Materials on 2003 Texas Legislation Affecting Probate, Guardianship and Trust Law

Prepared by
Glenn M. Karisch
Barnes & Karisch, P. C.
2901-D Bee Caves Road
Austin, Texas 78746
(512) 328-8355 FAX (512) 328-8413
karisch@texasprobate.com
www.texasprobate.com

Contents

Glenn M. Karisch

Barnes & Karisch, P. C.
2901 Bee Caves Road, Suite D
Austin, Texas 78746
(512) 328-8355 Fax: (512) 328-8413
karisch@texasprobate.com

Education

The University of Texas School of Law, Austin, Texas
Juris Doctor with Honors, 1980

The University of Texas at Austin, Austin, Texas
Bachelor of Journalism with Highest Honors, 1977

Professional Experience

Barnes & Karisch, P. C., Austin, Texas, 1998 - Present
Ikard & Golden, P. C., Austin, Texas, 1992 - 8
Hoffman & Stephens, P. C., Austin, Texas, 1991-2
The Texas Methodist Foundation, Austin, Texas, Vice President and General Counsel, 1989-1991
Coats, Yale, Holm & Lee, Houston, Texas, 1980-1989

Professional Activities

Board Certified, Estate Planning and Probate Law, Texas Board of Legal Specialization
Fellow, American College of Trust and Estate Counsel
Member, Real Estate, Probate and Trust Law Council, State Bar of Texas, 1999-2003
Chair, Guardianship Law Committee, 1999-2000; Chair, Trust Code Committee, 2000-Present; Chair, Probate Legislation Committee, 2003-Present
Chair, Estate Planning and Probate Section, Travis County Bar Association, 1996-97

Selected Legal Articles and Papers

Author and Editor, Texas Probate Web Site [www.texasprobate.com] and email mailing list [probate@io.com] (1995-Present).

"The Two UPIAs – How They Will Change the World," State Bar of Texas Advanced Estate Planning and Probate Law Course (2003).

"Multi-Party Accounts in Texas," University of Texas School of Law Intermediate Estate Planning, Guardianship and Elder Law Conference (2000).

"Modifying and Terminating Irrevocable Trusts," State Bar of Texas Advanced Estate Planning and Probate Law Course (1999).

"Protecting the Surviving Spouse," Southwestern Legal Foundation Wills and Probate Institute (1999).

"Court-Created Trusts in Texas," State Bar of Texas Advanced Drafting: Estate Planning and Probate Law Course (1995), updated to reflect legislative changes.

2003 Legislative Update

By Glenn M. Karisch
Barnes & Karisch, P. C.
2901-D Bee Caves Road
Austin, Texas 78746
(512) 328-8355/FAX (512) 328-8413
karisch@texasprobate.com

☆☆☆

Table of Contents

2003 Legislative Update

By Glenn M. Karisch

The Legislature has come and gone, and the damage is done. As of July 30, 2003, the Legislators have come back for two special sessions, but nothing seems likely to pass that would affect probate and trust law. Here's the butcher's bill from the regular session of the 78th Texas Legislature:

- 58 – count 'em, 58 – sections of the Probate Code added, amended or repealed.
- Enactment of two major uniform acts affecting trusts.
- Several other changes, some big and some small.
- No changes on franchise tax, state inheritance tax, durable powers of attorney or the rule against perpetuities.

This paper summarizes the changes made by the 78th Texas Legislature in 2003, first by focusing on the significant changes and then on the other changes affecting probate, guardianship and trust law in Texas. It also offers "practice pointers" – tips for lawyers for adapting to these changes.

1. Significant Changes

These legislative developments are worthy of special attention:

a. The Two UPIAs

The Texas Legislature has enacted two uniform trust acts in 2003 – the Uniform Prudent Investor Act of 1994 (HB 2240 – new Chapter 117 of the Texas Trust Code) and the Uniform Principal and Income Act of 1997 (HB 2241 – new Chapter 116 of the Texas Trust Code). Texas lagged behind the majority of states in enacting these acts. Roughly 40 states have already adopted the Uniform Prudent Investor Act, while roughly 30 have enacted part or all of the Uniform Principal and Income Act. These bills will bring significant changes to the default rules governing how trusts are administered and accounted for in Texas.

i. The Uniform Prudent Investor Act

The Uniform Prudent Investor Act (HB 2240 – new Chapter 117 of the Texas Trust Code) changes the default rules regarding investment of trusts. It replaces Texas's modified "prudent man" investment standard found in Texas Trust Code §113.056(a)[1] with the "prudent

[1] ". . . [A] trustee shall exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income from as well as the probable increase in value and the safety of their capital. In determining whether a trustee has exercised prudence with respect to an investment decision, such determination shall be made taking into

investor" rule based on the American Law Institute's Restatement (Third) of Trusts: Prudent Investor Rule (1992). The new rule requires the trustee to give greater attention to all of the circumstances surrounding the trust. In many cases it will encourage, if not mandate, investing the trust for the best total return regardless of whether the return is in the form of principal or income.

Under the new Uniform Prudent Investor Act, trustees will have an affirmative duty to diversify investments (new Texas Trust Code Section 117.005) and an affirmative duty to review the trust assets and to make and implement decisions concerning the retention and disposition of assets in order to bring them in compliance with the prudent investor rule (new Texas Trust Code Section 117.006). Gone is the old Texas provision permitting retention of trust assets held at the inception of the trust without liability for diversification (old Texas Trust Code §113.003).

The fiduciary duties of loyalty and impartiality, which previously were common law duties in Texas, now are codified in new Texas Trust Code Sections 117.007 and 117.008.

The Texas version of the Uniform Prudent Investor Act follows the uniform act very closely. There is one major departure. The Texas provision permitting trustees to delegate the investment function and avoid liability for the actions of the agent (new Texas Trust Code §117.011) is stricter than the uniform act. In addition to the requirements imposed by the uniform act, under the Texas provision a trustee does not avoid liability for the actions of its agent if (1) the agent is an affiliate of the trustee, (2) the delegation agreement requires arbitration or (3) the delegation agreement shortens the statute of limitation. Still, the new Texas delegation standard should be easier for trustees to meet than the former Texas delegation statute (Texas Trust Code §113.060), which was repealed.

The Uniform Prudent Investor Act imposes default rules. Its provisions may be overriden by provisions in the trust instrument.

The Uniform Prudent Investor Act takes effect January 1, 2004, and applies to new and existing trusts. With respect to existing trusts, actions taken by the trustee on or after January 1, 2004, will be judged by the new standard.

Practice Pointers

1. For guidance on interpreting the Uniform Prudent Investor Act, see the official comments of the National Conference of Commissioners on Uniform State Laws and the Real Estate, Probate and Trust Law Section of the State Bar of Texas. The full text of the act with these comments may be downloaded from the Texas Probate Web Site, http://www.texasprobate.com – click on "2003" under "Legislation." A derivation table is available on the same site.

2. Lawyers representing individual trustees can really earn their fees by advising their clients about the new delegation rules. Individual trustees who retain someone to

---

consideration the investment of all of the assets of the trust . . . over which the trustee had management and control, rather than a consideration as to the prudence of the single investment of the trust. . . ."

manage the investments should be made aware that choosing an agent that does *not* require arbitration or shorten the statute of limitations may make it possible for the trustee to avoid liability, while selecting an agent who sticks an arbitration provision in the delegation agreement will mean that the trustee stays on the hook for the misdeeds of the agent.

3. Since the act applies to existing trusts, consider writing existing trustee clients about the new act prior to January 1, 2004, emphasizing among other things the increased duty to diversify.

4. In appropriate cases, consider opting out of the new investment standard by drafting a different standard into the trust instrument.

ii. The Uniform Principal and Income Act

The Uniform Principal and Income Act (HB 2241 – new Chapter 116 of the Texas Trust Code) changes the default rules a trustee uses to allocate receipts and disbursements between principal and income. The most significant change is in new Texas Trust Code §116.005, which permits the trustee to make adjustments between principal and income in certain cases. This power to adjust is necessary in income-only trusts if the trustee invests for total return under the prudent investor rule. For example, if the trustee invests for total return by investing in growth stocks, thereby achieving a 20% return but with virtually no "traditional" trust income, the trustee may use Section 116.005 to make an adjustment so that the income beneficiary receives a reasonable rate of return (say 3% to 5%). The power to adjust cannot be used in some cases, including cases in which the trustee also is a beneficiary of the trust.

This adjustment power caused corporate trustees to flinch at the potential liability to beneficiaries for making these adjustments. New Texas Trust Code §116.006 permits the trustee to go to court in some cases and obtain an advisory opinion that the proposed adjustment will not be a breach of trust. There are conditions placed on the trustee's right to bring this action, however. Also, while the section requires the trustee to advance attorney's fees to beneficiaries in connection with the action, it permits the court to charge these fees to the trustee, to one or more beneficiaries (or their trust interests), or to the trust at the conclusion of the proceeding as circumstances warrant.

Several states have adopted statutes permitting existing trusts to be converted to unitrusts. Texas did *not* adopt a unitrust conversion statute. However, new Texas Trust Code §116.007 permits a settlor to define trust income in terms of a unitrust percentage, which will be helpful if Proposed Treasury Regulation 1.643(b)-1, 66 Fed. Reg. 10396 (February 15, 2001), becomes final. Then a marital deduction trust could be set up as a unitrust and meet the all-income-to-spouse requirement.

In most cases, the Texas version of the Uniform Principal and Income Act follows the uniform act, which has a stated bias toward principal (Section 116.004(a)(4) provides, in essence, when in doubt, a receipt is principal). However, in a few key places the Texas statute differs. These include:

Deferred Compensation Plans – Section 116.172. Rather than adopting the uniform act

rule, which would have made 90% of any required payment from a qualified plan or IRA principal and only 10% income, the Texas statute provides that distributions of up to 4% of the value of the plan or IRA in any one year is income and any excess is principal.[2] The Real Estate, Probate and Trust Law Section of the State Bar of Texas, which pushed for this legislation, thought this was fairer to the income beneficiary and more in keeping with one's expectations. The new provision replaces former Texas Trust Code §113.109, which was repealed.

Oil, Gas and Minerals – Section 116.174. Under old Texas Trust Code §113.107, 72 ½ % of royalties were income and 27 ½ % were principal. Under the uniform act, only 10% would have been income while 90% would have been principal. The Real Estate, Probate and Trust Law Section of the State Bar of Texas thought that this was unfair to the income beneficiary and not in keeping with one's expectations, so the Texas version varies from the uniform act. Under it, the trustee is required to allocate these receipts "equitably," and allocating in accordance with the available federal tax depletion deduction is presumed to be equitable. Also, for existing trusts, trustees may continue to apply the old 72 ½ % income rule.

The Uniform Principal and Income Act also impacts the allocation of receipts and disbursements in estates. Some of the subsections of Section 378B of the Probate Code have been repealed or substantially changed.

The Uniform Principal and Income Act provides default rules for allocating income. The settlor may override these provisions by placing contrary provisions in the trust instrument.

This act takes effect January 1, 2004, and applies to existing as well as new trusts. Thus, the trust accounting rules for existing trusts will change January 1, 2004.

Practice Pointers

1. For guidance on interpreting the Uniform Principal and Income Act, see the official comments of the National Conference of Commissioners on Uniform State Laws and the Real Estate, Probate and Trust Law Section of the State Bar of Texas. The full text of the act with these comments may be downloaded from the Texas Probate Web Site, http://www.texasprobate.com – click on "2003" under "Legislation." A derivation table and a side-by-side comparison of the old and new allocation rules are available on the same site.

2. The power to adjust in Section 116.005 is central to the new Act. It provides drafting challenges (opportunities?). Here are a few:

   - Drafting to permit the trustee to make principal distributions based on a health, education, maintenance and support standard eliminates the need for the power to adjust and will be a better approach in most cases.

[2] Section 116.172 was garbled in the legislative process and is somewhat confusing. See the Official Comments of the Real Estate, Probate and Trust Law Section of the State Bar of Texas for explanation and examples, and look for a clarifying amendment in 2005.

- If an income-only standard is to be used, consider drafting a non-charitable unitrust. See Section 116.007, but be careful in marital deduction trusts until the proposed regulations are finalized.

- If an income-only standard is to be used, selection of the trustee is important, since a trustee who also is a beneficiary cannot make adjustments. Consider an independent trustee, a co-trustee who has sole authority to make adjustments, or a trust protector arrangement.

3. The procedure permitting a trustee to seek an advisory opinion about a proposed adjustment (Section 116.006) must be carefully handled by all parties. The trustee must make a reasonable disclosure to the beneficiaries and must have a reasonable belief that a beneficiary will object before it can initiate the proceeding. Does the trustee ask the beneficiary to state whether or not he or she objects in writing? If so, does the trustee have to warn the beneficiary that objecting will trigger an expensive proceeding? How should a beneficiary respond to a request for consent or objection? If a proceeding is started, how can each party best assure that it will not be saddled with all of the costs and attorneys' fees?

4. Consider altering the default rules regarding allocation of receipts between income and principal in two cases – retirement plans and oil, gas and mineral royalties. In both cases, consider allocating all such receipts to income or, in the case of royalties, consider using the former objective standard (72 ½ % income/ 27 ½ % principal) instead of the new subjective standard ("equitably").

b. New Rules for Guardians of the Estate

HB 1470 imposes new, and tougher, rules on guardians of the estate. These changes have a particularly tough bite at the inception of guardianships. Attorneys representing guardians need to study these changes and advise clients appropriately.

Previously, guardians had 90 days (or such longer period that may be granted by the court) to file an inventory. Under the new law (Probate Code § 729), that deadline is shortened to 30 days. Section 765 also was amended to require a successor guardian to file an inventory within 30 days.

The reason for the deadline is a new requirement that the guardian apply for approval of a monthly allowance within 30 days of the granting of letters of guardianship (Probate Code § 776). The judges wanted the inventory filed before the monthly allowance application was heard. In some parts of the state, monthly allowances are common. Now they will be required.

One bright spot is that the $5,000 limit on after-the-fact approval of unauthorized (but justified) principal distributions in Section 776 is removed. However, to be approved, the guardian must show that (1) the expenditures were made when it was not convenient or possible for the guardian to first secure court approval, (2) the proof is clear and convincing that the expenditures were reasonable and proper, (3) the court would have granted authority in advance to make the expenditures, and (4) the ward received the benefits of the expenditures.

Another new requirement is the filing of an application for approval of an investment plan for the guardianship within 180 days of the granting of letters (new Texas Probate Code § 855B). The new scheme anticipates that the guardian will spend the first six months deciding which assets to keep and which ones to sell. The investment plan provides the guardian and the court with a road map of how to invest and manage the ward's assets.

HB 1470 makes a general overhaul of the investment rules for guardians (see changes to Sections 768, 814, 854, 855, 855A, 855B, 857, 858, 860 and 863). In general, the new rules adopt a "prudent man" standard for investment, rather than a "prudent investor" standard (see Section 855). There are changes to the rules governing loans of the ward's funds, including a presumption that a reasonable rate of interest is 120% of the applicable federal rate (Section 858), and real estate investments (Section 860).

HB 1470 provides that most of these new investment rules apply to new guardianships and to existing guardianships which are "modified to conform to the changes in law." At least one statutory probate court plans to issue a blanket order modifying all existing guardianships to conform to the changes wrought by HB 1470.

Practice Pointers

1. Because of the new requirements 30 days and 180 days after letters of guardianship are granted, in most cases the applicant for a guardianship will have to be pretty far along in the inventory process when he or she files the guardianship application. If possible, the applicant should file the application for monthly allowance and approval of the investment plan at the time the guardianship application is filed and have the inventory more or less ready to go when the application is filed. The court will appreciate this, and the client will appreciate this. Otherwise, the applicant/guardian will be spending a lot of time at the attorney's office in the first 14 months of a guardianship as one requirement after the other is met. Of course, in contested guardianships and in guardianships where no one really knows what assets the ward owns, this will be difficult. Hopefully the courts will be willing to extend the deadlines in these cases.

2. These guardianship changes will help get the guardian off on the right foot, but they add complexity and expense to a procedure which already was cumbersome and costly. If ever there was a reason to use powers of attorney and revocable trusts to avoid guardianships, the 2003 legislative changes are it.

3. In many respects, these new investment rules for guardians are as significant to guardians as the Uniform Prudent Investor Act is to trustees. The effective date of the guardianship changes is September 1, 2003, so any effort to educate guardians about the new rules needs to start soon. Check to see if your court has issued an order modifying your existing guardianship to conform to the new investment rules.

c. Medicaid Estate Recovery – Don't Mess With Texas. Er, Never Mind.

Texas has avoided implementing a Medicaid estate recovery program for 10 years (since it was required by the Omnibus Budget Reconciliation Act (OBRA) of 1993) with no ill effects. This meant that a Texan owning a home going into a nursing home could receive Medicaid

benefits without the family losing the home to pay back Medicaid. Unfortunately, due to greed, timidity, stupidity, mean-spiritedness or fiscal responsibility (take your pick), a provision was added to HB 2292 late in the session which requires the appropriate state agency to implement an estate recovery system. This means that the successor to the Department of Human Services will be working up the terms of Texas's very own estate recovery plan in the near future.

It is not clear exactly how the estate recovery program will be implemented. It may be limited to probate estates, meaning that living trust planning may be an effective workaround. What is clear, though, is that a Medicaid recipient's family can no longer count on the patient's house being protected from seizure by the state after the patient's death.

Practice Pointer

Elder law specialists will have to spend a lot of time evaluating the significance of this change for clients. The rest of us need to place firmly in our consciousness that our elder clients' homes are not 100% safe. It may be that drafting options will be available to protect homes from seizure, but it is too early to tell. If a client must act now during this time of uncertainty, (1) consider referring the client to an elder law specialist or (2) consider a living trust, which may provide protection, although that is not clear.

d. Exculpatory Clauses in Trusts

On December 31, 2002, the Texas Supreme Court issued its opinion in *Texas Commerce Bank, N. A. v. Grizzle,* 96 S. W. 3d 240 (Tex. 2002). The *Grizzle* case took a very broad view of Section 113.059 of the Texas Trust Code which, if taken to its logical conclusion, could mean that the settlor of a trust could override all statutory and common law trustee duties, so long as he or she did not attempt to relieve a *corporate* trustee from the prohibited actions in Section 113.052 and 113.053. For example, the *Grizzle* opinion leaves open the door to a trustee being exculpated for actions taken in bad faith or with reckless indifference and to flatly refusing to give any kind of accounting, if the trust instrument backs him or her up. Reasonable minds differ about whether *Grizzle* can be read to reach this far, but the Legislature chose to respond to *Grizzle* by amending Trust Code §113.059 to incorporate the provisions of the Restatement (2nd) of Trusts, §222, which prohibit the enforcement of an exculpation clause that would relieve a trustee of liability for a breach of trust committed in bad faith, intentionally or with reckless indifference to the interest of the beneficiary. It also may not relieve the trustee for liability for any profit derived by the trustee from a breach of trust (HB 3503).

Another reaction to *Grizzle* were amendments to the statutes governing 142 Trusts (Texas Property Code §142.005) and 867 Trusts (Texas Probate Code §867). These amendments make any provision in one of these court-created trusts unenforceable to the extent that it limits the liability of a trustee beyond that imposed by the Texas Trust Code, unless there is a specific finding by clear and convincing evidence that the specific property of that trust justifies the exculpation provision (HB 3503).

Practice Pointers

1. Since most settlors don't exculpate trustees for bad faith actions or reckless

indifference, most exculpation clauses will not cross the line drawn by HB 3503 except possibly in one case: liability for profit derived from breach of trust. Since the new law applies to existing trusts, if you have an existing trustee client, see if the trust instrument contains an exculpation provision which crosses the line and warn the client if it does.

2. One consequence of HB 3503 is that we now know how far an exculpation provision can go. Therefore, in drafting situations where the settlor wishes to include the broadest possible exculpation provision, following the statutory language should allow the drafter to paint precisely within the lines. However, please, *please, **please*** don't stick exculpation provisions in the boilerplate – they should only be used in special, limited circumstances.

3. Exculpation clauses in existing 142 Trusts and 867 Trusts will become unenforceable on September 1, 2003, unless the court makes the new, specific finding that the exculpation provision is justified. Notify your clients who are trustees of existing 142 Trusts and 867 Trusts of this.

4. When creating new 142 Trusts and 867 Trusts, consider whether or not the specific facts exist to justify an exculpation provision. If so, be sure to seek and obtain the necessary court finding. Don't just stick an exculpation provision in the trust.

e. Statutory Probate Court Jurisdiction Gets Even More Complicated

Three bills passed affecting the power of statutory probate courts to hear cases. HB 1470 and HB 1473, which had the support of most, if not all, of the statutory probate judges, takes away the power of district courts to hear any case in which the personal representative of an estate (or guardian) is a party unless (1) it is a wrongful death, survival or personal injury action or (2) "in all actions involving a personal representative of an estate in which each other party aligned with the personal representative is not an interested person in that estate."[3] In these cases, the jurisdiction of the statutory probate court and the district court is concurrent. Thus, except for these few cases, virtually every case in which the personal representative or guardian is a party must be brought in the statutory probate court even if the case has nothing to do with probate.

HB 1470 and HB 1473 also rewrite and reorganize Sections 5, 5A, 606 and 607. In general, the reorganization moves some of the "jurisdictional" provisions from Section 5A to Section 5 and from Section 607 to Section 606, leaving the "appertaining and incident to estate" language in Sections 5A and Section 607. (HB 4, discussed below, amends Sections 5A and 607,

[3] This loophole is intended to permit cases in which the personal representative of an estate is one of many parties on the same side and which have nothing to do with probate to be heard in the district court. For example, a lawsuit by all royalty owners against the operator of an oil and gas well could be heard in the district court if one of the royalty owners is the personal representative of an estate, but only if no person interested in the estate (such as the decedent's wife, etc.) is one of the plaintiff royalty owners. This last condition was viewed as necessary to catch estate-related cases (thus forcing them into the statutory probate courts) but it is written so broadly as to make the exception unusable in many cases.

which makes things interesting [in other words, confusing], since HB 4 amended the former statute, not the amended statute.)

The proponents of HB 1470 and HB 1473 get an "E" for effort, but the reorganized statutes do not eliminate all of the potential construction issues. One issue which jumps out is the jurisdiction of the district courts and the statutory probate courts over testamentary trusts. Based upon the changes made by HB 1473, there are at least these five possibilities for the proper jurisdiction of a proceeding concerning a testamentary trust (but not an inter vivos or charitable trust). The case either:

- Must be brought in the statutory probate court which probated the will creating the trust, but only if the estate is still pending in the court; ***or***

- Must be brought in the statutory probate court which probated the will creating the trust, even if the estate is no longer pending in the court; ***or***

- Must be brought in the statutory probate court which has proper Trust Code venue (in other words, where the trustee resides or in the "situs of administration" – see Texas Trust Code §115.002) and not in the district court or in the statutory probate court which probated the will creating the trust; ***or***

- May always be brought in the district court and may also be brought in statutory probate court if the trust is related to an estate that is pending in a statutory probate court or if the personal representative of an estate is a party to the proceeding; ***or***

- Must be brought in the district court unless the trust is related to an estate that is pending in a statutory probate court or unless the personal representative of an estate is a party to the proceeding.

What a mess, huh? To understand jurisdiction over testamentary trusts after HB 1473, one must look to four subsections:

- Texas Trust Code §115.001(d) states the general jurisdictional rule regarding trusts: "The jurisdiction of the district court over proceedings concerning trusts ***is exclusive except for jurisdiction conferred by law on a statutory probate court***. . . ." [emphasis added]

- Probate Code §5A(b), as amended by HB 1473, reads: ***"In proceedings in the statutory probate courts*** [~~and district courts~~], the phrases "appertaining to estates" and "incident to an estate" in this Code include the probate of wills, the issuance of letters testamentary and of administration, and the determination of heirship, and also include, but are not limited to, all claims by or against an estate, all actions for trial of title to land and for the enforcement of liens thereon, all actions for trial of the right of property, all actions to construe wills, ***the interpretation and administration of testamentary trusts and the applying of constructive trusts***, and generally all matters relating to the <u>collection</u>, settlement, partition, and distribution of estates of deceased persons. All statutory probate courts may,

in the exercise of their jurisdiction, notwithstanding any other provisions of this Code, hear all suits, actions, and applications filed against or on behalf of any heirship proceeding or decedent's estate, including estates administered by an independent executor; all such suits, actions, and applications are appertaining to and incident to an estate. This subsection shall be construed in conjunction with and in harmony with Section 145 and all other sections of this Code dealing with independent executors, but shall not be construed so as to increase permissible judicial control over independent executors. ***Except for*** [~~All statutory probate courts shall have the same powers over independent executors that are exercisable by the district courts. In~~] ***situations in which [~~where~~] the jurisdiction of a statutory probate court is concurrent with that of a district court as provided by Section 5(e) of this Code or any other court, any cause of action appertaining to estates or incident to an estate shall be brought in a statutory probate court*** [~~rather than in the district court~~]." [emphasis added]

- Probate Code §5(e), as amended by HB 1473, reads: "***A statutory probate court has concurrent jurisdiction with the district court in*** all personal injury, survival, or wrongful death actions by or against a person in the person's capacity as a personal representative, in ***all actions involving an inter vivos trust***, in all actions involving a charitable trust, and in all actions involving a personal representative of an estate in which each other party aligned with the personal representative is not an interested person in that estate [~~***testamentary trust***~~]." [emphasis added]

- Probate Code §5(h), which was added by HB 1473, reads: "***A statutory probate court has jurisdiction over any matter appertaining to an estate or incident to an estate*** and has jurisdiction over any cause of action in which a personal representative of an estate pending in the statutory probate court is a party." [emphasis added]

Texas Trust Code §115.001(d) may be read as *always* vesting in the district court jurisdiction over testamentary trusts, but allowing statutory probate courts also to have jurisdiction if conferred by law. In this case, filing a proceeding concerning a testamentary trust always is proper in the district court. On the other hand, Section 115.001(d) may be read as permitting a statute granting jurisdiction over testamentary trusts to the statutory probate court to completely strip the district court of jurisdiction. In this case, one may be required to file a proceeding concerning a testamentary trust in statutory probate court in some cases and in district court in other cases, depending on where venue lies and/or where the original probate occurred.

The only basis for saying a statutory probate court has jurisdiction over a testamentary trust is Section 5A(b) – "the interpretation and administration of testamentary trusts and the applying of constructive trusts" is "incident to an estate." Does this mean that a proceeding concerning the interpretation and administration of a testamentary trust ***always*** is "incident to an estate?" What about the case where the probate proceeding ended 20 years ago and the testamentary trust has been administered ever since? To what "estate" is that proceeding "incident?" If the 20-year-old trust ***is*** "incident to an estate," does that mean the statutory probate court which heard the original probate proceeding has jurisdiction, or does it mean that the statutory probate court in the county where trust venue lies (see Texas Trust Code §115.002) has jurisdiction? If it means that latter, how can the trust action be considered "incident to an estate" when there never was and never will be an "estate" in that court?

Here's another one: Trust modification or termination suits are "proceedings concerning trusts" for purposes of Trust Code §115.001(d), but are they proceedings concerning "the interpretation and administration of a testamentary trust" under Probate Code §5A(b)?

Unless an appellate court gives direction, no one will know where an action concerning a testamentary trust may, or must, be filed until the Legislature fixes this mess in 2005, which it no doubt will be asked to do. In the meantime, if "either end" of a case involving a testamentary trust – the original probate or Trust Code venue – is in a county with a statutory probate court, the litigants could be in trouble for filing in the wrong court. If the original probate was in a statutory probate court, if the independent executor is still alive, and if no "closing affidavit" or other estate closing procedure was utilized, one possible safe course of action appears to be to bring the proceeding in the statutory probate court where the original probate proceeding was held and make the independent executor a party, since Section 5 always gives the statutory probate court jurisdiction when the personal representative is a party.

HB 1470 amends Section 608 to permit statutory probate courts to exercise their transfer power in cases where there is a guardian of the *person* only.

While the judges were pushing through HB 1470 and HB 1473, Senator Robert Duncan of Lubbock was tacking on amendments to the main tort reform bill (HB 4) attempting to restrict the authority of statutory probate courts to hear personal injury, death and property damage cases. HB 4 amends Sections 5A, 5B and 607 to provide:

> Notwithstanding any other provision of this chapter, the proper venue for an action by or against a personal representative for personal injury, death, or property damages is determined under Section 15.007, Civil Practice and Remedies Code.

As an apparent oversight, this same provision was *not* added to Section 608 – the guardianship equivalent of Section 5B.

Section 15.007 of the Civil Practice and Remedies Code was enacted in 1995 in an attempt to put a stop to the transfer of personal injury and wrongful death cases by statutory probate courts from counties of proper venue to counties where the probate or guardianship was pending. One line of cases in the courts of appeal (*see, e.g., In Re Houston Northwest Partners,* 98 S. W. 3d 777 (Tex. App. – Austin 2003)) holds that Section 15.007 has no practical affect on the authority of the statutory probate courts to transfer cases under Sections 5B or 608 because those sections are jurisdiction statutes, not venue statutes. Another case (*Reliant Energy v. Gonzales*, ___ S. W. 3d ___, 01-02-00679-CV (Tex. App. – Houston [1st Dist.] 2003)) holds that Section 15.007 trumps the authority of a statutory probate court to transfer a case from the county of proper venue.

Despite the clear intention of its proponent, HB 4's amendments to Sections 5A, 5B and 607 leave the door open to the courts to interpret them as inapplicable to Section 5B and Section 608 transfers, since the amendments speak in terms of "venue" rather than "jurisdiction." No doubt there will be litigation on this point shortly after HB 4 becomes effective. In the meantime, the Texas Supreme Court may give us a pre-HB 4 answer to question of whether TCPRC §15.007 trumps Sections 5B and 608, or vice versa.

Note that the HB 4 amendments to Sections 5A, 5B and 607 speak in terms of suits for "personal injury, death or property damages," while the HB 1470 and HB 1473 amendments to Sections 5 and 606 speak in terms of "personal injury, survival, or wrongful death actions." This could lead to confusion and litigation. The most obvious potential problem is the meaning of "property damages." HB 4 appears to be addressing tort cases, such as an automobile accident case where there are personal injuries as well as damage to a car or other property. However, "property damages" could be read to have a broader meaning. For example, a surcharge action against an independent executor for malfeasance is a fiduciary case, not a tort case, but the remedy sought could be characterized as "property damages." Wouldn't it be ironic if this language is interpreted broadly, meaning that a person living in Williamson County who is independent executor of an estate pending in the statutory probate court of Travis County could insist on being sued in a surcharge action in a Williamson County district court rather than in the Travis County probate court?

Practice Pointer

If you are involved, or about to become involved, (a) in litigation involving a testamentary trust or (b) in litigation in which a personal representative of an estate or a guardian is involved and where the guardianship or estate is pending in a statutory probate court, then pay very careful attention to the new rules, because a failure to file the case in the right court could lead to disastrous results.

f. "Voluntary" In-Patient Psychiatric Care for Wards

HB 2679 makes it possible for a guardian of the person to "voluntarily" admit the ward in an in-patient psychiatric facility and to consent to the administration of medications in some cases. There are limits on this authority, but this should close a huge gap in Texas jurisprudence that resulted in many unnecessary civil commitment proceedings. (Probate Code §§ 743(b), 767, 770(b) and 770A; Heath and Safety Code Chapter 573).

2. Other Changes

a. Decedents' Estates

i. Effect of Filing a Contested Pleading

HB 1473 added Section 10C to the Probate Code, which provides that the filing or contesting in probate court of any pleading relating to a decedent's estate does not constitute tortious interference with inheritance of the estate. The section says that this does not abrogate the rights of a person under Rule 13, Texas Rules of Civil Procedure, or Chapter 10, Civil Practice and Remedies Code.

The Texas Supreme Court has not recognized a cause of action for tortious interference with the inheritance of an estate, although it has been recognized at the court of appeals level. *See, e.g., King v. Acker,* 725 S. W. 2d 750 (Tex. App. – Houston [1st Dist.] 1987, no writ). We don't have a Texas statute saying what tortious interference *is,* but we now have a statute saying what it *isn't.*

ii. Contracts Concerning Succession

HB 1473 amends Texas Probate Code § 59A to permit a contract to make a will or devise, or not to revoke a will or devise, to be enforced if it is contained in the provisions of a written agreement that is binding and enforceable.

In 1979, the Texas Legislature added Section 59A to the Probate Code. This legislation was intended to deal with two problems: First, and foremost, was the problem of joint wills. The practice of having a husband and wife sign a joint will has mostly died out, but it used to be quite common. These wills led to litigation over whether the joint will was contractual -- whether the surviving spouse was free to adopt a different dispositive plan or was stuck with the one in the joint will. Section 59A requires a joint will to say that it is contractual, and its enactment in 1979 has effectively eliminated litigation in this area. Second was the problem of caregiver arrangements: an alleged oral agreement that "if you move in and take care of me until I die, I promise to leave you my house." *See* Johanson's Texas Probate Code Annotated (2002), Commentary to Section 59A. . Section 59A dealt effectively with this problem as well.

While the 1979 enactment of Section 59A solved these two problems, it inadvertently created another problem -- the one that HB 1473 fixes. Section 59A was modeled after Section 2-514 of the Uniform Probate Code (UPC). The UPC was drafted by the National Conference of Commissioners on Uniform State Laws and has been enacted in at least 18 states. The UPC version includes a significant provision which was left out of Section 59A: that a contract to make a will or not to revoke a will could be included in a writing signed by the decedent and evidencing a contract but not contained in the will itself. The widespread use of marital property agreements which has sprung up in Texas since 1979 has illustrated the need for this provision to be added to Section 59A. It is common for a testamentary conveyance to be a material part of a pre-marital or post-marital agreement. Other types of agreements which contain these types of provisions and are affected by Texas's failure to follow the UPC approach are divorce property settlement agreements and buy-sell agreements. Many practitioners and commentators believe that these provisions are enforceable even with Section 59A reading the way it read before the HB 1473 change, but the absence of a clear provision in Section 59A resulted in confusion and unnecessary litigation.

The change made by HB 1473 makes it clear that such a provision in a marital property agreement or buy-sell agreement is permitted.

iii. Satisfaction of Bequest

Section 44 of the Texas Probate Code deals with the issue of an intestate donor giving property to an heir in advance of his or her death by providing that these gifts are treated as advancements and deducted from the heir's share only if the decedent declared in a contemporaneous writing or the heir acknowledged in writing that the gift was an advancement or otherwise was to be taken into account in determining intestate shares. Section 44 does not deal with the same issue as it relates to a donor with a will. HB 1473 adds Section 37C to the Probate Code, which provides that a lifetime gift is treated as a satisfaction of a devise only if the will provides for deduction of the lifetime gift, or the testator declares in a contemporaneous writing that the gift is to be deducted from the devise or is in satisfaction of the devise, or the

devisee acknowledges in writing that the gift is in satisfaction of the devise.

iv. Allowance for Defending Will is an Administrative Expense

Section 243 permits a person who, in good faith and just cause, seeks to have a will admitted to probate to be awarded his or her attorney's fees and costs from the estate in some cases. HB 1473 amends Section 322 of the Probate Code to make these fees and costs administrative expenses for priority purposes rather than general unsecured claims. This means that they are more likely to be paid in an insolvent estate situation.

b. Guardianships

i. Temporary Guardianships

HB 2189 makes significant changes to Section 875 – the procedure for obtaining a temporary guardianship. The most significant change is that no temporary guardianship can be granted before an application is filed, and immediately upon filing of an application an attorney ad litem must be appointed for the proposed ward. This is intended to eliminate the practice of *ex parte* temporary guardianships, where the court creates the temporary guardianship before the proposed ward or an attorney ad litem is aware of what is going on.

HB 2189 mistakenly deleted the following sentence from Section 875(b): "A person for whom a temporary guardian has been appointed may not be presumed to be incapacitated." This sentence was important because it made clear that the granting of a temporary guardianship did not affect the presumption of capacity in the permanent guardianship proceeding to follow. The proponents of the bill had agreed to keep this sentence in the statute, but it was inadvertently deleted in the Senate Jurisprudence Committee late in the session. The proponents agreed that the granting of a temporary guardianship should not be evidence of incapacity in a subsequent proceeding to appoint a permanent guardian (*i.e.,* "He must be crazy. Otherwise the court wouldn't have appointed a temporary guardian.")

Practice Pointer

Attorneys ad litem representing proposed wards in temporary guardianship proceedings should insist that the order appointing a temporary guardian contains something like the following: "Notwithstanding the appointment of the temporary guardian, for purposes of any subsequent judicial proceeding (including any application for the appointment of a permanent guardian for the Ward), the Ward may not be presumed to be incapacitated and the fact that a temporary guardian was appointed may not be entered into evidence."

ii. Limited Immunity of Guardians Ad Litem

Occasionally a guardian ad litem is appointed in a proceeding to create, terminate or modify a guardianship and is asked to express opinions to the court regarding what is in the best interests of the ward. HB 1470 adds Section 645A to the Probate Code to provide judicial immunity to guardians ad litem expressing such opinions, so long as they do not act wilfully wrongful, with conscious indifference or reckless disregard, in bad faith, with malice or in a manner which is grossly negligent. This immunity does not apply in other situations in which a

guardian ad litem may be appointed.

iii. Payment of Applicant's Attorney's Fees

Previously, Probate Code §665B permitted the court to order that the attorney's fees of an applicant for guardianship who asked the court to name himself or herself as guardian to be paid from the ward's estate. HB 1470 amends the section to permit the award of attorney's fees even if the applicant asks for someone other than himself or herself to be appointed guardian.

iv. MHMR Report for Mentally Retarded Proposed Ward

Previously Section 687 permitted a guardianship based on an examination report of the Department of Mental Health and Mental Retardation that was no more than six months old. HB 1470 amends this section to change six months to 24 months. Apparently MHMR routinely re-examines persons in its system every 24 months, so this change is consistent with that practice. This does not affect the currency requirement for physician's certificates for proposed wards who are not mentally retarded. Those certificates still must be dated within 120 days of filing the application.

v. Miller Trusts

HB 1470 amends Section 767 to permit a guardian of the *person* to apply for creation of a "Miller trust" under 42 U.S.C. Section 1396p(d)(4)(B). HB 1470 also amends Section 774 to permit guardians of the *estate* to apply for creation of Miller trusts. These types of trusts help persons qualified for governmental assistance programs such as Medicaid.

vi. Discharge of Guardian When 867 Trust is Created

HB 1470 amends Section 868A to eliminate the requirement that either a guardian of the person or guardian of the estate must remain after the creation of a guardianship management trust under Section 867 of the Probate Code.

vii. Incapacitated Spouse Management Rules And Marital Property Rights

In 2001 the procedure for managing the community property of an incapacitated spouse was revamped. Section 883 of the Probate Code was amended and Sections 883A, 883B, 883C and 883D were added. As a result, it is possible that management of a married couple's community property could be divided between the competent spouse and a guardian of the estate of the incapacitated spouse. HB 1470 amends Section 883 to make it clear that this division of management does not partition community property into separate property, that the property given to the competent spouse to manage is that spouse's sole management community property, that the property given to the guardian to manage is the incapacitated spouse's sole management community property, and that the order dividing the property for management purposes does not affect a creditor's claim existing on the date of the order.

viii. Application and Citation

HB 1470 amends Section 682 regarding the contents of the application for guardian. Previously Section 682 (10) and (12) required the names and addresses of certain persons (for example, a minor ward's parents) to be listed, but it did not state what should happen if this information was not known. Thus, in a case of a child who was abandoned by one of his or her parents, some courts found the failure of the applicant for a guardianship to list that parent's address in the application (even though the address was not known) as an impediment to getting a guardianship. HB 1470 provides that the information must be stated "if known by the applicant." It also expands the list of persons whose names and addresses must be listed.

