CHRISTIANA
BANK & TRUST

~ ROUNDTABLE ~

THE PURSUIT OF INNOVATIVE TRUST STRATEGIES IN AN UNCERTAIN ESTATE PLANNING ENVIRONMENT

MODERATOR

Elizabeth Harris, *Reporter*
WORTH

PANELISTS

Todd Flubacher, *Attorney*
MORRIS, NICHOLS, ARSHT & TUNNELL, LLP

Linda B. Hirschson, *Attorney*
GREENBERG TRAURIG, LLP

Tom Pulsifer, *Attorney*
MORRIS, NICHOLS, ARSHT & TUNNELL, LLP

Jeffrey Levin, *Attorney*
HOLLAND & KNIGHT, LLP

Gideon Rothschild, *Attorney*
MOSES & SINGER

HOST

Tom Campbell, *E.V.P.*
CHRISTIANA BANK & TRUST COMPANY

SUMMER 2007

TOM CAMPBELL: Thank you all for joining us today. The past decade has witnessed attempts by a number of states, led by Delaware and Nevada, to provide attorneys with greater leeway to fashion innovative trust strategies. I believe all of us will agree that there are many more opportunities today to create trusts that meet a client's specific estate planning or other financial needs than there were when each of us began his or her career.

This morning's Roundtable will focus on those strategies that you find to be most useful today. We are honored to have, as our moderator, Elizabeth Harris, a reporter from Worth magazine and a long-time writer who has proved especially adept at explaining complex financial topics. I haven't polled our panelists, but I suspect that we would all agree that Worth is one of the few publications that truly is knowledgeable about leading-edge trust and estate planning strategies.

To begin, it may be helpful if each of you told us about your practice. Gideon, let's begin with you.

GIDEON ROTHSCHILD: I'm Gideon Rothschild, a partner at Moses & Singer in New York. We focus on domestic and international estate planning, as well as asset protection planning.

JEFF LEVIN: I'm Jeff Levin from the New York office of Holland & Knight. I'm a tax lawyer in our private wealth services group, where I focus on the various tax aspects of estate planning and international tax planning transactions.

LINDA HIRSCHSON: I'm Linda Hirschson from the New York office of Greenberg Traurig. I'm part of the tax, trust and estates group. My practice mainly centers on estate planning for high-net-worth individuals and the administration of trusts and estates.

TOM PULSIFER: I'm Tom Pulsifer, a partner in the trust, estates and tax group of Morris, Nichols, Arsht & Tunnell in Wilmington. We do traditional estate planning; however, about 80 percent of our practice involves advising institutional fiduciaries and attorneys who are considering a Delaware trust as an option for clients.

TODD FLUBACHER: I'm Todd Flubacher, Tom's colleague at Morris, Nichols.

TOM CAMPBELL: I'm Tom Campbell, and I run the Delaware and Nevada trust business of Christiana Bank & Trust Company.

DINGS AND DECANTING

ELIZABETH HARRIS: There have been a lot of changes and developments in terms of estate law from jurisdictions outside of New York State, such as Delaware and Nevada. Perhaps we can begin by touching on some of the interesting developments you've observed and how they affect your clients.

GIDEON ROTHSCHILD: One of the major jurisdictional issues we've seen is the repeal of the rule against perpetuities, which has been enacted in approximately 20 states. The self-settled trust legislation that currently exists in eight states also is a key development, as is the trend among estate attorneys to favor states that have no income tax on trust or fiduciary income.

TOM PULSIFER: Gideon, we are seeing considerable interest in the self-settled feature used in combination with the Delaware Incomplete Gift Non-grantor Trust – the so-called DING product. If employed appropriately and prudently, this enables individuals to create a self-settled trust (meaning the settlor is eligible to receive distributions from the trust), treated as a separate taxpayer for federal income tax purposes – perhaps beyond the reach of the taxing authorities in the settlor's home state.

For example, if you're living in New York and are considering an asset protection trust, one option is to design it as a DING trust. The assets held in the trust are not only beyond the reach of the settlor's creditors, but also are exempt from state income tax.

ELIZABETH HARRIS: I can't imagine that state legislators are uniformly happy with that feature.

TOM PULSIFER: That's an issue, Elizabeth. If these trusts are employed in an abusive manner, they could have a short shelf life. We would not be surprised if legislation is passed by a number of states to preclude this strategy's utility.

GIDEON ROTHSCHILD: Until that may occur, it's helpful to have some benefits other than just asset protection. In this case, the client receives both state income and federal income tax benefits.

