Millage, Chair
Larson
Parmenter

HSB 174

Suc JUDICIARY

HOUSE FILE _____ SF/(HF) 5

BY (PROPOSED COMMITTEE ON JUDICIARY BILL BY CHAIRPERSON LARSON)

Passed House, Date _____ Passed Senate, Date _____

Vote: Ayes _____ Nays _____ Vote: Ayes _____ Nays _____

Approved _____

A BILL FOR

1 An Act relating to the uniform principal and interest Act and
2 providing for its applicability.
3 BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:
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Succeeded by SF\HF

CHAPTER 637

UNIFORM PRINCIPAL AND INCOME ACT

SUBCHAPTER 1

DEFINITIONS AND FIDUCIARY DUTIES

Section 1. NEW SECTION. 637.101 SHORT TITLE.

This Act may be cited as the "Uniform Principal and Income Act".

Sec. 2. NEW SECTION. 637.102 DEFINITIONS.

As used in this chapter:

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

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

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

4. "Income" means money or property a fiduciary receives as the current return from a principal asset. The term includes a portion of the receipts from a sale, exchange, or liquidation of a principal asset, to the extent provided in subchapter 4.

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

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

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

1 8. "Net income" means the total receipts allocated to
2 income during an accounting period minus the disbursements
3 made from income during the period. In this definition,
4 receipts and disbursements include items transferred to or
5 from income during the period under this chapter.
6 9. "Person" means an individual, corporation, business
7 trust, estate, trust, partnership, limited liability company,
8 association, joint venture, or any other legal or commercial
9 entity. The term does not include a government or
10 governmental subdivision, agency, or instrumentality.
11 10. "Principal" means property held in trust for
12 distribution to a remainder beneficiary when the trust
13 terminates.
14 11. "Remainder beneficiary" means a person, including
15 another trust, entitled to receive principal when an income
16 interest ends.
17 12. "Terms of a trust" means the manifestation of the
18 intent of a settlor or decedent with respect to the trust,
19 expressed in a manner that admits of its proof in a judicial
20 proceeding, whether by written or spoken words or by conduct.
21 13. "Trustee" includes an original, additional, or
22 successor trustee, whether or not appointed or confirmed by a
23 court.
24 Sec. 3. NEW SECTION. 637.103 FIDUCIARY DUTIES -- GENERAL
25 PRINCIPLES.
26 1. In allocating receipts and disbursements to or between
27 principal and income, and in any matter within the scope of
28 subchapters 2 and 3, a fiduciary shall do all of the
29 following:
30 a. Administer a trust or estate in accordance with the
31 terms of the trust or the will, even if there is a different
32 provision in this chapter.
33 b. Administer a trust or estate by the exercise of a
34 discretionary power of administration given the fiduciary by
35 the terms of the trust or the will, although the fiduciary may

1 exercise that power in a manner different from a provision of
2 this chapter.
3 c. Administer a trust or estate in accordance with this
4 chapter if the terms of the trust or the will do not contain a
5 different provision or do not give the fiduciary a
6 discretionary power of administration.
7 d. Add a receipt or charge a disbursement to principal to
8 the extent that the terms of the trust and this chapter do not
9 provide a rule for allocating the receipt or disbursement to
10 or between principal and income.
11 2. In exercising the power to adjust granted by section
12 637.104, subsection 1, or a discretionary power of
13 administration regarding a matter within the scope of this
14 chapter, whether granted by the terms of a trust, a will, or
15 this chapter, a fiduciary shall administer a trust or estate
16 impartially, based on what is fair and reasonable to all of
17 the beneficiaries, unless the terms of the trust or the will
18 clearly manifest an intention that the fiduciary shall or may
19 favor one or more of the beneficiaries. A determination in
20 accordance with this chapter is presumed to be fair and
21 reasonable to all of the beneficiaries.
22 Sec. 4. NEW SECTION. 637.104 TRUSTEE'S POWER TO ADJUST.
23 1. A trustee may adjust between principal and income to
24 the extent the trustee considers necessary if the trustee
25 invests and manages trust assets as a prudent investor, the
26 terms of the trust describe the amount that may or must be
27 distributed to a beneficiary by referring to the trust's
28 income, and the trustee determines that, after applying the
29 rules in section 637.103, subsection 1, the trustee is unable
30 to comply with the rule in section 637.103, subsection 2.
31 2. In deciding whether and to what extent to exercise the
32 power conferred by subsection 1, a trustee shall consider all
33 of the factors relevant to the trust and its beneficiaries,
34 including each of the following factors to the extent it is
35 relevant:

1 a. The nature, purpose, and expected duration of the
2 trust.
3 b. The intent of the settlor.
4 c. The identity and circumstances of the beneficiaries.
5 d. The needs for liquidity, regularity of income, and
6 preservation and appreciation of capital.
7 e. The assets held in the trust; the extent to which they
8 consist of financial assets, interests in closely held
9 enterprises, tangible and intangible personal property, or
10 real property; the extent to which an asset is used by a
11 beneficiary; and whether an asset was purchased by the trustee
12 or received from the settlor.
13 f. The net amount allocated to income under the other
14 sections of this chapter and the increase or decrease in the
15 value of the principal assets, which the trustee may estimate
16 as to assets for which market values are not readily
17 available.
18 g. Whether and to what extent the terms of the trust give
19 the trustee the power to invade principal or accumulate income
20 or prohibit the trustee from invading principal or
21 accumulating income, and the extent to which the trustee has
22 exercised a power from time to time to invade principal or
23 accumulate income.
24 h. The actual and anticipated effect of economic
25 conditions on principal and income and effects of inflation
26 and deflation.
27 i. The anticipated tax consequences of an adjustment.
28 3. A trustee shall not make an adjustment if it would
29 result in any of the following:
30 a. Diminishes the income interest in a trust that requires
31 all of the income to be paid at least annually to a surviving
32 spouse and for which an estate tax or gift tax marital
33 deduction would be allowed, in whole or in part, if the
34 trustee did not have the power to make the adjustment.
35 b. Reduces the actuarial value of the income interest in a

1 trust to which a person transfers property with the intent to
2 qualify for a gift tax exclusion.
3 c. Changes the amount payable to a beneficiary as a fixed
4 annuity or a fixed fraction of the value of the trust's
5 assets.
6 d. If any amount is permanently set aside for charitable
7 purposes under a will or the terms of a trust.
8 e. In possessing or exercising the power to make an
9 adjustment may cause an individual to be treated as the owner
10 of all or part of the trust for income tax purposes, and the
11 individual would not be treated as the owner if the individual
12 did not possess the power to make an adjustment.
13 f. If possessing or exercising the power to make an
14 adjustment causes all or part of the trust assets to be
15 included for estate tax purposes in the estate of an
16 individual who has the power to remove a trustee or appoint a
17 trustee, or both, and the assets would not be included in the
18 estate of the individual if the individual did not have the
19 power to make an adjustment.
20 g. If the trustee is a beneficiary of the trust.
21 h. If the trustee is not a beneficiary, but the adjustment
22 would benefit the trustee directly or indirectly.
23 4. If subsection 3, paragraph "e", "f", "g", or "h",
24 applies to a trustee and there is more than one trustee, a
25 cotrustee to whom the provision does not apply may make the
26 adjustment unless the exercise of the power by the remaining
27 trustee or trustees is clearly not permitted by the terms of
28 the trust.
29 5. A trustee may release the entire power conferred by
30 subsection 1 or may release only the power to adjust from
31 income to principal or the power to adjust from principal to
32 income if the trustee is uncertain about whether possessing or
33 exercising the power will cause a result described in
34 subsection 3, paragraphs "a" through "f" or "h", or if the
35 trustee determines that possessing or exercising the power

1 will or may deprive the trust of a tax benefit or impose a tax
2 burden not described in subsection 3. The release may be
3 permanent or for a specified period, including a period
4 measured by the life of an individual.
5 6. Terms of a trust that limit the power of a trustee to
6 make an adjustment between principal and income are not
7 contrary to this section unless it is clear from the terms of
8 the trust that the terms are intended to deny the trustee the
9 power of adjustment conferred by subsection 1.
10 SUBCHAPTER 2
11 DECEDENT'S ESTATE OR TERMINATING INCOME INTEREST
12 Sec. 5. NEW SECTION. 637.201 DETERMINATION AND
13 DISTRIBUTION OF NET INCOME.
14 After a decedent dies, in the case of an estate, or after
15 an income interest in a trust ends, the following rules apply:
16 1. A fiduciary of an estate or a terminating income
17 interest shall determine the amount of net income and net
18 principal receipts received from property specifically given
19 to a beneficiary under the rules in subchapters 3 through 5
20 that apply to trustees, and under the rules in subsection 5.
21 The fiduciary shall distribute the net income and net
22 principal receipts to the beneficiary who is to receive the
23 specific property.
24 2. A fiduciary shall determine the remaining net income of
25 a decedent's estate or a terminating income interest under the
26 rules in subchapters 3 through 5 that apply to trustees, and
27 by doing the following:
28 a. Including in net income all income from property used
29 to discharge liabilities.
30 b. Paying from income or principal, in the fiduciary's
31 discretion, fees of attorneys, accountants, and fiduciaries;
32 court costs and other expenses of administration; and interest
33 on death taxes, but the fiduciary may pay those expenses from
34 income of property passing to a trust for which the fiduciary
35 claims an estate tax marital or charitable deduction only to

1 the extent that the payment of those expenses from income will
2 not cause the loss of the deduction.
3 c. Paying from principal all other disbursements made or
4 incurred in connection with the settlement of a decedent's
5 estate or the winding up of a terminating income interest,
6 including debts, funeral expenses, disposition of remains,
7 family allowances, and death taxes and related penalties that
8 are apportioned to the estate or terminating income interest
9 by the will, the terms of the trust, or applicable law.
10 3. A fiduciary shall distribute to a beneficiary who
11 receives a pecuniary amount outright the amount, if any,
12 provided by the will, the terms of the trust, or applicable
13 law, from net income determined under subsection 2 or from
14 principal to the extent the net income is insufficient. If a
15 beneficiary is to receive a pecuniary amount outright from a
16 trust after an income interest ends and no amount is provided
17 for by the terms of the trust or applicable law, the fiduciary
18 shall distribute the amount to which the beneficiary would be
19 entitled under applicable law if the pecuniary amount were
20 required to be paid under a will.
21 4. A fiduciary shall distribute the net income remaining
22 after distributions required by subsection 3 in the manner
23 described in section 637.202 to all other beneficiaries,
24 including a beneficiary who receives a pecuniary amount in
25 trust, even if the beneficiary holds an unqualified power to
26 withdraw assets from the trust or other presently exercisable
27 general power of appointment over the trust.
28 5. A fiduciary shall not reduce principal or income
29 receipts from property described in subsection 1 because of a
30 payment described in section 637.501 or 637.502 to the extent
31 that the will, the terms of the trust, or applicable law
32 requires the fiduciary to make the payment from assets other
33 than the property or to the extent that the fiduciary recovers
34 or expects to recover the payment from a third party. The
35 property's net income and principal receipts are determined by

1 including all of the amounts the fiduciary receives or pays
2 with respect to the property, whether those amounts accrued or
3 became due before, on, or after the date of a decedent's death
4 or an income interest's terminating event, and by making a
5 reasonable provision for amounts that the fiduciary believes
6 the estate or terminating income interest may become obligated
7 to pay after the property is distributed.
8 Sec. 6. NEW SECTION. 637.202 DISTRIBUTION TO RESIDUARY
9 AND REMAINDER BENEFICIARIES.
10 1. Each beneficiary described in section 637.201,
11 subsection 4, is entitled to receive a portion of the net
12 income equal to the beneficiary's fractional interest in
13 undistributed principal assets, using values as of the
14 distribution date. If a fiduciary makes more than one
15 distribution of assets to beneficiaries to whom this section
16 applies, each beneficiary, including one who does not receive
17 part of the distribution, is entitled, as of each distribution
18 date, to the net income the fiduciary has received after the
19 date of death or terminating event or earlier distribution
20 date but has not distributed as of the current distribution
21 date.
22 2. In determining a beneficiary's share of net income, the
23 following rules apply:
24 a. The beneficiary is entitled to receive a portion of the
25 net income equal to the beneficiary's fractional interest in
26 the undistributed principal assets immediately before the
27 distribution date, including assets that later may be sold to
28 meet principal obligations.
29 b. The beneficiary's fractional interest in the
30 undistributed principal assets must be calculated without
31 regard to property specifically given to a beneficiary and
32 property required to be pay pecuniary amounts not in trust.
33 c. The beneficiary's fractional interest in the
34 undistributed principal assets must be calculated on the basis
35 of the aggregate value of those assets as of the distribution

