family allowances; fees of attorneys,
35 accountants, and fiduciaries; court costs and other expenses of
36 administration; and interest on death taxes, but the fiduciary may pay
37 those expenses from income of property passing to a trust for which the

1 fiduciary claims an estate tax marital or charitable deduction only to
2 the extent that the payment of those expenses from income will not
3 cause the reduction or loss of the deduction; and

4 (iii) The fiduciary shall pay from principal all other
5 disbursements made or incurred in connection with the settlement of a
6 decedent's estate or the winding up of a terminating income interest,
7 including debts, funeral expenses, disposition of remains, and death
8 taxes and related penalties that are apportioned to the estate or
9 terminating income interest by the will, the terms of the trust, or
10 applicable law.

11 (3) A fiduciary shall distribute to a beneficiary who receives a
12 pecuniary amount outright the interest or any other amount provided by
13 the will, the terms of a trust, or applicable law from net income
14 determined under subsection (2) of this section or from principal to
15 the extent that net income is insufficient. Otherwise, no outright
16 gift of a pecuniary amount whether under a will, or under a trust after
17 an income interest ends shall receive interest or any other income.

18 (4) A fiduciary shall distribute the net income remaining after
19 distributions required by subsection (3) of this section in the manner
20 described in section 202 of this act to all other beneficiaries,
21 including a beneficiary who receives a pecuniary amount in trust, even
22 if the beneficiary holds an unqualified power to withdraw assets from
23 the trust or other presently exercisable general power of appointment
24 over the trust.

25 (5) A fiduciary may not reduce principal or income receipts from
26 property described in subsection (1) of this section because of a
27 payment described in section 501 or 502 of this act to the extent that
28 the will, the terms of the trust, or applicable law requires the
29 fiduciary to make the payment from assets other than the property or to
30 the extent that the fiduciary recovers or expects to recover the
31 payment from a third party. The net income and principal receipts from
32 the property are determined by including all of the amounts the
33 fiduciary receives or pays with respect to the property, whether those
34 amounts accrued or became due before, on, or after the date of a
35 decedent's death or an income interest's terminating event, and by
36 making a reasonable provision for amounts that the fiduciary believes
37 the estate or terminating income interest may become obligated to pay
38 after the property is distributed.

1 NEW SECTION. **Sec. 202.** DISTRIBUTION TO RESIDUARY AND REMAINDER

2 BENEFCIARIES. (a) Each beneficiary described in section 201(4) of
3 this act is entitled to receive a portion of the net income equal to
4 the beneficiary's fractional interest in undistributed principal
5 assets, using values as of the distribution date. If a fiduciary makes
6 more than one distribution of assets to beneficiaries to whom this
7 section applies, each beneficiary, including one who does not receive
8 part of the distribution, is entitled, as of each distribution date, to
9 the net income the fiduciary has received after the date of death or
10 terminating event or earlier distribution date but has not distributed
11 as of the current distribution date.

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

14 (1) The beneficiary is entitled to receive a portion of the net
15 income equal to the beneficiary's fractional interest in the
16 undistributed principal assets immediately before the distribution
17 date, including assets that later may be sold to meet principal
18 obligations.

19 (2) The beneficiary's fractional interest in the undistributed
20 principal assets must be calculated without regard to property
21 specifically given to a beneficiary and property required to pay
22 pecuniary amounts not in trust.

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

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

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

35 (d) A fiduciary may apply the rules in this section, to the extent
36 that the fiduciary considers it appropriate, to net gain or loss
37 realized after the date of death or terminating event or earlier
38 distribution date from the disposition of a principal asset if this
39 section applies to the income from the asset.

1
2 **ARTICLE 3**

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

4 NEW SECTION. **Sec. 301.** WHEN RIGHT TO INCOME BEGINS AND ENDS. (a)

5 An income beneficiary is entitled to net income from the date on which
6 the income interest begins. An income interest begins on the date
7 specified in the terms of the trust or, if no date is specified, on the
8 date an asset becomes subject to a trust or successive income interest.

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

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

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

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

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

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

26 NEW SECTION. **Sec. 302.** APPORTIONMENT OF RECEIPTS AND

27 DISBURSEMENTS WHEN DECEDENT DIES OR INCOME INTEREST BEGINS. (a) A
28 trustee shall allocate an income receipt or disbursement other than one
29 to which section 201(1) of this act applies to principal if its due
30 date occurs before a decedent dies in the case of an estate or before
31 an income interest begins in the case of a trust or successive income
32 interest.

