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# Fiduciary Accounting and Tax Issues of Estates and Trusts

FACT/19/V1-P1

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Revised June 2019

# **NOTES**

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# Introduction

## *Learning objectives*

After completing this chapter, you will be able to:

- Recognize legal terms used in connection with wills, trusts, and estates;
- Identify common components of client's wills; and
  - Differentiate between a pecuniary marital deduction and a qualified terminable interest property marital deduction.

## ***I. Legal concepts***

There are two basic types of fiduciary entities covered in this course: trusts and estates.

### **A. Trusts**

A trust is a legal arrangement whereby one party, the trustee, holds legal title to property for the benefit of another party or parties, the beneficiaries. The trustee has the power to manage and control the property, but is under a fiduciary duty to exercise these powers for the benefit of the beneficiaries according to the terms of the governing instrument. Trusts are usually created for property management or estate-planning purposes. They may have income tax avoidance as a primary goal, but not usually.

The party who creates and transfers property to a trust is called a grantor, settlor, or creator. Beneficiaries entitled to trust income are referred to as income beneficiaries. Beneficiaries who will receive the principal or corpus of the trust at some future date are called principal, corpus, or remainder beneficiaries or, simply, remaindermen.

A trust may be created by an individual during his or her lifetime, in which case it is called an inter vivos trust. A trust created by a decedent's will is called a testamentary trust.

### **B. Estates**

At death, an individual's property may pass to the decedent's estate, a legal entity created to wind up the decedent's affairs, pay debts, expenses, and taxes, and ultimately distribute the property and any accumulated income to those persons entitled to receive them.

The person charged with managing the estate, called the personal representative, executor, or administrator, has fiduciary duties similar to those of a trustee.

An individual may arrange to have property pass at death directly to another party without becoming subject to administration by an estate. This is commonly called "avoiding probate," and such property is nonprobate property. The usual methods used to avoid probate are joint ownership of property, life insurance payable to designated individuals, and the creation of inter vivos trusts.

## ***II. Illustration of a will and common components***

### **WILL**

I, John Malloy, of Marietta, Georgia, revoke all my former Wills and Codicils and declare this to be my last Will.

### **ARTICLE I**

- A. In this will, the use of the masculine gender includes the feminine, and the use of the singular or plural case includes the other where appropriate.
- B. I am married to Vivian Malloy, and she is referred to as "my wife." The terms "my children" and "my issue" include all of my children and descendants, respectively, whether born or adopted before or after this Will is executed.

### **ARTICLE II**

To my best friend, Hugh Hughes, I leave my entire Smith and Wesson collection.

I give the remainder of my tangible personal property, including any insurance policies thereon, to my wife if she survives me, or if not, to my children who survive me, to be divided as they agree, or if they do not agree within six months after my death, equally as my executor determines. The person having custody of a minor may represent the minor in dividing my tangible personal property, may receipt for the minor's share, hold it, sell all or any part of it, and deliver the share or proceeds when the minor becomes an adult or earlier if the person considers advisable.

### **ARTICLE III**

- A. If my wife survives me, I give to the Trustee of the John Malloy Trust, dated 6/17/87, the share specified in Paragraph B of this Article.

### **PECUNIARY MARITAL DEDUCTION FORMULA**

- B. The marital share shall consist of an amount, which, when combined with the value of other property included in my gross estate for federal estate tax purposes that qualifies for the marital deduction and that passes or has passed to my wife under this instrument or in any other manner, is equal to the lesser of:
  - 1. The maximum marital deduction allowable in determining the federal estate tax payable by my estate under the laws in effect at the time of my death; or
  - 2. The smallest amount that will eliminate all federal estate tax after taking into account all credits and deductions against the tax.

The amount of the marital share shall be determined by reference to the final federal estate tax values, and for purposes of distribution, each asset distributed in satisfaction of this amount shall be valued at its value on the date it is distributed.

My Executor shall have full authority to distribute the marital share in either cash or property or partly cash and partly property, provided that in no event shall any asset be selected for which a marital deduction would not be allowable for federal estate tax purposes.

My Executor shall have full authority to allocate particular assets or portions thereof or undivided interests therein to the marital share to any one or more beneficiaries, taking into account the income tax bases of such assets as it shall deem to be for the best interests of such beneficiaries. The decision of my Executor shall be final and binding upon all parties in interest.

- C. Notwithstanding any inconsistent provision herein, my wife may direct the Trustee in writing to convert any unproductive assets in the Marital Trust into productive assets within a reasonable time.

#### **QUALIFIED TERMINABLE INTEREST PROPERTY**

- D. If my spouse survives me, I give, devise, and bequeath the marital share specified in Paragraph B of this Article to the Trustee of the John Malloy Trust to hold, manage, and invest the same, to collect the income thereon, and to pay to or apply for the benefit of, my spouse the net income thereof in quarterly or other convenient installments, but at least annually, for and during the term of my spouse's life.

Upon the death of my spouse, my Trustee shall assign, transfer, and pay over the then principal of this trust to my then living issue, per stirpes.

#### **Direction**

I hereby direct my Executor to elect that any amount passing under this Article III be treated as qualified terminable interest property for the purpose of qualifying for the marital deduction allowable in determining the federal estate tax upon my estate.

#### **Authorization**

I hereby authorize my Executor, in his sole discretion, to elect that any part or all of any amount passing under this Article III be treated as qualified terminable interest property for the purpose of qualifying for the marital deduction allowable in determined the federal estate tax upon my estate. Without limiting the discretion contained in the foregoing sentence, it is my expectation that my Executor will make said election with respect to all of any such amount unless the timing of my spouse's death and mine and the computation of the combined death duties in our two estates render such an election inappropriate.

- E. Subject only to the limits of the marital deduction formula provided in Paragraph B of this Article (and the election provided in Paragraph C of this Article), no other provision of this Will shall be construed to limit or restrict any distribution to or for the benefit of my wife necessary to qualify my estate for the maximum material deduction under the federal estate tax law. To the extent any provision conflicts with this intention and purpose, it shall be void.
- F. My wife or her personal representative, by an instrument in writing delivered to my Trustee after my death, may disclaim all or any part of the distribution under Paragraph B of this Article. Any part so disclaimed shall be held and administered by the Trustee as a separate trust in accordance with the terms of the Residual Trust except that my wife shall not receive distributions of principal from this separate trust. If my wife further disclaims her income interest in this separate trust then it shall be held and administered in accordance with the terms of the Residual Trust as if she has predeceased me. Upon my wife's death, any assets segregated pursuant to the terms of this paragraph shall be merged with other assets being held in the Residual Trust.

#### **ARTICLE IV**

I give my residual estate, which is all my property not otherwise effectively disposed of, excluding any property over which I hold a power of appointment, to the trustee of the John Malloy Children's Trust dated 6/17/95, previously executed by me with myself as trustee, to administer under that instrument as in effect at my death.

#### **ARTICLE V**

In the event that my wife and I die simultaneously or under circumstances causing doubt as to which of us survived the other, it shall be conclusively presumed that my wife survived me.

#### **ARTICLE VI**

- A. I appoint First National Bank of Marietta, or its successor or successors, as Executor of this Will and Trustee of any trusts created hereunder.
- B. I direct my Executor to pay my funeral expenses, administration expenses, and legal debts as provided by law.
- C. My Executor shall pay, from the residue of my estate, all federal estate taxes, all state inheritance taxes, and any other taxes imposed as the result of my death, together with any interest and penalties thereon, whether or not the assets on which the taxes are imposed are a part of my probate estate. However, no such taxes shall be paid from my estate that result from the inclusion of property over which I have a power of appointment and which does not become a part of my estate.

My Executor shall seek reimbursement of taxes and other amounts resulting from inclusion in my estate of Qualified Terminable Interest Property as specified in §2207A of the Internal Revenue Code of 1986, as amended. My Executor shall have no duty to secure any other reimbursement to my estate from anyone for taxes so paid. My Executor may make such elections under tax laws as it deems advisable. Any action taken by my Executor as to such payments, elections, or taxes shall be conclusive on all persons.

- D. I authorize my Executor to make demand upon Trustee for payment to my Executor out of any nonprobate assets paid directly to my Trustee of such amounts as my Executor may require under Paragraph C of this Article; provided, however, in no event shall any portion of the proceeds of any life insurance excludable from state death taxes or in which I had no incidents of ownership, or any other asset not subject to death related taxes be used for these purposes. Written demand by my Executor shall be conclusive and relieve my Trustee of any duty to see to the application of these funds.
- E. Notwithstanding the preceding paragraphs of this Article, no portion of federal or state estate taxes, inheritance taxes, or similar taxes paid by or on behalf of my estate shall be allocable or chargeable to the Marital Trust created under this Will.

#### **ARTICLE VII**

- A. If my wife, Vivian Malloy, does not survive me, I designate my brother and his wife, Tony and Sarah Malloy, as the guardians or guardian of the person and estate of each minor child of mine.
- B. I direct that no security on the guardian's bond be required of any guardian named herein.

#### **ARTICLE VIII**

I have signed this will, consisting of four (4) pages, this page included, on the \_\_\_\_ day of \_\_\_\_\_, 20\_\_.

(s) John Malloy

JOHN MALLOY

This instrument, consisting of five (5) typewritten pages, including this one, was, on the above date and in our presence, signed by John Malloy, the testator. The testator declared this to be his Will, and we, at his request and in his presence and the presence of each other, have signed our names as attesting witnesses. At the time this Will was executed, we believe the testator was of sound mind and acting voluntarily.

(s) John Henderson

711 Manhasset Drive  
Dunwoody, GA

(s) J. J. Maier

550 Turnip Hill  
Decatur, GA

(s) Gloria Foster

3114 Twin Lakes Drive  
Marietta, GA

**This foregoing will is intended to be used for illustrative purposes and is not comprehensive or intended to be used as a model for client engagements.**

## **A. Exercise**

Name the Article and Section of the will where each of the provisions listed below is described.

1. Marital deduction \_\_\_\_\_.
2. QTIP trust \_\_\_\_\_.
3. Testator's identity \_\_\_\_\_.
4. Revocation of prior wills and codicils \_\_\_\_\_.
5. Appointment of executor \_\_\_\_\_.
6. Appointment of guardianship \_\_\_\_\_.
7. Legatee of the Smith & Wesson collection \_\_\_\_\_.
8. Residuary estate \_\_\_\_\_.
9. Simultaneous death \_\_\_\_\_.
10. Guardians to serve when spouse does not survive testator \_\_\_\_\_.

### ***III. Illustrative Marital Deduction Trust (QTIP)***

STATE OF: Virginia  
COUNTY OF: Accomack

I, John A. Scott, hereby transfer, assign, and convey to ABC BANK (hereinafter called the Trustee), as Trustee, the property shown on the attached schedule, in trust for the beneficiaries and upon the uses and trusts hereinafter set out.

#### **IRREVOCABLE -- ITEM I**

I have been fully advised and understand and declare that this trust is and shall be irrevocable and that after the execution of this trust I shall have no right, title, or interest in or power, privilege, or incident of ownership in regard to any of the property in this trust and no right to alter, amend, modify, revoke, or terminate this trust or any of its provisions.

#### **INCOME TO SPOUSE -- ITEM II**

**Distribution.** The Trustee shall pay to my wife, Anita B. Scott, all income from the property, in quarterly or more frequent installments, until her death.

**Encroachment for Wife.** The Trustee may also encroach on the principal of this trust at any time and from time to time in such amounts as the Trustee may deem necessary to provide for the health, support, and maintenance of my wife after taking into consideration any other means of support she may have to the knowledge of the Trustee.

**Disposition of Property on Death of Wife.** On the death of my wife, all property remaining in the trust (other than accrued or undistributed income, which shall be distributed to her estate) shall be distributed by the Trustee to my descendants from my first marriage who survive her, per stirpes.

**Failure of Beneficiaries.** If at any time before the final distribution of this trust all of the beneficiaries herein named or described should die and there should be no such beneficiary to take the property or the income therefrom, then the property remaining in the trust shall be distributed among the persons who would have been entitled thereto under the laws of descent and distribution of the State of Virginia if I had died intestate at that time owning such property in fee simple.

**Taxes Attributable to Qualified Terminable Interest Property.** Unless her will expressly directs otherwise, the Trustee shall pay on the death of my wife, either directly or through her personal representative, as the Trustee determines, the federal estate tax and state death tax attributable to the inclusion of property in this trust in the gross estate of my wife, computing the amount of the federal estate tax for this purpose in accordance with the applicable federal statute extending a right of recovery for such tax to her personal representative, and the amount of the state death tax as the difference between the death tax payable on account of the death of my wife with and without the inclusion of the property in this trust in the calculation. The Trustee may withhold distribution of an amount of property sufficient, in its judgment, to cover any liabilities imposed on the Trustee hereunder until such liability is finally satisfied.

### TRUST CORPUS -- ITEM III

**Additions to Trust.** I, John A. Scott, shall have the right at any time to add to this trust by depositing additional property with the Trustee hereunder, provided such property is acceptable to the Trustee. All property so deposited shall be held and distributed by the Trustee as if it had been a part of the property originally deposited hereunder, unless the instrument by which such property is deposited otherwise provides.

### DISCLOSURE -- ITEM IV

**Statements to Beneficiary.** The Trustee shall, at least annually, furnish to my wife a statement showing the property then held by the Trustee and the receipts and disbursements; but the Trustee shall not be required to make or file any inventory or appraisal, or file annual or other returns or reports to any court or to give bond.

### INVESTMENTS -- ITEM V

**Diversification.** I have confidence in the investments that have been or will be deposited hereunder and no change need be made by the Trustee in these investments solely for the purpose of creating a diversity of investments, but the Trustee shall be authorized to sell or otherwise dispose of such investments, if and to the extent the Trustee deems such sale or disposition to be in the best interest of the trust, without being constrained to do so.

### TRUSTEE -- ITEM VI

**Merger of Corporate Trustee.** Wherever ABC BANK is named herein, it shall be deemed to include any bank or trust company into which ABC BANK may hereafter be merged or consolidated.

**Compensation.** ABC BANK shall receive as compensation for its services as Trustee the fees it normally charges to similar trusts under its regularly published fee schedule as the same may, from time to time, be amended.

### FIDUCIARY GUIDANCE -- ITEM VII

**Powers of Trustee.** In the management, care and disposition of this trust, the Trustee shall have the power to do all things and to execute such instruments as may be deemed necessary or proper, including to the extent not otherwise provided hereunder, the powers set out in the Code of Virginia as amended to the date of execution of this trust, which powers are incorporated by reference herein. All such powers may be exercised without order of or report to any court.

**Distribution Held in Trust for Beneficiary Under Age 21.** Whenever the Trustee is directed to distribute any trust property in fee simple to a person who is then under twenty-one (21) years of age, the Trustee shall be authorized to hold such property in trust for such person until he or she becomes twenty-one (21) years of age, and in the meantime shall use such part of the income and the principal of the trust as the Trustee may deem necessary to provide for the proper support and education of such person. If such person should die before becoming twenty-one (21) years of age, the property then remaining in the trust shall be distributed to the personal representative of such person's estate.

**Loans and Sales Between Related Trusts and Estates.** The Trustee shall be authorized to lend or borrow, at an adequate rate of interest and with adequate security and upon such terms and conditions as the Trustee shall deem fair and equitable, and to sell or purchase, at the fair market value as determined by the Trustee, any property to or from my estate, the estate of my spouse or any trust created by me or my spouse during life or by will, even though the same person or corporation may be acting as executor of my estate or of the estate of my spouse or as trustee of any of such other trusts and as Trustee of this trust.

**SIGNATURE -- ITEM VIII**

IN WITNESS WHEREOF I have hereunto set my hand and affixed my seal and the Trustee, to evidence its acceptance of the trust herein created, has caused this instrument to be signed by its duly authorized officer, this \_\_\_\_ day of \_\_\_\_\_, 20\_\_.

\_\_\_\_\_(SEAL)

Grantor

ABC BANK, Trustee

By: \_\_\_\_\_(SEAL)

Title: \_\_\_\_\_

Signed, sealed, and delivered  
in the presence of:

\_\_\_\_\_, \_\_\_\_\_  
Witness                      Witness

\_\_\_\_\_  
Notary Public

Approved:

\_\_\_\_\_  
Attorney for Grantor

## IV. Glossary

**ADMINISTRATION EXPENSE:** Expense incidental to the management of an estate or trust such as accounting and legal fees, and brokerage commissions.

**BEQUEST:** A gift of personal property by will, to be distinguished from a devise.

**CORPUS:** The principal, capital, or residual of a trust, as distinguished from income.

**DEVISE:** A gift of real property by will, to be distinguished from a bequest.

**DEWISEE:** Person who receives a devise.

**DONEE:** One who receives a gift.

**DONOR:** One who makes a gift.

**ESTATE TAX:** A federal tax imposed on the transfer of property at death.

**FIDUCIARY:** An individual or organization charged with the duty to act for the benefit of another. Trustee-beneficiary and guardian-ward are examples of fiduciary relationships.

**INTER VIVOS:** Literally, between living persons; for example, a trust created by a living person.

**INTESTATE:** Description of the estate of a decedent who died without leaving a valid will. (In the absence of a will, local law provides the descent and distribution.)

**IRREVOCABLE TRUST:** A trust, which by its terms, cannot be revoked.

**JOINT TENANCY:** The holding of property by two or more persons in such a manner that, upon the death of one joint owner, the survivor or survivors inherit the entire property.

**LEGACY:** Once the debts of the estate are paid, legacies are distributed. A testator's bequest of personal property is a **legacy**, and its recipient is a **legatee**. Legacies are classified as **specific**, **demonstrative**, **general**, and **residual**.

- A **specific legacy** is a bequest of personal property (e.g., clothing, jewelry, other personal effects, furniture, and securities) specified in the will.
- A **demonstrative legacy** is a bequest payable from a designated fund or specified asset accumulation. A gift of cash payable from a designated bank account and the bequest of a quantity of grain from a specified granary are examples of demonstrative legacies.
- A **general legacy** is a bequest of money or other property with no indication of the source of the asset to be distributed.
- A **residual legacy** is the terminal distribution of personal property (the residue of the estate) occurring after all debts are paid and all other legacies are distributed. The residual legatee receives the residue of the estate.

Legacies are distributed in the preceding order. If there is insufficient property to satisfy all legacies, they are abated, or scaled down, in the reverse of this order. A legacy is not always paid, even though the estate is solvent. In such an instance, the default is termed a **failure** of a legacy. Failure may exist if the legatee dies prior to the testator, the property has deteriorated or has been destroyed, or related provisions in the will controvert public policy.

The statutes of many states provide for bequests by **advancement** if the decedent dies intestate. That is, if the decedent, during the decedent's lifetime, made a gift of property to individuals (usually children or other lineal descendants) who otherwise would have been entitled to inherit a part of the estate, the gift may be regarded as an advancement in anticipation of the advancee's intestate share. However, all gratuitous transfers before death are regarded as absolute gifts, not advancements, unless contrary intent is demonstrated.

**LIFE ESTATE:** The right to use or receive the income from property for life.

**POWER OF APPOINTMENT:** The right given to a person to dispose of property. A general power of appointment may be exercised in favor of anyone, including the holder of the estate. A special or limited power of appointment may be exercised only in favor of a specified class of persons.

**PROBATE:** In the narrow sense, the act of proving a decedent's will to a court as the first step in settlement of the estate. The term is often used to refer to the entire process of administration and distribution of a decedent's estate.

**REMAINDER:** A property right to be enjoyed in the future after termination of an intervening interest, usually a life estate.

**RESIDUAL ESTATE:** The property of a decedent remaining after debts, expenses, and taxes have been paid, and after all specific bequests have been distributed.

**RESIDUAL BENEFICIARY:** The beneficiary entitled to the residual estate.

**REVERSIONARY RIGHT:** A transferor's right to have property returned after the termination of an intervening estate or interest.

**REVOCABLE TRUST:** A trust that may be revoked; the opposite of an irrevocable trust.

**SPLIT-INTEREST TRUST:** A trust designated in part for a charitable purpose.

**TENANCY BY THE ENTIRETY:** A form of joint and survival ownership of real property restricted to husband and wife.

**TENANCY IN COMMON:** A form of ownership in which the interest of one of several owners does not pass to the others at death, but becomes part of the decedent's estate.

# Accounting for Estates and Trusts

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# Accounting for Estates and Trusts

## *Learning objectives*

After completing this chapter, you will be able to:

- Distinguish between income and principal items;
- Draft charge and discharge statements for clients; and
- Open books and record journal entries for an estate/trust.

## ***I. Introduction***

An executor of an estate or a trustee of a trust is entrusted with the safekeeping, management, and disposition of assets on behalf of others. In this capacity, the executor/trustee is a steward or fiduciary and is accountable to various parties, such as the probate court, beneficiaries, and federal and state taxing agencies. The fiduciary's accountability is increased by the receipt of assets and is decreased by the disposition of assets either as prescribed by law or in accordance with provisions of the will or trust instrument. Obligations of the decedent or claims resulting from the operation of the estate are normally not recorded until they are paid. Because the accounting records are designed to reflect the fiduciary's accountability, this accountability is not reduced until payment is made. Thus, the fundamental accounting equation for an estate or trust becomes:

$$\text{Assets} = \text{Accountability}$$

From a reporting point of view, the personal representative is concerned primarily with reporting on the fulfillment of the fiduciary responsibility, not on reporting the complete financial position of the estate. Also, in accounting for estates and trusts, the fiduciary should maintain a dual basis of accountability. That is, the fiduciary makes a distinction between initial principal and income, and transactions subsequently affecting principal and income. The principal-income distinction is important for several reasons. First, a trustor may specify different principal and income beneficiaries or different times for the distribution of principal and income. Second, this distinction is important in the calculation of income taxes. This distinction is considered further below.

## ***II. Principal (corpus) and income distinguished***

### **A. In general**

The principal-income distinction is often difficult to make because of the diverse provisions of state statutes and the special characteristics of these items. Nevertheless, in some cases, this distinction is not a problem. For example, a trustor may indicate, either in the will or in a trust indenture, the criteria to be used in distinguishing between principal and income. If these criteria are not apparent, courts follow state statutes in making the distinction. In any case, fiduciary accounting records are maintained so that the principal-income distinction is maintained for the reasons mentioned earlier.

The **Revised Uniform Principal and Income Act** defines **principal** essentially as property that has been set aside for a remainderman and income as the return in money or property derived from the use of principal that is set aside for an income beneficiary. The rules for determining whether an item is principal or income are complex under this act. However, some of the elements of principal and income identified in this act are listed below, since they are typical of the principal-income distinction in general.

## **B. Examples**

### **1. Principal**

Principal includes the following:

- Consideration received from the sale or other transfer of property and receipts from the repayments of loans;
- Proceeds from eminent domain proceedings;
- Certain proceeds from insurance on property included in principal;
- Stock dividends, receipts on liquidation of a corporation, and certain other corporate distributions;
- Receipts from the disposition of corporate securities;
- Royalties and other receipts from disposition of natural resources;
- Certain receipts from principal subject to depletion; and
- Certain profits resulting from any change in the form of principal.

### **2. Income**

Income includes the following:

- Rent of real or personal property;
- Interest on money lent;
- Income earned during administration of a decedent's estate;
- Corporate cash dividend distributions;
- Accrued increment on bonds or other obligations issued at discount;
- Receipts from business and farming operations;
- Receipts from disposition of natural resources; and
- Receipts from principal subject to depletion.

### **3. Certain transactions**

In regard to certain transactions affecting principal and interest, the **Revised Uniform Principal and Income Act** also contains the following general provisions.

- a. In general, expenses incurred in connection with the settlement of a decedent's estate, including debts, funeral expenses, estate taxes, interest, and penalties related to taxes, family allowances, fees of attorneys, and other personal representatives, and court costs are charged against estate principal.
- b. Unless the will specifies otherwise, income from the assets of a decedent's estate, as well as related expenses, are distributed as follows:
  - To specific legatees and devisees -- (i) the income from the property bequeathed or devised to them respectively, less taxes, ordinary repairs, and other expenses of operating and managing the property; and (ii) an appropriate portion of the interest accrued since the death of the testator and of taxes imposed on income (excluding taxes on capital gains) that accrue during the period of administration.

- To all other legatees and devisees, except legatees of pecuniary bequests not in trust -- (i) the balance of the income, less the balance of taxes, ordinary repairs, and other expenses of operating and managing all property from which the estate is entitled to income; and (ii) interest accrued since the death of the testator, and taxes imposed on income (excluding taxes on capital gains) that accrue during the period of administration, in proportion to their respective interests in the undistributed assets of the estate computed at times of distribution on the basis of inventory value.

## **C. Items charged to principal and income**

### ***1. Items charged to principal***

The following items are charged to principal:

- Certain trustee's compensation not chargeable to income, special compensation of trustees, expenses reasonably incurred in connection with principal, court costs, and attorney's fees pertaining to principal, and trustee's compensation computed on principal as an acceptance, distribution, or termination fee;
- Costs of investing and reinvesting principal, payments on indebtedness principal, expenses of preparing property for rental or sale, and unless the court directs otherwise, expenses incurred in maintaining or defending principal;
- Extraordinary repairs or expenses incurred in making a capital improvement to principal, including special assessments;
- Taxes levied on profit, gain, or other receipts allocated to principal; and
- Estate and inheritance taxes, including interest and penalties, even though an income beneficiary also has rights in principal.

### ***2. Items are charged to income***

The following items are charged to income:

- Ordinary expenses of administering, managing, and preserving property, including: (i) recurring taxes assessed against principal; (ii) water rates; (iii) premiums on insurance protecting the interests of the income beneficiary, remainderman, or trustee; (iv) interest paid by the trustee; and (v) ordinary repairs;
- A reasonable allowance for depreciation on property subject to depreciation under generally accepted accounting principles (excluding property used by a beneficiary as a residence);
- One-half of court costs, attorney's fees, and other fees on periodic judicial accounting (unless the court directs otherwise);
- Court costs, attorney's fees, and other fees related to accounting and judicial proceedings pertaining to the income interest (unless the court directs otherwise);
- One-half of the trustee's regular compensation (whether based on a percentage of principal or income) and all expenses reasonably incurred for current management of principal and application of income; and
- Any tax levied on receipts defined as income under this act or the trust instrument and payable by the trustee.

## D. Fiduciary accounts and reports

### 1. *In general*

Estate books are opened once the inventory of the decedent's assets is filed. The opening entry includes debits for the assets, and related values, shown in the inventory and a single offsetting credit to "Estate Principal" (or Estate Corpus). This credit reflects the fiduciary's initial accountability. If other **assets are discovered subsequently**, accounts are opened for them, and related credits are made to the "Assets Subsequently Discovered" account. This account is closed to estate principal at the end of the fiduciary accounting period. Note that cash related to principal is accounted for separately from cash related to income using "Cash -- Principal and Cash -- Income" accounts.

### 2. *Liabilities*

**Liabilities** of the decedent are not recorded by the fiduciary until paid. On settlement, the "Debts of the Decedent Paid" account is debited for the amount of the settlement. Settlements of debt constitute reductions in accountability; thus, debits to "Debts of the Decedent Paid" are equivalent to debits to "Estate Principal." Ultimately, this account is closed to "Estate Principal." With respect to both assets and liabilities, the amount of account detail (and the necessity for subsidiary records) is governed by the magnitude and diversity of assets in, and the number of claims against, the estate.

### 3. *Gains*

**Gains** (losses) on the conversion of principal assets increase (decrease) the accountability of the fiduciary in regard to the principal of the estate. Gains are credited to the "Gain on Realization" account, and losses are debited to the "Loss on Realization" account. Both accounts are closed to "Estate Principal" at the end of the accounting period. As implied previously, the increased (decreased) accountability of the fiduciary pertaining to gains and losses is not related to an attempt to measure income.

### 4. *Funeral and administration expenses*

The accountability of the fiduciary is also decreased by **disbursements for funeral and administration expenses**. A single "Funeral and Administration Expenses" account is often used to record the related debits, or it may be desirable to use separate accounts for the various types of funeral and administrative expenses if they are numerous. Typical funeral and administrative expenses are those related to the last illness; the funeral; the administrative services of the executor or trustee; **accountants'**, **attorneys'**, and **appraisers'** services; and court costs.

### 5. *Other items*

Other items that reduce the fiduciary's accountability with respect to principal are the **payment of estate and inheritance taxes** and the **distribution of legacies**. Estate and inheritance taxes are debited to the "Expenses -- Principal" account when paid. If a legacy involves the distribution of specific assets, the values assigned to the assets in the inventory (or when discovered subsequently) constitute their accounting bases, regardless of their current market values. If there are relatively few legatees, a single account -- "Legacies" -- may be sufficient for record-keeping purposes; however, if the number of legatees is large, the use of a separate account for each may be desirable. In either case, the pertinent legacy-type account is debited when a legacy is distributed. Note that if inheritance taxes are to be charged against the legatees (which is often the case), or the various legacies may be reduced for other reasons, record keeping is facilitated by using separate legatee accounts.

Fiduciaries typically account for various items of income by crediting the "Income" account, although the use of separate income-type accounts facilitates record keeping if there are numerous sources of income. Expenses chargeable to income are debited to the "Expenses-Income" account (or to several expense type accounts that reveal the natures of the expense). Although not expenses, distributions to income beneficiaries are usually charged to the "Distribution to Income Beneficiary" (or Beneficiaries) account. If there are numerous income beneficiaries, record keeping again may be facilitated by using separate "Distribution to Income Beneficiary" accounts for each.

## E. Accounting for an estate

### 1. Initial accounting

The following scenario depicts record-keeping procedures for an estate. Cabell Mapp died on May 1, 2019. His will, admitted to probate on May 12, 2019, names Dora Mapp, daughter of the decedent, executrix. The will stipulates specific legacies of \$5,000 for both Eric and Jason, grandchildren of the decedent. Also, \$20,000 and the decedent's personal automobile are awarded to Dora. Louise (the surviving spouse) receives the personal effects of Cabell. The remainder of the estate property, after payment of debts, expenses, and distributions to legacies, is placed in trust. The income from the trust is to be paid to Louise during her lifetime, with the remaining principal being distributed equally to Eric and Jason upon her death.

Dora Mapp files the following inventory with the probate court on May 27, 2019.

Cash in bank	\$ 30,000	
Personal effects	1,000	
Life insurance policies payable to the estate	60,000	
1,000 shares of M Company \$60 par value common stock -- at market	59,000	
1,000 shares of A, Inc., 7%, \$40 par value preferred stock -- at market	40,000	
50 X Corporation 6%, 20-year \$1,000 bonds (interest payable March 1 and September 1)	49,800	
Automobile	5,000	
Dividend receivable (declared April 14, date of record April 21, payable June 15, M Company common)	2,000	
Interest receivable (X Corporation bonds)	<u>500</u>	
		\$247,300

On the same date, the fiduciary opens accounts for the estate of Cabell Mapp and records the inventory as follows.

Cash - Principal	\$ 30,000	
Personal effects	1,000	
Life insurance	60,000	
M Company common stock	59,000	
A, Inc., preferred stock	40,000	
X Corporation bonds	49,800	
Automobile	5,000	
Dividend receivable	2,000	
Interest receivable	500	
Estate principal		\$247,300

Other transactions, entries, and events related to the fiduciary in 2019 are identified next.

**May 26, 2019** -- Public notice is given to creditors of the estate of the decedent to make a presentation of their claims.

**June 14, 2019** -- Funeral expenses of \$2,000 are paid.

Funeral and Administration Expenses	2,000	
Cash - Principal		2,000

**June 15, 2019** -- Dividends on the M stock are collected. These dividends are part of the estate's principal because both their declaration and record dates are before the date of death.

Cash - Principal	2,000	
Dividends Receivable		2,000

**June 20, 2019** -- Undeposited cash of \$1,000 is discovered among the decedent's personal belongings.

Cash - Principal	1,000	
Assets Subsequently Discovered		1,000

**June 30, 2019** -- Proceeds from the insurance policies are received. The proceeds from these policies are included in the estate's principal because the estate is the beneficiary.

Cash - Principal	60,000	
Life Insurance		60,000

**July 18, 2019** -- Two hundred shares of A, Inc., stock are sold for \$9,000.

Cash - Principal	9,000	
A, Inc., preferred stock		8,000
Gain on Realization		1,000

**September 1, 2019** -- Interest on X Corporation bonds is collected. One-third of the interest on these bonds is included in principal (income) because it is available to the depositor before (after) death.

Cash - Principal	500	
Cash Income	1,000	
Interest Receivable		500
Income		1,000

**September 15, 2019** -- Debts of the decedent of \$3,000 are paid.

Debts of the decedent paid	3,000	
Cash - Principal		3,000

**September 20, 2019** -- Cash legacies are distributed.

Legacy - Dora Mapp	20,000	
Legacy - Eric Mapp	5,000	
Legacy - Jason Mapp	5,000	
Cash - Principal		30,000

**October 1, 2019** -- The automobile is delivered to Dora Mapp.

Legacy - Dora Mapp	5,000	
Automobile		5,000

**October 5, 2019** -- The decedent's personal effects are delivered to the surviving spouse.

Legacy - Louise Mapp	1,000	
Personal Effects		1,000

**October 10, 2019** -- Cash dividends of \$2,000 on the M Company common stock are collected. These dividends are included in income because both their declaration and record dates are after date of death.

Cash - Income	2,000	
Income		2,000

**October 12, 2019** -- Attorney's fees of \$500 and funeral and administrative expenses of \$3,500 are paid. Of the former, \$500 pertains to income.

Funeral and Administration Expenses	3,500	
Expenses - Income	500	
Cash - Principal		3,500
Cash - Income		500

**October 30, 2019** -- A 3.5 percent semiannual dividend on the A, Inc., stock is declared. These dividends are included in income because both their declaration and record dates are after date of death.

Dividend Receivable	1,120	
Income		1,120

**November 1, 2019** -- Income of the estate in the amount of \$800 is distributed to the surviving spouse.

Distribution to Income Beneficiary - Louise Mapp	800	
Cash - Income		800

**November 10, 2019** -- Two hundred shares of M Company common stock are sold for \$11,000.

Cash - Principal	11,000	
Loss on Realization	800	
M Company Common Stock (20% x \$59,000)		11,800

**December 31, 2019** -- Interest of \$1,000 is accrued on X Corporation bonds.

Interest Receivable	1,000	
Income		1,000

**December 31, 2019** -- The executor submits a charge and discharge statement, an accountability report, to the probate court.