1 date without reducing the value by any unpaid principal
2 obligation.
3 d. The distribution date for purposes of this section may
4 be the date as of which the fiduciary calculates the value of
5 the assets if that date is reasonably near the date on which
6 assets are actually distributed.
7 3. The rules in this section apply to net gain or loss
8 realized after the date of death or terminating event or
9 earlier distribution date from the disposition of a principal
10 asset if this section applies to the income from the asset.
11 4. If a fiduciary does not distribute all of the collected
12 but undistributed net income or gain to each person as of a
13 distribution date, the fiduciary shall maintain appropriate
14 records showing the interest of each beneficiary in that net
15 income or gain.
16 SUBCHAPTER 3
17 APPORTIONMENT AT BEGINNING AND END OF INCOME INTEREST
18 Sec. 7. NEW SECTION. 637.301 WHEN RIGHT TO INCOME BEGINS
19 AND ENDS.
20 1. An income beneficiary is entitled to net income from
21 the date on which the income interest begins. An income
22 interest begins on the date specified in the terms of the
23 trust or, if no date is specified, on the date an asset
24 becomes subject to a trust or successive income interest.
25 2. An asset becomes subject to a trust at the first
26 occurrence of one of the following events:
27 a. On the date it is transferred to the trust in the case
28 of an asset that is transferred to a trust during the
29 transferor's life.
30 b. On the date of a testator's death in the case of an
31 asset that becomes subject to a trust by reason of a will,
32 even if there is an intervening period of administration of
33 the testator's estate.
34 c. On the date of an individual's death in the case of an
35 asset that is transferred to a fiduciary by a third party

1 because of the individual's death.
2 3. An asset becomes subject to a successive income
3 interest on the day after the preceding income interest ends,
4 as determined under subsection 4, even if there is an
5 intervening period of administration to wind up the preceding
6 income interest.
7 4. An income interest ends on the day before an income
8 beneficiary dies or another terminating event occurs. For
9 purposes of this chapter, an income interest also ends on the
10 last day of a period during which there is no beneficiary to
11 whom a trustee may distribute income.
12 Sec. 8. NEW SECTION. 637.302 APPORTIONMENT OF RECEIPTS
13 AND DISBURSEMENTS WHEN DECEDENT DIES OR INCOME INTEREST
14 BEGINS.
15 1. An income receipt or disbursement other than one to
16 which section 637.201, subsection 1, applies must be allocated
17 to principal if its due date occurs before a decedent dies in
18 the case of an estate, or before an income interest begins in
19 the case of a trust or successive income interest.
20 2. An income receipt or disbursement must be allocated to
21 income if its due date occurs on or after the date on which a
22 decedent dies or an income interest begins and it is a
23 periodic due date. An income receipt or disbursement must be
24 treated as accruing from day to day if its due date is not
25 periodic or it has no due date. The portion of the receipt or
26 disbursement accruing before the date on which a decedent dies
27 or an income interest begins must be allocated to principal
28 and the balance must be allocated to income.
29 3. An item of income or an obligation is due on the date
30 on which the payor is required to make a payment. If there is
31 no stated payment date, there is no due date for the purposes
32 of this chapter. Distributions to shareholders or other
33 owners from an entity to which section 637.401 applies are
34 deemed to be due on the date fixed by the entity for
35 determining who is entitled to receive the distribution or, if

1 no date is fixed, on the declaration date for the
2 distribution. A due date is periodic for receipts or
3 disbursements that must be paid at regular intervals under a
4 lease or an obligation to pay interest or if an entity
5 customarily makes distributions at regular intervals.
6 Sec. 9. NEW SECTION. 637.303 APPORTIONMENT WHEN INCOME
7 INTEREST ENDS.
8 1. For purposes of this section, "undistributed income"
9 means net income received before the date on which an income
10 interest ends. The term does not include an item of income or
11 expense that is due or accrued or net income that has been
12 added or is required to be added to principal pursuant to the
13 terms of the trust.
14 2. When a mandatory income interest ends, the trustee
15 shall pay to a mandatory income beneficiary who survives that
16 date, or the estate of a deceased mandatory income beneficiary
17 whose death causes the interest to end, the beneficiary's
18 share of the undistributed income that is not disposed of
19 pursuant to the terms of the trust unless the beneficiary has
20 an unqualified power to revoke more than five percent of the
21 trust immediately before the income interest ends. In the
22 latter case, the undistributed income from the portion of the
23 trust that may be revoked must be added to principal.
24 3. When a trustee's obligation to pay a fixed annuity or a
25 fixed fraction of the value of the trust's assets ends, the
26 trustee shall prorate the final payment if and to the extent
27 required by applicable law to accomplish a purpose of the
28 trust or its settlor relating to income, gift, estate, or
29 other tax requirements.
30 SUBCHAPTER 4
31 ADMINISTRATION OF TRUST
32 Part 1
33 RECEIPTS FROM ENTITIES
34 Sec. 10. NEW SECTION. 637.401 CHARACTER OF RECEIPTS.
35 1. For purposes of this section, "entity" means a

1 corporation, partnership, joint venture, limited liability
2 company, regulated investment company, real estate investment
3 trust, common trust fund, and any other organization in which
4 a trustee has an interest other than a trust or estate to
5 which section 637.402 applies or a business or activity to
6 which section 637.403 applies.
7 2. Except as otherwise provided in this section, cash
8 received by a trustee from an entity must be allocated to
9 income.
10 3. Receipts from an entity which must be allocated to
11 principal include the following items:
12 a. Property other than cash, except as otherwise provided
13 in paragraph "d".
14 b. Cash or property received in one distribution or a
15 series of related distributions in exchange for part or all of
16 a trust's interest in the entity.
17 c. Cash or property received in total or partial
18 liquidation of the entity.
19 d. Cash or property received from an entity that is a
20 regulated investment company or a real estate investment trust
21 if the distribution is a capital gain dividend for federal
22 income tax purposes.
23 4. Cash or property is received in partial liquidation
24 according to one of the following principles:
25 a. To the extent that the entity, at or near the time of a
26 distribution, indicates that it is a distribution in partial
27 liquidation.
28 b. If the total amount received in a distribution or
29 series of related distributions is greater than twenty percent
30 of the entity's gross assets, as shown by the entity's year-
31 end financial statements immediately preceding the initial
32 receipt.
33 5. Cash shall not be received in partial liquidation, nor
34 shall it be taken into account under subsection 4, paragraph
35 "b", to the extent that it does not exceed the amount of

1 income tax that a trustee or beneficiary must pay on taxable
2 income of the entity that distributes the cash.
3 6. A trustee may rely upon a statement made by an entity
4 about the source or character of a distribution if the
5 statement is made at or near the time of distribution by the
6 entity's board of directors or other person or group of
7 persons authorized to exercise powers to pay money or transfer
8 property comparable to those of a corporation's board of
9 directors.
10 Sec. 11. NEW SECTION. 637.402 DISTRIBUTION FROM TRUST OR
11 ESTATE.
12 1. Subject to the terms of a recipient trust, an amount
13 received as a distribution of income from a trust or an estate
14 in which the trust has an interest other than a purchased
15 interest shall be allocated to income.
16 2. An amount received as a distribution of principal from
17 such a trust or estate shall be allocated to principal.
18 3. If a trustee purchases an interest in a trust that is
19 an investment entity, or a decedent or donor transfers an
20 interest in such a trust to a trustee, section 637.401 applies
21 to a receipt from the trust.
22 Sec. 12. NEW SECTION. 637.403 BUSINESS AND OTHER
23 ACTIVITIES CONDUCTED BY TRUSTEE.
24 1. If a trustee who conducts a business or other activity
25 determines that it is in the best interest of all the
26 beneficiaries to account separately for the business or
27 activity instead of accounting for it as part of the trust's
28 general accounting records, the trustee may maintain separate
29 accounting records for its transactions, whether or not its
30 assets are segregated from other trust assets.
31 2. A trustee who accounts separately for a business or
32 other activity shall determine the extent to which its net
33 cash receipts must be retained for working capital, the
34 acquisition or replacement of fixed assets, and other
35 reasonably foreseeable needs of the business or activity, and

1 the extent to which the remaining net cash receipts are
2 accounted for as principal or income in the trust's general
3 accounting records. If a trustee sells assets of the business
4 or other activity, other than in the ordinary course of the
5 business or activity, the trustee shall account for the net
6 amount received as principal in the trust's general accounting
7 records to the extent the trustee determines that the amount
8 received is no longer required in the conduct of the business.
9 3. The trustee may maintain separate accounting records
10 for any of the following activities:
11 a. Retail, manufacturing, service, and other traditional
12 business activities.
13 b. Farming.
14 c. Raising and selling livestock and other animals.
15 d. Management of rental properties.
16 e. Extraction of minerals and other natural resources.
17 f. Timber operations.
18 g. Activities to which section 637.426 applies.
19 Part 2
20 RECEIPTS NOT NORMALLY APPORTIONED
21 Sec. 13. NEW SECTION. 637.410 PRINCIPAL RECEIPTS.
22 The following items must be allocated to principal:
23 1. To the extent not allocated to income under this
24 chapter, assets received from any of the following sources:
25 a. A transferor during the transferor's lifetime.
26 b. A decedent's estate.
27 c. A trust with a terminating income interest.
28 d. A payor pursuant to a contract naming the trust or its
29 trustee as beneficiary.
30 2. Cash or other property received from the sale,
31 exchange, liquidation, or change in form of a principal asset,
32 including realized profit, subject to this subchapter.
33 3. Amounts recovered from third parties to reimburse the
34 trust because of disbursements described in section 637.502,
35 subsection 1, paragraph "g", or for other reasons to the

1 extent not based on the loss of income.
2 4. Proceeds of property taken by eminent domain, but a
3 separate award made for the loss of income with respect to an
4 accounting period during which a current income beneficiary
5 had a mandatory income interest is income.
6 5. Net income received in a period during which there is
7 no beneficiary to whom a trustee may or must distribute
8 income.
9 6. Other receipts, as provided in part 3.
10 Sec. 14. NEW SECTION. 637.411 RENTAL PROPERTY.
11 1. An amount received as rent of real or personal
12 property, including an amount received for cancellation or
13 renewal of a lease, must be allocated to income.
14 2. An amount received as a refundable deposit, including a
15 security deposit or a deposit that is to be applied as rent
16 for future periods, must be added to principal and held
17 subject to the terms of the lease and is not available for
18 distribution to a beneficiary until the trustee's contractual
19 obligations have been satisfied with respect to that amount.
20 Sec. 15. NEW SECTION. 637.412 OBLIGATION TO PAY MONEY.
21 1. An amount received as interest, whether determined at a
22 fixed, variable, or floating rate, on an obligation to pay
23 money to the trustee, including an amount received as
24 consideration for prepaying principal, must be allocated to
25 income without any provision for amortization of premium.
26 2. An amount received from the sale, redemption, or other
27 disposition of an obligation to pay money to the trustee more
28 than one year after it is purchased or acquired by the
29 trustee, including an obligation whose purchase price or value
30 when it is acquired is less than its value at maturity, must
31 be allocated to principal. If the obligation matures within
32 one year after it is purchased or acquired by the trustee, an
33 amount received in excess of its purchase price or its value
34 when acquired by the trust must be allocated to income.
35 3. This section does not apply to obligations to which

1 sections 637.421 through 637.424, 637.426, and 637.427 apply.
2 Sec. 16. NEW SECTION. 637.413 INSURANCE POLICIES AND
3 SIMILAR CONTRACTS.
4 1. Proceeds from a life insurance policy whose beneficiary
5 is the trust or its trustee or a policy that insures the trust
6 or its trustee against loss for the damage or destruction of,
7 or loss of title to, a principal asset must be allocated to
8 principal. Dividends received from an insurance policy and
9 the proceeds of any other contract in which the trust or its
10 trustee is named as beneficiary must also be allocated to
11 principal.
12 2. Insurance proceeds must be allocated to income if they
13 are from a policy that insures the trustee against the loss of
14 occupancy or other use by an income beneficiary, the loss of
15 income, or, subject to section 637.403, the loss of profits
16 from a business.
17 3. This section does not apply to a contract to which
18 section 637.421 applies.
19 Part 3
20 RECEIPTS NORMALLY APPORTIONED
21 Sec. 17. NEW SECTION. 637.420 INSUBSTANTIAL ALLOCATIONS
22 NOT REQUIRED.
23 1. If a trustee determines that an allocation between
24 principal and income required by sections 637.421 through
25 637.424 or section 637.427 is insubstantial, the trustee may
26 allocate the entire receipt to principal if one of the
27 circumstances described in section 637.104, subsection 3, does
28 not apply to such an allocation. This power may be exercised
29 by a cotrustee in the circumstances described in section
30 637.104, subsection 4, and it may be released for the reasons
31 and in the manner described in section 637.104, subsection 3.
32 2. An allocation is presumed to be insubstantial if either
33 of the following would be true if an allocation was made:
34 a. The amount of the allocation would increase or decrease
35 an accounting period's net income, as determined before the

1 allocation, by less than ten percent.
2 b. The value of the asset producing the receipt for which
3 the allocation would be made is less than ten percent of the
4 total value of the trust's assets at the beginning of the
5 accounting period.
6 Sec. 18. NEW SECTION. 637.421 DEFERRED COMPENSATION,
7 ANNUITIES, AND SIMILAR PAYMENTS.
8 1. This section applies to payments that a trustee may
9 receive over a fixed number of years or during the life of one
10 or more individuals because of services rendered or property
11 transferred to the payor in exchange for future payments. The
12 payments include those made in cash or property from the
13 payor's general assets or from a separate fund created by the
14 payor, including a private or commercial annuity, an
15 individual retirement account, and a pension, profit sharing,
16 stock bonus, or stock ownership plan. This section does not
17 apply to payments to which section 637.422 applies.
18 2. To the extent that a payment is characterized as
19 interest or a dividend or a payment made in lieu of interest
20 or a dividend, it must be allocated to income. The balance of
21 the payment and any other payment received in the same
22 accounting period that is not characterized as interest, a
23 dividend, or an equivalent payment must be allocated to
24 principal.
25 3. If no part of a payment is characterized as interest, a
26 dividend, or an equivalent payment, and all or part of the
27 payment is required to be made, a trustee shall allocate to
28 income ten percent of the part that is required to be made
29 during the accounting period and the balance to principal. If
30 no part of a payment is required to be made or the payment
31 received is the entire amount to which the trustee is
32 entitled, the entire payment must be allocated to principal.
33 4. If, to obtain an estate tax marital deduction for a
34 trust, a trustee must allocate more of a payment to income
35 than provided for by this section, the trustee shall allocate

