3B:19B-1

LEGISLATIVE HISTORY CHECKLIST

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LAWS OF: 2001 **CHAPTER:** 212

NJSA: 3B:19B-1 ("Uniform Principal and Income Act")

BILL NO: A3261 (Substituted for S1667)

SPONSOR(S): Bateman and Biondi

DATE INTRODUCED: March 1, 2001

COMMITTEE: **ASSEMBLY:** Banking and Insurance

SENATE: ----

AMENDED DURING PASSAGE: Yes

DATE OF PASSAGE: **ASSEMBLY:** June 14, 2001

SENATE: June 28, 2001

DATE OF APPROVAL: August 15, 2001

FOLLOWING ARE ATTACHED IF AVAILABLE:

FINAL TEXT OF BILL (1st reprint enacted)

(Amendments during passage denoted by superscript numbers)

A3261

SPONSORS STATEMENT: (Begins on page 19 of original bill) Yes

COMMITTEE STATEMENT: **ASSEMBLY**: Yes

SENATE: No

FLOOR AMENDMENT STATEMENTS: No

LEGISLATIVE FISCAL ESTIMATE: No

S1667

SPONSORS STATEMENT: (Begins on page 19 of original bill) Yes

Bill and Sponsors Statement identical to A3261

COMMITTEE STATEMENT: **ASSEMBLY**: No

SENATE: Yes

Identical to Assembly Statement for A3261

FLOOR AMENDMENT STATEMENTS: No

LEGISLATIVE FISCAL ESTIMATE: No

VETO MESSAGE: No

GOVERNOR'S PRESS RELEASE ON SIGNING: No

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ASSEMBLY, No. 3261

STATE OF NEW JERSEY

209th LEGISLATURE

INTRODUCED MARCH 1, 2001

Sponsored by:
Assemblyman CHRISTOPHER "KIP" BATEMAN
District 16 (Morris and Somerset)
Assemblyman PETER J. BIONDI
District 16 (Morris and Somerset)

SYNOPSIS

Replaces "Revised Uniform Principal and Income Act" with "Uniform Principal and Income Act of 2000."

CURRENT VERSION OF TEXT

As introduced.

AN ACT concerning principal and income guidelines for trusts and estates and repealing N.J.S.3B:19A-1 et seq.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. This act shall be known and may be cited as the "Uniform Principal and Income Act of 2000."

2. As used in this act:

"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.

"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.

"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.

"Income" means money or property that a fiduciary receives as current return from a principal asset. The term includes a portion of receipts from a sale, exchange or liquidation of a principal asset, to the extent provided in sections 10 through 24 of this act.

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

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

"Mandatory income interest" means the right of an income beneficiary to receive net income that the terms of the trust require the fiduciary to distribute.

"Net income" means the total receipts allocated to income during an accounting period minus the disbursements made from income during the period, plus or minus transfers under this act to or from income during the period.

"Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency or instrumentality, public corporation or any other legal or commercial entity.

"Principal" means property held in trust for distribution to a remainder beneficiary when the trust terminates.

"Remainder beneficiary" means a person entitled to receive principal when an income interest ends.

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

"Trustee" includes an original, additional or successor trustee, whether or not appointed or confirmed by a court.

3. a. In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of sections 5 through 9 of this act, a fiduciary:

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

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

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

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

b. In exercising the power to adjust under subsection a. of section 4 of this act or a discretionary power of administration regarding a matter within the scope of this act, whether granted by the terms of a trust, a will or this act, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with this act is presumed to be fair and reasonable to all of the beneficiaries.

4. a. A trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or shall be distributed to a beneficiary by referring to the trust's income and the trustee determines, after applying the rules in subsection a. of section 3 of this act, that the trustee is unable to comply with subsection b. of section 3 of this act.

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

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

(2) the intent of the settlor;

(3) the identity and circumstances of the beneficiaries;

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

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

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

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

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

(9) the anticipated tax consequences of an adjustment.

c. A trustee shall not make an adjustment:

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

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

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

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

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

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

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

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

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

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

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

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

a. A fiduciary of an estate or of a terminating income interest shall determine the amount of net income and net principal receipts received from property specifically given to a beneficiary under the rules in sections 7 through 30 of this act which apply to trustees and the rules in subsection e. of this section. The fiduciary shall distribute the net income and net principal receipts to the beneficiary who is to receive the specific property.

b. A fiduciary shall determine the remaining net income of a decedent's estate or a terminating income interest under the rules in sections 7 through 30 of this act which apply to trustees and by:

(1) including in net income all income from property used to discharge liabilities;

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

(3) paying from principal all other disbursements made or incurred

in connection with the settlement of a decedent's estate or the winding up of a terminating income interest, including debts, funeral expenses, disposition of remains, family allowances and death taxes and related penalties that are apportioned to the estate or terminating income interest by the will, the terms of the trust or applicable law.

c. A fiduciary shall distribute to a beneficiary who receives a pecuniary amount outright the interest or any other amount provided by the will, the terms of the trust or applicable law from net income determined under subsection b. of this section or from principal to the extent that net income is insufficient. If a beneficiary is to receive a pecuniary amount outright from a trust after an income interest ends and no interest or other amount is provided for by the terms of the trust or applicable law, the fiduciary shall distribute the interest or other amount to which the beneficiary would be entitled under applicable law if the pecuniary amount were required to be paid under a will.

d. A fiduciary shall distribute the net income remaining after distributions required by subsection c. of this section in the manner described in section 6 of this act to all other beneficiaries, including a beneficiary who receives a pecuniary amount in trust, even if the beneficiary holds an unqualified power to withdraw assets from the trust or other presently exercisable general power of appointment over the trust.

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

6. a. Each beneficiary described in subsection d. of section 5 of this act is entitled to receive a portion of the net income equal to the beneficiary's fractional interest in undistributed principal assets, using values as of the distribution date. If a fiduciary makes more than one distribution of assets to beneficiaries to whom this section applies, each beneficiary, including one who does not receive part of the distribution, is entitled, as of each distribution date, to the net income the fiduciary has received after the date of death or terminating event

or earlier distribution date but has not distributed as of the current distribution date.

b. In determining a beneficiary's share of net income, the following rules apply:

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

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

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

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

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

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

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

b. An asset becomes subject to a trust:

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

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

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

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

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

8. a. A trustee shall allocate an income receipt or disbursement other than one to which paragraph (1) of subsection b. of section 5 of this act applies to principal if its due date occurs before a decedent dies in the case of an estate or before an income interest begins in the case of a trust or successive income interest.

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

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

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

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

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

10. a. As used in this section, "entity" means a corporation, partnership, limited liability company, regulated investment company, real estate investment trust, common trust fund or any other organization in which a trustee has an interest other than a trust or estate to which section 11 of this act applies, a business or activity to which section 12 of this act applies or an asset-backed security to which section 24 of this act applies.

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

c. A trustee shall allocate the following receipts from an entity to principal:

(1) property other than money;

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

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

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

d. Money is received in partial liquidation:

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

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

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

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

11. A trustee shall allocate to income an amount received as a distribution of income from a trust or an estate in which the trust has an interest other than a purchased interest, and shall allocate to principal an amount received as a distribution of principal from such a trust or estate. If a trustee purchases an interest in a trust that is an investment entity, or a decedent or donor transfers an interest in such a trust to a trustee, section 10 or 24 of this act applies to a receipt from the trust.

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

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

c. Activities for which a trustee may maintain separate accounting records include:

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

(2) farming;

(3) raising and selling livestock and other animals;

(4) management of rental properties;

(5) extraction of minerals and other natural resources;

(6) timber operations; and

(7) activities to which section 23 of this act applies.

13. A trustee shall allocate to principal:

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

b. Money or other property received from the sale, exchange, liquidation or change in form of a principal asset, including realized profit, subject to sections 10 through 24 of this act;

c. Amounts recovered from third parties to reimburse the trust because of disbursements described in paragraph (7) of subsection a. of section 26 of this act or for other reasons to the extent not based on the loss of income;

d. Proceeds of property taken by eminent domain, but a separate award made for the loss of income with respect to an accounting period during which a current income beneficiary had a mandatory income interest is income;

e. Net income received in an accounting period during which there is no beneficiary to whom a trustee may or shall distribute income; and

f. Other receipts as provided in sections 17 through 24 of this act.

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

15. a. An amount received as interest, whether determined at a fixed, variable or floating rate, on an obligation to pay money to the trustee, including an amount received as consideration for prepaying principal, shall be allocated to income without any provision for amortization of premium.

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

c. This section does not apply to an obligation to which section 18, 19, 20, 21, 23 or 24 of this act applies.

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

b. A trustee shall allocate to income proceeds of a contract that insures the trustee against loss of occupancy or other use by an income beneficiary, loss of income or, subject to section 12 of this act, loss of profits from a business.

c. This section does not apply to a contract to which section 18 of this act applies.

17. If a trustee determines that an allocation between principal and income required by section 18, 19, 20, 21 or 24 of this act is insubstantial, the trustee may allocate the entire amount to principal unless one of the circumstances described in subsection c. of section 4 of this act applies to the allocation. This power may be exercised by a cotrustee in the circumstances described in subsection d. of section 4 of this act and may be released for the reasons and in the manner described in subsection e. of section 4 of this act. An allocation is presumed to be insubstantial if:

(1) the amount of the allocation would increase or decrease net income in an accounting period, as determined before the allocation, by less than 10 percent; or

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

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

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

c. If no part of a payment is characterized as interest, a dividend or an equivalent payment, and all or part of the payment is required to be made, a trustee shall allocate to income 10 percent of the part that is required to be made during the accounting period and the balance to principal. If no part of a payment is required to be made or the payment received is the entire amount to which the trustee is entitled, the trustee shall allocate the entire payment to principal. For purposes of this subsection, a payment is not "required to be made" to the extent that it is made because the trustee exercises a right of withdrawal.

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

e. This section does not apply to payments to which section 19 of this act applies.

19. a. As used in this section, "liquidating asset" means an asset whose value will diminish or terminate because the asset is expected to produce receipts for a period of limited duration. The term includes a leasehold, patent, copyright, royalty right and right to receive payments during a period of more than one year under an arrangement that does not provide for the payment of interest on the unpaid balance. The term does not include a payment subject to section 18 of this act, resources subject to section 20 of this act, timber subject to section 21 of this act, an activity subject to section 23 of this act, an asset subject to section 24 of this act, or any asset for which the trustee establishes a reserve for depreciation under section 27 of this act.

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

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

(1) if received as nominal delay rental or nominal annual rent on a lease, a receipt shall be allocated to income;

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

(3) if an amount received as a royalty, shut-in-well payment, take-or-pay payment, bonus or delay rental is more than nominal, 90 percent shall be allocated to principal and the balance to income;

(4) if an amount is received from a working interest or any other interest not provided for in paragraph (1), (2) or (3) of this subsection a., 90 percent of the net amount received shall be allocated to principal and the balance to income.

b. An amount received on account of an interest in water that is renewable shall be allocated to income. If the water is not renewable, 90 percent of the amount shall be allocated to principal and the balance to income.

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

d. If a trust owns an interest in minerals, water, or other natural resources on the effective date of this act, the trustee may allocate receipts from the interest as provided in this act or in the manner used by the trustee before the effective date of this act. If the trust acquires an interest in minerals, water or other natural resources after the effective date of this act, the trustee shall allocate receipts from the interest as provided in this act.

21. a. To the extent that a trustee accounts for receipts from the sale of timber and related products pursuant to this section, the trustee shall allocate the net receipts:

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

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

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

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

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

c. This section applies whether or not a decedent or transferor was harvesting timber from the property before it became subject to the trust.

d. If a trust owns an interest in timberland on the effective date of this act, the trustee may allocate net receipts from the sale of timber and related products as provided in this act or in the manner used by the trustee before the effective date of this act. If the trust acquires an interest in timberland after the effective date of this act, the trustee shall allocate net receipts from the sale of timber and related products as provided in this act.

22. a. If a marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the spouse with sufficient income from or use of the trust assets, and if the amounts that the trustee transfers from principal to income under section 4 of this act and distributes to the spouse from principal pursuant to the terms of the trust are insufficient to provide the spouse

with the beneficial enjoyment required to obtain the marital deduction, the spouse may require the trustee to make property productive of income, convert property within a reasonable time or exercise the power conferred by subsection a. of section 4 of this act. The trustee may decide which action or combination of actions to take.

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

23. a. As used in this section, "derivative" means a contract or financial instrument or a combination of contracts and financial instruments which gives a trust the right or obligation to participate in some or all changes in the price of a tangible or intangible asset or group of assets, or changes in a rate, an index of prices or rates or other market indicator for an asset or a group of assets.

b. To the extent that a trustee does not account under section 12 of this act for transactions in derivatives, the trustee shall allocate to principal receipts from and disbursements made in connection with those transactions.

c. If a trustee grants an option to buy property from the trust, whether or not the trust owns the property when the option is granted, grants an option that permits another person to sell property to the trust or acquires an option to buy property for the trust or an option to sell an asset owned by the trust, and the trustee or other owner of the asset is required to deliver the asset if the option is exercised, an amount received for granting the option shall be allocated to principal. An amount paid to acquire the option shall be paid from principal. A gain or loss realized upon the exercise of an option, including an option granted to a settlor of the trust for services rendered, shall be allocated to principal.

24. a. As used in this section, "asset-backed security" means an asset whose value is based upon the right it gives the owner to receive distributions from the proceeds of financial assets that provide collateral for the security. The term includes an asset that gives the owner the right to receive from the collateral financial assets only the interest or other current return or only the proceeds other than interest or current return. The term does not include an asset to which section 10 or 18 of this act applies.

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

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

25. A trustee shall make the following disbursements from income to the extent that they are not disbursements to which paragraph (1) or (2) of subsection b. of section 5 of this act applies:

a. one-half of the regular compensation of the trustee and of any person providing investment advisory or custodial services to the trustee;

b. one-half of all expenses for accountings, judicial proceedings, or other matters that involve both the income and remainder interests;

c. all of the other ordinary expenses incurred in connection with the administration, management, or preservation of trust property and the distribution of income, including interest, ordinary repairs, regularly recurring taxes assessed against principal and expenses of a proceeding or other matter that concerns primarily the income interest; and

d. recurring premiums on insurance covering the loss of a principal asset or the loss of income from or use of the asset.

26. a. A trustee shall make the following disbursements from principal:

(1) the remaining one-half of the disbursements described in subsections a. and b. of section 25 of this act;

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

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

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

(5) premiums paid on a policy of insurance not described in subsection d. of section 25 of this act of which the trust is the owner and beneficiary;

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

(7) disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the costs of those activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or

regulations, statutory or common law claims by third parties and defending claims based on environmental matters.

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

27. a. As used in this section, "depreciation" means a reduction in value due to wear, tear, decay, corrosion or gradual obsolescence of a fixed asset having a useful life of more than one year.

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

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

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

(3) under this section if the trustee is accounting under section 12 of this act for the business or activity in which the asset is used.

c. An amount transferred to principal need not be held as a separate fund.

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

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

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

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

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

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

(5) disbursements described in paragraph (7) of subsection a. of section 26 of this act.

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

29. a. A tax required to be paid by a trustee based on receipts allocated to income shall be paid from income.

b. A tax required to be paid by a trustee based on receipts allocated to principal shall be paid from principal, even if the tax is called an income tax by the taxing authority.

c. A tax required to be paid by a trustee on the trust's share of an entity's taxable income shall be paid proportionately:

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

(2) from principal to the extent that:

(a) receipts from the entity are allocated to principal; and

(b) the trust's share of the entity's taxable income exceeds the total receipts described in paragraph (1) and subparagraph (a) of this paragraph (2).

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

30. a. A fiduciary may make adjustments between principal and income to offset the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries which arise from:

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

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

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

b. If the amount of an estate tax marital deduction or charitable contribution deduction is reduced because a fiduciary deducts an amount paid from principal for income tax purposes instead of deducting it for estate tax purposes, and as a result estate taxes paid from principal are increased and income taxes paid by an estate, trust or beneficiary are decreased, each estate, trust or beneficiary that benefits from the decrease in income tax shall reimburse the principal from which the increase in estate tax is paid. The total reimbursement shall equal the increase in the estate tax to the extent that the principal used to pay the increase would have qualified for a marital deduction or charitable contribution deduction but for the payment. The proportionate share of the reimbursement for each estate, trust or beneficiary whose income taxes are reduced shall be the same as its proportionate share of the total decrease in income tax. An estate or trust shall reimburse principal from income.

31. In applying and construing this act, consideration shall be given to the fact that this is a uniform act, and there is a need to promote uniformity of the act with respect to its subject matter among states that enact it.

32. This act applies to every trust or decedent's estate existing on the effective date of this act, except as otherwise expressly provided in the will or terms of the trust or in this act.

33. N.J.S.3B:19A-1 et seq. is repealed.

34. This act shall take effect immediately.

STATEMENT

This bill enacts the Uniform Principal and Income Act as revised in 1997 by the National Conference of Commissioners on Uniform State Laws, and replaces the Revised Uniform Principal and Income Act adopted in this State in 1991.

Like the prior law, the new Uniform Principal and Income Act provides procedures by which trustees administering an estate are to separate principal from income and ensure that the intention of the trust creator is the guiding principle for management of the estate. The central innovations of the new act, however, are to allow trustees greater discretion in allocating income and expenses between a trust's principal and income and the flexibility to invest assets for a total return, as long as the investments are prudent.

In addition, the new act clarifies required allocations of acquired assets and regulates trustees' handling of derivatives, options, deferred payment obligations and synthetic financial assets. The act also addresses disbursements made to comply with environmental laws and imbalances or inequities that may result from tax elections.

[First Reprint]

ASSEMBLY, No. 3261

STATE OF NEW JERSEY

209th LEGISLATURE

INTRODUCED MARCH 1, 2001

Sponsored by:
Assemblyman CHRISTOPHER "KIP" BATEMAN
District 16 (Morris and Somerset)
Assemblyman PETER J. BIONDI
District 16 (Morris and Somerset)

Co-Sponsored by:
Senators Adler and Cardinale

SYNOPSIS

Replaces "Revised Uniform Principal and Income Act" with "Uniform Principal and Income Act of 2000."

CURRENT VERSION OF TEXT

As reported by the Assembly Banking and Insurance Committee on May 3, 2001, with amendments.

(Sponsorship Updated As Of: 6/29/2001)

AN ACT concerning principal and income guidelines for trusts and estates and repealing N.J.S.3B:19A-1 et seq.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. [1]<u>Short Title.</u>[1] This act shall be known and may be cited as the "Uniform Principal and Income Act of [1]**[**2000**]** <u>2001</u>[1]."

2. [1]<u>Definitions.</u>[1] As used in this act:

"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.

"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.

"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.

