

No. 2002-50

AN ACT

SB 1014

Amending Title 20 (Decedents, Estates and Fiduciaries) of the Pennsylvania Consolidated Statutes, further providing for situs of inter vivos trust, for rules of succession, for power of decedent, for equitable apportionment of Federal estate tax, for definitions and for termination of custodianship; providing for delay in transfer of custodial property after minor attains age 21 and for individuals presumed dead from the September 11, 2001, terrorist attack; further providing for effect of disclaimer; providing for power of trustee to resign; extensively revising provisions on principal and income; and making conforming amendments.

The General Assembly of the Commonwealth of Pennsylvania hereby enacts as follows:

Section 1. Section 724 of Title 20 of the Pennsylvania Consolidated Statutes is amended to read:

§ 724. Situs of inter vivos trust.

(a) When provided for in trust instrument.—If the trust instrument expressly provides for the situs of the inter vivos trust, its situs shall be at the place within or without the Commonwealth which is in accord with such provision.

(b) Not provided for in trust instrument.—If the trust instrument does not expressly provide for the situs of the inter vivos trust, its situs shall be:

(1) Resident settlor.—In the case of an inter vivos trust whose settlor is domiciled in the Commonwealth:

(i) in the settlor's lifetime, either in the county of his principal residence or in the county in which any of the trustees resides or [**is located**] *has a place of business*; and

(ii) after the settlor's death, either in the county in which letters have been granted to his personal representative, or in a county in which letters could have been granted, or in a county *which is the principal place of the trust's administration* in which any trustee resides [**or is located**] *or has a place of business*.

(2) Nonresident settlor.—In the case of an inter vivos trust whose settlor:

(i) is not domiciled in the Commonwealth at the time when during his lifetime the first application is made to a court concerning the trust; or

(ii) was not domiciled in the Commonwealth at his death if the first application to a court concerning the trust was made thereafter, in a county *which is the principal place of the trust's administration or in which any trustee resides [or is located,] or has a place of business* and if there is no such trustee, then in a county where property of the trust is located.

Section 2. Section 2104 of Title 20 is amended by adding a paragraph to read:

§ 2104. Rules of succession.

The provisions of this chapter shall be applied to both real and personal estate in accordance with the following rules:

* * *

(11) Intestacy following valid prior estate.—In the event of an intestacy occurring at the termination of a valid prior estate, the identity and shares of the intestate heirs then entitled to take shall be ascertained as though the death of the testator, settlor or grantor had occurred at the time of the termination of the prior estate.

Section 3. Section 3701 of Title 20 is amended to read:

§ 3701. Power of decedent.

A testator, settlor, donor or possessor of any appropriate power of appointment may direct how the Federal estate tax or the Federal generation-skipping *transfer* tax due because of his death, including interest and penalties, shall be apportioned or may grant a discretionary power to another so to direct, but:

(1) any direction regarding apportionment of the Federal generation-skipping transfer tax must expressly refer to that tax[.]; and

(2) [Any] any direction waiving the right of recovery of Federal estate tax, provided for under section 2207A of the Internal Revenue Code of 1986 (Public Law 99-514, 26 U.S.C. § 2207A), on [the] property includable in the [taxable] gross estate by reason of section 2044 of the Internal Revenue Code of 1986, must expressly refer to that right.

Any such direction shall take precedence over the provisions of this chapter insofar as the direction provides for the payment of the tax or any part thereof from property the disposition of which can be controlled by the instrument containing the direction or delegating the power to another.

Section 4. Section 3702(f) and (h) of Title 20 are amended and the section is amended by adding a subsection to read:

§ 3702. Equitable apportionment of Federal estate tax.

* * *

(f) Additional Federal estate tax.—

(1) Any increase in Federal estate tax caused by the inclusion under section 2044 of the Internal Revenue Code of 1986 (Public Law 99-514, 26 U.S.C. § 2044) of a qualified terminable interest trust in the estate of a decedent shall be apportioned against that trust.

(2) Any increase in Federal estate tax caused by a taxable event occurring in a qualified domestic trust under section 2056A of the Internal Revenue Code of 1986 (Public Law 99-514, 26 U.S.C. § 2056A) shall be apportioned against that trust notwithstanding the provisions of subsection (b) or (c).

(3) Any additional Federal estate tax due because a qualified heir disposes of qualified real property or ceases to use it for the qualified use shall be apportioned against the qualified heir notwithstanding the provisions of subsection (b).

* * *

(h) Interest and penalties.—Interest and penalties shall be apportioned in the same manner as the principal amount of the Federal estate tax **[unless the court finds it inequitable to do so by reason of special circumstances in which case the court may direct a different apportionment of interest and penalties.]** *subject to a fiduciary's power to adjust under Chapter 81 (relating to principal and income).*

* * *

(j) *Gift tax.—Gift tax paid by the decedent and imposed on a gift by the decedent or his spouse within three years of the date of his death and included in his gross estate shall be treated in the same manner as though the amount of such gift tax had been a preresiduary testamentary gift by the decedent to the donee of the gift.*

Section 5. Section 5164 of Title 20 is amended to read:

§ 5164. Distributions for support and education.

All income received by a guardian of the estate of a minor, including, subject to the requirements of Federal law relating thereto, all funds received from the Department of Veterans' Affairs, Social Security Administration and other periodic retirement or disability payments under private or government plans, in the exercise of a reasonable discretion, may be expended in the care, maintenance and education of the minor without the necessity of court approval. The court, for cause shown and with only such notice as it considers appropriate in the circumstances, may authorize or direct the payment or application of any or all of the income or principal of the estate of a minor for the care, maintenance or education of the minor, his spouse or children, or for the reasonable funeral expenses of the minor's spouse, child or indigent parent. In proper cases, the court may order payment of amounts directly to the ward for his maintenance or for incidental expenses and may ratify payments made for these purposes. ***For purposes of this section, the term "income" means income as determined in accordance with the rules set forth in Chapter 81 (relating to principal and income), other than the power to adjust and the power to convert to a unitrust.***

Section 6. The definition of "minor" in section 5301(b) of Title 20 is amended to read:

§ 5301. Short title of chapter and definitions.

* * *

(b) Definitions.—The following words and phrases when used in this chapter shall have the meanings given to them in this subsection unless the context clearly indicates otherwise:

* * *

“Minor.” An individual who has not attained 21 years of age[.], *except that, when used with reference to the beneficiary for whose benefit custodial property is held or is to be held, an individual who has not attained the age at which the custodian is required under sections 5320 (relating to termination of custodianship) and 5321 (relating to delay in transfer of custodial property after minor attains age 21) to transfer the custodial property to the beneficiary.*

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Section 7. Section 5320 of Title 20 is amended to read:

§ 5320. Termination of custodianship.

