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. (2003-232, s. 2.)

§ 37A-1-102. Definitions.

The following definitions apply in this Chapter:

(1) "Accounting period" means a calendar year unless another 12-month period is selected by a fiduciary. The term includes a portion of a calendar year or other 12-month period that begins when an income interest begins or ends when an income interest ends.

(2) "Beneficiary" includes, in the case of a decedent's estate, an heir and devisee and, in the case of a trust, an income beneficiary and a remainder beneficiary.

(3) "Fiduciary" means a personal representative or a trustee. The term includes an executor, administrator, successor personal representative, special administrator, and a person performing substantially the same function.

(4) "Income" means money or property that a fiduciary receives as current return from a principal asset. The term includes a portion of receipts from a sale, exchange, or liquidation of a principal asset, to the extent provided in Article 4 of this Chapter.

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

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

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

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

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

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

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

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

(13) "Trustee" includes an original, additional, or successor trustee, whether or not appointed or confirmed by a court. (2003-232, s. 2; 2011-284, s. 47.)

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

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

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

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

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

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

(b) In exercising the power to adjust under G.S. 37A-1-104(a), any discretionary power in connection with the conversion or administration of a unitrust under Part 2 of this Article, or a discretionary power of administration regarding a matter within the scope of this Chapter, whether granted by the terms of a trust, a will, or this Chapter, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with this Chapter is presumed to be fair and reasonable to all of the beneficiaries.

(c) The exercise of powers of allocation of receipts and expenditures contained or incorporated by reference to G.S. 32-27(29) in wills dated prior to January 1, 2004, shall continue to be valid. (2003-232, s. 2.)

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

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

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

(1) The nature, purpose, and expected duration of the trust;

(2) The intent of the grantor or settlor;

(3) The identity and circumstances of the beneficiaries;

(4) The needs for liquidity, regularity of income, and preservation and appreciation of capital;

(5) The assets held in the trust; the extent to which they consist of financial assets, interests in closely held enterprises, tangible and intangible personal property, or real property; the extent to which an asset is used by a beneficiary; and whether an asset was purchased by the trustee or received from the settlor;

(6) The net amount allocated to income under the other sections of this Chapter and the increase or decrease in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available;

(7) Whether and to what extent the terms of the trust give the trustee the power to invade principal or accumulate income or prohibit the trustee from invading principal or accumulating income, and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income;

(8) The actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation; and

(9) The anticipated tax consequences of an adjustment.

(c) A trustee shall not make an adjustment:

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

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

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

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

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

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

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

(8) If the trustee is not a beneficiary but the adjustment would benefit the trustee directly or indirectly, except that a trustee may make an adjustment that also benefits a beneficiary even if the terms of the trust provide for trustee compensation as a percentage of the trust's income; or

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

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

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

(f) Terms of a trust that limit the power of a trustee to make an adjustment between principal and income do not affect the application of this section unless it is clear from the terms of the trust that the terms are intended to deny the trustee the power of adjustment conferred by subsection (a) of this section. (2003-232, s. 2; 2007-106, s. 44.)

Part 2. Conversion to Unitrust.

§ 37A-1-104.1. Definitions.

The following definitions apply to this Part:

(1) Code. – The Internal Revenue Code of 1986, as amended from time to time, and any statutory enactment successor to the Code; reference to a specific section of the Code in this Part shall be considered a reference also to any successor provision dealing with the subject matter of that section of the Code.

(2) Repealed by Session Laws 2007-106, s. 45, effective October 1, 2007.

(3) Disinterested person. – A person who is not a related or subordinate party with respect to the person then acting as trustee of the trust and excludes the settlor of the trust and any interested trustee.

(4) Repealed by Session Laws 2007-106, s. 45, effective October 1, 2007.

(5) Income trust. – 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, and regardless of whether the trust directs or permits the trustee to distribute principal of the trust to one or more of those persons.

(6) Interested distributee. – A living beneficiary who is a distributee or permissible distributee of trust income or principal who has the power to remove the existing trustee and designate as successor a person who may be a related or subordinate party with respect to that distributee.