33 (b) A trustee shall allocate an income receipt or disbursement to
34 income if its due date occurs on or after the date on which a decedent
35 dies or an income interest begins and it is a periodic due date. An
36 income receipt or disbursement must be treated as accruing from day to
37 day if its due date is not periodic or it has no due date. The portion
of the receipt or disbursement accruing before the date on which a

1 decedent dies or an income interest begins must be allocated to
2 principal and the balance must be allocated to income.

3 (c) An item of income or an obligation is due on the date the payer
4 is required to make a payment. If a payment date is not stated, there
5 is no due date for the purposes of this act. Distributions to
6 shareholders or other owners from an entity to which section 401 of
7 this act applies are deemed to be due on the date fixed by the entity
8 for determining who is entitled to receive the distribution or, if no
9 date is fixed, on the declaration date for the distribution. A due
10 date is periodic for receipts or disbursements that must be paid at
11 regular intervals under a lease or an obligation to pay interest or if
12 an entity customarily makes distributions at regular intervals.

13 NEW SECTION. **Sec. 303.** APPORTIONMENT WHEN INCOME INTEREST ENDS.

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

19 (b) When a mandatory income interest ends, the trustee shall pay to
20 a mandatory income beneficiary who survives that date, or the estate of
21 a deceased mandatory income beneficiary whose death causes the interest
22 to end, the beneficiary's share of the undistributed income that is not
23 disposed of under the terms of the trust unless the beneficiary has an
24 unqualified power to revoke more than five percent of the trust
25 principal immediately before the income interest ends. In the latter
26 case, the undistributed income from the portion of the trust that may
27 be revoked must be added to principal.

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

33 **ARTICLE 4**

34 **ALLOCATION OF RECEIPTS DURING ADMINISTRATION OF TRUST**

35 **PART 1: RECEIPTS FROM ENTITIES**

1 NEW SECTION. **Sec. 401.** CHARACTER OF RECEIPTS. (a) In this

2 section, "entity" means a corporation, partnership, limited liability
3 company, regulated investment company, real estate investment trust,
4 common trust fund, or any other organization in which a trustee has an
5 interest. "Entity" does not mean a trust or estate to which section
6 402 of this act applies, a business or activity to which section 403 of
7 this act applies, or an asset-backed security to which section 415 of
8 this act applies.

9 (b) Except as otherwise provided in this section, a trustee shall
10 allocate to income money received from an entity.

11 (c) A trustee shall allocate the following receipts from an entity
12 to principal:

13 (1) Property other than money;

14 (2) Money received in one distribution or a series of related
15 distributions in exchange for part or all of a trust's interest in the
16 entity;

17 (3) Money received in total or partial liquidation of the entity;
18 and

19 (4) Money received from an entity that is a regulated investment
20 company or a real estate investment trust if the money distributed is
21 a capital gain dividend for federal income tax purposes.

22 (d) Money is received in partial liquidation:

23 (1) To the extent that the entity, at or near the time of a
24 distribution, indicates that it is a distribution in partial
25 liquidation; or

26 (2) If the total amount of money and property distributed in a
27 distribution or series of related distributions is greater than twenty
28 percent of the entity's gross assets, as shown by the entity's year-end
29 financial statements immediately preceding the initial distribution.

30 (e) Money is not received in partial liquidation, nor may it be
31 taken into account under subsection (d)(2) of this section, to the
32 extent that it does not exceed the amount of income tax that a trustee
33 or beneficiary must pay on taxable income of the entity that
34 distributes the money.

35 (f) A trustee may rely upon a statement made by an entity about the
36 source or character of a distribution if the statement is made at or
37 near the time of distribution by the entity's board of directors or
38 other person or group of persons authorized to exercise powers to pay

1 money or transfer property comparable to those of a corporation's board
2 of directors.

3 NEW SECTION. **Sec. 402.** DISTRIBUTION FROM TRUST OR ESTATE. A
4 trustee shall allocate to income an amount received as a distribution
5 of income from a trust or an estate in which the trust has an interest
6 other than a purchased interest in a trust that is an investment
7 entity, and shall allocate to principal an amount received as a
8 distribution of principal from such a trust or estate. If a trustee
9 purchases an interest in a trust that is an investment entity, or a
10 decedent or donor transfers an interest in such a trust to a trustee,
11 section 401 or 415 of this act applies to a receipt from the trust.

