

DIRECTED TRUSTS, DECANTING AND ASSET PROTECTION: A POTPOURRI OF PLANNING OPPORTUNITIES IN DELAWARE

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What we will cover today

- We will discuss the benefits of Delaware trusts and contrast with Michigan trusts, including the following topics:
 - Favorable income taxation and rule against perpetuities
 - Trust flexibility including silent trusts and purpose trusts
 - Directed trusts
 - Decanting, reforming, and modifying trusts in Delaware
 - Self settled asset protection trusts
 - Trust protectors
 - Delaware nexus for existing trusts and new trusts
 - Update on current Delaware legislation and new court rules
- We will focus on clients in Michigan, and may also reference clients in Illinois
- We will discuss practical administration and drafting implications

The Delaware Advantages – a snapshot



It is the combination of:

- ✓ Favorable tax treatment
- ✓ Perpetual trusts
- ✓ Trust instrument flexibility
- ✓ Directed trusts
- ✓ Protection from creditors
- ✓ Sophisticated judicial and legislative environment
- ✓ Significant history and robust trust industry
- ✓ Members of the bar who continually review and modify the law to maintain Delaware's preeminent position in trust law

Favorable income tax treatment

- In general, Delaware treats a trust as a resident trust if there is at least one Delaware trustee. (30 Del. C. §1601(8))
- Delaware resident non-grantor trusts may take an income tax deduction for both the amount of their federal distributable net income that is actually distributed and for the amount of their federal taxable income that is set aside for future distribution to nonresident beneficiaries (30 Del. C. §§1635 and 1636)
- Therefore as long as there are no Delaware beneficiaries, there will be no Delaware fiduciary income tax on accumulated income and realized capital gains in the trust (30 Del. C. § 1636)
- But the Delaware non-grantor trust may be subject to income tax of other states. The following can form the basis for states imposing taxation on an out-of-state trust:
 - If the trust was created by will of testator resident in the state at time of death, or if settlor of an inter vivos trust lived in the state when the trust became irrevocable
 - If one or more of the trustees reside or do business in the state, or if the trust is administered in the state
 - If one or more beneficiaries live in the state
- **Michigan** imposes a tax on resident non-grantor trusts, defined as a trust where the settlor was a resident or domiciled in Michigan (MCLA §§206.18(1)(a) and (c), §206.110(1)). However, the Michigan statute has been held unconstitutional on the grounds that the domicile of the grantor of an inter vivos trust at the creation is not a sufficient nexus alone to justify taxation by the state in later years. Blue v. Dep't of Treasury, 185 Mich. App. 406, 462 N.W.2d 762 (1990). So if trustees, administration and beneficiaries are outside of Michigan, there is insufficient nexus for Michigan fiduciary income tax. The Michigan fiduciary income tax rate is 4.35%
- **Illinois** imposes a tax on resident non-grantor trusts, which is defined as a trust where the settlor was domiciled in Illinois at the time the trust became irrevocable (35 ILCS 5 / 201 (a) and 1501 (a) (20))

Combine the favorable tax treatment with perpetual trusts

No rule against perpetuities

- Delaware abolished its Rule Against Perpetuities for intangible assets (25 Del. C. § 503)
- The 110-year limit on real estate still applies in Delaware (25 Del. C. § 503 (b))
 - However entities such as corporations, LLCs, and LLPs owning real property may be held in a Delaware trust in perpetuity (25 Del. C. § 503 (e))

What this combination means to your client

- Perpetual trusts which are not subject to state fiduciary income taxation make Delaware ideal for establishing dynasty trusts that maximize the value of assets to future generations
- As long as the assets stay in trust, no further estate, gift or generation-skipping transfer taxes apply
 - Transfer of GST-exempt assets to future generations is possible
 - This benefit can be maximized in 2011 and 2012 with the \$5 million exemption
- Think of this as a long-term tax advantaged family savings vehicle
- **Michigan** abolished its rule against perpetuities with respect to personal property held in trusts for trusts created on or after May 28, 2008 (MCLA § 554.51). Real property remains subject to the 90-year rule against perpetuities (MCLA § 554.72)
- **Illinois** does not have a rule against perpetuities for “qualified perpetual trusts” which includes any trust created after January 1, 1998 that expressly states that the rule does not apply (765 ILCS 305/4)