However, it's important to note that there is a problem with DING, in practice. In order to make this work, the distribution committee has to be adverse to the settlor. Clients must acknowledge who their adverse parties will be. Not all clients are comfortable with that.

"I've had problems with old trusts on account of the way the New York statute reads. It requires full discretion in the trustee, but older trusts often are limited to an ascertainable standard. In that case, the trustee may not be able to decant under the New York statute."

– Linda Hirschson

JEFF LEVIN: Taking a macro view, Elizabeth, I believe we will see an even larger number of trusts shift to Delaware, on behalf of residents of New York and other high income tax states. This can enable clients to save the state income taxes on the trust income, as long as it's accumulated within the trust and not distributed to beneficiaries or residents in those states. The use of Delaware trusts is already an important part of our practice, but it is poised to assume even larger proportions.

GIDEON ROTHSCHILD: Another development worth mentioning is that Delaware, New York and Florida have all created decanting statutes. It's become popular for the trustee to have certain powers to alter a trust if circumstances or individual family situations have changed, or the client does not like the way the trust was written, perhaps long ago.

Generally you have to retain the same beneficiaries, unless you have a purely discretionary spending trust. Then, you can exclude beneficiaries. You do have to be careful, though: there may be exposure for the trustee if some beneficiaries are suddenly cut out and others added.

LINDA HIRSCHSON: One development that would be welcome, Elizabeth, would be far greater flexibility to decant under the New York statute. I've had problems with old trusts on account of the way this statute reads. It requires full discretion in the trustee, but older trusts often are limited to an ascertainable standard. In that case, the trustee may not be able to decant under the New York statute.

GIDEON ROTHSCHILD: Even worse, Linda, are the insurance trusts. Attorneys sometimes assume that the trust's provisions will not go into effect until after the grantor's death, so they include absolutely nothing to provide for trustee powers during the grantor's lifetime. That can be a problem.

TOM PULSIFER: You might have noticed that the Delaware statute expressly allows for decanting, even if there's an ascertainable standard in the trust agreement. Delaware used the New York statute as its model when crafting its own statute, but unlike New York decided to permit decanting from trusts governed by an ascertainable standard.

We assumed that the most common use of the decanting statute would be to clean up old documents, since they tend to have amorphous provisions that are difficult to interpret, or arcane provisions that simply don't work anymore.

We wanted the opportunity to clean up these old documents to be available to all trusts regardless of the distribution standard appearing in the trust instrument. However, decanting can be used for all sorts of purposes. For example, your client may want to divide a trust into smaller trusts, so different beneficiary groups can invest differently.

If a statute allows you to decant even with an ascertainable standard, you can then decant into a new trust that's identical with respect to beneficial interests, maintains the same ascertainable standard, but changes administrative provisions.

ELIZABETH HARRIS: In the new trust, are you required to keep the same ascertainable standard?

TOM PULSIFER: Not necessarily, but you do have to abide by the ascertainable standard in the first instance when making a distribution to the new trust. As a result, you are constrained. If the agreement says you can make distributions among A, B and C only for health, education, and maintenance, you can't create a new trust that says you can make distributions to A for any reason you want. It would be difficult to argue that you abided by the ascertainable standard when making the distribution. In theory, you could, however, use a portion of the trust assets to set up an education trust just for A, or create a standalone health trust essentially going from a broader ascertainable standard to a narrower one. But you don't see that done very often.

When there is an ascertainable standard, it's most common to see no change in beneficial interests. Decanting is used primarily to modernize the document or deal with administrative provisions.

GIDEON ROTHSCHILD: Another positive development is an increase in the number of states that allow for a protector. Because we never know what the future holds, a protector who's given certain powers to amend the trust or to add and remove beneficiaries can be very useful. This is particularly true when we deal with perpetual trusts. It's very possible that an old trust won't have a protector, and you may want to use the decanting statute to provide for protector status.

STRUCTURING THE ROLE OF TRUSTEES

ELIZABETH HARRIS: Let's discuss the nature of the risks to trustees and the trustees' role. Todd?

TODD FLUBACHER: In Delaware there is a statute that says you can draft virtually anything you want in a trust agreement, except for exculpating the trustee for willful misconduct or preventing a beneficiary from being able to remove a trustee for willful misconduct. Apart from those two things, you can draft a trust agreement in any manner that accomplishes your goals. Through astute drafting, you can provide a standard of trustee liability and the right to indemnification that you and the trustee can agree to. You also can add various provisions with trust protectors, investment advisors and distribution committees.

