

BILL ANALYSIS

Senate Research Center

H.B. 2241
By: Paxton (Harris)
Jurisprudence
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Committee Report (Amended)

DIGEST AND PURPOSE

H.B. 2241 changes the default rules governing how trusts are administered and accounted for. This bill provides accounting rules to assure that the relative rights of the beneficiaries are protected. Trustees and their attorneys and accountants are provided a detailed set of rules for allocating receipts and disbursements to principal or income. H.B. 2241 allows a settlor to create a unitrust that qualifies for the marital deduction so that a settlor may provide that his or her spouse receive a fixed percentage of the trust rather than net income.

RULEMAKING AUTHORITY

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Subtitle B, Title 9, Property Code, by adding Chapter 116, as follows:

CHAPTER 116. UNIFORM PRINCIPAL AND INCOME ACT

SUBCHAPTER A. DEFINITIONS, FIDUCIARY DUTIES, AND OTHER MISCELLANEOUS PROVISIONS

Sec. 116.001. SHORT TITLE: Uniform Principal and Income Act.

Sec. 116.002. DEFINITIONS. Defines "accounting period," "beneficiary," "fiduciary," "income," "income beneficiary," "income interest," "mandatory income interest," "net income," "person," "principal," "remainder beneficiary," "terms of a trust," and "trustee."

Sec. 116.003. UNIFORMITY OF APPLICATION AND CONSTRUCTION. Provides that in applying and construing this Uniform Act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

Sec. 116.004. FIDUCIARY DUTIES; GENERAL PRINCIPLES. (a) Sets forth particular duties of a fiduciary in allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of Subchapters B and C.

(b) Requires a fiduciary in exercising the power to adjust under Section 116.005(a) or a discretionary power of administration regarding a matter within the scope of this chapter, whether granted by the terms of a trust, a will, or this chapter, to administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. Provides that a determination in accordance with this chapter is presumed to be fair and reasonable to all of the beneficiaries.

Sec. 116.005. TRUSTEE'S POWER TO ADJUST. (a) Authorizes a trustee to adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income, and the trustee determines, after applying the rules in Section 116.004(a), that the trustee is unable to comply with Section 116.004(b). Provides that the power to adjust conferred by this subsection includes the power to allocate all or part of a capital gain to trust income.

(b) Requires a trustee, in deciding whether and to what extent to exercise the power conferred by Subsection (a), to consider all factors relevant to the trust and its beneficiaries, including certain factors to the extent they are relevant.

(c) Prohibits a trustee from making certain adjustments.

(d) Provides that if certain Subdivisions of Subsection (c) apply to a trustee and there is more than one trustee, a cotrustee to whom the provision does not apply may make the adjustment unless the exercise of the power by the remaining trustee or trustees is not permitted by the terms of the trust.

(e) Authorizes a trustee to release the entire power conferred by Subsection (a) or to release only the power to adjust from income to principal or the power to adjust from principal to income if the trustee is uncertain about certain outcomes. Authorizes the release to be permanent or for a specified period, including a period measured by the life of an individual.

(f) Provides that terms of a trust that limit the power of a trustee to make an adjustment between principal and income do not affect the application of this section unless it is clear from the terms of the trust that the terms are intended to deny the trustee the power of adjustment conferred by Subsection (a).

Sec. 116.006. JUDICIAL CONTROL OF DISCRETIONARY POWER. (a) Prohibits the court from ordering a fiduciary to change a decision to exercise or not to exercise a discretionary power conferred by this chapter unless the court determines that the decision was an abuse of the fiduciary's discretion. Provides that a fiduciary's decision is not an abuse of discretion merely because the court would have exercised the power in a different manner or would not have exercised the power.

(b) Provides that the decisions to which Subsection (a) applies include certain decisions.

(c) Authorizes the court, if the court determines that a fiduciary has abused the fiduciary's discretion, to place the income and remainder beneficiaries in the positions they would have occupied if the discretion had not been abused, according to certain rules.

