

NORTH CAROLINA GENERAL ASSEMBLY
1973 SESSION

CHAPTER 729
SENATE BILL 194

AN ACT TO REWRITE THE LAWS RELATING TO THE APPORTIONMENT OF
PRINCIPAL AND INCOME.

The General Assembly of North Carolina enacts:

Section 1. Chapter 37 of the General Statutes is hereby amended by rewriting the title thereof to read "Allocation of Principal and Income" and by designating the existing provisions of Chapter 37 as Article 1 entitled "Uniform Principal and Income Act."

Sec. 2. Chapter 37 is further amended by adding a new Article 2 to read as follows:

"Article 2.

"Principal and Income Act of 1973.

"§ 37-16. **Definitions.** — (a) As used in this article:

- (1) 'Income beneficiary' means the person to whom income is presently payable or for whom it is accumulated for distribution as income.
- (2) 'Inventory value' means the cost of property purchased by the trustee and the market value of other property at the time it became subject to the trust, but in the case of a testamentary trust the trustee may use any value finally determined for the purposes of an estate or inheritance tax.
- (3) 'Personal representative' shall include executor, any successor executor, administrator of intestate estates, administrator CTA, successor administrator, collector, or any fiduciary appointed to administer or conserve an estate.
- (4) 'Remainderman' means the person entitled to principal, including income which has been accumulated and added to principal.
- (5) 'Trustee' means an original trustee and any successor or added trustee and, where applicable, the personal representative of a decedent's estate.
- (6) 'Trust' includes, where applicable, a decedent's estate whether testate or intestate.
- (7) 'Tax' includes any interest or penalty thereon except where such interest or penalty is separately provided for in this article.

"§ 37-17. **Duty of trustee or personal representative as to receipts and expenditures.** — (a) A trust or a decedent's estate shall be administered with due regard to the respective interests of income beneficiaries and remaindermen. A trust or a decedent's estate is so administered with respect to the allocation of receipts and expenditures if a receipt is credited or an expenditure is charged to income or principal or partly to each:

- (1) In accordance with the terms of the trust instrument or will, notwithstanding contrary provisions of this article; or
- (2) In the absence of any contrary terms of the trust instrument or will, in accordance with the provisions of this article; or
- (3) If neither of the preceding rules of administration is applicable, in accordance with what is reasonable and equitable in view of the interests of those entitled to income as well as of those entitled to principal, and in view

of the manner in which men of ordinary prudence, discretion and judgment would act in the management of their own affairs.

(b) If the trust instrument or will gives the trustee or personal representative discretion in crediting a receipt or charging an expenditure to income or principal or partly to each, no inference of imprudence, partiality or abuse of discretion arises from the fact that the trustee or personal representative has made an allocation contrary to a provision of this article.

"§ 37-18. **Income; principal; charges.** — (a) Income is the return in money or property derived from the use of principal, including return received as:

- (1) Rent of real or personal property, including sums received for cancellation or renewal of a lease;
- (2) Interest on money lent, including sums received as consideration for the privilege of prepayment of principal, except as provided in G.S. 37-22 with respect to bond premium;
- (3) Income earned during administration of a decedent's estate as provided in G.S. 37-20;
- (4) Corporate distributions as provided in G.S. 37-21;
- (5) Accrued increment on bonds or other obligations issued at discount, as provided in G.S. 37-22;
- (6) Receipts from business and farming operations, as provided in G.S. 37-26;
- (7) Receipts from disposition of natural resources, as provided in sections G.S. 37-24 and G.S. 37-25, and receipts from other principal subject to depletion, as provided in G.S. 37-26; or
- (8) Receipts from disposition of underproductive property as provided in G.S. 37-27.

