

By: Paxton

H.B. No. 2241

A BILL TO BE ENTITLED

AN ACT

relating to adoption of the Uniform Principal and Income Act.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

SECTION 1. Subtitle B, Title 9, Property Code, is amended by adding Chapter 116 to read as follows:

CHAPTER 116. UNIFORM PRINCIPAL AND INCOME ACT

SUBCHAPTER A. DEFINITIONS, FIDUCIARY DUTIES, AND OTHER

MISCELLANEOUS PROVISIONS

Sec. 116.001. SHORT TITLE. This chapter may be cited as the Uniform Principal and Income Act.

Sec. 116.002. DEFINITIONS. In this chapter:

(1) "Accounting period" means a calendar year unless another 12-month period is selected by a fiduciary. The term includes a portion of a calendar year or other 12-month period that begins when an income interest begins or ends when an income interest ends.

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

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

(4) "Income" means money or property that a fiduciary

1 receives as current return from a principal asset. The term  
2 includes a portion of receipts from a sale, exchange, or  
3 liquidation of a principal asset, to the extent provided in  
4 Subchapter D.

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

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

11 (7) "Mandatory income interest" means the right of an  
12 income beneficiary to receive net income that the terms of the trust  
13 require the fiduciary to distribute.

14 (8) "Net income" means the total receipts allocated to  
15 income during an accounting period minus the disbursements made  
16 from income during the period, plus or minus transfers under this  
17 chapter to or from income during the period.

18 (9) "Person" means an individual, corporation,  
19 business trust, estate, trust, partnership, limited liability  
20 company, association, joint venture, government; governmental  
21 subdivision, agency, or instrumentality; public corporation, or  
22 any other legal or commercial entity.

23 (10) "Principal" means property held in trust for  
24 distribution to a remainder beneficiary when the trust terminates.

25 (11) "Remainder beneficiary" means a person entitled  
26 to receive principal when an income interest ends.

27 (12) "Terms of a trust" means the manifestation of the

1 intent of a settlor or decedent with respect to the trust, expressed  
2 in a manner that admits of its proof in a judicial proceeding,  
3 whether by written or spoken words or by conduct.

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

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

11 Sec. 116.004. FIDUCIARY DUTIES; GENERAL PRINCIPLES. (a)  
12 In allocating receipts and disbursements to or between principal  
13 and income, and with respect to any matter within the scope of  
14 Subchapters B and C, a fiduciary:

15 (1) shall administer a trust or estate in accordance  
16 with the terms of the trust or the will, even if there is a different  
17 provision in this chapter;

18 (2) may administer a trust or estate by the exercise of  
19 a discretionary power of administration given to the fiduciary by  
20 the terms of the trust or the will, even if the exercise of the power  
21 produces a result different from a result required or permitted by  
22 this chapter;

23 (3) shall administer a trust or estate in accordance  
24 with this chapter if the terms of the trust or the will do not  
25 contain a different provision or do not give the fiduciary a  
26 discretionary power of administration; and

27 (4) shall add a receipt or charge a disbursement to

1 principal to the extent that the terms of the trust and this chapter  
2 do not provide a rule for allocating the receipt or disbursement to  
3 or between principal and income.

4 (b) In exercising the power to adjust under Section  
5 116.005(a) or a discretionary power of administration regarding a  
6 matter within the scope of this chapter, whether granted by the  
7 terms of a trust, a will, or this chapter, a fiduciary shall  
8 administer a trust or estate impartially, based on what is fair and  
9 reasonable to all of the beneficiaries, except to the extent that  
10 the terms of the trust or the will clearly manifest an intention  
11 that the fiduciary shall or may favor one or more of the  
12 beneficiaries. A determination in accordance with this chapter is  
13 presumed to be fair and reasonable to all of the beneficiaries.

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

24 (b) In deciding whether and to what extent to exercise the  
25 power conferred by Subsection (a), a trustee shall consider all  
26 factors relevant to the trust and its beneficiaries, including the  
27 following factors to the extent they are relevant:

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

3           (2) the intent of the settlor;

4           (3) the identity and circumstances of the  
5 beneficiaries;

6           (4) the needs for liquidity, regularity of income, and  
7 preservation and appreciation of capital;

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

14           (6) the net amount allocated to income under the other  
15 sections of this chapter and the increase or decrease in the value  
16 of the principal assets, which the trustee may estimate as to assets  
17 for which market values are not readily available;

18           (7) whether and to what extent the terms of the trust  
19 give the trustee the power to invade principal or accumulate income  
20 or prohibit the trustee from invading principal or accumulating  
21 income, and the extent to which the trustee has exercised a power  
22 from time to time to invade principal or accumulate income;

23           (8) the actual and anticipated effect of economic  
24 conditions on principal and income and effects of inflation and  
25 deflation; and

26           (9) the anticipated tax consequences of an adjustment.

