

# Trust Topics



## Highlights of Delaware Trust and Tax Laws

This *Trust Topics* highlights a few of the favorable trust and tax laws that keep Delaware in the forefront as one of the most attractive jurisdictions for personal trusts.

Delaware has long been considered a desirable jurisdiction in which to do business. For individuals and families interested in preserving and maximizing their wealth, Delaware is the jurisdiction of choice, due to its well-developed, flexible trust and tax laws.

Some of the many benefits afforded by a Delaware trust include:

### TAX SAVINGS

**Income and capital gains tax savings.** For those individuals who live in a state that imposes a tax on trust income and capital gains, Delaware may be a particularly advantageous jurisdiction for creating an irrevocable trust. Properly structured, a Delaware trust can be administered free of Delaware income and capital gains taxes, assuming the irrevocable Delaware trust has only nonresident remainder beneficiaries. Delaware does not impose income tax on accumulated income or capital gains if the irrevocable Delaware trust has only nonresident remainder beneficiaries. In addition, Delaware imposes no income tax on required income distributions to beneficiaries not residing in Delaware.

**Transfer tax savings.** Unlike most states, Delaware law permits personal property to be held in trust indefinitely, and real property held in trust need not be distributed to beneficiaries until the expiration of 110 years. This results in distinct tax savings. For example, a generation-skipping trust, also known as a “dynasty trust,” can be created to provide for the transfer of wealth to multiple generations without transfer taxes.

**Additional tax saving benefits.** Under Delaware law, trusts are not subject to intangible personal property tax or state franchise tax, and there is no business license tax.

### ASSET PROTECTION

**For your beneficiaries.** Delaware strictly enforces spendthrift trusts—trusts specifically created to protect beneficiaries from their own imprudence or incapacity—so that creditors of your beneficiaries cannot reach the trust assets other than for spousal support obligations.

**For yourself.** Traditionally, the only way an individual could create an irrevocable trust and retain some benefits that could not be reached by creditors was to create an offshore trust. As an alternative, a Delaware law allows an individual to transfer assets to an irrevocable Delaware trust, commonly known as a “Delaware Asset Protection Trust.” Under the terms of such a trust, the settlor may continue to benefit from the assets, in

the trustee's discretion, while potentially protecting assets from most creditors. The instances in which a creditor can make claims against a trust include:

- When the claim resulted from an agreement or court order for payment of alimony, child support or property division, and
- When the claim resulted in death, personal injury or property damage on or before the assets were transferred to the trust.

Additionally, Delaware law may provide more creditor protection for your IRA than under other state laws.

### **INVESTMENT FLEXIBILITY**

**Flexibility to pursue capital growth.** Under Delaware's Total Return Unitrust statute, trustees may elect, upon proper notification to the beneficiaries, to pay out between 3% and 5% of the fair market value of trust assets to current beneficiaries. Thus, trustees can invest in assets providing long-term growth and ensure that the distribution needs of the current beneficiaries are met.

Additionally, under Delaware's power to adjust statute, trustees can adjust receipts and disbursements between income and principal. Basically, this power allows a trustee to increase the amount to be distributed to income only beneficiaries, while at the same time allowing the trustee to invest for long-term growth.

Delaware's Prudent Investor Rule allows a trustee to invest in almost any type of asset so long as the beneficiaries' needs and objectives are met. A trustee's investment performance is measured based on the trust portfolio as a whole, not on an asset-by-asset basis.

### **Flexibility to establish your own investment strategy.**

Delaware law allows a settlor to direct the trust investment strategy by express language in the governing instrument. This means that a settlor can structure his or her own investment approach, which may vary from the investment parameters authorized under Delaware's Prudent Investor Rule.

### **Flexibility to control your investments and distributions.**

Under Delaware law, a settlor can name either an individual or institution to direct the trustee on the investments. This arrangement may be particularly attractive where the settlor owns a closely held family business and wants to ensure that the business remains in the family for years to come—or that control of the business stays in the hands of specific individuals other than the trustee. The settlor may also want to use his or her own outside money manager to make trust investment decisions, leaving the administrative duties in the hands of the trustee. Should the settlor want to retain investment control, he or she may serve as the adviser without jeopardizing any potential estate planning benefits.

In Delaware, a settlor can authorize individual co-trustees, protectors or advisers to direct the trustee to make distributions to beneficiaries. Therefore, all distribution decisions can be made by someone other than the corporate trustee.

Except in cases of willful misconduct, a trustee will not be held liable for any loss resulting from complying with an investment direction or a distribution decision given or made by an authorized person. Correspondingly, an investment adviser will not be held liable for any of the trustee's non-investment activities. Generally, the fee of a Delaware corporate trustee is less when administering a trust with a directed investment adviser serving.

## **CONTROL OVER TRUST TERMS**

**Flexibility to modify the trust.** Under Delaware law, so long as certain conditions are met, a trustee has the ability to modify the trust terms by distributing the trust assets of an existing irrevocable trust to a new irrevocable trust. This is called “decanting” a trust. Otherwise, a court reformation proceeding would often be required to modify the trust terms—which could be costly, with no guarantee of success.

**Enforceability of trust terms.** Under Delaware law, beneficiary-instigated litigation may be deterred because a beneficiary’s interest will be reduced or eliminated if the will or trust’s validity is contested. This is called a No-Contest or In Terrorem Clause.

### **Ability to care for a pet or for other declared purposes.**

Delaware has enacted a statute that allows a settlor to establish a noncharitable purpose trust for the care of pets living at his or her death or for another declared purpose, such as for the maintenance of a family property.

## **CONFIDENTIAL AND EXPEDIENT JUDICIAL SETTLEMENTS**

**No duty to inform and report to beneficiaries.** Generally, a trustee has the duty to inform a beneficiary of his or her interests in a discretionary trust. In Delaware, so long as the settlor expressly provides language in the trust, the trustee has no duty to inform a beneficiary of his or her own interest in the trust “for a period of time.”

**No court filings.** In Delaware, the confidentiality of a trust agreement created outside of a will is preserved by rules waiving court filings. Additionally, trust accountings are not required to be filed with a court unless court ordered, resulting in lower costs in the administration of a trust.

**Delaware Court of Chancery is nationally renowned.** Should a court proceeding be necessary, the Delaware Court of Chancery is nationally renowned for its corporate litigation decisions, experience in fiduciary matters and its generally expeditious handling of trust issues.

## **OTHER ESTATE PLANNING OPTIONS**

Delaware law provides other estate planning vehicles such as limited partnerships and limited liability companies, business trusts and investment companies to enhance tax savings and flexibility.

For more information on the benefits of Delaware trusts, please contact your trust and estate professional or your Fiduciary Trust representative.

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## About the Authors

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