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HOUSE BILL NO. 1388

AMENDMENT IN THE NATURE OF A SUBSTITUTE

(Proposed by the House Committee for Courts of Justice
on February 13, 2004)

(Patron Prior to Substitute—Delegate Janis)

A BILL to amend the Code of Virginia by adding in Article 1 of Chapter 15.1 of Title 55 a section numbered 55-277.4:1, relating to trusts; total return investing.

Be it enacted by the General Assembly of Virginia:

1. That the Code of Virginia is amended by adding in Article 1 of Chapter 15.1 of Title 55 a section numbered 55-277.4:1 as follows:

§ 55-277.4:1. Total Return Unitrust.

A. As used in this section:

1. "Disinterested person" means a person who is not a "related or subordinate party" (as defined in § 672(c) of the Internal Revenue Code, 26 U.S.C. § 1, et seq., (hereinafter referred to in this section as the "I.R.C."), and all such references shall include the specific section referred to and any successor provisions thereof) with respect to the person then acting as trustee of the trust, and excludes the grantor of the trust and any interested trustee.

2. "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, and regardless of whether the trust directs or permits the trustee to distribute the principal of the trust to one or more such persons.

3. "Interested distributee" means a person to whom distributions of income or principal can currently be made who has the power to remove the existing trustee and designate as successor a person who may be a "related or subordinate party" as defined in I.R.C. § 672(c), 26 U.S.C. § 672(c), with respect to such distributee.

4. "Interested trustee" means: (i) an individual trustee to whom the net income or principal of the trust can currently be distributed or would be distributed if the trust were then to terminate and be distributed; (ii) any trustee who may be removed and replaced by an interested distributee; or (iii) an individual trustee whose legal obligation to support a beneficiary may be satisfied by distributions of income and principal of the trust.

5. "Total return unitrust" means an income trust, which has been converted under and meets the provisions of this section.

6. "Trustee" means all persons acting as trustee of the trust, except where expressly noted otherwise, whether acting in their discretion or at the direction of one or more persons acting in a fiduciary capacity.

7. "Grantor" means an individual who created an inter vivos or a testamentary trust.

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

B. A trustee, other than an interested trustee, or where two or more persons are acting as trustee a majority of the trustees who are not an interested trustee, may, in its sole discretion and without judicial 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 such action, along with copies of such written policy and this section, to: (i) the grantor of the trust, if living; (ii) all living persons who are currently receiving or eligible to receive distributions of income of the trust; (iii) all living persons who would receive principal of the trust if the trust were to terminate at the time of the giving of such notice, without regard to the exercise of any power of appointment, or, if the trust does not provide for its termination, all living persons who would receive or be eligible to receive distributions of income or principal of the trust if the persons identified in clause (ii) of this subdivision 2 were deceased; and (iv) all persons acting as advisor or protector of the trust;

3. At least one person receiving notice under each of clauses (ii) and (iii) of subdivision 2 is legally competent; and

60 4. No person receiving such notice objects, by written instrument delivered to the trustee, to the
61 proposed action of the trustee within 60 days of receipt of such notice.

62 C. If there is no trustee of the trust other than an interested trustee, the interested trustee or, where
63 two or more persons are acting as trustee and are interested trustees, a majority of such interested
64 trustees may, in its sole discretion and without judicial approval, (i) convert an income trust to a total
65 return unitrust; (ii) reconvert a total return unitrust to an income trust; or (iii) change the percentage
66 used to calculate the unitrust amount or the method used to determine the fair market value of the trust
67 if:

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

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

78 3. The trustee sends written notice of its intention to take such action, along with copies of such
79 written policy and this section, to: (i) the grantor of the trust, if living; (ii) all living persons who are
80 currently receiving or eligible to receive distributions of income of the trust; (iii) all living persons who
81 would receive principal of the trust if the trust were to terminate at the time of the giving of such
82 notice, without regard to the exercise of any power of appointment, or, if the trust does not provide for
83 its termination, all living persons who would receive or be eligible to receive distributions of income or
84 principal of the trust if the persons identified in clause (ii) of this subdivision 3 were deceased; and (iv)
85 all persons acting as advisor or protector of the trust;

86 4. At least one person receiving notice under each of clauses (ii) and (iii) of subdivision 3 is legally
87 competent; and

88 5. No person receiving such notice objects, by written instrument delivered to the trustee, to the
89 proposed action of the trustee within 60 days of receipt of such notice.

