

1-1 By: Paxton (Senate Sponsor - Harris) H.B. No. 2241
1-2 (In the Senate - Received from the House May 1, 2003;
1-3 May 7, 2003, read first time and referred to Committee on
1-4 Jurisprudence; May 22, 2003, reported favorably, as amended, by
1-5 the following vote: Yeas 5, Nays 0; May 22, 2003, sent to printer.)

1-6 COMMITTEE AMENDMENT NO. 1 By: Harris

1-7 Amend HB 2241 by striking page 4, line 69 to page 5, line 53
1-8 and substituting the following:

1-9 Sec. 116.006. JUDICIAL CONTROL OF DISCRETIONARY POWER.

1-10 (a) The court may not order a trustee to change a decision to
1-11 exercise or not to exercise a discretionary power conferred by
1-12 Section 116.005 of this chapter unless the court determines that
1-13 the decision was an abuse of the trustee's discretion. A trustee's
1-14 decision is not an abuse of discretion merely because the court
1-15 would have exercised the power in a different manner or would not
1-16 have exercised the power.

1-17 (b) The decisions to which Subsection (a) applies include:

1-18 (1) a decision under Section 116.005(a) as to whether
1-19 and to what extent an amount should be transferred from principal to
1-20 income or from income to principal; and

1-21 (2) a decision regarding the factors that are relevant
1-22 to the trust and its beneficiaries, the extent to which the factors
1-23 are relevant, and the weight, if any, to be given to those factors,
1-24 in deciding whether and to what extent to exercise the
1-25 discretionary power conferred by Section 116.005(a).

1-26 (c) If the court determines that a trustee has abused the
1-27 trustee's discretion, the court may place the income and remainder
1-28 beneficiaries in the positions they would have occupied if the
1-29 discretion had not been abused, according to the following rules:

1-30 (1) to the extent that the abuse of discretion has
1-31 resulted in no distribution to a beneficiary or in a distribution
1-32 that is too small, the court shall order the trustee to distribute
1-33 from the trust to the beneficiary an amount that the court
1-34 determines will restore the beneficiary, in whole or in part, to the
1-35 beneficiary's appropriate position;

1-36 (2) to the extent that the abuse of discretion has
1-37 resulted in a distribution to a beneficiary which is too large, the
1-38 court shall place the beneficiaries, the trust, or both, in whole or
1-39 in part, in their appropriate positions by ordering the trustee to
1-40 withhold an amount from one or more future distributions to the
1-41 beneficiary who received the distribution that was too large or
1-42 ordering that beneficiary to return some or all of the distribution
1-43 to the trust; and

1-44 (3) to the extent that the court is unable, after
1-45 applying Subdivisions (1) and (2), to place the beneficiaries, the
1-46 trust, or both, in the positions they would have occupied if the
1-47 discretion had not been abused, the court may order the trustee to
1-48 pay an appropriate amount from its own funds to one or more of the
1-49 beneficiaries or the trust or both.

1-50 (d) If the trustee of a trust reasonably believes that one
1-51 or more beneficiaries of such trust will object to the manner in
1-52 which the trustee intends to exercise or not exercise a
1-53 discretionary power conferred by Section 116.005 of this chapter,
1-54 the trustee may petition the court having jurisdiction over the
1-55 trust, and the court shall determine whether the proposed exercise
1-56 or nonexercise by the trustee of such discretionary power will
1-57 result in an abuse of the trustee's discretion. The trustee shall
1-58 state in such petition the basis for its belief that a beneficiary
1-59 would object. The failure or refusal of a beneficiary to sign a
1-60 waiver or release is not reasonable grounds for a trustee to believe
1-61 the beneficiary will object. The court may appoint one or more
1-62 guardians ad litem pursuant to Section 115.014 of this subtitle. If
1-63 the petition describes the proposed exercise or nonexercise of the
1-64 power and contains sufficient information to inform the

2-1 beneficiaries of the reasons for the proposal, the facts upon which
2-2 the trustee relies, and an explanation of how the income and
2-3 remainder beneficiaries will be affected by the proposed exercise
2-4 or nonexercise of the power, a beneficiary who challenges the
2-5 proposed exercise or nonexercise has the burden of establishing
2-6 that it will result in an abuse of discretion. The trustee shall
2-7 advance from the trust principal all costs incident to the judicial
2-8 determination, including the reasonable attorney's fees and costs
2-9 of the trustee, any beneficiary or beneficiaries who are parties to
2-10 the action and who retain counsel, and any guardian ad litem. At
2-11 the conclusion of the proceeding, the court may award costs and
2-12 reasonable and necessary attorney's fees as provided in Section
2-13 114.064 of this subtitle, including, if the court considers it
2-14 appropriate, awarding part or all of such costs against the trust
2-15 principal or income, awarding part or all of such costs against one
2-16 or more beneficiaries or such beneficiary's or beneficiaries' share
2-17 of the trust, or awarding part or all of such costs against the
2-18 trustee in the trustee's individual capacity if the court
2-19 determines the trustee's exercise or nonexercise of discretionary
2-20 power would have resulted in an abuse of discretion or that the
2-21 trustee did not have reasonable grounds for believing one or more
2-22 beneficiaries will object to the proposed exercise or nonexercise
2-23 of the discretionary power.

2-24 A BILL TO BE ENTITLED
2-25 AN ACT

2-26 relating to adoption of the Uniform Principal and Income Act.
2-27 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:
2-28 SECTION 1. Subtitle B, Title 9, Property Code, is amended by
2-29 adding Chapter 116 to read as follows:

2-30 CHAPTER 116. UNIFORM PRINCIPAL AND INCOME ACT
2-31 SUBCHAPTER A. DEFINITIONS, FIDUCIARY DUTIES, AND OTHER
2-32 MISCELLANEOUS PROVISIONS

2-33 Sec. 116.001. SHORT TITLE. This chapter may be cited as
2-34 the Uniform Principal and Income Act.

2-35 Sec. 116.002. DEFINITIONS. In this chapter:

2-36 (1) "Accounting period" means a calendar year unless
2-37 another 12-month period is selected by a fiduciary. The term
2-38 includes a portion of a calendar year or other 12-month period that
2-39 begins when an income interest begins or ends when an income
2-40 interest ends.

2-41 (2) "Beneficiary" includes, in the case of a
2-42 decedent's estate, an heir, legatee, and devisee and, in the case of
2-43 a trust, an income beneficiary and a remainder beneficiary.

2-44 (3) "Fiduciary" means a personal representative or a
2-45 trustee. The term includes an executor, administrator, successor
2-46 personal representative, special administrator, and a person
2-47 performing substantially the same function.

2-48 (4) "Income" means money or property that a fiduciary
2-49 receives as current return from a principal asset. The term
2-50 includes a portion of receipts from a sale, exchange, or
2-51 liquidation of a principal asset, to the extent provided in
2-52 Subchapter D.

2-53 (5) "Income beneficiary" means a person to whom net
2-54 income of a trust is or may be payable.

2-55 (6) "Income interest" means the right of an income
2-56 beneficiary to receive all or part of net income, whether the terms
2-57 of the trust require it to be distributed or authorize it to be
2-58 distributed in the trustee's discretion.

2-59 (7) "Mandatory income interest" means the right of an
2-60 income beneficiary to receive net income that the terms of the trust
2-61 require the fiduciary to distribute.

2-62 (8) "Net income" means the total receipts allocated to
2-63 income during an accounting period minus the disbursements made
2-64 from income during the period, plus or minus transfers under this
2-65 chapter to or from income during the period.

2-66 (9) "Person" means an individual, corporation,
2-67 business trust, estate, trust, partnership, limited liability

3-1 company, association, joint venture, government; governmental
 3-2 subdivision, agency, or instrumentality; public corporation, or
 3-3 any other legal or commercial entity.

3-4 (10) "Principal" means property held in trust for
 3-5 distribution to a remainder beneficiary when the trust terminates.

3-6 (11) "Remainder beneficiary" means a person entitled
 3-7 to receive principal when an income interest ends.