## **2. Charge and discharge statement for an estate**

A report that reveals the details of the fiduciary's estate administration is prepared and submitted periodically to the court of jurisdiction. Such a report is the charge and discharge statement, and it may be interim or final, depending on the period required for the settlement of the estate. The general form of the statement is usually prescribed by state statute; however, there is no consensus concerning its form. The statement in Illustration 2-1 is typical of the reports presently used in 48 states.

The charge and discharge statement lists the estate assets for which the fiduciary is accountable and describes the manner in which the fiduciary's accountability has been discharged. The responsibilities related to principal and income are reported separately in the statement. The initial section of the report (the "As to Principal" section) first identifies the assets for which the fiduciary is charged (i.e., those for which the fiduciary has accepted custodial responsibility). They include the following:

- Assets identified in the inventory;
- Assets subsequently discovered; and
- Gains recognized on the conversion or other disposition of principal assets.

The next part of the “As to Principal” section represents the discharge of the fiduciary’s accountability; that is, it reflects items for which the fiduciary is credited. The items discharged include the following:

- Funeral and administration expenses;
- Decedent’s debts;
- Estate and inheritance taxes;
- Legacies; and
- Losses realized on principal assets.

<b>Illustration 2-1</b> <b>Estate of Cabell Mapp</b> Dora Mapp, Executrix Charge and Discharge Statement May 1, <b>2019</b> to December 31, <b>2019</b>		
As to Principal		
I charge myself with:		
Assets per inventory		\$247,300
Assets subsequently discovered		1,000
Gain on realization		1,000
Total		\$249,300
I credit myself with:		
Funeral and administration expenses	\$5,500	
Debts of decedent paid	3,000	
Legacies paid or distributed:		
Dora Mapp	25,000	
Eric Mapp	5,000	
Jason Mapp	5,000	
Louise Mapp	1,000	
Loss on realization	800	45,300
Balance as to principal		<u>\$204,000</u>
Which includes:		
Cash		\$75,000
M Company common stock		47,200
A, Inc., preferred stock		32,000
X Corporation bonds		49,800
Total		<u>\$204,000</u>
As to Income		
I charge myself with:		
Income collected or accrued		\$5,120
I credit myself with:		
Expenses chargeable to income	\$500	
Distribution to income beneficiary	800	1,300
Balance as to income		<u>\$3,820</u>
Which includes:		
Cash		\$1,700
Dividends receivable		1,120
Interest receivable		1,000
Total		<u>\$3,820</u>

To the extent that undistributed principal-related assets remain (as in an interim report or in a final report preceding the transfer of assets to a testamentary trust), the related accounts are identified in the third section of the statement.

With respect to income, the fiduciary is charged for income earned since the date of the decedent's death. These charges are shown in the "As to Income" section of the statement. The sources of the items of income are identified in the statement if they are significant. Dispositions of income for which the fiduciary is customarily credited in this section of the statement include the following:

- Expenses chargeable to income; and
- Payments or other distributions to income beneficiaries.

The data pertaining to the estate of Cabell Mapp, in a typical charge and discharge statement, are presented in Illustration 2-1. If subsequent charge and discharge statements are necessary, they are prepared on a cumulative basis and thus continue to disclose the fiduciary's activities over the entire period of the fiduciary's accountability.

### **3. Closing entries of an estate**

When an estate's activities are concluded, a final charge and discharge statement is prepared, and the fiduciary closes the estate accounts. With respect to principal, the closing process involves closing the accounts created representing increases or decreases in the fiduciary's principal-related accountability to estate principal. Accordingly, the "Assets Subsequently Discovered," "Gains and Losses on Realization," "Debts of the Decedent Paid," "Legacies Paid or Distributed," and "Funeral and Administration Expenses" accounts are closed to the estate principal. Similarly, the accounts related to income are closed to the income account; they include "Expenses - Income and Distributions to Income Beneficiary."

The closing entries for the preceding case are presented in the next section since they involve a transfer of assets into a trust. The first two of these entries close the accounts pertaining to principal; the third entry closes the accounts related to income. The fourth closing entry closes the balances in the "Income and Estate Principal" accounts to the Ed Foth, Trustee, account -- which reflects the trustee's accountability immediately prior to final disposition of the estates assets. Closing entries five and six, record the transfer of the remaining assets pertaining to both principal and income into the trust.

### **4. Properties transferred into trust**

As indicated, provision is made in the preceding case for the transfer of the remaining estate assets into a trust. Assuming that the transfer is made at the same time the charge and discharge statement is prepared (December 31, 2019), the entries given in the following tabulation are required to close the books of the estate and to open the trust accounts. The closing entries were explained previously.

Note that entries seven and eight record the transfer of the estate assets pertaining to principal and income, respectively, into the trust. The trustee normally accepts fiduciary responsibility concurrent with the transfer of trust property. We emphasize that a testamentary trust usually becomes effective as of the date of death. Thus, in this case, the income of the estate is, in effect, income of the trust and is consequently transferred as income into the trust. In contrast, all income accrued prior to the creation of a living trust is included in trust principal, but income earned thereafter is distributable to income beneficiaries.

Once the trust books are opened, the trustee's accounting essentially parallels that of the executor. Thus, the "Trust Principal" account and the related "Income" account reflect the trustee's accountability related to principal and income, respectively. The trustee also renders periodic and final reports of the trustee's stewardship to the court recounting the activities as trustee. Although trustee's statements are generally

not referred to as charge and discharge statements, their main feature, under the Uniform Trustees Accounting Act, is the disclosure of the trustee's financial activities related to principal and income, along with indications of how they have fulfilled their fiduciary responsibilities.

<b>Executrix's Books - December 31, 2019</b>		
1.	Assets Subsequently Discovered	1,000
	Gain on Realization	1,000
	Estate Principal	2,000
2.	Estate Principal	45,300
	Debts of the Decedent Paid	3,000
	Funeral and Administration Expenses	5,500
	Legacy - Dora Mapp	25,000
	Legacy - Eric Mapp	5,000
	Legacy - Jason Mapp	5,000
	Legacy - Louise Mapp	1,000
	Loss on Realization	800
3.	Income	1,300
	Expenses - Income	500
	Distribution to Income Beneficiary	800
4.	Estate Principal	204,000
	Income	3,820
	Ed Foth, Trustee	207,820
5.	Ed Foth, Trustee	204,000
	Cash - Principal	75,000
	M Company Common Stock	47,200
	A, Inc., Preferred Stock	32,000
	X Corporation Bonds	49,800
6.	Ed Foth, Trustee	3,820
	Cash - Income	1,700
	Dividends Receivable	1,120
	Interest Receivable	1,000

<b>Trustee's Books - December 31, 2019</b>		
7.	Cash - Principal	75,000
	M Company Common Stock	47,200
	A, Inc., Preferred Stock	32,000
	X Corporation Bonds	49,800
	Trust Principal	204,000
8.	Cash - Income	1,700
	Dividend Receivable	1,120
	Interest Receivable	1,000
	Income	3,820

### III. Exercise

#### A. Problem 2-1

Lisa Brooks, realtor, died on July 1, 2019. Her partner, Ula Brown, was appointed executrix of her estate and filed with the probate court on July 15 the following inventory assets of the deceased.

Deposit balance, First Union Bank	\$ 9,600
Four-percent AB bonds, interests payable April and October 1 (par, \$80,000)	64,400
Accrued interest on AB bonds	800
Six-percent cumulative S, Inc., preferred stock, 200 shares (par, \$70,000)	38,600
100 shares of XY no-par common stock	8,400
Value of properties established by court-appointed appraisers:	
Office building of the real estate partnership (separately owned by Brooks)	92,000
Automobile	4,400
	<u>\$ 218,200</u>

An additional 200 shares of XY were discovered by the executor on September 1.

The office building was sold on September 14 to Martinson and Sons, realtors, for \$82,000; the 300 shares of XY were sold on September 21 for \$26,200. On October 1, interest was collected on the AB bonds.

During the three months ended October 1, 2019, the executrix made the following payments.

Funeral expenses	\$ 2,500
Administrative expenses	1,900
Debts of the decedent	15,500

The will of the deceased provides that legacies and income be distributed as follows.

To widower, Otto:	To son, Frank:	To daughter, Bertha:
Cash, \$34,000	Cash, \$20,000	Cash, \$20,000
S stock	Automobile	AB bonds
Income of estate		The residue

#### B. Exercise

- Prepare the executor's journal entries for estate transactions for the quarter ended October 1, 2019.
- Journalize the distribution of income and the distribution of legacies on October 2, making closing entries for the estate.

### C. Problem 2-2

Frank Stabler was named executor of the estate of Donna Hughes, who died on March 13, 2019. On December 31, 2019, the executor prepared the following trial balance.

<b>Estate of Donna Hughes Trial Balance December 31, 2019</b>		
	<b>Debit</b>	<b>Credit</b>
Investments:		
Stocks	\$118,500	
Bonds	42,000	
Accrued interest receivable	75	
Cash – Principal	10,850	
Cash – Income	2,125	
Household effects	2,375	
Loss on realization	650	
Gain on realization		\$ 1,200
Assets subsequently discovered		5,520
Debts of decedent paid	5,600	
Funeral expenses	950	
Administration expenses	2,570	
Estate corpus		179,275
Income		3,575
Expenses - Income	380	
Distribution to income beneficiary	995	
Legacy - Holly Hughes	<u>2,500</u>	
	<u>\$189,570</u>	<u>\$189,570</u>

### D. Exercise

Prepare a charge and discharge statement for the estate of Donna Hughes.

## IV. Specimen forms

Mapp Estate Trial Balance 1/10/18				
A/C	Title		Debit	Credit
100	Cash on hand	\$		\$
101	Principal cash			
102	Income cash			
104	Business interest			
105	Mortgages receivable			
106	Interest receivable on mortgages			
107	Corporate stocks			
108	Municipal bonds			
109	Accrued interest on bonds			
111	Rental building			
112	Accrued rents on building			
113	Allowance for depreciation			
114	Diamond ring			
115	Other jewelry			
116	Household furnishings			
117	Automobiles			
118	Director fee receivable			
119	Government bonds			
300	Estate principal			
310	Assets not inventoried			

**Mapp Estate  
Cash Receipts Journal  
Year ended 12/31/18**

			DR	DR	CR	CR	CR	CR	CR	OTHER ACCOUNTS		
			101	102	105	701	702	703	704			
Date 2019	Description	Item #	Principal Cash	Income Cash	Mortgages	Interest	Dividends	Bond Interest	Rents	Account Number	DR	CR
TOTAL DEBITS												
TOTAL CREDITS												

**Mapp Estate  
Cash Disbursements Journal  
Year ended 12/31/18**

			CR	CR	DR	DR	DR	DR	DR	OTHER ACCOUNTS		
			101	102	800	801	802	803	804			
Date 2019	Description	Item #	Principal Cash	Income Cash	Office Expenses	Repairs	Insurance	Utilities	Taxes	Account Number	DR	CR
TOTAL DEBITS												
TOTAL CREDITS												

**Mapp Estate**  
**Worksheet for Year Ending 12/31/18**

A/C	TITLE	INTERIM TRIAL BALANCE 12/31/18			CLOSING ENTRIES			BALANCE SHEET 12/31/18		
		Debit		Credit	Debit		Credit	Debit		Credit
100	Cash on hand	\$		\$	\$		\$	\$		\$
101	Principal cash									
102	Income cash									
104	Business interest									
105	Mortgages receivable									
106	Interest receivable on mortgages									
107	Corporate stocks									
108	Municipal bonds									
109	Accrued interest on bonds									
111	Rental building									
112	Accrued rents on building									
113	Allowance for depreciation									
114	Diamond ring									
115	Other jewelry									
116	Household furnishings									
117	Automobiles									
118	Director's fee receivable									
119	Government bonds									
300	Estate principal									
310	Assets not inventoried									
401	Debts of the decedent									
402	Funeral expenses									
403	Administration expenses									
404	Estate and inheritance taxes									
405	Gains, losses on realization									
406	Legacies paid									
500	Estate income									

**Mapp Estate**  
**Worksheet for Year Ending 12/31/18**

600	Distributions of income											
700	Business income											
701	Interest on mortgages											
702	Dividends received											
703	Interest on municipal bonds											
704	Rental income											
800	Office expenses											
801	Building repairs											
802	Insurance											
803	Utilities											
804	Real estate taxes											
805	Depreciation											
806	Interest expense											
		\$		\$		\$		\$		\$		\$

## V. Problem solutions

### A. Solution: Problem 2-1

A. JULY 15:

CASH -- PRINCIPAL .....	9,600
AB BONDS.....	64,400
ACCRUED INTEREST RECEIVABLE.....	800
S, INC., PREFERRED STOCK.....	38,600
XY STOCK.....	8,400
OFFICE BUILDING.....	92,000
AUTOMOBILE .....	4,400
ESTATE PRINCIPAL.....	218,200

SEPT. 1 :

XY STOCK .....	16,800
ASSETS SUBSEQUENTLY DISCOVERED.....	16,800

SEPT. 14 :

CASH--PRINCIPAL.....	82,000
LOSS ON REALIZATION.....	10,000
OFFICE BUILDING.....	92,000

SEPT. 21:

CASH--PRINCIPAL.....	26,200
XY STOCK .....	25,200
GAIN ON REALIZATION.....	1,000

OCT.1:

CASH--PRINCIPAL.....	800
CASH--INCOME.....	800
ACCRUED INTEREST RECEIVABLE.....	800
INCOME.....	800

JULY 1-OCT.1:

FUNERAL EXPENSES .....	2,500
ADMINISTRATIVE EXPENSES.....	1,900
DEBTS OF DECEDENT PAID.....	15,500
CASH--PRINCIPAL.....	19,900

B. OCT.2:

LEGACY--OTTO.....	72,600
CASH--PRINCIPAL.....	34,000
S, INC. , PRFERRED STOCK.....	38,600

OCT.2:

DISTRIBUTION TO INCOME BENEFICIARY--OTTO...800	
CASH--INCOME.....	800

OCT.2:

LEGACY--FRANK.....	24,400
CASH--PRINCIPAL.....	20,000
AUTOMOBILE.....	4,400

OCT.2:

LEGACY--BERTHA.....	84,400
CASH--PRINCIPAL.....	20,000
AB BONDS.....	64,400

OCT.2:

LEGACY(RESIDUAL)--BERTHA.....	24,700
CASH--PRINCIPAL.....	24,700

OCT.2:

ASSETS SUBSEQUENTLY DISCOVERED.....	16,800
ESTATE PRINCIPAL.....	16,800

OCT.2:

ESTATE PRINCIPAL.....	235,000
GAIN ON REALIZATION.....	1,000
LOSS ON REALIZATION.....	1,000
FUNERAL EXPENSES .....	2,500
ADMINISTRATIVE EXPENSES.....	1,900
DEBTS OF DECEDENT PAID.....	15,500
LEGACY--OTTO.....	72,600
LEGACY--FRANK.....	24,400
LEGACY--BERTHA.....	109,100

OCT.2:

INCOME .....	800
DISTRIBUTION TO INCOME BENEFICIARY - OTTO .....	800

**B. Solution: Problem 2-2**

ESTATE OF DONNA HUGHES  
Frank Stabler, Executor  
Charge and Discharge Statement  
March 31, 2019 to December 31, 2019

## As to Principal:

## I charge myself with:

Assets per inventory	\$179,275	
Assets subsequently discovered	5,520	
Gains on realization	<u>1,200</u>	\$185,995

## I credit myself with:

Funeral expenses	950	
Administration expenses	2,570	
Debts of decedent paid	5,600	
Loss on realization	650	
Legacy – Holly Hughes	<u>2,500</u>	<u>12,270</u>
Balance as to principal		<u>173,725</u>

## Consisting of:

Cash – Principal	10,850
Bonds	42,000
Stocks	118,500
Household Effects	<u>2,375</u>
	<u>173,725</u>

## As to Income:

## I charge myself with:

Income earned	3,575
---------------	-------

## I credit myself with:

Expenses – Income	380	
Distribution to income beneficiary	995	<u>1,375</u>
Balance as to Income		<u>\$ 2,200</u>

## Consisting of:

Cash – Income	2,125
Accrued interest receivable	<u>75</u>
	<u>\$ 2,200</u>



# Fiduciary Accounting Income

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# Fiduciary Accounting Income

## *Learning objectives*

After completing this chapter, you will be able to:

- Explain the concept of fiduciary accounting income and contrast this to taxable income;
- Differentiate between **underproductive property** in the **1962 Act** and the **1997 Act**; and
- Describe the beneficial difference between depreciation for a trust under the **1962 Act** and the **1997 Act**.

## ***I. Introduction***

Income of an estate or trust is taxed either to the fiduciary or to the beneficiaries under rules established by the Code. However, it is first necessary to determine what constitutes such income and the amount distributable to beneficiaries. This involves local law and the terms of the governing instrument. The maximum amount of income available for distribution is fiduciary accounting income, commonly referred to as “FAI” or “state law” income. After completing this chapter, you will be able to:

- Distinguish income from principal;
- Determine FAI under the Revised Uniform Principal and Income Act or local law; and
- Explain the function of FAI.

## ***II. Function of fiduciary accounting income***

In fiduciary accounting, all receipts and disbursements are allocated to income or principal. Because it is not unusual for income and principal to benefit different beneficiaries, this allocation is of particular significance for economic as well as tax purposes.

FAI is a tax concept created by the Code and described as follows in §643(b):

“...The term ... when not preceded by the words ‘taxable,’ ‘distributable net,’ ‘undistributed net,’ or ‘gross’ means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law.”

As a practical matter, FAI is a threshold determination for most fiduciary income-tax purposes.

## ***III. Receipts of income and principal***

Fiduciary accounting differs somewhat from regular accounting or tax accounting. Rules for determining FAI have their origins in English and American court decisions over several centuries. Most states have now adopted so-called principal and income acts that codify judicial or common law.

State laws vary even though a majority of the states have substantially adopted the Uniform Principal and Income Act. However, all state laws permit the controlling instrument to provide overriding rules.

**Practitioner alert:**

When you encounter an income or principal issue that depends on whether an item is includable in FAI, you should first review the controlling instrument. If this covers the question, research of state law is not necessary.

## **A. Statutory definitions**

The citations that follow are to the **Revised Uniform Principal and Income Act**, which appears later in this book.

- Section 3(a) defines income as “the return in money or property derived from the use of principal. ...” Examples include rent, corporate dividends, interest, and receipts from a farm or business.
- Section 3(b) defines principal as “property that has been set aside by the owner ... so that it is held in trust. ...” Thus, cash and property initially transferred by a decedent or grantor to a fiduciary is principal, and any such subsequent transfers are also principal.
- When property is sold, the total proceeds are principal even though a profit or gain is realized on the transaction. (See §3(b)(8)). Property remains principal even though it changes in form. Examples are transactions such as loan repayments, bond redemptions, or savings-account withdrawals.

## **B. Corporate distributions**

Corporate stock splits and stock dividends pose particular problems. As a general rule, traditional splits -- for example, two for one, or three for one -- do not result in income. The same is true of a 50-percent “share dividend,” which leaves the shareholder in essentially the same economic position. Difficulties arise with small share dividends. Section 6(a) provides that these are also principal, but in some states, historically, New York, New Jersey, and Pennsylvania, they were income.

Dividends payable in either cash or stock, at the shareholder’s option, are income.<sup>1</sup>

S corporations and limited partnerships are specially treated.

**Example 1:** An estate holds 50 percent of the stock of an S corporation that has \$40,000 in taxable income for 2019 but pays no dividends. Although the estate has \$20,000 of taxable income, it has no FAI.

**Example 2:** Partnership has portfolio and trade or business investments. It realizes dividend income of \$20,000 and business income of \$30,000, all the latter of which is retained for business expansion. The partnership distributes \$19,000 portfolio income to trust partner that has a 95-percent profits interest. Trust accounting income is \$19,000, the actual cash distribution, even though the trust’s DNI must reflect its \$47,500 share of total partnership income, including \$28,500 of undistributed business income.

**Example 3:** If, under the previous facts, partnership made a \$60,000 cash distribution to its partners, with trust receiving 95 percent or \$57,000 of that distribution, its FAI would be \$47,500 (i.e., its share of partnership portfolio and business income for the year), and DNI would also be the same amount. The balance of \$9,500 distributed would be a return of capital and creditable to the trust principal account.

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<sup>1</sup> See Uniform Principal and Income Act §6(d).

## C. Partnership and proprietorship profits

With respect to partnerships and proprietorships, §8 provides that income includes "... the net profits of the business, computed in accordance with generally accepted accounting principles. ..." However, any losses incurred are charged to principal.

## D. Underproductive property

Unless the governing instrument provides to the contrary, a fiduciary has a duty to dispose of or to convert unproductive property to income-producing property as soon as reasonably possible. Section 9 establishes a "delayed income" concept whereby an income beneficiary becomes entitled to a share of sales proceeds of "underproductive" property. Thus, a capital gain arising from the sale of an underproductive asset, normally regarded as principal, is FAI under the Revised Uniform Principal and Income Act.<sup>2</sup>

**Example:** A testamentary trust owns 200 acres of farmland that has been idle for the last three years. The land's inventory value is \$400,000. This year the land was sold for \$600,000. Real estate commissions were \$36,000 on the sale, and property taxes totaled \$12,000 for the three-year period. The net proceeds of the sale are as follows.

Gross proceeds	\$600,000
Less: Commissions	\$(36,000)
Capital gains tax (.15 X \$164,000)	\$(24,600)
Property taxes	\$(12,000)
Net proceeds	<u>\$527,400</u>

Net proceeds	\$527,400
Less: Investments required to produce net proceeds of \$527,400 divided by 1.12	(470,893)
Difference	\$ 56,507
Add: Property taxes	\$ 12,000
Delayed income to the income beneficiary under the <b>Revised Uniform Principal and Income Act</b>	<u>\$ 68,507</u>

Under the **1997 Uniform Principal and Income Act** (see Chapter 6 – §413), the notion of underproductive property has changed dramatically. That is, no longer will underproductive property force an individual asset's sale proceeds to be allocated differently than the trustee's normal method. Naturally, this treatment was in conflict with the **Prudent Investor Act**. As a result, the **1997 Act** relates underproductive property solely to marital-deduction trusts, and allows great discretion to the trustee on which actions to take in order to make the marital property productive of income.

## E. Accrued interest

One of the changes made by the Uniform Principal and Income Act of 1997 was in the allocation of accrued interest and is illustrated by the change in most states adopting the act (e.g., Fla. Stat. §738.301 and N.Y. Stat. §11-A-3.2). A fact pattern is useful in showing the difference. Assume the decedent dies June 10, holding a \$100,000 bond that pays 6 percent in semi-annual installments, January 1 and July 1. For estate tax purposes, the estate reports the value of the bond, whatever that may be, plus accrued interest of \$2,664 (160/180 of the July 1 payment of \$3,000) as part of the estate.

<sup>2</sup> See Rev. Rul. 85-116, 1985-2 C.B. 174.

Under the Revised Principal and Income Act (1962), the accrued interest of \$2,664 is principal of the estate ("receipts in the form of periodic payments...such as...interest...not due at the death of the testator shall be treated as accruing from day to day"). Under the Uniform Principal and Income Act (1997), the entire \$3,000 received on July 1 is estate accounting income. EPTL 11-A-2.1(2) says the fiduciary will determine net income of a decedent's estate under the rules in parts 3 through 5 of the Act which apply to trustees, and EPTL 11-A-3.2(b) (in part 3) says, "A trustee shall allocate an income receipt...to income if its due date occurs on or after the date on which a decedent dies...and it is a periodic due date."

The accrued interest of \$2,664 is income in respect of a decedent under I.R.C. §691, and the income beneficiary is entitled to a §691(c) deduction for the federal estate tax attributable to the interest. Thus, the income beneficiary is benefited not only by the receipt but also by the estate tax attributable to the receipt.

## ***IV. Charges against income and principal***

Ordinary expenses incurred in the administration, management, or preservation of trust or estate property are charges against income. Property taxes fall into this category.<sup>3</sup> Income taxes related to the production of ordinary income are chargeable to income.<sup>4</sup> Income taxes related to principal, such as capital gains, are chargeable to principal.<sup>5</sup>

Under the Revised Uniform Principal and Income Act, attorney fees, trustee fees, and personal representative commissions are divided equally between income and principal.<sup>6</sup> In some states, they are charged entirely to principal.

Mortgage interest payments are charged against income. The loan repayment portions are charged against principal.<sup>7</sup>

### **A. Depreciation**

Section 13(a)(2) permits a "reasonable allowance for depreciation under generally accepted accounting principles." Accelerated depreciation would probably not meet this definition. Moreover, many states have not adopted this provision of the Uniform Act and allow depreciation only when the fiduciary establishes a depreciation reserve fund and makes reasonable allocations annually to this reserve.

Whenever a depreciation reserve is established, it is not a mere bookkeeping entry. That is, the reserve must be funded. Assume a depreciation reserve of \$5,000 is established each year for the remainderman. Therefore, the fiduciary must debit cash principal - \$5,000 and credit cash income - \$5,000.

Under the **1997 Act** (§503), a trustee may transfer to principal a reasonable amount of the net cash receipts from a principal asset that is subject to depreciation. Additionally, the 1997 Act provides that an amount transferred to principal need not be held as a separate fund.

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<sup>3</sup> Uniform Principal and Income Act §13(a)(1).

<sup>4</sup> Uniform Principal and Income Act §13(a)(b).

<sup>5</sup> Uniform Principal and Income Act §13(c)(4).

<sup>6</sup> Uniform Principal and Income Act §§13(a)(3) and 13(a)(5).

<sup>7</sup> Uniform Principal and Income Act §§13(c)(1) and 13(c)(2).

**Practitioner alert:**

Because of the potential litigation problems and poor accounting practices by some fiduciaries, an ounce of prevention (i.e., setting up a separate fund) through the use of a segregated reserve fund may be worth millions in the long run.

## **V. Computation of fiduciary accounting income**

Income-tax exemptions, exclusions, and credits are purely tax concepts and do not enter into FAI. Also, tax-exempt interest is includable in FAI.

**Example:** A trust has receipts and disbursements as shown next, and made no distributions during the accounting year. Taxable income is \$33,900 and FAI is \$36,000, computed as follows.

	<b>Receipt (Disbursement)</b>	<b>Taxable Income</b>	<b>FAI</b>
Tax-exempt interest	\$10,000		\$10,000
Dividends	10,000	\$10,000	10,000
Taxable interest	10,000	10,000	10,000
Rental income	10,000	10,000	10,000
Property taxes	(1,600)	(1,600)	(1,600)
Depreciation (no reserve)		(1,000)	
Mortgage interest	(400)	(400)	(400)
Mortgage principal	(600)		
Long-term capital gains	10,000	10,000	
Trustee fees (allocated)*	(4,000)	(3,000)	(2,000)
Exemption		( 100)	
Totals		<u>\$33,900</u>	<u>\$36,000</u>

Tax-exempt income is FAI even though it does not appear on the Form 1041 as part of taxable income. Capital gains are allocated to principal rather than to income and are not considered in computing FAI.

\*The method of allocating indirect expense will be discussed below.

Most fiduciaries do not establish a depreciation reserve. Under §13(a)(2) of the Revised Uniform Act, the trustee would be authorized to reduce FAI by depreciation, but in practice such reduction is seldom made.

Under both the Revised Uniform Act and the Uniform Principal and Income Act of 1997, one-half of the trustee's fees is a charge against principal and does not reduce FAI. Mortgage interest payments are applied against income, and mortgage principal payments are applied against principal. For purposes of computing taxable income, general administration expenses (in this case, trustee fees) are prorated between tax-exempt and certain other classes of taxable income. This proration is not required for the computation of FAI.

**Practitioner alert:**

Return preparers sometimes erroneously equate taxable income with FAI and therefore treat capital gains as having been distributed, and thus taxable to beneficiaries. This results in a loss of tax revenue to the Service because tax rates for estates and trusts are frequently significantly higher than for the beneficiaries.

In administering a trust or estate, the fiduciary is concerned with and governed by FAI rules that have been established by local law and the controlling instrument. Practitioners should remember that FAI frequently differs from taxable income because depreciation and capital gains are usually excluded from FAI.

### A. Problems

1. In 2019, the executor received \$100,000 from a working interest in oil and gas. The will is silent as to how to treat this payment.
2. Trustee fees totaled \$12,000 in 2019.
3. A judicial accounting, by a CPA, was rendered to the probate court at a cost of \$1,800 in 2019.

5. A federal gift tax return for the decedent was filed on April 15, 2019 for the year 2018, and it included a \$62,000 payment.

## **B. Solutions**

1. \$90,000-principal, \$10,000-income; page 6-14, §411 a(4).
2. \$6,000-principal, \$6,000-income; page 6-18, §§501(1) and 502(1).
3. \$900-principal, \$900-income; page 6-18, §501(2).
4. Debit cash principal \$6,000 and credit cash income \$6,000; page 6-19, §503(b).
5. \$62,000 goes against principal; page 6-18, §502(6).

# Fiduciary Accounting Income, Distributable Net Income, and Charitable Contributions

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# Fiduciary Accounting Income, Distributable Net Income, and Charitable Contributions

## *Learning objectives*

After completing this chapter, you will be able to:

- Differentiate between the computational differences of fiduciary accounting income (i.e., State Law Income) and distributable net income (DNI);
- Identify the tax issues surrounding charitable contributions for estates and complex trusts;
- Determine the tax issues surrounding capital gains under the **1997 Act's Power to Adjust Provisions**; and
- Identify fiduciary audit issues.

## ***I. Introduction***

Because an estate or trust is a tax-paying entity, double taxation would be imposed if the income previously taxed to the fiduciary was again taxed when distributed to beneficiaries. In order to avoid double taxation, a system was needed to measure the amount and character of income distributed to beneficiaries or retained by an estate or trust. As a result, distributable net income (DNI) was brought into the Code.

Additionally, this chapter illustrates the charitable deduction rules applicable to estates and trusts, shows the computational aspects relating to charitable deductions, and analyzes the charitable deduction's role and position in the income taxation of estates and trusts.

## ***II. Background***

The income tax treatment of estates and trusts is essentially premised upon a "conduit principle." The trust or estate reports its income and computes its tax in a manner similar to individuals. The beneficiary must include in the beneficiary's gross income the distributions of income received from the trust or estate. And the fiduciary is allowed a deduction for income distributed, or required to be distributed, to the beneficiary. The estate or trust is thereby a "conduit" through which the income passes to the beneficiary, and the income is taxable in the hands of the beneficiary as though the beneficiary had received it directly.

### **A. DNI concept**

In order to make the conduit principle work, a device was required to measure the **amount** of income distributed to beneficiaries or retained by the estate. Also, a measure was needed to determine the **character** of amounts distributed to beneficiaries or retained by the estate or trust. Furthermore, a true conduit approach must identify the items of estate income that are given special treatment elsewhere in the Code, such as capital gains, dividends, and interest on municipal bonds, and must keep these items separate as they pass out to the estate or trust's beneficiaries.

To do this, an analytical method or technique was required. Such a method, new in the 1954 Code, is supplied in the concept of distributable net income. DNI has three basic functions:<sup>1</sup>

- It limits the amount of the distribution deduction of the estate and trust;
- It limits the amount on which beneficiaries can be taxed; and
- It is used to determine the character of amounts retained by an estate or trust and the character of amounts distributed to the beneficiaries.

Thus, DNI has been termed the yardstick or measuring rod to be employed in determining, on one hand, the maximum deduction for distributions that may be allowed to the estate or trust and for gauging, on the other hand, the extent to which beneficiaries may be taxable on the distributions.

## **B. DNI -- A modification of taxable income**

In order to serve as a measure of the maximum deduction to be allowed to trusts or estates for distributions to beneficiaries (and conversely to determine the amounts includable in the beneficiaries' gross income), taxable income must be modified in several important respects. Section 643(a) of the Internal Revenue Code of 1954 sets out the modifications to taxable income and labels this modified income "distributable net income." In this Code section, DNI is defined as the taxable income of the estate or trust computed with six modifications. The modifications are as follows.

- No deduction is allowed for amounts distributed or distributable to beneficiaries.
- No deduction is allowed for personal exemptions -- \$600 for estates, \$300 for simple trusts, and \$100 for complex trusts.
- Gains from the sale or exchange of capital assets are excluded to the extent that they are allocated to corpus and are not paid, credited, or required to be distributed to any beneficiary or paid or set aside for charities. Capital losses are excluded except to the extent that such losses are taken into account in determining the amount of capital gain to be paid, credited, or required to be distributed to any beneficiary during the taxable year.
- With respect only to simple trusts, extraordinary dividends and taxable stock dividends, if properly allocated by the trustee in good faith to corpus, are excluded.
- Interest that is fully tax-exempt (less nondeductible disbursements allocated to such interest) is included.
- In the case of foreign trusts, income from sources without the United States (less nondeductible disbursements allocable to such income) is included.

## **C. DNI computations for a simple trust**

The rules applicable to a trust required to distribute all of its income currently and to its beneficiaries (that is, a simple trust falling under §§651 and 652) may be illustrated in the following manner.<sup>2</sup>

Pursuant to the terms of a simple trust, all of the income is to be distributed equally to Beneficiaries X and Y and capital gains are to be allocated to corpus. The trust and both beneficiaries file returns on the calendar-year basis. No provision is made for depreciation in the governing instrument. Therefore, it will follow income. During the taxable year, the trust had the following items of income and expenses.

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<sup>1</sup> Treas. Regs. §1.643(a)-0.

<sup>2</sup> Treas. Regs. §1.652(c)-4.

Rents	\$25,000
Dividends of domestic corporations	50,000
Tax-exempt interest on municipal bonds	25,000
Long-term capital gains	15,000
Taxes and expenses directly attributable to rents	5,000
Trustee's commissions allocable to income account	2,600
Trustee's commissions allocable to principal account	1,300
Depreciation	5,000

### 1. Step I -- State law income

The state law income of the trust for fiduciary accounting purposes is \$92,400, computed as follows.

Rents		\$25,000
Dividends		50,000
Tax-exempt		<u>25,000</u>
Total		\$100,000
Deductions:		
Expenses directly attributable to rental income	\$5,000	
Trustee's commissions allocable to income account	2,600	<u>7,600</u>
State law income computed under §643(b)		<u>\$92,400</u>

One-half (\$46,200) of the income of \$92,400 is currently distributable to each beneficiary.

