

Approved by the Judicial Council December 4, 2009

**MEMORANDUM**

**TO: Kansas Judicial Council**

**FROM: Probate Law Advisory Committee**

**DATE: December 4, 2009**

**RE: Proposed Amendment to the Uniform Principal and Income Act**

At its annual meeting in 2008 the Uniform Law Commission approved amendments to sections 409 and 505 of the Uniform Principal and Income Act. The Probate Law Advisory Committee has studied and approved the amendments recommended by the ULC.

A copy of the proposed amendments, with both ULC comments and comments prepared by the PLAC (Kansas Comments) is attached. A copy of the Kansas Uniform Principal and Income Act is also attached.

The PLAC noted that the amendments have been adopted in 17 states.

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**Section 1. K.S.A. 58-9-409. Deferred compensation, annuities and similar payments.** (a) As used in this section: (1) "Payment" "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. For purposes of subsections (d), (e), (f), and (g), the term also includes any payment from any separate fund, regardless of the reason for the payment. (2) "Separate fund" includes a private or commercial annuity, an individual retirement account, and a pension, profit-sharing, stock-bonus, or stock-ownership plan.

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

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

(d) If, to obtain an estate tax marital deduction for a trust, a trustee must allocate more of a payment to income than provided for by this section, the trustee shall allocate to income the additional amount necessary to obtain the marital deduction. Except as otherwise provided in subsection (e), subsections (f) and (g) apply, and subsections (b) and (c) do not apply, in determining the allocation of a payment made from a separate fund to:

(1) a trust to which an election to qualify for a marital deduction under Section 2056(b)(7) of the Internal Revenue Code of 1986 [ , as amended ] [ , 26 U.S.C. Section 2056(b)(7) ] [ , as amended ], has been made; or

(2) a trust that qualifies for the marital deduction under Section 2056(b)(5) of the Internal Revenue Code of 1986 [ , as amended ] [ , 26 U.S.C. Section 2056(b)(5) ] [ , as amended ].

(e) Subsections (d), (f), and (g) do not apply if and to the extent that the series of payments would, without the application of subsection (d), qualify for the marital deduction under Section 2056(b)(7)(C) of the Internal Revenue Code of 1986 [ , as amended ] [ , 26 U.S.C. Section 2056(b)(7)(C) ] [ , as amended ].

(f) A trustee shall determine the internal income of each separate fund for the accounting period as if the separate fund were a trust subject to this [act]. Upon request of the surviving spouse, the trustee shall demand that the person administering the separate fund distribute the internal income to the trust. The trustee shall allocate a payment from the separate fund to income to the extent of the internal income of the separate fund and distribute that amount to the surviving spouse. The trustee shall allocate the balance of the payment to principal. Upon request of the surviving spouse, the trustee shall allocate principal to income to the extent the internal income of the separate fund exceeds payments made from the separate fund to the trust during the accounting period.

(g) If a trustee cannot determine the internal income of a separate fund but can determine the value of the separate fund, the internal income of the separate fund is deemed to equal [insert number at least three percent and not more than five percent] four percent of the fund's value, according to the most recent statement of value preceding the beginning of the accounting period. If the trustee can determine neither the internal income of the separate fund nor the fund's value, the internal income of the fund is deemed to equal the product of the interest rate and the present value of the expected future payments, as determined under Section 7520 of the Internal Revenue Code of 1986 [ , as amended] [ , 26 U.S.C. Section 7520] [ , as amended], for the month preceding the accounting period for which the computation is made.

(e) This section does not apply to ~~payments~~ ~~a payment~~ to which K.S.A. 58-9-410 and amendments thereto applies.

#### **UPIA Comment**

**Scope.** Section 409 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 (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 because of their special characteristics.

Section 409 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).** Section 409(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), 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) 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).

