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Referred: Judiciary

BY THE RULES COMMITTEE BY  
REQUEST OF THE LEGISLATIVE  
COUNCIL (for the Code  
Revision Commission)

1 IN THE HOUSE

2 HOUSE BILL NO. 693

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 THIRTEENTH LEGISLATURE - SECOND SESSION

5 A BILL

6 For an Act entitled: "An Act relating to principal and income of trusts;  
7 and providing for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 \* Section 1. AS 13 is amended by adding a new chapter to read:

10 CHAPTER 38. PRINCIPAL AND INCOME OF TRUSTS.

11 Sec. 13.38.010. DUTY OF TRUSTEE AS TO RECEIPTS AND EXPENDITURE.

12 (a) In administering a trust, a trustee shall credit a receipt or  
13 charge an expenditure to income or principal or partly to each

14 (1) in accordance with the terms of the trust instrument,  
15 regardless of contrary provisions of this chapter;

16 (2) in the absence of a contrary term of the trust instru-  
17 ment, in accordance with this chapter; or

18 (3) if neither paragraph (1) or (2) of this subsection  
19 applies; in accordance with reason and equity to the interests of  
20 those entitled to income and principal, in the way a person of ordi-  
21 nary prudence, discretion and judgment would act in managing the  
22 person's own affairs.

23 (b) If the trust instrument gives the trustee discretion in  
24 crediting a receipt or charging an expenditure to income or principal  
25 or partly to each, no inference of imprudence or partiality arises  
26 from the fact that the trustee makes an allocation contrary to a  
27 provision of this chapter.

28 Sec. 13.38.020. INCOME AND PRINCIPAL DEFINED. (a) Income is  
29 the return in money or property derived from the use of principal,

1 including return received as

2 (1) rent of real or personal property, including money or  
3 property received for cancellation or renewal of a lease;

4 (2) interest on money lent, including money or property  
5 received as consideration for the privilege of prepayment of principal  
6 except as provided in AS 13.38.060 on bond premium and bond discount;

7 (3) income earned during administration of a decedent's  
8 estate as provided in AS 13.38.040;

9 (4) corporate distributions as provided in AS 13.38.050;

10 (5) accrued increment on bonds or other obligations issued  
11 at discount as provided in AS 13.38.060;

12 (6) receipts from business and farming operations as pro-  
13 vided in AS 13.38.070;

14 (7) receipts from disposition of natural resources as  
15 provided in AS 13.38.080 and 13.38.090;

16 (8) receipts from other principal subject to depletion as  
17 provided in AS 13.38.100; and

18 (9) receipts from disposition of underproductive property  
19 as provided in AS 13.38.110.

20 (b) Principal is the property that has been set aside by the  
21 owner or the person legally empowered so that it is held in trust  
22 eventually to be delivered to a remainderman while the return or use  
23 of the principal is in the meantime taken or received by or held for  
24 accumulation for an income beneficiary. Principal includes

25 (1) consideration received by the trustee on the sale or  
26 other transfer of principal or on repayment of a loan or as a refund  
27 or replacement or change in the form of principal;

28 (2) proceeds of property taken in eminent domain proceed-  
29 ings;

1           (3) proceeds of insurance upon property forming part of the  
2 principal except proceeds of insurance upon a separate interest of an  
3 income beneficiary;

4           (4) stock dividends, receipts on liquidation of a corpora-  
5 tion and other corporate distributions as provided in AS 13.38.050;

6           (5) receipts from the disposition of corporate securities  
7 as provided in AS 13.38.060;

8           (6) royalties and other receipts from disposition of natu-  
9 ral resources as provided in AS 13.38.080 and 13.38.090;

10           (7) receipts from other principal subject to depletion as  
11 provided in AS 13.38.100;

12           (8) profit resulting from a change in the form of principal  
13 except as provided in AS 13.38.110 on underproductive property;

14           (9) receipts from disposition of underproductive property  
15 as provided in AS 13.38.110; and

16           (10) an allowance for depreciation established under AS 13.-  
17 38.070 and 13.38.120(a)(2).