HB 1470 also amends Section 633 of the Probate Code to eliminate the service of citation by the county clerk on various persons when an application for a guardianship is filed. Rather, the applicant is required to send the notice to the listed persons by certified mail and file proof of delivery with the court. Any next of kin required to be listed on the application by Section 682 (10) or (12) also must receive this notice. This does not change the requirement of personal service on the proposed ward.

c. Trusts

i. Trust Accountings

HB 1471 amends Section 113.151(a) of the Trust Code to impose a 90-day deadline for trust accountings. Previously the accounting was due in a "reasonable time." Under the change, the trustee can ask a court to extend the deadline in appropriate cases. The amendments to this section also permit a beneficiary who is forced to bring a lawsuit to enforce the accounting demand to recover attorney's fees and costs from the trust or the trustee, in the discretion of the court.

ii. Trustee Removal

HB 1471 amends Section 113.082 of the Trust Code to make it clear that, upon the occurrence of one of the specific grounds for removal of a trustee listed in the statute, the court may *in its discretion* remove the trustee. Yes, "may" should be sufficient to make it clear that the court's authority is discretionary without the addition of "in its discretion," but two cases (*Akin v. Dahl,* 661 S. W. 2d 911, 913 (Tex. 1983), and *Lee v. Lee,* 47 S. W. 3d 767, 785-6 (Tex. App. — Houston [14th Dist.] 2001)) called this into question. The amendment also adds the failure to make an accounting required by law or the trust instrument to the list of specific, discretionary grounds for removal.

iii. Income/Principal Adjustments in Charitable Trusts

HB 1471 adds Section 113.0211 to the Trust Code. This provision applies only to charitable trusts, and it gives the trustee of a charitable trust the power to adjust receipts between principal and income. This power is similar to the power given to trustees of all types of trusts in new Section 116.005. It is unclear if trustees of charitable trusts must use the Section 113.0211 power to adjust or may avail themselves of the Section 116.005 power to adjust. A potential advantage of using the Section 116.005 adjustment power is the ability to use the advisory

opinion procedure of Section 116.006.

d. Other

i. Creditor Protection for Section 529 Plans

SB 1588 adds Section 42. 0022 to the Texas Property Code, making it clear that Texans' investments in both types of college savings plans (prepaid tuition plans and Section 529 college savings plans) are exempt from creditors regardless of which state sponsors the plan. Under prior law, creditor protection was assured only if Texans invested in one of the Texas-sponsored plans. However, 529 plans of other states are marketed to Texans, and this bill closes the creditor protection gap for these plans.

ii. Powers of Appointment

Two bills passed (HB 1472 and HB 1473) affecting powers of appointment. HB 1473 added Section 58c to the Probate Code, providing that a residuary clause in a will, or a will making general disposition of all of the testator's property, does not exercise a power of appointment held by a testator unless specific reference is made to the power or there is some other indication of intention to include the property subject to the power. HB 1472 adds Sections 181.081 – 181.083 to the Texas Property Code, providing that, unless contrary intent is evidenced by the instrument, a donee who holds a power of appointment may (1) make appointments of present or future interests or both; (2) make appointments with conditions and limitations; (3) make appointments with restraints on alienation upon the appointed interests; (4) make appointments of interests to a trustee for the benefit of one or more objects of the power; (5) make appointments that create in the object of the power additional powers of appointment to permissible objects of the power of appointment pursuant to which such powers are created; (6) if the donee could appoint outright to the object of a power, make appointments that create in the object of the power additional powers of appointment and such powers of appointment may be exercisable in favor of such persons or entities as the person creating such power may direct, even thought the objects of such powers of appointment may not have been permissible objects of the power of appointment pursuant to which such powers are created; and (7) make appointments that create any right existing under common law. Most or all of these points are covered in well-drafted instruments, and to a large extent this may just be a restatement of the common law. In fact, the effective date provisions state that these are merely clarifications of existing law.

iii. Notice Required in Recorded Real Estate Documents

HB 2930 requires any instrument executed on or after January 1, 2004, transferring an interest in real property to or from an individual to include the following notice in 12-point boldfaced or upper-case type:

> NOTICE OF CONFIDENTIALITY RIGHTS: IF YOU ARE A NATURAL PERSON, YOU MAY REMOVE OR STRIKE ANY OF THE FOLLOWING INFORMATION FROM THIS INSTRUMENT BEFORE IT IS FILED FOR RECORD IN THE PUBLIC RECORDS: YOUR SOCIAL SECURITY NUMBER

OR YOUR DRIVER'S LICENSE NUMBER.

Instrument not containing the notice are still effective as between the parties to the instrument but *may not be recorded.* HB 2930 provides that the county clerk may not reject an instrument presented for recording because the instrument contains or fails to contain a social security number or driver's license number, but apparently it *can (and must)* reject it if it does not contain the notice. If the county clerk accepts an instrument for recording, the recording of the instrument creates a conclusive presumption that the requirements of this section have been met.

Practice Pointers

1. Get in the habit of inserting the required notice into all deeds and other conveyance instruments.

2. Is an affidavit of heirship under Section 52 and 52A that is recorded in the real property records an "instrument . . . transferring an interest in real property" for purposes of HB 2930? Probably not, since Tex. Prob. Code §52 says that the recorded document "shall be received in a proceeding . . . as prima facie evidence of the facts therein stated," so the affidavit does not transfer title, but rather evidences title transfer. Still, it cannot hurt to put the notice in the affidavit.

3. Does a foreign will recorded in the real property records (see Tex. Prob. Code §§ 96 – 98) transfer an interest in real property? Probably so, since Section 98 says that the will and record of its probate "shall take effect and be valid and effectual as a deed of conveyance." Putting the notice on the instrument in this case may be impossible, since neither the foreign will nor the copy of its probate in the other state are likely to have the notice. Perhaps an affidavit containing the notice could be attached as a "cover page" for the will and record of probate. The affidavit is not the "instrument . . . transferring an interest," but . . . .

iv. Partners Owe Duties to Transferees of Deceased Partners

HB 1637 amends the Texas Revised Partnership Act to provide that a partner owes a duty of loyalty and a duty of care not only to the partnership and to the other partners but also to the transferee of a deceased partner's interest.

v. Gestational Agreements

HB 729 adopts a portion of the Uniform Parentage Act that deals with gestational agreements. It recognizes and authorizes gestational agreements -- agreements between a birth mother and the "intended parents" regarding the birth of a child. These agreements may be adjudicated under the procedure in the statute, thereby fixing the rights of the parties to the agreement. HB 729 amends Chapter 160 of the Family Code. The rights of the child, the birth mother and the "intended parents" to take under the intestacy statutes may be affected by HB 729.

vi. Marital Property

HB 885 tinkers with the formula for determining a claim for economic contribution

(Family Code § 3.403), creates a presumption that the partition and exchange of community property into separate property makes the income from that property separate property, too (Family Code § 4.102), and tinkers with the division of quasi-community property (or perhaps it should be called quasi-separate property) on divorce (Family Code § 7.002).

vii. Accounts at Financial Institutions

Two bills affect multi-party accounts. HB 2238 loosens up the requirements for convenience accounts to permit multiple account owners and convenience signers (Probate Code Sections 438A and 439A). Under prior law, some thought that a husband and wife could not establish an account on which both of them were parties and owners but which had a child as a non-survivorship convenience signer. This bill is intended to permit that to occur. Also, under prior law, some thought that a convenience account could not have more than one convenience signer. This bill is intended to permit grandpa to have two of his grandchildren as convenience signers, not just one.

HB 1590 permits persons "on" a multi-party account who are not "owners" of the account (*e.g.,* joint tenants, tenants in common, etc.) to pledge the account to secure a debt. Notice of the pledge must be given to all parties to the account, unless the account is at a non-FDIC institution (*i.e.,* a credit union). "Convenience signers" cannot pledge the account (Probate Code Section 442).

A third bill does not deal with multi-party accounts, but it deals with trust accounts. HB 1307 is a big bill dealing with many issues affecting credit unions. This bill has one troubling provision (Finance Code §125.309) permitting credit unions to establish accounts for trustees based on a "certificate of trust" rather than a written trust agreement. A lot of the ills of this section can be avoided if the settlor, trustee, beneficiary or attorney gives the credit union a copy of the trust instrument and "certifies" to its "authenticity." A similar provision applies to trust accounts at banks.

Practice Pointers

1. The loosening of the rules regarding creation of convenience accounts with "convenience signers," coupled with the changes to Section 442 which permit non-owners other than "convenience signers" to pledge the account, makes it that much more important for persons using multi-party accounts in caregiver situations to use convenience accounts rather than survivorship accounts or tenants in common accounts.

2. Advise clients who are trustees of trusts to deliver copies of the trust instrument to banks and credit unions when opening accounts for the trust *and retain proof of delivery of the agreement in the trust records.* Failure to do so may permit the bank or credit union to pay the account proceeds other than is required in the trust instrument, resulting in possible liability for the trustee.

viii. "Probate Masters" Are Now "Associate Judges"

HB 1539 renames "probate masters" in statutory probate courts to "associate judges." It

also permits associate judges to hear jury trials unless one of the parties timely objects. (Subchapter G, Chapter 54, Government Code.)

ix. Directives to Physicians and Family or Surrogates

The good news is that there were no changes to the statutory directive to physicians form. SB 1320 focuses on what happens when a physician or health care facility refuses to honor the directions given, and it may be useful in moving the patient to a facility that will comply with the family member's wishes.

3. Things That Could Have Been, But Weren't

The Texas Bankers Association Trust Services Division tried to pass a bill and constitutional amendment extending the rule against perpetuities for trusts to 1,000 years. These measures failed to make it out of committee.

The Texas Bankers Association Trust Services Division also tried to pass SB 1668, which would have permitted a corporate trustee to buy insurance for a trust from an affiliated company. This bill failed to pass.

Several bills would have closed the so-called "Delaware sub loophole," making some or all limited partnerships subject to the franchise tax. However, none of these bills passed, so limited partnerships are not subject to the franchise tax for now.

Several bills would have tinkered with the state inheritance tax, either resurrecting it from its impending death when the state death tax credit phases out or repealing it before it dies a natural death. None of these bills passed.

HB 710 would have made substantial changes to the durable power of attorney act, including changing the statutory durable power of attorney form and imposing the duties of a trustee on an agent under a power of attorney. The bill failed to get out of committee.

Practice Pointer

None of the major disability planning forms changed in 2003. This includes the statutory durable power of attorney form, the medical power of attorney form, the declaration of guardian form and the directive to physicians and family or surrogates form.

Sections of the Texas Probate Code Amended in 2003

[This compilation was prepared by Glenn M. Karisch. While he believes it to be accurate and complete, he cannot assure that this is the case.]

☆☆☆

Table of Contents

☆☆☆

Sec. 5. JURISDICTION [~~OF DISTRICT COURT AND OTHER COURTS OF RECORD~~] WITH RESPECT TO PROBATE PROCEEDINGS [~~AND APPEALS FROM PROBATE ORDERS~~]. [HB 1473]

(a) [repealed] [HB 1473]

(b) In those counties in which there is no statutory probate court, county court at law, or other statutory court exercising the jurisdiction of a probate court, all applications, petitions, and motions regarding probate and administrations shall be filed and heard in the county court. In[~~, except that in~~] contested probate matters, the judge of the county court may on the judge's own motion [~~(~~] or shall on the motion of any party to the proceeding, according to the motion:

(1) [~~)~~] request [~~as provided by Section 25.0022, Government Code,~~] the assignment of a statutory probate court judge to hear the contested portion of the proceeding, as provided by Section 25.0022, Government Code; or

(2) transfer the contested portion of the proceeding to the district court, which may then hear the contested matter as if originally filed in district court. [HB 1473]

(b-1) If the judge of the county court has not transferred a contested probate matter to the district court at the time a party files a motion for assignment of a statutory probate court judge, the county judge shall grant the motion and may not transfer the matter to district court unless the party withdraws the motion. [HB 1473]

(b-2) A statutory probate court judge assigned to a contested probate matter as provided by Subsection (b) of this section [~~this subsection~~] has [~~for that matter~~] the jurisdiction and authority granted to a statutory probate court by Sections 5A and 5B of this code. On resolution of a contested matter, including an appeal of a matter, to which a statutory probate court judge has been assigned, the statutory probate court judge shall transfer the resolved portion of the case to the county court for further proceedings not inconsistent with the orders of the statutory probate court judge [~~The county court shall continue to exercise jurisdiction over the management of the estate with the exception of the contested matter until final disposition of the contested matter is made by the assigned judge or the district court~~]. [HB 1473]

(b-3) In contested matters transferred to the district court [~~in those counties~~], the district court has [~~, concurrently with the county court, shall have~~] the general jurisdiction of a probate court. On [~~Upon~~] resolution of a [~~all pending~~] contested matter, including an appeal of a matter, the district court shall transfer [~~matters,~~] the resolved [~~contested~~] portion of the case [~~probate proceeding shall be transferred by the district court~~] to the county court for further proceedings not inconsistent with the orders of the district court. [HB 1473]

(b-4) The county court shall continue to exercise jurisdiction over the management of the estate with the exception of the contested matter until final disposition of the contested matter is made by the assigned statutory probate court judge or the district court. [HB 1473]

(b-5) If a contested portion of the proceeding is transferred to a district court under Subsection (b-3) of this section [~~this subsection~~], the clerk of the district court may perform in

relation to the transferred portion of the proceeding any function a county clerk may perform in that type of contested proceeding. [HB 1473]

(c) In those counties in which there is no statutory probate court, but in which there is a county court at law or other statutory court exercising the jurisdiction of a probate court, all applications, petitions, and motions regarding probate and administrations shall be filed and heard in those courts and the constitutional county court[~~, rather than in the district courts~~], unless otherwise provided by law. The judge of a county court may hear any of those matters regarding probate or administrations sitting for the judge of any other county court. In contested probate matters, the judge of the constitutional county court may on the judge's own motion, and shall on the motion of a party to the proceeding, transfer the proceeding to the county court at law or a statutory court exercising the jurisdiction of a probate court other than a statutory probate court. The court to which the proceeding is transferred may hear the proceeding as if originally filed in the court. [HB 1473]

(d) In those counties in which there is a statutory probate court, all applications, petitions, and motions regarding probate or administrations shall be filed and heard in the statutory probate court[~~, unless otherwise provided by law~~]. [HB 1473]

(e) A statutory probate court has concurrent jurisdiction with the district court in all personal injury, survival, or wrongful death actions by or against a person in the person's capacity as a personal representative, in all actions involving an inter vivos trust, in all actions involving a charitable trust, and in all actions involving a personal representative of an estate in which each other party aligned with the personal representative is not an interested person in that estate [~~testamentary trust~~]. [HB 1473]

(f) All courts exercising original probate jurisdiction shall have the power to hear all matters incident to an estate. When a surety is called on to perform in place of an administrator, all courts exercising original probate jurisdiction may award judgment against the personal representative in favor of his surety in the same suit. [unchanged in 2003]

(g) All final orders of any court exercising original probate jurisdiction shall be appealable to the courts of appeals. [unchanged in 2003]

(h) A statutory probate court has jurisdiction over any matter appertaining to an estate or incident to an estate and has jurisdiction over any cause of action in which a personal representative of an estate pending in the statutory probate court is a party. [HB 1473]

(i) A statutory probate court may exercise the pendent and ancillary jurisdiction necessary to promote judicial efficiency and economy. [HB 1473]

Sec. 5A. MATTERS APPERTAINING AND INCIDENT TO AN ESTATE [~~AND OTHER PROBATE COURT JURISDICTION~~]. [HB 1473]

(a) In proceedings in the constitutional county courts and statutory county courts at law, the phrases "appertaining to estates" and "incident to an estate" in this Code include the probate of wills, the issuance of letters testamentary and of administration, the determination of heirship, and also include, but are not limited to, all claims by or against an estate, all actions for trial of title to land incident to an estate and for the enforcement of liens thereon incident to an estate, all

actions for trial of the right of property incident to an estate, and actions to construe wills, and generally all matters relating to the settlement, partition, and distribution of estates of deceased persons. [unchanged in 2003]

(b) In proceedings in the statutory probate courts [~~and district courts~~], the phrases "appertaining to estates" and "incident to an estate" in this Code include the probate of wills, the issuance of letters testamentary and of administration, and the determination of heirship, and also include, but are not limited to, all claims by or against an estate, all actions for trial of title to land and for the enforcement of liens thereon, all actions for trial of the right of property, all actions to construe wills, the interpretation and administration of testamentary trusts and the applying of constructive trusts, and generally all matters relating to the collection, settlement, partition, and distribution of estates of deceased persons. All statutory probate courts may, in the exercise of their jurisdiction, notwithstanding any other provisions of this Code, hear all suits, actions, and applications filed against or on behalf of any heirship proceeding or decedent's estate, including estates administered by an independent executor; all such suits, actions, and applications are appertaining to and incident to an estate. This subsection shall be construed in conjunction with and in harmony with Section 145 and all other sections of this Code dealing with independent executors, but shall not be construed so as to increase permissible judicial control over independent executors. Except for [~~All statutory probate courts shall have the same powers over independent executors that are exercisable by the district courts. In~~] situations in which [~~where~~] the jurisdiction of a statutory probate court is concurrent with that of a district court as provided by Section 5(e) of this Code or any other court, any cause of action appertaining to estates or incident to an estate shall be brought in a statutory probate court [~~rather than in the district court~~]. [HB 1473]

(c) [repealed] [HB 1473]

(d) [repealed] [HB 1473]

(e) [repealed] [HB 1473]

(f) Notwithstanding any other provision of this chapter, the proper venue for an action by or against a personal representative for personal injury, death, or property damages is determined under Section 15.007, Civil Practice and Remedies Code. [HB 4]

Sec. 5B. TRANSFER OF PROCEEDING. (a) A judge of a statutory probate court, on the motion of a party to the action or on the motion of a person interested in an estate, may transfer to his court from a district, county, or statutory court a cause of action appertaining to or incident to an estate pending in the statutory probate court or a cause of action in which a personal representative of an estate pending in the statutory probate court is a party and may consolidate the transferred cause of action with the other proceedings in the statutory probate court relating to that estate. [HB 4]

(b) Notwithstanding any other provision of this chapter, the proper venue for an action by or against a personal representative for personal injury, death, or property damages is determined under Section 15.007, Civil Practice and Remedies Code. [HB 4]

Sec. 8. CONCURRENT VENUE AND TRANSFER OF PROCEEDINGS

(a) Concurrent Venue. When two or more courts have concurrent venue of an estate, the court in which application for probate proceedings thereon is first filed shall have and retain jurisdiction of the estate to the exclusion of the other court or courts. The proceedings shall be deemed commenced by the filing of an application averring facts sufficient to confer venue; and the proceeding first legally commenced shall extend to all of the property of the estate. Provided, however, that a bona fide purchaser of real property in reliance on any such subsequent proceeding, without knowledge of its invalidity, shall be protected in such purchase unless the decree admitting the will to probate or granting administration in the prior proceeding shall be recorded in the office of the county clerk of the county in which such property is located. [unchanged in 2003]

(b) Proceedings in More Than One County. If proceedings for probate are commenced in more than one county, they shall be stayed except in the county where first commenced until final determination of venue in the county where first commenced. If the proper venue is finally determined to be in another county, the clerk, after making and retaining a true copy of the entire file in the case, shall transmit the original file to the proper county, and proceedings shall thereupon be had in the proper county in the same manner as if the proceedings had originally been instituted therein. [unchanged in 2003]

(c) Transfer of Proceeding.

(1) Transfer for Want of Venue. If it appears to the court at any time before the final decree that the proceeding was commenced in a court which did not have priority of venue over such proceeding, the court shall, on the application of any interested person, transfer the proceeding to the proper county by transmitting to the proper court in such county the original file in such case, together with certified copies of all entries in the minutes theretofore made, and administration of the estate in such county shall be completed in the same manner as if the proceeding had originally been instituted therein; but, if the question as to priority of venue is not raised before final decree in the proceedings is announced, the finality of such decree shall not be affected by any error in venue. [unchanged in 2003]

(2) Transfer for Convenience of the Estate. If it appears to the court at any time before the estate is closed that it would be in the best interest of the estate, the court, in its discretion, may order the proceeding transferred to the proper court in any other county in this State. The clerk of the court from which the proceeding is transferred shall transmit to the court to which the proceeding is transferred the original file in the proceeding and a certified copy of the <u>index</u> [~~entries in the minutes that relate to the proceeding~~]. [HB 1473]

(d) Validation of Prior Proceedings. When a proceeding is transferred to another county under any provision of this Section of this Code, all orders entered in connection with the proceeding shall be valid and shall be recognized in the second court, provided such orders were made and entered in conformance with the procedure prescribed by this Code. [unchanged in 2003]

(e) Jurisdiction to Determine Venue. Any court in which there has been filed an application for proceedings in probate shall have full jurisdiction to determine the venue of such

proceeding, and of any proceeding relating thereto, and its determination shall not be subject to collateral attack. [unchanged in 2003]

Sec. 10C. EFFECT OF FILING OR CONTESTING PLEADING. (a) The filing or contesting in probate court of any pleading relating to a decedent's estate does not constitute tortious interference with inheritance of the estate. [HB 1473]

(b) This section does not abrogate any rights of a person under Rule 13, Texas Rules of Civil Procedure, or Chapter 10, Civil Practice and Remedies Code. [HB 1473]

Sec. 37C. SATISFACTION OF DEVISE. (a) Property given to a person by a testator during the testator's lifetime is considered a satisfaction, either wholly or partly, of a devise to the person if:

(1) the testator's will provides for deduction of the lifetime gift;

(2) the testator declares in a contemporaneous writing that the lifetime gift is to be deducted from or is in satisfaction of the devise; or

(3) the devisee acknowledges in writing that the lifetime gift is in satisfaction of the devise. [HB 1473]

(b) Property given in partial satisfaction of a devise shall be valued as of the earlier of the date on which the devisee acquires possession of or enjoys the property or the date on which the testator dies. [HB 1473]

Sec. 58c. EXERCISE OF POWER OF APPOINTMENT. A testator may not exercise a power of appointment through a residuary clause in the testator's will or through a will providing for general disposition of all the testator's property unless:

(1) the testator makes a specific reference to the power in the will; or

(2) there is some other indication in writing that the testator intended to include the property subject to the power in the will. [HB 1473]

Sec. 59A. CONTRACTS CONCERNING SUCCESSION. (a) A contract to make a will or devise, or not to revoke a will or devise, if executed or entered into on or after September 1, 1979, can be established only by:

(1) provisions of a written agreement that is binding and enforceable; or

(2) provisions of a will stating that a contract does exist and stating the material provisions of the contract. [HB 1473]

(b) The execution of a joint will or reciprocal wills does not by itself suffice as evidence of the existence of a contract. [unchanged in 2003]

Sec. 67. PRETERMITTED CHILD. (a) Whenever a pretermitted child is not mentioned in the testator's will, provided for in the testator's will, or otherwise provided for by the testator, the pretermitted child shall succeed to a portion of the testator's estate as provided by Subsection (a)(1) or (a)(2) of this section.

(1) If the testator has one or more children living when he executes his last will, and:

(A) No provision is made therein for any such child, a pretermitted child succeeds to the portion of the testator's separate and community estate to which the pretermitted child would have been entitled pursuant to Section 38(a) of this code had the testator died intestate without a surviving spouse owning only that portion of his estate not devised or bequeathed to the parent of the pretermitted child.

(B) Provision, whether vested or contingent, is made therein for one or more of such children, a pretermitted child is entitled to share in the testator's estate as follows:

(i) The portion of the testator's estate to which the pretermitted child is entitled is limited to the disposition made to children under the will.

(ii) The pretermitted child shall receive such share of the testator's estate, as limited in Subparagraph (i), as he would have received had the testator included all pretermitted children with the children upon whom benefits were conferred under the will, and given an equal share of such benefits to each such child.

(iii) To the extent that it is feasible, the interest of the pretermitted child in the testator's estate shall be of the same character, whether an equitable or legal life estate or in fee, as the interest that the testator conferred upon his children under the will.

(2) If the testator has no child living when he executes his last will, the pretermitted child succeeds to the portion of the testator's separate and community estate to which the pretermitted child would have been entitled pursuant to Section 38(a) of this code had the testator died intestate without a surviving spouse owning only that portion of his estate not devised or bequeathed to the parent of the pretermitted child. [HB 1473]

(b) The pretermitted child may recover the share of the testator's estate to which he is entitled either from the other children under Subsection (a)(1)(B) or the testamentary beneficiaries under Subsections (a)(1)(A) and (a)(2) other than the parent of the pretermitted child, ratably, out of the portions of such estate passing to such persons under the will. In abating

the interests of such beneficiaries, the character of the testamentary plan adopted by the testator shall be preserved to the maximum extent possible. [unchanged in 2003]

(c) A "pretermitted child," as used in this section, means a child of a testator who, during the lifetime of the testator, or after his death, is born or adopted after the execution of the will of the testator. [unchanged in 2003]

(d) For the purposes of this section, a child is provided for or a provision is made for a child if a disposition of property to or for the benefit of the pretermitted child, whether vested or contingent, is made:

(1) in the testator's will, including a devise or bequest to a trustee as authorized by Section 58(a) of this code; or

(2) outside the testator's will and is intended to take effect at the testator's death. [unchanged in 2003]

Sec. 84. PROOF OF WRITTEN WILL PRODUCED IN COURT. (a) Self-Proved Will. If a will is self-proved as provided in this Code, no further proof of its execution with the formalities and solemnities and under the circumstances required to make it a valid will shall be necessary. [unchanged in 2003]

(b) Attested Written Will. If not self-proved as provided in this Code, an attested written will produced in court may be proved:

(1) By the sworn testimony or affidavit of one or more of the subscribing witnesses thereto, taken in open court.

(2) If all the witnesses are non-residents of the county, or those who are residents are unable to attend court, by the sworn testimony of any one or more of them by deposition, either written or oral, taken in the same manner and under the same rules as depositions taken in other civil actions; or, if no opposition in writing to such will is filed on or before the date set for hearing thereon, then by the sworn testimony or affidavit of two witnesses taken in open court, or by deposition in the manner provided herein, to the signature or the handwriting evidenced thereby of one or more of the attesting witnesses, or of the testator, if he signed the will; or, if it be shown under oath to the satisfaction of the court that, diligent search having been made, only one witness can be found who can make the required proof, then by the sworn testimony or affidavit of such one taken in open court, or by deposition in the manner provided herein, to such signatures or handwriting.

(3) If none of the witnesses is living, or if all of such witnesses are members of the armed forces of the United States of America or of any auxiliary thereof, or of the armed forces

reserve of the United States of America or of any auxiliary thereof, or of the Maritime Service, and are beyond the jurisdiction of the court, by two witnesses to the handwriting of one or both of the subscribing witnesses thereto, or of the testator, if signed by him, and such proof may be either by sworn testimony or affidavit taken in open court, or by deposition, either written or oral, taken in the same manner and under the same rules as depositions taken in other civil actions; or, if it be shown under oath to the satisfaction of the court that, diligent search having been made, only one witness can be found who can make the required proof, then by the sworn testimony or affidavit of such one taken in open court, or by deposition in the manner provided herein, to such signatures or handwriting. [unchanged in 2003]

(c) [~~(b)~~] Holographic Will. If not self-proved as provided in this Code, a will wholly in the handwriting of the testator may be proved by two witnesses to his handwriting, which evidence may be by sworn testimony or affidavit taken in open court, or, if such witnesses are non-residents of the county or are residents who are unable to attend court, by deposition, either written or oral, taken in the same manner and under the same rules as depositions taken in other civil actions. [HB 1473]

(d) [~~(c)~~] Depositions if No Contest Filed. If no contest has been filed, depositions for the purpose of establishing a will may be taken in the same manner as provided in this Code for the taking of depositions where there is no opposing party or attorney of record upon whom notice and copies of interrogatories may be served; and, in such event, this Subsection, rather than the preceding portions of this Section which provide for the taking of depositions under the same rules as depositions in other civil actions, shall be applicable. [HB 1473]

Sec. 222A. REINSTATEMENT AFTER REMOVAL. (a) Not later than the 10th day after the date the court signs the order of removal, a personal representative who is removed under Subsection (a)(1)(F) or (G), Section 222, of this code may file an application with the court for a hearing to determine whether the personal representative should be reinstated. [unchanged in 2003]

(b) On the filing of an application for a hearing under this section, the court clerk shall issue a notice stating that the application for reinstatement was filed, the name of the [~~ward or~~] decedent, and the name of the applicant. The clerk shall issue the notice to the applicant and to the successor representative of [~~, the ward, a person interested in the welfare of the ward,~~] the decedent's estate[~~, or the ward's estate and, if applicable, to a person who has control of the care and custody of the ward~~]. The notice must cite all persons interested in the estate [~~or welfare of the ward~~] to appear at the time and place stated in the notice if they wish to contest the application. [HB 1473]

(c) If, at the conclusion of a hearing under this section, the court is satisfied by a preponderance of the evidence that the applicant did not engage in the conduct that directly led to the applicant's removal, the court shall set aside an order appointing a successor representative, if any, and shall enter an order reinstating the applicant as personal representative of the ward or estate. [unchanged in 2003]

(d) If the court sets aside the appointment of a successor representative under this section, the court may require the successor representative to prepare and file, under oath, an accounting of the estate and to detail the disposition the successor has made of the property of the estate. [unchanged in 2003]

Sec. 245. WHEN COSTS ARE ADJUDGED AGAINST REPRESENTATIVE. When a [~~the~~] personal representative [~~of an estate or person~~] neglects to perform a required [~~the performance of any~~] duty [~~required of him, and any costs are incurred thereby,~~] or if a personal representative [~~he~~] is removed for cause, the personal representative [~~he~~] and the sureties on the personal representative's [~~his~~] bond are [~~shall be~~] liable for: (1) costs of removal and other additional costs incurred that are not authorized expenditures, as defined by this code; [~~,~~] and (2) [~~for~~] reasonable attorney's fees incurred in removing the personal representative or [~~him and~~] in obtaining [~~his~~] compliance regarding any statutory duty the personal representative [~~he~~] has neglected. [HB 1473]

Sec. 322. CLASSIFICATION OF CLAIMS AGAINST ESTATES OF DECEDENT. Claims against an estate of a decedent shall be classified and have priority of payment, as follows:

Class 1. Funeral expenses and expenses of last sickness for a reasonable amount to be approved by the court, not to exceed a total of Fifteen Thousand Dollars, with any excess to be classified and paid as other unsecured claims. [unchanged in 2003]

Class 2. Expenses of administration and expenses incurred in the preservation, safekeeping, and management of the estate, including fees and expenses awarded under Section 243 of this code. [HB 1473]

Class 3. Secured claims for money under Section 306(a)(1), including tax liens, so far as the same can be paid out of the proceeds of the property subject to such mortgage or other lien, and when more than one mortgage, lien, or security interest shall exist upon the same property, they shall be paid in order of their priority. [unchanged in 2003]

Class 4. Claims for the principal amount of and accrued interest on delinquent child support and child support arrearages that have been confirmed and reduced to money judgment, as determined under Subchapter F, Chapter 157, Family Code. [unchanged in 2003]

Class 5. Claims for taxes, penalties, and interest due under Title 2, Tax Code; Chapter 8, Title 132, Revised Statutes; Section 81.111, Natural Resources Code; the Municipal Sales and Use Tax Act (Chapter 321, Tax Code); Section 451.404, Transportation Code; or Subchapter I, Chapter 452, Transportation Code. [unchanged in 2003]

Class 6. Claims for the cost of confinement established by the institutional division of the Texas Department of Criminal Justice under Section 501.017, Government Code. [unchanged in 2003]

Class 7. Claims for repayment of medical assistance payments made by the state under Chapter 32, Human Resources Code, to or for the benefit of the decedent. Class 8. All other

claims. [unchanged in 2003]

Sec. 322A. APPORTIONMENT OF TAXES. (a) In this section:

(1) "Estate" means the gross estate of a decedent as determined for the purpose of estate taxes.

(2) "Estate tax" means any estate, inheritance, or death tax levied or assessed on the property of a decedent's estate, because of the death of a person, imposed by federal, state, local, or foreign law, including the federal estate tax and the additional inheritance tax imposed by Chapter 211, Tax Code, and including interest and penalties imposed in addition to those taxes. Estate tax does not include a tax imposed under Section 2701(d)(1)(A), Internal Revenue Code of 1986 (26 U.S.C. Section 2701(d)).

(3) "Person" includes a trust, natural person, partnership, association, joint stock company, corporation, government, political subdivision, or governmental agency.

(4) "Person interested in the estate" means a person, or a fiduciary on behalf of that person, who is entitled to receive, or who has received, from a decedent or because of the death of the decedent, property included in the decedent's estate for purposes of the estate tax, but does not include a creditor of the decedent or of the decedent's estate.

(5) "Representative" means the representative, executor, or administrator of an estate, or any other person who is required to pay estate taxes assessed against the estate. [unchanged in 2003]

(b) (1) The representative shall charge each person interested in the estate a portion of the total estate tax assessed against the estate. The portion of each estate tax that is charged to each person interested in the estate must represent the same ratio as the taxable value of that person's interest in the estate included in determining the amount of the tax bears to the total taxable value of all the interests of all persons interested in the estate included in determining the amount of the tax. In apportioning an estate tax under this subdivision, the representative shall disregard a portion of the tax that is apportioned under the law imposing the tax, otherwise apportioned by federal law, or apportioned as otherwise provided by this section.

(2) Subdivision (1) of this subsection does not apply to the extent the decedent in a written inter vivos or testamentary instrument disposing of or creating an interest in property specifically directs the manner of apportionment of estate tax or grants a discretionary power of apportionment to another person. A direction for the apportionment or nonapportionment of estate tax is limited to the estate tax on the property passing under the instrument unless the instrument is a will that provides otherwise.

(3) If under Subdivision (2) of this subsection directions for the apportionment of an estate tax in two or more instruments executed by the same person conflict, the instrument disposing of or creating an interest in the property to be taxed controls. If directions for the

apportionment of estate tax in two or more instruments executed by different persons conflict, the direction of the person in whose estate the property is included controls.

(4) Subdivisions (2) and (3) of this subsection do not grant or enlarge the power of a person to apportion estate tax to property passing under an instrument created by another person in excess of the estate tax attributable to the property. Subdivisions (2) and (3) of this subsection do not apply to the extent federal law directs a different manner of apportionment. [unchanged in 2003]

(c) Any deduction, exemption, or credit allowed by law in connection with the estate tax inures to a person interested in the estate as provided by Subsections (d)-(f) of this section. [unchanged in 2003]

(d) If the deduction, exemption, or credit is allowed because of the relationship of the person interested in the estate to the decedent, or because of the purpose of the gift, the deduction, exemption, or credit inures to the person having the relationship or receiving the gift, unless that person's interest in the estate is subject to a prior present interest that is not allowable as a deduction. The estate tax apportionable to the person having the present interest shall be paid from the corpus of the gift or the interest of the person having the relationship. [unchanged in 2003]

(e) A deduction for property of the estate that was previously taxed and a credit for gift taxes or death taxes of a foreign country that were paid by the decedent or his estate inures proportionally to all persons interested in the estate who are liable for a share of the estate tax. [unchanged in 2003]

(f) A credit for inheritance, succession, or estate taxes, or taxes of a similar nature applicable to property or interests includable in the estate, inures to the persons interested in the estate who are chargeable with payment of a portion of those taxes to the extent that the credit reduces proportionately those taxes. [unchanged in 2003]

(g) To the extent that property passing to or in trust for a surviving spouse or a charitable, public, or similar gift or devise is not an allowable deduction for purposes of the estate tax solely because of an inheritance tax or other death tax imposed on and deductible from the property, the property is not included in the computation provided for by Subsection (b) of this section, and to that extent no apportionment is made against the property. The exclusion provided by this subsection does not apply if the result would be to deprive the estate of a deduction otherwise allowable under Section 2053(d), Internal Revenue Code of 1986, relating to deductions for state death taxes on transfers for public, charitable, or religious uses. [unchanged in 2003]

(h) Except as provided by Subsection (i)(3) of this section, an interest in income, an estate for years or for life, or another temporary interest in any property or fund is not subject to apportionment. The estate tax apportionable to the temporary interest and the remainder, if any,

is chargeable against the corpus of the property or the funds that are subject to the temporary interest and remainder. [unchanged in 2003]

(i) (1) In this subsection, "qualified real property" has the meaning assigned by Section 2032A, Internal Revenue Code of 1986 (26 U.S.C. Section 2032A).

(2) If an election is made under Section 2032A, Internal Revenue Code of 1986 (26 U.S.C. Section 2032A), the representative shall apportion estate taxes according to the amount of federal estate tax that would be payable if the election were not made. The amount of the reduction of the estate tax resulting from the election shall be applied to reduce the amount of the estate tax allocated based on the value of the qualified real property that is the subject of the election. If the amount applied to reduce the taxes allocated based on the value of the qualified real property is greater than the amount of those taxes, the excess shall be applied to the portion of the taxes allocated for all other property. This amount is to be apportioned under Subsection (b)(1) of this section.