**Allocations Under Section 409(c).** The focus of Section 409, 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)). 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), which differentiates between payments that are required to be made and all other payments. 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) 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 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. 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) 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) should not be necessary.~~

**Marital deduction requirements.** When an IRA or other retirement arrangement (a "plan") is payable to a marital deduction trust, the IRS treats the plan as a separate property interest that itself must qualify for the marital deduction. IRS Revenue Ruling 2006-26 said that, as written, Section 409 does not cause a trust to qualify for the IRS' safe harbors. Revenue Ruling 2006-26 was limited in scope to certain situations involving IRAs and defined contribution retirement plans. Without necessarily agreeing with the IRS' position in that ruling, the revision to this section is designed to satisfy the IRS' safe harbor and to address concerns that might be raised for similar assets. No IRS pronouncements have addressed the scope of Code §2056(b)(7)(C).

Subsection (f) requires the trustee to demand certain distributions if the surviving spouse so requests. The safe harbor of Revenue Ruling 2006-26 requires that the surviving spouse be separately entitled to demand the fund's income (without regard to the income from the trust's other assets) and the income from the other assets (without regard to the fund's income). In any event, the surviving spouse is not required to demand that the trustee distribute all of the fund's income from the fund or from other trust assets. Treas. Reg. § 20.2056(b)-5(f)(8).

Subsection (f) also recognizes that the trustee might not control the payments that the trustee receives and provides a remedy to the surviving spouse if the distributions under subsection (d)(1) are insufficient.

Subsection (g) addresses situations where, due to lack of information provided by the fund's administrator, the trustee is unable to determine the fund's actual income. The bracketed language is the range approved for unitrust payments by Treas. Reg. § 1.643(b)-1. In determining the value for purposes of applying the unitrust percentage, the trustee would seek to obtain the value of the assets as of the most recent statement of value immediately preceding the beginning of the year. For example, suppose a trust's accounting period is January 1 through December 31. If a retirement plan administrator furnishes information annually each September 30 and declines to provide information as of December 31, then the trustee may rely on the September 30 value to determine the distribution for the following year. For funds whose values are not readily available, subsection (g) relies on Code section 7520 valuation methods because many funds described in Section 409 are annuities, and one consistent set of valuation principles should apply whether or not the fund is, in fact, an annuity.

**Application of Section 104.** Section 104(a) of this Act 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.

#### Kansas Comment

The general rule is that the estate tax marital deduction is not allowed for a transfer to a trust that benefits a surviving spouse. The most important exceptions to this rule are embodied in IRC § 2056(b)(5) (life estate power of appointment trust, or LEPA) and IRC § 2056(b)(7) (qualified terminable interest property, or QTIP). Each provision requires that the surviving spouse be assured of a genuine income interest for life, and specific and demanding requirements in this respect are set forth in the Regulations, primarily, Treas. Reg. § 20.2065(b)-5(f).

The UPIA is drafted so as to assure compliance with these rules. However, special problems arise if a LEPA or QTIP trust is named as the beneficiary of a qualified retirement plan or IRA. In these circumstances, the IRS requires that the surviving spouse be assuring of receiving all the income produced by the qualified plan or IRA, even though she is not directly named as a beneficiary of the qualified plan or IRA. The position of the IRS on this issue, and its interpretation of the

relevant UPIA provisions, is addressed in Rev. Rul. 2006-26, 2006-1 C.B. 939. Rev. Rul. 2006-26 describes certain “safe harbor” rules assuring that a trust entitled to qualified plan or IRA benefits will qualify under the LEPA and QTIP rules.

The proposed amendments to UPIA § 409 are designed to satisfy these rules. The central idea is that the trustee of the LEPA or QTIP trust must treat each separate qualified plan or IRA as a separate asset, and the trustee can and must assure that the trust has the requisite income entitlement with respect to that qualified plan or IRA.

The Probate Law Advisory Committee is of the opinion that the proposed amendments to § 409 are appropriately drafted and is an important issue because of the greatly increased presence of qualified plans and IRAs in the estates of “baby boomers.” The Probate Law Advisory Committee recommends enactment of the proposed changes.