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

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

6           (2) that reduces the actuarial value of the income  
7 interest in a trust to which a person transfers property with the  
8 intent to qualify for a gift tax exclusion;

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

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

15           (5) if possessing or exercising the power to make an  
16 adjustment causes an individual to be treated as the owner of all or  
17 part of the trust for income tax purposes, and the individual would  
18 not be treated as the owner if the trustee did not possess the power  
19 to make an adjustment;

20           (6) if possessing or exercising the power to make an  
21 adjustment causes all or part of the trust assets to be included for  
22 estate tax purposes in the estate of an individual who has the power  
23 to remove a trustee or appoint a trustee, or both, and the assets  
24 would not be included in the estate of the individual if the trustee  
25 did not possess the power to make an adjustment;

26           (7) if the trustee is a beneficiary of the trust; or

27           (8) if the trustee is not a beneficiary, but the

1 adjustment would benefit the trustee directly or indirectly.

2 (d) If Subsection (c)(5), (6), (7), or (8) applies to a  
3 trustee and there is more than one trustee, a cotrustee to whom the  
4 provision does not apply may make the adjustment unless the  
5 exercise of the power by the remaining trustee or trustees is not  
6 permitted by the terms of the trust.

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

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

22 Sec. 116.006. JUDICIAL CONTROL OF DISCRETIONARY POWER. (a)  
23 The court may not order a fiduciary to change a decision to exercise  
24 or not to exercise a discretionary power conferred by this chapter  
25 unless the court determines that the decision was an abuse of the  
26 fiduciary's discretion. A fiduciary's decision is not an abuse of  
27 discretion merely because the court would have exercised the power

1 in a different manner or would not have exercised the power.

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

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

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

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

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

22 (2) to the extent that the abuse of discretion has  
23 resulted in a distribution to a beneficiary which is too large, the  
24 court shall place the beneficiaries, the trust, or both, in whole or  
25 in part, in their appropriate positions by ordering the fiduciary  
26 to withhold an amount from one or more future distributions to the  
27 beneficiary who received the distribution that was too large or

1 ordering that beneficiary to return some or all of the distribution  
2 to the trust; and

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

9 (d) Upon petition by the fiduciary, the court having  
10 jurisdiction over a trust or estate shall determine whether a  
11 proposed exercise or nonexercise by the fiduciary of a  
12 discretionary power conferred by this chapter will result in an  
13 abuse of the fiduciary's discretion. If the petition describes the  
14 proposed exercise or nonexercise of the power and contains  
15 sufficient information to inform the beneficiaries of the reasons  
16 for the proposal, the facts upon which the fiduciary relies, and an  
17 explanation of how the income and remainder beneficiaries will be  
18 affected by the proposed exercise or nonexercise of the power, a  
19 beneficiary who challenges the proposed exercise or nonexercise has  
20 the burden of establishing that it will result in an abuse of  
21 discretion.

22 Sec. 116.007. PROVISIONS REGARDING NONCHARITABLE  
23 UNITRUSTS. (a) This section does not apply to a charitable  
24 remainder unitrust as defined by Section 664(d), Internal Revenue  
25 Code of 1986 (26 U.S.C. Section 664), as amended.

26 (b) In this section:

27 (1) "Unitrust" means a trust the terms of which

1 require distribution of a unitrust amount.

2 (2) "Unitrust amount" means a distribution mandated by  
3 the terms of a trust in an amount equal to a fixed percentage of not  
4 less than three or more than five percent per year of the net fair  
5 market value of the trust's assets, valued at least annually. The  
6 unitrust amount may be determined by reference to the net fair  
7 market value of the trust's assets in one year or more than one  
8 year.

9 (c) Distribution of the unitrust amount is considered a  
10 distribution of all of the income of the unitrust and shall not be  
11 considered a fundamental departure from applicable state law. A  
12 distribution of the unitrust amount reasonably apportions the total  
13 return of a unitrust.

14 (d) Unless the terms of the trust specifically provide  
15 otherwise, a distribution of the unitrust amount shall be treated  
16 as first being made from the following sources in order of priority:

17 (1) from net accounting income determined as if the  
18 trust were not a unitrust;

19 (2) from ordinary accounting income not allocable to  
20 net accounting income;

21 (3) from net realized short-term capital gains;

22 (4) from net realized long-term capital gains; and

23 (5) from the principal of the trust estate.

