Delaware Trusts

Unique advantages for extending your legacy and protecting your wealth

U.S. TRUST

Delaware has long been recognized as a trust-friendly jurisdiction — one that may be beneficial in minimizing taxes, preserving privacy or retaining assets with special significance.

As the leading provider of personal trust services,[1] Bank of America can help you take advantage of Delaware's advantageous trust laws through U.S. Trust Company of Delaware ("U.S. Trust").[2] With extensive experience, U.S. Trust can work with you and your advisors to evaluate whether a Delaware trust could be helpful in addressing your unique needs. U.S. Trust can provide fiduciary investment management as well as comprehensive trust administration, structuring a collaborative relationship that is exclusively focused on your specific goals.

It's all part of our commitment to providing the type of exceptional service that has characterized our trust relationships for generations.

[1] Spectrem Group, "2018 Comprehensive Bank Trust Update," November, 2018.

[2] Trust and fiduciary services are provided by Bank of America, N.A., Member FDIC, or U.S. Trust Company of Delaware. Both are wholly owned subsidiaries of Bank of America Corporation.

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Investment products:

Are Not FDIC Insured	Are Not Bank Guaranteed	May Lose Value

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Delaware trusts: Advantages for extending your legacy and protecting your wealth

Tax savings and advantages

A Delaware trust may offer significant tax advantages. An irrevocable Delaware trust for a beneficiary who is not a Delaware resident may avoid state fiduciary income taxes on the trust's undistributed income and capital gains. In addition, neither a trust having its situs in Delaware nor its non-Delaware resident beneficiaries are subject to:

- Delaware taxes on trust income that is actually distributed to nonresident beneficiaries (unless it consists of "source income," income whose source is an operating business in Delaware).
- Sales or use taxes on the purchase or ownership of tangible personal property, including precious metals such as gold or silver.
- Personal property taxes or other ad valorem taxes on intangible assets.

Greater flexibility

Delaware law permits a grantor to separate the trust's investment function from its administrative responsibilities by appointing an investment advisor who has exclusive responsibility for trust investments.

A trustee who follows investment directions from a designated advisor has no liability for trust investment results. This approach also makes it easier for a Delaware trustee to hold concentrated positions, closely held assets, family businesses, interests in partnerships, LLCs and similar assets. In addition, this arrangement typically permits significantly lower fees for trustee services. Other types of advisors may also be named.

Widely recognized as the nation's leading home for large corporations, Delaware offers equally compelling advantages as a venue for personal trusts. These include favorable income tax treatment in certain instances, investment flexibility, attractive long-term planning options and asset protection.

PROFILE | Capitalizing on unusual trust flexibility

Because Delaware law allows a grantor to appoint a separate investment advisor and administrative trustee, individuals focused on the transfer of businesses and other complex assets can often structure highly customized trust solutions.

As owners of a profitable and growing business, our clients wanted to gift their appreciating interests to their children through a trust. A directed trust allowed them to appoint U.S. Trust as administrative trustee and name themselves as investment advisors. Through this structure, they continue to control investment decisions regarding the business interests owned by the trust.

Please see back cover for additional important disclosure information.

A Delaware-based trustee is required

In order to qualify for many of the advantages offered by Delaware law, the trust must be administered by a trustee located in Delaware.

If a trust is not initially created in Delaware, it may be possible to move the trust to Delaware either by following procedures spelled out in the trust agreement or state law, or through judicial proceedings.

U.S. Trust is ideally positioned to help implement wealth planning strategies that take full advantage of the jurisdiction's unique flexibility and protections.

Extended multigenerational benefits of unlimited duration through a Delaware dynasty trust

Trusts in most states are subject to the "rule against perpetuities" (RAP), which requires the trust to terminate and distribute assets after a maximum period determined by law — typically based on the lives of the individuals who were living when the trust was created. This limits the life of a trust to a few generations. Once assets are distributed by the trust, they become subject to federal, and often state, transfer taxes as the recipients die and pass those assets to the next generation. If you would like to maximize the impact that your well-earned assets can have across generations of your heirs, the RAP can frustrate that intent.