18           (c) After determining income and principal in accordance with  
19 the terms of the trust instrument or the provisions of this chapter,  
20 the trustee shall charge to income or principal expenses and other  
21 charges as provided in AS 13.38.120.

22           Sec. 13.38.030. WHEN RIGHT TO INCOME ARISES; APPORTIONMENT OF  
23 INCOME. (a) An income beneficiary is entitled to income from the  
24 date specified in the trust instrument, or, if none is specified, from  
25 the date an asset becomes subject to the trust. An asset that becomes  
26 subject to a trust under a will becomes subject to the trust as of the  
27 date of the death of the testator even though there is an intervening  
28 period of administration of the testator's estate.

29           (b) In the administration of a decedent's estate or an asset

1 becoming subject to a trust under a will

2 (1) receipts due but not paid at the date of death of the  
3 testator are principal;

4 (2) receipts in the form of periodic payments, other than  
5 corporate distributions to stockholders, including rent, interest, or  
6 annuities, not due at the date of the death of the testator shall be  
7 treated as accruing from day to day; that portion of the receipts  
8 accruing before the date of death is principal, and the balance is  
9 income.

10 (c) In all other cases, a receipt from an income producing asset  
11 is income even though the receipt was earned or accrued wholly or  
12 partly before the date the asset became subject to the trust.

13 (d) On termination of an income interest, the income beneficiary  
14 whose interest is terminated, or the income beneficiary's estate, is  
15 entitled to

16 (1) income undistributed on the date of termination;

17 (2) income due but not paid to the trustee on the date of  
18 termination;

19 (3) income in the form of periodic payments, other than  
20 corporate distributions to stockholders, including rent, interest, or  
21 annuities, not due on the date of termination, accrued from day to  
22 day.

23 (e) Corporate distributions to stockholders shall be treated as  
24 due on the day fixed by the corporation for determination of stock-  
25 holders of record entitled to distribution or, if no date is fixed, on  
26 the date the corporation declares a distribution.

27 Sec. 13.38.040. INCOME EARNED DURING ADMINISTRATION OF A DECE-  
28 DENT'S ESTATE. (a) Unless the will provides otherwise and subject to

29 (b) of this section, all expenses incurred in connection with the

1 settlement of a decedent's estate, including debts, funeral expenses,  
2 estate taxes, interest and penalties concerning taxes, family allow-  
3 ances, fees of attorneys and personal representatives, and court costs  
4 shall be charged against the principal of the estate.

5 (b) Unless the will provides otherwise, income from the assets  
6 of a decedent's estate after the death of the testator and before  
7 distribution, including income from property used to discharge liabil-  
8 ities, shall be determined in accordance with the rules applicable to  
9 a trustee under this chapter and distributed as follows:

10 (1) to specific legatees and devisees, the income from the  
11 property bequeathed or devised to them respectively, less taxes,  
12 ordinary repairs, and other expenses of management and operation of  
13 the property, and an appropriate portion of interest accrued since the  
14 death of the testator and of taxes imposed on income, excluding taxes  
15 on capital gains, that accrue during the period of administration;

16 (2) to all other legatees and devisees, except legatees of  
17 pecuniary bequests not in trust, the balance of the income, less the  
18 balance of taxes, ordinary repairs, and other expenses of management  
19 and operation of all property from which the estate is entitled to  
20 income, interest accrued since the death of the testator, and taxes  
21 imposed on income, excluding taxes on capital gains, that accrue  
22 during the period of administration, in proportion to their respective  
23 interests in the undistributed assets of the estate computed at times  
24 of distribution on the basis of inventory value.

25 (c) Income received by a trustee under (b) of this section shall  
26 be treated as income of the trust.

27 Sec. 13.38.050. CORPORATE DISTRIBUTIONS. (a) Corporate distri-  
28 butions of shares of the distributing corporation, including distri-  
29 butions in the form of a stock split or stock dividend, are principal.

1 A right to subscribe to shares or other securities issued by the  
2 distributing corporation accruing to stockholders on account of their  
3 stock ownership and the proceeds of a sale of the right are principal.