3-8 (12) "Terms of a trust" means the manifestation of the
 3-9 intent of a settlor or decedent with respect to the trust, expressed
 3-10 in a manner that admits of its proof in a judicial proceeding,
 3-11 whether by written or spoken words or by conduct.

3-12 (13) "Trustee" includes an original, additional, or
 3-13 successor trustee, whether or not appointed or confirmed by a
 3-14 court.

3-15 Sec. 116.003. UNIFORMITY OF APPLICATION AND CONSTRUCTION.
 3-16 In applying and construing this Uniform Act, consideration must be
 3-17 given to the need to promote uniformity of the law with respect to
 3-18 its subject matter among states that enact it.

3-19 Sec. 116.004. FIDUCIARY DUTIES; GENERAL PRINCIPLES. (a)
 3-20 In allocating receipts and disbursements to or between principal
 3-21 and income, and with respect to any matter within the scope of
 3-22 Subchapters B and C, a fiduciary:

3-23 (1) shall administer a trust or estate in accordance
 3-24 with the terms of the trust or the will, even if there is a different
 3-25 provision in this chapter;

3-26 (2) may administer a trust or estate by the exercise of
 3-27 a discretionary power of administration given to the fiduciary by
 3-28 the terms of the trust or the will, even if the exercise of the power
 3-29 produces a result different from a result required or permitted by
 3-30 this chapter;

3-31 (3) shall administer a trust or estate in accordance
 3-32 with this chapter if the terms of the trust or the will do not
 3-33 contain a different provision or do not give the fiduciary a
 3-34 discretionary power of administration; and

3-35 (4) shall add a receipt or charge a disbursement to
 3-36 principal to the extent that the terms of the trust and this chapter
 3-37 do not provide a rule for allocating the receipt or disbursement to
 3-38 or between principal and income.

3-39 (b) In exercising the power to adjust under Section
 3-40 116.005(a) or a discretionary power of administration regarding a
 3-41 matter within the scope of this chapter, whether granted by the
 3-42 terms of a trust, a will, or this chapter, a fiduciary shall
 3-43 administer a trust or estate impartially, based on what is fair and
 3-44 reasonable to all of the beneficiaries, except to the extent that
 3-45 the terms of the trust or the will clearly manifest an intention
 3-46 that the fiduciary shall or may favor one or more of the
 3-47 beneficiaries. A determination in accordance with this chapter is
 3-48 presumed to be fair and reasonable to all of the beneficiaries.

3-49 Sec. 116.005. TRUSTEE'S POWER TO ADJUST. (a) A trustee may
 3-50 adjust between principal and income to the extent the trustee
 3-51 considers necessary if the trustee invests and manages trust assets
 3-52 as a prudent investor, the terms of the trust describe the amount
 3-53 that may or must be distributed to a beneficiary by referring to the
 3-54 trust's income, and the trustee determines, after applying the
 3-55 rules in Section 116.004(a), that the trustee is unable to comply
 3-56 with Section 116.004(b). The power to adjust conferred by this
 3-57 subsection includes the power to allocate all or part of a capital
 3-58 gain to trust income.

3-59 (b) In deciding whether and to what extent to exercise the
 3-60 power conferred by Subsection (a), a trustee shall consider all
 3-61 factors relevant to the trust and its beneficiaries, including the
 3-62 following factors to the extent they are relevant:

3-63 (1) the nature, purpose, and expected duration of the
 3-64 trust;

3-65 (2) the intent of the settlor;

3-66 (3) the identity and circumstances of the
 3-67 beneficiaries;

3-68 (4) the needs for liquidity, regularity of income, and
 3-69 preservation and appreciation of capital;

4-1 (5) the assets held in the trust; the extent to which
 4-2 they consist of financial assets, interests in closely held
 4-3 enterprises, tangible and intangible personal property, or real
 4-4 property; the extent to which an asset is used by a beneficiary; and
 4-5 whether an asset was purchased by the trustee or received from the
 4-6 settlor;

4-7 (6) the net amount allocated to income under the other
 4-8 sections of this chapter and the increase or decrease in the value
 4-9 of the principal assets, which the trustee may estimate as to assets
 4-10 for which market values are not readily available;

4-11 (7) whether and to what extent the terms of the trust
 4-12 give the trustee the power to invade principal or accumulate income
 4-13 or prohibit the trustee from invading principal or accumulating
 4-14 income, and the extent to which the trustee has exercised a power
 4-15 from time to time to invade principal or accumulate income;

4-16 (8) the actual and anticipated effect of economic
 4-17 conditions on principal and income and effects of inflation and
 4-18 deflation; and

4-19 (9) the anticipated tax consequences of an adjustment.

4-20 (c) A trustee may not make an adjustment:

4-21 (1) that diminishes the income interest in a trust
 4-22 that requires all of the income to be paid at least annually to a
 4-23 spouse and for which an estate tax or gift tax marital deduction
 4-24 would be allowed, in whole or in part, if the trustee did not have
 4-25 the power to make the adjustment;

4-26 (2) that reduces the actuarial value of the income
 4-27 interest in a trust to which a person transfers property with the
 4-28 intent to qualify for a gift tax exclusion;

4-29 (3) that changes the amount payable to a beneficiary
 4-30 as a fixed annuity or a fixed fraction of the value of the trust
 4-31 assets;

4-32 (4) from any amount that is permanently set aside for
 4-33 charitable purposes under a will or the terms of a trust unless both
 4-34 income and principal are so set aside;

4-35 (5) if possessing or exercising the power to make an
 4-36 adjustment causes an individual to be treated as the owner of all or
 4-37 part of the trust for income tax purposes, and the individual would
 4-38 not be treated as the owner if the trustee did not possess the power
 4-39 to make an adjustment;

4-40 (6) if possessing or exercising the power to make an
 4-41 adjustment causes all or part of the trust assets to be included for
 4-42 estate tax purposes in the estate of an individual who has the power
 4-43 to remove a trustee or appoint a trustee, or both, and the assets
 4-44 would not be included in the estate of the individual if the trustee
 4-45 did not possess the power to make an adjustment;

4-46 (7) if the trustee is a beneficiary of the trust; or

4-47 (8) if the trustee is not a beneficiary, but the
 4-48 adjustment would benefit the trustee directly or indirectly.

4-49 (d) If Subsection (c)(5), (6), (7), or (8) applies to a
 4-50 trustee and there is more than one trustee, a cotrustee to whom the
 4-51 provision does not apply may make the adjustment unless the
 4-52 exercise of the power by the remaining trustee or trustees is not
 4-53 permitted by the terms of the trust.

4-54 (e) A trustee may release the entire power conferred by
 4-55 Subsection (a) or may release only the power to adjust from income
 4-56 to principal or the power to adjust from principal to income if the
 4-57 trustee is uncertain about whether possessing or exercising the
 4-58 power will cause a result described in Subsection (c)(1)-(6) or
 4-59 (c)(8) or if the trustee determines that possessing or exercising
 4-60 the power will or may deprive the trust of a tax benefit or impose a
 4-61 tax burden not described in Subsection (c). The release may be
 4-62 permanent or for a specified period, including a period measured by
 4-63 the life of an individual.

4-64 (f) Terms of a trust that limit the power of a trustee to
 4-65 make an adjustment between principal and income do not affect the
 4-66 application of this section unless it is clear from the terms of the
 4-67 trust that the terms are intended to deny the trustee the power of
 4-68 adjustment conferred by Subsection (a).

4-69 Sec. 116.006. JUDICIAL CONTROL OF DISCRETIONARY POWER. (a)

5-1 The court may not order a fiduciary to change a decision to exercise
5-2 or not to exercise a discretionary power conferred by this chapter
5-3 unless the court determines that the decision was an abuse of the
5-4 fiduciary's discretion. A fiduciary's decision is not an abuse of
5-5 discretion merely because the court would have exercised the power
5-6 in a different manner or would not have exercised the power.