12 NEW SECTION. **Sec. 403.** BUSINESS AND OTHER ACTIVITIES CONDUCTED BY
13 TRUSTEE. (a) If a trustee who conducts a business or other activity
14 determines that it is in the best interest of all the beneficiaries to
15 account separately for the business or activity instead of accounting
16 for it as part of the trust's general accounting records, the trustee
17 may maintain separate accounting records for its transactions, whether
18 or not its assets are segregated from other trust assets. The trustee
19 shall maintain such records in accordance with principles of accounting
20 that are generally accepted.

21 (b) A trustee who accounts separately for a business or other
22 activity may determine the extent to which its net cash receipts must
23 be retained for working capital, the acquisition or replacement of
24 fixed assets, and other reasonably foreseeable needs of the business or
25 activity, and the extent to which the remaining net cash receipts are
26 accounted for as principal or income in the trust's general accounting
27 records. If a trustee sells assets of the business or other activity,
28 other than in the ordinary course of the business or activity, the
29 trustee shall account for the net amount received as principal in the
30 trust's general accounting records to the extent the trustee determines
31 that the amount received is no longer required in the conduct of the
32 business.

33 (c) Activities for which a trustee may maintain separate accounting
34 records include:

35 (1) Retail, manufacturing, service, and other traditional business
36 activities;

37 (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; and
- 5 (7) Activities to which section 414 of this act applies.

6 **PART 2: RECEIPTS NOT NORMALLY APPORTIONED**

7 NEW SECTION. **Sec. 404.** PRINCIPAL RECEIPTS. A trustee shall
8 allocate to principal:

9 (1) To the extent not allocated to income under this act, assets
10 received from a transferor during the transferor's lifetime, a
11 decedent's estate, a trust with a terminating income interest, or a
12 payer under a contract naming the trust or its trustee as beneficiary;

13 (2) Money or other property received from the sale, exchange,
14 liquidation, or change in form of a principal asset, including realized
15 profit, subject to this Article;

16 (3) Amounts recovered from third parties to reimburse the trust
17 because of disbursements described in section 502(a)(7) of this act or
18 for other reasons to the extent not based on the loss of income;

19 (4) Proceeds of property taken by eminent domain, but a separate
20 award made for the loss of income with respect to an accounting period
21 during which a current income beneficiary had a mandatory income
22 interest is income;

23 (5) Net income received in an accounting period during which there
24 is no beneficiary to whom a trustee may or must distribute income; and

25 (6) Other receipts as provided in Part 3 of this Article.

26 NEW SECTION. **Sec. 405.** RENTAL PROPERTY. To the extent that a
27 trustee accounts for receipts from rental property pursuant to this
28 section, the trustee shall allocate to income an amount received as
29 rent of real or personal property, including an amount received for
30 cancellation or renewal of a lease. An amount received as a refundable
31 deposit, including a security deposit or a deposit that is to be
32 applied as rent for future periods, must be added to principal and held
33 subject to the terms of the lease and is not available for distribution
34 to a beneficiary until the trustee's contractual obligations have been
35 satisfied with respect to that amount.

1 NEW SECTION. **Sec. 406.** OBLIGATION TO PAY MONEY. (a) An amount
2 received as interest, whether determined at a fixed, variable, or
3 floating rate, on an obligation to pay money to the trustee, including
4 an amount received as consideration for prepaying principal, must be
5 allocated to income without any provision for amortization of premium.

6 (b) A trustee shall allocate to principal an amount received from
7 the sale, redemption, or other disposition of an obligation to pay
8 money to the trustee more than one year after it is purchased or
9 acquired by the trustee, including an obligation whose purchase price
10 or value when it is acquired is less than its value at maturity. If
11 the obligation matures within one year after it is purchased or
12 acquired by the trustee, an amount received in excess of its purchase
13 price or its value when acquired by the trust must be allocated to
14 income.

15 (c) This section does not apply to an obligation to which section
16 409, 410, 411, 412, 414, or 415 of this act applies.

