WILMINGTON TRUST

MEMBER OF THE M&T FAMILY

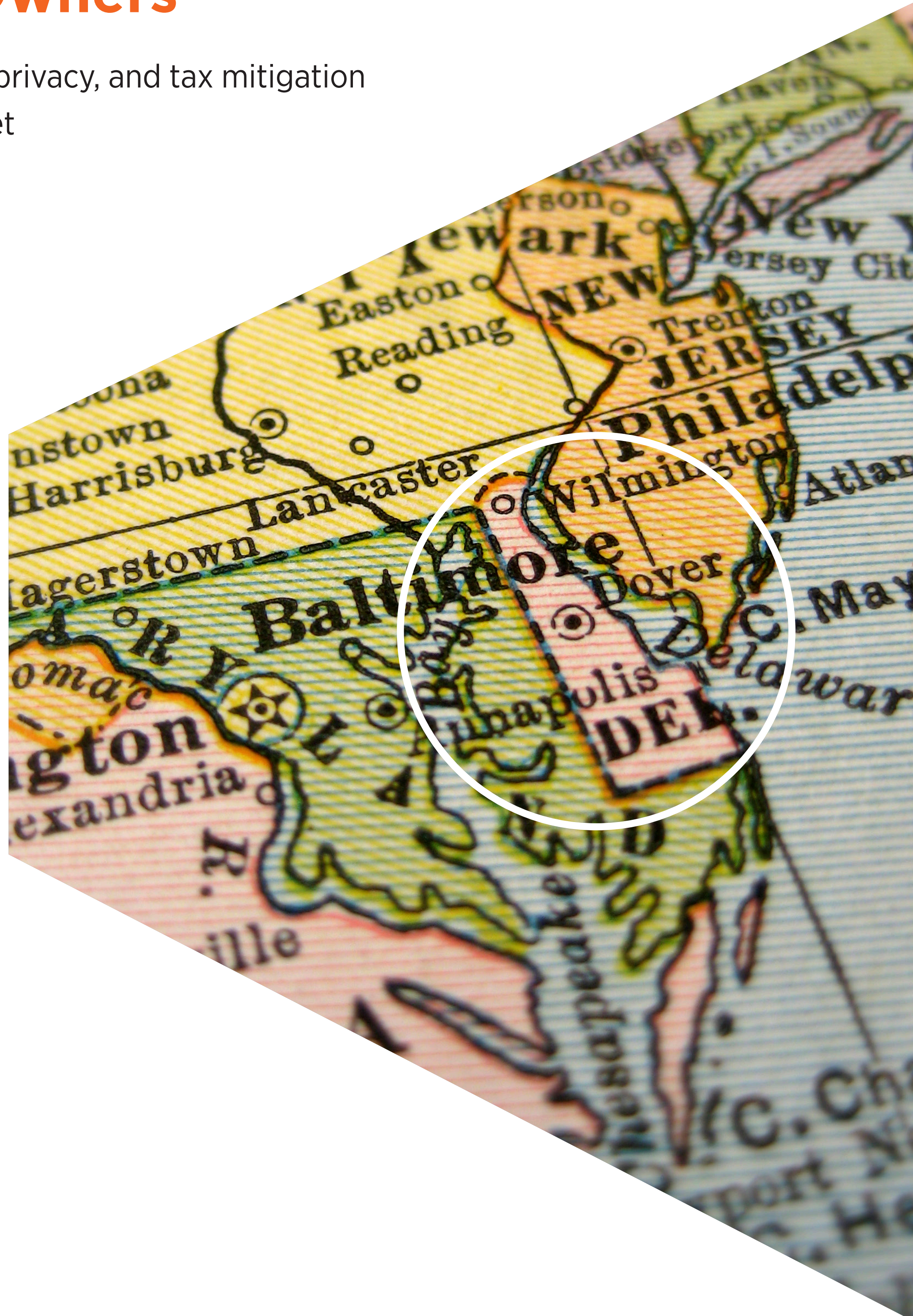
Delaware Trust Advantages for Business Owners

