

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2005

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SENATE BILL 461
Judiciary II Committee Substitute Adopted 4/5/05

Short Title: Unitrust Amendments.

(Public)

Sponsors:

Referred to:

March 10, 2005

1 A BILL TO BE ENTITLED
2 AN ACT TO AMEND THE LAW RELATING TO UNITRUSTS.
3 The General Assembly of North Carolina enacts:

4 **SECTION 1.** G.S. 37A-1-104.1(5) reads as rewritten:

5 "(5) "Income trust" means a trust, created by either an inter vivos or a
6 testamentary instrument, which directs or permits the trustee to
7 distribute the net income of the trust to one or more persons, either in
8 fixed proportions or in amounts or proportions determined by the
9 trustee. ~~Notwithstanding the foregoing, no trust that may be subject to~~
10 ~~taxation under section 2001 or section 2501 of the Code shall be an~~
11 ~~income trust for purposes of this Part, until the expiration of the period~~
12 ~~for filing the return therefor, including all extensions for the filing.~~
13 trustee, and regardless of whether the trust directs or permits the
14 trustee to distribute principal of the trust to one or more of those
15 persons."

16 **SECTION 2.** G.S. 37A-1-104.1 is amended by adding a new subdivision to
17 read:

18 "(9a) "Treasury Regulations" means the regulations, rulings, procedures,
19 notices, or other administrative pronouncements issued by the Internal
20 Revenue Service, as amended from time to time."

21 **SECTION 3.** G.S. 37A-1-104.2 reads as rewritten:

22 **"§ 37A-1-104.2. Conversion in trustee's discretion without court approval.**

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

- 1 (1) The trustee adopts a written policy for the trust providing (i) in the
2 case of a trust being administered as an income trust, that future
3 distributions from the trust will be unitrust amounts rather than net
4 income, (ii) in the case of a trust being administered as a total return
5 unitrust, that future distributions from the trust will be net income
6 rather than unitrust amounts, or (iii) that the percentage used to
7 calculate the unitrust amount or the method used to determine the fair
8 market value of the trust will be changed as stated in the policy;
- 9 (2) The trustee sends written notice of its intention to take the action,
10 along with copies of the written policy and this Part, to (i) the grantor
11 of the trust, if living, (ii) all the competent beneficiaries who are
12 currently receiving or eligible to receive distributions of income of the
13 trust, (iii) without regard to the exercise of a general power of
14 appointment, all competent beneficiaries who would receive or be
15 eligible to receive the distributions of income of the trust if the
16 interests of the beneficiaries currently receiving or eligible to receive
17 the income terminated at the time of the giving of the notice but the
18 termination of those interests would not cause the trust to terminate,
19 (iv) without regard to the exercise of any power of appointment, all the
20 competent beneficiaries who would receive principal of the trust if the
21 trust were to terminate at the time of the giving of the notice ~~(without~~
22 ~~regard to the exercise of any power of appointment)~~ notice, and (iv) (v)
23 all persons acting as advisor or protector of the trust;
- 24 (3) ~~There is at least one competent beneficiary who is currently receiving~~
25 ~~or eligible to receive distributions of income of the trust and there is at~~
26 ~~least one competent beneficiary who would receive principal of the~~
27 ~~trust if the trust were to terminate at the time of the giving of the~~
28 ~~notice; There is at least one competent beneficiary described in~~
29 ~~subdivision (2)(ii) of this subsection or subdivision (2)(iii) of this~~
30 ~~subsection and one competent beneficiary described in subdivision~~
31 ~~(2)(iv) of this subsection; and~~
- 32 (4) No person receiving notice of the trustee's intention to take the
33 proposed action ~~of the trustee~~ objects to the action within 60 days of
34 receipt of the notice by written instrument delivered to the trustee.
- 35 (b) If there is no trustee of the trust other than an interested trustee, the interested
36 trustee or, where two or more persons are acting as trustee and are interested trustees, a
37 majority of the interested trustees may, in its sole discretion and without court approval,
38 (i) convert an income trust to a total return unitrust, (ii) reconvert a total return unitrust
39 to an income trust, or (iii) change the percentage used to calculate the unitrust amount or
40 the method used to determine the fair market value of the trust if:
- 41 (1) The trustee adopts a written policy for the trust providing (i) in the
42 case of a trust being administered as an income trust, that future
43 distributions from the trust will be unitrust amounts rather than net
44 income as determined under this Chapter, (ii) in the case of a trust