24 [Sections 116.008-116.050 reserved for expansion]

25 SUBCHAPTER B. DECEDENT'S ESTATE OR

26 TERMINATING INCOME INTEREST

27 Sec. 116.051. DETERMINATION AND DISTRIBUTION OF NET INCOME.

1 After a decedent dies, in the case of an estate, or after an income  
2 interest in a trust ends, the following rules apply:

3 (1) A fiduciary of an estate or of a terminating income  
4 interest shall determine the amount of net income and net principal  
5 receipts received from property specifically given to a beneficiary  
6 under the rules in Subchapters C, D, and E which apply to trustees  
7 and the rules in Subdivision (5). The fiduciary shall distribute  
8 the net income and net principal receipts to the beneficiary who is  
9 to receive the specific property.

10 (2) A fiduciary shall determine the remaining net  
11 income of a decedent's estate or a terminating income interest  
12 under the rules in Subchapters C, D, and E which apply to trustees  
13 and by:

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

16 (B) paying from income or principal, in the  
17 fiduciary's discretion, fees of attorneys, accountants, and  
18 fiduciaries; court costs and other expenses of administration; and  
19 interest on death taxes, but the fiduciary may pay those expenses  
20 from income of property passing to a trust for which the fiduciary  
21 claims an estate tax marital or charitable deduction only to the  
22 extent that the payment of those expenses from income will not cause  
23 the reduction or loss of the deduction; and

24 (C) paying from principal all other  
25 disbursements made or incurred in connection with the settlement of  
26 a decedent's estate or the winding up of a terminating income  
27 interest, including debts, funeral expenses, disposition of

1 remains, family allowances, and death taxes and related penalties  
2 that are apportioned to the estate or terminating income interest  
3 by the will, the terms of the trust, or applicable law.

4 (3) A fiduciary shall distribute to a beneficiary who  
5 receives a pecuniary amount outright the interest or any other  
6 amount provided by the will, the terms of the trust, or applicable  
7 law from net income determined under Subdivision (2) or from  
8 principal to the extent that net income is insufficient. If a  
9 beneficiary is to receive a pecuniary amount outright from a trust  
10 after an income interest ends and no interest or other amount is  
11 provided for by the terms of the trust or applicable law, the  
12 fiduciary shall distribute the interest or other amount to which  
13 the beneficiary would be entitled under applicable law if the  
14 pecuniary amount were required to be paid under a will. Unless  
15 otherwise provided by the will or the terms of the trust, a  
16 beneficiary who receives a pecuniary amount, regardless of whether  
17 in trust, shall be paid interest on the pecuniary amount at the  
18 legal rate of interest as provided by Section 302.002, Finance  
19 Code. Interest on the pecuniary amount is payable:

20 (A) under a will, beginning on the first  
21 anniversary of the date of the decedent's death; or

22 (B) under a trust, beginning on the first  
23 anniversary of the date on which an income interest ends.

24 (4) A fiduciary shall distribute the net income  
25 remaining after distributions required by Subdivision (3) in the  
26 manner described in Section 116.052 to all other beneficiaries even  
27 if the beneficiary holds an unqualified power to withdraw assets

1 from the trust or other presently exercisable general power of  
2 appointment over the trust.

3 (5) A fiduciary may not reduce principal or income  
4 receipts from property described in Subdivision (1) because of a  
5 payment described in Section 116.201 or 116.202 to the extent that  
6 the will, the terms of the trust, or applicable law requires the  
7 fiduciary to make the payment from assets other than the property or  
8 to the extent that the fiduciary recovers or expects to recover the  
9 payment from a third party. The net income and principal receipts  
10 from the property are determined by including all of the amounts the  
11 fiduciary receives or pays with respect to the property, whether  
12 those amounts accrued or became due before, on, or after the date of  
13 a decedent's death or an income interest's terminating event, and by  
14 making a reasonable provision for amounts that the fiduciary  
15 believes the estate or terminating income interest may become  
16 obligated to pay after the property is distributed.

17 (6) A fiduciary, without reduction for taxes, shall  
18 pay to a charitable organization that is entitled to receive income  
19 under Subdivision (4) any amount allowed as a tax deduction to the  
20 estate or trust for income payable to the charitable organization.

21 Sec. 116.052. DISTRIBUTION TO RESIDUARY AND REMAINDER  
22 BENEFICIARIES. (a) Each beneficiary described in Section  
23 116.051(4) is entitled to receive a portion of the net income equal  
24 to the beneficiary's fractional interest in undistributed  
25 principal assets, using values as of the distribution date. If a  
26 fiduciary makes more than one distribution of assets to  
27 beneficiaries to whom this section applies, each beneficiary,

1 including one who does not receive part of the distribution, is  
2 entitled, as of each distribution date, to the net income the  
3 fiduciary has received after the date of death or terminating event  
4 or earlier distribution date but has not distributed as of the  
5 current distribution date.

