

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 AND FIDUCIARY DUTIES

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 receives as current return from a principal asset. The term

1 includes a portion of receipts from a sale, exchange, or
2 liquidation of a principal asset, to the extent provided in
3 Subchapter D.

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

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

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

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

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

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

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

26 (12) "Terms of a trust" means the manifestation of the
27 intent of a settlor or decedent with respect to the trust, expressed

1 in a manner that admits of its proof in a judicial proceeding,
2 whether by written or spoken words or by conduct.

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

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

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

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

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

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

26 (4) shall add a receipt or charge a disbursement to
27 principal to the extent that the terms of the trust and this chapter

1 do not provide a rule for allocating the receipt or disbursement to
2 or between principal and income.

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

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

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

27 (1) the nature, purpose, and expected duration of the

1 trust;

2 (2) the intent of the settlor;

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

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

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

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

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

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

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

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

27 (1) that diminishes the income interest in a trust

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

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

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

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

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

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

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

26 (8) if the trustee is not a beneficiary, but the
27 adjustment would benefit the trustee directly or indirectly.

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

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

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

21 Sec. 116.006. PROVISIONS REGARDING NONCHARITABLE
22 UNITRUSTS. (a) This section does not apply to a charitable
23 remainder unitrust as defined by Section 664(d), Internal Revenue
24 Code of 1986 (26 U.S.C. Section 664), as amended.

25 (b) In this section:

26 (1) "Unitrust" means a trust the terms of which
27 require distribution of a unitrust amount.

1 (2) "Unitrust amount" means a distribution mandated by
2 the terms of a trust in an amount equal to a fixed percentage
3 between three and five percent per year of the net fair market value
4 of the trust's assets, valued at least annually. The unitrust
5 amount may be determined by reference to the net fair market value
6 of the trust's assets in one year or more.

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

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

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

17 (2) from ordinary accounting income not allocable to
18 net accounting income;

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

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

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

22 [Sections 116.007-116.050 reserved for expansion]

23 SUBCHAPTER B. DECEDENT'S ESTATE OR

24 TERMINATING INCOME INTEREST

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

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

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

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

12 (A) including in net income all income from
13 property used to discharge liabilities;

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

22 (C) paying from principal all other
23 disbursements made or incurred in connection with the settlement of
24 a decedent's estate or the winding up of a terminating income
25 interest, including debts, funeral expenses, disposition of
26 remains, family allowances, and death taxes and related penalties
27 that are apportioned to the estate or terminating income interest

1 by the will, the terms of the trust, or applicable law.

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

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

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

22 (4) A fiduciary shall distribute the net income
23 remaining after distributions required by Subdivision (3) in the
24 manner described in Section 116.052 to all other beneficiaries even
25 if the beneficiary holds an unqualified power to withdraw assets
26 from the trust or other presently exercisable general power of
27 appointment over the trust.

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

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

19 Sec. 116.052. DISTRIBUTION TO RESIDUARY AND REMAINDER
20 BENEFICIARIES. (a) Each beneficiary described in Section
21 116.051(4) is entitled to receive a portion of the net income equal
22 to the beneficiary's fractional interest in undistributed
23 principal assets, using values as of the distribution date. If a
24 fiduciary makes more than one distribution of assets to
25 beneficiaries to whom this section applies, each beneficiary,
26 including one who does not receive part of the distribution, is
27 entitled, as of each distribution date, to the net income the

1 fiduciary has received after the date of death or terminating event
2 or earlier distribution date but has not distributed as of the
3 current distribution date.

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

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

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

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

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

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

27 (d) A fiduciary may apply the rules in this section, to the

1 extent that the fiduciary considers it appropriate, to net gain or
2 loss realized after the date of death or terminating event or
3 earlier distribution date from the disposition of a principal asset
4 if this section applies to the income from the asset.

5 [Sections 116.053-116.100 reserved for expansion]

6 SUBCHAPTER C. APPORTIONMENT AT BEGINNING

7 AND END OF INCOME INTEREST

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

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

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

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

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

25 (c) An asset becomes subject to a successive income interest
26 on the day after the preceding income interest ends, as determined
27 under Subsection (d), even if there is an intervening period of

1 administration to wind up the preceding income interest.