In proposed 409(g), lines 2 and 3, there was an option regarding the deemed income. The Probate Law Advisory Committee suggests 4% as an appropriate percentage, although any number in the 3% to 5% range would be permissible.

If K.S.A. 58-9-409 is amended as proposed, the “Alternative A” version of New Section 606 of the Uniform Principal and Income Act (see section 3 of this bill) should be adopted.

**Section 2. 58-9-505. Income taxes.** (a) A tax required to be paid by a trustee based on receipts allocated to income must be paid from income.

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

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

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

(2) from principal to the extent that: (A) Receipts receipts from the entity are allocated only to principal; and (B) the trust's share of the entity's taxable income exceeds the total receipts described in subsections (1) and (2)(A).

(3) proportionately from principal and income to the extent that receipts from the entity are allocated to both income and principal; and

(4) from principal to the extent that the tax exceeds the total receipts from the entity.

(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. After applying subsections (a) through (c), the trustee shall adjust income or principal receipts to the extent that the trust's taxes are reduced because the trust receives a deduction for payments made to a beneficiary.

#### UPIA 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 to make adjustments are probably sufficient to enable a trustee to correct inequities that may arise because of technical problems.



**Taxes on Undistributed Entity Taxable Income.** When a trust owns an interest in a pass-through entity, such as a partnership or S corporation, it must report its share of the entity's taxable income regardless of how much the entity distributes to the trust. Whether the entity distributes more or less than the trust's tax on its share of the entity's taxable income, the trust must pay the taxes and allocate them between income and principal.

Subsection (c) requires the trust to pay the taxes on its share of an entity's taxable income from income or principal receipts to the extent that receipts from the entity are allocable to each. This assures the trust a source of cash to pay some or all of the taxes on its share of the entity's taxable income. Subsection 505(d) recognizes that, except in the case of an Electing Small Business Trust (ESBT), a trust normally receives a deduction for amounts distributed to a beneficiary. Accordingly, subsection 505(d) requires the trust to increase receipts payable to a beneficiary as determined under subsection (c) to the extent the trust's taxes are reduced by distributing those receipts to the beneficiary.

Because the trust's taxes and amounts distributed to a beneficiary are interrelated, the trust may be required to apply a formula to determine the correct amount payable to a beneficiary. This formula should take into account that each time a distribution is made to a beneficiary, the trust taxes are reduced and amounts distributable to a beneficiary are increased. The formula assures that after deducting distributions to a beneficiary, the trust has enough to satisfy its taxes on its share of the entity's taxable income as reduced by distributions to beneficiaries.

**Example (1) -**Trust T receives a Schedule K-1 from Partnership P reflecting taxable income of \$1 million. Partnership P distributes \$100,000 to T, which allocates the receipts to income. Both Trust T and income Beneficiary B are in the 35 percent tax bracket. Trust T's tax on \$1 million of taxable income is \$350,000. Under Subsection (c) T's tax must be paid from income receipts because receipts from the entity are allocated only to income. Therefore, T must apply the entire \$100,000 of income receipts to pay its tax. In this case, Beneficiary B receives nothing.

**Example (2) -**Trust T receives a Schedule K-1 from Partnership P reflecting taxable income of \$1 million. Partnership P distributes \$500,000 to T, which allocates the receipts to income. Both Trust T and income Beneficiary B are in the 35 percent tax bracket. Trust T's tax on \$1 million of taxable income is \$350,000. Under Subsection (c), T's tax must be paid from income receipts because receipts from P are allocated only to income. Therefore, T uses \$350,000 of the \$500,000 to pay its taxes and distributes the remaining \$150,000 to B. The \$150,000 payment to B reduces T's taxes by \$52,500, which it must pay to B. But the \$52,500 further reduces T's taxes by \$18,375, which it also must pay to B. In fact, each time T makes a distribution to B, its taxes are further reduced, causing another payment to be due B.