90 D. If any trustee desires to convert an income trust to a total return unitrust, reconvert a total return
91 unitrust to an income trust, or change the percentage used to calculate the unitrust amount or the
92 method used to determine the fair market value of the trust but does not have the ability to or elects not
93 to do it under the provisions of subsections B or C above, the trustee may petition the circuit court in
94 which the trustee qualified, or if there is no such qualification, the circuit court for the jurisdiction in
95 which the trustee or beneficiary resides, or if the trustee is a corporate trustee and there is no resident
96 beneficiary, the circuit court where the trust account is administered, for such order as the trustee
97 deems appropriate. In the event, however, there is only one trustee of such trust and such trustee is an
98 interested trustee or in the event there are two or more trustees of such trust and a majority of them are
99 interested trustees, the court, in its own discretion or on the petition of such trustee or trustees or any
100 person interested in the trust, may appoint a disinterested person who, acting in a fiduciary capacity,
101 shall present such information to the court as shall be necessary to enable the court to make its
102 determinations hereunder.

103 E. The fair market value of the trust shall be determined at least annually, using such valuation date
104 or dates or averages of valuation dates as are deemed appropriate. Assets for which a fair market value
105 cannot be readily ascertained shall be valued using such valuation methods as are deemed reasonable
106 and appropriate. Such assets may be excluded from valuation, provided all income received with respect
107 to such assets is distributed to the extent distributable in accordance with the terms of the governing
108 instrument.

109 F. The percentage to be used in determining the unitrust amount shall be a reasonable current
110 return from the trust, in any event no less than three percent nor more than five percent, taking into
111 account the intentions of the grantor of the trust as expressed in the governing instrument, the needs of
112 the beneficiaries, general economic conditions, projected current earnings and appreciation for the trust,
113 and projected inflation and its impact on the trust.

114 G. Following the conversion of an income trust to a total return unitrust, the trustee:

115 1. Shall treat the unitrust amount as if it were net income of the trust for purposes of determining
116 the amount available, from time to time, for distribution from the trust; and

117 2. May allocate to trust income for each taxable year of the trust, or portion thereof:

118 (i) net short-term capital gain described in I.R.C. § 1222(5), 26 U.S.C. § 1222(5), for such year or
119 portion thereof, but only to the extent that the amount so allocated together with all other amounts
120 allocated to trust income for such year or portion thereof does not exceed the unitrust amount for such
121 year or portion thereof; and

(ii) net long-term capital gain described in I.R.C. § 1222(7), 26 U.S.C. § 1222(7), for such year or portion thereof but only to the extent that the amount so allocated together with all other amounts, including amounts described in clause (i) of this subdivision, allocated to trust income for such year, or portion thereof, does not exceed the unitrust amount for such year, or portion thereof.

3. Shall treat the unitrust amount as if it were income of the trust for purposes of determining the amount of trustee compensation where the governing instrument directs that such compensation be based wholly or partially on income.

H. In administering a total return unitrust, the trustee may, in its sole discretion but subject to the provisions of the governing instrument, determine: (i) the effective date of the conversion; (ii) 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; (iii) whether distributions are to be made in cash or in kind or partly in cash and partly in kind; (iv) if the trust is reconverted to an income trust, the effective date of such reconversion; and (v) such other administrative matters as may be necessary or appropriate to carry out the purposes of this section.

I. Conversion to a total return unitrust under the provisions of this section shall not affect any other provision of the governing instrument, if any, regarding distributions of principal.

J. This section shall be construed as pertaining to the administration of a trust and shall be available to any trust that is administered under Virginia law unless:

1. The governing instrument reflects an intention that the current beneficiary or beneficiaries are to receive an amount other than a reasonable current return from the trust;

2. The trust is a trust described in I.R.C. § 170(f)(2)(B) or § 664(d), 26 U.S.C. § 170(f)(2)(B) or § 664(d); or

3. The governing instrument expressly prohibits use of this section by specific reference to this section or expressly reflects the grantor's intent that net income not be calculated as a unitrust amount. A provision in the governing instrument that "The provisions of § 55-277.4:1, Code of Virginia, as amended, or any corresponding provision of future law, shall not be used in the administration of this trust," or "My trustee shall not determine the distributions to the income beneficiary as a unitrust amount", or similar words reflecting such intent shall be sufficient to preclude the use of this section.

K. Any trustee or disinterested person who in good faith takes or fails to take any action under this section shall not be liable to any person affected by such action or inaction, regardless of whether such person received written notice as provided in this section and regardless of whether such person was under a legal disability at the time of the delivery of such notice. Such person's exclusive remedy shall be to obtain an order of the court directing the trustee to convert an income trust to a total return unitrust, to reconvert from a total return unitrust to an income trust or to change the percentage used to calculate the unitrust amount.

2. That this act shall be applicable to trusts in existence at the date of passage of this act.