







BUSINESS SUCCESSION PLANNING

Statistics on Failure of Family Businesses

- Statistics from a 2003 American Family Business Survey indicate that over 53% of small business owners and CEO's do not plan for the transfer or succession of the business on their death.
- According to leading researcher Joseph Astrachan, former editor of the Family Business Review for the Family Firm Institute, the unavoidable result of this lack of planning is that
 - **over 70% of small businesses fail in the generation following the death of the founding owner**
 - **approximately 90% fail to continue in the third generation**

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BUSINESS SUCCESSION PLANNING

Unintended consequences of no succession plan

1. Lack of defined management upon death of owner
2. Lack of sufficient funds/liquidity
3. Family conflicts
4. Loss of value in assets/business
5. Failure to provide for loved ones
6. Loss of key employees/partners
7. Complete failure of the business on death of owner

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BUSINESS SUCCESSION PLANNING

Roadblocks to Succession Planning

1. Procrastination
2. Cost considerations
3. Conflicts with family members/ partners
4. Questions of capacity of Owner
5. Desire to retain control

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**CONFLICTING VALUES AND INTERESTS:
THE FAMILY VERSUS THE BUSINESS**

- **Family Values**
 - Providing wealth transition
 - Providing maximum income for spouse
 - Retaining control over business
 - Paying estate taxes

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**CONFLICTING VALUES AND INTERESTS:
THE FAMILY VERSUS THE BUSINESS**

- **Business Values**
 - Retaining clients/customers
 - Profitability
 - Avoiding liquidation
 - Providing security/employment for employees

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**CONFLICTING VALUES AND INTERESTS:
THE "FAMILY FOOD FIGHT"**

- **Concept of entitlement to inheritance**
- **Sibling rivalries**
- **Undue influence by a sibling**

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**CONFLICTING VALUES AND INTERESTS:
THE NEEDS OF OWNER VS. NEEDS OF BUSINESS**

- **Owner's Goals and Interests:**
 - Retirement security
 - Retention/transition of power
 - Providing for spouse/loved ones
 - Succession to future generations
 - Payment of Estate taxes
 - Stability of business

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**CONFLICTING VALUES AND INTERESTS:
THE NEEDS OF OWNER VS. NEEDS OF BUSINESS**

- **Business's Goals and Interests:**
 - Preservation of assets
 - Expansion of business
 - Provision for/retention of employees
 - Long term growth
 - Maximizing profits for partners

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TYPES OF SUCCESSION PLANNING

1. Estate Planning:

- Minimize Estate and Income Taxes
- Paying Estate Taxes
 - Liquidation plans
 - Ensuring liquidity
 - Extending payments to pay through income
- Choosing the heirs/manner of distribution

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TYPES OF SUCCESSION PLANNING

2. Succession Planning:

- Selling or liquidating the business
- Sale of decedent's interest to family, partners, or employees
- Transitioning to the next generation
- Assuring the continuity of the business

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TYPES OF SUCCESSION PLANNING

3. Retirement Planning:

- Providing funds for the owner
- Transferring the owner's interest
- Planning for incapacity/disability

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STRUCTURING THE FAMILY SUCCESSION

Identification of key issues

Lifetime Transfers vs. Transfers on Death

LIFETIME TRANSFERS	TRANSFERS ON DEATH
Structured transition of management	Retention of control by owner
Owner's control over process	Potentially cheaper to set up plan (short term)
Identification of problems prior to death	Estate planning advantages
Greater chance of succession to next generation	Less conflict during lifetime of owner
Easier resolution of family disputes	
Participation of others – acceptance of transition	
Flexibility to change goals	

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STRUCTURING THE FAMILY SUCCESSION

Identification of key issues
 Planning for Creditors/Lenders/Suppliers

- Avoiding foreclosure/calling the note
- Paying claims of creditors
- Assigning/transferring personal guarantees
- Maintaining relationships and contracts

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STRUCTURING THE FAMILY SUCCESSION

Identification of key issues
 Long-Term Goals vs. Short-Term Goals

LONG-TERM GOALS	SHORT-TERMS GOALS
Profitability of business	Providing liquidity of owner's estate
Growing the business after the owner dies	Providing for the surviving spouse/retirement of owner
Preserving the business to future generations	Transitioning the business to the next generation

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STRUCTURING THE FAMILY SUCCESSION

Identification of key issues
 Control/Management

- Conflict between owner's retention of control and survival of business
- Who manages the company on death of the owner?

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STRUCTURING THE FAMILY SUCCESSION

Identification of key issues
Conflicts between family interests and business interests

- Maximizing values vs. sustained growth
- Liquidation vs. continuation
- Forcing a partnership with the family
- Valuation issues

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STRUCTURING THE FAMILY SUCCESSION

Involvement of the Spouse
Active vs. Non-Active Spouses

ACTIVE SPOUSE	NON-ACTIVE SPOUSE
Acceptance of spouse by employees/partners	Providing for income
Expertise/qualifications to manage the business	Limiting spousal involvement/control
Possibility of undue influence	

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STRUCTURING THE FAMILY SUCCESSION

Involvement of the Spouse
Protecting family interests and preserving for future generations

- Possible liquidation/sale of business by spouse
- Potential remarriage by spouse
- Mechanisms to protect interests for children
 - Use of Trusts
 - Forfeiture clauses
 - Conversion of interest to limited partner/preferred stock

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STRUCTURING THE FAMILY SUCCESSION

Involvement of the Spouse
Providing sufficient income

- Potential conflicts with other owners
- Uncertainty of future income of business

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STRUCTURING THE FAMILY SUCCESSION

Analysis of the Children

- Managing vs. Non-Managing Children

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STRUCTURING THE FAMILY SUCCESSION

Analysis of the Children
Equitable Distributions

- Distributing ownership equally
 - Problems of sibling rivalry
 - Active vs. Non-Active children
 - Training children to take over the business
 - Mechanisms for resolving disputes
- Providing for Non-Active children through other assets/limited financial interests

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STRUCTURING THE FAMILY SUCCESSION

Analysis of the Children
Divorce/Creditors

- Prenuptial agreements
- Use of trusts
- Limitation of transferability of interest

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STRUCTURING THE FAMILY SUCCESSION

Analysis of the Children
Dealing with Minor Children

- Incapability of ownership interest
- Planning for their inclusion in the business
- Planning techniques

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STRUCTURING THE FAMILY SUCCESSION

Managing Conflicts

- Prior to death or incapacity of key owner
- After death of key owner

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SUCCESSION PLANNING FOR PARTNERS

Representation of Multiple Partners

- Ethical concerns
- Representing the business itself

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SUCCESSION PLANNING FOR PARTNERS

Conflicts between Family and Partners

- Personality conflicts – the forced partnership
- Differing values
- The fight for control

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SUCCESSION PLANNING FOR PARTNERS

Identification of Interests/Problem Areas

- Valuation of business interests
- Control
- Expertise
- Tax implications
- Capital, liquidity, funding problems
- Participation in business by heirs

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SUCCESSION PLANNING FOR PARTNERS

Structuring the Succession – Before Death

- Buyout provisions
- Buy-Sell Agreements
- Liquidity and the role of insurance
- Review/revisions to the Operating Agreement or Bylaws
- Preparing for the family partnership

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SUCCESSION PLANNING FOR PARTNERS

Structuring the Succession – After Death

- Review of Operating Agreement or Bylaws
- Dealing with the family partnership
- Problems with finding liquidity for the buyout

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**TRANSITION TO THE NEXT GENERATION:
STRUCTURE OF TRANSACTION**

- Intra-family sales
- Sales to Intentionally Defective Grantor Trusts
- Grantor Retained Annuity Trusts

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FACT PATTERN

Clients are Davida (56 years old) and Theo (60 years old) Fenway, who are married with two adult children, a son Dustin and daughter Marianna.

