

ESTATE PLANNING AND DELAWARE TRUSTS

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FEDERAL ESTATE TAX

2005 – 2009

- Maximum rates
 - 47% in 2005
 - 46% in 2006
 - 45% in 2007 – 2009

2010

- Estate tax repealed

2011 and after

- Estate tax reinstated with 55% maximum rate

President Bush's Budget Proposals (released February 8, 2005)

- Provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) that sunset on December 31, 2010 would be permanently extended
- Reason for change
 - Taxpayers should have the certainty of knowing that the provisions of EGTRRA will extend beyond 2010

STATE ESTATE TAX

Federal Treatment of State Estate Tax

- 2005 – 2009: Federal credit repealed and replaced with deduction
- 2010: Federal estate tax repealed
- 2011 and after: Return to Federal credit (maximum rate of 16%)

Types of State Estate Tax Provisions

- Conformed pick-up tax with no separate tax
- Conformed pick-up tax with separate tax
- Decoupled pick-up tax with no separate tax
- Decoupled pick-up tax with separate tax

ESTATE PLANNING AT DEATH

- Federal estate tax credit
- Marital deduction
- Charitable deduction
- Generation-skipping transfers
- Provisions in case of estate tax repeal

Estate tax credit and GST tax exemption

2005	\$1.5 million
2006-08	\$2 million
2009	\$3.5 million
2010	Tax repealed
2011	\$1 million

ESTATE PLANNING DURING LIFE

Tax-free Gifts

- Annual Exclusion
- Tuition and Medical Exclusion
- Life Insurance Trust
- Gift Tax Credit (\$1 million)
- Grantor Retained Annuity Trust (GRAT)
- Sale to Grantor Trust
- Valuation Discounts
- Personal Residence Trust

Taxable Gifts

GST DYNASTY TRUSTS

Gift tax credit: \$1 million

GST exemption

- 2005: \$1.5 million
- 2006 – 2008: \$2 million
- 2009: \$3.5 million
- 2010: Tax repealed
- 2011 and after: \$1 million

GST planning techniques

- Transfer gift tax credit to GST trust
- Transfer GST exemption to lifetime QTIP trust

Dynasty trusts

- Delaware Code, Title 25, Section 503
 - Perpetual trusts for personal property
 - 110 year perpetuities limit for real property
- New trusts
- Existing trusts
 - Caution regarding GST grandfathered trusts
- Property shielded from future transfer tax

USING DELAWARE TRUSTS FOR GIFTS

In order for a gift to be removed from the donor's estate, the donor generally must part with control

- Section 2036 includes property where donor retains income or enjoyment or right to control interests of others
- Section 2038 includes property where donor retains right to alter, amend or revoke
- If donor's creditors can reach property, assets will be included in donor's estate
 - If donor transfers property to an irrevocable trust and the trustee has the discretion to make payments to the donor, creditors generally can reach trust assets
 - In certain jurisdictions, however, the ability of the trustee to make discretionary distributions to donor may not subject the assets to claims of creditors
 - Delaware Qualified Dispositions in Trust Act (1997)
 - Alaska (1997)
 - Rhode Island (1999)
 - Nevada (1999)
 - Utah (2003)

ASSET PROTECTION - WITHOUT TRUSTS

Asset protection has become popular in recent years

- Publicized cases involving large awards to plaintiffs
- Possibility of Federal estate tax repeal allows focus on other concerns
- Domestic asset protection statutes

Forms of asset protection

- Transfers to others
 - Marital deduction for interspousal transfers
 - Gift tax consequences for other transfers
- Corporate form of ownership
 - Shareholder not liable for debts of corporation
- Limited partnership and limited liability company
 - Limited partner or member not liable for debts of entity
 - Creditors of partner or member may not satisfy claims out of entity's assets
 - Creditor may only be entitled to distributions from entity which are otherwise made (charging order)

ASSET PROTECTION - TRUSTS

Donor transfers property to an irrevocable trust

- Trustee has discretion to distribute income or principal to donor
- Donor retains testamentary special power of appointment