1 being administered as a total return unitrust, that future distributions
2 from the trust will be net income as determined under this Chapter
3 rather than unitrust amounts, or (iii) that the percentage used to
4 calculate the unitrust amount or the method used to determine the fair
5 market value of the trust will be changed as stated in the policy;

6 (2) The trustee appoints a disinterested person who, in its sole discretion
7 but acting in a fiduciary capacity, determines for the trustee (i) the
8 percentage to be used to calculate the unitrust amount, (ii) the method
9 to be used in determining the fair market value of the trust, and (iii)
10 which assets, if any, are to be excluded in determining the unitrust
11 amount;

12 (3) The trustee sends written notice of its intention to take the action,
13 along with copies of the written policy and this Part, and the
14 determinations of the disinterested person to (i) the grantor of the trust,
15 if living, (ii) all the competent beneficiaries who are currently
16 receiving or eligible to receive distributions of income of the trust, (iii)
17 without regard to the exercise of a general power of appointment, all
18 competent beneficiaries who would receive or be eligible to receive
19 the distributions of income of the trust if the interests of the
20 beneficiaries currently receiving or eligible to receive the income
21 terminated at the time of the giving of the notice but the termination of
22 those interests would not cause the trust to terminate, (iv) without
23 regard to the exercise of any power of appointment, all the competent
24 beneficiaries who would receive principal of the trust if the trust were
25 to terminate at the time of the giving of the notice (without regard to
26 the exercise of any power of appointment) notice, and (iv) (v) all
27 persons acting as advisor or protector of the trust;

28 (4) ~~There is at least one competent beneficiary who is currently receiving~~
29 ~~or eligible to receive distributions of income of the trust and there is at~~
30 ~~least one competent beneficiary who would receive principal of the~~
31 ~~trust if the trust were to terminate at the time of the giving of the~~
32 ~~notice; There is at least one competent beneficiary described in~~
33 ~~subdivision (3)(ii) of this subsection or subdivision (3)(iii) of this~~
34 ~~subsection and one competent beneficiary described in subdivision~~
35 ~~(3)(iv) of this subsection; and~~

36 (5) No person receiving notice of the trustee's intention to take the
37 proposed action of the trustee objects to the action or to the
38 determination of the disinterested person within 60 days of receipt of
39 the notice by written instrument delivered to the trustee.

40 (c) A trustee may act under subsection (a) or (b) of this section with respect to a
41 trust for which both income and principal have been set aside permanently for charitable
42 purposes under the governing instrument and for which a federal estate or gift tax
43 deduction has been taken, provided that:

- 1 (1) Instead of sending written notice to the persons described in
2 subdivisions (2) and (3) of subsection (a) of this section or
3 subdivisions (2) and (3) of subsection (b) of this section, as the case
4 may be, the trustee shall send written notice to the named charity or
5 charities then entitled to receive income of the trust and, if no named
6 charity or charities are entitled to receive all of the income, to the
7 Attorney General of this State;
- 8 (2) Subdivision (4) of subsection (a) of this section or subdivision (4) of
9 subsection (b) of this section, as the case may be, shall not apply to
10 this action; and
- 11 (3) In each taxable year, the trustee shall distribute the greater of the
12 unitrust amount or the amount required by section 4942 of the Code."

