

GENERAL ASSEMBLY OF NORTH CAROLINA  
SESSION 2003

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SENATE DRS55102-LL-38 (2/19)

Short Title: Uniform Principal and Income Act. (Public)

Sponsors: Senator Hagan.

Referred to:

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.**

In this [Act]:

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

- 1           (4)    "Income" means money or property that a fiduciary receives as current  
2           return from a principal asset. The term includes a portion of receipts  
3           from a sale, exchange, or liquidation of a principal asset, to the extent  
4           provided in Article 4.
- 5           (5)    "Income beneficiary" means a person to whom net income of a trust is  
6           or may be payable.
- 7           (6)    "Income interest" means the right of an income beneficiary to receive  
8           all or part of net income, whether the terms of the trust require it to be  
9           distributed or authorize it to be distributed in the trustee's discretion.
- 10          (7)    "Mandatory income interest" means the right of an income beneficiary  
11          to receive net income that the terms of the trust require the fiduciary to  
12          distribute.
- 13          (8)    "Net income" means the total receipts allocated to income during an  
14          accounting period minus the disbursements made from income during  
15          the period, plus or minus transfers under this Chapter to or from  
16          income during the period.
- 17          (9)    "Person" means an individual, corporation, business trust, estate, trust,  
18          partnership, limited liability company, association, joint venture,  
19          government; governmental subdivision, agency, or instrumentality;  
20          public corporation, or any other legal or commercial entity.
- 21          (10)   "Principal" means property held in trust for distribution to a remainder  
22          beneficiary when the trust terminates.
- 23          (11)   "Remainder beneficiary" means a person entitled to receive principal  
24          when an income interest ends.
- 25          (12)   "Terms of a trust" means the manifestation of the intent of a settlor or  
26          decedent with respect to the trust, expressed in a manner that admits of  
27          its proof in a judicial proceeding, whether by written or spoken words  
28          or by conduct.
- 29          (13)   "Trustee" includes an original, additional, or successor trustee, whether  
30          or not appointed or confirmed by a court.

31    **"§ 37A-1-103. Fiduciary duties; general principles.**

- 32          (a)    In allocating receipts and disbursements to or between principal and income,  
33          and with respect to any matter within the scope of Articles 2 and 3, a fiduciary:
- 34               (1)    Shall administer a trust or estate in accordance with the terms of the  
35               trust or the will, even if there is a different provision in this Chapter;
- 36               (2)    May administer a trust or estate by the exercise of a discretionary  
37               power of administration given to the fiduciary by the terms of the trust  
38               or the will, even if the exercise of the power produces a result different  
39               from a result required or permitted by this Chapter;
- 40               (3)    Shall administer a trust or estate in accordance with this Chapter if the  
41               terms of the trust or the will do not contain a different provision or do  
42               not give the fiduciary a discretionary power of administration; and
- 43               (4)    Shall add a receipt or charge a disbursement to principal to the extent  
44               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 must 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 (c)(5), (6), (7), or (8) applies to a trustee and there is more than  
30 one trustee, a cotrustee to whom the provision does not apply may make the adjustment  
31 unless the exercise of the power by the remaining trustee or trustees is not permitted by  
32 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 (c)(1) through (6) or  
37 (c)(8) or if the trustee determines that possessing or exercising the power will or may  
38 deprive the trust of a tax benefit or impose a tax burden not described in subsection (c)  
39 of this section. The release may be permanent or for a specified period, including a  
40 period measured by the life of an individual.

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

"Part 2. Conversion to Unitrust.

"§ 37A-1-104.1. Definitions.