5-7 (b) The decisions to which Subsection (a) applies include:

5-8 (1) a decision under Section 116.005(a) as to whether
5-9 and to what extent an amount should be transferred from principal to
5-10 income or from income to principal; and

5-11 (2) a decision regarding the factors that are relevant
5-12 to the trust and its beneficiaries, the extent to which the factors
5-13 are relevant, and the weight, if any, to be given to those factors,
5-14 in deciding whether and to what extent to exercise the
5-15 discretionary power conferred by Section 116.005(a).

5-16 (c) If the court determines that a fiduciary has abused the
5-17 fiduciary's discretion, the court may place the income and
5-18 remainder beneficiaries in the positions they would have occupied
5-19 if the discretion had not been abused, according to the following
5-20 rules:

5-21 (1) to the extent that the abuse of discretion has
5-22 resulted in no distribution to a beneficiary or in a distribution
5-23 that is too small, the court shall order the fiduciary to distribute
5-24 from the trust to the beneficiary an amount that the court
5-25 determines will restore the beneficiary, in whole or in part, to the
5-26 beneficiary's appropriate position;

5-27 (2) to the extent that the abuse of discretion has
5-28 resulted in a distribution to a beneficiary which is too large, the
5-29 court shall place the beneficiaries, the trust, or both, in whole or
5-30 in part, in their appropriate positions by ordering the fiduciary
5-31 to withhold an amount from one or more future distributions to the
5-32 beneficiary who received the distribution that was too large or
5-33 ordering that beneficiary to return some or all of the distribution
5-34 to the trust; and

5-35 (3) to the extent that the court is unable, after
5-36 applying Subdivisions (1) and (2), to place the beneficiaries, the
5-37 trust, or both, in the positions they would have occupied if the
5-38 discretion had not been abused, the court may order the fiduciary to
5-39 pay an appropriate amount from its own funds to one or more of the
5-40 beneficiaries or the trust or both.

5-41 (d) Upon petition by the fiduciary, the court having
5-42 jurisdiction over a trust or estate shall determine whether a
5-43 proposed exercise or nonexercise by the fiduciary of a
5-44 discretionary power conferred by this chapter will result in an
5-45 abuse of the fiduciary's discretion. If the petition describes the
5-46 proposed exercise or nonexercise of the power and contains
5-47 sufficient information to inform the beneficiaries of the reasons
5-48 for the proposal, the facts upon which the fiduciary relies, and an
5-49 explanation of how the income and remainder beneficiaries will be
5-50 affected by the proposed exercise or nonexercise of the power, a
5-51 beneficiary who challenges the proposed exercise or nonexercise has
5-52 the burden of establishing that it will result in an abuse of
5-53 discretion.

5-54 Sec. 116.007. PROVISIONS REGARDING NONCHARITABLE
5-55 UNITRUSTS. (a) This section does not apply to a charitable
5-56 remainder unitrust as defined by Section 664(d), Internal Revenue
5-57 Code of 1986 (26 U.S.C. Section 664), as amended.

5-58 (b) In this section:

5-59 (1) "Unitrust" means a trust the terms of which
5-60 require distribution of a unitrust amount.

5-61 (2) "Unitrust amount" means a distribution mandated by
5-62 the terms of a trust in an amount equal to a fixed percentage of not
5-63 less than three or more than five percent per year of the net fair
5-64 market value of the trust's assets, valued at least annually. The
5-65 unitrust amount may be determined by reference to the net fair
5-66 market value of the trust's assets in one year or more than one
5-67 year.

5-68 (c) Distribution of the unitrust amount is considered a
5-69 distribution of all of the income of the unitrust and shall not be

6-1 considered a fundamental departure from applicable state law. A
 6-2 distribution of the unitrust amount reasonably apportions the total
 6-3 return of a unitrust.

6-4 (d) Unless the terms of the trust specifically provide
 6-5 otherwise, a distribution of the unitrust amount shall be treated
 6-6 as first being made from the following sources in order of priority:

6-7 (1) from net accounting income determined as if the
 6-8 trust were not a unitrust;

6-9 (2) from ordinary accounting income not allocable to
 6-10 net accounting income;

6-11 (3) from net realized short-term capital gains;

6-12 (4) from net realized long-term capital gains; and

6-13 (5) from the principal of the trust estate.

6-14 [Sections 116.008-116.050 reserved for expansion]

6-15 SUBCHAPTER B. DECEDENT'S ESTATE OR
 6-16 TERMINATING INCOME INTEREST

6-17 Sec. 116.051. DETERMINATION AND DISTRIBUTION OF NET INCOME.

6-18 After a decedent dies, in the case of an estate, or after an income
 6-19 interest in a trust ends, the following rules apply:

6-20 (1) A fiduciary of an estate or of a terminating income
 6-21 interest shall determine the amount of net income and net principal
 6-22 receipts received from property specifically given to a beneficiary
 6-23 under the rules in Subchapters C, D, and E which apply to trustees
 6-24 and the rules in Subdivision (5). The fiduciary shall distribute
 6-25 the net income and net principal receipts to the beneficiary who is
 6-26 to receive the specific property.

6-27 (2) A fiduciary shall determine the remaining net
 6-28 income of a decedent's estate or a terminating income interest
 6-29 under the rules in Subchapters C, D, and E which apply to trustees
 6-30 and by:

6-31 (A) including in net income all income from
 6-32 property used to discharge liabilities;

6-33 (B) paying from income or principal, in the
 6-34 fiduciary's discretion, fees of attorneys, accountants, and
 6-35 fiduciaries; court costs and other expenses of administration; and
 6-36 interest on death taxes, but the fiduciary may pay those expenses
 6-37 from income of property passing to a trust for which the fiduciary
 6-38 claims an estate tax marital or charitable deduction only to the
 6-39 extent that the payment of those expenses from income will not cause
 6-40 the reduction or loss of the deduction; and

6-41 (C) paying from principal all other
 6-42 disbursements made or incurred in connection with the settlement of
 6-43 a decedent's estate or the winding up of a terminating income
 6-44 interest, including debts, funeral expenses, disposition of
 6-45 remains, family allowances, and death taxes and related penalties
 6-46 that are apportioned to the estate or terminating income interest
 6-47 by the will, the terms of the trust, or applicable law.

6-48 (3) A fiduciary shall distribute to a beneficiary who
 6-49 receives a pecuniary amount outright the interest or any other
 6-50 amount provided by the will, the terms of the trust, or applicable
 6-51 law from net income determined under Subdivision (2) or from
 6-52 principal to the extent that net income is insufficient. If a
 6-53 beneficiary is to receive a pecuniary amount outright from a trust
 6-54 after an income interest ends and no interest or other amount is
 6-55 provided for by the terms of the trust or applicable law, the
 6-56 fiduciary shall distribute the interest or other amount to which
 6-57 the beneficiary would be entitled under applicable law if the
 6-58 pecuniary amount were required to be paid under a will. Unless
 6-59 otherwise provided by the will or the terms of the trust, a
 6-60 beneficiary who receives a pecuniary amount, regardless of whether
 6-61 in trust, shall be paid interest on the pecuniary amount at the
 6-62 legal rate of interest as provided by Section 302.002, Finance
 6-63 Code. Interest on the pecuniary amount is payable:

6-64 (A) under a will, beginning on the first
 6-65 anniversary of the date of the decedent's death; or

6-66 (B) under a trust, beginning on the first
 6-67 anniversary of the date on which an income interest ends.

6-68 (4) A fiduciary shall distribute the net income
 6-69 remaining after distributions required by Subdivision (3) in the

7-1 manner described in Section 116.052 to all other beneficiaries even
 7-2 if the beneficiary holds an unqualified power to withdraw assets
 7-3 from the trust or other presently exercisable general power of
 7-4 appointment over the trust.

