

# Delaware Trust and Tax Law Update 2008-2009

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In the last two years, Delaware has made some significant changes to its fiduciary and tax laws. A summary of the more significant changes is reflected below. If you have any questions regarding any of the legislative changes, please feel free to contact George Kern, the Senior Trust Officer in Bessemer's Delaware office.

## **2008 Legislative Changes To The Trust Code**

### **Purpose & Pet Trusts (See 12 Del. C. §3555, 12 Del. C §3556, and 25 Del. C. §503(a))**

As a refinement of the recently introduced concepts of Purpose Trusts and Pet Trusts to the Delaware Trust Code, a few modifications and improvements were made in 2008.

- (1) Though pet trusts and purpose trusts are both defined as non-charitable purpose trusts, they are now located in distinct sections because the rules related to each are now slightly different. New §3555 of Title 12 now pertains exclusively to trusts created for the care of animals. The rules particular to all other noncharitable purpose trusts (commonly referred to as “Purpose Trusts”) are contained in new §3556.
- (2) Section 503(a) of Title 25, relating to whether a perpetuities period is applicable, has been amended to confirm that Purpose trusts (those governed by §3556) may be perpetual.

### **Judiciary's Power To Allow a Fiduciary To Deviate From Investment Terms (See 12 Del. C. §3306)**

Section 3306 of Title 12, which relates to a court's power to allow a fiduciary to deviate from the terms of a governing instrument with regard to the investment or management of fiduciary property, has been modified to clarify that such power is subject to the provisions of §3303, which gives governing effect to express language.

### **Trust Protectors (See 12 Del. C. §3313(f))**

Delaware's “Directed Trust” statute, Section 3313 of Title 12, has been expanded to add a new subsection (f), which now specifically acknowledges the term “protector” and clarifies that the term “adviser” shall include a “protector”. Like any other adviser, a protector will serve in a fiduciary capacity, unless the governing instrument provides otherwise, and the protectors will have all of the powers and authority granted to them in the governing instrument. For those unfamiliar with the roles typically allocated to a protector, the new subsection contains a non-exhaustive list of the powers that a protector might be granted.

### **Tax Savings Statute (See 12 Del. C. §3314)**

Until the enactment of this legislation, Delaware was in the minority of states which did not have a statute preventing a beneficiary from being inadvertently subject to federal estate or gift tax as a result of distribution powers they possess as fiduciary. With the addition of new §3314, Delaware has now joined the majority. This new section prevents a fiduciary from having the ability to exercise a power which would otherwise result in the imposition of federal estate or gift tax. This section is a default rule, but trustors may opt out of the application of this statute, if they wish, through the inclusion of specific language in the governing instrument rejecting the application of §3314.

### **Discretionary Trusts (See 12 Del. C. §3315)**

To ensure no confusion exists regarding the standard to which a trustee's exercise of discretion will be measured, new §3315 was added. This section makes it clear that where a fiduciary has discretion with respect to the exercise of a particular power, its exercise is deemed proper unless a court determines such discretion has been abused. Delaware discretionary trusts are intended to be governed by Section 187 of the Restatement (Second) of Trusts and not by Sections 50 and 60 of the Restatement (Third) of Trusts. Moreover, a creditor of a beneficiary with a discretionary interest may neither directly nor indirectly compel the distribution except to the extent expressly allowed by the terms of the governing instrument.

### **Qualified Dispositions in Trust Act Changes (See 12 Del. C. §3570(11)(b)(7) and (9))**

- (1) **Change to Requirement Associated with the Power to Remove and Replace Fiduciaries.** Recognizing that many "Delaware Asset Protection Trusts" are established as incomplete gifts, it made sense to modify the current requirement for qualification under the Qualified Dispositions in Trust Act (the "Act") relating to retained powers to remove and replace trustees or adviser. Prior to the enactment of this legislation, a trust would only qualify under the Act if the Transferor's retained power mandated that the Transferor only appoint a replacement who was not related or subordinate as defined under IRC 672(c). Trusts will now qualify as a Delaware Asset Protection Trust under the Act even where the Transferor has retained an unrestricted right to remove and replace. (12 Del. C. §3570(11)(b)(7)).
- (2) **Income Tax Reimbursement.** A trust which mandates reimbursement of the trustor for income taxes paid on account of the income of the trust will now qualify under the Act as a Delaware Asset Protection Trust. Prior to this change, only discretionary reimbursement clauses were permissible under the Act. (12 Del. C. §3570(11)(b)(9)).