"Income" means money or property that a fiduciary receives as current return from a principal asset. The term includes a portion of receipts from a sale, exchange or liquidation of a principal asset, to the extent provided in sections 10 through [1]**[**24**]** <u>23</u>[1] of this act.

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

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

"Mandatory income interest" means the right of an income beneficiary to receive net income that the terms of the trust require the fiduciary to distribute.

"Net income" means the total receipts allocated to income during an accounting period minus the disbursements made from income during the period, plus or minus transfers under this act to or from income during the period.

"Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency or instrumentality,

EXPLANATION - Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and intended to be omitted in the law.

Matter underlined <u>thus</u> is new matter.
Matter enclosed in superscript numerals has been adopted as follows:
[1] Assembly ABI committee amendments adopted May 3, 2001.

public corporation or any other legal or commercial entity.

"Principal" means property held in trust for distribution to a remainder beneficiary when the trust terminates.

"Remainder beneficiary" means a person entitled to receive principal when an income interest ends.

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

"Trustee" includes an original, additional or successor trustee, whether or not appointed or confirmed by a court.

3. [1]Fiduciary Duties; General Principles.[1] a. In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of sections 5 through 9 of this act, a fiduciary:

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

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

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

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

b. [1]**[**In exercising the power to adjust under subsection a. of section 4 of this act or a discretionary power of administration regarding a matter within the scope of this act, whether granted by the terms of a trust, a will or this act, a**]** A[1] fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. [1]**[**A determination in accordance with this act is presumed to be fair and reasonable to all of the beneficiaries.**]**[1]

4. [1]Trustee's Power to Adjust.[1] a. A trustee may adjust between principal and income [1]**[**to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor,**]** if[1] the terms of the trust describe the amount that may or shall be

distributed to a beneficiary by referring to the trust's income and the trustee determines, after applying the rules in subsection a. of section 3 of this act, that the trustee is unable to comply with subsection b. of section 3 of this act. [1]A decision by a trustee to increase the distribution to the income beneficiary or beneficiaries in any accounting period to an amount not in excess of four percent, or to decrease that period's distributions to not less than six percent, of the net fair market value of the trust assets on the first business day of that accounting period shall be presumed to be fair and reasonable to all of the beneficiaries. Any adjustment by a trustee between income and principal with respect to any accounting period shall be made during that accounting period or within 65 days after the end of that period.[1]

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

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

(2) the intent of the settlor;

(3) the identity and circumstances of the beneficiaries;

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

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

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

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

(8) the actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation; [1]**[**and**]**[1]

(9) [1]the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries that arise from elections and decisions regarding tax matters, the imposition of an income or other tax on the fiduciary or a beneficiary as a result of a transaction involving a distribution from the estate or trust, or the ownership of an interest in an entity whose taxable income, whether or not distributed, is includable in the taxable income of the estate, trust or a beneficiary; and

(10)[1] the anticipated tax consequences of an adjustment.

c. A trustee shall not make an adjustment:

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

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

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

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

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

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

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

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

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

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

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

5. [1]Determination and Distribution of Net Income. [1]After a decedent dies, in the case of an estate or after an income interest in a trust ends, the following rules apply:

a. A fiduciary of an estate or of a terminating income interest shall determine the amount of net income and net principal receipts received from property specifically [1][given] devised[1] to a beneficiary under the rules in sections 7 through [1][30] 28[1] of this act which apply to trustees and the rules in subsection e. of this section. The fiduciary shall distribute the net income and net principal receipts to the beneficiary who is to receive the specific property.

b. A fiduciary shall determine the remaining net income of a decedent's estate or a terminating income interest under the rules in sections 7 through [1][30] 28[1] of this act which apply to trustees and by:

(1) including in net income all income from property used to discharge liabilities; [1]and[1]

(2) [1][paying from income or principal, in the fiduciary's discretion, fees of attorneys, accountants and fiduciaries, court costs and other expenses of administration and interest on death taxes, but the fiduciary may pay those expenses from income of property passing to a trust for which the fiduciary claims an estate tax marital or charitable deduction only to the extent that the payment of those expenses from income will not cause the reduction or loss of the deduction; and

(3)][1] paying from principal all [1][other disbursements made or incurred in connection with the settlement of a decedent's estate or the winding up of a terminating income interest, including debts, funeral expenses, disposition of remains, family allowances and death taxes and related penalties that are apportioned to the estate or terminating income interest by the will, the terms of the trust or applicable law] disbursements made or incurred in connection with the settlement of a decedent's estate or the winding up of a terminating income interest, expenses of administration, including fees of attorneys, accountants and fiduciaries, court costs, debts, funeral expenses, disposition of remains, family allowances and death taxes and related penalties that are apportioned to the estate or terminating income interest by the will, the terms of the trust or applicable law[1].

c. A fiduciary shall distribute to a beneficiary who receives a pecuniary amount outright the interest or any other amount provided by the will, the terms of the trust or applicable law from net income determined under subsection b. of this section or from principal to the extent that net income is insufficient. If a beneficiary is to receive a pecuniary amount outright from a trust after an income interest ends and no interest or other amount is provided for by the terms of the trust or applicable law, the fiduciary shall distribute the interest or other amount to which the beneficiary would be entitled under applicable law if the pecuniary amount were required to be paid under a will.

d. A fiduciary shall distribute the net income remaining after distributions required by subsection c. of this section in the manner described in section 6 of this act to all other beneficiaries, [1]**[**including a beneficiary who receives a pecuniary amount in trust, even if the beneficiary holds an unqualified power to withdraw assets from the trust or other presently exercisable general power of appointment over the trust**]** excluding a beneficiary who receives a pecuniary amount outright or in trust[1].

e. A fiduciary shall not reduce principal or income receipts from property described in subsection a. of this section because of a payment described in section [1]**[**25**]** 24[1] or [1]**[**26**]** 25[1] of this act to the extent that the will, the terms of the trust, or applicable law requires the fiduciary to make the payment from assets other than the property or to the extent that the fiduciary recovers or expects to recover the payment from a third party. The net income and principal receipts from the property are determined by including all of the amounts the fiduciary receives or pays with respect to the property, whether those amounts accrued or became due before, on or after the date of a decedent's death or an income interest's terminating event, and by making a reasonable provision for amounts that the fiduciary believes the estate or terminating income interest may become obligated to pay after the property is distributed.

6. [1]Distribution to Residuary and Remainder Beneficiaries.[1] a. Each beneficiary described in subsection d. of section 5 of this act is entitled to receive a portion of the net income equal to the beneficiary's fractional interest in undistributed principal assets, using values as of the distribution date. If a fiduciary makes more than one distribution of assets to beneficiaries to whom this section applies, each beneficiary, including one who does not receive part of the distribution, is entitled, as of each distribution date, to the net income the fiduciary has received after the date of death or terminating event or earlier distribution date but has not distributed as of the current distribution date.

b. In determining a beneficiary's share of net income, the following rules apply:

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

(2) The beneficiary's fractional interest in the undistributed principal assets shall be calculated without regard to property specifically given to a beneficiary and property required to pay

pecuniary amounts not in trust.

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

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

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

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

7. [1]When Right to Income Begins and Ends.[1] a. An income beneficiary is entitled to net income from the date on which the income interest begins. An income interest begins on the date specified in the terms of the trust or, if no date is specified, on the date an asset becomes subject to a trust or successive income interest.

b. An asset becomes subject to a trust:

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

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

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

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

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

8. [1]Apportionment of Receipts and Disbursements When Decedent Dies or Income Interest Begins.[1] a. A trustee shall allocate an income receipt or disbursement [1],[1] other than one to which [1][paragraph (1) of][1] subsection [1][b.] a.[1] of section 5 of this act applies [1],[1] to principal

if its due date occurs before a decedent dies in the case of an estate or before an income interest begins in the case of a trust or successive income interest.

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

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

9. [1]<u>Apportionment When Income Interest Ends.</u>[1] a. As used in this section, "undistributed income" means net income received before the date on which an income interest ends. The term does not include an item of income or expense that is due or accrued or net income that has been added or is required to be added to principal under the terms of the trust.

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

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

10. [1]<u>Character of Receipts.</u>[1] a. As used in this section, "entity" means a corporation, partnership, limited liability company, regulated investment company, real estate investment trust, common trust fund

or any other organization in which a trustee has an interest other than a trust or estate to which section 11 of this act applies, a business or activity to which section 12 of this act applies or an asset-backed security to which section [1][24] 23[1] of this act applies.

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

c. A trustee shall allocate the following receipts from an entity to principal:

(1) property other than money;

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

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

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

d. Money is received in partial liquidation:

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

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

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

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

11. [1]Distribution from Trust or Estate.[1] A trustee shall allocate to income an amount received as a distribution of income from a trust or an estate in which the trust has an interest other than a purchased interest, and shall allocate to principal an amount received as a distribution of principal from such a trust or estate. If a trustee purchases an interest in a trust that is an investment entity, or a decedent or donor transfers an interest in such a trust to a trustee, section 10 or [1][24] 23[1] of this act applies to a receipt from the trust.

12. [1]Business and Other Activities Conducted by Trustee.[1] a. If a trustee who conducts a business or other activity determines that it

is in the best interest of all the beneficiaries to account separately for the business or activity instead of accounting for it as part of the trust's general accounting records, the trustee may maintain separate accounting records for its transactions, whether or not its assets are segregated from other trust assets.

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

c. Activities for which a trustee may maintain separate accounting records include:

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

(2) farming;

(3) raising and selling livestock and other animals;

(4) management of rental properties;

(5) extraction of minerals and other natural resources;

(6) timber operations; and

(7) activities to which section [1][23] 22[1] of this act applies.

13. [1]Principal Receipts.[1] A trustee shall allocate to principal:

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

b. Money or other property received from the sale, exchange, liquidation or change in form of a principal asset, including realized profit, subject to sections 10 through [1][24] 23[1] of this act;

c. Amounts recovered from third parties to reimburse the trust because of disbursements described in paragraph [1][(7)] (9)[1] of subsection a. of section [1][26] 25[1] of this act or for other reasons to the extent not based on the loss of income;

d. Proceeds of property taken by eminent domain, but a separate award made for the loss of income with respect to an accounting period during which a current income beneficiary had a mandatory income interest is income;

e. Net income received in an accounting period during which there is no beneficiary to whom a trustee may or shall distribute income; and

f. Other receipts as provided in sections 17 through [1][24] 23[1] of this act.

14. [1]Rental Property.[1] To the extent that a trustee accounts for receipts from rental property pursuant to this section, the trustee shall allocate to income an amount received as rent of real or personal property, including an amount received for cancellation or renewal of a lease. An amount received as a refundable deposit, including a security deposit or a deposit that is to be applied as rent for future periods, shall be added to principal and held subject to the terms of the lease and is not available for distribution to a beneficiary until the trustee's contractual obligations have been satisfied with respect to that amount.

15. [1]Obligation to Pay Money.[1] a. An amount received as interest, whether determined at a fixed, variable or floating rate, on an obligation to pay money to the trustee, including an amount received as consideration for prepaying principal, shall be allocated to income without any provision for amortization of premium.

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

c. This section does not apply to an obligation to which section [1]17,[1] 18, 19, 20, [1]**[**21,**]** 22 or[1] 23 [1]**[**or 24**]**[1] of this act applies.

16. [1]Insurance Policies and Similar Contracts.[1] a. Except as otherwise provided in subsection b. of this section, a trustee shall allocate to principal the proceeds of a life insurance policy or other contract in which the trust or its trustee is named as beneficiary, including a contract that insures the trust or its trustee against loss for damage to, destruction of or loss of title to a trust asset. The trustee shall allocate dividends on an insurance policy to income if the premiums on the policy are paid from income, and to principal if the premiums are paid from principal.

b. A trustee shall allocate to income proceeds of a contract that insures the trustee against loss of occupancy or other use by an income beneficiary, loss of income or, subject to section 12 of this act, loss of profits from a business.

c. This section does not apply to a contract to which section [1]**[**18**]** 17[1] of this act applies.

[1]**[**17. If a trustee determines that an allocation between principal

and income required by section 18, 19, 20, 21 or 24 of this act is insubstantial, the trustee may allocate the entire amount to principal unless one of the circumstances described in subsection c. of section 4 of this act applies to the allocation. This power may be exercised by a cotrustee in the circumstances described in subsection d. of section 4 of this act and may be released for the reasons and in the manner described in subsection e. of section 4 of this act. An allocation is presumed to be insubstantial if:

(1) the amount of the allocation would increase or decrease net income in an accounting period, as determined before the allocation, by less than 10 percent; or

(2) the value of the asset producing the receipt for which the allocation would be made is less than 10 percent of the total value of the trust's assets at the beginning of the accounting period.][1]

[1][18.] 17. Deferred Compensation, Retirement Benefits, Annuities, and Similar Payments.[1] a. As used in this section, "payment" means a payment that a trustee may receive over a fixed [1][number] period[1] of [1][years] time[1] or during the life of one or more individuals because of services rendered or property transferred to the payer in exchange for future payments. The term includes a payment made in money or property from the payer's general assets or from a separate fund created by the payer [1]or by another[1], including a private or commercial annuity, an individual retirement account and a pension, profit-sharing, stock-bonus, or stock-ownership plan.

b. To the extent that a [1][payment is characterized as interest or a dividend or a payment made in lieu of interest or a dividend, a trustee shall allocate it to income. The trustee shall allocate to principal the balance of the payment and any other payment received in the same accounting period that is not characterized as interest, a dividend or an equivalent payment] trustee can readily ascertain the part of a payment from a separate fund held for the benefit of the trust that represents the then undistributed net income of the fund realized since the trust acquired its interest in the fund, a trustee shall allocate that part to income. The trustee shall allocate to principal the balance of the payment[1].

c. If no part of a payment is [1][characterized as interest, a dividend or an equivalent payment] allocated to income under subsection b. of this section[1], and all or part of the payment is required to be made, a trustee shall allocate to income 10 percent of the part that is required to be made during the accounting period and the balance to principal. If no part of a payment is required to be made or the payment received is the entire amount to which the trustee is entitled, the trustee shall allocate the entire payment to principal. For purposes of this subsection, a payment is not "required to be made" to the extent that it is made because the trustee exercises a right of withdrawal.

d. If, to obtain an estate tax [1]or gift tax[1] marital deduction for a trust, [1][a] the[1] trustee must allocate more of a payment to income than provided for by this section, the trustee shall allocate to income the additional amount necessary to obtain the marital deduction.

e. This section does not apply to payments to which section [1][19] 18[1] of this act applies.

[1][19.] 18. Liquidating Asset. [1]a. As used in this section, "liquidating asset" means an asset whose value will diminish or terminate because the asset is expected to produce receipts for a period of limited duration. The term includes a leasehold, patent, copyright, royalty right and right to receive payments during a period of more than one year under an arrangement that does not provide for the payment of interest on the unpaid balance. The term does not include a payment subject to section [1][18] 17[1] of this act, resources subject to section [1][20] 19[1] of this act, timber subject to section [1][21] 20[1] of this act, an activity subject to section [1][23] 22[1] of this act, an asset subject to section [1][24] 23[1] of this act, or any asset for which the trustee establishes a reserve for depreciation under section [1][27] 26[1] of this act.

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

[1][20.] 19. Minerals, Water and Other Natural Resources.[1] a. To the extent that a trustee accounts for receipts from an interest in minerals or other natural resources pursuant to this section, the trustee shall allocate them as follows:

(1) if received as nominal delay rental or nominal annual rent on a lease, a receipt shall be allocated to income;

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

(3) if an amount received as a royalty, shut-in-well payment, take-or-pay payment, bonus or delay rental is more than nominal, 90 percent shall be allocated to principal and the balance to income;

(4) if an amount is received from a working interest or any other interest not provided for in paragraph (1), (2) or (3) of this subsection a., 90 percent of the net amount received shall be allocated to principal and the balance to income.

b. An amount received on account of an interest in water that is renewable shall be allocated to income. If the water is not renewable, 90 percent of the amount shall be allocated to principal and the balance to income.

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

d. If a trust owns an interest in minerals, water, or other natural resources on the effective date of this act, the trustee may allocate receipts from the interest as provided in this act or in the manner used by the trustee before the effective date of this act. If the trust acquires an interest in minerals, water or other natural resources after the effective date of this act, the trustee shall allocate receipts from the interest as provided in this act.

[1]**[**21.**]** 20. Timber.[1] a. To the extent that a trustee accounts for receipts from the sale of timber and related products pursuant to this section, the trustee shall allocate the net receipts:

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

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

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

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

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

c. This section applies whether or not a decedent or transferor was harvesting timber from the property before it became subject to the trust.

d. If a trust owns an interest in timberland on the effective date of this act, the trustee may allocate net receipts from the sale of timber and related products as provided in this act or in the manner used by the trustee before the effective date of this act. If the trust acquires an interest in timberland after the effective date of this act, the trustee shall allocate net receipts from the sale of timber and related products as provided in this act.

[1]**[**22.**]** 21. Property Not Productive of Income.[1] a. If a marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the spouse with sufficient income from or use of the trust assets, and if the amounts

that the trustee transfers from principal to income under section 4 of this act and distributes to the spouse from principal pursuant to the terms of the trust are insufficient to provide the spouse with the beneficial enjoyment required to obtain the marital deduction, the spouse may require the trustee to make property productive of income, convert property within a reasonable time or exercise the power conferred by subsection a. of section 4 of this act. The trustee may decide which action or combination of actions to take.

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

[1]**[**23.**]** 22. Derivatives and Options.[1] a. As used in this section, “derivative” means a contract or financial instrument or a combination of contracts and financial instruments which gives a trust the right or obligation to participate in some or all changes in the price of a tangible or intangible asset or group of assets, or changes in a rate, an index of prices or rates or other market indicator for an asset or a group of assets.

b. To the extent that a trustee does not account under section 12 of this act for transactions in derivatives, the trustee shall allocate to principal receipts from and disbursements made in connection with those transactions.

c. If a trustee grants an option to buy property from the trust, whether or not the trust owns the property when the option is granted, grants an option that permits another person to sell property to the trust or acquires an option to buy property for the trust or an option to sell an asset owned by the trust, and the trustee or other owner of the asset is required to deliver the asset if the option is exercised, an amount received for granting the option shall be allocated to principal. An amount paid to acquire the option shall be paid from principal. A gain or loss realized upon the exercise of an option, including an option granted to a settlor of the trust for services rendered, shall be allocated to principal.

[1]**[**24.**]** 23. Asset-backed Securities.[1] a. As used in this section, “asset-backed security” means an asset whose value is based upon the right it gives the owner to receive distributions from the proceeds of financial assets that provide collateral for the security. The term includes an asset that gives the owner the right to receive from the collateral financial assets only the interest or other current return or only the proceeds other than interest or current return. The term does not include an asset to which section 10 or [1]**[**18**]** 17[1] of this act applies.