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

- (1) Consideration received by the trustee or personal representative on the sale or other transfer of principal or on repayment of a loan or as a refund or replacement or change in the form of principal;
- (2) Proceeds of property taken in eminent domain proceedings;
- (3) Proceeds of insurance upon property forming part of the principal except proceeds of insurance upon a separate interest of an income beneficiary;
- (4) Certain stock dividends, receipts on liquidation of a corporation, and other corporate distributions, as provided in G.S. 37-21;
- (5) Amortization of premium and certain receipts from the disposition of securities, as provided in G.S. 37-22;
- (6) Royalties and other receipts from disposition of natural resources, as provided in G.S. 37-24 and G.S. 37-25, and receipts from other principal subject to depletion as provided in G.S. 37-26;
- (7) Any profit resulting from any change in the form of principal except as provided in G.S. 37-27 on underproductive property;
- (8) Receipts from disposition of underproductive property as provided in G.S. 37-27; and
- (9) Any allowances for depreciation established under G.S. 37-23 and G.S. 37-26.

(c) After determining income and principal in accordance with this article, the trustee or personal representative shall charge expenses and other charges to income or principal as provided in G.S. 37-20 and G.S. 37-28 through G.S. 37-38.

"§ 37-19. **When right to income arises; apportionment of income.** — (a) An income beneficiary is entitled to income for the period beginning on the date specified in the trust instrument or will, or, if no date is specified, on the date an asset becomes subject to the trust or on the date of the decedent's death and ending on the date the income interest of the beneficiary terminates. In the case of an asset becoming subject to a trust by reason of a will, it becomes subject to the trust as of the date of the death of the testator even though there is an intervening period of administration of the testator's estate.

(b) In the administration of a decedent's estate or when an asset becomes subject to a trust by reason of a will:

- (1) Receipts due but not paid at the date of death are principal; and
- (2) Receipts in the form of periodic payments (other than corporate distributions to stockholders and receipts incident to the operation of a trade or business), including rent, interest or annuities, not due at the date of death shall be treated as accruing day to day. That portion of any receipt accruing before the date of death is principal, and the balance is income.

(c) On termination of an income interest, the income beneficiary whose interest is terminated, or his estate, is entitled to:

- (1) Income undistributed on the date of termination;
- (2) Income due but not paid to the trustee or personal representative on the date of termination; and
- (3) Income in the form of periodic payments (other than corporate distributions to stockholders and receipts incident to the operation of a trade or business), including rent, interest, or annuities, not due on the date of termination, accrued, on a day-to-day basis, on or before the date of termination.

(d) In the administration of a decedent's estate or when an asset becomes subject to a trust, income defined in G.S. 37-23 for the period ending on the date of death or when the asset becomes subject to a trust is principal.

(e) Corporate distributions to stockholders shall be treated as due on the day fixed by the corporation for determination of stockholders of record entitled to distribution or, if no date is fixed, on the date of declaration of the distribution by the corporation.

(f) In all other cases any receipt from an income-producing asset is income as of the date of receipt even though it was earned or accrued in whole or in part before or after such date.

"§ 37-20. **Income earned and expenses incurred during administration of a decedent's estate.** — (a) Unless the will otherwise provides or the court otherwise directs:

- (1) All expenses incurred in connection with the administration and settlement of a decedent's estate (other than expenses of management and operation of the estate property), including debts, funeral and burial expenses, death taxes, penalties concerning death taxes, family allowances shall be charged against the principal of the estate; and
- (2) Compensation of attorneys and personal representatives and court costs, to the extent they are incurred in the administration and settlement of a decedent's estate, shall be charged against the principal of the estate. All expenses incurred in the management and operation of the estate property shall be charged against principal or income of the estate in accordance with the rules applicable to a trustee under this article.

(b) Unless the will otherwise provides, or the court otherwise directs, income from the assets of a decedent's estate after the death of the decedent and before distribution, including income from property used to discharge liabilities, shall be determined in accordance with the rules applicable to a trustee under this chapter and distributed as follows:

- (1) To specific legatees and devisees, the income from the property bequeathed or devised to them respectively, less taxes, ordinary repairs and other expenses of management and operation of the property, and appropriate portions of interest expense accrued since the death of the decedent and taxes imposed on income (excluding taxes chargeable against principal) which accrue during the period of administration;
 - (2) To all other legatees and devisees (except legatees of pecuniary bequests not in trust) and to all takers by intestacy, the balance of the income, less the balance of taxes, ordinary repairs and other expenses of management and operation of all property from which the estate is entitled to income, interest expense accrued since the death of the decedent and taxes imposed on income (excluding taxes chargeable against principal) which accrue during the period of administration, in proportion to their respective interests in the undistributed assets of the estate computed at times of distribution on the basis of inventory value.
- (c) Income received under subsection (b) by a trustee shall be treated as income of the trust.

