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Delaware Trust Law

Why Delaware?

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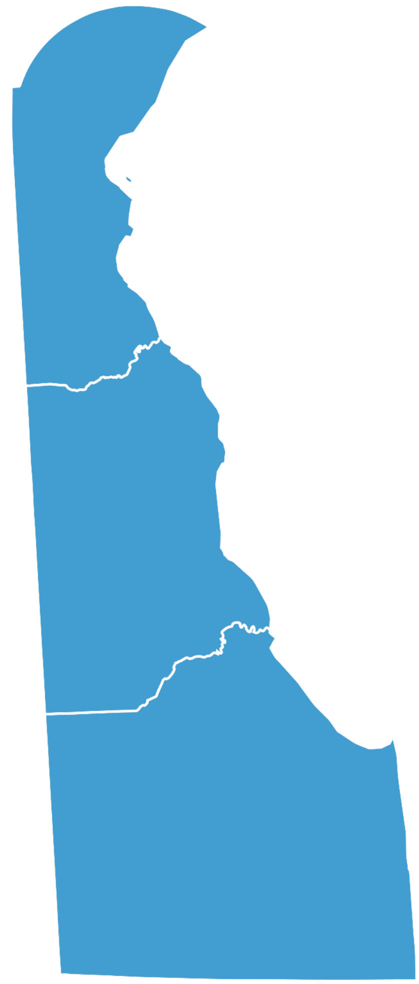
Delaware Dynasty Trusts



Under Delaware law, a trust holding personal property may last forever.

Under Delaware law, a trust holding real property may last no more than 110 years.

The 110-year limitation can easily be avoided by transferring the real property to an entity, such as a limited liability company.

Abolition of "Rule Against Perpetuities"

Delaware has abolished the archaic "Rule Against Perpetuities," which limited the duration of trusts to 21 years following the death of the last surviving "life in being" at the time of the creation of the trust (i.e., 21 years following the death of the last beneficiary who was alive at the time of the creation of the trust).

Perpetual Trusts

Under Delaware law, a trust can be established, in perpetuity, for the benefit of the children, grandchildren and further descendants of a Settlor.

This is a technique commonly used in conjunction with use of the Settlor's GST Exemption or by wealthy families to provide income for subsequent generations.

Delaware Directed Trusts

Appointment of "Advisors"

Delaware law specifically provides for the appointment of advisors to direct a trustee with respect to the investment and distribution of trust assets and the purchase of life insurance by a trustee (for

- Dynasty Trusts
- Directed Trusts
- Incomplete Non-Grantor Trusts
- Moving Trusts to Delaware
- Decanting
- Asset Protection Trusts

example, in the case of a trust intended to own a policy insuring the life of the Settlor, i.e., an irrevocable life insurance trust or "ILIT").

The ability to appoint advisers to direct the trustee with regard to investments is often a useful tool for non-Delaware residents to take advantage of Delaware trust law while retaining some control over investment and distributions.

Client Comfort

Typically, a corporate fiduciary acting upon the direction or consent of (a so-called "directed" fiduciary) will charge less as result of being relieved of responsibility for exercising discretion.

Out-of-state clients obtain peace of mind knowing that the Delaware trustee is acting only upon the direction of their local trusted advisors (such as accountants, attorneys or financial advisors).

Delaware Incomplete Non-Grantor Trust

"DING!"

Delaware law provides a fiduciary income tax deduction equal to income and capital gains accumulated by a trust for future distribution to beneficiaries who are not residents of the State of Delaware. As a result, most Delaware funds pay no income tax at the state level.

Ideal for non-Delaware residents who:

Are planning on selling an appreciated interest in a closely held business

Reside in a state with high state income tax rates (such as California, Hawaii, New Jersey and New York).

Consent Petitions

Delaware has a unique process – the Consent Petition.

Petitions frequently contain requests for the Court of Chancery to

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approve changes to the administrative provisions of the governing instrument (e.g., update of investment provisions, provisions relating to the removal and replacement of trustees, updated provisions relating to trustee compensation, confirmation of control of Delaware law, change of situs, appointment of advisors, etc.).

The Consent Petition is filed electronically.

Assuming all beneficiaries consent and the trustee does not object, an Order approving relocation of situs of trust or other requested relief will be received electronically within a matter of weeks.

