

GENERAL ASSEMBLY OF NORTH CAROLINA  
SESSION 2003

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SENATE BILL 549  
Judiciary II Committee Substitute Adopted 4/22/03

Short Title: Uniform Principal and Income Act.

(Public)

Sponsors:

Referred to:

March 27, 2003

A BILL TO BE ENTITLED

AN ACT TO ADOPT THE REVISED UNIFORM PRINCIPAL AND INCOME ACT.

The General Assembly of North Carolina enacts:

**SECTION 1.** The General Statutes are amended by adding a new Chapter to read:

**"Chapter 37A.**

**"Uniform Principal and Income Act.**

**"Article 1.**

**"Definitions and Fiduciary Duties; Conversion to Unitrust; Judicial Control of Discretionary Power.**

**"Part 1. Definitions.**

**"§ 37A-1-101. Short title.**

This Chapter may be cited as the Uniform Principal and Income Act.

**"§ 37A-1-102. Definitions.**

The following definitions apply in this Chapter:

- (1) "Accounting period" means a calendar year unless another 12-month period is selected by a fiduciary. The term includes a portion of a calendar year or other 12-month period that begins when an income interest begins or ends when an income interest ends.
- (2) "Beneficiary" includes, in the case of a decedent's estate, an heir, legatee, and devisee and, in the case of a trust, an income beneficiary and a remainder beneficiary.
- (3) "Fiduciary" means a personal representative or a trustee. The term includes an executor, administrator, successor personal representative, special administrator, and a person performing substantially the same function.
- (4) "Income" means money or property that a fiduciary receives as current return from a principal asset. The term includes a portion of receipts

1 from a sale, exchange, or liquidation of a principal asset, to the extent  
2 provided in Article 4 of this Chapter.

3 (5) "Income beneficiary" means a person to whom net income of a trust is  
4 or may be payable.

5 (6) "Income interest" means the right of an income beneficiary to receive  
6 all or part of net income, whether the terms of the trust require it to be  
7 distributed or authorize it to be distributed in the trustee's discretion.

8 (7) "Mandatory income interest" means the right of an income beneficiary  
9 to receive net income that the terms of the trust require the fiduciary to  
10 distribute.

11 (8) "Net income" means the total receipts allocated to income during an  
12 accounting period minus the disbursements made from income during  
13 the period, plus or minus transfers under this Chapter to or from  
14 income during the period.

15 (9) "Person" means an individual, corporation, business trust, estate, trust,  
16 partnership, limited liability company, association, joint venture, or  
17 government; governmental subdivision, agency, or instrumentality;  
18 public corporation, or any other legal or commercial entity.

19 (10) "Principal" means property held in trust for distribution to a remainder  
20 beneficiary when the trust terminates.

21 (11) "Remainder beneficiary" means a person entitled to receive principal  
22 when an income interest ends.

23 (12) "Terms of a trust" means the manifestation of the intent of a settlor or  
24 decedent with respect to the trust, expressed in a manner that admits of  
25 its proof in a judicial proceeding, whether by written or spoken words  
26 or by conduct.

27 (13) "Trustee" includes an original, additional, or successor trustee, whether  
28 or not appointed or confirmed by a court.

29 **"§ 37A-1-103. Fiduciary duties; general principles.**

30 (a) In allocating receipts and disbursements to or between principal and income,  
31 and with respect to any matter within the scope of Articles 2 and 3 of this Chapter, a  
32 fiduciary:

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

35 (2) May administer a trust or estate by the exercise of a discretionary  
36 power of administration given to the fiduciary by the terms of the trust  
37 or the will, even if the exercise of the power produces a result different  
38 from a result required or permitted by this Chapter;

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

42 (4) Shall add a receipt or charge a disbursement to principal to the extent  
43 that the terms of the trust and this Chapter do not provide a rule for

1 allocating the receipt or disbursement to or between principal and  
2 income.

3 (b) In exercising the power to adjust under G.S. 37A-1-104(a) or a discretionary  
4 power of administration regarding a matter within the scope of this Chapter, whether  
5 granted by the terms of a trust, a will, or this Chapter, a fiduciary shall administer a trust  
6 or estate impartially, based on what is fair and reasonable to all of the beneficiaries,  
7 except to the extent that the terms of the trust or the will clearly manifest an intention  
8 that the fiduciary shall or may favor one or more of the beneficiaries. A determination in  
9 accordance with this Chapter is presumed to be fair and reasonable to all of the  
10 beneficiaries.

11 **"§ 37A-1-104. Trustee's power to adjust.**

12 (a) A trustee may adjust between principal and income to the extent the trustee  
13 considers necessary if the trustee invests and manages trust assets as a prudent investor,  
14 the terms of the trust describe the amount that may or shall be distributed to a  
15 beneficiary by referring to the trust's income, and the trustee determines, after applying  
16 the rules in G.S. 37A-1-103(a), that the trustee is unable to comply with G.S.  
17 37A-1-103(b). In lieu of exercising the power to adjust, the trustee may convert the trust  
18 to a unitrust as permitted under Part 2 of this Article, in which case the unitrust amount  
19 shall become the net income of the trust.

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

- 23 (1) The nature, purpose, and expected duration of the trust;
- 24 (2) The intent of the grantor or settlor;
- 25 (3) The identity and circumstances of the beneficiaries;
- 26 (4) The needs for liquidity, regularity of income, and preservation and  
27 appreciation of capital;
- 28 (5) The assets held in the trust; the extent to which they consist of  
29 financial assets, interests in closely held enterprises, tangible and  
30 intangible personal property, or real property; the extent to which an  
31 asset is used by a beneficiary; and whether an asset was purchased by  
32 the trustee or received from the settlor;
- 33 (6) The net amount allocated to income under the other sections of this  
34 Chapter and the increase or decrease in the value of the principal  
35 assets, which the trustee may estimate as to assets for which market  
36 values are not readily available;
- 37 (7) Whether and to what extent the terms of the trust give the trustee the  
38 power to invade principal or accumulate income or prohibit the trustee  
39 from invading principal or accumulating income, and the extent to  
40 which the trustee has exercised a power from time to time to invade  
41 principal or accumulate income;
- 42 (8) The actual and anticipated effect of economic conditions on principal  
43 and income and effects of inflation and deflation; and
- 44 (9) The anticipated tax consequences of an adjustment.

