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HOUSE BILL NO. 2435

AMENDMENT IN THE NATURE OF A SUBSTITUTE

(Proposed by the House Committee for Courts of Justice
on February 6, 2009)

(Patron Prior to Substitute—Delegate Janis)

A BILL to amend and reenact §§ 55-277.4:1, 55-277.18, and 55-277.29 of the Code of Virginia, relating to the Uniform Principal and Income Act.

Be it enacted by the General Assembly of Virginia:

1. That §§ 55-277.4:1, 55-277.18, and 55-277.29 of the Code of Virginia are amended and reenacted 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. "Grantor" means an individual who created an inter vivos or a testamentary trust.

3. "Grantor-created unitrust" means a trust, created either by an inter vivos or a testamentary instrument, which provides that the trust shall be administered in the manner of a total return unitrust as provided in this section.

24. "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.

35. "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.

46. "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.

57. "Total return unitrust" means (i) an income trust, which has been converted under and meets the provisions of this section; or (ii) a grantor-created unitrust.

68. "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.

89. "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 trustees the trustee that is not an interested trustee, or where more than two 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~~ convert 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 in a manner authorized under § 55-541.09 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

60 the trust does not provide for its termination, all living persons who would receive or be eligible to
61 receive distributions of income or principal of the trust if the persons identified in clause (ii) of this
62 subdivision 2 were deceased; and (iv) without regard to the exercise of any power of appointment, the
63 qualified beneficiaries of the trust then determined under §§ 55-541.03 and 55-541.10, other than the
64 attorney general of the Commonwealth; and (iii) all persons acting as advisor or protector of the trust.
65 The representation provisions of §§ 55-543.01, 55-543.03, 55-543.04, and 55-543.05 shall apply to
66 notice under this subdivision;

67 3. At least one ~~person~~ member of each class of qualified beneficiaries receiving notice under each of
68 clauses clause (ii) and (iii) of subdivision 2 is (i) legally competent, (ii) in the case of a charitable
69 organization, then existing, or (iii) represented in the manner set forth in subdivision 2; and

70 4. No person receiving such notice objects, by written instrument delivered to the trustee, to the
71 proposed action of the trustee within 60 30 days of receipt of such notice.

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

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

84 2. The trustee appoints a disinterested person who, in its sole discretion but acting in a fiduciary
85 capacity, ~~determines for the trustee~~: (i) in the case of conversion to a total return unitrust, determines
86 for the trustee (a) the percentage to be used to calculate the unitrust amount; ~~(ii)~~, (b) the method to be
87 used in determining the fair market value of the trust; ~~and (iii)~~, and (c) which assets, if any, are to be
88 excluded in determining the unitrust amount; and (ii) determines for the trustee that conversion is in the
89 best interests of the trust;

90 3. The trustee sends ~~written~~ notice in a manner authorized under § 55-541.09 of its intention to take
91 such action, along with copies of such written policy and this section, to: (i) the grantor of the trust, if
92 living; (ii) all living persons who are currently receiving or eligible to receive distributions of income of
93 the trust; (iii) all living persons who would receive principal of the trust if the trust were to terminate at
94 the time of the giving of such notice, without regard to the exercise of any power of appointment, or, if
95 the trust does not provide for its termination, all living persons who would receive or be eligible to
96 receive distributions of income or principal of the trust if the persons identified in clause (ii) of this
97 subdivision 3 were deceased; and (iv) without regard to the exercise of any power of appointment, the
98 qualified beneficiaries of the trust then determined under §§ 55-541.03 and 55-541.10, other than the
99 attorney general of the Commonwealth; and (iii) all persons acting as advisor or protector of the trust.
100 The representation provisions of §§ 55-543.01, 55-543.03, 55-543.04, and 55-543.05 shall apply to
101 notice under this subdivision;

102 4. At least one ~~person~~ member of each class of qualified beneficiaries receiving notice under each of
103 clauses clause (ii) and (iii) of subdivision 3 is (i) legally competent, (ii) in the case of a charitable
104 organization, then existing, or (iii) represented in the manner set forth in subdivision 3; and

105 5. No person receiving such notice objects, by written instrument delivered to the trustee, to the
106 proposed action of the trustee or the determinations of the disinterested person within 60 30 days of
107 receipt of such notice.

108 D. If any trustee desires to convert an income trust to a total return unitrust, ~~reconvert~~ convert a total
109 return unitrust to an income trust, or change the percentage used to calculate the unitrust amount or the
110 method used to determine the fair market value of the trust but does not have the ability to or elects not
111 to do it under the provisions of subsections B or C above, the trustee may petition the circuit court in
112 which the trustee qualified, or if there is no such qualification, the circuit court for the jurisdiction in
113 which the trustee or beneficiary resides, or if the trustee is a corporate trustee and there is no resident
114 beneficiary, the circuit court where the trust account is administered, for such order as the trustee deems
115 appropriate. In the event, however, there is only one trustee of such trust and such trustee is an
116 interested trustee or in the event there are two or more trustees of such trust and a majority of them are
117 interested trustees, the court, in its own discretion or on the petition of such trustee or trustees or any
118 person interested in the trust, may appoint a disinterested person who, acting in a fiduciary capacity,
119 shall present such information to the court as shall be necessary to enable the court to make its
120 determinations hereunder. Any qualified beneficiary of the trust then determined under §§ 55-541.03 and
121 55-541.10, other than the attorney general of the Commonwealth, may also petition such circuit court to

convert an income trust to a total return unitrust, convert a total return unitrust to an income trust, or change the percentage used to calculate the unitrust amount or the method used to determine the fair market value of the trust assets.