(3) If additional federal estate tax is imposed under Section 2032A(c), Internal Revenue Code of 1986 (26 U.S.C. Section 2032A) because of an early disposition or cessation of a qualified use, the additional tax shall be equitably apportioned among the persons who have an interest in the portion of the qualified real property to which the additional tax is attributable in proportion to their interests. The additional tax is a charge against such qualified real property. If the qualified real property is split between one or more life or term interests and remainder interests, the additional tax shall be apportioned to each person whose action or cessation of use caused the imposition of additional tax, unless all persons with an interest in the qualified real property agree in writing to dispose of the property, in which case the additional tax shall be apportioned among the remainder interests. [unchanged in 2003]

(j) [repealed] [HB 1473]

(k) If the date for the payment of any portion of an estate tax is extended, the amount of the extended tax shall be apportioned to the persons who receive the specific property that gives rise to the extension. Those persons are entitled to the benefits and shall bear the burdens of the extension. [unchanged in 2003]

(l) If federal law directs the apportionment of the federal estate tax, a similar state tax shall be apportioned in the same manner. [unchanged in 2003]

(m) Interest on an extension of estate tax and interest and penalties on a deficiency shall be apportioned equitably to reflect the benefits and burdens of the extension or deficiency and of any tax deduction associated with the interest and penalties, but if the assessment or penalty and interest is due to delay caused by the negligence of the representative, the representative shall be charged with the amount of assessed penalty and interest. [unchanged in 2003]

(n) If property includable in an estate does not come into possession of the representative obligated to pay the estate tax, the representative shall recover from each person interested in the estate the amount of the estate tax apportioned to the person under this section or assign to persons affected by the tax obligation the representative's right of recovery. The obligation to recover a tax under this subsection does not apply if:

(1) the duty is waived by the parties affected by the tax obligation or by the instrument under which the representative derives powers; or

(2) in the reasonable judgment of the representative, proceeding to recover the tax is not cost-effective. [unchanged in 2003]

(o) If a representative cannot collect from a person interested in the estate an unpaid amount of estate tax apportioned to the person, the amount not collected shall be apportioned among the other persons interested in the estate who are subject to apportionment in the same manner as provided by Subsection (b)(1) of this section. A person who is charged with or who pays an apportioned amount under this subsection because another person failed to pay an amount of estate tax apportioned to the person has a right of reimbursement for that amount from the person who failed to pay the tax. The representative may enforce the right of reimbursement, or the person who is charged with or who pays an apportioned amount under this subsection may enforce the right of reimbursement directly by an assignment from the representative. A person assigned the right under this subsection is subrogated to the rights of the representative. A representative who has a right of reimbursement may petition a court to determine the right of reimbursement. [unchanged in 2003]

(p) This section shall be applied after giving effect to any disclaimers made in accordance with Section 37A of this code. [unchanged in 2003]

(q) Interest and penalties assessed against the estate by a taxing authority shall be apportioned among and charged to the persons interested in the estate in the manner provided by Subsection (b) of this section, unless, on application by any person interested in the estate, the court determines that the proposed apportionment is not equitable or that the assessment of interest or penalties was caused by a breach of fiduciary duty of a representative. If the apportionment is not equitable, the court may apportion interest and penalties in an equitable manner. If the assessment of interest or penalties was caused by a breach of fiduciary duty of a representative, the court may charge the representative with the amount of the interest and penalties assessed attributable to his conduct. [unchanged in 2003]

(r) Expenses reasonably incurred by a representative in determination of the amount, apportionment, or collection of the estate tax shall be apportioned among and charged to persons interested in the estate in the manner provided by Subsection (b) of this section unless, on application by any person interested in the estate, the court determines that the proposed apportionment is not equitable. If the court determines that the assessment is not equitable, the court may apportion the expenses in an equitable manner. [unchanged in 2003]

(s) For the purposes of this section, "court" means a court in which proceedings for administration of the estate are pending or have been completed or, if no proceedings are pending or have been completed, a court in which venue lies for the administration of the estate of the decedent. [unchanged in 2003]

(t) A representative who has possession of any property of an estate that is distributable to a person interested in the estate may withhold from that property an amount equal to the person's apportioned share of the estate tax. [unchanged in 2003]

(u) A representative shall recover from any person interested in the estate the unpaid amount of the estate tax apportioned and charged to the person under this section, unless the representative determines in good faith that an attempt to recover this amount would be economically impractical. [unchanged in 2003]

(v) A representative required to recover unpaid amounts of estate tax apportioned to persons interested in the estate under this section may not be required to initiate the necessary actions until the expiration of 90 days after the date of the final determination of the amount of the estate tax by the Internal Revenue Service. A representative who initiates an action under this section within a reasonable time after the 90-day period is not subject to any liability or surcharge because any portion of the estate tax apportioned to any person interested in the estate was collectible at a time following the death of the decedent but thereafter became uncollectible. [unchanged in 2003]

(w) A representative acting in another state may initiate an action in a court of this state to recover a proportionate amount of the federal estate tax, of an estate tax payable to another state, or of a death duty due by a decedent's estate to another state, from a person interested in the estate who is domiciled in this state or owns property in this state subject to attachment or execution. In the action, a determination of apportionment by the court having jurisdiction of the administration of the decedent's estate in the other state is prima facie correct. This section applies only if the state in which the determination of apportionment was made affords a substantially similar remedy. [unchanged in 2003]

(x) A reference in this section to a section of the Internal Revenue Code of 1986 refers to the section as it exists at the time in question. The reference also includes a corresponding section of a subsequent Internal Revenue Code and the referenced section as renumbered if it is renumbered. [unchanged in 2003]

(y) The prevailing party in an action initiated by a person for the collection of estate taxes from a person interested in the estate to whom estate taxes were apportioned and charged under Subsection (b) of this section shall be awarded necessary expenses, including reasonable attorney's fees. [unchanged in 2003]

Sec. 333. CERTAIN PERSONAL PROPERTY TO BE SOLD. (a) The representative of

an estate, after approval of inventory and appraisement, shall promptly apply for an order of the court to sell at public auction or privately, for cash or on credit not exceeding six months, all of the estate that is liable to perish, waste, or deteriorate in value, or that will be an expense or disadvantage to the estate if kept. Property exempt from forced sale, specific legacies, and personal property necessary to carry on a farm, ranch, factory, or any other business which it is thought best to operate, shall not be included in such sales. [unchanged in 2003]

(b) In determining whether to order the sale of an asset under Subsection (a) of this section, the court shall consider:

(1) the representative's duty to take care of and manage the estate as a person of ordinary prudence, discretion, and intelligence would exercise in the management of the person's own affairs; and

(2) whether the asset constitutes an asset that a trustee is authorized to invest under Chapter 117 [~~Section 113.056~~] or Subchapter F, Chapter 113, Property Code. [HB 2240]

Sec. 378B. ALLOCATION OF INCOME AND EXPENSES DURING ADMINISTRATION OF DECEDENT'S ESTATE. (a) Except as provided by Subsection (b) of this section and unless the will provides otherwise, all expenses incurred in connection with the settlement of a decedent's estate, including debts, funeral expenses, estate taxes, [~~interest and~~] penalties relating to estate taxes, and family allowances, shall be charged against the principal of the estate. Fees and expenses of an attorney, accountant, or other professional advisor, commissions and expenses of a personal representative, court costs, and all other similar fees or expenses relating to the administration of the estate and interest relating to estate taxes shall be allocated between the income and principal of the estate as the executor determines in its discretion to be just and equitable. [HB 2241]

(b) Unless the will provides otherwise, income from the assets of a decedent's estate that accrues after the death of the testator and before distribution, including income from property used to discharge liabilities, shall be determined according to the rules applicable to a trustee under the Texas Trust Code (Subtitle B, Title 9, Property Code) and distributed as provided by Chapter 116, Property Code, and Subsections (c) and [~~,~~] (d)[~~, and (e)~~] of this section. [HB 2241]

(c) The income from the property bequeathed or devised to a specific devisee shall be distributed to the devisee after reduction for property taxes, ordinary repairs, insurance premiums, interest accrued after the death of the testator, other expenses of management and operation of the property, and other taxes, including the taxes imposed on the income that accrues during the period of administration and that is payable to the devisee. [unchanged in 2003]

(d) The [~~Except as provided by Subsection (f) of this section, the~~] balance of the net income shall be distributed to all other devisees after reduction for the balance of property taxes, ordinary repairs, insurance premiums, interest accrued, [~~including interest accruing as provided by Subsection (f) of this section after the death of the testator,~~] other expenses of management and operation of all property from which the estate is entitled to income, and taxes imposed on

income that accrues during the period of administration and that is payable or allocable to the devisees, in proportion to the devisees' respective interests in the undistributed assets of the estate. [HB 2241]

(e) [repealed] [HB 2241]

[Note the possible conflict in Section 378B(f) between HB 1473 and HB 2241]

(f) [repealed] [HB 2241]

(f) A devisee of a pecuniary bequest, whether or not in trust, shall be paid interest on the bequest at the legal rate of interest as provided by Section 302.002, Finance Code [~~Article 1.03, Revised Statutes (Article 5069-1.03, Vernon's Texas Civil Statutes)~~], and its subsequent amendments, beginning one year after the date the court grants letters testamentary or letters of administration. [HB 1473]

(g) Income received by a trustee under this section shall be treated as income of the trust as provided by Section 116.101 [~~113.103~~], Property Code. [HB 2241]

(h) In this section, "undistributed assets" includes funds used to pay debts, administration expenses, and federal and state estate, inheritance, succession, and generation-skipping transfer taxes until the date of payment of the debts, expenses, and taxes. Except as required by Sections 2055 and 2056 of the Internal Revenue Code of 1986 (26 U.S.C. Secs. 2055 and 2056), and its subsequent amendments, the frequency and method of determining the beneficiaries' respective interests in the undistributed assets of the estate shall be in the executor's sole and absolute discretion. The executor may consider all relevant factors, including administrative convenience and expense and the interests of the various beneficiaries of the estate in order to reach a fair and equitable result among beneficiaries. [unchanged in 2003]

(i) Chapter 116, Property Code, prevails to the extent of any conflict between this section and Chapter 116, Property Code. [HB 2241]

Sec. 389. [repealed] [HB 1470]

Sec. 438A. CONVENIENCE ACCOUNT. (a) If an account is established at a financial institution by one or more parties [~~a party~~] in the names of the parties [~~party~~] and one or more convenience signers [~~a cosigner~~] and the terms of the account provide that the sums on deposit are paid or delivered to the parties [~~party~~] or to the convenience signers [~~cosigner~~] "for the convenience" of the parties [~~party~~], the account is a convenience account. [HB 2238]

(b) The making of a deposit in a convenience account does not affect the title to the deposit. [unchanged in 2003]

(c) A [~~The~~] party to a convenience account is not considered to have made a gift [~~of one-half~~] of the deposit or of any additions or accruals to the deposit to a convenience signer [~~the cosigner~~]. [HB 2238]

(d) On the death of the last surviving party, a convenience signer [~~the cosigner~~] shall have no right of survivorship in the account and ownership of the account remains in the estate of the last surviving party. [HB 2238]

(e) If an addition is made to the account by anyone other than a [~~the~~] party, the addition and accruals to the addition are considered to have been made by a [~~the~~] party. [HB 2238]

(f) All deposits to a convenience account and additions and accruals to the deposits may be paid to a [~~the~~] party or to a convenience signer [~~the cosigner~~]. The financial institution is completely released from liability for a payment made from the account before the financial institution receives notice in writing signed by a [~~the~~] party not to make the payment in accordance with the terms of the account. After receipt of the notice from a [~~the~~] party, the financial institution may require a [~~the~~] party to approve any further payments from the account. [HB 2238]

(g) If the financial institution makes a payment of the sums on deposit in a convenience account to a convenience signer [~~the cosigner~~] after the death of the last surviving party and before the financial institution has received written notice of the last surviving party's death, the financial institution is completely released from liability for the payment. If a financial institution makes payment to the personal representative of the deceased last surviving party's estate after the death of the last surviving party and before service on the financial institution of a court order prohibiting payment, the financial institution is released to the extent of the payment from liability to any person claiming a right to the funds. The receipt by the representative to whom payment is made is a complete release and discharge of the financial institution. [HB 2238]

Sec. 439A. UNIFORM SINGLE-PARTY OR MULTIPLE-PARTY ACCOUNT FORM. (a) A contract of deposit that contains provisions substantially the same as in the form provided by Subsection (b) of this section establishes the type of account selected by a party. The provisions of this part of Chapter XI of this code govern an account selected under the form, other than a single-party account without a P.O.D. designation. A contract of deposit that does not contain provisions substantially the same as in the form provided by Subsection (b) of this section is governed by the provisions of this chapter applicable to the account that most nearly conforms to the depositor's intent. [unchanged in 2003]

(b) A financial institution may use the following form to establish the type of account selected by a party:

UNIFORM SINGLE-PARTY OR MULTIPLE-PARTY ACCOUNT SELECTION FORM

NOTICE: The type of account you select may determine how property passes on your death. Your will may not control the disposition of funds held in some of the following accounts.

Select one of the following accounts by placing your initials next to the account selected:

___ (1) SINGLE-PARTY ACCOUNT WITHOUT "P.O.D." (PAYABLE ON DEATH) DESIGNATION. The party to the account owns the account. On the death of the party, ownership of the account passes as a part of the party's estate under the party's will or by intestacy.

Enter the name of the party:

_____

___ (2) SINGLE-PARTY ACCOUNT WITH "P.O.D." (PAYABLE ON DEATH) DESIGNATION. The party to the account owns the account. On the death of the party, ownership of the account passes to the P.O.D. beneficiaries of the account. The account is not a part of the party's estate.

Enter the name of the party:

_____

Enter the name or names of the P.O.D. beneficiaries:

_____

_____

___ (3) MULTIPLE-PARTY ACCOUNT WITHOUT RIGHT OF SURVIVORSHIP. The parties to the account own the account in proportion to the parties' net contributions to the account. The financial institution may pay any sum in the account to a party at any time. On the death of a party, the party's ownership of the account passes as a part of the party's estate under the party's will or by intestacy.

Enter the names of the parties:

_____

_____

_____

___ (4) MULTIPLE-PARTY ACCOUNT WITH RIGHT OF SURVIVORSHIP. The parties to the account own the account in proportion to the parties' net contributions to the account. The financial institution may pay any sum in the account to a party at any time. On the death of a

party, the party's ownership of the account passes to the surviving parties.

Enter the names of the parties:

_____

_____

___ (5) MULTIPLE-PARTY ACCOUNT WITH RIGHT OF SURVIVORSHIP AND P.O.D. (PAYABLE ON DEATH) DESIGNATION. The parties to the account own the account in proportion to the parties' net contributions to the account. The financial institution may pay any sum in the account to a party at any time. On the death of the last surviving party, the ownership of the account passes to the P.O.D. beneficiaries.

Enter the names of the parties:

_____

_____

Enter the name or names of the P.O.D. beneficiaries:

_____

_____

___ (6) CONVENIENCE ACCOUNT. The parties [~~party~~] to the account own [~~owns~~] the account. One or more convenience signers [~~The cosigner~~] to the account may make account transactions for a [~~the~~] party. A convenience signer [~~The cosigner~~] does not own the account. On the death of the last surviving party, ownership of the account passes as a part of the last surviving party's estate under the last surviving party's will or by intestacy. The financial institution may pay funds in the account to a convenience signer [~~the cosigner~~] before the financial institution receives notice of the death of the last surviving party. The payment to a convenience signer [~~the cosigner~~] does not affect the parties' [~~party's~~] ownership of the account.

Enter the names [~~name~~] of the parties [~~party~~]:

_____

_____

Enter the names [~~name~~] of the convenience signers [~~cosigner~~]:

_____

_____

___ (7) TRUST ACCOUNT. The parties named as trustees to the account own the account in proportion to the parties' net contributions to the account. A trustee may withdraw funds from the account. A beneficiary may not withdraw funds from the account before all trustees are deceased.

On the death of the last surviving trustee, the ownership of the account passes to the beneficiary. The trust account is not a part of a trustee's estate and does not pass under the trustee's will or by intestacy, unless the trustee survives all of the beneficiaries and all other trustees.

Enter the name or names of the trustees:

_____

_____

Enter the name or names of the beneficiaries:

_____

_____ [HB 2238]

(c) A financial institution shall be deemed to have adequately disclosed the information provided in this section if the financial institution uses the form set forth in Subsection (b) of this section. If a financial institution varies the format of the form set forth in Subsection (b) of this section, then such financial institution may make disclosures in the account agreement or in any other form which adequately discloses the information provided in this section. [unchanged in 2003]

(d) A financial institution may combine any of the provisions and vary the format of the selections form and notices described in Subsection (b) of this section provided that the customer receives adequate disclosure of the ownership rights and there is appropriate indication of the names of the parties. This may be accomplished in a universal account form with options listed for selection and additional disclosures provided in the account agreement, or in any other manner which adequately discloses the information provided in this section. [unchanged in 2003]

Sec. 442. RIGHTS OF CREDITORS; PLEDGE OF ACCOUNT. No multiple-party account will be effective against an estate of a deceased party to transfer to a survivor sums needed to pay debts, taxes, and expenses of administration, including statutory allowances to the surviving spouse and minor children, if other assets of the estate are insufficient. No multiple-party account will be effective against the claim of a secured creditor who has a lien on the account. A party to a multiple-party account may pledge the account or otherwise create a security interest in the account without the joinder of, as appropriate, a P.O.D. payee, a beneficiary, a convenience signer, or any other party to a joint account, regardless of whether there is a right of survivorship. A convenience signer may not pledge or otherwise create a security interest in an account. Not later than the 30th day after the date on which a security interest on a multiple-party account is perfected, a secured creditor that is a financial institution the accounts of which are insured by the Federal Deposit Insurance Corporation shall provide written notice of the pledge of the account to any other party to the account who did not create the security interest. The notice must be sent by certified mail to any other party at the last address the party provided to the depository bank and is not required to be provided to a P.O.D. payee, a beneficiary, or a convenience signer. A party, P.O.D. payee, or beneficiary who receives payment from a multiple-party account after the death of a deceased party shall be liable to account to the deceased party's personal representative for amounts the decedent owned beneficially immediately before his death to the extent necessary to discharge the claims and

charges mentioned above remaining unpaid after application of the decedent's estate, but is not liable in an amount greater than the amount that the party, P.O.D. payee, or beneficiary received from the multiple-party account. No proceeding to assert this liability shall be commenced unless the personal representative has received a written demand by a surviving spouse, a creditor, or one acting for a minor child of the decedent, and no proceeding shall be commenced later than two years following the death of the decedent. Sums recovered by the personal representative shall be administered as part of the decedent's estate. This section shall not affect the right of a financial institution to make payment on multiple-party accounts according to the terms thereof, or make it liable to the estate of a deceased party unless before payment the institution received written notice from the personal representative stating the sums needed to pay debts, taxes, claims, and expenses of administration. [HB 1590]

Sec. 606. [~~DISTRICT COURT AND OTHER COURT OF RECORD~~] JURISDICTION WITH RESPECT TO GUARDIANSHIP PROCEEDINGS. [HB 1470]

(a) [repealed] [HB 1470]

(b) In those counties in which there is no statutory probate court, county court at law, or other statutory court exercising the jurisdiction of a probate court, all applications, petitions, and motions regarding guardianships, mental health matters, and other matters covered by this chapter shall be filed and heard in the county court. In [~~, except that in~~] contested guardianship matters, the judge of the county court may on the judge's own motion, or shall on the motion of any party to the proceeding, according to the motion:

(1) [~~;~~] request [~~as provided by Section 25.0022, Government Code,~~] the assignment of a statutory probate court judge to hear the contested portion of the proceeding, as provided by Section 25.0022, Government Code; or

(2) transfer the contested portion of the proceeding to the district court, which may hear the transferred contested matter [~~matters~~] as if originally filed in the district court. [HB 1470]

(b-1) If the judge of the county court has not transferred a contested guardianship matter to the district court at the time a party files a motion for assignment of a statutory probate court judge, the county judge shall grant the motion and may not transfer the matter to the district court unless the party withdraws the motion. [HB 1470]

(b-2) A statutory probate court judge assigned to a contested guardianship [~~probate~~] matter as provided by Subsection (b) of this section [~~subsection~~] has [~~for that matter~~] the jurisdiction and authority granted to a statutory probate court by Sections 607 and 608 of this code. On resolution of a contested matter, including an appeal of a matter, to which a statutory probate court judge has been assigned, the statutory probate court judge shall transfer the resolved portion of the case to the county court for further proceedings not inconsistent with the orders of the statutory probate court judge [~~The county court continues to exercise jurisdiction over the management of the guardianship with the exception of the contested matter until final disposition of the contested matter is made by the assigned judge or the district court~~]. [HB 1470]

(b-3) In contested matters transferred to the district court [~~as provided by this subsection~~], the district court[~~, concurrently with the county court,~~] has the general jurisdiction of a probate

court. On resolution of a [~~all pending~~] contested matter, including an appeal of a matter [~~matters~~], the district court shall transfer the resolved [~~contested~~] portion of the case [~~guardianship proceeding~~] to the county court for further proceedings not inconsistent with the orders of the district court. [HB 1470]

(b-4) The county court shall continue to exercise jurisdiction over the management of the guardianship with the exception of the contested matter until final disposition of the contested matter is made by the assigned judge or the district court. [HB 1470]

(b-5) If a contested portion of the proceeding is transferred to a district court under Subsection (b-3) of this section [~~subsection~~], the clerk of the district court may perform in relation to the transferred portion of the proceeding any function a county clerk may perform in that type of contested proceeding. [HB 1470]

(c) In those counties in which there is no statutory probate court, but in which there is a county court at law or other statutory court exercising the jurisdiction of a probate court, all applications, petitions, and motions regarding guardianships, mental health matters, or other matters addressed by this chapter shall be filed and heard in those courts and the constitutional county court, [~~rather than in the district courts,~~] unless otherwise provided by law. The judge of a county court may hear any of those matters sitting for the judge of any other county court. Except as provided by Section 608 of this code, in contested guardianship matters, the judge of the constitutional county court may on the judge's own motion, and shall on the motion of a party to the proceeding, transfer the proceeding to the county court at law or a statutory court exercising the jurisdiction of a probate court other than a statutory probate court. The court to which the proceeding is transferred may hear the proceeding as if originally filed in the court. [HB 1470]

(d) In those counties in which there is a statutory probate court, all applications, petitions, and motions regarding guardianships, mental health [~~illness~~] matters, or other matters addressed by this chapter shall be filed and heard in the statutory probate court[~~, unless otherwise provided by law~~]. [HB 1470]

(e) [~~A statutory probate court has concurrent jurisdiction with the district court in all actions by or against a person in the person's capacity as guardian.~~] A court that exercises original probate jurisdiction has the power to hear all matters incident to an estate. After a guardianship of the estate of a ward is required to be settled as provided by Section 745 of this chapter, the court exercising original probate jurisdiction over the settling of the former ward's estate has the jurisdiction to hear: (1) an action brought by or on behalf of the former ward against a former guardian of the ward for alleged misconduct arising from the performance of the person's duties as guardian; (2) an action against a former guardian of the former ward that is brought by a surety that is called on to perform in place of the former guardian; (3) a claim for the payment of compensation, expenses, and court costs and any other matter authorized under Subpart H, Part 2, of this chapter; (4) a matter related to an authorization made or duty performed by a guardian under Subpart C, Part 4, of this chapter; and (5) any other matter related or appertaining to a guardianship estate that a court exercising original probate jurisdiction is specifically authorized to hear under this chapter. [HB 1470]

(f) [~~A court that exercises original probate jurisdiction has the power to hear all matters incident to an estate.~~] When a surety is called on to perform in place of a guardian or former

guardian, a court exercising original probate jurisdiction, including jurisdiction exercised under Subsection (e)(2) of this section, may award judgment against the guardian or former guardian in favor of the surety of the guardian or former guardian in the same suit[~~, even if the ward has died, regained capacity, or the ward's disabilities of minority have been removed~~]. [HB 1470]

(g) A final order of a court that exercises original probate jurisdiction is appealable to a court of appeals. [unchanged in 2003]

(h) A statutory probate court has concurrent jurisdiction with the district court in all personal injury, survival, or wrongful death actions by or against a person in the person's capacity as a guardian and in all actions involving a guardian in which each other party aligned with the guardian is not an interested person in the guardianship. [HB 1470]

(i) A statutory probate court has jurisdiction over any matter appertaining to an estate or incident to an estate and has jurisdiction over any cause of action in which a guardian in a guardianship proceeding pending in the statutory probate court is a party. [HB 1470]

(j) A statutory probate court may exercise the pendent and ancillary jurisdiction necessary to promote judicial efficiency and economy. [HB 1470]

Sec. 607. MATTERS APPERTAINING AND INCIDENT TO AN ESTATE. (a) In a proceeding in a constitutional county court or a statutory county court at law, the phrases "appertaining to estates" and "incident to an estate" in this chapter include the appointment of guardians, the issuance of letters of guardianship, a claim by or against a guardianship estate, all actions for trial of title to land incident to a guardianship estate and for the enforcement of liens incident to a guardianship estate, all actions for trial of the right of property incident to a guardianship estate, and generally all matters relating to the settlement, partition, and distribution of a guardianship estate. [unchanged in 2003]

(b) In a proceeding in a statutory probate court [~~or district court~~], the phrases "appertaining to estates" and "incident to an estate" in this chapter include the appointment of guardians, the issuance of letters of guardianship, all claims by or against a guardianship estate, all actions for trial of title to land and for the enforcement of liens on the land, all actions for trial of the right of property, and generally all matters relating to the collection, settlement, partition, and distribution of a guardianship estate. A statutory probate court, in the exercise of its jurisdiction and notwithstanding any other provision of this chapter, may hear all suits, actions, and applications filed against or on behalf of any guardianship; all such suits, actions, and applications are appertaining to and incident to an estate. Except for situations [~~In a situation~~] in which the jurisdiction of a statutory probate court is concurrent with that of a district court or any other court, any[~~, a~~] cause of action appertaining to or incident to a guardianship estate shall be brought in a statutory probate court [~~rather than in the district court~~]. [HB 1470]

(c) [repealed] [HB 1470]

(d) [repealed] [HB 1470]

[Note the possible conflict in Section 607(e) between HB 1470 and HB 4]

(e) [repealed] [HB 1470]

(e) Notwithstanding any other provision of this chapter, the proper venue for an action by or against a personal representative for personal injury, death, or property damages is determined under Section 15.007, Civil Practice and Remedies Code. [HB 4]

Sec. 608. TRANSFER OF GUARDIANSHIP PROCEEDING. A judge of a statutory probate court, on the motion of a party to the action or of a person interested in a guardianship, may transfer to the judge's court from a district, county, or statutory court a cause of action appertaining to or incident to a guardianship estate that is pending in the statutory probate court or a cause of action relating to a guardianship in which a guardian, ward, or proposed ward in a guardianship [~~personal representative of an estate~~] pending in the statutory probate court is a party and may consolidate the transferred cause of action with the other proceedings in the statutory probate court relating to the guardianship estate. [HB 1470]

Sec. 633. NOTICE AND CITATION. (a) On the filing of an application for guardianship, notice shall be issued and served as provided by this section. [unchanged in 2003]

(b) The court clerk shall issue a citation stating that the application for guardianship was filed, the name of the proposed ward, the name of the applicant, and the name of the person to be appointed guardian as provided in the application, if that person is not the applicant. The citation must cite all persons interested in the welfare of the proposed ward to appear at the time and place stated in the notice if they wish to contest the application. The citation shall be posted. [unchanged in 2003]

(c) The sheriff or other officer shall personally serve citation to appear and answer the application for guardianship on:

(1) a proposed ward who is 12 years of age or older;

(2) the parents of a proposed ward if the whereabouts of the parents are known or can be reasonably ascertained;

(3) any court-appointed conservator or person having control of the care and welfare of the proposed ward;

(4) a proposed ward's spouse if the whereabouts of the spouse are known or can be reasonably ascertained; and

(5) the person named in the application to be appointed guardian, if that person is not the applicant. [unchanged in 2003]

(d) The [~~court clerk, at the applicant's request, or the~~] applicant shall mail a copy of the application for guardianship and a notice containing the information required in the citation issued under Subsection (b) of this section by registered or certified mail, return receipt requested, or by any other form of mail that provides proof of delivery, to the following persons, if their whereabouts are known or can be reasonably ascertained:

(1) all adult children of a proposed ward;

(2) all adult siblings of a proposed ward;

(3) the administrator of a nursing home facility or similar facility in which the proposed ward resides;

(4) the operator of a residential facility in which the proposed ward resides;

(5) a person whom the applicant knows to hold a power of attorney signed by the proposed ward;

(6) a person designated to serve as guardian of the proposed ward by a written declaration under Section 679 of this code, if the applicant knows of the existence of the declaration;

(7) a person designated to serve as guardian of the proposed ward in the probated will of the last surviving parent of the ward; [~~and~~]

(8) a person designated to serve as guardian of the proposed ward by a written declaration of the proposed ward's last surviving parent, if the declarant is deceased and the applicant knows of the existence of the declaration; and

(9) each person named as next of kin in the application for guardianship as required by Section 682(10) or (12) of this code. [HB 1470]

(d-1) The applicant shall file with the court:

(1) a copy of any notice required by Subsection (d) of this section and the proofs of delivery of the notice; and

(2) an affidavit sworn to by the applicant or the applicant's attorney stating:

(A) that the notice was mailed as required by Subsection (d) of this section; and

(B) the name of each person to whom the notice was mailed, if the person's name is not shown on the proof of delivery. [HB 1470]

(e) A person other than the proposed ward who is entitled to receive notice or personal service of citation under Subsections (c) and (d) of this section may choose, in person or by attorney ad litem, by writing filed with the clerk, to waive the receipt of notice or the issuance and personal service of citation. [unchanged in 2003]

(f) The court may not act on an application for the creation of a guardianship until the Monday following the expiration of the 10-day period beginning the date service of notice and citation has been made as provided by Subsections (b), (c), and (d)(1) of this section and the applicant has complied with Subsection (d-1) of this section. The validity of a guardianship created under this chapter is not affected by the failure of the [~~clerk or~~] applicant to comply with the requirements of Subsections (d)(2)-(9) [~~(d)(2)-(8)~~] of this section. [HB 1470]

(g) It is not necessary for a person who files an application for the creation of a guardianship under this chapter to be served with citation or waive the issuance and personal service of citation under this section. [unchanged in 2003]

Sec. 634. SERVICE ON ATTORNEY. (a) If an attorney has entered an appearance on record for a party in a guardianship proceeding, a citation or notice required to be served on the party shall be served on the attorney. Service on the attorney of record is in lieu of service on the party for whom the attorney appears. Except as provided by Section 633(e) [~~633(f)~~] of this code, an attorney ad litem may not waive personal service of citation.

(b) A notice served on an attorney under this section may be served by registered or certified mail, return receipt requested, by any other form of mail requiring proof of delivery, or by delivery to the attorney in person. A party to the proceeding or the party's attorney of record, an appropriate sheriff or constable, or another person who is competent to testify may serve notice or citation to an attorney under this section.

(c) A written statement by an attorney of record, the return of the officer, or the affidavit of a person that shows service is prima facie evidence of the fact of service. [HB 1470]

Sec. 645A. IMMUNITY. (a) A guardian ad litem appointed under Section 645, 683, or 694A of this code to represent the interests of an incapacitated person in a guardianship proceeding involving the creation, modification, or termination of a guardianship is not liable for civil damages arising from a recommendation made or an opinion given in the capacity of guardian ad litem.

(b) Subsection (a) of this section does not apply to a recommendation or opinion that is:

(1) wilfully wrongful;

(2) given with conscious indifference or reckless disregard to the safety of another;

(3) given in bad faith or with malice; or

(4) grossly negligent. [HB 1985]

Sec. 665B. COMPENSATION OF CERTAIN ATTORNEYS. (a) A court that creates a guardianship for a ward under this chapter, on request of a person who filed an application to be appointed guardian of the proposed ward or for the appointment of another suitable person as guardian of the proposed ward, may authorize compensation of an attorney who represents the person who filed the application at the application hearing, regardless of whether the person is appointed the ward's guardian, from:

(1) available funds of the ward's estate; or

(2) the county treasury if:

(A) the ward's estate is insufficient to pay for the services provided by the attorney; and

(B) funds in the county treasury are budgeted for that purpose. [HB 1470]

(b) The court may not authorize compensation under this section unless the court finds that the applicant acted in good faith and for just cause in the filing and prosecution of the application. [unchanged in 2003]

Sec. 682. APPLICATION; CONTENTS. Any person may commence a proceeding for the appointment of a guardian by filing a written application in a court having jurisdiction and venue. The application must be sworn to by the applicant and state:

(1) the name, sex, date of birth, and address of the proposed ward;

(2) the name, relationship, and address of the person the applicant desires to have appointed as guardian;

(3) whether guardianship of the person or estate, or both, is sought;

(4) the nature and degree of the alleged incapacity, the specific areas of protection and assistance requested, and the limitation of rights requested to be included in the court's order of appointment;

(5) the facts requiring that a guardian be appointed and the interest of the applicant in the appointment;

(6) the nature and description of any guardianship of any kind existing for the proposed ward in any other state;

(7) the name and address of any person or institution having the care and custody of the proposed ward;

(8) the approximate value and description of the proposed ward's property, including any compensation, pension, insurance, or allowance to which the proposed ward may be entitled;

(9) the name and address of any person whom the applicant knows to hold a power of attorney signed by the proposed ward and a description of the type of power of attorney;

(10) if the proposed ward is a minor and if known by the applicant:

(A) the name of each parent of the proposed ward and state the parent's address or that the parent is [~~, the names of the parents and next of kin of the proposed ward and whether either or both of the parents are~~] deceased;

(B) the name and age of each sibling, if any, of the proposed ward and state the sibling's address or that the sibling is deceased; and

(C) if each of the proposed ward's parents and siblings are deceased, the names and addresses of the proposed ward's next of kin who are adults;

(11) if the proposed ward is a minor, whether the minor was the subject of a legal or conservatorship proceeding within the preceding two-year period and, if so, the court involved, the nature of the proceeding, and the final disposition, if any, of the proceeding;

(12) if the proposed ward is an adult and if known by the applicant:

(A) the name [~~60 years of age or older, the names and addresses, to the best of the applicant's knowledge,~~] of the proposed ward's spouse, if any, and state the spouse's address or that the spouse is deceased;

(B) the name of each of the proposed ward's parents and state the parent's address or that the parent is deceased;

(C) the name and age of each of the proposed ward's siblings, if any, and state the sibling's address or that the sibling is deceased;

(D) the name and age of each of the proposed ward's children, if any, and state the child's address or that the child is deceased; and

(E) if the proposed ward's spouse and each of the proposed ward's parents, siblings, and children are deceased, or, if there is no spouse, parent, adult sibling, or adult child, the names and addresses of the proposed ward's next of kin who are adults;

(13) facts showing that the court has venue over the proceeding; and

(14) if applicable, that the person whom the applicant desires to have appointed as a guardian is a private professional guardian who has complied with the requirements of Section 697 of this code. [HB 1470]

Sec. 687. EXAMINATIONS AND REPORTS. (a) The court may not grant an application to create a guardianship for an incapacitated person, other than a minor, person whose alleged incapacity is mental retardation, or person for whom it is necessary to have a guardian appointed only to receive funds from a governmental source, unless the applicant presents to the court a written letter or certificate from a physician licensed in this state that is dated not earlier than the 120th day before the date of the filing of the application and based on an examination the physician performed not earlier than the 120th day before the date of the filing of the application. The letter or certificate must:

(1) describe the nature and degree of incapacity, including the medical history if reasonably available;

(2) provide a medical prognosis specifying the estimated severity of the incapacity;

(3) state how or in what manner the proposed ward's ability to make or communicate responsible decisions concerning himself or herself is affected by the person's physical or mental health;

(4) state whether any current medication affects the demeanor of the proposed ward or the proposed ward's ability to participate fully in a court proceeding;

(5) describe the precise physical and mental conditions underlying a diagnosis of senility, if applicable; and

(6) include any other information required by the court. [unchanged in 2003]

(b) Except as provided by Subsection (c) of this section, if the court determines it is necessary, the court may appoint the necessary physicians to examine the proposed ward. The court must make its determination with respect to the necessity for a physician's examination of the proposed ward at a hearing held for that purpose. Not later than the fourth day before the date of the hearing, the applicant shall give to the proposed ward and the proposed ward's attorney ad litem written notice specifying the purpose and the date and time of the hearing. A physician who examines the proposed ward, other than a physician or psychologist who examines the proposed ward under Subsection (c) of this section, shall make available to an attorney ad litem appointed to represent the proposed ward, for inspection, a written letter or certificate from the physician that complies with the requirements of Subsection (a) of this section. [unchanged in 2003]

(c) If the basis of the proposed ward's alleged incapacity is mental retardation, the proposed ward shall be examined by a physician or psychologist licensed in this state or certified by the Texas Department of Mental Health and Mental Retardation to perform the examination, unless there is written documentation filed with the court that shows that the proposed ward has been examined according to the rules adopted by the Texas Department of Mental Health and Mental Retardation not earlier than 24 [~~six~~] months before the date of a hearing to appoint a guardian for the proposed ward. The physician or psychologist shall conduct the examination according to the rules adopted by the Texas Department of Mental Health and Mental Retardation and shall submit written findings and recommendations to the court. [HB 1470]

Sec. 729. INVENTORY AND APPRAISEMENT. (a) Not later than the 30th [~~90th~~] day after the date the guardian of the estate qualifies as guardian, unless a longer time is granted by the court, the guardian of the estate shall file with the clerk of the court a verified, full, and detailed inventory, in one written instrument, of all the property of the ward that has come into the guardian's possession or knowledge. The inventory filed by the guardian under this section must include:

(1) all real property of the ward that is located in this state; and

(2) all personal property of the ward wherever located. [HB 1470]

(b) The guardian shall set out in the inventory the guardian's appraisement of the fair market value of each item of the property on the date of the grant of letters of guardianship. If the court appoints an appraiser of the estate, the guardian shall determine the fair market value of each item of the inventory with the assistance of the appraiser and shall set out in the inventory the appraisement made by the appraiser. [unchanged in 2003]

(c) An inventory made under this section must specify what portion of the property is separate property and what portion is community property. If any property is owned in common with other persons, the interest owned by the ward shall be shown in the inventory, together with the names and relationship, if known, of co-owners. [unchanged in 2003]

(d) The inventory, when approved by the court and duly filed with the clerk of court, is for purposes of this chapter the inventory and appraisement of the estate referred to in this chapter. [unchanged in 2003]

(e) The court for good cause shown may require the filing of the inventory and appraisement at a time not later than the 30th [~~90th~~] day after the date of qualification of the guardian. [HB 1470]

Sec. 743. REPORTS OF GUARDIANS OF THE PERSON. (a) The guardian of the person of a ward shall return to the court a sworn, written report showing each item of receipts and disbursements for the support and maintenance of the ward, the education of the ward when necessary, and support and maintenance of the ward's dependents, when authorized by order of court. [unchanged in 2003]