7-5 (5) A fiduciary may not reduce principal or income
 7-6 receipts from property described in Subdivision (1) because of a
 7-7 payment described in Section 116.201 or 116.202 to the extent that
 7-8 the will, the terms of the trust, or applicable law requires the
 7-9 fiduciary to make the payment from assets other than the property or
 7-10 to the extent that the fiduciary recovers or expects to recover the
 7-11 payment from a third party. The net income and principal receipts
 7-12 from the property are determined by including all of the amounts the
 7-13 fiduciary receives or pays with respect to the property, whether
 7-14 those amounts accrued or became due before, on, or after the date of
 7-15 a decedent's death or an income interest's terminating event, and by
 7-16 making a reasonable provision for amounts that the fiduciary
 7-17 believes the estate or terminating income interest may become
 7-18 obligated to pay after the property is distributed.

7-19 (6) A fiduciary, without reduction for taxes, shall
 7-20 pay to a charitable organization that is entitled to receive income
 7-21 under Subdivision (4) any amount allowed as a tax deduction to the
 7-22 estate or trust for income payable to the charitable organization.

7-23 Sec. 116.052. DISTRIBUTION TO RESIDUARY AND REMAINDER
 7-24 BENEFICIARIES. (a) Each beneficiary described in Section
 7-25 116.051(4) is entitled to receive a portion of the net income equal
 7-26 to the beneficiary's fractional interest in undistributed
 7-27 principal assets, using values as of the distribution date. If a
 7-28 fiduciary makes more than one distribution of assets to
 7-29 beneficiaries to whom this section applies, each beneficiary,
 7-30 including one who does not receive part of the distribution, is
 7-31 entitled, as of each distribution date, to the net income the
 7-32 fiduciary has received after the date of death or terminating event
 7-33 or earlier distribution date but has not distributed as of the
 7-34 current distribution date.

7-35 (b) In determining a beneficiary's share of net income, the
 7-36 following rules apply:

7-37 (1) The beneficiary is entitled to receive a portion
 7-38 of the net income equal to the beneficiary's fractional interest in
 7-39 the undistributed principal assets immediately before the
 7-40 distribution date, including assets that later may be sold to meet
 7-41 principal obligations.

7-42 (2) The beneficiary's fractional interest in the
 7-43 undistributed principal assets must be calculated without regard to
 7-44 property specifically given to a beneficiary and property required
 7-45 to pay pecuniary amounts not in trust.

7-46 (3) The beneficiary's fractional interest in the
 7-47 undistributed principal assets must be calculated on the basis of
 7-48 the aggregate value of those assets as of the distribution date
 7-49 without reducing the value by any unpaid principal obligation.

7-50 (4) The distribution date for purposes of this section
 7-51 may be the date as of which the fiduciary calculates the value of
 7-52 the assets if that date is reasonably near the date on which assets
 7-53 are actually distributed.

7-54 (c) If a fiduciary does not distribute all of the collected
 7-55 but undistributed net income to each person as of a distribution
 7-56 date, the fiduciary shall maintain appropriate records showing the
 7-57 interest of each beneficiary in that net income.

7-58 (d) A fiduciary may apply the rules in this section, to the
 7-59 extent that the fiduciary considers it appropriate, to net gain or
 7-60 loss realized after the date of death or terminating event or
 7-61 earlier distribution date from the disposition of a principal asset
 7-62 if this section applies to the income from the asset.

7-63 [Sections 116.053-116.100 reserved for expansion]

7-64 SUBCHAPTER C. APPORTIONMENT AT BEGINNING
 7-65 AND END OF INCOME INTEREST

7-66 Sec. 116.101. WHEN RIGHT TO INCOME BEGINS AND ENDS. (a) An
 7-67 income beneficiary is entitled to net income from the date on which
 7-68 the income interest begins. An income interest begins on the date
 7-69 specified in the terms of the trust or, if no date is specified, on

8-1 the date an asset becomes subject to a trust or successive income
 8-2 interest.

8-3 (b) An asset becomes subject to a trust:

8-4 (1) on the date it is transferred to the trust in the
 8-5 case of an asset that is transferred to a trust during the
 8-6 transferor's life;

8-7 (2) on the date of a testator's death in the case of an
 8-8 asset that becomes subject to a trust by reason of a will, even if
 8-9 there is an intervening period of administration of the testator's
 8-10 estate; or

8-11 (3) on the date of an individual's death in the case of
 8-12 an asset that is transferred to a fiduciary by a third party because
 8-13 of the individual's death.

8-14 (c) An asset becomes subject to a successive income interest
 8-15 on the day after the preceding income interest ends, as determined
 8-16 under Subsection (d), even if there is an intervening period of
 8-17 administration to wind up the preceding income interest.

8-18 (d) An income interest ends on the day before an income
 8-19 beneficiary dies or another terminating event occurs, or on the
 8-20 last day of a period during which there is no beneficiary to whom a
 8-21 trustee may distribute income.

8-22 Sec. 116.102. APPORTIONMENT OF RECEIPTS AND DISBURSEMENTS
 8-23 WHEN DECEDENT DIES OR INCOME INTEREST BEGINS. (a) A trustee shall
 8-24 allocate an income receipt or disbursement other than one to which
 8-25 Section 116.051(1) applies to principal if its due date occurs
 8-26 before a decedent dies in the case of an estate or before an income
 8-27 interest begins in the case of a trust or successive income
 8-28 interest.

8-29 (b) A trustee shall allocate an income receipt or
 8-30 disbursement to income if its due date occurs on or after the date
 8-31 on which a decedent dies or an income interest begins and it is a
 8-32 periodic due date. An income receipt or disbursement must be
 8-33 treated as accruing from day to day if its due date is not periodic
 8-34 or it has no due date. The portion of the receipt or disbursement
 8-35 accruing before the date on which a decedent dies or an income
 8-36 interest begins must be allocated to principal and the balance must
 8-37 be allocated to income.

8-38 (c) An item of income or an obligation is due on the date the
 8-39 payer is required to make a payment. If a payment date is not
 8-40 stated, there is no due date for the purposes of this chapter.
 8-41 Distributions to shareholders or other owners from an entity to
 8-42 which Section 116.151 applies are deemed to be due on the date fixed
 8-43 by the entity for determining who is entitled to receive the
 8-44 distribution or, if no date is fixed, on the declaration date for
 8-45 the distribution. A due date is periodic for receipts or
 8-46 disbursements that must be paid at regular intervals under a lease
 8-47 or an obligation to pay interest or if an entity customarily makes
 8-48 distributions at regular intervals.

8-49 Sec. 116.103. APPORTIONMENT WHEN INCOME INTEREST ENDS. (a)
 8-50 In this section, "undistributed income" means net income received
 8-51 before the date on which an income interest ends. The term does not
 8-52 include an item of income or expense that is due or accrued or net
 8-53 income that has been added or is required to be added to principal
 8-54 under the terms of the trust.

8-55 (b) When a mandatory income interest ends, the trustee shall
 8-56 pay to a mandatory income beneficiary who survives that date, or the
 8-57 estate of a deceased mandatory income beneficiary whose death
 8-58 causes the interest to end, the beneficiary's share of the
 8-59 undistributed income that is not disposed of under the terms of the
 8-60 trust unless the beneficiary has an unqualified power to revoke
 8-61 more than five percent of the trust immediately before the income
 8-62 interest ends. In the latter case, the undistributed income from
 8-63 the portion of the trust that may be revoked must be added to
 8-64 principal.

8-65 (c) When a trustee's obligation to pay a fixed annuity or a
 8-66 fixed fraction of the value of the trust's assets ends, the trustee
 8-67 shall prorate the final payment if and to the extent required by
 8-68 applicable law to accomplish a purpose of the trust or its settlor
 8-69 relating to income, gift, estate, or other tax requirements.

[Sections 116.104-116.150 reserved for expansion]

SUBCHAPTER D. ALLOCATION OF RECEIPTS DURING

ADMINISTRATION OF TRUST

PART 1. RECEIPTS FROM ENTITIES

9-5 Sec. 116.151. CHARACTER OF RECEIPTS. (a) In this section,
 9-6 "entity" means a corporation, partnership, limited liability
 9-7 company, regulated investment company, real estate investment
 9-8 trust, common trust fund, or any other organization in which a
 9-9 trustee has an interest other than a trust or estate to which
 9-10 Section 116.152 applies, a business or activity to which Section
 9-11 116.153 applies, or an asset-backed security to which Section
 9-12 116.178 applies.