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

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

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

22 (c) An item of income or an obligation is due on the date the
23 payer is required to make a payment. If a payment date is not
24 stated, there is no due date for the purposes of this chapter.
25 Distributions to shareholders or other owners from an entity to
26 which Section 116.151 applies are deemed to be due on the date fixed
27 by the entity for determining who is entitled to receive the

1 distribution or, if no date is fixed, on the declaration date for
2 the distribution. A due date is periodic for receipts or
3 disbursements that must be paid at regular intervals under a lease
4 or an obligation to pay interest or if an entity customarily makes
5 distributions at regular intervals.

6 Sec. 116.103. APPORTIONMENT WHEN INCOME INTEREST ENDS. (a)
7 In this section, "undistributed income" means net income received
8 before the date on which an income interest ends. The term does not
9 include an item of income or expense that is due or accrued or net
10 income that has been added or is required to be added to principal
11 under the terms of the trust.

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

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

27 [Sections 116.104-116.150 reserved for expansion]

1 SUBCHAPTER D. ALLOCATION OF RECEIPTS DURING

2 ADMINISTRATION OF TRUST

3 PART 1. RECEIPTS FROM ENTITIES

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

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

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

16 (1) property other than money;

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

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

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

26 (d) Money is received in partial liquidation:

27 (1) to the extent that the entity, at or near the time

1 of a distribution, indicates that it is a distribution in partial
2 liquidation; or

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

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

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

19 Sec. 116.152. DISTRIBUTION FROM TRUST OR ESTATE. A trustee
20 shall allocate to income an amount received as a distribution of
21 income from a trust or an estate in which the trust has an interest
22 other than a purchased interest, and shall allocate to principal an
23 amount received as a distribution of principal from such a trust or
24 estate. If a trustee purchases an interest in a trust that is an
25 investment entity, or a decedent or donor transfers an interest in
26 such a trust to a trustee, Section 116.151 or 116.178 applies to a
27 receipt from the trust.

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

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

21 (c) Activities for which a trustee may maintain separate
22 accounting records include:

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

25 (2) farming;

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

27 (4) management of rental properties;

1 (5) extraction of minerals and other natural
2 resources;

3 (6) timber operations; and

4 (7) activities to which Section 116.177 applies.

5 [Sections 116.154-116.160 reserved for expansion]

6 PART 2. RECEIPTS NOT NORMALLY APPORTIONED

7 Sec. 116.161. PRINCIPAL RECEIPTS. A trustee shall allocate
8 to principal:

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

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

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

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

25 (5) net income received in an accounting period during
26 which there is no beneficiary to whom a trustee may or must
27 distribute income; and

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

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

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

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

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

4 Sec. 116.164. INSURANCE POLICIES AND SIMILAR CONTRACTS.

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

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

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

20 [Sections 116.165-116.170 reserved for expansion]

21 PART 3. RECEIPTS NORMALLY APPORTIONED

22 Sec. 116.171. INSUBSTANTIAL ALLOCATIONS NOT REQUIRED. If a
23 trustee determines that an allocation between principal and income
24 required by Section 116.172, 116.173, 116.174, 116.175, or 116.178
25 is insubstantial, the trustee may allocate the entire amount to
26 principal unless one of the circumstances described in Section
27 116.005(c) applies to the allocation. This power may be exercised

1 by a cotrustee in the circumstances described in Section 116.005(d)
2 and may be released for the reasons and in the manner described in
3 Section 116.005(e).

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

6 (1) "Future payment asset" means the asset from which
7 a payment is derived.

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

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

23 (c) If no part of a payment is characterized as interest, a
24 dividend, or an equivalent payment, and all or part of the payment
25 is required to be made, a trustee shall allocate to income the part
26 of the payment that does not exceed an amount equal to:

27 (1) four percent of the fair market value of the future

1 payment asset as determined under Subsection (d); less

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

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

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

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

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

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

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

25 (h) If, to obtain an estate tax marital deduction for a
26 trust, a trustee must allocate more of a payment to income than
27 provided for by this section, the trustee shall allocate to income

1 the additional amount necessary to obtain the marital deduction.