(7) Interested trustee. – Any of the following:

a. An individual trustee who is a qualified beneficiary.

b. Any trustee who may be removed and replaced by an interested distributee.

c. An individual trustee whose legal obligation to support a beneficiary may be satisfied by distributions of income and principal of the trust.

(7a) Legal disability. – A person under a legal disability is a person who is a minor, an incompetent, or an unborn individual, or whose identity or location is unknown.

(7b) Qualified beneficiary. – A qualified beneficiary as defined in G.S. 36C-1-103(15).

(8) Related or subordinate party. – A related or subordinate party as defined in section 672(c) of the Code.

(8a) Representative. – A person who may represent and bind another as provided in Article 3 of Chapter 36C of the General Statutes, the provisions of which shall apply for purposes of this Article.

(8b) Settlor. – An individual, including a testator, who creates a trust.

(9) Total return unitrust. – An income trust that has been converted under and meets the provisions of this Part.

(9a) Treasury regulations. – The regulations, rulings, procedures, notices, or other administrative pronouncements issued by the Internal Revenue Service, as amended from time to time.

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

(11) Unitrust amount. – An amount computed as a percentage of the fair market value of the trust. (2003-232, s. 2; 2005-244, ss. 1, 2; 2007-106, s. 45.)

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

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

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

(2) The trustee gives written notice of its intention to take the action, including copies of the written policy and this Part, to (i) the settlor of the trust, if living, and (ii) all persons who are the qualified beneficiaries of the trust at the time the notice is given. If a qualified beneficiary is under a legal disability, notice shall be given to the representative of the qualified beneficiary if a representative is available without court order.

(3) There is at least (i) one qualified beneficiary described in G.S. 36C-1-103(15)a. or b. who is not under a legal disability or a representative of a qualified beneficiary so described and (ii) one qualified beneficiary described in G.S. 36C-1-103(15)c. who is not under a legal disability or a representative of a qualified beneficiary so described.
and

(4) No person receiving notice of the trustee's intention to take the proposed action objects to the action within 60 days after notice has been given. The objection shall be by written instrument delivered to the trustee.

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

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

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

(3) The trustee gives written notice of its intention to take the action, including copies of the written policy and this Part, and the determinations of the disinterested person to (i) the settlor of the trust, if living, and (ii) all persons who are the qualified beneficiaries of the trust at the time of the giving of the notice. If a qualified beneficiary is under a legal disability, notice shall be given to the representative of the qualified beneficiary if a representative is available without court order.

(4) There is at least one (i) qualified beneficiary described in G.S. 36C-1-103(15)a. or b. or a representative of a beneficiary so described and (ii) one qualified beneficiary described in G.S. 36C-1-103(15)c. or a representative of a qualified beneficiary so described.

(5) No person receiving notice of the trustee's intention to take the proposed action of the trustee objects to the action or to the determination of the disinterested person within 60 days after notice has been given. The objection must be by written instrument delivered to the trustee.

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

(1) Instead of sending written notice to the persons described in subdivisions (2) and (3) of subsection (a) of this section or subdivisions (3) and (4) of subsection (b) of this section, as the case may be, the trustee shall send written notice to each charitable organization expressly designated to receive the income of the trust under the governing instrument and, if no charitable organization is expressly designated to receive all of the income of the trust under the governing instrument, to the Attorney General of this State.

(2) Subdivision (4) of subsection (a) of this section or subdivision (5) of subsection (b) of this section, as the case may be, shall not apply to this action.

(3) In each taxable year, the trustee shall distribute the greater of the unitrust amount or the amount required by section 4942 of the Code.

(d) The provisions of G.S. 36C-1-109 regarding notices and the sending of documents to persons under Chapter 36C of the General Statutes shall apply for purposes of notices and the sending of documents under this section. (2003-232, s. 2; 2005-244, s. 3; 2007-106, s. 46.)