For purposes of this Part:

- (1) "Code" means the Internal Revenue Code of 1986, as amended from time to time, and any statutory enactment successor thereto; reference to a specific section of the Code in this Part shall be deemed a reference also to any successor provision dealing with the subject matter of such section of the Code.
- (2) "Competent beneficiary" includes:

  - a. A beneficiary who has attained his or her majority and is not otherwise under a legal disability;
  - b. A court-appointed guardian of an incompetent beneficiary;
  - c. An attorney-in-fact or agent under a durable power of attorney for an incompetent beneficiary;
  - d. A court-appointed guardian of a minor beneficiary's estate; and
  - e. In the case of a minor beneficiary for whom no guardian has been appointed, a parent of the minor beneficiary, but only if such parent does not have an interest in the estate or trust that conflicts with the interest of the minor beneficiary.
- (3) "Grantor" means an individual who created an inter vivos trust.
- (4) "Disinterested person" means a person who is not a "related or subordinate party" as defined in section 672(c) of the Code with respect to the person then acting as trustee of the trust and excludes the grantor of the trust and any interested trustee.
- (5) "Income trust" means a trust, created by either an inter vivos or a testamentary instrument, which directs or permits the trustee to distribute the net income of the trust to one or more persons, either in fixed proportions or in amounts or proportions determined by the trustee. Notwithstanding the foregoing, no trust that may be subject to taxation under section 2001 or section 2501 of the Code shall be an income trust for purposes of this Part, until the expiration of the period for filing the return therefor, including all extensions for such filing.
- (6) "Interested distributee" means a person to whom distributions of income or principal can currently be made who has the power to remove the existing trustee and designate as successor a person who may be a "related or subordinate party" (as defined in section 672(c) of the Code) with respect to such distributee.
- (7) "Interested trustee" means (i) an individual trustee to whom the net income or principal of the trust can currently be distributed or would be distributed if the trust were then to terminate and be distributed, (ii) any trustee who may be removed and replaced by an interested distributee or (iii) an individual trustee whose legal obligation to support a beneficiary may be satisfied by distributions of income and principal of the trust.

1           (8) "Total return unitrust" means an income trust which has been  
2 converted under and meets the provisions of this Part.

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

7           (10) "Unitrust amount" means an amount computed as a percentage of the  
8 fair market value of the trust.

9 **"§ 37A-1-104.2. Conversion in trustee's discretion without court approval.**

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

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

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

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

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

41         (b) If there is no trustee of the trust other than an interested trustee, the interested  
42 trustee or, where two or more persons are acting as trustee and are interested trustees, a  
43 majority of such interested trustees may, in its sole discretion and without court  
44 approval, (i) convert an income trust to a total return unitrust, (ii) reconvert a total return

1 unitrust to an income trust, or (iii) change the percentage used to calculate the unitrust  
2 amount or the method used to determine the fair market value of the trust if:

3 (1) The trustee adopts a written policy for the trust providing (i) in the  
4 case of a trust being administered as an income trust, that future  
5 distributions from the trust will be unitrust amounts rather than net  
6 income as determined under Chapter 37A of the General Statutes of  
7 North Carolina, (ii) in the case of a trust being administered as a total  
8 return unitrust, that future distributions from the trust will be net  
9 income as determined under Chapter 37A of the General Statutes of  
10 North Carolina rather than unitrust amounts, or (iii) that the percentage  
11 used to calculate the unitrust amount or the method used to determine  
12 the fair market value of the trust will be changed as stated in the  
13 policy.

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

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

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

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

39 **§ 37A-1-104.3. Conversion with court approval.**

40 (a) If any trustee desires to (i) convert an income trust to a total return unitrust,  
41 (ii) reconvert a total return unitrust to an income trust, or (iii) change the percentage  
42 used to calculate the unitrust amount or the method used to determine the fair market  
43 value of the trust but does not have the ability to or elects not to do it under the  
44 provisions of G.S. 36A-1-104.2, the trustee may petition the court for such order as the

1 trustee deems appropriate. In the event, however, there is only one trustee of such trust  
2 and such trustee is an interested trustee or in the event there are two or more trustees of  
3 such trust and a majority of them are interested trustees, the court, in its own discretion  
4 or on the petition of such trustee or trustees or any person interested in the trust, may  
5 appoint a disinterested person who, acting in a fiduciary capacity, shall present such  
6 information to the court as shall be necessary to enable the court to make its  
7 determinations under this Part.