17 NEW SECTION. **Sec. 407.** INSURANCE POLICIES AND SIMILAR CONTRACTS.

18 (a) Except as otherwise provided in subsection (b) of this section, a
19 trustee shall allocate to principal the proceeds of a life insurance
20 policy or other contract in which the trust or its trustee is named as
21 beneficiary, including a contract that insures the trust or its trustee
22 against loss for damage to, destruction of, or loss of title to a trust
23 asset. The trustee shall allocate dividends on an insurance policy to
24 income if the premiums on the policy are paid from income, and to
25 principal if the premiums are paid from principal.

26 (b) A trustee shall allocate to income proceeds of a contract that
27 insures the trustee against loss of occupancy or other use by an income
28 beneficiary, loss of income, or, subject to section 403 of this act,
29 loss of profits from a business.

30 (c) This section does not apply to a contract to which section 409
31 of this act applies.

32 **PART 3: RECEIPTS NORMALLY APPORTIONED**

33 NEW SECTION. **Sec. 408.** INSUBSTANTIAL ALLOCATIONS NOT REQUIRED.

34 If a trustee determines that an allocation between principal and income
35 required by section 409, 410, 411, 412, or 415 of this act is
36 insubstantial, the trustee may allocate the entire amount to principal

1 unless one of the circumstances described in section 104(c) of this act
2 applies to the allocation. This power may be exercised by a cotrustee
3 in the circumstances described in section 104(d) of this act and may be
4 released for the reasons and in the manner described in section 104(f)
5 of this act. An allocation is presumed to be insubstantial if:

6 (1) The amount of the allocation would increase or decrease net
7 income in an accounting period, as determined before the allocation, by
8 less than ten percent; or

9 (2) The value of the asset producing the receipt for which the
10 allocation would be made is less than ten percent of the total value of
11 the trust's assets at the beginning of the accounting period.

12 NEW SECTION. **Sec. 409.** DEFERRED COMPENSATION, ANNUITIES, AND
13 SIMILAR PAYMENTS. (a) In this section, "payment" means a payment that
14 a trustee may receive over a fixed number of years or during the life
15 of one or more individuals because of services rendered or property
16 transferred to the payer in exchange for future payments. The term
17 includes a payment made in money or property from the payer's general
18 assets or from a separate fund created by the payer, including a
19 private or commercial annuity, an individual retirement account, and a
20 pension, profit-sharing, stock-bonus, or stock-ownership plan.

21 (b) To the extent that a payment is characterized as interest or a
22 dividend or a payment made in lieu of interest or a dividend, a trustee
23 shall allocate it to income. The trustee shall allocate to principal
24 the balance of the payment and any other payment received in the same
25 accounting period that is not characterized as interest, a dividend, or
26 an equivalent payment.

27 (c) If no part of a payment is characterized as interest, a
28 dividend, or an equivalent payment, a trustee shall allocate to income
29 four percent of the total value of the interests of the trustee in the
30 plan, annuity, or similar payment as of the first business day of the
31 accounting period and the balance to principal.

32 (d) If, to obtain an estate tax marital deduction for a trust, a
33 trustee must allocate more of a payment to income than provided for by
34 this section, the trustee shall allocate to income the additional
35 amount necessary to obtain the marital deduction.

36 (e) This section does not apply to payments to which section 410 of
37 this act applies.

1 NEW SECTION. **Sec. 410.** LIQUIDATING ASSET. (a) In this section,
2 "liquidating asset" means an asset whose value will diminish or
3 terminate because the asset is expected to produce receipts for a
4 period of limited duration. The term includes a leasehold, patent,
5 copyright, royalty right, and right to receive payments during a period
6 of more than one year under an arrangement that does not provide for
7 the payment of interest on the unpaid balance. The term does not
8 include a payment subject to section 409 of this act, resources subject
9 to section 411 of this act, timber subject to section 412 of this act,
10 an activity subject to section 414 of this act, an asset subject to
11 section 415 of this act, or any asset for which the trustee establishes
12 a reserve for depreciation under section 503 of this act.

13 (b) A trustee shall allocate to income ten percent of the receipts
14 from a liquidating asset and the balance to principal.

15 NEW SECTION. **Sec. 411.** MINERALS, WATER, AND OTHER NATURAL
16 RESOURCES. (a) To the extent that a trustee accounts for receipts from
17 an interest in minerals or other natural resources pursuant to this
18 section, the trustee shall allocate them as follows:

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

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

25 (3) If an amount received as a royalty, shut-in-well payment, take-
26 or-pay payment, bonus, or delay rental is more than nominal, ninety
27 percent must be allocated to principal and the balance to income; or

28 (4) If an amount is received from a working interest or any other
29 interest not provided for in subsection (1), (2), or (3) of this
30 section, ninety percent of the net amount received must be allocated to
31 principal and the balance to income.