### 2. Step II -- Section 643(a) ceiling

The distributable net income (income ceiling) of the trust computed under §643(a) is \$91,100, determined as follows (cents are disregarded in the computation):

Rents		\$25,000
Dividends		50,000
Tax-exempt interest		
Less: Expenses allocable thereto	\$25,000	
(25,000/100,000 x \$3,900)	<u>975</u>	<u>24,025</u>
Total		\$99,025
Deductions:		
Expenses directly attributable to rental income	\$5,000	
Trustee's commissions		
(\$3,900 less \$975 allocable to tax-exempt interest)	<u>2,925</u>	<u>7,925</u>
Distributable net income as the income ceiling		<u>\$91,100</u>

In computing the distributable net income of \$91,100, the taxable income of the trust was computed with the following modifications:

- No deductions were allowed for distributions to the beneficiaries and for a personal exemption of the trust;<sup>3</sup>
- Capital gains were excluded;<sup>4</sup> and
- The tax-exempt interest (as adjusted for expenses) was included.<sup>5</sup>

<sup>3</sup> I.R.C. §§643(a)(1) and (2).

<sup>4</sup> I.R.C. §643(a)(3).

<sup>5</sup> I.R.C. §§643(a)(5) and (7).

### 3. Step III -- Section 651(a) ceiling

The deduction ceiling allowable to the trust under §651(a) for distributions to the beneficiaries is \$67,075 computed as follows.

Distributable net income computed under §643(a)	\$91,100
Less:	
Tax-exempt interest as adjusted	24,025
Distributable net income (deduction ceiling) as determined under §651(b)	\$67,075

Since the amount of the income (\$92,400) required to be distributed currently by the trust exceeds the distributable net income (\$67,075) as computed under §651(b), the deduction allowable under §651(a) is limited to the distributable net income of \$67,075.

### 4. Step IV -- Trust's income

The taxable income of the trust is \$14,700, computed as follows.

Rents		\$25,000
Dividends		50,000
Long-term capital gains		<u>15,000</u>
Gross income		\$90,000
Deductions:		
Rental expenses	\$5,000	
Trustee's commissions	2,925	
Distributions to beneficiaries	67,075	
Personal exemption for a simple trust	<u>300</u>	75,300
Taxable income		<u>\$14,700</u>

The trust is not allowed a deduction for the portion (\$975) of the trustee's commissions allocable to tax-exempt interest in computing its taxable income.

Also, it should be noted that a simple trust that is allocating capital gains to corpus can perform a supplemental calculation to check its taxable income. For example, in the above calculation, the trust's taxable income was \$14,700; this could have been figured as follows.

Capital gains	\$15,000
Less:	
Personal exemption	<u>(300)</u>
Taxable income	<u>\$14,700</u>

### 5. Step V -- Inclusion and characterization to beneficiaries

In determining the character of the amounts includable in the gross income of X and Y, it is assumed that the trustee elects to allocate to rents the expenses not directly attributable to a specific item of income, other than the portion (\$975) of such expenses allocated to tax-exempt interest.

The allocation of expenses among the items of income, as required by §652(b), is shown below.

	<b>Rents</b>	<b>Dividends</b>	<b>Tax-exempt interest</b>	<b>Total</b>
Income for trust accounting purposes	\$25,000	\$50,000	\$25,000	\$100,000
Less:				
Rental expenses	5,000	-0-	-0-	5,000
Trustee's commissions	<u>2,925</u>	<u>-0-</u>	<u>975</u>	<u>3,900</u>
Total deductions	7,925	-0-	975	8,900
Character of amounts in the hands of the beneficiaries	\$17,075	\$50,000	\$24,025	<u>\$91,100</u>

Inasmuch as the income of the trust is to be distributed equally to X and Y, each is deemed to have received one-half of each item of income, that is, rents of \$8,537.50, dividends of \$25,000, and tax-exempt interest of \$12,012.50. The dividends of \$25,000 allocated to each beneficiary are to be aggregated with the beneficiary's other dividends.

Additionally, each beneficiary is allowed a deduction of \$2,500 for depreciation of rental property attributable to the portion (one-half) of the income of the trust distributed to the beneficiary. If depreciation had been a charge against income and consequently required a reserve, then it should have appeared at Step I (reducing state-law income) and at Step IV (as a deduction to the trust in computing its taxable income). Note, of course, that the beneficiaries are responsible for only \$91,100 of DNI while, in fact, \$92,400 has been distributed to them.

***Planning tip:***

If the client desires to benefit the current income beneficiary(ies) the most, then an over-allocation to corpus of floating expenses is desired. Conversely, if the client desires to benefit the remainder beneficiary(ies) the most, then an over allocation to income is required. Of course, this is why the **Uniform Principal and Income Act** allocates the expenses 50-50.

## **6. How to handle depreciation and depletion deductions**

Either an estate or trust may be entitled to depreciation and depletion deductions if it holds qualified property.<sup>6</sup>

### **7. Rules for estates only**

Even though an estate may be allowed a depreciation or depletion deduction, it must be recognized that this is a residual claim to these deductions. For an estate, Treas. Regs. §§1.167(h)-1(c) and 1.611-1(c)(5) provide that the allowable deduction for depreciation and/or depletion shall be apportioned between the estate and the heirs, legatees, and devisees on the basis of income of the estate that is allocable to each.

### **8. Rules for trusts only**

Trusts are permitted greater flexibility than estates in receiving depreciation and depletion deductions. For instance, Treas. Regs. §§1.167(h)-1(b) and 1.611-1(c)(4) provide that, if property is held in trust, the depreciation or depletion deductions are to be apportioned between the income beneficiaries and the trust on the basis of the trust income allocable to each. However, if the governing instrument (or local law) requires or permits the trustee to maintain a reserve for depreciation in any amounts, then the deduction

<sup>6</sup> I.R.C. §§167(a) and (h); I.R.C. §§661(a) and (b)(3).

is first allocated to the trust to the extent that income is set aside for a depreciation reserve. Any part of the deduction in excess of this amount set aside for the reserve shall be apportioned between the income beneficiaries and the trust on the basis of the trust income allocable to each.

**Example:** John Doe creates a trust, with his son, Harry, and his daughter, Mary, as income beneficiaries, by the transfer of income producing depreciable property. Pursuant to the terms of the trust instrument, the income from the trust is to be distributed annually on a 60-percent basis to Harry and 40 percent to Mary. Additionally, the trustee is permitted to set aside income as a depreciation reserve. In 2019, depreciation on the trust property amounts to \$9,000, and the trustee allocates \$6,000 of trust income as a depreciation reserve. As a result, the trust can claim \$6,000 as a depreciation deduction, Harry can claim \$1,800  $[(\$9,000 - \$6,000 \times 60 \text{ percent})]$  and Mary can claim \$1,200  $[(\$9,000 - \$6,000 \times 40 \text{ percent})]$ .

## D. DNI computations for a complex trust or an estate

In the case of a simple trust, the basic issue was the allocation of income between the trust and the beneficiaries. However, the problem of allocation among the beneficiaries will become more prominent with the complex trust and estate. Even though the complex trust and estate are taxed in substantially the same manner as a simple trust, nonetheless, some complications arise from the tier system and charitable contributions.

### 1. Tier system

The 1954 Code provides a two-tier system of priorities (affecting DNI), which characterize the amounts distributed to beneficiaries as either income or corpus (a detailed discussion of the tier system is provided in a later chapter). This system provides first tier, income required to be distributed currently including annuity payments out of income,<sup>7</sup> and second tier, all other amounts properly paid, credited, or required to be distributed.<sup>8</sup> This would include: (i) current income that the trustee was not required to distribute; (ii) accumulated income; and (iii) corpus.

Because of the system's hierarchy, the first tier has a priority on using up DNI. If the first-tier payments do not exhaust the ceiling amount of DNI, then any balance of DNI will affect the taxability of all other distributions that fall into the second tier.

**Example:** A trust is required to pay \$10,000 out of income each year to A. Also, the trust is to pay B \$15,000 out of income or corpus. The DNI of the trust is \$20,000. Thus, the tier system allocates \$10,000 taxable income to A as a first-tier beneficiary, and \$10,000 taxable income to B as a second-tier beneficiary. The other \$5,000 distributed to B would be a tax-free return of corpus (absence the application of the throwback rules prior to 1998).

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<sup>7</sup> I.R.C. §662(a)(1).

<sup>8</sup> I.R.C. §662(a)(2).

## 2. Charitable contributions

Complex trusts and estates are allowed an unlimited deduction for charitable contributions paid out of taxable gross income.<sup>9</sup> In general, charitable contributions are deemed to have been made pro rata from all the types of income received by the fiduciary. Also, when charitable contributions come from long-term capital gains,<sup>10</sup> there is a specific downward adjustment that must be made to the charitable contribution. (This adjustment and the complexities of charitable contributions are discussed in detail in the last section of this chapter.)

DNI is affected by charitable contributions made from income. This is because charitable contributions are deducted in determining the amount of DNI that can be allocated to second-tier beneficiaries.<sup>11</sup> However, charitable contributions do not affect first-tier beneficiaries.<sup>12</sup>

## 3. Computations

The rules applicable to a complex trust or an estate in computing DNI may be illustrated in the following manner.<sup>13</sup>

Under the terms of a complex trust, which reports on the calendar-year basis, \$20,000 a year is required to be paid out of income to the University of Pennsylvania. The balance of the income may, in the trustee's discretion, be accumulated or distributed to Beneficiary A. Expenses are allocable against corpus and the trust instrument requires a reserve for depreciation. During the taxable year, the trustee contributes \$20,000 to the University of Pennsylvania and in the trustee's discretion distributes \$20,000 of income to A. The trust has the following items of income and expenses for the taxable year.

Dividends	\$30,000
Interest	20,000
Fully tax-exempt interest	10,000
Rents	20,000
Rental expenses	2,000
Depreciation of rental property	3,000
Trustee's commissions	5,000

## 4. Step 1 -- State law income

The state law income of the trust for fiduciary accounting purposes is \$75,000, computed as follows.

Dividends		\$30,000
Interest		20,000
Fully tax-exempt interest		10,000
Rents		20,000
Total		\$80,000
Deductions:		
Rental expenses	\$2,000	
Depreciation	3,000	
		5,000
Income as computed under §643(b)		\$75,000

<sup>9</sup> I.R.C. §642(c).

<sup>10</sup> I.R.C. §642(c)(4).

<sup>11</sup> Treas. Regs. §1.662(h)-2.

<sup>12</sup> Treas. Regs. §1.662(a)(1).

<sup>13</sup> Treas. Regs. §1.661(c)(2).

### 5. Step II -- Section 643(a) ceiling

The distributable net income of the trust as computed under §643(a) is \$50,000, determined as follows.

Rents			\$20,000
Dividends			30,000
Interest			20,000
Fully tax-exempt interest		\$10,000	
Less: Expenses allocable thereto			
(10,000 / 80,000 x \$5,000)	\$625		
Charitable contributions allocable thereto			
(10,000 / 80,000 x \$20,000)	<u>2,500</u>	<u>3,125</u>	6,875
TOTAL			\$76,875
Deductions:			
Rental expenses		\$2,000	
Depreciation of rental property		3,000	
Trustees' commissions			
(\$5,000 less \$625 allocated to tax-exempt interest)		4,375	
Charitable contributions			
(\$20,000 less \$2,500 allocated to tax-exempt interest)		<u>17,500</u>	<u>26,875</u>
Distributable Net Income (§643(a))			<u>\$50,000</u>

Where a reserve for depreciation exists, the depreciation deduction, as previously noted, would be expected at Step I (state-law income) and Step IV (taxable income of trust and character to beneficiaries).

However, in the above example, a question arises concerning its appearance at Step II (DNI by §643). Its appearance gives the deduction a two-fold use, which seems unwarranted: (i) at Step II, as a deduction from DNI it reduces the amount ultimately includable by the beneficiaries (in this particular example, includability by the beneficiary is not reduced since there is ample DNI even after the depreciation deduction to cover the \$20,000 distribution); and (ii) at Step IV, it is taken again and reduces the taxable income of the trust. Thus, it appears that the IRS's position on the depreciation reserve is very advantageous to taxpayers.

### 6. Step III -- Section 661(a) ceiling

The deduction ceiling allowable to the trust under §661(a) for distributions to Beneficiary A is \$17,250, is computed as follows.

Distribution to A	\$20,000
Tax-exempt	Less: <u>(2,750)</u>
Trust's deduction for Beneficiary A	<u>\$17,250</u>

## 7. Step IV -- Trust's income

The taxable income of the trust is computed as follows.

Rental income		\$20,000
Dividends		30,000
Interest		20,000
<b>Gross Income</b>		<b>\$70,000</b>
Deductions:		
Rental expenses	\$2,000	
Depreciation of rental property	3,000	
Trustee's commissions	4,375	
Charitable contributions	17,500	
Distributions to Beneficiary X	17,250	
Personal exemption	100	\$44,225
<b>Taxable Income</b>		<b>\$25,775</b>

In computing the taxable income of the trust, no deduction is allowable for the portions of the charitable contributions deduction (\$2,000) and trustee's commissions (\$1,000), which are treated under §661(b) as attributable to the tax-exempt interest excludable from gross income.

## 8. Step V -- Inclusion and characterization to Beneficiary A

The character of the amounts distributed under §661(a), determined in accordance with the rules prescribed in Treas. Regs. §§1.661(b)-1 and 1.661(b)-2, is shown next. For the purpose of this allocation, it is assumed that the trustee elected to allocate the trustee's commissions to rental income except for the amount required to be allocated to tax-exempt interest.

In the absence of specific provisions in the trust instrument for the allocation of different classes of income, the charitable contribution is deemed to consist of a pro rata portion of the gross amount of each item of income of the trust; the trust is deemed to have distributed to A a pro rata portion (one-half) of each item of income included in distributable net income.

**Character of amounts distributed under §661(a)**

	<b>Rental income</b>	<b>Taxable dividends</b>	<b>Interest</b>	<b>Tax-exempt interest</b>	<b>Total</b>
Trust income	\$20,000	\$30,000	\$20,000	\$10,000	\$80,000
Less:					
Charitable contributions	5,000	7,500	5,000	2,500	20,000
Rental expenses	2,000				2,000
Depreciation	3,000				3,000
Trustee's commissions	4,375			625	5,000
Total deductions	14,375	7,500	5,000	3,125	30,000
Distributable net income	5,625	22,500	15,000	6,875	50,000
Amounts deemed distributed under §661(a) before applying the limitation of §661(c)	2,250	9,000	6,000	2,750	20,000

### III. Charts and notes

#### A. Practitioner check sheet

	Includable in	
	FAI	DNI
Tax-exempt income	Yes	yes
Dividend income	Yes	yes
Interest income	Yes	yes
Gross rentals, business, and farm income	Yes	yes
Less:		
Direct expenses		
Paid from income	Yes	yes
Paid from corpus	No	yes
Depreciation		
Allocable to corpus	see below	yes
Allocable to income	see below	no
Capital gains and losses		
Allocable to income	Yes	yes
Allocable to corpus	No	no
Charitable contribution	No	yes
Indirect expenses		
Paid from income	Yes	yes
Paid from corpus	No	yes

Depreciation enters into the computation of FAI only if local law so provides. Many jurisdictions require that a funded depreciation reserve be established before depreciation can be allocated to FAI. For income tax purposes and the computation of DNI, depreciation is allocated between beneficiaries and fiduciary in proportion to their rights to the related income. Note that a major distinction between DNI and FAI is that the former is reduced by expenses paid out of principal, whereas the latter is reduced only by expenses paid out of income.

#### B. Fiduciary audit issues

***Practitioner alert:***

If you see capital gains distributed to a beneficiary, review the controlling instrument for the fiduciary's authority to make distributions of corpus. In the absence of express authority, such an allocation is incorrect. Even if there is such authority, you should consider the applicability of Treas. Regs. §1.643(a)-3(a) and Rev. Rul. 68-392.

***Practitioner alert:***

Indirect expense allocations are frequently computed incorrectly. Form 1041 requires attachment of the computation for the allocation of indirect expenses to tax-exempt income. If it is not attached, the Service can request the computation for their pre-audit analysis. Treas. Regs. §1.6012-3(a)(d) authorizes the IRS to also request a copy of the governing instrument.

**Practitioner alert:**

Provisions of the Code and Treasury regulations are very clear with respect to capital losses. These may not be included in DNI except for the year of final distribution and termination of the trust, and only to the extent that they:

- Offset capital gains taxable to the trust or estate; or
- Offset gains taxable to the beneficiary.

**DNI Computations Under the 1997 Act and/or the Instrument Allowing Capital Gains to be Distributed to the Current Income Beneficiaries**

Pursuant to the terms of a simple trust all of the income is to be distributed equally to beneficiaries X and Y and capital gains are allocated to the income beneficiaries pursuant to the trustee discretion under state law. No reserve is maintained for depreciation by the fiduciary. Therefore, it will follow income. During 2019, the trust had the following items of income and expenses.

Rents	\$25,000	
Dividends of domestic corporations (Qualifying)	\$50,000	
Tax-exempt interest on municipal bonds	\$25,000	
Long-term capital gains	\$25,000	
Taxes and expenses directly attributable to rents	\$5,000	
Trustee's commissions allocable to income account	\$2,000	
Trustee's commissions allocable to principal account	\$2,000	
Depreciation	\$5,000	
<b>Step 1 : State Law Income / Trust Accounting Income</b>		
Rents	\$25,000	
Dividends of domestic corporations	\$50,000	
Tax-exempt interest on municipal bonds	\$25,000	
Long-term capital gains	\$25,000	\$125,000
Deductions:		
Expenses directly attributable to rental income	\$5,000	
Trustee's commissions allocable to income account	\$2,000	\$7,000
State law income computes under Code Sec. 643(b) Line 8....	.....	\$118,000
<b>Step 2 : Code Sec. 643(a) Ceiling</b>		
Rents		\$25,000
Dividends		\$50,000
Long-term capital gains		\$25,000
Tax-exempt	\$25,000	
Less: Expenses allocable thereto (25000/125000 * 4000)	\$800	\$24,200
		\$124,200

Deductions:					
Expenses directly attributable to rental income		\$5,000			
Trustee's commissions					
(4000-800 allocable to tax-exempt interest)		\$3,200	\$8,200		
Line 7....		.....	\$116,000		
Step 3 : Code Sec. 651(a) Ceiling					
Distributable net income computed under Code Sec. 643 (a)			\$116,000		
Less: Tax-exempt interest as adjusted			\$24,200		
Distributable net income (deduction ceiling) Line 15...		.....	\$91,800		
Step 4 : Trust's Taxable Income					
Rents			\$25,000		
Dividends			\$50,000		
Long-term capital gains			\$25,000		
Gross income			\$100,000		
Deductions					
Rental Expenses		\$5,000			
Trustee's commissions		\$3,200			
Distributions to beneficiaries		\$91,800			
Personal exemption for a simple trust		\$300	\$100,300		
Taxable income Line 22....		.....	\$0		
Step 5 : Inclusion and Characterization of Beneficiaries:					
	Rents	Dividends	LT Capital Gain	Tax-exempt interest	Total
Income for trust accounting	\$25,000	\$50,000	\$25,000	\$25,000	\$125,000
Less Rental expenses	\$5,000				\$5,000
Trustee's Commissions	\$800	\$1,600	\$800	\$800	\$4,000
Total Deductions	\$5,800	\$1,600	\$800	\$800	\$9,000
Character of amount to beneficiaries	\$19,200	\$48,400	\$24,200	\$24,200	\$116,000

K-1 Amounts for X and Y

\$ 9,600 – Line 7—Rents  
\$24,200 – Line 2b—Qualifying Dividends  
\$12,100 – Line 4a—Long-term capital gains  
\$12,100 – Line 14A—Tax-exempt  
\$ 2,500 – Line 9A—Depreciation

## IV. Exercise

### A. Problem

In 2019, ABC Trust has the following items of income and expenses.

Cash dividends	\$10,000
Stock dividends	5,000
Taxable interest	10,000
Tax-exempt interest	10,000
Rental income	10,000
Long-term capital gains	5,000
Income from timber operations	20,000
Oil and gas royalties	10,000
Net loss from a partnership	(2,000)
Depreciation expense	5,000
Property taxes	3,000
Trustee fees	10,000
Charitable contribution to Emory	10,000

Other information gleaned from the trust instrument, local law, and discussions with the trustee are as follows.

1. Timber is to be allocated a reserve based on the federally allowed amount. The land that the timber is on has a cost of \$1 million and \$250,000 is allocable to timber. Total timber estimated that can be cut down is 50,000 board feet. One thousand board feet were cut down in 2019.
2. A reserve for depreciation has been established by the trustee pursuant to local law.
3. Special trustee compensation of \$3,000 is allocated to corpus and is part of the total trustees' fees.
4. An eminent domain proceeding produced the capital gain of \$5,000. That is, land was taken by the state for road widening purposes. Basis to the trustee was \$55,000 and net proceeds from the proceedings were \$60,000.
5. A reserve for depletion based on the federally allowed amount is being maintained by the fiduciary.
6. The trust is required to distribute 50 percent of FAI to the widow each year.

### B. Exercise

- Determine FAI; determine DNI as an income ceiling; and determine DNI as a deduction ceiling.

## V. Problem solution

	FAI	DNI Income Ceiling
Cash dividends	\$10,000	\$10,000
Stock dividends	-0-	-0-
Taxable interest	10,000	10,000
Tax-exempt interest	10,000	7,144
Long-term capital gains	-0-	-0-
Rental income	10,000	10,000
Income from timber operations	20,000	20,000
Oil and gas royalties	10,000	10,000
Net loss from a partnership	-0-	-0-
Depreciation reserve	(5,000)	(5,000)
Depletion reserve - oil and gas	(1,500)	(1,500)
Depletion reserve - timber	(5,000)	(5,000)
Property taxes	(3,000)	(3,000)
Trustee fees	(3,500)	(8,572)
Charitable contribution	-0-	(8,572)
Totals	\$52,000	\$35,500

### DNI - Deduction ceiling

Distribution to income beneficiary	- \$26,000	
		$7,144 \times 26,000 = 5,232$
Less: Tax-exempt	- <u>5,232</u> <u>\$20,768</u>	35,550

# Accounting for Distributions

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# Accounting for Distributions

## *Learning objectives*

After completing this chapter, you will be able to:

- Describe the tier system in fiduciary taxation;
- Explain the rationale behind the use of specific legacies and bequests;
- Determine the maximum amount that can qualify under the 65-day rule; and
- Explain the accounting requirements of the separate-share rule.

## ***I. Introduction***

Even though distributable net income governs the maximum amount of taxability on distributions, it does not control which distributions will be taxed in full, taxed in part, or exempt. This control is lodged in the tier system of accounting for distributions from estates and complex trusts. Also, some distributions are exempted by legislative fiat from being taxed to the extent of DNI. Additionally, the Code has incorporated intricate separate-share accounting provisions governing certain distributions.

The purpose of this chapter is to illustrate and analyze the accounting and accompanying income-tax effects of distributions from complex trusts and estates.

## ***II. The tier system***

In order to guard against trustees and executors manipulating distributions and to finalize who is to be allocated taxable income each year, the 1954 Internal Revenue Code adopted a tier system for classifying distributions. The tier system provides the following format.

- First tier -- Income required to be distributed currently including annuity payments made out of income.<sup>1</sup> It should be noted, as stated before, the charitable deduction does not affect first-tier beneficiaries, but it does affect second-tier beneficiaries.
- Second tier -- All other amounts properly paid, credited, or required to be distributed.<sup>2</sup> This would include: (i) current income, which the trustee was not required to distribute; (ii) accumulated income; and (iii) corpus.

Thus, distributable net income is applied by mandate to the first tier, and only if there is any excess amount will the second tier be taxable at all.

### **A. First-tier distributions in excess of DNI**

Whenever the amount of income required to be distributed currently to all beneficiaries (first tier) exceeds DNI, the amount includable in the beneficiary's gross income is computed as follows.<sup>3</sup>

Amount of income required to be distributed <u>currently to the first-tier beneficiary</u>	x	Distributable net income (computed without deduction for charitable contributions)	=	Amount beneficiary includes in gross income
Amount of income required to be distributed currently to all first-tier beneficiaries				

<sup>1</sup> I.R.C. §662(a)(1).

<sup>2</sup> I.R.C. §662(a)(2).

<sup>3</sup> Treas. Regs. §1.662(a)-2.

**Example:** Pursuant to the trust instrument, the trustee is required to distribute 40 percent of the trust's current income to X, the grantor's son, 30 percent to Y, the grantor's daughter, 20 percent to Z, the nephew of the grantor, and 10 percent to R, a charity. In the current year, the trust has income of \$50,000 and distributable net income of \$36,000 (computed without the deduction of charitable contributions). Thus, X receives \$20,000 (.40 x \$50,000), Y receives \$15,000 (.30 x \$50,000), Z receives \$10,000 (.20 x \$50,000), and R receives \$5,000 (.10 x \$50,000). By using the above formula, the beneficiaries will determine the amount included in gross income as follows.

Beneficiary	Beneficiary Formula Application = Amount taxable				
X	<u>\$20,000</u> \$45,000	x	\$36,000	=	\$16,000 =====
Y	<u>\$15,000</u> \$45,000	x	\$36,000	=	\$12,000 =====
Z	<u>\$10,000</u> \$45,000	x	\$36,000	=	\$ 8,000 =====

## B. First- and second-tier distributions in excess of DNI

In the event that first-tier distributions do not exhaust DNI, then beneficiaries may be taxed on second-tier distributions. Furthermore, if both first- and second-tier distributions exceed DNI, then another allocation formula is necessary to determine the amount on which a beneficiary will be taxed. This formula is as follows.<sup>4</sup>

Second-tier distributions to the beneficiary		Distributable net income (less first-tier distributions and charitable contributions)		Beneficiary's share of distributable net income
Second-tier distributions to all beneficiaries	x		=	

**Example:** The trust instrument requires the trustee to distribute \$10,000 annually to X, the grantor's son. Any residual income may be distributed or accumulated for R, S, and T in the trustee's discretion. Also, the trustee may invade corpus for the benefit of X, R, S, and T. The trust has distributable net income of \$40,000. The trustee distributes \$10,000 of income to X. Next the trustee distributes \$12,000 to R, \$8,000 to S and T, and an additional \$12,000 to X. The beneficiaries' taxable amounts are computed as follows.

Step 1 -- Distributable net income	\$40,000
Less: first-tier distribution to X	<u>10,000</u>
Available for second-tier distributions	\$30,000 =====

<sup>4</sup> Treas. Regs. §1.662(a)-3.

## Step 2 -- Second-tier distributions

Beneficiary	Formula Application	=	Amount taxable
X	$\frac{\$12,000}{\$40,000} \times \$30,000$	=	\$9,000
R	$\frac{\$12,000}{\$40,000} \times \$30,000$	=	\$9,000
S	$\frac{\$8,000}{\$40,000} \times \$30,000$	=	\$6,000
T	$\frac{\$8,000}{\$40,000} \times \$30,000$	=	\$6,000

Now the tax effects on the first- and second-tier beneficiary can be summarized as follows.

Beneficiary		Amount Distributed	Included in Gross Income	Excluded from Gross Income
First tier:	X	\$ 10,000	\$ 10,000	\$ 0
Second tier:	X	12,000	9,000	3,000
	R	12,000	9,000	3,000
	S	8,000	6,000	2,000
	T	8,000	6,000	2,000
		\$ 50,000	\$ 40,000	\$ 10,000

### III. How to use a gift of specific money or specific property as a tax-free distribution

In general, the Code treats any distribution to a beneficiary by an estate or trust as out of income to the extent that the trust or estate has distributable net income. However, if one comes within the protection of §663(a), the distribution will not be taxed as a distribution under §661(a) or §662(a). That is, the amount will not be deductible by the trust nor will it be includable by the recipient. Such amounts will be received tax-free under the gift exemption of §102.

#### A. Background

Prior to 1954, the executor or trustee could designate the source of a distribution as corpus and thereby immunize the distribution. But, under the 1954 distributable net income approach, the distribution would be taxed as income up to the extent of DNI regardless of the trustee or executor's designation.

**Example:** Assume that a will left equal one-quarter shares to a wife and three children. The estate contains \$1.8 million in securities and a house. In the first year, the estate has income of \$240,000 and makes a partial distribution to the widow of the house worth \$360,000. Under these facts, the widow would have taxable income of \$240,000 and as a consequence, she is bearing a substantially disproportionate (to the other heirs) tax burden.

#### B. Purpose of §663

In order to alleviate the inordinate tax problem (as previously illustrated) that an ordinary estate distribution of corpus could cause, the 1954 Code embodied exemptions for specific legacies. Section 663(a) is based on the standard gift-exclusion reasoning that distinguishes between gifts of corpus and gifts of income. It is, of course, traditional to say that a gift of corpus should be nontaxable to the recipient. However, Congress refines this thought in §663(a) to require, in addition, that the gift be specific and practically lump sum in payout (only three installments are permitted).

### C. Requirements of a specific sum of money or property

In order to be specific under §663(a), the amount of money or the identity of the specific property must be ascertainable under the terms of a testator's will as of the date of death or, if inter vivos, as of the date of creation of the trust.<sup>5</sup> Bequests that qualify as being specific are as follows:

- A bequest of Blackacre to Y;
- A legacy of \$60,000 to X;
- A bequest of General Motors stock to C; and
- A bequest of decedent's partnership interest to decedent's son and an equal sum of money to decedent's daughter.<sup>6</sup>

### D. Installments under §663

Treas. Regs. §1.663(a)-1(c)(i) provides that in determining whether a gift or bequest of a specific sum of money or of specific property is required to be paid or credited to a particular beneficiary in more than three installments:

- Gifts or bequests of articles for personal use (such as personal and household effects, automobiles, and the like) are disregarded;
- Specifically devised real property, the title to which passes directly from the decedent to the devisee under local law, is not taken into account, since it would not constitute an amount paid, credited, or required to be distributed under §661;
- All gifts and bequests under a decedent's will for which no time of payment or crediting is specified, and which are to be paid or credited in the ordinary course of administration of the decedent's estate, are considered as required to be paid or credited in a single installment; and
- All gifts and bequests payable at any one specified time under the terms of the governing instrument are taken into account as a single installment. Therefore, for purposes of determining the number of installments paid or credited to a particular beneficiary, a decedent's estate and a testamentary trust shall each be treated as a separate entity.

### E. Examples of qualifying and nonqualifying installments

The application of the aforementioned rules governing installments under §663(a) can best be appreciated by a careful review of the illustrations that follow.

- Example:** Under the terms of a decedent's will, \$10,000 in cash, household furniture, a watch, an automobile, 100 shares of X Company stock, 1,000 bushels of grain, 500 head of cattle, and a farm (title to which passed directly to A under local law) are bequeathed or devised outright to A. The will also provides for the creation of a trust for the benefit of A, under the terms of which there are required to be distributed to A, \$10,000 in cash and 100 shares of Y Company stock when he reaches age 25, \$25,000 in cash and 200 shares of Y Company stock when he reaches age 30, and \$50,000 in cash and 300 shares of Y Company stock when he reaches age 35. Here is how they are categorized.
- (i) The furniture, watch, automobile, and the farm are excluded in determining whether any gift or bequest is required to be paid or credited to A in more than three installments. These items qualify for the exclusion under §663(a)(1) regardless of the treatment of the other items of property bequeathed to A.

<sup>5</sup> Treas. Regs. §1.663(a)-1(b)(1).

<sup>6</sup> Id.

- (ii) The \$10,000 in cash; the shares of X Company stock; the grain; the cattle; and the assets required to create the trust, to be paid or credited by the estate to A and the trust are considered as required to be paid or credited in a single installment to each, regardless of the manner of payment of distribution by the executor, since no time of payment or crediting is specified in the will.
- (iii) The \$10,000 in cash and shares of Y Company stock required to be distributed by the trust to A when he is 25 years old are considered as required to be paid or distributed as one installment under the trust. Likewise, the distributions to be made by the trust to A when he is age 30 and 35 are each considered as one installment under the trust. Since the total number of installments to be made by the estate does not exceed three, all of the items of money and property distributed by the estate qualify for the exclusion under §663(a)(1). Similarly, the three distributions by the trust qualify.<sup>7</sup>

## ***IV. Accounting for delayed distributions and the 65-day rule***

Section 663(b) provides that a fiduciary of a complex trust may elect to treat any amount or portion thereof that is properly paid or credited to a beneficiary within the first 65 days following the close of the taxable year as an amount that was properly paid or credited on the last day of that taxable year.

### **A. Limitation on the 65-day rule**

Under the 65-day rule, distributions cannot exceed the greater of the trust accounting income for the year of election, or the trust's distributable net income for the year. Also, the limitation is reduced by distributions in the election year except those amounts for which the election was claimed in the prior tax year.<sup>8</sup>

### **B. Effect of election**

The election is considered effective by making it on the return for the tax year in which the distribution is considered made. An application of the 65-day rule is illustrated below.

**Example:** In 2019, a calendar-year trust has \$2,000 of state law income and \$1,600 of distributable net income. The trust properly pays \$1,100 to X, a beneficiary, on February 2, 2019, which the trustee elects to treat under §663(b) (65-day rule) as paid on December 31, 2018. The trust also properly pays to X \$1,200 on August 1, 2019 and \$900 on January 21, 2020. For 2019, the maximum amount that may be elected under the 65-day rule as properly paid or credited on the last day of 2019 is \$800 (\$2,000 - \$1,200). The \$1,100 paid on February 2, 2019 does not reduce the maximum amount to which the 65-day election may apply, because that amount is treated as properly paid on December 31, 2018.<sup>9</sup>

### **C. Accounting and tax rules prior to June 2, 1984 for property distributions in kind not covered by §663(a)**

The general rule is that an estate or complex trust realizes no gain or loss on the distribution of property.<sup>10</sup> Additionally, a distribution from an estate or complex trust will be taxed to the recipient beneficiary to the extent of the trust or estate's DNI. In summary, a distribution of property by an estate or complex trust produces the following results:<sup>11</sup>

<sup>7</sup> Treas. Regs. §1.663(a)-l(c)(2), Ex. 1.

<sup>8</sup> Treas. Regs. §1.663(b)-l(a)(2)(b).

<sup>9</sup> Based in part on Treas. Regs. §1.663(b)-l(a)(2)(b).

