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## AB-307 Allocation of principal or income. (2017-2018)

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### Assembly Bill No. 307

#### CHAPTER 577

An act to repeal and add Section 16350 of the Probate Code, relating to estates and trusts.

[ Approved by Governor October 08, 2017. Filed with Secretary of State October 08, 2017. ]

#### LEGISLATIVE COUNSEL'S DIGEST

AB 307, Maienschein. Allocation of principal or income.

The Uniform Principal and Income Act, among other things, generally directs a trustee how to allocate money to beneficiaries of an estate or trust as either principal or income. The act requires that money received from certain types of business entities be allocated to income, but provides that money received in total or partial liquidation of one of these entities be allocated to principal. Money is received in partial liquidation to the extent the amount is attributable to the proceeds from the sale of a capital asset. The act defines the term "capital asset" based on the definition of the term in the Internal Revenue Code.

The bill would delete these provisions and provide revised directions for how a trustee is required to allocate money to beneficiaries of an estate or trust as either principal or income. The directions would include, among others, how a trustee is to determine that a distribution is a return of capital that is allocated as principal.

Vote: majority Appropriation: no Fiscal Committee: no Local Program: no

#### THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

**SECTION 1.** Section 16350 of the Probate Code is repealed.

**SEC. 2.** Section 16350 is added to the Probate Code, to read:

**16350.** (a) As used in this section, "entity" shall mean a corporation, partnership, limited-liability company, regulated investment company, real estate investment trust, common trust fund, or any other organization in which a trustee has an interest other than a trust or estate to which Section 16351 applies, a business or activities to which Section 16352 applies, or an asset-backed security to which Section 16367 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 to principal the following receipts from an entity:

(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 a distribution if and to the extent that the trustee determines that the distribution is a return of capital under subdivision (d), (e), (f), or (g).

(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) A trustee may determine that money is received as a return of capital if and to the extent that the money received exceeds the total amount of income tax that the beneficiaries must pay on their respective shares of the taxable income of the entity and the trust must pay from income under Article 4 (commencing with Section 16345), Article 5.1 (commencing with Section 16350), Article 5.2 (commencing with Section 16355), and Article 5.3 (commencing with Section 16360), inclusive, on its share of the taxable income of the entity. A trustee may determine that money which represents gain upon the sale or other disposition of property described in subdivision (e) is a return of capital.

(e) In determining if and to what extent a distribution is a return of capital, a trustee may rely upon and determine the weight to be given to any information concerning the source of the money from which the distribution is made which is reasonably available to the trustee, including, but not limited to, information concerning any of the following:

(1) The amount of the distribution in question compared to the amount of the entity's regular, periodic distributions, if any, during the year in which the distribution is made and in prior years.

(2) If the primary activity of the entity is not an investment activity described in paragraph (3), the amount of money the entity has received from the conduct of its normal business activities compared to the amount of money the entity has received from all other sources, including, but not limited to, any of the following:

(A) The sale of all or part of a business conducted by the entity or by another entity in which it owns an interest, directly or indirectly, including, but not limited to, money representing any gain realized on such a sale.

(B) The sale of one or more business assets that are not sold to customers in the normal course of the entity's business, including, but not limited to, money representing any gain realized on such a sale.

(C) The sale of one or more investment assets, including, but not limited to, money representing any gain realized on such a sale.

(3) If the primary activity of the entity is to invest funds in another entity or in investment property that the entity owns directly for the purpose of realizing gain on the disposition of all or a part of an investment, the amount of money that the entity has received from the sale of all or part of one or more of those investments, including, but not limited to, money representing any gain realized on a disposition.

(4) The amount of money the entity has accumulated, to the extent that the governing body of the entity has decided the money is no longer needed for the business or investment needs of the entity.

(5) The amount of income tax, if any, that each beneficiary has paid on the undistributed income of the entity before the year of the distribution and the amount of income tax on the undistributed income of the entity that the trust has paid from the income or principal of the trust.

(6) The amount of money the entity has borrowed, whether or not repayment of the loan is secured to any extent by one or more of the entity's assets.

(7) The amount of money the entity has received from the sources described in Sections 16358, 16362, 16363, and 16364.

(8) The amount of money the entity has received from a source not described in this subdivision.

(f) If a trustee determines that only a portion of a distribution is a return of capital and is in doubt about the amount of the distribution that is a return of capital, the trustee shall resolve the doubt by allocating to income the amount, if any, the trustee determines is not a return of capital and by allocating the balance of the distribution to principal.

(g) A trustee shall consider and may rely upon, without independent investigation, the financial statements of an entity and any other information provided by an entity about the character of a distribution or the source of funds from which the distribution is made if the information is provided 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. The trustee is not bound by any statement made or implied by the entity about the extent to which a distribution is or is not a return of capital. If the trustee receives additional information about the distribution and the trustee has not yet made a distribution to a trust beneficiary of any portion of that distribution from the entity for which the trustee has made the determination of whether the amount is a return of capital, the trustee shall consider the additional information received and may make an

adjustment to that decision. If the trustee receives additional information about the distribution after the trustee has made a distribution to a trust beneficiary of any portion of that distribution from the entity for which the trustee has made the determination of whether the amount is a return of capital, the trustee is not required to change that decision.

(h) In exercising the discretion provided to the trustee pursuant to subdivisions (d), (e), (f), and (g), the trustee shall comply with the duties provided for under Article 1 (commencing with Section 16000) of Chapter 1, including, but not limited to, Sections 16000, 16003, and 16004.