1 to income the additional amount necessary to obtain the
2 marital deduction.
3 Sec. 19. NEW SECTION. 637.422 LIQUIDATING ASSET.
4 1. In this section, "liquidating asset" means an asset
5 whose value will diminish or terminate because the asset is
6 expected to produce receipts for a period of limited duration.
7 The term includes leaseholds, patents, trademarks, copyrights,
8 royalty rights, and rights to receive payments during a period
9 of more than one year under an arrangement that does not
10 provide for the payment of interest on the unpaid balance.
11 The term does not include deferred compensation that is
12 subject to section 637.421, natural resources that are subject
13 to section 637.423, timber that is subject to section 637.424,
14 an activity that is subject to section 637.426, or any asset
15 for which the trustee establishes a reserve for depreciation
16 under section 637.503.
17 2. A trustee shall allocate to income ten percent of the
18 receipts from a liquidating asset and the balance to
19 principal.
20 Sec. 20. NEW SECTION. 637.423 MINERALS, WATER, AND OTHER
21 NATURAL RESOURCES.
22 1. Receipts from an interest in minerals or other natural
23 resources must be allocated according to the type of payment,
24 as follows:
25 a. If received as nominal delay rental or annual rent on a
26 lease, a receipt must be allocated to income.
27 b. If received from a production payment, a receipt must
28 be allocated to income to the extent that the agreement
29 creating the production payment provides a factor for interest
30 or its equivalent. The balance must be allocated to
31 principal.
32 c. If an amount received as a royalty, bonus, or delay
33 rental is more than nominal, ninety percent must be allocated
34 to principal and the balance to income.
35 d. If an amount is received from a working interest or any

1 other interest not provided for in paragraph "a", "b", or "c",
2 ninety percent of the net amount received must be allocated to
3 principal and the balance to income.
4 2. An amount received on account of an interest in water
5 that is renewable must be allocated to income. If the water
6 is not renewable, ninety percent of the amount must be
7 allocated to principal and the balance to income.
8 3. This chapter applies without regard to whether a
9 decedent or donor was extracting minerals, water, or other
10 natural resources before the interest became subject to the
11 trust.
12 4. If a trust owns an interest in minerals, water, or
13 other natural resources on or before July 1, 1999, the trustee
14 may allocate receipts from the interest as provided in this
15 section or in the manner used by the trustee before July 1,
16 1999. If the trust acquires an interest in minerals, water,
17 or other natural resources after July 1, 1999, the trustee
18 shall allocate receipts from the interest as provided in this
19 section.
20 Sec. 21. NEW SECTION. 637.424 TIMBER.
21 1. A trustee may account for net receipts from the sale of
22 timber and related products under subsection 2 or section
23 637.403 or, if the trustee determines that net receipts are
24 insubstantial, may allocate the net receipts to principal.
25 The presumptions in section 637.420 apply in determining
26 whether net receipts are insubstantial. If a trust owns more
27 than one block of timberland, the trustee may use different
28 methods to account for net receipts from different blocks.
29 2. If a trustee does not account under section 637.403 for
30 net receipts from the sale of timber and related products or
31 allocate the net receipts to principal because they are
32 insubstantial, the trustee shall allocate the net receipts
33 according to one of the following rules:
34 a. Allocate the net receipts to income to the extent that
35 the amount of timber removed from the land does not exceed the

1 rate of growth of the block as a whole during the accounting
2 periods in which a beneficiary has a mandatory income
3 interest.
4 b. Allocate the net receipts to principal to the extent
5 that the amount of timber removed from the land exceeds the
6 block's rate of growth or the net receipts are from the sale
7 of standing timber.
8 c. Allocate the net receipts to or between income and
9 principal if the net receipts are from the lease of timberland
10 or from a contract to cut timber from land owned by a trust,
11 by determining the amount of timber removed from the land
12 under the lease or contract and applying the rules in
13 paragraphs "a" and "b".
14 d. Allocate the net receipts to principal to the extent
15 that advance payments, bonuses, and other payments are not
16 allocated pursuant to paragraph "a", "b", or "c".
17 3. In determining the net receipts from the sale of
18 timber, a trustee shall deduct and transfer to principal a
19 reasonable amount for depletion.
20 4. This chapter applies regardless of whether a decedent
21 or transferor was harvesting timber from the property before
22 it became subject to the trust.
23 5. If a trust owns an interest in timberland on or before
24 July 1, 1999, the trustee may allocate net receipts from the
25 sale of timber and related products as provided in this
26 section or in the manner used by the trustee before July 1,
27 1999. If the trust acquires an interest in timberland after
28 July 1, 1999, the trustee shall allocate net receipts from the
29 sale of timber and related products as provided in this
30 section.
31 Sec. 22. NEW SECTION. 637.425 PROPERTY NOT PRODUCTIVE OF
32 INCOME.
33 1. If a marital deduction is allowed for all or part of a
34 trust whose assets consist substantially of property that does
35 not provide the surviving spouse with sufficient income from

1 or use of the trust assets, and if the amounts that the
2 trustee transfers from principal to income under section
3 637.104 and distributes to the spouse from principal pursuant
4 to the terms of the trust are insufficient to provide the
5 spouse with the beneficial enjoyment required to obtain the
6 marital deduction, the spouse may require the trustee to make
7 property productive of income, convert property within a
8 reasonable time, or exercise the power conferred by section
9 637.104, subsection 1. The trustee may decide which action or
10 combination of actions to take.
11 2. In all other cases, proceeds from the sale or other
12 disposition of an asset are principal without regard to the
13 amount of income the asset produces during any accounting
14 period.
15 Sec. 23. NEW SECTION. 637.426 DERIVATIVES AND OPTIONS.
16 1. For purposes of this section, "derivative" means a
17 contract or financial instrument or a combination of contracts
18 and financial instruments which gives a trust the right or
19 obligation to participate in some or all changes in the price
20 of a tangible or intangible asset or group of assets, or
21 changes in a rate, an index of prices or rates, or other
22 market indicator for an asset or a group of assets.
23 2. To the extent that a trustee does not account under
24 section 637.403 for transactions in derivatives, receipts from
25 and disbursements made in connection with those transactions
26 must be allocated to principal.
27 3. If a trustee grants an option to buy property from the
28 trust, whether or not the trust owns the property when the
29 option is granted, grants an option that permits another
30 person to sell property to the trust, or acquires an option to
31 buy property for the trust or an option to sell an asset owned
32 by the trust, and the trustee or other owner of the asset is
33 required to deliver the asset if the option is exercised, an
34 amount received for granting the option must be allocated to
35 principal, and an amount paid to acquire the option must be

1 paid from principal. A gain or loss realized upon the
2 exercise of an option, including an option granted to a
3 settlor of the trust for services rendered, must be allocated
4 to principal.
5 Sec. 24. NEW SECTION. 637.427 ASSET-BACKED SECURITIES.
6 1. For purposes of this section, "asset-backed security"
7 means an asset whose value is based upon the right it gives
8 the owner to receive distributions from the proceeds of
9 financial assets that provide collateral for the security.
10 The term includes an asset that gives the owner the right to
11 receive only the interest or other current return from the
12 collateral financial assets or only the proceeds from the
13 capital investment in the collateral financial assets. It
14 does not include an asset to which section 637.401 or 637.421
15 applies.
16 2. If a trust receives a payment from the interest or
17 other current return and the capital investment of the
18 collateral financial assets, the trustee shall allocate to
19 income the portion of a payment that the payor identifies as
20 being from the interest or other current return, and shall
21 allocate the balance of the payment to principal.
22 3. If a trust receives one or more payments in exchange
23 for the trust's entire interest in an asset-backed security in
24 one accounting period, the trustee shall allocate the payments
25 to principal. If a payment is one of a series of payments
26 that will result in the liquidation of the trust's interest in
27 the security over more than one accounting period, the trustee
28 shall allocate ten percent of the payment to income and the
29 balance to principal.
30 SUBCHAPTER 5
31 ALLOCATION OF DISBURSEMENTS DURING
32 ADMINISTRATION OF TRUST
33 Sec. 25. NEW SECTION. 637.501 DISBURSEMENTS FROM INCOME.
34 A trustee shall make disbursements from income, to the
35 extent that they are not disbursements to which section

1 637.201, subsection 2, paragraph "b" or "c", applies,
2 according to the following:
3 1. One-half of the regular compensation of the trustee and
4 of any person providing investment advisory or custodial
5 services to the trustee.
6 2. One-half of all expenses for accountings, judicial
7 proceedings, or other matters that involve both the income and
8 remainder interests.
9 3. All of the other ordinary expenses incurred in
10 connection with the administration, management, or
11 preservation of trust property and the distribution of income,
12 including interest, ordinary repairs, regularly recurring
13 taxes assessed against principal, and expenses of a proceeding
14 or other matter that concerns primarily the income interest.
15 4. Recurring premiums on insurance covering the loss of a
16 principal asset or the loss of income from or use of the
17 asset.
18 Sec. 26. NEW SECTION. 637.502 DISBURSEMENTS FROM
19 PRINCIPAL.
20 1. A trustee shall make disbursements from principal
21 according to the following:
22 a. The remaining one-half of the disbursements described
23 in section 637.501, subsections 1 and 2.
24 b. All of the trustee's compensation calculated on
25 principal as an acceptance, distribution, or termination fee,
26 and disbursements made to prepare property for sale.
27 c. Payments on the principal of a trust debt.
28 d. Expenses of a proceeding that concerns primarily
29 principal, including a proceeding to construe the trust or to
30 protect the trust or its property.
31 e. Insurance premiums paid on a policy not described in
32 section 637.501, subsection 4, of which the trust is the owner
33 and beneficiary.
34 f. Estate, inheritance, and other transfer taxes,
35 including penalties, apportioned to the trust.

1 g. Disbursements related to environmental matters,
2 including reclamation, assessing environmental conditions,
3 remedying and removing environmental contamination, monitoring
4 remedial activities and the release of substances, preventing
5 future releases of substances, collecting amounts from persons
6 liable or potentially liable for the costs of those
7 activities, penalties imposed under environmental laws or
8 regulations and other payments made to comply with those laws
9 or regulations, statutory or common law claims by third
10 parties, and defending claims based on environmental matters.
11 2. If a trust owns a policy of insurance on the life of an
12 individual and the trust is not the beneficiary of the policy,
13 premiums paid on the policy are a distribution from principal
14 to the policy beneficiary.
15 3. If a principal asset is encumbered with an obligation
16 that requires income from that asset to be paid directly to
17 the creditor, the trustee shall transfer from principal to
18 income an amount equal to the income paid to the creditor in
19 reduction of the obligation's principal balance.
20 Sec. 27. NEW SECTION. 637.503 TRANSFERS FROM INCOME TO
21 PRINCIPAL FOR DEPRECIATION.
22 1. For purposes of this section, "depreciation" means a
23 reduction in value of a fixed asset having a useful life of
24 more than one year due to wear, tear, decay, corrosion, or
25 gradual obsolescence.
26 2. A trustee may transfer to principal a reasonable amount
27 of the net cash receipts from a principal asset that is
28 subject to depreciation, but a transfer shall not be made for
29 depreciation under any of the following circumstances:
30 a. When the depreciation involves the portion of real
31 property used or available for use by a beneficiary as a
32 residence, or tangible personal property held or made
33 available for the personal use or enjoyment of a beneficiary.
34 b. When the depreciation occurs during the administration
35 of a decedent's estate.

1 c. If the trustee is accounting under section 637.403 for
2 the business or activity in which the asset is used.
3 3. An amount transferred to principal need not be held as
4 a separate fund.
5 Sec. 28. NEW SECTION. 637.504 TRANSFERS FROM INCOME TO
6 REIMBURSE PRINCIPAL.
7 1. If a trustee makes or expects to make a principal
8 disbursement described in this section, the trustee may
9 transfer an appropriate amount from income to principal in one
10 or more accounting periods to reimburse principal or to
11 provide a reserve for future principal disbursements.
12 2. Principal disbursements to which subsection 1 applies
13 include all of the following, but only to the extent that the
14 trustee has not been and does not expect to be reimbursed by a
15 third party:
16 a. An amount chargeable to income but paid from principal
17 because it is unusually large, including extraordinary
18 repairs.
19 b. A capital improvement to a principal asset, whether in
20 the form of changes to an existing asset or the construction
21 of a new asset, including special assessments.
22 c. Disbursements made to prepare property for rental,
23 including leasehold improvements and broker's commissions.
24 d. Periodic payments on an obligation secured by a
25 principal asset to the extent that the amount transferred from
26 income to principal for depreciation is less than the periodic
27 payments.
28 e. Disbursements described in section 637.502, subsection
29 1, paragraph "g".
30 3. If the asset whose ownership gives rise to the
31 disbursements becomes subject to a successive income interest
32 after an income interest ends, a trustee may continue to
33 transfer amounts from income to principal as provided in
34 subsection 1.
35 Sec. 29. NEW SECTION. 637.505 INCOME TAXES.