With no RAP for assets held in trust, other than real estate (limited to 110 years unless the real estate is held in an entity such as a limited liability company, in which case the 110 year limitation does not apply), Delaware is among the states that allow the creation of dynasty trusts (also known as perpetual trusts), which can continue to exist indefinitely. There are no legally mandated terminations that trigger distributions of trust assets, and therefore no termination-related transfer taxes, including, with proper planning, generation-skipping transfer taxes (GST taxes). Assets can continue to grow indefinitely rather than become subject to estate, gift and GST taxes when transferred to beneficiaries from generation to generation.

PROFILE | Looking ahead to future generations

A Delaware dynasty trust creates unique legacy and tax-planning opportunities. Our clients, a couple in their late 60s, wanted to establish a long-term family legacy while minimizing their estate taxes.

They began by making a $11.58 million gift to a Delaware dynasty trust for the benefit of their three children and two grandchildren — and for successive generations. Because they each used their $11,580,000 lifetime gift tax exemption and $11,580,000 of their generation-skipping transfer tax exemption, the transfer created no tax liability.

In addition, because the couple funded the trust during their lives, all asset growth will be excluded from their estates at death. The terms of the trust can also protect the assets against imprudent spending by beneficiaries and dilution due to divorce or lawsuits.

Under favorable economic conditions, the trust will grow free of transfer tax for generations and provide a pool of assets to fund family endeavors and aspirations for years to come.

Please see back cover for additional important disclosure information.

Safeguarding assets from creditors

Delaware is among the very few states that allows the creation of domestic asset protection trusts (DAPTs). DAPTs offer individuals a vehicle to help put assets out of the reach of certain creditors. A DAPT can also play a role in premarital and pre-immigration planning and in protecting an inheritance from future creditors.

A DAPT can be a discreet alternative to a prenuptial agreement. Establishing a Delaware trust and transferring assets to it prior to marriage may protect those assets from future claims by a spouse.

Keep in mind, however, that a DAPT cannot help you avoid current creditor claims, including those brought by a spouse to whom you were married at the time of the creation of the trust. In addition, creditors have a window, from the date of the trust's creation or date of transfer to the trust, to challenge the validity of the trust or any transfer to it. Consult your advisors on the limitations of DAPT.

PROFILE | Protecting assets in the event of divorce or death

Many professionals and business owners have found that Delaware asset protection trusts help to provide both financial security and important advantages in aligning business and family interests. Our client, a 54-year-old business owner, had earned a sizable amount of assets during her life and was about to marry for the second time. She was concerned with preserving her assets for her children from her first marriage. Rather than opting for a prenuptial agreement and its financial disclosures, she decided to fund a DAPT with a "nest egg" of $10 million, protecting the assets from future claims by a spouse. Additionally, the assets are beyond the reach of any future claimants relating to her business. The transfer to the trust was structured as an incomplete gift, allowing the client to avoid gift tax consequences. Under Delaware law, she could also retain the right to direct investments. Upon her death, the assets in the trust will fund further trusts for the benefit of her children and their families.

PROFILE | Aligning beneficiary interest to ease family concerns

Second marriages and extended families can raise complex and sometimes emotional estate planning issues. Our client wanted to create a trust for the benefit of his second wife, but he also wanted the children from his first marriage to benefit from the trust at her death.

Although his children had a good relationship with their stepmother, he wanted to leave the assets to his family in a way that would avoid causing any future friction between them.

The total return unitrust he established in Delaware will provide his wife with an annual income equal to a fixed percentage of the trust's value, and at her death, the remainder will pass to his children.

As a result, both she and his children benefit from trust appreciation, an alignment of interests that allows the trustee to invest for total return.

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Flexible trust structures and accounting rules to address other unique needs

Total Return Unitrusts (TRU)

Delaware law allows trustees to convert certain types of existing net income trusts (for instance, a trust that requires the payment of all net income to one beneficiary for life and the remainder to another) into a TRU. Such a trust pays a specified percentage of the trust's total value as income, determined at least annually. TRUs permit trustees to weight trust assets more heavily toward equities in order to achieve greater growth.

A TRU may allocate the net short-term capital gain and net long-term capital gain to the beneficiary's trust income, assuming those amounts do not exceed the unitrust amount. This may allow a trustee to distribute capital gain income to the income beneficiary at more favorable tax rates.

There are, however, two cases where trustees must distribute the greater of the unitrust amount or the net accounting income of a trust:

- A marital deduction trust for which a deduction has been taken.
- A trust that is exempt from GST tax as a result of its being "grandfathered" from the GST tax (generally, trusts created prior to September 1985).