32 (b) An amount received on account of an interest in water that is
33 renewable must be allocated to income. If the water is not renewable,
34 ninety percent of the amount must be allocated to principal and the
35 balance to income.

36 (c) This act applies whether or not a decedent or donor was
37 extracting minerals, water, or other natural resources before the
38 interest became subject to the trust.

1 (d) If a trust owns an interest in minerals, water, or other
2 natural resources on January 1, 2003, the trustee may allocate receipts
3 from the interest as provided in this act or in the manner used by the
4 trustee before January 1, 2003. If the trust acquires an interest in
5 minerals, water, or other natural resources after January 1, 2003, the
6 trustee shall allocate receipts from the interest as provided in this
7 act.

8 NEW SECTION. **Sec. 412.** TIMBER. (a) To the extent that a trustee
9 accounts for receipts from the sale of timber and related products
10 pursuant to this section, the trustee shall allocate the net receipts:

11 (1) To income to the extent that the amount of timber removed from
12 the land does not exceed the rate of growth of the timber during the
13 accounting periods in which a beneficiary has a mandatory income
14 interest;

15 (2) To principal to the extent that the amount of timber removed
16 from the land exceeds the rate of growth of the timber or the net
17 receipts are from the sale of standing timber;

18 (3) To or between income and principal if the net receipts are from
19 the lease of timberland or from a contract to cut timber from land
20 owned by a trust, by determining the amount of timber removed from the
21 land under the lease or contract and applying the rules in (1) and (2)
22 of this subsection; or

23 (4) To principal to the extent that advance payments, bonuses, and
24 other payments are not allocated pursuant to (1), (2), or (3) of this
25 subsection.

26 (b) In determining net receipts to be allocated pursuant to
27 subsection (a) of this section, a trustee shall deduct and transfer to
28 principal a reasonable amount for depletion.

29 (c) This act applies whether or not a decedent or transferor was
30 harvesting timber from the property before it became subject to the
31 trust.

32 (d) If a trust owns an interest in timberland on January 1, 2003,
33 the trustee may allocate net receipts from the sale of timber and
34 related products as provided in this act or in the manner used by the
35 trustee before January 1, 2003. If the trust acquires an interest in
36 timberland after January 1, 2003, the trustee shall allocate net
37 receipts from the sale of timber and related products as provided in
38 this act.

1 NEW SECTION. **Sec. 413.** PROPERTY NOT PRODUCTIVE OF INCOME. (a) If
2 a marital deduction is allowed for all or part of a trust whose assets
3 consist substantially of property that does not provide the spouse with
4 sufficient income from or use of the trust assets, and if the amounts
5 that the trustee transfers from principal to income under section 104
6 of this act and distributes to the spouse from principal pursuant to
7 the terms of the trust are insufficient to provide the spouse with the
8 beneficial enjoyment required to obtain the marital deduction, the
9 spouse may require the trustee to make property productive of income,
10 convert property within a reasonable time, or exercise the power
11 conferred by section 104(a) of this act. The trustee may decide which
12 action or combination of actions to take.

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

17 NEW SECTION. **Sec. 414.** DERIVATIVES AND OPTIONS. (a) In this
18 section, "derivative" means a contract or financial instrument or a
19 combination of contracts and financial instruments which gives a trust
20 the right or obligation to participate in some or all changes in the
21 price of a tangible or intangible asset or group of assets, or changes
22 in a rate, an index of prices or rates, or other market indicator for
23 an asset or a group of assets.

24 (b) To the extent that a trustee does not account under section 403
25 of this act for transactions in derivatives, the trustee shall allocate
26 to principal receipts from and disbursements made in connection with
27 those transactions.

28 (c) If a trustee grants an option to buy property from the trust,
29 whether or not the trust owns the property when the option is granted,
30 grants an option that permits another person to sell property to the
31 trust, or acquires an option to buy property for the trust or an option
32 to sell an asset owned by the trust, and the trustee or other owner of
33 the asset is required to deliver the asset if the option is exercised,
34 an amount received for granting the option must be allocated to
35 principal. An amount paid to acquire the option must be paid from
36 principal. A gain or loss realized upon the exercise of an option,
37 including an option granted to a settlor of the trust for services
38 rendered, must be allocated to principal.