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

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

16 **"§ 37A-1-104.4. Determination of unitrust amount.**

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

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 generation-  
36 skipping transfer tax due under section 2601 of the Code does not apply by reason of  
37 any effective date or transition rule, the unitrust amount in any taxable year shall not be  
38 less than the net income of the trust, determined without regard to the provisions of  
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 thereof) (i) net short-term capital gain described in section  
3 1222(5) of the Code for such year (or portion thereof) but only to the  
4 extent that the amount so allocated together with all other amounts  
5 allocated to trust income for such year (or portion thereof) does not  
6 exceed the unitrust amount for such year (or portion thereof); and (ii)  
7 net long-term capital gain described in section 1222(7) of the Code for  
8 such year (or portion thereof) but only to the extent that the amount so  
9 allocated together with all other amounts, including amounts described  
10 in clause (i) above, allocated to trust income for such year (or portion  
11 thereof) does not exceed the unitrust amount for such year (or portion  
12 thereof).

13 **"§ 37A-1-104.5. Matters in trustee's discretion.**

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

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

26 **"§ 37A-1-104.6. No effect on principal distributions.**

27 Conversion to a total return unitrust under the provisions of this Part shall not affect  
28 any other provision of the governing instrument, if any, regarding distributions of  
29 principal; for purposes of this Part, the distribution of a unitrust amount shall be  
30 considered a distribution of income and not of principal.

31 **"§ 37A-1-104.7. Marital deduction trusts.**

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

39 **"§ 37A-1-104.8. No liability on part of trustee or disinterested person acting in**  
40 **good faith.**

41 No trustee or disinterested person who in good faith takes or fails to take any action  
42 under this Part shall be liable to any person affected by such action or inaction,  
43 regardless of whether such person received written notice as provided in this Part and  
44 regardless of whether such person was under a legal disability at the time of the delivery

1 of such notice. The exclusive remedy for any person affected by such action or inaction  
2 shall be to obtain an order of the court directing the trustee (i) to convert an income trust  
3 to a total return unitrust, (ii) to reconvert from a total return unitrust to an income trust,  
4 or (iii) to change the percentage used to calculate the unitrust amount.

5 **"§ 37A-1-104.9. Applicability.**

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

16 "Part 3. Judicial Control of Discretionary Power.

17 **"§ 37A-1-105. Judicial control of discretionary power.**

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

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

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

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

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

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

40 (2) To the extent that the abuse of discretion has resulted in a distribution  
41 to a beneficiary which is too large, the court shall place the  
42 beneficiaries, the trust, or both, in whole or in part, in their appropriate  
43 positions by ordering the fiduciary to withhold an amount from one or  
44 more future distributions to the beneficiary who received the

1 distribution that was too large or ordering that beneficiary to return  
2 some or all of the distribution to the trust.

3 (3) To the extent that the court is unable, after applying subdivisions (1)  
4 and (2) of this subsection, to place the beneficiaries, the trust, or both,  
5 in the positions they would have occupied if the discretion had not  
6 been abused, the court may order the fiduciary to pay an appropriate  
7 amount from its own funds to one or more of the beneficiaries or the  
8 trust or both.

9 (d) Upon petition by the fiduciary, the court having jurisdiction over a trust or  
10 estate shall determine whether a proposed exercise or nonexercise by the fiduciary of a  
11 discretionary power conferred by this Chapter will result in an abuse of the fiduciary's  
12 discretion. If the petition describes the proposed exercise or nonexercise of the power  
13 and contains sufficient information to inform the beneficiaries of the reasons for the  
14 proposal, the facts upon which the fiduciary relies, and an explanation of how the  
15 income and remainder beneficiaries will be affected by the proposed exercise or  
16 nonexercise of the power, a beneficiary who challenges the proposed exercise or  
17 nonexercise has the burden of establishing that it will result in an abuse of discretion.

18 "Article 2.

19 "Decedent's Estate or Terminating Income Interest.

20 "**§ 37A-2-201. Determination and distribution of net income.**

21 After a decedent dies, in the case of an estate, or after an income interest in a trust  
22 ends, the following rules apply:

23 (1) A fiduciary of an estate or of a terminating income interest shall  
24 determine the amount of net income and net principal receipts received  
25 from property specifically given to a beneficiary under the rules in  
26 Articles 3 through 5 which apply to trustees and the rules in  
27 subdivision (5) of this section. The fiduciary shall distribute the net  
28 income and net principal receipts to the beneficiary who is to receive  
29 the specific property.