Five years ago, Davida sold her successful public relations firm for \$8,000,000

A year later, Theo's grandfather Yawkey passed away and left Theo publicly traded stock worth \$10,000,000

Davida & Theo consulted an estate planner and implemented a gifting program which resulted in each of them using approximately \$3,500,000 of their respective exemptions



FACT PATTERN

Three years ago, Theo, Dustin and Marianna began a specialized on-line sports information business, Beantown Services, LLC

Theo believes Beantown will grow at a rapid rate and become extremely attractive to a public company within five years

Theo, Dustin and Marianna each owns 1/3 of Beantown

Davida and Theo consulted with their planner to discuss the transfer of Theo's interest in Beantown before an anticipated increase in value



FACT PATTERN

Davida & Theo would like to avoid exhausting their remaining gift tax exemptions

They also would like to receive some value for the transferred interest but exclude appreciation from their estates

Their planner recommended that an appropriate vehicle would be to implement an installment sale of Theo's interest in Beantown to a "defective" grantor trust" or "IDGT"

...DISCUSSION...



SALE TO INTENTIONALLY DEFECTIVE GRANTOR TRUST (IDGT)

Client → Gift of cash to trust → **IDGT** → Trust uses cash to make down payment → **Client** → Sale of asset to trust → **IDGT** → Issuance of trust note to client → **Client** → Trust issues promissory note for balance due: Annual payments of interest and principal to client → **IDGT** → Beneficiaries

ADVANTAGES:

- Not a sale for income tax
- During Grantor's life, Grantor pays income of trust for beneficiaries benefit w/out gift tax
- Basis increased to payments on note
- Slightly lower interest rate
- Cash flow should be able to cover the note
- Arrangement does not fail if Grantor dies during term of note
- Client continues to receive cash flow, no income tax on interest
- Transfer for gift and estate tax purposes
- GST

DISADVANTAGES:

- Need 10% seed money for initial gift
 - Could trigger gift tax immediately
- Not a statutorily approved vehicle
- Income tax recognition to estate if Grantor dies during term of the trust
- Trust loses Grantor-Trust status upon Grantor's death.

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SALE TO INTENTIONALLY DEFECTIVE GRANTOR TRUST (IDGT)

ASSET 2 (10% seed gift) → **IDGT TRUST** (f/b/o younger family members) → **NOTE TO CLIENT** (Client takes back promissory note, Long term AFR Rate) → Cash flow from business to cover loan payments, balloon payment at end of the term

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BUY-SELL AGREEMENTS

- What is a buy-sell agreement?
- Trigger provisions – including the following
 - Voluntary transfers
 - Retirement
 - Termination of employment
 - Death
 - Involuntary transfers, divorce, bankruptcy

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BUY-SELL AGREEMENTS

- Benefits of a buy-sell agreement
 - To the surviving owners
 - To the deceased's estate and family
 - To both!

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TYPES OF AGREEMENTS

- Types of Buy-Sell Agreements
 - Cross purchase
 - Redemption
 - Hybrid
 - Wait-and-See
- Advantages and Disadvantages

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PURCHASE PRICE

- Methods of Determining Purchase Price
 - Fixed dollar
 - Book value
 - Certificate of value
 - Appraisal value
 - Agreed upon value

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VALUATION

- Fair market value – Reg. Sec. 20-2031-1(b)
- Methods of valuation include the following methods:
 - Discounted future returns
 - Capitalization of earning
 - Industry rules of thumb
 - Asset value
- Revenue Ruling 59-60 – seminal IRS guidance on valuation
- Importance of case law

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DISCOUNTS

- Lack of marketability
- Minority
- Control premium
- Unique factors of the business

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INCOME TAX ISSUES

- Entity Type
- Characterization
- Basis
- Conflicting goals

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INCOME TAX ISSUES

- Entity Type
- Characterization
- Basis
- Conflicting goals




C-CORP ISSUES

- Entity purchase – redemption
 - Section 302 applies – general rule is redemption will be treated as distribution
 - Exceptions to 302 – key planning tool for obtaining sale or exchange treatment
- Taxability on corporation
 - No taxes on distribution
 - Section 311 applies to distribution of appreciated property
 - Reduction of E&P

S-CORP ISSUES

- Entity Purchase
 - Same rules as C-Corp – Section 302 applies
 - Different accounting issues for S-Corp distribution – Section 1368

S-CORP ISSUES

- Cross Purchase
 - Sale or Exchange treatment for purchase
 - Increased basis of shareholders in purchased stock

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S-CORP ISSUES

- Other issues for S-Corp redemptions
 - One class of stock requirement – Reg. 1.1361-1(f)(2)(iii)(A)
 - Election to close books (Section 1377)

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PARTNERSHIPS

- Entity purchase
 - Redemption under Section 736
 - 736(a) versus 736(b) payments
 - Section 751(b) – the Hot Assets rules

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PARTNERSHIPS

- Cross Purchases
 - Section 731 sale or exchange
 - Hot assets – Section 751 – Special rule for inventory
 - Application of Section 741 to remaining accounts

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PARTNERSHIPS

- 754 Election
 - Result of disparity between outside basis and inside basis
 - 754 allows adjustment of these bases to avoid double tax
 - 708(b)(1)(B) – exception to the rule for sale of 50% within 12 months

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ESTATE TAX ISSUES

- Key issue: Will IRS recognize the valuation?
- Estate freeze
- Treatment depends upon the year of agreement

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PRE-1990 AGREEMENTS

- Reg. Section 2031-2(h)
- Four factor approach from cases
 - Obligation of estate to sell stock at fixed price
 - Reasonable and ascertainable price for the stock
 - No sale by decedent at greater price
 - The BS agreement is not a device to transfer the business interests to the natural object of the decedent's bounty for inadequate consideration
- Very subjective tests – *Estate of True v. Commissioner*, T.C. Memo 2001-167, *aff'd* 94 AFTR 2004-7039 (10th Cir. 2004)

POST-1990 AGREEMENTS

- Section 2703 adds requirements
 - Modification of device test
 - Comparable agreements – need for expert testimony
 - Safe harbor – Reg. 25.2703-1(b)(3)





POST-1990 AGREEMENTS




- Significant cases on Section 2703
 - *Smith III v. U.S.*, 94 AFTR 2d 2004-5283 (W.D. Pa 2004)
 - *Estate of Blount v. Commissioner*, T.C. Memo 2004-116, *aff'd* 428 F. 3d 1338 (11th Cir. 2005)
 - *Estate of Amlie v. Commissioner*, T.C. Memo 2006-76
 - *Holman v. Commissioner*, 130 T.C. No. 12 (2008), *aff'd* 105 AFTR 2d 2010-1802 (8th Cir. 2010)





ADDITIONAL ESTATE TAX ISSUES

- Effect on marital deduction—PLR 9147065
- Effect on annual exclusion—Hackl v. Commissioner, 335 F.3d 664 (7th Cir. 2003)
- Estate tax deferral – IRC 6166
- Planning – Family and Non-Family controlled entities


Sacred Heart University High Net Worth Conference, June 7, 2019

**“Selecting a Domicile for Family Trusts
(Alaska, Delaware, Nevada, New Hampshire,
South Dakota & Wyoming)”**

Shelby Wilson, Esq.
Green & Sklarz LLC (New Haven, Westport & Stamford)


Anthony Vitiello, Esq.
Connell Foley (New Jersey, New York & Philadelphia)

Al W. King III, J.D., LL.M., AEP, TEP
South Dakota Trust Company LLC (Sioux Falls, Rapid City, Jackson
Wyoming, New York City, Westport)