9-13 (b) Except as otherwise provided in this section, a trustee
 9-14 shall allocate to income money received from an entity.

9-15 (c) A trustee shall allocate the following receipts from an
 9-16 entity to principal:

9-17 (1) property other than money;

9-18 (2) money received in one distribution or a series of
 9-19 related distributions in exchange for part or all of a trust's
 9-20 interest in the entity;

9-21 (3) money received in total or partial liquidation of
 9-22 the entity; and

9-23 (4) money received from an entity that is a regulated
 9-24 investment company or a real estate investment trust if the money
 9-25 distributed is a capital gain dividend for federal income tax
 9-26 purposes.

9-27 (d) Money is received in partial liquidation:

9-28 (1) to the extent that the entity, at or near the time
 9-29 of a distribution, indicates that it is a distribution in partial
 9-30 liquidation; or

9-31 (2) if the total amount of money and property received
 9-32 in a distribution or series of related distributions is greater
 9-33 than 20 percent of the entity's gross assets, as shown by the
 9-34 entity's year-end financial statements immediately preceding the
 9-35 initial receipt.

9-36 (e) Money is not received in partial liquidation, nor may it
 9-37 be taken into account under Subsection (d)(2), to the extent that it
 9-38 does not exceed the amount of income tax that a trustee or
 9-39 beneficiary must pay on taxable income of the entity that
 9-40 distributes the money.

9-41 (f) A trustee may rely upon a statement made by an entity
 9-42 about the source or character of a distribution if the statement is
 9-43 made at or near the time of distribution by the entity's board of
 9-44 directors or other person or group of persons authorized to
 9-45 exercise powers to pay money or transfer property comparable to
 9-46 those of a corporation's board of directors.

9-47 Sec. 116.152. DISTRIBUTION FROM TRUST OR ESTATE. A trustee
 9-48 shall allocate to income an amount received as a distribution of
 9-49 income from a trust or an estate in which the trust has an interest
 9-50 other than a purchased interest, and shall allocate to principal an
 9-51 amount received as a distribution of principal from such a trust or
 9-52 estate. If a trustee purchases an interest in a trust that is an
 9-53 investment entity, or a decedent or donor transfers an interest in
 9-54 such a trust to a trustee, Section 116.151 or 116.178 applies to a
 9-55 receipt from the trust.

9-56 Sec. 116.153. BUSINESS AND OTHER ACTIVITIES CONDUCTED BY
 9-57 TRUSTEE. (a) If a trustee who conducts a business or other
 9-58 activity determines that it is in the best interest of all the
 9-59 beneficiaries to account separately for the business or activity
 9-60 instead of accounting for it as part of the trust's general
 9-61 accounting records, the trustee may maintain separate accounting
 9-62 records for its transactions, whether or not its assets are
 9-63 segregated from other trust assets.

9-64 (b) A trustee who accounts separately for a business or
 9-65 other activity may determine the extent to which its net cash
 9-66 receipts must be retained for working capital, the acquisition or
 9-67 replacement of fixed assets, and other reasonably foreseeable needs
 9-68 of the business or activity, and the extent to which the remaining
 9-69 net cash receipts are accounted for as principal or income in the

10-1 trust's general accounting records. If a trustee sells assets of
 10-2 the business or other activity, other than in the ordinary course of
 10-3 the business or activity, the trustee shall account for the net
 10-4 amount received as principal in the trust's general accounting
 10-5 records to the extent the trustee determines that the amount
 10-6 received is no longer required in the conduct of the business.

10-7 (c) Activities for which a trustee may maintain separate
 10-8 accounting records include:

10-9 (1) retail, manufacturing, service, and other
 10-10 traditional business activities;

10-11 (2) farming;

10-12 (3) raising and selling livestock and other animals;

10-13 (4) management of rental properties;

10-14 (5) extraction of minerals and other natural
 10-15 resources;

10-16 (6) timber operations; and

10-17 (7) activities to which Section 116.177 applies.

10-18 [Sections 116.154-116.160 reserved for expansion]

10-19 PART 2. RECEIPTS NOT NORMALLY APPORTIONED

10-20 Sec. 116.161. PRINCIPAL RECEIPTS. A trustee shall allocate
 10-21 to principal:

10-22 (1) to the extent not allocated to income under this
 10-23 chapter, assets received from a transferor during the transferor's
 10-24 lifetime, a decedent's estate, a trust with a terminating income
 10-25 interest, or a payer under a contract naming the trust or its
 10-26 trustee as beneficiary;

10-27 (2) money or other property received from the sale,
 10-28 exchange, liquidation, or change in form of a principal asset,
 10-29 including realized profit, subject to this subchapter;

10-30 (3) amounts recovered from third parties to reimburse
 10-31 the trust because of disbursements described in Section
 10-32 116.202(a)(7) or for other reasons to the extent not based on the
 10-33 loss of income;

10-34 (4) proceeds of property taken by eminent domain, but
 10-35 a separate award made for the loss of income with respect to an
 10-36 accounting period during which a current income beneficiary had a
 10-37 mandatory income interest is income;

10-38 (5) net income received in an accounting period during
 10-39 which there is no beneficiary to whom a trustee may or must
 10-40 distribute income; and

10-41 (6) other receipts as provided in Part 3.

10-42 Sec. 116.162. RENTAL PROPERTY. To the extent that a trustee
 10-43 accounts for receipts from rental property pursuant to this
 10-44 section, the trustee shall allocate to income an amount received as
 10-45 rent of real or personal property, including an amount received for
 10-46 cancellation or renewal of a lease. An amount received as a
 10-47 refundable deposit, including a security deposit or a deposit that
 10-48 is to be applied as rent for future periods, must be added to
 10-49 principal and held subject to the terms of the lease and is not
 10-50 available for distribution to a beneficiary until the trustee's
 10-51 contractual obligations have been satisfied with respect to that
 10-52 amount.

10-53 Sec. 116.163. OBLIGATION TO PAY MONEY. (a) An amount
 10-54 received as interest, whether determined at a fixed, variable, or
 10-55 floating rate, on an obligation to pay money to the trustee,
 10-56 including an amount received as consideration for prepaying
 10-57 principal, must be allocated to income without any provision for
 10-58 amortization of premium.

10-59 (b) A trustee shall allocate to principal an amount received
 10-60 from the sale, redemption, or other disposition of an obligation to
 10-61 pay money to the trustee more than one year after it is purchased or
 10-62 acquired by the trustee, including an obligation whose purchase
 10-63 price or value when it is acquired is less than its value at
 10-64 maturity. If the obligation matures within one year after it is
 10-65 purchased or acquired by the trustee, an amount received in excess
 10-66 of its purchase price or its value when acquired by the trust must
 10-67 be allocated to income.

10-68 (c) This section does not apply to an obligation to which
 10-69 Section 116.172, 116.173, 116.174, 116.175, 116.177, or 116.178

11-1 applies.

11-2 Sec. 116.164. INSURANCE POLICIES AND SIMILAR CONTRACTS.
 11-3 (a) Except as otherwise provided in Subsection (b), a trustee shall
 11-4 allocate to principal the proceeds of a life insurance policy or
 11-5 other contract in which the trust or its trustee is named as
 11-6 beneficiary, including a contract that insures the trust or its
 11-7 trustee against loss for damage to, destruction of, or loss of title
 11-8 to a trust asset. The trustee shall allocate dividends on an
 11-9 insurance policy to income if the premiums on the policy are paid
 11-10 from income, and to principal if the premiums are paid from
 11-11 principal.

11-12 (b) A trustee shall allocate to income proceeds of a
 11-13 contract that insures the trustee against loss of occupancy or
 11-14 other use by an income beneficiary, loss of income, or, subject to
 11-15 Section 116.153, loss of profits from a business.

11-16 (c) This section does not apply to a contract to which
 11-17 Section 116.172 applies.