(b) The guardian of the person, whether or not there is a separate guardian of the estate, shall submit to the court an annual report by sworn affidavit that contains the following information:

(1) the guardian's current name, address, and phone number;

(2) the ward's current:

(A) name, address, and phone number; and

(B) age and date of birth;

(3) the type of home in which the ward resides, described as the ward's own; a nursing, guardian's, foster, or boarding home; a relative's home, and the ward's relationship to the relative; a hospital or medical facility; or other type of residence;

(4) the length of time the ward has resided in the present home and, if there has been a change in the ward's residence in the past year, the reason for the change;

(5) the date the guardian most recently saw the ward, and how frequently the guardian has seen the ward in the past year;

(6) a statement indicating whether or not the guardian has possession or control of the ward's estate;

(7) the following statements concerning the ward's health during the past year:

(A) whether the ward's mental health has improved, deteriorated, or remained unchanged, and a description if there has been a change; and

(B) whether the ward's physical health has improved, deteriorated, or remained unchanged, and a description if there has been a change;

(8) a statement concerning whether or not the ward has regular medical care, and the ward's treatment or evaluation by any of the following persons during the last year, including the name of that person, and the treatment involved:

(A) a physician;

(B) a psychiatrist, psychologist, or other mental health care provider;

(C) a dentist;

(D) a social or other caseworker; or

(E) another individual who provided treatment;

(9) a description of the ward's activities during the past year, including recreational, educational, social, and occupational activities, or if no activities are available or if the ward is unable or has refused to participate in them, a statement to that effect;

(10) the guardian's evaluation of the ward's living arrangements as excellent, average, or below average, including an explanation if the conditions are below average;

(11) the guardian's evaluation of whether the ward is content or unhappy with the ward's living arrangements;

(12) the guardian's evaluation of unmet needs of the ward;

(13) a statement of whether or not the guardian's power should be increased, decreased, or unaltered, including an explanation if a change is recommended;

(14) a statement that the guardian has paid the bond premium for the next

reporting period; and

(15) any additional information the guardian desires to share with the court regarding the ward, including whether the guardian has filed for emergency detention of the ward under Subchapter A, Chapter 573, Health and Safety Code, and if applicable, the number of times the guardian has filed and the dates of the applications. [HB 2679]

(c) If the ward is deceased, the guardian shall provide the court with the date and place of death, if known, in lieu of the information about the ward otherwise required to be provided in the annual report. [unchanged in 2003]

(d) Unless the judge is satisfied that the facts stated are true, he shall issue orders as are necessary for the best interests of the ward. [unchanged in 2003]

(e) If the judge is satisfied that the facts stated in the report are true, the court shall approve the report. [unchanged in 2003]

(f) The court on the court's own motion may waive the costs and fees related to the filing of a report approved under Subsection (e) of this section. [unchanged in 2003]

(g) Once each year for the duration of the guardianship, a guardian of the person shall file the report that contains the information required by Subsections (a) and (b) of this section. Except as provided by Subsection (h) of this section, the report must cover a 12-month reporting period that begins on the date the guardian qualifies to serve. [unchanged in 2003]

(h) The court may change a reporting period for purposes of this section but may not extend a reporting period so that it covers more than 12 months. [unchanged in 2003]

(i) Each report is due not later than the 60th day after the date on which the reporting period ends. [unchanged in 2003]

(j) A guardian of the person may complete and file the report required under this section without the assistance of an attorney. [unchanged in 2003]

Sec. 745. SETTLING GUARDIANSHIPS OF THE ESTATE. (a) A guardianship of the estate of a ward shall be settled when:

(1) a minor ward dies or becomes an adult by becoming 18 years of age, or by removal of disabilities of minority according to the law of this state, or by marriage;

(2) an incapacitated ward dies, or is decreed as provided by law to have been restored to full legal capacity;

(3) the spouse of a married ward has qualified as survivor in community and the ward owns no separate property;

(4) the estate of a ward becomes exhausted;

(5) the foreseeable income accruing to a ward or to his estate is so negligible that maintaining the guardianship in force would be burdensome;

(6) all of the assets of the estate have been placed in a management trust under Subpart N, Part 4, of this code and the court determines that a guardianship for the ward is no longer necessary; or

(7) the court determines for any other reason that a guardianship for the ward is no longer necessary. [unchanged in 2003]

(b) In a case arising under Subsection (a)(5) of this section, the court may authorize the income to be paid to a parent, or other person who has acted as guardian of the ward, to assist in the maintenance of the ward and without liability to account to the court for the income. [unchanged in 2003]

(c) When the estate of a minor ward consists only of cash or cash equivalents in an amount of $100,000 or less, the guardianship of the estate may be terminated and the assets paid to the county clerk of the county in which the guardianship proceeding is pending, and the clerk shall manage the funds as provided by Section 887 of this code. [HB 1470]

(d) In the settlement of a guardianship, the court may appoint an attorney ad litem to represent the interests of the ward, and may allow the attorney reasonable compensation for services provided by the attorney out of the ward's estate. [unchanged in 2003]

Sec. 747. TERMINATION OF GUARDIANSHIP OF THE PERSON. (a) When the guardianship of an incapacitated person is required to be settled as provided by Section 745 of this code, the guardian of the person shall deliver all property of the ward in the possession or control of the guardian to the emancipated ward or other person entitled to the property. If the ward is deceased, the guardian shall deliver the property to the personal representative of the deceased ward's estate or other person entitled to the property. [unchanged in 2003]

(b) If there is no property of the ward in the possession or control of the guardian of the person, the guardian shall, not later than the 60th day after the date on which the guardianship is

required to be settled, file with the court a sworn affidavit that states the reason the guardianship was terminated and to whom the property of the ward in the guardian's possession was delivered. The judge may issue orders as necessary for the best interests of the ward or of the estate of a deceased ward. This section does not discharge a guardian of the person from liability for breach of the guardian's fiduciary duties. [HB 1709]

Sec. 762. REINSTATEMENT AFTER REMOVAL. (a) Not later than the 10th day after the date the court signs the order of removal, a personal representative who is removed under Subsection (a)(6) or (7), Section 761, of this code may file an application with the court for a hearing to determine whether the personal representative should be reinstated. [unchanged in 2003]

(b) On the filing of an application for a hearing under this section, the court clerk shall issue a notice stating that the application for reinstatement was filed, the name of the ward [~~or decedent~~], and the name of the applicant. The clerk shall issue the notice to the applicant, the ward, a person interested in the welfare of the ward[~~, the decedent's estate,~~] or the ward's estate, and, if applicable, [~~to~~] a person who has control of the care and custody of the ward. The notice must cite all persons interested in the estate or welfare of the ward to appear at the time and place stated in the notice if they wish to contest the application. [HB 1470]

(c) If, at the conclusion of a hearing under this section, the court is satisfied by a preponderance of the evidence that the applicant did not engage in the conduct that directly led to the applicant's removal, the court shall set aside an order appointing a successor representative, if any, and shall enter an order reinstating the applicant as personal representative of the ward or estate. [unchanged in 2003]

(d) If the court sets aside the appointment of a successor representative under this section, the court may require the successor representative to prepare and file, under oath, an accounting of the estate and to detail the disposition the successor has made of the property of the estate. [unchanged in 2003]

Sec. 765. SUCCESSORS' RETURN OF INVENTORY, APPRAISEMENT, AND LIST OF CLAIMS. A successor guardian who has qualified to succeed a prior guardian shall make and return to the court an inventory, appraisement, and list of claims of the estate, not later than the 30th day [~~90 days~~] after the date the successor guardian qualifies as guardian [~~of qualification~~], in the same manner as is required of an original appointee. The successor guardian shall in like manner as is required of an original appointee return additional inventories, appraisements, and lists of claims. In all orders appointing a successor guardian, the court shall appoint an appraiser as in original appointments on the application of any person interested in the estate. [HB 1470]

[Note the possible conflict in Section 767 between HB 1470 and HB 2679]

Sec. 767. POWERS AND DUTIES OF GUARDIANS OF THE PERSON. The guardian of the person is entitled to the charge and control of the person of the ward, and the duties of the guardian correspond with the rights of the guardian. A guardian of the person has:

(1) the right to have physical possession of the ward and to establish the ward's legal domicile;

(2) the duty of care, control, and protection of the ward;

(3) the duty to provide the ward with clothing, food, medical care, and shelter; [~~and~~]

(4) the power to consent to medical, psychiatric, and surgical treatment other than the in-patient psychiatric commitment of the ward; and

(5) on application to and order of the court, the power to establish a trust in accordance with 42 U.S.C. Section 1396p(d)(4)(B), as amended, and direct that the income of the ward as defined by that section be paid directly to the trust, solely for the purpose of the ward's eligibility for medical assistance under Chapter 32, Human Resources Code. [HB 1470]

Sec. 767. POWERS AND DUTIES OF GUARDIANS OF THE PERSON. (a) The guardian of the person is entitled to the charge and control of the person of the ward, and the duties of the guardian correspond with the rights of the guardian. A guardian of the person has:

(1) the right to have physical possession of the ward and to establish the ward's legal domicile;

(2) the duty of care, control, and protection of the ward;

(3) the duty to provide the ward with clothing, food, medical care, and shelter; and

(4) the power to consent to medical, psychiatric, and surgical treatment other than the in-patient psychiatric commitment of the ward.

(b) Notwithstanding Subsection (a)(4) of this section, a guardian of the person of a ward has the power to transport the ward to an inpatient mental health facility for a preliminary examination in accordance with Subchapters A and C, Chapter 573, Health and Safety Code. [HB 2679]

Sec. 768. GENERAL POWERS AND DUTIES OF GUARDIAN OF THE ESTATE. The guardian of the estate of a ward is entitled to the possession and management of all property belonging to the ward, to collect all debts, rentals, or claims that are due to the ward, to enforce all obligations in favor of the ward, and to bring and defend suits by or against the ward; but, in the management of the estate, the guardian is governed by the provisions of this chapter. It is the duty of the guardian of the estate to take care of and manage the estate as a prudent person would manage the person's own property, except as otherwise provided by this chapter. The guardian of the estate shall account for all rents, profits, and revenues that the estate would have produced by such prudent management. [HB 1470]

Sec. 770. CARE OF WARD; COMMITMENT. (a) The guardian of an adult may expend funds of the guardianship as provided by court order to care for and maintain the incapacitated person. The guardian may apply for residential care and services provided by a public or private

facility on behalf of an incapacitated person who has decision-making ability if the person agrees to be placed in the facility. The guardian shall report the condition of the person to the court at regular intervals at least annually, unless the court orders more frequent reports. If the person is receiving residential care in a public or private residential care facility, the guardian shall include in any report to the court a statement as to the necessity for continued care in the facility. [unchanged in 2003]

(b) Except as provided by Subsection (c) or (d) of this section, a guardian may not voluntarily admit an incapacitated person to a public or private in-patient psychiatric facility or to a residential facility operated by the Texas Department of Mental Health and Mental Retardation for care and treatment. If care and treatment in a psychiatric or a residential facility are necessary, the person or the person's guardian may:

(1) apply for services under Section 593.027 or 593.028, Health and Safety Code;

(2)[~~, or~~] apply to a court to commit the person under Subtitle D, Title 7, Health and Safety Code (Persons with Mental Retardation Act), Subtitle C, Title 7, Health and Safety Code (Texas Mental Health Code), or Chapter 462, Health and Safety Code; or

(3) transport the ward to an inpatient mental health facility for a preliminary examination in accordance with Subchapters A and C, Chapter 573, Health and Safety Code. [HB 2679]

(c) A guardian of a person younger than 16 years of age may voluntarily admit an incapacitated person to a public or private inpatient psychiatric facility for care and treatment. [unchanged in 2003]

(d) A guardian of a person may voluntarily admit an incapacitated person to a residential care facility for emergency care or respite care under Section 593.027 or 593.028, Health and Safety Code. [unchanged in 2003]

Sec. 770A. ADMINISTRATION OF MEDICATION. (a) In this section, "psychoactive medication" has the meaning assigned by Section 574.101, Health and Safety Code.

(b) If a person under a protective custody order as provided by Subchapter B, Chapter 574, Health and Safety Code, is a ward who is not a minor, the guardian of the person of the ward may consent to the administration of psychoactive medication as prescribed by the ward's treating physician regardless of the ward's expressed preferences regarding treatment with psychoactive medication. [HB 2679]

Sec. 774. EXERCISE OF POWER WITH OR WITHOUT COURT ORDER. (a) On application, and if authorized by an order, the guardian of the estate may renew or extend any

obligation owed by or to the ward. On written application to the court and when a guardian of the estate deems it is in the best interest of the estate, the guardian may, if authorized by an order of the court:

(1) purchase or exchange property;

(2) take a claim or property for the use and benefit of the estate in payment of a debt due or owing to the estate;

(3) compound a bad or doubtful debt due or owing to the estate;

(4) make a compromise or a settlement in relation to property or a claim in dispute or litigation;

(5) compromise or pay in full any secured claim that has been allowed and approved as required by law against the estate by conveying to the holder of the secured claim the real estate or personalty securing the claim, in full payment, liquidation, and satisfaction of the claim, and in consideration of cancellation of a note, deed of trust, mortgage, chattel mortgage, or other evidence of a lien that secures the payment of the claim;

(6) abandon worthless or burdensome property and the administration of that property. Abandoned real or personal property may be foreclosed on by a secured party, trustee, or mortgagee without further order of the court; [~~and~~]

(7) purchase a prepaid funeral benefits contract; and

(8) establish a trust in accordance with 42 U.S.C. Section 1396p(d)(4)(B), as amended, and direct that the income of the ward as defined by that section be paid directly to the trust, solely for the purpose of the ward's eligibility for medical assistance under Chapter 32, Human Resources Code. [HB 1470]

(b) The guardian of the estate of a person, without application to or order of the court, may exercise the following powers provided, however, that a guardian may apply and obtain an order if doubtful of the propriety of the exercise of any such power:

(1) release a lien on payment at maturity of the debt secured by the lien;

(2) vote stocks by limited or general proxy;

(3) pay calls and assessments;

(4) insure the estate against liability in appropriate cases;

(5) insure property of the estate against fire, theft, and other hazards; and

(6) pay taxes, court costs, and bond premiums. [unchanged in 2003]

Sec. 776. AMOUNTS [~~SUMS~~] ALLOWABLE FOR EDUCATION AND MAINTENANCE OF WARD. (a) Subject to Section 777 of this code, if a monthly allowance for the ward was not ordered in the court's order appointing a guardian, the guardian of the estate shall file an application with the court requesting a monthly allowance to be expended from the income and corpus of the ward's estate [~~the court may direct the guardian of the person to expend,~~] for the education and maintenance of the [~~guardian's~~] ward and the maintenance of the ward's property. [HB 1470]

(a-1) The guardian must file the application requesting the monthly allowance not later than the 30th day after the date on which the guardian qualifies as guardian or the date specified by the court, whichever is later. The application must clearly separate amounts requested for education and maintenance of the ward from amounts requested for maintenance of the ward's property. [HB 1470]

(a-2) In determining the amount of the monthly allowance for the ward and the ward's property, the court shall consider the condition of the estate and the income and corpus of the estate necessary to pay the reasonably anticipated regular education and maintenance expenses of the ward and maintenance expenses of the ward's property. The court's order setting a monthly allowance must specify the types of expenditures the guardian may make on a monthly basis for the ward or the ward's property. An order setting a monthly allowance does not affect the guardian's duty to account for expenditures of the allowance in the annual account required by Section 741 of this code[~~, a sum in excess of the income of the ward's estate. Otherwise, the guardian may not be allowed, for the education and maintenance of the ward, more than the net income of the estate~~]. [HB 1470]

(a-3) When different persons have the guardianship of the person and estate of a ward, the guardian of the estate shall pay to the guardian of the person the monthly allowance [~~a sum that is~~] set by the court, at a time specified by the court, for the education and maintenance of the ward. If the guardian of the estate fails to pay to the guardian of the person the monthly allowance [~~sum~~] set by the court, the guardian of the estate shall be compelled to make the payment by court order after the guardian is duly cited to appear. [HB 1470]

(b) When a guardian has in good faith expended funds from the income and corpus of the estate of the ward [~~of the guardian~~] for support and maintenance of [~~for~~] the ward [~~under this section or Section 777 of this code,~~] and the expenditures exceed the monthly allowance authorized by the court, the guardian shall file a motion with the court requesting approval of the expenditures. The court may approve the excess expenditures if:

(1) the expenditures were made when it was [~~is~~] not convenient or possible for the guardian to first secure court approval;

(2) [~~, if~~] the proof is clear and convincing that the expenditures were reasonable and proper;

(3) [~~, and are expenditures that~~] the court would have granted authority in advance to make the expenditures; and

(4) [~~out of the corpus, and~~] the ward received the benefits of the expenditures[~~, the court may approve the expenditures in the same manner as if the expenditures were made by the guardian out of the income from the ward's estate. An expenditure under this subsection may not exceed $5,000 per ward during an annual accounting period, unless the expenditure is made to a nursing home in which case the court may ratify any amount~~]. [HB 1470]

Sec. 812. CERTAIN PERSONAL PROPERTY TO BE SOLD. (a) The guardian of an estate, after approval of inventory and appraisement, shall promptly apply for an order of the court to sell at public auction or privately, for cash or on credit not exceeding six months, all of the estate that is liable to perish, waste, or deteriorate in value or that will be an expense or disadvantage to the estate if kept. Property exempt from forced sale, a specific legacy, or personal property necessary to carry on a farm, ranch, factory, or any other business that it is thought best to operate, may not be included in a sale under this section. [unchanged in 2003]

(b) In determining whether to order the sale of an asset under Subsection (a) of this section, the court shall consider:

(1) the guardian's duty to take care of and manage the estate as a person of ordinary prudence, discretion, and intelligence would exercise in the management of the person's own affairs; and

(2) whether the asset constitutes an asset that a trustee is authorized to invest under Chapter 117 [~~Section 113.056~~] or Subchapter F, Chapter 113, Property Code. [HB 2240]

Sec. 814. SPECIAL PROVISIONS PERTAINING TO LIVESTOCK. (a) When the guardian of an estate has in the guardian's possession any livestock that the guardian deems necessary or to the advantage of the estate to sell, the guardian may, in addition to any other method provided by law for the sale of personal property, obtain authority from the court in which the estate is pending to sell the livestock through a bonded livestock commission merchant or a bonded livestock auction commission merchant.

(b) On written and sworn application by the guardian or by any person interested in the estate that describes the livestock sought to be sold and that sets out the reasons why it is deemed necessary or to the advantage of the estate that the application be granted, the court may authorize the sale. The court shall consider the application and may hear evidence for or against the application, with or without notice, as the facts warrant.

(c) If the application is granted, the court shall enter its order to that effect and shall authorize delivery of the livestock to any bonded livestock commission merchant or bonded livestock auction commission merchant for sale in the regular course of business. The commission merchant shall be paid the merchant's [~~his~~] usual and customary charges, not to

exceed five [~~three~~] percent of the sale price, for the sale of the livestock. A report of the sale, supported by a verified copy of the merchant's account of sale, shall be made promptly by the guardian to the court, but no order of confirmation by the court is required to pass title to the purchaser of the livestock. [HB 1470]

Sec. 854. GUARDIAN REQUIRED TO KEEP ESTATE INVESTED UNDER CERTAIN CIRCUMSTANCES. (a) The guardian of the estate is not required to invest funds that are immediately necessary for the education, support, and maintenance of the ward or others the ward supports, if any, as provided by this chapter. The guardian of the estate shall invest any other funds and assets available for investment unless the court orders otherwise under this subpart.

(b) The court may, on its own motion or on written request of a person interested in the guardianship, cite the guardian to appear and show cause why the estate is not invested or not properly invested. At any time after giving notice to all parties, the court may conduct a hearing to protect the estate, except that the court may not hold a final hearing on whether the estate is properly invested until the 31st day after the date the guardian was originally cited to appear under this subsection. On the hearing of the court's motion or a request made under this section, the court shall render an order the court considers to be in the best interests of the ward.

(c) The court may appoint a guardian ad litem for the limited purpose of representing the ward's best interests with respect to the investment of the ward's property at a hearing under this section. [HB 1470]

Sec. 855. STANDARD FOR MANAGEMENT AND INVESTMENTS [~~WITHOUT COURT ORDER~~]. (a) In acquiring, investing, reinvesting, exchanging, retaining, selling, supervising, and managing a ward's estate, a guardian of the estate shall exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, considering the probable income from as well as the probable increase in value and the safety of their capital. The guardian shall also consider all other relevant factors, including:

(1) the anticipated costs of supporting the ward;

(2) the ward's age, education, current income, ability to earn additional income, net worth, and liabilities;

(3) the nature of the ward's estate; and

(4) any other resources reasonably available to the ward [~~The guardian of the estate may retain, without regard to diversification of investments and without liability for any depreciation or loss resulting from the retention, any property received into a guardianship estate~~

~~at its inception or added to the estate by gift, devise, or inheritance or by mutation or increase. A guardian of the estate is not relieved from the duty to take care of and manage the estate as a person of ordinary prudence, discretion, and intelligence would exercise in the management of the person's own affairs~~]. [HB 1470]

(a-1) In determining whether a guardian has exercised the standard of investment required by this section with respect to an investment decision, the court shall, absent fraud or gross negligence, take into consideration the investment of all the assets of the estate over which the guardian has management or control, rather than taking into consideration the prudence of only a single investment made by the guardian. [HB 1470]

(b) A guardian of the estate is considered to have exercised the standard required by this section with respect to investing the ward's estate if the guardian invests in the following [~~If the guardian of the estate has on hand money that belongs to the ward that exceeds that amount of money that may be necessary for the education and maintenance of the ward, the guardian shall invest the money as follows~~]:

(1) [~~in~~] bonds or other obligations of the United States;

(2) [~~in~~] tax-supported bonds of this state;

(3) except as limited by Subsections (c) and (d) of this section, [~~in~~] tax-supported bonds of a county, district, political subdivision, or incorporated city or town in this state;

(4) [~~in~~] shares or share accounts of a state savings and loan association or savings bank with its main office or a branch office in this state if the payment of the shares or share accounts is insured by the Federal Deposit Insurance Corporation;

(5) [~~in~~] the shares or share accounts of a federal savings and loan association or savings bank with its main office or a branch office in this state if the payment of the shares or share accounts is insured by the Federal Deposit Insurance Corporation;

(6) [~~in~~] collateral bonds of companies incorporated under the laws of this state, having a paid-in capital of $1,000,000 or more, when the bonds are a direct obligation of the company that issues the bonds and are specifically secured by first mortgage real estate notes or other securities pledged with a trustee; or

(7) [~~in~~] interest-bearing time deposits that may be withdrawn on or before one year after demand in a bank that does business in this state where the payment of the time deposits is insured by the Federal Deposit Insurance Corporation. [HB 1470]

(c) The bonds of a county, district, or subdivision may be purchased only if the net funded debt of the county, district, or subdivision that issues the bonds does not exceed 10 percent of the assessed value of taxable property in the county, district, or subdivision. [unchanged in 2003]

(d) The bonds of a city or town may be purchased only if the net funded debt of the city or town does not exceed 10 percent of the assessed value of taxable property in the city or town less that part of the debt incurred for acquisition or improvement of revenue-producing utilities, the revenues of which are not pledged to support other obligations of the city or town. [unchanged in 2003]

(e) The limitations in Subsections (c) and (d) of this section do not apply to bonds issued for road purposes in this state under Section 52, Article III, of the Texas Constitution that are supported by a tax unlimited as to rate or amount. [unchanged in 2003]

(f) In this section, "net funded debt" means the total funded debt less sinking funds on hand. [unchanged in 2003]

(g) The court may modify or eliminate the guardian's duty to keep the estate invested or the standard required by this section with regard to investments of estate assets on a showing by clear and convincing evidence that the modification or elimination is in the best interests of the ward and the ward's estate. [HB 1470]

Sec. 855A. RETENTION OF ASSETS. (a) A guardian of the estate may retain without court approval until the first anniversary of the date of receipt any property received into the guardianship estate at its inception or added to the estate by gift, devise, inheritance, mutation, or increase, without regard to diversification of investments and without liability for any depreciation or loss resulting from the retention. The guardian shall care for and manage the retained assets as a person of ordinary prudence, discretion, and intelligence would in caring for and managing the person's own affairs.

(b) On application and a hearing, the court may render an order authorizing the guardian to continue retaining the property after the period prescribed by Subsection (a) of this section if the retention is an element of the guardian's investment plan as provided by this subpart. [HB 1470]

Sec. 855B. PROCEDURE FOR MAKING INVESTMENTS OR RETAINING ESTATE ASSETS. (a) Not later than the 180th day after the date on which the guardian of the estate qualified as guardian or another date specified by the court, the guardian shall file a written application with the court for an order:

(1) authorizing the guardian to:

(A) develop and implement an investment plan for estate assets;

(B) declare that one or more estate assets must be retained, despite being underproductive with respect to income or overall return; or

(C) loan estate funds, invest in real estate or make other investments, or purchase a life, term, or endowment insurance policy or an annuity contract; or

(2) modifying or eliminating the guardian's duty to invest the estate.

(b) On hearing the application under this section and on a finding by the preponderance of the evidence that the action requested in the application is in the best interests of the ward and the ward's estate, the court shall render an order granting the authority requested in the application or an order modifying or eliminating the guardian's duty to keep the estate invested. The order must state in reasonably specific terms:

(1) the nature of the investment, investment plan, or other action requested in the application and authorized by the court;

(2) when an investment must be reviewed and reconsidered by the guardian; and

(3) whether the guardian must report the guardian's review and recommendations to the court.

(c) The fact that an account or other asset is the subject of a specific or general gift under a ward's will, if any, or that a ward has funds, securities, or other property held with a right of survivorship does not prevent:

(1) a guardian of the estate from taking possession and control of the asset or closing the account; or

(2) the court from authorizing an action or modifying or eliminating a duty with respect to the possession, control, or investment of the account or other asset.

(d) The procedure prescribed by this section does not apply if a different procedure is prescribed for an investment or sale by a guardian. A guardian is not required to follow the procedure prescribed by this section with respect to an investment or sale that is specifically authorized by other law. [HB 1470]

[Note the possible conflict in Section 856 between HB 1470 and HB 2240]

Sec. 856. [repealed] [HB 1470]

Sec. 856. OTHER INVESTMENTS. (a) If a guardian of an estate deems it is in the best interests of the ward the guardian is appointed to represent to invest on behalf of the ward in the Texas tomorrow constitutional trust fund [~~Tomorrow Fund~~] established by Subchapter F, Chapter 54, Education Code, or to invest in or sell any property or security in which a trustee is authorized to invest by either Chapter 117 [~~Section 113.056~~] or Subchapter F, Chapter 113, of the Texas Trust Code (Subtitle B, Title 9, Property Code), and the investment or sale is not expressly permitted by other sections of this chapter, the guardian may file a written application in the court in which the guardianship is pending that asks for an order authorizing the guardian to make the desired investment or sale and states the reason why the guardian is of the opinion that the investment or sale would be beneficial to the ward. A citation or notice is not necessary under this subsection unless ordered by the court. [HB 2240]

Sec. 857. INVESTMENT IN, OR CONTINUED INVESTMENT IN, LIFE INSURANCE OR ANNUITIES. (a) In this section, "life insurance company" means a stock or mutual legal reserve life insurance company that maintains the full legal reserves required under the laws of this state and that is licensed by the State Board of Insurance to transact the business of life insurance in this state. [HB 1470]

(b) The guardian of the estate may invest in life, term, or endowment insurance policies, or in annuity contracts, or both, issued by a life insurance company or administered by the Veterans Administration, subject to conditions and limitations in this section. [unchanged in 2003]

(c) The guardian shall first apply to the court for an order that authorizes the guardian to make the investment. The application filed under this subsection must include a report that shows:

(1) in detail the financial condition of the estate at the time the application is made;

(2) the name and address of the life insurance company from which the policy or annuity contract is to be purchased and that the company is licensed by the State Board of Insurance to transact that business in this state on the date the application is filed, or that the policy or contract is administered by the Veterans Administration;

(3) a statement of the face amount and plan of the policy of insurance sought to be purchased and of the amount, frequency, and duration of the annuity payments to be provided by the annuity contract sought to be purchased;

(4) a statement of the amount, frequency, and duration of the premiums required by the policy or annuity contract; and

(5) a statement of the cash value of the policy or annuity contract at its anniversary nearest the 21st birthday of the ward, assuming that all premiums to the anniversary are paid and that there is no indebtedness against the policy or contract incurred in accordance with its terms. [unchanged in 2003]

(d) An insurance policy must be issued on the life of the ward, or the father, mother, spouse, child, brother, sister, grandfather, or grandmother of the ward or a person in whose life the ward may have an insurable interest. [unchanged in 2003]

(e) Only the ward, the ward's estate, or the father, mother, spouse, child, brother, sister, grandfather, or grandmother of the ward may be a beneficiary of the insurance policy and of the death benefit of the annuity contract, and the ward must be the annuitant in the annuity contract. [unchanged in 2003]

(f) The control of the policy or the annuity contract and of the incidents of ownership in the policy or annuity contract is vested in the guardian during the life and disability of the ward. [unchanged in 2003]

(g) The policy or annuity contract may not be amended or changed during the life and disability of the ward except on application to and order of the court. [unchanged in 2003]

(h) If a life, term, or endowment insurance policy or a contract of annuity is owned by the ward when a proceeding for the appointment of a guardian is begun, and it is made to appear that the company issuing the policy or contract of annuity is a life insurance company as defined by this section or the policy or contract is administered by the Veterans Administration, the policy or contract may be continued in full force and effect. All future premiums may be paid out of surplus funds of the ward's estate. The guardian shall apply to the court for an order to continue the policy or contract, or both, according to the existing terms of the policy or contract or to modify the policy or contract to fit any new developments affecting the welfare of the ward. Before any application filed under this subsection is granted, the guardian shall file a report in the court that shows in detail the financial condition of the ward's estate at the time the application is filed. [unchanged in 2003]

(i) The court, if satisfied by the application and the evidence adduced at the hearing that it is in the interests of the ward to grant the application, shall enter an order granting the application. [unchanged in 2003]

(j) A right, benefit, or interest that accrues under an insurance or annuity contract that

comes under the provisions of this section shall become the exclusive property of the ward when the ward's disability is terminated. [unchanged in 2003]

Sec. 858. LOANS AND SECURITY FOR LOANS. (a) If, at any time, the guardian of the estate has on hand money belonging to the ward in an amount that provides a return that is more than is [~~beyond what may be~~] necessary for the education, support, and maintenance of the ward and others the ward supports, if applicable, the guardian may lend the money for a reasonable [~~the highest~~] rate of interest [~~that can be obtained for the money~~]. The guardian shall take the note of the borrower for the money that is loaned, secured by a mortgage with a power of sale on unencumbered real estate located in this state worth at least twice the amount of the note, or by collateral notes secured by vendor's lien notes, as collateral, or the guardian may purchase vendor's lien notes if at least one-half has been paid in cash or its equivalent on the land for which the notes were given.

(b) A guardian of the estate is considered to have obtained a reasonable rate of interest for a loan for purposes of Subsection (a) of this section if the rate of interest is at least equal to 120 percent of the applicable short-term, midterm, or long-term interest rate under Section 7520, Internal Revenue Code of 1986, as amended, for the month during which the loan was made.

(c) Except as provided by this subsection, a guardian of the estate who loans estate money with the court's approval on security approved by the court is not personally liable if the borrower is unable to repay the money and the security fails. If the guardian committed fraud or was negligent in making or managing the loan, including in collecting on the loan, the guardian and the guardian's surety are liable for the loss sustained by the guardianship estate as a result of the fraud or negligence.

(d) Except as provided by Subsection (e) of this section, a guardian of the estate who lends estate money may not pay or transfer any money to consummate the loan until the guardian:

(1) submits to an attorney for examination all bonds, notes, mortgages, abstracts, and other documents relating to the loan; and

(2) receives a written opinion from the attorney stating that the documents under Subdivision (1) of this subsection are regular and that the title to relevant bonds, notes, or real estate is clear.

(e) A guardian of the estate may obtain a mortgagee's title insurance policy on any real estate loan in lieu of an abstract and attorney's opinion under Subsection (d) of this section.

(f) The borrower shall pay attorney's fees for any legal services required by this section.

(g) Not later than the 30th day after the date the guardian of the estate loans money from the estate, the guardian shall file with the court a written report, accompanied by an affidavit, stating fully the facts related to the loan. This subsection does not apply to a loan made in accordance with a court order.

(h) This section does not apply to an investment in a debenture, bond, or other publicly traded debt security. [HB 1470]

Sec. 859 [repealed] [HB 1470]

Sec. 860. GUARDIAN'S INVESTMENTS IN REAL ESTATE. (a) The [~~When the~~] guardian of the estate may invest estate assets in real estate if:

(1) the guardian believes that the investment is in the best interests of the ward;

(2) there are on hand sufficient additional assets to provide a return sufficient to provide for:

(A) the education, support, and maintenance of the ward and others the ward supports, if applicable; and

(B) the maintenance, insurance, and taxes on the real estate in which the guardian wishes to invest;

(3) the guardian files [~~of a ward thinks it is best for the ward who has a surplus of money on hand to invest the money in real estate, the guardian shall file~~] a written application with [~~in~~] the court [~~in which the guardianship is pending~~] requesting a court order authorizing the guardian to make the desired investment and stating the reasons why the guardian is of the opinion that the investment would be for the benefit of the ward; and

(4) the court renders an order authorizing the investment as provided by this section [HB 1470]

(b) When an application is filed by the guardian under this section, the judge's attention shall be called to the application, and the judge shall make investigation as necessary to obtain all the facts concerning the investment. The judge may not render an opinion or make an order on the application until 10 days from the date of the filing of the application have expired. On the hearing of the application, if the court is satisfied that the investment benefits the ward, the court shall issue an order that authorizes the guardian to make the investment. The order shall specify the investment to be made and contain other directions the court thinks are advisable. [unchanged in 2003]

(c) When a contract is made for the investment of money in real estate under court order,

the guardian shall report the contract in writing to the courts. The court shall inquire fully into the contract. If satisfied that the investment will benefit the estate of the ward and that the title of the real estate is valid and unencumbered, the court may approve the contract and authorize the guardian to pay over the money in performance of the contract. The guardian may not pay any money on the contract until the contract is approved by court order to that effect. [unchanged in 2003]

(d) When the money of the ward has been invested in real estate, the title to the real estate shall be made to the ward. The guardian shall inventory, appraise, manage, and account for the real estate as other real estate of the ward. [unchanged in 2003]

Sec. 863. LIABILITY OF GUARDIAN AND GUARDIAN'S SURETY [~~FOR FAILURE TO LEND OR INVEST FUNDS~~]. (a) In addition to any other remedy authorized by law, if [~~If~~] the guardian of the estate fails [~~neglects~~] to invest or lend estate assets in the manner provided by this subpart, the guardian and the guardian's surety are [~~surplus money on hand at interest when the guardian can do so by using reasonable diligence, the guardian shall be~~] liable for the principal and the greater of:

(1) [~~for~~] the highest legal rate of interest on the principal during the period the guardian failed to invest or lend the assets; or

(2) the overall return that would have been made on the principal if the principal were invested in the manner provided by this subpart.

(b) In addition to the liability under Subsection (a) of this section, the guardian and the guardian's surety are liable for attorney's fees, litigation expenses, and costs related to a proceeding brought to enforce this section [~~for the time the guardian neglects to invest or lend the surplus money. The amount of principal and interest on the principal may be recovered in a court of competent jurisdiction~~]. [HB 1470]

Sec. 864. [repealed] [HB 1470]

Sec. 868. TERMS OF MANAGEMENT TRUST. (a) Except as provided by Subsection (d) of this section, a trust created under Section 867 of this code must provide that:

(1) the ward is the sole beneficiary of the trust;

(2) the trustee may disburse an amount of the trust's principal or income as the trustee determines is necessary to expend for the health, education, support, or maintenance of the ward;

(3) the income of the trust that the trustee does not disburse under Subdivision (2) of this subsection must be added to the principal of the trust;

(4) if the trustee is a corporate fiduciary, the trustee serves without giving a bond; and

(5) the trustee, on annual application to the court and subject to the court's approval, is entitled to receive reasonable compensation for services that the trustee provided to the ward as the ward's trustee that is:

(A) to be paid from the trust's income, principal, or both; and

(B) determined in the same manner as compensation of a guardian of an estate under Section 665 of this code. [unchanged in 2003]

(b) The trust may provide that a trustee make a distribution, payment, use, or application of trust funds for the health, education, support, or maintenance of the ward or of another person whom the ward is legally obligated to support, as necessary and without the intervention of a guardian or other representative of the ward, to:

(1) the ward's guardian;

(2) a person who has physical custody of the ward or another person whom the ward is legally obligated to support; or

(3) a person providing a good or service to the ward or another person whom the ward is legally obligated to support. [unchanged in 2003]

(c) A provision in a trust created under Section 867 that relieves a trustee from a duty, responsibility, or liability imposed by this subpart or Subtitle B, Title 9, Property Code, is enforceable only if:

(1) the provision is limited to specific facts and circumstances unique to the property of that trust and is not applicable generally to the trust; and

(2) the court creating or modifying the trust makes a specific finding that there is clear and convincing evidence that the inclusion of the provision is in the best interests of the beneficiary of the trust. [HB 3503]

(d) When creating or modifying a trust, the court may omit or modify terms required by Subsection (a)(1) or (2) of this section only if the court determines that the omission or modification:

(1) is necessary and appropriate for the ward to be eligible to receive public benefits or assistance under a state or federal program that is not otherwise available to the ward; and

(2) is in the ward's best interests. [unchanged in 2003]

(e) The court may include additional provisions in a trust created or modified under this section if the court determines an addition does not conflict with Subsection (a) and, if appropriate, Subsection (d) of this section. [unchanged in 2003]

(f) If the trustee determines that it is in the best interest of the ward, the trustee may invest funds of the trust in the Texas tomorrow fund established by Subchapter F, Chapter 54, Education Code. [unchanged in 2003]

Sec. 868A. DISCHARGE OF GUARDIAN OF ESTATE AND CONTINUATION OF TRUST. On or at any time after the creation of a trust under this subpart, the court may discharge the guardian of the ward's estate [~~only~~] if [~~a guardian of the ward's person remains and~~] the court determines that the discharge is in the ward's best interests. [HB 1470]

Sec. 875. TEMPORARY GUARDIAN——PROCEDURE. (a) If a court is presented with substantial evidence that a person may be a minor or other incapacitated person, and the court has probable cause to believe that the person or person's estate, or both, requires the immediate appointment of a guardian, the court shall appoint a temporary guardian with limited powers as the circumstances of the case require. [unchanged in 2003]

(b) [~~A person for whom a temporary guardian has been appointed may not be presumed to be incapacitated.~~] The person retains all rights and powers that are not specifically granted to the person's temporary guardian by court order. [HB 2189]

(c) A sworn, written application for the appointment of a temporary guardian shall [~~may~~] be filed before the court appoints a temporary guardian. [~~The application must be filed not later than the end of the next business day of the court after the date of appointment of the temporary guardian.~~] The application must state:

(1) the name and address of the person who is the subject of the guardianship proceeding;

(2) the danger to the person or property alleged to be imminent;

(3) the type of appointment and the particular protection and assistance being requested;

(4) the facts and reasons supporting the allegations and requests;

(5) the name, address, and qualification of the proposed temporary guardian;

(6) the name, address, and interest of the applicant; and

(7) if applicable, that the proposed temporary guardian is a private professional guardian who has complied with the requirements of Section 697 of this code. [HB 2189]

(d) On [~~At the earliest of~~] the filing of an application for temporary guardianship [~~or the appointment of a temporary guardian~~], the court shall appoint an attorney to represent the proposed ward in all guardianship proceedings in which independent counsel has not been retained by or on behalf of the proposed ward. [HB 2189]

(e) On the filing of an application for temporary guardianship, the clerk shall issue notice that shall be served on the respondent, the respondent's appointed attorney, and the proposed temporary guardian named in the application, if that person is not the applicant. The notice must describe the rights of the parties and the date, time, place, purpose, and possible consequences of a hearing on the application. A copy of the application [~~and, if applicable, a copy of the order appointing the temporary guardian~~] must be attached to the notice. [HB 2189]

(f) (1) A hearing shall be held not later than the 10th day after the date of the filing of the application for temporary guardianship unless the hearing date is postponed [~~extended~~] as provided by Subdivision (2) of this subsection. At a hearing under this section, the respondent has the right to:

(A) receive prior notice;

(B) have representation by counsel;

(C) be present;

(D) present evidence and confront and cross-examine witnesses; and

(E) a closed hearing if requested by the respondent or the respondent's attorney.

