Delaware Trusts

Presented to The Central Texas Estate Planning Council

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Bank of America Private Wealth Management

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Why do clients choose Delaware?

Flexible Trust Structures	Favorable Trust Laws	Advantageous Tax Laws	Trust-Friendly Environment
• Directed Trusts • Use of Investment Advisors • Use of Distribution Advisors • Use of Protectors • Trust Decanting • Equitable Adjustments	• Asset Protection Trusts • Dynasty Trusts • Total Return Trusts • Purpose Trusts	• No Delaware state income tax on trusts* • No intangibles or excise taxes	• High regard for privacy and confidentiality • Well-respected Court of Chancery • Industry-leading and innovative body of trust law

* Provided beneficiaries are not residents of Delaware

Flexible trust structures — Administrative/Directed trusts

Flexibility

Clients can divide traditional trust responsibilities among multiple parties

- Administrative/Directed trustee
- Investment Advisor
- Distribution Advisor
- Trust Protector

May be used with:

- Asset Protection Trusts
- Dynasty Trusts
- Total Return Trusts
- Other Trusts

Flexible trust structures — Administrative/Directed Trusts

Defining the roles

Administrative Trustee	Investment Advisor	Distribution Advisor	Trust Protector
• Sole Trustee or Co-trustee • May or may not have discretionary distribution authority or investment authority • Fiduciary income taxes, statements, principal and income accounting • If an Investment Advisor is appointed, takes direction from Investment Advisor regarding trust assets • If a Distribution Advisor is appointed, takes direction from Distribution Advisor regarding distributions of trust income and principal	• Directs Trustee regarding investment decisions • Fiduciary capacity, unless stated otherwise in document • Responsible for investment of trust assets • Selects Investment Managers/manages assets	• Directs Trustee with respect to discretionary distributions • May be an individual or committee • May have unique family insights	• Adds flexibility to an irrevocable trust • Powers defined by trust and can be specifically tailored • May be given various powers, such as power to amend, to remove Trustee and/or change situs

Flexible trust structures — The Investment Advisor

Administrative Trustee

- Administers trust
- Legal owner of trust assets
- Custody of trust assets
- Fiduciary tax return preparation
- Principal and Income accounting and reporting
- Implements investment decisions
- Makes trust distribution of Income and Principal as required or authorized by governing trust agreement
- Other administrative duties

Investment Manager

- Works with Investment Advisor (IA)
- Manages trust assets
- IA may hire multiple Investment Managers

Investment Advisor

- Individual or Registered Investment Advisor (RIA)
- Manages assets and/or selects Investment Manager(s)
- Monitors Investment Manager(s)
- Directs Trustee to implement investment decisions

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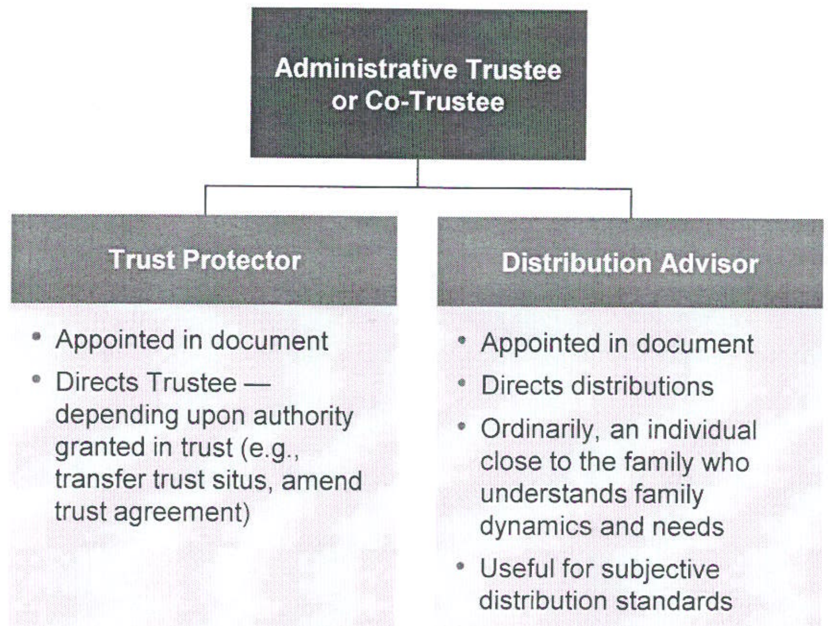
Flexible trust structures —
The Distribution Advisor and Trust Protector