Alternatively, T can apply the following algebraic formula to determine the amount payable to B:

$$D = (C-R*K)/(1-R)$$

D = Distribution to income beneficiary  
C = Cash paid by the entity to the trust  
R = tax rate on income  
K = entity's K-1 taxable income

Applying the formula to Example (2) above, Trust T must pay \$230,769 to B so that after deducting the payment, T has exactly enough to pay its tax on the remaining taxable income from P.

|                               |                              |
|-------------------------------|------------------------------|
| <u>Taxable Income per K-1</u> | <u>1,000,000</u>             |
| <u>Payment to beneficiary</u> | <u>230,769<sup>(1)</sup></u> |
| <u>Trust Taxable Income</u>   | <u>\$ 769,231</u>            |
| <u>35 percent tax</u>         | <u>269,231</u>               |

|                                   |                   |
|-----------------------------------|-------------------|
| <u>Partnership Distribution</u>   | <u>\$ 500,000</u> |
| <u>Fiduciary's Tax Liability</u>  | <u>(269,231)</u>  |
| <u>Payable to the Beneficiary</u> | <u>\$ 230,769</u> |

In addition, B will report \$230,769 on his or her own personal income tax return, paying taxes of \$80,769. Because Trust T withheld \$269,231 to pay its taxes and B paid \$80,769 taxes of its own, B bore the entire \$350,000 tax burden on the \$1 million of entity taxable income, including the \$500,000 that the entity retained that presumably increased the value of the trust's investment entity.

If a trustee determines that it is appropriate to so, it should consider exercising the discretion granted in UPIA section 506 to adjust between income and principal. Alternatively, the trustee may exercise the power to adjust under UPIA section 104 to the extent it is available and appropriate under the circumstances, including whether a future distribution from the entity that would be allocated to principal should be reallocated to income because the income beneficiary already bore the burden of taxes on the reinvested income. In exercising the power, the trust should consider the impact that future distributions will have on any current adjustments.

### **Kansas Comment**

The Probate Law Advisory Committee (PLAC) proposes that the amendments to K.S.A. 58-9-505 be adopted as proposed by the Uniform Law Commissioners.

It is the opinion of the PLAC that while the result is not changed, the amended language does make the process somewhat clearer, as explained in the comment. It appears that when section 505 of the Uniform Principle and Income Act was first adopted the drafters had not fully analyzed the circular aspect of the computation process.

**New Section 3. TRANSITIONAL MATTERS.** (a) Section 409, K.S.A. 58-9-409, as amended by this act, applies to a trust described in Section 409(d) K.S.A. 58-9-409(d) on and after the following dates:

(1) If the trust is not funded as of the date of the decedent's death.

(2) If the trust is initially funded in the calendar year beginning January 1, \_\_\_\_\_ [insert year in which this [act] takes effect], the date of the decedent's death.

(3) If the trust is not described in paragraph (1) or (2), January 1, \_\_\_\_\_ [insert year in which this [act] takes effect].

(b) This section shall be a part of the Uniform Principal and Income Act.

#### **Kansas Comment**

If K.S.A. 58-9-409 is amended as proposed \_\_\_\_ this version ("Alternative A") of new section 606 of the Uniform Principal and Income Act should be adopted.

The Probate Law Advisory Committee suggests that the Revisor of Statutes designate this new section of the Uniform Principal and Income Act as K.S.A. 58-9-606.

#### **Staff Note to Committee**

The PLAC needs to complete subsections (a)(2) and (a)(3) above.

# UNIFORM PRINCIPAL AND INCOME ACT

## Part I.—DEFINITIONS AND FIDUCIARY DUTIES

### Revisor's Note:

The numbering system utilized in codification of this article incorporates the numbering system utilized by the National Conference of Commissioners on Uniform State Laws in preparing the Uniform Principal and Income Act (1997). Within this article, the Kansas system utilized the UPIA section number (those digits following "58-9-") as a part of the Kansas citation. For example, UPIA Sec. 101 is codified at K.S.A. 58-9-101. Therefore, any reference to UPIA Sec. 101 may be relevant to K.S.A. 58-9-101. For a general explanation of the Kansas numbering system, see the explanatory preface at the front of any hardbound volume of the Kansas Statutes Annotated.

