The Delaware Personal Trust Advantage Is Useful in Many Scenarios

An increasing number of individuals are creating dynasty trusts, asset protection trusts, and tax-advantaged trusts in Delaware. Advisors should consider the benefits of Delaware trusts in view of a client's circumstances and goals.

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An understanding of Delaware trusts is essential to every advisor who counsels clients concerning wealth transfer, asset protection, and tax minimization. This article examines the various features of Delaware personal trust and tax laws that have caused a growing number of individuals throughout the U.S. and abroad to establish trusts in, or move existing trusts to, Delaware.

Delaware offers individuals and businesses a unique climate for protecting and perpetuating wealth. It is distinguished not only for its well-known favorable corporate and tax laws, but also for its long tradition of being a leader in the field of personal trusts. The state has a history of leadership in enacting progressive legislation, such as laws permitting perpetual trusts and self-settled spendthrift trusts, adopting the prudent investor rule, and allowing conversion from income trusts to total return unitrusts. Delaware's innovative laws add flexibility and cost savings to the creation and administration of trusts. Delaware courts are knowledgeable and highly respected, and have been consistently ranked as the best in the country.[1]

Delaware's personal trust laws are generally regarded as the most advantageous in the nation. Delaware law (1) imposes no taxes on most trusts with nonresident beneficiaries, (2) permits settlors virtually unlimited discretion in establishing a trust's investment policies, (3) contains a prudent investor statute that allows trustees to invest trust assets in accordance with modern investment practices, (4) permits the settlor or investment advisors chosen by the settlor to direct the investment of trust assets, (5) protects confidentiality, and (6) contains special rules for irrevocable trusts that provide favorable income tax treatment and permit such trusts to exist in perpetuity. Because trust administration is generally not supervised by the courts, Delaware settlors can save substantial amounts in accounting and other court costs.

Delaware dynasty trusts

A dynasty trust is generally a multigenerational trust that is used to create a legacy for future generations, provide asset protection for

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beneficiaries, and, if properly structured, avoid federal transfer taxes for future generations. Many states limit the duration of trusts under the common law rule against perpetuities or a statutory version of the common law rule. Some states, including Delaware, have abolished the rule against perpetuities and permit trusts to last forever or for a very long time.[2]

Delaware law permits trusts of personal property to last in perpetuity. Trusts generally may hold real property for no more than 110 years. However, for purposes of Delaware's statute, real property does not include intangible personal property, such as an interest in a corporation, limited liability company ("LLC"), partnership, statutory trust, business trust or other entity, regardless of whether such entity is the owner of real property.[3] Consequently, a Delaware trust funded with marketable securities as well as interests in a closely held business may last forever, even if the underlying assets of the business include real property.

When creating a dynasty trust for a client, many attorneys choose the best jurisdiction for the trust in view of the client's objectives. Delaware may be the top choice for many clients because of its overall favorable trust climate as well as its flexible trust laws. For example, Delaware law gives maximum effect to the freedom of settlors to expand, restrict, eliminate or otherwise vary: (1) the rights and interests of the beneficiaries; (2) the circumstances in which the fiduciary must diversify investments; and (3) a fiduciary's powers, duties, standard of care and rights of indemnification and liability, except that a fiduciary may not be excused from liability for willful misconduct.[4]

Accordingly, Delaware may be the jurisdiction of choice for a dynasty trust if, for example, a settlor wishes to restrict the trustee's duty to disclose information about the trust to beneficiaries until a certain age, to prevent diversification of a concentrated stock position, or to prevent the sale of stock in a family business. The creation of the trust in Delaware may also minimize or even eliminate state tax on the accumulated income of the trust, thus maximizing the assets available to grow for the benefit of future beneficiaries.

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Asset protection

Certain individuals, such as physicians and other professionals, directors, and business owners are more likely than others to have their personal assets attacked by creditors. Other individuals are concerned about protecting assets from the claims of a future spouse. The challenge for the advisor is to find a way to protect assets before the potential liability materializes.