Trust Instrument Flexibility

The language in the trust instrument is paramount

- Key: Delaware trust law gives maximum freedom to the wishes of the grantor, as expressed in the trust instrument (12 Del. C. § 3303(a)). The grantor can modify various duties such as the duty to diversify and the duty to disclose information to beneficiaries. The grantor can also divide traditional trustee duties among multiple parties such as institutional trustees and others
 - 12 Del. C. § 3303(a) states that it is the policy to give maximum effect to the principle of freedom of disposition and to the enforceability of governing instruments
 - Trustees are protected when acting in accordance with the trust instrument. “A trustee who acted in good faith reliance on the terms of a written trust instrument is not liable to a beneficiary for breach of trust to the extent the breach resulted from the reliance.” (12 Del. C. § 3586)
 - Delaware also has a shortened claims period during which trustees may be sued. For example, Delaware limits the ability to contest the validity of a trust, giving a period of the earlier of 120 days of notice to the person, or 2 years after the trustor’s death (12 Del. C. § 3546)

Trust Instrument Flexibility – Notice to Beneficiaries

- The trust instrument can expand, restrict or eliminate the rights of beneficiaries (including the rights to know of the trust and to receive statements) and trustee's powers, duties, standard of care and liability and can exculpate the trustee for acts other than willful misconduct (12 Del. C. § 3303(a))
 - Since this includes the ability to restrict or eliminate the rights of a beneficiary to know of the trust and receive trust statements, this provides the trustee with statutory protection that was uncertain under case law
 - But see e.g., McNeil v. McNeil, 798 A.2d 503 (Del. 2002). This case illustrates how the duty to treat beneficiaries equally may be forcefully applied in the context of the duty to disclose
 - Mr. McNeil established 5 trusts from the sale of his pharmaceutical company in 1959, four for each of his children and the fifth for his wife, Lois (the latter the “Lois Trust”)
 - Mr. McNeil's descendants, their spouse and Lois were discretionary beneficiaries of the Lois Trust
 - Son Hank became estranged from the family and was not made aware of information about the Lois Trust even though his siblings were (largely through their participation in the family holding company)
 - Hank sued the trustees of the Lois Trust on the basis that he was misled about his status as a current beneficiary
 - The trial court found that the trustees breached their fiduciary duty by failing to inform Hank about his status as a current beneficiary and favoring the other siblings. It ordered a 7.5% makeup distribution to Hank and his children, removed one trustee and surcharged the others 1/5th of their commissions. On appeal, the Delaware Supreme Court affirmed most of the decision noting that **the trust did not expressly relieve the trustees of the duty to disclose information** and the trustees had a duty to disclose the essential fact that Hank was a current beneficiary

Trust Instrument Flexibility – Notice to Beneficiaries (cont.)

- **Michigan:**

- Michigan law requires trustees to keep qualified beneficiaries reasonably informed about administration matters and material facts necessary for them to protect their interests (MCLA § 7814(1))
- Trustees must also provide relevant information to a beneficiary upon request which includes the terms of the trust that affect a beneficiary's interest and other relevant information ((MCLA § 7814(2)(a))
- Permissible beneficiaries of trust income and principal and all other qualified beneficiaries are also entitled to statements or accountings at least annually and final statements upon trust termination (MCLA § 7814(3))
- See Welch v. Weiner, 2007 Mich. App. LEXIS 2704 (December 4, 2007)

Trust Instrument Flexibility – The “Purpose Trust”

- Delaware allows grantors to create perpetual, non-charitable purpose trusts (12 Del. C. § §3555 and 3556)
- Delaware provides that a trust for a declared purpose that is not impossible of attainment is valid even if it lacks an identifiable person as a beneficiary (12 Del. C. § 3556)
 - May or may not have named beneficiaries
 - Can be perpetual
 - Trust instrument can name an individual to enforce the terms of the trust
- Uses of Purpose Trusts:
 - To own business interests that the client wants to be held indefinitely
 - To take care of pets
 - To own family property (e.g., a vacation compound)
 - To preserve a collection (e.g., art)