<sup>10</sup> Treas. Regs. §1.661(a)-2.

<sup>11</sup> Treas. Regs. §1.661(a)-2(f).

- The estate or trust does not realize gain or loss through property distributions;
- The amount deductible by the estate or trust and taxable to the beneficiary is the fair market value of the property distributed; and
- The distributee gets a new basis for the property using the date-of-distribution value of the property.

**Example:** An estate has a security with a cost basis of \$10,000 and a fair market value of \$60,000. In the year of distribution, it has DNI of \$100,000. The estate receives a deduction of \$60,000 if it distributes the security. The beneficiary's basis for the security becomes \$60,000. As a result, the increment in value over basis of \$50,000 escapes tax.

### **1. Exception to the general rule**

Whenever an estate or trust distributes property in satisfaction of a right to receive a distribution in a specific dollar amount, then the trust or estate will recognize a gain or loss on the distribution.<sup>12</sup>

**Example:** A testamentary trust was created in 1991 and provided that a niece of the grantor, upon reaching age 40, should receive the sum of \$5 million. The trustee was given discretion to give \$5 million in marketable securities in place of cash. In 2019, the niece reached age 40 and received \$5, million, which included \$1 million in cash and \$4 million in securities. The securities had appreciated in value from \$2 million to \$4 million. As a consequence, the trust had \$2 million in taxable long-term capital gains.

### **2. Exception provided by Tax Reform Act of 1976**

Section 1040(a), as added by the Tax Reform Act of 1976, provided that no gain (but loss) would be recognized to the extent that appreciated carryover basis property was used to satisfy a pecuniary bequest from an estate or trust. But, post-death appreciation would result in gain being recognized. This exception has been eliminated, however, by the Crude Oil Windfall Profit Tax Act of 1980.

## **D. Other rules**

### **1. Distribution of property that has declined in value**

When property of an estate or complex trust has economically depreciated in value, and is distributed to a beneficiary, the resulting loss may be wasted.

**Example:** If property has a basis of \$100,000 and a fair market value of \$60,000, and the estate has DNI of \$80,000, a distribution of the property to a beneficiary would give the beneficiary a tax basis of \$60,000 for the property. As a result, the \$40,000 loss would not be recognized unless the distribution was in satisfaction of an obligation.

#### ***Planning caveat:***

By reference to the above example, the executor or trustee, in a similar situation, should first sell the property for \$60,000, recognize the loss of \$40,000, and then distribute the \$60,000 proceeds to the beneficiary. As a consequence, the loss is not wasted.

<sup>12</sup> *Kenan v. Commissioner*, 114 F. 2d 217 (2nd Cir. 1940); Rev. Rul. 66-207, 1966-2; C.B. 243-245.

## 2. Cash and property distributed together

When a trust or estate distributes cash and property in the same taxable year, then DNI, which is used for basis adjustments, is first decreased by any cash distributed.<sup>13</sup>

**Example:** Assume an estate has DNI of \$30,000. The executor distributes to a residuary beneficiary stock having a zero basis with a fair market of \$35,000 plus \$10,000 cash. The results of this distribution are: (i) beneficiary has gross income to the extent of the estate's \$30,000 DNI; and (ii) stock has a basis to the beneficiary of \$20,000.

### **Planning caveat:**

The executor or trustee should minimize cash distributions when distributing appreciated property.

## 3. Allocation of DNI and basis adjustments

When DNI is not large enough for the estate or complex trust to receive a distribution deduction for the full amount of the fair market value of the property, the beneficiary will only receive a partial step-up in basis.

**Example:** An estate with DNI of \$50,000 distributes the following assets to a beneficiary in 1983.

	Basis to estate	Value at date of distribution
Cash	\$ 10,000	\$ 10,000
General Motors stock	100,000	200,000
Real estate	50,000	170,000
Taco Mucho stock	40,000	30,000
	<u>\$200,000</u>	<u>\$410,000</u>

Since DNI was \$50,000, the beneficiary must include the \$50,000 in the beneficiary's income.

In computing the beneficiary's basis in the distributed assets, the cash reduces the portion of DNI that is allocated to the beneficiary's basis.<sup>14</sup>

Pursuant to Rev. Rul. 64-314,<sup>15</sup> the DNI less cash (\$10,000) is the numerator in a fraction used to allocate the appreciation or depreciation to each asset. The denominator in the fraction is the fair market value of the assets (less cash) at the date of distribution. Therefore, the allocation fraction becomes  $\$40,000/\$400,000 = 10$  percent.

Now the following allocation is made to derive the beneficiary's adjusted basis in the property.

<sup>13</sup> Treas. Regs. §1.661(a)-2(f)(3).

<sup>14</sup> Treas. Regs. §1.661(a)-2(f)(3).

<sup>15</sup> 1964-2 C.B. 167.

	Unrealized appreciation or depreciation	Multiplied by 10 percent	Adjusted basis
General Motors stock	\$100,000	\$10,000	\$110,000
Real estate	120,000	12,000	62,000
Taco Mucho stock	(10,000)	(1,000)	39,000
			<u>\$211,000</u>

As a result of DNI being insufficient to cover the fair market value, the beneficiary has not received the step-up in basis equal to the full appreciation in value.

#### **4. Rules applicable after June 1, 1984, and the impact of new §643(e)**

Under new §643(e), in-kind distributions will require, at the fiduciary's election, either recognition of gain or a carryover basis. That is, §643(e)(1) provides that the beneficiary's basis in property received in an in-kind distribution will be the adjusted basis of the property in the hands of the estate or trust, increased by any gain and decreased by any loss recognized on the distribution. If no election is made, §643(e) preserves the result of prior law that no gain or loss is recognized, but the amount deductible by the fiduciary and taken into income by the beneficiary as a distribution of DNI is limited by §643(e)(2) to the lesser of the basis or the fair market value of the property. As a result, the beneficiary receives a carryover basis.

**Example:** A trust distributes an asset with a fair market value of \$20,000 and a basis of \$14,000. That year, it has \$20,000 of DNI. Under the old rules, the distributee would have \$20,000 of ordinary income and a basis of \$20,000 in the asset. Under the new rules, the distribution would carry out only \$14,000 of ordinary income to the beneficiary, leaving \$6,000 of ordinary income to be taxed to the fiduciary, and the beneficiary would only receive a basis of \$14,000.

When the fiduciary elects, however, §643(e)(3)(ii) provides that the estate or trust may treat gain property as if it were sold to the distributee at its fair market value. Nevertheless, a loss may not be recognized by either an estate or a trust, because §267(b)(6) disallows recognition of losses on sales between a trust and/or an estate and its beneficiary. Thus, when the election is made, the distribution carries out DNI to the extent of the property's fair market value. The fair market value of the property becomes the beneficiary's basis, except in the case of a distribution of loss property from an estate or trust, in which the disallowance of the fiduciary's loss permits the beneficiary to take a carryover basis. In the previous example, the distribution would carry out \$20,000 of DNI, produce \$6,000 of recognized gain, and give the beneficiary a basis of \$20,000.

Section 643(e)(4) provides that the new rules will not apply to distributions described in §663(a), i.e., specific bequests or pecuniary legacies, charitable transfers, and amounts subject to a distribution deduction in an earlier taxable year. Therefore, the new rules will not apply to a pecuniary formula marital bequest, as to which recognition of gain or loss will continue to be mandatory.

## **E. Accounting requirements for §663(c)**

### **1. Rationale for the separate-share rule**

Under §663(c), solely, for the purposes of determining the amount of DNI of a trust that is allocable to a particular beneficiary, substantially separate shares of different beneficiaries in the trust are treated as separate trusts. The separate-share rule is a very beneficial exception to the normal taxing rules of a

trust. That is, when determining the amount taxable to beneficiaries, allocation by tiers may work an injustice when a trust is administered in substantially separate shares. Consider carefully the following illustration.

**Example:** Assume that a trust has two beneficiaries, John and Mary, and DNI of \$60,000. The trustee makes a mandatory distribution of one-half this amount, or \$30,000 to John. He accumulates the other \$30,000 for future distribution to Mary. Also, the fiduciary made a discretionary distribution of \$30,000 from corpus to John. Under the tier system, John would be taxed on the entire \$60,000 of DNI. Is this result reasonable or equitable? That is, John's tax is measured, in part, by \$30,000 of income that can only go to Mary and will never be available for John.

In order to alleviate the inordinate tax problem that the above scenario depicted, the separate-share rule was brought into the Code. Therefore, in the above example, only \$30,000 of DNI would be allocated to John and the rest would stay with the trust (Mary's share). It should be noted that the separate-share rule is now applicable to estates, and the separate-share rule is also employed in determining the effect of the throwback rules, to the extent still applicable, on an accumulation distribution from a trust having separate shares.

## **2. Attributes**

The separate-share rule does not allow the application of separate shares as separate trusts for any purpose other than the application of DNI. For example, it does not permit the treatment of separate shares as separate trusts for purposes of:<sup>16</sup>

- The filing of returns and payment of tax;
- The deduction of personal exemption under §642(b); and
- The allowance to beneficiaries succeeding to the trust property of excess deductions, unused net operating loss, and capital loss carryovers on termination of the trust under §642(h).

Separate-shares treatment is not an elective process. Therefore, when a trust is treated as having separate and independent shares, this treatment must prevail in all the taxable years of the trust. However, if an event occurs that makes the terms of the trust instrument and the attributes of proper administration change, then different treatment may be allowed.

## **3. The meaning of "substantially separate"**

Treas. Regs. §1.663(c)-3(a) provides that separate shares will not be separate unless payment of income or corpus to one beneficiary cannot affect the proportionate share of income or corpus of another, or unless proper adjustment is made.

**Example 1:** A trustee may invade corpus for benefit of any beneficiary, but the beneficiary's right to future income and corpus is proportionately reduced.

However, a trust may permit a disproportionate invasion of corpus if the possibility of exercise of the power is remote.<sup>17</sup>

**Example 2:** A power to invade for health of R if she needs it where R is very wealthy. Thus, the power would be considered as acceptable for this seemingly remote chance of occurrence. However, a power to invade corpus for the pleasure of R would destroy separate shares.

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<sup>16</sup> Treas. Regs. §1.663(c)-1(b).

<sup>17</sup> Treas. Regs. §1.663(c)-3(d).

## V. Comprehensive illustration of accounting for separate shares

The following depiction of the accounting and tax effects of separate shares for a trust is based on §1.663(c)-4.

Fact Scenario -- A single trust was created in 1999 for the benefit of A, B, and C who were aged three, two, and one, respectively. Under the terms of the instrument, the trust income is required to be divided into three equal shares. Each beneficiary's share of the income is to be accumulated until he becomes age 21. When a beneficiary reaches age 21, his share of the income may thereafter be either accumulated or distributed to him in the discretion of the trustee. The trustee also has discretion to invade corpus for the benefit of any beneficiary to the extent of his share of the trust estate, and the trust instrument requires that the beneficiary's right to future income and corpus will be proportionately reduced. When each beneficiary reaches age 35, his share of the trust estate shall be paid over to him. The interest in the trust estate of any beneficiary dying without issue and before he has attained the age 35 is to be equally divided between the other beneficiaries of the trust. All expenses of the trust are allocable to income under the terms of the trust instrument.

No distributions of income or corpus were made by the trustee prior to 2019, although A became age 21 on June 30, 2018. During the taxable year 2019, the trust has income from royalties of \$20,000 and expenses of \$5,000. The trustee, in his discretion, distributes \$12,000 to A. Both A and the trust report on the calendar-year basis.

The trust qualifies for the separate-share treatment under §663(c) and the DNI must be divided into three parts for the purpose of determining the amount deductible by the trust under §661 and the amount includable in A's gross income §662.

Accounting's Impact for Tax Purposes -- The DNI of each share of the trust is \$5,000 (\$6,667 less \$1,667). Since the amount of \$12,000 distributed to A during 2019 exceeds the DNI of \$5,000 allocated to his share, the trust is deemed to have distributed to him \$5,000 of 2019 income and \$7,000 of amounts other than 2019 income. Accordingly, the trust is allowed a deduction of \$5,000 under §661. The taxable income of the trust for 2019 is \$9,900, computed as follows.

Royalties		\$20,000
Deductions:		
Expenses	\$ 5,000	
Distribution to A	5,000	
Personal exemption	<u>100</u>	<u>10,100</u>
Taxable income		<u>\$ 9,900</u>

In accordance with §662, A must include in his gross income for 2019 an amount equal to the portion (\$5,000) of the DNI of the trust allocated to his share.

## VI. Impact of 1997 Act and new regulations

Section 663(c) was amended in 1997 to extend the application of the separate-share rule to estates, as well as trusts. Section 663(c) before amendment provided that for purposes of determining the amount of distributable net income in the application of §§661 and 662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries (or class of beneficiaries) of the trust shall be treated as separate trusts. As a result of prior law, a distribution to a beneficiary of an estate often resulted in the beneficiary being taxed on a disproportionate share of the estate's income. For example, if one of several residuary beneficiaries received a distribution in a taxable

year where none of the other beneficiaries received a distribution, the beneficiary receiving the distribution could be taxed on all of the estates' income even though the other beneficiaries share the benefits of the income taxed to the distributee. *The application of the separate-share rule is mandatory when separate shares exist.*

The explanation of the Joint Committee on Taxation of the extension of the separate-share rule to estates provides: "There are separate shares in an estate when the governing instrument of the estate (e.g., the will and applicable local law) creates separate economic interests in one beneficiary or class of beneficiaries such that the economic interests of those beneficiaries (e.g., rights to income or gain from specified items of property) are not affected by economic interests accruing to another separate beneficiary or class of beneficiary. For example, a separate share in an estate would exist where the decedent's will provides that all of the shares of a closely held corporation should be paid only to that beneficiary and any such dividends would not affect any other amounts, which that beneficiary would receive under the will." (General Explanation of Tax Legislation Enacted in 1997, prepared by the Staff of the Joint Committee on Taxation, December 17, 1997.)

Final regulations were issued on December 28, 1999 (T.D. 8849).<sup>18</sup> The final regulations are effective for estates and qualified revocable trusts of individuals dying after December 28, 1999.<sup>19</sup> The general rule under the separate-share final regulations is that a separate share exists "if the economic interests of the beneficiary or class of beneficiaries neither affect nor are affected by the economic interests accruing to another beneficiary or class of beneficiaries."<sup>20</sup> The final regulations provide that "a separate share comes into existence upon the earliest moment that a fiduciary may reasonably determine, based upon the known facts, that a separate economic interest exists."<sup>21</sup> If a formula pecuniary bequest is entitled under state law only to a statutory interest payment in lieu of income, the regulations have long provided that funding with appreciated assets will trigger gain, and will carry out distributable net income.<sup>22</sup>

The separate-share final regulations may minimize (at least to some extent) the long-standing inequities in the tax treatment of distributions funding a formula pecuniary bequest, such as a formula marital bequest. The final regulations provide that a pecuniary formula bequest that, under the terms of the governing instrument of applicable local law, **is** entitled to income or to share in appreciation or depreciation constitutes a separate share. Furthermore, a pecuniary formula bequest that, under the terms of the governing instrument or applicable law, **is not** entitled to income or to share in appreciation or depreciation also constitutes a separate share if the governing instrument does not provide that it is to be paid or credited in more than three installments.

**Example:** Facts -- Testator, who dies in 2019, is survived by a spouse and one child. Testator's will provides for a pecuniary formula bequest to be paid in not more than three installments to a trust for the benefit of the child in the amount needed to reduce the estate taxes to zero and a bequest of the residuary to the surviving spouse. The will provides that the bequest to the child's trust is not entitled to any of the estate's income and does not participate in appreciation or depreciation in estate assets. During the 2019 taxable year, the estate receives dividend income of \$200,000 and pays expenses of \$15,000 that are deductible on the estate's federal income tax return. The executor partially funds the child's trust by distributing to it securities that have an adjusted basis to the estate of

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<sup>18</sup> Treas. Reg. Sec. 1.663(c)-1 et seq.

<sup>19</sup> Treas. Reg. Sec. 1.663(c)-6.

<sup>20</sup> Treas. Reg. Sec. 1.663(c)-2(a).

<sup>21</sup> Treas. Reg. Sec. 1.663(c)-2(a).

<sup>22</sup> Treas. Reg. Sec. 1.663-(a)-1(b)(1).

\$350,000 and a fair market value of \$380,000 on the date of distribution. As a result of this distribution, the estate realizes long-term capital gain of \$30,000.

Conclusion -- The estate has two separate shares consisting of a formula pecuniary bequest to the child's trust and a residuary bequest to the surviving spouse. Because, under the terms of the will, no estate income is allocated to the bequest to the child's trust, the distributable net income for that trust's share is zero. Therefore, with respect to the \$380,000 distribution to the child's trust, the estate is allowed no deduction under §661, and no amount is included in the trust's gross income under §662. Because no distributions were made to the spouse, there is no need to compute the distributable net income allocable to the marital share. The taxable income of the estate for the 2019 taxable year is \$214,400 (\$200,000 (dividend income) plus \$30,000 (capital gain) minus \$15,000 (expenses) and minus \$600 (personal exemption)).<sup>23</sup>

**Note:**

When an election under Code §645 is made to treat the revocable trust as part of the grantor's estate for income-tax purposes, remember that the **separate-share rule** applies to the electing trust share and the related estate share. Therefore, if during the taxable year, a distribution is made by the electing trust or related estate, then the **DNI** of the share making the distribution must be determined and the distribution provisions of Code §§661 and 662 must be applied using the separately determined **DNI** applicable to the distributing share.<sup>24</sup>

<sup>23</sup> Treas. Reg. Sec. 1-663(c)-5.

<sup>24</sup> Prop. Regs. §1.645-1(e)(2)(iii).

# Appendix

## EXCERPTS FROM THE REVISED UNIFORM PRINCIPAL AND INCOME ACT

### Section 1. Definitions.

As used in this act:

- (1) “Income beneficiary” means the person to whom income is presently payable or for whom it is accumulated for distribution as income;
- (2) “Inventory value” means the cost of property purchased by the trustee and the market value of other property at the time it became subject to the trust, but in the case of a testamentary trust, the trustee may use any value finally determined for the purposes of an estate or inheritance tax;
- (3) “Remainderman” means the person entitled to principal, including income, which has been accumulated and added to principal; and
- (4) “Trustee” means an original trustee and any successor or added trustee.

### Section 2. Duty of Trustee as to Receipts and Expenditures.

- a. A trust shall be administered with due regard to the respective interests of income beneficiaries and remaindermen. A trust is so administered with respect to the allocation of receipts and expenditures if a receipt is credited or an expenditure is charged to income or principal, or partly to each:
  - (1) In accordance with the terms of the trust instrument notwithstanding the contrary provisions of this act;
  - (2) In the absence of any contrary terms of the trust instrument, in accordance with the provisions of this act; or
  - (3) If neither of the preceding rules of administration is applicable, in accordance with what is reasonable and equitable in view of the interests of those entitled to income as well as of those entitled to principal, and in view of the manner in which men of ordinary prudence, discretion and judgment would act in the management of their own affairs.
- b. If the trust instrument gives the trustee discretion in crediting a receipt or charging an expenditure to income or principal or partly to each, no inference of imprudence or partiality arises from the fact that the trustee has made an allocation contrary to a provision of this act.

### Section 3. Income; Principal; Charges.

- a. Income is the return in money or property derived from the use of principal, including return received as:
  - (1) Rent of real or personal property, including sums received for cancellation or renewal of a lease;
  - (2) Interest on money lent, including sums received as consideration for the privilege of prepayment of principal except as provided in §7 on bond premium and bond discount;
  - (3) Income earned during administration of a decedent’s estate as provided in §5;
  - (4) Corporate distributions as provided in §6;
  - (5) Accrued increment on bonds or other obligations issued at discount as provided in §7;
  - (6) Receipts from business and farming operations as provided in §8; and
  - (7) Receipts from disposition of underproductive property as provided in §12.

- b. Principal is the property that has been set aside by the owner or the person legally empowered so that it is held in trust eventually to be delivered to a remainderman while the return or use of the principal is in the meantime taken or received by or held for accumulation for an income beneficiary. Principal includes:
  - (1) Consideration received by the trustee on the sale or other transfer of principal or on repayment of a loan, or as a refund or replacement or change in the form of principal;
  - (2) Proceeds of property taken on eminent domain proceedings;
  - (3) Proceeds of insurance upon property forming part of the principal, except proceeds of insurance upon a separate interest of an income beneficiary;
  - (4) Stock dividends, receipts on liquidation of a corporation, and other corporate distributions as provided in §6;
  - (5) Receipts from the disposition of corporate securities as provided in §7;
  - (8) Any profit resulting from any change in the form of principal, except as provided in §12 on underproductive property;
  - (9) Receipts from disposition of underproductive property as provided in §12; and
  - (10) Any allowances for depreciation established under §§8 and 13(a)(2).
- c. After determining income and principal in accordance with the terms of the trust instrument or of this act, the trustee shall charge to income or principal expenses and other charges as provided in §13.

#### **Section 5. Income Earned during Administration of a Decedent's Estate.**

- a. Unless the will otherwise provides, subject to Subsection (b), all expenses incurred in connection with the settlement of a decedent's estate, including debts, funeral expenses, estate taxes, interest and penalties concerning taxes, family allowances, fees of attorneys and personal representatives, and court costs shall be charged against the principal of the estate.
- b. Unless the will otherwise provides, income from the assets of a decedent's estate after the death of the testator and before distribution, including income from property used to discharge liabilities, shall be determined in accordance with the rules applicable to a trustee under this act and distributed as follows:
  - (1) To specific legatees and devisees, the income from the property bequeathed or devised to them respectively, less taxes, ordinary repairs, and other expenses of management and operation of the property, and an appropriate portion of interest accrued since the death of the testator and of taxes imposed on income (excluding taxes on capital gains), which accrue during the period of administration; and
  - (2) To all other legatees and devisees, except legatees of pecuniary bequests not in trust, the balance of the income, less the balance of taxes, ordinary repairs, and other expenses of management and operation of all property from which the estate is entitled to income, interest accrued since the death of the testator, and taxes imposed on income (excluding taxes on capital gains), which accrue during the period of administration, in proportion to their respective interests in the undistributed assets of the estate computed at times of distribution on the basis of inventory value.
- c. Income received by a trustee under Subsection (b) shall be treated as income of the trust.

## **Section 6. Corporate Distributions.**

- a. Corporate distributions of shares of the distributing corporation, including distributions in the form of a stock split or stock dividend, are principal. A right to subscribe to shares or other securities issued by the distributing corporation accruing to stockholders on account of their stock ownership and the proceeds of any sale of the right are principal.
- b. ....
- c. Distributions made from ordinary income by a regulated investment company or by a trust qualifying and electing to be taxed under federal law as a real estate investment trust are income. All other distributions made by the company or trust, including distributions from capital gains; depreciation; or depletion, whether in the form of cash or an option to take new stock or cash; or an option to purchase additional shares, are principal.
- d. Except as provided in Subsections (a), (b), and (c), all corporate distributions are income, including cash dividends, distributions of or rights to subscribe to shares or securities or obligations of corporations other than the distributing corporation, and the proceeds of the rights or property distributions. Except as provided in Subsections (b) and (c), if the distributing corporation gives a stockholder an option to receive a distribution either in cash or in its own shares, the distribution chosen is income.
- e. ....

## **Section 8. Business and Farming Operations.**

- a. If a trustee uses any part of the principal in the continuance of a business of which the settlor was a sole proprietor or a partner, the net profits of the business, computed in accordance with generally accepted accounting principles for a comparable business, are income. If a loss results in any fiscal or calendar year, the loss falls on principal and shall not be carried into any other fiscal or calendar year for purposes of calculating net income.
- b. Generally accepted accounting principles shall be used to determine income from an agricultural or farming operation, including the raising of animals or the operation of a nursery.

## **Section 9. Disposition of Natural Resources.**

- a. If any part of the principal consists of a right to receive royalties, overriding or limited royalties, working interests, production payments, net profit interests, or other interests in minerals or other natural resources in, on or under land, the receipts from taking the natural resources from the land shall be allocated as follows:
  - (1) If received as rent on a lease or extension payments on a lease, the receipts are income;
  - (2) If received from a production payment, the receipts are income to the extent of any factor for interest or its equivalent provided in the governing instrument. There shall be allocated to principal the fraction of the balance of the receipts that the unrecovered cost of the production payment bears to the balance owed on the production payment, exclusive of any factor for interest or its equivalent. The receipts not allocated to principal are income; and
  - (3) If received as a royalty, overriding or limited royalty, or bonus, or from a working, net profit, or any other interest in minerals or other natural resources, receipts not provided for in the preceding paragraphs of this section shall be apportioned on a yearly basis in accordance with this paragraph whether or not any natural resource was being taken from the land at the time the trust was established. Twenty-seven and one-half percent of the gross receipts (but not to exceed 50 percent of the net receipts remaining after

payment of all expenses, direct and indirect), computed without allowance for depletion. The balance of the gross receipts, after payment therefrom of all expenses, direct and indirect, is income.

- b. If a trustee, on the effective date of this act, held an item of depletable property of a type specified in this section, he shall allocate receipts from the property in the manner used before the effective date of this act, but as to all depletable property acquired after the effective date of this act by an existing or new trust, the method of allocation provided herein shall be used.
- c. This section does not apply to timber, water, soil, sod, dirt, turf, or mosses.

#### **Section 10. Timber.**

If any part of the principal consists of land from which merchantable timber may be removed, the receipts from taking the timber from the land shall be allocated in accordance with §2(a)(3).

#### **Section 12. Underproductive Property.**

- a. Except as otherwise provided in this section, a portion of the net proceeds of sale of any part of principal that has not produced an average net income of at least one percent per year of its inventory value for more than a year (including as income the value of any beneficial use of the property by the income beneficiary) shall be treated as delayed income to which the income beneficiary is entitled as provided in this section. The net proceeds of sale are the gross proceeds received, including the value of any property received in substitution for the property disposed of, less the expenses, including capital gains tax, if any, incurred in disposition and less any carrying charges paid while the property was underproductive.
- b. The sum allocated as delayed income is the difference between the net proceeds and the amount that, had it been invested at simple interest (at four percent) per year while property was underproductive, would have produced the net proceeds. This sum, plus any carrying charges and expenses previously charged against income while the property was underproductive, less any income received by the income beneficiary from the property and less the value of any beneficial use of the property by the income beneficiary, is income, and the balance is principal.
- c. An income beneficiary or his estate is entitled to delayed income under this section as if it accrued from day to day during the time he was a beneficiary.
- d. If principal subject to this section is disposed of by conversion into property that cannot be apportioned easily, including land or mortgages (for example, realty acquired by or in lieu of foreclosure), the income beneficiary is entitled to the net income from any property or obligation into which the original principal is converted while the substituted property or obligation is held. If within five years after the conversion, the substituted property has not been further converted into easily apportionable property, no allocation as provided in this section shall be made.

#### **Section 13. Charges against Income and Principal.**

- a. The following charges shall be made against income:
  - (1) Ordinary expenses incurred in connection with the administration, management, or preservation of the trust property, including regularly recurring taxes assessed against any portion of the principal, water rates, premiums on insurance taken upon the interests of the income beneficiary, remainderman, or trustee, interest paid by the trustee, and ordinary repairs;
  - (2) A reasonable allowance for depreciation on property subject to depreciation under generally accepted accounting principles, but no allowance shall be made for depreciation of that portion of any real property used by a beneficiary as a residence or

- for depreciation of any property held by the trustee on the effective date of this act for which the trustee is not then making an allowance for depreciation;
  - (3) One-half of court costs, attorneys' fees, and other fees on periodic judicial accounting, unless the court directs otherwise;
  - (4) Court costs, attorneys' fees, and other fees on the accounting or judicial proceedings if the matter primarily concerns the income interest, unless the court directs otherwise;
  - (5) One-half of the trustee's regular compensation, whether based on a percentage of principal or income, and all expenses reasonably incurred for current management of principal and application of income; and
  - (6) Any tax levied upon receipts defined as income under this act or the trust instrument and payable by the trustee.
- b. If charges against income are of unusual amount, the trustee may by means of reserves or other reasonable means charge them over a reasonable period of time and withhold from distribution sufficient sums to regularize distributions.
- c. The following charges shall be made against principal:
- (1) Trustee's compensation not chargeable to income under Subsections (a)(4) and (a)(5), special compensation of trustees, expenses reasonably incurred in connection with principal, court costs and attorneys' fees primarily concerning matters of principal, and trustee's compensation computed on principal as an acceptance, distribution, or termination fee;
  - (2) Charges not provided for in Subsection (a), including the cost of investing and reinvesting principal, the payments on principal of an indebtedness (including a mortgage amortized by periodic payments of principal), expenses for preparation of property for rental or sale, and, unless the court directs otherwise, expenses incurred in maintaining or defending any action to construe the trust or protect it or the property, or assure the title of any trust property;
  - (3) Extraordinary repairs or expenses incurred in making a capital improvement of principal, including special assessments, but a trustee may establish an allowance for depreciation out of income to the extent permitted by Subsection (a)(2) and by §8;
  - (4) Any tax levied upon profit, gain, or other receipts allocated to principal notwithstanding denomination of the tax as an income tax by the taxing authority; and
  - (5) If an estate or inheritance tax is levied in respect of a trust in which both an income beneficiary and a remainderman have an interest, any amount apportioned to the trust, including interest and penalties, even though the income beneficiary also has rights in the principal.

## **UNIFORM PRINCIPAL AND INCOME ACT (1997)**

### **Section 103. Fiduciary Duties; General Principles.**

- a. In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of [Articles] 2 and 3, a fiduciary:
- (1) Shall administer a trust or estate in accordance with the terms of the trust or the will, even if there is a different provision in this [Act];
  - (2) May administer a trust or estate by the exercise of a discretionary power of administration given to the fiduciary by the terms of the trust or the will, even if the exercise of the power produces a result different from a result required or permitted by this [Act];

- (3) Shall administer a trust or estate in accordance with this [Act] if the terms of the trust or the will do not contain a different provision or do not give the fiduciary a discretionary power of administration; and
  - (4) Shall add a receipt or charge a disbursement to principal to the extent that the terms of the trust and this [Act] do not provide a rule for allocating the receipt or disbursement to or between principal and income.
- b. In exercising the power to adjust under §104(a) or a discretionary power of administration regarding a matter within the scope of this [Act], a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with this [Act] is presumed to be fair and reasonable to all of the beneficiaries.

#### **Section 104. Trustee's Power to Adjust.**

- a. A trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income, and the trustee determines, after applying the rules in §103(a), that the trustee is unable to comply with §103(b).
- b. In deciding whether and to what extent to exercise the power conferred by subsection (a), a trustee shall consider all factors relevant to the trust and its beneficiaries, including the following factors to the extent they are relevant:
  - (1) The nature, purpose, and expected duration of the trust;
  - (2) The intent of the settlor;
  - (3) The identity and circumstances of the beneficiaries;
  - (4) The needs for liquidity, regularity of income, and preservation and appreciation of capital;
  - (5) The assets held in the trust; the extent to which they consist of financial assets, interests in closely held enterprises, tangible and intangible personal property, or real property; the extent to which an asset is used by a beneficiary; and whether an asset was purchased by the trustee or received from the settlor;
  - (6) The net amount allocated to income under the other sections of this [Act] and the increase or decrease in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available;
  - (7) Whether and to what extent the terms of the trust give the trustee the power to invade principal or accumulate income or prohibit the trustee from invading principal or accumulating income, and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income;
  - (8) The actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation; and
  - (9) The anticipated tax consequences of an adjustment.
- c. A trustee may not make an adjustment:
  - (1) That diminishes the income interest in a trust that requires all of the income to be paid at least annually to a surviving spouse and for which an estate tax or gift tax marital deduction would be allowed, in whole or in part, if the trustee did not have the power to make the adjustment;
  - (2) That reduces the actuarial value of the income interest in a trust to which a person transfers property with the intent to qualify for a gift tax exclusion;

- (3) That changes the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets;
  - (4) From any amount that is permanently set aside for charitable purposes under a will or the terms of a trust unless both income and principal are so set aside;
  - (5) If possessing or exercising the power to make an adjustment causes an individual to be treated as the owner of all or part of the trust for income tax purposes, and the individual would not be treated as the owner if the trustee did not possess the power to make an adjustment;
  - (6) If possessing or exercising the power to make an adjustment causes all or part of the trust assets to be included for estate tax purposes in the estate of an individual who has the power to remove a trustee or appoint a trustee, or both, and the assets would not be included in the estate of the individual if the trustee did not possess the power to make an adjustment;
  - (7) If the trustee is a beneficiary of the trust; or
  - (8) If the trustee is not a beneficiary; but the adjustment would benefit the trustee directly or indirectly.
- d. If subsection (c)(5), (6), (7), or (8) applies to a trustee and there is more than one trustee, a co-trustee to whom the provision does not apply may make the adjustment unless the exercise of the power by the remaining trustee or trustees is not permitted by the terms of the trust.
  - e. A trustee may release the entire power conferred by subsection (a) or may release only the power to adjust from income to principal or the power to adjust from principal to income if the trustee is uncertain about whether possessing or exercising the power will cause a result described in subsection (c)(1) through (6) or (c)(8) or if the trustee determines that possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax burden not described in subsection (c). The release may be permanent or for a specified period, including a period measured by the life of an individual.
  - f. Terms of a trust that limit the power of a trustee to make an adjustment between principal and income do not affect the application of this section unless it is clear from the terms of the trust that the terms are intended to deny the trustee the power of adjustment conferred by subsection (a).

**Section 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 of a terminating income interest shall determine the amount of net income and net principal receipts received from property specifically given to a beneficiary under the rules in [Articles] 3 through 5 which apply to trustees and the rules in paragraph (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 [Articles] 3 through 5 which apply to trustees and by:
  - (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 reduction or loss of the deduction; and

- (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 interest or any other amount provided by the will, the terms of the trust, or applicable law from net income determined under paragraph (2) or from principal to the extent that net income is insufficient. If a beneficiary is to receive a pecuniary amount outright from a trust after an income interest ends and no interest or other amount is provided for by the terms of the trust or applicable law, the fiduciary shall distribute the interest or other amount to which the beneficiary would be entitled under applicable law if the pecuniary amount were required to be paid under a will.
- (4) A fiduciary shall distribute the net income remaining after distributions required by paragraph (3) in the manner described in Section 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 may not reduce principal or income receipts from property described in paragraph (1) because of a payment described in Section 501 or 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 net income and principal receipts from the property are determined by including all of the amounts the fiduciary receives or pays with respect to the property, whether those amounts accrued or became due before, on, or after the date of a decedent's death or an income interest's terminating event, and by making a reasonable provision for amounts that the fiduciary believes the estate or terminating income interest may become obligated to pay after the property is distributed.