All asset protection tools, including offshore trusts, LLCs, and titling assets jointly with a spouse, have limitations and involve risks. A domestic asset protection trust ("DAPT") is generally easier and less expensive to create and administer than an offshore trust and is not subject to the same geographical or political risks. A DAPT addresses concerns about the misconduct or insolvency of a foreign trustee, the difficulty, if not impossibility, of pursuing actions against a foreign trustee for improper actions or misconduct, and the possibility of foreign trust classification for tax purposes. When balancing the risks and protections offered by offshore trusts and other asset protection techniques, the advisor may conclude that a DAPT, alone or in conjunction with one or more other techniques, best fulfills the asset protection objectives of a particular client.

Planning note. A Delaware asset protection trust should be funded with only a portion of the transferor's assets. The transferor should retain sufficient assets to cover living expenses and any current or reasonably foreseeable obligations. The assets in the trust should be regarded as an emergency or "rainy day" fund. Ideally, the assets transferred to the trust should be those that the transferor intends to pass to his/her heirs absent material unanticipated financial losses.

Delaware Qualified Dispositions in Trust Act. In 1997, Alaska and Delaware enacted the first DAPT statutes. Since then, nine other states have enacted similar laws, many of them copying Delaware's statute.[5] Delaware's Qualified Dispositions in Trust Act[6] ("the Delaware Act") has been modified and improved annually.

1 2008 U.S. Chamber of Commerce State Liability Systems Ranking Study, dated 4/15/08, www.instituteforlegalreform.com/states/lawsuitclimate2008/pdf/FullHarrisSurvey.pdf.

2 Alaska, Delaware (with respect to interests in personal property), Idaho, New Jersey, North Carolina, Pennsylvania, Rhode Island, South Dakota, and Wisconsin have abolished the rule against perpetuities. Arizona, Colorado, Illinois, Maine, Maryland, Missouri, Ohio, Nebraska, New Hampshire, Virginia, and Wyoming permit a settlor to opt out of the rule against perpetuities in varying degrees. The following states allow trusts to last for a longer period of time: Nevada (365 years), Tennessee (360 years), Utah (1,000 years), Florida (360 years), and Washington (150 years).

3 25 Del. Code § 503.

4 12 Del. Code § 3303(a).

5 In addition to Delaware and Alaska, the following states permit APTs: Nevada, Rhode Island, South Dakota, Utah, Missouri, Oklahoma, Colorado (according to some commentators), Wyoming, and Tennessee.

6 12 Del. Code § 3570 *et seq.*

Delaware law limits the rights of creditors with respect to a qualified disposition and specifically protects trustees and advisors, as well as any person involved in the counseling, drafting, preparation, execution or funding of a Delaware asset protection trust, from claims by creditors or any other person.[7]

Delaware Act requirements. A "qualified disposition" under the Delaware Act is a disposition by a transferor to a qualified trustee by means of a trust instrument.[8] A "transferor" is broadly defined to include not only individuals, but also entities. A "qualified trustee" must be either a Delaware resident individual (other than the transferor), or an entity that is authorized by Delaware law to act as a trustee and whose activities are subject to supervision by the Delaware Bank Commissioner, the FDIC, the Comptroller of the Currency, or the Office of Thrift Supervision.[9] The trust may have non-Delaware co-trustees, advisors, and trust protectors.[10]

In order for a transfer to a trust to be a qualified disposition, the trust instrument must be irrevocable and it must incorporate the law of Delaware to govern the validity, construction, and administration of the trust.[11] The trust instrument must also contain a spendthrift clause, which provides that the interest of the beneficiaries in the trust property or income may not be transferred, assigned, pledged or mortgaged, whether voluntarily or involuntarily, before the trustee actually distributes trust property or income to the beneficiary. The qualified trustee must materially participate in the administration of the trust.[12]

Settlor's retained rights. Persons considering creating a Delaware asset protection trust ("Delaware APT") often express concern about the rights and powers that may be retained after transferring assets to the trust. Of primary concern is the settlor's right to receive distributions from the trust. Under Delaware law, the settlor may retain, among other distribution rights, the following rights to distributions from the trust:[13]

- The ability to receive income or principal distributions pursuant to the trustee's or an advisor's broad discretion or a standard as determined by the trustee and/or the advisors;
- The annual right to receive current income distributions and/or a specified percentage (not in excess of 5%) of the value of trust property;
- An interest in a charitable remainder trust ("CRT");
- A qualified annuity interest in a grantor retained annuity trust ("GRAT") or a grantor retained unitrust ("GRUT"); and
- The use of real property under a qualified personal residence trust ("QPRT").