Gift tax - not a completed gift for gift tax purposes

Estate tax – property included in donor's estate

Income tax - income taxed to donor (grantor trust)

Creditors' rights

- Most United States jurisdictions – subject to claims
- Certain foreign (offshore) jurisdictions – limitation on claims
- Domestic asset protection jurisdictions – limitation on claims
 - Delaware Qualified Dispositions in Trust Act (1997)
 - Alaska (1997)
 - Rhode Island (1999)
 - Nevada (1999)
 - Utah (2003)

DELAWARE QUALIFIED DISPOSITIONS IN TRUST ACT

Delaware Code, Title 12, Sections 3570 – 3576 (effective July 1, 1997)

- Qualified Trustee
 - Natural person (other than transferor) who resides in Delaware or is a Delaware entity
 - Maintain or arrange for custody in Delaware of some or all of the trust property, maintain trust records, arrange for preparation of fiduciary income tax returns, or otherwise materially participate in the administration of the trust
 - May also have non-Delaware trustees
 - Transferor may also appoint advisers
- Trust instrument
 - Expressly incorporate Delaware law
 - Spendthrift clause
 - Irrevocable
 - Trustee may have discretion to make distributions of income or principal to transferor
 - Transferor may retain testamentary special power of appointment

DELAWARE QUALIFIED DISPOSITIONS IN TRUST ACT

Certain creditors may reach property

- Present creditors
 - Must prove that transfer was fraudulent
 - If debtor made transfer without receiving fair value and debtor was insolvent or became insolvent as a result of transfer, or
 - If below definition applies
 - Time limit: within 4 years of transfer, or if later within 1 year after transfer was or reasonably could have been discovered
 - Future creditors
 - Must prove that transfer was fraudulent
 - If debtor made transfer
 - » with actual intent to hinder, delay or defraud, or
 - » without receiving fair value and (1) debtor engaged in business transaction for which remaining assets were unreasonably small or (2) debtor intended to incur debts beyond debtor's ability
 - Time limit: within 4 years of transfer
 - Support or alimony payment for spouse (who was married to transferor at or before the disposition) or children
 - Any person who suffers death, personal injury or property damage on or before the date of the disposition
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DELAWARE ADMINISTRATIVE TRUSTS

Delaware Code, Title 12, Section 3313

- One or more advisers may be given authority by terms of instrument to direct a fiduciary's investment decisions
- If the fiduciary follows the adviser's directions, the fiduciary shall not be liable for any loss resulting directly or indirectly, except in case of willful misconduct

U.S. Trust Company of Delaware as Administrative Trustee

- Administrative functions handled by USTDE
 - Custody of assets
 - Trust accounting
 - Fiduciary tax preparation
 - Income collection and distribution
 - Exercise of non-investment discretion
- Investment functions handled by investment adviser

DELAWARE ADMINISTRATIVE TRUSTS

New trusts

- Mandatory provisions
 - Appointment of investment adviser
 - Exoneration of administrative trustee
 - Resignation and removal of administrative trustee
 - Removal of investment adviser
 - Delaware governing law and selection of Delaware as forum for any judicial proceedings

Existing trusts

- Reformation of trust terms
 - Change law governing administrative aspects to Delaware
 - Add above mandatory provisions
 - Reformation proceeding in Delaware or in original jurisdiction
 - Caution regarding GST grandfathered trusts

FIDUCIARY INCOME TAX

Delaware resident trust

- Definition (Delaware Code, Title 30, Section 1601)
 - Created by will of Delaware decedent
 - Created by Delaware resident
 - Delaware trustee
- Allowance of deduction for income which is set aside for future distribution to nonresident beneficiaries (Delaware Code, Title 30, Section 1636)
 - Avoids Delaware fiduciary income tax on undistributed income and capital gains
- Delaware also does not impose any tax on trust income that is distributed to beneficiaries

DISCLOSURES AND FOOTNOTES

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