**Section 202. Distribution to residuary and remainder beneficiaries.**

- a. Each beneficiary described in Section 201(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.
- b. In determining a beneficiary's share of net income, the following rules apply:
  - (1) The beneficiary is entitled to receive a portion of the net income equal to the beneficiary's fractional interest in the undistributed principal assets immediately before the distribution date, including assets that later may be sold to meet principal obligations.
  - (2) The beneficiary's fractional interest in the undistributed principal assets must be calculated without regard to property specifically given to a beneficiary and property required to pay pecuniary amounts not in trust.

- (3) The beneficiary's fractional interest in the undistributed principal assets 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.
  - (4) The distribution date for purposes of this section may be the date as of which the fiduciary calculates the value of the assets if that date is reasonably near the date on which assets are actually distributed.
- c. If a fiduciary does not distribute all of the collected but undistributed net income to each person as of a distribution date, the fiduciary shall maintain appropriate records showing the interest of each beneficiary in that net income.
- d. A fiduciary may apply the rules in this section, to the extent that the fiduciary considers it appropriate, to net gain or loss realized after the date of death or terminating event or earlier distribution date from the disposition of a principal asset if this section applies to the income from the asset.

**Section 301. When right to income begins and ends.**

- a. An income beneficiary is entitled to net income from the date on which the income interest begins. An income interest begins on the date specified in the terms of the trust or, if no date is specified, on the date an asset becomes subject to a trust or successive income interest.
- b. An asset becomes subject to a trust:
  - (1) on the date it is transferred to the trust in the case of an asset that is transferred to a trust during the transferor's life;
  - (2) on the date of a testator's death in the case of an asset that becomes subject to a trust by reason of a will, even if there is an intervening period of administration of the testator's estate; or
  - (3) on the date of an individual's death in the case of an asset that is transferred to a fiduciary by a third party because of the individual's death.
- c. An asset becomes subject to a successive income interest on the day after the preceding income interest ends, as determined under subsection (d), even if there is an intervening period of administration to wind up the preceding income interest.
- d. An income interest ends on the day before an income beneficiary dies or another terminating event occurs, or on the last day of a period during which there is no beneficiary to whom a trustee may distribute income.

**Section 302. Apportionment of receipts and disbursements when a decedent dies or an income interest begins.**

- a. A trustee shall allocate an income receipt or disbursement other than one to which Section 201(1) applies to principal if its due date occurs before a decedent dies in the case of an estate or before an income interest begins in the case of a trust or successive income interest.
- b. A trustee shall allocate an income receipt or disbursement to income if its due date occurs on or after the date on which a decedent dies or an income interest begins and it is a periodic due date. An income receipt or disbursement must be treated as accruing from day to day if its due date is not periodic or it has no due date. The portion of the receipt or disbursement accruing before the date on which a decedent dies or an income interest begins must be allocated to principal and the balance must be allocated to income.
- c. An item of income or an obligation is due on the date the payer is required to make a payment. If a payment date is not stated, there is no due date for the purposes of this [Act]. Distributions to shareholders or other owners from an entity to which Section 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.

### **Section 303. Apportionment when income interest ends.**

- a. In this section, “undistributed income” means net income received before the date on which an income interest ends. The term does not include an item of income or expense that is due or accrued or net income that has been added or is required to be added to principal under the terms of the trust.
- b. When a mandatory income interest ends, the trustee shall pay to a mandatory income beneficiary who survives that date, or the estate of a deceased mandatory income beneficiary whose death causes the interest to end, the beneficiary’s share of the undistributed income that is not disposed of under the terms of the trust unless the beneficiary has an unqualified power to revoke more than five percent of the trust immediately before the income interest ends. In the latter case, the undistributed income from the portion of the trust that may be revoked must be added to principal.
- c. When a trustee’s obligation to pay a fixed annuity or a fixed fraction of the value of the trust’s assets ends, the trustee shall prorate the final payment if and to the extent required by applicable law to accomplish a purpose of the trust or its settlor relating to income, gift, estate, or other tax requirements.

### **Section 401. Character of Receipts.**

- a. In this section, “entity” means a corporation, partnership, limited liability company, regulated investment company, real estate investment trust, common trust fund, or any other organization in which a trustee has an interest other than a trust or estate to which §402 applies, a business or activity to which §403 applies, or an asset-backed security to which §415 applies.
- b. Except as otherwise provided in this section, a trustee shall allocate to income money received from an entity.
- c. A trustee shall allocate the following receipts from an entity to principal:
  - (1) Property other than money;
  - (2) Money received in one distribution or a series of related distributions in exchange for part or all of a trust’s interest in the entity;
  - (3) Money received in total or partial liquidation of the entity; and
  - (4) Money received from an entity that is a regulated investment company or a real estate investment trust if the money distributed is a capital gain dividend for federal income tax purposes.
- d. Money is received in partial liquidation:
  - (1) To the extent that the entity, at or near the time of a distribution, indicates that it is a distribution in partial liquidation; or
  - (2) If the total amount of money and property received in a distribution or series of related distributions is greater than 20 percent of the entity’s gross assets, as shown by the entity’s year-end financial statements immediately preceding the initial receipt.
- e. Money is not received in partial liquidation, nor may it be taken into account under subsection (d)(2), to the extent that it does not exceed the amount of income tax that a trustee or beneficiary must pay on taxable income of the entity that distributes the money.
- f. A trustee may rely upon a statement made by an entity about the source or character of a distribution if the statement is made at or near the time of distribution by the entity’s board of

directors or other person or group of persons authorized to exercise powers to pay money or transfer property comparable to those of a corporation's board of directors.

### Comment

**Entities to which §401 applies.** The reference to partnerships in §401(a) is intended to include all forms of partnerships, including limited partnerships, limited liability partnerships, and variants that have slightly different names and characteristics from state to state. The section does not apply, however, to receipts from an interest in property that a trust owns as a tenant in common with one or more co-owners, nor would it apply to an interest in a joint venture if, under applicable law, the trust's interest is regarded as that of a tenant in common.

**Capital-gain dividends.** Under the Internal Revenue Code and the Income Tax Regulations, a "capital-gain dividend" from a mutual fund or real estate investment trust is the excess of the fund or trust's net long-term capital gain over its net short-term capital loss. As a result, a capital gain dividend does not include any net short-term capital gain, and cash received by a trust because of a net short-term capital gain is income under this Act.

**Reinvested dividends.** If a trustee elects (or continues an election made by its predecessor) to reinvest dividends in shares of stock of a distributing corporation or fund, whether evidenced by new certificates or entries on the books of the distributing entity, the new shares would be principal, but the trustee may determine, after considering the return from the portfolio as a whole, whether an adjustment under §104 is necessary as a result.

**Distribution of property.** The 1962 Act describes a number of types of property that would be principal if distributed by a corporation. This becomes unwieldy in a section that applies to both corporations and all other entities. By stating that principal includes the distribution of any property other than money, §401 embraces all of the items enumerated in §6 of the 1962 Act as well as any other form of nonmonetary distribution not specifically mentioned in that Act.

**Partial liquidations.** Under subsection (d)(1), any distribution designated by the entity as a partial liquidating distribution is principal regardless of the percentage of total assets that it represents. If a distribution exceeds 20 percent of the entity's gross assets, the entire distribution is a partial liquidation under subsection (d)(2) whether or not the entity describes it as a partial liquidation. In determining whether a distribution is greater than 20 percent of the gross assets, the portion of the distribution that does not exceed the amount of the income tax that the trustee or a beneficiary must pay on the entity's taxable income is ignored.

**Other large distributions.** A cash distribution may be quite large (for example, more than 10 percent but not more than 20 percent of the entity's gross assets) and have characteristics that suggest it should be treated as principal rather than income. For example, an entity may have received cash from a source other than its normal business operations because it sold an investment asset; or because it sold a business asset other than one held for sale in the ordinary course of business and did not replace it; or it borrowed a large sum of money and secured the repayment of the loan with a substantial asset; or a principal source of its cash was from assets such as mineral interests, 90 percent of which would have been allocated to principal if the trust had owned the assets directly. In such a case the trustee, after considering the total return from the portfolio as a whole and the income component of that return, may

decide to exercise the power under §104(a) to make an adjustment between income and principal, subject to the limitations in §104(c).

#### **Section 409. Deferred Compensation, Annuities, and Similar Payments.**

- a. In this section, “payment” means a payment that a trustee may receive over a fixed number of years or during the life of one or more individuals because of services rendered or property transferred to the payer in exchange for future payments. The term includes a payment made in money or property from the payer’s general assets or from a separate fund created by the payer, including a private or commercial annuity, an individual retirement account, and a pension, profit-sharing, stock-bonus, or stock-ownership plan.
- b. To the extent that a payment is characterized as interest or a dividend or a payment made in lieu of interest or a dividend, a trustee shall allocate it to income. The trustee shall allocate to principal the balance of the payment and any other payment received in the same accounting period that is not characterized as interest, a dividend, or an equivalent payment.
- c. If no part of a payment is characterized as interest, a dividend, or an equivalent payment, and all or part of the payment is required to be made, a trustee shall allocate to income 10 percent of the part that is required to be made during the accounting period and the balance to principal. If no part of a payment is required to be made or the payment received is the entire amount to which the trustee is entitled, the trustee shall allocate the entire payment to principal. For purposes of this subsection, a payment is not “required to be made” to the extent that it is made because the trustee exercises a right of withdrawal.
- d. If, to obtain an estate tax marital deduction for a trust, a trustee must allocate more of a payment to income than provided for by this section, the trustee shall allocate to income the additional amount necessary to obtain the marital deduction.
- e. This section does not apply to payments to which §410 applies.

#### **Section 410. Liquidating Asset.**

- a. In this section, “liquidating asset” means an asset whose value will diminish or terminate because the asset is expected to produce receipts for a period of limited duration. The term includes a leasehold, patent, copyright, royalty right, and right to receive payments during a period of more than one year under an arrangement that does not provide for the payment of interest on the unpaid balance. The term does not include a payment subject to §409, resources subject to §411, timber subject to §412, an activity subject to §414, an asset subject to §415, or any asset for which the trustee establishes a reserve for depreciation under §503.
- b. A trustee shall allocate to income 10 percent of the receipts from a liquidating asset and the balance to principal.

#### **Comment**

**Prior Acts.** Section 11 of the 1962 Act allocates receipts from “property subject to depletion” to income in an amount “not in excess of five percent” of the asset’s inventory value. The 1931 Act has a similar five-percent rule that applies when the trustee is under a duty to change the form of the investment. The five-percent rule imposes on a trust the obligation to pay a fixed annuity to the income beneficiary until the asset is exhausted. Under both the 1931 and 1962 Acts the balance of each year’s receipts is added to principal. A fixed payment can produce unfair results. The remainder beneficiary receives all of the receipts from unexpected growth in the asset, e.g., if royalties on a patent or copyright increase significantly. Conversely, if the receipts diminish more rapidly than expected, most of the amount received by the trust will be allocated to income and little to principal. Moreover, if the annual payments

remain the same for the life of the asset, the amount allocated to principal will usually be less than the original inventory value. For these reasons, §410 abandons the annuity approach under the five-percent rule.

**Lottery payments.** The reference in subsection (a) to rights to receive payments under an arrangement that does not provide for the payment of interest includes state lottery prizes and similar fixed amounts payable over time that are not deferred compensation arrangements covered by §409.

#### **Section 411. Minerals, Water, and Other Natural Resources.**

- a. To the extent that a trustee accounts for receipts from an interest in minerals or other natural resources pursuant to this section, the trustee shall allocate them as follows:
  - (1) If received as nominal delay rental or nominal annual rent on a lease, a receipt must be allocated to income;
  - (2) If received from a production payment, a receipt must be allocated to income if and to the extent that the agreement creating the production payment provides a factor for interest or its equivalent. The balance must be allocated to principal;
  - (3) If an amount received as a royalty, shut-in-well payment, take-or-pay payment, bonus, or delay rental is more than nominal, 90 percent must be allocated to principal and the balance to income; and
  - (4) If an amount is received from a working interest or any other interest not provided for in paragraph (1), (2), or (3), 90 percent of the net amount received must be allocated to principal and the balance to income.
- b. An amount received on account of an interest in water that is renewable must be allocated to income. If the water is not renewable, 90 percent of the amount must be allocated to principal and the balance to income.
- c. This [Act] applies whether or not a decedent or donor was extracting minerals, water, or other natural resources before the interest became subject to the trust.
- d. If a trust owns an interest in minerals, water, or other natural resources on [the effective date of this [Act]], the trustee may allocate receipts from the interest as provided in this [Act] or in the manner used by the trustee before [the effective date of this [Act]]. If the trust acquires an interest in minerals, water, or other natural resources after [the effective date of this [Act]], the trustee shall allocate receipts from the interest as provided in this [Act].

#### **Comment**

**Prior Acts.** The 1962 Act allocates to principal as a depletion allowance, 27.5 percent of the gross receipts, but not more than 50 percent of the net receipts after paying expenses. The Internal Revenue Code no longer provides for a 27.5-percent depletion allowance, although the major oil-producing states have retained the 27.5-percent provision in their principal and income acts (Texas amended its Act in 1993, but did not change the depletion provision). Section 9 of the 1931 Act allocates all of the net proceeds received as consideration for the “permanent severance of natural resources from the lands” to principal.

Section 411 allocates 90 percent of the net receipts to principal and 10 percent to income. A depletion provision that is tied to past or present Code provisions is undesirable because it causes a large portion of the oil and gas receipts to be paid out as income. As wells are depleted, the amount received by the income beneficiary falls drastically. Allocating a larger portion of the receipts to principal enables the

trustee to acquire other income producing assets that will continue to produce income when the mineral reserves are exhausted.

#### **Section 412. Timber.**

- a. To the extent that a trustee accounts for receipts from the sale of timber and related products pursuant to this section, the trustee shall allocate the net receipts:
  - (1) To income to the extent that the amount of timber removed from the land does not exceed the rate of growth of the timber during the accounting periods in which a beneficiary has a mandatory income interest;
  - (2) To principal to the extent that the amount of timber removed from the land exceeds the rate of growth of the timber or the net receipts are from the sale of standing timber;
  - (3) To or between income and principal if the net receipts are from the lease of timberland or from a contract to cut timber from land owned by a trust, by determining the amount of timber removed from the land under the lease or contract and applying the rules in paragraphs (1) and (2); or
  - (4) To principal to the extent that advance payments, bonuses, and other payments are not allocated pursuant to paragraphs (1), (2), or (3).
- b. In determining net receipts to be allocated pursuant to subsection (a), a trustee shall deduct and transfer to principal a reasonable amount for depletion.
- c. This [Act] applies whether or not a decedent or transferor was harvesting timber from the property before it become subject to the trust.
- d. If a trust owns an interest in timberland on [the effective date of this [Act]], the trustee may allocate net receipts from the sale of timber and related products as provided in this [Act] or in the manner used by the trustee before [the effective date of this [Act]]. If the trust acquires an interest in timberland after [the effective date of this [Act]], the trustee shall allocate net receipts from the sale of timber and related products as provided in this [Act].

#### **Comment**

**Scope of section.** The rules in §412 are intended to apply to net receipts from the sale of trees and by-products from harvesting and processing trees without regard to the kind of trees that are cut or whether the trees are cut before or after a particular number of years of growth. The rules apply to the sale of trees that are expected to produce lumber for building purposes, trees sold as pulpwood, and Christmas and other ornamental trees. Subsection (a) applies to net receipts from property owned by the trustee and property leased by the trustee. The Act is not intended to prevent a tenant in possession of the property from using wood that he cuts on the property for personal, noncommercial purposes, such as a Christmas tree, firewood, mending old fences or building new fences, or making repairs to structures on the property.

Under subsection (a), the amount of net receipts allocated to income depends upon whether the amount of timber removed is more or less than the rate of growth. The method of determining the amount of timber removed and the rate of growth is up to the trustee, based on methods customarily used for the kind of timber involved.

**Application of §§403 and 408.** This section applies to the extent that the trustee does not account separately for net receipts from the sale of timber and related products under §403 or allocate all of the receipts to principal under §408. The option to account for net receipts separately under §403 takes into consideration the possibility that timber harvesting operations may have been conducted before the

timber property became subject to the trust, and that it may make sense to continue using accounting methods previously established for the property. It also permits a trustee to use customary accounting practices for timber operations even if no harvesting occurred on the property before it became subject to the trust.

#### **Section 413. Property Not Productive of Income.**

- a. If a marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the surviving spouse with sufficient income from or use of the trust assets, and if the amounts that the trustee transfers from principal to income under §104 and distributes to the spouse from principal pursuant to the terms of the trust are insufficient to provide the spouse with the beneficial enjoyment required to obtain the marital deduction, the spouse may require the trustee to make property productive of income, convert property within a reasonable time, or exercise the power conferred by §104(a). The trustee may decide which action or combination of actions to take.
- b. In cases not governed by subsection (a), proceeds from the sale or other disposition of an asset are principal without regard to the amount of income the asset produces during any accounting period.

#### **Comment**

**Prior Acts' Conflict with Uniform Prudent Investor Act.** Section 2(b) of the Uniform Prudent Investor Act provides that “[a] trustee’s investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole... .” The underproductive property provisions in §12 of the 1962 Act and §11 of the 1931 Act give the income beneficiary a right to receive a portion of the proceeds from the sale of underproductive property as “delayed income.” In each Act the provision applies on an asset by asset basis and not by taking into consideration the trust portfolio as a whole, which conflicts with the basic precept in §2(b) of the Prudent Investor Act. Moreover, in determining the amount of delayed income, the prior Acts do not permit a trustee to take into account the extent to which the trustee may have distributed principal to the income beneficiary, under principal invasion provisions in the terms of the trust, to compensate for insufficient income from the unproductive asset. Under §104(b)(7) of this Act, a trustee must consider prior distributions of principal to the income beneficiary in deciding whether and to what extent to exercise the power to adjust conferred by §104(a).

**Duty to make property productive of income.** In order to implement the Uniform Prudent Investor Act, this Act abolishes the right to receive delayed income from the sale proceeds of an asset that produces little or no income, but it does not alter existing state law regarding the income beneficiary’s right to compel the trustee to make property productive of income. As the law continues to develop in this area, the duty to make property productive of current income in a particular situation should be determined by taking into consideration the performance of the portfolio as a whole and the extent to which a trustee makes principal distributions to the income beneficiary under the terms of the trust and adjustments between principal and income under §104 of this Act.

Trusts for which the value of the right to receive income is important for tax reasons may be affected by Reg. Sec. 1.7520-3(b)(2)(v) *Example (1)* Sec. 20.7520-3(b)(2)(v) *Examples (1) and (2)*, and Sec. 25.7520-3(b)(2)(v) *Examples (1) and (2)*, which provide that if the income beneficiary does not have the right to compel the trustee to make the property productive, the income interest is considered unproductive and may not be valued actuarially under those sections.

**Marital deduction trusts.** Subsection (a) draws on language in Reg. Sec. 20.2056(b)-5(f)(4) and (5) to enable a trust for a surviving spouse to qualify for a marital deduction if applicable state law is unclear about the surviving spouse's right to compel the trustee to make property productive of income. The trustee should also consider the application of §104 of this Act and the provisions of Restatement of Trusts 3d: Prudent Investor Rule Sec. 240, at 186, app. Sec. 240, at 252 (1992). Example (6) in the Comment to §104 describes a situation involving the payment from income of carrying charges on unproductive real estate in which §104 may apply.

Once the two conditions have occurred—insufficient beneficial enjoyment from the property and the spouse's demand that the trustee take action under this section—the trustee must act; but instead of the formulaic approach of the 1962 Act, which is triggered only if the trustee sells the property, this Act permits the trustee to decide whether to make the property productive of income, convert it, transfer funds from principal to income, or to take some combination of those actions. The trustee may rely on the power conferred by §104(a) to adjust from principal to income if the trustee decides that it is not feasible or appropriate to make the property productive of income or to convert the property. Given the purpose of §413, the power under §104(a) would be exercised to transfer principal to income and not to transfer income to principal.

Section 413 does not apply to a so-called “estate” trust, which will qualify for the marital deduction, even though the income may be accumulated for a term of years or for the life of the surviving spouse, if the terms of the trust require the principal and undistributed income to be paid to the surviving spouse's estate when the spouse dies. Reg. Sec. 20.2056(c)-2(b)(1)(iii).

#### **Section 414. Derivatives and Options.**

- a. In this section, “derivative” means a contract or financial instrument or a combination of contracts and financial instruments which gives a trust the right or obligation to participate in some or all changes in the price of a tangible or intangible asset or group of assets, or changes in a rate, an index of prices or rates, or other market indicator for an asset or a group of assets.
- b. To the extent that a trustee does not account under §403 for transactions in derivatives, the trustee shall allocate to principal receipts from and disbursements made in connection with those transactions.
- c. If a trustee grants an option to buy property from the trust, whether or not the trust owns the property when the option is granted, grants an option that permits another person to sell property to the trust, or acquires an option to buy property for the trust or an option to sell an asset owned by the trust, and the trustee or other owner of the asset is required to deliver the asset if the option is exercised, an amount received for granting the option must be allocated to principal. An amount paid to acquire the option must be paid from principal. A gain or loss realized upon the exercise of an option, including an option granted to a settlor of the trust for services rendered, must be allocated to principal.

**[Article] 5**  
**Allocation of Disbursements During Administration of Trust**

**Section 501. Disbursements from Income.**

A trustee shall make the following disbursements from income to the extent that they are not disbursements to which §§201(2)(B) or (C) apply:

- (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; and
- (4) Recurring premiums on insurance covering the loss of a principal asset or the loss of income from or use of the asset.

**Comment**

**Trustee fees.** The regular compensation of a trustee or the trustee's agent includes compensation based on a percentage of either principal or income or both.

**Insurance premiums.** The reference in paragraph (4) to "recurring" premiums is intended to distinguish premiums paid annually for fire insurance from premiums on title insurance, each of which covers the loss of a principal asset. Title insurance premiums would be a principal disbursement under §502(a)(5).

**Regularly recurring taxes.** The reference to "regularly recurring taxes assessed against principal" includes all taxes regularly imposed on real property and tangible and intangible personal property.

**Section 502. Disbursements from Principal.**

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

- (1) The remaining one-half of the disbursements described in §§501(1) and (2);
- (2) All of the trustee's compensation calculated on principal as a fee for acceptance, distribution, or termination, and disbursements made to prepare property for sale;
- (3) Payments on the principal of a trust debt;
- (4) Expenses of a proceeding that concerns primarily principal, including a proceeding to construe the trust or to protect the trust or its property;
- (5) Premiums paid on a policy of insurance not described in §501(4) of which the trust is the owner and beneficiary;
- (6) Estate, inheritance, and other transfer taxes, including penalties, apportioned to the trust; and
- (7) Disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the costs of those activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or regulations, statutory or common law claims by third parties, and defending claims based on environmental matters.

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

**Section 503. Transfers from Income to Principal for Depreciation.**

- a. In this section, “depreciation” means a reduction in value due to wear, tear, decay, corrosion, or gradual obsolescence of a fixed asset having a useful life of more than one year.
- b. A trustee may transfer to principal a reasonable amount of the net cash receipts from a principal asset that is subject to depreciation, but may not transfer any amount for depreciation:
  - (1) Of that portion of real property used or available for use by a beneficiary as a residence or of tangible personal property held or made available for the personal use or enjoyment of a beneficiary;
  - (2) During the administration of a decedent’s estate; or
  - (3) Under this section if the trustee is accounting under §403 for the business or activity in which the asset is used.
- c. An amount transferred to principal need not be held as a separate fund.

**Comment**

**Prior Acts.** The 1931 Act has no provision for depreciation. Section 13(a)(2) of the 1962 Act provides that a charge shall be made against income for “... a reasonable allowance for depreciation on property subject to depreciation under generally accepted accounting principles... .” That provision has been resisted by many trustees, who do not provide for any depreciation for a variety of reasons. One reason relied upon is that a charge for depreciation is not needed to protect the remainder beneficiaries if the value of the land is increasing; another is that generally accepted accounting principles may not require depreciation to be taken if the property is not part of a business. The Drafting Committee concluded that the decision to provide for depreciation should be discretionary with the trustee. The power to transfer funds from income to principal that is granted by this section is a discretionary power of administration referred to in §103(b), and in exercising the power a trustee must comply with §103(b).

One purpose served by transferring cash from income to principal for depreciation is to provide funds to pay the principal of an indebtedness secured by the depreciable property. Section 504(b)(4) permits the trustee to transfer additional cash from income to principal for this purpose to the extent that the amount transferred from income to principal for depreciation is less than the amount of the principal payments.

**Section 504. Transfers from Income to Reimburse Principal.**

- a. If a trustee makes or expects to make a principal disbursement described in this section, the trustee may transfer an appropriate amount from income to principal in one or more accounting periods to reimburse principal or to provide a reserve for future principal disbursements.
- b. Principal disbursements to which subsection (a) applies include the following, but only to the extent that the trustee has not been and does not expect to be reimbursed by a third party:
  - (1) An amount chargeable to income but paid from principal because it is unusually large, including extraordinary repairs;
  - (2) A capital improvement to a principal asset, whether in the form of changes to an existing asset or the construction of a new asset, including special assessments;
  - (3) Disbursements made to prepare property for rental, including tenant allowances, leasehold improvements, and broker’s commissions;

- (4) Periodic payments on an obligation secured by a principal asset to the extent that the amount transferred from income to principal for depreciation is less than the periodic payments; and
  - (5) Disbursements described in §502(a)(7).
- c. If the asset whose ownership gives rise to the disbursements becomes subject to a successive income interest after an income interest ends, a trustee may continue to transfer amounts from income to principal as provided in subsection (a).

#### **Section 505. Income Taxes.**

- a. A tax required to be paid by a trustee based on receipts allocated to income must be paid from income.
- b. 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.
- c. A tax required to be paid by a trustee on the trust's share of an entity's taxable income must be paid proportionately:
  - (1) From income to the extent that receipts from the entity are allocated to income; and
  - (2) From principal to the extent that:
    - (A) Receipts from the entity are allocated to principal; and
    - (B) The trust's share of the entity's taxable income exceeds the total receipts described in paragraphs (1) and (2)(A).
- d. For purposes of this section, receipts allocated to principal or income must be reduced by the amount distributed to a beneficiary from principal or income for which the trust receives a deduction in calculating the tax.

#### **Section 506. Adjustments between Principal and Income because of Taxes.**

- a. A fiduciary may make adjustments between principal and income to offset the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries that arise from:
  - (1) Elections and decisions, other than those described in subsection (b), that the fiduciary makes from time to time regarding tax matters;
  - (2) An income tax or any other tax that is imposed upon the fiduciary or a beneficiary as a result of a transaction involving or a distribution from the estate or trust; or
  - (3) The ownership by an estate or trust of an interest in an entity whose taxable income, whether or not distributed, is includable in the taxable income of the estate, trust, or beneficiary.
- b. If the amount of an estate tax marital deduction or charitable contribution deduction is reduced because a fiduciary deducts an amount paid from principal for income tax purposes instead of deducting it for estate tax purposes, and as a result estate taxes paid from principal are increased and income taxes paid by an estate, trust, or beneficiary are decreased, each estate, trust, or beneficiary that benefits from the decrease in income tax shall reimburse the principal from which the increase in estate tax is paid. The total reimbursements must equal the increase in the estate tax to the extent that the principal used to pay the increase would have qualified for a marital deduction or charitable contribution deduction but for the payment. The proportionate share of the reimbursement for each estate, trust, or beneficiary whose income taxes are reduced must be the same as its proportionate share of the total decrease in income tax. An estate or trust shall reimburse principal from income.

<b>A</b> Check all that apply: <input type="checkbox"/> Decedent's estate <input type="checkbox"/> Simple trust <input type="checkbox"/> Complex trust <input type="checkbox"/> Qualified disability trust <input type="checkbox"/> ESBT (S portion only) <input type="checkbox"/> Grantor type trust <input type="checkbox"/> Bankruptcy estate—Ch. 7 <input type="checkbox"/> Bankruptcy estate—Ch. 11 <input type="checkbox"/> Pooled income fund		For calendar year 2019 or fiscal year beginning _____, 2019, and ending _____, 20____ <b>B</b> Number of Schedules K-1 attached (see instructions) ▶		<b>C</b> Employer identification number _____  <b>D</b> Date entity created _____		
Name of estate or trust (If a grantor type trust, see the instructions.) _____  Name and title of fiduciary _____  Number, street, and room or suite no. (If a P.O. box, see the instructions.) _____  City or town, state or province, country, and ZIP or foreign postal code _____		<b>E</b> Nonexempt charitable and split-interest trusts, check applicable box(es). See instructions. <input type="checkbox"/> Described in sec. 4947(a)(1). Check here if not a private foundation . . . ▶ <input type="checkbox"/> <input type="checkbox"/> Described in sec. 4947(a)(2)		<b>F</b> Check applicable boxes: <input type="checkbox"/> Initial return <input type="checkbox"/> Final return <input type="checkbox"/> Amended return <input type="checkbox"/> Net operating loss carryback <input type="checkbox"/> Change in trust's name <input type="checkbox"/> Change in fiduciary <input type="checkbox"/> Change in fiduciary's name <input type="checkbox"/> Change in fiduciary's address		
<b>G</b> Check here if the estate or filing trust made a section 645 election . . . . . <input type="checkbox"/> Trust TIN ▶ _____						
Income	1	Interest income . . . . .				1
	2a	Total ordinary dividends . . . . .				2a
	b	Qualified dividends allocable to: (1) Beneficiaries . . . . . (2) Estate or trust . . . . .				
	3	Business income or (loss). Attach Schedule C (Form 1040 or 1040-SR) . . . . .				3
	4	Capital gain or (loss). Attach Schedule D (Form 1041) . . . . .				4
	5	Rents, royalties, partnerships, other estates and trusts, etc. Attach Schedule E (Form 1040 or 1040-SR) . . . . .				5
	6	Farm income or (loss). Attach Schedule F (Form 1040 or 1040-SR) . . . . .				6
	7	Ordinary gain or (loss). Attach Form 4797 . . . . .				7
	8	Other income. List type and amount . . . . .				8
9	Total income. Combine lines 1, 2a, and 3 through 8 . . . . . ▶				9	
Deductions	10	Interest. Check if Form 4952 is attached ▶ <input type="checkbox"/> . . . . .				10
	11	Taxes . . . . .				11
	12	Fiduciary fees. If only a portion is deductible under section 67(e), see instructions . . . . .				12
	13	Charitable deduction (from Schedule A, line 7) . . . . .				13
	14	Attorney, accountant, and return preparer fees. If only a portion is deductible under section 67(e), see instructions . . . . .				14
	15a	Other deductions (attach schedule). See instructions for deductions allowable under section 67(e) . . . . .				15a
	b	Net operating loss deduction. See instructions . . . . .				15b
	16	Add lines 10 through 15b . . . . . ▶				16
	17	Adjusted total income or (loss). Subtract line 16 from line 9 . . . . .				17
	18	Income distribution deduction (from Schedule B, line 15). Attach Schedules K-1 (Form 1041) . . . . .				18
19	Estate tax deduction including certain generation-skipping taxes (attach computation) . . . . .				19	
20	Qualified business income deduction. Attach Form 8995 or 8995-A . . . . .				20	
21	Exemption . . . . .				21	
22	Add lines 18 through 21 . . . . . ▶				22	
Tax and Payments	23	Taxable income. Subtract line 22 from line 17. If a loss, see instructions . . . . .				23
	24	Total tax (from Schedule G, Part I, line 9) . . . . .				24
	25	2019 net 965 tax liability paid from Form 965-A, Part II, column (k), line 3 . . . . .				25
	26	Total payments (from Schedule G, Part II, line 17) . . . . .				26
	27	Estimated tax penalty. See instructions . . . . .				27
	28	Tax due. If line 26 is smaller than the total of lines 24, 25, and 27, enter amount owed . . . . .				28
	29	Overpayment. If line 26 is larger than the total of lines 24, 25, and 27, enter amount overpaid . . . . .				29
	30	Amount of line 29 to be: <b>a</b> Credited to 2020 ▶ _____ ; <b>b</b> Refunded . . . . . ▶ _____				30
Sign Here	Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.					
	Signature of fiduciary or officer representing fiduciary _____ Date _____ EIN of fiduciary if a financial institution _____					
Paid Preparer Use Only	Print/Type preparer's name _____		Preparer's signature _____	Date _____	Check <input type="checkbox"/> if self-employed PTIN _____	
	Firm's name ▶ _____		Firm's EIN ▶ _____			
	Firm's address ▶ _____		Phone no. _____			

For Paperwork Reduction Act Notice, see the separate instructions.