"Power to adjust" between principal and income

Delaware has enacted legislation giving trustees of certain types of trusts and in certain specified instances a "power to adjust" between principal and income, as a reflection of Treasury Regulations expanding the definitions of income and principal in order to reflect modern trust investment standards and techniques. The power to adjust, similar to the flexibility of a Total Return Unitrust, enables a trustee to make distributions to the current beneficiaries commensurate with a "fair return," even though the trust investments provide a relatively low cash flow yield. This is accomplished by the trustee transferring trust principal to income for fiduciary accounting and distribution purposes.

Delaware's "power to adjust" provision is unique in that it provides an ordering provision as to the types of income used in satisfying the exercise of the power, namely, (i) ordinary income for federal income tax purposes to the extent not allocable to net accounting income, (ii) net short-term capital gain, and then (iii) net long-term capital gain.

Enhanced charitable accounting rules

Favorable trust accounting principles of Delaware law create an opportunity for an attractive income tax deferral strategy: the Net Income with Makeup Charitable Remainder Unitrust (NIMCRUT). A properly designed NIMCRUT can serve as a private retirement vehicle, allowing investment income to accumulate tax-deferred until the income beneficiary chooses to draw income.

A NIMCRUT has the flexibility to pay the income beneficiary the lesser of the trust's net income or a specified unitrust amount (5% or more). Current shortfalls in income may be made up in subsequent years. If a trustee of a NIMCRUT invests in an asset that traps current income and does not distribute it to the trust (for example, a common trust fund, a life insurance contract, an annuity contract before annuitization, a partnership or a zero-coupon bond), the NIMCRUT will have no current accounting income. In that case, there is nothing to distribute. Within the underlying investment, accrued income accumulates free of income tax until the investment is sold or redeemed and the NIMCRUT distributes the proceeds to the income beneficiary.

Delaware's history of pro-trust legislation

- **1986** **Directed trusts** — Delaware allows trustees to follow the investment directions of an "investment advisor" named by the trust.
- **1995** **Dynasty trusts** — Delaware repeals the "rule Against Perpetuities" and allows trust to span generations and limit transfer tax exposure.[3]
- **1997** **Domestic asset protection trusts** — Delaware allows trust that protect assets from future creditors' claims while allowing the grantor to receive discretionary distributions.
- **2000** **Total return unitrusts** — Delaware enacts the first total return unitrust statute that helps trustees align the investment interests of current and future beneficiaries.
- **2003** **Trust decanting** — Delaware creates a mechanism to modify the terms of an irrevocable trust to deal with legal, tax, investment or beneficiary changes over time.
- **2009** **Power to adjust** — Delaware allows a trustee to adjust between principal and income to impartially serve both current and future beneficiaries.
- **2013** **Nonjudicial settlement agreements** — Delaware permits resolution of conflicts over trust administration to be resolved without the time and expense of court involvement.
- **2016** **Trust modification** — Delaware allows more extensive modification of irrevocable trusts with grantor participation but without court involvement.
- **2017** **Excluded trustee** — Delaware permits the allocation of fiduciary duties among co-trustees.
  Trust decanting — Delaware allows decanting into the same trust, eliminating the need to create a new trust.

Other states have followed Delaware's lead in adopting favorable trust legislation that allows for the creation of trusts in perpetuity, directed trusts and asset protection trusts. The fact that Delaware adopted this legislation ahead of most, however, results in a body of law that consistently validates these arrangements.

[3] The Delaware RAP, which applies only to real estate, is 110 years. However, if real estate is owned by a limited liability company (or other entity) and that entity is held in trust, the entity is considered an intangible asset that is not subject to the RAP. In this case, the assets owned by the entity, including real estate, may be held in perpetuity under Delaware law.

Supporting you with generations of experience

As a qualified Delaware trustee, U.S. Trust can work with you, your advisor and your attorney to establish a Delaware trust. We regularly consult with attorneys who are drafting trust agreements to help meet our mutual clients' goals. When named as a trustee, we work with attorneys to manage the countless and complex details of administering a trust.

To find out more about the ways Bank of America and U.S. Trust can help you simplify your life, address your unique goals and bring lasting meaning to your wealth, reach out to your advisor.

Assumes 2020 federal GST exemption of $11,580,000 and federal gift exemption of $11,580,000, as set forth by the 2017 tax reform bill, are applied to the transferred assets (fully shields the transfer from federal GST and gift tax).

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