Delaware Directed Trusts

Directed Trusts – Delaware’s trust adviser statute

Directed trusts are provided under 12 Del. C. § 3313

- One of the most frequent reasons clients seek Delaware as a jurisdiction for their trusts is the ability to access its directed trustee statute. Delaware recognizes directed trustees and limits their liability for following the direction of an adviser (investment adviser, distribution adviser or other type of adviser) who is named in the trust instrument. Delaware has had directed trustee legislation since 1985
- **How it works:** A directed trust removes one or more powers from the trustee gives that power to an individual, committee or other entity, known as an “adviser”
 - An “adviser” may be appointed under instrument to direct, consent or veto any investment, distribution, administrative or any traditional trustee decision
 - Advisers are fiduciaries
 - In the absence of willful misconduct, the trustee is exonerated from liability as long as the trustee follows the direction of the adviser
 - Willful misconduct is defined as “intentional wrong doing, not mere negligence, gross negligence, or recklessness” (12 Del. C. § § 3301(a) and 3301(h)(4)) – the 2011 revision to the statute defines “wrong doing” as intentionally malicious conduct or conduct intended to defraud or seek an unconscionable advantage
 - The trustee acts solely at the direction of the adviser
 - In 2010, Delaware adopted a provision requiring that each fiduciary (advisers, the trustee, protectors and others) have the duty to keep each other reasonably informed with respect to the duty or function being performed by that fiduciary but no fiduciary has the duty to monitor other fiduciaries (12 Del. C. § 3317)

Delaware's trust adviser statute

3313. Advisers

- (a) Where 1 or more persons are given authority by the terms of a governing instrument to direct, consent to or disapprove a fiduciary's actual or proposed investment decisions, distribution decisions or other decision of the fiduciary, **such persons shall be considered to be advisers and fiduciaries when exercising such authority unless the governing instrument otherwise provides**
- (b) If a governing instrument provides that a fiduciary is to follow the **direction of an adviser**, and the fiduciary acts in accordance with such a direction, then except in cases of **willful misconduct on the part of the fiduciary** so directed, the fiduciary shall not be liable for any loss resulting directly or indirectly from any such act
- (c) If a governing instrument provides that a fiduciary is to make decisions **with the consent of an adviser**, then except in cases of **willful misconduct or gross negligence on the part of the fiduciary**, the fiduciary shall not be liable for any loss resulting directly or indirectly from any act taken or omitted as a result of such adviser's failure to provide such consent after having been requested to do so by the fiduciary
- (d) For purposes of this section, "investment decision" means with respect to any investment, the retention, purchase, sale, exchange, tender or other transaction affecting the ownership thereof or rights therein, and an adviser with authority with respect to such decisions is an investment adviser

Delaware's trust adviser statute (cont.)

3313. Advisers (cont.)

- (e) Whenever a governing instrument provides that a fiduciary is to follow the direction of an adviser with respect to investment decisions, distribution decisions, or other decisions of the fiduciary, then, except to the extent that the governing instrument provides otherwise, **the fiduciary shall have no duty to:**
 - 1) **Monitor** the conduct of the adviser;
 - 2) **Provide advice** to the adviser or consult with the adviser; or
 - 3) **Communicate with or warn or apprise** any beneficiary or third party concerning instances in which the fiduciary would or might have exercised the fiduciary's own discretion in a manner different from the manner directed by the adviser

Absent clear and convincing evidence to the contrary, the actions of the fiduciary pertaining to matters within the scope of the adviser's authority (such as confirming that the adviser's directions have been carried out and recording and reporting actions taken at the adviser's direction), shall be presumed to be administrative actions taken by the fiduciary solely to allow the fiduciary to perform those duties assigned to the fiduciary under the governing instrument and **such administrative actions shall not be deemed to constitute an undertaking by the fiduciary to monitor the adviser or otherwise participate in actions within the scope of the adviser's authority**

Comparative state law and relevant case law on directed trusts

Statutory law from other sources

- **Uniform Trust Code** § 808(b) (2005), which governs trust advisor statutes in approximately 25 states. The standard under the UTC is that the trustee is liable if the direction is manifestly contrary to terms of the trust or if the trustee knows the direction is a serious breach of fiduciary duty of the directing person – thus putting an obligation on the trustee to review the direction
- **Michigan** has a directed trustee statute (MCL § 700.7809) that closely follows the UTC other than:
 - The Michigan statute calls all the power holders with the ability to direct the trustee a “protectors”;
 - All trust protectors fiduciaries *unless* the power is a power of administration within the meaning of Section 675(4) of the Internal Revenue Code or the protector is a beneficiary (MCL § 700.7809);
 - The trust protector is subject to the jurisdiction of the Michigan courts (MCL § 700.7809); and
 - There is a non-modifiable limit on the exculpation of trust protectors, which match the limits on exculpation that apply to trustees
- **Illinois** directed trust legislation was passed this summer. Expected to become law on January 1, 2013.