Planning note. Asset protection provisions can be incorporated into grantor retained interest trusts ("GRITs") to protect trust assets from potential creditors of the settlor. This is a compelling reason to create a charitable remainder annuity trust ("CRAT"), charitable remainder unitrust ("CRUT"), GRAT, GRIT or QPRT in, or to move such trusts to, Delaware.

Planning note. The philanthropist who wishes to defer the receipt of income until later years when he/she may be in a lower income tax bracket and/or needs supplemental retirement income should consider creating a Delaware net income with make-up CRUT ("NIMCRUT"). Under Delaware law, assets in a NIMCRUT, such as deferred annuity contracts or limited partnership ("LP") interests, will not produce trust accounting income until the trust receives a distribution. The investments may be allowed to grow tax-free for an additional period of time until the distributions begin.[14]

Delaware law permits the settlor of an APT to retain additional rights,[15] including a testamentary special power of appointment, the right to remove and replace trustees or advisors, and to appoint advisors with the authority to remove and appoint qualified trustees or trust advisors. The settlor may also retain the right to consent to or direct investments, a power that is significant when trust assets include interests in closely held businesses or real estate. Additionally, the settlor may retain the power to veto distributions, which may be important, for example, to a settlor whose child is a beneficiary of the trust. The trust instrument may also mandate distribution of income or principal to the settlor to pay income taxes on trust income.[16] If the settlor retains certain powers, such as the power to veto distributions to beneficiaries and a testamentary special power of appointment, the transfer to the trust is an incomplete gift and the trust assets will be included the settlor's estate for estate tax purposes.

Planning note. The settlor should not retain the right to serve as trustee of the APT, to direct distributions from the trust, or to get the assets back.

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7 12 Del. Code § 3572(d).
8 12 Del. Code § 3570(7).
9 12 Del. Code § 3570(8).
10 12 Del. Code § 3570(8)c and § 3570(8)f.
11 12 Del. Code § 3570(11).
12 12 Del. Code § 3570(8)b.
13 12 Del. Code § 3570(11)b.
14 Principal and Income Act, 12 Del. Code § 6112.
15 12 Del.Code § 3570(11)b.
16 12 Del. Code § 3570(11)b9.

Limitations. Property subject to a qualified disposition under Delaware law is not protected if the transfer is a fraudulent conveyance.[17] Delaware law also protects claims against such property for child support or claims of the transferor's spouse or former spouse, provided the spouse was married to the transferor at or before the time of the transfer. This limitation does not apply to any claim for forced heirship or elective share.[18] Finally, such assets are not protected from the claims of a person who suffers death, personal injury, or property damage prior to the transfer.[19]

Fraudulent conveyance. No action of any kind, including an action to enforce a judgment entered by a court, may be brought against property that is the subject of a qualified disposition, *unless* the action is to avoid the qualified disposition under Delaware's fraudulent transfer law.[20]

Planning note. Advisors should document the transferor's solvency to help defend any future fraudulent transfer claims by obtaining the transferor's financial statement and an executed Solvency Affidavit, which generally affirms the transferor's solvency before and upon the transfer, that the transferor has retained sufficient assets to pay living expenses and to satisfy any current or expected obligations, and that the transferor has no knowledge of any existing claims or judgments against him/her.

Planning note. An individual who has existing creditors should not be precluded from creating an asset protection trust to protect assets from *future* creditors. While the assets in the trust will not be protected from an existing creditor if the transfer is made with the actual intent to hinder, delay or defraud such creditor, the trust assets may nevertheless be protected from future creditors. The transferor should specifically identify existing creditors and retain sufficient assets outside the trust to satisfy claims by such creditors.

The settlor should not retain the right to serve as trustee of a Delaware asset protection trust, to direct distributions from the trust, or to get the assets back.

Four-year tail period. To void a qualified disposition, the creditor not only must prove that the transfer was fraudulent, it must also bring the claim within statutory time limitations. There is generally a four-year tail period during which the claim for fraudulent transfer must be brought.[21] If a creditor's claim arose *before* the trust's creation, however, the creditor must bring suit within four years after the trust's creation or, if later, within one year after the creditor discovered or should have discovered the transfer.[22] In cases in which a subsequent transfer is made to a previously created asset protection trust, Delaware law specifically provides that the subsequent transfer is disregarded in determining whether a creditor's claim with respect to a prior qualified disposition is brought within the four-year tail period. Any distribution to a beneficiary of the trust is deemed to be made from the latest transfer to the trust.