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

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

[1]**[**25.**]** 24. Disbursements from Income.[1] A trustee shall make the following disbursements from income to the extent that they are not disbursements to which paragraph (1) or (2) of subsection b. of section 5 of this act applies:

a. [1]**[**one-half of the regular compensation of the trustee and of any person providing investment advisory or custodial services to the trustee**]** commissions allowed by law to a trustee on income receipts, if properly chargeable to the trust[1];

b. one-half of [1]**[**all expenses for accountings, judicial proceedings, or other matters that involve both the income and remainder interests**]** the fees paid to banks and other financial institutions for custodial services to the fiduciary if properly chargeable to the trust[1];

c. all of the other ordinary expenses incurred in connection with the administration, management, or preservation of trust property and the distribution of income, including interest [1]**[**, ordinary repairs, regularly recurring taxes assessed against principal and expenses of a proceeding or other matter that concerns primarily the income interest**]** paid by the trustee, including interest on death taxes, regularly recurring taxes assessed against any portion of the principal, water rates, bond premiums, and the expenses, including court costs, attorneys' fees, and accountants' fees, of an accounting, judicial proceeding or other matter that concerns primarily the income interest, unless the court directs otherwise[1]; and

d. recurring premiums on insurance covering the loss of a principal asset or the loss of income from or use of the asset.

[1]**[**26.**]** 25. Disbursements from Principal.[1] a. A trustee shall make the following disbursements from principal:

(1) [1]**[**the remaining one-half of the disbursements described in subsections a. and b. of section 25 of this act**]** commissions allowed by law to a trustee on principal receipts or distributions or on termination of the trust estate[1];

(2) [1]**[**all of the trustee's compensation calculated on principal as a

fee for acceptance, distribution, or termination, and disbursements made to prepare property for sale] the remaining one-half of the fees paid to banks and other financial institutions for custodial services, if properly chargeable to the trust[1];

(3) [1][payments on the principal of a trust debt] fees paid to banks and other financial institutions and registered investment advisors for investment advisory or investment management services, if properly chargeable to the trust[1];

(4) [1][expenses of a proceeding that concerns primarily principal, including a proceeding to construe the trust or to protect the trust or its property] costs of investing and reinvesting principal and payments on the principal of an indebtedness, including a mortgage or security interest amortized by periodic payments of principal[1];

(5) [1][premiums paid on a policy of insurance not described in subsection d. of section 25 of this act of which the trust is the owner and beneficiary] extraordinary repairs or expenses incurred in making a capital improvement, including special assessments, and disbursements made to prepare property for sale[1];

(6) [1][estate, inheritance and other transfer taxes, including penalties, apportioned to the trust] court costs, attorneys' fees, accountants' fees and other fees, incurred on an accounting or judicial proceeding or in maintaining or defending any action to construe a will or a trust, protect it or the trust estate, or assure the title of any property, unless properly chargeable to income under subsection c. of section 24 of this act or the court otherwise directs[1]; [1][and][1]

(7) [1][disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the costs of those activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or regulations, statutory or common law claims by third parties and defending claims based on environmental matters] premiums paid on an insurance policy not described in subsection d. of section 24 of this act of which the trust is the owner and beneficiary;

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

(9) disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the cost of those activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or

regulations, statutory or common law claims by third parties and defending claims based on environmental matters; and

(10) if an estate or inheritance tax is levied in respect of a trust in which both an income beneficiary and remainderman have an interest, any amount apportioned to the trust, including penalties, even though the income beneficiary also has rights in the principal[1].

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

[1]**[**27.**]** 26. Transfers from Income to Principal for Depreciation.[1]

a. As used in this section, “depreciation” means a reduction in value due to wear, tear, decay, corrosion or gradual obsolescence of a fixed asset having a useful life of more than one year.

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

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

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

(3) under this section if the trustee is accounting under section 12 of this act for the business or activity in which the asset is used.

c. An amount transferred to principal need not be held as a separate fund.

[1]**[**28.**]** 27. Transfer from Income to Reimburse Principal.[1] a. If a trustee makes or expects to make a principal disbursement described in this section, the trustee may transfer an appropriate amount from income to principal in one or more accounting periods to reimburse principal or to provide a reserve for future principal disbursements.

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

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

(2) [1]**[**a capital improvement to a principal asset, whether in the form of changes to an existing asset or the construction of a new asset, including special assessments;

(3)**]**[1] disbursements made to prepare property for rental, including tenant allowances, leasehold improvements and broker’s commissions; [1]and[1]

[1]**[**(4)**]** (3)[1] periodic payments on an obligation secured by a principal asset to the extent that the amount transferred from income

to principal for depreciation is less than the periodic payments [1][; and

(5) disbursements described in paragraph (7) of subsection a. of section 26 of this act][1].

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

[1][29.] <u>28. Income Taxes.</u> [1] a. A tax required to be paid by a trustee based on receipts allocated to income shall be paid from income.

b. A tax required to be paid by a trustee based on receipts allocated to principal shall be paid from principal, even if the tax is called an income tax by the taxing authority.

c. A tax required to be paid by a trustee on the trust's share of an entity's taxable income shall be paid proportionately:

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

(2) from principal to the extent that:

(a) receipts from the entity are allocated to principal; and

(b) the trust's share of the entity's taxable income exceeds the total receipts described in paragraph (1) and subparagraph (a) of this paragraph (2).

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

[1][30. a. A fiduciary may make adjustments between principal and income to offset the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries which arise from:

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

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

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

b. If the amount of an estate tax marital deduction or charitable contribution deduction is reduced because a fiduciary deducts an amount paid from principal for income tax purposes instead of deducting it for estate tax purposes, and as a result estate taxes paid from principal are increased and income taxes paid by an estate, trust or beneficiary are decreased, each estate, trust or beneficiary that benefits from the decrease in income tax shall reimburse the principal from which the increase in estate tax is paid. The total reimbursement shall equal the increase in the estate tax to the extent that the principal used to pay the increase would have qualified for a marital deduction or charitable contribution deduction but for the payment. The proportionate share of the reimbursement for each estate, trust or beneficiary whose income taxes are reduced shall be the same as its proportionate share of the total decrease in income tax. An estate or trust shall reimburse principal from income.][1]

[1][31.] 29. Uniformity of Application and Construction. [1] In applying and construing this act, consideration shall be given to the fact that this is a uniform act, and there is a need to promote uniformity of the act with respect to its subject matter among states that enact it.

[1][32.] 30. Application of Act to Existing and Future Trusts and Estates.[1] This act applies to every trust or decedent's estate existing on [1]or after[1] the effective date of this act, except as otherwise expressly provided in the will or terms of the trust or in this act.

[1]31. Judicial Control of Discretionary Powers. a. A court shall not change a fiduciary's decision to exercise or not to exercise a discretionary power conferred by this act unless it determines that the decision was an abuse of discretion. A court shall not determine that a fiduciary abused its discretion merely because the court would have exercised the discretion in a different manner or would not have exercised the discretion.

b. The decisions to which subsection a. of this section applies include:

(1) A determination under subsection a. of section 4 of this act of whether and to what extent an amount should be transferred from principal to income or from income to principal.

(2) A determination of the factors that are relevant to the trust and its beneficiaries, the extent to which they are relevant, and the weight, if any, to be given to the relevant factors in deciding whether and to what extent to exercise the powers conferred by subsection a. of section 4 of this act.

c. If a court determines that a fiduciary has abused its discretion, the remedy is to restore the income and remainder beneficiaries to the position they would have occupied if the fiduciary had not abused its discretion, according to the following rules:

(1) To the extent that the abuse of discretion has resulted in no distribution to a beneficiary or a distribution that is too small, the court shall require the fiduciary to distribute from the trust to the

beneficiary an amount that the court determines will restore the beneficiary, in whole or in part, to his appropriate position.

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

(3) To the extent that the court is unable, after applying paragraphs (1) and (2) of this subsection to restore the beneficiaries, the trust, or both, to the position they would have occupied if the fiduciary had not abused its discretion, the court may require the fiduciary to pay an appropriate amount from its own funds to one or more of the beneficiaries or the trust or both.

d. Upon a petition by the fiduciary, the court having jurisdiction over the trust or estate shall determine whether a proposed exercise or nonexercise by the fiduciary of a discretionary power conferred by this act will result in an abuse of the fiduciary's discretion. If the petition describes the proposed exercise or nonexercise of the power and contains sufficient information to inform the beneficiaries of the reasons for the proposal, the facts upon which the fiduciary relies, and an explanation of how the income and remainder beneficiaries will be affected by the proposed exercise or nonexercise of the power, a beneficiary who challenges the proposed exercise or nonexercise has the burden of establishing that it will result in an abuse of discretion.[1]

[1]**[**33.**]** 32. Repealer.[1] N.J.S.3B:19A-1 et seq. is repealed.

[1]**[**34.**]** 33. Effective Date.[1] This act shall take effect [1]**[**immediately**]** on January 1 of the year following enactment[1].

ASSEMBLY BANKING AND INSURANCE COMMITTEE

STATEMENT TO

ASSEMBLY, No. 3261

with committee amendments

STATE OF NEW JERSEY

DATED: MAY 3, 2001

The Assembly Banking and Insurance Committee reports favorably and with committee amendments, Assembly Bill No. 3261.

This bill, as amended by the committee, enacts the Uniform Principal and Income Act as revised in 1997 by the National Conference of Commissioners on Uniform State Laws (NCCUSL) with certain changes and additions, and replaces the Revised Uniform Principal and Income Act adopted in this State in 1991.

The primary purpose of the bill is to better allow a trustee (or a personal representative of an estate) to satisfy fiduciary duties to the two types of beneficiaries of a trust, whose interests often are in conflict: remainder beneficiaries, who benefit from a trust's principal, and income beneficiaries, who benefit from a trust's income distribution. The bill's most significant change from existing law is that it provides a trustee with the discretion to allocate trust assets either to principal or income, in conformity with rules established by the bill and with the "Prudent Investor Act" (P.L.1997, c.26; C.3B:20-11.1 et seq.). Some other key provisions of the bill are discussed below.

The bill provides new and clarified rules for allocation, including the rule that any money received by a trustee is regarded as income, unless it fits into certain categories. Those categories include:

(1) Money received as part of liquidation of the trust;

(2) Money received from an investment company that has labeled the distribution as a capital gain; or

(3) Property received that is not money, such as a stock distribution.

In addition, receipts from derivatives, with one exception, are considered principal; receipts from asset-backed securities, on the other hand, may be either income or principal, depending on the category into which the payor of the security falls. Where a trust provides a fixed income for the income beneficiary, the bill allows the trustee to adjust principal and income if necessary for compliance with prudent investment standards. Before adjusting principal and income in this way, a trustee is required by the bill to consider a list of factors including the nature, purpose and expected duration of the trust, as well as the intent of the settlor. In addition, the bill creates a safe harbor for a trustee in this allocation by providing that a decision by a trustee to adjust distributions to an income beneficiary to four percent of the principal of the trust (or to decrease distributions to six percent) will be deemed a fair and reasonable adjustment. The bill forbids a trustee from making adjustments when they would diminish income in a trust that requires full income to be paid annually to a surviving spouse, and in other circumstances.

The bill provides that the payment of administration expenses are to be paid out of principal when an income interest in a trust ends (or when a decedent dies).

During the life of the trust, the bill provides for payment of expenses as follows: ordinary expenses are to be paid out of income; commissions to a trustee on income receipts and principal receipts are to be paid from income and principal, respectively; payments for legal proceedings defending a will or trust or to assure title of any property are to be paid from principal; and expenses that are specific to the remainder are made from principal. Additional rules govern situations such as depreciation or enhancement of assets.

The bill specifies that the only remedy available for an exercise or nonexercise of discretion is an abuse of discretion. A court cannot change a fiduciary's decision to exercise or not to exercise a discretionary power conferred by this bill unless it determines that the decision was an abuse of discretion. A court cannot determine that a fiduciary abused its discretion merely because the court would have exercised the discretion in a different manner or would not have exercised the discretion. The bill limits the remedy for an abuse of discretion to restoring the beneficiaries and the trust to the position they would have occupied if there had not been an abuse. The objective is to accomplish the restoration initially by making adjustments between the beneficiaries and the trust to the extent possible; to the extent that restoration is not possible by such adjustments, a court may order the trustee to pay an amount to one or more beneficiaries, the trust or both. The bill allows a fiduciary to petition a court to determine whether a proposed exercise or nonexercise by the fiduciary of a discretionary power conferred by this bill will result in an abuse of the fiduciary's discretion. If the petition contains the information prescribed in subsection d. of section 31 of this bill, the proposed action or inaction is presumed not to result in an abuse, and a beneficiary who challenges the proposal must establish that it will.

Finally, the bill provides that the express language of a trust instrument, will or other applicable document will govern that trust or estate, and that the bill merely provides the default rule if the governing instrument is silent.

As reported by the committee, this bill is identical to Senate Bill No. 1667(1R).

SENATE, No. 1667

STATE OF NEW JERSEY

209th LEGISLATURE

INTRODUCED SEPTEMBER 25, 2000

Sponsored by:
Senator JOHN H. ADLER
District 6 (Camden)
Senator GERALD CARDINALE
District 39 (Bergen)

SYNOPSIS

Replaces "Revised Uniform Principal and Income Act" with "Uniform Principal and Income Act of 2000."

CURRENT VERSION OF TEXT

As introduced.

AN ACT concerning principal and income guidelines for trusts and estates and repealing N.J.S.3B:19A-1 et seq.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. This act shall be known and may be cited as the "Uniform Principal and Income Act of 2000."

2. As used in this act:

"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.

"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.

"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.

"Income" means money or property that a fiduciary receives as current return from a principal asset. The term includes a portion of receipts from a sale, exchange or liquidation of a principal asset, to the extent provided in sections 10 through 24 of this act.

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

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

"Mandatory income interest" means the right of an income beneficiary to receive net income that the terms of the trust require the fiduciary to distribute.

"Net income" means the total receipts allocated to income during an accounting period minus the disbursements made from income during the period, plus or minus transfers under this act to or from income during the period.

"Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency or instrumentality, public corporation or any other legal or commercial entity.

"Principal" means property held in trust for distribution to a remainder beneficiary when the trust terminates.

"Remainder beneficiary" means a person entitled to receive principal when an income interest ends.

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

"Trustee" includes an original, additional or successor trustee, whether or not appointed or confirmed by a court.

3. a. In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of sections 5 through 9 of this act, a fiduciary:

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

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

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

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

b. In exercising the power to adjust under subsection a. of section 4 of this act or a discretionary power of administration regarding a matter within the scope of this act, whether granted by the terms of a trust, a will or this act, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with this act is presumed to be fair and reasonable to all of the beneficiaries.

4. a. A trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or shall be distributed to a beneficiary by referring to the trust's income and the trustee determines, after applying the rules in subsection a. of section 3 of this act, that the trustee is unable to comply with subsection b. of section 3 of this act.

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

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

(2) the intent of the settlor;

(3) the identity and circumstances of the beneficiaries;

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

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

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

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

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

(9) the anticipated tax consequences of an adjustment.

c. A trustee shall not make an adjustment:

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

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

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

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

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

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

power to make an adjustment;

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

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

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

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

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

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

a. A fiduciary of an estate or of a terminating income interest shall determine the amount of net income and net principal receipts received from property specifically given to a beneficiary under the rules in sections 7 through 30 of this act which apply to trustees and the rules in subsection e. of this section. The fiduciary shall distribute the net income and net principal receipts to the beneficiary who is to receive the specific property.

b. A fiduciary shall determine the remaining net income of a decedent's estate or a terminating income interest under the rules in sections 7 through 30 of this act which apply to trustees and by:

(1) including in net income all income from property used to discharge liabilities;

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

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

c. A fiduciary shall distribute to a beneficiary who receives a pecuniary amount outright the interest or any other amount provided by the will, the terms of the trust or applicable law from net income determined under subsection b. of this section or from principal to the extent that net income is insufficient. If a beneficiary is to receive a pecuniary amount outright from a trust after an income interest ends and no interest or other amount is provided for by the terms of the trust or applicable law, the fiduciary shall distribute the interest or other amount to which the beneficiary would be entitled under applicable law if the pecuniary amount were required to be paid under a will.

d. A fiduciary shall distribute the net income remaining after distributions required by subsection c. of this section in the manner described in section 6 of this act to all other beneficiaries, including a beneficiary who receives a pecuniary amount in trust, even if the beneficiary holds an unqualified power to withdraw assets from the trust or other presently exercisable general power of appointment over the trust.

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

6. a. Each beneficiary described in subsection d. of section 5 of this act is entitled to receive a portion of the net income equal to the beneficiary's fractional interest in undistributed principal assets, using values as of the distribution date. If a fiduciary makes more than one distribution of assets to beneficiaries to whom this section applies, each beneficiary, including one who does not receive part of the distribution, is entitled, as of each distribution date, to the net income

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

b. In determining a beneficiary's share of net income, the following rules apply:

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

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

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

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

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

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

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

b. An asset becomes subject to a trust:

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

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

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

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

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

8. a. A trustee shall allocate an income receipt or disbursement other than one to which paragraph (1) of subsection b. of section 5 of this act applies to principal if its due date occurs before a decedent dies in the case of an estate or before an income interest begins in the case of a trust or successive income interest.

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

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

9. a. As used in this section, “undistributed income” means net income received before the date on which an income interest ends. The term does not include an item of income or expense that is due or accrued or net income that has been added or is required to be added to principal under the terms of the trust.

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

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

10. a. As used in this section, "entity" means a corporation, partnership, limited liability company, regulated investment company, real estate investment trust, common trust fund or any other organization in which a trustee has an interest other than a trust or estate to which section 11 of this act applies, a business or activity to which section 12 of this act applies or an asset-backed security to which section 24 of this act applies.

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

c. A trustee shall allocate the following receipts from an entity to principal:

(1) property other than money;

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

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

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

d. Money is received in partial liquidation:

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

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

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

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

11. A trustee shall allocate to income an amount received as a distribution of income from a trust or an estate in which the trust has an interest other than a purchased interest, and shall allocate to

principal an amount received as a distribution of principal from such a trust or estate. If a trustee purchases an interest in a trust that is an investment entity, or a decedent or donor transfers an interest in such a trust to a trustee, section 10 or 24 of this act applies to a receipt from the trust.

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

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

c. Activities for which a trustee may maintain separate accounting records include:

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

(2) farming;

(3) raising and selling livestock and other animals;

(4) management of rental properties;

(5) extraction of minerals and other natural resources;

(6) timber operations; and

(7) activities to which section 23 of this act applies.

13. A trustee shall allocate to principal:

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

b. Money or other property received from the sale, exchange, liquidation or change in form of a principal asset, including realized profit, subject to sections 10 through 24 of this act;

c. Amounts recovered from third parties to reimburse the trust because of disbursements described in paragraph (7) of subsection a. of section 26 of this act or for other reasons to the extent not based on the loss of income;

d. Proceeds of property taken by eminent domain, but a separate award made for the loss of income with respect to an accounting period during which a current income beneficiary had a mandatory income interest is income;

e. Net income received in an accounting period during which there is no beneficiary to whom a trustee may or shall distribute income; and

f. Other receipts as provided in sections 17 through 24 of this act.