1 1. A tax required to be paid by a trustee based on
2 receipts allocated to income must be paid from income.
3 2. A tax required to be paid by a trustee based on
4 receipts allocated to principal must be paid from principal,
5 even if the tax is called an income tax by the taxing
6 authority.
7 3. A tax required to be paid by a trustee on the trust's
8 share of an entity's taxable income must be paid
9 proportionately, according to all of the following principles:
10 a. From income, to the extent that receipts from the
11 entity are allocated to income.
12 b. From principal, to the extent that the following
13 principles are observed:
14 (1) Receipts from the entity are allocated to principal.
15 (2) The trust's share of the entity's taxable income
16 exceeds the total receipts in paragraph "a" and in
17 subparagraph (1).
18 4. For purposes of this section, receipts allocated to
19 principal or income shall be reduced by the amount distributed
20 to a beneficiary from principal or income for which the trust
21 receives a deduction in calculating the tax.
22 Sec. 30. NEW SECTION. 637.506 ADJUSTMENTS BETWEEN
23 PRINCIPAL AND INCOME BECAUSE OF TAXES.
24 1. A fiduciary may make adjustments between principal and
25 income to offset the shifting of economic interests or tax
26 benefits between income beneficiaries and remainder
27 beneficiaries which arise from any of the following:
28 a. Elections and decisions, other than those described in
29 subsection 2, that the fiduciary makes from time to time
30 regarding tax matters.
31 b. An income tax or any other tax that is imposed upon the
32 fiduciary or a beneficiary as a result of a transaction
33 involving or a distribution from the estate or trust.
34 c. The ownership by an estate or trust of an interest in
35 an entity whose taxable income, whether or not distributed, is

1 includable in the taxable income of the estate, trust, or a
2 beneficiary.
3 2. If the amount of an estate tax marital deduction or
4 charitable contributions deduction is reduced because a
5 fiduciary deducts an amount that is paid from principal for
6 income tax purposes instead of deducting it for estate tax
7 purposes, and as a result estate taxes paid from principal are
8 increased and income taxes paid by an estate, trust, or
9 beneficiary are decreased, each estate, trust, or beneficiary
10 that benefits from the decrease in income tax shall reimburse
11 the principal from which the increase in estate tax is paid.
12 The total reimbursement must equal the increase in the estate
13 tax to the extent that the principal used to pay the increase
14 would have qualified for a martial deduction or charitable
15 contributions deduction but for the payment. The
16 proportionate share of the reimbursement for each estate,
17 trust, or beneficiary whose income taxes are reduced must be
18 the same as its proportionate share of the total decrease in
19 income tax. An estate or trust shall reimburse principal from
20 income.
21 SUBCHAPTER 6
22 MISCELLANEOUS PROVISIONS
23 Sec. 31. NEW SECTION. 637.601 APPLICATION OF CHAPTER TO
24 EXISTING TRUSTS AND ESTATES -- CHAPTER PREVAILS.
25 This chapter applies to every trust or decedent's estate on
26 and after July 1, 1999, except as otherwise expressly provided
27 in the will, the terms of the trust, or in this chapter.
28 Notwithstanding any Code provision to the contrary, the
29 provisions of this chapter shall prevail over any other
30 applicable Code provision.
31 Sec. 32. Section 633.103, Code 1999, is repealed.
32 EXPLANATION
33 This bill enacts the uniform principal and interest Act, as
34 revised by the national conference of commissioners on uniform
35 state laws in 1997. Certain technical changes have been made

1 to adjust the format of the uniform Act so that it complies
2 with the general style of the Iowa Code.
3 Subchapter 1 contains the short title of the Act, relevant
4 definitions, and general principles regarding fiduciary duties
5 and the powers of the trustee.
6 Subchapter 2 addresses distribution issues at the end of a
7 trust.
8 Subchapter 3 addresses apportionment issues at the
9 beginning and the end of income interest.
10 Subchapter 4 contains three parts addressing allocation of
11 receipts during the administration of a trust. Part 1
12 pertains to allocation of receipts from entities. Part 2
13 addresses receipts that are not normally apportioned but are
14 allocated wholly to principal or income. Part 3 addresses
15 receipts that are normally apportioned between principal and
16 income.
17 Subchapter 5 addresses the issue of disbursements during
18 the administration of a trust, including disbursements from
19 principal and from income, in general, as well as certain
20 transfers and the payment of taxes.
21 The bill contains an applicability provision, making the
22 bill applicable to trusts and estates on and after July 1,
23 1999, except as provided in the will, the terms of the trust,
24 or in particular sections of the bill. This chapter prevails
25 over any other applicable Code provision.
26 A corresponding repeal is made of one Code section that
27 specified allocations to principal and income.
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5-3/17/99 Judiciary
5-3/31/99 Do Pass

MAR 10 1999

Place On Calendar

HOUSE FILE 584
BY COMMITTEE ON JUDICIARY

(SUCCESSOR TO HSB 174)

Passed House, (P. 716) Date 3-17-99 Passed Senate, (P. 1144) Date 4/15/99
Vote: Ayes 95 Nays 0 Vote: Ayes 47 Nays 0
Approved 5/14-99

A BILL FOR

1 An Act relating to the uniform principal and income Act and
2 providing for its applicability.
3 BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:
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1 CHAPTER 637
2 UNIFORM PRINCIPAL AND INCOME ACT
3 SUBCHAPTER 1
4 DEFINITIONS AND FIDUCIARY DUTIES
5 Section 1. NEW SECTION. 637.101 SHORT TITLE.
6 This Act may be cited as the "Uniform Principal and Income
7 Act".
8 Sec. 2. NEW SECTION. 637.102 DEFINITIONS.
9 As used in this chapter:
10 1. "Accounting period" means a calendar year, unless
11 another twelve-month period is selected by a fiduciary. The
12 term includes a portion of a calendar year or other twelve-
13 month period that begins when an income interest begins or
14 ends when an income interest ends.
15 2. "Beneficiary" includes, in the case of a decedent's
16 estate, an heir, legatee, and devisee, and, in the case of a
17 trust, an income beneficiary and a remainder beneficiary.
18 3. "Fiduciary" means a personal representative or a
19 trustee. The term includes an executor, administrator,
20 successor personal representative, special administrator, and
21 a person performing substantially the same function.
22 4. "Income" means money or property a fiduciary receives
23 as the current return from a principal asset. The term
24 includes a portion of the receipts from a sale, exchange, or
25 liquidation of a principal asset, to the extent provided in
26 subchapter 4.
27 5. "Income beneficiary" means a person to whom a trust's
28 net income is or may be payable.
29 6. "Income interest" means an income beneficiary's right
30 to receive all or part of the net income, whether the terms of
31 the trust require it to be distributed or authorize it to be
32 distributed in the trustee's discretion.
33 7. "Mandatory income interest" means an income
34 beneficiary's right to receive net income that the terms of
35 the trust require the fiduciary to distribute.

1 8. "Net income" means the total receipts allocated to
2 income during an accounting period minus the disbursements
3 made from income during the period. In this definition,
4 receipts and disbursements include items transferred to or
5 from income during the period under this chapter.
6 9. "Person" means an individual, corporation, business
7 trust, estate, trust, partnership, limited liability company,
8 association, joint venture, or any other legal or commercial
9 entity. The term does not include a government or
10 governmental subdivision, agency, or instrumentality.
11 10. "Principal" means property held in trust for
12 distribution to a remainder beneficiary when the trust
13 terminates.
14 11. "Remainder beneficiary" means a person, including
15 another trust, entitled to receive principal when an income
16 interest ends.
17 12. "Terms of a trust" means the manifestation of the
18 intent of a settlor or decedent with respect to the trust,
19 expressed in a manner that admits of its proof in a judicial
20 proceeding, whether by written or spoken words or by conduct.
21 13. "Trustee" includes an original, additional, or
22 successor trustee, whether or not appointed or confirmed by a
23 court.
24 Sec. 3. NEW SECTION. 637.103 FIDUCIARY DUTIES -- GENERAL
25 PRINCIPLES.
26 1. In allocating receipts and disbursements to or between
27 principal and income, and in any matter within the scope of
28 subchapters 2 and 3, a fiduciary shall do all of the
29 following:
30 a. Administer a trust or estate in accordance with the
31 terms of the trust or the will, even if there is a different
32 provision in this chapter.
33 b. Administer a trust or estate by the exercise of a
34 discretionary power of administration given the fiduciary by
35 the terms of the trust or the will, although the fiduciary may

1 exercise that power in a manner different from a provision of
2 this chapter.
3 c. Administer a trust or estate in accordance with this
4 chapter if the terms of the trust or the will do not contain a
5 different provision or do not give the fiduciary a
6 discretionary power of administration.
7 d. Add a receipt or charge a disbursement to principal to
8 the extent that the terms of the trust and this chapter do not
9 provide a rule for allocating the receipt or disbursement to
10 or between principal and income.
11 2. In exercising a discretionary power of administration
12 regarding a matter within the scope of this chapter, whether
13 granted by the terms of a trust, a will, or this chapter, a
14 fiduciary shall administer a trust or estate impartially,
15 based on what is fair and reasonable to all of the
16 beneficiaries, unless the terms of the trust or the will
17 clearly manifest an intention that the fiduciary shall or may
18 favor one or more of the beneficiaries. A determination in
19 accordance with this chapter is presumed to be fair and
20 reasonable to all of the beneficiaries.
21 SUBCHAPTER 2
22 DECEDENT'S ESTATE OR TERMINATING INCOME INTEREST
23 Sec. 4. NEW SECTION. 637.201 DETERMINATION AND
24 DISTRIBUTION OF NET INCOME.
25 After a decedent dies, in the case of an estate, or after
26 an income interest in a trust ends, the following rules apply:
27 1. A fiduciary of an estate or a terminating income
28 interest shall determine the amount of net income and net
29 principal receipts received from property specifically given
30 to a beneficiary under the rules in subchapters 3 through 5
31 that apply to trustees, and under the rules in subsection 5.
32 The fiduciary shall distribute the net income and net
33 principal receipts to the beneficiary who is to receive the
34 specific property.
35 2. A fiduciary shall determine the remaining net income of

1 a decedent's estate or a terminating income interest under the
2 rules in subchapters 3 through 5 that apply to trustees, and
3 by doing the following:
4 a. Including in net income all income from property used
5 to discharge liabilities.
6 b. Paying from income or principal, in the fiduciary's
7 discretion, fees of attorneys, accountants, and fiduciaries;
8 court costs and other expenses of administration; and interest
9 on death taxes, but the fiduciary may pay those expenses from
10 income of property passing to a trust for which the fiduciary
11 claims an estate tax marital or charitable deduction only to
12 the extent that the payment of those expenses from income will
13 not cause the loss of the deduction.
14 c. Paying from principal all other disbursements made or
15 incurred in connection with the settlement of a decedent's
16 estate or the winding up of a terminating income interest,
17 including debts, funeral expenses, disposition of remains,
18 family allowances, and death taxes and related penalties that
19 are apportioned to the estate or terminating income interest
20 by the will, the terms of the trust, or applicable law.
21 3. A fiduciary shall distribute to a beneficiary who
22 receives a pecuniary amount outright the amount, if any,
23 provided by the will, the terms of the trust, or applicable
24 law, from net income determined under subsection 2 or from
25 principal to the extent the net income is insufficient. If a
26 beneficiary is to receive a pecuniary amount outright from a
27 trust after an income interest ends and no amount is provided
28 for by the terms of the trust or applicable law, the fiduciary
29 shall distribute the amount to which the beneficiary would be
30 entitled under applicable law if the pecuniary amount were
31 required to be paid under a will.
32 4. A fiduciary shall distribute the net income remaining
33 after distributions required by subsection 3 in the manner
34 described in section 637.202 to all other beneficiaries,
35 including a beneficiary who receives a pecuniary amount in

1 trust, even if the beneficiary holds an unqualified power to
2 withdraw assets from the trust or other presently exercisable
3 general power of appointment over the trust.
4 5. A fiduciary shall not reduce principal or income
5 receipts from property described in subsection 1 because of a
6 payment described in section 637.501 or 637.502 to the extent
7 that the will, the terms of the trust, or applicable law
8 requires the fiduciary to make the payment from assets other
9 than the property or to the extent that the fiduciary recovers
10 or expects to recover the payment from a third party. The
11 property's net income and principal receipts are determined by
12 including all of the amounts the fiduciary receives or pays
13 with respect to the property, whether those amounts accrued or
14 became due before, on, or after the date of a decedent's death
15 or an income interest's terminating event, and by making a
16 reasonable provision for amounts that the fiduciary believes
17 the estate or terminating income interest may become obligated
18 to pay after the property is distributed.
19 Sec. 5. NEW SECTION. 637.202 DISTRIBUTION TO RESIDUARY
20 AND REMAINDER BENEFICIARIES.
21 1. Each beneficiary described in section 637.201,
22 subsection 4, is entitled to receive a portion of the net
23 income equal to the beneficiary's fractional interest in
24 undistributed principal assets, using values as of the
25 distribution date. If a fiduciary makes more than one
26 distribution of assets to beneficiaries to whom this section
27 applies, each beneficiary, including one who does not receive
28 part of the distribution, is entitled, as of each distribution
29 date, to the net income the fiduciary has received after the
30 date of death or terminating event or earlier distribution
31 date but has not distributed as of the current distribution
32 date.
33 2. In determining a beneficiary's share of net income, the
34 following rules apply:
35 a. The beneficiary is entitled to receive a portion of the