Case law

- *Duemler v. Wilmington Trust Company*, 20033 NC, 2004, Strine, V.C. (Nov. 24, 2004) which upheld the Delaware statute and said that the directed trustee was not liable for investment losses
- *Paradee v. Paradee*, C.A. No 4988-VCL, October 5, 2010 (memorandum opinion) which cited § 3313 even though there was not a trust adviser
- *Rollins v. Branch Banking, Trust Company of Virginia*, 2001 Va.Cir.Lexis 146 (Va. Cir. Ct. 2001) which upheld the statute but held that the trustee was liable and could not “rid himself of this duty to warn”

Protectors

Delaware's Adviser Statute Also Creates the Role of a Trust Protector:

- Delaware statutes specifically recognize the role of trust protector, distinct from other trust advisers
- Under the Delaware statute a “**protector**” has all of the power and authority granted by the terms of the governing instrument, which may include but shall not be limited to:
 - 1) The power to remove and appoint trustees, advisers, trust committee members, and other protectors;
 - 2) The power to modify or amend the governing instrument to achieve favorable tax status or to facilitate the efficient administration of the trust; and
 - 3) The power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the governing instrument (12 Del. C. § 3313)
- Protectors cannot be beneficiaries
- A protector is presumed to be a fiduciary but the terms of the trust can negate it

Comparative State Law and Relevant Cases on Protectors

Statutory law from other sources

- **Michigan:**
 - The trust protector role is recognized in Michigan (MCL § 700.7809)
 - A trust protector is anyone other than a settlor or holder of a power of appointment, with the power to direct actions of the trustee (MCL § 700.7301(n))
 - A trust protector shall act in good faith and in accordance with the terms of the trust
 - A trust protector is a fiduciary, unless their power is administrative within the meaning of § 675(4)
 - A trust protector cannot be relieved of liability for acts committed in bad faith or with reckless indifference to the purposes of the trust or interests of the beneficiaries. This state default standard cannot be modified by the trust instrument
- **Illinois** directed trust legislation (which includes a trust protector) was passed this summer. Expected to become law on January 1, 2013. It outlines specific duties a protector may be given

Case law

- Robert T. McLean Irrev Trust v. Davis, 283 S.W.3d 786 (Mo. Ct. App. 2009)
- Friedman v U.S. Trust Company of Delaware, C.A. No. 20205 NC (2003 Del. Ch.) where court vacated the order appointing son as trust protector and trust company as administrative trustee but court did not assess any liability against the corporate fiduciary

Decanting

Delaware's decanting statute

- Delaware law allows a trustee to create another trust and transfer to it (pour-over or “decant”) some or all assets of the old trust (12 Del. C. § 3528)
- This can be used as a method to modify a current trust
 - Old trust must have a Delaware trustee or co-trustee and the administration must be governed by Delaware law
 - Old trust must grant the trustee power to “invade principal” (intended to be a looser requirement than other state decanting statutes that require the trustee to have absolute discretion over principal); an ascertainable standard meets “invasion” requirement
 - Distribution provisions of new trust must follow same standards of original trust
 - New trust beneficiaries must be same as old; however, decanting may be used to modify contingent remainder beneficiaries by granting existing trust beneficiary a power of appointment
 - Invasion cannot reduce income interest of marital deduction trust or move assets subject to presently exercisable power of withdrawal
 - No judicial action required
 - A written “decanting instrument” must be signed and acknowledged by the trustee and filed with the trust records (12 Del. C. § 3528(c))
 - Consent of beneficiaries not required (though it is common practice to have the beneficiaries consent to the decant and release and indemnify the trustee from liability in connection with the decant if it can be done without gift tax implications)

Delaware's decanting statute – potential uses

When to consider decanting

- Most situations involve changes to administrative provisions, including:
 - Adding or changing successor trustees
 - Granting individuals powers to remove and appoint trustees
 - Adding a distribution committee
 - Updating outdated investment or other administrative provisions
 - Adding trust adviser provisions
 - Domesticating a foreign trust
- Other situations may involve changes to beneficiary provisions, including:
 - Granting beneficiary power of appointment over trust assets
 - Extending duration of trusts for creditor protection, personal protection of beneficiary (substance abuse concerns) or other planning reasons; be careful of GST issues when extending duration of trust by decanting
- Trustee takes responsibility for decision to decant