11-18 [Sections 116.165-116.170 reserved for expansion]

11-19 PART 3. RECEIPTS NORMALLY APPORTIONED

11-20 Sec. 116.171. INSUBSTANTIAL ALLOCATIONS NOT REQUIRED. If a
 11-21 trustee determines that an allocation between principal and income
 11-22 required by Section 116.172, 116.173, 116.174, 116.175, or 116.178
 11-23 is insubstantial, the trustee may allocate the entire amount to
 11-24 principal unless one of the circumstances described in Section
 11-25 116.005(c) applies to the allocation. This power may be exercised
 11-26 by a cotrustee in the circumstances described in Section 116.005(d)
 11-27 and may be released for the reasons and in the manner described in
 11-28 Section 116.005(e).

11-29 Sec. 116.172. DEFERRED COMPENSATION, ANNUITIES, AND
 11-30 SIMILAR PAYMENTS. (a) In this section:

11-31 (1) "Future payment asset" means the asset from which
 11-32 a payment is derived.

11-33 (2) "Payment" means a payment that a trustee may
 11-34 receive over a fixed number of years or during the life of one or
 11-35 more individuals because of services rendered or property
 11-36 transferred to the payer in exchange for future payments. The term
 11-37 includes a payment made in money or property from the payer's
 11-38 general assets or from a separate fund created by the payer,
 11-39 including a private or commercial annuity, an individual retirement
 11-40 account, and a pension, profit-sharing, stock-bonus, or
 11-41 stock-ownership plan.

11-42 (b) To the extent that the payer characterizes a payment as
 11-43 interest or a dividend or a payment made in lieu of interest or a
 11-44 dividend, a trustee shall allocate it to income. The trustee shall
 11-45 allocate to principal the balance of the payment and any other
 11-46 payment received in the same accounting period that is not
 11-47 characterized as interest, a dividend, or an equivalent payment.

11-48 (c) If no part of a payment is characterized as interest, a
 11-49 dividend, or an equivalent payment, and all or part of the payment
 11-50 is required to be made, a trustee shall allocate to income the part
 11-51 of the payment that does not exceed an amount equal to:

11-52 (1) four percent of the fair market value of the future
 11-53 payment asset as determined under Subsection (d); less

11-54 (2) the total amount that the trustee has allocated to
 11-55 income for a previous payment received from the future payment
 11-56 asset during the accounting period prescribed by Subsection (d).

11-57 (d) For purposes of Subsection (c)(1), the determination of
 11-58 a future payment asset is made on the later of:

11-59 (1) the date on which the future payment right first
 11-60 becomes subject to the trust; or

11-61 (2) the first day of the trust's accounting period
 11-62 during which the future payment asset is received.

11-63 (e) For each year a future payment asset is made, the amount
 11-64 determined under Subsection (c) must be prorated on a daily basis
 11-65 unless the determination of a future payment asset is made under
 11-66 Subsection (d)(2) and is for an accounting period of 365 days or
 11-67 more.

11-68 (f) A trustee shall allocate to principal the part of the
 11-69 payment described by Subsection (c) that is not allocated to

12-1 income.

12-2 (g) If no part of a payment is required to be made or the
 12-3 payment received is the entire amount to which the trustee is
 12-4 entitled, the trustee shall allocate the entire payment to
 12-5 principal. For purposes of Subsection (c) and this subsection, a
 12-6 payment is not "required to be made" to the extent that it is made
 12-7 only because the trustee exercises a right of withdrawal.

12-8 (h) If, to obtain an estate tax marital deduction for a
 12-9 trust, a trustee must allocate more of a payment to income than
 12-10 provided for by this section, the trustee shall allocate to income
 12-11 the additional amount necessary to obtain the marital deduction.

12-12 Sec. 116.173. LIQUIDATING ASSET. (a) In this section,
 12-13 "liquidating asset" means an asset whose value will diminish or
 12-14 terminate because the asset is expected to produce receipts for a
 12-15 period of limited duration. The term includes a leasehold, patent,
 12-16 copyright, royalty right, and right to receive payments during a
 12-17 period of more than one year under an arrangement that does not
 12-18 provide for the payment of interest on the unpaid balance. The term
 12-19 does not include a payment subject to Section 116.172, resources
 12-20 subject to Section 116.174, timber subject to Section 116.175, an
 12-21 activity subject to Section 116.177, an asset subject to Section
 12-22 116.178, or any asset for which the trustee establishes a reserve
 12-23 for depreciation under Section 116.203.

12-24 (b) A trustee shall allocate to income 10 percent of the
 12-25 receipts from a liquidating asset and the balance to principal.

12-26 (c) The trustee may allocate a receipt from any interest in
 12-27 a liquidating asset the trust owns on January 1, 2004, in the manner
 12-28 provided by this chapter or in any lawful manner used by the trustee
 12-29 before January 1, 2004, to make the same allocation.

12-30 Sec. 116.174. MINERALS, WATER, AND OTHER NATURAL RESOURCES.
 12-31 (a) To the extent that a trustee accounts for receipts from an
 12-32 interest in minerals or other natural resources pursuant to this
 12-33 section, the trustee shall allocate them as follows:

12-34 (1) If received as nominal delay rental or nominal
 12-35 annual rent on a lease, a receipt must be allocated to income.

12-36 (2) If received from a production payment, a receipt
 12-37 must be allocated to income if and to the extent that the agreement
 12-38 creating the production payment provides a factor for interest or
 12-39 its equivalent. The balance must be allocated to principal.

12-40 (3) If an amount received as a royalty, shut-in-well
 12-41 payment, take-or-pay payment, bonus, or delay rental is more than
 12-42 nominal, the trustee shall allocate the receipt equitably.

12-43 (4) If an amount is received from a working interest or
 12-44 any other interest not provided for in Subdivision (1), (2), or (3),
 12-45 the trustee must allocate the receipt equitably.

12-46 (b) An amount received on account of an interest in water
 12-47 that is renewable must be allocated to income. If the water is not
 12-48 renewable, the trustee must allocate the receipt equitably.

12-49 (c) This chapter applies whether or not a decedent or donor
 12-50 was extracting minerals, water, or other natural resources before
 12-51 the interest became subject to the trust.

12-52 (d) The trustee may allocate a receipt from any interest in
 12-53 minerals, water, or other natural resources the trust owns on
 12-54 January 1, 2004, in the manner provided by this chapter or in any
 12-55 lawful manner used by the trustee before January 1, 2004, to make
 12-56 the same allocation. The trustee shall allocate a receipt from any
 12-57 interest in minerals, water, or other natural resources acquired by
 12-58 the trust after January 1, 2004, in the manner provided by this
 12-59 chapter.

12-60 (e) An allocation of a receipt under this section is
 12-61 presumed to be equitable if the amount allocated to principal is
 12-62 equal to the amount allowed by the Internal Revenue Code of 1986 as
 12-63 a deduction for depletion of the interest.

12-64 Sec. 116.175. TIMBER. (a) To the extent that a trustee
 12-65 accounts for receipts from the sale of timber and related products
 12-66 pursuant to this section, the trustee shall allocate the net
 12-67 receipts:

12-68 (1) to income to the extent that the amount of timber
 12-69 removed from the land does not exceed the rate of growth of the

13-1 timber during the accounting periods in which a beneficiary has a
 13-2 mandatory income interest;

13-3 (2) to principal to the extent that the amount of
 13-4 timber removed from the land exceeds the rate of growth of the
 13-5 timber or the net receipts are from the sale of standing timber;

13-6 (3) to or between income and principal if the net
 13-7 receipts are from the lease of timberland or from a contract to cut
 13-8 timber from land owned by a trust, by determining the amount of
 13-9 timber removed from the land under the lease or contract and
 13-10 applying the rules in Subdivisions (1) and (2); or

13-11 (4) to principal to the extent that advance payments,
 13-12 bonuses, and other payments are not allocated pursuant to
 13-13 Subdivision (1), (2), or (3).