There are a lot of bells and whistles available under Delaware law in terms of defining the trustee's role and the role that special advisors can play to accomplish your goals for the trust. Delaware has a directed trustee statute that enables the trustee to act solely at the direction of an advisor without having to monitor or second guess the decisions of the advisor. The ability to have a directed trust in Delaware has become a huge attraction for clients because they can effectively bifurcate responsibility for investments, distributions or other activities from the rest of the trust administration.

For example, you want to fund a trust with real estate, a closely held company or a large concentration of a single stock, which trustees generally do not want to hold because of their fiduciary duties, you can name an investment advisor that will have sole responsibility for investment decisions generally, or over that one asset. In addition, the trust can hold the assets in a LLC and an advisor can direct the trustee to hold the LLC. We see existing trusts moving to Delaware and getting a court reformation to add an investment advisor to direct the trustee.

JEFF LEVIN: There have been situations where families have had historic trusts managed by large trust companies, and the beneficiaries over time have become dissatisfied with the performance. Under the Delaware Statutory Trust, an individual can choose his personal financial advisor to manage the trust assets, but still receive the benefits of the trust from an estate planning and asset protection standpoint.

TOM CAMPBELL: The Delaware Statutory Trust has been used on the corporate side for a long time, but it essentially turns the trust into a contract that also can have applications for families.

TOM PULSIFER: Right. Initially, the Delaware Statutory Trust was envisioned as being useful in a commercial setting rather than in a family estate planning setting. However, we're seeing these trusts used more often on the family side, because they enable the family to file a certificate of formation that is recognized by the government. This is akin to a corporation or a limited partnership formed pursuant to state law and sometimes makes it easier to deal with conflicts of law issues.

I would argue, however, that although some families may be more comfortable with a statutory model, they should be able to use a Delaware common law trust in a contract-like manner, as well.

> **"The Delaware Statutory Trust has been used on the corporate side for a long time, but it essentially turns the trust into a contract that also can have applications for families."**
>
> *– Tom Campbell*

BENEFICIARY CONTROL

ELIZABETH HARRIS: Beneficiaries in recent decades have been seeking greater control. Are there any interesting examples that you've dealt with in the last six months?

GIDEON ROTHSCHILD: One of my clients set up an asset protection trust. Years afterward, her husband, from whom she had received funds, was involved in a settlement in which he was responsible for liabilities representing several million dollars. The husband had a million dollars he could contribute, and my client had agreed that she would contribute a million dollars from her trust. However, the trust company, after being told that she needed this money to contribute towards a settlement for which she was a creditor, refused to allow the transfer. They maintained that she had an asset protection trust, and as the trustee, the bank was obligated to protect the trust from creditors.

So, she removed the trust company. That's just one of many examples of beneficiaries who wish to control a trust to a greater extent. One way that we are able to assure some degree of control is to allow the beneficiary to have the power to remove a trustee if the trustee is not willing to play ball.

TOM PULSIFER: The dynasty trust is the most classic example of a situation in which beneficiaries believe they have a right to greater control.

For example, the grandfather sets up the trust, and upon his death it divides into as many shares as he has then-living children. On the death of each child, a share is set aside, again, for grandchildren. So each issue through the years will have a trust that's dedicated to him or her and their then living issue.

This keeps those assets out of the transfer tax system, and also beyond the reach of creditors. We've always favored this kind of planning, and we believe it's wise to convince the next generation that it's more valuable to receive assets in trust than to receive the assets outright. I'd rather have a million dollars in a properly designed trust than a million dollars in my pocket. That million dollars in my pocket will be subject to greater taxation, and if I am involved in a car accident and subject to a lawsuit, it may disappear altogether – when it could have been better protected from taxes and creditors in the trust.

FAIR AND EQUAL

ELIZABETH HARRIS: It's been said that in estate planning there's a difference between fair and equal. I'm wondering how you advise clients who may wish to give different amounts to different family members. Are there any interesting examples?

LINDA HIRSCHSON: I can think of one example where circumstances favored a client's daughter more than his son. The son had an equal amount of money as the father, so the father didn't feel the need to provide for him. We ended up in a lawsuit, because the son felt he was entitled to more equitable treatment. We won the lawsuit.