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

8 (1) The beneficiary is entitled to receive a portion  
9 of the net income equal to the beneficiary's fractional interest in  
10 the undistributed principal assets immediately before the  
11 distribution date, including assets that later may be sold to meet  
12 principal obligations.

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

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

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

25 (c) If a fiduciary does not distribute all of the collected  
26 but undistributed net income to each person as of a distribution  
27 date, the fiduciary shall maintain appropriate records showing the

1 interest of each beneficiary in that net income.

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

7 [Sections 116.053-116.100 reserved for expansion]

8 SUBCHAPTER C. APPORTIONMENT AT BEGINNING

9 AND END OF INCOME INTEREST

10 Sec. 116.101. WHEN RIGHT TO INCOME BEGINS AND ENDS. (a) An  
11 income beneficiary is entitled to net income from the date on which  
12 the income interest begins. An income interest begins on the date  
13 specified in the terms of the trust or, if no date is specified, on  
14 the date an asset becomes subject to a trust or successive income  
15 interest.

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

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

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

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

27 (c) An asset becomes subject to a successive income interest

1 on the day after the preceding income interest ends, as determined  
2 under Subsection (d), even if there is an intervening period of  
3 administration to wind up the preceding income interest.

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

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

15 (b) A trustee shall allocate an income receipt or  
16 disbursement to income if its due date occurs on or after the date  
17 on which a decedent dies or an income interest begins and it is a  
18 periodic due date. An income receipt or disbursement must be  
19 treated as accruing from day to day if its due date is not periodic  
20 or it has no due date. The portion of the receipt or disbursement  
21 accruing before the date on which a decedent dies or an income  
22 interest begins must be allocated to principal and the balance must  
23 be allocated to income.

24 (c) An item of income or an obligation is due on the date the  
25 payer is required to make a payment. If a payment date is not  
26 stated, there is no due date for the purposes of this chapter.  
27 Distributions to shareholders or other owners from an entity to

1 which Section 116.151 applies are deemed to be due on the date fixed  
2 by the entity for determining who is entitled to receive the  
3 distribution or, if no date is fixed, on the declaration date for  
4 the distribution. A due date is periodic for receipts or  
5 disbursements that must be paid at regular intervals under a lease  
6 or an obligation to pay interest or if an entity customarily makes  
7 distributions at regular intervals.

8 Sec. 116.103. APPORTIONMENT WHEN INCOME INTEREST ENDS. (a)

9 In this section, "undistributed income" means net income received  
10 before the date on which an income interest ends. The term does not  
11 include an item of income or expense that is due or accrued or net  
12 income that has been added or is required to be added to principal  
13 under the terms of the trust.

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

24 (c) When a trustee's obligation to pay a fixed annuity or a  
25 fixed fraction of the value of the trust's assets ends, the trustee  
26 shall prorate the final payment if and to the extent required by  
27 applicable law to accomplish a purpose of the trust or its settlor

1 relating to income, gift, estate, or other tax requirements.

2 [Sections 116.104-116.150 reserved for expansion]

3 SUBCHAPTER D. ALLOCATION OF RECEIPTS DURING

4 ADMINISTRATION OF TRUST

5 PART 1. RECEIPTS FROM ENTITIES

6 Sec. 116.151. CHARACTER OF RECEIPTS. (a) In this section,  
7 "entity" means a corporation, partnership, limited liability  
8 company, regulated investment company, real estate investment  
9 trust, common trust fund, or any other organization in which a  
10 trustee has an interest other than a trust or estate to which  
11 Section 116.152 applies, a business or activity to which Section  
12 116.153 applies, or an asset-backed security to which Section  
13 116.178 applies.

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

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

18 (1) property other than money;

19 (2) money received in one distribution or a series of  
20 related distributions in exchange for part or all of a trust's  
21 interest in the entity;

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

24 (4) money received from an entity that is a regulated  
25 investment company or a real estate investment trust if the money  
26 distributed is a capital gain dividend for federal income tax  
27 purposes.

1        (d) Money is received in partial liquidation:

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

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

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

15        (f) A trustee may rely upon a statement made by an entity  
16 about the source or character of a distribution if the statement is  
17 made at or near the time of distribution by the entity's board of  
18 directors or other person or group of persons authorized to  
19 exercise powers to pay money or transfer property comparable to  
20 those of a corporation's board of directors.

21        Sec. 116.152. DISTRIBUTION FROM TRUST OR ESTATE. A trustee  
22 shall allocate to income an amount received as a distribution of  
23 income from a trust or an estate in which the trust has an interest  
24 other than a purchased interest, and shall allocate to principal an  
25 amount received as a distribution of principal from such a trust or  
26 estate. If a trustee purchases an interest in a trust that is an  
27 investment entity, or a decedent or donor transfers an interest in

1 such a trust to a trustee, Section 116.151 or 116.178 applies to a  
2 receipt from the trust.