(d) Requires the court having jurisdiction over a trust or estate, upon petition by the fiduciary, to determine whether a proposed exercise or nonexercise by the fiduciary of a discretionary power conferred by this chapter will result in an abuse of the fiduciary's discretion. Provides that if the petition describes the proposed exercise or nonexercise of the power and contains sufficient information to inform the beneficiaries of the reasons for the proposal, the facts upon which the fiduciary relies, and an explanation of how the income and remainder beneficiaries will be affected by the proposed exercise or nonexercise has the burden of establishing that it will result in an abuse of discretion.

Sec. 116.007. PROVISIONS REGARDING NONCHARITABLE UNITRUSTS. (a)

Provides that this section does not apply to a charitable remainder unitrust as defined by Section 664(d), Internal Revenue Code of 1986 (26 U.S.C. Section 664), as amended.

(b) Defines "unitrust" and "unitrust amount."

(c) Provides that distribution of the unitrust amount is considered a distribution of all of the income of the unitrust and may not be considered a fundamental departure from applicable state law. Provides that a distribution of the unitrust amount reasonably apportions the total return of a unitrust.

(d) Requires distribution of the unitrust amount, unless the terms of the trust specifically provide otherwise, to be treated as first being made from certain sources in a specified order of priority.

[Reserves Sections 116.008-116.050 for expansion.]

SUBCHAPTER B. DECEDENT'S ESTATE OR TERMINATING INCOME INTEREST

Sec. 116.051. DETERMINATION AND DISTRIBUTION OF NET INCOME. Provides that after a decedent dies, in the case of an estate, or after an income interest in a trust ends, certain rules apply.

Sec. 116.052. DISTRIBUTION TO RESIDUARY AND REMAINDER BENEFICIARIES.

(a) Entitles each beneficiary described in Section 116.051(4) to receive a portion of the net income equal to the beneficiary's fractional interest in undistributed principal assets, using values as of the distribution date. Provides that if a fiduciary makes more than one distribution of assets to beneficiaries to whom this section applies, each beneficiary, including one who does not receive part of the distribution, is entitled, as of each distribution date, to the net income the fiduciary has received after the date of death or terminating event or earlier distribution date but has not distributed as of the current distribution date.

(b) Provides that in determining a beneficiary's share of net income, certain rules apply.

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

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

[Reserves Sections 116.053-116.100 for expansion.]

SUBCHAPTER C. APPORTIONMENT AT BEGINNING AND END OF INCOME INTEREST

Sec. 116.101. WHEN RIGHT TO INCOME BEGINS AND ENDS. (a) Entitles an income beneficiary to net income from the date on which the income interest begins. Provides that an income interest begins on the date specified in the terms of the trust or, if no date is specified, on the date an asset becomes subject to a trust or successive income interest.

(b) Provides that an asset becomes subject to a trust on certain dates.

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

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

Sec. 116.102. APPORTIONMENT OF RECEIPTS AND DISBURSEMENTS WHEN DECEDENT DIES OR INCOME INTEREST BEGINS. (a) Requires a trustee to allocate an income receipt or disbursement other than one to which Section 116.051(1) applies to principal if its due date occurs before a decedent dies in the case of an estate or before an income interest begins in the case of a trust or successive income interest.

(b) Requires a trustee to allocate an income receipt or disbursement to income if its due date occurs on or after the date on which a decedent dies or an income interest begins and it is a periodic due date. Requires an income receipt or disbursement to be treated as accruing from day to day if its due date is not periodic or it has no due date. Provides that the portion of the receipt or disbursement accruing before the date on which a decedent dies or an income interest begins must be allocated to principal and the balance must be allocated to income.

(c) Provides that an item of income or an obligation is due on the date the payer is required to make a payment. Provides that if a payment date is not stated, there is no due date for the purposes of this chapter. Deems distributions to shareholders or other owners from an entity to which Section 116.151 applies to be due on the date fixed by the entity for determining who is entitled to receive the distribution or, if no date is fixed, on the declaration date for the distribution. Provides that a due date is periodic for receipts or disbursements that must be paid at regular intervals under a lease or an obligation to pay interest or if an entity customarily makes distributions at regular intervals.