The custodian shall transfer in an appropriate manner the custodial property to the minor or the minor’s estate upon the earlier of:

(1) the minor’s attainment of 21 years of age with respect to custodial property transferred *by gift* under section 5304 (relating to transfer by gift or exercise of power of appointment) [*or 5305 (relating to transfer authorized by will or trust)*];

~~[(2) the minor’s attainment of majority under the laws of this Commonwealth other than this chapter with respect to custodial property transferred under section 5306 (relating to other transfer by fiduciary) or 5307 (relating to transfer by obligor); or~~

~~(3) the minor’s death.]~~

~~(2) the minor’s attainment of 21 years of age with respect to a custodian nominated under section 5303 (relating to nomination of custodian) or with respect to custodial property transferred by exercise of power of appointment under section 5304 or by will or trust under section 5305 (relating to transfer authorized by will or trust), unless the time of transfer of the custodial property to the minor is delayed under section 5321 (relating to delay in transfer of custodial property after minor attains age 21) to a time after the minor attains 21 years of age;~~

~~(3) the time specified in the transfer pursuant to section 5309 (relating to manner of creating custodial property and effecting transfer) if the time of transfer of the custodial property to the minor is delayed under section 5321 to a time after the time the minor attains 21 years of age;~~

~~(4) the minor’s attainment of majority under the laws of this Commonwealth other than this chapter with respect to custodial property transferred under section 5306 (relating to other transfer by fiduciary) or 5307 (relating to transfer by obligor); or~~

~~(5) the minor’s death.~~

Section 8. Title 20 is amended by adding a section to read:
§ 5321. Delay in transfer of custodial property after minor attains age 21.

(a) General rule.—Subject to the requirements and limitations of this section, the time for transfer to the minor of custodial property transferred under or pursuant to section 5303 (relating to nomination of

custodian), 5304 (relating to transfer by gift or exercise of power of appointment) or 5305 (relating to transfer authorized by will or trust) may be delayed until a specified time after the time the minor attains 21 years of age, which time shall be specified in the transfer pursuant to section 5309 (relating to manner of creating custodial property and effecting transfer).

(b) How to specify a delayed time for transfer.—To specify a delayed time for transfer to the minor of the custodial property, the words “as custodian for (name of minor) until age (age for delivery of property to minor) under the Pennsylvania Uniform Transfers to Minors Act” shall be substituted in substance for the words “as custodian for (name of minor) under the Pennsylvania Uniform Transfers to Minors Act” in making the transfer pursuant to section 5309.

(c) Transfer authorized by will or trust; nomination of custodian.—The time for transfer to the minor of custodial property transferred under or pursuant to section 5303 or 5305 may be delayed under this section only if the governing will or trust or nomination provides in substance that the custodianship is to continue until the time the minor attains a specified age, which time may not be later than the time the minor attains 25 years of age, and in that case the governing will or trust or nomination shall determine the time to be specified in the transfer pursuant to section 5309.

(d) Transfer by exercise of power appointment.—The time for transfer to the minor of custodial property transferred by the irrevocable exercise of a power of appointment under section 5304 may be delayed under this section only if the transfer pursuant to section 5309 provides in substance that the custodianship is to continue until the time the minor attains a specified age, which time may not be later than the time the minor attains 25 years of age.

(e) When section not applicable.—This section shall not apply to the time for transfer to the minor of custodial property transferred by irrevocable gift under section 5304.

(f) When transfer does not specify age.—If the transfer pursuant to section 5309 does not specify any age, the time for the transfer of the custodial property to the minor under section 5320 (relating to termination of custodianship) is the time when the minor attains 21 years of age.

(g) When transfer provides for a longer duration of custodianship than permitted by this section.—If the transfer pursuant to section 5309 provides in substance that the duration of the custodianship is for a time longer than the maximum time permitted by this section for the duration of a custodianship created by that type of transfer, the custodianship shall be deemed to continue only until the time the minor attains the maximum age permitted by this section for the duration of a custodianship created by that type of transfer.

Section 9. Section 5536(a) of Title 20 is amended to read:

§ 5536. Distributions of income and principal during incapacity.

(a) In general.—All income received by a guardian of the estate of an incapacitated person, including (subject to the requirements of Federal law relating thereto) all funds received from the Veterans' Administration, Social Security Administration and other periodic retirement or disability payments under private or governmental plans, in the exercise of a reasonable discretion, may be expended in the care and maintenance of the incapacitated person, without the necessity of court approval. The court, for cause shown and with only such notice as it considers appropriate in the circumstances, may authorize or direct the payment or application of any or all of the income or principal of the estate of an incapacitated person for the care, maintenance or education of the incapacitated person, his spouse, children or those for whom he was making such provision before his incapacity, or for the reasonable funeral expenses of the incapacitated person's spouse, child or indigent parent. In proper cases, the court may order payment of amounts directly to the incapacitated person for his maintenance or for incidental expenses and may ratify payments made for these purposes. *For purposes of this subsection, the term "income" means income as determined in accordance with the rules set forth in Chapter 81 (relating to principal and income), other than the power to adjust and the power to convert to a unitrust.*

* * *

Section 9.1. Section 5601 of Title 20 is amended by adding subsections to read:

§ 5601. General provisions.

* * *

(e.1) Limitation on applicability in commercial transaction.—

(1) Subsections (c), (d) and (e) do not apply to a power or a power of attorney contained in an instrument used in a commercial transaction which simply authorizes an agency relationship. This paragraph includes the following:

(i) A power given to or for the benefit of a creditor in connection with a loan or other credit transaction.

(ii) A power exclusively granted to facilitate transfer of stock, bonds and other assets.

(iii) A power contained in the governing document for a corporation, partnership or limited liability company or other legal entity by which a director, partner or member authorizes others to do other things on behalf of the entity.

(iv) A warrant of attorney conferring authority to confess judgment.

(2) Powers and powers of attorney exempted by this subsection need not be dated.

(e.2) Limitation on applicability in health care power of attorney.—Subsections (c) and (d) do not apply to a power of attorney which exclusively provides for health care decision making.

* * *

Section 9.2. Title 20 is amended by adding a section to read:

§ 5706. Persons presumed dead from September 11, 2001, terrorist attack.

The requirements of sections 5703 (relating to distribution of property of absentee) and 5704 (relating to notice to absentee) shall not apply with respect to a person who is presumed dead as a result of the terrorist attacks on September 11, 2001. These terrorist attacks constitute specific perils within the meaning of section 5701(c) (relating to proof of death) which would justify a court to immediately determine that the presumed decedent died on September 11, 2001.

Section 10. Section 6205(a) of Title 20 is amended and the section is amended by adding a subsection to read:

§ 6205. Effect of disclaimer.

(a) In general.—A disclaimer relates back for all purposes to the date of the death of the decedent or the effective date of the inter vivos transfer or third-party beneficiary contract as the case may be. The disclaimer shall [be binding upon the disclaimant and all persons claiming through or under him.] not in any way diminish the interest of any person other than the disclaimant in such person's own right under the instrument creating the disclaimed interest or under the intestate laws nor diminish any interest to which such person becomes entitled under subsection (b) by reason of the disclaimer.

* * *

(d) Rights of creditors of disclaimant.—Nothing in this section shall determine the effect of a disclaimer upon the rights of creditors of the disclaimant.

Section 11. Title 20 is amended by adding sections to read:

§ 7104. Power of trustee to resign.

(a) Court approval.—Any trustee may resign with court approval.