**58-9-101.** Short title. This act shall be known and may be cited as the uniform principal and income act (1997).

History: L. 2000, ch. 61, § 1; July 1.

### Law Review and Bar Journal References:

"The Kansas Uniform Trust Code," David M. English, 51 K.L.R. 311 (2003).

**58-9-102.** Definitions. As used in this act:

(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 part 4.

(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 act 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.

History: L. 2000, ch. 61, § 2; July 1.

### Law Review and Bar Journal References:

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-103.** Fiduciary duties; general principles. (a) In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of parts 2 and 3, a fiduciary:

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

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

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

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

(b) In exercising the power to adjust under subsection (a) of K.S.A. 58-9-104, and amendments thereto, or a discretionary power of administration regarding a matter within the scope of this act, whether granted by the terms of a trust, a will, or this act, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with this act is presumed to be fair and reasonable to all of the beneficiaries.

**History:** L. 2000, ch. 61, § 3; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-104. Trustee's power to adjust. (a)**

A trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, pursuant to K.S.A. 58-24a02, and amendments thereto, 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 subsection (a) of K.S.A. 58-9-103, and amendments thereto, that the trustee is unable to comply with subsection (b) of K.S.A. 58-9-103, and amendments thereto.

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

- (1) The nature, purpose, and expected duration of the trust;
- (2) the intent of the settlor;
- (3) the identity and circumstances of the beneficiaries;
- (4) the needs for liquidity, regularity of income, and preservation and appreciation of capital;
- (5) the assets held in the trust; the extent to which they consist of financial assets, interests in closely held enterprises, tangible and intangible personal property, or real property; the extent to which an asset is used by a beneficiary; and whether an asset was purchased by the trustee or received from the settlor;
- (6) the net amount allocated to income under the other sections of this act and the increase or decrease in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available;

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

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

(9) the anticipated tax consequences of an adjustment.

(c) A trustee may not make an adjustment:

(1) That diminishes the income interest in a trust that requires all of the income to be paid at least annually to a 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) through (6) or (c)(8) or if the trustee determines that possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax burden not described in subsection (c). The release may be permanent or for a specified period, including a period measured by the life of an individual.

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

**History:** L. 2000, ch. 61, § 4; L. 2001, ch. 75, § 7; July 1.

**Law Review and Bar Journal References:**

"2001 Legislative Wrap-Up," Paul T. Davis, 70 J.K.B.A. No. 7, 14 (2001).

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**Part 2.—DECEDENT'S ESTATE OR TERMINATING INCOME INTEREST**

**58-9-201. Determination and distribution of net income.** After a decedent dies, in the case of an estate, or after an income interest in a trust ends, the following rules apply:

(1) A fiduciary of an estate or of a terminating income interest shall determine the amount of net income and net principal receipts received from property specifically given to a beneficiary under the rules in parts 3 through 5 which apply to trustees and the rules in subsection (5). The fiduciary shall distribute the net income and net principal receipts to the beneficiary who is to receive the specific property.

(2) A fiduciary shall determine the remaining net income of a decedent's estate or a terminating income interest under the rules in parts 3 through 5 which apply to trustees and by:

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

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

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

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

(4) A fiduciary shall distribute the net income remaining after distributions required by subsection (3) in the manner described in K.S.A. 58-9-202, and amendments thereto, to all other beneficiaries, including a beneficiary who receives a pecuniary amount in trust, even if the beneficiary holds an unqualified power to withdraw assets from the trust or other presently exercisable general power of appointment over the trust.

(5) A fiduciary may not reduce principal or income receipts from property described in subsection (1) because of a payment described in K.S.A. 58-9-501 or 58-9-502, and amendments thereto, 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.

**History:** L. 2000, ch. 61, § 5; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-202. Distribution to residuary and remainder beneficiaries.** (a) Each beneficiary described in subsection (4) of K.S.A. 58-9-201, and amendments thereto, 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.

