Client Alert: Gift and Creditor Protection Planning with Virginia's New Self-Settled Spendthrift Trust Statute

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From a pure asset protection standpoint, Virginia is not as attractive as other jurisdictions, such as Alaska or Nevada. First, Virginia provides existing creditors with five years to set aside an existing claim, which is generally longer than the period provided by most states. Second, the grantor may not retain the power to veto trust distributions, nor may the grantor name a family member or employee as independent qualified trustee. And third, Virginia only protects the grantor's discretionary interest in the trust, which may cause some of the trust assets to be exposed to the grantor's creditors. Nevertheless, a trust properly structured under Virginia law may provide clients with adequate asset protection from the claims of future creditors.

Despite somewhat limited utility from an asset protection perspective, Virginia's new provisions create excellent wealth transfer opportunities for clients and their families. In short, clients may now make large lifetime gifts in trust for the benefit of their children and more remote descendants, yet retain a discretionary interest in such trust in case the client's financial circumstances change. The reasons for making such gifts in 2012, including the scheduled decrease in the gift tax exemption amount from $5.12 million to $1 million per person in 2013, are detailed in a recent client alert by Farhad Aghdami, which can be accessed here.

To appreciate the impact of Virginia's new self-settled spendthrift trust statute, consider a common planning scenario:

Martha owns substantial assets and would like to reduce her estate by making a gift to a trust for the benefit of her children and grandchildren. Martha understands that such gift will not only reduce her estate by the amount gifted, but also by all of the appreciation of the gifted assets over time. Martha also desires to make such gifts in 2012, in order to take advantage of the limited window of opportunity to give away $5.12 million without incurring any gift tax. Despite this, Martha is concerned that if her financial circumstances change, she may need the gifted assets at some point in the future and that she would be unable to access the funds held within the trust. Martha decides not to make a $5.12 million *gift in 2012 because she may want or need the assets in the future. The $5.12 million appreciates over the next 10 years at 7% per year, and, at Martha's death, the assets are worth $10,071,814. If the estate tax exemption drops, as scheduled in 2013, to $1 million with a top 55% marginal tax rate, Martha's heirs will pay $4,838,088 in estate tax.*

Prior to the enactment of Virginia's self-settled spendthrift trust statute, clients who sought to make substantial gifts to their families while maintaining a financial safety net had few options. Starting July 1, 2012, however, clients may make gifts to a qualified self-settled spendthrift trust, which could be structured as follows:

Martha creates a qualified self-settled spendthrift trust under Virginia Code § 55-545.03:3 and names Qualified Trustee to serve as initial trustee. The trust provides that Qualified Trustee may make distributions of income or principal to or for the benefit of Children and Grandchildren for their health, education, maintenance, and support. In addition, if an Independent Qualified Trustee is appointed, Independent Qualified Trustee may make distributions of income or principal to or for the benefit of Martha for any purpose. Assuming that Martha gifts $5.12 million into a Virginia self-settled spendthrift trust and the assets appreciate over the next 10 years at 7% per year, at Martha's death, the assets are worth $10,071,814. There is no additional estate tax on the value of the assets in the trust, which pass estate and gift tax free to Martha's heirs.

The enactment of the Virginia statute creates a compelling opportunity for clients who wish to make gifts in 2012, but who worry that they may want or need the assets at some point in the future.

Conclusion

Self-settled spendthrift trusts create immense planning opportunities for clients and their families, particularly when combined with the favorable wealth transfer tax window of opportunity in 2012. Quite simply, these trusts permit clients to "have their cake and eat it too" — not only can the trust serve as a vehicle to remove appreciating assets from a client's estate, it can also permit the client to retain access to the trust assets through a discretionary beneficial interest. We are extremely excited for the opportunities this new legislation creates, and strongly believe that the self-settled spendthrift trust provides an optimal structure to make large lifetime gifts in trust.

For more information about this topic, please contact the author or any member of the Williams Mullen Private Client & Fiduciary Services Team.

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with particular needs on specific issues should retain the services of competent counsel. For more information, please visit our website at www.williamsmullen.com or contact John H. Turner, III, 804.420.6480 or jturner@williamsmullen.com. For mailing list inquiries or to be removed from this mailing list, please contact Julie Layne at jlayne@williamsmullen.com or 804.420.6311.

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