 **“Selecting a Domicile for Family Trusts
(Alaska, Delaware, Nevada, New Hampshire,
South Dakota & Wyoming)”**

- **Powerful Planning Opportunities Using the Top-Rated Domestic Trust Jurisdictions**
 - Approach taken by state to abolish or modify its **Rule Against Perpetuities (RAP)**
 - **Directed Trust** statutes (investments and/or distributions)
 - Trust Protector statutes and/or recognition
 - Family advisor statute
 - Special Purpose Entities/Trust Protector Companies
 - **Modification, Reformation and Decanting** statutes
 - **Virtual Representation**
 - **Privacy** statutes
 - **Beneficiary quiet** statutes
 - Beneficiary **No Contest/ In Terrorem** statute
 - **Domestic Asset Protection Trusts (DAPT)/Self Settled Trust Laws**
 - **State income taxation** of trusts
 - **State premium taxes**
 - **Community Property Trust**
 - **Purpose Trust** statute
 - **Private Family Trust Company** statutes
 - **International family planning and statutes**


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**“Selecting a Domicile for Family Trusts
(Alaska, Delaware, Nevada, New Hampshire,
South Dakota & Wyoming)”**

- Appendix A: Existence and Scope of Decanting Power
- Appendix B: Ferri v. Powell-Ferri
- Appendix C: Berlinger v. Casselberry
- Appendix D: Pfannenstiel v. Pfannenstiel
- Appendix E: Toni I Trust v. Walker
- Appendix F: Taxation Based Upon Domicile of Person Creating Trust

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**“Selecting a Domicile for Family Trusts
(Alaska, Delaware, Nevada, New Hampshire,
South Dakota & Wyoming)”**

Main Factors to Consider

- • Approach taken by state to abolish or modify its Rule Against Perpetuities(RAP)
- Directed Trust statutes (investments and/or distributions)
 - Trust Protector status and/or recognition
 - Family advisor
 - Special Purpose Entities/Trust Protector Companies
- Modification, Reformation and Decanting statutes
- Virtual Representation
- Privacy statutes
- Beneficiary quiet statutes
- Beneficiary No Contest/In Terrorem statute
- Domestic Asset Protection Trusts (DAPT)/Self Settled Trust Laws
- State income taxation of trusts
- State premium taxes
- Community Property Trust
- Purpose Trust statute
- Private Family Trust Company statutes
- International family planning and statutes


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**Trust Duration:
Depends upon State Law**

- A **trust's** maximum **duration varies** by **state**
 - **Many states** (i.e. 21 states) **limit** a trust's **duration**
 - (e.g., maximum in **New York** and many other states is the Common Law or “lives in being” plus 21 years; **Connecticut** is USRAP, which is the longer of 90 years or Common Law)
 - **Trusts** can be **perpetual** in 21 states plus D.C.
 - Term states with long period of years – 8 states
 - **Rules** are typically **based** on **where** the trust is **administered**
 - **Client** does **not have to live where trust** is **administered**


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Types of RAP States:

- Common Law Rule Against Perpetuities
- Uniform Statutory Rule Against Perpetuities
- States Modifying RAP
- States Repealing RAP

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Generation Skipping Transfer (GST) Trust and Dynasty Trust States:


GENERATION SKIPPING TRANSFER (GST) TRUST STATES		DYNASTY TRUST STATES	
Common Law Rule Against Perpetuities States (90-110 years)	Uniform Statutory Rule Against Perpetuities (USRAP) States (90 years)	Term States**	Unlimited Duration States (Lived Chronologically by Year of Trust Establishment)
Iowa	Arkansas	Delaware*** (1993) (Real Estate 110 years)	Idaho* (1959, Pre-1986)
Mississippi	California	Alaska (2000) (100 years) w/ LPoFA	Wisconsin* (1967, Pre-1986)
New York	Connecticut	Colorado (2001) (100 years)	South Dakota* (1983, Pre-1986)
Oklahoma	Georgia	Florida (2001) (360 years)	Delaware (1995)
Texas	Indiana	Washington (2012) (150 years)	Alaska* (1997, 2000)
Vermont	Kansas	Wyoming (2005) (100 years)	Arizona (1998)
	Massachusetts	Utah (2004) (1000 years)	Illinois (1998)
	Minnesota	Nevada (2005) (365 years)	Maryland (1998)
	Montana	Tennessee (2003) (360 years)	Maine (1999)
	New Mexico	Alabama (2011) (360 years)	New Jersey* (1999)
	North Dakota	Oregon	Diax (1999)
	Ohio	South Carolina	Rhode Island (1999)
	West Virginia	Virginia (2000)	Missouri (2001)
		Nebraska (2002)	Washington D.C. (2001)
		Michigan (2008)	New Hampshire* (2000)
		Hawaii (2011)	North Carolina* (2007)
		Kentucky (2010)	Pennsylvania (2006)

* Seven states follow the *Mumby* case in whole or in part as the method for abolishing their RAP by dealing with both the required "vesting" and "settling" issues associated with the RAP. The IRS acquiesced in the *Mumby* case, which allows for an unlimited trust duration.

** Please note the term states do not address both the required vesting and timing issues associated with the RAP and the IRS may only recognize 90 years. No authority for the term states to affirmatively choose a term extending the 90 year statute.

*** Generally place real estate in LLC, hence subject to unlimited duration

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Estate of Murphy v. Commissioner 71 T.C. 671 (1979) (Wisconsin):

- **IRS acquiesced** in *Murphy* 1979
- **Only reported case** involving IRC § 2041(a)(5)
- **Tax court held:** the exercised LPoFA to create another LPoFA did not spring Delaware Tax Trap because:
 - Under applicable Wisconsin law, the exercise of a LPoFA did not commence a new perpetuities period.
 - Delaware Tax Trap was not violated in Wisconsin,
 - Wisconsin has/had a perpetuities statute expressed in terms of a rule against suspension of power of alienation

[rather than]

based upon the remoteness of vesting
- **States that follow the *Murphy* Case:**
 - **Pre 1986:** Idaho, South Dakota and Wisconsin relied on *Murphy* case
 - **Post 1986:** Alaska, New Hampshire, New Jersey and North Carolina all relied upon *Murphy*

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Murphy Case Approach

Suspension of the Power to Alienate:

- [IRS Acquiesced](#)
- [Deals with both the "Vesting" and "Timing" Issues:](#)
 - **Vesting:**
 - **Rule Against Suspension Power of Alienation:**
 - » Limits Duration of Trust
 - » Exception to Limitation of Duration of Trust
 - **If Trustee Power to Sell:**
 - » Jump Outside Rule Against Suspension of Alienation
 - » Creates Alternative Vesting Rule to Avoid Vesting Problem
 - **Timing:**
 - No Common Law Rule Against Perpetuities by Statute (Did Away With/Abrogated)

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Dynasty Trust –


Enormous Size Potential:
(Before Tax Reform Bill)

➤ [Assumptions](#) - \$5.6 million Gift to Trust; Trust lasts 150 years and earns 3% after-tax; 40% transfer tax every 30 years

- Three Generation GST Trust (Common Law RAP orUSRAP)- \$48,049,566
- Dynastic trust (unlimited duration/perpetual or long term)- \$471,814,949

Number of Years	Value of Perpetual Dynasty Trust After # Years	Three Generation Dynasty Trust (i.e., Common Law or USRAP State)
31 Years	\$13,592,669	\$13,592,669
61 Years	\$32,992,975	\$32,992,975
91 Years	\$80,082,609	\$80,082,609 (\$32,033,044) Taxes \$48,049,566
121 Years	\$194,381,512	\$69,977,344
151 Years	\$471,814,949	\$101,912,029

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Dynasty Trust –


Enormous Size Potential:
(After Tax Reform Bill)

➤ [Assumptions](#) - \$11.4 million Gift to Trust; Trust lasts 150 years and earns 3% after-tax; 40% transfer tax every 30 years

- Three Generation GST Trust (Common Law RAP orUSRAP)- \$97,815,193
- Dynastic trust (unlimited duration/perpetual or long term)- \$960,480,496

Number of Years	Three Generation Dynasty Trust (i.e., Common Law or USRAP State)	Value of Perpetual Dynasty Trust after # of years
30 Years	\$27,670,792	\$27,670,792
60 Years	\$67,164,274	\$67,164,274
90 Years	\$97,815,194	\$163,025,323
120 Years	\$142,453,889	\$395,705,247
150 Years	\$207,463,787	\$960,480,496

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Possible Perpetuity Issues:

- **Dynasty states with constitutional bans on perpetuities:**
 - Arizona
 - Nevada (although see *Bullion Monarch Mining, Inc. v. Barrick Goldstrike Mines, Inc.*, 131 Nev. Advance Opinion 13 (2015))
 - North Carolina
 - Tennessee
 - Wyoming

Source: Horowitz and Sitkoff, Unconstitutional Perpetual Trusts, 67 Vanderbilt L. Rev. 1769 (2014)

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Do You Need to Be Wealthy to Have a Dynasty Trust?