1 a proceeding or other matter that concerns primarily the income
2 interest; and

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

5 NEW SECTION. **Sec. 502.** DISBURSEMENTS FROM PRINCIPAL. (a) A
6 trustee shall make the following disbursements from principal:

7 (1) The remaining one-half of the disbursements described in
8 section 501 (1) and (2) of this act;

9 (2) All of the trustee's compensation calculated on principal as a
10 fee for acceptance, distribution, or termination, and disbursements
11 made to prepare property for sale;

12 (3) Payments on the principal of a trust debt;

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

16 (5) Premiums paid on a policy of insurance not described in section
17 501(4) of this act of which the trust is the owner and beneficiary;

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

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

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

34 (c) For disbursements not covered in this section or section 501 of
35 this act, see section 103(a)(4) of this act.

36 NEW SECTION. **Sec. 503.** TRANSFERS FROM INCOME TO PRINCIPAL FOR
37 DEPRECIATION. (a) In this section, "depreciation" means a reduction in

1 value due to wear, tear, decay, corrosion, or gradual obsolescence of
2 a fixed asset having a useful life of more than one year.

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

6 (1) Of that portion of real property used or available for use by
7 a beneficiary as a residence or of tangible personal property held or
8 made available for the personal use or enjoyment of a beneficiary; or

9 (2) Under this section if the trustee is accounting under section
10 403 of this act for the business or activity in which the asset is
11 used.

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

14 NEW SECTION. **Sec. 504.** TRANSFERS FROM INCOME TO REIMBURSE

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

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

23 (1) An amount chargeable to income but paid from principal because
24 it is unusually large, including extraordinary repairs;

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

28 (3) Disbursements made to prepare property for rental, including
29 tenant allowances, leasehold improvements, and broker's commissions;

30 (4) Periodic payments on an obligation secured by a principal asset
31 to the extent that the amount transferred from income to principal for
32 depreciation is less than the periodic payments; and

33 (5) Disbursements described in section 502(a)(7) of this act.

34 (c) If the asset whose ownership gives rise to the disbursements
35 becomes subject to a successive income interest after an income
36 interest ends, a trustee may continue to transfer amounts from income
37 to principal as provided in subsection (a) of this section.

1 NEW SECTION. **Sec. 505.** INCOME TAXES. (a) A tax required to be
2 paid by a trustee based on receipts allocated to income must be paid
3 from income.

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

7 (c) A tax required to be paid by a trustee on the trust's share of
8 an entity's taxable income must be paid proportionately:

9 (1) From income to the extent that receipts from the entity are
10 allocated to income; and

11 (2) From principal to the extent that:

12 (i) Receipts from the entity are allocated to principal; and

13 (ii) The trust's share of the entity's taxable income exceeds the
14 total receipts described in (1) and (2)(i) of this subsection.

15 (d) For purposes of this section, receipts allocated to principal
16 or income must be reduced by the amount distributed to a beneficiary
17 from principal or income for which the trust receives a deduction in
18 calculating the tax.

19 NEW SECTION. **Sec. 506.** ADJUSTMENTS BETWEEN PRINCIPAL AND INCOME
20 BECAUSE OF TAXES. (a) A fiduciary may make adjustments between
21 principal and income to offset the shifting of economic interests or
22 tax benefits between income beneficiaries and remainder beneficiaries
23 which arise from:

24 (1) Elections and decisions, other than those described in
25 subsection (b) of this section, that the fiduciary makes from time to
26 time regarding tax matters;

27 (2) An income tax or any other tax that is imposed upon the
28 fiduciary or a beneficiary as a result of a transaction involving or a
29 distribution from the estate or trust; or

30 (3) The ownership by an estate or trust of an interest in an entity
31 whose taxable income, whether or not distributed, is includable in the
32 taxable income of the estate, trust, or a beneficiary.