13 **SECTION 4.** G.S. 37A-1-104.4 reads as rewritten:

14 **"§ 37A-1-104.4. Determination of unitrust amount.**

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

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

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

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

- 42 (1) ~~Shall treat the unitrust amount as if it were net income of the trust for~~
43 ~~purposes of determining the amount available, from time to time, for~~
44 ~~distribution from the trust; and~~

1 (2) ~~May allocate to trust income for each taxable year of the trust (or~~
2 ~~portion of that year) (i) net short term capital gain described in section~~
3 ~~1222(5) of the Code for that year or portion of that year, but only to~~
4 ~~the extent that the amount allocated together with all other amounts~~
5 ~~allocated to trust income for that year or portion of that year does not~~
6 ~~exceed the unitrust amount for that year or portion of that year; and (ii)~~
7 ~~net long term capital gain described in section 1222(7) of the Code for~~
8 ~~that year or portion of that year, but only to the extent that the amount~~
9 ~~allocated together with all other amounts, including amounts described~~
10 ~~in clause (i) above, allocated to trust income for that year or portion of~~
11 ~~that year does not exceed the unitrust amount for that year or portion~~
12 ~~of that year.~~

13 (1) Shall consider the unitrust amount as paid from net accounting income
14 determined as if the trust were not a unitrust;

15 (2) Shall then consider the unitrust amount as paid from ordinary income
16 not allocable to net accounting income;

17 (3) May, in the trustee's discretion, consider the unitrust amount as paid
18 from net short-term gain described in section 1222(5) of the Code and
19 then from net long-term capital gain described in section 1222(7) of
20 the Code so long as the discretionary power is exercised consistently
21 and in a reasonable and impartial manner, but the amount so paid from
22 net capital gains may not be greater than the excess of the unitrust
23 amount over the amount of distributable net income as defined in
24 section 643(a) of the Code without regard to section 1.643(a)-3(b) of
25 the Treasury Regulations, as amended from time to time; and

26 (4) Shall then consider the unitrust amount as coming from the principal
27 of the trust."

28 **SECTION 5.** G.S. 37A-1-104.9 reads as rewritten:

29 **§ 37A-1-104.9. Applicability.**

30 This Part shall apply to all trusts in existence on, or created after January 1, 2004,
31 unless (i) the governing instrument contains a provision clearly expressing the grantor's
32 intention that the current beneficiary or beneficiaries are to receive an amount other than
33 a reasonable current return from the trust, (ii) the trust is a trust described in section
34 170(f)(2)(B), section 664(d), section 2702(a)(3), or section 2702(b) of the Code, (iii)
35 ~~one or more persons to whom the trustee could distribute income has a power of~~
36 ~~withdrawal over the trust that is not subject to an ascertainable standard under section~~
37 ~~2041 or section 2514 of the Code, or the power of withdrawal can be exercised to~~
38 ~~discharge a duty of support the person possesses, or the trust is a trust under which any~~
39 ~~amount is, or has been in the past, set aside permanently for charitable purposes unless~~
40 ~~the income from the trust also is devoted permanently to charitable purposes, or (iv) the~~
41 ~~governing instrument expressly prohibits use of this Part by specific reference to this~~
42 ~~Part. Part, or expressly states the grantor's intent that net income not be calculated as a~~
43 ~~unitrust amount. A provision in the governing instrument that the provisions of Part 2~~
44 ~~of Article 1 of Chapter 37A or any corresponding provision of future law, shall not be~~

1 used in the administration of this trust.' or 'the trustee shall not determine the
2 distributions to the income beneficiary as a unitrust amount.' or similar words reflecting
3 that intent is sufficient to preclude the use of this Part."

4 **SECTION 6.** Chapter 37A of the General Statutes is amended by adding a
5 new Part to read:

6 "Part 2A. Express Total Return Unitrusts.

7 **"§ 37A-1-104A.1. Definitions.**

8 (a) An "express total return unitrust" means a trust that has a governing
9 instrument requiring the distribution at least annually of a unitrust amount equal to a
10 fixed percentage of not less than three percent (3%) nor more than five percent (5%) per
11 year of the net fair market value of the trust's assets, valued at least annually.