Sec. 116.103. APPORTIONMENT WHEN INCOME INTEREST ENDS. (a) Defines "undistributed income."

(b) Requires the trustee, when a mandatory income interest ends, to pay to a mandatory income beneficiary who survives that date, or the estate of a deceased mandatory income beneficiary whose death causes the interest to end, the beneficiary's share of the undistributed income that is not disposed of under the terms of the trust unless the beneficiary has an unqualified power to revoke more than five percent of the trust immediately before the income interest ends. Provides that in the latter case, the undistributed income from the portion of the trust that may be revoked must be added to principal.

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

[Reserves Sections 116.104-116.150 for expansion.]

SUBCHAPTER D. ALLOCATION OF RECEIPTS DURING ADMINISTRATION OF TRUST

PART 1. RECEIPTS FROM ENTITIES

Sec. 116.151. CHARACTER OF RECEIPTS. (a) Defines "entity" in this section.

(b) Requires a trustee, except as otherwise provided in this section, to allocate to income money received from an entity.

(c) Requires a trustee to allocate certain receipts from an entity to principal.

(d) Provides that money is received in partial liquidation:

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

(2) if the total amount of money and property received in a distribution or series of related distributions is greater than 20 percent of the entity's gross assets, as shown by the entity's year-end financial statements immediately preceding the initial receipt.

(e) Provides that money is not received in partial liquidation, nor may it be taken into account under Subsection (d)(2), to the extent that it does not exceed the amount of income tax that a trustee or beneficiary must pay on taxable income of the entity that distributes the money.

(f) Authorizes a trustee to rely upon a statement made by an entity about the source or character of a distribution if the statement is made at or near the time of distribution by the entity's board of directors or other certain other persons.

Sec. 116.152. DISTRIBUTION FROM TRUST OR ESTATE. Requires a trustee to allocate to income an amount received as a distribution of income from a trust or an estate in which the trust has an interest other than a purchased interest, and to allocate to principal an amount received as a distribution of principal from such a trust or estate. Provides that if a trustee purchases an interest in a trust that is an investment entity, or a decedent or donor transfers an interest in such a trust to a trustee, Section 116.151 or 116.178 applies to a receipt from the trust.

Sec. 116.153. BUSINESS AND OTHER ACTIVITIES CONDUCTED BY TRUSTEE.

(a) Authorizes the trustee, if a trustee who conducts a business or other activity determines that it is in the best interest of all the beneficiaries to account separately for the business or activity instead of accounting for it as part of the trust's general accounting records, to maintain separate accounting records for its transactions, whether or not its assets are segregated from other trust assets.

(b) Authorizes a trustee who accounts separately for a business or other activity to determine the extent to which its net cash receipts must be retained for working capital, the acquisition or replacement of fixed assets, and other reasonably foreseeable needs of the business or activity, and the extent to which the remaining net cash receipts are accounted for as principal or income in the trust's general accounting records. Requires the trustee, if a trustee sells assets of the business or other activity, other than in the ordinary course of the business or activity, to account for the net amount received as principal in the trust's general accounting records to the extent the trustee determines that the amount received is no longer required in the conduct of the business.

(c) Authorizes a trustee to maintain separate accounting records, including certain activities.

[Reserves Sections 116.154-116.160 for expansion.]

PART 2. RECEIPTS NOT NORMALLY APPORTIONED

Sec. 116.161. **PRINCIPAL RECEIPTS.** Requires a trustee to allocate to principal:

- (1) to the extent not allocated to income under this chapter, assets received from a transferor during the transferor's lifetime, a decedent's estate, a trust with a terminating income interest, or a payer under a contract naming the trust or its trustee as beneficiary;
- (2) money or other property received from the sale, exchange, liquidation, or change in form of a principal asset, including realized profit, subject to this subchapter;
- (3) amounts recovered from third parties to reimburse the trust because of disbursements described in Section 116.202(a)(7) or for other reasons to the extent not based on the loss of income;
- (4) proceeds of property taken by eminent domain, but a separate award made for the loss of income with respect to an accounting period during which a current income beneficiary had a mandatory income interest is income;
- (5) net income received in an accounting period during which there is no beneficiary to whom a trustee may or must distribute income; and
- (6) other receipts as provided in Part 3.