Typical South Dakota Dynasty GST Trust Planning Scenarios (unlimited duration/perpetual):

Scenario #1- New York Will pours over at death to nominally funded South Dakota revocable trust with dynasty trust provisions:

NY Will

Pour Over at Death

Nominally Funded South Dakota Revocable Living Trust (Dynasty Provisions)

- Account opened and nominally funded with \$10
- Dynasty trust awaiting pour over from NY Will at death
- \$2,500 one time set up fee – no other fees until fully funded
- Advantages of a South Dakota Dynasty Trust at death without the need to fully fund during lifetime

Scenario #2- Inter-vivos (Lifetime) South Dakota Dynasty Trust

NY Will

Inter-vivos South Dakota Dynasty Trust

- Utilizing \$11.4 MM Gift Exemption (\$22.8 MM per married couple)
- \$11.4 MM of GST Exemption per spouse


NY Marital Trust

NY Estate Tax Exemption Trust

Scenario #3- South Dakota Dynasty Trust ILIT (\$1,500 set-up fee and \$2,500 annual fee)

South Dakota Dynasty Trust ILIT


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Numerous Reasons for a South Dakota Dynasty Trust Even with New NY Accumulated Earnings Tax (Effective 2014):

	NY GST Trust	South Dakota Dynasty Trust
Federal Death Tax Savings	90-110 years	Perpetual
NY Death Tax Savings	90-110 years	Perpetual
Self-Settled DAPT – Grantor Permissible beneficiary	No	Yes
Third Party Asset Protection	Spendthrift only – Exception creditors – Alimony and child support (possible issue re <i>Casabery case FL</i>)	Spendthrift combined with statute that a discretionary interest not a property right/claimant – Protection against exception creditors (alimony)
If our trusts and unsuccessful reinstate legal fees to trustee	No	Yes
Trust Privacy – Reformation/Litigation	No – Public	Yes – Automatic total seal in perpetuity
Keeping Trusts Private From Beneficiaries (Beneficiary Query)	No	Yes – Even after grantor's death and/or disability – Beneficiaries do not need to receive any trust information
Investment flexibility – Ability to hold one asset or allow a sophisticated asset diversification	Limited, possible issues	Yes
Directed Trusts	No	Yes
Trust Protector	No	Yes
Family Co. Treatment & Fiduciaries	High potential liability	Great judgment/willful misconduct standard
State Income Tax on Trust	Yes	No
State Income Tax on Trust Distributions	Yes (assuming NY resident)	Possible? <ul style="list-style-type: none"> • Appears as though NY accumulated earnings tax applies to only income not capital gains • May not apply if beneficiary moves to Florida • Distributions from PPTL policy not taxed • SD has the lowest premium tax in the US


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Numerous Reasons for a South Dakota Dynasty Trust Versus Connecticut Generation Skipping Tax Trust (GST Trust):

	Connecticut GST Trust	South Dakota Dynasty Trust
Federal Death Tax Savings	90 years	Perpetual
State Death Tax Savings	90 years	Perpetual
Self-Settled DAPT - Grantor Permissible Discretionary Beneficiary of Irrevocable Trust	No	Yes
Third Party Asset Protection	Spendthrift with limited discretionary interest statute - Possible exception creditors: alimony and child support (possible issue see Casalbany/Plomenczki/Tom cases)	Spendthrift combined with powerful expansive statute that codifies that a discretionary interest is not a property right/entitlement - Protects against exception creditors (i.e., alimony)
Trust Reformation/Modification	Yes, limited	Yes, flexible, cost efficient, quick and inexpensive
Trust Privacy - Reformations/Litigation	No - Public	Yes - Automatic total seal in perpetuity
Keeping Trusts Private From Beneficiaries (Beneficiary Quiet)	No	Yes - Perpetual, even after grantor's death and/or disability - Beneficiaries do not need to receive any trust information
Trust Protector	No	Yes (First statute in the nation - 1997)
Investment flexibility - Ability to hold one asset or allow a sophisticated asset diversification	Yes	Yes
Family Advise Statute	No	Yes
Family Co Trustees & Fiduciaries	High personal liability	Gross negligence/willful misconduct standard
State Premium Tax	175 basis points	8 basis points
State Income Tax on Trust	6.99%	No

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“Selecting a Domicile for Family Trusts (Alaska, Delaware, Nevada, New Hampshire, South Dakota & Wyoming)”

Main Factors to Consider

- Approach taken by state to abolish or modify its Rule Against Perpetuities (RAP)
- Directed Trust statutes (investments and/or distributions)
 - Trust Protector status and/or recognition
 - Special Purpose Entities/Trust Protector Companies
- Modification, Reformation and Decanting statutes
- Privacy statutes
- Beneficiary quiet statutes
- Beneficiary No Contest/In Terrorem statute
- Domestic Asset Protection Trusts (DAPT)/Self-Settled Trust Laws
- State income taxation of trusts
- State premium taxes
- Community Property Trust
- Purpose Trust statute
- Private Family Trust Company statutes
- International family planning and statutes


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Who to Name as Trustee?

- **Popular** trustee or co-trustee **choices** are:
 - **Family** members
 - **Business colleagues** (possible conflicts)
 - **Friends**
- **70%** of wealthy families **do not use** corporate trustees (FOX)
- **Biggest family trustee concerns** and **liability issues**:
 - **Concentration of assets/lack of diversification**
 - Proper asset allocation
 - **Business interests**: Conflicts, diversification, lack of yield, etc.
 - **Delegated trusts**: Improper due diligence and monitoring of investments/trust assets
 - **Distributions**: Taxable versus non-taxable, independent decision makers for taxable, documentation
 - **Environmental**
- **Personal liability**: Most states - High standards

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Types of Trust Administration:

- **Traditional Trust Administration Alternatives (both available in all 50 states, i.e., NY & CT):**
 - **“Full” Trustee** – One stop shopping: Bank or trust company does everything.
 - **“Delegated” Trustee*** – Corporate and/or family trustee delegates certain duties/functions to outside advisors (i.e., investment management)
- **Preferred Modern Trust Administration Alternatives:**
 - **“Directed” Trustee*** – “Best of Class” Model – Trifurcates the traditional trustee role: i.e. investments, distributions and Administration.
 - » **Directed Trust limited availability:** Selected states allowing this without income taxes: Alaska, Delaware, Florida (limited), Nevada, New Hampshire, South Dakota and Wyoming
 - » **Existing Full and/or Delegated Trust:** Change situs and Reform/Modify/Decant to Directed Trust

*Please Note – Al W. King, III and Perce H. McDowell, III, “Delegated vs. Directed Trusts”, *Trusts & Estates*, July 2006; Al W. King, III, “Myths About Trusts and Investment Management: The Glass is Half Full”, *Trusts & Estates*, December 2014

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Full Trustee

(Typically Bank or Trust Company):

- **Available in all 50 states**
 - NY, CA, CT, NJ, etc.
 - **Please note:** State income and capital gain taxes on trusts
- **Full trustee functions:**
 - Trust administration
 - Trust distributions
 - Trust accounting
 - Trust tax returns and reporting
 - Trust custody
 - Trust investment analysis/due diligence/allocation/ diversification
 - Trust investment management and review
- **Disadvantages:**
 - **Minimal family control & flexibility:**
 - **Co-trustee with family/friend and/or Business Colleagues:** Personal liability and/or conflicts
 - **Fiduciary liability:** High
 - **Inability to hold one asset** without diversifying
 - **Inability to broadly diversify** to alternatives, direct private equity, hedge funds, offshore investments, etc.