1       (c) A trustee may not make an adjustment:

2           (1) That diminishes the income interest in a trust that requires all of the  
3           income to be paid at least annually to a spouse and for which an estate  
4           tax or gift tax marital deduction would be allowed, in whole or in part,  
5           if the trustee did not have the power to make the adjustment;

6           (2) That reduces the actuarial value of the income interest in a trust to  
7           which a person transfers property with the intent to qualify for a gift  
8           tax exclusion;

9           (3) That changes the amount payable to a beneficiary as a fixed annuity or  
10           a fixed fraction of the value of the trust assets;

11           (4) From any amount that is permanently set aside for charitable purposes  
12           under a will or the terms of a trust unless both income and principal  
13           are so set aside;

14           (5) If possessing or exercising the power to make an adjustment causes an  
15           individual to be treated as the owner of all or part of the trust for  
16           income tax purposes and the individual would not be treated as the  
17           owner if the trustee did not possess the power to make an adjustment;

18           (6) If possessing or exercising the power to make an adjustment causes all  
19           or part of the trust assets to be included for estate tax purposes in the  
20           estate of an individual who has the power to remove a trustee or  
21           appoint a trustee, or both, and the assets would not be included in the  
22           estate of the individual if the trustee did not possess the power to make  
23           an adjustment;

24           (7) If the trustee is a beneficiary of the trust;

25           (8) If the trustee is not a beneficiary but the adjustment would benefit the  
26           trustee directly or indirectly; or

27           (9) If the trust has been converted to, and is then operating as, a unitrust  
28           under Part 2 of this Article.

29       (d) If subdivision (5), (6), (7), or (8) of subsection (c) of this section applies to a  
30       trustee and there is more than one trustee, a cotrustee to whom the provision does not  
31       apply may make the adjustment unless the exercise of the power by the remaining  
32       trustee or trustees is not permitted by the terms of the trust.

33       (e) A trustee may release the entire power conferred by subsection (a) of this  
34       section or may release only the power to adjust from income to principal or the power to  
35       adjust from principal to income if the trustee is uncertain about whether possessing or  
36       exercising the power will cause a result described in subdivisions (1) through (6) or  
37       subdivision (8) of subsection (c) of this section or if the trustee determines that  
38       possessing or exercising the power will or may deprive the trust of a tax benefit or  
39       impose a tax burden not described in subsection (c) of this section. The release may be  
40       permanent or for a specified period, including a period measured by the life of an  
41       individual.

42       (f) Terms of a trust that limit the power of a trustee to make an adjustment  
43       between principal and income do not affect the application of this section unless it is

1 clear from the terms of the trust that the terms are intended to deny the trustee the power  
2 of adjustment conferred by subsection (a) of this section.

3 "Part 2. Conversion to Unitrust.

4 **"§ 37A-1-104.1. Definitions.**

5 For purposes of this Part:

- 6 (1) "Code" means the Internal Revenue Code of 1986, as amended from  
7 time to time, and any statutory enactment successor thereto; reference  
8 to a specific section of the Code in this Part shall be deemed a  
9 reference also to any successor provision dealing with the subject  
10 matter of that section of the Code.
- 11 (2) "Competent beneficiary" includes:
- 12 a. A beneficiary who has attained his or her majority and is not  
13 otherwise under a legal disability;
- 14 b. A court-appointed guardian of an incompetent beneficiary;
- 15 c. An attorney-in-fact or agent under a durable power of attorney  
16 for an incompetent beneficiary;
- 17 d. A court-appointed guardian of a minor beneficiary's estate; and
- 18 e. In the case of a minor beneficiary for whom no guardian has  
19 been appointed, a parent of the minor beneficiary, but only if  
20 the parent does not have an interest in the estate or trust that  
21 conflicts with the interest of the minor beneficiary.
- 22 (3) "Grantor" means an individual who created an inter vivos trust.
- 23 (4) "Disinterested person" means a person who is not a related or  
24 subordinate party with respect to the person then acting as trustee of  
25 the trust and excludes the grantor of the trust and any interested  
26 trustee.
- 27 (5) "Income trust" means a trust, created by either an inter vivos or a  
28 testamentary instrument, which directs or permits the trustee to  
29 distribute the net income of the trust to one or more persons, either in  
30 fixed proportions or in amounts or proportions determined by the  
31 trustee. Notwithstanding the foregoing, no trust that may be subject to  
32 taxation under section 2001 or section 2501 of the Code shall be an  
33 income trust for purposes of this Part, until the expiration of the period  
34 for filing the return therefor, including all extensions for the filing.
- 35 (6) "Interested distributee" means a person to whom distributions of  
36 income or principal can currently be made who has the power to  
37 remove the existing trustee and designate as successor a person who  
38 may be a related or subordinate party with respect to that distributee.
- 39 (7) "Interested trustee" means (i) an individual trustee to whom the net  
40 income or principal of the trust can currently be distributed or would  
41 be distributed if the trust were then to terminate and be distributed, (ii)  
42 any trustee who may be removed and replaced by an interested  
43 distributee, or (iii) an individual trustee whose legal obligation to

1 support a beneficiary may be satisfied by distributions of income and  
2 principal of the trust.

3 (8) "Related or subordinate party" means a related or subordinate party as  
4 defined in section 672(c) of the Code.

5 (9) "Total return unitrust" means an income trust which has been  
6 converted under and meets the provisions of this Part.

7 (10) "Trustee" means any person acting as trustee of the trust, except as  
8 otherwise expressly provided in this Part, whether acting in that  
9 person's discretion or on the direction of one or more persons acting in  
10 a fiduciary capacity.

11 (11) "Unitrust amount" means an amount computed as a percentage of the  
12 fair market value of the trust.

13 **"§ 37A-1-104.2. Conversion in trustee's discretion without court approval.**

14 (a) Any trustee, other than an interested trustee, or, where two or more persons  
15 are acting as trustees, a majority of the trustees who are not interested trustees (in either  
16 case hereafter "trustee"), may, in the trustee's sole discretion and without court approval,  
17 (i) convert an income trust to a total return unitrust, (ii) reconvert a total return unitrust  
18 to an income trust, or (iii) change the percentage used to calculate the unitrust amount or  
19 the method used to determine the fair market value of the trust if:

20 (1) The trustee adopts a written policy for the trust providing (i) in the  
21 case of a trust being administered as an income trust, that future  
22 distributions from the trust will be unitrust amounts rather than net  
23 income, (ii) in the case of a trust being administered as a total return  
24 unitrust, that future distributions from the trust will be net income  
25 rather than unitrust amounts, or (iii) that the percentage used to  
26 calculate the unitrust amount or the method used to determine the fair  
27 market value of the trust will be changed as stated in the policy.