TOM PULSIFER: There is a Delaware statute that hasn't been used that frequently, but it was designed specifically for the situation you just described, Linda. The statute provides that once you notify the beneficiaries that you have created a trust that provides for a disposition of assets, they have a very limited time-frame within which to challenge the trust's validity. This holds even if it is a revocable trust. Should a disgruntled party initiate a lawsuit, it will be a lot easier for Mom and Dad to defeat it while they're alive, rather than relying on personal representatives after the trust provisions have been triggered.

JEFF LEVIN: Theoretically, the parents will have an opportunity to diffuse some of the conflict, since they can explain the rationale behind their decision in-person. However, the safest approach is to convey this rationale in a written memorandum or in letters. If it is challenged, there's a written record of why the parents decided to dispose of the assets in a certain way.

GIDEON ROTHSCHILD: The "fair and equal" issue often emerges when a family business is involved. A proprietor with three children may reason that his oldest son, who worked in the business for the last 20 years, should be left the business. Unfortunately, what the proprietor may consider fair from a business perspective may be viewed as terribly unfair by the two children who did nothing to build or sustain the business – especially if there aren't enough assets to provide an equal distribution.

INCENTIVE TRUSTS

ELIZABETH HARRIS: Does anyone have experience with incentive trusts that are meant to motivate beneficiaries to behave or act in a certain manner?

GIDEON ROTHSCHILD: Incentive trusts are a terrible idea. An incentive trust is simply too rigid. I favor giving more discretion to a trustee who can exercise his best judgment, based on the circumstances that exist at the time. If you have a child with a substance abuse problem, for example, there simply is no need to establish an incentive trust to motivate him to be drug-free. You can create a discretionary trust that enables the trustee to respond to the situation as it evolves.

A number of incentive trusts seek to motivate children to be economically successful through some form of match. But it is patently unfair if one child opts to be a teacher who makes $50,000 a year and her sibling makes $5 million a year as an investment banker.

LINDA HIRSCHSON: There are a number of variations on this theme. An incentive trust with the type of match that you describe also might be unfair to a child who stays home to raise her children. That may be a valuable service to her family and society, but how do you put a price on that?

JEFF LEVIN: I've seen the reverse, Linda. Rather than have a match, distributions can be cut off if the beneficiary has substance abuse problems or refuses to look for work. We also have been involved with a discretionary trust in which distributions are allowed to be stopped if certain actions are undertaken by a child. In this case the parents are using the trust to encourage certain behavior, but from a more punitive standpoint.

GIDEON ROTHSCHILD: In many cases, I will strongly advise that the trust documents provide for a holdback provision in the event of creditor problems, divorce or substance abuse. However, even that should still be at the trustee's discretion.

If a beneficiary has creditor problems and the trust calls for mandatory distributions of income, the trustee of a mandatory income trust can rearrange the investments in that trust to minimize the income. Similarly, if a beneficiary is going through a divorce, income also can be minimized. This flexibility doesn't exist with a unitrust in New York, which mandates that the trustee has to distribute four percent each year to the beneficiary, regardless of their situation. Normally, I'm not an advocate of the unitrust. A trustee's discretion can be essential in these cases.

LINDA HIRSCHSON: I've taken a totally opposite view on occasion, Gideon, especially in a marital trust. In cases where I represented the wife in negotiating a pre-nuptial or a post-nuptial agreement, I've provided for the marital share to be a unitrust. This avoids a situation where the trustees, who may be children from the first marriage, may deprive the spouse of needed income due to their investment decisions. The unitrust works very well under those circumstances.

TOM PULSIFER: I have spent a lot of my career reading documents from the 1930s. Some of these documents were probably written by the best lawyers around, but it is mind boggling how arcane and inappropriate the provisions are today. These attorneys did the best they could, but they didn't have a crystal ball, so the documents often just don't work anymore.

By limiting the flexibility of a trust, we may be making the same mistakes that attorneys and their clients made in years past. Whenever we create a trust, it's essential to keep in mind that that a lawyer may be looking at it 70 or 80 years from now.

Absent special circumstances along the lines of what Linda discussed, I believe it is permissible and even prudent to write into the trust instrument the broadest possible provisions. Providing maximum flexibility for the administration of the trust is the best we can do, considering that the future is always unknowable.

THE ROLE OF PROTECTORS

GIDEON ROTHSCHILD: If a child needs money for reasonable expenses, the trustee will distribute it. If the trustee refuses, the child's protector will remove him. If the child requests the money to buy a house in the Hamptons, then I would encourage the trustee to allow the trust to buy that house and let the child have full, rent-free use of the asset. That can help to ensure that the property doesn't become subject to a divorce or creditors.