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NY & CT Traditional Delegated Trust –

Bank, Trust Company, Family member,
Family Advisor or Friend:

- **State Statutes** – Delegated Trust statutes available in all 50 states

NY & CT Trust

Family Trustee
(Personal Liability)

→

Investment Manager(s)
and/or Consultants

Delegates Investment Management and/or Asset Allocation

- **“Delegated” Trust** – Trustee delegates to outside investment advisors following the procedures below:
 - **Due diligence on the consultants providing the asset allocation as well as the selection of investment managers for the trust (i.e., those being delegated to)** – Experience, track record, ADV, Compensation, Duration
 - **Monitoring of both asset allocation and trust investment managers being delegated to** – FMV drop, large concentration, investment, improper allocations
 - **Trust Investment Policy Statement** – Drafted by both trustee and investment advisors & managers, and updated and reviewed quarterly or at least annually.
 - **High liability standard** for personal trustee delegating and monitoring:
 - **Exonerations for testamentary trusts not allowed in many jurisdictions** (Example: NYEPTL 11-1.7)
 - **Please Note:** Trustee due diligence and monitoring requirements may **limit the types of investments** the trustee can delegate investment management (i.e., alternatives, hedge funds, direct private equity, offshores, etc. may be problematic)
- **Delegate:** Other non-investment management functions & duties
- **Fiduciary liability** of delegating trustee is high and personal if family member or family friend/advisor

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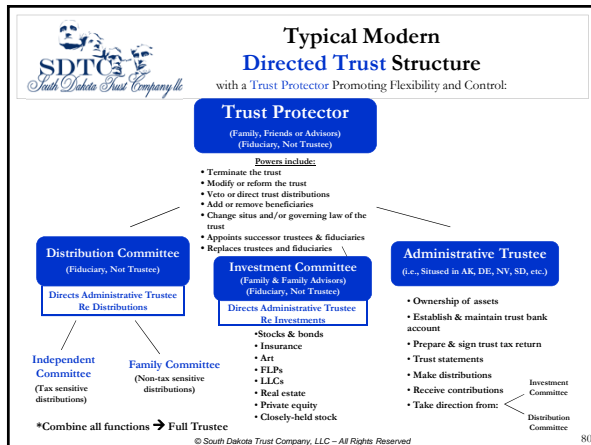
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Modern Directed Trusts Provide Powerful Social and Fiscal Responsibility:

“Trusts are no longer vehicles that lawyers and banks create to keep what is rightfully the beneficiaries”

- Trusts created with **“open architecture”**
- **Collaborative relationship** among **beneficiaries** and **trustee**
- **Multiple trustees/fiduciaries** and **managers** assume duties once assigned to single trustee
 - **Specialization of function** (distributions, investments, custody, administration/accounting)
 - **Active family and family advisors involvement**

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Modern Directed Trusts:

- **“Directed” Trustee – Trifurcates the traditional trustee role into an investment committee, distribution committee and a directed administrative trustee:**
 - **Section 185 2nd Restatement of Trusts** – the directed administrative trustee is generally not liable for following the instructions of an empowered person (i.e., investment and/or distribution committees) within the trust instrument – State Statutes.
 - The **administrative trustee** has no **discretionary investment (3rd party) duties** regarding the trust. The selection of investment managers is generally the responsibility of the investment committee run by the family.
 - The **administrative trustee** takes **direction** from the **investment committee** and the **distribution committee** respectively regarding both investments and distributions.
 - **State statutes** and the **trust document protect the administrative trustee** from taking direction for investments and/or distributions. Typically “gross negligence and willful misconduct statutes”.
 - **Please Note:** Some advisors utilize “directed” trust language without state “directed” trust statutes (not as powerful).
 - **Great combination** of independent administrative trustee, family, friends and family advisors.
 - Provides **flexibility and control** regarding investments and distributions.
 - **Liability Protection:** Gross negligence/willful misconduct standard for liability of family members serving as co-fiduciaries.
 - **State Statutes** – Not all states have directed trust statutes.
 - **Most popular states are:** Alaska, Delaware, Nevada, New Hampshire, South Dakota and Wyoming.

*Source: Al W. King III, “Drafting Modern Trusts” *Trusts & Estates Magazine*, November 2015

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Selected Popular Modern Directed Trust States with No State Income Tax:

- Alaska
- Delaware
- Florida
(Limited Directed Trust Statute)
- Nevada
- New Hampshire
- South Dakota
- Wyoming

Please note: Client does not have to live in these states to take advantage of their favorable trust and tax laws. All they need to do is to establish a trust in the states administered by a trustee in these states.

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Key Advantages of Directed Trust:

- **Dramatically lower** family and/or individual's **fiduciary liability**
- **Ability to hold one trust asset** – Public or private
 - Versus diversifying
 - Ability to override Prudent Investor Act
- **Ability to broadly diversify**
 - Similar to Harvard or Yale Endowment asset allocation model

[Please see:](#) Al W. King III, "Myths About Trusts and Investment Management: The Glass is Half Full!" *Trusts & Estates Magazine*, December 2014.

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Model Portfolio – What the Average Global Family Office Portfolio Looks Like:

Category	Sub-category	Percentage
Stocks and bonds		37%
Direct investments in private equity, venture capital and real estate	Private equity funds	7%
	Agriculture and commodities	4%
	ETFs, REITs, etc.	4%
	Valuables (art, etc.)	2%
Cash or equivalent funds		8%
Hedge funds		8%

Note: Due to rounding, totals may not add up to 100%. *Includes co-investments.
Source: IBC's Campden Wealths Global Family Office Report 2016. **THE WALL STREET JOURNAL.**

[Please see:](#) Al W. King III and Pierce H. McDowell III, "Selecting Modern Trust Structures Based on a Family's Assets" *Trusts & Estates Magazine*, August 2017.

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Typical Trust Protector Powers
(Vary by State Statute):

- Flexibility
 - ◀ Future Circumstances
 - ◀ Drafting
- Personal vs. fiduciary powers
 - No personal gain, duty of loyalty & impartiality, actions for good of trust & beneficiaries
- Power to remove or to replace trustees
- Power to veto or direct trust distributions
- Power to add or remove beneficiaries
 - Trust protectors may add beneficiaries from a class of beneficiaries identified in the governing instrument. – See South Dakota Statute: SDCL 55-1B-6(3),(4), (effective 7/1/16)
- Power to change situs and the governing law of the trust
- Power to veto or direct investment decisions
- Consent to exercise power of appointment
- Amend the trust as to the administrative and dispositive provisions
- Approve trustee accounts
- Ability to bring a court action
- Terminate the Trust

Selected States with Trust Protector Statutes		
◀ Alaska*	◀ Nevada*	◀ Wyoming*
◀ Delaware*	◀ South Dakota*	◀ New Hampshire

Please see: Alexander A. Bove, Jr., *Trust Protectors: A Practice Manual With Forms*, Juris Publishing, (2014).