28 (2) The trustee sends written notice of its intention to take such action,  
29 along with copies of such written policy and this Part, to (i) the grantor  
30 of the trust, if living, (ii) all the competent beneficiaries who are  
31 currently receiving or eligible to receive distributions of income of the  
32 trust, (iii) all the competent beneficiaries who would receive principal  
33 of the trust if the trust were to terminate at the time of the giving of  
34 such notice (without regard to the exercise of any power of  
35 appointment), and (iv) all persons acting as advisor or protector of the  
36 trust.

37 (3) There is at least one competent beneficiary who is currently receiving  
38 or eligible to receive distributions of income of the trust and there is at  
39 least one competent beneficiary who would receive principal of the  
40 trust if the trust were to terminate at the time of the giving of such  
41 notice.

42 (4) No person receiving notice of the trustee's intention to take the  
43 proposed action of the trustee objects to such action within 60 days of  
44 receipt of such notice by written instrument delivered to the trustee.

1       (b) If there is no trustee of the trust other than an interested trustee, the interested  
2 trustee or, where two or more persons are acting as trustee and are interested trustees, a  
3 majority of such interested trustees may, in its sole discretion and without court  
4 approval, (i) convert an income trust to a total return unitrust, (ii) reconvert a total return  
5 unitrust to an income trust, or (iii) change the percentage used to calculate the unitrust  
6 amount or the method used to determine the fair market value of the trust if:

7           (1) The trustee adopts a written policy for the trust providing (i) in the  
8 case of a trust being administered as an income trust, that future  
9 distributions from the trust will be unitrust amounts rather than net  
10 income as determined under this Chapter, (ii) in the case of a trust  
11 being administered as a total return unitrust, that future distributions  
12 from the trust will be net income as determined under this Chapter  
13 rather than unitrust amounts, or (iii) that the percentage used to  
14 calculate the unitrust amount or the method used to determine the fair  
15 market value of the trust will be changed as stated in the policy.

16           (2) The trustee appoints a disinterested person who, in its sole discretion  
17 but acting in a fiduciary capacity, determines for the trustee (i) the  
18 percentage to be used to calculate the unitrust amount, (ii) the method  
19 to be used in determining the fair market value of the trust, and (iii)  
20 which assets, if any, are to be excluded in determining the unitrust  
21 amount.

22           (3) The trustee sends written notice of its intention to take such action,  
23 along with copies of such written policy and this Part, and the  
24 determinations of the disinterested person to (i) the grantor of the trust,  
25 if living, (ii) all the competent beneficiaries who are currently  
26 receiving or eligible to receive distributions of income of the trust, (iii)  
27 all the competent beneficiaries who would receive principal of the trust  
28 if the trust were to terminate at the time of the giving of such notice  
29 (without regard to the exercise of any power of appointment), and (iv)  
30 all persons acting as advisor or protector of the trust.

31           (4) There is at least one competent beneficiary who is currently receiving  
32 or eligible to receive distributions of income of the trust and there is at  
33 least one competent beneficiary who would receive principal of the  
34 trust if the trust were to terminate at the time of the giving of such  
35 notice.

36           (5) No person receiving notice of the trustee's intention to take the  
37 proposed action of the trustee objects to such action or to the  
38 determination of the disinterested person within 60 days of receipt of  
39 such notice by written instrument delivered to the trustee; in such case,  
40 the trustee may take such action without court approval.

41 **"§ 37A-1-104.3. Conversion with court approval.**

42       (a) If any trustee desires to (i) convert an income trust to a total return unitrust,  
43 (ii) reconvert a total return unitrust to an income trust, or (iii) change the percentage  
44 used to calculate the unitrust amount or the method used to determine the fair market

1 value of the trust but does not have the ability to or elects not to do it under  
2 G.S. 36A-1-104.2, the trustee may petition the court for such order as the trustee deems  
3 appropriate. In the event, however, there is only one trustee of such trust and such  
4 trustee is an interested trustee or in the event there are two or more trustees of such trust  
5 and a majority of them are interested trustees, the court, in its own discretion or on the  
6 petition of such trustee or trustees or any person interested in the trust, may appoint a  
7 disinterested person who, acting in a fiduciary capacity, shall present such information  
8 to the court as shall be necessary to enable the court to make its determinations under  
9 this Part.

10 (b) A competent beneficiary may request the trustee to (i) convert an income trust  
11 to a total return unitrust, (ii) reconvert a total return unitrust to an income trust, or (iii)  
12 change the percentage used to calculate the unitrust amount or the method used to  
13 determine the fair market value of the trust. If the trustee does not take the action  
14 requested, the competent beneficiary may petition the court to order the trustee to take  
15 such action.

16 (c) All proceedings under this section shall be conducted as provided in Article 3  
17 of Chapter 36A of the General Statutes.

18 **"§ 37A-1-104.4. Determination of unitrust amount.**

19 (a) The fair market value of the trust shall be determined at least annually, using  
20 such valuation date as selected by the trustee in its discretion. The trustee, in its  
21 discretion, may use an average of the fair market value on the same valuation date for  
22 the current fiscal year and not more than three preceding fiscal years, if the use of such  
23 average appears desirable to reduce the impact of fluctuations in market value on the  
24 unitrust amount. Assets for which a fair market value cannot be readily ascertained shall  
25 be valued using such valuation methods as are deemed reasonable and appropriate by  
26 the trustee. Such assets may be excluded from valuation, provided all income received  
27 with respect to such assets is distributed to the extent distributable in accordance with  
28 the terms of the governing instrument.

29 (b) The percentage to be used in determining the unitrust amount shall be a  
30 reasonable current return from the trust, in any event not less than three percent (3%)  
31 nor more than five percent (5%), taking into account the intentions of the grantor of the  
32 trust as expressed in the governing instrument, the needs of the beneficiaries, general  
33 economic conditions, projected current earnings and appreciation for the trust, and  
34 projected inflation and its impact on the trust.

35 (c) In the case of a trust (i) for which a marital deduction has been taken for  
36 federal tax purposes under section 2056 or section 2523 of the Code (during the lifetime  
37 of the spouse for whom the trust was created) or (ii) a trust to which the  
38 generation-skipping transfer tax due under section 2601 of the Code does not apply by  
39 reason of any effective date or transition rule, the unitrust amount in any taxable year  
40 shall not be less than the net income of the trust, determined without regard to  
41 subsection (d) of this section.