**History:** L. 2000, ch. 61, § 6; July 1.

**Part 3.—APPORTIONMENT AT BEGINNING AND END OF INCOME INTEREST**

**58-9-301. When right to income begins and ends.** (a) An income beneficiary is entitled to net income from the date on which the income interest begins. An income interest begins on the date specified in the terms of the trust or, if no date is specified, on the date an asset becomes subject to a trust or successive income interest.

(b) An asset becomes subject to a trust:

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

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

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

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

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

**History:** L. 2000, ch. 61, § 7; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-302. Apportionment of receipts and disbursements when decedent dies or income interest begins.** (a) A trustee shall allocate an income receipt or disbursement other than one to which subsection (1) of K.S.A. 58-9-201, and amendments thereto, applies to principal if its due date occurs before a decedent dies in the case of an estate or before an income interest begins in the case of a trust or successive income interest.

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

(c) An item of income or an obligation is due on the date the payer is required to make a payment. If a payment date is not stated, there is no due date for the purposes of this act. Distributions to shareholders or other owners from an entity to which K.S.A. 58-9-401, and amendments thereto, 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.

**History:** L. 2000, ch. 61, § 8; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-303. Apportionment when income interest ends.** (a) As used in this section, "undistributed income" means net income received before the date on which an income interest ends. The term does not include an item of income or expense that is due or accrued or net income that has been added or is required to be added to principal under the terms of the trust.

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

**History:** L. 2000, ch. 61, § 9; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).



Part 4.—ALLOCATION OF RECEIPTS  
DURING ADMINISTRATION OF TRUST

RECEIPTS FROM ENTITIES

**58-9-401. Character of receipts.** (a) As used in this section, "entity" means a corporation, partnership, limited liability company, regulated investment company, real estate investment trust, common trust fund, or any other organization in which a trustee has an interest other than a trust or estate to which K.S.A. 58-9-402, and amendments thereto, applies, a business or activity to which K.S.A. 58-9-403, and amendments thereto, applies, or an asset-backed security to which K.S.A. 58-9-415, and amendments thereto, 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.

**History:** L. 2000, ch. 61, § 10; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-402. 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, K.S.A. 58-9-401 or 58-9-415, and amendments thereto, applies to a receipt from the trust.

**History:** L. 2000, ch. 61, § 11; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-403. 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 K.S.A. 58-9-414, and amendments thereto, applies.

**History:** L. 2000, ch. 61, § 12; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**RECEIPTS NOT NORMALLY APPORTIONED**

**58-9-404. Principal receipts.** A trustee shall allocate to principal:

- (1) To the extent not allocated to income under this act, assets received from a transferor during the transferor's lifetime, a decedent's estate, a trust with a terminating income interest, or a payer under a contract naming the trust or its trustee as beneficiary;
- (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 part;
- (3) amounts recovered from third parties to reimburse the trust because of disbursements described in subsection (a)(7) of K.S.A. 58-9-502 and amendments thereto 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 K.S.A. 58-9-408 through 58-9-415 and amendments thereto.

**History:** L. 2000, ch. 61, § 13; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-405. 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.

**History:** L. 2000, ch. 61, § 14; July 1.

**58-9-406. 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 K.S.A. 58-9-409, 58-9-410, 58-9-411, 58-9-412, 58-9-414 or 58-9-415 and amendments thereto applies.

**History:** L. 2000, ch. 61, § 15; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-407. 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 K.S.A. 58-9-403 and amendments thereto, loss of profits from a business.

(c) This section does not apply to a contract to which K.S.A. 58-9-409 and amendments thereto applies.