Effectiveness of Delaware asset protection trusts

Domestic asset protection trusts have increased in popularity. Individuals are generally inclined to choose such trusts over offshore trusts because of the ease of trust administration and the reassurance that the trustee and trust assets remain in the United States.[23] To date, nine states have followed Alaska's and Delaware's lead in permitting APTs. Creditors are deterred from pursuing claims against assets held in APTs because of the high costs and time involved in attempting to overcome the numerous hurdles and obstacles imposed by APT statutes.

Support for the use of domestic asset protection trusts can also be found in the 2005 federal Bankruptcy Act amendments, which specifically recognize such trusts. Section 548(e) of the amendments authorizes the bankruptcy trustee to avoid any transfer to a self-settled trust made within ten years of the filing of the bankruptcy petition if the transfer was fraudulent.[24] Hence, a debtor's interest in a self-settled trust should be excluded from the debtor's bankruptcy estate,[25] unless it is brought back into the estate under section 548(e).

Full Faith and Credit argument. To date, there are no reported cases testing the effectiveness of DAPTs. Some attorneys express concern that a Delaware court may be compelled to enforce a foreign judgment obtained against a Delaware asset protection trust under the Full Faith and Credit Clause of the U.S. Constitution. Such concern appears to be unfounded. As long

17 12 Del. Code § 3572(a).
18 12 Del. Code § 3573(1).
19 12 Del. Code § 3573(2).
20 6 Del. Code § § 1301—1311.
21 12 Del. Code § 3572(b)(2).
22 12 Del. Code § 3572(b)(1).
23 See e.g., Rothschild and Soukavanitch, "The United States of Asset Protection," 147 Tr. & Est. 38 (Jan. 2008).
24 11 U.S.C. § 548(e).
25 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, § 541(c)(2).

as Delaware does not discriminate against foreign judgments in applying its procedural requirements (e.g., the tail periods and fraudulent transfer standards), it passes the constitutional challenge.[26]

Furthermore, in *Lewis v. Hanson,*[27] the Delaware Supreme Court refused to enforce a Florida judgment that invalidated a Delaware trust on the ground that Delaware trusts are under the exclusive jurisdiction of Delaware courts, stating: "To give effect to the Florida judgment would be to permit a sister state to subject a Delaware trust and...trustee to a rule of law diametrically opposed to the Delaware law. It is our duty to apply Delaware law to controversies involving property located in Delaware, and not to relinquish that duty to courts of a state having at best only a shadowy pretense of jurisdiction."[28]

Hurdles and obstacles. The Delaware Act creates significant obstacles to creditors' claims and attachment of trust assets. The Act specifically limits remedies available for such judgments, such as proof of fraudulent transfer and the tail-period limitation discussed above. The creditor faces additional challenges in bringing an action against a Delaware trust before a non-Delaware court, such as lack of jurisdiction, challenge to the creditor's venue of choice, and the application of Delaware law by a non-Delaware court. Finally, if a foreign court refuses to apply Delaware law in an action seeking to satisfy the creditor's claim from the trust assets, the Delaware statute removes the trustee from office, thus preventing a creditor from obtaining relief in a foreign court that it could not obtain in a Delaware court.[29]

Structuring a Delaware APT

Most APTs are structured as incomplete gifts, and the trust assets are included in the settlor's estate for estate tax purposes. The settlor may make an incomplete gift by retaining the power to veto distributions to beneficiaries and a testamentary special power of appointment. However, the transfer to the trust may constitute a completed gift if the settlor does not retain sufficient dominion and control over the assets of the trust to prevent treatment as a completed gift. There is authority for the proposition that although the settlor has retained the right to receive distributions of income and principal in the sole discretion of the trustee, if the settlor's creditors cannot reach the assets of the trust, the grantor has made a completed gift and there should be no estate tax inclusion.