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

(a) If any trustee desires to (i) convert an income trust to a total return unitrust, (ii) reconvert a total return unitrust to an income trust, or (iii) change the percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust but does not have the ability to or elects not to do it under G.S. 37A-1-104.2, the trustee may petition the court for an order as the trustee considers appropriate. In the event, however, there is only one trustee of the trust and the trustee is an interested trustee or in the event there are two or more trustees of the trust and a majority of them are interested trustees, the court, in its own discretion or on the petition of the trustee or trustees or any person interested in the trust, may appoint a disinterested person who, acting in a fiduciary capacity, shall present information to the court as shall be necessary to enable the court to make its determinations under this Part.

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

(c) All proceedings under this section shall be conducted as provided in Article 2 of Chapter 36C of the General Statutes. (2003-232, s. 2; 2007-106, s. 47.)

§ 37A-1-104.4. Determination of unitrust amount.

(a) The fair market value of the trust shall be determined at least annually, using a valuation date selected by the trustee in its discretion. The trustee, in its discretion, may use an average of the fair market value on the same valuation date for the current fiscal year and not more than three preceding fiscal years, if the use of this average appears desirable to reduce the impact of fluctuations in market value on the unitrust amount. Assets for which a fair market value cannot be readily ascertained shall be valued using valuation methods as are considered reasonable and appropriate by the trustee. Assets, such as a residence or tangible personal property, used by the trust beneficiary may be excluded from the fair market value for computing the unitrust amount.

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

(c) Repealed by Session Laws 2005-244, s. 4, effective July 30, 2005. See notes for applicability language.

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

(1) Shall consider the unitrust amount as paid from net accounting income determined as if the trust were not a unitrust;
(2) Shall then consider the unitrust amount as paid from ordinary income not allocable to net accounting income;
(3) May, in the trustee's discretion, consider the unitrust amount as paid from net short-term gain described in section 1222(5) of the Code and then from net long-term capital gain described in section 1222(7) of the Code so long as the discretionary power is exercised consistently and in a reasonable and impartial manner, but the amount so paid from net capital gains may not be greater than the excess of the unitrust amount over the amount of distributable net income as defined in section 643(a) of the Code without regard to section 1.643(a)-3(b) of the Treasury Regulations, as amended from time to time; and
(4) Shall then consider the unitrust amount as coming from the principal of the trust. (2003-232, s. 2; 2005-244, s. 4; 2007-106, ss. 48, 49.)

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

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

(1) The effective date of the conversion;
(2) The timing of distributions, including provisions for prorating a distribution for a short year in which a beneficiary's right to payments commences or ceases;
(3) Whether distributions are to be made in cash or in kind or partly in cash and partly in kind;
(4) If the trust is reconverted to an income trust, the effective date of the reconversion; and
(5) Any other administrative issues as may be necessary or appropriate to carry out the purposes of this Part. (2003-232, s. 2.)

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

Conversion to a total return unitrust under this Part shall not affect any other provision of the governing instrument, if any, regarding distributions of principal. For purposes of this Part, the distribution of a unitrust amount is considered a distribution of income and not of principal. (2003-232, s. 2.)

§ 37A-1-104.7: Repealed by Session Laws 2007-106, s. 49.1, effective October 1, 2007.

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

No trustee or disinterested person who in good faith takes or fails to take any action under this Part shall be liable to any person affected by the action or inaction, regardless of whether the person received written notice as provided in this Part and regardless of whether the person was under a legal disability at the time of the delivery of the notice. The exclusive remedy for any person affected by an action or inaction shall be to obtain an order of the court directing the trustee (i) to convert an income trust to a total return unitrust, (ii) to reconvert from a total return unitrust to an income trust, or (iii) to change the percentage used to calculate the unitrust amount. (2003-232, s. 2.)

§ 37A-1-104.9. Applicability.