Cat. No. 11370H

Form 1041 (2019)

**Schedule A Charitable Deduction.** Don't complete for a simple trust or a pooled income fund.

1	Amounts paid or permanently set aside for charitable purposes from gross income. See instructions	1
2	Tax-exempt income allocable to charitable contributions. See instructions	2
3	Subtract line 2 from line 1	3
4	Capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes	4
5	Add lines 3 and 4	5
6	Section 1202 exclusion allocable to capital gains paid or permanently set aside for charitable purposes. See instructions	6
7	<b>Charitable deduction.</b> Subtract line 6 from line 5. Enter here and on page 1, line 13	7

**Schedule B Income Distribution Deduction**

1	Adjusted total income. See instructions	1
2	Adjusted tax-exempt interest	2
3	Total net gain from Schedule D (Form 1041), line 19, column (1). See instructions	3
4	Enter amount from Schedule A, line 4 (minus any allocable section 1202 exclusion)	4
5	Capital gains for the tax year included on Schedule A, line 1. See instructions	5
6	Enter any gain from page 1, line 4, as a negative number. If page 1, line 4, is a loss, enter the loss as a positive number	6
7	<b>Distributable net income.</b> Combine lines 1 through 6. If zero or less, enter -0-	7
8	If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law	8
9	Income required to be distributed currently	9
10	Other amounts paid, credited, or otherwise required to be distributed	10
11	Total distributions. Add lines 9 and 10. If greater than line 8, see instructions	11
12	Enter the amount of tax-exempt income included on line 11	12
13	Tentative income distribution deduction. Subtract line 12 from line 11	13
14	Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-	14
15	<b>Income distribution deduction.</b> Enter the smaller of line 13 or line 14 here and on page 1, line 18	15

**Schedule G Tax Computation and Payments** (see instructions)**Part I — Tax Computation**

1	<b>Tax:</b>	
a	Tax on taxable income. See instructions	1a
b	Tax on lump-sum distributions. Attach Form 4972	1b
c	Alternative minimum tax (from Schedule I (Form 1041), line 54)	1c
d	<b>Total.</b> Add lines 1a through 1c	1d
2a	Foreign tax credit. Attach Form 1116	2a
b	General business credit. Attach Form 3800	2b
c	Credit for prior year minimum tax. Attach Form 8801	2c
d	Bond credits. Attach Form 8912	2d
e	<b>Total credits.</b> Add lines 2a through 2d	2e
3	Subtract line 2e from line 1d. If zero or less, enter -0-	3
4	Tax on the ESBT portion of the trust (from ESBT Tax Worksheet, line 17). See instructions	4
5	Net investment income tax from Form 8960, line 21	5
6	Recapture taxes. Check if from: <input type="checkbox"/> Form 4255 <input type="checkbox"/> Form 8611	6
7	Household employment taxes. Attach Schedule H (Form 1040 or 1040-SR)	7
8	Other taxes and amounts due	8
9	<b>Total tax.</b> Add lines 3 through 8. Enter here and on page 1, line 24	9

**Part II — Payments**

10	2019 estimated tax payments and amount applied from 2018 return	10
11	Estimated tax payments allocated to beneficiaries (from Form 1041-T)	11
12	Subtract line 11 from line 10	12
13	Tax paid with Form 7004. See instructions	13
14	Federal income tax withheld. If any is from Form(s) 1099, check here <input type="checkbox"/>	14
15	2019 net 965 tax liability from Form 965-A, Part I, column (f), line 3	15
16	Other payments: a Form 2439 ; b Form 4136 ; Total	16c
17	<b>Total payments.</b> Add lines 12 through 15 and 16c. Enter here and on page 1, line 26	17

Form **1041** (2019)

**Other Information**

	Yes	No
<b>1</b> Did the estate or trust receive tax-exempt income? If "Yes," attach a computation of the allocation of expenses. Enter the amount of tax-exempt interest income and exempt-interest dividends . . . . . ▶ \$ _____		
<b>2</b> Did the estate or trust receive all or any part of the earnings (salary, wages, and other compensation) of any individual by reason of a contract assignment or similar arrangement? . . . . .		
<b>3</b> At any time during calendar year 2019, did the estate or trust have an interest in or a signature or other authority over a bank, securities, or other financial account in a foreign country? . . . . . See the instructions for exceptions and filing requirements for FinCEN Form 114. If "Yes," enter the name of the foreign country ▶ _____		
<b>4</b> During the tax year, did the estate or trust receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," the estate or trust may have to file Form 3520. See instructions . . . . .		
<b>5</b> Did the estate or trust receive, or pay, any qualified residence interest on seller-provided financing? If "Yes," see the instructions for the required attachment . . . . .		
<b>6</b> If this is an estate or a complex trust making the section 663(b) election, check here. See instructions . . . . . ▶ <input type="checkbox"/>		
<b>7</b> To make a section 643(e)(3) election, attach Schedule D (Form 1041), and check here. See instructions . . . . . ▶ <input type="checkbox"/>		
<b>8</b> If the decedent's estate has been open for more than 2 years, attach an explanation for the delay in closing the estate, and check here . . . . . ▶ <input type="checkbox"/>		
<b>9</b> Are any present or future trust beneficiaries skip persons? See instructions . . . . .		
<b>10</b> Was the trust a specified domestic entity required to file Form 8938 for the tax year (see the Instructions for Form 8938)? . . . . .		
<b>11a</b> Did the estate or trust distribute S corporation stock for which it made a section 965(i) election? . . . . .		
<b>b</b> If "Yes," did each beneficiary enter into an agreement to be liable for the net tax liability? See instructions . . . . .		
<b>12</b> Did the estate or trust make a section 965(i) election for S corporation stock held on the last day of the tax year? See instructions . . . . .		
<b>13 ESBTs only.</b> Does the ESBT have a nonresident alien grantor? If "Yes," see instructions . . . . .		
<b>14 ESBTs only.</b> Did the S portion of the trust claim a qualified business income deduction? If "Yes," see instructions . . . . .		

Form **1041** (2019)

**SCHEDULE I  
(Form 1041)**Department of the Treasury  
Internal Revenue Service

Name of estate or trust

**Alternative Minimum Tax—Estates and Trusts**

▶ Attach to Form 1041.

▶ Go to [www.irs.gov/Form1041](http://www.irs.gov/Form1041) for instructions and the latest information.

OMB No. 1545-0082

**2019**

Employer identification number

**Part I Estate's or Trust's Share of Alternative Minimum Taxable Income**

1	Adjusted total income or (loss) (from Form 1041, line 17). ESBTs, see instructions	1
2	Interest	2
3	Taxes	3
4	Refund of taxes	4 ( )
5	Depletion (difference between regular tax and AMT)	5
6	Net operating loss deduction. Enter as a positive amount	6
7	Interest from specified private activity bonds exempt from the regular tax	7
8	Qualified small business stock (see instructions)	8
9	Exercise of incentive stock options (excess of AMT income over regular tax income)	9
10	Other estates and trusts (amount from Schedule K-1 (Form 1041), box 12, code A)	10
11	Disposition of property (difference between AMT and regular tax gain or loss)	11
12	Depreciation on assets placed in service after 1986 (difference between regular tax and AMT)	12
13	Passive activities (difference between AMT and regular tax income or loss)	13
14	Loss limitations (difference between AMT and regular tax income or loss)	14
15	Circulation costs (difference between regular tax and AMT)	15
16	Long-term contracts (difference between AMT and regular tax income)	16
17	Mining costs (difference between regular tax and AMT)	17
18	Research and experimental costs (difference between regular tax and AMT)	18
19	Income from certain installment sales before January 1, 1987	19 ( )
20	Intangible drilling costs preference	20
21	Other adjustments, including income-based related adjustments	21
22	Alternative tax net operating loss deduction (See the instructions for the limitation that applies.)	22 ( )
23	Adjusted alternative minimum taxable income. Combine lines 1 through 22	23
<b>Note:</b> Complete Part II below before going to line 24.		
24	Income distribution deduction from Part II, line 42	24
25	Estate tax deduction (from Form 1041, line 19)	25
26	Add lines 24 and 25	26
27	Estate's or trust's share of alternative minimum taxable income. Subtract line 26 from line 23	27

If line 27 is:

- \$25,000 or less, stop here and enter -0- on Form 1041, Schedule G, line 1c. The estate or trust isn't liable for the alternative minimum tax.
- Over \$25,000, but less than \$183,500, go to line 43.
- \$183,500 or more, enter the amount from line 27 on line 49 and go to line 50.
- ESBTs, see instructions.

**Part II Income Distribution Deduction on a Minimum Tax Basis**

28	Adjusted alternative minimum taxable income (see instructions)	28
29	Adjusted tax-exempt interest (other than amounts included on line 7)	29
30	Total net gain from Schedule D (Form 1041), line 19, column (1). If a loss, enter -0-	30
31	Capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes (from Form 1041, Schedule A, line 4)	31
32	Capital gains paid or permanently set aside for charitable purposes from gross income (see instructions)	32
33	Capital gains computed on a minimum tax basis included on line 23	33 ( )
34	Capital losses computed on a minimum tax basis included on line 23. Enter as a positive amount	34
35	Distributable net alternative minimum taxable income (DNAMTI). Combine lines 28 through 34. If zero or less, enter -0-	35
36	Income required to be distributed currently (from Form 1041, Schedule B, line 9)	36
37	Other amounts paid, credited, or otherwise required to be distributed (from Form 1041, Schedule B, line 10)	37
38	Total distributions. Add lines 36 and 37	38
39	Tax-exempt income included on line 38 (other than amounts included on line 7)	39
40	Tentative income distribution deduction on a minimum tax basis. Subtract line 39 from line 38	40

For Paperwork Reduction Act Notice, see the Instructions for Form 1041.

Cat. No. 51517Q

Schedule I (Form 1041) (2019)

**Part II** Income Distribution Deduction on a Minimum Tax Basis (continued)

<b>41</b>	Tentative income distribution deduction on a minimum tax basis. Subtract line 29 from line 35. If zero or less, enter -0-	<b>41</b>	
<b>42</b>	Income distribution deduction on a minimum tax basis. Enter the smaller of line 40 or line 41. Enter here and on line 24	<b>42</b>	

**Part III** Alternative Minimum Tax

<b>43</b>	Exemption amount	<b>43</b>	\$25,000
<b>44</b>	Enter the amount from line 27	<b>44</b>	
<b>45</b>	Phase-out of exemption amount	<b>45</b>	\$83,500
<b>46</b>	Subtract line 45 from line 44. If zero or less, enter -0-	<b>46</b>	
<b>47</b>	Multiply line 46 by 25% (0.25)	<b>47</b>	
<b>48</b>	Subtract line 47 from line 43. If zero or less, enter -0-	<b>48</b>	
<b>49</b>	Subtract line 48 from line 44	<b>49</b>	
<b>50</b>	Go to Part IV of Schedule I to figure line 50 if the estate or trust has qualified dividends or has a gain on lines 18a and 19 of column (2) of Schedule D (Form 1041) (as refigured for the AMT, if necessary). Otherwise, if line 49 is: • \$194,800 or less, multiply line 49 by 26% (0.26). • Over \$194,800, multiply line 49 by 28% (0.28) and subtract \$3,896 from the result	<b>50</b>	
<b>51</b>	Alternative minimum foreign tax credit (see instructions)	<b>51</b>	
<b>52</b>	Tentative minimum tax. Subtract line 51 from line 50	<b>52</b>	
<b>53</b>	Enter the tax from Form 1041, Schedule G, line 1a (minus any foreign tax credit from Schedule G, line 2a)	<b>53</b>	
<b>54</b>	Alternative minimum tax. Subtract line 53 from line 52. If zero or less, enter -0-. Enter here and on Form 1041, Schedule G, line 1c	<b>54</b>	

**Part IV** Line 50 Computation Using Maximum Capital Gains Rates

**Caution:** If you didn't complete Part V of Schedule D (Form 1041), the Schedule D Tax Worksheet, or the Qualified Dividends Tax Worksheet in the Instructions for Form 1041, see the instructions before completing this part.

<b>55</b>	Enter the amount from line 49	<b>55</b>	
<b>56</b>	Enter the amount from Schedule D (Form 1041), line 26, line 13 of the Schedule D Tax Worksheet, or line 4 of the Qualified Dividends Tax Worksheet in the Instructions for Form 1041, whichever applies (as refigured for the AMT, if necessary)	<b>56</b>	
<b>57</b>	Enter the amount from Schedule D (Form 1041), line 18b, column (2) (as refigured for the AMT, if necessary). If you didn't complete Schedule D for the regular tax or the AMT, enter -0-	<b>57</b>	
<b>58</b>	If you didn't complete a Schedule D Tax Worksheet for the regular tax or the AMT, enter the amount from line 56. Otherwise, add lines 56 and 57 and enter the <b>smaller</b> of that result or the amount from line 10 of the Schedule D Tax Worksheet (as refigured for the AMT, if necessary)	<b>58</b>	
<b>59</b>	Enter the <b>smaller</b> of line 55 or line 58	<b>59</b>	
<b>60</b>	Subtract line 59 from line 55	<b>60</b>	
<b>61</b>	If line 60 is \$194,800 or less, multiply line 60 by 26% (0.26). Otherwise, multiply line 60 by 28% (0.28) and subtract \$3,896 from the result	<b>61</b>	
<b>62</b>	Maximum amount subject to the 0% rate	<b>62</b>	\$2,650
<b>63</b>	Enter the amount from line 27 of Schedule D (Form 1041), line 14 of the Schedule D Tax Worksheet, or line 5 of the Qualified Dividends Tax Worksheet in the Instructions for Form 1041, whichever applies (as figured for the regular tax). If you didn't complete Schedule D or either worksheet for the regular tax, enter the amount from Form 1041, line 22; if zero or less, enter -0-	<b>63</b>	
<b>64</b>	Subtract line 63 from line 62. If zero or less, enter -0-	<b>64</b>	
<b>65</b>	Enter the <b>smaller</b> of line 55 or line 56	<b>65</b>	
<b>66</b>	Enter the <b>smaller</b> of line 64 or line 65. This amount is taxed at 0%	<b>66</b>	
<b>67</b>	Subtract line 66 from line 65	<b>67</b>	

Schedule I (Form 1041) (2019)

**Part IV** Line 50 Computation Using Maximum Capital Gains Rates (continued)

68	Maximum amount subject to rates below 20%	68	\$12,950	
69	Enter the amount from line 64	69		
70	Enter the amount from line 27 of Schedule D (Form 1041), line 18 of the Schedule D Tax Worksheet, or line 5 of the Qualified Dividends Tax Worksheet, whichever applies (as figured for the regular tax). If you didn't complete Schedule D or either worksheet for the regular tax, enter the amount from Form 1041, line 22; if zero or less, enter -0-	70		
71	Add line 69 and line 70	71		
72	Subtract line 71 from line 68. If zero or less, enter -0-	72		
73	Enter the <b>smaller</b> of line 67 or 72	73		
74	Multiply line 73 by 15% (0.15)	74		
75	Add lines 66 and 73	75		
If lines 75 and 55 are the same, skip lines 76 through 80 and go to line 81. Otherwise, go to line 76.				
76	Subtract line 75 from line 65	76		
77	Multiply line 76 by 20% (0.20)	77		
If line 57 is zero or blank, skip lines 78 through 80 and go to line 81. Otherwise, go to line 78.				
78	Add lines 60, 75, and 76	78		
79	Subtract line 78 from line 55	79		
80	Multiply line 79 by 25% (0.25)	80		
81	Add lines 61, 74, 77, and 80	81		
82	If line 55 is \$194,800 or less, multiply line 55 by 26% (0.26). Otherwise, multiply line 55 by 28% (0.28) and subtract \$3,896 from the result	82		
83	Enter the <b>smaller</b> of line 81 or line 82 here and on line 50	83		

Schedule I (Form 1041) (2019)

**SCHEDULE D  
(Form 1041)**

Department of the Treasury  
Internal Revenue Service

Name of estate or trust

**Capital Gains and Losses**

▶ Attach to Form 1041, Form 5227, or Form 990-T.

▶ Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9 and 10.

▶ Go to [www.irs.gov/F1041](http://www.irs.gov/F1041) for instructions and the latest information.

OMB No. 1545-0092

**2019**

Employer identification number

Did you dispose of any investment(s) in a qualified opportunity fund during the tax year? ☐ Yes ☐ No

If "Yes," attach Form 8949 and see its instructions for additional requirements for reporting your gain or loss.

**Note:** Form 5227 filers need to complete **only** Parts I and II.

**Part I Short-Term Capital Gains and Losses—Generally Assets Held One Year or Less** (see instructions)

See instructions for how to figure the amounts to enter on the lines below.

This form may be easier to complete if you round off cents to whole dollars.

	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
<b>1a</b> Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b				
<b>1b</b> Totals for all transactions reported on Form(s) 8949 with <b>Box A</b> checked				
<b>2</b> Totals for all transactions reported on Form(s) 8949 with <b>Box B</b> checked				
<b>3</b> Totals for all transactions reported on Form(s) 8949 with <b>Box C</b> checked				
<b>4</b> Short-term capital gain or (loss) from Forms 4684, 6252, 6781, and 8824				<b>4</b>
<b>5</b> Net short-term gain or (loss) from partnerships, S corporations, and other estates or trusts				<b>5</b>
<b>6</b> Short-term capital loss carryover. Enter the amount, if any, from line 9 of the 2018 Capital Loss Carryover Worksheet				<b>6</b> ( )
<b>7</b> <b>Net short-term capital gain or (loss).</b> Combine lines 1a through 6 in column (h). Enter here and on line 17, column (3) on the back				<b>7</b>

**Part II Long-Term Capital Gains and Losses—Generally Assets Held More Than One Year** (see instructions)

See instructions for how to figure the amounts to enter on the lines below.

This form may be easier to complete if you round off cents to whole dollars.

	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
<b>8a</b> Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b				
<b>8b</b> Totals for all transactions reported on Form(s) 8949 with <b>Box D</b> checked				
<b>9</b> Totals for all transactions reported on Form(s) 8949 with <b>Box E</b> checked				
<b>10</b> Totals for all transactions reported on Form(s) 8949 with <b>Box F</b> checked				
<b>11</b> Long-term capital gain or (loss) from Forms 2439, 4684, 6252, 6781, and 8824				<b>11</b>
<b>12</b> Net long-term gain or (loss) from partnerships, S corporations, and other estates or trusts				<b>12</b>
<b>13</b> Capital gain distributions				<b>13</b>
<b>14</b> Gain from Form 4797, Part I				<b>14</b>
<b>15</b> Long-term capital loss carryover. Enter the amount, if any, from line 14 of the 2018 Capital Loss Carryover Worksheet				<b>15</b> ( )
<b>16</b> <b>Net long-term capital gain or (loss).</b> Combine lines 8a through 15 in column (h). Enter here and on line 18a, column (3) on the back				<b>16</b>

For Paperwork Reduction Act Notice, see the Instructions for Form 1041.

Cat. No. 11376V

Schedule D (Form 1041) 2019

<b>Part III Summary of Parts I and II</b> Caution: Read the instructions before completing this part.		(1) Beneficiaries' (see instr.)	(2) Estate's or trust's	(3) Total
<b>17</b>	<b>Net short-term gain or (loss)</b> . . . . .	<b>17</b>		
<b>18</b>	<b>Net long-term gain or (loss):</b>			
<b>a</b>	Total for year . . . . .	<b>18a</b>		
<b>b</b>	Unrecaptured section 1250 gain (see line 18 of the worksheet.) . . . . .	<b>18b</b>		
<b>c</b>	28% rate gain . . . . .	<b>18c</b>		
<b>19</b>	<b>Total net gain or (loss).</b> Combine lines 17 and 18a . . . . .	<b>19</b>		

**Note:** If line 19, column (3), is a net gain, enter the gain on Form 1041, line 4 (or Form 990-T, Part I, line 4a). If lines 18a and 19, column (2), are net gains, go to Part V, and **don't** complete Part IV. If line 19, column (3), is a net loss, complete Part IV and the **Capital Loss Carryover Worksheet**, as necessary.

### Part IV Capital Loss Limitation

<b>20</b>	Enter here and enter as a (loss) on Form 1041, line 4 (or Form 990-T, Part I, line 4c, if a trust), the smaller of:	
<b>a</b>	The loss on line 19, column (3) or <b>b</b> \$3,000 . . . . .	<b>20</b> ( )

**Note:** If the loss on line 19, column (3), is more than \$3,000, or if Form 1041, page 1, line 23 (or Form 990-T, line 39), is a loss, complete the **Capital Loss Carryover Worksheet** in the instructions to figure your capital loss carryover.

### Part V Tax Computation Using Maximum Capital Gains Rates

**Form 1041 filers.** Complete this part **only** if both lines 18a and 19 in column (2) are gains, or an amount is entered in Part I or Part II and there is an entry on Form 1041, line 2b(2), and Form 1041, line 23, is more than zero.

**Caution:** Skip this part and complete the **Schedule D Tax Worksheet** in the instructions if:

- Either line 18b, col. (2) or line 18c, col. (2) is more than zero, or
- Both Form 1041, line 2b(1), and Form 4952, line 4g are more than zero.

**Form 990-T trusts.** Complete this part **only** if both lines 18a and 19 are gains, or qualified dividends are included in income in Part I of Form 990-T, and Form 990-T, line 39, is more than zero. Skip this part and complete the **Schedule D Tax Worksheet** in the instructions if either line 18b, col. (2) or line 18c, col. (2) is more than zero.

<b>21</b>	Enter taxable income from Form 1041, line 23 (or Form 990-T, line 39) . . . . .	<b>21</b>		
<b>22</b>	Enter the <b>smaller</b> of line 18a or 19 in column (2) but not less than zero . . . . .	<b>22</b>		
<b>23</b>	Enter the estate's or trust's qualified dividends from Form 1041, line 2b(2) (or enter the qualified dividends included in income in Part I of Form 990-T) . . . . .	<b>23</b>		
<b>24</b>	Add lines 22 and 23 . . . . .	<b>24</b>		
<b>25</b>	If the estate or trust is filing Form 4952, enter the amount from line 4g; otherwise, enter -0- . . . . .	<b>25</b>		
<b>26</b>	Subtract line 25 from line 24. If zero or less, enter -0- . . . . .	<b>26</b>		
<b>27</b>	Subtract line 26 from line 21. If zero or less, enter -0- . . . . .	<b>27</b>		
<b>28</b>	Enter the <b>smaller</b> of the amount on line 21 or \$2,650 . . . . .	<b>28</b>		
<b>29</b>	Enter the <b>smaller</b> of the amount on line 27 or line 28 . . . . .	<b>29</b>		
<b>30</b>	Subtract line 29 from line 28. If zero or less, enter -0-. This amount is taxed at 0% . . . . .	<b>30</b>		
<b>31</b>	Enter the <b>smaller</b> of line 21 or line 26 . . . . .	<b>31</b>		
<b>32</b>	Subtract line 30 from line 26 . . . . .	<b>32</b>		
<b>33</b>	Enter the <b>smaller</b> of line 21 or \$12,950 . . . . .	<b>33</b>		
<b>34</b>	Add lines 27 and 30 . . . . .	<b>34</b>		
<b>35</b>	Subtract line 34 from line 33. If zero or less, enter -0- . . . . .	<b>35</b>		
<b>36</b>	Enter the <b>smaller</b> of line 32 or line 35 . . . . .	<b>36</b>		
<b>37</b>	Multiply line 36 by 15% (0.15) . . . . .	<b>37</b>		
<b>38</b>	Enter the amount from line 31 . . . . .	<b>38</b>		
<b>39</b>	Add lines 30 and 36 . . . . .	<b>39</b>		
<b>40</b>	Subtract line 39 from line 38. If zero or less, enter -0- . . . . .	<b>40</b>		
<b>41</b>	Multiply line 40 by 20% (0.20) . . . . .	<b>41</b>		
<b>42</b>	Figure the tax on the amount on line 27. Use the 2019 Tax Rate Schedule for Estates and Trusts (see the Schedule G instructions in the instructions for Form 1041) . . . . .	<b>42</b>		
<b>43</b>	Add lines 37, 41, and 42 . . . . .	<b>43</b>		
<b>44</b>	Figure the tax on the amount on line 21. Use the 2019 Tax Rate Schedule for Estates and Trusts (see the Schedule G instructions in the instructions for Form 1041) . . . . .	<b>44</b>		
<b>45</b>	<b>Tax on all taxable income.</b> Enter the <b>smaller</b> of line 43 or line 44 here and on Form 1041, Schedule G, Part I, line 1a (or Form 990-T, line 41) . . . . .	<b>45</b>		

Schedule D (Form 1041) 2019

**SCHEDULE E**  
(Form 1040 or 1040-SR)

Department of the Treasury  
Internal Revenue Service (99)

**Supplemental Income and Loss**  
(From rental real estate, royalties, partnerships, S corporations, estates, trusts, REMICs, etc.)  
▶ Attach to Form 1040, 1040-SR, 1040-NR, or 1041.  
▶ Go to [www.irs.gov/ScheduleE](http://www.irs.gov/ScheduleE) for instructions and the latest information.

OMB No. 1545-0074

**2019**  
Attachment  
Sequence No. **13**

Name(s) shown on return

Your social security number

**Part I** **Income or Loss From Rental Real Estate and Royalties** **Note:** If you are in the business of renting personal property, use **Schedule C** (see instructions). If you are an individual, report farm rental income or loss from **Form 4835** on page 2, line 40.

**A** Did you make any payments in 2019 that would require you to file Form(s) 1099? (see instructions) . . . . . ☐ Yes ☐ No

**B** If "Yes," did you or will you file required Forms 1099? . . . . . ☐ Yes ☐ No

**1a** Physical address of each property (street, city, state, ZIP code)

**A** \_\_\_\_\_

**B** \_\_\_\_\_

**C** \_\_\_\_\_

<b>1b</b>	Type of Property (from list below)	<b>2</b>	Fair Rental Days	Personal Use Days	QJV
<b>A</b>		For each rental real estate property listed above, report the number of fair rental and personal use days. Check the <b>QJV</b> box only if you meet the requirements to file as a qualified joint venture. See instructions.	<b>A</b>		<input type="checkbox"/>
<b>B</b>			<b>B</b>		<input type="checkbox"/>
<b>C</b>			<b>C</b>		<input type="checkbox"/>

**Type of Property:**

- 1 Single Family Residence      3 Vacation/Short-Term Rental      5 Land      7 Self-Rental  
2 Multi-Family Residence      4 Commercial      6 Royalties      8 Other (describe)

**Income:** \_\_\_\_\_ **Properties:** \_\_\_\_\_ **A** \_\_\_\_\_ **B** \_\_\_\_\_ **C** \_\_\_\_\_

**3** Rents received . . . . . **3** \_\_\_\_\_

**4** Royalties received . . . . . **4** \_\_\_\_\_

**Expenses:** \_\_\_\_\_

**5** Advertising . . . . . **5** \_\_\_\_\_

**6** Auto and travel (see instructions) . . . . . **6** \_\_\_\_\_

**7** Cleaning and maintenance . . . . . **7** \_\_\_\_\_

**8** Commissions . . . . . **8** \_\_\_\_\_

**9** Insurance . . . . . **9** \_\_\_\_\_

**10** Legal and other professional fees . . . . . **10** \_\_\_\_\_

**11** Management fees . . . . . **11** \_\_\_\_\_

**12** Mortgage interest paid to banks, etc. (see instructions) . . . . . **12** \_\_\_\_\_

**13** Other interest . . . . . **13** \_\_\_\_\_

**14** Repairs . . . . . **14** \_\_\_\_\_

**15** Supplies . . . . . **15** \_\_\_\_\_

**16** Taxes . . . . . **16** \_\_\_\_\_

**17** Utilities . . . . . **17** \_\_\_\_\_

**18** Depreciation expense or depletion . . . . . **18** \_\_\_\_\_

**19** Other (list) ▶ \_\_\_\_\_ **19** \_\_\_\_\_

**20** Total expenses. Add lines 5 through 19 . . . . . **20** \_\_\_\_\_

**21** Subtract line 20 from line 3 (rents) and/or 4 (royalties). If result is a (loss), see instructions to find out if you must file **Form 6198** . . . . . **21** \_\_\_\_\_

**22** Deductible rental real estate loss after limitation, if any, on **Form 8582** (see instructions) . . . . . **22** ( ) ( ) ( )

**23a** Total of all amounts reported on line 3 for all rental properties . . . . . **23a** \_\_\_\_\_

**b** Total of all amounts reported on line 4 for all royalty properties . . . . . **23b** \_\_\_\_\_

**c** Total of all amounts reported on line 12 for all properties . . . . . **23c** \_\_\_\_\_

**d** Total of all amounts reported on line 18 for all properties . . . . . **23d** \_\_\_\_\_

**e** Total of all amounts reported on line 20 for all properties . . . . . **23e** \_\_\_\_\_

**24** **Income.** Add positive amounts shown on line 21. **Do not** include any losses . . . . . **24** \_\_\_\_\_

**25** **Losses.** Add royalty losses from line 21 and rental real estate losses from line 22. Enter total losses here . . . . . **25** ( )

**26** **Total rental real estate and royalty income or (loss).** Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 40 on page 2 do not apply to you, also enter this amount on Schedule 1 (Form 1040 or 1040-SR), line 5, or Form 1040-NR, line 18. Otherwise, include this amount in the total on line 41 on page 2 . . . . . **26** \_\_\_\_\_

For Paperwork Reduction Act Notice, see the separate instructions.

Cat. No. 11344L

Schedule E (Form 1040 or 1040-SR) 2019

Name(s) shown on return. Do not enter name and social security number if shown on other side.

Your social security number

**Caution:** The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

**Part II Income or Loss From Partnerships and S Corporations** — **Note:** If you report a loss, receive a distribution, dispose of stock, or receive a loan repayment from an S corporation, you **must** check the box in column (e) on line 28 and attach the required basis computation. If you report a loss from an at-risk activity for which **any** amount is **not** at risk, you **must** check the box in column (f) on line 28 and attach **Form 6198** (see instructions).

**27** Are you reporting any loss not allowed in a prior year due to the at-risk or basis limitations, a prior year unallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses? If you answered "Yes," see instructions before completing this section. ☐ Yes ☐ No

<b>28</b>	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if basis computation is required	(f) Check if any amount is not at risk
<b>A</b>			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
<b>B</b>			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
<b>C</b>			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
<b>D</b>			<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>

<b>Passive Income and Loss</b>		<b>Nonpassive Income and Loss</b>		
(g) Passive loss allowed (attach Form 8582 if required)	(h) Passive income from Schedule K-1	(i) Nonpassive loss allowed (see Schedule K-1)	(j) Section 179 expense deduction from Form 4562	(k) Nonpassive income from Schedule K-1
<b>A</b>				
<b>B</b>				
<b>C</b>				
<b>D</b>				
<b>29a Totals</b>				
<b>b Totals</b>				
<b>30</b> Add columns (h) and (k) of line 29a.			<b>30</b>	
<b>31</b> Add columns (g), (i), and (j) of line 29b.			<b>31</b>	( )
<b>32</b> <b>Total partnership and S corporation income or (loss).</b> Combine lines 30 and 31			<b>32</b>	

**Part III Income or Loss From Estates and Trusts**

<b>33</b>	(a) Name	(b) Employer identification number
<b>A</b>		
<b>B</b>		

<b>Passive Income and Loss</b>		<b>Nonpassive Income and Loss</b>	
(c) Passive deduction or loss allowed (attach Form 8582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
<b>A</b>			
<b>B</b>			
<b>34a Totals</b>			
<b>b Totals</b>			
<b>35</b> Add columns (d) and (f) of line 34a.			<b>35</b>
<b>36</b> Add columns (c) and (e) of line 34b.			<b>36</b> ( )
<b>37</b> <b>Total estate and trust income or (loss).</b> Combine lines 35 and 36.			<b>37</b>

**Part IV Income or Loss From Real Estate Mortgage Investment Conduits (REMICs)—Residual Holder**

<b>38</b>	(a) Name	(b) Employer identification number	(c) Excess inclusion from Schedules Q, line 2c (see instructions)	(d) Taxable income (net loss) from Schedules Q, line 1b	(e) Income from Schedules Q, line 3b
<b>39</b>	Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below				<b>39</b>

**Part V Summary**

<b>40</b>	Net farm rental income or (loss) from <b>Form 4835</b> . Also, complete line 42 below	<b>40</b>
<b>41</b>	Total income or (loss). Combine lines 26, 32, 37, 39, and 40. Enter the result here and on Schedule 1 (Form 1040 or 1040-SR), line 5, or Form 1040-NR, line 18	<b>41</b>
<b>42</b>	<b>Reconciliation of farming and fishing income.</b> Enter your gross farming and fishing income reported on Form 4835, line 7; Schedule K-1 (Form 1065), box 14, code B; Schedule K-1 (Form 1120-S), box 17, code AC; and Schedule K-1 (Form 1041), box 14, code F (see instructions)	<b>42</b>
<b>43</b>	<b>Reconciliation for real estate professionals.</b> If you were a real estate professional (see instructions), enter the net income or (loss) you reported anywhere on Form 1040, Form 1040-SR, or Form 1040-NR from all rental real estate activities in which you materially participated under the passive activity loss rules	<b>43</b>

**Depreciation and Amortization**  
(Including Information on Listed Property)

▶ Attach to your tax return.

▶ Go to [www.irs.gov/Form4562](http://www.irs.gov/Form4562) for instructions and the latest information.

OMB No. 1545-0172

**2019**Attachment  
Sequence No. 179

Name(s) shown on return

Business or activity to which this form relates

Identifying number

**Part I Election To Expense Certain Property Under Section 179****Note:** If you have any listed property, complete Part V before you complete Part I.

1	Maximum amount (see instructions)	1
2	Total cost of section 179 property placed in service (see instructions)	2
3	Threshold cost of section 179 property before reduction in limitation (see instructions)	3
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions	5
6	(a) Description of property	(b) Cost (business use only)
		(c) Elected cost
7	Listed property. Enter the amount from line 29	7
8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	8
9	Tentative deduction. Enter the smaller of line 5 or line 8	9
10	Carryover of disallowed deduction from line 13 of your 2018 Form 4562	10
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5. See instructions	11
12	Section 179 expense deduction. Add lines 9 and 10, but don't enter more than line 11	12
13	Carryover of disallowed deduction to 2020. Add lines 9 and 10, less line 12	13

**Note:** Don't use Part II or Part III below for listed property. Instead, use Part V.**Part II Special Depreciation Allowance and Other Depreciation (Don't include listed property. See instructions.)**

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year. See instructions.	14
15	Property subject to section 168(f)(1) election	15
16	Other depreciation (including ACRS)	16

**Part III MACRS Depreciation (Don't include listed property. See instructions.)****Section A**

17	MACRS deductions for assets placed in service in tax years beginning before 2019	17
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here <input type="checkbox"/>	

**Section B—Assets Placed in Service During 2019 Tax Year Using the General Depreciation System**

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19a 3-year property						
b 5-year property						
c 7-year property						
d 10-year property						
e 15-year property						
f 20-year property						
g 25-year property			25 yrs.		S/L	
h Residential rental property			27.5 yrs.	MM	S/L	
i Nonresidential real property			27.5 yrs.	MM	S/L	
			39 yrs.	MM	S/L	
				MM	S/L	

**Section C—Assets Placed in Service During 2019 Tax Year Using the Alternative Depreciation System**

20a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 30-year			30 yrs.	MM	S/L	
d 40-year			40 yrs.	MM	S/L	

**Part IV Summary (See instructions.)**

21	Listed property. Enter amount from line 28	21
22	<b>Total.</b> Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions	22
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs	23

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 12906N

Form **4562** (2019)

**Part V Listed Property** (Include automobiles, certain other vehicles, certain aircraft, and property used for entertainment, recreation, or amusement.)