- Trustee will make distributions to beneficiaries as directed by Distribution Advisor
- Trustee will take direction from Trust Protector with respect to powers granted to the Trust Protector in the trust agreement
- Trust may also have an Investment Advisor



Flexible trust structures — Case study

Administrative/Directed Trusts: planning for a family business

Andrew and Eileen, ages 57 and 55, own a profitable business. The business is now valued at $7 million. They anticipate that the value will grow over time – and that their private company may eventually be purchased by a public company. The couple wants to gift interests in the business to their children, but also wants to control decisions related to the business.

Trustee and Client Roles:

- Andrew appoints ABC Trust Company of Delaware as Administrative Trustee and names himself as Investment Advisor. The trust names Eileen as Successor Investment Advisor.

Solution:

- The clients decide to gift $2 million in closely held stock to a Delaware Administrative Trust, appointing Andrew as the Investment Advisor and Eileen as Successor Investment Advisor. Andrew maintains control over the trust investments during his life, and if Eileen survives him, she will control trust investments for the remainder of her life.
- In addition, because they control the business, they control when the earnings of the company are distributed among the shareholders (of which the trust is now one).
- ABC Trust Company of Delaware, as Administrative/Directed Trustee is responsible for all other aspects of the administration of the trust, including making mandatory and discretionary distributions of income and/or principal to the couple's children.

This story is intended to illustrate an Administrative/Directed Trust. It may not represent the experience of every client, nor does it indicate future performance or success.

Flexible trust structures — Case study
Administrative/Directed Trusts: planning for a family business (cont.)

How It Works:

- $2 million in closely held stock is transferred to trust
- Potential benefit from valuation discounts on the transferred stock
- Gift and GST tax exemptions are applied to the transfer
- All future appreciation is removed from the grantors' estates
- Trust may be perpetual (known as a "Dynasty Trust"), avoiding future transfer taxes
- Can be structured as a grantor trust for income tax purposes, if desirable — meaning that all items of taxable income, gain and loss are attributed to the grantor (leaving more assets in the trust)
- As Investment Advisors, the clients control trust investments, and their continuing control over the business allows them to decide when to distribute business earnings to shareholders
- Can make additional gifts to the trust utilizing annual gift tax exclusions if withdrawal ("Crummey") powers are conferred upon the beneficiaries (but should only be made if additional GST exemption is allocated to the contributions, as appropriate)

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Favorable and innovative trust laws

Delaware: a history of pro-trust legislation

1986

Administrative trusts

Delaware adopted Modern Portfolio Theory for trust investing and authorized trustees to follow the investment directions of an "investment advisor" named in the trust instrument, without liability for the investment results.

1995

Dynasty trusts

Delaware repealed the "Rule Against Perpetuities," enabling grantors to establish trusts that span generations and limit transfer tax exposure.

1997

Domestic asset protection trusts

The Qualified Dispositions in Trust Act authorizes self-settled asset protection trusts designed to protect assets from a client's future creditors' claims — while allowing the grantor to retain certain interests in the trust, such as the ability to receive discretionary distributions. While no court has considered the effectiveness of such a trust, Delaware offers this progressive option for clients seeking domestic asset protection strategies.

2000

Total return unitrusts

Delaware enacted the first total return unitrust statute allowing grantors to establish a unitrust and trustees to convert existing trusts to a unitrust — thus aligning the investment interests of both current beneficiaries and remaindermen.