1 net income equal to the beneficiary's fractional interest in
2 the undistributed principal assets immediately before the
3 distribution date, including assets that later may be sold to
4 meet principal obligations.
5 b. The beneficiary's fractional interest in the
6 undistributed principal assets must be calculated without
7 regard to property specifically given to a beneficiary and
8 property required to be pay pecuniary amounts not in trust.
9 c. The beneficiary's fractional interest in the
10 undistributed principal assets must be calculated on the basis
11 of the aggregate value of those assets as of the distribution
12 date without reducing the value by any unpaid principal
13 obligation.
14 d. The distribution date for purposes of this section may
15 be the date as of which the fiduciary calculates the value of
16 the assets if that date is reasonably near the date on which
17 assets are actually distributed.
18 3. The rules in this section apply to net gain or loss
19 realized after the date of death or terminating event or
20 earlier distribution date from the disposition of a principal
21 asset if this section applies to the income from the asset.
22 4. If a fiduciary does not distribute all of the collected
23 but undistributed net income or gain to each person as of a
24 distribution date, the fiduciary shall maintain appropriate
25 records showing the interest of each beneficiary in that net
26 income or gain.
27 SUBCHAPTER 3
28 APPORTIONMENT AT BEGINNING AND END OF INCOME INTEREST
29 Sec. 6. NEW SECTION. 637.301 WHEN RIGHT TO INCOME BEGINS
30 AND ENDS.
31 1. An income beneficiary is entitled to net income from
32 the date on which the income interest begins. An income
33 interest begins on the date specified in the terms of the
34 trust or, if no date is specified, on the date an asset
35 becomes subject to a trust or successive income interest.

1 2. An asset becomes subject to a trust at the first
2 occurrence of one of the following events:
3 a. On the date it is transferred to the trust in the case
4 of an asset that is transferred to a trust during the
5 transferor's life.
6 b. On the date of a testator's death in the case of an
7 asset that becomes subject to a trust by reason of a will,
8 even if there is an intervening period of administration of
9 the testator's estate.
10 c. On the date of an individual's death in the case of an
11 asset that is transferred to a fiduciary by a third party
12 because of the individual's death.
13 3. An asset becomes subject to a successive income
14 interest on the day after the preceding income interest ends,
15 as determined under subsection 4, even if there is an
16 intervening period of administration to wind up the preceding
17 income interest.
18 4. An income interest ends on the day before an income
19 beneficiary dies or another terminating event occurs. For
20 purposes of this chapter, an income interest also ends on the
21 last day of a period during which there is no beneficiary to
22 whom a trustee may distribute income.
23 Sec. 7. NEW SECTION. 637.302 APPORTIONMENT OF RECEIPTS
24 AND DISBURSEMENTS WHEN DECEDENT DIES OR INCOME INTEREST
25 BEGINS.
26 1. An income receipt or disbursement other than one to
27 which section 637.201, subsection 1, applies must be allocated
28 to principal if its due date occurs before a decedent dies in
29 the case of an estate, or before an income interest begins in
30 the case of a trust or successive income interest.
31 2. An income receipt or disbursement must be allocated to
32 income if its due date occurs on or after the date on which a
33 decedent dies or an income interest begins and it is a
34 periodic due date. An income receipt or disbursement must be
35 treated as accruing from day to day if its due date is not

1 periodic or it has no due date. The portion of the receipt or
2 disbursement accruing before the date on which a decedent dies
3 or an income interest begins must be allocated to principal
4 and the balance must be allocated to income.
5 3. An item of income or an obligation is due on the date
6 on which the payor is required to make a payment. If there is
7 no stated payment date, there is no due date for the purposes
8 of this chapter. Distributions to shareholders or other
9 owners from an entity to which section 637.401 applies are
10 deemed to be due on the date fixed by the entity for
11 determining who is entitled to receive the distribution or, if
12 no date is fixed, on the declaration date for the
13 distribution. A due date is periodic for receipts or
14 disbursements that must be paid at regular intervals under a
15 lease or an obligation to pay interest or if an entity
16 customarily makes distributions at regular intervals.
17 Sec. 8. NEW SECTION. 637.303 APPORTIONMENT WHEN INCOME
18 INTEREST ENDS.
19 1. For purposes of this section, "undistributed income"
20 means net income received before the date on which an income
21 interest ends. The term does not include an item of income or
22 expense that is due or accrued or net income that has been
23 added or is required to be added to principal pursuant to the
24 terms of the trust.
25 2. When a mandatory income interest ends, the trustee
26 shall pay to a mandatory income beneficiary who survives that
27 date, or the estate of a deceased mandatory income beneficiary
28 whose death causes the interest to end, the beneficiary's
29 share of the undistributed income that is not disposed of
30 pursuant to the terms of the trust unless the beneficiary has
31 an unqualified power to revoke more than five percent of the
32 trust immediately before the income interest ends. In the
33 latter case, the undistributed income from the portion of the
34 trust that may be revoked must be added to principal.
35 3. When a trustee's obligation to pay a fixed annuity or a

1 fixed fraction of the value of the trust's assets ends, the
2 trustee shall prorate the final payment if and to the extent
3 required by applicable law to accomplish a purpose of the
4 trust or its settlor relating to income, gift, estate, or
5 other tax requirements.

6 SUBCHAPTER 4
7 ADMINISTRATION OF TRUST
8 Part 1
9 RECEIPTS FROM ENTITIES

10 Sec. 9. NEW SECTION. 637.401 CHARACTER OF RECEIPTS.
11 1. For purposes of this section, "entity" means a
12 corporation, partnership, joint venture, limited liability
13 company, regulated investment company, real estate investment
14 trust, common trust fund, and any other organization in which
15 a trustee has an interest other than a trust or estate to
16 which section 637.402 applies or a business or activity to
17 which section 637.403 applies.
18 2. Except as otherwise provided in this section, cash
19 received by a trustee from an entity must be allocated to
20 income.
21 3. Receipts from an entity which must be allocated to
22 principal include the following items:
23 a. Property other than cash, except as otherwise provided
24 in paragraph "d".
25 b. Cash or property received in one distribution or a
26 series of related distributions in exchange for part or all of
27 a trust's interest in the entity.
28 c. Cash or property received in total or partial
29 liquidation of the entity.
30 d. Cash or property received from an entity that is a
31 regulated investment company or a real estate investment trust
32 if the distribution is a capital gain dividend for federal
33 income tax purposes.
34 4. Cash or property is received in partial liquidation
35 according to one of the following principles:

1 a. To the extent that the entity, at or near the time of a
2 distribution, indicates that it is a distribution in partial
3 liquidation.
4 b. If the total amount received in a distribution or
5 series of related distributions is greater than twenty percent
6 of the entity's gross assets, as shown by the entity's year-
7 end financial statements immediately preceding the initial
8 receipt.
9 5. Cash shall not be received in partial liquidation, nor
10 shall it be taken into account under subsection 4, paragraph
11 "b", to the extent that it does not exceed the amount of
12 income tax that a trustee or beneficiary must pay on taxable
13 income of the entity that distributes the cash.
14 6. A trustee may rely upon a statement made by an entity
15 about the source or character of a distribution if the
16 statement is made at or near the time of distribution by the
17 entity's board of directors or other person or group of
18 persons authorized to exercise powers to pay money or transfer
19 property comparable to those of a corporation's board of
20 directors.
21 Sec. 10. NEW SECTION. 637.402 DISTRIBUTION FROM TRUST OR
22 ESTATE.
23 1. Subject to the terms of a recipient trust, an amount
24 received as a distribution of income from a trust or an estate
25 in which the trust has an interest other than a purchased
26 interest shall be allocated to income.
27 2. An amount received as a distribution of principal from
28 such a trust or estate shall be allocated to principal.
29 3. If a trustee purchases an interest in a trust that is
30 an investment entity, or a decedent or donor transfers an
31 interest in such a trust to a trustee, section 637.401 applies
32 to a receipt from the trust.
33 Sec. 11. NEW SECTION. 637.403 BUSINESS AND OTHER
34 ACTIVITIES CONDUCTED BY TRUSTEE.
35 1. If a trustee who conducts a business or other activity

1 determines that it is in the best interest of all the
2 beneficiaries to account separately for the business or
3 activity instead of accounting for it as part of the trust's
4 general accounting records, the trustee may maintain separate
5 accounting records for its transactions, whether or not its
6 assets are segregated from other trust assets.
7 2. A trustee who accounts separately for a business or
8 other activity shall determine the extent to which its net
9 cash receipts must be retained for working capital, the
10 acquisition or replacement of fixed assets, and other
11 reasonably foreseeable needs of the business or activity, and
12 the extent to which the remaining net cash receipts are
13 accounted for as principal or income in the trust's general
14 accounting records. If a trustee sells assets of the business
15 or other activity, other than in the ordinary course of the
16 business or activity, the trustee shall account for the net
17 amount received as principal in the trust's general accounting
18 records to the extent the trustee determines that the amount
19 received is no longer required in the conduct of the business.
20 3. The trustee may maintain separate accounting records
21 for any of the following activities:
22 a. Retail, manufacturing, service, and other traditional
23 business activities.
24 b. Farming.
25 c. Raising and selling livestock and other animals.
26 d. Management of rental properties.
27 e. Extraction of minerals and other natural resources.
28 f. Timber operations.
29 g. Activities to which section 637.426 applies.
30 Part 2
31 RECEIPTS NOT NORMALLY APPORTIONED
32 Sec. 12. NEW SECTION. 637.410 PRINCIPAL RECEIPTS.
33 The following items must be allocated to principal:
34 1. To the extent not allocated to income under this
35 chapter, assets received from any of the following sources:

1 a. A transferor during the transferor's lifetime.
2 b. A decedent's estate.
3 c. A trust with a terminating income interest.
4 d. A payor pursuant to a contract naming the trust or its
5 trustee as beneficiary.
6 2. Cash or other property received from the sale,
7 exchange, liquidation, or change in form of a principal asset,
8 including realized profit, subject to this subchapter.
9 3. Amounts recovered from third parties to reimburse the
10 trust because of disbursements described in section 637.502,
11 subsection 1, paragraph "g", or for other reasons to the
12 extent not based on the loss of income.
13 4. Proceeds of property taken by eminent domain, but a
14 separate award made for the loss of income with respect to an
15 accounting period during which a current income beneficiary
16 had a mandatory income interest is income.
17 5. Net income received in a period during which there is
18 no beneficiary to whom a trustee may or must distribute
19 income.
20 6. Other receipts, as provided in part 3.
21 Sec. 13. NEW SECTION. 637.411 RENTAL PROPERTY.
22 1. An amount received as rent of real or personal
23 property, including an amount received for cancellation or
24 renewal of a lease, must be allocated to income.
25 2. An amount received as a refundable deposit, including a
26 security deposit or a deposit that is to be applied as rent
27 for future periods, must be added to principal and held
28 subject to the terms of the lease and is not available for
29 distribution to a beneficiary until the trustee's contractual
30 obligations have been satisfied with respect to that amount.
31 Sec. 14. NEW SECTION. 637.412 OBLIGATION TO PAY MONEY.
32 1. An amount received as interest, whether determined at a
33 fixed, variable, or floating rate, on an obligation to pay
34 money to the trustee, including an amount received as
35 consideration for prepaying principal, must be allocated to

1 income without any provision for amortization of premium.
2 2. An amount received from the sale, redemption, or other
3 disposition of an obligation to pay money to the trustee more
4 than one year after it is purchased or acquired by the
5 trustee, including an obligation whose purchase price or value
6 when it is acquired is less than its value at maturity, must
7 be allocated to principal. If the obligation matures within
8 one year after it is purchased or acquired by the trustee, an
9 amount received in excess of its purchase price or its value
10 when acquired by the trust must be allocated to income.
11 3. This section does not apply to obligations to which
12 sections 637.421 through 637.424, 637.426, and 637.427 apply.
13 Sec. 15. NEW SECTION. 637.413 INSURANCE POLICIES AND
14 SIMILAR CONTRACTS.
15 1. Proceeds from a life insurance policy whose beneficiary
16 is the trust or its trustee or a policy that insures the trust
17 or its trustee against loss for the damage or destruction of,
18 or loss of title to, a principal asset must be allocated to
19 principal. Dividends received from an insurance policy and
20 the proceeds of any other contract in which the trust or its
21 trustee is named as beneficiary must also be allocated to
22 principal.
23 2. Insurance proceeds must be allocated to income if they
24 are from a policy that insures the trustee against the loss of
25 occupancy or other use by an income beneficiary, the loss of
26 income, or, subject to section 637.403, the loss of profits
27 from a business.
28 3. This section does not apply to a contract to which
29 section 637.421 applies.
30 Part 3
31 RECEIPTS NORMALLY APPORTIONED
32 Sec. 16. NEW SECTION. 637.420 INSUBSTANTIAL ALLOCATIONS
33 NOT REQUIRED.
34 1. If a trustee determines that an allocation between
35 principal and income required by sections 637.421 through