(b) Without court approval if authorized by governing instrument.—Any trustee may resign without court approval if authorized to resign by the governing instrument.

(c) When individual trustee may resign without court approval and without authorization in governing instrument.—Unless expressly provided to the contrary in the governing instrument, an individual trustee may resign without court approval and without authorization in the governing instrument if:

(1) consented to in writing by all co-trustees, if there are one or more co-trustees; and

(2) consented to in writing by all the sui juris beneficiaries currently eligible to receive income and by all the sui juris

beneficiaries who would receive, if no powers of appointment were exercised, a distribution of principal if the trust were to terminate immediately prior to the resignation, provided that no such resignation shall be effective unless there is at least one such income beneficiary and at least one such remainderman.

This subsection shall not authorize the sole trustee of a trust to resign unless the governing instrument names a successor trustee or provides a method for appointing a successor trustee, and in either case the resignation shall not be effective until the successor trustee accepts in writing his appointment.

(d) Liability.—The resignation of a trustee shall not by itself relieve the resigning trustee of liability in connection with the administration of the trust.

(e) Definition.—As used in this section, the term “sui juris beneficiary” includes a guardian for an incapacitated beneficiary, an agent acting under a durable power of attorney for an incompetent beneficiary and a court-appointed guardian of a minor’s estate or, if none, the minor’s parents.

§ 7105. Filing resignations and appointments.

A resignation of a trustee, an appointment of a trustee and an acceptance of an appointment of a trustee may be filed with the clerk of the orphans’ court division having jurisdiction over the trust.

Section 12. Chapter 81 of Title 20 is repealed.

Section 13. Title 20 is amended by adding a chapter to read:

CHAPTER 81 PRINCIPAL AND INCOME

Subchapter

- A. Preliminary Provisions; Power to Adjust; Power to Convert to Unitrust
- B. Decedent’s Estate or Terminating Income Interest
- C. Apportionment at Beginning and End of Income Interest
- D. Allocation of Receipts During Administration of Trust
- E. Allocation of Disbursements During Administration of Trust
- F. (Reserved)
- G. (Reserved)
- H. Miscellaneous Provisions

SUBCHAPTER A PRELIMINARY PROVISIONS; POWER TO ADJUST; POWER TO CONVERT TO UNITRUST

Sec.

8101. Short title of chapter.

8102. Definitions.

8103. Fiduciary duties; general principles.

8104. Trustee’s power to adjust.

- 8105. Power to convert to unitrust.
- 8106. Judicial control of discretionary powers.
- 8107. (Reserved).
- 8108. (Reserved).
- 8109. (Reserved).
- 8110. (Reserved).
- 8111. (Reserved).
- 8112. (Reserved).
- 8113. Charitable trusts.

§ 8101. Short title of chapter.

This chapter shall be known and may be cited as the Pennsylvania Uniform Principal and Income Act.

§ 8102. Definitions.

The following words and phrases when used in this chapter shall have the meanings given to them in this section unless the context clearly indicates otherwise:

“Accounting period.” 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 which begins when an income interest begins or ends when an income interest ends.

“Beneficiary.” Includes:

(1) in the case of a decedent’s estate, any heir, legatee and devisee; and

(2) in the case of a trust, an income beneficiary and a remainder beneficiary.

“Fiduciary.” A personal representative or a trustee.

“Income.” Money or property which 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 Subchapter D (relating to allocation of receipts during administration of trust).

“Income beneficiary.” A person to whom or which net income of a trust is or may be payable.

“Income interest.” The right of an income beneficiary to receive all or part of net income, whether the governing instrument requires it to be distributed or authorizes it to be distributed in the trustee’s discretion.

“Mandatory income interest.” The right of an income beneficiary to receive net income which the governing instrument requires the fiduciary to distribute.

“Net income.” The:

(1) total receipts allocated to income during an accounting period; minus

(2) disbursements made from income during the period; plus or minus

(3) transfers under this chapter to or from income during the period.

“Person.” Any individual; corporation; business trust; estate; trust; partnership; limited liability company; association; joint venture; government; governmental subdivision, agency or instrumentality; public corporation; or other legal or commercial entity.

“Principal.” Property held in trust for distribution to a remainder beneficiary when the trust terminates.

“Remainder beneficiary.” A person entitled to receive principal when an income interest ends.

“Sui juris beneficiary.” Includes:

- (1) a court-appointed guardian of an incapacitated beneficiary;
- (2) an agent for an incompetent beneficiary; and
- (3) a court-appointed guardian of a minor beneficiary’s estate or, if none, the parents of the minor beneficiary.

“Trust.” Includes a legal life estate arrangement.

“Trustee.” Includes an original, additional or successor trustee whether or not appointed or confirmed by a court.

§ 8103. Fiduciary duties; general principles.

(a) Allocation.—In allocating receipts and disbursements to or between principal and income and with respect to any matter within the scope of this chapter, the following shall apply:

(1) A fiduciary shall administer a trust or estate in accordance with the governing instrument, even if there is a different provision in this chapter.

(2) A fiduciary may administer a trust or estate by the exercise of a discretionary power of administration regarding a matter within the scope of this chapter given to the fiduciary by the governing instrument, even if the exercise of the power produces a result different from a result required or permitted by this chapter. No inference that the fiduciary has improperly exercised the discretionary power shall arise from the fact that the fiduciary has made an allocation contrary to a provision of this chapter.

(3) A fiduciary shall administer a trust or estate in accordance with this chapter if the governing instrument does not contain a different provision or does not give the fiduciary a discretionary power of administration regarding a matter within the scope of this chapter.

(4) A fiduciary shall add a receipt or charge a disbursement to principal to the extent that the governing instrument and this chapter do not provide a rule for allocating the receipt or disbursement to or between principal and income.

(b) Discretionary power.—In exercising a discretionary power of administration regarding a matter within the scope of this chapter, whether granted by the governing instrument or this chapter, including sections 8104 (relating to trustee’s power to adjust) and 8105 (relating to power to convert to unitrust), 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 governing instrument clearly manifests an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with this chapter is presumed to be fair and reasonable to all of the beneficiaries.

§ 8104. Trustee's power to adjust.

(a) Adjustment.—Subject to subsections (c) and (f), a trustee may adjust between principal and income by allocating an amount of income to principal or an amount of principal to income to the extent the trustee considers appropriate if:

- (1) the governing instrument describes what may or must be distributed to a beneficiary by referring to the trust's income; and
- (2) the trustee determines, after applying the rules in section 8103(a) (relating to fiduciary duties; general principles), that the trustee is unable to comply with section 8103(b).

(b) Considerations.—In deciding whether and to what extent to exercise the power conferred by subsection (a), a trustee may consider, among other things, all of the following:

- (1) The size of the trust.
- (2) The nature and estimated duration of the trust.
- (3) The liquidity and distribution requirements of the trust.
- (4) The needs for regular distributions and preservation and appreciation of capital.
- (5) The expected tax consequences of an adjustment.
- (6) The net amount allocated to income under the other sections of this chapter 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) 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 or testator.
- (8) To the extent reasonably known to the trustee, the needs of the beneficiaries for present and future distributions authorized or required by the governing instrument.
- (9) Whether and to what extent the governing instrument gives the trustee the power to invade principal or accumulate income or prohibits 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.