2003

Trust decanting

Delaware created a mechanism for a trustee of an irrevocable trust to modify the terms of the trust by creating an entirely new trust and transferring the existing trust's assets to the new trust. This is a powerful tool for a trustee to have when administering long-term trusts to deal with constant legal, tax, investment or beneficiary changes that occur over time.

2008

Purpose trusts

Delaware adopted one of the first statutes allowing a client to create a trust for a noncharitable purpose that does not have a traditional identifiable beneficiary — for example, the care of pets or animals or the preservation of collections, art or real estate.

Dynasty Trust — Basics

What it is:

- A multigenerational irrevocable trust
- Also known as a "Perpetual" Trust
- Serves as resource to provide for income and support to children, grandchildren and future generations
- Can be structured to avoid or limit exposure to federal gift, estate and generation-skipping transfer (GST) taxes
- Assets placed in the trust, plus all future appreciation, will not be subject to federal estate tax in the Grantor's estate nor in any future beneficiary's estate

Dynasty Trust — Background

Old "common law" rule — No Perpetual Trusts

- Rule Against Perpetuities
- Duration of a trust was generally limited to a specified term of years based on measuring lives identified in the governing trust agreement

Introduction of current GST Tax regime in 1986

- A tax incurred upon certain transfers to members of younger generations in addition to estate tax
- GST tax on transfers that "skip" a generation
- GST exemption, currently $5 million, can be utilized during life or at death

In 1995, Delaware repealed the Rule Against Perpetuities with respect to assets held in trust (other than real estate, which can be held in trust for 110 years).

- Real estate can be placed into an entity such as an LLC to avoid the 110 year limitation

Dynasty Trust — How it works

- Irrevocable trust governed by Delaware law
- Typically funded with gift tax exemption amount (currently $1 million for an individual, $2 million for a married couple)
- GST tax exemption allocated to trust; additional funds can be added at death to take advantage of any GST exemption remaining at death
- Provides benefits to heirs, but not direct ownership
  - Protects assets from consequences of divorce, creditors and uncontrolled spending
- Additional assets can be added to the trust through the use of annual gift tax exclusion gifts if the trust confers upon beneficiaries withdrawal ("Crummey") powers; but should only be made if additional GST Exemption is allocated to the contributions as appropriate
- Life insurance and Family Limited Partnerships/LLC interests are common assets used to fund Dynasty Trusts because of the leverage that can be obtained as a result of "reduced" or potentially "discounted" values at time of funding (versus value of policy death benefit or value of underlying FLP/LLC assets)

Transfer tax benefits of a Delaware Dynasty Trust[1]

Assuming an initial transfer of $5,120,000[2]	Value of a Delaware Dynasty Trust	Value of an outright gift
End of year 1	$5,120,000	$5,120,000
End of year 20	$12,937,985	$12,937,985
End of year 40 (transfer to next generation)	$34,328,326	$22,313,412 (after transfer tax)
End of year 70 (transfer to next generation)	$148,365,046	$96,437,280
End of year 100	$641,225,181	$270,917,639 (after transfer tax)

Calculations assume a 5% rate of return after taxes and fees, a transfer tax rate of 35% and no distributions.

[1] These projections are estimates only and are based on constantly changing assumptions. Your actual results may be better or worse. Long-term financial projections cannot be made with any certainty and are never guaranteed. Always consult with your independent attorney, tax advisor, investment manager and insurance agent for final recommendations and before changing or implementing any financial, tax or estate planning strategy.

[2] Assumes $5,120,000 of GST exemption and $5,120,000 of gift tax exemption is applied to the transferred assets (fully shields the transfer from GST and gift tax).