Decanting

Decanting is a power exercised by a trustee by which a trust corpus is invaded for purposes of paying it to another trust, which may have different, but more unclear or desirable, administrative provisions, such as provisions for advisers, change of situs or removal and replacement of trustees.

A trustee does not need beneficiary consent to decant, but as a practical matter, often attains it anyway.

Generally, a trustee cannot exercise power in favor of the trustee, trustee's estate, trustee's creditors or trustee's creditors of their estate.

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Delaware Asset Protection Trusts

Qualified Disposition in Trust Act (12 Del.C. § 3570 et seq.)

Enacted in Delaware in 1997. To date 12 other states have enacted similar laws:

• Arkansas	• Nevada	• South Dakota
• Colorado	• New Hampshire	• Tennessee
• Hawaii	• Oklahoma	• Utah
• Missouri	• Rhode Island	• Wyoming

The Delaware Qualified Disposition in Trust Act (the "Trust Act") is reviewed and revised annually by a standing Committee of the Estate and Trust Section of the Delaware State Bar Association.

The Trust Act is intended to a offer domestic alternative to offshore asset protection trusts.

The Trust Act authorizes the creation of a "self-settled" spendthrift trust, permitting the Settlor to receive limited distributions from the trust and to retain certain rights and powers with respect to the trust assets, without exposing the principal of the trust to the Settlor's creditors.

Requirements

The trust's governing instrument must specifically provide that:

- The trust is irrevocable.
- Delaware law governs the validity, construction and administration of the trust.
- Beneficial interest may not be transferred, pledged or assigned, voluntarily or involuntarily (i.e., as a result of bankruptcy, divorce, etc.) until the income or principal is actually distributed.
- At least one trustee is a "qualified trustee," as defined in the Act (e.g., a Delaware resident individual – not the Settlor – or a bank or trust company authorized under Delaware law to serve as a trustee).

The "qualified trustee" must:

- Maintain all or a portion of trust records within the State of Delaware.

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- Maintain custody of all or a portion of trust assets within the State of Delaware.
- Prepare or arrange for preparation of fiduciary income tax returns (Form 1041).
- Materially participate in administration of the trust.

Settlor's Permissible Distribution Rights

Under the Trust Act, the settlor may retain the following rights with regard to assets transferred to the trust:

- Income and/or principal according to trustee's discretion or the direction of a distribution advisor (not the settlor).
- Income or unitrust distributions (not in excess of five percent of trust principal on an annual basis).
- Right to reside in a home owned by the trust.
- May receive distributions to pay income taxes on trust income.

Settlor's Permissible Powers

Ditto, but powers not rights.

Power to veto proposed distributions.

Power to direct or consent to investment decisions.

Limited testamentary power of appointment w/r/t trust principal.

Right to remove/replace trustees (not related/subordinate to Settlor as defined in IRC 672(c)).

Settlor "No-Nos"

In order to qualify the trust as an APT under the Trust Act, the settlors may not retain

- The ability to recover assets from the trust.
- The ability to direct (as opposed to veto) distributions from the trust.
- The ability to appoint himself of herself (or a related or subordinate party as defined in IRC 672(c)) as trustee.

Protection Provided

The Act bars claims of creditors arising <u>prior</u> to transfer of assets to the trust that are brought later than: (1) four years from the transfer

- Dynasty Trusts
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- Asset Protection Trusts

of assets to the trust; or (2) one year from the discovery by the creditor of the existence of the trust and creditor can prove, through "clear and convincing" evidence, that the transfer of the property to the trust was a "fraudulent transfer" as defined under Delaware law.

A "fraudulent transfer," under Delaware law, is:

- A transfer made with intent to hinder, delay or defraud current creditors.
- With respect to current creditors, a transfer made without receiving equivalent value in exchange and such transfer renders the Settlor insolvent.

The Trust Act bars claims of creditors arising subsequent to transfer of assets to the trust unless actual intent to defraud by Settlor.

Exceptions to Creditor Protection

- Alimony/Child Support
- Claims for death, personal injury or property damage arising prior to transfer to trust

Summary

There are no guarantees. The Trust Act has never been tested in any court.

Despite the lack of court action, the use of a Delware Asset Protection Trust creates significant hurdles for creditors and increases the costs and time for creditors challenging dispositions to trust.

Further, there are non-asset protection considerations, such as state income tax advantages when used in conjunction with a Delaware incomplete non-grantor trust.

For more information, please contact:

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