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## SENATE BILL NO. 432

Senate Amendments in [ ] - January 23, 2012

A *BILL to amend and reenact §§ 55-277.26 and 55-545.05 of the Code of Virginia, relating to grantor trusts; settlor's creditors; payment of taxes.*

Patron Prior to Engrossment—Senator Stuart

Referred to Committee for Courts of Justice

**Be it enacted by the General Assembly of Virginia:****1. That §§ 55-277.26 and 55-545.05 of the Code of Virginia are amended and reenacted as follows:**

§ 55-277.26. Disbursements from principal.

A. A trustee shall make the following disbursements from principal:

1. The remaining one-half of the disbursements described in subdivisions 1 and 2 of § 55-277.25;

2. All of the trustee's compensation calculated on principal as a fee for acceptance, distribution, or termination, and disbursements made to prepare property for sale;

3. Payments on the principal of a trust debt;

4. Expenses of a proceeding that concerns primarily principal, including a proceeding to construe the trust or to protect the trust or its property;

5. Premiums paid on a policy of insurance not described in subdivision 4 of § 55-277.25 of which the trust is the owner and beneficiary;

6. Estate, inheritance, and other transfer taxes, including penalties, apportioned to the trust; and

7. Disbursements related to environmental matters, including reclamation, assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, collecting amounts from persons liable or potentially liable for the costs of those activities, penalties imposed under environmental laws or regulations and other payments made to comply with those laws or regulations, statutory or common law claims by third parties, and defending claims based on environmental matters.

B. If a principal asset is encumbered with an obligation that requires income from that asset to be paid directly to the creditor, the trustee shall transfer from principal to income an amount equal to the income paid to the creditor in reduction of the principal balance of the obligation.

C. *Notwithstanding any other provision of law and unless the governing instrument provides to the contrary, a trustee may pay from the principal of the trust from time to time (i) the federal or state income taxes, or both, imposed upon the settlor on income of the trust that is not distributed to the settlor, or (ii) such amounts that are required to reimburse the settlor for any federal or state income taxes, or both, imposed on the [ ~~settlor~~ settlor ] on income of the trust that is not distributed to the settlor. The trustee shall not have the power to make payments pursuant to this subsection with respect to any trust where a charitable income, estate, or gift tax deduction has been allowed, in whole or in part, for the contributions to such trust if the exercise of such power would limit or reduce the amount of such deduction.*

§ 55-545.05. Creditor's claim against settlor.

A. Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

1. During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.

2. With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution. *A trustee's discretionary authority to pay directly or to reimburse the settlor for any tax on trust income or principal that is payable by the settlor shall not be considered to be an amount that can be distributed to or for the settlor's benefit, and a creditor or assignee of the settlor shall not be entitled to reach any amount solely by reason of this discretionary authority.*

3. After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and statutory allowances to a surviving spouse and children including the family allowance, the right to exempt property, and the homestead allowance to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses, and allowances. This section shall not apply to life insurance proceeds under § 38.2-3122. No proceeding to subject a trustee, trust

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59 assets or distributees of such assets to such claims, costs and expenses shall be commenced unless the  
60 personal representative of the settlor has received a written demand by a surviving spouse, a creditor or  
61 one acting for a minor or dependent child of the settlor and no proceeding shall be commenced later  
62 than two years following the death of the settlor. This section shall not affect the right of a trustee to  
63 make distributions required or permitted by the terms of the trust prior to being served with process in a  
64 proceeding brought by the personal representative.

65 B. For purposes of this section:

66 1. During the period the power may be exercised, the holder of a power of withdrawal is treated in  
67 the same manner as the settlor of a revocable trust to the extent of the property subject to the power;  
68 and

69 2. Upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust  
70 only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greatest  
71 of (i) the amount specified in § 2041(b)(2) or 2514(e) of the Internal Revenue Code of 1986, (ii) the  
72 amount specified in § 2503(b) of the Internal Revenue Code of 1986, or (iii) two times the amount  
73 specified in § 2503(b) of the Internal Revenue Code of 1986 if the donor was married at the time of the  
74 transfer to which the power of withdrawal applies.

75 3. The assets in a trust that are attributable to a contribution to an inter vivos marital deduction trust  
76 described in either § 2523(e) or (f) of the Internal Revenue Code of 1986, after the death of the spouse  
77 of the settlor of the inter vivos marital deduction trust shall be deemed to have been contributed by the  
78 settlor's spouse and not by the settlor.