This Part shall apply to all trusts in existence on, or created after January 1, 2004, unless (i) the governing instrument contains a provision clearly expressing the settlor's intention that the current beneficiary or beneficiaries are to receive an amount other than a reasonable current return from the trust, (ii) the trust is a trust described in section 170(f)(2)(B), section 664(d), section 2702(a)(3), or section 2702(b) of the Code, (iii) the trust is a trust under which any amount is, or has been in the past, set aside permanently for charitable purposes unless the income from the trust also is devoted permanently to charitable purposes, or (iv) the governing instrument expressly prohibits use of this Part by specific reference to this Part, or expressly states the settlor's intent that net income not be calculated as a unitrust amount. A provision in the governing instrument that "the provisions of Part 2 of Article 1 of Chapter 37A of the General Statutes or any corresponding provision of future law, shall not be used in the administration of this trust." or "the trustee shall not determine the distributions to the income beneficiary as a unitrust amount." or similar words reflecting that intent is sufficient to preclude the use of this Part. (2003-232, s. 2; 2005-244, s. 5; 2007-106, s. 50.)

Part 2A. Express Total Return Unitrusts.

§ 37A-1-104.21. Definitions.

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

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

(c) "Treasury regulations" means the treasury regulations described in G.S. 37A-1-104.1(9a). (2005-244, s. 6.)

§ 37A-1-104.22. Determination of unitrust amount.

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

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

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

(2) Assets, such as a residence property or tangible personal property, used by the trust beneficiary entitled to the unitrust amount may be excluded from the net fair market value for computing the unitrust amount. (2005-244, s. 6.)

§ 37A-1-104.23. Effect of distribution of unitrust amount.

The distribution from an express total return unitrust of the fixed percentage of not less than three percent (3%) nor more than five percent (5%) reasonably apportions between the income beneficiaries and remaindermen the total return of an express total return unitrust. (2005-244, s. 6.)

§ 37A-1-104.24. Change or conversion of unitrust amount.

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

(b) If the terms of the governing instrument of an express total return unitrust do not specifically or by reference to G.S. 37A-1-104.2 grant a power to the trustee to change the unitrust percentage or change to an income trust, the trustee shall not have that power. (2005-244, s. 6.)

§ 37A-1-104.25. Determination of character of unitrust amount.

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

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

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

(3) May, in the trustee's discretion, consider the unitrust amount as paid from net short-term gain described in section 1222(5) of the Code and then from net long-term capital gain described in section 1222(7) of the Code so long as this discretionary power is exercised consistently and in a reasonable and impartial manner, but the amount so paid from net capital gains may not be greater than the excess of the unitrust amount over the amount of distributable net income as defined in section 643(a) of the Code without regard to section 1.643(a)-3(b) of the treasury regulations; and

(4) Shall then consider the unitrust amount as coming from the principal of the trust. (2005-244, s. 6.)

§ 37A-1-104.26. Unitrust amount in excess of a five percent payout.

A trust that provides for a fixed percentage payout in excess of five percent (5%) per year is considered an express total return unitrust that pays out a fixed percentage of five percent (5%) per year and pays out principal to the extent that the fixed percentage payout exceeds five percent (5%) per year. (2005-244, s. 6.)

Part 3. Judicial Control of Discretionary Power.

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

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

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

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

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

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

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

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

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

(d) Upon petition by the fiduciary, the court having jurisdiction over a trust or estate shall determine whether a proposed exercise or nonexercise by the fiduciary of a discretionary power conferred by this Chapter will result in an abuse of the fiduciary's discretion. If the petition describes the proposed exercise or nonexercise of the power and contains sufficient information to inform the beneficiaries of the reasons for the proposal, the facts upon which the fiduciary relies, and an explanation of how the income and remainder beneficiaries will be affected by the proposed exercise or nonexercise of the power, a beneficiary who challenges the proposed exercise or nonexercise has the burden of establishing that it will result in an abuse of discretion. (2003-232, s. 2.)

Article 2.

Decedent's Estate or Terminating Income Interest.