(10) The intent of the settlor or testator.

(11) The actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation.

(c) Prohibited adjustments.—A trustee may not make an adjustment under this section if any of the following apply:

(1) The adjustment would diminish the income interest in a trust which requires all of the income to be paid at least annually to a spouse and for which a Federal 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) The adjustment would reduce the actuarial value of the income interest in a trust to which a person transfers property with the intent to qualify for a Federal gift tax exclusion.

(3) The adjustment would change the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets.

(4) The adjustment is from any amount which is permanently set aside for charitable purposes under the governing instrument and for which a Federal estate or gift tax deduction has been taken unless both income and principal are so set aside.

(5) If:

(i) possessing or exercising the power to make an adjustment would cause an individual to be treated as the owner of all or part of the trust for Federal income tax purposes; and

(ii) the individual would not be treated as the owner if the trustee did not possess the power to make an adjustment.

(6) If:

(i) possessing or exercising the power to make an adjustment would cause all or part of the trust assets to be subject to Federal estate or gift tax with respect to an individual; and

(ii) the assets would not be subject to Federal estate or gift tax with respect to the individual if the trustee did not possess the power to make an adjustment.

(7) If the trustee is a beneficiary of the trust.

(8) If the trust has been converted under section 8105 (relating to power to convert to unitrust).

(d) Permissible adjustment when otherwise prohibited.—If subsection (c)(5), (6) or (7) applies to a trustee and there is more than one trustee, a co-trustee to whom the provision does not apply may make the adjustment unless the exercise of the power by the remaining trustee or trustees is prohibited by the governing instrument.

(e) Release of the power to adjust.—

(1) If paragraph (2) applies, a trustee may release any of the following:

(i) The entire power conferred by subsection (a).

(ii) The power to adjust from income to principal.

(iii) The power to adjust from principal to income.

(2) A release under paragraph (1) is permissible if any of the following apply:

(i) The trustee is uncertain about whether possessing or exercising the power will cause a result described in subsection (c)(1) through (6).

(ii) 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).

(3) The release may be permanent or for a specified period, including a period measured by the life of an individual.

(f) Application.—A governing instrument which limits the power of a trustee to make an adjustment between principal and income does not affect the application of this section unless it is clear from the governing instrument that it is intended to deny the trustee the power of adjustment conferred by subsection (a).

§ 8105. Power to convert to unitrust.

(a) Conversion.—Unless expressly prohibited by the governing instrument, a trustee may release the power under section 8104 (relating to trustee's power to adjust) and convert a trust into a unitrust as described in this section if all of the following apply:

(1) The trustee determines that the conversion will enable the trustee to better carry out the intent of the settlor or testator and the purposes of the trust.

(2) The trustee gives written notice of the trustee's intention to release the power to adjust and to convert the trust into a unitrust and of how the unitrust will operate, including what initial decisions the trustee will make under this section, to all the sui juris beneficiaries who:

(i) are currently eligible to receive income from the trust; and

(ii) would receive, if no powers of appointment were exercised, a distribution of principal if the trust were to terminate immediately prior to the giving of notice.

(3) There is at least one sui juris beneficiary under paragraph (2)(i) and at least one sui juris beneficiary under paragraph (2)(ii).

(4) No sui juris beneficiary objects to the conversion to a unitrust in a writing delivered to the trustee within 60 days of the mailing of the notice under paragraph (2).

(b) Judicially approved conversion.—

(1) The trustee may petition the court to approve the conversion to a unitrust if any of the following apply:

(i) A beneficiary timely objects to the conversion to a unitrust.

(ii) There are no sui juris beneficiaries under subsection (a)(2)(i).

(iii) There are no sui juris beneficiaries under subsection (a)(2)(ii).

(2) A beneficiary may request a trustee to convert to a unitrust. If the trustee does not convert, the beneficiary may petition the court to order the conversion.

(3) The court shall approve the conversion or direct the requested conversion if the court concludes that the conversion will enable the

trustee to better carry out the intent of the settlor or testator and the purposes of the trust.

(c) Consideration.—In deciding whether to exercise the power conferred by subsection (a), a trustee may consider, among other things, all of the following:

- (1) The size of the trust.
- (2) The nature and estimated duration of the trust.
- (3) The liquidity and distribution requirements of the trust.
- (4) The needs for regular distributions and preservation and appreciation of capital.
- (5) The expected tax consequences of the conversion.
- (6) 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; and the extent to which an asset is used by a beneficiary.
- (7) To the extent reasonably known to the trustee, the needs of the beneficiaries for present and future distributions authorized or required by the governing instrument.
- (8) Whether and to what extent the governing instrument gives the trustee the power to invade principal or accumulate income or prohibits 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.
- (9) The actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation.

(d) Post conversion.—After a trust is converted to a unitrust, all of the following apply:

- (1) The trustee shall follow an investment policy seeking a total return for the investments held by the trust, whether the return is to be derived:
 - (i) from appreciation of capital;
 - (ii) from earnings and distributions from capital; or
 - (iii) from both.

(2) The trustee shall make regular distributions in accordance with the governing instrument construed in accordance with the provisions of this section.

(3) The term “income” in the governing instrument shall mean an annual distribution (the unitrust distribution) equal to 4% (the payout percentage) of the net fair market value of the trust’s assets, whether such assets would be considered income or principal under other provisions of this chapter, averaged over the lesser of:

- (i) the three preceding years; or
- (ii) the period during which the trust has been in existence.

(e) Discretion of trustee.—The trustee may, in the trustee’s discretion from time to time, determine all of the following:

- (1) The effective date of a conversion to a unitrust.
- (2) The provisions for prorating a unitrust distribution for a short year in which a beneficiary's right to payments commences or ceases.
- (3) The frequency of unitrust distributions during the year.
- (4) The effect of other payments from or contributions to the trust on the trust's valuation.
- (5) Whether to value the trust's assets annually or more frequently.
- (6) What valuation dates to use.
- (7) How frequently to value nonliquid assets and whether to estimate their value.
- (8) Whether to omit from the calculations trust property occupied or possessed by a beneficiary.
- (9) Any other matters necessary for the proper functioning of the unitrust.

(f) Allocation.—

(1) Expenses which would be deducted from income if the trust were not a unitrust may not be deducted from the unitrust distribution.

(2) Unless otherwise provided by the governing instrument, the unitrust distribution shall be paid from net income as such term would be determined if the trust were not a unitrust. To the extent net income is insufficient, the unitrust distribution shall be paid from net realized short-term capital gains. To the extent income and net realized short-term capital gains are insufficient, the unitrust distribution shall be paid from net realized long-term capital gains. To the extent income and net realized short-term and long-term capital gains are insufficient, the unitrust distribution shall be paid from the principal of the trust.

(g) Court orders.—The trustee or, if the trustee declines to do so, a beneficiary may petition the court to:

- (1) Select a payout percentage different than 4%.
- (2) Provide for a distribution of net income, as would be determined if the trust were not a unitrust, in excess of the unitrust distribution if such distribution is necessary to preserve a tax benefit.
- (3) Average the valuation of the trust's net assets over a period other than three years.
- (4) Reconvert from a unitrust. Upon a reconversion, the power to adjust under section 8104 shall be revived.