42 (d) Following the conversion of an income trust to a total return unitrust, the  
43 trustee:



- 1           (1) Shall treat the unitrust amount as if it were net income of the trust for  
2 purposes of determining the amount available, from time to time, for  
3 distribution from the trust; and
- 4           (2) May allocate to trust income for each taxable year of the trust (or  
5 portion thereof) (i) net short-term capital gain described in section  
6 1222(5) of the Code for that year or portion of that year, but only to  
7 the extent that the amount so allocated together with all other amounts  
8 allocated to trust income for that year or portion of that year does not  
9 exceed the unitrust amount for that year or portion of that year; and (ii)  
10 net long-term capital gain described in section 1222(7) of the Code for  
11 that year or portion of that year, but only to the extent that the amount  
12 so allocated together with all other amounts, including amounts  
13 described in clause (i) above, allocated to trust income for that year or  
14 portion of that year does not exceed the unitrust amount for that year  
15 or portion of that year.

16 **"§ 37A-1-104.5. Matters in trustee's discretion.**

17 In administering a total return unitrust, the trustee may, in its sole discretion but  
18 subject to the provisions of the governing instrument, determine:

- 19           (1) The effective date of the conversion;  
20           (2) The timing of distributions, including provisions for prorating a  
21 distribution for a short year in which a beneficiary's right to payments  
22 commences or ceases;  
23           (3) Whether distributions are to be made in cash or in kind or partly in  
24 cash and partly in kind;  
25           (4) If the trust is reconverted to an income trust, the effective date of such  
26 reconversion; and  
27           (5) Any other administrative issues as may be necessary or appropriate to  
28 carry out the purposes of this Part.

29 **"§ 37A-1-104.6. No effect on principal distributions.**

30 Conversion to a total return unitrust under this Part shall not affect any other  
31 provision of the governing instrument, if any, regarding distributions of principal. For  
32 purposes of this Part, the distribution of a unitrust amount is considered a distribution of  
33 income and not of principal.

34 **"§ 37A-1-104.7. Marital deduction trusts.**

35 In the case of any trust for which a marital deduction has been taken, in whole or in  
36 part, for federal tax purposes under section 2056 or section 2523 of the Code, the spouse  
37 otherwise entitled to receive the net income of the trust shall have the right, by written  
38 instrument delivered to the trustee, to compel for his or her lifetime (i) the conversion of  
39 the trust from an income trust to a total return unitrust or (ii) the reconversion of the  
40 trust from a total return unitrust to an income trust, notwithstanding anything in this Part  
41 to the contrary.

42 **"§ 37A-1-104.8. No liability on part of trustee or disinterested person acting in**  
43 **good faith.**

1 No trustee or disinterested person who in good faith takes or fails to take any action  
2 under this Part shall be liable to any person affected by the action or inaction, regardless  
3 of whether the person received written notice as provided in this Part and regardless of  
4 whether the person was under a legal disability at the time of the delivery of the notice.  
5 The exclusive remedy for any person affected by an action or inaction shall be to obtain  
6 an order of the court directing the trustee (i) to convert an income trust to a total return  
7 unitrust, (ii) to reconvert from a total return unitrust to an income trust, or (iii) to change  
8 the percentage used to calculate the unitrust amount.

9 **"§ 37A-1-104.9. Applicability.**

10 This Part shall apply to all trusts in existence on, or created after January 1, 2004,  
11 unless (i) the governing instrument contains a provision clearly expressing the grantor's  
12 intention that the current beneficiary or beneficiaries are to receive an amount other than  
13 a reasonable current return from the trust, (ii) the trust is a trust described in section  
14 170(f)(2)(B), section 664(d), section 2702(a)(3), or section 2702(b) of the Code, (iii)  
15 one or more persons to whom the trustee could distribute income has a power of  
16 withdrawal over the trust that is not subject to an ascertainable standard under section  
17 2041 or section 2514 of the Code, or the power of withdrawal can be exercised to  
18 discharge a duty of support the person possesses, or (iv) the governing instrument  
19 expressly prohibits use of this Part by specific reference to the Part.

20 "Part 3. Judicial Control of Discretionary Power.

21 **"§ 37A-1-105. Judicial control of discretionary power.**

22 (a) The court may not order a fiduciary to change a decision to exercise or not to  
23 exercise a discretionary power conferred by this Chapter unless it determines that the  
24 decision was an abuse of the fiduciary's discretion. A fiduciary's decision is not an abuse  
25 of discretion merely because the court would have exercised the power in a different  
26 manner or would not have exercised the power.

27 (b) The decisions to which subsection (a) of this section applies include:

28 (1) A decision under G.S. 37A-1-104(a) as to whether and to what extent  
29 an amount should be transferred from principal to income or from  
30 income to principal.

31 (2) A decision regarding the factors that are relevant to the trust and its  
32 beneficiaries, the extent to which the factors are relevant, and the  
33 weight, if any, to be given to those factors in deciding whether and to  
34 what extent to exercise the discretionary power conferred by G.S.  
35 37A-1-104(a).

36 (c) If the court determines that a fiduciary has abused the fiduciary's discretion,  
37 the court may place the income and remainder beneficiaries in the positions they would  
38 have occupied if the discretion had not been abused, according to the following rules:

39 (1) To the extent that the abuse of discretion has resulted in no distribution  
40 to a beneficiary or in a distribution that is too small, the court shall  
41 order the fiduciary to distribute from the trust to the beneficiary an  
42 amount that the court determines will restore the beneficiary, in whole  
43 or in part, to the beneficiary's appropriate position.