(2) The [~~Every temporary guardianship granted before a hearing on the application required by Subdivision (1) of this subsection expires on its own terms at the conclusion of the~~

~~hearing unless the~~] respondent or the respondent's attorney may consent to postpone the hearing on the application for temporary guardianship for a period [~~consents that the order appointing the temporary guardian may be extended for a longer period~~] not to exceed 30 [~~60~~] days after the date of the filing of the application [~~for temporary guardianship~~].

(3) Every application for temporary guardianship [~~granted before a hearing on the application required by Subdivision (1) of this subsection shall be set for hearing at the earliest possible date and~~] takes precedence over all matters except older matters of the same character.

(4) Immediately after an application for [~~Every~~] temporary guardianship is filed, the court shall issue [~~granted before a hearing on the application required by Subdivision (1) of this subsection must include~~] an order that sets a certain date for hearing on the application for temporary guardianship.

(5) On one day's notice to the party who filed the application for [~~obtained a~~] temporary guardianship [~~before a hearing on the application required by Subdivision (1) of this subsection~~], the respondent or the respondent's attorney may appear and move for the dismissal [~~dissolution or modification~~] of the application for temporary guardianship. If a motion is made for dismissal [~~dissolution or modification~~] of the application for temporary guardianship, the court shall hear and determine the motion as expeditiously as the ends of justice require.

(6) If the applicant is not the proposed temporary guardian, a temporary guardianship may not be granted before a hearing on the application required by Subdivision (1) of this subsection unless the proposed temporary guardian appears in court. [HB 2189]

(g) If at the conclusion of the hearing required by Subsection (f)(1) of this section the court determines that the applicant has established that there is substantial evidence that the person is a minor or other incapacitated person, that there is imminent danger that the physical health or safety of the respondent will be seriously impaired, or that the respondent's estate will be seriously damaged or dissipated unless immediate action is taken, the court shall appoint a temporary guardian by written order. The court shall assign to the temporary guardian only those powers and duties that are necessary to protect the respondent against the imminent danger shown. The court shall set bond according to Subpart B, Part 3, of this chapter. The reasons for the temporary guardianship and the powers and duties of the temporary guardian must be described in the order of appointment. [HB 2189]

(h) Except as provided by Subsection (k) of this section, a temporary guardianship may not remain in effect for more than 60 days. [unchanged in 2003]

(i) If the court appoints a temporary guardian after the hearing required by Subsection (f)(1) of this section, all court costs, including attorney's fees, may be assessed as provided in Section 665A, 665B, or 669 of this code. [unchanged in 2003]

(j) The court may not customarily or ordinarily appoint the Department of Protective and Regulatory Services as a temporary guardian under this section. The appointment of the department as a temporary guardian under this section should be made only as a last resort. [unchanged in 2003]

(k) If an application for a temporary guardianship, for the conversion of a temporary guardianship to a permanent guardianship, or for a permanent guardianship is challenged or contested, the court, on the court's own motion or on the motion of any interested party, may appoint a new temporary guardian or grant a temporary restraining order under Rule 680, Texas Rules of Civil Procedure, or both, without issuing additional citation if the court finds that the appointment or the issuance of the order is necessary to protect the proposed ward or the proposed ward's estate. [HB 2189]

(l) A temporary guardian appointed under Subsection (k) of this section [~~this subsection~~] must qualify in the same form and manner required of a guardian under this code. The term of the temporary guardian expires at the conclusion of the hearing challenging or contesting the application or on the date a permanent guardian the court appoints for the proposed ward qualifies to serve as the ward's guardian. [HB 2189]

Sec. 883. INCAPACITATED SPOUSE. (a) Except as provided by Subsection (c) of this section, when a husband or wife is judicially declared to be incapacitated:

(1) the other spouse, in the capacity of surviving partner of the marital partnership, acquires full power to manage, control, and dispose of the entire community estate as community administrator, including the part of the community estate that the incapacitated spouse legally has the power to manage in the absence of the incapacity, without an administration; and

(2) if the incapacitated spouse owns separate property, the court shall appoint the other spouse or another person or entity, in the order of precedence established under Section 677 of this code, as guardian of the estate to administer only the separate property of the incapacitated spouse. [unchanged in 2003]

(b) The spouse who is not incapacitated is presumed to be suitable and qualified to serve as community administrator. The qualification of a guardian of the estate of the separate property of an incapacitated spouse as required under Subsection (a) of this section does not deprive the competent spouse of the right to manage, control, and dispose of the entire community estate as provided in this chapter. [unchanged in 2003]

(c) If a spouse who is not incapacitated is removed as community administrator or if the court finds that the spouse who is not incapacitated would be disqualified to serve as guardian under Section 681 of this code or is not suitable to serve as community administrator for any other reason, the court:

(1) shall appoint a guardian of the estate for the incapacitated spouse if the court:

(A) has not appointed a guardian of the estate under Subsection (a)(2) of this section; or

(B) has appointed the spouse who is not incapacitated as guardian of the estate under Subsection (a)(2) of this section;

(2) after taking into consideration the financial circumstances of the spouses and any other relevant factors, may order the spouse who is not incapacitated to deliver to the guardian of the estate of the incapacitated spouse a portion, not to exceed one-half, of the community property that is subject to the spouses' joint management, control, and disposition under Section 3.102, Family Code; and

(3) shall authorize the guardian of the estate of the incapacitated spouse to administer:

(A) any separate property of the incapacitated spouse;

(B) any community property that is subject to the incapacitated spouse's sole management, control, and disposition under Section 3.102, Family Code;

(C) any community property delivered to the guardian of the estate under Subdivision (2) of this subsection; and

(D) any income earned on property described in this subsection. [unchanged in 2003]

(d) On a person's removal as community administrator or on qualification of a guardian of the estate of the person's incapacitated spouse under Subsection (c) of this section, as appropriate, a spouse who is not incapacitated shall continue to administer:

(1) the person's own separate property;

(2) any community property that is subject to the person's sole management, control, and disposition under Section 3.102, Family Code;

(3) any community property subject to the spouses' joint management, control,

and disposition under Section 3.102, Family Code, unless the person is required to deliver a portion of that community property to the guardian of the estate of the person's incapacitated spouse under Subsection (c)(2) of this section, in which event, the person shall continue to administer only the portion of the community property remaining after delivery; and

(4) any income earned on property described in this subsection the person is authorized to administer. [unchanged in 2003]

(e) The duties and obligations between spouses, including the duty to support the other spouse, and the rights of any creditor of either spouse are not affected by the manner in which community property is administered under this section. [unchanged in 2003]

(f) This section does not partition community property between an incapacitated spouse and a spouse who is not incapacitated. [HB 1470]

(g) If the court renders an order directing the guardian of the estate of the incapacitated spouse to administer certain community property as provided by Subsection (c) of this section, the community property administered by the guardian is considered the incapacitated spouse's community property, subject to the incapacitated spouse's sole management, control, and disposition under Section 3.102, Family Code. If the court renders an order directing the spouse who is not incapacitated to administer certain community property as provided by Subsection (d) of this section, the community property administered by the spouse who is not incapacitated is considered that spouse's community property, subject to that spouse's sole management, control, and disposition under Section 3.102, Family Code. [HB 1470]

(h) An order described by Subsection (g) of this section does not affect the enforceability of a creditor's claim existing on the date the court renders the order. [HB 1470]

THE UNIFORM PRUDENT INVESTOR ACT OF TEXAS

As Enacted by the 78th Texas Legislature (2003)

Effective January 1, 2004

With the Official Comments of

The National Conference of Commissioners on Uniform State Laws

and

The Real Estate, Probate and Trust Law Section
of the State Bar of Texas

June 2003

Table of Contents

INTRODUCTION

The 78th Texas Legislature enacted a Texas version of the Uniform Prudent Investor Act of 1994. HB 2240 becomes effective January 1, 2004. This legislation was part of the 2003 legislative package of the Real Estate, Probate and Trust Law Section of the State Bar of Texas. The Section studied three uniform acts promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL) – the Uniform Prudent Investor Act of 1994, the Uniform Principal and Income Act of 1997 and the Uniform Trust Code of 2000 – for more than two years. The Section urged the adoption of Texas versions of two of those acts – Prudent Investor and Principal and Income – in 2003, and both were enacted into law.

Following are the provisions of the Uniform Prudent Investor Act of 1994 (the "Act") as enacted in Texas, the official NCCUSL notes and comments to the Act and each section of the Act (identified as "Uniform Act Notes" or "Uniform Act Comments") and the official comments of the Real Estate, Probate and Trust Law Section of the State Bar of Texas (the "Section") on the Texas variations of the Act (identified as "Texas Bar Comments").

UNIFORM ACT PREFATORY NOTE

Over the quarter century from the late 1960's the investment practices of fiduciaries experienced significant change. The Uniform Prudent Investor Act (UPIA) undertakes to update trust investment law in recognition of the alterations that have occurred in investment practice. These changes have occurred under the influence of a large and broadly accepted body of empirical and theoretical knowledge about the behavior of capital markets, often described as "modern portfolio theory."

This Act draws upon the revised standards for prudent trust investment promulgated by the American Law Institute in its Restatement (Third) of Trusts: Prudent Investor Rule (1992) [hereinafter Restatement of Trusts 3d: Prudent Investor Rule; also referred to as 1992 Restatement].

Objectives of the Act. UPIA makes five fundamental alterations in the former criteria for prudent investing. All are to be found in the Restatement of Trusts 3d: Prudent Investor Rule.

(1) The standard of prudence is applied to any investment as part of the total portfolio, rather than to individual investments. In the trust setting the term "portfolio" embraces all the trust's assets. UPIA § 2(b) [Texas Trust Code § 117.004(b)].

(2) The tradeoff in all investing between risk and return is identified as the fiduciary's central consideration. UPIA § 2(b) [Texas Trust Code § 117.004(b)].

(3) All categoric restrictions on types of investments have been abrogated; the trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the trust and that meets the other requirements of prudent investing. UPIA § 2(e) [Texas Trust Code § 117.004(e)].

(4) The long familiar requirement that fiduciaries diversify their investments has been integrated into the definition of prudent investing. UPIA § 3 [Texas Trust Code § 117.005].

(5) The much criticized former rule of trust law forbidding the trustee to delegate investment and management functions has been reversed. Delegation is now permitted, subject to safeguards. UPIA § 9 [Texas Trust Code § 117.011].

Literature. These changes in trust investment law have been presaged in an extensive body of practical and scholarly writing. See especially the discussion and reporter's notes by Edward C. Halbach, Jr., in Restatement of Trusts 3d: Prudent Investor Rule (1992); see also Edward C. Halbach, Jr., Trust Investment Law in the Third Restatement, 27 Real Property, Probate & Trust J. 407 (1992); Bevis Longstreth, Modern Investment Management and the Prudent Man Rule (1986); Jeffrey N. Gordon, The Puzzling Persistence of the Constrained Prudent Man Rule, 62 N.Y.U.L. Rev. 52 (1987); John H. Langbein & Richard A. Posner, The Revolution in Trust Investment Law, 62 A.B.A.J. 887 (1976); Note, The Regulation of Risky Investments, 83 Harvard L. Rev. 603 (1970). A succinct account of the main findings of modern portfolio theory, written for lawyers, is Jonathan R. Macey, An Introduction to Modern Financial Theory (1991) (American College of Trust & Estate Counsel Foundation). A leading introductory text on modern portfolio theory is R.A. Brealey, An Introduction to Risk and Return from

Common Stocks (2d ed. 1983).

Legislation. Most states have legislation governing trust-investment law. This Act promotes uniformity of state law on the basis of the new consensus reflected in the Restatement of Trusts 3d: Prudent Investor Rule. Some states have already acted. California, Delaware, Georgia, Minnesota, Tennessee, and Washington revised their prudent investor legislation to emphasize the total-portfolio standard of care in advance of the 1992 Restatement. These statutes are extracted and discussed in Restatement of Trusts 3d: Prudent Investor Rule § 227, reporter's note, at 60-66 (1992).

Drafters in Illinois in 1991 worked from the April 1990 "Proposed Final Draft" of the Restatement of Trusts 3d: Prudent Investor Rule and enacted legislation that is closely modeled on the new Restatement. 760 ILCS § 5/5 (prudent investing); and § 5/5.1 (delegation) (1992). As the Comments to this Uniform Prudent Investor Act reflect, the Act draws upon the Illinois statute in several sections. Virginia revised its prudent investor act in a similar vein in 1992. Virginia Code § 26-45.1 (prudent investing) (1992). Florida revised its statute in 1993. Florida Laws, ch. 93-257, amending Florida Statutes § 518.11 (prudent investing) and creating § 518.112 (delegation). New York legislation drawing on the new Restatement and on a preliminary version of this Uniform Prudent Investor Act was enacted in 1994. N.Y. Assembly Bill 11683-B, Ch. 609 (1994), adding Estates, Powers and Trusts Law § 11-2.3 (Prudent Investor Act).

Remedies. This Act does not undertake to address issues of remedy law or the computation of damages in trust matters. Remedies are the subject of a reasonably distinct body of doctrine. See generally Restatement (Second) of Trusts §§ 197-226A (1959) [hereinafter cited as Restatement of Trusts 2d; also referred to as 1959 Restatement].

Implications for charitable and pension trusts. This Act is centrally concerned with the investment responsibilities arising under the private gratuitous trust, which is the common vehicle for conditioned wealth transfer within the family. Nevertheless, the prudent investor rule also bears on charitable and pension trusts, among others. "In making investments of trust funds the trustee of a charitable trust is under a duty similar to that of the trustee of a private trust." Restatement of Trusts 2d § 389 (1959). The Employee Retirement Income Security Act (ERISA), the federal regulatory scheme for pension trusts enacted in 1974, absorbs trust-investment law through the prudence standard of ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a). The Supreme Court has said: "ERISA's legislative history confirms that the Act's fiduciary responsibility provisions 'codif[y] and mak[e] applicable to [ERISA] fiduciaries certain principles developed in the evolution of the law of trusts.'" *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110-11 (1989) (footnote omitted).

Other fiduciary relationships. The Uniform Prudent Investor Act regulates the investment responsibilities of trustees. Other fiduciaries – such as executors, conservators, and guardians of the property – sometimes have responsibilities over assets that are governed by the standards of prudent investment. It will often be appropriate for states to adapt the law governing investment by trustees under this Act to these other fiduciary regimes, taking account of such changed circumstances as the relatively short duration of most executorships and the intensity of court supervision of conservators and guardians in some jurisdictions. The present Act does not undertake to adjust trust-investment law to the special circumstances of the state schemes for administering decedents' estates or conducting the affairs of protected persons.

Although the Uniform Prudent Investor Act by its terms applies to trusts and not to charitable

corporations, the standards of the Act can be expected to inform the investment responsibilities of directors and officers of charitable corporations. As the 1992 Restatement observes, "the duties of the members of the governing board of a charitable corporation are generally similar to the duties of the trustee of a charitable trust." Restatement of Trusts 3d: Prudent Investor Rule § 379, Comment *b*, at 190 (1992). See also id. § 389, Comment *b*, at 190-91 (absent contrary statute or other provision, prudent investor rule applies to investment of funds held for charitable corporations).

TEXAS TRUST CODE CHAPTER 117. UNIFORM PRUDENT INVESTOR ACT

Sec. 117.001. SHORT TITLE. This chapter may be cited as the "Uniform Prudent Investor Act."

Sec. 117.002. UNIFORMITY OF APPLICATION AND CONSTRUCTION. This chapter shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this chapter among the states enacting it.

Sec. 117.003. PRUDENT INVESTOR RULE. (a) Except as otherwise provided in Subsection (b), a trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule set forth in this chapter.

(b) The prudent investor rule, a default rule, may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust. A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on the provisions of the trust.

Uniform Act Comment

This section imposes the obligation of prudence in the conduct of investment functions and identifies further sections of the Act that specify the attributes of prudent conduct.

Origins. The prudence standard for trust investing traces back to *Harvard College v. Amory*, 26 Mass. (9 Pick.) 446 (1830). Trustees should "observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested." Id. at 461.

Prior legislation. The Model Prudent Man Rule Statute (1942), sponsored by the American Bankers Association, undertook to codify the language of the *Amory* case. See Mayo A. Shattuck, The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century, 12 Ohio State L.J. 491, at 501 (1951); for the text of the model act, which inspired many state statutes, see id. at 508-09. Another prominent codification of the *Amory* standard is Uniform Probate Code § 7-302 (1969), which provides that "the trustee shall observe the standards in dealing with the trust assets that would be observed by a prudent man dealing with the property of another . . . ."

Congress has imposed a comparable prudence standard for the administration of pension and employee benefit trusts in the Employee Retirement Income Security Act (ERISA), enacted in 1974. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a), provides that "a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and . . . with the care, skill,

prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with like aims . . . ."

Prior Restatement. The Restatement of Trusts 2d (1959) also tracked the language of the *Amory* case: "In making investments of trust funds the trustee is under a duty to the beneficiary . . . to make such investments and only such investments as a prudent man would make of his own property having in view the preservation of the estate and the amount and regularity of the income to be derived . . . ." Restatement of Trusts 2d § 227 (1959).

Objective standard. The concept of prudence in the judicial opinions and legislation is essentially relational or comparative. It resembles in this respect the "reasonable person" rule of tort law. A prudent trustee behaves as other trustees similarly situated would behave. The standard is, therefore, objective rather than subjective. Sections 2 through 9 of this Act [Texas Trust Code §§117.004 – 117.011] identify the main factors that bear on prudent investment behavior.

Variation. Almost all of the rules of trust law are default rules, that is, rules that the settlor may alter or abrogate. Subsection (b) carries forward this traditional attribute of trust law. Traditional trust law also allows the beneficiaries of the trust to excuse its performance, when they are all capable and not misinformed. Restatement of Trusts 2d § 216 (1959).

Texas Bar Comment

Adoption of the prudent investor rule reflects a significant departure from prior Texas law. The prudent investor rule is the majority rule among the states, so its adoption brings Texas in line with the national trend.

Sec. 117.004. STANDARD OF CARE; PORTFOLIO STRATEGY; RISK AND RETURN OBJECTIVES. (a) A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.

(b) 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 and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.

(c) Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries:

(1) general economic conditions;

(2) the possible effect of inflation or deflation;

(3) the expected tax consequences of investment decisions or strategies;

(4) the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enterprises, tangible and intangible personal property, and real property;

(5) the expected total return from income and the appreciation of capital;

(6) other resources of the beneficiaries;

(7) needs for liquidity, regularity of income, and preservation or appreciation of capital; and

(8) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

(d) A trustee shall make a reasonable effort to verify facts relevant to the investment and management of trust assets.

(e) Except as otherwise provided by and subject to this subtitle, a trustee may invest in any kind of property or type of investment consistent with the standards of this chapter.

(f) A trustee who has special skills or expertise, or is named trustee in reliance upon the trustee's representation that the trustee has special skills or expertise, has a duty to use those special skills or expertise.

Uniform Act Comment

Section 2 [Texas Trust Code §117.004] is the heart of the Act. Subsections (a), (b), and (c) are patterned loosely on the language of the Restatement of Trusts 3d: Prudent Investor Rule § 227 (1992), and on the 1991 Illinois statute, 760 § ILCS 5/5a (1992). Subsection (f) is derived from Uniform Probate Code § 7-302 (1969).

Objective standard. Subsection (a) of this Act carries forward the relational and objective standard made familiar in the *Amory* case, in earlier prudent investor legislation, and in the Restatements. Early formulations of the prudent person rule were sometimes troubled by the effort to distinguish between the standard of a prudent person investing for another and investing on his or her own account. The language of subsection (a), by relating the trustee's duty to "the purposes, terms, distribution requirements, and other circumstances of the trust," should put such questions to rest. The standard is the standard of the prudent investor similarly situated.

Portfolio standard. Subsection (b) emphasizes the consolidated portfolio standard for evaluating investment decisions. An investment that might be imprudent standing alone can become prudent if undertaken in sensible relation to other trust assets, or to other nontrust assets. In the trust setting the term "portfolio" embraces the entire trust estate.

Risk and return. Subsection (b) also sounds the main theme of modern investment practice, sensitivity to the risk/return curve. See generally the works cited in the Prefatory Note to this Act, under "Literature." Returns correlate strongly with risk, but tolerance for risk varies greatly with the financial and other circumstances of the investor, or in the case of a trust, with the purposes of the trust and the relevant circumstances of the beneficiaries. A trust whose main purpose is to support an elderly widow of modest means will have a lower risk tolerance than a trust to accumulate for a young scion of great wealth.

Subsection (b) of this Act follows Restatement of Trusts 3d: Prudent Investor Rule § 227(a), which provides that the standard of prudent investing "requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust."

Factors affecting investment. Subsection (c) points to certain of the factors that commonly bear on risk/return preferences in fiduciary investing. This listing is nonexclusive. Tax considerations, such as preserving the stepped up basis on death under Internal Revenue Code § 1014 for low-basis assets, have traditionally been exceptionally important in estate planning for affluent persons. Under the present recognition rules of the federal income tax, taxable investors, including trust beneficiaries, are in general best served by an investment strategy that minimizes the taxation incident to portfolio turnover. See generally Robert H. Jeffrey & Robert D. Arnott, Is Your Alpha Big Enough to Cover Its Taxes?, Journal of Portfolio Management 15 (Spring 1993).

Another familiar example of how tax considerations bear upon trust investing: In a regime of pass-through taxation, it may be prudent for the trust to buy lower yielding tax-exempt securities for high-bracket taxpayers, whereas it would ordinarily be imprudent for the trustees of a charitable trust, whose income is tax exempt, to accept the lowered yields associated with tax-exempt securities.

When tax considerations affect beneficiaries differently, the trustee's duty of impartiality requires attention to the competing interests of each of them.

Subsection (c)(8), allowing the trustee to take into account any preferences of the beneficiaries respecting heirlooms or other prized assets, derives from the Illinois act, 760 ILCS § 5/5(a)(4) (1992).

Duty to monitor. Subsections (a) through (d) apply both to investing and managing trust assets. "Managing" embraces monitoring, that is, the trustee's continuing responsibility for oversight of the suitability of investments already made as well as the trustee's decisions respecting new investments.

Duty to investigate. Subsection (d) carries forward the traditional responsibility of the fiduciary investor to examine information likely to bear importantly on the value or the security of an investment – for example, audit reports or records of title. E.g., *Estate of Collins*, 72 Cal. App. 3d 663, 139 Cal. Rptr. 644 (1977) (trustees lent on a junior mortgage on unimproved real estate, failed to have land appraised, and accepted an unaudited financial statement; held liable for losses).

Abrogating categoric restrictions. Subsection 2(e) [Texas Trust Code §117.004(e)] clarifies that no particular kind of property or type of investment is inherently imprudent. Traditional trust law was encumbered with a variety of categoric exclusions, such as prohibitions on junior mortgages or new ventures. In some states legislation created so-called "legal lists" of approved trust investments. The universe of investment products changes incessantly. Investments that were at one time thought too risky, such as equities, or more recently, futures, are now used in fiduciary portfolios. By contrast, the investment that was at one time thought ideal for trusts, the long-term bond, has been discovered to import a level of risk and volatility – in this case, inflation risk – that had not been anticipated. Accordingly, section 2(e) [Texas Trust Code §117.004(e)] of this Act follows Restatement of Trusts 3d: Prudent Investor Rule in abrogating categoric restrictions. The Restatement says: "Specific investments or techniques are not per se prudent or imprudent. The riskiness of a specific property, and thus the propriety of its inclusion in the trust estate, is not judged in the abstract but in terms of its anticipated effect on the particular trust's portfolio." Restatement of Trusts 3d: Prudent Investor Rule § 227, Comment f, at 24 (1992). The premise of subsection 2(e) [Texas Trust Code §117.004(e)] is that trust beneficiaries are better protected by the Act's emphasis on close attention to risk/return objectives as prescribed in subsection 2(b) [Texas Trust Code §117.004(b)] than in attempts to identify categories of investment that are per se prudent or imprudent.

The Act impliedly disavows the emphasis in older law on avoiding "speculative" or "risky" investments. Low levels of risk may be appropriate in some trust settings but inappropriate in others. It is the trustee's task to invest at a risk level that is suitable to the purposes of the trust.

The abolition of categoric restrictions against types of investment in no way alters the trustee's conventional duty of loyalty, which is reiterated for the purposes of this Act in Section 5 [Texas Trust Code §117.007)]. For example, were the trustee to invest in a second mortgage on a piece of real property owned by the trustee, the investment would be wrongful on account of the trustee's breach of the duty to abstain from self-dealing, even though the investment would no longer automatically offend the former categoric restriction against fiduciary investments in junior mortgages.

Professional fiduciaries. The distinction taken in subsection (f) between amateur and professional trustees is familiar law. The prudent investor standard applies to a range of fiduciaries, from the most sophisticated professional investment management firms and corporate fiduciaries, to family members of minimal experience. Because the standard of prudence is relational, it follows that the standard for professional trustees is the standard of prudent professionals; for amateurs, it is the standard of prudent amateurs. Restatement of Trusts 2d § 174 (1959) provides: "The trustee is under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property; and if the trustee has or procures his appointment as trustee by representing that he has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill." Case law strongly supports the concept of the higher standard of care for the trustee

representing itself to be expert or professional. See Annot., Standard of Care Required of Trustee Representing Itself to Have Expert Knowledge or Skill, 91 A.L.R. 3d 904 (1979) & 1992 Supp. at 48-49.

The Drafting Committee declined the suggestion that the Act should create an exception to the prudent investor rule (or to the diversification requirement of Section 3 [Texas Trust Code §117.005]) in the case of smaller trusts. The Committee believes that subsections (b) and (c) of the Act emphasize factors that are sensitive to the traits of small trusts; and that subsection (f) adjusts helpfully for the distinction between professional and amateur trusteeship. Furthermore, it is always open to the settlor of a trust under Section 1(b) of the Act [Texas Trust Code §117.003(b)] to reduce the trustee's standard of care if the settlor deems such a step appropriate. The official comments to the 1992 Restatement observe that pooled investments, such as mutual funds and bank common trust funds, are especially suitable for small trusts. Restatement of Trusts 3d: Prudent Investor Rule § 227, Comments *h*, *m*, at 28, 51; reporter's note to Comment *g*, id. at 83.

Matters of proof. Although virtually all express trusts are created by written instrument, oral trusts are known, and accordingly, this Act presupposes no formal requirement that trust terms be in writing. When there is a written trust instrument, modern authority strongly favors allowing evidence extrinsic to the instrument to be consulted for the purpose of ascertaining the settlor's intent. See Uniform Probate Code § 2-601 (1990), Comment; Restatement (Third) of Property: Donative Transfers (Preliminary Draft No. 2, ch. 11, Sept. 11, 1992).

Sec. 117.005. DIVERSIFICATION. A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.

Uniform Act Comment

The language of this section derives from Restatement of Trusts 2d § 228 (1959). ERISA insists upon a comparable rule for pension trusts. ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C). Case law overwhelmingly supports the duty to diversify. See Annot., Duty of Trustee to Diversify Investments, and Liability for Failure to Do So, 24 A.L.R. 3d 730 (1969) & 1992 Supp. at 78-79.

The 1992 Restatement of Trusts takes the significant step of integrating the diversification requirement into the concept of prudent investing. Section 227(b) of the 1992 Restatement treats diversification as one of the fundamental elements of prudent investing, replacing the separate section 228 of the Restatement of Trusts 2d. The message of the 1992 Restatement, carried forward in Section 3 of this Act, is that prudent investing ordinarily requires diversification.

Circumstances can, however, overcome the duty to diversify. For example, if a tax-sensitive trust owns an underdiversified block of low-basis securities, the tax costs of recognizing the gain may outweigh the advantages of diversifying the holding. The wish to retain a family business is another situation in which the purposes of the trust sometimes override the conventional duty to diversify.

Rationale for diversification. "Diversification reduces risk . . . [because] stock price movements are not uniform. They are imperfectly correlated. This means that if one holds a well

diversified portfolio, the gains in one investment will cancel out the losses in another." Jonathan R. Macey, An Introduction to Modern Financial Theory 20 (American College of Trust and Estate Counsel Foundation, 1991). For example, during the Arab oil embargo of 1973, international oil stocks suffered declines, but the shares of domestic oil producers and coal companies benefitted. Holding a broad enough portfolio allowed the investor to set off, to some extent, the losses associated with the embargo.

Modern portfolio theory divides risk into the categories of "compensated" and "uncompensated" risk. The risk of owning shares in a mature and well-managed company in a settled industry is less than the risk of owning shares in a start-up high-technology venture. The investor requires a higher expected return to induce the investor to bear the greater risk of disappointment associated with the start-up firm. This is compensated risk – the firm pays the investor for bearing the risk. By contrast, nobody pays the investor for owning too few stocks. The investor who owned only international oils in 1973 was running a risk that could have been reduced by having configured the portfolio differently – to include investments in different industries. This is uncompensated risk – nobody pays the investor for owning shares in too few industries and too few companies. Risk that can be eliminated by adding different stocks (or bonds) is uncompensated risk. The object of diversification is to minimize this uncompensated risk of having too few investments. "As long as stock prices do not move exactly together, the risk of a diversified portfolio will be less than the average risk of the separate holdings." R.A. Brealey, An Introduction to Risk and Return from Common Stocks 103 (2d ed. 1983).

There is no automatic rule for identifying how much diversification is enough. The 1992 Restatement says: "Significant diversification advantages can be achieved with a small number of well-selected securities representing different industries . . . . Broader diversification is usually to be preferred in trust investing," and pooled investment vehicles "make thorough diversification practical for most trustees." Restatement of Trusts 3d: Prudent Investor Rule § 227, General Note on Comments *e-h*, at 77 (1992). See also Macey, supra, at 23-24; Brealey, supra, at 111-13.

Diversifying by pooling. It is difficult for a small trust fund to diversify thoroughly by constructing its own portfolio of individually selected investments. Transaction costs such as the round-lot (100 share) trading economies make it relatively expensive for a small investor to assemble a broad enough portfolio to minimize uncompensated risk. For this reason, pooled investment vehicles have become the main mechanism for facilitating diversification for the investment needs of smaller trusts.

Most states have legislation authorizing common trust funds; see 3 Austin W. Scott & William F. Fratcher, The Law of Trusts § 227.9, at 463-65 n.26 (4th ed. 1988) (collecting citations to state statutes). As of 1992, 35 states and the District of Columbia had enacted the Uniform Common Trust Fund Act (UCTFA) (1938), overcoming the rule against commingling trust assets and expressly enabling banks and trust companies to establish common trust funds. 7 Uniform Laws Ann. 1992 Supp. at 130 (schedule of adopting states). The Prefatory Note to the UCTFA explains: "The purposes of such a common or joint investment fund are to diversify the investment of the several trusts and thus spread the risk of loss, and to make it easy to invest any amount of trust funds quickly and with a small amount of trouble." 7 Uniform Laws Ann. 402 (1985).

Fiduciary investing in mutual funds. Trusts can also achieve diversification by investing in mutual funds. See Restatement of Trusts 3d: Prudent Investor Rule, § 227, Comment *m*, at 99-100 (1992) (endorsing trust investment in mutual funds). ERISA § 401(b)(1), 29 U.S.C. § 1101(b)(1), expressly authorizes pension trusts to invest in mutual funds, identified as securities "issued by an investment company registered under the Investment Company Act of 1940 . . . ."

Sec. 117.006. DUTIES AT INCEPTION OF TRUSTEESHIP. Within a reasonable time after accepting a trusteeship or receiving trust assets, a trustee shall review the trust assets and make and implement decisions concerning the retention and disposition of assets, in order to bring the trust portfolio into compliance with the purposes, terms, distribution requirements, and other circumstances of the trust, and with the requirements of this chapter.

Uniform Act Comment

Section 4 [Texas Trust Code §117.006], requiring the trustee to dispose of unsuitable assets within a reasonable time, is old law, codified in Restatement of Trusts 3d: Prudent Investor Rule § 229 (1992), lightly revising Restatement of Trusts 2d § 230 (1959). The duty extends as well to investments that were proper when purchased but subsequently become improper. Restatement of Trusts 2d § 231 (1959). The same standards apply to successor trustees, see Restatement of Trusts 2d § 196 (1959).

The question of what period of time is reasonable turns on the totality of factors affecting the asset and the trust. The 1959 Restatement took the view that "[o]rdinarily any time within a year is reasonable, but under some circumstances a year may be too long a time and under other circumstances a trustee is not liable although he fails to effect the conversion for more than a year." Restatement of Trusts 2d § 230, comment *b* (1959). The 1992 Restatement retreated from this rule of thumb, saying, "No positive rule can be stated with respect to what constitutes a reasonable time for the sale or exchange of securities." Restatement of Trusts 3d: Prudent Investor Rule § 229, comment *b* (1992).

The criteria and circumstances identified in Section 2 of this Act [Texas Trust Code §117.004] as bearing upon the prudence of decisions to invest and manage trust assets also pertain to the prudence of decisions to retain or dispose of inception assets under this section.

Texas Bar Comment

This section is a significant departure from prior Texas law, which allowed a trustee to retain the initial trust estate without diversification and without liability for loss or depreciation. See former Texas Property Code § 113.003. This change is consistent with the overall purpose and effect of the prudent investor rule.

Sec. 117.007. LOYALTY. A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries.

Uniform Act Comment

The duty of loyalty is perhaps the most characteristic rule of trust law, requiring the trustee to act exclusively for the beneficiaries, as opposed to acting for the trustee's own interest or that of third parties. The language of Section 4 [*sic*] of this Act [Texas Trust Code §117.006] derives from Restatement of Trusts 3d: Prudent Investor Rule § 170 (1992), which makes minute changes in Restatement of Trusts 2d § 170 (1959).

The concept that the duty of prudence in trust administration, especially in investing and managing trust assets, entails adherence to the duty of loyalty is familiar. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B), extracted in the Comment to Section 1 of this Act [Texas Trust Code §117.003], effectively merges the requirements of prudence and loyalty. A fiduciary cannot be prudent in the conduct of investment functions if the fiduciary is sacrificing the interests of the beneficiaries.

The duty of loyalty is not limited to settings entailing self-dealing or conflict of interest in which the trustee would benefit personally from the trust. "The trustee is under a duty to the beneficiary in administering the trust not to be guided by the interest of any third person. Thus, it is improper for the trustee to sell trust property to a third person for the purpose of benefitting the third person rather than the trust." Restatement of Trusts 2d § 170, comment *q*, at 371 (1959).

No form of so-called "social investing" is consistent with the duty of loyalty if the investment activity entails sacrificing the interests of trust beneficiaries – for example, by accepting below-market returns – in favor of the interests of the persons supposedly benefitted by pursuing the particular social cause. See, e.g., John H. Langbein & Richard Posner, Social Investing and the Law of Trusts, 79 Michigan L. Rev. 72, 96-97 (1980) (collecting authority). For pension trust assets, see generally Ian D. Lanoff, The Social Investment of Private Pension Plan Assets: May it Be Done Lawfully under ERISA?, 31 Labor L.J. 387 (1980). Commentators supporting social investing tend to concede the overriding force of the duty of loyalty. They argue instead that particular schemes of social investing may not result in below-market returns. See, e.g., Marcia O'Brien Hylton, "Socially Responsible" Investing: Doing Good Versus Doing Well in an Inefficient Market, 42 American U.L. Rev. 1 (1992). In 1994 the Department of Labor issued an Interpretive Bulletin reviewing its prior analysis of social investing questions and reiterating that pension trust fiduciaries may invest only in conformity with the prudence and loyalty standards of ERISA §§ 403-404. Interpretive Bulletin 94-1, 59 Fed. Regis. 32606 (Jun. 22, 1994), to be codified as 29 CFR § 2509.94-1. The Bulletin reminds fiduciary investors that they are prohibited from "subordinat[ing] the interests of participants and beneficiaries in their retirement income to unrelated objectives."

Sec. 117.008. IMPARTIALITY. If a trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries.

Uniform Act Comment

The duty of impartiality derives from the duty of loyalty. When the trustee owes duties to more than one beneficiary, loyalty requires the trustee to respect the interests of all the beneficiaries. Prudence in investing and administration requires the trustee to take account of the interests of all the beneficiaries for whom the trustee is acting, especially the conflicts between the interests of beneficiaries interested in income and those interested in principal.