1 637.424 or section 637.427 is insubstantial, the trustee may
2 allocate the entire receipt to principal.
3 2. An allocation is presumed to be insubstantial if either
4 of the following would be true if an allocation was made:
5 a. The amount of the allocation would increase or decrease
6 an accounting period's net income, as determined before the
7 allocation, by less than ten percent.
8 b. The value of the asset producing the receipt for which
9 the allocation would be made is less than ten percent of the
10 total value of the trust's assets at the beginning of the
11 accounting period.
12 Sec. 17. NEW SECTION. 637.421 DEFERRED COMPENSATION,
13 ANNUITIES, AND SIMILAR PAYMENTS.
14 1. This section applies to payments that a trustee may
15 receive over a fixed number of years or during the life of one
16 or more individuals because of services rendered or property
17 transferred to the payor in exchange for future payments. The
18 payments include those made in cash or property from the
19 payor's general assets or from a separate fund created by the
20 payor, including a private or commercial annuity, an
21 individual retirement account, and a pension, profit sharing,
22 stock bonus, or stock ownership plan. This section does not
23 apply to payments to which section 637.422 applies.
24 2. To the extent that a payment is characterized as
25 interest or a dividend or a payment made in lieu of interest
26 or a dividend, it must be allocated to income. The balance of
27 the payment and any other payment received in the same
28 accounting period that is not characterized as interest, a
29 dividend, or an equivalent payment must be allocated to
30 principal.
31 3. If no part of a payment is characterized as interest, a
32 dividend, or an equivalent payment, and all or part of the
33 payment is required to be made, a trustee shall allocate to
34 income ten percent of the part that is required to be made
35 during the accounting period and the balance to principal. If

1 no part of a payment is required to be made or the payment
2 received is the entire amount to which the trustee is
3 entitled, the entire payment must be allocated to principal.
4 4. If, to obtain an estate tax marital deduction for a
5 trust, a trustee must allocate more of a payment to income
6 than provided for by this section, the trustee shall allocate
7 to income the additional amount necessary to obtain the
8 marital deduction.
9 Sec. 18. NEW SECTION. 637.422 LIQUIDATING ASSET.
10 1. In this section, "liquidating asset" means an asset
11 whose value will diminish or terminate because the asset is
12 expected to produce receipts for a period of limited duration.
13 The term includes leaseholds, patents, trademarks, copyrights,
14 royalty rights, and rights to receive payments during a period
15 of more than one year under an arrangement that does not
16 provide for the payment of interest on the unpaid balance.
17 The term does not include deferred compensation that is
18 subject to section 637.421, natural resources that are subject
19 to section 637.423, timber that is subject to section 637.424,
20 an activity that is subject to section 637.426, or any asset
21 for which the trustee establishes a reserve for depreciation
22 under section 637.503.
23 2. A trustee shall allocate to income ten percent of the
24 receipts from a liquidating asset and the balance to
25 principal.
26 Sec. 19. NEW SECTION. 637.423 MINERALS, WATER, AND OTHER
27 NATURAL RESOURCES.
28 1. Receipts from an interest in minerals or other natural
29 resources must be allocated according to the type of payment,
30 as follows:
31 a. If received as nominal delay rental or annual rent on a
32 lease, a receipt must be allocated to income.
33 b. If received from a production payment, a receipt must
34 be allocated to income to the extent that the agreement
35 creating the production payment provides a factor for interest

1 or its equivalent. The balance must be allocated to
2 principal.
3 c. If an amount received as a royalty, bonus, or delay
4 rental is more than nominal, ninety percent must be allocated
5 to principal and the balance to income.
6 d. If an amount is received from a working interest or any
7 other interest not provided for in paragraph "a", "b", or "c",
8 ninety percent of the net amount received must be allocated to
9 principal and the balance to income.
10 2. An amount received on account of an interest in water
11 that is renewable must be allocated to income. If the water
12 is not renewable, ninety percent of the amount must be
13 allocated to principal and the balance to income.
14 3. This chapter applies without regard to whether a
15 decedent or donor was extracting minerals, water, or other
16 natural resources before the interest became subject to the
17 trust.
18 4. If a trust owns an interest in minerals, water, or
19 other natural resources on or before July 1, 1999, the trustee
20 may allocate receipts from the interest as provided in this
21 section or in the manner used by the trustee before July 1,
22 1999. If the trust acquires an interest in minerals, water,
23 or other natural resources after July 1, 1999, the trustee
24 shall allocate receipts from the interest as provided in this
25 section.
26 Sec. 20. NEW SECTION. 637.424 TIMBER.
27 1. A trustee may account for net receipts from the sale of
28 timber and related products under subsection 2 or section
29 637.403 or, if the trustee determines that net receipts are
30 insubstantial, may allocate the net receipts to principal.
31 The presumptions in section 637.420 apply in determining
32 whether net receipts are insubstantial. If a trust owns more
33 than one block of timberland, the trustee may use different
34 methods to account for net receipts from different blocks.
35 2. If a trustee does not account under section 637.403 for

1 net receipts from the sale of timber and related products or
2 allocate the net receipts to principal because they are
3 insubstantial, the trustee shall allocate the net receipts
4 according to one of the following rules:
5 a. Allocate the net receipts to income to the extent that
6 the amount of timber removed from the land does not exceed the
7 rate of growth of the block as a whole during the accounting
8 periods in which a beneficiary has a mandatory income
9 interest.
10 b. Allocate the net receipts to principal to the extent
11 that the amount of timber removed from the land exceeds the
12 block's rate of growth or the net receipts are from the sale
13 of standing timber.
14 c. Allocate the net receipts to or between income and
15 principal if the net receipts are from the lease of timberland
16 or from a contract to cut timber from land owned by a trust,
17 by determining the amount of timber removed from the land
18 under the lease or contract and applying the rules in
19 paragraphs "a" and "b".
20 d. Allocate the net receipts to principal to the extent
21 that advance payments, bonuses, and other payments are not
22 allocated pursuant to paragraph "a", "b", or "c".
23 3. In determining the net receipts from the sale of
24 timber, a trustee shall deduct and transfer to principal a
25 reasonable amount for depletion.
26 4. This chapter applies regardless of whether a decedent
27 or transferor was harvesting timber from the property before
28 it became subject to the trust.
29 5. If a trust owns an interest in timberland on or before
30 July 1, 1999, the trustee may allocate net receipts from the
31 sale of timber and related products as provided in this
32 section or in the manner used by the trustee before July 1,
33 1999. If the trust acquires an interest in timberland after
34 July 1, 1999, the trustee shall allocate net receipts from the
35 sale of timber and related products as provided in this

1 section.
2 Sec. 21. NEW SECTION. 637.425 PROPERTY NOT PRODUCTIVE OF
3 INCOME.
4 1. If a marital deduction is allowed for all or part of a
5 trust whose assets consist substantially of property that does
6 not provide the surviving spouse with sufficient income from
7 or use of the trust assets, the spouse may require the trustee
8 to make property productive of income or convert property
9 within a reasonable time. The trustee may decide which action
10 or combination of actions to take.
11 2. In all other cases, proceeds from the sale or other
12 disposition of an asset are principal without regard to the
13 amount of income the asset produces during any accounting
14 period.
15 Sec. 22. NEW SECTION. 637.426 DERIVATIVES AND OPTIONS.
16 1. For purposes of this section, "derivative" means a
17 contract or financial instrument or a combination of contracts
18 and financial instruments which gives a trust the right or
19 obligation to participate in some or all changes in the price
20 of a tangible or intangible asset or group of assets, or
21 changes in a rate, an index of prices or rates, or other
22 market indicator for an asset or a group of assets.
23 2. To the extent that a trustee does not account under
24 section 637.403 for transactions in derivatives, receipts from
25 and disbursements made in connection with those transactions
26 must be allocated to principal.
27 3. If a trustee grants an option to buy property from the
28 trust, whether or not the trust owns the property when the
29 option is granted, grants an option that permits another
30 person to sell property to the trust, or acquires an option to
31 buy property for the trust or an option to sell an asset owned
32 by the trust, and the trustee or other owner of the asset is
33 required to deliver the asset if the option is exercised, an
34 amount received for granting the option must be allocated to
35 principal, and an amount paid to acquire the option must be

1 paid from principal. A gain or loss realized upon the
2 exercise of an option, including an option granted to a
3 settlor of the trust for services rendered, must be allocated
4 to principal.
5 Sec. 23. NEW SECTION. 637.427 ASSET-BACKED SECURITIES.
6 1. For purposes of this section, "asset-backed security"
7 means an asset whose value is based upon the right it gives
8 the owner to receive distributions from the proceeds of
9 financial assets that provide collateral for the security.
10 The term includes an asset that gives the owner the right to
11 receive only the interest or other current return from the
12 collateral financial assets or only the proceeds from the
13 capital investment in the collateral financial assets. It
14 does not include an asset to which section 637.401 or 637.421
15 applies.
16 2. If a trust receives a payment from the interest or
17 other current return and the capital investment of the
18 collateral financial assets, the trustee shall allocate to
19 income the portion of a payment that the payor identifies as
20 being from the interest or other current return, and shall
21 allocate the balance of the payment to principal.
22 3. If a trust receives one or more payments in exchange
23 for the trust's entire interest in an asset-backed security in
24 one accounting period, the trustee shall allocate the payments
25 to principal. If a payment is one of a series of payments
26 that will result in the liquidation of the trust's interest in
27 the security over more than one accounting period, the trustee
28 shall allocate ten percent of the payment to income and the
29 balance to principal.
30 SUBCHAPTER 5
31 ALLOCATION OF DISBURSEMENTS DURING
32 ADMINISTRATION OF TRUST
33 Sec. 24. NEW SECTION. 637.501 DISBURSEMENTS FROM INCOME.
34 A trustee shall make disbursements from income, to the
35 extent that they are not disbursements to which section

1 637.201, subsection 2, paragraph "b" or "c", applies,
2 according to the following:
3 1. One-half of the regular compensation of the trustee and
4 of any person providing investment advisory or custodial
5 services to the trustee.
6 2. One-half of all expenses for accountings, judicial
7 proceedings, or other matters that involve both the income and
8 remainder interests.
9 3. All of the other ordinary expenses incurred in
10 connection with the administration, management, or
11 preservation of trust property and the distribution of income,
12 including interest, ordinary repairs, regularly recurring
13 taxes assessed against principal, and expenses of a proceeding
14 or other matter that concerns primarily the income interest.
15 4. Recurring premiums on insurance covering the loss of a
16 principal asset or the loss of income from or use of the
17 asset.
18 Sec. 25. NEW SECTION. 637.502 DISBURSEMENTS FROM
19 PRINCIPAL.
20 1. A trustee shall make disbursements from principal
21 according to the following:
22 a. The remaining one-half of the disbursements described
23 in section 637.501, subsections 1 and 2.
24 b. All of the trustee's compensation calculated on
25 principal as an acceptance, distribution, or termination fee,
26 and disbursements made to prepare property for sale.
27 c. Payments on the principal of a trust debt.
28 d. Expenses of a proceeding that concerns primarily
29 principal, including a proceeding to construe the trust or to
30 protect the trust or its property.
31 e. Insurance premiums paid on a policy not described in
32 section 637.501, subsection 4, of which the trust is the owner
33 and beneficiary.
34 f. Estate, inheritance, and other transfer taxes,
35 including penalties, apportioned to the trust.

1 g. Disbursements related to environmental matters,
2 including reclamation, assessing environmental conditions,
3 remedying and removing environmental contamination, monitoring
4 remedial activities and the release of substances, preventing
5 future releases of substances, collecting amounts from persons
6 liable or potentially liable for the costs of those
7 activities, penalties imposed under environmental laws or
8 regulations and other payments made to comply with those laws
9 or regulations, statutory or common law claims by third
10 parties, and defending claims based on environmental matters.
11 2. If a trust owns a policy of insurance on the life of an
12 individual and the trust is not the beneficiary of the policy,
13 premiums paid on the policy are a distribution from principal
14 to the policy beneficiary.
15 3. If a principal asset is encumbered with an obligation
16 that requires income from that asset to be paid directly to
17 the creditor, the trustee shall transfer from principal to
18 income an amount equal to the income paid to the creditor in
19 reduction of the obligation's principal balance.
20 Sec. 26. NEW SECTION. 637.503 TRANSFERS FROM INCOME TO
21 PRINCIPAL FOR DEPRECIATION.
22 1. For purposes of this section, "depreciation" means a
23 reduction in value of a fixed asset having a useful life of
24 more than one year due to wear, tear, decay, corrosion, or
25 gradual obsolescence.
26 2. A trustee may transfer to principal a reasonable amount
27 of the net cash receipts from a principal asset that is
28 subject to depreciation, but a transfer shall not be made for
29 depreciation under any of the following circumstances:
30 a. When the depreciation involves the portion of real
31 property used or available for use by a beneficiary as a
32 residence, or tangible personal property held or made
33 available for the personal use or enjoyment of a beneficiary.
34 b. When the depreciation occurs during the administration
35 of a decedent's estate.