"I have spent a lot of my career reading documents from the 1930s. Some of these documents were probably written by the best lawyers around, but it is mind boggling how arcane and inappropriate the provisions are today."

– Tom Pulsifer

LINDA HIRSCHSON: Gideon, I have a problem if you rely too much on the ability of the protector to fire and hire. If that happens again and again, every time there is a disgruntled beneficiary, the end result may be serious tax problems.

TOM PULSIFER: I find that for the most part, you rarely have to fire the trustee. Usually he doesn't call your bluff, especially if your arguments fall within the range of how the trust is reasonably expected to be administered. A beneficiary who wants the trustee to buy a house can act as the investment advisor and direct the purchase of the house. The beneficiary will need the trustee to give him permission to live in the house without rent, but can still retain a lot of control without stepping over that invisible tax line.

The invisible creditor line is more problematic. Some beneficiaries, in all candor, are folks that you wouldn't wish on your worst enemy. So maybe the trustee would be happy to be fired. There are situations where beneficiaries incessantly hire and fire trustees, and badger them mercilessly. If there's an appropriate section 672 (C) constraint upon the selection of successor trustees, the chances of creating a general power of appointment by course of conduct seem negligible to me. However, there may be some point at which the beneficiaries create a track record that will open the trust up to creditor problems.

TOM CAMPBELL: I would just follow up on that by saying that trustees want to make the trust work in line with how the trust is written. It's not a matter of a trustee saying "no," but a matter of doing what is reasonable and appropriate. Ultimately, it is the trustee's responsibility to follow the wishes of the settlors. However, that doesn't mean that the trustee must be totally inflexible.

ASSET PROTECTION TRUSTS

ELIZABETH HARRIS: What do you consider the best practices in regards to asset protection trusts?

GIDEON ROTHSCHILD: There are 10 states that now permit individuals to create trusts for their own benefit. And that's become very useful, to avoid having to go offshore to accomplish the same objectives. As long as these trusts are established at a time when there are no creditors on the horizon, they should stand up. So far, we haven't seen any challenges.

I don't know how many thousands of Delaware trusts have been set up for pure asset protection purposes. Although the number may be quite high, I suspect that only a small percentage of Delaware residents have actually established Delaware self-settled trusts, and that puzzles me. You would assume that the doctors and lawyers in Delaware are concerned about malpractice – and for people in any profession or line of business, there is always the potential for divorce.

ELIZABETH HARRIS: How do these trusts address the possibility of a divorce?

GIDEON ROTHSCHILD: There are crucial differences in the way state asset protection statutes are written in regard to divorce, which can make one state more favorable than others. Delaware, for example, has a statute that says that if you settle the trust prior to marriage, then the future spouse cannot make a claim against the trust in the event of a divorce. Delaware law also stipulates that if you settle the trust after you're married, it doesn't prevent a spouse from making a claim to enforce a judgment.

Nevada and Alaska, on the other hand, have taken different approaches. Alaska provides specifically that an asset protection trust is protected from all claims, including those that arise out of a family or marital relationship. Nevada is silent on this issue and has a two-year statute of limitations. Someone who is concerned with keeping things open for a while might choose to go to Nevada versus Delaware.

Alaska and Delaware probably have the most detailed provisions because they keep improving and updating them. Other states are somewhat complacent and just live with whatever was originally adopted. However, I understand South Dakota is making some modifications now to their statutes, as is Nevada.

TOM PULSIFER: Gideon, does the state limitation period really matter much anymore, given the federal bankruptcy limitation period?

GIDEON ROTHSCHILD: That depends on whether you're in bankruptcy or not. You're referring to the 10-year statute that was adopted under the 2005 Bankruptcy Act, which applies to any self-settled trust or similar device that was settled with an intent to avoid future creditors. There are many unknowns that have to be parsed out in litigation. For example, what is a similar device? Who constitutes a future creditor? Is it any creditor that arises during that 10-year period or is it creditors who are foreseeable at the time you settle the trust?

TOM PULSIFER: The concern I have is the creditor who may be able to throw the settlor into involuntary bankruptcy.

GIDEON ROTHSCHILD: That is a concern, but it's not that easy to force a settlor into involuntary bankruptcy. Less than one percent of all bankruptcies are involuntary filings, and there is somewhat of a catch-22 in the Bankruptcy Act. In order to file a petition for bankruptcy, the debtor has to go through credit counseling. Unless the law is changed, it may be very difficult for a creditor to force you to go through credit counseling before the bankruptcy filing.