3 Sec. 116.153. BUSINESS AND OTHER ACTIVITIES CONDUCTED BY  
4 TRUSTEE. (a) If a trustee who conducts a business or other  
5 activity determines that it is in the best interest of all the  
6 beneficiaries to account separately for the business or activity  
7 instead of accounting for it as part of the trust's general  
8 accounting records, the trustee may maintain separate accounting  
9 records for its transactions, whether or not its assets are  
10 segregated from other trust assets.

11 (b) A trustee who accounts separately for a business or  
12 other activity may determine the extent to which its net cash  
13 receipts must be retained for working capital, the acquisition or  
14 replacement of fixed assets, and other reasonably foreseeable needs  
15 of the business or activity, and the extent to which the remaining  
16 net cash receipts are accounted for as principal or income in the  
17 trust's general accounting records. If a trustee sells assets of  
18 the business or other activity, other than in the ordinary course of  
19 the business or activity, the trustee shall account for the net  
20 amount received as principal in the trust's general accounting  
21 records to the extent the trustee determines that the amount  
22 received is no longer required in the conduct of the business.

23 (c) Activities for which a trustee may maintain separate  
24 accounting records include:

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

27 (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  
4 resources;
- 5           (6) timber operations; and
- 6           (7) activities to which Section 116.177 applies.

7           [Sections 116.154-116.160 reserved for expansion]

8           PART 2. RECEIPTS NOT NORMALLY APPORTIONED

9           Sec. 116.161. PRINCIPAL RECEIPTS. A trustee shall allocate  
10 to principal:

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

16           (2) money or other property received from the sale,  
17 exchange, liquidation, or change in form of a principal asset,  
18 including realized profit, subject to this subchapter;

19           (3) amounts recovered from third parties to reimburse  
20 the trust because of disbursements described in Section  
21 116.202(a)(7) or for other reasons to the extent not based on the  
22 loss of income;

23           (4) proceeds of property taken by eminent domain, but  
24 a separate award made for the loss of income with respect to an  
25 accounting period during which a current income beneficiary had a  
26 mandatory income interest is income;

27           (5) net income received in an accounting period during

1 which there is no beneficiary to whom a trustee may or must  
2 distribute income; and

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

4 Sec. 116.162. RENTAL PROPERTY. To the extent that a trustee  
5 accounts for receipts from rental property pursuant to this  
6 section, the trustee shall allocate to income an amount received as  
7 rent of real or personal property, including an amount received for  
8 cancellation or renewal of a lease. An amount received as a  
9 refundable deposit, including a security deposit or a deposit that  
10 is to be applied as rent for future periods, must be added to  
11 principal and held subject to the terms of the lease and is not  
12 available for distribution to a beneficiary until the trustee's  
13 contractual obligations have been satisfied with respect to that  
14 amount.

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

21 (b) A trustee shall allocate to principal an amount received  
22 from the sale, redemption, or other disposition of an obligation to  
23 pay money to the trustee more than one year after it is purchased or  
24 acquired by the trustee, including an obligation whose purchase  
25 price or value when it is acquired is less than its value at  
26 maturity. If the obligation matures within one year after it is  
27 purchased or acquired by the trustee, an amount received in excess

1 of its purchase price or its value when acquired by the trust must  
2 be allocated to income.

3 (c) This section does not apply to an obligation to which  
4 Section 116.172, 116.173, 116.174, 116.175, 116.177, or 116.178  
5 applies.

6 Sec. 116.164. INSURANCE POLICIES AND SIMILAR CONTRACTS.

7 (a) Except as otherwise provided in Subsection (b), a trustee shall  
8 allocate to principal the proceeds of a life insurance policy or  
9 other contract in which the trust or its trustee is named as  
10 beneficiary, including a contract that insures the trust or its  
11 trustee against loss for damage to, destruction of, or loss of title  
12 to a trust asset. The trustee shall allocate dividends on an  
13 insurance policy to income if the premiums on the policy are paid  
14 from income, and to principal if the premiums are paid from  
15 principal.

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

20 (c) This section does not apply to a contract to which  
21 Section 116.172 applies.

22 [Sections 116.165-116.170 reserved for expansion]

23 PART 3. RECEIPTS NORMALLY APPORTIONED

24 Sec. 116.171. INSUBSTANTIAL ALLOCATIONS NOT REQUIRED. If a  
25 trustee determines that an allocation between principal and income  
26 required by Section 116.172, 116.173, 116.174, 116.175, or 116.178  
27 is insubstantial, the trustee may allocate the entire amount to

1 principal unless one of the circumstances described in Section  
2 116.005(c) applies to the allocation. This power may be exercised  
3 by a cotrustee in the circumstances described in Section 116.005(d)  
4 and may be released for the reasons and in the manner described in  
5 Section 116.005(e).