**History:** L. 2000, ch. 61, § 16; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**RECEIPTS NORMALLY APPORTIONED**

**58-9-408. Insubstantial allocations not required.** If a trustee determines that an allocation between principal and income required by K.S.A. 58-9-409, 58-9-410, 58-9-411, 58-9-412 or 58-9-415 and amendments thereto is insubstantial, the trustee may allocate the entire amount to principal unless one of the circumstances described in subsection (c) of K.S.A. 58-9-104 and amendments thereto applies to the allocation. This power may be exercised by a cotrustee in the circumstances described in subsection (d) of K.S.A. 58-9-104 and amendments thereto and may be released for the reasons and in the manner described in subsection (e) of K.S.A. 58-9-104 and amendments thereto. An allocation is presumed to be insubstantial if:

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

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

**History:** L. 2000, ch. 61, § 17; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-409. Deferred compensation, annuities and similar payments.** (a) As used in this section, "payment" means a payment that a trustee

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

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

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

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

(e) This section does not apply to payments to which K.S.A. 58-9-410 and amendments thereto applies.

**History:** L. 2000, ch. 61, § 18; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-410. Liquidating asset.** (a) As used in this section, "liquidating asset" means an asset whose value will diminish or terminate because the asset is expected to produce receipts for a period of limited duration. The term includes a leasehold, patent, copyright, royalty right, and

right to receive payments during a period of more than one year under an arrangement that does not provide for the payment of interest on the unpaid balance. The term does not include a payment subject to K.S.A. 58-9-409 and amendments thereto, resources subject to K.S.A. 58-9-411 and amendments thereto, timber subject to K.S.A. 58-9-412 and amendments thereto, an activity subject to K.S.A. 58-9-414 and amendments thereto, an asset subject to K.S.A. 58-9-415 and amendments thereto, or any asset for which the trustee establishes a reserve for depreciation under K.S.A. 58-9-503 and amendments thereto.

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

**History:** L. 2000, ch. 61, § 19; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-411. Minerals, water and other natural resources.** (a) To the extent that a trustee accounts for receipts from an interest in minerals or other natural resources pursuant to this section, the trustee shall allocate them as follows:

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

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

(3) If an amount received as a royalty, shut-in-well payment, take-or-pay payment, bonus, or delay rental is more than nominal, 15 percent must be allocated to principal and the balance to income.

(4) If an amount is received from a working interest or any other interest not provided for in subsection (1), (2), or (3), 15 percent of the net amount received must be allocated to principal and the balance to income.

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

(c) This act applies whether or not a decedent or donor was extracting minerals, water, or other

natural resources before the interest became subject to the trust.

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

**History:** L. 2000, ch. 61, § 20; L. 2003, ch. 38, § 1; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-412. Timber.** (a) To the extent that a trustee accounts for receipts from the sale of timber and related products pursuant to this section, the trustee shall allocate the net receipts:

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

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

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

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

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

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

(d) If a trust owns an interest in timberland on the effective date of this act, the trustee may allocate net receipts from the sale of timber and related products as provided in this act or in the

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

**History:** L. 2000, ch. 61, § 21; July 1.

**58-9-413. Property not productive of income.** (a) If a marital deduction is allowed for all or part of a trust whose assets consist substantially of property that does not provide the spouse with sufficient income from or use of the trust assets, and if the amounts that the trustee transfers from principal to income under K.S.A. 58-9-104 and amendments thereto and distributes to the spouse from principal pursuant to the terms of the trust are insufficient to provide the spouse with the beneficial enjoyment required to obtain the marital deduction, the spouse may require the trustee to make property productive of income, convert property within a reasonable time, or exercise the power conferred by subsection (a) of K.S.A. 58-9-104 and amendments thereto. 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.

**History:** L. 2000, ch. 61, § 22; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-414. Derivatives and options.** (a) As used in this section, "derivative" means a contract or financial instrument or a combination of contracts and financial instruments which gives a trust the right or obligation to participate in some or all changes in the price of a tangible or intangible asset or group of assets, or changes in a rate, an index of prices or rates, or other market indicator for an asset or a group of assets.

(b) To the extent that a trustee does not account under K.S.A. 58-9-403 and amendments thereto 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.