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

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

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

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

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

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

c. Paying from principal all other disbursements made or incurred in connection with the settlement of a decedent's estate or the winding up of a terminating income interest, including debts, funeral expenses, disposition of remains, family allowances, and death taxes and related penalties that are apportioned to the estate or terminating income interest by the will, the terms of the trust, or applicable law.

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

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

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

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

(5) A fiduciary shall not reduce principal or income receipts from property described in subdivision (1) of this section because of a payment described in G.S. 37A-5-501 or G.S. 37A-5-502 to the extent that the will, the terms of the trust, or applicable law requires the fiduciary to make the payment from assets other than the property or to the extent that the fiduciary recovers or expects to recover the payment from a third party. The net income and principal receipts from the property are determined by including all of the amounts the fiduciary receives or pays with respect to the property, whether those amounts accrued or became due before, on, or after the date of a decedent's death or an income interest's terminating event, and by making a reasonable provision for amounts that the fiduciary believes the estate or terminating income interest may become obligated to pay after the property is distributed. (2003-232, s. 2; 2011-284, s. 48.)

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

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

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

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

(2) The beneficiary's fractional interest in the undistributed principal assets shall be calculated without regard to property specifically given to a beneficiary and property required to pay pecuniary amounts not in trust to which G.S. 37A-2-201(3) applies.

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

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

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

(d) A fiduciary may apply the rules in this section, to the extent that the fiduciary considers it appropriate, to net gain or loss realized after the date of death or terminating event or earlier distribution date from the disposition of a principal asset if this section applies to the income from the asset. (2003-232, s. 2; 2006-259, s. 13(p).)

Article 3.

Apportionment at Beginning and End of Income Interest.

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

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

(b) An asset becomes subject to a trust:

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

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

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

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

(d) An income interest ends on the day before an income beneficiary dies or another terminating event occurs or on the last day of a period during which there is no beneficiary to whom a trustee may distribute income. (2003-232, s. 2.)

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

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

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

(c) An item of income or an obligation is due on the date the payer is required to make a payment. If a payment date is not stated, there is no due date for the purposes of this Chapter. Distributions to shareholders or other owners from an entity to which G.S. 37A-4-401 applies are considered to be due on the date fixed by the entity for determining who is entitled to receive the distribution or, if no date is fixed, on the declaration date for the distribution. A due date is periodic for receipts or disbursements that shall be paid at regular intervals under a lease or an obligation to pay interest or if an entity customarily makes distributions at regular intervals. (2003-232, s. 2.)

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

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

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

(c) When a trustee's obligation to pay a fixed annuity or a fixed fraction of the value of the trust's assets ends, the trustee shall prorate the final payment if and to the extent required by applicable law to accomplish a purpose of the trust or its settlor relating to income, gift, estate, or other tax requirements. (2003-232, s. 2.)

Article 4.

Allocation of Receipts During Administration of Trust.

Part 1. Receipts From Entities.

§ 37A-4-401. Character of receipts.

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

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

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

(1) Property other than money;

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

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

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

(d) Money is received in partial liquidation:

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

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

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

(f) A trustee may rely upon a statement made by an entity about the source or character of a distribution if the statement is made at or near the time of distribution by the entity's board of directors or other person or group of persons authorized to exercise powers to pay money or transfer property comparable to those of a corporation's board of directors. (2003-232, s. 2.)

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

A trustee shall allocate to income an amount received as a distribution of income from a trust or an estate in which the trust has an interest other than a purchased interest and shall allocate to principal an amount received as a distribution of principal from the trust or estate. If a trustee purchases an interest in a trust that is an investment entity, or a decedent or donor transfers an interest in a trust to a trustee, G.S. 37A-4-401 or G.S. 37A-4-415 applies to a receipt from the trust. (2003-232, s. 2.)

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

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

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

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

(1) Retail, manufacturing, service, and other traditional business activities;
(2) Farming;
(3) Raising and selling livestock and other animals;
(4) Management of rental properties;
(5) Extraction of minerals and other natural resources;
(6) Timber operations; and
(7) Activities to which G.S. 37A-4-414 applies. (2003-232, s. 2.)

