

Delaware Trust Act 2022 Legislative Update

Client Alert

08.16.2022

Delaware Governor John C. Carney recently signed House Bill 406 (“Trust Act 2022”) into law. The legislation includes the following highlights:

- Enactment of new 12 Del. C. § 3536A, which permits trust beneficiaries to release their interest, in full or in part, even if the beneficiary previously accepted the benefits of such interest, subject to certain conditions and limitations.
- Amendment of 12 Del. C. § 3585, the statutory provision which codifies the limitations period applicable to an action against a trustee following the trustee’s report: (i) clarifying that this section bars judicial proceedings; (ii) expanding the applicability of the bar beyond only beneficiaries; (iii) defining the presumption of receipt of a report to be seven (7) days after the report was sent in accordance with 12 Del. C. § 3534; (iv) providing that a person may waive the one year period under Subsection (a)(1) or the 120-day period under (a)(2) to accelerate what would otherwise occur upon expiration of those periods; and (v) clarifying that the limitation period of 12 Del. C. § 3585 does not expand the limitation period for claims against the estate or revocable trust of a deceased individual fiduciary.
- Amendment to Delaware’s notice procedure statute, 12 Del. C. § 3534, to include “designated representatives,” within the meaning of 12 Del. C. § 3339, among the class of persons who may receive notice under the statute.
- Amendment to Delaware’s rights of creditors and assignees of beneficiary trust statute, 12 Del. C. § 3536, to expand upon the ability of a beneficiary of a charitable remainder trust to transfer the remainder interest to charity and to expand upon the ability of a beneficiary of a QTIP trust to transfer an interest in the trust to the next succeeding beneficial interest.
- Amendment to Delaware’s statute of limitations on an action contesting the validity of a trust, 12 Del. C. § 3546, designating that, absent evidence to the contrary, it will be presumed that notice was received by a person seven (7) days after it was sent to such person in accordance with 12 Del. C. § 3534.

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SECTION 3536A—RELEASE OF BENEFICIAL INTERESTS BY BENEFICIARIES

Trust Act 2022 enacts new Section 3536A, which codifies a beneficiary's right to release his or her beneficial interests. Notwithstanding any existing statutory authority that may be used to achieve the release of an interest in trust, this new section applies even if a beneficiary previously accepted the benefits of such interests and provides a more efficient framework for releases of interests in trusts.

Subsection (a) broadly states that a beneficiary of a trust may, in whole or in part, release the beneficiary's beneficial interest in the trust, including any discretionary power of withdrawal or consumption, with or without consideration, with respect to the whole or any part of the property subject to such interest. This broad release power is subject, however, to the limitations and conditions of Subsections (b) through (f). Subsection (h) provides that a full or partial release under new Section 3536A of any interest in a trust results in the releasing party being treated as having died or ceased to exist as of the time the release becomes effective, but only with respect to the interest released, unless otherwise specified by the trust's governing instrument.

Recognizing the primacy of trustor's intent, Section 3536A includes limitations that will prevent the statute from being used to defeat a trustor's intent and material terms of the trust's governing instrument. For example, Subsection (b) prohibits a beneficiary from releasing any condition in the governing instrument that a beneficiary must comply with in order to receive a distribution from the trust. Similarly, Subsection (d) prohibits a beneficiary from releasing an interest if the governing instrument expressly prohibits such an act; provided, however, that "a prohibition in the nature of a spendthrift provision or similar provision of the governing instrument does not constitute such an express prohibition of such a release."

Subsection (e) further explains the effect of a spendthrift or similar protective provision and provides that a beneficiary may not release the beneficiary's interest in the trust's income or principal of the trust, unless the released income or principal will be distributed to or held in further trust for one or more of the trustor's descendants (other than the releasing beneficiary) or the releasing beneficiary's descendants. In effect, this subsection operates as a means of preventing a beneficiary subject to spendthrift provisions from releasing his or her interest in favor of creditors, spouses who are not descendants of the trustor, etc.

Another limitation aimed at preserving the applicability of other provisions of Delaware law is outlined in Subsection (c), which provides that Section 3536A does not supersede or apply to: (1) an interest that may be disclaimed, or a power that may be disclaimed or released, under Chapter 6 of Title 12 of the Delaware Code; (2) a beneficiary's right to release, assign, or dispose of an interest in a trust under Section 3536(b) or (e) of Title 12 of the Delaware Code; or (3) the release of a power of appointment under Section 502 of Title 25 of the Delaware Code. Moreover, Subsection (f) clarifies

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that no release of an interest shall be deemed to make imperative an interest that was not imperative before the release unless the governing instrument expressly provides so, which means that a beneficial interest will not be converted into a power that a beneficiary has a fiduciary duty to exercise.