If you have more than 11 creditors, three creditors must move to push you into involuntary bankruptcy. That may be relatively easy in some states, where your creditors are allowed to include your American Express bill, your utility bills and the like. However, in some states those types of creditors are specifically excluded from the 11.

The silver lining in that statute, from my point of view, is that it doesn't include the provisions proposed by Senator Schumer. He would have done away with all asset protection trusts by providing an exemption of only $125,000 for a self-settled trust. This, of course, would make them basically useless. His proposal was defeated, and the current bill provides that, after ten years, you're basically home-free.

In effect, Congress says that an asset protection trust is against public policy if it is set up with the intent to defraud creditors. Congress has placed a very long tail period in this legislation, ten years, to ensure that the settlor is not attempting to do so. This suggests that these trusts should be established as early as possible, with the hope that the ten-year period runs its course before creditor problems arise. Then, presumably, you're free and clear, to the extent that you live in one of the 10 states that allow for these trusts.

"We are beginning to see a trend in which U.S. citizens prefer to use domestic asset protection trusts, rather than the foreign trusts. You are almost waving a red flag when you establish a foreign trust."

– Jeff Levin

TOM PULSIFER: But even during the ten-year period, if the transfer into the trust wasn't originally meant to defraud creditors, the trust assets should be beyond the creditor's reach.

JEFF LEVIN: We are beginning to see a trend in which U.S. citizens prefer to use domestic asset protection trusts, rather than foreign trusts. In recent years, the tax code has strengthened the reporting notice requirements for U.S. persons transferring and forming foreign trusts. You are almost waving a red flag when you establish a foreign trust, and there are tax consequences if appreciated property is transferred to a foreign trust. Whereas, you don't have this compliance consideration for U.S. trusts. Consequently, there are some distinct advantages for U.S. citizens to use Delaware and the other states that have favorable asset protection trust legislation.

ELIZABETH HARRIS: Linda, are you seeing anything along those lines?

LINDA HIRSCHSON: We have worked on foreign asset protection trusts, including one fairly recently, where the clients were moving to France. Under those circumstances, it made sense. Other than that, I agree with Jeff that it is more prudent to do them on shore – except for the possibility that the trust may still be subject to full faith and credit. If the creditor is based in one of the 50 states and brings judgment against a person here in New York, it's possible that the creditor may be permitted to go after the trust.

GIDEON ROTHSCHILD: I don't intend to promote Christiana Trust, Tom, but one of the advantages of using your bank is that you don't have a New York office. So at the end of the day, the Delaware court is not required to recognize a New York court judgment. Another trust company that has multiple offices may benefit from its ability to serve the trustee in the domicile where the settlor is located – but if creditors go after the trust, that might prove to be a disadvantage.

On the other hand, even if you don't have jurisdiction over the trustee, there's still the issue of where the property is located. If the property's located in New York, whether it's intangible or tangible, a New York court could conceivably make the trust asset available to creditors. Suppose that the settlor holds an account at Merrill Lynch in New York. The court's order of attachment may actually require Merrill Lynch to turn over those assets.

I would be curious as to how Delaware laws would handle it. One might imagine that counsel for the trust would ask the Delaware court for injunctive relief, to prevent Merrill Lynch from turning over those assets pursuant to the New York court order. That might compel the two sides to duke it out in Delaware.

TOM PULSIFER: Let's consider another example, Gideon. I live in New York and I settle a Delaware trust. Christiana Bank & Trust Company is plainly my trustee, the situs of the trust and the place where it is administered are plainly Delaware. I design the trust as a so-called good asset protection trust.

Unfortunately, I then run over my neighbor's pedigreed dog in New York. My neighbor sues and wins a $10 million dollar judgment against me. If my assets can be found in Delaware, Delaware has to honor the judgment of the New York court, finding that I have caused $10 million damage to the neighbor. If I happen to have assets that are physically located in Delaware there is little doubt that my creditor can import that judgment and have it recorded in Delaware. He can pursue any asset of mine that he finds in Delaware.

However, the neighbor can't say to my trustee, "Look, the New York judge said Pulsifer ran over my dog and he owes me $10 million. Hand it over to me out of the trust." If I were advising the trustee, I would say that the New York judgment, though enforceable against the settlor's assets wherever they may be, is not enforceable against the trust. The trustee wasn't a party to the New York action and therefore has no duty to honor the New York judgment. As Gideon suggested, we would go to the Delaware Chancery Court for an instruction that our interpretation and understanding of the law is correct.