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Family Advisor Statute
(i.e. Lawyers, CPAs etc.):

- [Delaware and South Dakota](#)
- [Delaware Statute:](#) 12 Del. C. § 3313
- [Example South Dakota Statute:](#)
 - [Provides](#) for the power to [appoint](#) a “**family advisor**”:
 - Person who is [authorized](#) to [consult or advise](#) a [fiduciary](#) with regard to fiduciary or non fiduciary matters
 - [The “family advisor” may have the following powers:](#)
 - [Remove and appoint trustee](#), a fiduciary, trust advisor, investment committee member or distribution member
 - [Appointment of successor trust protector](#) or successor family advisor
 - [Advise the trustee](#) on matters [concerning a beneficiary](#) and [consult](#) with a [fiduciary or advisor](#)
 - Provide [direction](#) regarding [notification of qualified beneficiaries](#)
 - [Powers granted are in sole discretion of family advisor](#)
 - [Nonfiduciary capacity](#).
 - [Limited liability to dishonest or improper motive](#)


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Summary: Comparison of a “Directed” & “Delegated” Irrevocable Trust:

	Individual Delegated Trustee	Corporate Delegated Trustee	Directed Trust Structure with Administrative Trustee
Family & Friends Can Control Investments	Yes	Not Usually	Yes
Trustee Initial Due Diligence and Quarterly Monitoring of Trust Assets	High Level (Need to document file)	High Level (Need to document file)	Low Level (Left to Trust Family Investment Committee)
Family & Friends Can Control Distributions	Yes (Need Independent Trustee for tax sensitive)	Not Usually, Unless Co-Trustee	Yes as Distribution Committee Fiduciaries (Need Independent distribution committee membership) for tax sensitive)
Personal Liability (For Investment & Distribution Decisions)	Yes, as an Individual Trustee or Co-Trustee (High)	Yes, as an Individual Co-Trustee with Corporate Trustee (High)	Yes, but very limited and only as a fiduciary (not trustee) running the investment and/or distribution committee with gross negligence or willful misconduct standard
Trust Protector	Not Usually	Not Usually	Yes
Power to Remove Trustee and/or Fiduciary	Yes	Yes	Yes
State Income Tax	Yes	Yes	Generally, No
Asset Diversification Requirements	Yes	Yes	No
Broad Based Investments Allowed in the Trust (Investment Flexibility)	No	No	Yes

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**Grantor as Investment Co-Trustee/
Investment Committee Fiduciary:**

- **References:**
 - *Jennings v. Smith*, 161 F. 2d 74 (2nd Cir. 1947)
 - **IRC 2036(a)(2)** – Right to designate who will enjoy the trust property
 - **IRC 2038** – Power to alter a beneficiary’s interest
- **Alternatives:**
 - **LLC** – Manager
 - **Directed trust investment committee:** Grantor and/or family
- **Possible Issues:**
 - State income tax?
 - Asset protection?

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Example: Trust Investment LLC
Promoting Flexibility, Control and Ease of Trust Administration regarding Trust Investments
(Also AK, DE, NV, WY etc.):

Example: South Dakota Directed Trust

**Trust Company in South Dakota –
Administrative Directed Trustee**


- **Directed Trust**
 - **Administrative Trustee:** Trust company providing trust administration in South Dakota
 - **Distribution Committee:** Family, family advisors, and/or trustee make distribution decisions
 - **Investment Committee:** Family directs trust company to hold investment management LLC

↓ Trust assets

South Dakota Investment LLC
(South Dakota trust company – Member)
(Family members or other – Manager)
Investment Management

- **Please note:** One popular method for handling the investment management of a trust is with the use of a limited liability company (LLC), and South Dakota has a very powerful LLC statute. A LLC that's owned by the trust may handle the investment management of a trust, and a member of the client's family or a family advisor can be named as the manager of the LLC. The trustee/trust would, generally, be the sole member (that is, owner) of the LLC. The LLC manager would account to the trustee as to the underlying investment management taking place within the LLC on behalf of the trust. The investment committee of a directed trust would, likely, direct the administrative trustee in a directed trust state (South Dakota) to hold the LLC that will be responsible for the investment management.
- **Please note:** LLC can be any state LLC for administrative purposes. Usually best if not an LLC from grantor's resident state for asset protection and tax purposes, and also generally best if LLC provides charging order protection as the sole and exclusive remedy which is available in most of the Directed Trust states.
- **South Dakota:** Sole member LLC statute

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**Trust Protector Company (TPC)
Qualified Trust Advisor (QTA)
(Alternative to SPE):**

- **Popular States:** Delaware (TPC), Wyoming (TPC) and New Hampshire (QTA)
- **Purpose:** House the trust protector as well as investment and distribution committees (TPC) or trust advisor and trust protector (QTA)
- **Required Trustee:** Generally any directed trust jurisdiction with a trust protector statute
- **Required Trust Law:** Generally any directed trust jurisdiction with a trust protector statute
- **Summary:** Delaware or Wyoming trust protector company can serve with South Dakota trustee of a South Dakota directed trust

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South Dakota Special Purpose Entity (SPE)
[and]
South Dakota Directed Trust:

- **SPE is recognized** by South Dakota statute
- **SPE is a SD LLC – wrapper** for investment committee, distribution committee and trust protector of a **directed** South Dakota trust
 - **Not a trustee** (cannot be held out as trust company for public)
 - **Required** to work with a **Qualified South Dakota Trustee** (i.e. SDTC)
 - **Special Operating Agreement**
 - **May work** with all trusts of all family members
- **Substantial presence** – trust situs
- **Governance** – Family meetings etc..
- **D&O/E&O Insurance** – [versus] personal liability as co-trustees without insurance
- **Inexpensive** – \$2,500- \$3,500

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Special Purpose Entity (SPE) or Trust Protector Company
(i.e., Delaware, Nevada, New Hampshire, South Dakota & Wyoming)
(Combined with Separate Investment Management LLC):

Typical South Dakota Example:

Special Purpose Entity (South Dakota LLC)

- Board of Managers
- Trust Protector
- Investment Committee
- Distribution Committee

– Unique South Dakota SPE Statute

– Not a trust company

- Registers with the South Dakota Division of Banking

– D&O, E&O Insurance

– More ties to South Dakota situs

– Meetings outside client's resident state

– Governance

Directs:

- **Trust Protector**
- **Investments:**
 - Directs directed administrative trustee to hold investment management LLC
- **Distributions:**
 - As determined, usually discretionary

Directed Trust

South Dakota Trust Company- Administrative Directed Trustee

- Directed Trust
- Administrative Trustee

↓ Trust assets

South Dakota Investment LLC
(South Dakota Trust Company – Member)
(Family members or other – Manager)
Investment Management

Trust protector, investment committee and distribution committee are housed in an LLC acting as agents or employees of the LLC to further tie the trust to the favorable situs state and reduce their liability by purchasing insurance (D&O) as well as provide continuity. Other states: Trust Protector Company - Delaware, Nevada and Wyoming (all less formal, and case-by-case).