Subsection (g) outlines the procedure for effectuating a release of interest under this new statute. First, the release must be in writing and that writing must declare that the releasing party is releasing the interest “absolutely and unconditionally.” Second, the writing must declare the scope of the release, such as whether the release applies to the whole or any part of the property subject to such interest. Third, the writing must describe the interest released. Fourth, it must be signed by (i) the releasing party; (ii) a designated representative on behalf of the releasing party under Section 3339 of Title 12 of the Delaware Code, but only to the extent such designated representative is a fiduciary with respect to the releasing party or is otherwise expressly so authorized under the terms of the trust’s governing instrument to release such interest; (iii) an agent under a power of attorney, but only to the extent expressly authorized by the power of attorney or the terms of the trust’s governing instrument; or (iv) the guardian, or similar court-appointed representative, of the releasing party’s property with the approval of the court supervising the guardian. Fifth, the writing must be delivered to all fiduciaries of the trust serving at the time of the release and to any person designated in the trust’s governing instrument to receive a release.

As described in the Synopsis to Trust Act 2022, although statutory authority existed that could be used to achieve the same outcome as is permitted by this new section, Section 3536A provides a more efficient framework for releasing interests in trusts. This section is designed to streamline the resolution of the typical scenario involving a longtime beneficiary of a trust who no longer wants or needs the income and would like for the beneficiary’s interest to terminate so that the beneficiary’s children may receive the remainder interest. Rather than awaiting the beneficiary’s death, which is a random event that could occur at any time, Section 3536A may be utilized to permit a beneficiary to terminate an interest before death. Beneficiaries and their advisers should be mindful, of course, of the transfer tax implications that may arise in connection with a release that does not constitute a qualified disclaimer within the meaning of the Internal Revenue Code.

SECTION 3585—LIMITATION OF ACTION AGAINST TRUSTEE FOLLOWING TRUSTEE’S REPORT

Trust Act 2022 makes several changes to Section 3585 of Title 12 of the Delaware Code, which codifies the limitations periods applicable to certain actions against a trustee for breach of trust or other claims. Prior to the enactment of Trust Act 2022, Subsection (a) provided that a person may initiate a “proceeding” against a trustee for breach of trust or other claims until the first to occur of certain enumerated events. Trust Act 2022 clarifies that this Section applies specifically to “judicial proceedings”, conforming what is barred by the statute with Section 3546, which pertains to

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limitations on actions contesting the validity of a trust. Trust Act 2022 also clarifies that the 120-day limitations period set forth in Subsection (a)(2) that applies to trustees who cease to serve also applies to persons other than beneficiaries by replacing the word “beneficiary” with “person” throughout the subsection. Previously, there was an incongruity between the introductory sentence of the statute that states when a “person” may initiate a proceeding and Subsection 3585(a)(2) which stated that a trustee may provide a report to a “beneficiary” to begin the 120-day limitations period.

Subsection (b) was also amended to provide guidance regarding when the limitations periods in Subsections (a)(1) and (a)(2) commence. Prior to Trust Act 2022, either period commenced when the report that triggered the period was sent to a person. Trust Act 2022 modifies what triggers the limitations period by providing that such period begins when the report is *received* by the person, and codifies a presumption that a report was received by the person to whom it was sent seven (7) days after it was sent in accordance with Section 3534 of Title 12 of the Delaware Code, absent evidence to the contrary. Subsection (c), which outlines when a person is deemed to have been sent a report, remains unchanged by Trust Act 2022.

Trust Act 2022 also adds a new Subsection (d), which permits a person who has been sent a report to waive the limitations period under Subsections (a)(1) and (a)(2) by an instrument in writing executed by that person and delivered to the trustee who sent the report. Upon delivery of such a writing to the trustee, the applicable limitations period will be deemed to have expired with respect to that person to whom the report was sent or deemed to have been sent under Subsection (c), and who waived the time period.