12 (b) "Code" means the Internal Revenue Code as described in
13 G.S. 37A-1-104.1(1).

14 (c) "Treasury Regulations" means the Treasury Regulations described in
15 G.S. 37A-1-104.1(9a).

16 **"§ 37A-1-104A.2. Determination of unitrust amount.**

17 (a) The unitrust amount to be distributed by the express total return unitrust may
18 be determined in the governing instrument by reference to the net fair market value of
19 the trust's assets determined annually or averaged on a multiple year basis.

20 (b) The terms of the governing instrument of an express total return unitrust may
21 provide that:

22 (1) Assets for which a fair market value cannot be readily ascertained shall
23 be valued using valuation methods that the trustee considers
24 reasonable and appropriate.

25 (2) Assets, such as a residence property or tangible personal property,
26 used by the trust beneficiary entitled to the unitrust amount may be
27 excluded from the net fair market value for computing the unitrust
28 amount.

29 **"§ 37A-1-104A.3. Effect of distribution of unitrust amount.**

30 The distribution from an express total return unitrust of the fixed percentage of not
31 less than three percent (3%) nor more than five percent (5%) reasonably apportions
32 between the income beneficiaries and remaindermen the total return of an express total
33 return unitrust.

34 **"§ 37A-1-104A.4. Change or conversion of unitrust amount.**

35 (a) The terms of the governing instrument of an express total return unitrust may
36 provide the method similar to the method provided under G.S. 37A-1-104.2(a) for
37 changing the unitrust percentage or for converting from a unitrust to an income trust or
38 for a reconversion of an income trust to a unitrust, or for all of these actions.

39 (b) If the terms of the governing instrument of an express total return unitrust do
40 not specifically or by reference to G.S. 37A-1-104.2 grant a power to the trustee to
41 change the unitrust percentage or change to an income trust, the trustee shall not have
42 that power.

43 **"§ 37A-1-104A.5. Determination of character of unitrust amount.**

1 Unless the terms of the governing instrument of the express total return unitrust
2 specifically provide otherwise, the trustee:

- 3 (1) Shall consider the unitrust amount as paid from net accounting income
4 determined as if the trust were not a unitrust;
5 (2) Shall then consider the unitrust amount as paid from ordinary income
6 not allocable to net accounting income;
7 (3) May, in the trustee's discretion, consider the unitrust amount as paid
8 from net short-term gain described in section 1222(5) of the Code and
9 then from net long-term capital gain described in section 1222(7) of
10 the Code so long as this discretionary power is exercised consistently
11 and in a reasonable and impartial manner, but the amount so paid from
12 net capital gains may not be greater than the excess of the unitrust
13 amount over the amount of distributable net income as defined in
14 section 643(a) of the Code without regard to section 1.643(a)-3(b) of
15 the Treasury Regulations; and
16 (4) Shall then consider the unitrust amount as coming from the principal
17 of the trust.

18 **"§ 37A-104A.6. Unitrust amount in excess of a five percent payout.**

19 A trust that provides for a fixed percentage payout in excess of five percent (5%) per
20 year is considered an express total return unitrust that pays out a fixed percentage of
21 five percent (5%) per year and pays out principal to the extent that the fixed percentage
22 payout exceeds five percent (5%) per year."

23 **SECTION 7.** This act is effective when it becomes law and applies to every
24 trust or decedent's estate existing on that date or coming into existence after that date,
25 except as otherwise expressly provided in the will or terms of the trust or in the
26 provisions of Chapter 37A of the General Statutes. G.S. 37A-1-104.9(iii), as rewritten
27 in Section 5 of this act, applies retroactively to October 1, 2004, and applies to every
28 trust or decedent's estate existing on that date or coming into existence after that date,
29 except as otherwise expressly provided in the will or terms of the trust or in the
30 provisions of Chapter 37A of the General Statutes.