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“Selecting a Domicile for Family Trusts (Alaska, Delaware, Nevada, New Hampshire, South Dakota & Wyoming)”

Main Factors to Consider

- Approach taken by state to abolish or modify its Rule Against Perpetuities (RAP)
- Directed Trust statutes (investments and/or distributions)
 - Trust Protector status and/or recognition
 - Family Advisor
 - Special Purpose Entities/Trust Protector Companies
- **Modification, Reformation and Decanting statutes**
- Virtual Representation
- Privacy statutes
- Beneficiary quiet statutes
- Beneficiary No Contest/In Terrorem statute
- Domestic Asset Protection Trusts (DAPIT)/Self Settled Trust Laws
- State income taxation of trusts
- State premium taxes
- Community Property Trust
- Purpose Trust statute
- Private Family Trust Company statutes
- International family planning and statutes


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Are Irrevocable Trusts Really Irrevocable - Reformation and/or Modification:

- **Modification:**
 - “Carry out the material purpose of the trust had the grantor known”
- **Reformation:**
 - Mistake of law or fact
 - “What was actually intended”

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Selected States with Reformation/Modification Statutes:

» Alaska*	» Nevada*	» South Dakota*
» Delaware*	» New Hampshire	» Wyoming*

* No State Income Tax

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Reforming/Modifying or Decanting an Existing Irrevocable Trust:

- **Reform/Modify Existing Trust after change of trust situs:**
 - Generally **keeps original state law** for **interpretation** purposes
 - **Reformation cannot conflict** with the **settlor's "material purpose"** or "**probable intention**"
 - Reform/Modify **administrative provisions** to **South Dakota law**
 - Once trust situs is moved to South Dakota with the appointment of a South Dakota trustee.
 - **Example of Costs:** The South Dakota Reformation/Modification process is quick (averaging 2-10 days) and inexpensive (average \$2,500-\$3,000)
 - **Grandfathered Generation Skipping Trusts** – OK (cannot extend duration)
 - **Privacy** (SD is total seal forever; Delaware also allows the ability to seal for 3 years)
 - Most other states "open to the public"
 - **Virtual Representation:** Unborn beneficiaries represented

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Example: Change of Trust Situs and Reformation/Modification:

New York "Delegated" Trust	<ol style="list-style-type: none"> 1. Change Situs to South Dakota by naming a South Dakota Trustee 2. Upon change of Situs and appointment of South Dakota Trustee, reform/modify to SD Law for administration 	Reformed/Modified New York Trust				
New York Law for Construction/ Interpretation, Validity and Administration	→ To Save State Income Tax/ Modernize Administration (i.e., Directed Trust and Trust Protector)	<table border="1" style="font-size: x-small;"> <tr> <td style="background-color: #e0e0e0;">New York Law:</td> <td style="background-color: #e0e0e0;">South Dakota Law:</td> </tr> <tr> <td>Construction/ Interpretation and Validity</td> <td>Administration – • "Directed" • "Trust Protector"</td> </tr> </table>	New York Law:	South Dakota Law:	Construction/ Interpretation and Validity	Administration – • "Directed" • "Trust Protector"
New York Law:	South Dakota Law:					
Construction/ Interpretation and Validity	Administration – • "Directed" • "Trust Protector"					

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Trustees or Beneficiaries Might Wish to Reform or Modify an Existing Trust in Order to:

- **Change** the **governing law** applicable to the trust – Administration
 - Possibly **construction/interpretation and validity** (restating trust)
- **Modernize** an outdated **trust agreement**
 - **Change** the **administrative terms** of the **trust** to **add directed trust** structure with investment and distribution committees/ advisors
 - **Lessen families fiduciary liability**
- **Add trust protector**
- **Improve** the trust's **governance structure**
- **Add flexibility regarding appointment** of **trustees/fiduciaries**


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Trustees or Beneficiaries Might Wish to Reform or Modify an Existing Trust In Order to (cont'd):

- **Change dispositive provisions:**
 - **Change term:** i.e., remove 1/3 of principal at age 25, 1/3 at age 30, and 1/3 at age 35 and make discretionary for asset protection purposes (family as distribution committee directs Corporate Trustee as to distribution)
 - **Cannot change** trust **duration** (i.e., RAP)
- **Improve tax provisions**
- Possibly **save** state **income taxes** (depending upon the state)

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Reformation/Modification Vs. Decanting – Change of Situs Planning:

- **Reformation/Modification** – Keep old trust but modernize
- **Decanting** – Distribution from old trust to new trust:
 - **Existence of decanting power; statute, trust provisions** (may be broader than statute), **common law** (*Phipps v. Palm Beach Trust Co.*, 196 So. 299 (Fla. 1940)), (*Morse v. Kraft*, SJC-11233 (Mass. 2013))
 - If trustee has **discretionary power** to distribute assets:
 - Generally **appoint** trustee in a state with a decanting statute (i.e., change trust situs) who then decants.
 - **Decanting is a distribution from old trust to new trust** in state with decanting statute, modern trust laws and usually no income tax.
 - Generally **decanting is considered** to be an exercise of **special power of appointment**
 - **Generation-skipping trusts OK**, but caution and cannot generally extend the duration beyond the existing duration.
 - **Summary** – Trustee with **discretionary distribution authority** may **exercise** that **authority** to **appoint property further in trust rather** than make **outright distributions**

Please see: "Decanting: A Statutory Perspective" by Rahul Wadh & Eric Dorosh, Trusts & Estates, March 2012. "Trust Remodeling" by Rahul Wadh, Trusts & Estates, August 2007. "4th Annual Trust Decanting State Ranking Chart" by Steven J. Oshins, updated January 2017. "Decanting is a Popular Strategy, But Don't Ignore Several Key Considerations" Trusts & Estates, August 2018.
Please see: Appendix A – Existence and Scope of Decanting Power
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Trustee’s Decanting Authority:

- **When decanting the trustee takes into account:**
 - 1.) **Purpose** of trust from which property decanted
 - 2.) **Terms** of new trust
 - 3.) **Consequences** of decanting
- **Decanting is at trustee’s discretion:** When distribution decisions are left to trustees discretion:
 - Courts do not generally substitute judgment unless abuse by the trustee
- **Trustee** may possibly **decant** into a trust **giving** the **current beneficiaries** a **power of appointment** which would be **equivalent of outright distribution**.

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Trustee’s Decanting Authority (cont’d):

- **Statute** – Selected states with decanting statutes:

* Alaska*	* Illinois	* Missouri	* North Carolina	* Tennessee
* Arizona	* Indiana	* Nevada*	* Ohio	* Texas*
* Colorado	* Kentucky	* New Hampshire*	* Rhode Island	* Virginia
* Delaware*	* Michigan	* New Mexico	* South Carolina	* Wisconsin
* Florida*	* Minnesota	* New York	* South Dakota*	* Wyoming

- * No state income tax
- **Trust Provision:** **Decanting** power may be **drafted into the trust** – which may be **broader** than **statute**
- **Common Law:** **Power to decant** also exists in **common law:**
 - *Phipps v. Palm Beach Trust Co.*, 196 So. 299 (Fla. 1940)
 - *Morse v. Kraft*, SJC-11233 (Mass. 2013)
 - *Ferri v. Pavell-Ferri*, 476 Mass. 651 (2017) - See Appendix B

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Example: Trust Decanting:

Existing Trust

New York Law Trust:
(Interpretation/Construction, Validity, and Administration)

- Trustee Power to Distribute Assets
- Appoint a South Dakota Trust Company as Trustee

Trustee Decants →

New Trust

South Dakota Law Trust
with South Dakota Trustee

(Construction/Interpretation, Validity and Administration)

Please note – Generally cannot extend the RAP

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Summary of Some of the More Popular Reasons to Decant are as follows:

(Most are also reasons for Reformation/Modification/Restatement)

1. Modifying [powers of appointment](#)
2. Amending [administrative provisions](#) of a trust
3. Adding [spendthrift](#) protections
 - Also eliminating spendthrift provisions so interests may be assigned
4. Adding (or removing) [grantor trust provisions](#)
5. Qualifying a trust as a qualified [subchapter S trust](#), a QDOT, an IRA conduit trust, etc.
6. [Combining](#) trusts for greater efficiencies
7. [Separating](#) trusts to allow investment philosophies to be "fine tuned" for beneficiaries
8. [Segregating](#) higher risk assets
9. Avoiding state and local [taxes](#)
10. [Reducing distribution rights](#) for Medicaid eligibility planning purposes
11. [Amending trustee succession](#) provisions, removing or replacing a trustee
12. [Extending](#) the term of a trust
13. Changing the [governing law](#) provisions of a trust
14. Correcting a [servitor's error](#) or ambiguity
15. Decanting a beneficiary's share of a trust to a [supplemental needs trust](#) in order to preserve or obtain eligibility for public benefits
16. [Combining](#), segregating or otherwise improving [irrevocable life insurance trusts \(ILITs\)](#) and [credit shelter trusts](#)
17. [Dynasty trusts](#), although less common, are also excellent candidates for decanting

Source: Thomas E. Simmons, "Decanting and Its Alternatives: Remodeling and Revamping Irrevocable Trusts" *South Dakota Law Review*, 2010

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Virtual Representation:

- **Definition:** These [statutes](#) are designed to [facilitate](#) the [administration](#) and/or [court supervision of trusts](#) in which there are [contingent, unborn, or unascertainable beneficiaries](#) so they can be properly represented.*
 - **Reformation/Modification:** Typically, these statutes allow the contingent, unborn, or unascertainable beneficiaries to be represented by a person with the same or similar interests in a court reformation, modification and/or restatement.
 - **Decanting:** In a trust decanting, generally [consent is not recommended](#) of trust beneficiaries for gift tax purposes and the [court is not generally involved](#).
 - However, with virtual representation statutes, the contingent, unborn, or unascertainable beneficiaries might be [represented](#).