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

15. a. An amount received as interest, whether determined at a fixed, variable or floating rate, on an obligation to pay money to the trustee, including an amount received as consideration for prepaying principal, shall be allocated to income without any provision for amortization of premium.

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

c. This section does not apply to an obligation to which section 18, 19, 20, 21, 23 or 24 of this act applies.

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

b. A trustee shall allocate to income proceeds of a contract that insures the trustee against loss of occupancy or other use by an income beneficiary, loss of income or, subject to section 12 of this act, loss of profits from a business.

c. This section does not apply to a contract to which section 18 of this act applies.

17. If a trustee determines that an allocation between principal and income required by section 18, 19, 20, 21 or 24 of this act is insubstantial, the trustee may allocate the entire amount to principal unless one of the circumstances described in subsection c. of section 4 of this act applies to the allocation. This power may be exercised by a cotrustee in the circumstances described in subsection d. of section 4 of this act and may be released for the reasons and in the manner described in subsection e. of section 4 of this act. An allocation is presumed to be insubstantial if:

(1) the amount of the allocation would increase or decrease net income in an accounting period, as determined before the allocation, by less than 10 percent; or

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

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

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

c. If no part of a payment is characterized as interest, a dividend or an equivalent payment, and all or part of the payment is required to be made, a trustee shall allocate to income 10 percent of the part that is required to be made during the accounting period and the balance to principal. If no part of a payment is required to be made or the payment received is the entire amount to which the trustee is entitled, the trustee shall allocate the entire payment to principal. For purposes of this subsection, a payment is not "required to be made" to the extent that it is made because the trustee exercises a right of withdrawal.

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

e. This section does not apply to payments to which section 19 of this act applies.

19. a. As used in this section, “liquidating asset” means an asset whose value will diminish or terminate because the asset is expected to produce receipts for a period of limited duration. The term includes a leasehold, patent, copyright, royalty right and right to receive payments during a period of more than one year under an arrangement that does not provide for the payment of interest on the unpaid balance. The term does not include a payment subject to section 18 of this act, resources subject to section 20 of this act, timber subject to section 21 of this act, an activity subject to section 23 of this act, an asset subject to section 24 of this act, or any asset for which the trustee establishes a reserve for depreciation under section 27 of this act.

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

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

(1) if received as nominal delay rental or nominal annual rent on a lease, a receipt shall be allocated to income;

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

(3) if an amount received as a royalty, shut-in-well payment, take-or-pay payment, bonus or delay rental is more than nominal, 90 percent shall be allocated to principal and the balance to income;

(4) if an amount is received from a working interest or any other interest not provided for in paragraph (1), (2) or (3) of this subsection a., 90 percent of the net amount received shall be allocated to principal and the balance to income.

b. An amount received on account of an interest in water that is renewable shall be allocated to income. If the water is not renewable, 90 percent of the amount shall be allocated to principal and the balance to income.

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

d. If a trust owns an interest in minerals, water, or other natural resources on the effective date of this act, the trustee may allocate receipts from the interest as provided in this act or in the manner used by the trustee before the effective date of this act. If the trust acquires an interest in minerals, water or other natural resources after the effective date of this act, the trustee shall allocate receipts from the interest as provided in this act.

21. a. To the extent that a trustee accounts for receipts from the sale of timber and related products pursuant to this section, the trustee shall allocate the net receipts:

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

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

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

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

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

c. This section applies whether or not a decedent or transferor was harvesting timber from the property before it became subject to the trust.

d. If a trust owns an interest in timberland on the effective date of this act, the trustee may allocate net receipts from the sale of timber and related products as provided in this act or in the manner used by the trustee before the effective date of this act. If the trust acquires an interest in timberland after the effective date of this act, the trustee shall allocate net receipts from the sale of timber and related products as provided in this act.

22. a. If a marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the spouse with sufficient income from or use of the trust assets, and if the amounts that the trustee transfers from principal to income under section 4 of this act and distributes to the spouse from principal pursuant to the terms of the trust are insufficient to provide the spouse with the beneficial enjoyment required to obtain the marital deduction, the spouse may require the trustee to make property productive of income, convert property within a reasonable time or exercise the power conferred by subsection a. of section 4 of this act. The trustee

may decide which action or combination of actions to take.

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

23. a. As used in this section, “derivative” means a contract or financial instrument or a combination of contracts and financial instruments which gives a trust the right or obligation to participate in some or all changes in the price of a tangible or intangible asset or group of assets, or changes in a rate, an index of prices or rates or other market indicator for an asset or a group of assets.

b. To the extent that a trustee does not account under section 12 of this act for transactions in derivatives, the trustee shall allocate to principal receipts from and disbursements made in connection with those transactions.

c. If a trustee grants an option to buy property from the trust, whether or not the trust owns the property when the option is granted, grants an option that permits another person to sell property to the trust or acquires an option to buy property for the trust or an option to sell an asset owned by the trust, and the trustee or other owner of the asset is required to deliver the asset if the option is exercised, an amount received for granting the option shall be allocated to principal. An amount paid to acquire the option shall be paid from principal. A gain or loss realized upon the exercise of an option, including an option granted to a settlor of the trust for services rendered, shall be allocated to principal.

24. a. As used in this section, “asset-backed security” means an asset whose value is based upon the right it gives the owner to receive distributions from the proceeds of financial assets that provide collateral for the security. The term includes an asset that gives the owner the right to receive from the collateral financial assets only the interest or other current return or only the proceeds other than interest or current return. The term does not include an asset to which section 10 or 18 of this act applies.

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

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

25. A trustee shall make the following disbursements from income to the extent that they are not disbursements to which paragraph (1) or (2) of subsection b. of section 5 of this act applies:

a. one-half of the regular compensation of the trustee and of any person providing investment advisory or custodial services to the trustee;

b. one-half of all expenses for accountings, judicial proceedings, or other matters that involve both the income and remainder interests;

c. all of the other ordinary expenses incurred in connection with the administration, management, or preservation of trust property and the distribution of income, including interest, ordinary repairs, regularly recurring taxes assessed against principal and expenses of a proceeding or other matter that concerns primarily the income interest; and

d. recurring premiums on insurance covering the loss of a principal asset or the loss of income from or use of the asset.

26. a. A trustee shall make the following disbursements from principal:

(1) the remaining one-half of the disbursements described in subsections a. and b. of section 25 of this act;

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

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

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

(5) premiums paid on a policy of insurance not described in subsection d. of section 25 of this act of which the trust is the owner and beneficiary;

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

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

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

27. a. As used in this section, “depreciation” means a reduction in value due to wear, tear, decay, corrosion or gradual obsolescence of a fixed asset having a useful life of more than one year.

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

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

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

(3) under this section if the trustee is accounting under section 12 of this act for the business or activity in which the asset is used.

c. An amount transferred to principal need not be held as a separate fund.

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

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

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

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

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

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

(5) disbursements described in paragraph (7) of subsection a. of section 26 of this act.

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

29. a. A tax required to be paid by a trustee based on receipts allocated to income shall be paid from income.

b. A tax required to be paid by a trustee based on receipts allocated to principal shall be paid from principal, even if the tax is called an income tax by the taxing authority.

c. A tax required to be paid by a trustee on the trust's share of an entity's taxable income shall be paid proportionately:

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

(2) from principal to the extent that:

(a) receipts from the entity are allocated to principal; and

(b) the trust's share of the entity's taxable income exceeds the total receipts described in paragraph (1) and subparagraph (a) of this paragraph (2).

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

30. a. A fiduciary may make adjustments between principal and income to offset the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries which arise from:

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

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

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

b. If the amount of an estate tax marital deduction or charitable contribution deduction is reduced because a fiduciary deducts an amount paid from principal for income tax purposes instead of deducting it for estate tax purposes, and as a result estate taxes paid from principal are increased and income taxes paid by an estate, trust or beneficiary are decreased, each estate, trust or beneficiary that benefits from the decrease in income tax shall reimburse the principal from which the increase in estate tax is paid. The total reimbursement shall equal the increase in the estate tax to the extent that the principal used to pay the increase would have qualified for a marital deduction or charitable contribution deduction but for the payment. The proportionate share of the reimbursement for each estate, trust or beneficiary whose income taxes are reduced shall be the same as its proportionate share of the total decrease in income tax. An estate or trust shall reimburse principal from income.

31. In applying and construing this act, consideration shall be given to the fact that this is a uniform act, and there is a need to promote uniformity of the act with respect to its subject matter among states that enact it.

32. This act applies to every trust or decedent's estate existing on the effective date of this act, except as otherwise expressly provided in the will or terms of the trust or in this act.

33. N.J.S.3B:19A-1 et seq. is repealed.

34. This act shall take effect immediately.

STATEMENT

This bill enacts the Uniform Principal and Income Act as revised in 1997 by the National Conference of Commissioners on Uniform State Laws, and replaces the Revised Uniform Principal and Income Act adopted in this State in 1991.

Like the prior law, the new Uniform Principal and Income Act provides procedures by which trustees administering an estate are to separate principal from income and ensure that the intention of the trust creator is the guiding principle for management of the estate. The central innovations of the new act, however, are to allow trustees greater discretion in allocating income and expenses between a trust's principal and income and the flexibility to invest assets for a total return, as long as the investments are prudent.

In addition, the new act clarifies required allocations of acquired assets and regulates trustees' handling of derivatives, options, deferred payment obligations and synthetic financial assets. The act also addresses disbursements made to comply with environmental laws and imbalances or inequities that may result from tax elections.

SENATE COMMERCE COMMITTEE

STATEMENT TO

SENATE, No. 1667

with committee amendments

STATE OF NEW JERSEY

DATED: MARCH 8, 2001

The Senate Commerce Committee reports favorably and with committee amendments Senate Bill No. 1667.

This bill, as amended by the committee, enacts the Uniform Principal and Income Act as revised in 1997 by the National Conference of Commissioners on Uniform State Laws (NCCUSL) with certain changes and additions, and replaces the Revised Uniform Principal and Income Act adopted in this State in 1991.

The primary purpose of the bill is to better allow a trustee (or a personal representative of an estate) to satisfy fiduciary duties to the two types of beneficiaries of a trust, whose interests often are in conflict: remainder beneficiaries, who benefit from a trust's principal, and income beneficiaries, who benefit from a trust's income distribution. The bill's most significant change from existing law is that it provides a trustee with the discretion to allocate trust assets either to principal or income, in conformity with rules established by the bill and with the "Prudent Investor Act" (P.L.1997, c.26; C.3B:20-11.1 et seq.). Some other key provisions of the bill are discussed below.

The bill provides new and clarified rules for allocation, including the rule that any money received by a trustee is regarded as income, unless it fits into certain categories. Those categories include:

(1) Money received as part of liquidation of the trust;

(2) Money received from an investment company that has labeled the distribution as a capital gain; or

(3) Property received that is not money, such as a stock distribution.

In addition, receipts from derivatives, with one exception, are considered principal; receipts from asset-backed securities, on the other hand, may be either income or principal, depending on the category into which the payor of the security falls. Where a trust provides a fixed income for the income beneficiary, the bill allows the trustee to adjust principal and income if necessary for compliance with prudent investment standards. Before adjusting principal and income in this way, a trustee is required by the bill to consider a list of factors including the nature, purpose and expected duration of the trust, as well as the intent of the settlor. In addition, the bill creates a safe harbor for a trustee in this allocation by providing that a decision by a trustee to adjust distributions to an income beneficiary to four percent of the principal of the trust (or to decrease distributions to six percent) will be deemed a fair and reasonable adjustment. The bill forbids a trustee from making adjustments when they would diminish income in a trust that requires full income to be paid annually to a surviving spouse, and in other circumstances.

The bill provides that the payment of administration expenses are to be paid out of principal when an income interest in a trust ends (or when a decedent dies).

During the life of the trust, the bill provides for payment of expenses as follows: ordinary expenses are to be paid out of income; commissions to a trustee on income receipts and principal receipts are to be paid from income and principal, respectively; payments for legal proceedings defending a will or trust or to assure title of any property are to be paid from principal; and expenses that are specific to the remainder are made from principal. Additional rules govern situations such as depreciation or enhancement of assets.

The bill specifies that the only remedy available for an exercise or nonexercise of discretion is an abuse of discretion. A court cannot change a fiduciary's decision to exercise or not to exercise a discretionary power conferred by this bill unless it determines that the decision was an abuse of discretion. A court cannot determine that a fiduciary abused its discretion merely because the court would have exercised the discretion in a different manner or would not have exercised the discretion. The bill limits the remedy for an abuse of discretion to restoring the beneficiaries and the trust to the position they would have occupied if there had not been an abuse. The objective is to accomplish the restoration initially by making adjustments between the beneficiaries and the trust to the extent possible; to the extent that restoration is not possible by such adjustments, a court may order the trustee to pay an amount to one or more beneficiaries, the trust or both. The bill allows a fiduciary to petition a court to determine whether a proposed exercise or nonexercise by the fiduciary of a discretionary power conferred by this bill will result in an abuse of the fiduciary's discretion. If the petition contains the information prescribed in subsection d. of section 31 of this bill, the proposed action or inaction is presumed not to result in an abuse, and a beneficiary who challenges the proposal must establish that it will.

Finally, the bill provides that the express language of a trust instrument, will or other applicable document will govern that trust or estate, and that the bill merely provides the default rule if the governing instrument is silent.

[First Reprint]

SENATE, No. 1667

STATE OF NEW JERSEY

209th LEGISLATURE

INTRODUCED SEPTEMBER 25, 2000

Sponsored by:
Senator JOHN H. ADLER
District 6 (Camden)
Senator GERALD CARDINALE
District 39 (Bergen)

SYNOPSIS

Replaces "Revised Uniform Principal and Income Act" with "Uniform Principal and Income Act of 2000."

CURRENT VERSION OF TEXT

As reported by the Senate Commerce Committee on March 8, 2001, with amendments.

AN ACT concerning principal and income guidelines for trusts and estates and repealing N.J.S.3B:19A-1 et seq.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. [1]Short Title.[1] This act shall be known and may be cited as the "Uniform Principal and Income Act of [1]**[**2000**]** 2001[1]."

2. [1]Definitions.[1] As used in this act:

"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.

"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.

"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.

"Income" means money or property that a fiduciary receives as current return from a principal asset. The term includes a portion of receipts from a sale, exchange or liquidation of a principal asset, to the extent provided in sections 10 through [1]**[**24**]** 23[1] of this act.

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

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

"Mandatory income interest" means the right of an income beneficiary to receive net income that the terms of the trust require the fiduciary to distribute.

"Net income" means the total receipts allocated to income during an accounting period minus the disbursements made from income during the period, plus or minus transfers under this act to or from income during the period.

"Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency or instrumentality,

EXPLANATION - Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and intended to be omitted in the law.

Matter underlined thus is new matter.
Matter enclosed in superscript numerals has been adopted as follows:
[1] Senate SCM committee amendments adopted March 8, 2001.

public corporation or any other legal or commercial entity.

"Principal" means property held in trust for distribution to a remainder beneficiary when the trust terminates.

"Remainder beneficiary" means a person entitled to receive principal when an income interest ends.

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

"Trustee" includes an original, additional or successor trustee, whether or not appointed or confirmed by a court.

3. [1]Fiduciary Duties; General Principles.[1] a. In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of sections 5 through 9 of this act, a fiduciary:

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

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

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

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

b. [1]**[**In exercising the power to adjust under subsection a. of section 4 of this act or a discretionary power of administration regarding a matter within the scope of this act, whether granted by the terms of a trust, a will or this act, a**]** A[1] fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. [1]**[**A determination in accordance with this act is presumed to be fair and reasonable to all of the beneficiaries.**]**[1]

4. [1]Trustee's Power to Adjust.[1] a. A trustee may adjust between principal and income [1]**[**to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor,**]** if[1] the terms of the trust describe the amount that may or shall be

distributed to a beneficiary by referring to the trust's income and the trustee determines, after applying the rules in subsection a. of section 3 of this act, that the trustee is unable to comply with subsection b. of section 3 of this act. [1]A decision by a trustee to increase the distribution to the income beneficiary or beneficiaries in any accounting period to an amount not in excess of four percent, or to decrease that period's distributions to not less than six percent, of the net fair market value of the trust assets on the first business day of that accounting period shall be presumed to be fair and reasonable to all of the beneficiaries. Any adjustment by a trustee between income and principal with respect to any accounting period shall be made during that accounting period or within 65 days after the end of that period.[1]

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

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

(2) the intent of the settlor;

(3) the identity and circumstances of the beneficiaries;

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

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

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

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

(8) the actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation; [1]**[**and**]**[1]

(9) [1]the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries that arise from elections and decisions regarding tax matters, the imposition of an income or other tax on the fiduciary or a beneficiary as a result of a transaction involving a distribution from the estate or trust, or the ownership of an interest in an entity whose taxable income, whether or not distributed, is includable in the taxable income of the estate, trust or a beneficiary; and

(10)[1] the anticipated tax consequences of an adjustment.

c. A trustee shall not make an adjustment:

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

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

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

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

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

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

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

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

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

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

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

5. [1]Determination and Distribution of Net Income. [1]After a decedent dies, in the case of an estate or after an income interest in a trust ends, the following rules apply:

a. A fiduciary of an estate or of a terminating income interest shall determine the amount of net income and net principal receipts received from property specifically [1][given] devised[1] to a beneficiary under the rules in sections 7 through [1][30] 28[1] of this act which apply to trustees and the rules in subsection e. of this section. The fiduciary shall distribute the net income and net principal receipts to the beneficiary who is to receive the specific property.

b. A fiduciary shall determine the remaining net income of a decedent's estate or a terminating income interest under the rules in sections 7 through [1][30] 28[1] of this act which apply to trustees and by:

(1) including in net income all income from property used to discharge liabilities; [1]and[1]

(2) [1][paying from income or principal, in the fiduciary's discretion, fees of attorneys, accountants and fiduciaries, court costs and other expenses of administration and interest on death taxes, but the fiduciary may pay those expenses from income of property passing to a trust for which the fiduciary claims an estate tax marital or charitable deduction only to the extent that the payment of those expenses from income will not cause the reduction or loss of the deduction; and

(3)][1] paying from principal all [1][other disbursements made or incurred in connection with the settlement of a decedent's estate or the winding up of a terminating income interest, including debts, funeral expenses, disposition of remains, family allowances and death taxes and related penalties that are apportioned to the estate or terminating income interest by the will, the terms of the trust or applicable law] disbursements made or incurred in connection with the settlement of a decedent's estate or the winding up of a terminating income interest, expenses of administration, including fees of attorneys, accountants and fiduciaries, court costs, debts, funeral expenses, disposition of remains, family allowances and death taxes and related penalties that are apportioned to the estate or terminating income interest by the will, the terms of the trust or applicable law[1].

c. A fiduciary shall distribute to a beneficiary who receives a pecuniary amount outright the interest or any other amount provided by the will, the terms of the trust or applicable law from net income determined under subsection b. of this section or from principal to the extent that net income is insufficient. If a beneficiary is to receive a pecuniary amount outright from a trust after an income interest ends and no interest or other amount is provided for by the terms of the trust or applicable law, the fiduciary shall distribute the interest or other amount to which the beneficiary would be entitled under applicable law if the pecuniary amount were required to be paid under a will.

d. A fiduciary shall distribute the net income remaining after distributions required by subsection c. of this section in the manner described in section 6 of this act to all other beneficiaries, [1] **[**including a beneficiary who receives a pecuniary amount in trust, even if the beneficiary holds an unqualified power to withdraw assets from the trust or other presently exercisable general power of appointment over the trust**]** excluding a beneficiary who receives a pecuniary amount outright or in trust[1].

e. A fiduciary shall not reduce principal or income receipts from property described in subsection a. of this section because of a payment described in section [1] **[**25**]** 24[1] or [1] **[**26**]** 25[1] of this act to the extent that the will, the terms of the trust, or applicable law requires the fiduciary to make the payment from assets other than the property or to the extent that the fiduciary recovers or expects to recover the payment from a third party. The net income and principal receipts from the property are determined by including all of the amounts the fiduciary receives or pays with respect to the property, whether those amounts accrued or became due before, on or after the date of a decedent's death or an income interest's terminating event, and by making a reasonable provision for amounts that the fiduciary believes the estate or terminating income interest may become obligated to pay after the property is distributed.

