

# TRUSTS & ESTATES



WEALTH PLANNING > ESTATE PLANNING

## Trust Friendly States

*A comparison of two jurisdictions*

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Most folks (and lawyers) tend to set up trusts in the state where they live and their lawyer practices. While this might seem logical has historically been the norm, it

may not be the optimal approach in many cases. The use of trust friendly jurisdictions has become commonplace, and for some practitioners, the default choice in structuring a trust. For estates that face a federal estate tax or which might absent the trust planning involved, as well as for clients concerned about asset or divorce protection, it can be advantageous to have that client's trust created in one of these better jurisdictions and have the law of that jurisdiction apply to the trust, instead of the client's home state.

The most popular trust friendly jurisdictions are: Alaska, Delaware, Nevada and South Dakota.

The following illustrates some of the many advantages one of the premier trust friendly jurisdictions can afford to a trust. While the advantages can be significant, some lawyers assume that the courts in the so-called trust friendly jurisdictions will "rubber stamp" any request made for a trust. Two recent cases make clear that, while these jurisdictions remain trust friendly, don't presume that means their courts will do anything you want. The Delaware courts, for example, will endeavor not to step on the toes of courts in other jurisdictions. Further, the mere fact that beneficiaries unanimously agree to make certain changes to a trust doesn't assure that the court will consent to the requested change if it violates the settlor's intent as evidenced in the governing instrument. Some believe that the Delaware Courts are becoming less inclined to rule on non-adversarial cases. None of this detracts from the many advantages the trust friendly jurisdictions can afford or the suggestion that using those jurisdictions as the default plan when forming a complex trust should change. Perhaps it's merely a sign of the growing use of these jurisdictions, the maturation of modern trust drafting and the delineation of reasonable boundaries as to the flexibility of modern trust drafting in practical terms.

## **New Jersey Versus Delaware**

To illustrate some of the many advantages of one trust friendly jurisdiction over what a different state offers, consider the following:

- Delaware has a directed trust statute, New Jersey doesn't. So in Delaware, the trust document can name an advisor or committee to direct the trustee on investments. Delaware has had this for over 100 years. This can be critical to holding a closely held business or other unique asset in a trust and still securing a top tier trustee. If a settlor in New Jersey wants a trust to hold interests in a family business he may need an individual trustee because many trust copies won't assume the liability exposure that holding a concentrated private equity asset in a trust will entail. If a corporate trustee does hold such an asset, it will likely have to factor into its fee the additional work and liability. Even if investment decisions are relegated to a different trustee, that won't assuredly insulate the institution.
- The Delaware courts have dealt with a range of "modern" trust drafting techniques, such as directed trusts and trust protectors, whereas the New Jersey courts appear to have had few if any cases involving these matters.
- Domestic asset protection trusts or self-settled trusts, which are trusts your client sets up and for which your client is a beneficiary, have been permitted in Delaware since 1997. About one third to one half of new Delaware trusts are some type of asset protection trust. New Jersey doesn't permit self-settled trusts.
- Silent trusts aren't sanctioned by statute in New Jersey. In Delaware, if the governing instrument says that trustee doesn't have to notify beneficiaries of interests in the trust, the trustee can honor that restriction. If the document is silent, then Delaware trustees have to provide notice. Many Delaware corporate trustees seem to interpret Delaware law, under the *McNeil* case, to suggest that current beneficiaries should receive disclosures (for example, a copy of the trust instrument and an annual statement) at a reasonable age (for example, 25 or 30) unless there are extenuating circumstances.
- Perpetual trusts are allowed in Delaware. New Jersey also allows perpetual trusts. Score one for the Garden State! But not all states have jumped on the perpetuities bandwagon. New York, for example, hasn't.
- Pre-mortem validation of a trust is feasible in Delaware. New Jersey doesn't have a statute for this. In Delaware, the trustee can send notice as to what the trust says to a beneficiary and then the beneficiary has 180 days to contest. If he doesn't do so, that beneficiary is precluded from challenging it later. The more substantial the planning done in advance of the notice, the better. So if the trust isn't funded, for example, the trust only had \$100, then after death \$10 million pours into it, the courts might not uphold the pre-mortem validation. Consider

the advantages to confirming an estate plan while the testator is alive and the potential cost savings of avoiding estate litigation.

- If your client funds an irrevocable trust in Delaware during his lifetime, then his probate estate won't be subjected to pay New Jersey estate tax. Since New Jersey doesn't have a gift tax, the New Jersey estate tax savings from funding a Delaware self-settled trust can be substantial.
- Delaware offers more flexibility in drafting. For example, your client can more securely establish a trust that instructs a trustee not to diversify a portfolio in Delaware than in New Jersey.
- Delaware updates its trust laws more frequently. This could prove vital if a new tax law, for example, had an adverse result. Delaware is more likely to respond, and to do so much more quickly, than a state like New Jersey.
- Income taxation of trusts is more favorable in Delaware. If a New Jersey resident sets up an irrevocable non-grantor Delaware trust (DING), it will avoid New Jersey capital gains tax. New York has restricted this technique.
- New Jersey taxes charitable remainder trusts (CRTs) at the trust level, Delaware doesn't. So if setting up a CRT, set it up in Delaware, not in New Jersey.

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