4 (b) Except to the extent that the corporation indicates that  
5 some part of a corporate distribution is a settlement of preferred or  
6 guaranteed dividends accrued since the trustee became a stockholder or  
7 is in lieu of an ordinary cash dividend, a corporate distribution is  
8 principal if the distribution is under

9 (1) a call of shares;

10 (2) a merger, consolidation, reorganization, or other plan  
11 by which assets of the corporation are acquired by another corpora-  
12 tion; or

13 (3) a total or partial liquidation of the corporation,  
14 including

15 (A) a distribution that the corporation indicates is a  
16 distribution in total or partial liquidation, or

17 (B) a distribution of assets, other than cash, under a  
18 court decree or final administrative order by a government agency  
19 ordering distribution of the particular assets.

20 (c) Distributions made from ordinary income by a regulated  
21 investment company or by a trust qualifying and electing to be taxed  
22 under federal law as a real estate investment trust are income. All  
23 other distributions made by the company or trust, including distribu-  
24 tions from capital gains, depreciation, or depletion, whether in the  
25 form of cash or an option to take new stock or cash or an option to  
26 purchase additional shares, are principal.

27 (d) Except as provided in (a) - (c) of this section, all corpo-  
28 rate distributions are income, including cash dividends, distributions  
29 of or rights to subscribe to shares or securities or obligations of

1 corporations other than the distributing corporation, and the proceeds  
2 of the rights or property distributions. Except as provided in (b)  
3 and (c) of this section, if the distributing corporation gives a  
4 stockholder an option to receive a distribution either in cash or in  
5 its own shares, the distribution chosen is income.

6 (e) The trustee may rely upon a statement of the distributing  
7 corporation as to a fact relevant under a provision of this chapter  
8 concerning the source or character of dividends or distributions of  
9 corporate assets.

10 Sec. 13.38.060. BOND PREMIUM AND DISCOUNT. (a) A bond or other  
11 obligation for the payment of money is principal at its inventory  
12 value except as provided in (b) of this section for discount bonds.  
13 The trustee may not make a provision for amortization of a bond pre-  
14 mium or for accumulation for discount. The proceeds of sale, redemp-  
15 tion, or other disposition of the bonds or obligations are principal.

16 (b) The increment in value of a bond or other obligation for the  
17 payment of money payable at a future time in accordance with a fixed  
18 schedule of appreciation in excess of the price at which it was issued  
19 is income. The trustee shall distribute the increment in value to the  
20 beneficiary who was the income beneficiary at the time of increment  
21 from the first principal cash available or, if none is available, when  
22 realized by sale, redemption, or other disposition. Whenever unreal-  
23 ized increment is distributed as income but out of principal, the  
24 principal shall be reimbursed for the increment when realized.

25 Sec. 13.38.070. BUSINESS AND FARMING OPERATIONS. (a) If a  
26 trust uses part of the principal in the continuance of a business of  
27 which the settlor was a sole proprietor or a partner, the net profits  
28 of the business, computed in accordance with generally accepted ac-  
29 counting principles for a comparable business, are income. If a loss

1 results in a fiscal or calendar year, the loss falls on principal and  
2 the trustee may not carry it into another fiscal or calendar year for  
3 the purpose of calculating net income.

4 (b) A trustee shall use generally accepted accounting principles  
5 to determine income from an agricultural or farming operation, includ-  
6 ing the raising of animals or the operation of a nursery.

7 Sec. 13.38.080. DISPOSITION OF NATURAL RESOURCES. (a) If part  
8 of the principal consists of a right to receive royalties, overriding  
9 or limited royalties, working interests, production payments, net  
10 profit interests, or other interests in minerals or other natural  
11 resources in, on or under land, the trustee shall allocate receipts  
12 from the natural resources from the land as follows:

13 (1) if received as rent on a lease or extension payments on  
14 a lease, the receipts are income;