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

33 a. Including in net income all income from property used to  
34 discharge liabilities;

35 b. Paying from income or principal, in the fiduciary's discretion,  
36 fees of attorneys, accountants, and fiduciaries; court costs and  
37 other expenses of administration; and interest on death taxes,  
38 but the fiduciary may pay those expenses from income of  
39 property passing to a trust for which the fiduciary claims an  
40 estate tax marital or charitable deduction only to the extent that  
41 the payment of those expenses from income will not cause the  
42 reduction or loss of the deduction; and

43 c. Paying from principal all other disbursements made or incurred  
44 in connection with the settlement of a decedent's estate or the

1 winding up of a terminating income interest, including debts,  
2 funeral expenses, disposition of remains, family allowances,  
3 and death taxes and related penalties that are apportioned to the  
4 estate or terminating income interest by the will, the terms of  
5 the trust, or applicable law.

6 (3) Unless the will or trust instrument otherwise provides, or the court  
7 otherwise directs, a fiduciary shall distribute to a beneficiary who  
8 receives a pecuniary amount outright interest computed as provided in  
9 G.S. 24-1 from the date that is one year following the date of death of  
10 the person whose death gives rise to the payment of the pecuniary  
11 bequest or the happening of the contingency which causes the income  
12 interest to end, from net income determined under subdivision (2) of  
13 this section or from principal to the extent that net income is  
14 insufficient; provided, that this subdivision shall not apply to a  
15 pecuniary bequest:

16 a. To or for the benefit of a decedent's surviving spouse which is,  
17 or can be, qualified for the federal estate tax marital deduction;

18 or

19 b. To or for the benefit of charitable organizations which are  
20 qualified for the federal estate tax charitable deduction,  
21 including a charitable remainder trust.

22 (4) A fiduciary shall distribute the net income remaining after distributions  
23 required by subdivision (3) of this section in the manner described in  
24 G.S. 37A-2-202 to all other beneficiaries, including a beneficiary who  
25 receives a pecuniary amount in trust, even if the beneficiary holds an  
26 unqualified power to withdraw assets from the trust or other presently  
27 exercisable general power of appointment over the trust.

28 (5) A fiduciary may not reduce principal or income receipts from property  
29 described in subdivision (1) of this section because of a payment  
30 described in G.S. 37A-5-501 or G.S. 37A-5-502 to the extent that the  
31 will, the terms of the trust, or applicable law requires the fiduciary to  
32 make the payment from assets other than the property or to the extent  
33 that the fiduciary recovers or expects to recover the payment from a  
34 third party. The net income and principal receipts from the property  
35 are determined by including all of the amounts the fiduciary receives  
36 or pays with respect to the property, whether those amounts accrued or  
37 became due before, on, or after the date of a decedent's death or an  
38 income interest's terminating event, and by making a reasonable  
39 provision for amounts that the fiduciary believes the estate or  
40 terminating income interest may become obligated to pay after the  
41 property is distributed.

42 **"§ 37A-2-202. Distribution to residuary and remainder beneficiaries.**

43 (a) Each beneficiary described in G.S. 37A-2-201(4) is entitled to receive a  
44 portion of the net income equal to the beneficiary's fractional interest in undistributed

1 principal assets, using values as of the distribution date. If a fiduciary makes more than  
2 one distribution of assets to beneficiaries to whom this section applies, each beneficiary,  
3 including one who does not receive part of the distribution, is entitled, as of each  
4 distribution date, to the net income the fiduciary has received after the date of death or  
5 terminating event or earlier distribution date but has not distributed as of the current  
6 distribution date.

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

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

12 (2) The beneficiary's fractional interest in the undistributed principal  
13 assets must be calculated without regard to property specifically given  
14 to a beneficiary and property required to pay pecuniary amounts not in  
15 trust.

16 (3) The beneficiary's fractional interest in the undistributed principal  
17 assets must be calculated on the basis of the aggregate value of those  
18 assets as of the distribution date without reducing the value by any  
19 unpaid principal obligation.

