

Innovation and Flexibility under Delaware Trust Law

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Northern Trust

The Delaware Advantages

- Wealth Enhancement with Dynasty Trusts
- Trust Friendly Jurisdiction
- Administrative Trusts with Third-Party Advisers
- Freedom of Disposition 12 Del C. § 3303(a)
- Modification of Irrevocable Trusts
- Asset Protection through Self-Settled Trusts
- Savings on State Fiduciary Income Taxes
- Delaware Court of Chancery

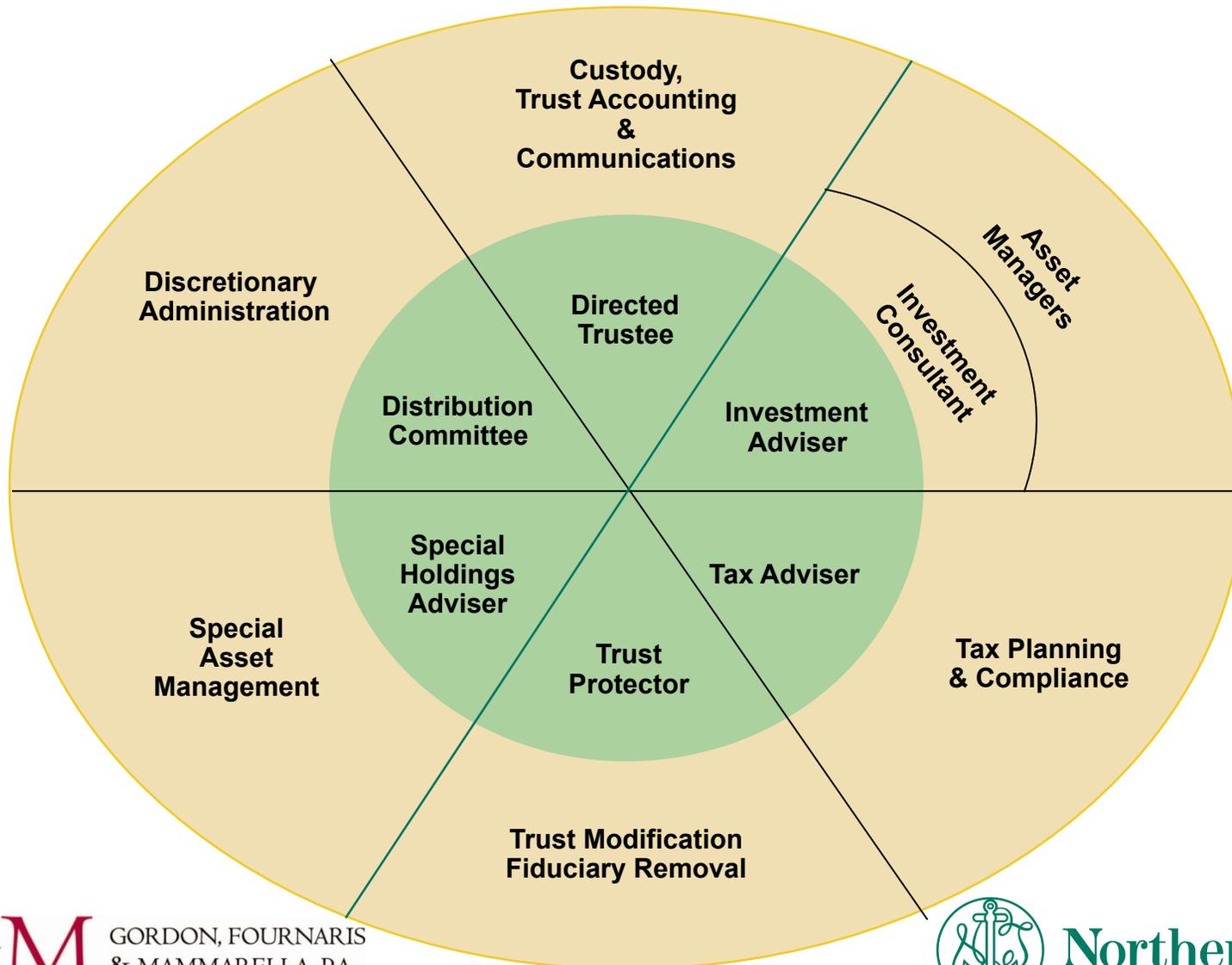
Dynasty Trusts – Post Tax Relief Act Strategies

- Gifts to grantor trusts – Client transfers up to \$5 MM to trust, pays trust's income taxes, reducing taxable estate.
- Gifts and sales to grantor trusts – Client transfers seed money in reliance on new \$5 MM exemption; client sells appreciating asset to trust in return for a note with interest at AFR.
- Gifts to asset protection trusts
 - Client utilizes new exemption to make a completed gift but remains a discretionary beneficiary to recoup assets for dire needs (after all, \$5MM isn't \$1 MM)
 - Springing asset protection trust – Trust Protector has the ability to add grantor as a permissible discretionary beneficiary

Directed Trusts

- Since 1986 Delaware law has allowed trustees to take direction from advisors (including investment advisors, distribution advisors and trust protectors), without limited liability for their decisions or results (12 Del. C. § 3303(a), 3313(b))
- Directed (or administrative) trusts represent a bifurcation of the trustee's duties, not a delegation under the Uniform Prudent Investor Act.
- Adviser liability
 - Advisers are fiduciaries by default under Delaware law, unless the governing instrument provides otherwise
 - The instrument may exonerate and indemnify advisers, except for willful misconduct