15 (2) if received from a production payment, the receipts are  
16 income to the extent of any factor for interest or its equivalent  
17 provided in the governing instrument; the trustee shall allocate to  
18 principal the fraction of the balance of the receipts that the unre-  
19 covered cost of the production payment bears to the balance owed on  
20 the production payment, exclusive of any factor for interest or its  
21 equivalent; the receipts not allocated to principal are income;

22 (3) if received as a royalty, overriding or limited royal-  
23 ty, or bonus, or from a working, net profit, or another interest in  
24 minerals or other natural resources, receipts not provided for in (1)  
25 and (2) of this subsection shall be apportioned on a yearly basis in  
26 accordance with this paragraph whether or not a natural resource was  
27 being taken from the land at the time the trust was established; 27-  
28 1/2 percent of the gross receipts, but not to exceed 50 percent of the  
29 net receipts remaining after payment of all expenses, direct and

1 indirect, computed without allowance for depletion, shall be added to  
2 principal as an allowance for depletion; after payment of all direct  
3 and indirect expenses from gross receipts, the balance is income.

4 (b) If a trustee, on December 31, 1984, holds an item of deplet-  
5 able property of a type specified in this section, the trustee shall  
6 allocate receipts from the property in the manner used before  
7 January 1, 1985, but as to all depletable property acquired on or  
8 after January 1, 1985 by an existing or new trust, the trustee shall  
9 use the method of allocation provided in this chapter.

10 (c) This section does not apply to timber, water, soil, sod,  
11 dirt, turf, or mosses.

12 Sec. 13.38.090. TIMBER. If part of the principal consists of  
13 land from which merchantable timber may be removed, the trustee shall  
14 allocate receipts from taking the timber from the land in accordance  
15 with AS 13.38.010(a)(3).

16 Sec. 13.38.100. OTHER PROPERTY SUBJECT TO DEPLETION. Except as  
17 provided in AS 13.38.080 and 13.38.090, if the principal consists of  
18 property subject to depletion, including leaseholds, patents, copy-  
19 rights, royalty rights, and rights to receive payments on a contract  
20 for deferred compensation, receipts from the property, not in excess  
21 of five percent a year of its inventory value, are income, and the  
22 balance is principal.

23 Sec. 13.38.110. UNDERPRODUCTIVE PROPERTY. (a) Except as other-  
24 wise provided in this section, a portion of the net proceeds of sale  
25 of any part of principal that has not produced an average net income  
26 of at least one percent per year of its inventory value for more than  
27 a year, including as income the value of a beneficial use of the  
28 property by the income beneficiary, shall be treated as delayed income  
29 to which the income beneficiary is entitled as provided in this

1 section. The net proceeds of sale are the gross proceeds received,  
2 including the value of any property received in substitution for the  
3 property disposed of, less the expenses, including taxes, if any,  
4 incurred in disposition and less any carrying charges paid while the  
5 property was underproductive.

6 (b) The sum allocated as delayed income is the difference be-  
7 tween the net proceeds and the amount that, had it been invested at  
8 simple interest at four percent per year while the property was under-  
9 productive, would have produced the net proceeds. This sum, plus any  
10 carrying charges and expenses previously charged against income while  
11 the property was underproductive, less any income received by the  
12 income beneficiary from the property and less the value of any benefi-  
13 cial use of the property by the income beneficiary, is income, and the  
14 balance is principal.

15 (c) An income beneficiary or the estate of the income benefi-  
16 ciary is entitled to delayed income under this section as if it ac-  
17 crued from day to day during the time the person was a beneficiary.

18 (d) If principal subject to this section is disposed of by  
19 conversion into property that cannot be apportioned easily, including  
20 land or mortgages, such as realty acquired by or in lieu of foreclo-  
21 sure, the income beneficiary is entitled to the net income from any  
22 property or obligation into which the original principal is converted  
23 while the substituted property or obligation is held.