There is an interesting and utterly fascinating provision in the Delaware statute. Let's say there is a trustee who is subject to the jurisdiction of another state's courts. The Delaware statute states that if the foreign court determines that the law of that jurisdiction governs creditor rights, the trustee over whom the foreign court has personal jurisdiction is removed by operation of Delaware law. This means the foreign court no longer has jurisdiction over an indispensable party which presumably would preclude the case from continuing in that jurisdiction.

GIDEON ROTHSCHILD: That's a great provision in the statute. I credit those who thought of it. Other states don't have that, of course.

Let's go back to your example, Tom. Even though the trustee was not made a party to the initial negligence action regarding the recently deceased dog, the creditor is entitled to a supplemental proceeding, which is basically a discovery proceeding. Once the creditor finds out that you have this trust settled in Delaware, it seems to me the creditor can go to the New York court and ask the court to rule on whether or not the judgment is enforceable against those trust assets. If the New York court takes the view that it would be offensive to New York's public policy to allow Delaware law to govern that trust, then the New York court might allow that creditor to seek remedy against the trust assets.

TOM PULSIFER: The New York court's ruling should not be enforceable against the trustee who was not a party to the New York proceeding. Or, if the trustee was a party, the New York court's decision to apply New York law to determine creditor rights would trigger the Delaware statute's trustee removal provision.

TOM CAMPBELL: There are some trustees that will allow assets to be held outside of Delaware. At Christiana, we require custody of the assets. So they're on our books in Delaware. The assets may, in fact, be traded through Merrill Lynch, but they are delivered to the trust through our custodian.

ELIZABETH HARRIS: Let's examine the LLC question. Todd or Jeff, maybe you'd like to discuss some of the best practices in establishing limited liability corporations?

JEFF LEVIN: For clients in New York who go back and forth between residences in, say, Florida, LLCs can have significant applications. Let's say you now establish your legal domicile at your former vacation home in Florida. How do you deal with your New York real property from a tax perspective? New York State imposes an estate tax on non-residents who own New York situs real property, whereas there is no state estate tax on the Florida property. In this situation, it might be helpful to use a two-member LLC to hold title to the New York real estate. This enables you to say that the decedent did not own real property. Rather, it was the LLC's intangible interest. This is a useful technique.

LINDA HIRSCHSON: You also avoid having to do ancillary probate. That is something you can do through a trust, too, but this way you get double the benefit.

JEFF LEVIN: Would you be comfortable, Linda, with a single-member LLC? I'm a little conservative on that. I insist that it have at least two members.

LINDA HIRSCHSON: Since for federal income tax purposes it's a disregarded entity, a single member LLC also will be a disregarded entity for New York income tax purposes. It is unclear if New York similarly will treat it as a disregarded entity for estate tax purposes. Therefore, I always recommend at least a two-member LLC.

> **"Many attorneys focus on one aspect of the self-settled trusts, without realizing that they can incorporate tax planning along with their creditor projection objectives."**
>
> *– Todd Flubacher*

GIDEON ROTHSCHILD: Many of our clients are reluctant to make gifts for fear that they might outlive their assets. To address this apprehension, I can utilize the self-settled trust laws to establish completed gift trusts. If I include the settlor as a beneficiary, and something happens that he needs to get the trust assets back, it's almost like a 529 plan. He will be able to reclaim the assets. Of course, if he does receive distributions, there may be a 2036 issue. If it turns out that he never needed the assets, however, he will still have successfully removed them from his estate.

The same holds true when one wishes to use this one-million-dollar lifetime exemption. I find that clients are very reluctant to do this for fear of outliving their assets. However, if you tell them that they can still be a beneficiary, it works well. That is a very important application for our clients, who would otherwise be very reluctant to make gifts.

TODD FLUBACHER: We work with four forms of asset protection trusts. You can set up asset protection trusts that are grantor trusts or non-grantor trusts, or completed or incompleted gifts, depending upon the situation. As you mentioned, Gideon, it may be that someone wants to make a completed gift but is afraid to give away the assets. Or, sometimes a client just wants pure asset protection planning and the ability to maximize the retained rights.

You can basically tailor these trusts to fit whatever tax objectives the client wants. This point is often missed in practice when you work with out-of-state counsel. Many attorneys focus on one aspect of self-settled trusts, without realizing that they can incorporate tax planning along with their creditor protection objectives.