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

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

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

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

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

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

26 (2) If received from a production payment, a receipt
27 must be allocated to income if and to the extent that the agreement

1 creating the production payment provides a factor for interest or
2 its equivalent. The balance must be allocated to principal.

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

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

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

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

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

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

27 Sec. 116.175. TIMBER. (a) To the extent that a trustee

1 accounts for receipts from the sale of timber and related products
2 pursuant to this section, the trustee shall allocate the net
3 receipts:

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

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

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

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

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

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

25 (d) If a trust owns an interest in timberland on January 1,
26 2004, the trustee may allocate a net receipt from the sale of timber
27 and related products in the manner provided by this chapter or in

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

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

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

22 Sec. 116.177. DERIVATIVES AND OPTIONS. (a) In this
23 section, "derivative" means a contract or financial instrument or a
24 combination of contracts and financial instruments which gives a
25 trust the right or obligation to participate in some or all changes
26 in the price of a tangible or intangible asset or group of assets,
27 or changes in a rate, an index of prices or rates, or other market

1 indicator for an asset or a group of assets.

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

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

18 Sec. 116.178. ASSET-BACKED SECURITIES. (a) In this
19 section, "asset-backed security" means an asset whose value is
20 based upon the right it gives the owner to receive distributions
21 from the proceeds of financial assets that provide collateral for
22 the security. The term includes an asset that gives the owner the
23 right to receive from the collateral financial assets only the
24 interest or other current return or only the proceeds other than
25 interest or current return. The term does not include an asset to
26 which Section 116.151 or 116.172 applies.

27 (b) If a trust receives a payment from interest or other

1 current return and from other proceeds of the collateral financial
2 assets, the trustee shall allocate to income the portion of the
3 payment which the payer identifies as being from interest or other
4 current return and shall allocate the balance of the payment to
5 principal.

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

13 [Sections 116.179-116.200 reserved for expansion]

14 SUBCHAPTER E. ALLOCATION OF DISBURSEMENTS DURING

15 ADMINISTRATION OF TRUST

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

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

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

26 (3) all of the other ordinary expenses incurred in
27 connection with the administration, management, or preservation of

1 trust property and the distribution of income, including interest,
2 ordinary repairs, regularly recurring taxes assessed against
3 principal, and expenses of a proceeding or other matter that
4 concerns primarily the income interest; and

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

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

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

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

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

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

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

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

23 (7) disbursements related to environmental matters,
24 including reclamation, assessing environmental conditions,
25 remedying and removing environmental contamination, monitoring
26 remedial activities and the release of substances, preventing
27 future releases of substances, collecting amounts from persons

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

26 (c) If the asset whose ownership gives rise to the
27 disbursements becomes subject to a successive income interest after

1 an income interest ends, a trustee may continue to transfer amounts
2 from income to principal as provided in Subsection (a).

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

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

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

11 (1) from income to the extent that receipts from the
12 entity are allocated to income; and

13 (2) from principal to the extent that:

14 (A) receipts from the entity are allocated to
15 principal; and

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

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

23 Sec. 116.206. ADJUSTMENTS BETWEEN PRINCIPAL AND INCOME
24 BECAUSE OF TAXES. (a) A fiduciary may make adjustments between
25 principal and income to offset the shifting of economic interests
26 or tax benefits between income beneficiaries and remainder
27 beneficiaries which arise from:

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

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

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

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

27 SECTION 2. Sections 111.004(5) and (11), Property Code, are

1 amended to read as follows:

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

3 (11) "Principal" is defined in Section 116.002
4 [~~113.102~~].

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

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

20 (b) Unless the will provides otherwise, income from the
21 assets of a decedent's estate that accrues after the death of the
22 testator and before distribution, including income from property
23 used to discharge liabilities, shall be determined according to the
24 rules applicable to a trustee under the Texas Trust Code (Subtitle
25 B, Title 9, Property Code) and distributed as provided by Chapter
26 116, Property Code, and Subsections (c) and [~~7~~] (d) [~~7 and (e)~~] of
27 this section.

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

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

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

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

19 SECTION 5. This Act takes effect January 1, 2004.