(h) Application.—A conversion to a unitrust does not affect a provision in the governing instrument directing or authorizing the trustee to distribute principal or authorizing a beneficiary to withdraw a portion or all of the principal.

(i) Prohibited conversions.—A trustee may not convert a trust into a unitrust in any of the following circumstances:

- (1) If payment of the unitrust distribution would change the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets.

(2) If the unitrust distribution would be made from any amount which is permanently set aside for charitable purposes under the governing instrument and for which a Federal estate or gift tax deduction has been taken, unless both income and principal are so set aside.

(3) If:

(i) possessing or exercising the power to convert would cause an individual to be treated as the owner of all or part of the trust for Federal income tax purposes; and

(ii) the individual would not be treated as the owner if the trustee did not possess the power to convert.

(4) If:

(i) possessing or exercising the power to convert would cause all or part of the trust assets to be subject to Federal estate or gift tax with respect to an individual; and

(ii) the assets would not be subject to Federal estate or gift tax with respect to the individual if the trustee did not possess the power to convert.

(5) If the conversion would result in the disallowance of a Federal estate tax or gift tax marital deduction which would be allowed if the trustee did not have the power to convert.

(6) If the trustee is a beneficiary of the trust.

(j) Permissible conversion when otherwise prohibited.—

(1) If subsection (i)(3), (4) or (6) applies to a trustee and there is more than one trustee, a co-trustee to whom the provision does not apply may convert the trust unless the exercise of the power by the remaining trustee or trustees is prohibited by the governing instrument.

(2) If subsection (i)(3), (4) or (6) applies to all the trustees, the trustees may petition the court to direct a conversion.

(k) Release of the power to convert.—

(1) A trustee may release the power conferred by subsection (a) to convert to a unitrust if any of the following apply:

(i) The trustee is uncertain about whether possessing or exercising the power will cause a result described in subsection (i)(3), (4) or (5).

(ii) 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 (i).

(2) The release may be permanent or for a specified period, including a period measured by the life of an individual.

§ 8106. Judicial control of discretionary powers.

(a) Standard of review.—A court shall not change a fiduciary's decision to exercise or not to exercise a discretionary power conferred by this chapter unless it determines that the decision was an abuse of the fiduciary's discretion.

(b) Remedies.—If a court determines that a fiduciary has abused its discretion regarding a discretionary power conferred by this chapter, the

remedy is to restore the income and remainder beneficiaries to the positions 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 which 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 the beneficiary's appropriate position.

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

(3) If the abuse of discretion concerns the power to convert a trust into a unitrust, the court shall require the trustee either to convert into a unitrust or to reconvert from a unitrust.

(4) To the extent that the court is unable, after applying paragraphs (1), (2) and (3), to restore the beneficiaries, the trust or both to the positions 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.

§ 8107. (Reserved).

§ 8108. (Reserved).

§ 8109. (Reserved).

§ 8110. (Reserved).

§ 8111. (Reserved).

§ 8112. (Reserved).

§ 8113. Charitable trusts.

(a) Election.—Notwithstanding the foregoing provisions of this chapter, the trustee of a trust held exclusively for charitable purposes may elect to be governed by this section unless the governing instrument expressly provides that the election provided by this section shall not be available.

(b) Eligibility for election.—To make an election under this section, the trustee shall adopt and follow an investment policy seeking a total return for the investments held by the trust, whether the return is to be derived from appreciation of capital or earnings and distributions with respect to capital or both. The policy constituting the election shall be in writing, shall be maintained as part of the permanent records of the trust and shall recite that it constitutes an election to be governed by this section.

(c) Effect of election.—If an election is made to be governed by this section, the term "income" shall mean a percentage of the value of the trust.

The trustee shall, in a writing maintained as part of the permanent records of the trust, annually select the percentage and determine that it is consistent with the long-term preservation of the real value of the principal of the trust, but in no event shall the percentage be less than 2% nor more than 7% per year. The term "principal" shall mean all other assets held by the trustee with respect to the trust.

(d) Revocation of election.—The trustee may revoke an election to be governed by this section if the revocation is made as part of an alternative investment policy seeking the long-term preservation of the real value of the principal of the trust. The revocation and alternative investment policy shall be in writing and maintained as part of the permanent records of the trust.

(e) Value determination.—For purposes of applying this section, the value of the trust shall be the fair market value of the cash and other assets held by the trustee with respect to the trust, whether such assets would be considered "income" or "principal" under the other provisions of this chapter, determined at least annually and averaged over a period of three or more preceding years. However, if the trust has been in existence less than three years, the average shall be determined over the period during which the trust has been in existence.

SUBCHAPTER B
DECEDENT'S ESTATE OR
TERMINATING INCOME INTEREST

Sec.

8121. Determination and distribution of net income.

8122. Distribution to residuary and remainder beneficiaries.

§ 8121. 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:

(1) 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 paragraph (5) and the provisions applicable to trustees in Subchapters C (relating to apportionment at beginning and end of income interest), D (relating to allocation of receipts during administration of trust) and E (relating to allocation of disbursements during administration of trust). The fiduciary shall distribute the net income and net principal receipts to the beneficiary who is to receive the specific property.

(2) A fiduciary shall distribute to a beneficiary who receives a pecuniary amount outright and shall allocate to a pecuniary amount in trust the interest, other income or other amount provided by the governing instrument or section 3543 (relating to interest or income on distributive shares) or 7187 (relating to interest or income on distributive shares) from net income determined under paragraph (3) or from principal to the extent that net income is insufficient.

(3) A fiduciary shall determine the remaining net income of a decedent's estate or a terminating income interest under the provisions applicable to trustees in Subchapters C, D and E and by:

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

(ii) paying from principal debts, funeral expenses, costs of disposition of remains, the family exemption, fees of personal representatives and their attorneys and accountants, and death taxes and related interest and penalties which are apportioned to the estate or terminating income interest by the governing instrument or applicable law.

(4) A fiduciary shall distribute the net income remaining after distributions required by paragraph (2) in the manner described in section 8122 (relating to distribution to residuary and remainder beneficiaries) to all other beneficiaries.

(5) A fiduciary may not reduce principal or income receipts from property described in paragraph (1) because of a payment described in section 8151 (relating to minerals, water and other natural resources) or 8152 (relating to timber) to the extent that the governing instrument 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:

(i) 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

(ii) 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.

§ 8122. Distribution to residuary and remainder beneficiaries.

(a) Distribution of net income.—Each beneficiary described in section 8121(4) (relating to determination and distribution of net income) 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) Allocation of net income.—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 or applied to meet principal obligations.

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

(3) The beneficiary's fractional interest in the undistributed principal assets must 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.

(c) Collected but undistributed net income.—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) Application.—To the extent that the fiduciary considers it appropriate, if this section applies to the income from an asset, the fiduciary may apply the rules in this section to net gain or loss from the disposition of a principal asset realized after the date of death or terminating event or earlier distribution date.