33 (b) If the amount of an estate tax marital deduction or charitable
34 contribution deduction is reduced because a fiduciary deducts an amount
35 paid from principal for income tax purposes instead of deducting it for
36 estate tax purposes, and as a result estate taxes paid from principal
37 are increased and income taxes paid by an estate, trust, or beneficiary
38 are decreased, each estate, trust, or beneficiary that benefits from

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

10 **ARTICLE 6**

11 **MISCELLANEOUS PROVISIONS**

12 NEW SECTION. **Sec. 601.** The following acts or parts of acts are
13 each repealed:

14 (1) RCW 11.104.010 (Definitions) and 1997 c 252 s 78 & 1985 c 30 s
15 84;

16 (2) RCW 11.104.020 (Duty of trustee as to receipts and
17 expenditures) and 1985 c 30 s 85;

18 (3) RCW 11.104.030 (Income--Principal--Charges) and 1985 c 30 s 86;

19 (4) RCW 11.104.040 (When right to income arises--Apportionment of
20 income) and 1985 c 30 s 87;

21 (5) RCW 11.104.050 (Income earned during administration of a
22 decedent's estate) and 1993 c 161 s 1 & 1985 c 30 s 88;

23 (6) RCW 11.104.060 (Corporate distribution) and 1985 c 30 s 89;

24 (7) RCW 11.104.070 (Bond premium and discount) and 1985 c 30 s 90;

25 (8) RCW 11.104.071 (Charitable remainder unitrusts) and 1997 c 252
26 s 79;

27 (9) RCW 11.104.080 (Trade, business and farming operations) and
28 1985 c 30 s 91;

29 (10) RCW 11.104.090 (Disposition of receipts from natural
30 resources) and 1985 c 30 s 92;

31 (11) RCW 11.104.100 (Timber) and 1971 c 74 s 10;

32 (12) RCW 11.104.110 (Other property subject to deferred payment
33 right--Inventory value determination) and 1997 c 252 s 80 & 1971 c 74
34 s 11;

35 (13) RCW 11.104.120 (Underproductive property--Definition) and 1985
36 c 30 s 93;

- 1 (14) RCW 11.104.130 (Charges against income and principal) and 1985
2 c 30 s 94;
- 3 (15) RCW 11.104.900 (Application of chapter) and 1971 c 74 s 14;
- 4 (16) RCW 11.104.901 (Application of RCW 11.104.010 through
5 11.104.130 as of January 1, 1985) and 1985 c 30 s 142;
- 6 (17) RCW 11.104.910 (Short title) and 1971 c 74 s 15;
- 7 (18) RCW 11.104.920 (Severability--1971 c 74) and 1971 c 74 s 16;
- 8 (19) RCW 11.104.930 (Section headings not part of law) and 1971 c
9 74 s 18; and
- 10 (20) RCW 11.104.940 (Effective date--1971 c 74) and 1971 c 74 s 19.

11 NEW SECTION. **Sec. 602.** UNIFORMITY OF APPLICATION AND
12 CONSTRUCTION. In applying and construing this act, consideration must
13 be given to the need to promote uniformity of the law with respect to
14 its subject matter among states that enact it.

15 NEW SECTION. **Sec. 603.** APPLICATION OF CHAPTER 11.96A RCW.
16 Nothing in this act is intended to restrict the application of chapter
17 11.96A RCW to issues, questions, or disputes that arise under or that
18 relate to this act. Any and all such issues, questions, or disputes
19 shall be resolved judicially or nonjudicially under chapter 11.96A RCW.

20 NEW SECTION. **Sec. 604.** SEVERABILITY CLAUSE. If any provision of
21 this act or its application to any person or circumstance is held
22 invalid, the remainder of the act or the application of the provision
23 to other persons or circumstances is not affected.

24 NEW SECTION. **Sec. 605.** Captions, article headings, and part
25 headings used in this act are not any part of the law.

26 NEW SECTION. **Sec. 606.** EFFECTIVE DATE. This act takes effect
27 January 1, 2003.

28 NEW SECTION. **Sec. 607.** APPLICATION OF ACT TO EXISTING TRUSTS AND
29 ESTATES. Except as specifically provided otherwise in the terms of a
30 trust or a will, this act shall apply to any receipt or expense
31 received or incurred on or after January 1, 2003, by any trust or
32 decedent's estate, whether established before, on, or after January 1,

1 2003, and whether the asset involved was acquired by the fiduciary
2 before, on, or after January 1, 2003.

3 NEW SECTION. **Sec. 608.** Sections 101 through 506 and 602 through
4 606 of this act are each added to chapter 11.104 RCW.

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