6 Sec. 116.172. DEFERRED COMPENSATION, ANNUITIES, AND  
7 SIMILAR PAYMENTS. (a) In this section:

8 (1) "Future payment asset" means the asset from which  
9 a payment is derived.

10 (2) "Payment" means a payment that a trustee may  
11 receive over a fixed number of years or during the life of one or  
12 more individuals because of services rendered or property  
13 transferred to the payer in exchange for future payments. The term  
14 includes a payment made in money or property from the payer's  
15 general assets or from a separate fund created by the payer,  
16 including a private or commercial annuity, an individual retirement  
17 account, and a pension, profit-sharing, stock-bonus, or  
18 stock-ownership plan.

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

25 (c) If no part of a payment is characterized as interest, a  
26 dividend, or an equivalent payment, and all or part of the payment  
27 is required to be made, a trustee shall allocate to income the part

1 of the payment that does not exceed an amount equal to:

2 (1) four percent of the fair market value of the future  
3 payment asset as determined under Subsection (d); less

4 (2) the total amount that the trustee has allocated to  
5 income for a previous payment received from the future payment  
6 asset during the accounting period prescribed by Subsection (d).

7 (d) For purposes of Subsection (c)(1), the determination of  
8 a future payment asset is made on the later of:

9 (1) the date on which the future payment right first  
10 becomes subject to the trust; or

11 (2) the first day of the trust's accounting period  
12 during which the future payment asset is received.

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

18 (f) A trustee shall allocate to principal the part of the  
19 payment described by Subsection (c) that is not allocated to  
20 income.

21 (g) If no part of a payment is required to be made or the  
22 payment received is the entire amount to which the trustee is  
23 entitled, the trustee shall allocate the entire payment to  
24 principal. For purposes of Subsection (c) and this subsection, a  
25 payment is not "required to be made" to the extent that it is made  
26 only because the trustee exercises a right of withdrawal.

27 (h) If, to obtain an estate tax marital deduction for a

1 trust, a trustee must allocate more of a payment to income than  
2 provided for by this section, the trustee shall allocate to income  
3 the additional amount necessary to obtain the marital deduction.

4 Sec. 116.173. LIQUIDATING ASSET. (a) In this section,  
5 "liquidating asset" means an asset whose value will diminish or  
6 terminate because the asset is expected to produce receipts for a  
7 period of limited duration. The term includes a leasehold, patent,  
8 copyright, royalty right, and right to receive payments during a  
9 period of more than one year under an arrangement that does not  
10 provide for the payment of interest on the unpaid balance. The term  
11 does not include a payment subject to Section 116.172, resources  
12 subject to Section 116.174, timber subject to Section 116.175, an  
13 activity subject to Section 116.177, an asset subject to Section  
14 116.178, or any asset for which the trustee establishes a reserve  
15 for depreciation under Section 116.203.

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

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

22 Sec. 116.174. MINERALS, WATER, AND OTHER NATURAL RESOURCES.

23 (a) To the extent that a trustee accounts for receipts from an  
24 interest in minerals or other natural resources pursuant to this  
25 section, the trustee shall allocate them as follows:

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

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

5           (3) If an amount received as a royalty, shut-in-well  
6 payment, take-or-pay payment, bonus, or delay rental is more than  
7 nominal, the trustee shall allocate the receipt equitably.

8           (4) If an amount is received from a working interest or  
9 any other interest not provided for in Subdivision (1), (2), or (3),  
10 the trustee must allocate the receipt equitably.

11           (b) An amount received on account of an interest in water  
12 that is renewable must be allocated to income. If the water is not  
13 renewable, the trustee must allocate the receipt equitably.

14           (c) This chapter applies whether or not a decedent or donor  
15 was extracting minerals, water, or other natural resources before  
16 the interest became subject to the trust.

17           (d) The trustee may allocate a receipt from any interest in  
18 minerals, water, or other natural resources the trust owns on  
19 January 1, 2004, in the manner provided by this chapter or in any  
20 lawful manner used by the trustee before January 1, 2004, to make  
21 the same allocation. The trustee shall allocate a receipt from any  
22 interest in minerals, water, or other natural resources acquired by  
23 the trust after January 1, 2004, in the manner provided by this  
24 chapter.

25           (e) An allocation of a receipt under this section is  
26 presumed to be equitable if the amount allocated to principal is  
27 equal to the amount allowed by the Internal Revenue Code of 1986 as

1 a deduction for depletion of the interest.

