

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2003

S

1

SENATE BILL 549

Short Title: Uniform Principal and Income Act.

(Public)

Sponsors: Senator Hagan.

Referred to: Judiciary II.

March 27, 2003

1 A BILL TO BE ENTITLED
2 AN ACT TO ADOPT THE REVISED UNIFORM PRINCIPAL AND INCOME ACT.
3 The General Assembly of North Carolina enacts:

4 **SECTION 1.** The General Statutes are amended by adding a new Chapter to
5 read:

6 **Chapter 37A.**
7 **"Uniform Principal and Income Act.**

8 **"Article 1.**

9 **"Definitions and Fiduciary Duties; Conversion to Unitrust; Judicial Control of**

10 **"Discretionary Power.**

11 **"Part 1. Definitions.**

12 **"§ 37A-1-101. Short title.**

13 This Chapter may be cited as the Uniform Principal and Income Act.

14 **"§ 37A-1-102. Definitions.**

15 In this [Act]:

- 16 (1) "Accounting period" means a calendar year unless another 12-month
17 period is selected by a fiduciary. The term includes a portion of a
18 calendar year or other 12-month period that begins when an income
19 interest begins or ends when an income interest ends.
- 20 (2) "Beneficiary" includes, in the case of a decedent's estate, an heir,
21 legatee, and devisee and, in the case of a trust, an income beneficiary
22 and a remainder beneficiary.
- 23 (3) "Fiduciary" means a personal representative or a trustee. The term
24 includes an executor, administrator, successor personal representative,
25 special administrator, and a person performing substantially the same
26 function.
- 27 (4) "Income" means money or property that a fiduciary receives as current
28 return from a principal asset. The term includes a portion of receipts

1 from a sale, exchange, or liquidation of a principal asset, to the extent
2 provided in Article 4.

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

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

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

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

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

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

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

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

27 (13) "Trustee" includes an original, additional, or successor trustee, whether
28 or not appointed or confirmed by a court.

29 **§ 37A-1-103. Fiduciary duties; general principles.**

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

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

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

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

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

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

9 **"§ 37A-1-104. Trustee's power to adjust.**

10 (a) A trustee may adjust between principal and income to the extent the trustee
11 considers necessary if the trustee invests and manages trust assets as a prudent investor,
12 the terms of the trust describe the amount that may or must be distributed to a
13 beneficiary by referring to the trust's income, and the trustee determines, after applying
14 the rules in G.S. 37A-1-103(a), that the trustee is unable to comply with G.S.
15 37A-1-103(b). In lieu of exercising the power to adjust, the trustee may convert the trust
16 to a unitrust as permitted under Part 2 of this Article, in which case the unitrust amount
17 shall become the net income of the trust.

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

- 21 (1) The nature, purpose, and expected duration of the trust;
- 22 (2) The intent of the grantor or settlor;
- 23 (3) The identity and circumstances of the beneficiaries;
- 24 (4) The needs for liquidity, regularity of income, and preservation and
25 appreciation of capital;
- 26 (5) The assets held in the trust; the extent to which they consist of
27 financial assets, interests in closely held enterprises, tangible and
28 intangible personal property, or real property; the extent to which an
29 asset is used by a beneficiary; and whether an asset was purchased by
30 the trustee or received from the settlor;
- 31 (6) The net amount allocated to income under the other sections of this
32 Chapter and the increase or decrease in the value of the principal
33 assets, which the trustee may estimate as to assets for which market
34 values are not readily available;
- 35 (7) Whether and to what extent the terms of the trust give the trustee the
36 power to invade principal or accumulate income or prohibit the trustee
37 from invading principal or accumulating income, and the extent to
38 which the trustee has exercised a power from time to time to invade
39 principal or accumulate income;
- 40 (8) The actual and anticipated effect of economic conditions on principal
41 and income and effects of inflation and deflation; and
- 42 (9) The anticipated tax consequences of an adjustment.