13-14 (b) In determining net receipts to be allocated pursuant to
 13-15 Subsection (a), a trustee shall deduct and transfer to principal a
 13-16 reasonable amount for depletion.

13-17 (c) This chapter applies whether or not a decedent or
 13-18 transferor was harvesting timber from the property before it became
 13-19 subject to the trust.

13-20 (d) If a trust owns an interest in timberland on January 1,
 13-21 2004, the trustee may allocate a net receipt from the sale of timber
 13-22 and related products in the manner provided by this chapter or in
 13-23 any lawful manner used by the trustee before January 1, 2004, to
 13-24 make the same allocation. If the trust acquires an interest in
 13-25 timberland after January 1, 2004, the trustee shall allocate net
 13-26 receipts from the sale of timber and related products in the manner
 13-27 provided by this chapter.

13-28 Sec. 116.176. PROPERTY NOT PRODUCTIVE OF INCOME. (a) If a
 13-29 marital deduction is allowed for all or part of a trust whose assets
 13-30 consist substantially of property that does not provide the spouse
 13-31 with sufficient income from or use of the trust assets, and if the
 13-32 amounts that the trustee transfers from principal to income under
 13-33 Section 116.005 and distributes to the spouse from principal
 13-34 pursuant to the terms of the trust are insufficient to provide the
 13-35 spouse with the beneficial enjoyment required to obtain the marital
 13-36 deduction, the spouse may require the trustee to make property
 13-37 productive of income, convert property within a reasonable time, or
 13-38 exercise the power conferred by Section 116.005(a). The trustee may
 13-39 decide which action or combination of actions to take.

13-40 (b) In cases not governed by Subsection (a), proceeds from
 13-41 the sale or other disposition of an asset are principal without
 13-42 regard to the amount of income the asset produces during any
 13-43 accounting period.

13-44 Sec. 116.177. DERIVATIVES AND OPTIONS. (a) In this
 13-45 section, "derivative" means a contract or financial instrument or a
 13-46 combination of contracts and financial instruments which gives a
 13-47 trust the right or obligation to participate in some or all changes
 13-48 in the price of a tangible or intangible asset or group of assets,
 13-49 or changes in a rate, an index of prices or rates, or other market
 13-50 indicator for an asset or a group of assets.

13-51 (b) To the extent that a trustee does not account under
 13-52 Section 116.153 for transactions in derivatives, the trustee shall
 13-53 allocate to principal receipts from and disbursements made in
 13-54 connection with those transactions.

13-55 (c) If a trustee grants an option to buy property from the
 13-56 trust, whether or not the trust owns the property when the option is
 13-57 granted, grants an option that permits another person to sell
 13-58 property to the trust, or acquires an option to buy property for the
 13-59 trust or an option to sell an asset owned by the trust, and the
 13-60 trustee or other owner of the asset is required to deliver the asset
 13-61 if the option is exercised, an amount received for granting the
 13-62 option must be allocated to principal. An amount paid to acquire
 13-63 the option must be paid from principal. A gain or loss realized
 13-64 upon the exercise of an option, including an option granted to a
 13-65 settlor of the trust for services rendered, must be allocated to
 13-66 principal.

13-67 Sec. 116.178. ASSET-BACKED SECURITIES. (a) In this
 13-68 section, "asset-backed security" means an asset whose value is
 13-69 based upon the right it gives the owner to receive distributions

14-1 from the proceeds of financial assets that provide collateral for
 14-2 the security. The term includes an asset that gives the owner the
 14-3 right to receive from the collateral financial assets only the
 14-4 interest or other current return or only the proceeds other than
 14-5 interest or current return. The term does not include an asset to
 14-6 which Section 116.151 or 116.172 applies.

14-7 (b) If a trust receives a payment from interest or other
 14-8 current return and from other proceeds of the collateral financial
 14-9 assets, the trustee shall allocate to income the portion of the
 14-10 payment which the payer identifies as being from interest or other
 14-11 current return and shall allocate the balance of the payment to
 14-12 principal.

14-13 (c) If a trust receives one or more payments in exchange for
 14-14 the trust's entire interest in an asset-backed security in one
 14-15 accounting period, the trustee shall allocate the payments to
 14-16 principal. If a payment is one of a series of payments that will
 14-17 result in the liquidation of the trust's interest in the security
 14-18 over more than one accounting period, the trustee shall allocate 10
 14-19 percent of the payment to income and the balance to principal.

14-20 [Sections 116.179-116.200 reserved for expansion]

14-21 SUBCHAPTER E. ALLOCATION OF DISBURSEMENTS DURING

14-22 ADMINISTRATION OF TRUST

14-23 Sec. 116.201. DISBURSEMENTS FROM INCOME. A trustee shall
 14-24 make the following disbursements from income to the extent that
 14-25 they are not disbursements to which Section 116.051(2)(B) or (C)
 14-26 applies:

14-27 (1) one-half of the regular compensation of the
 14-28 trustee and of any person providing investment advisory or
 14-29 custodial services to the trustee;

14-30 (2) one-half of all expenses for accountings, judicial
 14-31 proceedings, or other matters that involve both the income and
 14-32 remainder interests;

14-33 (3) all of the other ordinary expenses incurred in
 14-34 connection with the administration, management, or preservation of
 14-35 trust property and the distribution of income, including interest,
 14-36 ordinary repairs, regularly recurring taxes assessed against
 14-37 principal, and expenses of a proceeding or other matter that
 14-38 concerns primarily the income interest; and

14-39 (4) recurring premiums on insurance covering the loss
 14-40 of a principal asset or the loss of income from or use of the asset.

14-41 Sec. 116.202. DISBURSEMENTS FROM PRINCIPAL. (a) A trustee
 14-42 shall make the following disbursements from principal:

14-43 (1) the remaining one-half of the disbursements
 14-44 described in Sections 116.201(1) and (2);

14-45 (2) all of the trustee's compensation calculated on
 14-46 principal as a fee for acceptance, distribution, or termination,
 14-47 and disbursements made to prepare property for sale;

14-48 (3) payments on the principal of a trust debt;

14-49 (4) expenses of a proceeding that concerns primarily
 14-50 principal, including a proceeding to construe the trust or to
 14-51 protect the trust or its property;

14-52 (5) premiums paid on a policy of insurance not
 14-53 described in Section 116.201(4) of which the trust is the owner and
 14-54 beneficiary;

14-55 (6) estate, inheritance, and other transfer taxes,
 14-56 including penalties, apportioned to the trust; and

14-57 (7) disbursements related to environmental matters,
 14-58 including reclamation, assessing environmental conditions,
 14-59 remedying and removing environmental contamination, monitoring
 14-60 remedial activities and the release of substances, preventing
 14-61 future releases of substances, collecting amounts from persons
 14-62 liable or potentially liable for the costs of those activities,
 14-63 penalties imposed under environmental laws or regulations and other
 14-64 payments made to comply with those laws or regulations, statutory
 14-65 or common law claims by third parties, and defending claims based on
 14-66 environmental matters.

14-67 (b) If a principal asset is encumbered with an obligation
 14-68 that requires income from that asset to be paid directly to the
 14-69 creditor, the trustee shall transfer from principal to income an

15-1 amount equal to the income paid to the creditor in reduction of the
 15-2 principal balance of the obligation.

15-3 Sec. 116.203. TRANSFERS FROM INCOME TO PRINCIPAL FOR
 15-4 DEPRECIATION. (a) In this section, "depreciation" means a
 15-5 reduction in value due to wear, tear, decay, corrosion, or gradual
 15-6 obsolescence of a fixed asset having a useful life of more than one
 15-7 year.

15-8 (b) A trustee may transfer to principal a reasonable amount
 15-9 of the net cash receipts from a principal asset that is subject to
 15-10 depreciation, but may not transfer any amount for depreciation:

15-11 (1) of that portion of real property used or available
 15-12 for use by a beneficiary as a residence or of tangible personal
 15-13 property held or made available for the personal use or enjoyment of
 15-14 a beneficiary;

15-15 (2) during the administration of a decedent's estate;
 15-16 or

15-17 (3) under this section if the trustee is accounting
 15-18 under Section 116.153 for the business or activity in which the
 15-19 asset is used.