1 c. If the trustee is accounting under section 637.403 for
2 the business or activity in which the asset is used.
3 3. An amount transferred to principal need not be held as
4 a separate fund.
5 Sec. 27. NEW SECTION. 637.504 TRANSFERS FROM INCOME TO
6 REIMBURSE PRINCIPAL.
7 1. If a trustee makes or expects to make a principal
8 disbursement described in this section, the trustee may
9 transfer an appropriate amount from income to principal in one
10 or more accounting periods to reimburse principal or to
11 provide a reserve for future principal disbursements.
12 2. Principal disbursements to which subsection 1 applies
13 include all of the following, but only to the extent that the
14 trustee has not been and does not expect to be reimbursed by a
15 third party:
16 a. An amount chargeable to income but paid from principal
17 because it is unusually large, including extraordinary
18 repairs.
19 b. A capital improvement to a principal asset, whether in
20 the form of changes to an existing asset or the construction
21 of a new asset, including special assessments.
22 c. Disbursements made to prepare property for rental,
23 including leasehold improvements and broker's commissions.
24 d. Periodic payments on an obligation secured by a
25 principal asset to the extent that the amount transferred from
26 income to principal for depreciation is less than the periodic
27 payments.
28 e. Disbursements described in section 637.502, subsection
29 1, paragraph "g".
30 3. If the asset whose ownership gives rise to the
31 disbursements becomes subject to a successive income interest
32 after an income interest ends, a trustee may continue to
33 transfer amounts from income to principal as provided in
34 subsection 1.
35 Sec. 28. NEW SECTION. 637.505 INCOME TAXES.

1 1. A tax required to be paid by a trustee based on
2 receipts allocated to income must be paid from income.
3 2. A tax required to be paid by a trustee based on
4 receipts allocated to principal must be paid from principal,
5 even if the tax is called an income tax by the taxing
6 authority.
7 3. A tax required to be paid by a trustee on the trust's
8 share of an entity's taxable income must be paid
9 proportionately, according to all of the following principles:
10 a. From income, to the extent that receipts from the
11 entity are allocated to income.
12 b. From principal, to the extent that the following
13 principles are observed:
14 (1) Receipts from the entity are allocated to principal.
15 (2) The trust's share of the entity's taxable income
16 exceeds the total receipts in paragraph "a" and in
17 subparagraph (1).
18 4. For purposes of this section, receipts allocated to
19 principal or income shall be reduced by the amount distributed
20 to a beneficiary from principal or income for which the trust
21 receives a deduction in calculating the tax.
22 Sec. 29. NEW SECTION. 637.506 ADJUSTMENTS BETWEEN
23 PRINCIPAL AND INCOME BECAUSE OF TAXES.
24 1. A fiduciary may make adjustments between principal and
25 income to offset the shifting of economic interests or tax
26 benefits between income beneficiaries and remainder
27 beneficiaries which arise from any of the following:
28 a. Elections and decisions, other than those described in
29 subsection 2, that the fiduciary makes from time to time
30 regarding tax matters.
31 b. An income tax or any other tax that is imposed upon the
32 fiduciary or a beneficiary as a result of a transaction
33 involving or a distribution from the estate or trust.
34 c. The ownership by an estate or trust of an interest in
35 an entity whose taxable income, whether or not distributed, is

1 includable in the taxable income of the estate, trust, or a
2 beneficiary.
3 2. If the amount of an estate tax marital deduction or
4 charitable contributions deduction is reduced because a
5 fiduciary deducts an amount that is paid from principal for
6 income tax purposes instead of deducting it for estate tax
7 purposes, and as a result estate taxes paid from principal are
8 increased and income taxes paid by an estate, trust, or
9 beneficiary are decreased, each estate, trust, or beneficiary
10 that benefits from the decrease in income tax shall reimburse
11 the principal from which the increase in estate tax is paid.
12 The total reimbursement must equal the increase in the estate
13 tax to the extent that the principal used to pay the increase
14 would have qualified for a martial deduction or charitable
15 contributions deduction but for the payment. The
16 proportionate share of the reimbursement for each estate,
17 trust, or beneficiary whose income taxes are reduced must be
18 the same as its proportionate share of the total decrease in
19 income tax. An estate or trust shall reimburse principal from
20 income.
21 SUBCHAPTER 6
22 MISCELLANEOUS PROVISIONS
23 Sec. 30. NEW SECTION. 637.601 APPLICATION OF CHAPTER TO
24 EXISTING TRUSTS AND ESTATES -- CHAPTER PREVAILS.
25 This chapter applies to every trust or decedent's estate on
26 and after July 1, 2000, except as otherwise expressly provided
27 in the will, the terms of the trust, or in this chapter.
28 Notwithstanding any Code provision to the contrary, the
29 provisions of this chapter shall prevail over any other
30 applicable Code provision.
31 Sec. 31. Section 633.352, Code 1999, is amended to read as
32 follows:
33 633.352 COLLECTION OF RENTS AND PAYMENT OF TAXES AND
34 CHARGES.
35 Unless otherwise provided by the will, the personal

representative shall ~~collect the income from the property of which the personal representative has possession, pay the taxes and fixed charges thereon and apply the balance of such income to general estate obligations~~ allocate and distribute income of an estate in accordance with chapter 637. ~~Unless otherwise provided by will, any unexpended portion of such income shall become a part of the general assets of such estate.~~

Sec. 32. Section 633.103, Code 1999, is repealed.

EXPLANATION

This bill enacts the uniform principal and income Act, as revised by the national conference of commissioners on uniform state laws in 1997. Certain technical changes have been made to adjust the format of the uniform Act so that it complies with the general style of the Iowa Code.

Subchapter 1 contains the short title of the Act, relevant definitions, and general principles regarding fiduciary duties and the powers of the trustee.

Subchapter 2 addresses distribution issues at the end of a trust.

Subchapter 3 addresses apportionment issues at the beginning and the end of income interest.

Subchapter 4 contains three parts addressing allocation of receipts during the administration of a trust. Part 1 pertains to allocation of receipts from entities. Part 2 addresses receipts that are not normally apportioned but are allocated wholly to principal or income. Part 3 addresses receipts that are normally apportioned between principal and income.

Subchapter 5 addresses the issue of disbursements during the administration of a trust, including disbursements from principal and from income, in general, as well as certain transfers and the payment of taxes.

The bill contains an applicability provision, making the bill applicable to trusts and estates on and after July 1,

2000, except as provided in the will, the terms of the trust, or in particular sections of the bill. This chapter prevails over any other applicable Code provision.

Corresponding amendments are made regarding two current Code sections that addressed principal and income.

HOUSE FILE 584

AN ACT

RELATING TO THE UNIFORM PRINCIPAL AND INCOME ACT AND PROVIDING FOR ITS APPLICABILITY.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF IOWA:

CHAPTER 637

UNIFORM PRINCIPAL AND INCOME ACT

SUBCHAPTER 1

DEFINITIONS AND FIDUCIARY DUTIES

Section 1. NEW SECTION. 637.101 SHORT TITLE.

This Act may be cited as the "Uniform Principal and Income Act".

Sec. 2. NEW SECTION. 637.102 DEFINITIONS.

As used in this chapter:

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

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

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

4. "Income" means money or property a fiduciary receives as the current return from a principal asset. The term includes a portion of the receipts from a sale, exchange, or

liquidation of a principal asset, to the extent provided in subchapter 4.

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

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

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

8. "Net income" means the total receipts allocated to income during an accounting period minus the disbursements made from income during the period. In this definition, receipts and disbursements include items transferred to or from income during the period under this chapter.

9. "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, or any other legal or commercial entity. The term does not include a government or governmental subdivision, agency, or instrumentality.

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

11. "Remainder beneficiary" means a person, including another trust, entitled to receive principal when an income interest ends.

12. "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.

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

Sec. 3. NEW SECTION. 637.103 FIDUCIARY DUTIES -- GENERAL PRINCIPLES.

HF 584

1. In allocating receipts and disbursements to or between principal and income, and in any matter within the scope of subchapters 2 and 3, a fiduciary shall do all of the following:

a. 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 chapter.

b. Administer a trust or estate by the exercise of a discretionary power of administration given the fiduciary by the terms of the trust or the will, although the fiduciary may exercise that power in a manner different from a provision of this chapter.

c. Administer a trust or estate in accordance with this chapter 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.

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

2. In exercising a discretionary power of administration regarding a matter within the scope of this chapter, whether granted by the terms of a trust, a will, or this chapter, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, unless 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 chapter is presumed to be fair and reasonable to all of the beneficiaries.

SUBCHAPTER 2

DECEDENT'S ESTATE OR TERMINATING INCOME INTEREST

Sec. 4. NEW SECTION. 637.201 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 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 subchapters 3 through 5 that apply to trustees, and under the rules in subsection 5. 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 determine the remaining net income of a decedent's estate or a terminating income interest under the rules in subchapters 3 through 5 that apply to trustees, and by doing the following:

a. Including in net income all income from property used to discharge liabilities.

b. 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 loss of the deduction.

c. 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.

3. A fiduciary shall distribute to a beneficiary who receives a pecuniary amount outright the amount, if any, provided by the will, the terms of the trust, or applicable law, from net income determined under subsection 2 or from principal to the extent the net income is insufficient. If a beneficiary is to receive a pecuniary amount outright from a trust after an income interest ends and no amount is provided for by the terms of the trust or applicable law, the fiduciary

shall distribute the amount to which the beneficiary would be entitled under applicable law if the pecuniary amount were required to be paid under a will.

4. A fiduciary shall distribute the net income remaining after distributions required by subsection 3 in the manner described in section 637.202 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.

5. A fiduciary shall not reduce principal or income receipts from property described in subsection 1 because of a payment described in section 637.501 or 637.502 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 property's net income and principal receipts 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.

Sec. 5. NEW SECTION. 637.202 DISTRIBUTION TO RESIDUARY AND REMAINDER BENEFICIARIES.

1. Each beneficiary described in section 637.201, subsection 4, 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.

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

a. 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.

b. 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 be pay pecuniary amounts not in trust.

c. 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.

d. 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.

3. The rules in this section apply 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.

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

SUBCHAPTER 3

APPORTIONMENT AT BEGINNING AND END OF INCOME INTEREST

Sec. 6. NEW SECTION. 637.301 WHEN RIGHT TO INCOME BEGINS AND ENDS.

1. 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.

2. An asset becomes subject to a trust at the first occurrence of one of the following events:

a. 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.

b. 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.

c. 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.

3. An asset becomes subject to a successive income interest on the day after the preceding income interest ends, as determined under subsection 4, even if there is an intervening period of administration to wind up the preceding income interest.

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

Sec. 7. NEW SECTION. 637.302 APPORTIONMENT OF RECEIPTS AND DISBURSEMENTS WHEN DECEDENT DIES OR INCOME INTEREST BEGINS.

1. An income receipt or disbursement other than one to which section 637.201, subsection 1, applies must be allocated 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.

2. An income receipt or disbursement must be allocated 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.

3. An item of income or an obligation is due on the date on which the payor is required to make a payment. If there is no stated payment date, there is no due date for the purposes of this chapter. Distributions to shareholders or other owners from an entity to which section 637.401 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.

Sec. 8. NEW SECTION. 637.303 APPORTIONMENT WHEN INCOME INTEREST ENDS.

1. For purposes of 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 pursuant to the terms of the trust.

2. 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 pursuant to 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 must be added to principal.

3. 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.

SUBCHAPTER 4

ADMINISTRATION OF TRUST

Part 1

RECEIPTS FROM ENTITIES

Sec. 9. NEW SECTION. 637.401 CHARACTER OF RECEIPTS.

1. For purposes of this section, "entity" means a corporation, partnership, joint venture, limited liability company, regulated investment company, real estate investment trust, common trust fund, and any other organization in which a trustee has an interest other than a trust or estate to which section 637.402 applies or a business or activity to which section 637.403 applies.

2. Except as otherwise provided in this section, cash received by a trustee from an entity must be allocated to income.

3. Receipts from an entity which must be allocated to principal include the following items:

a. Property other than cash, except as otherwise provided in paragraph "d".

b. Cash or property received in one distribution or a series of related distributions in exchange for part or all of a trust's interest in the entity.

c. Cash or property received in total or partial liquidation of the entity.

d. Cash or property received from an entity that is a regulated investment company or a real estate investment trust if the distribution is a capital gain dividend for federal income tax purposes.

4. Cash or property is received in partial liquidation according to one of the following principles:

a. To the extent that the entity, at or near the time of a distribution, indicates that it is a distribution in partial liquidation.

b. If the total amount received in a distribution or series of related distributions is greater than twenty percent of the entity's gross assets, as shown by the entity's year-end financial statements immediately preceding the initial receipt.

5. Cash shall not be received in partial liquidation, nor shall it be taken into account under subsection 4, paragraph "b", 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 cash.

6. 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.

Sec. 10. NEW SECTION. 637.402 DISTRIBUTION FROM TRUST OR ESTATE.

1. Subject to the terms of a recipient trust, 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 shall be allocated to income.

2. An amount received as a distribution of principal from such a trust or estate shall be allocated to principal.

3. 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 637.401 applies to a receipt from the trust.

Sec. 11. NEW SECTION. 637.403 BUSINESS AND OTHER ACTIVITIES CONDUCTED BY TRUSTEE.

1. 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.

2. A trustee who accounts separately for a business or other activity shall determine the extent to which 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 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.