A Delaware APT may also be structured as a grantor trust or a nongrantor trust for income tax purposes. Generally, the trust will be a grantor trust and all the income, deductions, and credits of the trust will be attributed to the settlor under the grantor trust rules of IRC Section 677 because the settlor retains the right to receive distributions of income without the approval or consent of an adverse party. The trust should not be treated as a grantor trust under IRC Section 671 if the settlor does not retain any power or interest that would cause the settlor to be treated as the owner of any portion of the trust under IRC Sections 672-679. It should be possible to avoid grantor trust status under IRC Section 677 if distributions to the settlor and the settlor's spouse may be made only with the prior written consent of a person (or committee of persons) with a substantially adverse interest.

Planning note. An asset protection trust structured as a nongrantor trust should provide that members of the distribution committee composed of adverse parties are not permitted to appoint their own successors. This provides for a "shrinking" distribution committee upon the death of distribution committee members and falls squarely within Reg. 25.2514-3(b)(2), avoiding the potential for distribution committee members to be deemed to possess a general power of appointment. The distribution committee may, by unanimous vote, appoint additional distribution committee members at any time.

Tax-advantaged ('DING') trusts

Creating a trust in, or moving a trust to, Delaware can create a unique opportunity to minimize, or even eliminate, state income taxes. This opportunity arises because Delaware does not impose any income tax on the taxable income of an irrevocable trust which is accumulated for distribution in future years to nonresident beneficiaries.

Trusts that do not have Delaware resident beneficiaries will not be

[26] See, e.g., Matanuska Valley Lines, Inc. v. Molitor, 365 F. 2d 358 (CA-9, 1966), and Watkins v. Conway, 385 U.S. 188, 191, n. 4 (1966).

[27] 128 A.2d 819 (Del. Supr., 1957), *aff'd on other grounds sub nom.* Hanson v. Denckla, 357 U.S. 235 (1958).

[28] Lewis v. Hanson, 128 A.2d at 835.

[29] 12 Del. Code § 3572(g).

subject to any Delaware income tax because such trusts may take an income tax deduction for income that is actually distributed[30] as well as for the amount of income that is set aside for future distribution to nonresident beneficiaries.[31] The use of a Delaware trust, designed as a nongrantor trust and as a trust that may be funded without making a completed gift, a so-called Delaware Incomplete Gift Nongrantor Trust or "DING," may eliminate state income taxes on retained capital gains realized upon the sale of trust assets, making it attractive to closely held business owners who are considering selling their interests in the business.

Most APTs are structured as incomplete gifts, and the trust assets are included in the settlor's estate for estate tax purposes.

Example. Assume that a trust subject to New York state and city income tax sells an interest in a closely held business and realizes $5 million of long-term capital gain. The trust will pay approximately $750,000 in federal capital gains tax and $525,000 in New York state and city income tax; the net proceeds remaining will be $3,725,000. On the other hand, assume that the gain is realized in a Delaware trust and is retained for future distribution to nonresident beneficiaries. In this case, the total income tax liability would be limited to the federal tax, and the net proceeds ($4,250,000) would be increased by the amount of state income tax savings ($525,000).

Whether a particular individual can benefit from Delaware's favorable tax law depends on whether the individual's state of residence will independently impose income tax on the accumulated income of the trust because the settlor resided in that state at the time the trust became irrevocable or because of some other unavoidable connection to that state. The answer depends on the income tax laws of the individual's own state. When considering a Delaware trust, a tax advisor should be consulted concerning the income tax laws of the state of the individual's residence.

Some states, such as New York, New Jersey, Kentucky, Massachusetts, Michigan, and Missouri, require a significant and current nexus between the trust and the state in order to subject the trust to tax. In such states, it is generally possible to eliminate income tax with the creation of a Delaware trust or by moving an existing trust to Delaware.[32] Other states, such as Pennsylvania, Connecticut, Ohio, and the District of Columbia, require only a minimum nexus (such as the place of residence of the settlor) to subject the trust income to tax. Some of these states impose tax on all trust income throughout the trust's existence, even if the trustee, beneficiaries, and trust assets are located outside the state.

A constitutional challenge to the income tax laws of such minimum-nexus states has been made on due process grounds. In *Quill Corp. v. North Dakota*,[33] the U.S. Supreme Court held that the Due Process Clause of the U.S. Constitution requires minimum contacts between a state and a taxpayer to justify a state's authority to impose tax. State courts have reached different results regarding the constitutionality of similar minimum-nexus income tax statutes applicable to trusts,[34] and the Supreme Court has declined to address the issue.