- 1                    estate tax marital or charitable deduction only to the extent that  
2                    the payment of those expenses from income will not cause the  
3                    reduction or loss of the deduction; and  
4                    c.    Paying from principal all other disbursements made or incurred  
5                    in connection with the settlement of a decedent's estate or the  
6                    winding up of a terminating income interest, including debts,  
7                    funeral expenses, disposition of remains, family allowances,  
8                    and death taxes and related penalties that are apportioned to the  
9                    estate or terminating income interest by the will, the terms of  
10                   the trust, or applicable law.
- 11                   (3)   Unless the will or trust instrument otherwise provides, or the court  
12                   otherwise directs, a fiduciary shall distribute to a beneficiary who  
13                   receives a pecuniary amount outright interest, computed as provided in  
14                   G.S. 24-1 from the date that is one year following the date of death of  
15                   the person whose death gives rise to the payment of the pecuniary  
16                   bequest or the happening of the contingency which causes the income  
17                   interest to end, from net income determined under subdivision (2) of  
18                   this section or from principal to the extent that net income is  
19                   insufficient. However, this subdivision shall not apply to a pecuniary  
20                   bequest:
- 21                   a.    To or for the benefit of a decedent's surviving spouse that is, or  
22                   can be, qualified for the federal estate tax marital deduction; or  
23                   b.    To or for the benefit of charitable organizations that are  
24                   qualified for the federal estate tax charitable deduction,  
25                   including a charitable remainder trust.
- 26                   (4)   A fiduciary shall distribute the net income remaining after distributions  
27                   required by subdivision (3) of this section in the manner described in  
28                   G.S. 37A-2-202 to all other beneficiaries, including a beneficiary who  
29                   receives a pecuniary amount in trust, even if the beneficiary holds an  
30                   unqualified power to withdraw assets from the trust or other presently  
31                   exercisable general power of appointment over the trust.
- 32                   (5)   A fiduciary may not reduce principal or income receipts from property  
33                   described in subdivision (1) of this section because of a payment  
34                   described in G.S. 37A-5-501 or G.S. 37A-5-502 to the extent that the  
35                   will, the terms of the trust, or applicable law requires the fiduciary to  
36                   make the payment from assets other than the property or to the extent  
37                   that the fiduciary recovers or expects to recover the payment from a  
38                   third party. The net income and principal receipts from the property  
39                   are determined by including all of the amounts the fiduciary receives  
40                   or pays with respect to the property, whether those amounts accrued or  
41                   became due before, on, or after the date of a decedent's death or an  
42                   income interest's terminating event, and by making a reasonable  
43                   provision for amounts that the fiduciary believes the estate or

1 terminating income interest may become obligated to pay after the  
2 property is distributed.

3 **"§ 37A-2-202. Distribution to residuary and remainder beneficiaries.**

4 (a) Each beneficiary described in G.S. 37A-2-201(4) is entitled to receive a  
5 portion of the net income equal to the beneficiary's fractional interest in undistributed  
6 principal assets, using values as of the distribution date. If a fiduciary makes more than  
7 one distribution of assets to beneficiaries to whom this section applies, each beneficiary,  
8 including one who does not receive part of the distribution, is entitled, as of each  
9 distribution date, to the net income the fiduciary has received after the date of death or  
10 terminating event or earlier distribution date but has not distributed as of the current  
11 distribution date.

12 (b) In determining a beneficiary's share of net income, the following rules apply:

13 (1) The beneficiary is entitled to receive a portion of the net income equal  
14 to the beneficiary's fractional interest in the undistributed principal  
15 assets immediately before the distribution date, including assets that  
16 later may be sold to meet principal obligations.

17 (2) The beneficiary's fractional interest in the undistributed principal  
18 assets shall be calculated without regard to property specifically given  
19 to a beneficiary and property required to pay pecuniary amounts not in  
20 trust.

21 (3) The beneficiary's fractional interest in the undistributed principal  
22 assets shall be calculated on the basis of the aggregate value of those  
23 assets as of the distribution date without reducing the value by any  
24 unpaid principal obligation.

25 (4) The distribution date for purposes of this section may be the date as of  
26 which the fiduciary calculates the value of the assets if that date is  
27 reasonably near the date on which assets are actually distributed.

28 (c) If a fiduciary does not distribute all of the collected but undistributed net  
29 income to each person as of a distribution date, the fiduciary shall maintain appropriate  
30 records showing the interest of each beneficiary in that net income.

31 (d) A fiduciary may apply the rules in this section, to the extent that the fiduciary  
32 considers it appropriate, to net gain or loss realized after the date of death or terminating  
33 event or earlier distribution date from the disposition of a principal asset if this section  
34 applies to the income from the asset.

35 "Article 3.

36 "Apportionment at Beginning and End of Income Interest.

37 **"§ 37A-3-301. When right to income begins and ends.**

38 (a) An income beneficiary is entitled to net income from the date on which the  
39 income interest begins. An income interest begins on the date specified in the terms of  
40 the trust or, if no date is specified, on the date an asset becomes subject to a trust or  
41 successive income interest.

42 (b) An asset becomes subject to a trust:

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

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

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

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

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

14          **"§ 37A-3-302. Apportionment of receipts and disbursements when decedent dies**  
15          **or income interest begins.**

16          (a) A trustee shall allocate an income receipt or disbursement, other than one to  
17          which G.S. 37A-2-201(1) applies to principal, if its due date occurs before a decedent  
18          dies in the case of an estate or before an income interest begins in the case of a trust or  
19          successive income interest.

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

27          (c) An item of income or an obligation is due on the date the payer is required to  
28          make a payment. If a payment date is not stated, there is no due date for the purposes of  
29          this Chapter. Distributions to shareholders or other owners from an entity to which G.S.  
30          37A-4-401 applies are deemed to be due on the date fixed by the entity for determining  
31          who is entitled to receive the distribution or, if no date is fixed, on the declaration date  
32          for the distribution. A due date is periodic for receipts or disbursements that shall be  
33          paid at regular intervals under a lease or an obligation to pay interest or if an entity  
34          customarily makes distributions at regular intervals.

35          **"§ 37A-3-303. Apportionment when income interest ends.**

36          (a) In this section, "undistributed income" means net income received before the  
37          date on which an income interest ends. The term does not include an item of income or  
38          expense that is due or accrued or net income that has been added or is required to be  
39          added to principal under the terms of the trust.

40          (b) When a mandatory income interest ends, the trustee shall pay to a mandatory  
41          income beneficiary who survives that date, or to the estate of a deceased mandatory  
42          income beneficiary whose death causes the interest to end, the beneficiary's share of the  
43          undistributed income that is not disposed of under the terms of the trust unless the  
44          beneficiary has an unqualified power to revoke more than five percent (5%) of the trust

1 immediately before the income interest ends. In the latter case, the undistributed income  
2 from the portion of the trust that may be revoked shall be added to principal.

3 (c) When a trustee's obligation to pay a fixed annuity or a fixed fraction of the  
4 value of the trust's assets ends, the trustee shall prorate the final payment if and to the  
5 extent required by applicable law to accomplish a purpose of the trust or its settlor  
6 relating to income, gift, estate, or other tax requirements.

7 "Article 4.

8 "Allocation of Receipts During Administration of Trust.

9 "Part 1. Receipts From Entities.

10 **"§ 37A-4-401. Character of receipts.**

11 (a) In this section, "entity" means a corporation, partnership, limited liability  
12 company, regulated investment company, real estate investment trust, common trust  
13 fund, or any other organization in which a trustee has an interest other than a trust or  
14 estate to which G.S. 37A-4-402 applies, a business or activity to which G.S. 37A-4-403  
15 applies, or an asset-backed security to which G.S. 37A-4-415 applies.