(e) Distribution date.—For purposes of this section, the distribution date 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.

SUBCHAPTER C APPORTIONMENT AT BEGINNING AND END OF INCOME INTEREST

Sec.

8131. When right to income begins and ends.

8132. Apportionment of receipts and disbursements when decedent dies or income interest begins.

8133. Apportionment when income interest ends.

§ 8131. When right to income begins and ends.

(a) Accrual of income interest.—An income beneficiary is entitled to net income from the date on which the income interest begins. An income interest begins:

(1) on the date specified in the governing instrument; or

(2) if no date is specified, on the date an asset becomes subject to a trust or successive income interest.

(b) Asset subject to a trust.—An asset becomes subject to a trust:

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

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

(d) End of income interest.—An income interest ends on:

- (1) the day before an income beneficiary dies or another terminating event occurs; or
- (2) the last day of a period during which there is no beneficiary to whom a trustee may distribute income.

§ 8132. Apportionment of receipts and disbursements when decedent dies or income interest begins.

(a) Allocation to principal.—Unless section 8121(1) (relating to determination and distribution of net income) applies, a trustee shall allocate an income receipt or disbursement to principal if its due date occurs before:

- (1) a decedent dies in the case of an estate; or
- (2) an income interest begins in the case of a trust or successive income interest.

(b) Allocation to income.—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 must 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 must be allocated to principal and the balance must be allocated to income.

(c) Due dates.—An item of income or an obligation is due on the date the payor is required to make a payment. If a payment date is not stated, there is no due date for the purposes of this chapter. Distributions to shareholders or other owners from an entity to which section 8141 (relating to character of receipts) 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 must be paid at regular intervals under a lease or an obligation to pay interest or if an entity customarily makes distributions at regular intervals.

§ 8133. Apportionment when income interest ends.

(a) End of mandatory income interest.—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 which is not disposed of under the governing instrument unless the beneficiary has an unqualified power to revoke more than 5% 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.

(b) Proration of final payment.—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 or testator relating to income, gift, estate or other tax requirements.

(c) Definition.—As used in this section, the term "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 which is due or accrued or net income which has been added or is required to be added to principal under the governing instrument.

SUBCHAPTER D ALLOCATION OF RECEIPTS DURING ADMINISTRATION OF TRUST

Sec.

- 8141. Character of receipts.
- 8142. Distribution from trust or estate.
- 8143. Business and other activities conducted by trustee.
- 8144. Principal receipts.
- 8145. Rental property.
- 8146. Obligation to pay money.
- 8147. Insurance policies and similar contracts.
- 8148. Insubstantial allocations not required.
- 8149. Retirement benefits, individual retirement accounts, deferred compensation, annuities and similar payments.
- 8150. Liquidating asset.
- 8151. Minerals, water and other natural resources.
- 8152. Timber.
- 8153. Property not productive of income.
- 8154. Derivatives and options.
- 8155. Asset-backed securities.

§ 8141. Character of receipts.

(a) Allocation to income.—Except as otherwise provided in this section, a trustee shall allocate to income money received from an entity, including reinvested cash dividends.

(b) Allocation to principal.—A trustee shall allocate the following receipts from an entity to principal:

- (1) Property other than money, excluding reinvested cash dividends.
- (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.

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

(c) When received in partial liquidation.—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% of the entity's gross assets, as shown by the entity's year-end financial statements immediately preceding the initial receipt.

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

(e) Reliance upon a statement.—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.

(f) Definition.—As used in this section, the term "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:

(1) a trust or estate to which section 8142 (relating to distribution from trust or estate) applies;

(2) a business or activity to which section 8143 (relating to business and other activities conducted by trustee) applies;

(3) a payment to which section 8149 (relating to retirement benefits, individual retirement accounts, deferred compensation, annuities and similar payments) applies; or

(4) an asset-backed security to which section 8155 (relating to asset-backed securities) applies.

§ 8142. 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 8141 (relating to

character of receipts) or 8155 (relating to asset-backed securities) applies to a receipt from the trust.

§ 8143. Business and other activities conducted by trustee.

(a) Separate accounting for business or activity.—If a trustee that 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) Net receipts.—

(1) A trustee that accounts separately for a business or other activity may determine the extent to which:

(i) its net cash receipts must be retained for working capital, the acquisition or replacement of fixed assets and other reasonably foreseeable needs of the business or activity; and

(ii) the remaining net cash receipts are accounted for as principal or income in the trust's general accounting records.

(2) 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) Permissible activities for separate accounting.—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.

(7) Activities to which section 8154 (relating to derivatives and options) applies.

§ 8144. Principal receipts.

A trustee shall allocate to principal any of the following:

(1) To the extent not allocated to income under this chapter, assets received from:

(i) a transferor during the transferor's lifetime;

(ii) a decedent's estate;

(iii) a trust with a terminating income interest; or

(iv) a payor under a contract naming the trust or its trustee as beneficiary.

(2) Money or other property received from a principal asset's sale, exchange, liquidation or change in form. This paragraph includes realized profit subject to this subchapter.

(3) Amounts recovered from third parties to reimburse the trust because of disbursements described in section 8162(a)(8) (relating to mandatory disbursements from principal) or for other reasons to the extent not based on the loss of income.

(4) Proceeds of property taken by eminent domain. A separate award made for the loss of income with respect to an accounting period during which a current income beneficiary had a mandatory income interest is income.

(5) Net income received in an accounting period during which there is no beneficiary to whom a trustee may or must distribute income.

(6) Other receipts as provided in sections 8148 (relating to insubstantial allocations not required) through 8155 (relating to asset-backed securities).

§ 8145. Rental property.

(a) **Rent.**—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. This subsection includes an amount received for cancellation or renewal of a lease.

(b) **Deposit.**—An amount received as a refundable deposit, including a security deposit or a deposit which is to be applied as rent for future periods:

(1) shall be added to principal;

(2) shall be held subject to the terms of the lease; and

(3) is not available for distribution to a beneficiary until the trustee's contractual obligations have been satisfied with respect to that amount.

§ 8146. Obligation to pay money.

(a) **Interest allocated to income.**—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) **Allocation of obligations.**—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 the purchase price or value of which 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) **Application.**—This section does not apply to an obligation to which any of the following apply:

(1) Section 8149 (relating to retirement benefits, individual retirement accounts, deferred compensation, annuities and similar payments).

(2) Section 8150 (relating to liquidating asset).

(3) Section 8151 (relating to minerals, water and other natural resources).

(4) Section 8152 (relating to timber).

(5) Section 8154 (relating to derivatives and options).

(6) Section 8155 (relating to asset-backed securities).

§ 8147. Insurance policies and similar contracts.

(a) General rule.—

(1) Except as otherwise provided in subsection (b) or (c), 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. This paragraph includes a contract which insures the trust or its trustee against loss for damage to, destruction of or loss of title to a trust asset.

(2) If the premiums on the policy or contract are paid from income, the trustee shall allocate to income dividends on the policy or contract.

(3) If the premiums on the policy or contract are paid from principal, the trustee shall allocate to principal dividends on the policy or contract.