The language of Section 6 [Texas Trust Code §117.008] derives from Restatement of Trusts 2d § 183 (1959); see also id., § 232. Multiple beneficiaries may be beneficiaries in succession (such as life and remainder interests) or beneficiaries with simultaneous interests (as when the income interest in a trust is being divided among several beneficiaries).

The trustee's duty of impartiality commonly affects the conduct of investment and management functions in the sphere of principal and income allocations. This Act prescribes no regime for allocating receipts and expenses. The details of such allocations are commonly handled under specialized legislation, such as the Revised Uniform Principal and Income Act (1962) (which is presently under study by the Uniform Law Commission with a view toward further revision [*see* Texas Trust Code Chapter 116 – The Uniform Principal and Income Act]).

Sec. 117.009. INVESTMENT COSTS. In investing and managing trust assets, a trustee may only incur costs that are appropriate and reasonable in relation to the assets, the purposes of the trust, and the skills of the trustee.

Uniform Act Comment

Wasting beneficiaries' money is imprudent. In devising and implementing strategies for the investment and management of trust assets, trustees are obliged to minimize costs.

The language of Section 7 [Texas Trust Code §117.009] derives from Restatement of Trusts 2d § 188 (1959). The Restatement of Trusts 3d says: "Concerns over compensation and other charges are not an obstacle to a reasonable course of action using mutual funds and other pooling arrangements, but they do require special attention by a trustee. . . . [I]t is important for trustees to make careful cost comparisons, particularly among similar products of a specific type being considered for a trust portfolio." Restatement of Trusts 3d: Prudent Investor Rule § 227, comment *m*, at 58 (1992).

Sec. 117.010. REVIEWING COMPLIANCE. Compliance with the prudent investor rule is determined in light of the facts and circumstances existing at the time of a trustee's decision or action and not by hindsight.

Uniform Act Comment

This section derives from the 1991 Illinois act, 760 ILCS 5/5(a)(2) (1992), which draws upon Restatement of Trusts 3d: Prudent Investor Rule § 227, comment *b*, at 11 (1992). Trustees are not insurers. Not every investment or management decision will turn out in the light of hindsight to have been successful. Hindsight is not the relevant standard. In the language of law and economics, the standard is ex ante, not ex post.

Sec. 117.011. DELEGATION OF INVESTMENT AND MANAGEMENT FUNCTIONS. (a) A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in:

(1) selecting an agent;

(2) establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and

(3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.

(b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.

(c) A trustee who complies with the requirements of Subsection (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated, unless:

(1) the agent is an affiliate of the trustee; or

(2) under the terms of the delegation:

(A) the trustee or a beneficiary of the trust is required to arbitrate disputes with the agent; or

(B) the period for bringing an action by the trustee or a beneficiary of the trust with respect to an agent's actions is shortened from that which is applicable to trustees under the law of this state.

(d) By accepting the delegation of a trust function from the trustee of a trust that is subject to the law of this state, an agent submits to the jurisdiction of the courts of this state.

Uniform Act Comment

This section of the Act reverses the much-criticized rule that forbad trustees to delegate investment and management functions. The language of this section is derived from Restatement of Trusts 3d: Prudent Investor Rule § 171 (1992), discussed infra, and from the 1991 Illinois act, 760 ILCS § 5/5.1(b), (c) (1992).

Former law. The former nondelegation rule survived into the 1959 Restatement: "The trustee is under a duty to the beneficiary not to delegate to others the doing of acts which the trustee can reasonably be required personally to perform." The rule put a premium on the frequently arbitrary task of distinguishing discretionary functions that were thought to be nondelegable from supposedly

ministerial functions that the trustee was allowed to delegate. Restatement of Trusts 2d § 171 (1959).

The Restatement of Trusts 2d admitted in a comment that "There is not a clear-cut line dividing the acts which a trustee can properly delegate from those which he cannot properly delegate." Instead, the comment directed attention to a list of factors that "may be of importance: (1) the amount of discretion involved; (2) the value and character of the property involved; (3) whether the property is principal or income; (4) the proximity or remoteness of the subject matter of the trust; (5) the character of the act as one involving professional skill or facilities possessed or not possessed by the trustee himself." Restatement of Trusts 2d § 171, comment *d* (1959). The 1959 Restatement further said: "A trustee cannot properly delegate to another power to select investments." Restatement of Trusts 2d § 171, comment *h* (1959).

For discussion and criticism of the former rule see William L. Cary & Craig B. Bright, The Delegation of Investment Responsibility for Endowment Funds, 74 Columbia L. Rev. 207 (1974); John H. Langbein & Richard A. Posner, Market Funds and Trust-Investment Law, 1976 American Bar Foundation Research J. 1, 18-24.

The modern trend to favor delegation. The trend of subsequent legislation, culminating in the Restatement of Trusts 3d: Prudent Investor Rule, has been strongly hostile to the nondelegation rule. See John H. Langbein, Reversing the Nondelegation Rule of Trust-Investment Law, 59 Missouri L. Rev. 105 (1994).

The delegation rule of the Uniform Trustee Powers Act. The Uniform Trustee Powers Act (1964) effectively abrogates the nondelegation rule. It authorizes trustees "to employ persons, including attorneys, auditors, investment advisors, or agents, even if they are associated with the trustee, to advise or assist the trustee in the performance of his administrative duties; to act without independent investigation upon their recommendations; and instead of acting personally, to employ one or more agents to perform any act of administration, whether or not discretionary . . . ." Uniform Trustee Powers Act § 3(24), 7B Uniform Laws Ann. 743 (1985). The Act has been enacted in 16 states, see "Record of Passage of Uniform and Model Acts as of September 30, 1993," 1993-94 Reference Book of Uniform Law Commissioners (unpaginated, following page 111) (1993).

UMIFA's delegation rule. The Uniform Management of Institutional Funds Act (1972) (UMIFA), authorizes the governing boards of eleemosynary institutions, who are trustee-like fiduciaries, to delegate investment matters either to a committee of the board or to outside investment advisors, investment counsel, managers, banks, or trust companies. UMIFA § 5, 7A Uniform Laws Ann. 705 (1985). UMIFA has been enacted in 38 states, see "Record of Passage of Uniform and Model Acts as of September 30, 1993," 1993-94 Reference Book of Uniform Law Commissioners (unpaginated, following page 111) (1993).

ERISA's delegation rule. The Employee Retirement Income Security Act of 1974, the federal statute that prescribes fiduciary standards for investing the assets of pension and employee benefit plans, allows a pension or employee benefit plan to provide that "authority to manage, acquire or dispose of assets of the plan is delegated to one or more investment managers . . . ." ERISA § 403(a)(2), 29 U.S.C. § 1103(a)(2). Commentators have explained the rationale for ERISA's encouragement of delegation:

> ERISA . . . invites the dissolution of unitary trusteeship. . . . ERISA's

> fractionation of traditional trusteeship reflects the complexity of the modern pension trust. Because millions, even billions of dollars can be involved, great care is required in investing and safekeeping plan assets. Administering such plans–computing and honoring benefit entitlements across decades of employment and retirement–is also a complex business. . . . Since, however, neither the sponsor nor any other single entity has a comparative advantage in performing all these functions, the tendency has been for pension plans to use a variety of specialized providers. A consulting actuary, a plan administration firm, or an insurance company may oversee the design of a plan and arrange for processing benefit claims. Investment industry professionals manage the portfolio (the largest plans spread their pension investments among dozens of money management firms).

John H. Langbein & Bruce A. Wolk, Pension and Employee Benefit Law 496 (1990).

The delegation rule of the 1992 Restatement. The Restatement of Trusts 3d: Prudent Investor Rule (1992) repeals the nondelegation rule of Restatement of Trusts 2d § 171 (1959), extracted supra, and replaces it with substitute text that reads:

> § 171. Duty with Respect to Delegation. A trustee has a duty personally to perform the responsibilities of trusteeship except as a prudent person might delegate those responsibilities to others. In deciding whether, to whom, and in what manner to delegate fiduciary authority in the administration of a trust, and thereafter in supervising agents, the trustee is under a duty to the beneficiaries to exercise fiduciary discretion and to act as a prudent person would act in similar circumstances.

Restatement of Trusts 3d: Prudent Investor Rule § 171 (1992). The 1992 Restatement integrates this delegation standard into the prudent investor rule of section 227, providing that "the trustee must . . . act with prudence in deciding whether and how to delegate to others . . . ." Restatement of Trusts 3d: Prudent Investor Rule § 227(c) (1992).

Protecting the beneficiary against unreasonable delegation. There is an intrinsic tension in trust law between granting trustees broad powers that facilitate flexible and efficient trust administration, on the one hand, and protecting trust beneficiaries from the misuse of such powers on the other hand. A broad set of trustees' powers, such as those found in most lawyer-drafted instruments and exemplified in the Uniform Trustees' Powers Act, permits the trustee to act vigorously and expeditiously to maximize the interests of the beneficiaries in a variety of transactions and administrative settings. Trust law relies upon the duties of loyalty and prudent administration, and upon procedural safeguards such as periodic accounting and the availability of judicial oversight, to prevent the misuse of these powers. Delegation, which is a species of trustee power, raises the same tension. If the trustee delegates effectively, the beneficiaries obtain the advantage of the agent's specialized investment skills or whatever other attributes induced the trustee to delegate. But if the trustee delegates to a knave or an incompetent, the delegation can work harm upon the beneficiaries.

Section 9 of the Uniform Prudent Investor Act [Texas Trust Code §117.011] is designed to strike the appropriate balance between the advantages and the hazards of delegation. Section 9 [Texas Trust Code §117.011] authorizes delegation under the limitations of subsections (a) and (b). Section 9(a) [Texas Trust Code §117.011(a)] imposes duties of care, skill, and caution on the trustee in selecting the agent, in establishing the terms of the delegation, and in reviewing the agent's compliance.

The trustee's duties of care, skill, and caution in framing the terms of the delegation should protect the beneficiary against overbroad delegation. For example, a trustee could not prudently agree to an investment management agreement containing an exculpation clause that leaves the trust without recourse against reckless mismanagement. Leaving one's beneficiaries remediless against willful wrongdoing is inconsistent with the duty to use care and caution in formulating the terms of the delegation. This sense that it is imprudent to expose beneficiaries to broad exculpation clauses underlies both federal and state legislation restricting exculpation clauses, e.g., ERISA §§ 404(a)(1)(D), 410(a), 29 U.S.C. §§ 1104(a)(1)(D), 1110(a); New York Est. Powers Trusts Law § 11-1.7 (McKinney 1967).

Although subsection (c) of the Act exonerates the trustee from personal responsibility for the agent's conduct when the delegation satisfies the standards of subsection 9(a) [Texas Trust Code §117.011(a)], subsection 9(b) [Texas Trust Code §117.011(b)] makes the agent responsible to the trust. The beneficiaries of the trust can, therefore, rely upon the trustee to enforce the terms of the delegation. [Also see Texas Bar Comment below regarding additional safeguards in the Texas version of this section.]

Costs. The duty to minimize costs that is articulated in Section 7 of this Act [Texas Trust Code §117.009] applies to delegation as well as to other aspects of fiduciary investing. In deciding whether to delegate, the trustee must balance the projected benefits against the likely costs. Similarly, in deciding how to delegate, the trustee must take costs into account. The trustee must be alert to protect the beneficiary from "double dipping." If, for example, the trustee's regular compensation schedule presupposes that the trustee will conduct the investment management function, it should ordinarily follow that the trustee will lower its fee when delegating the investment function to an outside manager.

Texas Bar Comment

This section departs from prior Texas law. Former Texas Property Code § 113.060 allowed the trustee to delegate investment decisions to an agent but required the trustee to remain responsible for the agent's investment decisions unless certain conditions were met.

In order for a trustee to avoid liability for the action of the trustee's agent, the trustee must comply with Subsection (a). In addition, Subsection (c)(1) and (c)(2) provides that the trustee cannot avoid liability for the action of the trustee's agent under this section if the agent an an affiliate of the trustee or if the terms of the delegation require arbitration or shorten the applicable statute of limitations. For the definition of "affiliate," see Texas Trust Code § 111.004(1). These requirements are in addition to the requirement that the trustee comply with Subsection (a); they do not replace this requirement.

Sec. 117.012. LANGUAGE INVOKING STANDARD OF CHAPTER. The following terms or comparable language in the provisions of a trust, unless otherwise limited or modified, authorizes any investment or strategy permitted under this chapter: "investments permissible by law for investment of trust funds," "legal investments," "authorized investments," "using the judgment and care under the circumstances then prevailing that persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the

probable safety of their capital," "prudent man rule," "prudent trustee rule," "prudent person rule," and "prudent investor rule."

Uniform Act Comment

This provision is taken from the Illinois act, 760 ILCS § 5/5(d) (1992), and is meant to facilitate incorporation of the Act by means of the formulaic language commonly used in trust instruments.

EFFECTIVE DATE PROVISION

SECTION 19. (a) This Act takes effect January 1, 2004, and applies only to a trust existing on or created after that date.

(b) With respect to a trust existing on January 1, 2004, this Act applies only to an act or decision relating to the trust occurring after December 31, 2003.

THE UNIFORM PRINCIPAL AND INCOME ACT OF TEXAS

As Enacted by the 78th Texas Legislature (2003)

Effective January 1, 2004

With the Official Comments of

The National Conference of Commissioners on Uniform State Laws

and

The Real Estate, Probate and Trust Law Section
of the State Bar of Texas

June 2003

Table of Contents

INTRODUCTION

The 78th Texas Legislature enacted a Texas version of the Uniform Principal and Income Act of 1997. HB 2241 becomes effective January 1, 2004. This legislation was part of the 2003 legislative package of the Real Estate, Probate and Trust Law Section of the State Bar of Texas. The Section studied three uniform acts promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL) – the Uniform Prudent Investor Act of 1994, the Uniform Principal and Income Act of 1997 and the Uniform Trust Code of 2000 – for more than two years. The Section urged the adoption of Texas versions of two of those acts – Prudent Investor and Principal and Income – in 2003, and both were enacted into law.

Following are the provisions of the Uniform Principal and Income Act of 1997 (the "Act") as enacted in Texas, the official NCCUSL notes and comments to the Act and each section of the Act (identified as "Uniform Act Notes" or "Uniform Act Comments") and the official comments of the Real Estate, Probate and Trust Law Section of the State Bar of Texas (the "Section") on the Texas variations of the Act (identified as "Texas Bar Comments").

UNIFORM ACT PREFATORY NOTE

This revision of the 1931 Uniform Principal and Income Act and the 1962 Revised Uniform Principal and Income Act has two purposes.

One purpose is to revise the 1931 and the 1962 Acts. Revision is needed to support the now widespread use of the revocable living trust as a will substitute, to change the rules in those Acts that experience has shown need to be changed, and to establish new rules to cover situations not provided for in the old Acts, including rules that apply to financial instruments invented since 1962.

The other purpose is to provide a means for implementing the transition to an investment regime based on principles embodied in the Uniform Prudent Investor Act, especially the principle of investing for total return rather than a certain level of "income" as traditionally perceived in terms of interest, dividends, and rents.

Revision of the 1931 and 1962 Acts

The prior Acts and this revision of those Acts deal with four questions affecting the rights of beneficiaries:

(1) How is income earned during the probate of an estate to be distributed to trusts and to persons who receive outright bequests of specific property, pecuniary gifts, and the residue?

(2) When an income interest in a trust begins (i.e., when a person who creates the trust dies or when she transfers property to a trust during life), what property is principal that will eventually go to the remainder beneficiaries and what is income?

(3) When an income interest ends, who gets the income that has been received but not distributed, or that is due but not yet collected, or that has accrued but is not yet due?

(4) After an income interest begins and before it ends, how should its receipts and disbursements be allocated to or between principal and income?

Changes in the traditional sections are of three types: new rules that deal with situations not covered by the prior Acts, clarification of provisions in the 1962 Act, and changes to rules in the prior Acts.

New rules. Issues addressed by some of the more significant new rules include:

(1) The application of the probate administration rules to revocable living trusts after the settlor's death and to other terminating trusts. Articles 2 and 3 [Subchapters B and C, Chapter 116, Texas Trust Code].

(2) The payment of interest or some other amount on the delayed payment of an outright pecuniary gift that is made pursuant to a trust agreement instead of a will when the agreement or state law does not provide for such a payment. Section 201(3) [Texas Trust Code §116.051(3)].

(3) The allocation of net income from partnership interests acquired by the trustee other than from a decedent (the old Acts deal only with partnership interests acquired from a decedent). Section 401 [Texas Trust Code §116.151].

(4) An "unincorporated entity" concept has been introduced to deal with businesses operated by a trustee, including farming and livestock operations, and investment activities in rental real estate, natural resources, timber, and derivatives. Section 403 [Texas Trust Code §116.153].

(5) The allocation of receipts from discount obligations such as zero-coupon bonds. Section 406(b) [Texas Trust Code §116.163(b)].

(6) The allocation of net income from harvesting and selling timber between principal and income. Section 412 [Texas Trust Code §116.174].

(7) The allocation between principal and income of receipts from derivatives, options, and asset-backed securities. Sections 414 and 415 [Texas Trust Code §§116.177 and 116.178].

(8) Disbursements made because of environmental laws. Section 502(a)(7) [Texas Trust Code §116.202(a)(7)].

(9) Income tax obligations resulting from the ownership of S corporation stock and interests in partnerships. Section 505 [Texas Trust Code §116.205].

(10) The power to make adjustments between principal and income to correct inequities caused by tax elections or peculiarities in the way the fiduciary income tax rules apply. Section 506 [Texas Trust Code §116.206].

Clarifications and changes in existing rules. A number of matters provided for in the prior Acts have been changed or clarified in this revision, including the following:

(1) An income beneficiary's estate will be entitled to receive only net income actually received by a trust before the beneficiary's death and not items of accrued income. Section 303 [Texas Trust Code §116.103].

(2) Income from a partnership is based on actual distributions from the partnership, in the same manner as corporate distributions. Section 401 [Texas Trust Code §116.151].

(3) Distributions from corporations and partnerships that exceed 20% of the entity's gross assets will be principal whether or not intended by the entity to be a partial liquidation. Section 401(d)(2) [Texas Trust Code §116.151(d)(2)].

(4) Deferred compensation is dealt with in greater detail in a separate section. Section 409 [Texas Trust Code §116.172].

(5) The 1962 Act rule for "property subject to depletion," (patents, copyrights, royalties, and the like), which provides that a trustee may allocate up to 5% of the asset's inventory value to income and the balance to principal, has been replaced by a rule that allocates 90% of the amounts received to principal and the balance to income. Section 410 [Texas Trust Code §116.173].

(6) The percentage used to allocate amounts received from oil and gas has been changed – 90% of those receipts are allocated to principal and the balance to income. Section 411 [Texas Trust Code §116.174 – but see this section and the Texas Bar Comment for changes from uniform act].

(7) The unproductive property rule has been eliminated for trusts other than marital deduction trusts. Section 413 [Texas Trust Code §116.176].

(8) Charging depreciation against income is no longer mandatory, and is left to the discretion of the trustee. Section 503 [Texas Trust Code §116.203].

Coordination with the Uniform Prudent Investor Act

The law of trust investment has been modernized. See Uniform Prudent Investor Act (1994); Restatement (Third) of Trusts: Prudent Investor Rule (1992) (hereinafter Restatement of Trusts 3d: Prudent Investor Rule). Now it is time to update the principal and income allocation rules so the two bodies of doctrine can work well together. This revision deals conservatively with the tension between modern investment theory and traditional income allocation. The starting point is to use the traditional system. If prudent investing of all the assets in a trust viewed as a portfolio and traditional allocation effectuate the intent of the settlor, then nothing need be done. The Act, however, helps the trustee who has made a prudent, modern portfolio-based investment decision that has the initial effect of skewing return from all the assets under management, viewed as a portfolio, as between income and principal beneficiaries. The Act gives that trustee a power to reallocate the portfolio return suitably. To leave a trustee constrained by the traditional system would inhibit the trustee's ability to fully implement modern portfolio theory.

As to modern investing see, e.g., the Preface to, terms of, and Comments to the Uniform Prudent Investor Act (1994); the discussion and reporter's note by Edward C. Halbach, Jr. in Restatement of Trusts 3d: Prudent Investor Rule; John H. Langbein, The Uniform Prudent Investor Act and the Future of Trust Investing, 81 Iowa L. Rev. 641 (1996); Bevis Longstreth, Modern Investment Management and the Prudent Man Rule (1986); John H. Langbein & Richard A. Posner, The Revolution in Trust Investment Law, 62 A.B.A.J. 887 (1976); and Jeffrey N. Gordon, The Puzzling Persistence of the Constrained Prudent Man Rule, 62 N.Y.U. L. Rev. 52 (1987). See also R.A. Brearly, An Introduction to Risk and Return from Common Stocks (2d ed. 1983); Jonathan R. Macey, An Introduction to Modern Financial Theory (2d ed. 1998). As to the need for principal and income reform see, e.g., Joel C. Dobris, Real Return, Modern Portfolio Theory and College, University and Foundation Decisions on Annual Spending From Endowments: A Visit to the World of Spending Rules, 28 Real Prop., Prob., & Tr. J. 49 (1993);

Joel C. Dobris, The Probate World at the End of the Century: Is a New Principal and Income Act in Your Future?, 28 Real Prop., Prob., & Tr. J. 393 (1993); and Kenneth L. Hirsch, Inflation and the Law of Trusts, 18 Real Prop., Prob., & Tr. J. 601 (1983). See also, Jerold I. Horn, The Prudent Investor Rule – Impact on Drafting and Administration of Trusts, 20 ACTEC Notes 26 (Summer 1994).

TEXAS TRUST CODE CHAPTER 116. UNIFORM PRINCIPAL AND INCOME ACT

SUBCHAPTER A. DEFINITIONS, FIDUCIARY DUTIES, AND OTHER MISCELLANEOUS PROVISIONS

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

Sec. 116.002. DEFINITIONS. In this chapter:

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

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

(4) "Income" means money or property 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 Subchapter D.

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

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

(7) "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.

(8) "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.

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

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

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

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

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

Uniform Act Comment

"Income beneficiary." The definitions of income beneficiary (Section 102(5) [Texas Trust Code §116.002(5)]) and income interest (Section 102(6) [Texas Trust Code §116.002(6)]) cover both mandatory and discretionary beneficiaries and interests. There are no definitions for "discretionary income beneficiary" or "discretionary income interest" because those terms are not used in the Act.

Inventory value. There is no definition for inventory value in this Act because the provisions in which that term was used in the 1962 Act have either been eliminated (in the case of the underproductive property provision) or changed in a way that eliminates the need for the term (in the case of bonds and other money obligations, property subject to depletion, and the method for determining entitlement to income distributed from a probate estate).

"**Net income."** The reference to "transfers under this Act to or from income" means transfers made under Sections 104(a) [Texas Trust Code §116.005(a)], 412(b) [Texas Trust Code §116.174(b)], 502(b) [Texas Trust Code §116.202(b)] , 503(b) [Texas Trust Code §116.203(b)], 504(a) [Texas Trust Code §116.204], and 506 [Texas Trust Code §116.206].

"Terms of a trust." This term was chosen in preference to "terms of the trust instrument" (the phrase used in the 1962 Act) to make it clear that the Act applies to oral trusts as well as those whose terms are expressed in written documents. The definition is based on the Restatement (Second) of Trusts § 4 (1959) and the Restatement (Third) of Trusts § 4 (Tent. Draft No. 1, 1996). Constructional preferences or rules would also apply, if necessary, to determine the terms of the trust.

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

Sec. 116.004. 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 Subchapters B and C, 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 chapter;

(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 chapter;

(3) 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; and

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

(b) In exercising the power to adjust under Section 116.005(a) 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 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 chapter is presumed to be fair and reasonable to all of the beneficiaries.

Uniform Act Comment

Prior Act. The rule in Section 2(a) of the 1962 Act is restated in Section 103(a) [Texas Trust Code §116.004(a)], without changing its substance, to emphasize that the Act contains only default rules and that provisions in the terms of the trust are paramount. However, Section 2(a) of the 1962 Act applies only to the allocation of receipts and disbursements to or between principal and income. In this Act, the first sentence of Section 103(a) [Texas Trust Code §116.004(a)] states that it also applies to matters within the scope of Articles 2 and 3 [Subchapters B and C of Texas Trust Code Chapter 116]. Section 103(a)(2) [Texas Trust Code §116.004(b)(2)] incorporates the rule in Section 2(b) of the 1962 Act that a discretionary allocation made by the trustee that is contrary to a rule in the Act should not give rise to an inference of imprudence or partiality by the trustee.

The Act deletes the language that appears at the end of 1962 Act Section 2(a)(3) – "and in view of the manner in which men of ordinary prudence, discretion and judgment would act in the management of their affairs" – because persons of ordinary prudence, discretion and judgment, acting in the management of their own affairs do not normally think in terms of the interests of successive beneficiaries. If there is an analogy to an individual's decision-making process, it is probably the individual's decision to spend or to save, but this is not a useful guideline for trust administration. No case has been found in which a court has relied on the "prudent man" rule of the 1962 Act.

Fiduciary discretion. The general rule is that if a discretionary power is conferred upon a trustee, the exercise of that power is not subject to control by a court except to prevent an abuse of discretion. Restatement (Second) of Trusts § 187. The situations in which a court will control the exercise of a trustee's discretion are discussed in the comments to § 187. See also id. § 233 Comment *p.*

Questions for which there is no provision. Section 103(a)(4) [Texas Trust Code §116.004(a)(4)] allocates receipts and disbursements to principal when there is no provision for a different allocation in the terms of the trust, the will, or the Act. This may occur because money is received from a financial instrument not available at the present time (inflation-indexed bonds might have fallen into this category had they been announced after this Act was approved by the Commissioners on Uniform State Laws) or because a transaction is of a type or occurs in a manner not anticipated by the Drafting Committee for this Act or the drafter of the trust instrument.

Allocating to principal a disbursement for which there is no provision in the Act or the terms of the trust preserves the income beneficiary's level of income in the year it is allocated to principal, but thereafter will reduce the amount of income produced by the principal. Allocating to principal a receipt for which there is no provision will increase the income received by the income beneficiary in subsequent years, and will eventually, upon termination of the trust, also favor the remainder beneficiary. Allocating these items to principal implements the rule that requires a trustee to administer the trust impartially, based on what is fair and reasonable to both income and remainder beneficiaries. However, if the trustee decides that an adjustment between principal and income is needed to enable the trustee to comply with Section 103(b) [Texas Trust Code §116.004(b)], after considering the return from the portfolio as a whole, the trustee may make an appropriate adjustment under Section 104(a) [Texas Trust Code §116.005(a)].

Duty of impartiality. Whenever there are two or more beneficiaries, a trustee is under a duty to deal impartially with them. Restatement of Trusts 3d: Prudent Investor Rule § 183 (1992). This rule applies whether the beneficiaries' interests in the trust are concurrent or successive. If the terms of the trust give the trustee discretion to favor one beneficiary over another, a court will not control the exercise of such discretion except to prevent the trustee from abusing it. Id. § 183, Comment *a.* "The precise meaning of the trustee's duty of impartiality and the balancing of competing interests and objectives

inevitably are matters of judgment and interpretation. Thus, the duty and balancing are affected by the purposes, terms, distribution requirements, and other circumstances of the trust, not only at the outset but as they may change from time to time." Id. § 232, Comment *c*.

The terms of a trust may provide that the trustee, or an accountant engaged by the trustee, or a committee of persons who may be family members or business associates, shall have the power to determine what is income and what is principal. If the terms of a trust provide that this Act specifically or principal and income legislation in general does not apply to the trust but fail to provide a rule to deal with a matter provided for in this Act, the trustee has an implied grant of discretion to decide the question. Section 103(b) [Texas Trust Code §116.004(b)] provides that the rule of impartiality applies in the exercise of such a discretionary power to the extent that the terms of the trust do not provide that one or more of the beneficiaries are to be favored. The fact that a person is named an income beneficiary or a remainder beneficiary is not by itself an indication of partiality for that beneficiary.

Texas Bar Comment

Texas Trust Code §116.004(a)(4) provides that a receipt or disbursement shall be allocated to principal if neither the terms of the trust nor the Act addresses how such receipt or disbursement is to be allocated. In contrast, former Section 113.101 of the Texas Trust Code provided that the trustee must allocate such receipts and disbursements in accordance with what is reasonable and equitable. While this appears to be a significant change, its effect is mitigated by Texas Trust Code §116.005, which gives the fiduciary the power to make adjustments between income and principal and such adjustments must be based on what is fair and reasonable to all of the beneficiaries.

Texas Trust Code §116.004(b) provides greater protection for fiduciaries by providing that an allocation in accordance with the Uniform Act will be presumed to be fair and reasonable to all beneficiaries. The Section believes that this is a positive adjustment to former Section 113.101(b) of the Texas Trust Code, which provided that no inference arises from the fact that the fiduciary makes an allocation contrary to the Texas Trust Code.

Sec. 116.005. 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 Section 116.004(a), that the trustee is unable to comply with Section 116.004(b). The power to adjust conferred by this subsection includes the power to allocate all or part of a capital gain to trust income.

(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 chapter and the increase or decrease in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available;

(7) 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 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 cotrustee to whom the provision does not apply may make the adjustment unless the exercise of the power by the remaining trustee or trustees is not permitted by the terms of the trust.

(e) A trustee may release the entire power conferred by Subsection (a) 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)-(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).

Uniform Act Comment

Purpose and Scope of Provision. The purpose of Section 104 [Texas Trust Code §116.005] is to enable a trustee to select investments using the standards of a prudent investor without having to realize a particular portion of the portfolio's total return in the form of traditional trust accounting income such as interest, dividends, and rents. Section 104(a)]Texas Trust Code §116.005(a)] authorizes a trustee to make adjustments between principal and income if three conditions are met: (1) the trustee must be managing the trust assets under the prudent investor rule; (2) the terms of the trust must express the income beneficiary's distribution rights in terms of the right to receive "income" in the sense of traditional trust accounting income; and (3) the trustee must determine, after applying the rules in Section 103(a) [Texas Trust Code §116.004(a)], that he is unable to comply with Section 103(b) [Texas Trust Code §116.004(b)]. In deciding whether and to what extent to exercise the power to adjust, the trustee is required to consider the factors described in Section 104(b) [Texas Trust Code §116.005(b)], but the trustee may not make an adjustment in circumstances described in Section 104(c) [Texas Trust Code §116.005(c)].

Section 104 [Texas Trust Code §116.005] does not empower a trustee to increase or decrease the degree of beneficial enjoyment to which a beneficiary is entitled under the terms of the trust; rather, it authorizes the trustee to make adjustments between principal and income that may be necessary if the income component of a portfolio's total return is too small or too large because of investment decisions made by the trustee under the prudent investor rule. The paramount consideration in applying Section 104(a) [Texas Trust Code §116.005(a)] is the requirement in Section 103(b) [Texas Trust Code §116.004(b)] that "a fiduciary must 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." The power to adjust is subject to control by the court to prevent an abuse of discretion. Restatement (Second) of Trusts § 187 (1959). See also id. §§ 183, 232, 233, Comment *p* (1959).

Section 104 [Texas Trust Code §116.005] will be important for trusts that are irrevocable when a State adopts the prudent investor rule by statute or judicial approval of the rule in Restatement of Trusts 3d: Prudent Investor Rule. Wills and trust instruments executed after the rule is adopted can be drafted to describe a beneficiary's distribution rights in terms that do not depend upon the amount of trust accounting income, but to the extent that drafters of trust documents continue to describe an income beneficiary's distribution rights by referring to trust accounting income, Section 104 [Texas Trust Code §116.005] will be an important tool in trust administration.

Three conditions to the exercise of the power to adjust. The first of the three conditions that must be met before a trustee can exercise the power to adjust – that the trustee invest and manage trust assets as a prudent investor – is expressed in this Act by language derived from the Uniform Prudent Investor Act, but the condition will be met whether the prudent investor rule applies because the Uniform Act or other prudent investor legislation has been enacted, the prudent investor rule has been approved by the courts, or the terms of the trust require it. Even if a State's legislature or courts have not formally adopted the rule, the Restatement establishes the prudent investor rule as an authoritative interpretation of the common law prudent man rule, referring to the prudent investor rule as a "modest reformulation of the Harvard College dictum and the basic rule of prior Restatements." Restatement of Trusts 3d: Prudent

Investor Rule, Introduction, at 5. As a result, there is a basis for concluding that the first condition is satisfied in virtually all States except those in which a trustee is permitted to invest only in assets set forth in a statutory "legal list."

The second condition will be met when the terms of the trust require all of the "income" to be distributed at regular intervals; or when the terms of the trust require a trustee to distribute all of the income, but permit the trustee to decide how much to distribute to each member of a class of beneficiaries; or when the terms of a trust provide that the beneficiary shall receive the greater of the trust accounting income and a fixed dollar amount (an annuity), or of trust accounting income and a fractional share of the value of the trust assets (a unitrust amount). If the trust authorizes the trustee in its discretion to distribute the trust's income to the beneficiary or to accumulate some or all of the income, the condition will be met because the terms of the trust do not permit the trustee to distribute more than the trust accounting income.

To meet the third condition, the trustee must first meet the requirements of Section 103(a) [Texas Trust Code §116.004(a)], i.e., she must apply the terms of the trust, decide whether to exercise the discretionary powers given to the trustee under the terms of the trust, and must apply the provisions of the Act if the terms of the trust do not contain a different provision or give the trustee discretion. Second, the trustee must determine the extent to which the terms of the trust clearly manifest an intention by the settlor that the trustee may or must favor one or more of the beneficiaries. To the extent that the terms of the trust do not require partiality, the trustee must conclude that she is unable to comply with the duty to administer the trust impartially. To the extent that the terms of the trust do require or permit the trustee to favor the income beneficiary or the remainder beneficiary, the trustee must conclude that she is unable to achieve the degree of partiality required or permitted. If the trustee comes to either conclusion – that she is unable to administer the trust impartially or that she is unable to achieve the degree of partiality required or permitted – she may exercise the power to adjust under Section 104(a) [Texas Trust Code §116.005(a)].

Impartiality and productivity of income. The duty of impartiality between income and remainder beneficiaries is linked to the trustee's duty to make the portfolio productive of trust accounting income whenever the distribution requirements are expressed in terms of distributing the trust's "income." The 1962 Act implies that the duty to produce income applies on an asset by asset basis because the right of an income beneficiary to receive "delayed income" from the sale proceeds of underproductive property under Section 12 of that Act arises if "any part of principal ... has not produced an average net income of a least 1% per year of its inventory value for more than a year ... ." Under the prudent investor rule, "[t]o whatever extent a requirement of income productivity exists, ... the requirement applies not investment by investment but to the portfolio as a whole." Restatement of Trusts 3d: Prudent Investor Rule § 227, Comment *i,* at 34. The power to adjust under Section 104(a) [Texas Trust Code §116.005(a)] is also to be exercised by considering net income from the portfolio as a whole and not investment by investment. Section 413(b) [Texas Trust Code §116.176(b)] of this Act eliminates the underproductive property rule in all cases other than trusts for which a marital deduction is allowed; the rule applies to a marital deduction trust if the trust's assets "consist substantially of property that does not provide the spouse with sufficient income from or use of the trust assets ..." – in other words, the section applies by reference to the portfolio as a whole.

While the purpose of the power to adjust in Section 104(a) [Texas Trust Code §116.005(a)] is to eliminate the need for a trustee who operates under the prudent investor rule to be concerned about the income component of the portfolio's total return, the trustee must still determine the extent to which a distribution must be made to an income beneficiary and the adequacy of the portfolio's liquidity as a whole to make that distribution.

For a discussion of investment considerations involving specific investments and techniques under the prudent investor rule, see Restatement of Trusts 3d: Prudent Investor Rule § 227, Comments *k-p.*

Factors to consider in exercising the power to adjust. Section 104(b) [Texas Trust Code §116.005(b)] requires a trustee to consider factors relevant to the trust and its beneficiaries in deciding whether and to what extent the power to adjust should be exercised. Section 2(c) of the Uniform Prudent Investor Act [Texas Trust Code §117.004(c)] sets forth circumstances that a trustee is to consider in investing and managing trust assets. The circumstances in Section 2(c) of the Uniform Prudent Investor Act [Texas Trust Code §117.004(c)] are the source of the factors in paragraphs (3) through (6) and (8) of Section 104(b) [Texas Trust Code §116.005(b)] (modified where necessary to adapt them to the purposes of this Act) so that, to the extent possible, comparable factors will apply to investment decisions and decisions involving the power to adjust. If a trustee who is operating under the prudent investor rule decides that the portfolio should be composed of financial assets whose total return will result primarily from capital appreciation rather than dividends, interest, and rents, the trustee can decide at the same time the extent to which an adjustment from principal to income may be necessary under Section 104 [Texas Trust Code §116.005]. On the other hand, if a trustee decides that the risk and return objectives for the trust are best achieved by a portfolio whose total return includes interest and dividend income that is sufficient to provide the income beneficiary with the beneficial interest to which the beneficiary is entitled under the terms of the trust, the trustee can decide that it is unnecessary to exercise the power to adjust.

Assets received from the settlor. Section 3 of the Uniform Prudent Investor Act [Texas Trust Code §117.005] provides that "[a] trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying." The special circumstances may include the wish to retain a family business, the benefit derived from deferring liquidation of the asset in order to defer payment of income taxes, or the anticipated capital appreciation from retaining an asset such as undeveloped real estate for a long period. To the extent the trustee retains assets received from the settlor because of special circumstances that overcome the duty to diversify, the trustee may take these circumstances into account in determining whether and to what extent the power to adjust should be exercised to change the results produced by other provisions of this Act that apply to the retained assets. See Section 104(b)(5) [Texas Trust Code §116.105(b)(5)]; Uniform Prudent Investor Act § 3 [Texas Trust Code §117.005], Comment, 7B U.L.A. 18, at 25-26 (Supp. 1997); Restatement of Trusts 3d: Prudent Investor Rule § 229 and Comments *a-e.*

Limitations on the power to adjust. The purpose of subsections (c)(1) through (4) is to preserve tax benefits that may have been an important purpose for creating the trust. Subsections (c)(5), (6), and (8) deny the power to adjust in the circumstances described in those subsections in order to prevent adverse tax consequences, and subsection (c)(7) denies the power to adjust to any beneficiary, whether or not possession of the power may have adverse tax consequences.