"§ 37-21. Corporate distributions. — (a) Except as otherwise provided in this section, corporate distributions of shares of the distributing corporation, including distributions in the form of a stock split or stock dividend, are principal. A right to subscribe to shares or other securities issued by the distributing corporation accruing to stockholders on account of their stock ownership and the proceeds of any sale of the right are principal.

(b) Except to the extent that the corporation indicates that some part of a corporate distribution is a settlement of preferred or guaranteed dividends accrued since the trustee or personal representative became a stockholder or is in lieu of an ordinary cash dividend, a corporate distribution is principal if the distribution is pursuant to:

- (1) A call of shares;
- (2) A merger, consolidation, reorganization, or other plan by which assets of the corporation are acquired by another corporation; or
- (3) A total or partial liquidation of the corporation, including any distribution which the corporation indicates is a distribution in total or partial liquidation or any distribution of assets, other than cash, pursuant to a court decree or final administrative order by a government agency ordering distribution of the particular assets.

(c) Except as otherwise provided in this section, distributions made from ordinary income or from realized capital gains by a regulated investment company or by a trust qualifying and electing to be taxed under federal law as a real estate investment trust are income. All other distributions made by the company or trust, whether in the form of cash or an option to take new stock or cash or an option to purchase additional shares, are principal.

(d) Except as provided in subsections (a), (b), and (c), all corporate distributions are income, including cash dividends, distributions of or rights to subscribe to shares or securities or obligations of corporations other than the distributing corporation, and the proceeds of the rights or property distributions. In addition, in the following instances, a distribution is income notwithstanding that it is in shares of the distributing corporation:

- (1) If the distribution is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either in the stock of the distributing corporation or in property;
- (2) If the distribution (or a series of distributions of which such distribution is one) has the result of the receipt of property by some shareholders and an increase in the proportionate interests of other shareholders in the assets or earnings and profits of the distributing corporation;

- (3) If the distribution (or a series of distributions of which such distribution is one) has the result of the receipt of preferred stock by some common shareholders and the receipt of common stock by other common shareholders; or
- (4) If the distribution is with respect to preferred stock, other than an increase in the conversion ratio of convertible preferred stock made solely to take account of a stock dividend or stock split with respect to the stock into which such convertible stock is convertible.

(e) The trustee or personal representative may rely upon any statement of the distributing corporation as to any fact relevant under any provision of this section concerning the source or character of dividends or distributions of corporate assets.

"§ 37-22. Bond premium and discount. — (a) Bonds or other obligations for the payment of money are principal at their inventory value, except as provided in subsection (b) for discount bonds. No provision shall be made for amortization of bond premiums or for accumulation for discount. The proceeds of sale, redemption, or other disposition of the bonds or obligations are principal.

(b) The increment in value of a bond or other obligation for the payment of money payable at a future time in accordance with a fixed schedule of appreciation in excess of the price at which it was issued is distributable as income. The increment in value is distributable to the beneficiary who was the income beneficiary at the time of increment from the first principal cash available or, if none is available, when realized by sale, redemption, or other disposition. Whenever unrealized increment is distributed as income but out of principal, the principal shall be reimbursed for the increment when realized.

"§ 37-23. Business and farming operations. — (a) If a trustee or personal representative uses any part of the principal in the continuance of a business of which the settlor or decedent was a sole proprietor or a partner, the net profits of the business, computed in accordance with generally accepted accounting principles for a comparable business, are income. If a loss results in any fiscal or calendar year, the loss falls on principal and shall not be carried into any other fiscal or calendar year for purposes of calculating net income.

(b) Generally accepted accounting principles shall be used to determine income from an agricultural or farming operation, including the raising of animals or the operation of a nursery.