Sec. 116.162. **RENTAL PROPERTY.** Requires the trustee, to the extent that a trustee accounts for receipts from rental property pursuant to this section, to allocate to income an amount received as rent of real or personal property, including an amount received for cancellation or renewal of a lease. Provides that an amount received as a refundable deposit, including a security deposit or a deposit that is to be applied as rent for future periods, must be added to principal and held subject to the terms of the lease and is not available for distribution to a beneficiary until the trustee's contractual obligations have been satisfied with respect to that amount.

Sec. 116.163. **OBLIGATION TO PAY MONEY.** (a) Provides that an amount received as interest, whether determined at a fixed, variable, or floating rate, on an obligation to pay money to the trustee, including an amount received as consideration for prepaying principal, must be allocated to income without any provision for amortization of premium.

(b) Requires a trustee to allocate to principal a certain amount. Provides that if the obligation matures within one year after it is purchased or acquired by the trustee, an amount received in excess of its purchase price or its value when acquired by the trust must be allocated to income.

(c) Provides that this section does not apply to an obligation to which Section 116.172, 116.173, 116.174, 116.175, 116.177, or 116.178 applies.

Sec. 116.164. **INSURANCE POLICIES AND SIMILAR CONTRACTS.** (a) Requires a trustee, except as otherwise provided in Subsection (b), to allocate to principal the proceeds of a life insurance policy or other contract in which the trust or its trustee is named as beneficiary, including a contract that insures the trust or its trustee against loss for damage to, destruction of, or loss of title to a trust asset. Requires the trustee to allocate dividends on an insurance policy

to income if the premiums on the policy are paid from income, and to principal if the premiums are paid from principal.

(b) Requires a trustee to allocate to income proceeds of a contract that insures the trustee against loss of occupancy or other use by an income beneficiary, loss of income, or, subject to Section 116.153, loss of profits from a business.

(c) Provides that this section does not apply to a contract to which Section 116.172 applies.

[Reserves Sections 116.165-116.170 for expansion.]

PART 3. RECEIPTS NORMALLY APPORTIONED

Sec. 116.171. **INSUBSTANTIAL ALLOCATIONS NOT REQUIRED.** Authorizes the trustee if a trustee determines that an allocation between principal and income required by Section 116.172, 116.173, 116.174, 116.175, or 116.178 is insubstantial, to allocate the entire amount to principal unless one of the circumstances described in Section 116.005(c) applies to the allocation. Authorizes this power to be exercised by a cotrustee in the circumstances described in Section 116.005(d) and to be released for the reasons and in the manner described in Section 116.005(e).

Sec. 116.172. **DEFERRED COMPENSATION, ANNUITIES, AND SIMILAR PAYMENTS.** (a) Defines "future payment asset" and "payment" in this section.

(b) Requires a trustee, to the extent that the payer characterizes a payment as interest or a dividend or a payment made in lieu of interest or a dividend, to allocate it to income. Requires the trustee to allocate to principal the balance of the payment and any other payment received in the same accounting period that is not characterized as interest, a dividend, or an equivalent payment.

(c) Requires a trustee, if no part of a payment is characterized as interest, a dividend, or an equivalent payment, and all or part of the payment is required to be made, to allocate to income the part of the payment that does not exceed an amount equal to a certain amount.

(d) Provides that for purposes of Subsection (c)(1), the determination of a future payment asset is made on the later of certain specified dates.

(e) Provides that for each year a future payment asset is made, the amount determined under Subsection (c) must be prorated on a daily basis unless the determination of a future payment asset is made under Subsection (d)(2) and is for an accounting period of 365 days or more.

(f) Requires a trustee to allocate to principal the part of the payment described by Subsection (c) that is not allocated to income.

(g) Requires the trustee, if no part of a payment is required to be made or the payment received is the entire amount to which the trustee is entitled, to allocate the entire payment to principal. Provides that for purposes of Subsection (c) and this subsection, a payment is not "required to be made" to the extent that it is made only because the trustee exercises a right of withdrawal.