Dynasty Trusts and the advantages of Delaware

Income Taxes	Flexibility	Privacy and Confidentiality
• Delaware does not impose a state income tax as to beneficiaries who do not live in Delaware • Grantor Trust — Grantor pays taxes on items of income and capital gain • Non-Grantor Trust — Trust pays taxes on items of income and capital gain	• Administrative/Directed Trustee • Investment Advisors • Distribution Advisors/Trust Protectors	• Court accountings are not required • Non-disclosure permitted for a period of time

Dynasty Trusts — Flexible trust structures

Dynasty Trust

Administrative/Directed Trustee

- Administers trust
- Appointed in trust
- Prepares and files trust tax returns
- Custody and record-keeping
- Principal and Income accounting
- Follows directions of Investment and Distribution Advisors

Investment Advisor

- Directs investments
- Appointed in trust
- Selects and monitors investment managers
- Open architecture

Distribution Advisor

- Directs distributions
- Appointed in trust
- Useful for subjective distribution standards

Flexible trust structures — Case study
Dynasty Trusts: keeping wealth in the family (continued)

How It Works:

- $2 million is transferred to the trust
- Gift tax and GST tax exemptions are applied
- All future appreciation is removed from grantors' estates
- Trust is perpetual, avoiding future transfer taxes
- Structured as a grantor trust for income tax purposes, if desirable
- Grantors appoint a Distribution Advisor
- Grantors make additional gifts to the trust utilizing annual gift tax exclusions if withdrawal ("Crummey") powers are conferred upon the beneficiaries (but should only be made if additional GST exemption is allocated to the contributions as appropriate)
- Grantors direct trustee to maintain confidentiality until stated ages of beneficiaries as allowed by Delaware law

This story is intended to illustrate a Dynasty Trust. It may not represent the experience of every client, nor does it indicate future performance or success.

Asset Protection Trusts

- Traditionally, an individual could **not** create a domestic trust for his or her own benefit while protecting those same trust assets from creditors
- Offshore trusts have been used for years for asset protection purposes, but may be subject to onerous tax rules and uncertainty in their effectiveness depending upon the foreign jurisdiction selected
- Delaware was one of the first jurisdictions to recognize the ability to create a domestic Asset Protection Trust (APT)

Asset Protection Trusts —
Delaware's Qualified Dispositions in Trust Act

The Basics

- Transfer assets to an irrevocable trust that contains a spendthrift clause (an APT)
- Provision that Delaware law governs the trust's validity, construction and administration
- Delaware-resident trustee
- Delaware trustee must "materially participate" in the administration of the trust

* U.S. Trust Company of Delaware is a subsidiary of Bank of America, N.A.

Asset Protection Trusts —
Delaware's Qualified Dispositions in Trust Act (continued)

An APT grantor may retain:

- The power to direct investments or consent to investments (Administrative/Directed APT)
- The power to veto distributions
- A non-general testamentary power of appointment (to avoid inclusion of assets in estate)
- The ability to change trustees or advisors (subject to certain limitations so as to avoid negative tax consequences)
- The right to receive:
  - Current income distributions
  - Income and/or principal, subject to certain standards or in the discretion of the Trustee (or a Distribution Advisor)
  - A percentage or fixed amount of the trust's fair market value that does not exceed 5%

Asset Protection Trusts — Delaware's Qualified Dispositions in Trust Act (continued)

The "Tail Period"

- Pre-transfer claims must be brought within four years of transfer to the trust (or, if later, within one year after the creditor discovered or should have discovered the trust). Creditor must prove transfer to trust was a fraudulent transfer.
- Post-transfer claims will be barred unless the creditor can prove the transfer was made with actual intent to defraud.