43 (c) A trustee may not make an adjustment:

1 **"§ 37A-1-104.1. Definitions.**

2 For purposes of this Part:

- 3 (1) "Code" means the Internal Revenue Code of 1986, as amended from
4 time to time, and any statutory enactment successor thereto; reference
5 to a specific section of the Code in this Part shall be deemed a
6 reference also to any successor provision dealing with the subject
7 matter of such section of the Code.
- 8 (2) "Competent beneficiary" includes:
9 a. A beneficiary who has attained his or her majority and is not
10 otherwise under a legal disability;
11 b. A court-appointed guardian of an incompetent beneficiary;
12 c. An attorney-in-fact or agent under a durable power of attorney
13 for an incompetent beneficiary;
14 d. A court-appointed guardian of a minor beneficiary's estate; and
15 e. In the case of a minor beneficiary for whom no guardian has
16 been appointed, a parent of the minor beneficiary, but only if
17 such parent does not have an interest in the estate or trust that
18 conflicts with the interest of the minor beneficiary.
- 19 (3) "Grantor" means an individual who created an inter vivos trust.
- 20 (4) "Disinterested person" means a person who is not a "related or
21 subordinate party" as defined in section 672(c) of the Code with
22 respect to the person then acting as trustee of the trust and excludes the
23 grantor of the trust and any interested trustee.
- 24 (5) "Income trust" means a trust, created by either an inter vivos or a
25 testamentary instrument, which directs or permits the trustee to
26 distribute the net income of the trust to one or more persons, either in
27 fixed proportions or in amounts or proportions determined by the
28 trustee. Notwithstanding the foregoing, no trust that may be subject to
29 taxation under section 2001 or section 2501 of the Code shall be an
30 income trust for purposes of this Part, until the expiration of the period
31 for filing the return therefor, including all extensions for such filing.
- 32 (6) "Interested distributee" means a person to whom distributions of
33 income or principal can currently be made who has the power to
34 remove the existing trustee and designate as successor a person who
35 may be a "related or subordinate party" (as defined in section 672(c) of
36 the Code) with respect to such distributee.
- 37 (7) "Interested trustee" means (i) an individual trustee to whom the net
38 income or principal of the trust can currently be distributed or would
39 be distributed if the trust were then to terminate and be distributed, (ii)
40 any trustee who may be removed and replaced by an interested
41 distributee or (iii) an individual trustee whose legal obligation to
42 support a beneficiary may be satisfied by distributions of income and
43 principal of the trust.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

5 **"§ 37A-1-104.9. Applicability.**

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

16 "Part 3. Judicial Control of Discretionary Power.

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

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

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

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

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

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

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

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

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

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

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

18 "Article 2.

19 "Decedent's Estate or Terminating Income Interest.

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

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

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

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

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

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

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

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

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

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

18 or

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

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

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

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

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

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

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

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

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

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

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

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

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

30 "Article 3.

31 "Apportionment at Beginning and End of Income Interest.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

27 "Part 2. Receipts Not Normally Apportioned.

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

29 A trustee shall allocate to principal:

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

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

4 **"§ 37A-4-405. Rental property.**

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

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

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

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

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

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

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

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

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

38 "Part 3. Receipts Normally Apportioned.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

31 **"§ 37A-4-412. Timber.**

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

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

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

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

1 under the lease or contract and applying the rules in subdivisions (1)
2 and (2) of this subsection; or

3 (4) To principal to the extent that advance payments, bonuses, and other
4 payments are not allocated pursuant to subdivisions (1), (2), or (3) of
5 this subsection.

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

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

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

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

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

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

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

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

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

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

1 option granted to a settlor of the trust for services rendered, must be allocated to
2 principal.

3 **"§ 37A-4-415. Asset-backed securities.**

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

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

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

20 "Article 5.

21 "Allocation of Disbursements During Administration of Trust.

22 **"§ 37A-5-501. Disbursements from income.**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

13 **"§ 37A-5-505. Income taxes.**

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

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

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

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

23 (2) From principal to the extent that:

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

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

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

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

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

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

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

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