**Note:** For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete **only** 24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.

**Section A—Depreciation and Other Information** (Caution: See the instructions for limits for passenger automobiles.)

<b>24a</b> Do you have evidence to support the business/investment use claimed? <input type="checkbox"/> Yes <input type="checkbox"/> No										<b>24b</b> If "Yes," is the evidence written? <input type="checkbox"/> Yes <input type="checkbox"/> No	
(a) Type of property (list vehicles first)	(b) Date placed in service	(c) Business/investment use percentage	(d) Cost or other basis	(e) Basis for depreciation (business/investment use only)	(f) Recovery period	(g) Method/Convention	(h) Depreciation deduction	(i) Elected section 179 cost			
<b>25</b> Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use. See instructions.								<b>25</b>			
<b>26</b> Property used more than 50% in a qualified business use:											
		%									
		%									
		%									
<b>27</b> Property used 50% or less in a qualified business use:											
		%				S/L -					
		%				S/L -					
		%				S/L -					
<b>28</b> Add amounts in column (h), lines 25 through 27. Enter here and on line 21, page 1.								<b>28</b>			
<b>29</b> Add amounts in column (i), line 26. Enter here and on line 7, page 1.								<b>29</b>			

**Section B—Information on Use of Vehicles**

Complete this section for vehicles used by a sole proprietor, partner, or other "more than 5% owner," or related person. If you provided vehicles to your employees, first answer the questions in Section C to see if you meet an exception to completing this section for those vehicles.

	(a) Vehicle 1		(b) Vehicle 2		(c) Vehicle 3		(d) Vehicle 4		(e) Vehicle 5		(f) Vehicle 6	
<b>30</b> Total business/investment miles driven during the year (don't include commuting miles)												
<b>31</b> Total commuting miles driven during the year												
<b>32</b> Total other personal (noncommuting) miles driven												
<b>33</b> Total miles driven during the year. Add lines 30 through 32												
<b>34</b> Was the vehicle available for personal use during off-duty hours?	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
<b>35</b> Was the vehicle used primarily by a more than 5% owner or related person?												
<b>36</b> Is another vehicle available for personal use?												

**Section C—Questions for Employers Who Provide Vehicles for Use by Their Employees**

Answer these questions to determine if you meet an exception to completing Section B for vehicles used by employees who aren't more than 5% owners or related persons. See instructions.

	Yes	No
<b>37</b> Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees?		
<b>38</b> Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees? See the instructions for vehicles used by corporate officers, directors, or 1% or more owners.		
<b>39</b> Do you treat all use of vehicles by employees as personal use?		
<b>40</b> Do you provide more than five vehicles to your employees, obtain information from your employees about the use of the vehicles, and retain the information received?		
<b>41</b> Do you meet the requirements concerning qualified automobile demonstration use? See instructions.		

**Note:** If your answer to 37, 38, 39, 40, or 41 is "Yes," don't complete Section B for the covered vehicles.

**Part VI Amortization**

(a) Description of costs	(b) Date amortization begins	(c) Amortizable amount	(d) Code section	(e) Amortization period or percentage	(f) Amortization for this year
<b>42</b> Amortization of costs that begins during your 2019 tax year (see instructions):					
<b>43</b> Amortization of costs that began before your 2019 tax year					<b>43</b>
<b>44</b> Total. Add amounts in column (f). See the instructions for where to report					<b>44</b>

661117

**Schedule K-1  
(Form 1041)**

Department of the Treasury  
Internal Revenue Service

**2019**

For calendar year 2019, or tax year

beginning  /  / 2019 ending  /  /

**Beneficiary's Share of Income, Deductions, Credits, etc.** ▶ See back of form and instructions.

**Part I Information About the Estate or Trust**

**A** Estate's or trust's employer identification number

**B** Estate's or trust's name

**C** Fiduciary's name, address, city, state, and ZIP code

**D** ☐ Check if Form 1041-T was filed and enter the date it was filed

**E** ☐ Check if this is the final Form 1041 for the estate or trust

**Part II Information About the Beneficiary**

**F** Beneficiary's identifying number

**G** Beneficiary's name, address, city, state, and ZIP code

**H** ☐ Domestic beneficiary ☐ Foreign beneficiary

☐ Final K-1

☐ Amended K-1

OMB No. 1545-0092

**Part III Beneficiary's Share of Current Year Income, Deductions, Credits, and Other Items**

<b>1</b>	Interest income	<b>11</b>	Final year deductions
<b>2a</b>	Ordinary dividends		
<b>2b</b>	Qualified dividends		
<b>3</b>	Net short-term capital gain		
<b>4a</b>	Net long-term capital gain		
<b>4b</b>	28% rate gain	<b>12</b>	Alternative minimum tax adjustment
<b>4c</b>	Unrecaptured section 1250 gain		
<b>5</b>	Other portfolio and nonbusiness income		
<b>6</b>	Ordinary business income		
<b>7</b>	Net rental real estate income	<b>13</b>	Credits and credit recapture
<b>8</b>	Other rental income		
<b>9</b>	Directly apportioned deductions		
		<b>14</b>	Other information
<b>10</b>	Estate tax deduction		

\*See attached statement for additional information.  
**Note:** A statement must be attached showing the beneficiary's share of income and directly apportioned deductions from each business, rental real estate, and other rental activity.

For IRS Use Only

For Paperwork Reduction Act Notice, see the Instructions for Form 1041.

www.irs.gov/Form1041

Cat. No. 11380D

Schedule K-1 (Form 1041) 2019

This list identifies the codes used on Schedule K-1 for beneficiaries and provides summarized reporting information for beneficiaries who file Form 1040 or 1040-SR. For detailed reporting and filing information, see the Instructions for Schedule K-1 (Form 1041) for a Beneficiary Filing Form 1040 or 1040-SR and the instructions for your income tax return.

	Report on		Report on
<b>1. Interest income</b>	Form 1040 or 1040-SR, line 2b	<b>13. Credits and credit recapture</b>	
<b>2a. Ordinary dividends</b>	Form 1040 or 1040-SR, line 3b	Code	Form 1040 or 1040-SR, Schedule 3, line 8
<b>2b. Qualified dividends</b>	Form 1040 or 1040-SR, line 3a	<b>A</b> Credit for estimated taxes	
<b>3. Net short-term capital gain</b>	Schedule D, line 5	<b>B</b> Credit for backup withholding	Form 1040 or 1040-SR, line 17
<b>4a. Net long-term capital gain</b>	Schedule D, line 12	<b>C</b> Low-income housing credit	
<b>4b. 28% rate gain</b>	28% Rate Gain Worksheet, line 4 (Schedule D instructions)	<b>D</b> Rehabilitation credit and energy credit	
<b>4c. Unrecaptured section 1250 gain</b>	Unrecaptured Section 1250 Gain Worksheet, line 11 (Schedule D instructions)	<b>E</b> Other qualifying investment credit	
<b>5. Other portfolio and nonbusiness income</b>	Schedule E, line 33, column (f)	<b>F</b> Work opportunity credit	
<b>6. Ordinary business income</b>	Schedule E, line 33, column (d) or (f)	<b>G</b> Credit for small employer health insurance premiums	
<b>7. Net rental real estate income</b>	Schedule E, line 33, column (d) or (f)	<b>H</b> Biotrust producer credit	
<b>8. Other rental income</b>	Schedule E, line 33, column (d) or (f)	<b>I</b> Credit for increasing research activities	
<b>9. Directly apportioned deductions</b>		<b>J</b> Renewable electricity, refined coal, and Indian coal production credit	
Code		<b>K</b> Empowerment zone employment credit	See the beneficiary's instructions
<b>A</b> Depreciation	Form 6582 or Schedule E, line 33, column (c) or (e)	<b>L</b> Indian employment credit	
<b>B</b> Depletion	Form 6582 or Schedule E, line 33, column (c) or (e)	<b>M</b> Orphan drug credit	
<b>C</b> Amortization	Form 6582 or Schedule E, line 33, column (c) or (e)	<b>N</b> Credit for employer-provided child care and facilities	
<b>10. Estate tax deduction</b>	Schedule A, line 16	<b>O</b> Biodiesel and renewable diesel fuels credit	
<b>11. Final year deductions</b>		<b>P</b> Credit to holders of tax credit bonds	
<b>A</b> Excess deductions	See the beneficiary's instructions	<b>Q</b> Credit for employer differential wage payments	
<b>B</b> Short-term capital loss carryover	Schedule D, line 5	<b>R</b> Recapture of credits	
<b>C</b> Long-term capital loss carryover	Schedule D, line 12; line 5 of the wksht. for Sch. D, line 16; and line 16 of the wksht. for Sch. D, line 19	<b>Z</b> Other credits	
<b>D</b> Net operating loss carryover — regular tax	Form 1040 or 1040-SR, Schedule 1, line 8	<b>14. Other information</b>	
<b>E</b> Net operating loss carryover — minimum tax	Form 6251, line 2f	<b>A</b> Tax-exempt interest	Form 1040 or 1040-SR, line 2a
<b>12. Alternative minimum tax (AMT) items</b>		<b>B</b> Foreign taxes	Form 1040 or 1040-SR, Schedule 3, line 1 or Sch. A, line 6
<b>A</b> Adjustment for minimum tax purposes	Form 6251, line 2j	<b>C</b> Reserved	
<b>B</b> AMT adjustment attributable to qualified dividends		<b>D</b> Reserved	
<b>C</b> AMT adjustment attributable to net short-term capital gain		<b>E</b> Net investment income	Form 4952, line 4a
<b>D</b> AMT adjustment attributable to net long-term capital gain		<b>F</b> Gross farm and fishing income	Schedule E, line 42
<b>E</b> AMT adjustment attributable to unrecaptured section 1250 gain	See the beneficiary's instructions and the instructions for Form 6251	<b>G</b> Foreign trading gross receipts (IRC 942(a))	See the instructions for Form 8873
<b>F</b> AMT adjustment attributable to 28% rate gain		<b>H</b> Adjustment for section 1411 net investment income or deductions	Form 8960, line 7 (also see the beneficiary's instructions)
<b>G</b> Accelerated depreciation		<b>I</b> Section 199A information	See the beneficiary's instructions
<b>H</b> Depletion		<b>Z</b> Other information	See the beneficiary's instructions
<b>I</b> Amortization			
<b>J</b> Exclusion items	2020 Form 9901		

**Note:** If you are a beneficiary who does not file a Form 1040 or 1040-SR, see instructions for the type of income tax return you are filing.



**Florida**

# The Florida Senate

## 2018 Florida Statutes

Title XLII	Chapter 738
ESTATES AND TRUSTS	PRINCIPAL AND INCOME

### CHAPTER 738 PRINCIPAL AND INCOME

- 738.101 Short title.
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- 738.103 Fiduciary duties; general principles.
- 738.104 Trustee's power to adjust.
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- 738.607 Derivatives and options.
- 738.608 Asset-backed securities.
- 738.701 Disbursements from income.
- 738.702 Disbursements from principal.
- 738.703 Transfers from income to principal for depreciation.

- 738.704 Transfers from income to reimburse principal.
- 738.705 Income taxes.
- 738.706 Adjustments between principal and income because of taxes.
- 738.801 Apportionment of expenses; improvements.
- 738.802 Uniformity of application and construction.
- 738.803 Severability.
- 738.804 Application.

**738.101 Short title.**—This chapter may be cited as the “Florida Uniform Principal and Income Act.”

**History.**—s. 1, ch. 2002-42.

**738.102 Definitions.**—As used in this chapter, the term:

- (1) “Accounting period” means a calendar year unless another 12-month period is selected by a fiduciary. The term includes a portion of a calendar year or other 12-month period that begins when an income interest begins or ends when an income interest ends.
- (2) “Beneficiary” means, in the case of a decedent’s estate, an heir or devisee and, in the case of a trust, an income beneficiary or a remainder beneficiary.
- (3) “Carrying value” means the fair market value at the time the assets are received by the fiduciary. For the estates of decedents and trusts described in s. 733.707(3), after the grantor’s death, the assets are considered received as of the date of death. If there is a change in fiduciaries, a majority of the continuing fiduciaries may elect to adjust the carrying values to reflect the fair market value of the assets at the beginning of their administration. If such election is made, it must be reflected on the first accounting filed after the election. For assets acquired during the administration of the estate or trust, the carrying value is equal to the acquisition costs of the asset.
- (4) “Fiduciary” means a personal representative or a trustee. The term includes an executor, administrator, successor personal representative, special administrator, or a person performing substantially the same function.
- (5) “Income” means money or property that a fiduciary receives as current return from a principal asset. The term includes a portion of receipts from a sale, exchange, or liquidation of a principal asset, to the extent provided in ss. 738.401-738.403 and s. 738.503.
- (6) “Income beneficiary” means a person to whom net income of a trust is or may be payable.
- (7) “Income interest” means the right of an income beneficiary to receive all or part of net income, whether the terms of the trust require the net income to be distributed or authorize the net income to be distributed in the trustee’s discretion.
- (8) “Mandatory income interest” means the right of an income beneficiary to receive net income that the terms of the trust require the fiduciary to distribute.
- (9) “Net income” means the total receipts allocated to income during an accounting period minus the disbursements made from income during the period, plus or minus transfers under this chapter to or from income during the period.

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

(11) “Principal” means property held in trust for distribution to a remainder beneficiary when the trust terminates.

(12) “Remainder beneficiary” means a person entitled to receive principal when an income interest ends.

(13) “Terms of a trust” means the manifestation of the intent of a grantor 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.

(14) “Trustee” includes an original, additional, or successor trustee, whether or not appointed or confirmed by a court.

**History.**—s. 1, ch. 2002-42; s. 2, ch. 2012-49.

### **738.103 Fiduciary duties; general principles.—**

(1) In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of ss. 738.201 and 738.202 and ss. 738.301-738.303, a fiduciary:

(a) Shall administer a trust or estate in accordance with the terms of the trust or the will, even if there is a different provision in this chapter.

(b) May administer a trust or estate by the exercise of a discretionary power of administration given to the fiduciary by the terms of the trust or the will, even if the exercise of the power produces a result different from a result required or permitted by this chapter.

(c) Shall 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) Shall add a receipt or charge a disbursement to principal to the extent 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 the power to adjust under s. 738.104(1) or 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, except to the extent 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.

(3) Except as provided in s. 738.1041(9), this chapter pertains to the administration of a trust and is applicable to any trust that is administered in this state or under its law. This chapter also applies to any estate that is administered in this state unless the provision is limited in application to a trustee, rather than a fiduciary.

History.—s. 1, ch. 2002-42; s. 3, ch. 2012-49.

**738.104 Trustee's power to adjust.—**

(1) A trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or shall be distributed to a beneficiary by referring to the trust's income, and the trustee determines, after applying the rules in s. 738.103(1), that the trustee is unable to comply with s. 738.103(2).

(2) In deciding whether and to what extent to exercise the power conferred by subsection (1), a trustee shall consider all factors relevant to the trust and its beneficiaries, including the following factors to the extent they are relevant:

- (a) The nature, purpose, and expected duration of the trust.
- (b) The intent of the grantor.
- (c) The identity and circumstances of the beneficiaries.
- (d) The needs for liquidity, regularity of income, and preservation and appreciation of capital.
- (e) The assets held in the trust; the extent to which the assets consist of financial assets, interests in closely held enterprises, tangible and intangible personal property, or real property; the extent to which an asset is used by a beneficiary; and whether an asset was purchased by the trustee or received from the grantor.
- (f) The net amount allocated to income under the other sections of this chapter and the increases or decreases in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available.
- (g) Whether and to what extent the terms of the trust give the trustee the power to invade principal or accumulate income or prohibit the trustee from invading principal or accumulating income and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income.
- (h) The actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation.
- (i) The anticipated tax consequences of an adjustment.

(3) A trustee may not make an adjustment:

- (a) That reduces the actuarial value of the income interest in a trust to which a person transfers property with the intent to qualify for a gift tax exclusion;
- (b) That changes the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets;
- (c) From any amount that is permanently set aside for charitable purposes under a will or the terms of a trust unless both income and principal are so set aside;
- (d) If possessing or exercising the power to adjust causes an individual to be treated as the owner of all or part of the trust for income tax purposes and the individual would not be treated as the owner if the trustee did not possess the power to adjust;

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

(f) If the trustee is a beneficiary of the trust; or

(g) If the trustee is not a beneficiary of the trust but the adjustment would benefit the trustee directly or indirectly, except that in the case of a trustee whose compensation for acting as trustee is based upon the value of trust assets, an adjustment that affects the value of trust assets shall not be deemed to benefit the trustee.

(4) If paragraph (3)(d), paragraph (3)(e), paragraph (3)(f), or paragraph (3)(g) applies to a trustee and there is more than one trustee, a cotrustee to whom the provision does not apply may make the adjustment unless the exercise of the power by the remaining trustee is not permitted by the terms of the trust.

(5) A trustee may release the entire power to adjust conferred by subsection (1) or may release only the power to adjust from income to principal or the power to adjust from principal to income if the trustee is uncertain about whether possessing or exercising the power will cause a result described in paragraphs (3)(a)-(e) or paragraph (3)(g) or if the trustee determines that possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax burden not described in subsection (3). A release under this subsection may be permanent or for a specified period, including a period measured by the life of an individual.

(6) Terms of a trust that limit a trustee's power to adjust between principal and income do not affect the application of this section unless it is clear from the terms of the trust that the terms are intended to deny the trustee the power to adjust conferred by subsection (1).

(7) Nothing in this chapter is intended to create or imply a duty to make an adjustment and no inference of impropriety shall be made as a result of a trustee not exercising the power to adjust conferred by subsection (1).

(8) With respect to a trust in existence on January 1, 2003:

(a) A trustee shall not have the power to adjust under this section until the statement required in subsection (9) is provided and either no objection is made or any objection which is made has been terminated.

1. An objection is made if, within 60 days after the date of the statement required in subsection (9), a super majority of the eligible beneficiaries deliver to the trustee a written objection to the application of this section to such trust. An objection shall be deemed to be delivered to the trustee on the date the objection is mailed to the mailing address listed in the notice provided in subsection (9).

2. An objection is terminated upon the earlier of the receipt of consent from a super majority of eligible beneficiaries of the class that made the objection, or the resolution of the objection pursuant to paragraph (c).

(b) An objection or consent under this section may be executed by a legal representative or natural guardian of a beneficiary without the filing of any proceeding or approval of any court.

(c) If an objection is delivered to the trustee, then the trustee may petition the circuit court for an order quashing the objection and vesting in such trustee the power to adjust under this section. The burden will be on the objecting beneficiaries to prove that the power to adjust would be inequitable, illegal, or otherwise in contravention of the grantor's intent. The court may award costs and attorney's fees relating to the trustee's petition in the same manner as in chancery actions. When costs and attorney's fees are to be paid out of the trust, the court may, in its discretion, direct from which part of the trust they shall be paid.

(d) If no timely objection is made or if the trustee is vested with the power to adjust by court order, the trustee may thereafter exercise the power to adjust without providing notice of its intent to do so unless, in vesting the trustee with the power to adjust, the court determines that unusual circumstances require otherwise.

(e)1. If a trustee makes a good faith effort to comply with the notice provisions of subsection (9), but fails to deliver notice to one or more beneficiaries entitled to such notice, neither the validity of the notice required under this subsection nor the trustee's power to adjust under this section shall be affected until the trustee has actual notice that one or more beneficiaries entitled to notice were not notified. Until the trustee has actual notice of the notice deficiency, the trustee shall have all of the powers and protections granted a trustee with the power to adjust under this chapter.

2. When the trustee has actual notice that one or more beneficiaries entitled to notice under subsection (9) were not notified, the trustee's power to adjust under this section shall cease until all beneficiaries who are entitled to such notice, including those who were previously provided with such notice, are notified and given the opportunity to object as provided for under this subsection.

(f) The objection of a super majority of eligible beneficiaries under this subsection shall be valid for a period of 1 year after the date of the notice set forth in subsection (9). Upon expiration of the objection, the trustee may thereafter give a new notice under subsection (9).

(g) Nothing in this section is intended to create or imply a duty of the trustee of a trust existing on January 1, 2003, to seek a power to adjust pursuant to this subsection or to give the notice described in subsection (9) if the trustee does not desire to have a power to adjust under this section, and no inference of impropriety shall be made as the result of a trustee not seeking a power to adjust pursuant to this subsection.

(9)(a) A trustee of a trust in existence on January 1, 2003, that is not prohibited under subsection (3) from exercising the power to adjust shall, any time prior to initially exercising the power, provide to all eligible beneficiaries a statement containing the following:

1. The name, telephone number, street address, and mailing address of the trustee and of any individuals who may be contacted for further information;

2. A statement that unless a super majority of the eligible beneficiaries objects to the application of this section to the trust within 60 days after the date the statement pursuant to this subsection was served, this section shall apply to the trust; and

3. A statement that, if this section applies to the trust, the trustee will have the power to adjust between income and principal and that such a power may have an effect on the distributions to such beneficiary from the trust.

(b) The statement may contain information regarding a trustee's fiduciary obligations with respect to the power to adjust between income and principal under this section.

(c) The statement referred to in this subsection shall be served informally, in the manner provided in the Florida Rules of Civil Procedure relating to service of pleadings subsequent to the initial pleading. The statement may be served on a legal representative or natural guardian of a beneficiary without the filing of any proceeding or approval of any court.

(d) For purposes of subsection (8) and this subsection, the term:

1. "Eligible beneficiaries" means:

a. If at the time the determination is made there are one or more beneficiaries described in s. 736.0103(16)(c), the beneficiaries described in s. 736.0103(16)(a) and (c); or

b. If there is no beneficiary described in s. 736.0103(16)(c), the beneficiaries described in s. 736.0103(16)(a) and (b).

2. "Super majority of the eligible beneficiaries" means:

a. If at the time the determination is made there are one or more beneficiaries described in s. 736.0103(16)(c), at least two-thirds in interest of the beneficiaries described in s. 736.0103(16)(a) or two-thirds in interest of the beneficiaries described in s. 736.0103(16)(c), if the interests of the beneficiaries are reasonably ascertainable; otherwise, it means two-thirds in number of either such class; or

b. If there is no beneficiary described in s. 736.0103(16)(c), at least two-thirds in interest of the beneficiaries described in s. 736.0103(16)(a) or two-thirds in interest of the beneficiaries described in s. 736.0103(16)(b), if the interests of the beneficiaries are reasonably ascertainable, otherwise, two-thirds in number of either such class.

(10) A trust exists on January 1, 2003, if it is not revocable on January 1, 2003. A trust is revocable if revocable by the grantor alone or in conjunction with any other person. A trust is not revocable for purposes of this section if revocable by the grantor only with the consent of all persons having a beneficial interest in the property.

**History.**—s. 1, ch. 2002-42; s. 1, ch. 2003-43; s. 5, ch. 2005-85; s. 40, ch. 2006-217; s. 4, ch. 2012-49; s. 20, ch. 2013-172.

**738.1041 Total return unitrust.**—

(1) For purposes of this section, the term:

(a) “Average fair market value” means the average of the fair market values of assets held by the trust at the beginning of the current and each of the 2 preceding years, or for the entire term of the trust if there are less than 2 preceding years, and adjusted as follows:

1. If assets have been added to the trust during the years used to determine the average, the amount of each addition is added to all years in which such addition was not included.
2. If assets have been distributed from the trust during the years used to determine the average, other than in satisfaction of the unitrust amount, the amount of each distribution is subtracted from all years in which such distribution was not included.

(b) “Disinterested person” means a person who is not a related or subordinate party with respect to the person acting as trustee of the trust and excludes the grantor and any interested trustee.

(c) “Fair market value” means the fair market value of the assets held by the trust as otherwise determined under this chapter, reduced by all known noncontingent liabilities.

(d) “Income trust” means a trust, created by an inter vivos or a testamentary instrument, which directs or permits the trustee to distribute the net income of the trust to one or more persons, in fixed proportions or in amounts or proportions determined by the trustee and regardless of whether the trust directs or permits the trustee to distribute the principal of the trust to one or more such persons.

(e) “Interested distributee” means a person to whom distributions of income or principal can currently be made and who has the power to remove the existing trustee and designate as successor a person who may be a related or subordinate party with respect to such distributee.

(f) “Interested trustee” means an individual trustee to whom the net income or principal of the trust can currently be distributed or would be distributed if the trust were then to terminate and be distributed, any trustee whom an interested distributee has the power to remove and replace with a related or subordinate party, or an individual trustee whose legal obligation to support a beneficiary may be satisfied by distributions of income and principal of the trust.

(g) “Related or subordinate party” has the same meaning as provided in the Internal Revenue Code, 26 U.S.C. s. 672(c) or any successor provision thereof.

(h) “Unitrust amount” means the amount determined by multiplying the average fair market value of the assets as calculated in paragraph (a) by the percentage calculated under paragraph (2)(b).

(2) A trustee may, without court approval, convert an income trust to a total return unitrust, reconvert a total return unitrust to an income trust, or change the percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust if:

(a) The trustee adopts a written statement regarding trust distributions which provides:

1. In the case of a trust being administered as an income trust, that future distributions from the trust will be unitrust amounts rather than net income, and indicates the manner in which the unitrust amount will be calculated and the method in which the fair market value of the trust will be determined.

2. In the case of a trust being administered as a total return unitrust, that:

- a. Future distributions from the trust will be net income rather than unitrust amounts; or

b. The percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust will be changed, and indicates the manner in which the new unitrust amount will be calculated and the method in which the new fair market value of the trust will be determined;

(b) The trustee determines the terms of the unitrust under one of the following methods:

1. A disinterested trustee determines, or if there is no trustee other than an interested trustee, the interested trustee appoints a disinterested person who, in its sole discretion but acting in a fiduciary capacity, determines for the interested trustee:

a. The percentage to be used to calculate the unitrust amount, provided the percentage used is not greater than 5 percent nor less than 3 percent;

b. The method to be used in determining the fair market value of the trust; and

c. Which assets, if any, are to be excluded in determining the unitrust amount; or

2. The interested trustee or disinterested trustee administers the trust such that:

a. The percentage used to calculate the unitrust amount is 50 percent of the rate as defined in the Internal Revenue Code, 26 U.S.C. s. 7520, in effect for the month the conversion under this section becomes effective and for each January thereafter; however, if the percentage calculated exceeds 5 percent, the unitrust percentage is 5 percent and if the percentage calculated is less than 3 percent, the unitrust percentage is 3 percent; and

b. The fair market value of the trust shall be determined at least annually on an asset-by-asset basis, reasonably and in good faith, in accordance with s. 738.202(5), except the following property shall not be included in determining the value of the trust:

(I) Any residential property or any tangible personal property that, as of the first business day of the current valuation year, one or more current beneficiaries of the trust have or have had the right to occupy, or have or have had the right to possess or control, other than in his or her capacity as trustee of the trust, and instead the right of occupancy or the right to possession and control is the unitrust amount with respect to such property; however, the unitrust amount must be adjusted to take into account partial distributions from or receipt into the trust of such property during the valuation year;

(II) Any asset specifically given to a beneficiary and the return on investment on such property, which return on investment shall be distributable to the beneficiary; or

(III) Any asset while held in a decedent's estate;

(c) The trustee sends written notice of its intention to take such action, along with copies of the written statement regarding trust distributions and this section, and, if applicable, the determinations of the trustee or the disinterested person to:

1. The grantor of the trust, if living.

2. All living persons who are currently receiving or eligible to receive distributions of income from the trust.

3. All living persons who would receive distributions of principal of the trust if the trust were to terminate at the time of giving such notice without regard to the exercise of any power of appointment, or, if the trust does not provide for its termination, all living persons who would receive

or be eligible to receive distributions of income or principal of the trust if the persons identified in subparagraph 2. were deceased.

4. All persons acting as advisers or protectors of the trust.

Notice under this paragraph shall be served informally in the manner provided in the Florida Rules of Civil Procedure relating to service of pleadings subsequent to the initial pleading. Notice may be served on a legal representative or natural guardian of a person without filing any proceeding or approval of any court;

(d) At least one person receiving notice under each of subparagraphs (c)2. and 3. is legally competent; and

(e) No person receiving such notice objects, by written instrument delivered to the trustee, to the proposed action of the trustee or the determinations of the disinterested person within 60 days after service of such notice. An objection may be executed by a legal representative or natural guardian of a person without filing any proceeding or approval of any court.

(3) If a trustee desires to convert an income trust to a total return unitrust, reconvert a total return unitrust to an income trust, or change the percentage used to calculate the unitrust amount or the method used to determine a fair market value of the trust but does not have the ability to or elects not to do it under subsection (2), the trustee may petition the circuit court for such order as the trustee deems appropriate. In that event, the court, in its own discretion or on the petition of such trustee or any person having an income or remainder interest in the trust, may appoint a disinterested person who, acting in a fiduciary capacity, shall present such information to the court as is necessary for the court to make a determination hereunder.

(4) Following the conversion of an income trust to a total return unitrust, the trustee:

(a) Shall treat the unitrust amount as if it were net income of the trust for purposes of determining the amount available, from time to time, for distribution from the trust.

(b) May allocate to trust income for each taxable year of the trust, or portion thereof:

1. Net short-term capital gain described in the Internal Revenue Code, 26 U.S.C. s. 1222(5), for such year, or portion thereof, but only to the extent that the amount so allocated together with all other amounts allocated to trust income, as determined under the provisions of this chapter without regard to this section and s. 738.104, for such year, or portion thereof, does not exceed the unitrust amount for such year, or portion thereof.

2. Net long-term capital gain described in the Internal Revenue Code, 26 U.S.C. s. 1222(7), for such year, or portion thereof, but only to the extent that the amount so allocated together with all other amounts, including amounts described in subparagraph 1., allocated to trust income for such year, or portion thereof, does not exceed the unitrust amount for such year, or portion thereof.

(5) In administering a total return unitrust, the trustee may, in its sole discretion but subject to the provisions of the governing instrument, determine:

(a) The effective date of the conversion.

(b) The timing of distributions, including provisions for prorating a distribution for a short year in which a beneficiary's right to payments commences or ceases.

(c) Whether distributions are to be made in cash or in kind or partly in cash and partly in kind.

(d) If the trust is reconverted to an income trust, the effective date of such reconversion.

(e) Such other administrative issues as may be necessary or appropriate to carry out the purposes of this section.

(6) Conversion to a total return unitrust under this section does not affect any other provision of the governing instrument, if any, regarding distributions of principal.

(7) Any trustee or disinterested person who in good faith takes or fails to take any action under this section is not liable to any person affected by such action or inaction, regardless of whether such person received written notice as provided in this section or such person was under a legal disability at the time of the delivery of such notice. Such person's exclusive remedy is to obtain, under subsection (8), an order of the court directing the trustee to convert an income trust to a total return unitrust, to reconvert from a total return unitrust to an income trust, or to change the percentage used to calculate the unitrust amount. If a court determines that the trustee or disinterested person has not acted in good faith in taking or failing to take any action under this section, s. 738.105(3) applies.

(8) If a majority in interest of the income or remainder beneficiaries of an income trust has delivered to the trustee a written objection to the amount of the income distributions of the trust, and, if the trustee has failed to resolve the objection to the satisfaction of the objecting beneficiaries within 6 months after receipt of such written objection, the objecting beneficiaries may petition the court in accordance with subsection (3).

(9) This section pertains to the administration of a trust and is applicable to any trust that is administered in this state or under Florida law unless:

(a) The governing instrument reflects an intention that the current beneficiary or beneficiaries are to receive an amount other than a reasonable current return from the trust;

(b) The trust is a trust described in the Internal Revenue Code, 26 U.S.C. s. 170(f)(2)(B), s. 642(c)(5), s. 664(d), s. 2702(a)(3), or s. 2702(b);

(c) One or more persons to whom the trustee could distribute income have a power of withdrawal over the trust:

1. That is not subject to an ascertainable standard under the Internal Revenue Code, 26 U.S.C. s. 2041 or s. 2514, and exceeds in any calendar year the amount set forth in the Internal Revenue Code, 26 U.S.C. s. 2041(b)(2) or s. 2514(e); or

2. A power of withdrawal over the trust that can be exercised to discharge a duty of support he or she possesses; or

(d) The governing instrument expressly prohibits use of this section by specific reference to the section. A provision in the governing instrument that, "The provisions of section 738.1041, Florida Statutes, as amended, or any corresponding provision of future law, may not be used in the

administration of this trust,” or similar words reflecting such intent are sufficient to preclude the use of this section.

(10) The grantor of a trust may create an express total return unitrust that will be effective as provided in the trust instrument without requiring a conversion under this section.

(a) An express total return unitrust created by the grantor of the trust is treated as a unitrust only if the terms of the trust instrument contain all of the following provisions:

1. That distributions from the trust will be unitrust amounts and the manner in which the unitrust amount will be calculated; and

2. The percentage to be used to calculate the unitrust amount, provided the percentage used is not greater than 5 percent nor less than 3 percent.

(b) The trust instrument may also contain provisions specifying:

1. The method to be used in determining the fair market value of the trust, including whether to use an average fair market value or the fair market value of the assets held by the trust at the beginning of the current year; or

2. Which assets, if any, are to be excluded in determining the unitrust amount.

(c) This section establishes the method of determining the fair market value of the trust if the trust instrument is silent as to subparagraph (b)1., and to specify those assets, if any, which are to be excluded in determining the unitrust amount if the trust instrument is silent as to subparagraph (b)2.

**History.**—s. 1, ch. 2002-42; s. 2, ch. 2003-43; s. 6, ch. 2005-85; s. 41, ch. 2006-217; s. 5, ch. 2012-49.

#### **738.105 Judicial control of discretionary powers.—**

(1) A court may not change a trustee’s decision to exercise or not to exercise a discretionary power conferred by this chapter unless the court determines that the decision was an abuse of the trustee’s discretion. A court may not determine that a trustee abused its discretion merely because the court would have exercised the discretion in a different manner or would not have exercised the discretion.

(2) The decisions to which subsection (1) applies include:

(a) A determination under s. 738.104(1) of whether and to what extent an amount should be transferred from principal to income or from income to principal.

(b) A determination of the factors that are relevant to the trust and trust beneficiaries, the extent to which such factors are relevant, and the weight, if any, to be given to the relevant factors, in deciding whether and to what extent to exercise the power conferred by s. 738.104(1).