16 (b) Except as otherwise provided in this section, a trustee shall allocate to income  
17 money received from an entity.

18 (c) A trustee shall allocate the following receipts from an entity to principal:

19 (1) Property other than money;

20 (2) Money received in one distribution or a series of related distributions  
21 in exchange for part or all of a trust's interest in the entity;

22 (3) Money received in total or partial liquidation of the entity; and

23 (4) Money received from an entity that is a regulated investment company  
24 or a real estate investment trust if the money distributed is a capital  
25 gain dividend for federal income tax purposes.

26 (d) Money is received in partial liquidation:

27 (1) To the extent that the entity, at or near the time of a distribution,  
28 indicates that it is a distribution in partial liquidation; or

29 (2) If the total amount of money and property received in a distribution or  
30 series of related distributions is greater than twenty percent (20%) of  
31 the entity's gross assets, as shown by the entity's year-end financial  
32 statements immediately preceding the initial receipt.

33 (e) Money is not received in partial liquidation, nor may it be taken into account  
34 under subdivision (2) of subsection (d) of this section, to the extent that it does not  
35 exceed the amount of income tax that a trustee or beneficiary shall pay on taxable  
36 income of the entity that distributes the money.

37 (f) A trustee may rely upon a statement made by an entity about the source or  
38 character of a distribution if the statement is made at or near the time of distribution by  
39 the entity's board of directors or other person or group of persons authorized to exercise  
40 powers to pay money or transfer property comparable to those of a corporation's board  
41 of directors.

42 **"§ 37A-4-402. Distribution from trust or estate.**

43 A trustee shall allocate to income an amount received as a distribution of income  
44 from a trust or an estate in which the trust has an interest other than a purchased interest

1 and shall allocate to principal an amount received as a distribution of principal from  
2 such a trust or estate. If a trustee purchases an interest in a trust that is an investment  
3 entity, or a decedent or donor transfers an interest in such a trust to a trustee, G.S.  
4 37A-4-401 or G.S. 37A-4-415 applies to a receipt from the trust.

5 **"§ 37A-4-403. Business and other activities conducted by trustee.**

6 (a) If a trustee who conducts a business or other activity determines that it is in  
7 the best interest of all the beneficiaries to account separately for the business or activity  
8 instead of accounting for it as part of the trust's general accounting records, the trustee  
9 may maintain separate accounting records for its transactions, whether or not its assets  
10 are segregated from other trust assets.

11 (b) A trustee who accounts separately for a business or other activity may  
12 determine the extent to which its net cash receipts shall be retained for working capital,  
13 the acquisition or replacement of fixed assets, and other reasonably foreseeable needs of  
14 the business or activity, and the extent to which the remaining net cash receipts are  
15 accounted for as principal or income in the trust's general accounting records. If a  
16 trustee sells assets of the business or other activity, other than in the ordinary course of  
17 the business or activity, the trustee shall account for the net amount received as  
18 principal in the trust's general accounting records to the extent the trustee determines  
19 that the amount received is no longer required in the conduct of the business.

20 (c) Activities for which a trustee may maintain separate accounting records  
21 include:

- 22 (1) Retail, manufacturing, service, and other traditional business activities;
- 23 (2) Farming;
- 24 (3) Raising and selling livestock and other animals;
- 25 (4) Management of rental properties;
- 26 (5) Extraction of minerals and other natural resources;
- 27 (6) Timber operations; and
- 28 (7) Activities to which G.S. 37A-4-414 applies.

29 "Part 2. Receipts Not Normally Apportioned.

30 **"§ 37A-4-404. Principal receipts.**

31 A trustee shall allocate to principal:

- 32 (1) To the extent not allocated to income under this Chapter, assets  
33 received from a transferor during the transferor's lifetime, a decedent's  
34 estate, a trust with a terminating income interest, or a payer under a  
35 contract naming the trust or its trustee as beneficiary;
- 36 (2) Money or other property received from the sale, exchange, liquidation,  
37 or change in form of a principal asset, including realized profit, subject  
38 to this Article;
- 39 (3) Amounts recovered from third parties to reimburse the trust because of  
40 disbursements described in G.S. 37A-5-502(a)(7) or for other reasons  
41 to the extent not based on the loss of income;
- 42 (4) Proceeds of property taken by eminent domain, but a separate award  
43 made for the loss of income with respect to an accounting period



1 during which a current income beneficiary had a mandatory income  
2 interest is income;

3 (5) Net income received in an accounting period during which there is no  
4 beneficiary to whom a trustee may or shall distribute income; and

5 (6) Other receipts as provided in Part 3 of this Article.

6 **"§ 37A-4-405. Rental property.**

7 To the extent that a trustee accounts for receipts from rental property under this  
8 section, the trustee shall allocate to income an amount received as rent of real or  
9 personal property, including an amount received for cancellation or renewal of a lease.  
10 An amount received as a refundable deposit, including a security deposit or a deposit  
11 that is to be applied as rent for future periods, shall be added to principal and held  
12 subject to the terms of the lease and is not available for distribution to a beneficiary until  
13 the trustee's contractual obligations have been satisfied with respect to that amount.

14 **"§ 37A-4-406. Obligation to pay money.**

15 (a) An amount received as interest, whether determined at a fixed, variable, or  
16 floating rate, on an obligation to pay money to the trustee, including an amount received  
17 as consideration for prepaying principal, shall be allocated to income without any  
18 provision for amortization of premium.

19 (b) A trustee shall allocate to principal an amount received from the sale,  
20 redemption, or other disposition of an obligation to pay money to the trustee more than  
21 one year after it is purchased or acquired by the trustee, including an obligation whose  
22 purchase price or value when it is acquired is less than its value at maturity. If the  
23 obligation matures within one year after it is purchased or acquired by the trustee, an  
24 amount received in excess of its purchase price or its value when acquired by the trust  
25 shall be allocated to income.

26 (c) This section does not apply to an obligation to which G.S. 37A-4-409,  
27 37A-4-410, 37A-4-411, 37A-4-412, 37A-4-414, or 37A-4-415 applies.

28 **"§ 37A-4-407. Insurance policies and similar contracts.**

29 (a) Except as otherwise provided in subsection (b) of this section, a trustee shall  
30 allocate to principal the proceeds of a life insurance policy or other contract in which  
31 the trust or its trustee is named as beneficiary, including a contract that insures the trust  
32 or its trustee against loss for damage to, destruction of, or loss of title to a trust asset.  
33 The trustee shall allocate dividends on an insurance policy to income if the premiums on  
34 the policy are paid from income, and to principal if the premiums are paid from  
35 principal.