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

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

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

30 "Article 3.

31 "Apportionment at Beginning and End of Income Interest.

32 "**§ 37A-3-301. When right to income begins and ends.**

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

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

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

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

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

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

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

11          **"§ 37A-3-302. Apportionment of receipts and disbursements when decedent dies**  
12          **or income interest begins.**

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

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

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

32          **"§ 37A-3-303. Apportionment when income interest ends.**

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

37          (b) When a mandatory income interest ends, the trustee shall pay to a mandatory  
38          income beneficiary who survives that date, or to the estate of a deceased mandatory  
39          income beneficiary whose death causes the interest to end, the beneficiary's share of the  
40          undistributed income that is not disposed of under the terms of the trust unless the  
41          beneficiary has an unqualified power to revoke more than five percent (5%) of the trust  
42          immediately before the income interest ends. In the latter case, the undistributed income  
43          from the portion of the trust that may be revoked must be added to principal.

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

5                                     "Article 4.

6                     "Allocation of Receipts During Administration of Trust.

7                                     "Part 1. Receipts From Entities.

8 **"§ 37A-4-401. Character of receipts.**

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

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

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

17               (1)     Property other than money;

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

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

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

24       (d)     Money is received in partial liquidation:

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

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

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

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

40 **"§ 37A-4-402. Distribution from trust or estate.**

41       A trustee shall allocate to income an amount received as a distribution of income  
42 from a trust or an estate in which the trust has an interest other than a purchased interest  
43 and shall allocate to principal an amount received as a distribution of principal from  
44 such a trust or estate. If a trustee purchases an interest in a trust that is an investment

1 entity, or a decedent or donor transfers an interest in such a trust to a trustee, G.S.  
2 37A-4-401 or G.S. 37A-4-415 applies to a receipt from the trust.

3 **"§ 37A-4-403. Business and other activities conducted by trustee.**

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

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

18 (c) Activities for which a trustee may maintain separate accounting records  
19 include:

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

27 "Part 2. Receipts Not Normally Apportioned.

28 **"§ 37A-4-404. Principal receipts.**

29 A trustee shall allocate to principal:

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



- 1           (5) Net income received in an accounting period during which there is no  
2           beneficiary to whom a trustee may or must distribute income; and  
3           (6) Other receipts as provided in Part 3 of this Article.

4 **"§ 37A-4-405. Rental property.**

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

12 **"§ 37A-4-406. Obligation to pay money.**

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

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

24           (c) This section does not apply to an obligation to which G.S. 37A-4-409, 37A-4-  
25           410, 37A-4-411, 37A-4-412, 37A-4-414, or 37A-4-415 applies.

26 **"§ 37A-4-407. Insurance policies and similar contracts.**

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

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

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

38                                   "Part 3. Receipts Normally Apportioned.

39 **"§ 37A-4-408. Insubstantial allocations not required.**

40           If a trustee determines that an allocation between principal and income required by  
41           G.S. 37A-4-409, 37A-4-410, 37A-4-411, 37A-4-412, or 37A-4-415 is insubstantial, the  
42           trustee may allocate the entire amount to principal unless one of the circumstances  
43           described in G.S. 37A-1-104(c) applies to the allocation. This power may be exercised  
44           by a cotrustee in the circumstances described in G.S. 37A-1-104(d) and may be released

1 for the reasons and in the manner described in G.S. 37A-1-104(e). An allocation is  
2 presumed to be insubstantial if:

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

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

9 **"§ 37A-4-409. Deferred compensation, annuities, and similar payments.**

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

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

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

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

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

34 **"§ 37A-4-410. Liquidating asset.**

35 (a) In this section, "liquidating asset" means an asset whose value will diminish  
36 or terminate because the asset is expected to produce receipts for a period of limited  
37 duration. The term includes a leasehold, patent, copyright, royalty right, and right to  
38 receive payments during a period of more than one year under an arrangement that does  
39 not provide for the payment of interest on the unpaid balance. The term does not include  
40 a payment subject to G.S. 37A-4-409, resources subject to G.S. 37A-4-411, timber  
41 subject to G.S. 37A-4-412, an activity subject to G.S. 37A-4-414, an asset subject to  
42 G.S. 37A-4-415, or any asset for which the trustee establishes a reserve for depreciation  
43 under G.S. 37A-5-503.