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

F. The percentage to be used in determining the unitrust amount shall be a reasonable current return from the trust, in any event no less than three percent nor more than five percent, *either as provided by the grantor in the governing instrument in the case of a grantor-created unitrust, or otherwise* 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.

G. Following the conversion of an income trust to a total return unitrust, *or upon the creation of a grantor-created 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 the distribution of the unitrust amount shall be considered in full satisfaction of the distribution of all of the net income of the trust*;

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

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

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) *if the trust is converted to a total return unitrust*, 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~~ *converted* to an income trust, the effective date of such ~~reconversion~~ *conversion*; 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~~ *Subject to the provisions of the governing instrument*, 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, *regardless of the date the trust was created*, 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~~ *pooled income fund* described in I.R.C. § 170 (f) (2) (B) ~~or § 664 (d)~~, 26 U.S.C. § 170 (f) (2) (B) ~~or § 664 (d)~~ 642(c)(5), 26 U.S.C. § 642(c)(5), *or a charitable-remainder trust described in I.R.C. § 664(d), 26 U.S.C. § 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

183 unitrust, to ~~reconvert~~ convert from a total return unitrust to an income trust or to change the percentage
184 used to calculate the unitrust amount.

185 § 55-277.18. Deferred compensation, annuities, and similar payments.

186 A. In this section, "payment" means a payment that a trustee may receive over a fixed number of
187 years or during the life of one or more individuals because of services rendered or property transferred
188 to the payer in exchange for future payments. The term includes a payment made in money or property
189 from the payer's general assets or from a separate fund created by the payer, including a private or
190 commercial annuity, an individual retirement account, and a pension, profit-sharing, stock-bonus, or
191 stock-ownership plan. *For purposes of subsections D, E, F, and G, the term also includes any payment*
192 *from a separate fund, regardless of the reason for the payment.*

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

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

204 D. ~~If, to obtain an estate tax marital deduction for a trust, a trustee must allocate more of a payment~~
205 ~~to income than provided for by this section, the trustee shall allocate to income the additional amount~~
206 ~~necessary to obtain the marital deduction.~~ *Except as otherwise provided in subsection E, subsections F*
207 *and G apply, and subsections B and C do not apply, in determining the allocation of a payment made*
208 *from a separate fund to:*

209 1. *A trust to which an election to qualify for a marital deduction under § 2056(b)(7) of the Internal*
210 *Revenue Code of 1986, as amended, has been made; or*

211 2. *A trust that qualifies for the marital deduction under § 2056(b)(5) of the Internal Revenue Code of*
212 *1986, as amended.*

213 E. *Subsections D, F, and G do not apply if and to the extent that the series of payments would,*
214 *without the application of subsection D, qualify for the marital deduction under § 2056(b)(7)(C) of the*
215 *Internal Revenue Code of 1986, as amended.*

216 F. *A trustee shall determine the internal income of each separate fund for the accounting period as*
217 *if the separate fund were a trust subject to this Act. Upon request of the surviving spouse, the trustee*
218 *shall demand that the person administering the separate fund distribute the internal income to the trust.*
219 *The trustee shall allocate a payment from the separate fund to income to the extent of the internal*
220 *income of the separate fund and distribute that amount to the surviving spouse. The trustee shall*
221 *allocate the balance of the payment to principal. Upon request of the surviving spouse, the trustee shall*
222 *allocate principal to income to the extent the internal income of the separate fund exceeds payments*
223 *made from the separate fund to the trust during the accounting period.*

224 G. *If a trustee cannot determine the internal income of a separate fund but can determine the value*
225 *of the separate fund, the internal income of the separate fund is deemed to equal at least four percent of*
226 *the fund's value, according to the most recent statement of value preceding the beginning of the*
227 *accounting period. If the trustee can determine neither the internal income of the separate fund nor the*
228 *fund's value, the internal income of the fund is deemed to equal the product of the interest rate and the*
229 *present value of the expected future payments, as determined under § 7520 of the Internal Revenue Code*
230 *of 1986, as amended, for the month preceding the accounting period for which the computation is made.*

231 H. *Subsections D, E, F and G apply to a trust described in subsection D on and after the following*
232 *dates: (i) if the trust is not funded as of July 1, 2009, the date of the decedent's death, (ii) if the trust is*
233 *initially funded in the calendar year beginning January 1, 2009, the date of the decedent's death, or (iii)*
234 *if the trust is not described in (i) or (ii), January 1, 2009.*

235 ~~E I.~~ This section does not apply to ~~payments~~ a payment to which § 55-277.19 applies.

236 § 55-277.29. Income taxes.

237 A. A tax required to be paid by a trustee based on receipts allocated to income must be paid from
238 income.

239 B. A tax required to be paid by a trustee based on receipts allocated to principal must be paid from
240 principal, even if the tax is called an income tax by the taxing authority.

241 C. A tax required to be paid by a trustee on the trust's share of an entity's taxable income must be
242 paid proportionately:

243 1. From income to the extent that receipts from the entity are allocated *only* to income; ~~and~~

244 2. From principal to the extent that:

245 a. Receipts receipts from the entity are allocated *only* to principal; and
 246 b. The trust's share of the entity's taxable income exceeds the total receipts described in subdivisions
 247 1 and 2 a of this section.
 248 3. *Proportionately from principal and income to the extent that receipts from the entity are allocated*
 249 *to both income and principal; and*
 250 4. *From principal to the extent that the tax exceeds the total receipts from the entity.*
 251 D. For purposes of this section, receipts allocated to principal or income must be reduced by the
 252 amount distributed to a beneficiary from principal or income for which the trust receives a deduction in
 253 calculating the tax After applying subsections A through C, the trustee shall adjust income or principal
 254 receipts to the extent that the trust's taxes are reduced because the trust receives a deduction for
 255 payments made to a beneficiary.