Revised Subsection 3585(a)(2) may become a powerful tool that fiduciaries can use in lieu of preparing a full release, indemnification and approval of account for the beneficiaries to sign, that can often become time-consuming and expensive for the trust. When a fiduciary ceases to serve, the fiduciary can provide notice that it has ceased to serve (or is in the process of doing so), provide an accounting or other disclosure of facts that might constitute a claim, and disclose the 120-day limitations period under Section 3585, along with a brief waiver of the 120-day period with a signature line. Thereafter, the person will be barred from bringing a judicial action against the trustee for claims based on the facts that were disclosed, instead of waiting the full 120 days. A similar disclosure of facts along with a signed waiver of the one (1) year period under Subsection 3585(a)(1) could be used when a trust is being administered prior to account termination or the trustee ceasing to serve. In the right circumstances, the use of disclosures and waivers can provide a faster and more cost-effective process for account terminations than full-blown releases.

Lastly, Trust Act 2022 adds a new Subsection (g) to clarify that nothing in Section 3585 shall expand the period during which any claims may be brought against the estate of a deceased individual fiduciary, or trust of such fiduciary that was revocable by that fiduciary immediately before that fiduciary's death, under any law of the fiduciary's domicile that governs claims against that fiduciary's

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estate or trust.

SECTION 3534—NOTICE PROCEDURE

Section 3534 of Title 12 of the Delaware Code outlines the procedure for transmitting any notice of, or communication pertaining to, a trust by and among the trust's fiduciaries, beneficiaries, and other persons having an interest in the trust. Notably, this section does not apply to service of process or notice pursuant to a judicial proceeding that is already governed by court rules. Prior to Trust Act 2022, the individuals permitted to receive communications or notices under the statute was limited to the person themselves or that person's representative under Delaware's virtual representation statute, Section 3547 of Title 12 of the Delaware Code. Trust Act 2022 expanded this list to include such person's designated representative under Section 3339 of Title 12 of the Delaware Code. The amendment reflects the increased use and utility of the role of the designated representative in modern trust administration.

SECTION 3536—RIGHTS OF CREDITORS AND ASSIGNEES OF BENEFICIARY OF TRUST

Section 3536 of Title 12 of the Delaware Code outlines the rights of creditors and assignees of a beneficiary of a trust. Trust Act 2022 made two substantive amendments to Subsection (e) of that section: (1) expanding on the ability of a beneficiary of a charitable remainder trust to transfer the remainder interest to charity and (2) expanding on the ability of a beneficiary of a QTIP trust to transfer an interest in the trust to the next succeeding beneficial interest. These amendments are applicable unless the trust's governing instrument expressly provides otherwise.

Prior to Trust Act 2022, Subsection (e) only permitted a beneficiary of a charitable remainder unitrust or charitable remainder annuity trust to "release," in whole or in part, a retained interest in that trust to a charitable organization that has a succeeding beneficial interest in that trust. Trust Act 2022 now permits such beneficiaries to "assign" that interest as well. These revisions are intended to reflect language that is used in Revenue Rulings and Treasury Regulations.

Similarly, prior to Trust Act 2022, under Subsection (e), a trustor's spouse holding an interest in a trust was permitted to "release" that interest in a trust, in whole or in part, "to the beneficiary or beneficiaries having the next succeeding beneficial interest" in that trust. Trust Act 2022 now permits trustor's spouses to "release, assign, or otherwise dispose of within the meaning of § 2519 of the Internal Revenue Code of 1986 (26 U.S.C. § 2519)" that interest "in favor of the beneficiary or beneficiaries."

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SECTION 3546—LIMITATION ON ACTION CONTESTING VALIDITY OF TRUSTS

Section 3546 of Title 12 of the Delaware Code codifies the various limitations periods applicable to a challenge to the validity of a trust. One of the limitations periods, which appears in Subsection (a)(1), provides in part that a judicial proceeding may not be initiated “one hundred twenty days after the date that the trustee notified in writing the person who is contesting the trust of the trust’s existence, of the trustee’s name and address, of whether such person is a beneficiary, and of the time allowed under [Section 3546] for initiating a judicial proceeding to contest the trust.” Prior to Trust Act 2022, notice was deemed to be given when received by the person to whom the notice was given and, absent evidence to the contrary, it was presumed that notice mailed or delivered to the last known address of such person constitutes receipt by such person. As a result of Trust Act 2022, notice is now deemed to be given when *sent* to the person to whom the notice was given and, “absent evidence to the contrary, it shall be presumed that notice was received by the person seven (7) days after it was sent to such person” in accordance with Delaware’s notice statute, Section 3534 of Title 12 of the Delaware Code. Subsections (a)(2)–(4), which outline the other events that trigger a limitations period, remain unchanged by Trust Act 2022.

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