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

3 **"§ 37A-4-411. Minerals, water, and other natural resources.**

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

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

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

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

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

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

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

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

31 **"§ 37A-4-412. Timber.**

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

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

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

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

1           under the lease or contract and applying the rules in subdivisions (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 subdivisions (1), (2), or (3) of  
5           this subsection.

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

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

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

15          **"§ 37A-4-413. Property not productive of income.**

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

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

28          **"§ 37A- 4-414. Derivatives and options.**

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

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

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

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

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

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

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

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

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

20 **"§ 37A-5-503. Transfers from income to principal for depreciation.**

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

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

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

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

34 **"§ 37A-5-504. Transfers from income to reimburse principal.**

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

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

- 42           (1) An amount chargeable to income but paid from principal because it is  
43 unusually large, including extraordinary repairs;

- 1           (2) A capital improvement to a principal asset, whether in the form of  
2           changes to an existing asset or the construction of a new asset,  
3           including special assessments;  
4           (3) Disbursements made to prepare property for rental, including tenant  
5           allowances, leasehold improvements, and broker's commissions;  
6           (4) Periodic payments on an obligation secured by a principal asset to the  
7           extent that the amount transferred from income to principal for  
8           depreciation is less than the periodic payments; and  
9           (5) Disbursements described in G.S. 37A-5-502(a)(7).

10          (c) If the asset whose ownership gives rise to the disbursements becomes subject  
11 to a successive income interest after an income interest ends, a trustee may continue to  
12 transfer amounts from income to principal as provided in subsection (a) of this section.

13 **"§ 37A-5-505. Income taxes.**

14          (a) A tax required to be paid by a trustee based on receipts allocated to income  
15 must be paid from income.

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

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

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

23           (2) From principal to the extent that:

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

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

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

31 **"§ 37A-5-506. Adjustments between principal and income because of taxes.**

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

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

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

41           (3) The ownership by an estate or trust of an interest in an entity whose  
42 taxable income, whether or not distributed, is includable in the taxable  
43 income of the estate, trust, or a beneficiary.

1 (b) If the amount of an estate tax marital deduction or charitable contribution  
2 deduction is reduced because a fiduciary deducts an amount paid from principal for  
3 income tax purposes instead of deducting it for estate tax purposes, and as a result estate  
4 taxes paid from principal are increased and income taxes paid by an estate, trust, or  
5 beneficiary are decreased, each estate, trust, or beneficiary that benefits from the  
6 decrease in income tax shall reimburse the principal from which the increase in estate  
7 tax is paid. The total reimbursement must equal the increase in the estate tax to the  
8 extent that the principal used to pay the increase would have qualified for a marital  
9 deduction or charitable contribution deduction but for the payment. The proportionate  
10 share of the reimbursement for each estate, trust, or beneficiary whose income taxes are  
11 reduced must be the same as its proportionate share of the total decrease in income tax.  
12 An estate or trust shall reimburse principal from income.

13 "Article 6.

14 "Miscellaneous Provisions.

15 **"§ 37-A-6-601. Uniformity of Application and Construction.**

16 In applying and construing this Uniform Act, consideration must be given to the  
17 need to promote uniformity of the law with respect to its subject matter among states  
18 that enact it.

19 **"§ 37-A-6-602. Severability Clause.**

20 If any provision of this Chapter or its application to any person or circumstance is  
21 held invalid, the invalidity does not affect other provisions or applications of this  
22 Chapter which can be given effect without the invalid provision or application, and to  
23 this end the provisions of this Chapter are severable."

24 **SECTION 2.** Chapter 37 of the General Statutes is repealed.

25 **SECTION 3.** This act becomes effective January 1, 2004, and applies to  
26 every trust or decedent's estate existing on that date, except as otherwise expressly  
27 provided in the will or terms of the trust or in the provisions of Chapter 37A, as enacted  
28 in this act.