Comparative State Law on Decanting and Recent IRS Actions

Statutory law

- **Michigan** does not have a decanting statute
- **Illinois** decanting legislation was passed in June, 2012 and will become effective January 1, 2013. The legislation provides for non-judicial modification of trusts through decanting in response to circumstances unforeseen at the time the trust was established. Amendments to address potential IRS action already being worked on

IRS Actions

- The IRS has recognized that decanting is an emerging issue with tax consequences that are not completely clear under current law. In 2011, decantings were added to the “no ruling list” pursuant to Rev. Proc. 2011-13
- The IRS issued IRS Notice 2011-101 requesting comments on the tax implications of trust decantings that could result in a change in the beneficial interest in the trust. Many bar and other associations have responded. There are income tax, gift and estate tax and GST tax issues that the IRS is requesting comment on. A sample of the issues is below:
 - *Income Tax*: Whether the existence of a decanting power causes the trust to be treated as a grantor trust under IRC § 671
 - *Gift Tax*: Whether a beneficiary whose interests are diminished as a result of the decanting has made a taxable gift
 - *Gift Tax*: Whether the existence of a decanting power in a trust that otherwise qualifies for an estate or gift tax marital deduction under IRS § 2056(b)(7) will cause the trust to fail to qualify for the marital deduction
 - *GST Tax*: Whether a trust that has, by a decanting, received property from another trust that is grandfathered for GST purposes continues to maintain its grandfathered status

Self-Settled Asset Protection Trusts

Self-settled asset protection trusts

- Delaware enacted the Qualified Dispositions in Trust Act (12 Del. C. § 3570), which allows individuals to create self-settled spendthrift trusts (“asset protection”) which future creditors, including future spouses, cannot attach, if certain requirements are met:
 - Must be a “qualified disposition” which is a transfer to a trust which has a Delaware trustee by means of a trust instrument
 - Trust must be irrevocable
 - Trust must incorporate Delaware law, unless it was transferred to a Delaware trustee from an out-of-state trustee
 - Grantor cannot retain a general power of appointment over the assets, although the right to receive a fixed percentage of principal, not exceeding 5%, will not violate this rule
 - Trust must have a spendthrift clause
 - Certain administrative functions must be performed in Delaware

Self-settled asset protection trusts (cont.)

- Grantor may retain a number of potential powers:
 - Power to veto a distribution from the trust
 - Limited testamentary power of appointment
 - Potential or actual right to receive income or principal in certain circumstances
 - Power to remove a trustee or adviser and to appoint a new trustee or adviser (other than a related or subordinate party)
 - Power to serve as the investment adviser
 - Power to use real property held in a QPRT
- Grantor may retain ability to receive distributions to pay income tax liability associated with income of trust
- Delaware courts will not enforce other states' judgments to reach trust property
- However, creditors can reach assets if:
 - Transfer to trust was made to defraud creditors, subject to or the 4-year "look-back" under Delaware law (12 Del. C. § 3572(b))
 - The claim resulted from alimony, child support or property division for spouse married to settlor at the time of or before the transfer of the assets into the trust
 - Before transfer, creditor suffers death, personal injury or property damage as a result of transferor's acts

Private Letter Rulings on completed gifts and estate inclusion

- **PLR 9837007** – Settlor created a self-settled spendthrift trust and applied for a private letter ruling requesting determination of whether the transfer to the trust was a completed gift, and whether the trust is includable in her estate. The Service:
 - Ruled that the transfer to the trust was a completed gift for federal gift tax purposes
 - Declined to rule on whether the trust property would be excluded from the settlors gross estate

- **PLR 200944002** – Settlor created a self-settled spendthrift trust and applied for a private letter ruling requesting determinations regarding a completed gift and estate inclusion
 - Ruled that the transfer to the trust was a completed gift for federal gift tax purposes
 - Ruled that the self-settled spendthrift trust is not included in the settlor's gross estate merely because the settlor is eligible in the trustee's discretion to receive distributions of trust income and corpus
 - Subsequent articles indicate that this result might only be obtained in Alaska and Nevada due to other states having "carve outs" in their self-settled asset protection trust statutes - reasoning based on the Regs. under IRC § 2036 (a)(1) see e.g., Reg. 20.2031-1(b)(2), and Rev. Rul. 2004-64
 - Counter arguments indicate that this result should not be expected to be limited to Alaska and Nevada, based on
 - ✓ "acts of independent significance" doctrine – see e.g., Ellis v. Commissioner 51 T.C. 182 (1968), judgment aff'd, 437 F.2d 442; Rev. Rul. 80-255
 - ✓ federal statute of limitations for claims period for child support actions applying to Alaska statute – 28 U.S.C.A. § 1738B