(h) Requires the trustee, if to obtain an estate tax marital deduction for a trust a trustee must allocate more of a payment to income than provided for by this section, to allocate

to income the additional amount necessary to obtain the marital deduction.

Sec. 116.173. LIQUIDATING ASSET. (a) Defines "liquidating asset."

(b) Requires a trustee to allocate to income 10 percent of the receipts from a liquidating asset and the balance to principal.

(c) Authorizes the trustee to allocate a receipt from any interest in a liquidating asset the trust owns on January 1, 2004, in the manner provided by this chapter or in any lawful manner used by the trustee before January 1, 2004, to make the same allocation.

Sec. 116.174. MINERALS, WATER, AND OTHER NATURAL RESOURCES. (a) Requires the trustee, to the extent that a trustee accounts for receipts from an interest in minerals or other natural resources pursuant to this section, to allocate them in a certain manner.

(b) Requires an amount received on account of an interest in water that is renewable to be allocated to income. Requires the trustee, if the water is not renewable, to allocate the receipt equitably.

(c) Provides that this chapter applies whether or not a decedent or donor was extracting minerals, water, or other natural resources before the interest became subject to the trust.

(d) Authorizes the trustee to allocate a receipt from any interest in minerals, water, or other natural resources the trust owns on January 1, 2004, in the manner provided by this chapter or in any lawful manner used by the trustee before January 1, 2004, to make the same allocation. Requires the trustee to allocate a receipt from any interest in minerals, water, or other natural resources acquired by the trust after January 1, 2004, in the manner provided by this chapter.

(e) Provides that an allocation of a receipt under this section is presumed to be equitable if the amount allocated to principal is equal to the amount allowed by the Internal Revenue Code of 1986 as a deduction for depletion of the interest.

Sec. 116.175. TIMBER. (a) Requires the trustee, to the extent that a trustee accounts for receipts from the sale of timber and related products pursuant to this section, to allocate the net receipts:

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

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

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

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

(b) Requires a trustee, in determining net receipts to be allocated pursuant to

Subsection (a), to deduct and transfer to principal a reasonable amount for depletion.

(c) Provides that this chapter applies whether or not a decedent or transferor was harvesting timber from the property before it became subject to the trust.

(d) Authorizes the trustee if a trust owns an interest in timberland on January 1, 2004, to allocate a net receipt from the sale of timber and related products in the manner provided by this chapter or in any lawful manner used by the trustee before January 1, 2004, to make the same allocation. Requires the trustee if the trust acquires an interest in timberland after January 1, 2004, to allocate net receipts from the sale of timber and related products in the manner provided by this chapter.

Sec. 116.176. PROPERTY NOT PRODUCTIVE OF INCOME. (a) Authorizes the spouse if a marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the spouse with sufficient income from or use of the trust assets, and if the amounts that the trustee transfers from principal to income under Section 116.005 and distributes to the spouse from principal pursuant to the terms of the trust are insufficient to provide the spouse with the beneficial enjoyment required to obtain the marital deduction, to require the trustee to make property productive of income, convert property within a reasonable time, or exercise the power conferred by Section 116.005(a). Authorizes the trustee to decide which action or combination of actions to take.

(b) Provides that in cases not governed by Subsection (a), proceeds from the sale or other disposition of an asset are principal without regard to the amount of income the asset produces during any accounting period.

Sec. 116.177. DERIVATIVES AND OPTIONS. (a) Defines "derivative" in this section.

(b) Requires the trustee, to the extent that a trustee does not account under Section 116.153 for transactions in derivatives, to allocate to principal receipts from and disbursements made in connection with those transactions.

(c) Requires an amount received for granting the option to be allocated to principal if a trustee grants an option to buy property from the trust. An amount paid to acquire the option must be paid from principal. Requires a gain or loss realized upon the exercise of an option, including an option granted to a settlor of the trust for services rendered, to be allocated to principal.

Sec. 116.178. ASSET-BACKED SECURITIES. (a) Defines "asset-backed security." Provides that the term does not include an asset to which Section 116.151 or 116.172 applies.

