

**GENERAL ASSEMBLY OF NORTH CAROLINA  
SESSION 2005**

**SENATE BILL 461  
RATIFIED BILL**

AN ACT TO AMEND THE LAW RELATING TO UNITRUSTS.

The General Assembly of North Carolina enacts:

**SECTION 1.** G.S. 37A-1-104.1(5) reads as rewritten:

"(5) "Income trust" means a trust, created by either an inter vivos or a testamentary instrument, which directs or permits the trustee to distribute the net income of the trust to one or more persons, either in fixed proportions or in amounts or proportions determined by the trustee. Notwithstanding the foregoing, no trust that may be subject to taxation under section 2001 or section 2501 of the Code shall be an income trust for purposes of this Part, until the expiration of the period for filing the return therefor, including all extensions for the filing, 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."

**SECTION 2.** G.S. 37A-1-104.1 is amended by adding a new subdivision to read:

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

**SECTION 3.** G.S. 37A-1-104.2 reads as rewritten:

**"§ 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:

- (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 sends written notice of its intention to take the action, along with copies of the written policy and this Part, to (i) the grantor of the trust, if living, (ii) all the competent beneficiaries who are currently receiving or eligible to receive distributions of income of the trust, (iii) without regard to the exercise of a general power of appointment, all competent beneficiaries who would receive or be eligible to receive the distributions of income of the trust if the interests of the beneficiaries currently receiving or eligible to receive the income terminated at the time of the giving of the notice but the

termination of those interests would not cause the trust to terminate, (iv) without regard to the exercise of any power of appointment, all the competent beneficiaries who would receive principal of the trust if the trust were to terminate at the time of the giving of the notice (without regard to the exercise of any power of appointment) notice, and (iv) (v) all persons acting as advisor or protector of the trust;

- (3) ~~There is at least one competent beneficiary who is currently receiving or eligible to receive distributions of income of the trust and there is at least one competent beneficiary who would receive principal of the trust if the trust were to terminate at the time of the giving of the notice;~~ There is at least one competent beneficiary described in subdivision (2)(ii) of this subsection or subdivision (2)(iii) of this subsection and one competent beneficiary described in subdivision (2)(iv) of this subsection; and
- (4) No person receiving notice of the trustee's intention to take the proposed action ~~of the trustee~~ objects to the action within 60 days of receipt of the notice 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:

- (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 sends written notice of its intention to take the action, along with copies of the written policy and this Part, and the determinations of the disinterested person to (i) the grantor of the trust, if living, (ii) all the competent beneficiaries who are currently receiving or eligible to receive distributions of income of the trust, (iii) without regard to the exercise of a general power of appointment, all competent beneficiaries who would receive or be eligible to receive the distributions of income of the trust if the interests of the beneficiaries currently receiving or eligible to receive the income terminated at the time of the giving of the notice but the termination of those interests would not cause the trust to terminate, (iv) without regard to the exercise of any power of appointment, all the competent beneficiaries who would receive principal of the trust if the trust were to terminate at the time of the giving of the notice (without regard to the exercise of any power of appointment) notice, and (iv) (v) all persons acting as advisor or protector of the trust;

- (4) ~~There is at least one competent beneficiary who is currently receiving or eligible to receive distributions of income of the trust and there is at least one competent beneficiary who would receive principal of the trust if the trust were to terminate at the time of the giving of the notice; There is at least one competent beneficiary described in subdivision (3)(ii) of this subsection or subdivision (3)(iii) of this subsection and one competent beneficiary described in subdivision (3)(iv) of this subsection; and~~
- (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 of receipt of the notice 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:

- (1) Instead of sending written notice to the persons described in subdivisions (2) and (3) of subsection (a) of this section or subdivisions (2) and (3) of subsection (b) of this section, as the case may be, the trustee shall send written notice to the named charity or charities then entitled to receive income of the trust and, if no named charity or charities are entitled to receive all of the income, to the Attorney General of this State;
- (2) Subdivision (4) of subsection (a) of this section or subdivision (4) of subsection (b) of this section, as the case may be, shall not apply to this action; and
- (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."

**SECTION 4.** G.S. 37A-1-104.4 reads as rewritten:

**"§ 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. ~~These assets may be excluded from valuation, provided all income received with respect to these assets is distributed to the extent distributable in accordance with the terms of the governing instrument.~~ Assets, such as a residence or tangible personal property, used by the trust beneficiary also 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 grantor 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) In the case of a trust (i) for which a marital deduction has been taken for federal tax purposes under section 2056 or section 2523 of the Code (during the lifetime of the spouse for whom the trust was created) or (ii) a trust to which the generation skipping transfer tax due under section 2601 of the Code does not apply by reason of any effective date or transition rule, the unitrust amount in any taxable year shall not be less than the net income of the trust, determined without regard to subsection (d) of this section.~~

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

- ~~(1) Shall treat the unitrust amount as if it were net income of the trust for purposes of determining the amount available, from time to time, for distribution from the trust; and~~
- ~~(2) May allocate to trust income for each taxable year of the trust (or portion of that year) (i) net short term capital gain described in section 1222(5) of the Code for that year or portion of that year, but only to the extent that the amount allocated together with all other amounts allocated to trust income for that year or portion of that year does not exceed the unitrust amount for that year or portion of that year; and (ii) net long term capital gain described in section 1222(7) of the Code for that year or portion of that year, but only to the extent that the amount allocated together with all other amounts, including amounts described in clause (i) above, allocated to trust income for that year or portion of that year does not exceed the unitrust amount for that year or portion of that year.~~
- (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."

**SECTION 5.** G.S. 37A-1-104.9 reads as rewritten:

**"§ 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 grantor'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) ~~one or more persons to whom the trustee could distribute income has a power of withdrawal over the trust that is not subject to an ascertainable standard under section 2041 or section 2514 of the Code, or the power of withdrawal can be exercised to discharge a duty of support the person possesses, or~~ 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, Part, or expressly states the grantor'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."

**SECTION 6.** Chapter 37A of the General Statutes is amended by adding a new Part to read:

"Part 2A. Express Total Return Unitrusts.

**"§ 37A-1-104A.1. 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).

**"§ 37A-1-104A.2. 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.

**"§ 37A-1-104A.3. 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.

**"§ 37A-1-104A.4. 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.

**"§ 37A-1-104A.5. 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.

**"§ 37A-104A.6. 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."

**SECTION 7.** This act is effective when it becomes law and applies to every trust or decedent's estate existing on that date or coming into existence after that date, except as otherwise expressly provided in the will or terms of the trust or in the provisions of Chapter 37A of the General Statutes. G.S. 37A-1-104.9(iii), as rewritten in Section 5 of this act, applies retroactively to October 1, 2004, and applies to every trust or decedent's estate existing on that date or coming into existence after that date, except as otherwise expressly provided in the will or terms of the trust or in the provisions of Chapter 37A of the General Statutes.

In the General Assembly read three times and ratified this the 21<sup>st</sup> day of July, 2005.

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Marc Basnight  
President Pro Tempore of the Senate

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James B. Black  
Speaker of the House of Representatives

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Michael F. Easley  
Governor

Approved \_\_\_\_\_ .m. this \_\_\_\_\_ day of \_\_\_\_\_, 2005