DINGs: Delaware Incomplete Non-Grantor Trusts

Delaware Incomplete Non-Grantor (“DING”) Trusts – the basics

What it is

- This is a trust that is an incomplete transfer for gift and estate tax purposes, and a non-grantor trust for income tax purposes
- The settlor can place low basis assets in the trust without incurring gift taxes, and the trust can sell the assets without any state fiduciary income tax on the capital gains and the gains not be taxed to the settlor
- Trust assets can be distributed to the settlor, at the discretion of a distribution committee named by the trust instrument

How it works

- The DING Trust must be created in a state that allows self-settled asset protection trusts
- The DING Trust must be an asset protection trust because a trust is a grantor trust if the settlor's creditors can attach the trust's assets under Treasury Regulation Section 1.677(a)-1(d)
- **Whether the state income tax result can be obtained also depends on the state of the settlor, beneficiaries, or trustees**

Delaware Incomplete Non-Grantor (“DING”) Trusts – Considerations

- The transfer to a DING can be structured as an incomplete gift due to the settlor retaining a limited testamentary power of appointment and/or right to veto distributions to other beneficiaries
- The DING can be a non-grantor trust for income tax purposes by using a distribution committee with an adverse party having to approve distributions to the settlor
- A DING was not a possibility during 2010 due to IRC § 2511(c)
 - IRC § 2511(c) states that a “transfer in trust shall be treated as a transfer of property by gift, unless the trust is treated as wholly owned by the donor or the donor's spouse”
 - However the Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010 provided that IRC § 2511(c) expired as of December 31, 2009
- **Private Letter Rulings** issued by the Office of the Associate Chief Counsel, Passthroughs & Special Industries spanning from 2001 to 2007, the latest being PLR 2007729025 (April 10, 2007) address, in part, the gift tax consequences under sections 2511 and 2514 of the Internal Revenue Code of trusts that utilize a distribution committee consisting of trust beneficiaries who direct distributions of trust income and corpus
- **IR-2007-127** – July 2007, the Internal Revenue Service announced that it was reconsidering the private letter rulings, stating that, “It has come to the Office of Chief Counsel’s attention that the conclusions in the PLRs regarding the application of section 2514 may not be consistent with Rev. Rul. 76-503, 1976-2 C.B. 275, and Rev. Rul. 77-158, 1977-1 C.B. 285. Accordingly, the Office of Chief Counsel is requesting comments as to whether the conclusions in these PLRs regarding section 2514 can be reconciled with the revenue rulings”

Delaware Incomplete Non-Grantor (“DING”) Trusts – recent CCM

- Under Chief Counsel Memorandum (CCM), the IRS has changed its position on using testamentary powers of appointment to avoid gift tax through the creation of incomplete gifts
- Although the DING structure relies on a power of appointment, it also relies on the grantor:
 - Retaining a beneficial interest
 - Having a veto type of power over distributions

Moving an Existing Trust to Delaware and the Use of Trust Reforms

Moving existing trusts to Delaware – nexus for Delaware choice of law

- Moving existing trusts to Delaware may be desirable to the advantage of Delaware's directed trustee statute or other favorable law
- If the trust instrument does not incorporate the flexibility to change governing law or add trustees, it may be more difficult to move a trust to Delaware
- A material connection with Delaware is required to establish Delaware as a governing jurisdiction
 - Lewis v. Hansen, 128 A.2d 819 (Del. Supr. 1957), aff'd sub nom. Hanson v Denckla, 357 U.S. 235, reh'g denied, 358 U.S. 858 (1958)
 - Three prong test:
 - 1) Settlor's intent;
 - 2) Domicile of Trustee; and
 - 3) Location of the administration of the trust
- "Nexus Test" limits a settlor's ability to choose whose laws will determine the validity of the trust
- A "substantial connection" between a state and a trust is generally required for a state's law to apply to questions of validity and governance

Moving existing trusts to Delaware – procedures and practical considerations

Moving existing trusts to take advantage of trust adviser statute and other favorable state laws

Procedure

Trust adviser statute states “governing instrument” must authorize fiduciary to follow direction of an adviser. In order to amend an existing trust to include trust advisers under Delaware law, several steps are required:

Step 1:

- Pursuant to the trust instrument, remove or replace the current trustee with Delaware trustee or add Delaware co-trustee
- If trust instrument does not allow appointment of a Delaware trustee, court approval in the home state may need to be obtained. Virtual representation may also be available

Step 2:

- Add trust adviser provisions to governing instrument by “**reformation**” petition filed with Delaware Court of Chancery
 - If the trust instrument specifies that the trust must be governed by the original state law, it is advisable to get court approval in the home state to change administrative law to Delaware
- Need consent of interested parties (minors and unborns can be virtually represented)
- The reformation petition seeks an order from the Court of Chancery that:
 - i. Confirms the appointment of the Delaware trustee
 - ii. Accepts the jurisdiction over the trust
 - iii. Confirms the law of administration of the State of Delaware will thereafter govern trust administration, and
 - iv. Reforms the trust to avail it of the trust adviser (or other) statute
- Reformation process is expedient and inexpensive
- Note: Decanting may also be used to add the trust adviser provisions

Moving existing trusts to Delaware – procedures and practical considerations (cont.)

Moving existing trusts to take advantage of trust adviser statute and other favorable state laws

Procedure

Step 3:

- Court of Chancery issues an order confirming the petition
- Trust amended with trust adviser provisions
- Administrative law of Delaware will apply to trust
- Unless governing law is also changed, matters of validity will remain governed by laws in the home state

Recent Amendments to Court of Chancery Rules for Consent Petition Proceedings

On April 12, 2012 the court amended Court of Chancery Rules 100 – 103

- **Rule 100 – Contents of a petition to modify a trust by consent**
 - Describes the contents that the Petition must cover
 - Petition must specify whether Delaware law governs the trust
- **Rule 101 – Appendix of exhibits to consent petition**
 - Appendix must include terms of the proposed modification and a blacklined version of the trust
- **Rule 102 – Form of consents to the relief sought in the petition**
 - Specifies the signature and disclosure requirements for the consent
- **Rule 103 – Consent petitions appending consents under 12 Del. C. § 3547**
 - Details the requirements for consents when Delaware's virtual representation statute is used
 - Requires certification by “senior Delaware attorney and senior out-of-state attorney” involved in the matter

Moving Existing Trusts to Delaware – GST tax implications

- Treas. Reg. Section 26.2601-1
- Trust duration is a matter of “validity” under the state laws where trust was created
- Matters of validity such as trust duration usually do not change when a trust is moved and then administered in a different jurisdiction
- Attention must be given when moving a GST exempt trust to a jurisdiction with a longer (or no) perpetuities period to preserve exempt status
 - Treasury regulations provide that “modification” will not taint GST exempt status if modification does not (1) shift beneficial interest to lower generation beneficiary; or (2) extend vesting beyond period provided in the original trust
 - What if original trust instrument does not expressly state that the “validity” of the trust shall be determined in accordance with current state’s law? Possible concern that move to Delaware (i.e., no rule against perpetuities in Delaware) could cause trust to lose GST exempt status
 - 12 Del. C. § 3332 provides duration and time of vesting shall not change merely because the place of administration is changed from other jurisdiction to Delaware
 - Consider reformation petition in Delaware incorporating language of Delaware statute, stating that only laws of administration and not laws of validity nor construction are changed
- Consider whether obtaining a private letter ruling to confirm the GST exempt status after the move to Delaware is desirable

Delaware has a Long History of Being a Trust Friendly Jurisdiction

Delaware has a long tradition and is fully developed as a trust situs

- Court of Chancery has been in existence since 1792
 - Known for excellence, efficiency, and flexibility in acting on fiduciary cases
 - Court proceedings are quickly handled, and incur moderate cost
- Delaware's legal bar and trust industry are very developed
 - Many nationally known Delaware trusts and estates practitioners
 - Delaware attorneys work frequently and closely with local counsel
 - Delaware attorneys are experts and a resource to practitioners nationally
 - Delaware has more trust providers than many states – more than 75 institutions listed on the Delaware Banking Commissioner web site, including local, regional, national, and international providers
- Delaware has a long history of being a progressive trust environment
 - Known for investment flexibility long before the Prudent Investor Rule was promulgated
 - Known for confidentiality when needed
 - Many states have used Delaware's statutes as a model their trust laws

As we close for the day



Delaware is a small state with several advantages which may provide significant benefits for your clients.

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