(b) Requires the trustee, if a trust receives a payment from interest or other current return and from other proceeds of the collateral financial assets, to allocate to income the portion of the payment which the payer identifies as being from interest or other current return and shall allocate the balance of the payment to principal.

(c) Requires the trustee, if a trust receives one or more payments in exchange for the trust's entire interest in an asset-backed security in one accounting period, to allocate the payments to principal. Requires the trustee if a payment is one of a series of payments that will result in the liquidation of the trust's interest in the security over more than one accounting period, to allocate 10 percent of the payment to income and the balance to principal.

[Reserves Sections 116.179-116.200 for expansion.]

SUBCHAPTER E. ALLOCATION OF DISBURSEMENTS DURING
ADMINISTRATION OF TRUST

Sec. 116.201. DISBURSEMENTS FROM INCOME. Requires a trustee to make certain disbursements from income to the extent that they are not disbursements to which Section 116.051(2)(B) or (c) applies.

Sec. 116.202. DISBURSEMENTS FROM PRINCIPAL. (a) Requires a trustee to make certain disbursements from principal.

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

Sec. 116.203. TRANSFERS FROM INCOME TO PRINCIPAL FOR DEPRECIATION. (a) Defines "depreciation."

(b) Authorizes a trustee to transfer to principal a reasonable amount of the net cash receipts from a principal asset that is subject to depreciation, but prohibits the transfer of any amount for depreciation:

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

(2) during the administration of a decedent's estate; or

(3) under this section if the trustee is accounting under Section 116.153 for the business or activity in which the asset is used.

(c) Provides that an amount transferred to principal need not be held as a separate fund.

Sec. 116.204. TRANSFERS FROM INCOME TO REIMBURSE PRINCIPAL. (a) Authorizes the trustee, if a trustee makes or expects to make a principal disbursement described in this section, to transfer an appropriate amount from income to principal in one or more accounting periods to reimburse principal or to provide a reserve for future principal disbursements.

(b) Provides that principal disbursements to which Subsection (a) applies include certain payments, disbursements and a capital improvement to a principal asset, but only to the extent that the trustee has not been and does not expect to be reimbursed by a third party.

(c) Authorizes a trustee, if the asset whose ownership gives rise to the disbursements becomes subject to a successive income interest after an income interest ends, to continue to transfer amounts from income to principal as provided in Subsection (a).

Sec. 116.205. INCOME TAXES. (a) Provides that a tax required to be paid by a trustee based on receipts allocated to income must be paid from income.

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

(c) Provides that a tax required to be paid by a trustee on the trust's share of an entity's taxable income must be paid proportionately from certain sources.

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

Sec. 116.206. ADJUSTMENTS BETWEEN PRINCIPAL AND INCOME BECAUSE OF TAXES. (a) Authorizes a fiduciary to make adjustments between principal and income to offset the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries which arise from certain sources.

(b) Requires each estate, trust, or beneficiary that benefits from the decrease in income tax, if certain conditions exist, to reimburse the principal from which the increase in estate tax is paid. Requires the total reimbursement to equal a certain amount. Requires the proportionate share of the reimbursement for each estate, trust, or beneficiary whose income taxes are reduced to be the same as its proportionate share of the total decrease in income tax. Requires an estate or trust to reimburse principal from income.

SECTION 2. Amends Sections 111.004(5) and (11), Property Code, as follows:

(5) Provides that "income" is defined in Section 116.002, rather than 113.102.

(11) Provides that "principal" is defined in Section 116.002, rather than 113.102.

SECTION 3. Amends Section 378B, Texas Probate Code, by amending Subsections (a), (b), (d), and (g) and adding Subsection (I) as follows:

(a) Removes reference to interest. Requires fees and expenses of an attorney, accountant, or other professional advisor, commissions and expenses of a personal representative, court costs, and all other similar fees or expenses relating to the administration of the estate and interest relating to estate taxes to be allocated between the income and principal of the estate as the executor determines in its discretion to be just and equitable.

(b) Makes conforming changes.

(d) Removes reference to Subsection (f) of this section.