Seeking control, protection, privacy, and tax mitigation for your most important asset

by Jeffrey C. Wolken

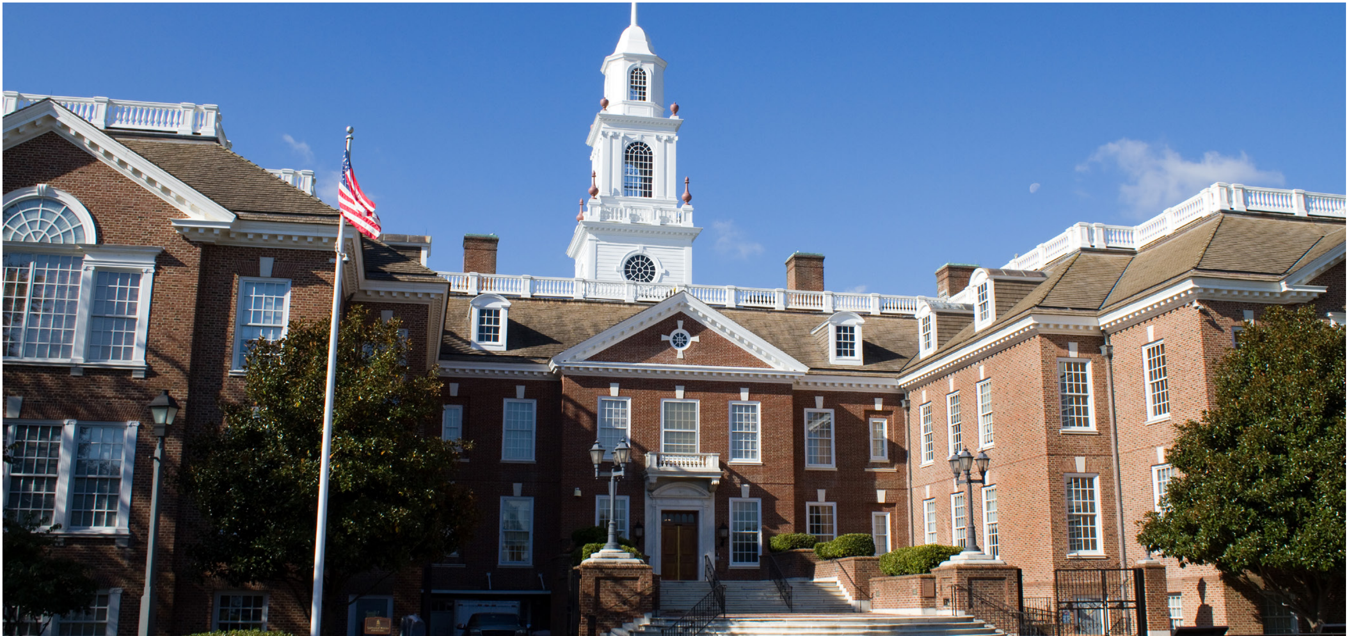
National Director

Delaware Trust Planning



Key points

- Business owners typically face special challenges in structuring estate plans because of their unique need for control, asset protection, confidentiality, and tax mitigation
- Delaware trusts can offer many of the advantages of other trust-friendly states, along with unique elements that make it a pre-eminent jurisdiction



The state of Delaware has long been one of the most favorable places to establish a business. But what many business owners don't recognize is that Delaware can also be a good place to create a personal trust for estate planning or asset protection purposes, even if neither the business nor the business owner resides in Delaware.

Business owners typically face special challenges in structuring estate plans because of their unique need for control, asset protection, and confidentiality regarding their main asset, the family business. Home-state tax mitigation is also a common goal for many business owners. Fortunately, Delaware provides some special advantages to business owners who establish personal trusts under its laws. While not all of these advantages are unique to the state of Delaware, utilizing them with a trust located in Delaware may afford the business owner access to other benefits that this trust-friendly state has to offer.

Directed trusts let business owners maintain control of their greatest asset: The business

One of the biggest hurdles for business owners considering estate planning using personal trusts is the fear of giving up control over their most significant asset. After many years of leading their company, they are understandably reluctant to let anyone else make decisions about how it is managed as an asset.