**History:** L. 2000, ch. 61, § 23; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-415. Asset-backed securities.** (a) As used in this section, "asset-backed security" means an asset whose value is based upon the right it gives the owner to receive distributions from the proceeds of financial assets that provide collateral for the security. The term includes an asset that gives the owner the right to receive from the collateral financial assets only the interest or other current return or only the proceeds other than interest or current return. The term does not include an asset to which K.S.A. 58-9-401 or 58-9-409 and amendments thereto 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.

**History:** L. 2000, ch. 61, § 24; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**Part 5.—ALLOCATION OF DISBURSEMENTS  
DURING ADMINISTRATION OF TRUST**

**58-9-501. Disbursements from income.**

A trustee shall make the following disbursements from income to the extent that they are not disbursements to which subsection (2)(B) or (C) of K.S.A. 58-9-201 and amendments thereto 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.

**History:** L. 2000, ch. 61, § 25; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-502. Disbursements from principal.**

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

(1) The remaining one-half of the disbursements described in subsections (1) and (2) of K.S.A. 58-9-501 and amendments thereto;

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

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

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

(5) premiums paid on a policy of insurance not described in subsection (4) of K.S.A. 58-9-501

and amendments thereto 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.

**History:** L. 2000, ch. 61, § 26; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-503. Transfers from income to principal for depreciation.** (a) As used in this section, "depreciation" means a reduction in value due to wear, tear, decay, corrosion, or gradual obsolescence of a fixed asset having a useful life of more than one year.

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

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

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

(3) under this section if the trustee is accounting under K.S.A. 58-9-403 for the business or activity in which the asset is used.

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

**History:** L. 2000, ch. 61, § 27; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-504. Transfers from income to reimburse principal.** (a) If a trustee makes or expects to make a principal disbursement described in this section, the trustee may transfer an appropriate amount from income to principal in one or more accounting periods to reimburse principal or to provide a reserve for future principal disbursements.

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

- (1) An amount chargeable to income but paid from principal because it is unusually large, including extraordinary repairs;
- (2) a capital improvement to a principal asset, whether in the form of changes to an existing asset or the construction of a new asset, including special assessments;
- (3) disbursements made to prepare property for rental, including tenant allowances, leasehold improvements, and broker's commissions;
- (4) periodic payments on an obligation secured by a principal asset to the extent that the amount transferred from income to principal for depreciation is less than the periodic payments; and
- (5) disbursements described in subsection (a)(7) of K.S.A. 58-9-502 and amendments thereto.

(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).

**History:** L. 2000, ch. 61, § 28; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-505. Income taxes.** (a) A tax required to be paid by a trustee based on receipts allocated to income must be paid from income.

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

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

- (1) From income to the extent that receipts from the entity are allocated to income; and
- (2) from principal to the extent that:
  - (A) Receipts from the entity are allocated to principal; and
  - (B) the trust's share of the entity's taxable income exceeds the total receipts described in subsections (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.

**History:** L. 2000, ch. 61, § 29; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-506. Adjustments between principal and income because of taxes.** (a) A fiduciary may make adjustments between principal and income to offset the shifting of economic interests or tax benefits between income beneficiaries and remainder beneficiaries 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 in-

crease 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.

**History:** L. 2000, ch. 61, § 30; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**Part 6.—MISCELLANEOUS PROVISIONS**

**58-9-601. Application of act.** Except as expressly provided in a will or terms of the trust or this act, this act applies to every trust or decedent's estate existing on the effective date of this act.

**History:** L. 2000, ch. 61, § 31; July 1.

**Law Review and Bar Journal References:**

"An Accounting Primer for Estate Planning, Probate and Trust Counsel (The New Kansas Uniform Principal and Income Act)," C. David Newbery and D. Thad Sullivan, 71 J.K.B.A. No. 6, 51 (2002).

**58-9-602. 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.

**History:** L. 2000, ch. 61, § 32; July 1.

**58-9-603. Severability clause.** If any provision of this act or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this act which can be given effect without the invalid provision or application, and to this end the provisions of this act are severable.

**History:** L. 2000, ch. 61, § 33; July 1.