(3) If a court determines that a trustee has abused its discretion, the remedy is to restore the income and remainder beneficiaries to the positions they would have occupied if the trustee had not abused its discretion, in accordance with the following:

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

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

(c) To the extent the court is unable, after applying paragraphs (a) and (b), to restore the beneficiaries or the trust, or both, to the positions they would have occupied if the trustee had not abused its discretion, the court may require the trustee to pay an appropriate amount from its own funds to one or more of the beneficiaries or the trust or both.

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

(5) If an action is instituted alleging an abuse of discretion in the exercise or nonexercise of the power of adjustment conferred by s. 738.104(1) and the court determines that no abuse of discretion has occurred, the trustee's costs and attorney's fees incurred in defending the action shall be paid from the trust assets.

**History.**—s. 1, ch. 2002-42; s. 6, ch. 2012-49.

**738.201 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 of a terminating income interest shall determine the amount of net income and net principal receipts received from property specifically given to a beneficiary under ss. 738.301-738.706 and 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 ss. 738.301-738.706 and by:

(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. 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 under the Internal Revenue Code or comparable law of any state only to the extent the payment of those expenses from income will not cause the reduction or 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) If a beneficiary who receives a pecuniary devise outright is also entitled to receive interest or any other amount on the devise under the terms of the will or trust, the fiduciary shall distribute the interest or other amount from net income determined under subsection (2) or from principal to the extent net income is insufficient.

(4) A fiduciary shall distribute the net income remaining after distributions required under subsections (1)-(3) in the manner described in s. 738.202 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 may not reduce principal or income receipts from property described in subsection (1) because of a payment described in s. 738.701 or s. 738.702 to the extent 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 the fiduciary recovers or expects to recover the payment from a third party. The net income and principal receipts from the property are determined by including all of the amounts the fiduciary receives or pays with respect to the property, whether those amounts accrued or became due before, on, or after the date of a decedent's death or an income interest's terminating event, and by making a reasonable provision for amounts the fiduciary believes the estate or terminating income interest may become obligated to pay after the property is distributed.

**History.**—s. 1, ch. 2002-42; s. 7, ch. 2012-49.

**738.202 Distribution to residuary and remainder beneficiaries.—**

(1) Each beneficiary described in s. 738.201(4) is entitled to receive a portion of the net income remaining after the application of s. 738.201(1)-(3), which is equal to the beneficiary's fractional interest in undistributed principal assets, using carrying 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 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 applies:

(a) The beneficiary is entitled to receive a portion of the net income equal to the beneficiary's fractional interest in the carrying value of the undistributed principal assets immediately before the distribution date, excluding the amount of unpaid liabilities.

(b) The beneficiary's fractional interest in the undistributed principal assets shall be calculated:

1. At the time the interest began and adjusted for any disproportionate distributions since the interest began;
2. By excluding any liabilities of the estate or trust from the calculation;
3. By also excluding property specifically given to a beneficiary and property required to pay pecuniary amounts not in trust; and
4. On the basis of the aggregate carrying value of those assets determined under subsection (1) as of the distribution date.

(c) If a disproportionate distribution of principal is made to any beneficiary, the respective fractional interests of all beneficiaries in the remaining underlying assets shall be recomputed by:

1. Adjusting the carrying value of the principal assets to their fair market value before the distribution;
2. Reducing the fractional interest of the recipient of the disproportionate distribution in the remaining principal assets by the fair market value of the principal distribution; and
3. Recomputing the fractional interests of all beneficiaries in the remaining principal assets based upon the now restated carrying values.

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

(4) A fiduciary may apply the provisions of this section, to the extent the fiduciary considers appropriate, to net gain or loss realized after the date of death or terminating event or earlier distribution date from the disposition of a principal asset if this section applies to the income from the asset.

(5) The carrying value or fair market value of trust assets shall be determined on an asset-by-asset basis and is conclusive if reasonable and determined in good faith. Determinations of fair market value based on appraisals performed within 2 years before or after the valuation date are presumed reasonable. The values of trust assets are conclusively presumed to be reasonable and determined in good faith unless proven otherwise in a proceeding commenced by or on behalf of a person interested in the trust within the time provided in s. 736.1008.

(6) All distributions to a beneficiary shall be valued based on their fair market value on the date of distribution.

**History.**—s. 1, ch. 2002-42; s. 3, ch. 2003-43; s. 42, ch. 2006-217; s. 8, ch. 2012-49.

**738.301 When right to income begins and ends.**—An income beneficiary is entitled to net income from the date on which the income interest begins.

(1) 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:

(a) On the date the asset 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; or

(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, or on the last day of a period during which there is no beneficiary to whom a fiduciary may distribute income.

**History.**—s. 1, ch. 2002-42; s. 9, ch. 2012-49.

**738.302 Apportionment of receipts and disbursements when decedent dies or income interest begins.—**

(1) A fiduciary shall allocate an income receipt or disbursement other than one to which s. 738.201(1) applies to principal if the due date of the receipt or disbursement 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) A fiduciary shall allocate an income receipt or disbursement to income if the due date of the receipt or disbursement occurs on or after the date on which a decedent dies or an income interest begins and the due date is a periodic due date. An income receipt or disbursement shall be treated as accruing from day to day if the due date of the receipt or disbursement is not periodic or the receipt or disbursement has no due date. The portion of the receipt or disbursement accruing before the date on which a decedent dies or an income interest begins shall be allocated to principal and the balance shall be allocated to income.

(3) An item of income or an obligation is due on the date the payor is required to make a payment. If a payment date is not stated, there is no due date for the purposes of this chapter. Distributions to shareholders or other owners from an entity to which s. 738.401 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 shall be paid at regular intervals under a lease or an obligation to pay interest or if an entity customarily makes distributions at regular intervals.

(4) Nothing in this section shall prevent the application of s. 733.817 to apportion tax to the income recipient under this section.

**History.**—s. 1, ch. 2002-42; s. 10, ch. 2012-49.

**738.303 Apportionment when income interest ends.—**

(1) For purposes of this section, "undistributed income" means net income received on or before the date on which an income interest ends. The term does not include an item of income or expense that is due or accrued or net income that has been added or is required to be added to principal under

the terms of the trust. In the case of a trust being administered as a unitrust under s. 738.1041, the term “undistributed income” means the prorated unitrust amount computed on a daily basis through the date on which the income interest ends.

(2) When a mandatory income interest ends, the fiduciary shall pay to a mandatory income beneficiary who survives that date, or the estate of a deceased mandatory income beneficiary whose death causes the interest to end, the beneficiary’s share of the undistributed income that is not disposed of under the terms of the trust unless the beneficiary has an unqualified power to revoke more than 5 percent of the trust immediately before the income interest ends. In the latter case, the undistributed income from the portion of the trust that may be revoked shall be added to principal.

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

**History.**—s. 1, ch. 2002-42; s. 7, ch. 2005-85; s. 11, ch. 2012-49.

#### **738.401 Character of receipts.—**

(1) For purposes of this section, the term “entity” means a corporation, partnership, limited liability company, regulated investment company, real estate investment trust, common trust fund, or any other organization in which a fiduciary has an interest other than a trust or estate to which s. 738.402 applies, a business or activity to which s. 738.403 applies, or an asset-backed security to which s. 738.608 applies.

(2) Except as otherwise provided in this section, a fiduciary shall allocate to income money received from an entity.

(3) Except as otherwise provided in this section, a fiduciary shall allocate the following receipts from an entity to principal:

- (a) Property other than money.
- (b) Money received in one distribution or a series of related distributions in exchange for part or all of a trust’s or estate’s interest in the entity.
- (c) Money received in total or partial liquidation of the entity.
- (d) Money received from an entity that is a regulated investment company or a real estate investment trust if the money received represents short-term or long-term capital gain realized within the entity.
- (e) Money received from an entity listed on a public stock exchange during any year of the trust or estate which exceeds 10 percent of the fair market value of the trust’s or estate’s interest in the entity on the first day of that year. The amount to be allocated to principal must be reduced to the extent that the cumulative distributions from the entity to the trust or estate allocated to income do not exceed a cumulative annual return of 3 percent of the fair market value of the interest in the entity at the beginning of each year or portion of a year for the number of years or portion of years in the period that the interest in the entity has been held by the trust or estate. If a trustee has exercised

a power to adjust under s. 738.104 during any period the interest in the entity has been held by the trust, the trustee, in determining the total income distributions from that entity, must take into account the extent to which the exercise of that power resulted in income to the trust from that entity for that period. If the income of the trust for any period has been computed under s. 738.1041, the trustee, in determining the total income distributions from that entity for that period, must take into account the portion of the unitrust amount paid as a result of the ownership of the trust's interest in the entity for that period.

(4) If a fiduciary elects, or continues an election made by its predecessor, to reinvest dividends in shares of stock of a distributing corporation or fund, whether evidenced by new certificates or entries on the books of the distributing entity, the new shares retain their character as income.

(5) Money is received in partial liquidation:

(a) To the extent the entity, at or near the time of a distribution, indicates that such money is a distribution in partial liquidation; or

(b) To the extent the total amount of money and property received in a distribution or series of related distributions from an entity that is not listed on a public stock exchange exceeds 20 percent of the trust's or estate's pro rata share of the entity's gross assets, as shown by the entity's year-end financial statements immediately preceding the initial receipt.

This subsection does not apply to an entity to which subsection (7) applies.

(6) Money may not be taken into account in determining any excess under paragraph (5)(b), to the extent that the cumulative distributions from the entity to the trust or the estate allocated to income do not exceed the greater of:

(a) A cumulative annual return of 3 percent of the entity's carrying value computed at the beginning of each period for the number of years or portion of years that the entity was held by the fiduciary. If a trustee has exercised a power to adjust under s. 738.104 during any period the interest in the entity has been held by the trust, the trustee, in determining the total income distributions from that entity, must take into account the extent to which exercise of the power resulted in income to the trust from that entity for that period. If the income of a trust for any period has been computed pursuant to s. 738.1041, the trustee, in determining the total income distributions from the entity for that period, must take into account the portion of the unitrust amount paid as a result of the ownership of the trust's interest in the entity for that period; or

(b) If the entity is treated as a partnership, subchapter S corporation, or a disregarded entity pursuant to the Internal Revenue Code of 1986, as amended, the amount of income tax attributable to the trust's or estate's ownership share of the entity, based on its pro rata share of the taxable income of the entity that distributes the money, for the number of years or portion of years that the interest in the entity was held by the fiduciary, calculated as if all of that tax was incurred by the fiduciary.

(7) The following applies to money or property received by a private trustee as a distribution from an investment entity described in this subsection:

(a) The trustee shall first treat as income of the trust all of the money or property received from the investment entity in the current year which would be considered income under this chapter if the trustee had directly held the trust's pro rata share of the assets of the investment entity. For this purpose, all distributions received in the current year must be aggregated.

(b) The trustee shall next treat as income of the trust any additional money or property received in the current year which would have been considered income in the prior 2 years under paragraph (a) if additional money or property had been received from the investment entity in any of those prior 2 years. The amount to be treated as income shall be reduced by any distributions of money or property made by the investment entity to the trust during the current and prior 2 years which were treated as income under this paragraph.

(c) The remainder of the distribution, if any, is treated as principal.

(d) As used in this subsection, the term:

1. "Investment entity" means an entity, other than a business activity conducted by the trustee described in s. 738.403 or an entity that is listed on a public stock exchange, which is treated as a partnership, subchapter S corporation, or disregarded entity pursuant to the Internal Revenue Code of 1986, as amended, and which normally derives 50 percent or more of its annual cumulative net income from interest, dividends, annuities, royalties, rental activity, or other passive investments, including income from the sale or exchange of such passive investments.

2. "Private trustee" means a trustee who is a natural person, but only if the trustee is unable to use the power to adjust between income and principal with respect to receipts from entities described in this subsection pursuant to s. 738.104. A bank, trust company, or other commercial trustee is not considered a private trustee.

(8) This section shall be applied before ss. 738.705 and 738.706 and does not modify or change any of the provisions of those sections.

**History.**—s. 1, ch. 2002-42; s. 4, ch. 2003-43; s. 8, ch. 2005-85; s. 12, ch. 2012-49.

**738.402 Distribution from trust or estate.**—A fiduciary shall allocate to income an amount received as a distribution of income from a trust or an estate in which the trust has an interest other than a purchased interest and allocate to principal an amount received as a distribution of principal from such a trust or estate. If a fiduciary 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 fiduciary, s. 738.401 or s. 738.608 applies to a receipt from the trust.

**History.**—s. 1, ch. 2002-42; s. 13, ch. 2012-49.

**738.403 Business and other activities conducted by fiduciary.**—

(1) If a fiduciary 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 the business or activity as part of the trust's or estate's general accounting records, the fiduciary may maintain separate accounting records for the transactions of the business or other activity, whether or not the assets of such business or activity are segregated from other trust or estate assets.

(2) A fiduciary who accounts separately for a business or other activity may determine the extent to which the net cash receipts of the business or activity 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 or estate's general accounting records. If a fiduciary sells assets of the business or other activity, other than in the ordinary course of the business or activity, the fiduciary must account for the net amount received as principal in the trust's or estate's general accounting records to the extent the fiduciary determines that the amount received is no longer required in the conduct of the business.

(3) Activities for which a fiduciary may maintain separate accounting records include:

- (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 s. 738.607 applies.

**History.**—s. 1, ch. 2002-42; s. 14, ch. 2012-49.

**738.501 Principal receipts.**—A fiduciary shall allocate to principal:

(1) To the extent not allocated to income under this chapter, assets received from a donor during the donor's lifetime, a decedent's estate, a trust with a terminating income interest, or a payor under a contract naming the trust, estate, or fiduciary as beneficiary.

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

(3) Amounts recovered from third parties to reimburse the trust or estate because of disbursements described in s. 738.702(1)(g) or for other reasons to the extent not based on the loss of income.

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

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

(6) Other receipts as provided in ss. 738.601-738.608.

**History.**—s. 1, ch. 2002-42; s. 15, ch. 2012-49.

**738.502 Rental property.**—If a fiduciary accounts for receipts from rental property pursuant to this section, the fiduciary shall allocate to income an amount received as rent of real or personal property, including an amount received for cancellation or renewal of a lease. An amount received as a refundable deposit, including a security deposit or a deposit that is to be applied as rent for future

periods, 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 fiduciary's contractual obligations have been satisfied with respect to that amount.

**History.**—s. 1, ch. 2002-42; s. 16, ch. 2012-49.

**738.503 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 fiduciary, including an amount received as consideration for prepaying principal, shall be allocated to income without any provision for amortization of premium.

(2) Except as otherwise provided herein, a fiduciary shall allocate to principal an amount received from the sale, redemption, or other disposition of an obligation to pay money to the fiduciary.

(3) The increment in value of a bond or other obligation for the payment of money bearing no stated interest but payable at a future time in excess of the price at which it was issued or purchased, if purchased after issuance, is distributable as income. If the increment in value accrues and becomes payable pursuant to a fixed schedule of appreciation, it may be distributed to the beneficiary who was the income beneficiary at the time of increment from the first principal cash available or, if none is available, when the increment is realized by sale, redemption, or other disposition. If unrealized increment is distributed as income but out of principal, the principal must be reimbursed for the increment when realized. If, in the reasonable judgment of the fiduciary, exercised in good faith, the ultimate payment of the bond principal is in doubt, the fiduciary may withhold the payment of incremental interest to the income beneficiary.

(4) This section does not apply to an obligation to which s. 738.602, s. 738.603, s. 738.604, s. 738.605, s. 738.607, or s. 738.608 applies.

**History.**—s. 1, ch. 2002-42; s. 17, ch. 2012-49.

**738.504 Insurance policies and similar contracts.—**

(1) Except as otherwise provided in subsection (2), a fiduciary shall allocate to principal the proceeds of a life insurance policy or other contract in which the trust, estate, or fiduciary is named as beneficiary, including a contract that insures the trust, estate, or fiduciary against loss for damage to, destruction of, or loss of title to a trust or estate asset. The fiduciary shall allocate dividends on an insurance policy to income if the premiums on the policy are paid from income and to principal if the premiums are paid from principal.

(2) A fiduciary shall allocate to income the proceeds of a contract that insures the fiduciary against loss of occupancy or other use by an income beneficiary, loss of income, or, subject to s. 738.403, loss of profits from a business.

(3) This section does not apply to a contract to which s. 738.602 applies.

**History.**—s. 1, ch. 2002-42; s. 18, ch. 2012-49.

**738.601 Insubstantial allocations not required.—**If a fiduciary determines that an allocation between principal and income required by s. 738.602, s. 738.603, s. 738.604, s. 738.605, or s. 738.608 is insubstantial, the fiduciary may allocate the entire amount to principal unless one of the

circumstances described in s. 738.104(3) applies to the allocation. This power may be exercised by a cofiduciary under the circumstances described in s. 738.104(4) and may be released for the reasons and in the manner described in s. 738.104(5). An allocation is presumed to be insubstantial if:

- (1) The amount of the allocation would increase or decrease net income in an accounting period, as determined before the allocation, by less than 10 percent; or
- (2) The value of the asset producing the receipt for which the allocation would be made is less than 10 percent of the total value of the trust or estate assets at the beginning of the accounting period.

**History.**—s. 1, ch. 2002-42; s. 19, ch. 2012-49.

**738.602 Payments from deferred compensation plans, annuities, and retirement plans or accounts.—**

(1) As used in this section, the term:

(a) “Fund” means a private or commercial annuity, an individual retirement account, an individual retirement annuity, a deferred compensation plan, a pension plan, a profit-sharing plan, a stock-bonus plan, an employee stock-ownership plan, or another similar arrangement in which federal income tax is deferred.

(b) “Income of the fund” means income that is determined according to subsection (2) or subsection (3).

(c) “Nonseparate account” means a fund for which the value of the participant’s or account owner’s right to receive benefits can be determined only by the occurrence of a date or event as defined in the instrument governing the fund.

(d) “Payment” means a distribution from a fund that a fiduciary 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 term includes a distribution made in money or property from the payor’s general assets or from a fund created by the payor or payee.

(e) “Separate account” means a fund holding assets exclusively for the benefit of a participant or account owner and:

1. The value of such assets or the value of the separate account is ascertainable at any time; or
2. The administrator of the fund maintains records that show receipts and disbursements associated with such assets.

(2)(a) For a fund that is a separate account, income of the fund shall be determined:

1. As if the fund were a trust subject to the provisions of ss. 738.401-738.706; or
2. As a unitrust amount calculated by multiplying the fair market value of the fund as of the first day of the first accounting period and, thereafter, as of the last day of the accounting period that immediately precedes the accounting period during which a payment is received by the percentage determined in accordance with s. 738.1041(2)(b)2.a. The fiduciary shall determine such percentage as of the first month that the fiduciary’s election to treat the income of the fund as a unitrust amount becomes effective. For purposes of this subparagraph, “fair market value” means the fair market value

of the assets held in the fund as of the applicable valuation date determined as provided in this subparagraph. The fiduciary is not liable for good faith reliance upon any valuation supplied by the person or persons in possession of the fund. If the fiduciary makes or terminates an election under this subparagraph, the fiduciary shall make such disclosure in a trust disclosure document that satisfies the requirements of s. 736.1008(4)(a).

(b) The fiduciary may elect the method of determining the income of the fund pursuant to this subsection and may change the method of determining income of the fund for any future accounting period.

(3) For a fund that is a nonseparate account, income of the fund is a unitrust amount determined by calculating the present value of the right to receive the remaining payments under the Internal Revenue Code, 26 U.S.C. s. 7520, as of the first day of the accounting period and multiplying it by the percentage determined in accordance with s. 738.1041(2)(b)2.a. The fiduciary shall determine the unitrust amount as of the first month that the fiduciary's election to treat the income of the fund as a unitrust amount becomes effective.

(4) Except for those trusts described in subsection (5), the fiduciary shall allocate to income the lesser of the payment received from a fund or the income determined under subsection (2) or subsection (3). Any remaining amount of the payment shall be allocated to principal.

(5) For a trust that, in order to qualify for the estate or gift tax marital deduction under the Internal Revenue Code or comparable law of any state, entitles the spouse to all of the income of the trust, and the terms of the trust are silent as to the time and frequency for distribution of the income of the fund:

(a) For a fund that is a separate account, unless the spouse directs the fiduciary to leave the income of the fund in the fund, the fiduciary shall withdraw and pay to the spouse, at least annually:

1. All of the income of the fund determined in accordance with subparagraph (2)(a)1.; or
2. The income of the fund as a unitrust amount determined in accordance with subparagraph (2)(a)2.

(b) For a fund that is a nonseparate account, the fiduciary shall withdraw and pay to the spouse, at least annually, the income of the fund as a unitrust amount determined in accordance with subsection (3).

(6) This section does not apply to payments to which s. 738.603 applies.

**History.**—s. 1, ch. 2002-42; s. 1, ch. 2009-207; s. 20, ch. 2012-49.

#### **738.603 Liquidating asset.—**

(1) For purposes of this section, the term “liquidating asset” means an asset the value of which will diminish or terminate because the asset is expected to produce receipts for a period of limited duration. The term includes a leasehold, patent, copyright, royalty right, and right to receive payments for more than 1 year under an arrangement that does not provide for the payment of interest on the unpaid balance. The term does not include a payment subject to s. 738.602, resources subject

to s. 738.604, timber subject to s. 738.605, an activity subject to s. 738.607, an asset subject to s. 738.608, or any asset for which the fiduciary establishes a reserve for depreciation under s. 738.703.

(2) A fiduciary shall allocate to income 5 percent of the receipts from the carrying value of a liquidating asset and the balance to principal. Amounts allocated to principal shall reduce the carrying value of the liquidating asset, but not below zero. Amounts received in excess of the remaining carrying value must be allocated to principal.

**History.**—s. 1, ch. 2002-42; s. 21, ch. 2012-49.

**738.604 Minerals, water, and other natural resources.—**

(1) If a fiduciary accounts for receipts from an interest in minerals or other natural resources pursuant to this section, the fiduciary shall allocate such receipts as follows:

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

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

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

(d) If an amount is received from a working interest or any other interest not provided for in paragraph (a), paragraph (b), or paragraph (c), 90 percent of the net amount received shall be allocated to principal and the balance to income.

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

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

(4) If a trust or estate owns an interest in minerals, water, or other natural resources on January 1, 2003, the fiduciary may allocate receipts from the interest as provided in this chapter or in the manner used by the fiduciary before January 1, 2003. If the trust or estate acquires an interest in minerals, water, or other natural resources after January 1, 2003, the fiduciary shall allocate receipts from the interest as provided in this chapter.

**History.**—s. 1, ch. 2002-42; s. 22, ch. 2012-49.

**738.605 Timber.—**

(1) If a fiduciary accounts for receipts from the sale of timber and related products pursuant to this section, the fiduciary shall allocate such net receipts as follows:

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

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

(c) 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 or estate by determining the amount of timber removed from the land under the lease or contract and applying the rules in paragraphs (a) and (b); or

(d) To principal to the extent advance payments, bonuses, and other payments are not allocated pursuant to paragraph (a), paragraph (b), or paragraph (c).

(2) In determining net receipts to be allocated pursuant to subsection (1), a fiduciary shall deduct and transfer to principal a reasonable amount for depletion.

(3) This chapter applies whether or not a decedent or donor was harvesting timber from the property before the property became subject to the trust or estate.

(4) If a trust or estate owns an interest in timberland on January 1, 2003, the fiduciary may allocate net receipts from the sale of timber and related products as provided in this chapter or in the manner used by the fiduciary before January 1, 2003. If the trust or estate acquires an interest in timberland after January 1, 2003, the fiduciary shall allocate net receipts from the sale of timber and related products as provided in this chapter.

**History.**—s. 1, ch. 2002-42; s. 23, ch. 2012-49.

#### **738.606 Property not productive of income.—**

(1) If a marital deduction under the Internal Revenue Code or comparable law of any state is allowed for all or part of a trust, or if assets are transferred to a trust that satisfies the requirements of s. 732.2025(2)(a) and (c), and such assets have been used in whole or in part to satisfy an election by a surviving spouse under s. 732.2125 and consist of property that, in the aggregate, does not provide the spouse with sufficient income from or use of the trust assets, and if amounts the trustee transfers from principal to income under s. 738.104 and distributes to the spouse from principal pursuant to the terms of the trust are insufficient to provide the spouse with the beneficial enjoyment required to obtain the marital deduction, even though, in the case of an elective share trust, a marital deduction is not made or is only partially made, the spouse may require the trustee of such marital trust or elective share trust to make property productive of income, convert property within a reasonable time, or exercise the power conferred by ss. 738.104 and 738.1041. The trustee may decide which action or combination of actions to take.

(2) In cases not governed by subsection (1), 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.

**History.**—s. 1, ch. 2002-42; s. 24, ch. 2012-49; s. 12, ch. 2017-121.

#### **738.607 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 a fiduciary does not account under s. 738.403 for transactions in derivatives, the fiduciary shall allocate to principal receipts from and disbursements made in connection with those transactions.

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

**History.**—s. 1, ch. 2002-42; s. 25, ch. 2012-49.

**738.608 Asset-backed securities.—**

(1) For purposes of this section, “asset-backed security” means an asset the value of which is based upon the right given the owner to receive distributions from the proceeds of financial assets that provide collateral for the security. The term includes an asset that gives the owner the right to receive from the collateral financial assets only the interest or other current return or only the proceeds other than interest or current return. The term does not include an asset to which s. 738.401 or s. 738.602 applies.

(2) If a trust or estate receives a payment from interest or other current return and from other proceeds of the collateral financial assets, the fiduciary shall allocate to income the portion of the payment which the payor identifies as being from interest or other current return and allocate the balance of the payment to principal.

(3) If a trust or estate receives one or more payments in exchange for the trust’s or estate’s entire interest in an asset-backed security during a single accounting period, the fiduciary 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 or estate’s interest in the security over more than a single accounting period, the fiduciary shall allocate 10 percent of the payment to income and the balance to principal.

**History.**—s. 1, ch. 2002-42; s. 26, ch. 2012-49.

**738.701 Disbursements from income.—**A fiduciary shall make the following disbursements from income to the extent they are not disbursements to which s. 738.201(2) applies:

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

(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.

**History.**—s. 1, ch. 2002-42; s. 27, ch. 2012-49.

**738.702 Disbursements from principal.—**

(1) A fiduciary shall make the following disbursements from principal:

(a) The remaining one-half of the disbursements described in s. 738.701(1) and (2).

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

(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 will, or to protect the trust, estate, or its property.

(e) Premiums paid on a policy of insurance not described in s. 738.701(4) of which the trust or estate 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 such 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.

(h) Payments representing extraordinary repairs or expenses incurred in making a capital improvement to principal, including special assessments; however, a fiduciary may establish an allowance for depreciation out of income to the extent permitted by s. 738.703.

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

**History.**—s. 1, ch. 2002-42; s. 28, ch. 2012-49.

**738.703 Transfers from income to principal for depreciation.—**

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

(2) A fiduciary may transfer to principal a reasonable amount of the net cash receipts from a principal asset that is subject to depreciation but may not transfer any amount for depreciation:

- (a) Of that portion of real property used or available for use by a beneficiary as a residence or of tangible personal property held or made available for the personal use or enjoyment of a beneficiary;
- (b) During the administration of a decedent's estate; or
- (c) Under this section if the fiduciary is accounting under s. 738.403 for the business or activity in which the asset is used.

(3) The amount of depreciation taken for tax purposes with respect to an asset shall be presumed to be a reasonable amount of depreciation. An amount taken for depreciation shall not be considered unreasonable solely because it is greater or less than the amount taken for tax purposes.

- (4) An amount transferred to principal need not be held as a separate fund.

**History.**—s. 1, ch. 2002-42; s. 29, ch. 2012-49.

#### **738.704 Transfers from income to reimburse principal.—**

(1) If a fiduciary makes or expects to make a principal disbursement described in this section, the fiduciary 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 the following, but only to the extent the fiduciary 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 the amount is unusually large.
- (b) Disbursements made to prepare property for rental, including tenant allowances, leasehold improvements, and broker's commissions.

- (c) Disbursements described in s. 738.702(1)(g).

(3) If the asset the ownership of which gives rise to the disbursements becomes subject to a successive income interest after an income interest ends, a fiduciary may continue to transfer amounts from income to principal as provided in subsection (1).

(4) To the extent principal cash is not sufficient to pay the principal balance of payments due on mortgaged property, income may be applied to such payment in order to avoid a default on any mortgage or security interest securing the property. Income shall be reimbursed for such payments out of the first available principal cash. If the asset the ownership of which gives rise to the disbursements described in this subsection becomes subject to a successive income interest after an income interest ends, all rights of the initial income interest shall lapse, and amounts remaining due from principal shall not be a lien on the assets of the trust.

**History.**—s. 1, ch. 2002-42; s. 30, ch. 2012-49.

#### **738.705 Income taxes.—**

(1) A tax required to be paid by a fiduciary based on receipts allocated to income shall be paid from income.

(2) A tax required to be paid by a fiduciary based on receipts allocated to principal shall 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 fiduciary on the trust's or estate's share of an entity's taxable income shall be paid proportionately:

- (a) From income to the extent receipts from the entity are allocated to income.
  - (b) From principal to the extent receipts from the entity are allocated to principal.
  - (c) From principal to the extent that the income taxes payable by the trust or estate exceed the total receipts from the entity.
- (4) After applying subsections (1)-(3), the fiduciary shall adjust income or principal receipts to the extent that the trust's or estate's income taxes are reduced, but not eliminated, because the trust or estate receives a deduction for payments made to a beneficiary. The amount distributable to that beneficiary as income as a result of this adjustment shall be equal to the cash received by the trust or estate, reduced, but not below zero, by the entity's taxable income allocable to the trust or estate multiplied by the trust's or estate's income tax rate. The reduced amount shall be divided by the difference between 1 and the trust's or estate's income tax rate in order to determine the amount distributable to that beneficiary as income before giving effect to other receipts or disbursements allocable to that beneficiary's interest.

**History.**—s. 1, ch. 2002-42; s. 31, ch. 2012-49.

**738.706 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:
- (a) Elections and decisions, other than those described in paragraph (b), 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; or
  - (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 contribution deduction is reduced because a fiduciary deducts an amount paid from principal for income tax purposes instead of deducting such amount for estate tax purposes, and as a result estate taxes paid from principal are increased and income taxes paid by an estate, trust, or beneficiary are decreased, each estate, trust, or beneficiary that benefits from the decrease in income tax shall reimburse the principal from which the increase in estate tax is paid. The total reimbursement shall equal the increase in the estate tax to the extent the principal used to pay the increase would have qualified for a marital deduction or charitable contribution deduction but for the payment. The proportionate share of the reimbursement for each estate, trust, or beneficiary whose income taxes are reduced shall be the same as such estate's, trust's, or beneficiary's proportionate share of the total decrease in income tax. An estate or trust shall reimburse principal from income.

**History.**—s. 1, ch. 2002-42.

**738.801 Apportionment of expenses; improvements.—**

- (1) For purposes of this section, the term:

- (a) “Remainderman” means the holder of the remainder interests after the expiration of a tenant’s estate in property.
- (b) “Tenant” means the holder of an estate for life or term of years in real property or personal property, or both.
- (2) If a trust has not been created, expenses shall be apportioned between the tenant and remainderman as follows:
- (a) The following expenses are allocated to and shall be paid by the tenant:
1. All ordinary expenses incurred in connection with the administration, management, or preservation of the property, including interest, ordinary repairs, regularly recurring taxes assessed against the property, and expenses of a proceeding or other matter that concerns primarily the tenant’s estate or use of the property.
  2. Recurring premiums on insurance covering the loss of the property or the loss of income from or use of the property.
  3. Any of the expenses described in subparagraph (b)3. which are attributable to the use of the property by the tenant.
- (b) The following expenses are allocated to and shall be paid by the remainderman:
1. Payments on the principal of a debt secured by the property, except to the extent the debt is for expenses allocated to the tenant.
  2. Expenses of a proceeding or other matter that concerns primarily the title to the property, other than title to the tenant’s estate.
  3. Except as provided in subparagraph (a)3., expenses 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 such 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.
  4. Extraordinary repairs.
- (c) If the tenant or remainderman incurred an expense for the benefit of his or her own estate without consent or agreement of the other, he or she must pay such expense in full.
- (d) Except as provided in paragraph (c), the cost of, or special taxes or assessments for, an improvement representing an addition of value to property forming part of the principal shall be paid by the tenant if the improvement is not reasonably expected to outlast the estate of the tenant. In all other cases, only a part shall be paid by the tenant while the remainder shall be paid by the remainderman. The part payable by the tenant is ascertainable by taking that percentage of the total that is found by dividing the present value of the tenant’s estate by the present value of an estate of the same form as that of the tenant, except that it is limited for a period corresponding to the reasonably expected duration of the improvement. The computation of present values of the estates

shall be made by using the rate defined in 26 U.S.C. s. 7520, then in effect and, in the case of an estate for life, the official mortality tables then in effect under 26 U.S.C. s. 7520. Other evidence of duration or expectancy may not be considered.

(3) This section does not apply to the extent it is inconsistent with the instrument creating the estates, the agreement of the parties, or the specific direction of the taxing or other statutes.

(4) The common law applicable to tenants and remaindermen supplements this section, except as modified by this section or other laws.

**History.**—s. 1, ch. 2002-42; s. 32, ch. 2012-49.

**738.802 Uniformity of application and construction.**—In applying and construing this act, consideration shall be given to the need to promote uniformity of the law with respect to the act's subject matter among states that enact such act.

**History.**—s. 1, ch. 2002-42.

**738.803 Severability.**—If any provision of this chapter or its application to any person or circumstance is held invalid, the invalidity shall not affect other provisions or applications of this chapter which can be given effect without the invalid provision or application, and to this end the provisions of this chapter are severable.

**History.**—s. 1, ch. 2002-42.

**738.804 Application.**—Except as provided in the trust instrument, the will, or this chapter, this chapter shall apply to any receipt or expense received or incurred and any disbursement made after January 1, 2003, by any trust or decedent's estate, whether established before or after January 1, 2003, and whether the asset involved was acquired by the trustee or personal representative before or after January 1, 2003. Receipts or expenses received or incurred and disbursements made before January 1, 2003, shall be governed by the law of this state in effect at the time of the event, except as otherwise expressly provided in the will or terms of the trust or in this chapter.

**History.**—s. 1, ch. 2002-42.

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