(b) Allocation of proceeds to income.—Except as provided in subsection (c), a trustee shall allocate to income proceeds of a contract which insures the trustee against any of the following:

(1) Loss of occupancy or other use by an income beneficiary.

(2) Loss of income.

(3) Subject to section 8143 (relating to business and other activities conducted by trustee), loss of profits from a business.

(c) Application.—This section does not apply to a contract to which section 8149 (relating to retirement benefits, individual retirement accounts, deferred compensation, annuities and similar payments) applies.

§ 8148. Insubstantial allocations not required.

If a trustee determines that an allocation between principal and income required by section 8149 (relating to retirement benefits, individual retirement accounts, deferred compensation, annuities and similar payments), 8150 (relating to liquidating asset), 8151 (relating to minerals, water and other natural resources), 8152 (relating to timber) or 8155 (relating to asset-backed securities) is insubstantial, the trustee may allocate the entire amount to principal unless one of the circumstances described in section 8104(c) (relating to trustee's power to adjust) applies to the allocation. This power may be exercised by a co-trustee in the circumstances described in section 8104(d) and may be released for the reasons and in the manner described in section 8104(e). 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 5%; or

(2) the value of the asset producing the receipt for which the allocation would be made is less than 5% of the total value of the trust's assets at the beginning of the accounting period.

§ 8149. Retirement benefits, individual retirement accounts, deferred compensation, annuities and similar payments.

(a) General rule.—

(1) The trustee shall allocate to income the greater of:

(i) the portion of a payment characterized by the payor as interest or a dividend or a remittance in lieu of interest or a dividend; or

(ii) the portion of the payment characterized as imputed interest for Federal income tax purposes.

(2) The balance of any such payment shall be allocated to principal.

(b) Allocation under contract calling for equal installments.—

(1) If no part of a payment under a contract calling for equal installments over a fixed period of time is allocable to income under the provisions of subsection (a), the difference between the trust's acquisition value of the contract and the total expected return shall be deemed to be interest.

(2) The trustee shall allocate to income the portion of each payment equivalent to interest on the then unpaid principal balance at the rate specified in the contract or a rate necessary to thus amortize the difference between the expected return and the acquisition value, where that rate is readily ascertainable by the trustee.

(c) Allocation when internal net income of fund is readily ascertained.—

(1) If no portion of a payment from a separate fund held exclusively for the benefit of the trust is allocable to income under subsections (a) and (b) but the internal net income of the fund determined as if the fund were a separate trust subject to Subchapters B (relating to decedent's estate or terminating income interest) through E (relating to allocation of disbursements during administration of trust) is readily ascertainable by the trustee, the portion of the payment equal to the then undistributed net income of the fund realized since the trust acquired its interest in the fund shall be deemed to be a distribution of such income and shall be allocated to the trust income account.

(2) The balance of any such payment shall be allocated to principal.

(d) When not otherwise allocable to income.—

(1) The trustee shall allocate to income 10% of the part of the payment which is required to be made during the accounting period and the balance to principal if:

(i) no part of the payment is allocable to income under subsection (a), (b) or (c); and

(ii) all or part of the payment is required to be made.

(2) The trustee shall allocate the entire payment to principal if:

(i) no part of a payment is required to be made; or

(ii) the payment received is the entire amount to which the trustee is entitled.

(3) 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.

(e) Allocation to obtain marital deduction.—If, to obtain a Federal estate 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.

(f) Application.—This section does not apply to payments to which section 8150 (relating to liquidating asset) applies.

(g) Definition.—As used in this section, the term “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 payor in exchange for future payments. The term includes all of the following:

- (1) A payment made in money or property from:
 - (i) the payor’s general assets; or
 - (ii) a separate fund created by the payor or another.
- (2) A payment on or from:
 - (i) an installment contract or note;
 - (ii) a private or commercial annuity;
 - (iii) a deferred compensation agreement;
 - (iv) an employee death benefit;
 - (v) an individual retirement account; or
 - (vi) a pension, profit-sharing, stock or other bonus, or stock-ownership plan.

§ 8150. Liquidating asset.

(a) Allocation.—A trustee shall allocate to income 10% of the receipts from a liquidating asset and the balance to principal.

(b) Definition.—As used in this section, the term “liquidating asset” means an asset the value of which 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 which does not provide for the payment of interest on the unpaid balance. The term does not include any of the following:

- (1) A payment subject to section 8149 (relating to retirement benefits, individual retirement accounts, deferred compensation, annuities and similar payments).
- (2) Resources subject to section 8151 (relating to minerals, water and other natural resources).
- (3) Timber subject to section 8152 (relating to timber).
- (4) An activity subject to section 8154 (relating to derivatives and options).

(5) An asset subject to section 8155 (relating to asset-backed securities).

(6) An asset for which the trustee establishes a reserve for depreciation under section 8163 (relating to discretionary allocation of disbursements).

§ 8151. Minerals, water and other natural resources.

(a) Allocation for receipts from minerals and other natural resources.—To the extent that a trustee accounts for receipts from an interest in minerals or other natural resources under 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:

(i) sixty-six and two-thirds percent shall be allocated to principal; and

(ii) the balance shall be allocated 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):

(i) sixty-six and two-thirds percent of the net amount received shall be allocated to principal; and

(ii) the balance shall be allocated to income.

(b) Allocation for receipts from water.—

(1) An amount received on account of an interest in renewable water shall be allocated to income.

(2) An amount received on account of an interest in nonrenewable water shall be allocated as follows:

(i) Sixty-six and two-thirds percent of the amount shall be allocated to principal.

(ii) The balance shall be allocated to income.

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

§ 8152. Timber.

(a) Allocation of net receipts.—To the extent that a trustee accounts for receipts from the sale of timber and related products under 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:

(i) the amount of timber removed from the land exceeds the rate of growth of the timber; or

(ii) the net receipts are from the sale of standing timber.

(3) To or between income and principal, by determining the amount of timber removed from the land under the lease or contract and applying the rules in paragraphs (1) and (2) if the net receipts are from:

(i) the lease of timberland; or

(ii) a contract to cut timber from land owned by a trust.

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

(b) Determining net receipts.—In determining net receipts to be allocated under subsection (a), a trustee shall deduct and transfer to principal a reasonable amount for depletion.

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

§ 8153. Property not productive of income.

(a) General rule.—If a Federal estate or gift tax marital deduction is allowed for all or part of a trust whose income is required to be paid to the settlor's or testator's spouse and 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 8104 (relating to trustee's power to adjust) and that the trustee distributes to the spouse from principal pursuant to the governing instrument 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 section 8104(a). The trustee may decide which action or combination of actions to take.

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

§ 8154. Derivatives and options.

(a) Derivatives.—To the extent that a trustee does not account under section 8143 (relating to business and other activities conducted by trustee) for transactions in derivatives, the trustee shall allocate to principal receipts from and disbursements made in connection with those transactions.

(b) Options.—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 must be allocated to principal. An amount paid to acquire the option must be paid from principal. A gain or loss realized upon the exercise of an option, including an option granted to a settlor or testator of the trust for services rendered, must be allocated to principal.