### **Statute of Limitations (See 12 Del. C. §3585)**

In certain circumstances, under the prior version of §3585, a limitations period for the initiation of actions against a trustee would never begin to run. Since not all claims would be barred after a reasonable period by the prior version of this section, a new subsection (d) was added to provide some finality to potential liability exposure of a trustee. This new subsection adopts a five year limitations period similar to that found in §1005(c) of the Uniform Trust Code ("UTC"). Under this new subsection (d) of §3585, an action against a trustee which is not otherwise barred through the application of the other subsections of §3585 will now be barred upon the running of five years from the first to occur of (1) the removal, resignation or death of the trustee; (2) the termination of the beneficiary's interest in the trust; or (3) the termination of the trust.

### **Effective Date**

The foregoing 2008 legislative updates to the Delaware Trust code became effective on August 1, 2008.

## 2009 Legislative Changes To The Trust Code

### **Trusts Resulting From Severance (See 12 Del. C. §3325(28))**

The trusts resulting from a trustee's exercise of a power to sever an existing trust do not have to be identical to the existing trust provided the interests of the beneficiaries of the resulting trusts are substantially equivalent to the interests the beneficiaries had before the trust was severed.

### **Personal Liability of Agents (See 12 Del. C. §3328(f))**

If an agent has been granted fiduciary powers, the agent is now provided the same protections from personal liability that other fiduciaries are provided under Delaware law.

### **Total Return Unitrusts (See 12 Del. C. §3527 and §3527A)**

Delaware law relating to the administration of total return unitrusts is now available to trusts which were initially converted to a total return unitrust under the laws of another jurisdiction.

### **"Decanting" Statute (See 12 Del. C. §3527)**

The current statute allowing for distributions in further trust, commonly referred to as the "decanting statute", allows for the distribution of principal in further trust even where the trustee's power to invade principal is subject to an ascertainable standard. However, the current statute failed to address whether the trust receiving the decanted principal had to be subject to the same invasion standard. This new legislation redresses that omission. It is now clear that any standard that limits the trustee's authority to make distributions from the first trust must be followed by the trustee when exercising the authority to decant.

### **Inter Vivos Marital Trust (See 12 Del. C. §3536(c))**

The Settlor of an *inter vivos* marital trust will not be deemed the settlor of a self-settled trust in instances where the settlor becomes a beneficiary of the trust as a result of the death of the settlor's spouse.

### **Tangible Personal Property Held in a Revocable Trust (See 12 Del. C. §3545)**

Tangible personal property held within a revocable trust may now be disposed of by a written memorandum.

### **Virtual Representation Available for Judicial Proceedings and Non-Judicial Matters (See 12 Del. C. §3547(d))**

Unless a governing instrument provides otherwise, Delaware's virtual representation laws will apply for the purposes of judicial proceedings and for any non-judicial matters. A "judicial proceeding" for the purposes of this section include any proceeding before a court or administrative tribunal in Delaware, including a proceeding that involves a trust whose administration is not currently governed by the laws of Delaware. "Non-judicial matters" for the purposes of this section include the grant of consents, releases or ratifications and the measurement of the limitation period for the initiation of actions against a trustee relating to matters disclosed within a report or statement provided by the trustee to a beneficiary.

### **Uniform Principal and Income Act (See 12 Del. C. Chapter 61)**

Delaware has now joined the forty-six other states which have adopted a version of the Uniform Principal and Income Act ("UPIA").

### **Effective Date**

The foregoing 2009 legislative updates to the Delaware Trust Code will become effective on August 1, 2009.

## 2009 Legislative Changes To The Tax Code

### Delaware Reinstated Its Estate Tax (*See 30 Del. C. Chapter 15*)

A budgetary shortfall in Delaware has precipitated the reinstatement of the Delaware Estate Tax. Within three days of its introduction, the new Estate Tax bill was enacted and made effective for decedents dying after June 30, 2009.

Following the elimination of the federal state death tax credit in 2005, Delaware did not have an Estate tax. The newly enacted Estate Tax will apply to taxable estates (i.e. those currently in excess of \$3.5 million) and will be calculated using the federal state death tax credit as it existed on January 1, 2001. However, the calculation of this tax will not take into account the I.R.C. §2058 deduction for state death taxes. This tax will have no application to nonresidents unless they own real or tangible personal property situated in Delaware.

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