

Article 5.

Allocation of Disbursements During Administration of Trust.

§ 37A-5-501. Disbursements from income.

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

- (1) One-half of the regular compensation of the trustee and of any person providing investment advisory or custodial services to the trustee;
- (2) One-half of all expenses for accountings, judicial proceedings, or other matters that involve both the income and remainder interests;
- (3) All of the other ordinary expenses incurred in connection with the administration, management, or preservation of trust property and the distribution of income, including interest, ordinary repairs, regularly recurring taxes assessed against principal, and expenses of a proceeding or other matter that concerns primarily the income interest; and
- (4) Recurring premiums on insurance covering the loss of a principal asset or the loss of income from or use of the asset. (2003-232, s. 2.)

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

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

- (1) The remaining one-half of the disbursements described in G.S. 37A-5-501(1) and G.S. 37A-5-501(2);
- (2) All of the trustee's compensation calculated on principal as a fee for acceptance, distribution, or termination and disbursements made to prepare property for sale;
- (3) Payments on the principal of a trust debt;
- (4) Expenses of a proceeding that concerns primarily principal, including a proceeding to construe the trust or to protect the trust or its property;
- (5) Premiums paid on a policy of insurance not described in G.S. 37A-5-501(4) of which the trust is the owner and beneficiary;
- (6) Estate, inheritance, and other transfer taxes, including penalties, apportioned to the trust; and
- (7) Disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the costs of those activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or regulations, statutory or common-law claims by third parties, and defending claims based on environmental matters.

(b) If a principal asset is encumbered with an obligation that requires income from that asset to be paid directly to the creditor, the trustee shall transfer from principal to income an amount equal to the income paid to the creditor in reduction of the principal balance of the obligation. (2003-232, s. 2.)

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

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

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

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

(c) An amount transferred to principal under this section need not be held as a separate fund. (2003-232, s. 2.)

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

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

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

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

(c) If the asset whose ownership gives rise to the disbursements becomes subject to a successive income interest after an income interest ends, a trustee may continue to transfer amounts from income to principal as provided in subsection (a) of this section. (2003-232, s. 2.)

§ 37A-5-505. Income taxes.

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

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

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

- (1) From income to the extent that receipts from the entity are only allocated to income;
- (2) From principal to the extent receipts from the entity are only allocated to principal;
- (3) Proportionately from principal and income to the extent that receipts from the entity are allocated to both income and principal; and
- (4) From principal to the extent that the tax exceeds the total receipts from the entity.

(d) After applying subsections (a) through (c) of this section, the trustee shall adjust income or principal receipts to the extent that the trust's taxes are reduced because the trust receives a deduction for payments made to a beneficiary. (2003-232, s. 2; 2010-181, s. 4.)

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

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

- (1) Elections and decisions, other than those described in subsection (b) of this section, that the fiduciary makes from time to time regarding tax matters;
- (2) An income tax or any other tax that is imposed upon the fiduciary or a beneficiary as a result of a transaction involving or a distribution from the estate or trust; or
- (3) The ownership by an estate or trust of an interest in an entity whose taxable income, whether or not distributed, is includable in the taxable income of the estate or trust or a beneficiary.

(b) If the amount of an estate tax marital deduction or charitable contribution deduction is reduced because a fiduciary deducts an amount paid from principal for income tax purposes instead of deducting it for estate tax purposes, and as a result estate taxes paid from principal are increased and income taxes paid by an estate, trust, or beneficiary are decreased, each estate, trust, or beneficiary that benefits from the decrease in income tax shall reimburse the principal from which the increase in estate tax is paid. The total reimbursement shall equal the increase in the estate tax to the extent that the principal used to pay the increase would have qualified for a marital deduction or charitable contribution deduction but for the payment. The proportionate share of the reimbursement for each estate, trust, or beneficiary whose income taxes are reduced shall be the same as its proportionate share of the total decrease in income tax. An estate or trust shall reimburse principal from income. (2003-232, s. 2.)