Part 2. Receipts Not Normally Apportioned.

§ 37A-4-404. Principal receipts.

A trustee shall allocate to principal:

(1) To the extent not allocated to income under this Chapter, assets received from a transferor during the transferor's lifetime, a decedent's estate, a trust with a terminating income interest, or a payer under a contract naming the trust or its trustee as beneficiary;
(2) Money or other property received from the sale, exchange, liquidation, or change in form of a principal asset, including realized profit, subject to this Article;
(3) Amounts recovered from third parties to reimburse the trust because of disbursements described in G.S. 37A-5-502(a)(7) or for other reasons to the extent not based on the loss of income;
(4) Proceeds of property taken by eminent domain, but a separate award made for the loss of income with respect to an accounting period during which a current income beneficiary had a mandatory income interest is income;
(5) Net income received in an accounting period during which there is no beneficiary to whom a trustee may or shall distribute income; and
(6) Other receipts as provided in Part 3 of this Article. (2003-232, s. 2.)

§ 37A-4-405. Rental property.

To the extent that a trustee accounts for receipts from rental property under this section, the trustee shall allocate to income an amount received as rent of real or personal property, including an amount received for cancellation or renewal of a lease. An amount received as a refundable deposit, including a security deposit or a deposit that is to be applied as rent for future periods, shall be added to principal and held subject to the terms of the lease and is not available for distribution to a beneficiary until the trustee's contractual obligations have been satisfied with respect to that amount. (2003-232, s. 2.)

§ 37A-4-406. Obligation to pay money.

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

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

(c) This section does not apply to an obligation to which G.S. 37A-4-409, 37A-4-410, 37A-4-411, 37A-4-412, 37A-4-414, or 37A-4-415 applies. (2003-232, s. 2.)

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

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

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

(c) This section does not apply to a contract to which G.S. 37A-4-409 applies. (2003-232, s. 2.)

Part 3. Receipts Normally Apportioned.

§ 37A-4-408. Insubstantial allocations not required.

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

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

(2) The value of the asset producing the receipt for which the allocation would be made is less than ten percent (10%) of the total value of the trust's assets at the beginning of the accounting period. (2003-232, s. 2.)

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

(a) In this section:

(1) "Payment" means a payment that a trustee may receive over a fixed number of years or during the life of one or more individuals because of services rendered

or property transferred to the payer in exchange for future payments. The term includes a payment made in money or property from the payer's general assets or from a separate fund created by the payer. For purposes of subsections (d), (d1), (d2), and (d3) of this section, the term also includes any payment from any separate fund, regardless of the reason for the payment.

(2) "Separate fund" includes a private or commercial annuity, an individual retirement account, and a pension, profit sharing, stock-bonus, or stock-ownership plan.

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

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

(d) Except as otherwise provided in subsection (d1) of this section, subsections (d2) and (d3) of this section apply, and subsections (b) and (c) of this section do not apply in determining the allocation of a payment from a separate fund to:

(1) A trust to which an election to qualify for a marital deduction under section 2056(b)(7) of the Internal Revenue Code has been made, or

(2) A trust that qualifies for the marital deduction under section 2056(b)(5) of the Internal Revenue Code.

(d1) Subsections (d), (d2), and (d3) of this section do not apply if and to the extent that the series of payments would, without the application of subsection (d) of this section, qualify for the marital deduction under section 2056(b)(7)(C) of the Internal Revenue Code.

(d2) A trustee shall determine the internal income of each separate fund for the accounting period as if the separate fund were a trust subject to this section. Upon request of the surviving spouse, the trustee shall demand that the person administering the separate fund distribute the internal income to the trust. The trustee shall allocate a payment from the separate fund to income to the extent of the internal income of the separate fund and distribute that amount to the surviving spouse. The trustee shall allocate the balance of the payment to principal. Upon request of the surviving spouse, the trustee shall allocate principal to income to the extent that the internal income of the separate fund exceeds payments made from the separate fund to the trust during the accounting period.