36 (b) A trustee shall allocate to income proceeds of a contract that insures the  
37 trustee against loss of occupancy or other use by an income beneficiary, loss of income,  
38 or, subject to G.S. 37A-4-403, loss of profits from a business.

39 (c) This section does not apply to a contract to which G.S. 37A-4-409 applies.

40 "Part 3. Receipts Normally Apportioned.

41 **"§ 37A-4-408. Insubstantial allocations not required.**

42 If a trustee determines that an allocation between principal and income required by  
43 G.S. 37A-4-409, 37A-4-410, 37A-4-411, 37A-4-412, or 37A-4-415 is insubstantial, the  
44 trustee may allocate the entire amount to principal unless one of the circumstances

1 described in G.S. 37A-1-104(c) applies to the allocation. This power may be exercised  
2 by a cotrustee in the circumstances described in G.S. 37A-1-104(d) and may be released  
3 for the reasons and in the manner described in G.S. 37A-1-104(e). An allocation is  
4 presumed to be insubstantial if:

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

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

11 **"§ 37A-4-409. Deferred compensation, annuities, and similar payments.**

12 (a) In this section, "payment" means a payment that a trustee may receive over a  
13 fixed number of years or during the life of one or more individuals because of services  
14 rendered or property transferred to the payer in exchange for future payments. The term  
15 includes a payment made in money or property from the payer's general assets or from a  
16 separate fund created by the payer, including a private or commercial annuity, an  
17 individual retirement account, and a pension, profit-sharing, stock-bonus, or  
18 stock-ownership plan.

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

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

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

35 (e) This section does not apply to payments to which G.S. 37A-4-410 applies.

36 **"§ 37A-4-410. Liquidating asset.**

37 (a) In this section, "liquidating asset" means an asset whose value will diminish  
38 or terminate because the asset is expected to produce receipts for a period of limited  
39 duration. The term includes a leasehold, patent, copyright, royalty right, and right to  
40 receive payments during a period of more than one year under an arrangement that does  
41 not provide for the payment of interest on the unpaid balance. The term does not include  
42 a payment subject to G.S. 37A-4-409, resources subject to G.S. 37A-4-411, timber  
43 subject to G.S. 37A-4-412, an activity subject to G.S. 37A-4-414, an asset subject to

1 G.S. 37A-4-415, or any asset for which the trustee establishes a reserve for depreciation  
2 under G.S. 37A-5-503.

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

5 **"§ 37A-4-411. Minerals, water, and other natural resources.**

6 (a) To the extent that a trustee accounts for receipts from an interest in minerals  
7 or other natural resources under this section, the trustee shall allocate them as follows:

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

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

14 (3) If an amount received as a royalty, shut-in-well payment, take-or-pay  
15 payment, bonus, or delay rental is more than nominal, ninety percent  
16 (90%) shall be allocated to principal and the balance to income.

17 (4) If an amount is received from a working interest or any other interest  
18 not provided for in subdivision (1), (2), or (3) of this subsection, ninety  
19 percent (90%) of the net amount received shall be allocated to  
20 principal and the balance to income.

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

24 (c) This Chapter applies whether or not a decedent or donor was extracting  
25 minerals, water, or other natural resources before the interest became subject to the  
26 trust.

27 (d) If a trust owns an interest in minerals, water, or other natural resources on  
28 January 1, 2004, the trustee may allocate receipts from the interest as provided in this  
29 Chapter or in the manner used by the trustee before January 1, 2004. If the trust acquires  
30 an interest in minerals, water, or other natural resources after January 1, 2004, the  
31 trustee shall allocate receipts from the interest as provided in this Chapter.

32 **"§ 37A-4-412. Timber.**

33 (a) To the extent that a trustee accounts for receipts from the sale of timber and  
34 related products pursuant to this section, the trustee shall allocate the net receipts:

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

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

42 (3) To or between income and principal if the net receipts are from the  
43 lease of timberland or from a contract to cut timber from land owned  
44 by a trust, by determining the amount of timber removed from the land

1           under the lease or contract and applying the rules in subdivision (1)  
2           and (2) of this subsection; or

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

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

9           (c) This Chapter applies whether or not a decedent or transferor was harvesting  
10          timber from the property before it becomes subject to the trust.

11          (d) If a trust owns an interest in timberland on January 1, 2004, the trustee may  
12          allocate net receipts from the sale of timber and related products as provided in this  
13          Chapter or in the manner used by the trustee before January 1, 2004. If the trust acquires  
14          an interest in timberland after January 1, 2004, the trustee shall allocate net receipts  
15          from the sale of timber and related products as provided in this Chapter.

16          **"§ 37A-4-413. Property not productive of income.**

17          (a) If a marital deduction is allowed for all or part of a trust whose assets consist  
18          substantially of property that does not provide the spouse with sufficient income from or  
19          use of the trust assets, and if the amounts that the trustee transfers from principal to  
20          income under G.S. 37A-1-104 and distributes to the spouse from principal under the  
21          terms of the trust are insufficient to provide the spouse with the beneficial enjoyment  
22          required to obtain the marital deduction, the spouse may require the trustee to make  
23          property productive of income, convert property within a reasonable time, or exercise  
24          the power conferred by G.S. 37A-1-104(a). The trustee may decide which action or  
25          combination of actions to take.

26          (b) In cases not governed by subsection (a) of this section, proceeds from the sale  
27          or other disposition of an asset are principal without regard to the amount of income the  
28          asset produces during any accounting period.

29          **"§ 37A-4-414. Derivatives and options.**

30          (a) In this section, "derivative" means a contract or financial instrument or a  
31          combination of contracts and financial instruments which gives a trust the right or  
32          obligation to participate in some or all changes in the price of a tangible or intangible  
33          asset or group of assets, or changes in a rate, an index of prices or rates, or other market  
34          indicator for an asset or a group of assets.

35          (b) To the extent that a trustee does not account under G.S. 37A-4-403 for  
36          transactions in derivatives, the trustee shall allocate to principal receipts from and  
37          disbursements made in connection with those transactions.

38          (c) If a trustee grants an option to buy property from the trust, whether or not the  
39          trust owns the property when the option is granted, grants an option that permits another  
40          person to sell property to the trust, or acquires an option to buy property for the trust or  
41          an option to sell an asset owned by the trust, and the trustee or other owner of the asset  
42          is required to deliver the asset if the option is exercised, an amount received for granting  
43          the option shall be allocated to principal. An amount paid to acquire the option shall be  
44          paid from principal. A gain or loss realized upon the exercise of an option, including an

1 option granted to a settlor of the trust for services rendered, shall be allocated to  
2 principal.