6. [1]Distribution to Residuary and Remainder Beneficiaries.[1] a. Each beneficiary described in subsection d. of section 5 of this act is entitled to receive a portion of the net income equal to the beneficiary's fractional interest in undistributed principal assets, using values as of the distribution date. If a fiduciary makes more than one distribution of assets to beneficiaries to whom this section applies, each beneficiary, including one who does not receive part of the distribution, is entitled, as of each distribution date, to the net income the fiduciary has received after the date of death or terminating event or earlier distribution date but has not distributed as of the current distribution date.

b. In determining a beneficiary's share of net income, the following rules apply:

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

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

(3) The beneficiary's fractional interest in the undistributed principal assets shall be calculated on the basis of the aggregate value of those assets as of the distribution date without reducing the value

by any unpaid principal obligation.

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

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

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

7. [1]<u>When Right to Income Begins and Ends.</u> [1] a. An income beneficiary is entitled to net income from the date on which the income interest begins. An income interest begins on the date specified in the terms of the trust or, if no date is specified, on the date an asset becomes subject to a trust or successive income interest.

b. An asset becomes subject to a trust:

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

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

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

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

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

8. [1]<u>Apportionment of Receipts and Disbursements When Decedent Dies or Income Interest Begins.</u>[1] a. A trustee shall allocate an income receipt or disbursement [1],[1] other than one to which [1][paragraph (1) of][1] subsection [1][b.] <u>a.</u>[1] of section 5 of this act applies [1],[1] to principal if its due date occurs before a decedent dies in the case of an estate or before an income interest begins in the case of a trust or successive income interest.

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

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

9. [1]Apportionment When Income Interest Ends.[1] a. As used in this section, "undistributed income" means net income received before the date on which an income interest ends. The term does not include an item of income or expense that is due or accrued or net income that has been added or is required to be added to principal under the terms of the trust.

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

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

10. [1]Character of Receipts.[1] a. As used in this section, "entity" means a corporation, partnership, limited liability company, regulated investment company, real estate investment trust, common trust fund or any other organization in which a trustee has an interest other than a trust or estate to which section 11 of this act applies, a business or activity to which section 12 of this act applies or an asset-backed security to which section [1]⟦24⟧ 23[1] of this act applies.

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

c. A trustee shall allocate the following receipts from an entity to principal:

(1) property other than money;

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

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

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

d. Money is received in partial liquidation:

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

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

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

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

11. [1]Distribution from Trust or Estate.[1] A trustee shall allocate to income an amount received as a distribution of income from a trust or an estate in which the trust has an interest other than a purchased interest, and shall allocate to principal an amount received as a distribution of principal from such a trust or estate. If a trustee purchases an interest in a trust that is an investment entity, or a decedent or donor transfers an interest in such a trust to a trustee, section 10 or [1]**[**24**]** 23[1] of this act applies to a receipt from the trust.

12. [1]Business and Other Activities Conducted by Trustee.[1] a. If a trustee who conducts a business or other activity determines that it is in the best interest of all the beneficiaries to account separately for the business or activity instead of accounting for it as part of the trust's general accounting records, the trustee may maintain separate accounting records for its transactions, whether or not its assets are segregated from other trust assets.

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

c. Activities for which a trustee may maintain separate accounting records include:

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

(2) farming;

(3) raising and selling livestock and other animals;

(4) management of rental properties;

(5) extraction of minerals and other natural resources;

(6) timber operations; and

(7) activities to which section [1]**[**23**]** 22[1] of this act applies.

13. [1]Principal Receipts.[1] A trustee shall allocate to principal:

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

b. Money or other property received from the sale, exchange, liquidation or change in form of a principal asset, including realized profit, subject to sections 10 through [1]**[**24**]** 23[1] of this act;

c. Amounts recovered from third parties to reimburse the trust because of disbursements described in paragraph [1]**[**(7)**]** (9)[1] of subsection a. of section [1]**[**26**]** 25[1] of this act or for other reasons to the extent not based on the loss of income;

d. Proceeds of property taken by eminent domain, but a separate award made for the loss of income with respect to an accounting period during which a current income beneficiary had a mandatory income interest is income;

e. Net income received in an accounting period during which there is no beneficiary to whom a trustee may or shall distribute income; and

f. Other receipts as provided in sections 17 through [1]**[**24**]** 23[1] of this act.

14. [1]Rental Property.[1] To the extent that a trustee accounts for receipts from rental property pursuant to this section, the trustee shall allocate to income an amount received as rent of real or personal property, including an amount received for cancellation or renewal of a lease. An amount received as a refundable deposit, including a security deposit or a deposit that is to be applied as rent for future

periods, shall be added to principal and held subject to the terms of the lease and is not available for distribution to a beneficiary until the trustee's contractual obligations have been satisfied with respect to that amount.

15. [1]Obligation to Pay Money.[1] a. An amount received as interest, whether determined at a fixed, variable or floating rate, on an obligation to pay money to the trustee, including an amount received as consideration for prepaying principal, shall be allocated to income without any provision for amortization of premium.

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

c. This section does not apply to an obligation to which section [1]17,[1] 18, 19, 20, [1]**[**21,**]** 22 or[1] 23 [1]**[**or 24**]**[1] of this act applies.

16. [1]Insurance Policies and Similar Contracts.[1] a. Except as otherwise provided in subsection b. of this section, a trustee shall allocate to principal the proceeds of a life insurance policy or other contract in which the trust or its trustee is named as beneficiary, including a contract that insures the trust or its trustee against loss for damage to, destruction of or loss of title to a trust asset. The trustee shall allocate dividends on an insurance policy to income if the premiums on the policy are paid from income, and to principal if the premiums are paid from principal.

b. A trustee shall allocate to income proceeds of a contract that insures the trustee against loss of occupancy or other use by an income beneficiary, loss of income or, subject to section 12 of this act, loss of profits from a business.

c. This section does not apply to a contract to which section [1]**[**18**]** 17[1] of this act applies.

[1]**[**17. If a trustee determines that an allocation between principal and income required by section 18, 19, 20, 21 or 24 of this act is insubstantial, the trustee may allocate the entire amount to principal unless one of the circumstances described in subsection c. of section 4 of this act applies to the allocation. This power may be exercised by a cotrustee in the circumstances described in subsection d. of section 4 of this act and may be released for the reasons and in the manner described in subsection e. of section 4 of this act. An allocation is presumed to be insubstantial if:

(1) the amount of the allocation would increase or decrease net

income in an accounting period, as determined before the allocation, by less than 10 percent; or

(2) the value of the asset producing the receipt for which the allocation would be made is less than 10 percent of the total value of the trust's assets at the beginning of the accounting period.**]**[1]

[1]**[**18.**]** 17. Deferred Compensation, Retirement Benefits, Annuities, and Similar Payments.[1] a. As used in this section, "payment" means a payment that a trustee may receive over a fixed [1]**[**number**]** period[1] of [1]**[**years**]** time[1] or during the life of one or more individuals because of services rendered or property transferred to the payer in exchange for future payments. The term includes a payment made in money or property from the payer's general assets or from a separate fund created by the payer [1]or by another[1], including a private or commercial annuity, an individual retirement account and a pension, profit-sharing, stock-bonus, or stock-ownership plan.

b. To the extent that a [1]**[**payment is characterized as interest or a dividend or a payment made in lieu of interest or a dividend, a trustee shall allocate it to income. The trustee shall allocate to principal the balance of the payment and any other payment received in the same accounting period that is not characterized as interest, a dividend or an equivalent payment**]** trustee can readily ascertain the part of a payment from a separate fund held for the benefit of the trust that represents the then undistributed net income of the fund realized since the trust acquired its interest in the fund, a trustee shall allocate that part to income. The trustee shall allocate to principal the balance of the payment[1].

c. If no part of a payment is [1]**[**characterized as interest, a dividend or an equivalent payment**]** allocated to income under subsection b. of this section[1], and all or part of the payment is required to be made, a trustee shall allocate to income 10 percent of the part that is required to be made during the accounting period and the balance to principal. If no part of a payment is required to be made or the payment received is the entire amount to which the trustee is entitled, the trustee shall allocate the entire payment to principal. For purposes of this subsection, a payment is not "required to be made" to the extent that it is made because the trustee exercises a right of withdrawal.

d. If, to obtain an estate tax [1]or gift tax[1] marital deduction for a trust, [1]**[**a**]** the[1] trustee must allocate more of a payment to income than provided for by this section, the trustee shall allocate to income the additional amount necessary to obtain the marital deduction.

e. This section does not apply to payments to which section [1]**[**19**]** 18[1] of this act applies.

[1]**[**19.**]** 18. Liquidating Asset.[1] a. As used in this section, "liquidating asset" means an asset whose value will diminish or

terminate because the asset is expected to produce receipts for a period of limited duration. The term includes a leasehold, patent, copyright, royalty right and right to receive payments during a period of more than one year under an arrangement that does not provide for the payment of interest on the unpaid balance. The term does not include a payment subject to section [1][18] 17[1] of this act, resources subject to section [1][20] 19[1] of this act, timber subject to section [1][21] 20[1] of this act, an activity subject to section [1][23] 22[1] of this act, an asset subject to section [1][24] 23[1] of this act, or any asset for which the trustee establishes a reserve for depreciation under section [1][27] 26[1] of this act.

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

[1][20.] 19. Minerals, Water and Other Natural Resources.[1] a. To the extent that a trustee accounts for receipts from an interest in minerals or other natural resources pursuant to this section, the trustee shall allocate them as follows:

(1) if received as nominal delay rental or nominal annual rent on a lease, a receipt shall be allocated to income;

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

(3) if an amount received as a royalty, shut-in-well payment, take-or-pay payment, bonus or delay rental is more than nominal, 90 percent shall be allocated to principal and the balance to income;

(4) if an amount is received from a working interest or any other interest not provided for in paragraph (1), (2) or (3) of this subsection a., 90 percent of the net amount received shall be allocated to principal and the balance to income.

b. An amount received on account of an interest in water that is renewable shall be allocated to income. If the water is not renewable, 90 percent of the amount shall be allocated to principal and the balance to income.

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

d. If a trust owns an interest in minerals, water, or other natural resources on the effective date of this act, the trustee may allocate receipts from the interest as provided in this act or in the manner used by the trustee before the effective date of this act. If the trust acquires an interest in minerals, water or other natural resources after the effective date of this act, the trustee shall allocate receipts from the interest as provided in this act.

[1][21.] 20. Timber.[1] a. To the extent that a trustee accounts for receipts from the sale of timber and related products pursuant to this section, the trustee shall allocate the net receipts:

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

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

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

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

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

c. This section applies whether or not a decedent or transferor was harvesting timber from the property before it became subject to the trust.

d. If a trust owns an interest in timberland on the effective date of this act, the trustee may allocate net receipts from the sale of timber and related products as provided in this act or in the manner used by the trustee before the effective date of this act. If the trust acquires an interest in timberland after the effective date of this act, the trustee shall allocate net receipts from the sale of timber and related products as provided in this act.

[1][22.] 21. Property Not Productive of Income.[1] a. If a marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the spouse with sufficient income from or use of the trust assets, and if the amounts that the trustee transfers from principal to income under section 4 of this act and distributes to the spouse from principal pursuant to the terms of the trust are insufficient to provide the spouse with the beneficial enjoyment required to obtain the marital deduction, the spouse may require the trustee to make property productive of income, convert property within a reasonable time or exercise the power conferred by subsection a. of section 4 of this act. The trustee may decide which action or combination of actions to take.

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

[1][23.] 22. Derivatives and Options.[1] a. As used in this section, “derivative” means a contract or financial instrument or a combination of contracts and financial instruments which gives a trust the right or obligation to participate in some or all changes in the price of a tangible or intangible asset or group of assets, or changes in a rate, an index of prices or rates or other market indicator for an asset or a group of assets.

b. To the extent that a trustee does not account under section 12 of this act for transactions in derivatives, the trustee shall allocate to principal receipts from and disbursements made in connection with those transactions.

c. If a trustee grants an option to buy property from the trust, whether or not the trust owns the property when the option is granted, grants an option that permits another person to sell property to the trust or acquires an option to buy property for the trust or an option to sell an asset owned by the trust, and the trustee or other owner of the asset is required to deliver the asset if the option is exercised, an amount received for granting the option shall be allocated to principal. An amount paid to acquire the option shall be paid from principal. A gain or loss realized upon the exercise of an option, including an option granted to a settlor of the trust for services rendered, shall be allocated to principal.

[1][24.] 23. Asset-backed Securities.[1] a. As used in this section, “asset-backed security” means an asset whose value is based upon the right it gives the owner to receive distributions from the proceeds of financial assets that provide collateral for the security. The term includes an asset that gives the owner the right to receive from the collateral financial assets only the interest or other current return or only the proceeds other than interest or current return. The term does not include an asset to which section 10 or [1][18] 17[1] of this act applies.

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

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

[1][25.] 24. Disbursements from Income.[1] A trustee shall make the following disbursements from income to the extent that they are not disbursements to which paragraph (1) or (2) of subsection b. of section 5 of this act applies:

a. [1][one-half of the regular compensation of the trustee and of any person providing investment advisory or custodial services to the trustee] commissions allowed by law to a trustee on income receipts, if properly chargeable to the trust[1];

b. one-half of [1][all expenses for accountings, judicial proceedings, or other matters that involve both the income and remainder interests] the fees paid to banks and other financial institutions for custodial services to the fiduciary if properly chargeable to the trust[1];

c. all of the other ordinary expenses incurred in connection with the administration, management, or preservation of trust property and the distribution of income, including interest [1][, ordinary repairs, regularly recurring taxes assessed against principal and expenses of a proceeding or other matter that concerns primarily the income interest] paid by the trustee, including interest on death taxes, regularly recurring taxes assessed against any portion of the principal, water rates, bond premiums, and the expenses, including court costs, attorneys' fees, and accountants' fees, of an accounting, judicial proceeding or other matter that concerns primarily the income interest, unless the court directs otherwise[1]; and

d. recurring premiums on insurance covering the loss of a principal asset or the loss of income from or use of the asset.

[1][26.] 25. Disbursements from Principal.[1] a. A trustee shall make the following disbursements from principal:

(1) [1][the remaining one-half of the disbursements described in subsections a. and b. of section 25 of this act] commissions allowed by law to a trustee on principal receipts or distributions or on termination of the trust estate[1];

(2) [1][all of the trustee's compensation calculated on principal as a fee for acceptance, distribution, or termination, and disbursements made to prepare property for sale] the remaining one-half of the fees paid to banks and other financial institutions for custodial services, if properly chargeable to the trust[1];

(3) [1][payments on the principal of a trust debt] fees paid to banks and other financial institutions and registered investment advisors for investment advisory or investment management services, if properly chargeable to the trust[1];

(4) [1][expenses of a proceeding that concerns primarily principal, including a proceeding to construe the trust or to protect the trust or its property] costs of investing and reinvesting principal and payments on the principal of an indebtedness, including a mortgage or security interest amortized by periodic payments of principal[1];

(5) [1][premiums paid on a policy of insurance not described in subsection d. of section 25 of this act of which the trust is the owner and beneficiary] extraordinary repairs or expenses incurred in making a capital improvement, including special assessments, and disbursements made to prepare property for sale[1];

(6) [1][estate, inheritance and other transfer taxes, including penalties, apportioned to the trust] court costs, attorneys' fees, accountants' fees and other fees, incurred on an accounting or judicial proceeding or in maintaining or defending any action to construe a will or a trust, protect it or the trust estate, or assure the title of any property, unless properly chargeable to income under subsection c. of section 24 of this act or the court otherwise directs[1]; [1][and][1]

(7) [1][disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the costs of those activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or regulations, statutory or common law claims by third parties and defending claims based on environmental matters] premiums paid on an insurance policy not described in subsection d. of section 24 of this act of which the trust is the owner and beneficiary;

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

(9) disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the cost of those activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or regulations, statutory or common law claims by third parties and defending claims based on environmental matters; and

(10) if an estate or inheritance tax is levied in respect of a trust in which both an income beneficiary and remainderman have an interest, any amount apportioned to the trust, including penalties, even though the income beneficiary also has rights in the principal[1].

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

[1][27.] 26. Transfers from Income to Principal for Depreciation.[1]

a. As used in this section, "depreciation" means a reduction in value due to wear, tear, decay, corrosion or gradual obsolescence of a fixed asset having a useful life of more than one year.

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

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

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

(3) under this section if the trustee is accounting under section 12 of this act for the business or activity in which the asset is used.

c. An amount transferred to principal need not be held as a separate fund.

[1]**[**28.**]** 27. Transfer from Income to Reimburse Principal.[1] a. If a trustee makes or expects to make a principal disbursement described in this section, the trustee may transfer an appropriate amount from income to principal in one or more accounting periods to reimburse principal or to provide a reserve for future principal disbursements.

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

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

(2) [1]**[**a capital improvement to a principal asset, whether in the form of changes to an existing asset or the construction of a new asset, including special assessments;

(3)**]**[1] disbursements made to prepare property for rental, including tenant allowances, leasehold improvements and broker's commissions; [1]and[1]

[1]**[**(4)**]** (3)[1] periodic payments on an obligation secured by a principal asset to the extent that the amount transferred from income to principal for depreciation is less than the periodic payments [1]**[**; and

(5) disbursements described in paragraph (7) of subsection a. of section 26 of this act**]**[1].