Exempt Classes of Creditors

- Current spouse at the time of the trust's creation, and children
- Personal injury claimants — if the injury arose at or before the transfer to the trust
- Claims related to death and to property damage

Asset Protection Trusts — Tax consequences

Income Taxes	Gift Taxes	Estate Taxes
• Grantor Trust — grantor pays taxes on items of income and capital gain • Non-Grantor Trust — trust pays taxes on items of income and capital gain • APTs are typically structured as grantor trusts for income tax purposes	• Gift tax consequences depend upon grantor's retained powers • Completed gift will be subject to gift taxes rules • No gift tax implications if there is no completed gift	• The trust will be included in grantor's estate if he or she retains the power to alter, amend, revoke or terminate the trust • It is unclear whether the sole right to receive distributions at the discretion of the trustee will cause estate tax inclusion in the grantor's estate, even if the creation of the trust was structured as a completed gift (I.R.C. 2036(a)(1))

Asset Protection Trusts — Effectiveness

- No court has ruled upon the effectiveness of a Delaware APT
- Potential areas of attack
  - Full Faith and Credit clause of the U.S. Constitution
  - Jurisdiction over a Delaware Trustee
  - Conflicts of Laws
  - Supremacy Clause and the Bankruptcy Code

Asset Protection Trusts — The bottom line

- Clients should rely upon the advice of an attorney well-versed in this area
- Clients should only fund Asset Protection Trusts with assets they do not ever expect to need — a “nest egg” approach
- Distribution requests by the Grantor should be rare and made only when necessary
- Client should not be insolvent or nearing insolvency

Putting it all together —
Delaware APT with Investment and Distribution Advisors

Asset Protection Trust Assets

Administrative/Directed Trustee

- Administers trust
- Appointed in trust
- Prepares and files trust tax returns
- Custody and record-keeping
- Principal and Income accounting
- Follows directions of Investment and Distribution Advisors

Investment Advisor

- Directs investments
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Flexible trust structures — Case study
Delaware Asset Protection Trust: the doctor's choice

Alison, a successful, unmarried doctor, has a strong plastic surgery practice. Her net worth is $25 million. To date, no lawsuit has ever been filed against her, but she is concerned about the rise in lawsuits against many of her colleagues. She meets with her attorney, advisor and trust professional to discuss her concerns.

Solution:

- Her attorney suggests a Delaware Asset Protection Trust (APT) to protect a portion of her assets from future creditors. She selects ABC Trust Company of Delaware as Administrative Trustee of her APT and a local Investment Advisor to manage and oversee trust investments.

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Flexible trust structures — Case study
Delaware Asset Protection Trust: the doctor's choice (continued)

How It Works:

- $5 million in assets is transferred to an irrevocable trust governed by Delaware law
- Client/Grantor retains the right to receive income and principal at the trustee's discretion
- An Investment Advisor is appointed in the agreement creating and governing the Trust
- The Trust is structured to be an incomplete gift so that no gift tax is incurred upon its creation or funding
- The Trust may serve as an alternative to a prenuptial agreement, should client marry in the future
- ABC Trust Company of Delaware serves as Administrative Trustee and carries out the investment directions of the Investment Advisor