(c) Definition.—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.

§ 8155. Asset-backed securities.

(a) General rule.—If a trust receives a payment from interest or other current return and from other proceeds of the collateral financial assets:

(1) The trustee shall allocate to income the portion of the payment which the payor identifies as being from interest or other current return.

(2) The trustee shall allocate the balance of the payment to principal.

(b) Allocation where liquidating trust’s interest in security.—

(1) 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.

(2) If a payment is one of a series of payments which will result in the liquidation of the trust’s interest in the security over more than one accounting period, the trustee shall allocate:

(i) ten percent of the payment to income; and

(ii) the balance to principal.

(c) Definition.—As used in this section, the term “asset-backed security” means an asset the value of which is based upon the right it gives the owner to receive distributions from the proceeds of financial assets which provide collateral for the security. The term includes an asset which 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 8141 (relating to character of receipts) or 8149 (relating to retirement benefits, individual retirement accounts, deferred compensation, annuities and similar payments) applies.

SUBCHAPTER E
ALLOCATION OF DISBURSEMENTS DURING
ADMINISTRATION OF TRUST

Sec.

8161. Mandatory disbursements from income.

8162. Mandatory disbursements from principal.

8163. Discretionary allocation of disbursements.

8164. Transfers from income to principal for depreciation.

8165. Transfers from income to reimburse principal.

8166. Income taxes.

8167. Adjustments between principal and income because of taxes.

§ 8161. Mandatory disbursements from income.

A trustee shall make the following disbursements from income:

- (1) Interest, except interest on death taxes.
- (2) Ordinary repairs.
- (3) Real estate and other regularly recurring taxes assessed against principal.
- (4) Recurring premiums on fire or other insurance covering the loss of a principal asset or the loss of income from or use of the asset.

§ 8162. Mandatory disbursements from principal.

(a) Mandatory disbursements.—A trustee shall make the following disbursements from principal:

- (1) Extraordinary expenses incurred in connection with the administration, management or preservation of trust property and the distribution of income.
- (2) Extraordinary repairs.
- (3) Compensation for legal services to the trustee.
- (4) Expenses in connection with accountings and judicial or other proceedings. This paragraph includes proceedings to construe, modify or reform the trust or to protect the trust or its property.
- (5) Payments on the principal of a trust debt.
- (6) Premiums paid on a policy of insurance not described in section 8161(4) (relating to mandatory disbursements from income) of which the trust is the owner and beneficiary.
- (7) Estate, inheritance and other transfer taxes, including interest and penalties, apportioned to the trust.
- (8) Disbursements related to environmental matters. This paragraph includes:
 - (i) Reclamation.
 - (ii) Assessing environmental conditions.
 - (iii) Remedying and removing environmental contamination.
 - (iv) Monitoring remedial activities and the release of substances.
 - (v) Preventing future releases of substances.
 - (vi) Collecting amounts from persons liable or potentially liable for the costs of those activities.
 - (vii) Penalties imposed under environmental statutes or regulations and other payments made to comply with those statutes or regulations.
 - (viii) Statutory or common law claims by third parties.
 - (ix) Defending claims based on environmental matters.

(b) Mandatory reimbursement.—If a principal asset is encumbered with an obligation which 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.

§ 8163. Discretionary allocation of disbursements.

Subject to sections 8161 (relating to mandatory disbursements from income) and 8162 (relating to mandatory disbursements from principal), a trustee may, in the trustee's discretion, allocate to income or principal or partly to each ordinary expenses incurred in connection with the administration, management or preservation of trust property and the distribution of income, including, but not limited to, the compensation of the trustee and of any person providing investment advisory, custodian or income tax return preparation services to the trustee.

§ 8164. Transfers from income to principal for depreciation.

(a) Transfers.—A trustee may transfer to principal a reasonable amount of the net cash receipts from a principal asset that is subject to depreciation. However, a trustee 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 8143 (relating to business and other activities conducted by trustee) for the business or activity in which the asset is used.

(b) Separate fund unnecessary for amount transferred.—An amount transferred to principal need not be held as a separate fund.

(c) Definition.—As used in this section, the term "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.

§ 8165. Transfers from income to reimburse principal.

(a) Permissible reimbursements.—A 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 disbursements if the trustee makes or expects to make a disbursement from principal which is allocable to income under section 8161 (relating to mandatory disbursements from income) or 8163 (relating to discretionary allocation of disbursements) and which:

(1) is paid from principal because it is unusually large; or

(2) is made to prepare property for rental, including tenant allowances, leasehold improvements and broker's commissions.

(b) Continued transfers.—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).

(c) Application.—This section shall not apply to the extent the trustee has been or expects to be reimbursed by a third party.

§ 8166. Income taxes.

(a) Receipts allocated to income.—A tax required to be paid by a trustee based on receipts allocated to income shall be paid from income.

(b) Receipts allocated to principal.—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) Tax on entity's taxable income.—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:

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

(ii) the trust's share of the entity's taxable income exceeds the total receipts described in paragraph (1) and subparagraph (i).

(d) Reductions in receipts allocated to principal or income.—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.

§ 8167. Adjustments between principal and income because of taxes.

A trustee 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 any of the following:

(1) An election or decision which the trustee makes regarding tax matters.

(2) An income tax or any other tax which is imposed upon the trustee or a beneficiary as a result of a transaction involving the trust or distribution from the trust.

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

SUBCHAPTERS F and G

(Reserved)

SUBCHAPTER H

MISCELLANEOUS PROVISIONS

Sec.

8191. Uniformity of application and construction.

§ 8191. Uniformity of application and construction.

In applying and construing this chapter, consideration shall be given to the need to promote uniformity of the law with respect to its subject matter among states which enact it.

Section 14. (a) Except as otherwise expressly provided in the governing instrument, in the addition of 20 Pa.C.S. Ch. 81 or in subsection (b), this act shall apply to all of the following:

(1) A trust existing on or after the effective date of this act.

(2) The estate of a decedent who dies on or after the effective date of this act.

(b) This act shall apply as follows:

(1) The amendment of 20 Pa.C.S. § 724 shall apply to trusts created before, on or after the effective date of this act.

(2) The amendment of 20 Pa.C.S. § 2104 shall apply to intestacies occurring on or after the effective date of this act, even if the trust became irrevocable before the effective date of this act.

(3) The amendment of 20 Pa.C.S. § 6205 shall apply to disclaimers made on or after the effective date of this act and shall apply to disclaimers made before the effective date of this act to the extent the distribution thereunder is made after the effective date of this act or, if made prior to the effective date, such distribution was consistent with this act.

(4) The addition of 20 Pa.C.S. §§ 7104 and 7105 shall apply to trusts created before, on or after the effective date of this act.

Section 15. This act shall take effect as follows:

(1) The addition of 20 Pa.C.S. § 5601(e.1) and (e.2) shall take effect April 12, 2000.

(2) The following provisions shall take effect immediately:

(i) The addition of 20 Pa.C.S. § 5706.

(ii) This section.

(3) The remainder of this act shall take effect in 60 days.

APPROVED—The 16th day of May, A.D. 2002.

MARK S. SCHWEIKER