24 Sec. 13.38.120. CHARGES AGAINST INCOME AND PRINCIPAL. (a) A  
25 trustee shall make the following charges against income:

26 (1) ordinary expenses incurred in connection with the  
27 administration, management, or preservation of the trust property,  
28 including regularly recurring taxes assessed against a portion of the  
29 principal, water rates, premiums on insurance taken upon the interests

1 of the income beneficiary, remainderman, or trustee, interest paid by  
2 the trustee, and ordinary repairs;

3 (2) a reasonable allowance for depreciation on property  
4 subject to depreciation under generally accepted accounting princi-  
5 ples, but the trustee may not make an allowance for depreciation of  
6 that portion of real property used by a beneficiary as a residence or  
7 for depreciation of property held by the trustee on January 1, 1985  
8 for which the trustee is not then making an allowance for deprecia-  
9 tion;

10 (3) one-half of court costs, attorney's fees, and other  
11 fees on periodic judicial accounting, unless the court directs other-  
12 wise;

13 (4) court costs, attorney's fees, and other fees on other  
14 accountings or judicial proceedings if the matter primarily concerns  
15 the income interest, unless the court directs otherwise;

16 (5) one-half of the trustee's regular compensation, whether  
17 based on a percentage of principal or income, and all expenses reason-  
18 ably incurred for current management of principal and application of  
19 income;

20 (6) a tax levied upon receipts defined as income under this  
21 chapter or the trust instrument and payable by the trustee.

22 (b) If charges against income are of unusual amount, the trustee  
23 may by means of reserves or other reasonable means charge them over a  
24 reasonable period of time and withhold from distribution sufficient  
25 sums to regularize distributions.

26 (c) A trustee shall charge against the principal

27 (1) trustee's compensation not chargeable to income under  
28 (a)(4) and (a)(5) of this section, special compensation of trustees,  
29 expenses reasonably incurred in connection with principal, court costs

1 and attorney's fees primarily concerning matters of principal, and  
2 trustee's compensation computed on principal as an acceptance, dis-  
3 tribution, or termination fee;

4 (2) charges not provided for in (a) of this section, in-  
5 cluding the cost of investing and reinvesting principal, the payments  
6 on principal of an indebtedness including a mortgage amortized by  
7 periodic payments of principal, expenses for preparation of property  
8 for rental or sale, and, unless the court directs otherwise, expenses  
9 incurred in maintaining or defending any action to construe the trust,  
10 protect it or the property, or assure the title of any trust property;

11 (3) extraordinary repairs or expenses incurred in making a  
12 capital improvement to principal, including special assessments, but,  
13 a trustee may establish an allowance for depreciation out of income to  
14 the extent permitted by (a)(2) of this section and by AS 13.38.070;

15 (4) a tax levied upon profit, gain, or other receipts  
16 allocated to principal notwithstanding denomination of the tax as an  
17 income tax by the taxing authority;

18 (5) if an estate or inheritance tax is levied in respect of  
19 trust in which both an income beneficiary and a remainderman have an  
20 interest, any amount apportioned to the trust, including interest and  
21 penalties, even though the income beneficiary also has rights in the  
22 principal.

23 (d) Regularly recurring charges payable from income shall be  
24 apportioned to the same extent and in the same manner that income is  
25 apportioned under AS 13.38.030.

26 Sec. 13.38.130. DEFINITIONS. In this chapter

27 (1) "income beneficiary" means the person to whom income is  
28 presently payable or for whom it is accumulated for distribution as  
29 income;

1                   (2) "inventory value" means the cost of property purchased  
2 by the trustee and the market value of other property at the time it  
3 became subject to the trust, but in the case of a testamentary trust  
4 the trustee may use any value finally determined for the purposes of  
5 an estate or inheritance tax;

6                   (3) "remainderman" means the person entitled to principal,  
7 including income that has been accumulated and added to principal;

8                   (4) "trustee" means an original trustee and a successor or  
9 added trustee.

10                  Sec. 13.38.140. APPLICATION OF CHAPTER. Except as specifically  
11 provided in the trust instrument or the will or in this chapter, this  
12 chapter applies to a receipt or expense received or incurred on or  
13 after January 1, 1985, by any trust or decedent's estate whenever  
14 established and without regard to when the asset involved was acquired  
15 by the trustee.

16 \* Sec. 2. This Act takes effect January 1, 1985.