The Directed Trust as an Enterprise Trust



Client Suitability

- Investment Advisers
 - Grantors who want to fund a trust with interests in closely-held entities and want to maintain control over the management of such entities.
 - Trusts that contain a concentrated position that has historical value to the family
- Distribution Advisers
 - May be useful if grantor imposes “productivity”, “lifestyle” standards or other subjective criteria for a beneficiary’s entitlement to distributions
 - Distribution Advisers can direct the Trustee to decant the assets of the trust into a new trust

Client Suitability

- Trust Protectors
 - Useful for modification or amendment of a trust instrument to achieve a favorable tax result or improve the trust's administration, to modify a power of appointment or to give a beneficiary a power of appointment
 - When client is making a completed gift to an asset protection trust, a trust protector may have the power to add the grantor as a permissible beneficiary of the trust (the "springing asset protection trust")

Modification of Irrevocable Trusts

- Consent Petition Process – movement of trusts to Delaware and simultaneous reformation
 - Rules of the Delaware Court of Chancery
 - Notice to and consent from beneficiaries
 - Jurisdictional Issues
 - Privacy issues – all “civil miscellaneous” matters filed under seal indefinitely
 - Case study of recent movement of several family trusts to Delaware

Modification of Irrevocable Trusts

- Decanting under Delaware's decanting statute, 12 Del. C. § 3528
 - Necessary provisions
 - Trustee liability
 - Potential tax consequences of decanting

Asset Protection Trusts

- In 1997 Delaware became the second state to permit an “asset protection” trust, a trust in which the grantor retains an interest as a beneficiary.
- Currently, twelve states permit asset protection trusts in some fashion: Delaware, Alaska, Rhode Island, Nevada, Utah, Missouri, Oklahoma, South Dakota, Tennessee, Wyoming, New Hampshire and Hawaii.

Asset Protection Trusts

- With a properly structured Delaware asset protection trust, the grantor may be a beneficiary of the trust and retain certain powers over the trust.
- A creditor of the grantor will not be able to reach the trust assets unless its claim is filed within the applicable tail period and it establishes that the funding of the trust was a fraudulent transfer.

Asset Protection Trusts

- A “future creditor” can prevail only by showing, with clear and convincing evidence, that the grantor actually intended to defraud *that particular creditor* by making a transfer of assets to the trust.
- The creditor must assert its claim against the trust within a “tail period” of four years from the funding of the trust.

Asset Protection Trusts – Exempt Claims Can Reach Trust

- Two classes of claims are not subject to the tail period or the need to prove a fraudulent transfer:
 - ◆ A spouse or child with claims for alimony, support or a share of marital property in connection with a divorce or separation proceeding (*a “spouse” does not include one who marries the grantor after the transfer.*)
 - ◆ Tort claimants whose claims for death, personal injury or property damage precede the funding of the trust.

Asset Protection Trusts – Tenancy By The Entireties Trusts

- Delaware law allows co-grantors to transfer tenancy-by-the-entireties (TBE) property into an asset protection trust.
- TBE property transferred to a Delaware asset protection trust retains its TBE character until the death of the first grantor.
- Benefits of transferring TBE property to Delaware APT
 - ◆ Creditor of both grantors will have additional hurdle of proving fraudulent transfer if TBE property is held in trust.
 - ◆ If a creditor successfully reaches the assets of the trust, the sole remedy is an order directing the trustee to transfer the property to the co-grantors as TBE property.
 - ◆ When first grantor dies, TBE character is destroyed and creditor of one grantor can reach the property, but if property is held in trust, creditor will be barred from reaching the property if claim is outside tail period.

Asset Protection – Powers a Grantor May Retain

- Veto distributions from the trust
- Limited power of appointment effective on grantor's death
- Potential or actual receipt of income
- Potential or actual receipt of principal if distribution is result of trustee or distribution adviser acting
 - In trustee's or distribution adviser's sole discretion, or
 - Pursuant to a standard that does not confer on the grantor a substantially unfettered right to principal
- The right to remove a trustee or adviser and appoint a new trustee or adviser
- The right to serve as the investment adviser for the trust

Asset Protection – Powers a Grantor May Not Retain

- The power to serve as trustee of the trust
- The power to serve as a distribution adviser for the trust
- The power to serve as the trust protector for the trust
- The power to direct distributions from the trust
- The power to demand a return of assets transferred to the trust

Privacy and Confidentiality

- Delaware trusts are not subject to any public registration or filing requirements.
- In the event of litigation, the Court of Chancery routinely seals the record of trust proceedings.
- Delaware law even permits a trustee to withhold knowledge of a trust's existence from future or discretionary beneficiaries, if the grantor so directs. 12 Del. C. § 3303(a).
- Use of Designated Representative

Pre-Mortem Notice/Validation

- Delaware law permits a trustee to give interested persons notice of the creation of a trust. The notice starts a 120-day period to contest the trust.
- 12 Del. C. § 3546(a)(1) requires the notice to specify: the fact of the trust's existence, the name of the trustee, whether the person is a beneficiary, and the time allowed for initiating a proceeding to contest the validity of the trust.
- The effect of the notice statute is to compel a dissenting person to mount a challenge to the validity of the trust while the grantor is still living.

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