FUTURE OF FEDERAL ESTATE PLANNING LEGISLATION

ELIZABETH HARRIS: One final question, since the hour is growing late. What is your outlook on possible developments in federal estate law?

TOM PULSIFER: I personally have been rooting for a complete repeal of the estate tax. I recognize that there are some estate planning lawyers who might wonder what they would do without it. However, if you look back in time, before there was a Generation Skipping Tax, wealth was passed along successfully from generation to generation through dynasty trusts. I believe that the use of dynasty trusts and the size of these trusts would both greatly increase (keeping all of us very busy) if the transfer tax system were repealed.

TOM CAMPBELL: At Christiana we have been watching this closely. Unfortunately, it's still impossible to guess how the major estate tax issues will be addressed. This necessitates clients to do trust and estate planning now, and will probably require more planning later. It is unrealistic to expect that we will be able to simply file away the planning that has already been done. Some changes will be required.

LINDA HIRSCHSON: That's a perceptive point, Tom. I find that most of my clients are proceeding with their estate planning and are not waiting to see if in fact there will be total repeal. Indeed, at this point they are assuming that there will be some sort of estate tax. Some younger clients however may be putting off extensive planning, but that wait-and-see strategy may be a mistake.

> **"Estate planning has become regrettably complex these days, and it's unfortunate that we have to put our clients through it."**
>
> *– Gideon Rothschild*

JEFF LEVIN: I'm seeing the same thing in my work, Linda. The two key variables are what the exemption amount will be and the rate. The exemption amount is currently scheduled to be $3.5 million in 2009, and I heard recently a proposal for it to go to $5 million. We also have heard that the current 45% rate may drop to the capital gain tax rate.

One proposal we like is that if a first spouse-to-die didn't take full advantage of his or her exemption, then the surviving spouse could take advantage of it. This is a very attractive provision, and it would substantially simplify some of our documentation, going forward.

ELIZABETH HARRIS: Todd, what's your outlook?

TODD FLUBACHER: Like everyone else, I don't have a crystal ball. However, with all of the uncertainty and different options floating around, it's clear that the average estate planning client will have to consider more changes in their documents over the next couple of years.

We find that clients with a combined estate of several million dollars, who did their estate planning a couple of years ago, are seeing their credit shelter trusts increase in size. This could trigger an unintended result under their current documents, because now they may have credit shelter trusts that are much larger than they expected and marital gifts that are smaller. That could be a source of confusion, and may increase the complexity of their estate planning.

GIDEON ROTHSCHILD: I would agree that estate planning has become regrettably complex these days, and it's unfortunate that we have to put our clients through it. If we do see a repeal of current provisions in 2010, it may create a hornet's nest of problems, because most lawyers that I know are not drafting with the thought of possible repeal. So how wills are drafted today may create all sorts of problems that the surrogate court will have to address.

My prediction is a $3.5 million exemption with two rates, a 15% rate for those under a certain level estate and a 35% rate for those above that. Hopefully, we'll also see a recoupling of the gift and estate tax exemption. Instead of having one exemption applied in a lifetime and a high exemption at death, we may be able to give away $3.5 million during our lifetime. This will make self-settled trusts even more important in the planning.

LINDA HIRSCHSON: We should add one wrinkle. Even if the federal provisions are repealed, we still have to take into account the estate taxes levied by decoupled states such as New York. In New York, which only has a $1-million exemption equivalent, we often start with a credit shelter trust funded with that amount, to the extent that it is available, and provide for it to be funded higher from disclaimers and elections. That solves the over-funding problem.

Apparently there's a bill in Congress to extend the 2009 exemptions and rates through 2012. That will give us more time to have to deal with the current uncertainty.

TOM CAMPBELL: We have actually run past our allotted time. I want to thank everybody here for participating, including a special thank you to Elizabeth Harris of Worth. You did a terrific job heading this discussion and you allowed us to touch on some very interesting and timely issues.

We extend an invitation to you to join the other individuals, families, financial advisors, businesses and institutions who have found **Christiana Bank & Trust Company** to be a firm that is uniquely responsive to client needs.

Let us show you how we can help you meet your goals and strategic objectives.

To learn more about us, please contact, **Amy Brown, Kevin Mooney, or Lou Geibel**

Christiana Bank & Trust Company
1314 King Street
Wilmington, DE 19801
(302) 888-7400

www.christianatrust.com