In some cases, residents of minimum-nexus states may enjoy tax saving benefits by creating an irrevocable trust in Delaware with proper planning.[35] One possible strategy is to give the trustee a discretionary power to distribute all the trust assets to a new trust. Upon exercise of this power and distribution of all the assets to a new Delaware resident trust, the original trust is terminated. The new trust might not be subject to taxation by the original settlor's state of residence, depending on the laws of that jurisdiction. A similar strategy is to give a nonresident of the minimum-nexus state a limited power of appointment. Upon exercise of the power and appointment of trust assets in favor of a new Delaware trust, the original trust is terminated. Similarly, a trustee may exercise its power to decant under Delaware law and pour the assets over to a new trust created by the trustee. (Delaware's decanting statute is discussed below.)

30 30 Del. Code § 1635.

31 30 Del. Code § 1636.

32 E.g., New York law creates a statutory safe harbor which provides that New York will not impose a state income tax on a resident trust if all the following conditions are met: (1) all the trustees are domiciled outside New York; (2) the entire corpus of the trust, including real and tangible property, is located outside New York; and (3) all income and gains of the trust are derived from non-New York sources, determined as if the trust were a nonresident trust. N.Y. Tax Law § 605(b)(3)(D), N.Y. Comp. Codes, Rules and Regulations, title 20, § 105.23.

33 504 U.S. 298 (1992).

34 See, e.g., Chase Manhattan Bank v. Gavin, 733 A.2d 782 (Conn., 1999), and District of Columbia v. Chase Manhattan Bank, 689 A.2d 539 (D.C., 1997), which interpreted *Quill* to allow a state to tax based on very limited contacts with the state; but see Mercantile-Safe Deposit & Trust Co. v. Murphy, 230 N.E. 2d 490 (N.Y., 1964), which held that constitutional limitations restrict the state's ability to tax resident trusts that have minimal current contacts with the state.

35 Pulsifer and Flubacher, "Minimizing Income Taxation of Trust Income: The Delaware Advantage," 106 Probate and Trust Law Section Newsletter 8 (Philadelphia Bar Association, Winter 2003-04).

There are a few states that impose tax based on the domicile of the trustees or beneficiaries. California, for example, taxes the entire income of a trust if the beneficiary is a California resident, unless the interest of the beneficiary is "contingent." It has been suggested that proper planning and drafting may render the beneficiary's interest sufficiently contingent to avoid California tax if the beneficiary's right to receive distributions is subject to the trustee's discretion or is subject to a condition precedent, such as survival.

Direction trusts

Delaware's well-known direction statute gives added flexibility to Delaware trusts. Under Delaware law, the settlor of a trust may allocate distribution, investment, and administrative decisions among co-trustees, advisors, and/or trust protectors.[36] Thus, the settlor may appoint someone other than the trustee to make investment decisions, which is an attractive feature for trusts that are funded with special assets, such as closely held business interests, permitting the management and control of the sale of such assets by the appointed advisor. The settlor may also appoint someone who has first-hand information about the beneficiaries to make distribution decisions. A trustee who follows the direction of such an advisor will not be liable for doing so, except in the case of willful misconduct. This statutory limitation on the liability of trustees reduces trustees' concerns about accepting special assets and greatly reduces the liability and responsibilities that a trustee otherwise retains upon the delegation of its duties to a third party.

Delaware's 'decanting' statute

Problems often arise after the creation of an irrevocable trust, sometimes because of a drafting error, an apparent ambiguity, the omission of a critical provision in the trust instrument or inadequate administrative provisions. Other times after the passage of time and a change in the circumstances of a beneficiary, the intent of the settlor in creating the trust may no longer be fulfilled. In most states, the trust may be decanted under common law, or such problems may be resolved only by petitioning the appropriate court for a modification or reformation of the trust.

To create more flexibility in amending irrevocable trusts without court costs, several states have enacted what are commonly referred to as "decanting" statutes.[37] Delaware's decanting statute permits a trustee of an irrevocable trust, who has the power to invade principal, to modify the trust by "decanting," or pouring over the assets of the trust, in favor of a new trust(s) without court approval.[38] This enhances the power of a trustee to amend an irrevocable trust and avoids the court costs that would otherwise be incurred. The consent of the beneficiaries to the decanting is not required.