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

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

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

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

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

21 (b) In determining net receipts to be allocated pursuant to  
22 Subsection (a), a trustee shall deduct and transfer to principal a  
23 reasonable amount for depletion.

24 (c) This chapter applies whether or not a decedent or  
25 transferor was harvesting timber from the property before it became  
26 subject to the trust.

27 (d) If a trust owns an interest in timberland on January 1,

1 2004, the trustee may allocate a net receipt from the sale of timber  
2 and related products in the manner provided by this chapter or in  
3 any lawful manner used by the trustee before January 1, 2004, to  
4 make the same allocation. If the trust acquires an interest in  
5 timberland after January 1, 2004, the trustee shall allocate net  
6 receipts from the sale of timber and related products in the manner  
7 provided by this chapter.

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

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

24 Sec. 116.177. DERIVATIVES AND OPTIONS. (a) In this  
25 section, "derivative" means a contract or financial instrument or a  
26 combination of contracts and financial instruments which gives a  
27 trust the right or obligation to participate in some or all changes

1 in the price of a tangible or intangible asset or group of assets,  
2 or changes in a rate, an index of prices or rates, or other market  
3 indicator for an asset or a group of assets.

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

8 (c) If a trustee grants an option to buy property from the  
9 trust, whether or not the trust owns the property when the option is  
10 granted, grants an option that permits another person to sell  
11 property to the trust, or acquires an option to buy property for the  
12 trust or an option to sell an asset owned by the trust, and the  
13 trustee or other owner of the asset is required to deliver the asset  
14 if the option is exercised, an amount received for granting the  
15 option must be allocated to principal. An amount paid to acquire  
16 the option must be paid from principal. A gain or loss realized  
17 upon the exercise of an option, including an option granted to a  
18 settlor of the trust for services rendered, must be allocated to  
19 principal.

20 Sec. 116.178. ASSET-BACKED SECURITIES. (a) In this  
21 section, "asset-backed security" means an asset whose value is  
22 based upon the right it gives the owner to receive distributions  
23 from the proceeds of financial assets that provide collateral for  
24 the security. The term includes an asset that gives the owner the  
25 right to receive from the collateral financial assets only the  
26 interest or other current return or only the proceeds other than  
27 interest or current return. The term does not include an asset to

1 which Section 116.151 or 116.172 applies.

2 (b) If a trust receives a payment from interest or other  
3 current return and from other proceeds of the collateral financial  
4 assets, the trustee shall allocate to income the portion of the  
5 payment which the payer identifies as being from interest or other  
6 current return and shall allocate the balance of the payment to  
7 principal.

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

15 [Sections 116.179-116.200 reserved for expansion]

16 SUBCHAPTER E. ALLOCATION OF DISBURSEMENTS DURING

17 ADMINISTRATION OF TRUST

18 Sec. 116.201. DISBURSEMENTS FROM INCOME. A trustee shall  
19 make the following disbursements from income to the extent that  
20 they are not disbursements to which Section 116.051(2)(B) or (C)  
21 applies:

22 (1) one-half of the regular compensation of the  
23 trustee and of any person providing investment advisory or  
24 custodial services to the trustee;

25 (2) one-half of all expenses for accountings, judicial  
26 proceedings, or other matters that involve both the income and  
27 remainder interests;

1           (3) all of the other ordinary expenses incurred in  
2 connection with the administration, management, or preservation of  
3 trust property and the distribution of income, including interest,  
4 ordinary repairs, regularly recurring taxes assessed against  
5 principal, and expenses of a proceeding or other matter that  
6 concerns primarily the income interest; and

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

9           Sec. 116.202. DISBURSEMENTS FROM PRINCIPAL. (a) A trustee  
10 shall make the following disbursements from principal:

11           (1) the remaining one-half of the disbursements  
12 described in Sections 116.201(1) and (2);

13           (2) all of the trustee's compensation calculated on  
14 principal as a fee for acceptance, distribution, or termination,  
15 and disbursements made to prepare property for sale;

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

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

20           (5) premiums paid on a policy of insurance not  
21 described in Section 116.201(4) of which the trust is the owner and  
22 beneficiary;

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

25           (7) disbursements related to environmental matters,  
26 including reclamation, assessing environmental conditions,  
27 remedying and removing environmental contamination, monitoring

1 remedial activities and the release of substances, preventing  
2 future releases of substances, collecting amounts from persons  
3 liable or potentially liable for the costs of those activities,  
4 penalties imposed under environmental laws or regulations and other  
5 payments made to comply with those laws or regulations, statutory  
6 or common law claims by third parties, and defending claims based on  
7 environmental matters.