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

[1]**[**29.**]** 28. Income Taxes.[1] a. A tax required to be paid by a trustee based on receipts allocated to income shall be paid from income.

b. A tax required to be paid by a trustee based on receipts allocated to principal shall be paid from principal, even if the tax is called an income tax by the taxing authority.

c. A tax required to be paid by a trustee on the trust's share of an entity's taxable income shall be paid proportionately:

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

(2) from principal to the extent that:

(a) receipts from the entity are allocated to principal; and

(b) the trust's share of the entity's taxable income exceeds the total receipts described in paragraph (1) and subparagraph (a) of this paragraph (2).

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

[1]**[**30. a. A fiduciary may make adjustments between principal and income to offset the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries which arise from:

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

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

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

b. If the amount of an estate tax marital deduction or charitable contribution deduction is reduced because a fiduciary deducts an amount paid from principal for income tax purposes instead of deducting it for estate tax purposes, and as a result estate taxes paid from principal are increased and income taxes paid by an estate, trust or beneficiary are decreased, each estate, trust or beneficiary that benefits from the decrease in income tax shall reimburse the principal from which the increase in estate tax is paid. The total reimbursement shall equal the increase in the estate tax to the extent that the principal used to pay the increase would have qualified for a marital deduction or charitable contribution deduction but for the payment. The proportionate share of the reimbursement for each estate, trust or beneficiary whose income taxes are reduced shall be the same as its proportionate share of the total decrease in income tax. An estate or trust shall reimburse principal from income.**]**[1]

[1]**[**31.**]** 29. Uniformity of Application and Construction.[1] In applying and construing this act, consideration shall be given to the fact that this is a uniform act, and there is a need to promote uniformity of the act with respect to its subject matter among states

that enact it.

[1][32.] 30. Application of Act to Existing and Future Trusts and Estates.[1] This act applies to every trust or decedent's estate existing on [1]or after [1]the effective date of this act, except as otherwise expressly provided in the will or terms of the trust or in this act.

[1]31. Judicial Control of Discretionary Powers. a. A court shall not change a fiduciary's decision to exercise or not to exercise a discretionary power conferred by this act unless it determines that the decision was an abuse of discretion. A court shall not determine that a fiduciary abused its discretion merely because the court would have exercised the discretion in a different manner or would not have exercised the discretion.

b. The decisions to which subsection a. of this section applies include:

(1) A determination under subsection a. of section 4 of this act of whether and to what extent an amount should be transferred from principal to income or from income to principal.

(2) A determination of the factors that are relevant to the trust and its beneficiaries, the extent to which they are relevant, and the weight, if any, to be given to the relevant factors in deciding whether and to what extent to exercise the powers conferred by subsection a. of section 4 of this act.

c. If a court determines that a fiduciary has abused its discretion, the remedy is to restore the income and remainder beneficiaries to the position they would have occupied if the fiduciary had not abused its discretion, according to the following rules:

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

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

(3) To the extent that the court is unable, after applying paragraphs (1) and (2) of this subsection to restore the beneficiaries, the trust, or both, to the position they would have occupied if the fiduciary had not abused its discretion, the court may require the fiduciary to pay an appropriate amount from its own funds to one or more of the beneficiaries or the trust or both.

d. Upon a petition by the fiduciary, the court having jurisdiction over the trust or estate shall determine whether a proposed exercise or nonexercise by the fiduciary of a discretionary power conferred by this act will result in an abuse of the fiduciary's discretion. If the petition describes the proposed exercise or nonexercise of the power and contains sufficient information to inform the beneficiaries of the reasons for the proposal, the facts upon which the fiduciary relies, and an explanation of how the income and remainder beneficiaries will be affected by the proposed exercise or nonexercise of the power, a beneficiary who challenges the proposed exercise or nonexercise has the burden of establishing that it will result in an abuse of discretion.[1]

[1]**[**33.**]** 32. Repealer.[1] N.J.S.3B:19A-1 et seq. is repealed.

[1]**[**34.**]** 33. Effective Date.[1] This act shall take effect [1]**[**immediately**]** on January 1 of the year following enactment[1].

§§1-31 -
C.3B:19B-1 to 3B:19B-31
Chapter 19B (New) of Title 3B
Principal and Income
§32 - Repealer
§33 - Note to §§1-32

P.L. 2001, CHAPTER 212, ***approved August 15, 2001***
Assembly No. 3261 ***(First Reprint)***

AN ACT concerning principal and income guidelines for trusts and estates and repealing N.J.S.3B:19A-1 et seq.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. [1]Short Title.[1] This act shall be known and may be cited as the "Uniform Principal and Income Act of [1]**[**2000**]** 2001[1]."

2. [1]Definitions.[1] As used in this act:

"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.

"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.

"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.

"Income" means money or property that a fiduciary receives as current return from a principal asset. The term includes a portion of receipts from a sale, exchange or liquidation of a principal asset, to the extent provided in sections 10 through [1]**[**24**]** 23[1] of this act.

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

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

"Mandatory income interest" means the right of an income beneficiary to receive net income that the terms of the trust require the fiduciary to distribute.

EXPLANATION - Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and intended to be omitted in the law.

Matter underlined thus is new matter.
Matter enclosed in superscript numerals has been adopted as follows:
[1] Assembly ABI committee amendments adopted May 3, 2001.

"Net income" means the total receipts allocated to income during an accounting period minus the disbursements made from income during the period, plus or minus transfers under this act to or from income during the period.

"Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency or instrumentality, public corporation or any other legal or commercial entity.

"Principal" means property held in trust for distribution to a remainder beneficiary when the trust terminates.

"Remainder beneficiary" means a person entitled to receive principal when an income interest ends.

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

"Trustee" includes an original, additional or successor trustee, whether or not appointed or confirmed by a court.

3. [1]Fiduciary Duties; General Principles.[1] a. In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of sections 5 through 9 of this act, a fiduciary:

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

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

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

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

b. [1][In exercising the power to adjust under subsection a. of section 4 of this act or a discretionary power of administration regarding a matter within the scope of this act, whether granted by the terms of a trust, a will or this act, a] A[1] fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. [1][A determination in accordance with this act is presumed to be fair and reasonable to all of the beneficiaries.**]**[1]

4. [1]Trustee's Power to Adjust.[1] a. A trustee may adjust between principal and income [1]**[**to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor,**]** if[1] the terms of the trust describe the amount that may or shall be distributed to a beneficiary by referring to the trust’s income and the trustee determines, after applying the rules in subsection a. of section 3 of this act, that the trustee is unable to comply with subsection b. of section 3 of this act. [1]A decision by a trustee to increase the distribution to the income beneficiary or beneficiaries in any accounting period to an amount not in excess of four percent, or to decrease that period's distributions to not less than six percent, of the net fair market value of the trust assets on the first business day of that accounting period shall be presumed to be fair and reasonable to all of the beneficiaries. Any adjustment by a trustee between income and principal with respect to any accounting period shall be made during that accounting period or within 65 days after the end of that period.[1]

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

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

(2) the intent of the settlor;

(3) the identity and circumstances of the beneficiaries;

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

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

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

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

(8) the actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation; [1]**[**and**]**[1]

(9) [1]the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries that arise from

elections and decisions regarding tax matters, the imposition of an income or other tax on the fiduciary or a beneficiary as a result of a transaction involving a distribution from the estate or trust, or the ownership of an interest in an entity whose taxable income, whether or not distributed, is includable in the taxable income of the estate, trust or a beneficiary; and

(10)[1] the anticipated tax consequences of an adjustment.

c. A trustee shall not make an adjustment:

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

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

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

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

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

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

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

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

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

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

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

5. [1]Determination and Distribution of Net Income.[1] After a decedent dies, in the case of an estate or after an income interest in a trust ends, the following rules apply:

a. A fiduciary of an estate or of a terminating income interest shall determine the amount of net income and net principal receipts received from property specifically [1]**[**given**]** devised[1] to a beneficiary under the rules in sections 7 through [1]**[**30**]** 28[1] of this act which apply to trustees and the rules in subsection e. of this section. The fiduciary shall distribute the net income and net principal receipts to the beneficiary who is to receive the specific property.

b. A fiduciary shall determine the remaining net income of a decedent's estate or a terminating income interest under the rules in sections 7 through [1]**[**30**]** 28[1] of this act which apply to trustees and by:

(1) including in net income all income from property used to discharge liabilities; [1]and[1]

(2) [1]**[**paying from income or principal, in the fiduciary's discretion, fees of attorneys, accountants and fiduciaries, court costs and other expenses of administration and interest on death taxes, but the fiduciary may pay those expenses from income of property passing to a trust for which the fiduciary claims an estate tax marital or charitable deduction only to the extent that the payment of those expenses from income will not cause the reduction or loss of the deduction; and

(3)**]**[1] paying from principal all [1]**[**other disbursements made or incurred in connection with the settlement of a decedent's estate or the winding up of a terminating income interest, including debts, funeral expenses, disposition of remains, family allowances and death taxes and related penalties that are apportioned to the estate or terminating income interest by the will, the terms of the trust or applicable law**]** disbursements made or incurred in connection with the settlement of a decedent's estate or the winding up of a terminating income interest, expenses of administration, including fees of attorneys, accountants and fiduciaries, court costs, debts, funeral expenses, disposition of remains, family allowances and death taxes and related penalties that are apportioned to the estate or terminating income interest by the will, the terms of the trust or applicable law[1].

c. A fiduciary shall distribute to a beneficiary who receives a pecuniary amount outright the interest or any other amount provided by the will, the terms of the trust or applicable law from net income determined under subsection b. of this section or from principal to the extent that net income is insufficient. If a beneficiary is to receive a pecuniary amount outright from a trust after an income interest ends and no interest or other amount is provided for by the terms of the trust or applicable law, the fiduciary shall distribute the interest or other amount to which the beneficiary would be entitled under applicable law if the pecuniary amount were required to be paid under a will.

d. A fiduciary shall distribute the net income remaining after distributions required by subsection c. of this section in the manner described in section 6 of this act to all other beneficiaries, [1][including a beneficiary who receives a pecuniary amount in trust, even if the beneficiary holds an unqualified power to withdraw assets from the trust or other presently exercisable general power of appointment over the trust] excluding a beneficiary who receives a pecuniary amount outright or in trust[1].

e. A fiduciary shall not reduce principal or income receipts from property described in subsection a. of this section because of a payment described in section [1][25] 24[1] or [1][26] 25[1] of this act to the extent that the will, the terms of the trust, or applicable law requires the fiduciary to make the payment from assets other than the property or to the extent that the fiduciary recovers or expects to recover the payment from a third party. The net income and principal receipts from the property are determined by including all of the amounts the fiduciary receives or pays with respect to the property, whether those amounts accrued or became due before, on or after the date of a decedent's death or an income interest's terminating event, and by making a reasonable provision for amounts that the fiduciary believes the estate or terminating income interest may become obligated to pay after the property is distributed.

6. [1]Distribution to Residuary and Remainder Beneficiaries.[1] a. Each beneficiary described in subsection d. of section 5 of this act is entitled to receive a portion of the net income equal to the beneficiary's fractional interest in undistributed principal assets, using values as of the distribution date. If a fiduciary makes more than one distribution of assets to beneficiaries to whom this section applies, each beneficiary, including one who does not receive part of the distribution, is entitled, as of each distribution date, to the net income the fiduciary has received after the date of death or terminating event or earlier distribution date but has not distributed as of the current distribution date.

b. In determining a beneficiary's share of net income, the following rules apply:

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

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

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

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

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

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

7. [1]<u>When Right to Income Begins and Ends.</u>[1] a. An income beneficiary is entitled to net income from the date on which the income interest begins. An income interest begins on the date specified in the terms of the trust or, if no date is specified, on the date an asset becomes subject to a trust or successive income interest.

b. An asset becomes subject to a trust:

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

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

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

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

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

8. [1]Apportionment of Receipts and Disbursements When Decedent Dies or Income Interest Begins.[1] a. A trustee shall allocate an income receipt or disbursement [1],[1] other than one to which [1][paragraph (1) of][1] subsection [1][b.] a.[1] of section 5 of this act applies[1],[1] to principal if its due date occurs before a decedent dies in the case of an estate or before an income interest begins in the case of a trust or successive income interest.

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

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

9. [1]Apportionment When Income Interest Ends.[1] a. As used in this section, "undistributed income" means net income received before the date on which an income interest ends. The term does not include an item of income or expense that is due or accrued or net income that has been added or is required to be added to principal under the terms of the trust.

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

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

10. [1]Character of Receipts.[1] a. As used in this section, “entity” means a corporation, partnership, limited liability company, regulated investment company, real estate investment trust, common trust fund or any other organization in which a trustee has an interest other than a trust or estate to which section 11 of this act applies, a business or activity to which section 12 of this act applies or an asset-backed security to which section [1]⟦24⟧ 23[1] of this act applies.

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

c. A trustee shall allocate the following receipts from an entity to principal:

(1) property other than money;

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

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

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

d. Money is received in partial liquidation:

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

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

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

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

11. [1]Distribution from Trust or Estate.[1] A trustee shall allocate to income an amount received as a distribution of income from a trust or an estate in which the trust has an interest other than a purchased interest, and shall allocate to principal an amount received as a

distribution of principal from such a trust or estate. If a trustee purchases an interest in a trust that is an investment entity, or a decedent or donor transfers an interest in such a trust to a trustee, section 10 or [1]**[**24**]** 23[1] of this act applies to a receipt from the trust.

12. [1]Business and Other Activities Conducted by Trustee.[1] a. If a trustee who conducts a business or other activity determines that it is in the best interest of all the beneficiaries to account separately for the business or activity instead of accounting for it as part of the trust's general accounting records, the trustee may maintain separate accounting records for its transactions, whether or not its assets are segregated from other trust assets.

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

c. Activities for which a trustee may maintain separate accounting records include:

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

(2) farming;

(3) raising and selling livestock and other animals;

(4) management of rental properties;

(5) extraction of minerals and other natural resources;

(6) timber operations; and

(7) activities to which section [1]**[**23**]** 22[1] of this act applies.

13. [1]Principal Receipts.[1] A trustee shall allocate to principal:

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

b. Money or other property received from the sale, exchange, liquidation or change in form of a principal asset, including realized profit, subject to sections 10 through [1]**[**24**]** 23[1] of this act;

c. Amounts recovered from third parties to reimburse the trust because of disbursements described in paragraph [1]**[**(7)**]** (9)[1] of subsection a. of section [1]**[**26**]** 25[1] of this act or for other reasons to the extent not based on the loss of income;

d. Proceeds of property taken by eminent domain, but a separate award made for the loss of income with respect to an accounting period during which a current income beneficiary had a mandatory income interest is income;

e. Net income received in an accounting period during which there is no beneficiary to whom a trustee may or shall distribute income; and

f. Other receipts as provided in sections 17 through [1][24] 23[1] of this act.

14. [1]Rental Property.[1] To the extent that a trustee accounts for receipts from rental property pursuant to this section, the trustee shall allocate to income an amount received as rent of real or personal property, including an amount received for cancellation or renewal of a lease. An amount received as a refundable deposit, including a security deposit or a deposit that is to be applied as rent for future periods, shall be added to principal and held subject to the terms of the lease and is not available for distribution to a beneficiary until the trustee's contractual obligations have been satisfied with respect to that amount.

15. [1]Obligation to Pay Money.[1] a. An amount received as interest, whether determined at a fixed, variable or floating rate, on an obligation to pay money to the trustee, including an amount received as consideration for prepaying principal, shall be allocated to income without any provision for amortization of premium.

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

c. This section does not apply to an obligation to which section [1]17,[1] 18, 19, 20, [1][21,] 22 or[1] 23 [1][or 24][1] of this act applies.

16. [1]Insurance Policies and Similar Contracts.[1] a. Except as otherwise provided in subsection b. of this section, a trustee shall allocate to principal the proceeds of a life insurance policy or other contract in which the trust or its trustee is named as beneficiary, including a contract that insures the trust or its trustee against loss for damage to, destruction of or loss of title to a trust asset. The trustee shall allocate dividends on an insurance policy to income if the premiums on the policy are paid from income, and to principal if the premiums are paid from principal.

b. A trustee shall allocate to income proceeds of a contract that insures the trustee against loss of occupancy or other use by an income beneficiary, loss of income or, subject to section 12 of this act, loss of profits from a business.

c. This section does not apply to a contract to which section [1][18] 17[1] of this act applies.

[1][17. If a trustee determines that an allocation between principal and income required by section 18, 19, 20, 21 or 24 of this act is insubstantial, the trustee may allocate the entire amount to principal unless one of the circumstances described in subsection c. of section 4 of this act applies to the allocation. This power may be exercised by a cotrustee in the circumstances described in subsection d. of section 4 of this act and may be released for the reasons and in the manner described in subsection e. of section 4 of this act. An allocation is presumed to be insubstantial if:

(1) the amount of the allocation would increase or decrease net income in an accounting period, as determined before the allocation, by less than 10 percent; or

(2) the value of the asset producing the receipt for which the allocation would be made is less than 10 percent of the total value of the trust's assets at the beginning of the accounting period.][1]

[1][18.] 17. Deferred Compensation, Retirement Benefits, Annuities, and Similar Payments.[1] a. As used in this section, "payment" means a payment that a trustee may receive over a fixed [1][number] period[1] of [1][years] time[1] or during the life of one or more individuals because of services rendered or property transferred to the payer in exchange for future payments. The term includes a payment made in money or property from the payer's general assets or from a separate fund created by the payer [1]or by another[1], including a private or commercial annuity, an individual retirement account and a pension, profit-sharing, stock-bonus, or stock-ownership plan.

b. To the extent that a [1][payment is characterized as interest or a dividend or a payment made in lieu of interest or a dividend, a trustee shall allocate it to income. The trustee shall allocate to principal the balance of the payment and any other payment received in the same accounting period that is not characterized as interest, a dividend or an equivalent payment] trustee can readily ascertain the part of a payment from a separate fund held for the benefit of the trust that represents the then undistributed net income of the fund realized since the trust acquired its interest in the fund, a trustee shall allocate that part to income. The trustee shall allocate to principal the balance of the payment[1].

c. If no part of a payment is [1][characterized as interest, a dividend or an equivalent payment] allocated to income under subsection b. of this section[1], and all or part of the payment is required to be made, a trustee shall allocate to income 10 percent of the part that is required to be made during the accounting period and the balance to principal. If no part of a payment is required to be made or the payment received is the entire amount to which the trustee is entitled, the trustee shall allocate the entire payment to principal. For purposes of this subsection, a payment is not "required to be made" to the extent that it is made because the trustee exercises a right of withdrawal.

d. If, to obtain an estate tax [1]or gift tax[1] marital deduction for a trust, [1][a] the[1] trustee must allocate more of a payment to income than provided for by this section, the trustee shall allocate to income the additional amount necessary to obtain the marital deduction.

e. This section does not apply to payments to which section [1][19] 18[1] of this act applies.