Under most traditional trust structures, the trustee becomes responsible for assets placed in trust. The trustee has to make regular decisions about how to manage these assets—which can be particularly challenging when the primary asset is a closely-held business. Because of its fiduciary duty to diversify the trust's investments, a trustee may decide that a closely-held business is not an appropriate investment for the trust, because it is undiversified and illiquid, and may decide to sell all or part of the ownership interest or manage it in a manner that is contrary to the family's goals. This, typically, is not what most business owners want. However, these issues can be addressed by establishing a trust with a directed trustee feature. With this feature, the business owner may designate one or more advisors to make investment decisions for the trust that holds the business as its main asset, while having a Delaware administrative trustee perform the remaining duties of a trustee.

Continued

©2024 M&T Bank and its affiliates and subsidiaries. All rights reserved.

Delaware's directed trust law provides:

- Freedom to engage in estate planning or asset protection planning using illiquid assets, such as stock in the family business, real estate, or hedge fund/private equity investments, when a trustee may otherwise be reluctant to hold these types of assets
- Flexibility for a trusted advisor or family member to retain control over a trustee's investment or distribution decisions so that they can do what is best for the family/ beneficiaries

Source: https://delcode.delaware.gov/title12/c033/index.html

Essentially, the directed trust splits fiduciary responsibilities, allowing the person who establishes the trust, often referred to as the settlor or grantor, to name his or her own investment advisor to manage the assets, while the trustee is responsible for other aspects of administering the trust. In many cases, the business owner-settlor may serve as his or her own investment advisor. The trustee can't be held liable for the investment advisor's actions unless the trustee engages in willful misconduct related to the investment process (https://delcode.delaware.gov/title12/c033/index.html). This structure may be particularly beneficial for business owners who do not wish to divest the business interests held in the trust.

The directed trust feature can provide significant flexibility since it can be added to virtually any type of trust structure in Delaware. Whether the goal is asset protection or a perpetual trust to save estate taxes, these trusts can be set up with an investment advisor directing the investment process.

Asset protection trusts offer security

Another beneficial planning option is the trust structure commonly referred to as an "asset protection trust," which allows business owners to take some of their winnings off the table and protect them from creditors. In 1997, Delaware was among the first states to allow this type of trust, which enables the person who creates the trust to remain as a beneficiary and to have the trust assets protected from the claims of his or her creditors (https://delcode.delaware.gov/title12/c035/sc06/). Under the terms of an asset protection trust, which is irrevocable, the business owner would place the assets he wants to protect into a trust in the state of Delaware. Within the limits provided by Delaware law, he or his beneficiaries can receive payments of income or principal from the trust. Properly structured and administered, creditors will generally not be able to gain access to these assets.

Another benefit of the asset protection trust is to provide the business owner with a "rainy day" fund. For instance, say that an entrepreneur has successfully taken one company public and plans to use some of the new liquidity to fund another venture. While willing to risk some of the gains, he or she may want to hold some back in case of an unexpected business reversal, an emergency, or for unplanned expenses.

Quiet trust provisions can keep business interests confidential

Another aspect of Delaware trust law that can be beneficial to business owners who want to transfer assets to children or grandchildren without disclosing the gift immediately is the so-called "quiet trust" law. Consider a family business owner with grandchildren in their early teens. The business owner worries that if the grandchildren know that they are to inherit several million dollars in business assets, they may not work as hard in school.

In most states, including Delaware, trustees have an obligation to keep beneficiaries informed of their interests in the trust. If there's an event that affects the beneficiaries' interests, the trustees have to tell them about it. In fact, many states require regular reporting to beneficiaries including quarterly updates on how much the assets are worth and what is being done to manage them. The trustees also have to inform beneficiaries about when they will receive control of the assets, perhaps at age 21 or on graduation from college or some other life event.