Under subsection (c)(1), a trustee cannot make an adjustment that diminishes the income interest in a trust that requires all of the income to be paid at least annually to a spouse and for which an estate tax or gift tax marital deduction is allowed; but this subsection does not prevent the trustee from making an adjustment that increases the amount of income paid from a marital deduction trust to the spouse. Subsection (c)(1) applies to a trust that qualifies for the marital deduction because the spouse has a general power of appointment over the trust, but it applies to a qualified terminable interest property (QTIP) trust only if and to the extent that the fiduciary makes the election required to obtain the tax deduction. Subsection (c)(1) does not apply to a so-called "estate" trust. This type of trust qualifies for the marital deduction because the terms of the trust require the principal and undistributed income to be

paid to the surviving spouse's estate when the spouse dies; it is not necessary for the terms of an estate trust to require the income to be distributed annually. Reg. § 20.2056(c)-2(b)(1)(iii).

Subsection (c)(3) applies to annuity trusts and unitrusts with no charitable beneficiaries as well as to trusts with charitable income or remainder beneficiaries; its purpose is to make it clear that a beneficiary's right to receive a fixed annuity or a fixed fraction of the value of a trust's assets is not subject to adjustment under Section 104(a) [Texas Trust Code §116.005(a)]. Subsection (c)(3) does not apply to any additional amount to which the beneficiary may be entitled that is expressed in terms of a right to receive income from the trust. For example, if a beneficiary is to receive a fixed annuity or the trust's income, whichever is greater, subsection (c)(3) does not prevent a trustee from making an adjustment under Section 104(a) [Texas Trust Code §116.005(a)] in determining the amount of the trust's income.

If subsection (c)(5), (6), (7), or (8), prevents a trustee from exercising the power to adjust, subsection (d) permits a cotrustee who is not subject to the provision to exercise the power unless the terms of the trust do not permit the cotrustee to do so.

Release of the power to adjust. Section 104(e) [Texas Trust Code §116.005(e)] permits a trustee to release all or part of the power to adjust in circumstances in which the possession or exercise of the power might deprive the trust of a tax benefit or impose a tax burden. For example, if possessing the power would diminish the actuarial value of the income interest in a trust for which the income beneficiary's estate may be eligible to claim a credit for property previously taxed if the beneficiary dies within ten years after the death of the person creating the trust, the trustee is permitted under subsection (e) to release just the power to adjust from income to principal.

Trust terms that limit a power to adjust. Section 104(f) [Texas Trust Code §116.005(f)] applies to trust provisions that limit a trustee's power to adjust. Since the power is intended to enable trustees to employ the prudent investor rule without being constrained by traditional principal and income rules, an instrument executed before the adoption of this Act whose terms describe the amount that may or must be distributed to a beneficiary by referring to the trust's income or that prohibit the invasion of principal or that prohibit equitable adjustments in general should not be construed as forbidding the use of the power to adjust under Section 104(a) [Texas Trust Code §116.005(a)] if the need for adjustment arises because the trustee is operating under the prudent investor rule. Instruments containing such provisions that are executed after the adoption of this Act should specifically refer to the power to adjust if the settlor intends to forbid its use. See generally, Joel C. Dobris, Limits on the Doctrine of Equitable Adjustment in Sophisticated Postmortem Tax Planning, 66 Iowa L. Rev. 273 (1981).

Examples. The following examples illustrate the application of Section 104 [Texas Trust Code §116.005]:

Example (1) – T is the successor trustee of a trust that provides income to A for life, remainder to B. T has received from the prior trustee a portfolio of financial assets invested 20% in stocks and 80% in bonds. Following the prudent investor rule, T determines that a strategy of investing the portfolio 50% in stocks and 50% in bonds has risk and return objectives that are reasonably suited to the trust, but T also determines that adopting this approach will cause the trust to receive a smaller amount of dividend and interest income. After considering the factors in Section 104(b) [Texas Trust

Code §116.005(b)], T may transfer cash from principal to income to the extent T considers it necessary to increase the amount distributed to the income beneficiary.

Example (2) – T is the trustee of a trust that requires the income to be paid to the settlor's son C for life, remainder to C's daughter D. In a period of very high inflation, T purchases bonds that pay double-digit interest and determines that a portion of the interest, which is allocated to income under Section 406 [Texas Trust Code §116.163] of this Act, is a return of capital. In consideration of the loss of value of principal due to inflation and other factors that T considers relevant, T may transfer part of the interest to principal.

Example (3) – T is the trustee of a trust that requires the income to be paid to the settlor's sister E for life, remainder to charity F. E is a retired schoolteacher who is single and has no children. E's income from her social security, pension, and savings exceeds the amount required to provide for her accustomed standard of living. The terms of the trust permit T to invade principal to provide for E's health and to support her in her accustomed manner of living, but do not otherwise indicate that T should favor E or F. Applying the prudent investor rule, T determines that the trust assets should be invested entirely in growth stocks that produce very little dividend income. Even though it is not necessary to invade principal to maintain E's accustomed standard of living, she is entitled to receive from the trust the degree of beneficial enjoyment normally accorded a person who is the sole income beneficiary of a trust, and T may transfer cash from principal to income to provide her with that degree of enjoyment.

Example (4) – T is the trustee of a trust that is governed by the law of State X. The trust became irrevocable before State X adopted the prudent investor rule. The terms of the trust require all of the income to be paid to G for life, remainder to H, and also give T the power to invade principal for the benefit of G for "dire emergencies only." The terms of the trust limit the aggregate amount that T can distribute to G from principal during G's life to 6% of the trust's value at its inception. The trust's portfolio is invested initially 50% in stocks and 50% in bonds, but after State X adopts the prudent investor rule T determines that, to achieve suitable risk and return objectives for the trust, the assets should be invested 90% in stocks and 10% in bonds. This change increases the total return from the portfolio and decreases the dividend and interest income. Thereafter, even though G does not experience a dire emergency, T may exercise the power to adjust under Section 104(a) [Texas Trust Code §116.005(a)] to the extent that T determines that the adjustment is from only the capital appreciation resulting from the change in the portfolio's asset allocation. If T is unable to determine the extent to which capital appreciation resulted from the change in asset allocation or is unable to maintain adequate records to determine the extent to which principal distributions to G for dire emergencies do not exceed the 6% limitation, T may not exercise the power to adjust. See Joel C. Dobris, Limits on the Doctrine of Equitable Adjustment in Sophisticated Postmortem Tax Planning, 66 Iowa L. Rev. 273 (1981).

Example (5) – T is the trustee of a trust for the settlor's child. The trust owns a diversified portfolio of marketable financial assets with a value of $600,000, and is also the sole beneficiary of the settlor's IRA, which holds a diversified portfolio of marketable financial assets with a value of $900,000. The trust receives a distribution from the IRA that is the minimum amount required to be distributed under the Internal Revenue Code, and T allocates 10% of the distribution to income under Section 409(c) [Texas Trust Code §116.172(c) – but see Section116.172(c) and the Texas Bar Comment to that section, since the Texas version varies from uniform act] of this Act. The total return on the IRA's assets exceeds the amount distributed to the trust, and the value of the IRA at the end of the year is more than its value at the beginning of the year. Relevant factors that T may consider in determining whether to exercise the power to adjust and the extent to which an adjustment should be made to comply with Section 103(b) [Texas Trust Code §116.004(b)] include the total return from all of

the trust's assets, those owned directly as well as its interest in the IRA, the extent to which the trust will be subject to income tax on the portion of the IRA distribution that is allocated to principal, and the extent to which the income beneficiary will be subject to income tax on the amount that T distributes to the income beneficiary.

Example (6) – T is the trustee of a trust whose portfolio includes a large parcel of undeveloped real estate. T pays real property taxes on the undeveloped parcel from income each year pursuant to Section 501(3) [Texas Trust Code §116.201(3)]. After considering the return from the trust's portfolio as a whole and other relevant factors described in Section 104(b) [Texas Trust Code §116.005(b)], T may exercise the power to adjust under Section 104(a) [Texas Trust Code §116.005(a)] to transfer cash from principal to income in order to distribute to the income beneficiary an amount that T considers necessary to comply with Section 103(b) [Texas Trust Code §116.004(b)].

Example (7) – T is the trustee of a trust whose portfolio includes an interest in a mutual fund that is sponsored by T. As the manager of the mutual fund, T charges the fund a management fee that reduces the amount available to distribute to the trust by $2,000. If the fee had been paid directly by the trust, one-half of the fee would have been paid from income under Section 501(1) [Texas Trust Code §116.201(1)] and the other one-half would have been paid from principal under Section 502(a)(1) [Texas Trust Code §116.202(a)(1)]. After considering the total return from the portfolio as a whole and other relevant factors described in Section 104(b) [Texas Trust Code §116.005(b)], T may exercise its power to adjust under Section 104(a) [Texas Trust Code §116.005(a)] by transferring $1,000, or half of the trust's proportionate share of the fee, from principal to income.

Texas Bar Comment

Other states that have adopted the Uniform Principal and Income Act have also adopted a provision which allows the trustee to give notice to the beneficiaries of a proposed adjustment and gives the beneficiaries a limited time to object to the proposed adjustment. The Section decided not to include such a notice provision, because statutory and common law provide adequate protections and remedies for trustees and beneficiaries if a trustee exercises its power to adjust.

Some states that have adopted the Uniform Principal and Income Act have also adopted a provision which allows the trustee to elect a unitrust distribution standard. Instead of requiring the trustee to allocate receipts between income and principal, these states authorized the trustee to pay a stated percentage of the trust property to the income beneficiaries. The Section decided that this provision is unnecessary. Each year, the trustee can use the power to adjust to allocate a certain percentage of the trust property to the income beneficiaries. Although this would require the trustee to determine whether to exercise the power each year, the trustee could effectively achieve a unitrust standard. The Section considered the yearly review and determination to be appropriate.

The Section included a specific provision permitting the allocation of capital gains to trust income in subsection (a) to allow the newly allocated income to be treated as distributable net income, in light of proposed treasury regulations under Section 643 of the Internal Revenue Code.

In cases where Section 116.005 cannot be used (for example, in cases where the trustee also is a beneficiary of the trust, judicial means may be available to provide relief in appropriate cases (see, for example, Sections 112.054 and 115.001 of the Texas Trust Code).

Sec. 116.006. JUDICIAL CONTROL OF DISCRETIONARY POWER. (a) The court may not order a trustee to change a decision to exercise or not to exercise a discretionary power conferred by Section 116.005 of this chapter unless the court determines that the decision was an abuse of the trustee's discretion. A trustee's decision is not an abuse of discretion merely because the court would have exercised the power in a different manner or would not have exercised the power.

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

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

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

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

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

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

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

(d) If the trustee of a trust reasonably believes that one or more beneficiaries of such trust will object to the manner in which the trustee intends to exercise or not exercise a discretionary power conferred by Section 116.005 of this chapter, the trustee may petition the court having jurisdiction over the trust, and the court shall determine whether the proposed exercise or nonexercise by the trustee of such discretionary power will result in an abuse of the trustee's discretion. The trustee shall state in such petition the basis for its belief that a beneficiary would object. The failure or refusal of a beneficiary to sign a waiver or release is not reasonable grounds for a trustee to believe the beneficiary will object. The court may appoint one or more guardians ad litem pursuant to Section 115.014 of this subtitle. 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 it will result in an abuse of discretion. The trustee shall advance from the trust principal all costs incident to the judicial determination, including the reasonable attorney's fees and costs of the trustee**,** any beneficiary or beneficiaries who are parties to the action and who retain counsel, and any guardian ad litem. At the conclusion of the proceeding, the court may award costs and reasonable and necessary attorney's fees as provided in Section 114.064 of this subtitle, including, if the court considers it appropriate, awarding part or all of such costs against the trust principal or income, awarding part or all of such costs against one or more beneficiaries or such beneficiary's or beneficiaries' share of the trust, or awarding part or all of such costs against the trustee in the trustee's individual capacity if the court determines the trustee's exercise or nonexercise of discretionary power would have resulted in an abuse of discretion or that the trustee did not have reasonable grounds for believing one or more beneficiaries will object to the proposed exercise or nonexercise of the discretionary power.

Texas Bar Comment

Section 116.006 is based on Section 105 of the Act. Section 105 was not originally included as part of the Act. Rather, it was added in 2000. It permits a trustee who worries that one or more beneficiaries may object to the trustee's exercise of discretion regarding a possible adjustment under Section 116.005 of the Act to seek a court determination that its proposed action (or inaction) will not be an abuse of their discretion. In such a proceeding, a beneficiary challenging the trustee's proposed action (or inaction) has the burden of establishing that it will result in an abuse of discretion.

The Section was concerned that Section 105 of the Act did not have adequate protection for the rights of beneficiaries. As a result, the Texas version has additional protections for beneficiaries.

First, the trustee must have a reasonable belief that a beneficiary will object, and the trustee must state the grounds for this belief in the petition. The failure of a beneficiary to sign a waiver or releas, standing alone, is not reasonable grounds for a trustee to believe the beneficiary will object. Thus, if the

trustee asks a beneficiary to sign a waiver or release and the beneficiary refuses to do so but does not affirmatively object, then the refusal, standing alone, cannot form the basis of the trustee's lawsuit under Section 116.006(d).

Second, Section 116.006(d) confirms that the court may appoint one or more guardians ad litem if under the terms of Trust Code Section 115.014 the court considers this appropriate.

Third, the trustee must advance "costs incident to the judicial determination" from trust principal. These costs include the reasonable attorney's fees and costs of the trustee and of any beneficiary who retains counsel in the proceeding, as well as the guardian ad litem's fees. These fees and costs must be incident to the judicial determination, but they are to be advanced to any beneficiary who retains counsel, not just to a beneficiary who objects to the trustee's proposed action. The advancement of costs makes it possible for all interested parties to obtain representation in the proceeding, but it does not mean that the principal of the trust ultimately will bear these costs. The provision permits the court to award costs and reasonable and necessary attorney's fees as provided in Trust Code Section 114.064. This could result in part or all of the costs being awarded against trust principal or income, against a beneficiary or his or her interest in the trust, or against the trustee in its individual capacity. The provision mentions two specific reasons why the court may choose to award costs against the trustee – if the trustee's action or inaction would have resulted in an abuse of discretion or if the trustee did not have reasonable grounds for believing a beneficiary would object to the trustee's action.

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

(b) In this section:

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

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

(c) Distribution of the unitrust amount is considered a distribution of all of the income of the unitrust and shall not be considered a fundamental departure from applicable state law. A distribution of the unitrust amount reasonably apportions the total return of a unitrust.

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

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

(2) from ordinary accounting income not allocable to net accounting income;

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

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

(5) from the principal of the trust estate.

Texas Bar Comment

Section 116.007 is not part of the uniform act and is not a unitrust conversion statute. Rather it permits a settlor to draft a non-charitable unitrust and includes support in Texas law for defining trust income in terms of a unitrust amount. This provision is intended to take advantage of Proposed Treasury Regulation 1.643(b)-1, 66 Fed. Reg. 10396 (February 15, 2001), when it becomes final, which provides that amounts allocated between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust. Under the proposed regulation, a state law that provides for the income beneficiary to receive each year a unitrust amount of between 3% and 5% of the annual fair market value of the trust assets is a reasonable apportionment of the total return of the trust. Section 116.007 provides support in Texas law for a settlor who wishes to create a non-charitable unitrust paying a unitrust amount of between 3% and 5% by defining such amount as "income" for state fiduciary accounting purposes. If the proposed regulation becomes final, this should make it unnecessary for a settlor to provide for the payment of the greater of the unitrust amount or actual income in order to meet tax requirements for a trust which requires the distribution of all income to a beneficiary (for example, a marital deduction trust). The provision does not require that trust income be defined in terms of a unitrust percentage, nor does it provide a means for converting an all-income trust into a unitrust. Because other rules apply to charitable unitrusts, this provision does not apply to them.

[Sections 116.008-116.050 reserved for expansion]

SUBCHAPTER B. DECEDENT'S ESTATE OR TERMINATING INCOME INTEREST

Sec. 116.051. 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 Subchapters C, D, and E which apply to trustees and the rules in Subdivision (5). The fiduciary shall distribute the net income and net principal receipts to the beneficiary who is to receive the specific property.

(2) A fiduciary shall determine the remaining net income of a decedent's estate or a terminating income interest under the rules in Subchapters C, D, and E 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 Subdivision (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. Unless otherwise provided by the will or the terms of the trust, a beneficiary who receives a pecuniary amount, regardless of whether in trust, shall be paid interest on the pecuniary amount at the legal rate of interest as provided by Section 302.002, Finance Code. Interest on the pecuniary amount is payable:

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

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

(4) A fiduciary shall distribute the net income remaining after distributions required by Subdivision (3) in the manner described in Section 116.052 to all other beneficiaries 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 Subdivision (1) because of a payment described in Section 116.201 or 116.202 to the extent that the will, the terms of the trust, or applicable law requires the fiduciary to make the payment from assets other than the property or to the extent that the fiduciary recovers or expects to recover the payment from a third party. The net income and principal receipts from the property are determined by including all of the amounts the fiduciary receives or pays with respect to the property, whether those amounts accrued or became due before, on, or after the date of a decedent's death or an income interest's terminating event, and by making a reasonable provision for amounts that the fiduciary believes the estate or terminating income interest may become obligated to pay after the property is distributed.

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

Uniform Act Comment

Terminating income interests and successive income interests. A trust that provides for a single income beneficiary and an outright distribution of the remainder ends when the income interest ends. A more complex trust may have a number of income interests, either concurrent or successive, and the trust will not necessarily end when one of the income interests ends. For that reason, the Act speaks in terms of income interests ending and beginning rather than trusts ending and beginning. When an

income interest in a trust ends, the trustee's powers continue during the winding up period required to complete its administration. A terminating income interest is one that has ended but whose administration is not complete.

If two or more people are given the right to receive specified percentages or fractions of the income from a trust concurrently and one of the concurrent interests ends, e.g., when a beneficiary dies, the beneficiary's income interest ends but the trust does not. Similarly, when a trust with only one income beneficiary ends upon the beneficiary's death, the trust instrument may provide that part or all of the trust assets shall continue in trust for another income beneficiary. While it is common to think and speak of this (and even to characterize it in a trust instrument) as a "new" trust, it is a continuation of the original trust for a remainder beneficiary who has an income interest in the trust assets instead of the right to receive them outright. For purposes of this Act, this is a successive income interest in the same trust. The fact that a trust may or may not end when an income interest ends is not significant for purposes of this Act.

If the assets that are subject to a terminating income interest pass to another trust because the income beneficiary exercises a general power of appointment over the trust assets, the recipient trust would be a new trust; and if they pass to another trust because the beneficiary exercises a nongeneral power of appointment over the trust assets, the recipient trust might be a new trust in some States (see 5A Austin W. Scott & William F. Fratcher, The Law of Trusts § 640, at 483 (4th ed. 1989)); but for purposes of this Act a new trust created in these circumstances is also a successive income interest.

Gift of a pecuniary amount. Section 201(3) and (4) [Texas Trust Code §116.051(3) and (4)] provide different rules for an outright gift of a pecuniary amount and a gift in trust of a pecuniary amount; this is the same approach used in Section 5(b)(2) of the 1962 Act.

Interest on pecuniary amounts. Section 201(3) [Texas Trust Code §116.051(3)] provides that the beneficiary of an outright pecuniary amount is to receive the interest or other amount provided by applicable law if there is no provision in the will or the terms of the trust. [See Texas Bar Comment, below.] Many States have no applicable law that provides for interest or some other amount to be paid on an outright pecuniary gift under an inter vivos trust; this section provides that in such a case the interest or other amount to be paid shall be the same as the interest or other amount required to be paid on testamentary pecuniary gifts. This provision is intended to accord gifts under inter vivos instruments the same treatment as testamentary gifts. The various state authorities that provide for the amount that a beneficiary of an outright pecuniary amount is entitled to receive are collected in Richard B. Covey, Marital Deduction and Credit Shelter Dispositions and the Use of Formula Provisions, App. B (4th ed. 1997).

Administration expenses and interest on death taxes. Under Section 201(2)(B) [Texas Trust Code §116.051(2)(B)] a fiduciary may pay administration expenses and interest on death taxes from either income or principal. An advantage of permitting the fiduciary to choose the source of the payment is that, if the fiduciary's decision is consistent with the decision to deduct these expenses for income tax purposes or estate tax purposes, it eliminates the need to adjust between principal and income that may arise when, for example, an expense that is paid from principal is deducted for income tax purposes or an expense that is paid from income is deducted for estate tax purposes.

The United States Supreme Court has considered the question of whether an estate tax marital deduction or charitable deduction should be reduced when administration expenses are paid from income

produced by property passing in trust for a surviving spouse or for charity and deducted for income tax purposes. The Court rejected the IRS position that administration expenses properly paid from income under the terms of the trust or state law must reduce the amount of a marital or charitable transfer, and held that the value of the transferred property is not reduced for estate tax purposes unless the administration expenses are material in light of the income the trust corpus could have been expected to generate. *Commissioner v. Estate of Otis C. Hubert*, 117 S.Ct. 1124 (1997). The provision in Section 201(2)(B) [Texas Trust Code §116.051(2)(B)] permits a fiduciary to pay and deduct administration expenses from income only to the extent that it will not cause the reduction or loss of an estate tax marital or charitable contributions deduction, which means that the limit on the amount payable from income will be established eventually by Treasury Regulations.

Interest on estate taxes. The IRS agrees that interest on estate and inheritance taxes may be deducted for income tax purposes without having to reduce the estate tax deduction for amounts passing to a charity or surviving spouse, whether the interest is paid from principal or income. Rev. Rul. 93-48, 93-2 C.B. 270. For estates of persons who died before 1998, a fiduciary may not want to deduct for income tax purposes interest on estate tax that is deferred under Section 6166 or 6163 because deducting that interest for estate tax purposes may produce more beneficial results, especially if the estate has little or no income or the income tax bracket is significantly lower than the estate tax bracket. For estates of persons who die after 1997, no estate tax or income tax deduction will be allowed for interest paid on estate tax that is deferred under Section 6166. However, interest on estate tax deferred under Section 6163 will continue to be deductible for both purposes, and interest on estate tax deficiencies will continue to be deductible for estate tax purposes if an election under Section 6166 is not in effect.

Under the 1962 Act, Section 13(c)(5) charges interest on estate and inheritance taxes to principal. The 1931 Act has no provision. Section 501(3) [Texas Trust Code §116.201(3)] of this Act provides that, except to the extent provided in Section 201(2)(B) or (C) [Texas Trust Code §116.051(2)(B) or (C)], all interest must be paid from income.

Texas Bar Comment

Section 201(3) of the Uniform Principal and Income Act, as originally promulgated, provided that a beneficiary who receives a pecuniary amount outright shall also receive the interest or any other amount provided by the will, the terms of the trust, or applicable law. This provision did not apply to a beneficiary who receives a pecuniary amount in trust. Prior Texas law (Texas Probate Code Section 378(B)(f)) did not differentiate between recipients of pecuniary amounts based on whether the amounts are to be received outright or in trust. Section 116.051(3) adopts the Texas Probate Code view regarding interest on pecuniary amounts by eliminating the differentiation between recipients of pecuniary amounts based on whether the amounts are to be received outright or in trust. Section 116.051(3) also provides that interest on pecuniary amounts begins one year after the death of the decedent for a pecuniary amount payable under a will and one year after an income interest ends for a pecuniary amount payable under a trust. This is a departure from former Texas Probate Code Section 378B(f), which provided that such interest began one year after the court grants letters testamentary or letters of administration

Section 116.051(2)(B) authorizes the fiduciary to allocate interest on estate taxes to either principal or income. In contrast, former Section 378(B)(a) of the Texas Probate Code required that interest on estate taxes be charged against principal. The Section believes that the flexibility provided for by the Uniform Principal and Income Act approach is advantageous.

Sec. 116.052. DISTRIBUTION TO RESIDUARY AND REMAINDER BENEFICIARIES. (a) Each beneficiary described in Section 116.051(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.

Uniform Act Comment

Relationship to prior Acts. Section 202 [Texas Trust Code §116.052] retains the concept in Section 5(b)(2) of the 1962 Act that the residuary legatees of estates are to receive net income earned during the period of administration on the basis of their proportionate interests in the undistributed assets when distributions are made. It changes the basis for determining their proportionate interests by using asset values as of a date reasonably near the time of distribution instead of inventory values; it extends the application of these rules to distributions from terminating trusts; and it extends these rules to gain or loss realized from the disposition of assets during administration, an omission in the 1962 Act that has been noted by several commentators. See, e.g., Richard B. Covey, Marital Deduction and Credit Shelter Dispositions and the Use of Formula Provisions 91 (4th ed. 1998); Thomas H. Cantrill, Fractional or Percentage Residuary Bequests: Allocation of Postmortem Income, Gain and Unrealized Appreciation, 10 Prob. Notes 322, 327 (1985).

Texas Bar Comment

Section 116.052 is an improvement over existing law because it provides more certainty for the fiduciary than former Section 378(B)(d) and (h) of the Texas Probate Code provided to an executor.

[Sections 116.053-116.100 reserved for expansion]

SUBCHAPTER C. APPORTIONMENT AT BEGINNING AND END OF INCOME INTEREST

Sec. 116.101. 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.

Uniform Act Comment

Period during which there is no beneficiary. The purpose of the second part of subsection (d) is to provide that, at the end of a period during which there is no beneficiary to whom a trustee may distribute income, the trustee must apply the same apportionment rules that apply when a mandatory income interest ends. This provision would apply, for example, if a settlor creates a trust for grandchildren before any grandchildren are born. When the first grandchild is born, the period preceding the date of birth is treated as having ended, followed by a successive income interest, and the apportionment rules in Sections 302 and 303 [Texas Trust Code §§116.102 and 116.103] apply accordingly if the terms of the trust do not contain different provisions.

Texas Bar Comment

Section 116.101 is substantially similar to former Section 113.103.

Sec. 116.102. APPORTIONMENT OF RECEIPTS AND DISBURSEMENTS WHEN DECEDENT DIES OR INCOME INTEREST BEGINS. (a) A trustee shall allocate an income receipt or disbursement other than one to which Section 116.051(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 chapter. Distributions to shareholders or other owners from an entity to which Section 116.151 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.

Uniform Act Comment

Prior Acts. Professor Bogert stated that "Section 4 of the [1962] Act makes a change with respect to the apportionment of the income of trust property not due until after the trust began but which accrued in part before the commencement of the trust. It treats such income as to be credited entirely to the income account in the case of a living trust, but to be apportioned between capital and income in the case of a testamentary trust. The [1931] Act apportions such income in the case of both types of trusts, except in the case of corporate dividends." George G. Bogert, The Revised Uniform Principal and Income Act, 38 Notre Dame Law. 50, 52 (1962). The 1962 Act also provides that an asset passing to an inter vivos trust by a bequest in the settlor's will is governed by the rule that applies to a testamentary trust, so that different rules apply to assets passing to an inter vivos trust depending upon whether they were transferred to the trust during the settlor's life or by his will.

Having several different rules that apply to similar transactions is confusing. In order to simplify administration, Section 302 [Texas Trust Code §116.102] applies the same rule to inter vivos trusts (revocable and irrevocable), testamentary trusts, and assets that become subject to an inter vivos trust by a testamentary bequest.

Periodic payments. Under Section 302 [Texas Trust Code §116.102], a periodic payment is principal if it is due but unpaid before a decedent dies or before an asset becomes subject to a trust, but the next payment is allocated entirely to income and is not apportioned. Thus, periodic receipts such as rents, dividends, interest, and annuities, and disbursements such as the interest portion of a mortgage payment, are not apportioned. This is the original common law rule. Edwin A. Howes, Jr., The American Law Relating to Income and Principal 70 (1905). In trusts in which a surviving spouse is dependent upon a regular flow of cash from the decedent's securities portfolio, this rule will help to maintain payments to the spouse at the same level as before the settlor's death. Under the 1962 Act, the pre-death portion of the first periodic payment due after death is apportioned to principal in the case of a testamentary trust or securities bequeathed by will to an inter vivos trust.

Nonperiodic payments. Under the second sentence of Section 302(b) [Texas Trust Code §116.102(b)], interest on an obligation that does not provide a due date for the interest payment, such as interest on an income tax refund, would be apportioned to principal to the extent it accrues before a person dies or an income interest begins unless the obligation is specifically given to a devisee or remainder beneficiary, in which case all of the accrued interest passes under Section 201(1) [Texas Trust Code §116.051(1)] to the person who receives the obligation. The same rule applies to interest on an obligation that has a due date but does not provide for periodic payments. If there is no stated interest on the obligation, such as a zero coupon bond, and the proceeds from the obligation are received more than one year after it is purchased or acquired by the trustee, the entire amount received is principal under Section 406 [Texas Trust Code §116.163].

Sec. 116.103. 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.

Uniform Act Comment

Prior Acts. Both the 1931 Act (Section 4) and the 1962 Act (Section 4(d)) provide that a deceased income beneficiary's estate is entitled to the undistributed income. The Drafting Committee concluded that this is probably not what most settlors would want, and that, with respect to undistributed income, most settlors would favor the income beneficiary first, the remainder beneficiaries second, and the income beneficiary's heirs last, if at all. However, it decided not to eliminate this provision to avoid causing disputes about whether the trustee should have distributed collected cash before the income beneficiary died.

Accrued periodic payments. Under the prior Acts, an income beneficiary or his estate is entitled to receive a portion of any payments, other than dividends, that are due or that have accrued when the income interest terminates. The last sentence of subsection (a) changes that rule by providing that such items are not included in undistributed income. The items affected include periodic payments of interest, rent, and dividends, as well as items of income that accrue over a longer period of time; the rule also applies to expenses that are due or accrued.

Example – accrued periodic payments. The rules in Section 302 and Section 303 [Texas Trust Code §§116.102 and 116.103] work in the following manner: Assume that a periodic payment of rent that is due on July 20 has not been paid when an income interest ends on July 30; the successive income interest begins on July 31, and the rent payment that was due on July 20 is paid on August 3. Under Section 302(a) [Texas Trust Code §116.102(a)], the July 20 payment is added to the principal of the successive income interest when received. Under Section 302(b) [Texas Trust Code §116.102(b)], the entire periodic payment of rent that is due on August 20 is income when received by the successive income interest. Under Section 303 [Texas Trust Code §116.103)], neither the income beneficiary of the terminated income interest nor the beneficiary's estate is entitled to any part of either the July 20 or the August 20 payments because neither one was received before the income interest ended on July 30. The same principles apply to expenses of the trust.

Beneficiary with an unqualified power to revoke. The requirement in subsection (b) to pay undistributed income to a mandatory income beneficiary or her estate does not apply to the extent the beneficiary has an unqualified power to revoke more than five percent of the trust immediately before the income interest ends. Without this exception, subsection (b) would apply to a revocable living trust whose settlor is the mandatory income beneficiary during her lifetime, even if her will provides that all of the assets in the probate estate are to be distributed to the trust.

If a trust permits the beneficiary to withdraw all or a part of the trust principal after attaining a specified age and the beneficiary attains that age but fails to withdraw all of the principal that she is permitted to withdraw, a trustee is not required to pay her or her estate the undistributed income attributable to the portion of the principal that she left in the trust. The assumption underlying this rule is that the beneficiary has either provided for the disposition of the trust assets (including the undistributed income) by exercising a power of appointment that she has been given or has not withdrawn the assets because she is willing to have the principal and undistributed income be distributed under the terms of the trust. If the beneficiary has the power to withdraw 25% of the trust principal, the trustee must pay to her or her estate the undistributed income from the 75% that she cannot withdraw.

[Sections 116.104-116.150 reserved for expansion]

SUBCHAPTER D. ALLOCATION OF RECEIPTS DURING ADMINISTRATION OF TRUST

PART 1. RECEIPTS FROM ENTITIES

Sec. 116.151. 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 Section 116.152 applies, a business or activity to which Section 116.153 applies, or an asset-backed security to which Section 116.178 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.

Uniform Act Comment

Entities to which Section 401 [Texas Trust Code §116.151] applies. The reference to partnerships in Section 401(a) [Texas Trust Code §116.151(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's 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. Making or continuing such an election would be equivalent to deciding under Section 104 [Texas Trust Code §116.005] to transfer income to principal in order to comply with Section 103(b) [Texas Trust Code §116.004(b)].. However, if the trustee makes or continues the election for a reason other than to comply with Section 103(b) [Texas Trust Code §116.004(b)], e.g., to make an investment without incurring brokerage commissions, the trustee should transfer cash from principal to income in an amount equal to the reinvested dividends.

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, Section 401 [Texas Trust Code §116.151] embraces all of the items enumerated in

Section 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% 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% of the gross assets, the portion of the distribution that does not exceed the amount of 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% but not more than 20% 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 the conduct of its normal business operations because it sold an investment asset; or because it sold a business asset other than one held for sale to customers in the normal course of its 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% 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 Section 104(a) [Texas Trust Code §116.005(a)] to make an adjustment between income and principal, subject to the limitations in Section 104(c) [Texas Trust Code §116.005(c)].

Texas Bar Comment

Former Sections 113.104 and 113.106 of the Texas Trust Code contained provisions applicable only to corporations, sole proprietorships, partnerships, and farming operations. In contrast, Section 116.151 applies to all forms of business entities. It also provides more detailed guidelines than the former Texas Trust Code provisions.

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

Uniform Act Comment

Terms of the distributing trust or estate. Under Section 103(a) [Texas Trust Code §116.004(a)], a trustee is to allocate receipts in accordance with the terms of the recipient trust or, if there is no provision, in accordance with this Act. However, in determining whether a distribution from another trust or an estate is income or principal, the trustee should also determine what the terms of the distributing trust or estate say about the distribution – for example, whether they direct that the

distribution, even though made from the income of the distributing trust or estate, is to be added to principal of the recipient trust. Such a provision should override the terms of this Act, but if the terms of the recipient trust contain a provision requiring such a distribution to be allocated to income, the trustee may have to obtain a judicial resolution of the conflict between the terms of the two documents.

Investment trusts. An investment entity to which the second sentence of this section applies includes a mutual fund, a common trust fund, a business trust or other entity organized as a trust for the purpose of receiving capital contributed by investors, investing that capital, and managing investment assets, including asset-backed security arrangements to which Section 415 [Texas Trust Code §116.178] applies. See John H. Langbein, The Secret Life of the Trust: The Trust as an Instrument of Commerce, 107 Yale L.J. 165 (1997).

Texas Bar Comment

Section 116.152 addresses issues that previously were not addressed in the Texas Trust Code.

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

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

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

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

(2) farming;

(3) raising and selling livestock and other animals;

(4) management of rental properties;

(5) extraction of minerals and other natural resources;

(6) timber operations; and

(7) activities to which Section 116.177 applies.

Uniform Act Comment

Purpose and scope. The provisions in Section 403 [Texas Trust Code §116.153] are intended to give greater flexibility to a trustee who operates a business or other activity in proprietorship form rather than in a wholly-owned corporation (or, where permitted by state law, a single-member limited liability company), and to facilitate the trustee's ability to decide the extent to which the net receipts from the activity should be allocated to income, just as the board of directors of a corporation owned entirely by the trust would decide the amount of the annual dividend to be paid to the trust. It permits a trustee to account for farming or livestock operations, rental properties, oil and gas properties, timber operations, and activities in derivatives and options as though they were held by a separate entity. It is not intended, however, to permit a trustee to account separately for a traditional securities portfolio to avoid the provisions of this Act that apply to such securities.

Section 403 [Texas Trust Code §116.153] permits the trustee to account separately for each business or activity for which the trustee determines separate accounting is appropriate. A trustee with a computerized accounting system may account for these activities in a "subtrust"; an individual trustee may continue to use the business and record-keeping methods employed by the decedent or transferor who may have conducted the business under an assumed name. The intent of this section is to give the trustee broad authority to select business record-keeping methods that best suit the activity in which the trustee is engaged.

If a fiduciary liquidates a sole proprietorship or other activity to which Section 403 [Texas Trust Code §116.153] applies, the proceeds would be added to principal, even though derived from the liquidation of accounts receivable, because the proceeds would no longer be needed in the conduct of the business. If the liquidation occurs during probate or during an income interest's winding up period, none of the proceeds would be income for purposes of Section 201 [Texas Trust Code §116.051].

Separate accounts. A trustee may or may not maintain separate bank accounts for business activities that are accounted for under Section 403 [Texas Trust Code §116.153]. A professional trustee may decide not to maintain separate bank accounts, but an individual trustee, especially one who has continued a decedent's business practices, may continue the same banking arrangements that were used during the decedent's lifetime. In either case, the trustee is authorized to decide to what extent cash is to be retained as part of the business assets and to what extent it is to be transferred to the trust's general accounts, either as income or principal.

Texas Bar Comment

Section 116.153 improves upon former Section 113.106 of the Texas Trust Code by providing important guidance for a fiduciary that conducts a business activity.

[Sections 116.154-116.160 reserved for expansion]

PART 2. RECEIPTS NOT NORMALLY APPORTIONED

Sec. 116.161. PRINCIPAL RECEIPTS. A trustee shall allocate to principal:

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

(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 subchapter;

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

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

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

(6) other receipts as provided in Part 3.

Uniform Act Comment

Eminent domain awards. Even though the award in an eminent domain proceeding may include an amount for the loss of future rent on a lease, if that amount is not separately stated the entire award is principal. The rule is the same in the 1931 and 1962 Acts.

Texas Bar Comment

Section 116.161 is substantially similar to former Section 113.102(B)(1), (2), and (8).

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

Uniform Act Comment

Application of Section 403 [Texas Trust Code §116.153]. This section applies to the extent that the trustee does not account separately under Section 403 [Texas Trust Code §116.153] for the management of rental properties owned by the trust.

Receipts that are capital in nature. A portion of the payment under a lease may be a reimbursement of principal expenditures for improvements to the leased property that is characterized as rent for purposes of invoking contractual or statutory remedies for nonpayment. If the trustee is accounting for rental income under Section 405 [Texas Trust Code §116.162], a transfer from income to reimburse principal may be appropriate under Section 504 [Texas Trust Code §116.204] to the extent that some of the "rent" is really a reimbursement for improvements. This set of facts could also be a relevant factor for a trustee to consider under Section 104(b) [Texas Trust Code §116.005(b)] in deciding whether and to what extent to make an adjustment between principal and income under Section 104(a) [Texas Trust Code §116.005(a)] after considering the return from the portfolio as a whole.

Texas Bar Comment

Section 116.162 is substantially similar to former Section 113.102(A)(1) and (B)(1).

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

(b) A trustee shall allocate to principal an amount received from the sale, redemption, or other disposition of an obligation to pay money to the trustee more than one year after it is purchased or acquired by the trustee, including an obligation whose

purchase price or value when it is acquired is less than its value at maturity. If the obligation matures within one year after it is purchased or acquired by the trustee, an amount received in excess of its purchase price or its value when acquired by the trust must be allocated to income.

(c) This section does not apply to an obligation to which Section 116.172, 116.173, 116.174, 116.175, 116.177, or 116.178 applies.