[1][19.] 18. Liquidating Asset.[1] a. As used in this section, "liquidating asset" means an asset whose value will diminish or terminate because the asset is expected to produce receipts for a period of limited duration. The term includes a leasehold, patent, copyright, royalty right and right to receive payments during a period of more than one year under an arrangement that does not provide for the payment of interest on the unpaid balance. The term does not include a payment subject to section [1][18] 17[1] of this act, resources subject to section [1][20] 19[1] of this act, timber subject to section [1][21] 20[1] of this act, an activity subject to section [1][23] 22[1] of this act, an asset subject to section [1][24] 23[1] of this act, or any asset for which the trustee establishes a reserve for depreciation under section [1][27] 26[1] of this act.

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

[1][20.] 19. Minerals, Water and Other Natural Resources.[1] a. To the extent that a trustee accounts for receipts from an interest in minerals or other natural resources pursuant to this section, the trustee shall allocate them as follows:

(1) if received as nominal delay rental or nominal annual rent on a lease, a receipt shall be allocated to income;

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

(3) if an amount received as a royalty, shut-in-well payment, take-or-pay payment, bonus or delay rental is more than nominal, 90 percent shall be allocated to principal and the balance to income;

(4) if an amount is received from a working interest or any other

interest not provided for in paragraph (1), (2) or (3) of this subsection a., 90 percent of the net amount received shall be allocated to principal and the balance to income.

b. An amount received on account of an interest in water that is renewable shall be allocated to income. If the water is not renewable, 90 percent of the amount shall be allocated to principal and the balance to income.

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

d. If a trust owns an interest in minerals, water, or other natural resources on the effective date of this act, the trustee may allocate receipts from the interest as provided in this act or in the manner used by the trustee before the effective date of this act. If the trust acquires an interest in minerals, water or other natural resources after the effective date of this act, the trustee shall allocate receipts from the interest as provided in this act.

[1]**[**21.**]** 20. Timber.[1] a. To the extent that a trustee accounts for receipts from the sale of timber and related products pursuant to this section, the trustee shall allocate the net receipts:

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

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

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

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

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

c. This section applies whether or not a decedent or transferor was harvesting timber from the property before it became subject to the trust.

d. If a trust owns an interest in timberland on the effective date of this act, the trustee may allocate net receipts from the sale of timber and related products as provided in this act or in the manner used by the trustee before the effective date of this act. If the trust acquires an interest in timberland after the effective date of this act, the trustee shall allocate net receipts from the sale of timber and related products as provided in this act.

[1][22.] 21. Property Not Productive of Income.[1] a. If a marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the spouse with sufficient income from or use of the trust assets, and if the amounts that the trustee transfers from principal to income under section 4 of this act and distributes to the spouse from principal pursuant to the terms of the trust are insufficient to provide the spouse with the beneficial enjoyment required to obtain the marital deduction, the spouse may require the trustee to make property productive of income, convert property within a reasonable time or exercise the power conferred by subsection a. of section 4 of this act. The trustee may decide which action or combination of actions to take.

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

[1][23.] 22. Derivatives and Options.[1] a. As used in this section, "derivative" means a contract or financial instrument or a combination of contracts and financial instruments which gives a trust the right or obligation to participate in some or all changes in the price of a tangible or intangible asset or group of assets, or changes in a rate, an index of prices or rates or other market indicator for an asset or a group of assets.

b. To the extent that a trustee does not account under section 12 of this act for transactions in derivatives, the trustee shall allocate to principal receipts from and disbursements made in connection with those transactions.

c. If a trustee grants an option to buy property from the trust, whether or not the trust owns the property when the option is granted, grants an option that permits another person to sell property to the trust or acquires an option to buy property for the trust or an option to sell an asset owned by the trust, and the trustee or other owner of the asset is required to deliver the asset if the option is exercised, an amount received for granting the option shall be allocated to principal. An amount paid to acquire the option shall be paid from principal. A gain or loss realized upon the exercise of an option, including an option granted to a settlor of the trust for services rendered, shall be allocated to principal.

[1][24.] 23. Asset-backed Securities.[1] a. As used in this section, "asset-backed security" means an asset whose value is based upon the right it gives the owner to receive distributions from the proceeds of financial assets that provide collateral for the security. The term includes an asset that gives the owner the right to receive from the collateral financial assets only the interest or other current return or only the proceeds other than interest or current return. The term does not include an asset to which section 10 or [1][18] 17[1] of this act applies.

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

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

[1][25.] 24. Disbursements from Income.[1] A trustee shall make the following disbursements from income to the extent that they are not disbursements to which paragraph (1) or (2) of subsection b. of section 5 of this act applies:

a. [1][one-half of the regular compensation of the trustee and of any person providing investment advisory or custodial services to the trustee] commissions allowed by law to a trustee on income receipts, if properly chargeable to the trust[1];

b. one-half of [1][all expenses for accountings, judicial proceedings, or other matters that involve both the income and remainder interests] the fees paid to banks and other financial institutions for custodial services to the fiduciary if properly chargeable to the trust[1];

c. all of the other ordinary expenses incurred in connection with the administration, management, or preservation of trust property and the distribution of income, including interest [1][, ordinary repairs, regularly recurring taxes assessed against principal and expenses of a proceeding or other matter that concerns primarily the income interest] paid by the trustee, including interest on death taxes, regularly recurring taxes assessed against any portion of the principal, water rates, bond premiums, and the expenses, including court costs, attorneys' fees, and accountants' fees, of an accounting, judicial proceeding or other matter that concerns primarily the income interest, unless the court directs otherwise[1]; and

d. recurring premiums on insurance covering the loss of a principal asset or the loss of income from or use of the asset.

[1][26.] 25. Disbursements from Principal.[1] a. A trustee shall make the following disbursements from principal:

(1) [1][the remaining one-half of the disbursements described in subsections a. and b. of section 25 of this act] commissions allowed by law to a trustee on principal receipts or distributions or on termination of the trust estate[1];

(2) [1][all of the trustee's compensation calculated on principal as a fee for acceptance, distribution, or termination, and disbursements made to prepare property for sale] the remaining one-half of the fees paid to banks and other financial institutions for custodial services, if properly chargeable to the trust[1];

(3) [1][payments on the principal of a trust debt] fees paid to banks and other financial institutions and registered investment advisors for investment advisory or investment management services, if properly chargeable to the trust[1];

(4) [1][expenses of a proceeding that concerns primarily principal, including a proceeding to construe the trust or to protect the trust or its property] costs of investing and reinvesting principal and payments on the principal of an indebtedness, including a mortgage or security interest amortized by periodic payments of principal[1];

(5) [1][premiums paid on a policy of insurance not described in subsection d. of section 25 of this act of which the trust is the owner and beneficiary] extraordinary repairs or expenses incurred in making a capital improvement, including special assessments, and disbursements made to prepare property for sale[1];

(6) [1][estate, inheritance and other transfer taxes, including penalties, apportioned to the trust] court costs, attorneys' fees, accountants' fees and other fees, incurred on an accounting or judicial proceeding or in maintaining or defending any action to construe a will or a trust, protect it or the trust estate, or assure the title of any property, unless properly chargeable to income under subsection c. of section 24 of this act or the court otherwise directs[1]; [1][and][1]

(7) [1][disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the costs of those activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or regulations, statutory or common law claims by third parties and defending claims based on environmental matters] premiums paid on an insurance policy not described in subsection d. of section 24 of this

act of which the trust is the owner and beneficiary;

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

(9) disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the cost of those activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or regulations, statutory or common law claims by third parties and defending claims based on environmental matters; and

(10) if an estate or inheritance tax is levied in respect of a trust in which both an income beneficiary and remainderman have an interest, any amount apportioned to the trust, including penalties, even though the income beneficiary also has rights in the principal[1].

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

[1][27.] 26. Transfers from Income to Principal for Depreciation.[1]

a. As used in this section, “depreciation” means a reduction in value due to wear, tear, decay, corrosion or gradual obsolescence of a fixed asset having a useful life of more than one year.

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

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

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

(3) under this section if the trustee is accounting under section 12 of this act for the business or activity in which the asset is used.

c. An amount transferred to principal need not be held as a separate fund.

[1][28.] 27. Transfer from Income to Reimburse Principal.[1] a. If a trustee makes or expects to make a principal disbursement described in this section, the trustee may transfer an appropriate amount from income to principal in one or more accounting periods to reimburse principal or to provide a reserve for future principal disbursements.

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

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

(2) [1][a capital improvement to a principal asset, whether in the form of changes to an existing asset or the construction of a new asset, including special assessments;

(3)][1] disbursements made to prepare property for rental, including tenant allowances, leasehold improvements and broker's commissions; [1]and[1]

[1][(4)] (3) [1] periodic payments on an obligation secured by a principal asset to the extent that the amount transferred from income to principal for depreciation is less than the periodic payments [1][; and

(5) disbursements described in paragraph (7) of subsection a. of section 26 of this act][1].

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

[1][29.] 28. Income Taxes.[1] a. A tax required to be paid by a trustee based on receipts allocated to income shall be paid from income.

b. A tax required to be paid by a trustee based on receipts allocated to principal shall be paid from principal, even if the tax is called an income tax by the taxing authority.

c. A tax required to be paid by a trustee on the trust's share of an entity's taxable income shall be paid proportionately:

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

(2) from principal to the extent that:

(a) receipts from the entity are allocated to principal; and

(b) the trust's share of the entity's taxable income exceeds the total receipts described in paragraph (1) and subparagraph (a) of this paragraph (2).

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

[1][30. a. A fiduciary may make adjustments between principal and income to offset the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries which arise from:

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

(2) an income tax or any other tax that is imposed upon the

fiduciary or a beneficiary as a result of a transaction involving or a distribution from the estate or trust; or

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

b. If the amount of an estate tax marital deduction or charitable contribution deduction is reduced because a fiduciary deducts an amount paid from principal for income tax purposes instead of deducting it for estate tax purposes, and as a result estate taxes paid from principal are increased and income taxes paid by an estate, trust or beneficiary are decreased, each estate, trust or beneficiary that benefits from the decrease in income tax shall reimburse the principal from which the increase in estate tax is paid. The total reimbursement shall equal the increase in the estate tax to the extent that the principal used to pay the increase would have qualified for a marital deduction or charitable contribution deduction but for the payment. The proportionate share of the reimbursement for each estate, trust or beneficiary whose income taxes are reduced shall be the same as its proportionate share of the total decrease in income tax. An estate or trust shall reimburse principal from income.][1]

[1][31.] 29. Uniformity of Application and Construction.[1] In applying and construing this act, consideration shall be given to the fact that this is a uniform act, and there is a need to promote uniformity of the act with respect to its subject matter among states that enact it.

[1][32.] 30. Application of Act to Existing and Future Trusts and Estates.[1] This act applies to every trust or decedent's estate existing on [1]or after[1] the effective date of this act, except as otherwise expressly provided in the will or terms of the trust or in this act.

[1]31. Judicial Control of Discretionary Powers. a. A court shall not change a fiduciary's decision to exercise or not to exercise a discretionary power conferred by this act unless it determines that the decision was an abuse of discretion. A court shall not determine that a fiduciary abused its discretion merely because the court would have exercised the discretion in a different manner or would not have exercised the discretion.

b. The decisions to which subsection a. of this section applies include:

(1) A determination under subsection a. of section 4 of this act of whether and to what extent an amount should be transferred from principal to income or from income to principal.

(2) A determination of the factors that are relevant to the trust and its beneficiaries, the extent to which they are relevant, and the weight,

if any, to be given to the relevant factors in deciding whether and to what extent to exercise the powers conferred by subsection a. of section 4 of this act.

c. If a court determines that a fiduciary has abused its discretion, the remedy is to restore the income and remainder beneficiaries to the position they would have occupied if the fiduciary had not abused its discretion, according to the following rules:

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

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

(3) To the extent that the court is unable, after applying paragraphs (1) and (2) of this subsection to restore the beneficiaries, the trust, or both, to the position they would have occupied if the fiduciary had not abused its discretion, the court may require the fiduciary to pay an appropriate amount from its own funds to one or more of the beneficiaries or the trust or both.

d. Upon a petition by the fiduciary, the court having jurisdiction over the trust or estate shall determine whether a proposed exercise or nonexercise by the fiduciary of a discretionary power conferred by this act will result in an abuse of the fiduciary's discretion. If the petition describes the proposed exercise or nonexercise of the power and contains sufficient information to inform the beneficiaries of the reasons for the proposal, the facts upon which the fiduciary relies, and an explanation of how the income and remainder beneficiaries will be affected by the proposed exercise or nonexercise of the power, a beneficiary who challenges the proposed exercise or nonexercise has the burden of establishing that it will result in an abuse of discretion.[1]

[1][33.] 32. Repealer.[1] N.J.S.3B:19A-1 et seq. is repealed.

[1][34.] 33. Effective Date.[1] This act shall take effect [1][immediately] on January 1 of the year following enactment[1].

Replaces "Revised Uniform Principal and Income Act" with "Uniform Principal and Income Act of 2000."

CHAPTER 212

AN ACT concerning principal and income guidelines for trusts and estates and repealing N.J.S.3B:19A-1 et seq.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

C.3B:19B-1 Short title.

1. Short Title. This act shall be known and may be cited as the "Uniform Principal and Income Act of 2001."

C.3B:19B-2 Definitions.

2. Definitions. As used in this act:

"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.

"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.

"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.

"Income" means money or property that a fiduciary receives as current return from a principal asset. The term includes a portion of receipts from a sale, exchange or liquidation of a principal asset, to the extent provided in sections 10 through 23 of this act.

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

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

"Mandatory income interest" means the right of an income beneficiary to receive net income that the terms of the trust require the fiduciary to distribute.

"Net income" means the total receipts allocated to income during an accounting period minus the disbursements made from income during the period, plus or minus transfers under this act to or from income during the period.

"Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency or instrumentality, public corporation or any other legal or commercial entity.

"Principal" means property held in trust for distribution to a remainder beneficiary when the trust terminates.

"Remainder beneficiary" means a person entitled to receive principal when an income interest ends.

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

"Trustee" includes an original, additional or successor trustee, whether or not appointed or confirmed by a court.

C.3B:19B-3 Fiduciary duties; general principles.

3. Fiduciary Duties; General Principles. a. In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of sections 5 through 9 of this act, a fiduciary:

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

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

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

(4) shall add a receipt or charge a disbursement to principal to the extent that the terms of

the trust and this act do not provide a rule for allocating the receipt or disbursement to or between principal and income.

b. A fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries.

C.3B:19B-4 Trustee's power to adjust.

4. Trustee's Power to Adjust. a. A trustee may adjust between principal and income if the terms of the trust describe the amount that may or shall be distributed to a beneficiary by referring to the trust's income and the trustee determines, after applying the rules in subsection a. of section 3 of this act, that the trustee is unable to comply with subsection b. of section 3 of this act. A decision by a trustee to increase the distribution to the income beneficiary or beneficiaries in any accounting period to an amount not in excess of four percent, or to decrease that period's distributions to not less than six percent, of the net fair market value of the trust assets on the first business day of that accounting period shall be presumed to be fair and reasonable to all of the beneficiaries. Any adjustment by a trustee between income and principal with respect to any accounting period shall be made during that accounting period or within 65 days after the end of that period.

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

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

(2) the intent of the settlor;

(3) the identity and circumstances of the beneficiaries;

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

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

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

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

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

(9) the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries that arise from elections and decisions regarding tax matters, the imposition of an income or other tax on the fiduciary or a beneficiary as a result of a transaction involving a distribution from the estate or trust, or the ownership of an interest in an entity whose taxable income, whether or not distributed, is includable in the taxable income of the estate, trust or a beneficiary; and

(10) the anticipated tax consequences of an adjustment.

c. A trustee shall not make an adjustment:

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

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

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

(4) from any amount that is permanently set aside for charitable purposes under a will or the

terms of a trust unless both income and principal are so set aside;

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

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

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

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

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

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

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

C.3B:19B-5 Determination and distribution of net income.

5. Determination and Distribution of Net Income. After a decedent dies, in the case of an estate or after an income interest in a trust ends, the following rules apply:

a. A fiduciary of an estate or of a terminating income interest shall determine the amount of net income and net principal receipts received from property specifically devised to a beneficiary under the rules in sections 7 through 28 of this act which apply to trustees and the rules in subsection e. of this section. The fiduciary shall distribute the net income and net principal receipts to the beneficiary who is to receive the specific property.

b. A fiduciary shall determine the remaining net income of a decedent’s estate or a terminating income interest under the rules in sections 7 through 28 of this act which apply to trustees and by:

(1) including in net income all income from property used to discharge liabilities; and

(2) paying from principal all disbursements made or incurred in connection with the settlement of a decedent's estate or the winding up of a terminating income interest, expenses of administration, including fees of attorneys, accountants and fiduciaries, court costs, debts, funeral expenses, disposition of remains, family allowances and death taxes and related penalties that are apportioned to the estate or terminating income interest by the will, the terms of the trust or applicable law.

c. A fiduciary shall distribute to a beneficiary who receives a pecuniary amount outright the interest or any other amount provided by the will, the terms of the trust or applicable law from net income determined under subsection b. of this section or from principal to the extent that net income is insufficient. If a beneficiary is to receive a pecuniary amount outright from a trust after an income interest ends and no interest or other amount is provided for by the terms of the trust or applicable law, the fiduciary shall distribute the interest or other amount to which the beneficiary would be entitled under applicable law if the pecuniary amount were required to be paid under a will.

d. A fiduciary shall distribute the net income remaining after distributions required by subsection c. of this section in the manner described in section 6 of this act to all other beneficiaries, excluding a beneficiary who receives a pecuniary amount outright or in trust.

e. A fiduciary shall not reduce principal or income receipts from property described in subsection a. of this section because of a payment described in section 24 or 25 of this act to the extent that the will, the terms of the trust, or applicable law requires the fiduciary to make the payment from assets other than the property or to the extent that the fiduciary recovers or expects to recover the payment from a third party. The net income and principal receipts from the property are determined by including all of the amounts the fiduciary receives or pays with respect to the property, whether those amounts accrued or became due before, on or after the date of a decedent's death or an income interest's terminating event, and by making a reasonable provision for amounts that the fiduciary believes the estate or terminating income interest may become obligated to pay after the property is distributed.

C.3B:19B-6 Distribution to residuary and remainder beneficiaries.