"§ 37-24. Disposition of natural resources. — (a) If any part of the principal consists of a right to receive royalties, overriding or limiting royalties, working interests, production payments, net profit interests, or other interests in minerals or other natural resources in, on or under land, the receipts from taking the natural resources from the land shall be allocated as follows:

- (1) If received as rent on a lease or extension payments on a lease, the receipts are income.
- (2) If received from a production payment, the receipts are income to the extent of any factor for interest or its equivalent provided in the governing instrument. There shall be allocated to principal the fraction of the balance of the receipts which the unrecovered cost of the production payment bears to the balance owed on the production payment, exclusive of any factor for interest or its equivalent. The receipts not allocated to principal are income.
- (3) If received as a royalty, overriding or limited royalty, or bonus, or from a working, net profit, or any other interest in minerals or other natural resources, receipts not provided for in the preceding paragraphs of this section shall be apportioned on a yearly basis in accordance with this paragraph whether or not any natural resource was being taken from the land at the time the trust or decedent's estate came into existence. Fifty percent (50%) of the gross receipts attributable to the permanent severance of the

natural resources (but not to exceed sixty-six and two-thirds percent (66 2/3%) of the net receipts attributable to the permanent severance of the natural resources remaining after payment of all expenses, direct and indirect, computed without allowance for depletion) shall be added to principal as an allowance for depletion. The balance of the gross receipts, after provision therefrom for all expenses, direct and indirect, is income.

(b) If a trustee or personal representative, on the effective date of this article, held an item of depletable property of a type specified in this section, he shall allocate receipts from the property in the manner used before the effective date of this article, but as to all depletable property acquired after the effective date of this article by an existing or new trust or decedent's estate, the method of allocation provided herein shall be used.

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

"§ 37-25. **Timber.** — If any part of the principal consists of land from which merchantable timber may be removed, the receipts from taking the timber from the land shall be allocated in accordance with G.S. 37-17(a)(3).

"§ 37-26. **Other property subject to depletion.** — Except as provided in G.S. 37-24 and G.S. 37-25, if the principal consists of tangible or intangible property subject to depletion, including leaseholds, patents, copyrights, royalty rights, and rights to receive payments on a contract for deferred compensation, or other intangible assets of a wasting nature, receipts from the property, not in excess of five percent (5%) per year of its inventory value or of its fair market value at the end of the particular fiscal or calendar year, whichever is greater, are income and the balance is principal.

"§ 37-27. **Underproductive property.** — (a) Except as otherwise provided in this section, a portion of the net proceeds of sale of any part of principal which part has not produced an average net income of at least one percent (1%) per year of its inventory value for more than a year (including as income the value of any beneficial use of the property by the income beneficiary) shall be treated as delayed income to which the income beneficiary is entitled as provided in this section. The net proceeds of sale are the gross proceeds received, including the value of any property received in substitution for the property disposed of, less the expenses, including capital gains tax, if any, incurred in disposition and less any carrying charges paid while the property was underproductive.

(b) The sum allocated as delayed income is the difference between the net proceeds and the amount which, had it been invested at simple interest at four percent (4%) per year while the property was underproductive, would have produced the net proceeds. This sum, plus any carrying charges and expenses previously charged against income while the property was underproductive, less any income received by the income beneficiary from the property and less the value of any beneficial use of the property by the income beneficiary, is income, and the balance is principal.

(c) Anything herein to the contrary notwithstanding:

- (1) No amount shall be allocated as delayed income under this section on account of the sale of any underproductive part of principal from a trust, when the whole of such principal has produced an average net income of four percent (4%) per annum of its inventory value for each year that the trust principal included such underproductive part;
- (2) The sum allocated as delayed income on account of the sale of the underproductive part of the trust principal shall not exceed that amount which is the difference between the actual average net income of the trust principal and that greater amount which would have been produced if the trust principal had yielded four percent (4%) per annum of its inventory value during the years in which the trust contained such underproductive part.

(d) An income beneficiary or his estate is entitled to delayed income under this section as if it accrued from day to day during the time he was a beneficiary.

(e) If principal subject to this section is disposed of by conversion into property which cannot be apportioned easily, including land or mortgages (for example, realty acquired by or in lieu of foreclosure), the income beneficiary is not, on account of such conversion, entitled to any allocation as delayed income under this section; however, the income beneficiary is entitled to the net income from any property or obligation into which the original principal is converted while the substituted property or obligation is held.