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

13 Sec. 116.203. TRANSFERS FROM INCOME TO PRINCIPAL FOR  
14 DEPRECIATION. (a) In this section, "depreciation" means a  
15 reduction in value due to wear, tear, decay, corrosion, or gradual  
16 obsolescence of a fixed asset having a useful life of more than one  
17 year.

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

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

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

27 (3) under this section if the trustee is accounting

1 under Section 116.153 for the business or activity in which the  
2 asset is used.

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

5 Sec. 116.204. TRANSFERS FROM INCOME TO REIMBURSE PRINCIPAL.

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

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

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

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

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

23 (4) periodic payments on an obligation secured by a  
24 principal asset to the extent that the amount transferred from  
25 income to principal for depreciation is less than the periodic  
26 payments; and

27 (5) disbursements described in Section 116.202(a)(7).

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

5 Sec. 116.205. INCOME TAXES. (a) A tax required to be paid  
6 by a trustee based on receipts allocated to income must be paid from  
7 income.

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

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

13 (1) from income to the extent that receipts from the  
14 entity are allocated to income; and

15 (2) from principal to the extent that:

16 (A) receipts from the entity are allocated to  
17 principal; and

18 (B) the trust's share of the entity's taxable  
19 income exceeds the total receipts described in Subdivisions (1) and  
20 (2)(A).

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

25 Sec. 116.206. ADJUSTMENTS BETWEEN PRINCIPAL AND INCOME  
26 BECAUSE OF TAXES. (a) A fiduciary may make adjustments between  
27 principal and income to offset the shifting of economic interests

1 or tax benefits between income beneficiaries and remainder  
2 beneficiaries which arise from:

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

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

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

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

1 reimburse principal from income.

2 SECTION 2. Sections 111.004(5) and (11), Property Code, are  
3 amended to read as follows:

4 (5) "Income" is defined in Section 116.002 [~~113.102~~].

5 (11) "Principal" is defined in Section 116.002  
6 [~~113.102~~].

7 SECTION 3. Section 378B, Texas Probate Code, is amended by  
8 amending Subsections (a), (b), (d), and (g) and adding Subsection  
9 (i) to read as follows:

10 (a) Except as provided by Subsection (b) of this section and  
11 unless the will provides otherwise, all expenses incurred in  
12 connection with the settlement of a decedent's estate, including  
13 debts, funeral expenses, estate taxes, [~~interest and~~] penalties  
14 relating to estate taxes, and family allowances, shall be charged  
15 against the principal of the estate. Fees and expenses of an  
16 attorney, accountant, or other professional advisor, commissions  
17 and expenses of a personal representative, court costs, and all  
18 other similar fees or expenses relating to the administration of  
19 the estate and interest relating to estate taxes shall be allocated  
20 between the income and principal of the estate as the executor  
21 determines in its discretion to be just and equitable.

22 (b) Unless the will provides otherwise, income from the  
23 assets of a decedent's estate that accrues after the death of the  
24 testator and before distribution, including income from property  
25 used to discharge liabilities, shall be determined according to the  
26 rules applicable to a trustee under the Texas Trust Code (Subtitle  
27 B, Title 9, Property Code) and distributed as provided by Chapter

1 116, Property Code, and Subsections (c) and [7] (d)[, and (e)] of  
2 this section.

3 (d) The [~~Except as provided by Subsection (f) of this~~  
4 ~~section, the~~] balance of the net income shall be distributed to all  
5 other devisees after reduction for the balance of property taxes,  
6 ordinary repairs, insurance premiums, interest accrued, [~~including~~  
7 ~~interest accruing as provided by Subsection (f) of this section~~  
8 ~~after the death of the testator,~~] other expenses of management and  
9 operation of all property from which the estate is entitled to  
10 income, and taxes imposed on income that accrues during the period  
11 of administration and that is payable or allocable to the devisees,  
12 in proportion to the devisees' respective interests in the  
13 undistributed assets of the estate.

14 (g) Income received by a trustee under this section shall be  
15 treated as income of the trust as provided by Section 116.101  
16 [~~113.103~~], Property Code.

17 (i) Chapter 116, Property Code, prevails to the extent of  
18 any conflict between this section and Chapter 116, Property Code.

19 SECTION 4. Subchapter D, Chapter 113, Property Code, and  
20 Sections 378B(e) and (f), Texas Probate Code, are repealed.

21 SECTION 5. (a) This Act takes effect January 1, 2004.

22 (b) Except as otherwise expressly provided by the will, the  
23 terms of the trust, or this Act, this Act applies only to:

24 (1) a trust existing or created on or after January 1,  
25 2004;

26 (2) the estate of a decedent who dies before January 1,  
27 2004, if the probate or administration of the estate is pending as

1 of January 1, 2004; and

2 (3) the estate of a decedent who dies on or after

3 January 1, 2004.