(g) Requires income received by a trustee under this section to be treated as income of the trust as provided by Section 116.101 rather than 113.103, Property Code.

(I) Provides that Chapter 116, Property Code, prevails to the extent of any conflict between this section and Chapter 116, Property Code.

SECTION 4. Repealers: Subchapter D, Chapter 113 (Allocation of Principal and Income), Property Code, and Sections 378B(e) and (f), Texas Probate Code.

SECTION 5. Effective date: January 1, 2004.

Makes application of this Act prospective.

LIST OF AMENDMENTS

Committee Amendment No. 1:

Amend HB 2241 by striking page 7, line 22 to page 9, line 21 and substituting the following:

Sec. 116.006. JUDICIAL CONTROL OF DISCRETIONARY POWER. (a) The court may not order a trustee to change a decision to exercise or not to exercise a discretionary power conferred by Section 166.005 of this chapter unless the court determines that the decision was an abuse of discretion merely because the court would have exercised the power in a different manner or would not have exercised the power.

(b) The decisions to which Subsection (a) applies include:

(1) a decision under Section 116.005(a) as to whether and to what extent an amount should be transferred from principal to income or from income to principal; and

(2) a decision regarding the factors that are relevant to the trust and its beneficiaries, the extent to which the factors are relevant, and the weight, if any, to be given those factors, in deciding whether and to what extent to exercise the discretionary power conferred by Section 116.005(a).

(c) If the court determines that the trustee has abused the trustee's discretion, the court may place the income and remainder beneficiaries in the positions they would have occupied if the discretion had not been abused, according to the following rules:

(1) to the extent that the abuse of discretion has resulted in no distribution to a beneficiary or in a distribution that is too small, the court shall order the trustee to distribute from the trust to the beneficiary an amount that the court determines will restore the beneficiary, in whole or in part, to the beneficiary's appropriate position;

(2) to the extent that the abuse of discretion has resulted in a distribution to a beneficiary which is too large, the court shall place the beneficiaries, the trust, or both, in whole or in part, in their appropriate positions by ordering the trustee to withhold an amount from one or more future distributions to the beneficiary who received the distribution that was too large or ordering that beneficiary to return some or all of the distribution to the trust; and

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

(d) If the trustee of a trust reasonably believes that one or more beneficiaries of such trust will object to the manner in which the trustee intends to exercise or not exercise a discretionary power conferred by Section 116.005 of this chapter, the trustee may petition the court having jurisdiction over the trust, and the court shall determine whether the proposed exercise or nonexercise by the trustee of such discretionary power will result in an abuse of the trustee's discretion. The trustee shall state in such petition the basis for its belief that a beneficiary would object. The failure or refusal of a beneficiary to sign a waiver or release is not reasonable grounds for a trustee to believe the beneficiary will object. The court may appoint one or more guardians ad litem pursuant to Section 115.014 of this subtitle. If the petition describes the proposed exercise or nonexercise of the power and contains sufficient information to inform the beneficiaries of the reasons for the proposal, the facts upon which the trustee relies, and an explanation of how the income and remainder beneficiaries will be affected by the proposed exercise or nonexercise of the power, a beneficiary who challenges the proposed exercise or nonexercise has the burden of establishing that it will result in an abuse of discretion. The trustee shall advance from the trust principal all costs incident to the judicial determination, including the reasonable attorney's fees and costs of the trustee, any beneficiary or beneficiaries who are parties to the action and who retain counsel, and any guardian ad litem. At the conclusion of the proceeding, the court may award costs and reasonable and necessary attorney's fees as provided in Section 114.064 of this subtitle, including, if the court considers it appropriate, awarding part or all of such costs against

the trust principal or income, awarding part or all of such costs against one or more beneficiaries or such beneficiary's or beneficiaries' share of the trust, or awarding part or all of such costs against the trustee in the trustee's individual capacity if the court determines the trustee's exercise or nonexercise of discretionary power would have resulted in an abuse of discretion or that the trustee did not have reasonable grounds for believing one or more beneficiaries will object to the proposed exercise or nonexercise of the discretionary power.