"§ 37-28. Expenses. — Expenses not included in G.S. 37-29 through G.S. 37-38 shall be charged against income if such expenses are ordinary expenses reasonably incurred in connection with the administration, management or preservation of the trust property; otherwise they shall be charged against principal.

"§ 37-29. Taxes. — (a) Regularly recurring taxes assessed against any portion of the principal and any tax levied on receipts defined as income under this article or the trust instrument shall be charged against income.

(b) Any tax levied upon profits, gains or receipts allocated to principal shall be charged against principal notwithstanding denomination of the tax as an income tax by the taxing authority.

(c) If an estate or inheritance tax is levied in respect of a trust in which both an income beneficiary and a remainderman have an interest, any amount apportioned to the trust shall be charged against principal even though the income beneficiary also has rights in the principal.

"§ 37-30. Compensation of trustee. — (a) Unless the Court otherwise directs, one-half of the regular compensation of the trustee, whether based on a percentage of principal or income, shall be charged against income, and one-half of such compensation shall be charged against principal.

(b) Unless the Court otherwise directs, compensation of the trustee other than regular compensation shall be charged against income if the matter primarily concerns the income interest, shall be charged against principal if the matter primarily concerns principal and shall be charged one-half against each if the primary concern cannot readily be determined; provided that compensation computed on principal as an acceptance, distribution or termination fee shall be charged against principal.

"§ 37-31. Court costs and attorneys' fees. — (a) Unless the Court otherwise directs, one-half of court costs and attorneys' fees on periodic judicial accountings shall be charged against income and one-half shall be charged against principal.

(b) Unless the Court otherwise directs, court costs, attorneys' fees and other expenses incurred in any judicial proceeding, other than periodic judicial accountings, shall be charged against income if the matter primarily concerns the income interest and shall be charged against principal if the matter primarily concerns principal and shall be charged one-half against each if the primary concern cannot readily be determined.

"§ 37-32. Management of principal and application of income. — All expenses reasonably incurred for current management of principal and application of income shall be charged against income; except that the direct costs of investing and reinvesting principal shall be charged against principal.

"§ 37-33. Interest and payments on indebtedness. — Interest paid by the trustee, including interest on death tax deficiencies, shall be charged against income. Payments on principal of an indebtedness (including a mortgage amortized by periodic payments of principal) shall be charged against principal.

"§ 37-34. Premiums on insurance. — Premiums on insurance taken upon the interests of the income beneficiary, remainderman, or trustee shall be charged against income.

"§ 37-35. Repairs, improvements, and special assessments. — (a) Ordinary repairs shall be charged against income.

(b) Expenses, other than ordinary repairs, in connection with the preparation of property for rental or sale, extraordinary repairs, expenditures for capital improvements to principal, and special assessments shall be charged against principal.

"§ 37-36. **Depreciation.** — A reasonable allowance for depreciation of property subject to depreciation under generally accepted accounting principles shall be charged against income, but no allowance for depreciation shall be made for that portion of any real property used by a beneficiary as a residence and no allowance for depreciation need be made for any property held by the trustee on the effective date of this article for which the trustee was not then required to make and was not then making an allowance for depreciation.

"§ 37-37. **Spreading charges against income.** — If charges against income are of unusual amount, the trustee may by means of reserves or other reasonable means charge them over a reasonable period of time and withhold from distribution sufficient sums to regularize distributions.

"§ 37-38. **Recurring charges; apportionment.** — Regularly recurring charges payable from income shall be apportioned to the same extent and in the same manner that income is apportioned under G.S. 37-19.

"§ 37-39. **Application of article.** — Except as specifically provided in the trust instrument or the will or in this article, this article shall apply to any receipt or expense received or incurred after the effective date of this article by any trust or decedent's estate whether established before or after the effective date of this article and whether the asset involved was acquired by the trustee before or after the effective date of this article.

"§ 37-40. **Short title.** — This article may be cited as the Principal and Income Act of 1973."

Sec. 3. G.S. 37-1 through 37-15, being Article 1 of this chapter as provided in Section 1 of this act, and all laws and clauses of laws in conflict with this act are hereby repealed.

Sec. 4. This act shall become effective on and after January 1, 1974.

In the General Assembly read three times and ratified, this the 23rd day of May, 1973.