(d3) If a trustee cannot determine the internal income of a separate fund but can determine the value of the separate fund, the internal income of the separate fund is deemed to equal four percent (4%) of the fund's value, according to the most recent statement of value preceding the beginning of the accounting period. If the trustee can determine neither the internal income of the separate fund nor the fund's value, the internal income of the fund is deemed to equal the product of the interest rate and the present value of the expected future payments, as determined under section 7520 of the Internal Revenue Code for the month preceding the accounting period for which the computation is made.

(e) This section does not apply to payments to which G.S. 37A-4-410 applies. (2003-232, s. 2; 2010-181, s. 3.)

§ 37A-4-410. Liquidating asset.

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

(b) A trustee shall allocate to income ten percent (10%) of the receipts from a liquidating asset and the balance to principal. (2003-232, s. 2.)

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

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

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

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

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

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

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

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

(d) If a trust owns an interest in minerals, water, or other natural resources on January 1, 2004, the trustee may allocate receipts from the interest as provided in this Chapter or in the manner used by the trustee before January 1, 2004. If the trust acquires an interest in minerals, water, or other natural resources after January 1, 2004, the trustee shall allocate receipts from the interest as provided in this Chapter. (2003-232, s. 2.)

§ 37A-4-412. Timber.

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

(1) To income to the extent that the amount of timber removed from the land does not exceed the rate of growth of the timber during the accounting periods in which a beneficiary has a mandatory income interest;
(2) To principal to the extent that the amount of timber removed from the land exceeds the rate of growth of the timber or the net receipts are from the sale of standing timber;
(3) To or between income and principal if the net receipts are from the lease of timberland or from a contract to cut timber from land owned by a trust, by determining the amount of timber removed from the land under the lease or contract and applying the rules in subdivisions (1) and (2) of this subsection; or
(4) To principal to the extent that advance payments, bonuses, and other payments are not allocated pursuant to subdivision (1), (2), or (3) of this subsection.

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

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

(d) If a trust owns an interest in timberland on January 1, 2004, the trustee may allocate net receipts from the sale of timber and related products as provided in this Chapter or in the manner used by the trustee before January 1, 2004. If the trust acquires an interest in timberland after January 1, 2004, the trustee shall allocate net receipts from the sale of timber and related products as provided in this Chapter. (2003-232, s. 2.)

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

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

(b) In cases not governed by subsection (a) of this section, proceeds from the sale or other disposition of an asset are principal without regard to the amount of income the asset produces during any accounting period. (2003-232, s. 2.)

§ 37A-4-414. Derivatives and options.

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

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

(c) If a trustee grants an option to buy property from the trust, whether or not the trust owns the property when the option is granted, grants an option that permits another person to sell property to the trust, or acquires an option to buy property for the trust or an option to sell an asset owned by the trust, and the trustee or other owner of the asset is required to deliver the asset if the option is exercised, an amount received for granting the option shall be allocated to principal. An amount paid to acquire the option shall be paid from principal. A gain or loss realized upon the exercise of an option, including an option granted to a settlor of the trust for services rendered, shall be allocated to principal. (2003-232, s. 2.)

§ 37A-4-415. Asset-backed securities.

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

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

(c) If a trust receives one or more payments in exchange for the trust's entire interest in an asset-backed security in one accounting period, the trustee shall allocate the payments to principal. If a payment is one of a series of payments that will result in the liquidation of the trust's interest in the security over more than one accounting period, the trustee shall allocate ten percent (10%) of the payment to income and the balance to principal. (2003-232, s. 2.)

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.)

Article 6.

Miscellaneous Provisions.

§ 37A-6-601. Uniformity of application and construction.

In applying and construing this Chapter, consideration shall be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it. (2003-232, s. 2.)

§ 37A-6-602. Severability clause.

If any provision of this Chapter or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this Chapter that can be given effect without the invalid provision or application, and to this end the provisions of this Chapter are severable. (2003-232, s. 2.)