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Advantageous tax laws

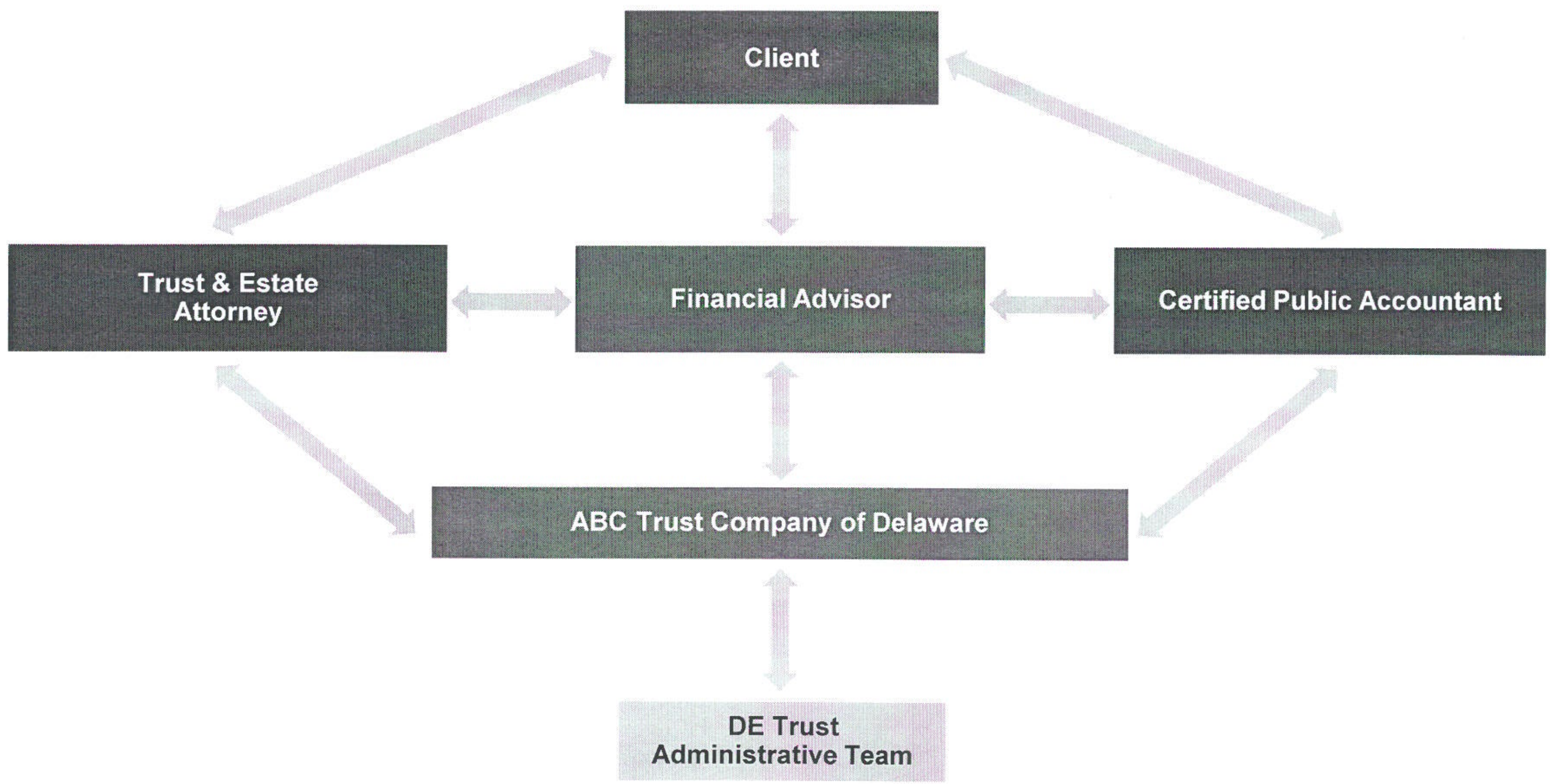
Taxes can frustrate the optimal growth of irrevocable trust assets

- Delaware does not impose an income tax on accumulated trust income or capital gains
  - This rule does not apply to trust beneficiaries who reside in Delaware
  - If possible, the trust should be structured to avoid a "nexus" to another state which may impose an income tax; some states tax trusts based on the residence of the grantor, co-trustee or beneficiary
- Delaware does not impose an intangible personal property tax

Trust-friendly environment

- Established body of industry-leading and innovative trust law professionals
- High regard for privacy and confidentiality
  - No public filings required
  - No required accountings, or accountings can be easily waived
  - Flexible rules on notifying beneficiaries about the existence of the trust
- Well-respected Court of Chancery, well-versed in complicated trust matters

Delaware Trust Company — A team approach



Accessing leading investment choices

Under Delaware law, clients have the flexibility to determine who will make investment decisions regarding their trust assets.

- Clients may appoint an "Investment Advisor" (IA) in their trust document
- IAs may include the client, another individual or a third party
- The IA can work directly with the client's advisor to access the firm's extensive investment platform

Disclosure

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