Delaware's decanting statute includes several specified limitations. The beneficiaries of the new or receptacle trust must be "proper objects" of the exercise of the power. While the new trust cannot add new beneficiaries, there is no requirement that the new trust must benefit all the original trust beneficiaries. The statute also specifies limitations for minor's trusts, marital deduction trusts, and trust property subject to a presently exercisable power of withdrawal held by a beneficiary who is the only trust beneficiary to whom the trustee may make distributions.

The trustee may exercise its power to decant to extend the termination date of a trust; add spendthrift provisions; create a supplemental needs trust; consolidate trust assets; modify administrative or dispositive provisions; change situs or governing law; correct drafting errors; divide property to facilitate planning strategies; divide a trust to achieve tax benefits; add a power of appointment; plan to minimize taxes; and appoint trust advisors or trust protectors. The decanting statute may also be used as a strategy to remove the nexus upon which some states base their authority to impose trust income taxes. The exercise of the power to decant should be done only after a careful consideration of the tax consequences, which may include generation-skipping transfer tax consequences.

Practice Notes
Delaware's decanting statute enhances the power of a trustee to amend an irrevocable trust and avoids the court costs that would otherwise be incurred.

Silent trusts

In most states, the trustee has a general duty to provide material information to trust beneficiaries and is generally obligated to provide complete and accurate information material to the beneficiary's status upon request. In some cases, the settlor may not wish beneficiaries to be informed of their interests in the trust. For example, a parent may not want children to know of their interests in a trust until they reach the age of majority or complete their education. Delaware is an attractive jurisdiction for the settlor who wishes to limit the trustee's duty to inform beneficiaries. Under Delaware law, the terms of a governing instrument may expand, restrict, eliminate, or otherwise vary the rights and interests of beneficiaries, including, but not limited to, the right to be informed of the beneficiary's interest for a period of time.[39]

Moving trusts to Delaware

The advantages of Delaware law may be enjoyed not only by trusts that are created under Delaware law, but also by existing trusts that may be moved to Delaware. It may be advantageous to move an existing trust to Delaware when the settlor's intent and the beneficiaries' interests may best be fulfilled under Delaware's favorable personal trust and tax law. Among the reasons to explore moving trusts to Delaware are to:

- Minimize or eliminate state income tax on the trust's accumulated income and capital gains.
- Benefit from Delaware's flexible personal trust laws, such as those permitting direction trusts and decanting.
- Extend the duration of the trust.
- Obtain more effective creditor protection for beneficiaries.
- Minimize fees and administrative costs.

Whether and how a trust may be moved to Delaware will depend on the terms of the governing instrument and applicable state law.

Additional advantages of Delaware trusts

Purpose trusts. Delaware law permits trusts for noncharitable purposes, such as a trust for the benefit of specific animals living at the time of the settlor's death; maintaining a private cemetery on family lands; maintaining and displaying a collection of fine art, antique furniture or vintage automobiles; or maintaining a family vacation residence.[40]

Private foundations. Creating a private foundation as a Delaware nonprofit trust is favorable because Delaware law gives clear guidance on fiduciary duties and there is minimal state governmental interference with the foundation's activities. The settlor, or someone the settlor designates to enforce his or her wishes, may maintain an action to enforce a charitable trust in Delaware.[41]

Surviving spouse's elective share. Under Delaware law, the surviving spouse of a Delaware decedent cannot reach trust assets by electing against the will. In addition, Delaware law does not defer to the law of a decedent's domicile to determine a surviving spouse's elective share rights.[42] By creating a trust in Delaware, an individual may be able to defeat his or her spouse's elective share rights.

Conclusion

Delaware has a long tradition as a leader in personal trust law. Delaware's award-winning courts have proven their competence and willingness to uphold the state's law even in difficult cases. An increasing number of individuals are creating dynasty trusts, asset protection trusts, and tax-advantaged ("DING") trusts in Delaware. The advisor should be knowledgeable about Delaware trusts and consider their appropriateness and benefits in view of the client's particular circumstances and goals. ■

36 12 Del. Code § 3528.

37 States that have enacted decanting statutes include New York, Delaware, Alaska, Florida, New Hampshire, Tennessee, and South Dakota.

38 12 Del. Code § 3528.

39 12 Del. Code § 3303.

40 12 Del. Code § § 3555 and 3556.

41 12 Del. Code § 3303(b).

42 12 Del. Code § § 901 and 908(b).