3. The trustee may maintain separate accounting records for any of the following activities:

a. Retail, manufacturing, service, and other traditional business activities.

b. Farming.

c. Raising and selling livestock and other animals.

d. Management of rental properties.

e. Extraction of minerals and other natural resources.

f. Timber operations.

g. Activities to which section 637.426 applies.

Part 2

RECEIPTS NOT NORMALLY APPORTIONED

Sec. 12. NEW SECTION. 637.410 PRINCIPAL RECEIPTS.

The following items must be allocated to principal:

1. To the extent not allocated to income under this chapter, assets received from any of the following sources:

a. A transferor during the transferor's lifetime.

b. A decedent's estate.

c. A trust with a terminating income interest.

d. A payor pursuant to a contract naming the trust or its trustee as beneficiary.

2. Cash or other property received from the sale, exchange, liquidation, or change in form of a principal asset, including realized profit, subject to this subchapter.

3. Amounts recovered from third parties to reimburse the trust because of disbursements described in section 637.502, subsection 1, paragraph "g", or for other reasons to the extent not based on the loss of income.

4. 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.

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

6. Other receipts, as provided in part 3.

Sec. 13. NEW SECTION. 637.411 RENTAL PROPERTY.

1. An amount received as rent of real or personal property, including an amount received for cancellation or renewal of a lease, must be allocated to income.

2. An amount received as a refundable deposit, including a security deposit or a deposit that is to be applied as rent for future periods, must 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.

Sec. 14. NEW SECTION. 637.412 OBLIGATION TO PAY MONEY.

1. 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, must be allocated to income without any provision for amortization of premium.

2. 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, must be allocated to principal. 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 must be allocated to income.

3. This section does not apply to obligations to which sections 637.421 through 637.424, 637.426, and 637.427 apply.

Sec. 15. NEW SECTION. 637.413 INSURANCE POLICIES AND SIMILAR CONTRACTS.

1. Proceeds from a life insurance policy whose beneficiary is the trust or its trustee or a policy that insures the trust or its trustee against loss for the damage or destruction of, or loss of title to, a principal asset must be allocated to principal. Dividends received from an insurance policy and the proceeds of any other contract in which the trust or its trustee is named as beneficiary must also be allocated to principal.

2. Insurance proceeds must be allocated to income if they are from a policy that insures the trustee against the loss of occupancy or other use by an income beneficiary, the loss of income, or, subject to section 637.403, the loss of profits from a business.

3. This section does not apply to a contract to which section 637.421 applies.

Part 3

RECEIPTS NORMALLY APPORTIONED

Sec. 16. NEW SECTION. 637.420 INSUBSTANTIAL ALLOCATIONS NOT REQUIRED.

1. If a trustee determines that an allocation between principal and income required by sections 637.421 through 637.424 or section 637.427 is insubstantial, the trustee may allocate the entire receipt to principal.

2. An allocation is presumed to be insubstantial if either of the following would be true if an allocation was made:

a. The amount of the allocation would increase or decrease an accounting period's net income, as determined before the allocation, by less than ten percent.

b. The value of the asset producing the receipt for which the allocation would be made is less than ten percent of the total value of the trust's assets at the beginning of the accounting period.

Sec. 17. NEW SECTION. 637.421 DEFERRED COMPENSATION, ANNUITIES, AND SIMILAR PAYMENTS.

1. This section applies to payments 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 payor in exchange for future payments. The payments include those made in cash or property from the payor's general assets or from a separate fund created by the payor, including a private or commercial annuity, an individual retirement account, and a pension, profit sharing, stock bonus, or stock ownership plan. This section does not apply to payments to which section 637.422 applies.

2. To the extent that a payment is characterized as interest or a dividend or a payment made in lieu of interest or a dividend, it must be allocated to income. 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 must be allocated to principal.

3. 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 ten 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 entire payment must be allocated to principal.

4. 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.

Sec. 18. NEW SECTION. 637.422 LIQUIDATING ASSET.

1. 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 leaseholds, patents, trademarks, copyrights,

royalty rights, and rights 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 deferred compensation that is subject to section 637.421, natural resources that are subject to section 637.423, timber that is subject to section 637.424, an activity that is subject to section 637.426, or any asset for which the trustee establishes a reserve for depreciation under section 637.503.

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

Sec. 19. NEW SECTION. 637.423 MINERALS, WATER, AND OTHER NATURAL RESOURCES.

1. Receipts from an interest in minerals or other natural resources must be allocated according to the type of payment, as follows:

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

b. If received from a production payment, a receipt must be allocated to income to the extent that the agreement creating the production payment provides a factor for interest or its equivalent. The balance must be allocated to principal.

c. If an amount received as a royalty, bonus, or delay rental is more than nominal, ninety percent must be allocated to principal and the balance to income.

d. If an amount is received from a working interest or any other interest not provided for in paragraph "a", "b", or "c", ninety percent of the net amount received must be allocated to principal and the balance to income.

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

3. This chapter applies without regard to whether a decedent or donor was extracting minerals, water, or other

natural resources before the interest became subject to the trust.

4. If a trust owns an interest in minerals, water, or other natural resources on or before July 1, 1999, the trustee may allocate receipts from the interest as provided in this section or in the manner used by the trustee before July 1, 1999. If the trust acquires an interest in minerals, water, or other natural resources after July 1, 1999, the trustee shall allocate receipts from the interest as provided in this section.

Sec. 20. NEW SECTION. 637.424 TIMBER.

1. A trustee may account for net receipts from the sale of timber and related products under subsection 2 or section 637.403 or, if the trustee determines that net receipts are insubstantial, may allocate the net receipts to principal. The presumptions in section 637.420 apply in determining whether net receipts are insubstantial. If a trust owns more than one block of timberland, the trustee may use different methods to account for net receipts from different blocks.

2. If a trustee does not account under section 637.403 for net receipts from the sale of timber and related products or allocate the net receipts to principal because they are insubstantial, the trustee shall allocate the net receipts according to one of the following rules:

a. Allocate the net receipts to income to the extent that the amount of timber removed from the land does not exceed the rate of growth of the block as a whole during the accounting periods in which a beneficiary has a mandatory income interest.

b. Allocate the net receipts to principal to the extent that the amount of timber removed from the land exceeds the block's rate of growth or the net receipts are from the sale of standing timber.

c. Allocate the net receipts 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 "a" and "b".

d. Allocate the net receipts to principal to the extent that advance payments, bonuses, and other payments are not allocated pursuant to paragraph "a", "b", or "c".

3. In determining the net receipts from the sale of timber, a trustee shall deduct and transfer to principal a reasonable amount for depletion.

4. This chapter applies regardless of whether a decedent or transferor was harvesting timber from the property before it became subject to the trust.

5. If a trust owns an interest in timberland on or before July 1, 1999, the trustee may allocate net receipts from the sale of timber and related products as provided in this section or in the manner used by the trustee before July 1, 1999. If the trust acquires an interest in timberland after July 1, 1999, the trustee shall allocate net receipts from the sale of timber and related products as provided in this section.

Sec. 21. NEW SECTION. 637.425 PROPERTY NOT PRODUCTIVE OF INCOME.

1. If a marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the surviving spouse with sufficient income from or use of the trust assets, the spouse may require the trustee to make property productive of income or convert property within a reasonable time. The trustee may decide which action or combination of actions to take.

2. In all other cases, 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.

Sec. 22. NEW SECTION. 637.426 DERIVATIVES AND OPTIONS.

1. For purposes of 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.

2. To the extent that a trustee does not account under section 637.403 for transactions in derivatives, receipts from and disbursements made in connection with those transactions must be allocated to principal.

3. 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, and 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 of the trust for services rendered, must be allocated to principal.

Sec. 23. NEW SECTION. 637.427 ASSET-BACKED SECURITIES.

1. For purposes of 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 only the interest or other current return from the collateral financial assets or only the proceeds from the capital investment in the collateral financial assets. It does not include an asset to which section 637.401 or 637.421 applies.

2. If a trust receives a payment from the interest or other current return and the capital investment of the collateral financial assets, the trustee shall allocate to income the portion of a payment that the payor identifies as being from the interest or other current return, and shall allocate the balance of the payment to principal.

3. 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 ten percent of the payment to income and the balance to principal.

SUBCHAPTER 5

ALLOCATION OF DISBURSEMENTS DURING ADMINISTRATION OF TRUST

Sec. 24. NEW SECTION. 637.501 DISBURSEMENTS FROM INCOME.

A trustee shall make disbursements from income, to the extent that they are not disbursements to which section 637.201, subsection 2, paragraph "b" or "c", applies, according to the following:

1. One-half of the regular compensation of the trustee and of any person providing investment advisory or custodial services to the trustee.

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

3. 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.

4. Recurring premiums on insurance covering the loss of a principal asset or the loss of income from or use of the asset.

Sec. 25. NEW SECTION. 637.502 DISBURSEMENTS FROM PRINCIPAL.

1. A trustee shall make disbursements from principal according to the following:

a. The remaining one-half of the disbursements described in section 637.501, subsections 1 and 2.

b. All of the trustee's compensation calculated on principal as an acceptance, distribution, or termination fee, and disbursements made to prepare property for sale.

c. Payments on the principal of a trust debt.

d. Expenses of a proceeding that concerns primarily principal, including a proceeding to construe the trust or to protect the trust or its property.

e. Insurance premiums paid on a policy not described in section 637.501, subsection 4, of which the trust is the owner and beneficiary.

f. Estate, inheritance, and other transfer taxes, including penalties, apportioned to the trust.

g. 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.

2. If a trust owns a policy of insurance on the life of an individual and the trust is not the beneficiary of the policy, premiums paid on the policy are a distribution from principal to the policy beneficiary.

3. 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 obligation's principal balance.

Sec. 26. NEW SECTION. 637.503 TRANSFERS FROM INCOME TO PRINCIPAL FOR DEPRECIATION.

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

2. A trustee may transfer to principal a reasonable amount of the net cash receipts from a principal asset that is subject to depreciation, but a transfer shall not be made for depreciation under any of the following circumstances:

a. When the depreciation involves the portion of real property used or available for use by a beneficiary as a residence, or tangible personal property held or made available for the personal use or enjoyment of a beneficiary.

b. When the depreciation occurs during the administration of a decedent's estate.

c. If the trustee is accounting under section 637.403 for the business or activity in which the asset is used.

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

Sec. 27. NEW SECTION. 637.504 TRANSFERS FROM INCOME TO REIMBURSE PRINCIPAL.

1. 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.

2. Principal disbursements to which subsection 1 applies include all of the following, but only to the extent that the trustee has not been and does not expect to be reimbursed by a third party:

a. An amount chargeable to income but paid from principal because it is unusually large, including extraordinary repairs.

b. 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.

c. Disbursements made to prepare property for rental, including leasehold improvements and broker's commissions.

d. 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.

e. Disbursements described in section 637.502, subsection 1, paragraph "g".

3. 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 1.

Sec. 28. NEW SECTION. 637.505 INCOME TAXES.

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

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

3. A tax required to be paid by a trustee on the trust's share of an entity's taxable income must be paid proportionately, according to all of the following principles:

a. From income, to the extent that receipts from the entity are allocated to income.

b. From principal, to the extent that the following principles are observed:

(1) Receipts from the entity are allocated to principal.

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

4. 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.

Sec. 29. NEW SECTION. 637.506 ADJUSTMENTS BETWEEN PRINCIPAL AND INCOME BECAUSE OF TAXES.

1. 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 any of the following:

a. Elections and decisions, other than those described in subsection 2, that the fiduciary makes from time to time regarding tax matters.

b. 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.

c. 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.

2. If the amount of an estate tax marital deduction or charitable contributions deduction is reduced because a fiduciary deducts an amount that is 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 must equal the increase in the estate tax to the extent that the principal used to pay the increase would have qualified for a martial deduction or charitable contributions deduction but for the payment. The proportionate share of the reimbursement for each estate, trust, or beneficiary whose income taxes are reduced must be the same as its proportionate share of the total decrease in income tax. An estate or trust shall reimburse principal from income.

SUBCHAPTER 6

MISCELLANEOUS PROVISIONS

Sec. 30. NEW SECTION. 637.601 APPLICATION OF CHAPTER TO EXISTING TRUSTS AND ESTATES -- CHAPTER PREVAILS.

This chapter applies to every trust or decedent's estate on and after July 1, 2000, except as otherwise expressly provided in the will, the terms of the trust, or in this chapter. Notwithstanding any Code provision to the contrary, the provisions of this chapter shall prevail over any other applicable Code provision.

Sec. 31. Section 633.352, Code 1999, is amended to read as follows:

633.352 COLLECTION OF RENTS AND PAYMENT OF TAXES AND CHARGES.

Unless otherwise provided by the will, the personal representative shall ~~collect the income from the property of which the personal representative has possession, pay the taxes and fixed charges thereon and apply the balance of such income to general estate obligations~~ allocate and distribute income of an estate in accordance with chapter 637. ~~Unless otherwise provided by will, any unexpended portion of such income shall become a part of the general assets of such estate.~~

Sec. 32. Section 633.103, Code 1999, is repealed.

BRENT SIEGRIST
Speaker of the House

MARY E. KRAMER
President of the Senate

I hereby certify that this bill originated in the House and is known as House File 584, Seventy-eighth General Assembly.

ELIZABETH ISAACSON
Chief Clerk of the House

Approved 5/14, 1999

THOMAS J. VILSACK
Governor