The flexibility in Delaware is that Delaware trusts can contain "quiet" provisions that tailor notice or disclosure provisions to the settlor's requirements. The settlor can instruct the trustee to keep the trust confidential until a certain age is attained or a certain milestone occurs. Consequently, the business owner, as settlor, can transfer assets to a trust for asset protection or estate planning purposes with the comfort that beneficiaries only receive notice or information upon terms set by the business owner. Even if the business owner is a resident of another state or the business is in another state, these Delaware advantages should be available to him or her.

Continued

©2024 M&T Bank and its affiliates and subsidiaries. All rights reserved.

Tax mitigation

While personal trusts have been used most commonly as estate and gift tax planning tools, they now have increased importance as vehicles for helping to mitigate a family's state income tax liability. If a business owner lives in a high-tax state there may be opportunities to reduce or eliminate state taxes on some of their income by establishing a new trust in Delaware or moving an existing trust to the First State. Holding family wealth inside a trust may limit the ability of the business owner's home state to tax the trust's income. The family's asset "location" (where the assets are held in trust) instead of asset "allocation" (how the assets are invested) is now a primary driver of wealth by working to reduce or eliminate the drag of income taxes. The following strategies may provide opportunities for the family to mitigate income taxes by making the First State the home state for their assets.

State income tax minimization using personal trusts

Delaware has a state fiduciary income tax on income accumulated in a "non-grantor" trust, where the trust itself, and not the grantor, is taxed on income earned by the trust. However, there is a full exemption from this tax if the income is accumulated for beneficiaries who are not current Delaware residents. Due to the low population of Delaware and the fact that many trusts coming into Delaware have no other ties to the state, most trusts administered in Delaware are not subject to Delaware state income tax. Consequently, using Delaware as a trust planning jurisdiction can be similar to using states that don't have any income tax.

- **Changing the trustee to help mitigate state taxes**
  If a business owner lives in a high-tax state and created a trust, or they are the beneficiary of a trust, it may be as simple as changing from a trustee located in their home state to one in a low or zero-tax state in order to reduce the trust's state income tax burden.

- **Appoint a successor trustee in tax-friendly jurisdiction.**
  During the lifetime of the business owner, some trusts are best administered by them or other family members. Since these trusts generally become their own taxpayer (or a "non-grantor" trust) following the settlor's death, appointing a successor corporate trustee in a tax-friendly state like Delaware offers professional management of these assets at the same time state taxes may be eliminated or deferred on income accumulated in the trust.

- **Delaware incomplete gift non-grantor (DING) trusts**
  A trust structure offered in Delaware is the DING trust, where the settlor retains ownership of the trust's assets for gift tax purposes while the trust owns the assets for income tax purposes. The trust is its own taxpayer for income tax purposes, so this allows the business owner to shift income out of their home state into a state where the trust will not pay a state income tax. This tax savings is generally not available for earned income, income from real estate, or some other types of income treated as "source" income (which state the money was earned in) in the settlor's home state. However, a DING trust is an effective tool to consider prior to the sale of a business or concentrated stock position that will incur a large capital gain, which is the increase in a capital asset's value and is realized when the asset is sold. In addition, it can be a nice way to help mitigate the tax burden on an invested portfolio that generates significant income.

Managing wealth through the generations

A Delaware dynasty trust may help a business owner achieve multigenerational tax savings and creditor protection, while retaining flexibility in managing family wealth through the generations. Because future growth of the trust's assets is not subject to estate, gift, or generation-skipping transfer (GST) taxes, the trust can in effect become a "family endowment fund" for future generations.

As the grantor, a business owner could establish the dynasty trust using appropriate GST tax and/or gift tax exemptions. The trust can be established as a "sprinkle" trust, which means that the funds held in the trust may be distributed or "sprinkled" to the beneficiaries as needed. The undistributed funds then could grow free of wealth transfer taxes for the next generation and beyond.