6. Distribution to Residuary and Remainder Beneficiaries. a. Each beneficiary described in subsection d. of section 5 of this act is entitled to receive a portion of the net income equal to the beneficiary's fractional interest in undistributed principal assets, using values as of the distribution date. If a fiduciary makes more than one distribution of assets to beneficiaries to whom this section applies, each beneficiary, including one who does not receive part of the distribution, is entitled, as of each distribution date, to the net income the fiduciary has received after the date of death or terminating event or earlier distribution date but has not distributed as of the current distribution date.

b. In determining a beneficiary's share of net income, the following rules apply:

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

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

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

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

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

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

C.3B:19B-7 When right to income begins and ends.

7. When Right to Income Begins and Ends. a. An income beneficiary is entitled to net income from the date on which the income interest begins. An income interest begins on the date specified in the terms of the trust or, if no date is specified, on the date an asset becomes subject to a trust or successive income interest.

b. An asset becomes subject to a trust:

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

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

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

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

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

C.3B:19B-8 Apportionment of receipts and disbursements when decedent dies or income interest begins.

8. Apportionment of Receipts and Disbursements When Decedent Dies or Income Interest Begins. a. A trustee shall allocate an income receipt or disbursement,other than one to which subsection a.of section 5 of this act applies,to principal if its due date occurs before a decedent dies in the case of an estate or before an income interest begins in the case of a trust or successive income interest.

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

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

C.3B:19B-9 Apportionment when income interest ends.

9. Apportionment When Income Interest Ends. a. As used in this section, "undistributed income" means net income received before the date on which an income interest ends. The term does not include an item of income or expense that is due or accrued or net income that has been added or is required to be added to principal under the terms of the trust.

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

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

C.3B:19B-10 Character of receipts.

10. Character of Receipts. a. As used in this section, "entity" means a corporation, partnership, limited liability company, regulated investment company, real estate investment trust, common trust fund or any other organization in which a trustee has an interest other than a trust or estate to which section 11 of this act applies, a business or activity to which section 12 of this act applies or an asset-backed security to which section 23 of this act applies.

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

c. A trustee shall allocate the following receipts from an entity to principal:

(1) property other than money;

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

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

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

d. Money is received in partial liquidation:

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

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

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

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

C.3B:19B-11 Distribution from trust or estate.

11. Distribution from Trust or Estate. A trustee shall allocate to income an amount received as a distribution of income from a trust or an estate in which the trust has an interest other than a purchased interest, and shall allocate to principal an amount received as a distribution of principal from such a trust or estate. If a trustee purchases an interest in a trust that is an investment entity, or a decedent or donor transfers an interest in such a trust to a trustee, section 10 or 23 of this act applies to a receipt from the trust.

C.3B:19B-12 Business and other activities conducted by trustee.

12. Business and Other Activities Conducted by Trustee. a. If a trustee who conducts a business or other activity determines that it is in the best interest of all the beneficiaries to account separately for the business or activity instead of accounting for it as part of the trust's general accounting records, the trustee may maintain separate accounting records for its transactions, whether or not its assets are segregated from other trust assets.

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

c. Activities for which a trustee may maintain separate accounting records include:

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

(2) farming;

(3) raising and selling livestock and other animals;

(4) management of rental properties;

(5) extraction of minerals and other natural resources;

(6) timber operations; and

(7) activities to which section 22 of this act applies.

C.3B:19B-13 Principal receipts.

13. Principal Receipts. A trustee shall allocate to principal:

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

b. Money or other property received from the sale, exchange, liquidation or change in form of a principal asset, including realized profit, subject to sections 10 through 23 of this act;

c. Amounts recovered from third parties to reimburse the trust because of disbursements described in paragraph (9)of subsection a. of section 25 of this act or for other reasons to the extent not based on the loss of income;

d. Proceeds of property taken by eminent domain, but a separate award made for the loss of income with respect to an accounting period during which a current income beneficiary had a mandatory income interest is income;

e. Net income received in an accounting period during which there is no beneficiary to whom a trustee may or shall distribute income; and

f. Other receipts as provided in sections 17 through 23 of this act.

C.3B:19B-14 Rental property.

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

C.3B:19B-15 Obligation to pay money.

15. Obligation to Pay Money. a. An amount received as interest, whether determined at a fixed, variable or floating rate, on an obligation to pay money to the trustee, including an amount received as consideration for prepaying principal, shall be allocated to income without any provision for amortization of premium.

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

c. This section does not apply to an obligation to which section 17,18, 19, 20, 22 or 23 of this act applies.

C.3B:19B-16 Insurance policies and similar contracts.

16. Insurance Policies and Similar Contracts. a. Except as otherwise provided in subsection b. of this section, a trustee shall allocate to principal the proceeds of a life insurance policy or other contract in which the trust or its trustee is named as beneficiary, including a contract that insures the trust or its trustee against loss for damage to, destruction of or loss of title to a trust asset. The trustee shall allocate dividends on an insurance policy to income if the premiums on the policy are paid from income, and to principal if the premiums are paid from principal.

b. A trustee shall allocate to income proceeds of a contract that insures the trustee against loss of occupancy or other use by an income beneficiary, loss of income or, subject to section 12 of this act, loss of profits from a business.

c. This section does not apply to a contract to which section 17 of this act applies.

C.3B:19B-17 Deferred compensation, retirement benefits, annuities, and similar payments.

17. Deferred Compensation, Retirement Benefits, Annuities, and Similar Payments. a. As used in this section, "payment" means a payment that a trustee may receive over a fixed period of time or during the life of one or more individuals because of services rendered or property transferred to the payer in exchange for future payments. The term includes a payment made in

money or property from the payer's general assets or from a separate fund created by the payer or by another, including a private or commercial annuity, an individual retirement account and a pension, profit-sharing, stock-bonus, or stock-ownership plan.

b. To the extent that a trustee can readily ascertain the part of a payment from a separate fund held for the benefit of the trust that represents the then undistributed net income of the fund realized since the trust acquired its interest in the fund, a trustee shall allocate that part to income. The trustee shall allocate to principal the balance of the payment.

c. If no part of a payment is allocated to income under subsection b. of this section, and all or part of the payment is required to be made, a trustee shall allocate to income 10 percent of the part that is required to be made during the accounting period and the balance to principal. If no part of a payment is required to be made or the payment received is the entire amount to which the trustee is entitled, the trustee shall allocate the entire payment to principal. For purposes of this subsection, a payment is not "required to be made" to the extent that it is made because the trustee exercises a right of withdrawal.

d. If, to obtain an estate tax or gift tax marital deduction for a trust, the trustee must allocate more of a payment to income than provided for by this section, the trustee shall allocate to income the additional amount necessary to obtain the marital deduction.

e. This section does not apply to payments to which section 18 of this act applies.

C.3B:19B-18 Liquidating asset.

18. Liquidating Asset. a. As used in this section, "liquidating asset" means an asset whose value will diminish or terminate because the asset is expected to produce receipts for a period of limited duration. The term includes a leasehold, patent, copyright, royalty right and right to receive payments during a period of more than one year under an arrangement that does not provide for the payment of interest on the unpaid balance. The term does not include a payment subject to section 17 of this act, resources subject to section 19 of this act, timber subject to section 20 of this act, an activity subject to section 22 of this act, an asset subject to section 23 of this act, or any asset for which the trustee establishes a reserve for depreciation under section 26 of this act.

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

C.3B:19B-19 Minerals, water and other natural resources.

19. Minerals, Water and Other Natural Resources. a. To the extent that a trustee accounts for receipts from an interest in minerals or other natural resources pursuant to this section, the trustee shall allocate them as follows:

(1) if received as nominal delay rental or nominal annual rent on a lease, a receipt shall be allocated to income;

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

(3) if an amount received as a royalty, shut-in-well payment, take-or-pay payment, bonus or delay rental is more than nominal, 90 percent shall be allocated to principal and the balance to income;

(4) if an amount is received from a working interest or any other interest not provided for in paragraph (1), (2) or (3) of this subsection a., 90 percent of the net amount received shall be allocated to principal and the balance to income.

b. An amount received on account of an interest in water that is renewable shall be allocated to income. If the water is not renewable, 90 percent of the amount shall be allocated to principal and the balance to income.

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

d. If a trust owns an interest in minerals, water, or other natural resources on the effective date of this act, the trustee may allocate receipts from the interest as provided in this act or in the manner used by the trustee before the effective date of this act. If the trust acquires an interest in minerals, water or other natural resources after the effective date of this act, the trustee shall allocate receipts from the interest as provided in this act.

C.3B:19B-20 Timber.

20. Timber. a. To the extent that a trustee accounts for receipts from the sale of timber and related products pursuant to this section, the trustee shall allocate the net receipts:

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

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

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

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

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

c. This section applies whether or not a decedent or transferor was harvesting timber from the property before it became subject to the trust.

d. If a trust owns an interest in timberland on the effective date of this act, the trustee may allocate net receipts from the sale of timber and related products as provided in this act or in the manner used by the trustee before the effective date of this act. If the trust acquires an interest in timberland after the effective date of this act, the trustee shall allocate net receipts from the sale of timber and related products as provided in this act.

C.3B:19B-21 Property not productive of income.

21. Property Not Productive of Income. a. If a marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the spouse with sufficient income from or use of the trust assets, and if the amounts that the trustee transfers from principal to income under section 4 of this act and distributes to the spouse from principal pursuant to the terms of the trust are insufficient to provide the spouse with the beneficial enjoyment required to obtain the marital deduction, the spouse may require the trustee to make property productive of income, convert property within a reasonable time or exercise the power conferred by subsection a. of section 4 of this act. The trustee may decide which action or combination of actions to take.

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

C.3B:19B-22 Derivatives and options.

22. Derivatives and Options. a. As used in this section, “derivative” means a contract or financial instrument or a combination of contracts and financial instruments which gives a trust the right or obligation to participate in some or all changes in the price of a tangible or intangible asset or group of assets, or changes in a rate, an index of prices or rates or other market indicator for an asset or a group of assets.

b. To the extent that a trustee does not account under section 12 of this act for transactions in derivatives, the trustee shall allocate to principal receipts from and disbursements made in connection with those transactions.

c. If a trustee grants an option to buy property from the trust, whether or not the trust owns the property when the option is granted, grants an option that permits another person to sell property to the trust or acquires an option to buy property for the trust or an option to sell an asset owned by the trust, and the trustee or other owner of the asset is required to deliver the asset if the option is exercised, an amount received for granting the option shall be allocated to principal. An amount paid to acquire the option shall be paid from principal. A gain or loss realized upon the exercise of an option, including an option granted to a settlor of the trust for services rendered, shall be allocated to principal.

C.3B:19B-23 Asset-backed securities.

23. Asset-backed Securities. a. As used in this section, “asset-backed security” means an asset whose value is based upon the right it gives the owner to receive distributions from the proceeds of financial assets that provide collateral for the security. The term includes an asset that gives the owner the right to receive from the collateral financial assets only the interest or other current return or only the proceeds other than interest or current return. The term does not include an asset to which section 10 or 17 of this act applies.

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

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

C.3B:19B-24 Disbursements from income.

24. Disbursements from Income. A trustee shall make the following disbursements from income to the extent that they are not disbursements to which paragraph (1) or (2) of subsection b. of section 5 of this act applies:

a. commissions allowed by law to a trustee on income receipts, if properly chargeable to the trust;

b. one-half of the fees paid to banks and other financial institutions for custodial services to the fiduciary if properly chargeable to the trust;

c. all of the other ordinary expenses incurred in connection with the administration, management, or preservation of trust property and the distribution of income, including interest paid by the trustee, including interest on death taxes, regularly recurring taxes assessed against any portion of the principal, water rates, bond premiums, and the expenses, including court costs, attorneys' fees, and accountants' fees, of an accounting, judicial proceeding or other matter that concerns primarily the income interest, unless the court directs otherwise; and

d. recurring premiums on insurance covering the loss of a principal asset or the loss of income from or use of the asset.

C.3B:19B-25 Disbursements from principal.

25. Disbursements from Principal. a. A trustee shall make the following disbursements from principal:

(1) commissions allowed by law to a trustee on principal receipts or distributions or on termination of the trust estate;

(2) the remaining one-half of the fees paid to banks and other financial institutions for custodial services, if properly chargeable to the trust;

(3) fees paid to banks and other financial institutions and registered investment advisors for investment advisory or investment management services, if properly chargeable to the trust;

(4) costs of investing and reinvesting principal and payments on the principal of an indebtedness, including a mortgage or security interest amortized by periodic payments of principal;

(5) extraordinary repairs or expenses incurred in making a capital improvement, including special assessments, and disbursements made to prepare property for sale;

(6) court costs, attorneys' fees, accountants' fees and other fees, incurred on an accounting or judicial proceeding or in maintaining or defending any action to construe a will or a trust, protect it or the trust estate, or assure the title of any property, unless properly chargeable to

income under subsection c. of section 24 of this act or the court otherwise directs;

(7) premiums paid on an insurance policy not described in subsection d. of section 24 of this act of which the trust is the owner and beneficiary;

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

(9) disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the cost of those activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or regulations, statutory or common law claims by third parties and defending claims based on environmental matters; and

(10) if an estate or inheritance tax is levied in respect of a trust in which both an income beneficiary and remainderman have an interest, any amount apportioned to the trust, including penalties, even though the income beneficiary also has rights in the principal.

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

C.3B:19B-26 Transfers from income to principal for depreciation.

26. Transfers from Income to Principal for Depreciation.

a. As used in this section, “depreciation” means a reduction in value due to wear, tear, decay, corrosion or gradual obsolescence of a fixed asset having a useful life of more than one year.

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

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

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

(3) under this section if the trustee is accounting under section 12 of this act for the business or activity in which the asset is used.

c. An amount transferred to principal need not be held as a separate fund.

C.3B:19B-27 Transfer from income to reimburse principal.

27. Transfer from Income to Reimburse Principal. a. If a trustee makes or expects to make a principal disbursement described in this section, the trustee may transfer an appropriate amount from income to principal in one or more accounting periods to reimburse principal or to provide a reserve for future principal disbursements.

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

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

(2) disbursements made to prepare property for rental, including tenant allowances, leasehold improvements and broker’s commissions; and

(3) periodic payments on an obligation secured by a principal asset to the extent that the amount transferred from income to principal for depreciation is less than the periodic payments.

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

C.3B:19B-28 Income taxes.

28. Income Taxes. a. A tax required to be paid by a trustee based on receipts allocated to income shall be paid from income.

b. A tax required to be paid by a trustee based on receipts allocated to principal shall be paid from principal, even if the tax is called an income tax by the taxing authority.

c. A tax required to be paid by a trustee on the trust's share of an entity's taxable income shall be paid proportionately:

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

(2) from principal to the extent that:

(a) receipts from the entity are allocated to principal; and

(b) the trust's share of the entity's taxable income exceeds the total receipts described in paragraph (1) and subparagraph (a) of this paragraph (2).

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

C.3B:19B-29 Uniformity of application and construction.

29. Uniformity of Application and Construction. In applying and construing this act, consideration shall be given to the fact that this is a uniform act, and there is a need to promote uniformity of the act with respect to its subject matter among states that enact it.

C.3B:19B-30 Application of act to existing and future trusts and estates.

30. Application of Act to Existing and Future Trusts and Estates. This act applies to every trust or decedent's estate existing on or after the effective date of this act, except as otherwise expressly provided in the will or terms of the trust or in this act.

C.3B:19B-31 Judicial control of discretionary powers.

31. Judicial Control of Discretionary Powers. a. A court shall not change a fiduciary's decision to exercise or not to exercise a discretionary power conferred by this act unless it determines that the decision was an abuse of discretion. A court shall not determine that a fiduciary abused its discretion merely because the court would have exercised the discretion in a different manner or would not have exercised the discretion.

b. The decisions to which subsection a. of this section applies include:

(1) A determination under subsection a. of section 4 of this act of whether and to what extent an amount should be transferred from principal to income or from income to principal.

(2) A determination of the factors that are relevant to the trust and its beneficiaries, the extent to which they are relevant, and the weight, if any, to be given to the relevant factors in deciding whether and to what extent to exercise the powers conferred by subsection a. of section 4 of this act.

c. If a court determines that a fiduciary has abused its discretion, the remedy is to restore the income and remainder beneficiaries to the position they would have occupied if the fiduciary had not abused its discretion, according to the following rules:

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

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

(3) To the extent that the court is unable, after applying paragraphs (1) and (2) of this subsection to restore the beneficiaries, the trust, or both, to the position they would have occupied if the fiduciary had not abused its discretion, the court may require the fiduciary to pay an appropriate amount from its own funds to one or more of the beneficiaries or the trust or both.

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

Repealer.
32. Repealer. N.J.S.3B:19A-1 et seq. is repealed.

33. Effective Date. This act shall take effect on January 1 of the year following enactment

Approved August 15, 2001.

Office of the Governor

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NEWS RELEASE

RELEASE: Aug 16, 2001

Acting Governor Donald T. DiFrancesco signed the following legislation:

S-1310, sponsored by Senators Robert Martin (R-Essex/Morris/Passaic) and James Cafiero (R-Cape May/Atlantic/Cumberland) and Assembly members Carol Murphy (R-Essex/Morris/Passaic) and Richard Merkt (R-Morris), changes the post-retirement State Health Benefits Program eligibility requirements from the current threshold of 25 or more years of service credit in a single state or locally-administered retirement system to 25 or more years of nonconcurring service credit in one or more state or locally-administered retirement systems.

S-2428, sponsored by Senator Gerald Cardinale (R-Bergen) and Assemblywoman Clare Farragher (R-Monmouth), repeals the existing "New Jersey Insurance Producer Licensing Act" and replaces it with a new regulatory system designed to create uniform laws governing the licensure of both resident and nonresident insurance producers. The bill defines key terms and establishes uniform examination and licensing requirements. The bill provides for reciprocity among states for nonresident licensees

A-3261, sponsored by Senators Gerald Cardinale (R-Bergen) and John Adler (D-Camden) and Assembly members Kip Bateman (R-Morris/Somerset) and Peter Biondi (R-Morris/Somerset), The Uniform Principal & Income Act enhances a trustee's ability to satisfy fiduciary duties to the two types of beneficiaries of a trust whose interests often are in conflict: remainder beneficiaries, who benefit from a trust's principal, and income beneficiaries, who benefit from a trust's income distribution. The bill provides a trustee with the discretion to allocate trust assets either to principal or income, in conformity with rules established by the bill and with the "Prudent Investor Act".

A-2601, sponsored by Assemblyman Richard Bagger (R-Middlesex/Morris/Somerset/ Union), pushes back the deadline established in current law for filing certain nominating petitions for party offices and public offices from the 54th day to the 57th day prior to the day of the general election and would affect: a) petitions of candidates seeking the nomination of a political party at the primary election; b) petitions nominating candidates for party positions at the primary election; c) petitions seeking to have the name of a person seeking nomination to the office of President of the United States by a political party appear on the ballot with the names of the delegates and alternates to the national convention of the party.