15-20 (c) An amount transferred to principal need not be held as a
 15-21 separate fund.

15-22 Sec. 116.204. TRANSFERS FROM INCOME TO REIMBURSE PRINCIPAL.

15-23 (a) If a trustee makes or expects to make a principal disbursement
 15-24 described in this section, the trustee may transfer an appropriate
 15-25 amount from income to principal in one or more accounting periods to
 15-26 reimburse principal or to provide a reserve for future principal
 15-27 disbursements.

15-28 (b) Principal disbursements to which Subsection (a) applies
 15-29 include the following, but only to the extent that the trustee has
 15-30 not been and does not expect to be reimbursed by a third party:

15-31 (1) an amount chargeable to income but paid from
 15-32 principal because it is unusually large, including extraordinary
 15-33 repairs;

15-34 (2) a capital improvement to a principal asset,
 15-35 whether in the form of changes to an existing asset or the
 15-36 construction of a new asset, including special assessments;

15-37 (3) disbursements made to prepare property for rental,
 15-38 including tenant allowances, leasehold improvements, and broker's
 15-39 commissions;

15-40 (4) periodic payments on an obligation secured by a
 15-41 principal asset to the extent that the amount transferred from
 15-42 income to principal for depreciation is less than the periodic
 15-43 payments; and

15-44 (5) disbursements described in Section 116.202(a)(7).

15-45 (c) If the asset whose ownership gives rise to the
 15-46 disbursements becomes subject to a successive income interest after
 15-47 an income interest ends, a trustee may continue to transfer amounts
 15-48 from income to principal as provided in Subsection (a).

15-49 Sec. 116.205. INCOME TAXES. (a) A tax required to be paid
 15-50 by a trustee based on receipts allocated to income must be paid from
 15-51 income.

15-52 (b) A tax required to be paid by a trustee based on receipts
 15-53 allocated to principal must be paid from principal, even if the tax
 15-54 is called an income tax by the taxing authority.

15-55 (c) A tax required to be paid by a trustee on the trust's
 15-56 share of an entity's taxable income must be paid proportionately:

15-57 (1) from income to the extent that receipts from the
 15-58 entity are allocated to income; and

15-59 (2) from principal to the extent that:

15-60 (A) receipts from the entity are allocated to
 15-61 principal; and

15-62 (B) the trust's share of the entity's taxable
 15-63 income exceeds the total receipts described in Subdivisions (1) and
 15-64 (2)(A).

15-65 (d) For purposes of this section, receipts allocated to
 15-66 principal or income must be reduced by the amount distributed to a
 15-67 beneficiary from principal or income for which the trust receives a
 15-68 deduction in calculating the tax.

15-69 Sec. 116.206. ADJUSTMENTS BETWEEN PRINCIPAL AND INCOME

16-1 BECAUSE OF TAXES. (a) A fiduciary may make adjustments between
 16-2 principal and income to offset the shifting of economic interests
 16-3 or tax benefits between income beneficiaries and remainder
 16-4 beneficiaries which arise from:

16-5 (1) elections and decisions, other than those
 16-6 described in Subsection (b), that the fiduciary makes from time to
 16-7 time regarding tax matters;

16-8 (2) an income tax or any other tax that is imposed upon
 16-9 the fiduciary or a beneficiary as a result of a transaction
 16-10 involving or a distribution from the estate or trust; or

16-11 (3) the ownership by an estate or trust of an interest
 16-12 in an entity whose taxable income, whether or not distributed, is
 16-13 includable in the taxable income of the estate, trust, or a
 16-14 beneficiary.

16-15 (b) If the amount of an estate tax marital deduction or
 16-16 charitable contribution deduction is reduced because a fiduciary
 16-17 deducts an amount paid from principal for income tax purposes
 16-18 instead of deducting it for estate tax purposes, and as a result
 16-19 estate taxes paid from principal are increased and income taxes
 16-20 paid by an estate, trust, or beneficiary are decreased, each
 16-21 estate, trust, or beneficiary that benefits from the decrease in
 16-22 income tax shall reimburse the principal from which the increase in
 16-23 estate tax is paid. The total reimbursement must equal the increase
 16-24 in the estate tax to the extent that the principal used to pay the
 16-25 increase would have qualified for a marital deduction or charitable
 16-26 contribution deduction but for the payment. The proportionate share
 16-27 of the reimbursement for each estate, trust, or beneficiary whose
 16-28 income taxes are reduced must be the same as its proportionate share
 16-29 of the total decrease in income tax. An estate or trust shall
 16-30 reimburse principal from income.

16-31 SECTION 2. Sections 111.004(5) and (11), Property Code, are
 16-32 amended to read as follows:

16-33 (5) "Income" is defined in Section 116.002 [~~113.102~~].

16-34 (11) "Principal" is defined in Section 116.002
 16-35 [~~113.102~~].

16-36 SECTION 3. Section 378B, Texas Probate Code, is amended by
 16-37 amending Subsections (a), (b), (d), and (g) and adding Subsection
 16-38 (i) to read as follows:

16-39 (a) Except as provided by Subsection (b) of this section and
 16-40 unless the will provides otherwise, all expenses incurred in
 16-41 connection with the settlement of a decedent's estate, including
 16-42 debts, funeral expenses, estate taxes, [~~interest and~~] penalties
 16-43 relating to estate taxes, and family allowances, shall be charged
 16-44 against the principal of the estate. Fees and expenses of an
 16-45 attorney, accountant, or other professional advisor, commissions
 16-46 and expenses of a personal representative, court costs, and all
 16-47 other similar fees or expenses relating to the administration of
 16-48 the estate and interest relating to estate taxes shall be allocated
 16-49 between the income and principal of the estate as the executor
 16-50 determines in its discretion to be just and equitable.

16-51 (b) Unless the will provides otherwise, income from the
 16-52 assets of a decedent's estate that accrues after the death of the
 16-53 testator and before distribution, including income from property
 16-54 used to discharge liabilities, shall be determined according to the
 16-55 rules applicable to a trustee under the Texas Trust Code (Subtitle
 16-56 B, Title 9, Property Code) and distributed as provided by Chapter
 16-57 116, Property Code, and Subsections (c) and [7] (d)[7 and (e)] of
 16-58 this section.

16-59 (d) ~~The [Except as provided by Subsection (f) of this~~
 16-60 ~~section, the]~~ balance of the net income shall be distributed to all
 16-61 other devisees after reduction for the balance of property taxes,
 16-62 ordinary repairs, insurance premiums, interest accrued, [~~including~~
 16-63 ~~interest accruing as provided by Subsection (f) of this section~~
 16-64 ~~after the death of the testator,]~~ other expenses of management and
 16-65 operation of all property from which the estate is entitled to
 16-66 income, and taxes imposed on income that accrues during the period
 16-67 of administration and that is payable or allocable to the devisees,
 16-68 in proportion to the devisees' respective interests in the
 16-69 undistributed assets of the estate.

17-1 (g) Income received by a trustee under this section shall be
17-2 treated as income of the trust as provided by Section 116.101
17-3 [~~113.103~~], Property Code.

17-4 (i) Chapter 116, Property Code, prevails to the extent of
17-5 any conflict between this section and Chapter 116, Property Code.

17-6 SECTION 4. Subchapter D, Chapter 113, Property Code, and
17-7 Sections 378B(e) and (f), Texas Probate Code, are repealed.

17-8 SECTION 5. (a) This Act takes effect January 1, 2004.

17-9 (b) Except as otherwise expressly provided by the will, the
17-10 terms of the trust, or this Act, this Act applies only to:

17-11 (1) a trust existing or created on or after January 1,
17-12 2004;

17-13 (2) the estate of a decedent who dies before January 1,
17-14 2004, if the probate or administration of the estate is pending as
17-15 of January 1, 2004; and

17-16 (3) the estate of a decedent who dies on or after
17-17 January 1, 2004.

17-18 * * * * *