Features of the Delaware dynasty trust

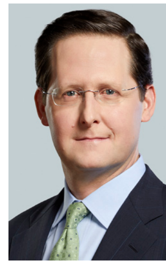
- Allows for accumulation of substantial wealth without incurring additional transfer taxes
- Can protect the trust's assets from a beneficiary's creditors, including in a divorce settlement
- Permits income tax-free growth of assets if the trust is a "grantor trust" for which the business owner, as the grantor, pays the trust's federal income tax during their lifetime
- There is presently no Delaware state income tax on income or capital gains accumulated for beneficiaries who are not current Delaware residents
- A Delaware dynasty trust can be perpetual if funded with personal property; real estate can remain in trust for 110 years

Continued

 ©2024 M&T Bank and its affiliates and subsidiaries. All rights reserved.

We believe Delaware is a pre-eminent state for trusts

For the complex estate planning needs of entrepreneurs and multigenerational business owners, Delaware is a trust-friendly state. Directed trusts, asset protection trusts, quiet trusts, and perpetual dynasty trusts are just a few of the ways that Delaware trusts can be used to help work toward achieving a business owner's unique goals. In addition, Delaware may provide opportunities for a business owner to mitigate state income taxes. Of course, every situation is different. To find out how a Delaware trust could work to meet specific goals, talk to a Wilmington Trust Company advisor.



Jeffrey C. Wolken

National Director
Delaware Trust Planning

302.651.8192
jwolken@wilmingtontrust.com

As part of the Wilmington Trust Emerald Family Office & Advisory® team, Jeff is responsible for developing trust planning strategies for wealthy individuals and families throughout the United States and abroad. He works closely with his clients' legal, tax, and investment advisors to construct and implement appropriate trust structures that take advantage of the state of Delaware's unique trust and tax laws. He earned his JD (summa cum laude) and MBA (with honors) from Syracuse University and holds a bachelor's degree in economics from Northwestern University. He is a frequent lecturer on topics involving the use of Delaware trusts for asset protection, state income tax mitigation, and investment management for unique trust assets.

Wilmington Trust is not authorized to and does not provide legal or accounting advice. Wilmington Trust does not provide tax advice, except where we have agreed to provide tax preparation services to you. Our advice and recommendations provided to you are illustrative only and subject to the opinions and advice of your own attorney, tax advisor, or other professional advisor.

This article is for informational purposes only and is not intended as an offer or solicitation for the sale of any financial product or service. It is not designed or intended to provide financial, tax, legal, investment, accounting, or other professional advice since such advice always requires consideration of individual circumstances. If professional advice is needed, the services of a professional advisor should be sought. There is no assurance that any investment, financial or estate planning strategy will be successful. These strategies require consideration for suitability of the individual, business or investor.

Wilmington Trust Emerald Family Office & Advisory® is a registered trademark and refers to wealth planning, family office and advisory services provided by Wilmington Trust, N.A., a member of the M&T family. Wilmington Family Office is a service mark for an offering of family office and advisory services provided by Wilmington Trust, N.A.

Wilmington Trust is a registered service mark used in connection with various fiduciary and non-fiduciary services offered by certain subsidiaries of M&T Bank Corporation including, but not limited to, Manufacturers & Traders Trust Company (M&T Bank), Wilmington Trust Company (WTC) operating in Delaware only, Wilmington Trust, N.A. (WTNA), Wilmington Trust Investment Advisors, Inc. (WTIA), Wilmington Funds Management Corporation (WFMC), Wilmington Trust Asset Management, LLC (WTAM), and Wilmington Trust Investment Management, LLC (WTIM). Such services include trustee, custodial, agency, investment management, and other services. International corporate and institutional services are offered through M&T Bank Corporation's international subsidiaries. Loans, credit cards, retail and business deposits, and other business and personal banking services and products are offered by M&T Bank, Member FDIC.

Wilmington Trust Company operates offices in Delaware only. Note that a few states, including Delaware, have special trust advantages that may not be available under the laws of your state of residence, including asset protection trusts and directed trusts.

This information has been obtained from sources believed to be reliable, but its accuracy and completeness are not guaranteed. Opinions, estimates, and projections constitute the judgment of Wilmington Trust and are subject to change without notice.

Investments: Are NOT FDIC Insured | Have NO Bank Guarantee | May Lose Value

©2024 M&T Bank and its affiliates and subsidiaries. All rights reserved. AMP-6880 240515 VF