Uniform Act Comment

Variable or floating interest rates. The reference in subsection (a) to variable or floating interest rate obligations is intended to clarify that, even though an obligation's interest rate may change from time to time based upon changes in an index or other market indicator, an obligation to pay money containing a variable or floating rate provision is subject to this section and is not to be treated as a derivative financial instrument under Section 414 [Texas Trust Code §116.177].

Discount obligations. Subsection (b) applies to all obligations acquired at a discount, including short-term obligations such as U.S. Treasury Bills, long-term obligations such as U.S. Savings Bonds, zero-coupon bonds, and discount bonds that pay interest during part, but not all, of the period before maturity. Under subsection (b), the entire increase in value of these obligations is principal when the trustee receives the proceeds from the disposition unless the obligation, when acquired, has a maturity of less than one year. In order to have one rule that applies to all discount obligations, the Act eliminates the provision in the 1962 Act for the payment from principal of an amount equal to the increase in the value of U.S. Series E bonds. The provision for bonds that mature within one year after acquisition by the trustee is derived from the Illinois act. 760 ILCS 15/8 (1996).

Subsection (b) also applies to inflation-indexed bonds – any increase in principal due to inflation after issuance is principal upon redemption if the bond matures more than one year after the trustee acquires it; if it matures within one year, all of the increase, including any attributable to an inflation adjustment, is income.

Effect of Section 104 [Texas Trust Code §116.005]. In deciding whether and to what extent to exercise the power to adjust between principal and income granted by Section 104(a) [Texas Trust Code §116.005(a)], a relevant factor for the trustee to consider is the effect on the portfolio as a whole of having a portion of the assets invested in bonds that do not pay interest currently.

Texas Bar Comment

Section 116.163(a) and former Section 113.102(a)(2) both allocate interest received to income. Section 116.163(b) provides new rules for the treatment of discount obligations. It provides that the proceeds from the sale of a discount obligation are principal, unless the obligation matured within one year after it was acquired by the trustee. In contrast, former Section 113.105(b) treated the increasing value of an obligation for the payment of money as income, regardless of whether the trustee holds the obligation for longer than one year. If the trustee determines that Section 113.163(b) creates unfairness, the trustee can exercise the Section 116.005 power to adjust.

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

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

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

Texas Bar Comment

Section 116.164 is substantially similar to former Section 113.102.

[Sections 116.165-116.170 reserved for expansion]

PART 3. RECEIPTS NORMALLY APPORTIONED

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

Uniform Act Comment

This section is intended to relieve a trustee from making relatively small allocations while preserving the trustee's right to do so if an allocation is large in terms of absolute dollars.

For example, assume that a trust's assets, which include a working interest in an oil well, have a value of $1,000,000; the net income from the assets other than the working interest is $40,000; and the

net receipts from the working interest are $400. The trustee may allocate all of the net receipts from the working interest to principal instead of allocating 10%, or $40, to income under Section 411 [Texas Trust Code §116.174 – but see Texas Bar Comment below and see Texas version of UPIA §411 at Texas Trust Code §116.174]. If the net receipts from the working interest are $35,000, so that the amount allocated to income under Section 411 [Texas Trust Code §116.174] would be $3,500, the trustee may decide that this amount is sufficiently significant to the income beneficiary that the allocation provided for by Section 411 [Texas Trust Code §116.174] should be made, even though the trustee is still permitted under Section 408[Texas Trust Code §116.171] to allocate all of the net receipts to principal because the $3,500 would increase the net income of $40,000, as determined before making an allocation under Section 411 [Texas Trust Code §116.174], by less than 10% [but see Texas Bar Comment below and see Texas version of UPIA §411 at Texas Trust Code §116.174]. Section 408 [Texas Trust Code §116.171] will also relieve a trustee from having to allocate net receipts from the sale of trees in a small woodlot between principal and income.

While the allocation to principal of small amounts under this section should not be a cause for concern for tax purposes, allocations are not permitted under this section in circumstances described in Section 104(c) [Texas Trust Code §116.005(c)] to eliminate claims that the power in this section has adverse tax consequences.

Texas Bar Comment

There was no Texas counterpart to Section 116.171 under prior Texas law. The Section determined that insubstantial allocations to income should not be required. However, the Section decided not to include a definition of what is presumed to be insubstantial. Without this presumption, the trustee will be able to use its discretion in determining when an allocation is insubstantial and should not be questioned merely because its determination did not satisfy an arbitrary presumption.

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

(1) "Future payment asset" means the asset from which a payment is derived.

(2) "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 the payer characterizes a payment 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 the part of the payment that does not exceed an amount equal to:

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

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

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

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

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

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

(f) A trustee shall allocate to principal the part of the payment described by Subsection (c) that is not allocated to income.

(g) 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 Subsection (c) and this subsection, a payment is not "required to be made" to the extent that it is made only because the trustee exercises a right of withdrawal.

(h) 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.

Uniform Act Comment

Scope. Section 409 [Texas Trust Code §116.172] applies to amounts received under contractual arrangements that provide for payments to a third party beneficiary as a result of services rendered or property transferred to the payer. While the right to receive such payments is a liquidating asset of the kind described in Section 410 [Texas Trust Code §116.173] (i.e., "an asset whose value will diminish or terminate because the asset is expected to produce receipts for a period of limited duration"), these payment rights are covered separately in Section 409 [Texas Trust Code §116.172] because of their special characteristics.

Section 409 [Texas Trust Code §116.172] applies to receipts from all forms of annuities and deferred compensation arrangements, whether the payment will be received by the trust in a lump sum or in installments over a period of years. It applies to bonuses that may be received over two or three years and payments that may last for much longer periods, including payments from an individual retirement account (IRA), deferred compensation plan (whether qualified or not qualified for special federal income tax treatment), and insurance renewal commissions. It applies to a retirement plan to which the settlor has made contributions, just as it applies to an annuity policy that the settlor may have purchased individually, and it applies to variable annuities, deferred annuities, annuities issued by commercial insurance companies, and "private annuities" arising from the sale of property to another individual or entity in exchange for payments that are to be made for the life of one or more individuals. The section applies whether the payments begin when the payment right becomes subject to the trust or are deferred until a future date, and it applies whether payments are made in cash or in kind, such as employer stock (in-kind payments usually will be made in a single distribution that will be allocated to principal under the second sentence of subsection (c)).

The 1962 Act. Under Section 12 of the 1962 Act, receipts from "rights to receive payments on a contract for deferred compensation" are allocated to income each year in an amount "not in excess of 5% per year" of the property's inventory value. While "not in excess of 5%" suggests that the annual allocation may range from zero to 5% of the inventory value, in practice the rule is usually treated as prescribing a 5% allocation. The inventory value is usually the present value of all the future payments, and since the inventory value is determined as of the date on which the payment right becomes subject to the trust, the inventory value, and thus the amount of the annual income allocation, depends significantly on the applicable interest rate on the decedent's date of death. That rate may be much higher or lower than the average long-term interest rate. The amount determined under the 5% formula tends to become fixed and remain unchanged even though the amount received by the trust increases or decreases.

Allocations Under Section 409(b) [Texas Trust Code §116.172(b)]. Section 409(b) [Texas Trust Code §116.172(b)] applies to plans whose terms characterize payments made under the plan as dividends, interest, or payments in lieu of dividends or interest. For example, some deferred compensation plans that hold debt obligations or stock of the plan's sponsor in an account for future delivery to the person rendering the services provide for the annual payment to that person of dividends received on the stock or interest received on the debt obligations. Other plans provide that the account of the person rendering the services shall be credited with "phantom" shares of stock and require an annual payment that is equivalent to the dividends that would be received on that number of shares if they were

actually issued; or a plan may entitle the person rendering the services to receive a fixed dollar amount in the future and provide for the annual payment of interest on the deferred amount during the period prior to its payment. Under Section 409(b) [Texas Trust Code §116.172(b)] , payments of dividends, interest or payments in lieu of dividends or interest under plans of this type are allocated to income; all other payments received under these plans are allocated to principal.

Section 409(b) [Texas Trust Code §116.172(b)] does not apply to an IRA or an arrangement with payment provisions similar to an IRA. IRAs and similar arrangements are subject to the provisions in Section 409(c) [Texas Trust Code §116.172(c)] .

Allocations Under Section 409(c) [Texas Trust Code §116.172(c)]. The focus of Section 409 [Texas Trust Code §116.172], for purposes of allocating payments received by a trust to or between principal and income, is on the payment right rather than on assets that may be held in a fund from which the payments are made. Thus, if an IRA holds a portfolio of marketable stocks and bonds, the amount received by the IRA as dividends and interest is not taken into account in determining the principal and income allocation except to the extent that the Internal Revenue Service may require them to be taken into account when the payment is received by a trust that qualifies for the estate tax marital deduction (a situation that is provided for in Section 409(d) [Texas Trust Code §116.172(h)). An IRA is subject to federal income tax rules that require payments to begin by a particular date and be made over a specific number of years or a period measured by the lives of one or more persons. The payment right of a trust that is named as a beneficiary of an IRA is not a right to receive particular items that are paid to the IRA, but is instead the right to receive an amount determined by dividing the value of the IRA by the remaining number of years in the payment period. This payment right is similar to the right to receive a unitrust amount, which is normally expressed as an amount equal to a percentage of the value of the unitrust assets without regard to dividends or interest that may be received by the unitrust.

An amount received from an IRA or a plan with a payment provision similar to that of an IRA is allocated under Section 409(c) [Texas Trust Code §116.172(c)] , which differentiates between payments that are required to be made and all other payments. [Note: The remainder of this paragraph is inapplicable in Texas due to Texas changes to the Uniform Act – see Texas Bar Comment below.] To the extent that a payment is required to be made (either under federal income tax rules or, in the case of a plan that is not subject to those rules, under the terms of the plan), 10% of the amount received is allocated to income and the balance is allocated to principal. All other payments are allocated to principal because they represent a change in the form of a principal asset; Section 409 follows the rule in Section 404(2), which provides that money or property received from a change in the form of a principal asset be allocated to principal.

Section 409(c) [Texas Trust Code §116.172(c)] produces an allocation to income that is similar to the allocation under the 1962 Act formula if the annual payments are the same throughout the payment period, and it is simpler to administer. The amount allocated to income under Section 409 [Texas Trust Code §116.172(c)] is not dependent upon the interest rate that is used for valuation purposes when the decedent dies, and if the payments received by the trust increase or decrease from year to year because the fund from which the payment is made increases or decreases in value, the amount allocated to income will also increase or decrease.

Marital deduction requirements. When an IRA is payable to a QTIP marital deduction trust, the IRS treats the IRA as separate terminable interest property and requires that a QTIP election be made for it. In order to qualify for QTIP treatment, an IRS ruling states that all of the IRA's income must be distributed annually to the QTIP marital deduction trust and then must be allocated to trust income for

distribution to the spouse. Rev. Rul. 89-89, 1989-2 C.B. 231. *[Note: Rev. Rul. 89-89 is obsolete. See Rev. Rul. 2000-2.]* If an allocation to income under this Act of 10% of the required distribution from the IRA does not meet the requirement that all of the IRA's income be distributed from the trust to the spouse, the provision in subsection (d) [Texas Trust Code §116.172(h)] requires the trustee to make a larger allocation to income to the extent necessary to qualify for the marital deduction. The requirement of Rev. Rul. 89-89 should also be satisfied if the IRA beneficiary designation permits the spouse to require the trustee to withdraw the necessary amount from the IRA and distribute it to her, even though the spouse never actually requires the trustee to do so. If such a provision is in the beneficiary designation, a distribution under subsection (d) [Texas Trust Code §116.172(h)] should not be necessary.

Application of Section 104 [Texas Trust Code §116.005]. Section 104(a) of this Act [Texas Trust Code §116.005(a)] gives a trustee who is acting under the prudent investor rule the power to adjust from principal to income if, considering the portfolio as a whole and not just receipts from deferred compensation, the trustee determines that an adjustment is necessary. See Example (5) in the Comment following Section 104 [Texas Trust Code §116.005].

Texas Bar Comment

The uniform act's rule on distributions from IRAs and other retirement plans is that 90% of each distribution is principal and 10% is income. The Section decided that this is unfair to the income beneficiary and not in keeping with what the settlor probably intended. The prior Texas provision (form Texas Trust Code §113.109) was fairer to the income beneficiary, but its approach (5% of the inventory value of the deferred payment right) was confusing, difficult to apply and did not adequately take into account changes in the value of the underlying asset. Section 116.172 contains a unique Texas provision which borrows from unitrust principles: generally payments during an accounting period are allocated to income until the payments received total 4% of the asset's fair market value determined at the beginning of the accounting period, and the balance of the payments are allocated to principal.

Examples. As enacted, subsections (c) through (e) are somewhat confusing. The Section hopes to clear up the confusion with legislation in 2005. In the meantime, here are examples of how this section should be applied:

Example (1) - T is the trustee of a trust which is the beneficiary of an IRA. The IRA became subject to the trust in 2003. In 2004, T receives one payment from the IRA for $50,000. This payment was required under the Internal Revenue Code minimum distribution rules. The IRA custodian did not characterize the payment. On January 1, 2004, the IRA had a fair market value of $1,000,000. T must allocate $40,000 (4% x $1,000,000) to income and the $10,000 balance to principal.

Example (2) - The facts are the same as in Example (1), except T receives two payments in 2004, $20,000 on April 1 and $30,000 on October 1. These payments were required to be made and the IRA custodian did not characterize the payments. T must allocate all the first payment to income. For the second payment, T must allocate $20,000 ((4%x $1,000,000) - $20,000) to income and $10,000 to principal.

Example (3) - On July 1, 2004, D dies, having designated T, trustee of the marital deduction trust created pursuant to D's will, as beneficiary of D's IRA. The accounting period of the trust ends December 31. On November 1, 2004, T receives a required payment from the IRA of $50,000. The

IRA custodian did not characterize the payment. The fair market value of the IRA on July 1, 2004 was $1,000,000. T must allocate $19,945 ((4% x $1,000,000) x (182 ÷365)) to income and the $30,055 balance to principal.

Sec. 116.173. 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 Section 116.172, resources subject to Section 116.174, timber subject to Section 116.175, an activity subject to Section 116.177, an asset subject to Section 116.178, or any asset for which the trustee establishes a reserve for depreciation under Section 116.203.

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

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

Uniform Act 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 5%" of the asset's inventory value. The 1931 Act has a similar 5% rule that applies when the trustee is under a duty to change the form of the investment. The 5% 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, Section 410 [Texas Trust Code §116.173] abandons the annuity approach under the 5% 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 Section 409 [Texas Trust Code §116.172].

Texas Bar Comment

Texas Trust Code §116.173 differs significantly from former Section 113.109. The Section believes that the rules in Section 116.173 are logical and easier to administer than those in former Section 113.109. Additionally, Section 116.173 provides a fairer result than former law.

Sec. 116.174. 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, the trustee shall allocate the receipt equitably.

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

(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, the trustee must allocate the receipt equitably.

(c) 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.

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

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

Uniform Act Comment

Prior Acts. The 1962 Act allocates to principal as a depletion allowance, 27-1/2% of the gross receipts, but not more than 50% of the net receipts after paying expenses. The Internal Revenue Code no longer provides for a 27-1/2% depletion allowance, although the major oil-producing States have retained the 27-1/2% 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.

[Note: Because of changes in the Texas version of this Section, the following paragraph is inapplicable in Texas.] Section 411 allocates 90% of the net receipts to principal and 10% 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.

Application of Sections 403 [Texas Trust Code §116.153] and 408 [Texas Trust Code §116.171]. This section applies to the extent that the trustee does not account separately for receipts from minerals and other natural resources under Section 403 [Texas Trust Code §116.153] or allocate all of the receipts to principal under Section 408 [Texas Trust Code §116.171].

Open mine doctrine. The purpose of Section 411(c) [Texas Trust Code §116.174(c)] is to abolish the "open mine doctrine" as it may apply to the rights of an income beneficiary and a remainder beneficiary in receipts from the production of minerals from land owned or leased by a trust. Instead, such receipts are to be allocated to or between principal and income in accordance with the provisions of this Act. For a discussion of the open mine doctrine, see generally 3A Austin W. Scott & William F. Fratcher, The Law of Trusts § 239.3 (4th ed. 1988), and *Nutter v. Stockton*, 626 P.2d 861 (Okla. 1981).

Effective date provision. Section 9(b) of the 1962 Act provides that the natural resources provision does not apply to property interests held by the trust on the effective date of the Act, which reflects concerns about the constitutionality of applying a retroactive administrative provision to interests in real estate, based on the opinion in the Oklahoma case of *Franklin v. Margay Oil Corporation*, 153 P.2d 486, 501 (Okla. 1944). Section 411(d) [Texas Trust Code §116.174(d)] permits a trustee to use either the method provided for in this Act or the method used before the Act takes effect. Lawyers in jurisdictions other than Oklahoma may conclude that retroactivity is not a problem as to property situated in their States, and this provision permits trustees to decide, based on advice from counsel in States whose law may be different from that of Oklahoma, whether they may apply this provision retroactively if they conclude that to do so is in the best interests of the beneficiaries.

If the property is in a State other than the State where the trust is administered, the trustee must be aware that the law of the property's situs may control this question. The outcome turns on a variety of

questions: whether the terms of the trust specify that the law of a State other than the situs of the property shall govern the administration of the trust, and whether the courts will follow the terms of the trust; whether the trust's asset is the land itself or a leasehold interest in the land (as it frequently is with oil and gas property); whether a leasehold interest or its proceeds should be classified as real property or personal property, and if as personal property, whether applicable state law treats it as a movable or an immovable for conflict of laws purposes. See 5A Austin W. Scott & William F. Fratcher, The Law of Trusts §§ 648, at 531, 533-534; § 657, at 600 (4th ed. 1989).

Texas Bar Comment

The Section determined that Section 411 of the Uniform Principal and Income Act would produce unfair results if not modified. Under the uniform act's provision, income beneficiaries who were receiving 72-1/2% of royalty payments could have their allocation reduced to 10% of the royalty payments. Because of this, the Texas version deleted the allocation rule calling for 90% of the payments to be allocated to principal and 10% to be allocated to income and replaced it with a rule requiring the trustee to allocate the receipt equitably. Subsection (e) provides a presumption of what is equitable. Additionally, subsection (d) permits the trustee to continue to follow the 72-1/2% / 27-1/2% rule with existing trusts.

Sec. 116.175. 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 Subdivisions (1) and (2); or

(4) to principal to the extent that advance payments, bonuses, and other payments are not allocated pursuant to Subdivision (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 chapter applies whether or not a decedent or transferor was harvesting timber from the property before it became subject to the trust.

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

Uniform Act Comment

Scope of section. The rules in Section 412 [Texas Trust Code §116.175] 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 Sections 403 [Texas Trust Code §116.153] and 408 [Texas Trust Code §116.171]. 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 Section 403 [Texas Trust Code §116.153] or allocate all of the receipts to principal under Section 408 [Texas Trust Code §116.171]. The option to account for net receipts separately under Section 403 [Texas Trust Code §116.153] 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.

Texas Bar Comment

Section 116.175 provides detailed rules for the allocation of timber receipts between income and principal. This section is a significant improvement over former Section 113.108, which merely provided that such receipts should be allocated reasonably and equitably.

Sec. 116.176. PROPERTY NOT PRODUCTIVE OF INCOME. (a) If a marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the spouse with sufficient income from or use of the trust assets, and if the amounts that the trustee transfers from principal to income under Section 116.005 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 Section 116.005(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.

Uniform Act Comment

Prior Acts' Conflict with Uniform Prudent Investor Act. Section 2(b) of the Uniform Prudent Investor Act [Texas Trust Code §117.004(b)] 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 Section 12 of the 1962 Act and Section 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 Section 2(b) of the Prudent Investor Act [Texas Trust Code §117.004(b)]. 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 Section 104(b)(7) of this Act [Texas Trust Code §116.005(b)(7)], 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 Section 104(a) [Texas Trust Code §116.005(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 Section 104 of this Act [Texas Trust Code §116.005].

Trusts for which the value of the right to receive income is important for tax reasons may be affected by Reg. § 1.7520-3(b)(2)(v) *Example (1)*, § 20.7520-3(b)(2)(v) *Examples (1)* and *(2)*, and § 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. § 20.2056(b)-5(f)(4) and (5) to enable a trust for a spouse to qualify for a marital deduction if applicable state law is unclear about the spouse's right to compel the trustee to make property productive of income. The trustee should also consider the application of Section 104 of this Act [Texas Trust Code §116.005] and the provisions of Restatement of Trusts 3d: Prudent Investor Rule § 240, at 186, app. § 240, at 252 (1992). Example (6) in the Comment to Section 104 [Texas Trust Code §116.005] describes a situation involving the payment from income of carrying charges on unproductive real estate in which Section 104 [Texas Trust Code §116.005] 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 Section 104(a) [Texas Trust Code §116.005(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 Section 413 [Texas Trust Code §116.176], the power under Section 104(a) [Texas Trust Code §116.005(a)] would be exercised to transfer principal to income and not to transfer income to principal.

Section 413 [Texas Trust Code §116.176] 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. § 20.2056(c)-2(b)(1)(iii).

Texas Bar Comment

Section 116.176 significantly alters Texas law contained in former Section 113.110. Section 116.176(a) allows a trustee to convert unproductive property to property productive of income, but only to satisfy the requirements for a marital deduction under Federal estate tax law. The underproductive property provisions of former Section 113.110 are not necessary because a trustee can make adjustments between income and principal upon the sale of underproductive property under Section 104 [Texas Trust Code §116.005] to correct any unfairness, including any unfairness attributable to the change from prior law to the Uniform Principal and Income Act.

Sec. 116.177. 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 Section 116.153 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.

Uniform Act Comment

Scope and application. It is difficult to predict how frequently and to what extent trustees will invest directly in derivative financial instruments rather than participating indirectly through investment entities that may utilize these instruments in varying degrees. If the trust participates in derivatives indirectly through an entity, an amount received from the entity will be allocated under Section 401 [Texas Trust Code §116.151] and not Section 414 [Texas Trust Code §116.177]. If a trustee invests directly in derivatives to a significant extent, the expectation is that receipts and disbursements related to derivatives will be accounted for under Section 403 [Texas Trust Code §116.153]; if a trustee chooses not to account under Section 403 [Texas Trust Code §116.153], Section 414(b) [Texas Trust Code §116.177(b)] provides the default rule. Certain types of option transactions in which trustees may engage are dealt with in subsection (c) to distinguish those transactions from ones involving options that are embedded in derivative financial instruments.

Definition of "derivative." "Derivative" is a difficult term to define because new derivatives are invented daily as dealers tailor their terms to achieve specific financial objectives for particular clients. Since derivatives are typically contract-based, a derivative can probably be devised for almost any set of objectives if another party can be found who is willing to assume the obligations required to meet those objectives.

The most comprehensive definition of derivative is in the Exposure Draft of a Proposed Statement of Financial Accounting Standards titled "Accounting for Derivative and Similar Financial Instruments and for Hedging Activities," which was released by the Financial Accounting Standards Board (FASB) on June 20, 1996 (No. 162-B). The definition in Section 414(a) [Texas Trust Code § 116.177(a)] is derived in part from the FASB definition. The purpose of the definition in subsection (a) is to implement the substantive rule in subsection (b) that provides for all receipts and disbursements to be allocated to principal to the extent the trustee elects not to account for transactions in derivatives under Section 403 [Texas Trust Code §116.153]. As a result, it is much shorter than the FASB definition, which serves much more ambitious objectives.

A derivative is frequently described as including futures, forwards, swaps and options, terms that also require definition, and the definition in this Act avoids these terms. FASB used the same approach, explaining in paragraph 65 of the Exposure Draft:

> The definition of *derivative financial instrument* in this Statement includes those financial instruments generally considered to be derivatives, such as forwards, futures, swaps, options, and similar instruments. The Board considered defining a derivative financial instrument by merely referencing those commonly understood instruments, similar to paragraph 5 of Statement 119, which says that "... a derivative financial instrument is a futures, forward, swap, or option contract, or other financial instrument with similar characteristics." However, the continued development of financial markets and innovative financial instruments could ultimately render a definition based on examples inadequate and obsolete. The Board, therefore, decided to base the definition of a derivative financial instrument on a description of the common characteristics of those instruments in order to accommodate the accounting for newly developed derivatives. (Footnote omitted.)

Marking to market. A gain or loss that occurs because the trustee marks securities to market or to another value during an accounting period is not a transaction in a derivative financial instrument that is income or principal under the Act – only cash receipts and disbursements, and the receipt of property in exchange for a principal asset, affect a trust's principal and income accounts.

Receipt of property other than cash. If a trustee receives property other than cash upon the settlement of a derivatives transaction, that property would be principal under Section 404(2) [Texas Trust Code §116.161(2)].

Options. Options to which subsection (c) applies include an option to purchase real estate owned by the trustee and a put option purchased by a trustee to guard against a drop in value of a large block of marketable stock that must be liquidated to pay estate taxes. Subsection (c) would also apply to a continuing and regular practice of selling call options on securities owned by the trust if the terms of the option require delivery of the securities. It does not apply if the consideration received or given for the option is something other than cash or property, such as cross-options granted in a buy-sell agreement between owners of an entity.

Texas Bar Comment

Section 116.177 provides useful guidance for the allocation of receipts from derivatives and options. The Texas Trust Code previously did not address these types of assets.

Sec. 116.178. ASSET-BACKED SECURITIES. (a) In this section, "asset-backed security" means an asset whose value is based upon the right it gives the owner to receive distributions from the proceeds of financial assets that provide collateral for the security. The term includes an asset that gives the owner the right to receive from the collateral financial assets only the interest or other current return or only the proceeds other than interest or current return. The term does not include an asset to which Section 116.151 or 116.172 applies.

(b) If a trust receives a payment from interest or other current return and from other proceeds of the collateral financial assets, the trustee shall allocate to income the

portion of the payment which the payer identifies as being from interest or other current return and shall allocate the balance of the payment to principal.

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

Uniform Act Comment

Scope of section. Typical asset-backed securities include arrangements in which debt obligations such as real estate mortgages, credit card receivables and auto loans are acquired by an investment trust and interests in the trust are sold to investors. The source for payments to an investor is the money received from principal and interest payments on the underlying debt. An asset-backed security includes an "interest only" or a "principal only" security that permits the investor to receive only the interest payments received from the bonds, mortgages or other assets that are the collateral for the asset-backed security, or only the principal payments made on those collateral assets. An asset-backed security also includes a security that permits the investor to participate in either the capital appreciation of an underlying security or in the interest or dividend return from such a security, such as the "Primes" and "Scores" issued by Americus Trust. An asset-backed security does not include an interest in a corporation, partnership, or an investment trust described in the Comment to Section 402 [Texas Trust Code §116.152], whose assets consist significantly or entirely of investment assets. Receipts from an instrument that do not come within the scope of this section or any other section of the Act would be allocated entirely to principal under the rule in Section 103(a)(4) [Texas Trust Code §116.004(a)(4)], and the trustee may then consider whether and to what extent to exercise the power to adjust in Section 104 [Texas Trust Code §116.005], taking into account the return from the portfolio as whole and other relevant factors.

Texas Bar Comment

Section 116.178 provides useful guidance for allocating receipts from asset-backed securities. The Texas Trust Code previously did not address these types of assets.

[Sections 116.179-116.200 reserved for expansion]

SUBCHAPTER E. ALLOCATION OF DISBURSEMENTS DURING ADMINISTRATION OF TRUST

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

(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.

Uniform Act 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 Section 502(a)(5) [Texas Trust Code §116.202(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.

Texas Bar Comment

There are two important differences between Section 116.201 and former Section 113.111. First, Section 116.201 allocates to income ½ of the compensation of trustees and of any person providing investment advisory or custodial services to the trustee. In contrast, Section 113.111(a)(6) allowed the trustee to allocate this compensation on a just and equitable basis. Second, Section 116.201 provides that ½ of the expenses of accountings and judicial proceedings shall be allocated to income. In contrast, Section 113.111 provided that all such costs were allocated to income.

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

(1) the remaining one-half of the disbursements described in Sections 116.201(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 Section 116.201(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.

Uniform Act Comment

Environmental expenses. All environmental expenses are payable from principal, subject to the power of the trustee to transfer funds to principal from income under Section 504 [Texas Trust Code §116.204]. However, the Drafting Committee decided that it was not necessary to broaden this provision to cover other expenditures made under compulsion of governmental authority. See generally the annotation at 43 A.L.R.4th 1012 (Duty as Between Life Tenant and Remainderman with Respect to Cost of Improvements or Repairs Made Under Compulsion of Governmental Authority).

Environmental expenses paid by a trust are to be paid from principal under Section 502(a)(7) [Texas Trust Code §116.202(a)(7)] on the assumption that they will usually be extraordinary in nature. Environmental expenses might be paid from income if the trustee is carrying on a business that uses or sells toxic substances, in which case environmental cleanup costs would be a normal cost of doing business and would be accounted for under Section 403 [Texas Trust Code §116.153]. In accounting under that Section, environmental costs will be a factor in determining how much of the net receipts from the business is trust income. Paying all other environmental expenses from principal is consistent with this Act's approach regarding receipts – when a receipt is not clearly a current return on a principal asset, it should be added to principal because over time both the income and remainder beneficiaries benefit from this treatment. Here, allocating payments required by environmental laws to principal imposes the detriment of those payments over time on both the income and remainder beneficiaries.

Under Sections 504(a) and 504(b)(5) [Texas Trust Code §§116.204(a) and 116.204(b)(5)], a trustee who makes or expects to make a principal disbursement for an environmental expense described in Section 502(a)(7) [Texas Trust Code §116.202(a)(7)] is authorized to transfer an appropriate amount from income to principal to reimburse principal for disbursements made or to provide a reserve for future principal disbursements.

The first part of Section 502(a)(7) [Texas Trust Code §116.202(a)(7)] is based upon the definition of an "environmental remediation trust" in Treas. Reg. § 301.7701-4(e)(as amended in 1996). This is not because the Act applies to an environmental remediation trust, but because the definition is a useful and thoroughly vetted description of the kinds of expenses that a trustee owning contaminated property might incur. Expenses incurred to comply with environmental laws include the cost of environmental consultants, administrative proceedings and burdens of every kind imposed as the result of an administrative or judicial proceeding, even though the burden is not formally characterized as a penalty.

Title proceedings. Disbursements that are made to protect a trust's property, referred to in Section 502(a)(4) [Texas Trust Code §116.202(a)(4)] , include an "action to assure title" that is mentioned in Section 13(c)(2) of the 1962 Act.

Insurance premiums. Insurance premiums referred to in Section 502(a)(5) [Texas Trust Code §116.202(a)(5)] include title insurance premiums. They also include premiums on life insurance policies owned by the trust, which represent the trust's periodic investment in the insurance policy. There is no provision in the 1962 Act for life insurance premiums.

Taxes. Generation-skipping transfer taxes are payable from principal under subsection (a)(6).

Texas Bar Comment

Section 116.202 provides that ½ of the following costs shall be allocated to principal: regular compensation of trustees and any person providing investment advisory or custodial services to the trustee, and expenses of accountings and judicial proceedings. These provisions are different from those formerly in the Texas Trust Code, as noted in the Texas Bar Comment to Section 116.201.

Sec. 116.203. 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 Section 116.153 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.

Uniform Act 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 Section 103(b) [Texas Trust Code §116.004(b)], and in exercising the power a trustee must comply with Section 103(b) [Texas Trust Code §116.004(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) [Texas Trust Code §116.204(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.

Texas Bar Comment

Section 116.203 allows greater flexibility to trustees by authorizing but not requiring a trustee to transfer to principal cash receipts that are otherwise income as an allowance for depreciation. Under former Section 113.111, a trustee was required to charge against income a reasonable allowance for depreciation.

Sec. 116.204. 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 Section 116.202(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).

Uniform Act Comment

Prior Acts. The sources of Section 504 [Texas Trust Code §116.204] are Section 13(b) of the 1962 Act, which permits a trustee to "regularize distributions," if charges against income are unusually large, by using "reserves or other reasonable means" to withhold sums from income distributions; Section 13(c)(3) of the 1962 Act, which authorizes a trustee to establish an allowance for depreciation out of income if principal is used for extraordinary repairs, capital improvements and special assessments; and Section 12(3) of the 1931 Act, which permits the trustee to spread income expenses of unusual amount "throughout a series of years." Section 504 [Texas Trust Code §116.204] contains a more detailed enumeration of the circumstances in which this authority may be used, and includes in subsection (b)(4) the express authority to use income to make principal payments on a mortgage if the depreciation charge against income is less than the principal payments on the mortgage.

Texas Bar Comment

Section 116.204 provides detailed rules designed to allow the trustee to regularize distributions, similar to the intent of former Section 113.111.

Sec. 116.205. 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 Subdivisions (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.

Uniform Act Comment

Electing Small Business Trusts. An Electing Small Business Trust (ESBT) is a creature created by Congress in the Small Business Job Protection Act of 1996 (P.L. 104-188). For years beginning after 1996, an ESBT may qualify as an S corporation stockholder even if the trustee does not distribute all of the trust's income annually to its beneficiaries. The portion of an ESBT that consists of the S corporation stock is treated as a separate trust for tax purposes (but not for trust accounting purposes), and the S corporation income is taxed directly to that portion of the trust even if some or all of that income is distributed to the beneficiaries.

A trust normally receives a deduction for distributions it makes to its beneficiaries. Subsection (d) takes into account the possibility that an ESBT may not receive a deduction for trust accounting income that is distributed to the beneficiaries. Only limited guidance has been issued by the Internal Revenue Service, and it is too early to anticipate all of the technical questions that may arise, but the powers granted to a trustee in Sections 506 and 104 [Texas Trust Code §§116.206 and 116.005] to make adjustments are probably sufficient to enable a trustee to correct inequities that may arise because of technical problems.

Texas Bar Comment

Section 116.205 is similar to former Section 113.111(a)(7) and (b)(5).

Sec. 116.206. 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 which 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 a beneficiary.

(b) If the amount of an estate tax marital deduction or charitable contribution deduction is reduced because a fiduciary deducts an amount paid from principal for income tax purposes instead of deducting it for estate tax purposes, and as a result estate taxes paid from principal are increased and income taxes paid by an estate, trust, or beneficiary are decreased, each estate, trust, or beneficiary that benefits from the decrease in income tax shall reimburse the principal from which the increase in estate tax is paid. The total reimbursement 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.

Uniform Act Comment

Discretionary adjustments. Section 506(a) [Texas Trust Code §116.206(a)] permits the fiduciary to make adjustments between income and principal because of tax law provisions. It would permit discretionary adjustments in situations like these: (1) A fiduciary elects to deduct administration expenses that are paid from principal on an income tax return instead of on the estate tax return; (2) a distribution of a principal asset to a trust or other beneficiary causes the taxable income of an estate or trust to be carried out to the distributee and relieves the persons who receive the income of any obligation to pay income tax on the income; or (3) a trustee realizes a capital gain on the sale of a principal asset and pays a large state income tax on the gain, but under applicable federal income tax rules the trustee may not deduct the state income tax payment from the capital gain in calculating the trust's federal capital gain tax, and the income beneficiary receives the benefit of the deduction for state income tax paid on the capital gain. See generally Joel C. Dobris, Limits on the Doctrine of Equitable Adjustment in Sophisticated Postmortem Tax Planning, 66 Iowa L. Rev. 273 (1981).

Section 506(a)(3) [Texas Trust Code §116.206(a)(3)] applies to a qualified Subchapter S trust (QSST) whose income beneficiary is required to include a pro rata share of the S corporation's taxable income in his return. If the QSST does not receive a cash distribution from the corporation that is large enough to cover the income beneficiary's tax liability, the trustee may distribute additional cash from principal to the income beneficiary. In this case the retention of cash by the corporation benefits the trust principal. This situation could occur if the corporation's taxable income includes capital gain from the sale of a business asset and the sale proceeds are reinvested in the business instead of being distributed to shareholders.

Mandatory adjustment. Subsection (b) provides for a mandatory adjustment from income to principal to the extent needed to preserve an estate tax marital deduction or charitable contributions deduction. It is derived from New York's EPTL § 11-1.2(A), which requires principal to be reimbursed by those who benefit when a fiduciary elects to deduct administration expenses on an income tax return instead of the estate tax return. Unlike the New York provision, subsection (b) limits a mandatory reimbursement to cases in which a marital deduction or a charitable contributions deduction is reduced by the payment of additional estate taxes because of the fiduciary's income tax election. It is intended to preserve the result reached in *Estate of Britenstool v. Commissioner*, 46 T.C. 711 (1966), in which the Tax Court held that a reimbursement required by the predecessor of EPTL § 11-1.2(A) resulted in the estate receiving the same charitable contributions deduction it would have received if the administration expenses had been deducted for estate tax purposes instead of for income tax purposes. Because a fiduciary will elect to deduct administration expenses for income tax purposes only when the income tax reduction exceeds the estate tax reduction, the effect of this adjustment is that the principal is placed in the same position it would have occupied if the fiduciary had deducted the expenses for estate tax purposes, but the income beneficiaries receive an additional benefit. For example, if the income tax benefit from the deduction is $30,000 and the estate tax benefit would have been $20,000, principal will be reimbursed $20,000 and the net benefit to the income beneficiaries will be $10,000.

Irrevocable grantor trusts. Under Sections 671-679 of the Internal Revenue Code (the "grantor trust" provisions), a person who creates an irrevocable trust for the benefit of another person may be subject to tax on the trust's income or capital gains, or both, even though the settlor is not entitled to receive any income or principal from the trust. Because this is now a well-known tax result, many trusts have been created to produce this result, but there are also trusts that are unintentionally subject to this rule. The Act does not require or authorize a trustee to distribute funds from the trust to the settlor in these cases because it is difficult to establish a rule that applies only to trusts where this tax result is unintended and does not apply to trusts where the tax result is intended. Settlors who intend this tax result rarely state it as an objective in the terms of the trust, but instead rely on the operation of the tax law to produce the desired result. As a result it may not be possible to determine from the terms of the trust if the result was intentional or unintentional. If the drafter of such a trust wants the trustee to have the authority to distribute principal or income to the settlor to reimburse the settlor for taxes paid on the trust's income or capital gains, such a provision should be placed in the terms of the trust. In some situations the Internal Revenue Service may require that such a provision be placed in the terms of the trust as a condition to issuing a private letter ruling.

Texas Bar Comment

Section 116.206 provides for equitable adjustments. The Texas Trust Code previously did not contain a provision dealing with equitable adjustments.

EFFECTIVE DATE PROVISION

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

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

(1) a trust existing or created on or after January 1, 2004;

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

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