3 **"§ 37A-4-415. Asset-backed securities.**

4 (a) In this section, "asset-backed security" means an asset whose value is based  
5 upon the right it gives the owner to receive distributions from the proceeds of financial  
6 assets that provide collateral for the security. The term includes an asset that gives the  
7 owner the right to receive from the collateral financial assets only the interest or other  
8 current return or only the proceeds other than interest or current return. The term does  
9 not include an asset to which G.S. 37A-4-401 or G.S. 37A-4-409 applies.

10 (b) If a trust receives a payment from interest or other current return and from  
11 other proceeds of the collateral financial assets, the trustee shall allocate to income the  
12 portion of the payment which the payer identifies as being from interest or other current  
13 return and shall allocate the balance of the payment to principal.

14 (c) If a trust receives one or more payments in exchange for the trust's entire  
15 interest in an asset-backed security in one accounting period, the trustee shall allocate  
16 the payments to principal. If a payment is one of a series of payments that will result in  
17 the liquidation of the trust's interest in the security over more than one accounting  
18 period, the trustee shall allocate ten percent (10%) of the payment to income and the  
19 balance to principal.

20 "Article 5.

21 "Allocation of Disbursements During Administration of Trust.

22 **"§ 37A-5-501. Disbursements from income.**

23 A trustee shall make the following disbursements from income to the extent that  
24 they are not disbursements to which G.S. 37A-2-201(2)b. or G.S. 37A-2-201(2)c.  
25 applies:

- 26 (1) One-half of the regular compensation of the trustee and of any person  
27 providing investment advisory or custodial services to the trustee;  
28 (2) One-half of all expenses for accountings, judicial proceedings, or other  
29 matters that involve both the income and remainder interests;  
30 (3) All of the other ordinary expenses incurred in connection with the  
31 administration, management, or preservation of trust property and the  
32 distribution of income, including interest, ordinary repairs, regularly  
33 recurring taxes assessed against principal, and expenses of a  
34 proceeding or other matter that concerns primarily the income interest;  
35 and  
36 (4) Recurring premiums on insurance covering the loss of a principal asset  
37 or the loss of income from or use of the asset.

38 **"§ 37A-5-502. Disbursements from principal.**

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

- 40 (1) The remaining one-half of the disbursements described in G.S.  
41 37A-5-501(1) and G.S. 37A-5-501(2);  
42 (2) All of the trustee's compensation calculated on principal as a fee for  
43 acceptance, distribution, or termination, and disbursements made to  
44 prepare property for sale;

- 1           (3) Payments on the principal of a trust debt;  
2           (4) Expenses of a proceeding that concerns primarily principal, including  
3           a proceeding to construe the trust or to protect the trust or its property;  
4           (5) Premiums paid on a policy of insurance not described in G.S.  
5           37A-5-501(4) of which the trust is the owner and beneficiary;  
6           (6) Estate, inheritance, and other transfer taxes, including penalties,  
7           apportioned to the trust; and  
8           (7) Disbursements related to environmental matters, including  
9           reclamation, assessing environmental conditions, remedying and  
10           removing environmental contamination, monitoring remedial activities  
11           and the release of substances, preventing future releases of substances,  
12           collecting amounts from persons liable or potentially liable for the  
13           costs of those activities, penalties imposed under environmental laws  
14           or regulations and other payments made to comply with those laws or  
15           regulations, statutory or common-law claims by third parties, and  
16           defending claims based on environmental matters.

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

21           **§ 37A-5-503. Transfers from income to principal for depreciation.**

22           (a) In this section, "depreciation" means a reduction in value due to wear, tear,  
23           decay, corrosion, or gradual obsolescence of a fixed asset having a useful life of more  
24           than one year.

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

- 28           (1) Of that portion of real property used or available for use by a  
29           beneficiary as a residence or of tangible personal property held or  
30           made available for the personal use or enjoyment of a beneficiary;  
31           (2) During the administration of a decedent's estate; or  
32           (3) Under this section if the trustee is accounting under G.S. 37A-4-403  
33           for the business or activity in which the asset is used.

34           (c) An amount transferred to principal under this section need not be held as a  
35           separate fund.

36           **§ 37A-5-504. Transfers from income to reimburse principal.**

37           (a) If a trustee makes or expects to make a principal disbursement described in  
38           this section, the trustee may transfer an appropriate amount from income to principal in  
39           one or more accounting periods to reimburse principal or to provide a reserve for future  
40           principal disbursements.

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

- 1           (1) An amount chargeable to income but paid from principal because it is  
2           unusually large, including extraordinary repairs;  
3           (2) A capital improvement to a principal asset, whether in the form of  
4           changes to an existing asset or the construction of a new asset,  
5           including special assessments;  
6           (3) Disbursements made to prepare property for rental, including tenant  
7           allowances, leasehold improvements, and broker's commissions;  
8           (4) Periodic payments on an obligation secured by a principal asset to the  
9           extent that the amount transferred from income to principal for  
10           depreciation is less than the periodic payments; and  
11           (5) Disbursements described in G.S. 37A-5-502(a)(7).  
12           (c) If the asset whose ownership gives rise to the disbursements becomes subject  
13           to a successive income interest after an income interest ends, a trustee may continue to  
14           transfer amounts from income to principal as provided in subsection (a) of this section.

15 **"§ 37A-5-505. Income taxes.**

16           (a) A tax required to be paid by a trustee based on receipts allocated to income  
17           shall be paid from income.

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

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

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

25                   (2) From principal to the extent that:

26                           a. Receipts from the entity are allocated to principal; and

27                           b. The trust's share of the entity's taxable income exceeds the total  
28                           receipts described in subdivision (1) and sub-subdivision (2)a.  
29                           of this subsection.

30           (d) For purposes of this section, receipts allocated to principal or income shall be  
31           reduced by the amount distributed to a beneficiary from principal or income for which  
32           the trust receives a deduction in calculating the tax.

33 **"§ 37A-5-506. Adjustments between principal and income because of taxes.**

34           (a) A fiduciary may make adjustments between principal and income to offset  
35           the shifting of economic interests or tax benefits between income beneficiaries and  
36           remainder beneficiaries that arise from:

37                   (1) Elections and decisions, other than those described in subsection (b) of  
38                   this section, that the fiduciary makes from time to time regarding tax  
39                   matters;

40                   (2) An income tax or any other tax that is imposed upon the fiduciary or a  
41                   beneficiary as a result of a transaction involving or a distribution from  
42                   the estate or trust; or