* Daniel Worthington and Mark Merrie, "Which Situs is Best in 2018?", *Trusts & Estates*, January 2018.

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“Selecting a Domicile for Family Trusts (Alaska, Delaware, Nevada, New Hampshire, South Dakota & Wyoming)”

Main Factors to Consider

- Approach taken by state to abolish or modify its Rule Against Perpetuities (RAP)
- Directed Trust statutes (investments and/or distributions)
 - Trust Protector statutes and/or recognition
 - Family Advisor
 - Special Purpose Entities/Trust Protector Companies
- Modification, Reformation and Decanting statutes
- Virtual Representation
- **Privacy statutes**
- **Beneficiary quiet statutes**
 - Beneficiary No Contest/In Terrorem statute
 - Domestic Asset Protection Trusts (DAPT)/Self Settled Trust Laws
- State income taxation of trusts
- State premium taxes
- Community Property Trust
- Purpose Trust statute
- Private Family Trust Company statutes
- International family planning and statutes


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Privacy for Trust Matters?

- **Privacy:** Very important to clients, particularly for the following:
 - A **lawsuit** involving the trust and court
 - A **reformation/modification**/restatement involving court
 - An optional court approved **decant**
- **Selected state statutes:**
 - **AK:** Up to a court
 - **DE:** Up to a court (limited 3 years)
 - **NV:** Up to a court (not perpetual)
 - **SD:** Automatic total seal in perpetuity
 - **TREND:** Most states public


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Keeping a Trust Quiet to Beneficiaries – Selected Beneficiary Notice Statutes (Notice of Trust/Trust Assets):

- **Alaska** allows for beneficiary waiver of notice but limits settlor to exempt the trustee from the notice requirements during the **life of the settlor** or until the **settlor’s incapacity**, whichever is shorter.
- **Delaware** does allow for the waiver of beneficiary notice but **restricts** it to a **period of time** and does **not expressly allow** for the **trust advisor** or **trust protector** to **modify notice** to beneficiaries.
- **Nevada** restricts it to a **period of time** and does **not expressly allow** for the **trust advisor** or **trust protector** to **modify notice** to beneficiaries.
- **South Dakota:** Ability to waive beneficiary notice of trusts assets and information. **Trust document** provides:
 - The **settlor, trust protector and/or advisor**
 - The **ability to expand, restrict, eliminate, or modify**
 - The **rights of beneficiaries** to receive **trust information**
 - **Sample Trust Provision Notice:** “I hereby direct that the Trustee is not required to provide the notice set forth in SDCL § 55-2-13 to qualified beneficiaries.”

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Keeping a Trust Quiet to Beneficiaries – Common Reasons for Silence:

Reasons for Silence:

- Beneficiary isn't financially mature
- Trust Baby Syndrome – Trust knowledge might negatively affect the promotion of social and fiscal responsibility of beneficiaries (viable alternative: directed incentive trust)
- Privacy
- Asset Protection
- Prevent unnecessary lawsuits
 - Bad in-laws/undesirable friends (current or future)
- Identity theft
- Family safety
- Non-voting business stock

Source: Al W. King, "Should you keep a trust quiet (silent) from beneficiaries?" *Trusts & Estates*, April 2015.

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“Selecting a Domicile for Family Trusts (Alaska, Delaware, Nevada, New Hampshire, South Dakota & Wyoming)”

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 - Special Purpose Entities/Trust Protector Companies
- Modification, Reformation and Decanting statutes
- Privacy statutes
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- **Beneficiary No Contest/In Terrorem statute**
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Beneficiary No Contest/In Terrorem Clause:

- **Generally:** Provision in a will or trust that discourages a beneficiary from contesting a will or trust by providing that such a challenge, will forfeit any interests that the beneficiary may have under the will or trust
- **50 of 51 jurisdictions have specifically addressed the question of enforceability:**
 - Approximately twenty-one have extended no-contest clauses to both wills and trusts (e.g. Delaware, Michigan, South Dakota)
- **Approximately 22 jurisdictions follow some form of the Uniform Probate Code (e.g. Alaska, Arizona, Colorado, South Dakota):**
 - No Contest clauses **enforceable unless** for **probable cause** (e.g. fraud, duress, undue influence, forgery)
 - Approximately 14 jurisdictions enforce no-contest clauses **without** regard to **probable cause or good faith** (e.g. New Hampshire, Virginia, Wyoming)
 - Generally enforceable in **California** and **New York** but limited in scope
 - **Delaware** generally enforceable though if instrument contested and contesting party prevails, Delaware will not enforce the no-contest clause
 - Some states provide power for the court to reward attorney fees and costs to prevailing party
- **No-contest clauses** are specifically **unenforceable** in only 1 state: **Florida**

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“Selecting a Domicile for Family Trusts (Alaska, Delaware, Nevada, New Hampshire, South Dakota & Wyoming)”

Main Factors to Consider

- Approach taken by state to abolish or modify its Rule Against Perpetuities (RAP)
- Directed Trust statutes (investments and/or distributions)
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- Privacy statutes
- Beneficiary quiet statutes
- Beneficiary No Contest/In Terrorem statute
- • **Domestic Asset Protection Trusts (DAPT)/Self Settled Trust Laws**
- State income taxation of trusts
- State premium taxes
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Self-Settled/Domestic Asset Protection Trust (DAPT):

- **17 states** have enacted **laws** allowing for **Self-Settled trust statutes**:
 - Grantor can be permissible discretionary beneficiary of irrevocable trust they create (either included or excluded from their estate)

Alaska	Michigan	Nevada	Oklahoma	Tennessee	West Virginia
Delaware	Mississippi	New Hampshire	Rhode Island	Utah	Wyoming
Hawaii	Missouri	Ohio	South Dakota	Virginia	

- **Domestic Asset Protection Trusts** – Self-Settled
- **Prior** to these laws, **foreign asset protection trusts** were the **common asset protection vehicle**
 - **Alaska** – First statute 1997
 - **Foreign** asset protection trust **losing popularity**:
 - **U.S. courts, government** and **IRS** scrutiny with offshore trusts
 - **FATCA**
 - **FBAR**

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Domestic Asset Protection Trust (DAPT) (cont'd):

- **General Definition:**
 - **Irrevocable trust**
 - **Properly established** and **administered** under the **laws** of one of the **DAPT jurisdictions**
 - Allow **settlor** to be **permissible discretionary beneficiary** of the trust (i.e., self-settled)
 - **No preexisting understanding** between settlor and trustee
 - **Protects trust assets** from settlor's creditors, if structured properly
 - **Creditors** of settlor **unable** to **access** trust **property interest** as defined by state law – Except **exception creditors**
 - **Assets not transferred fraudulently** (no fraudulent conveyance)
 - Either **established** to be **excluded** from or **included** in the estate of settlor [or] **both**

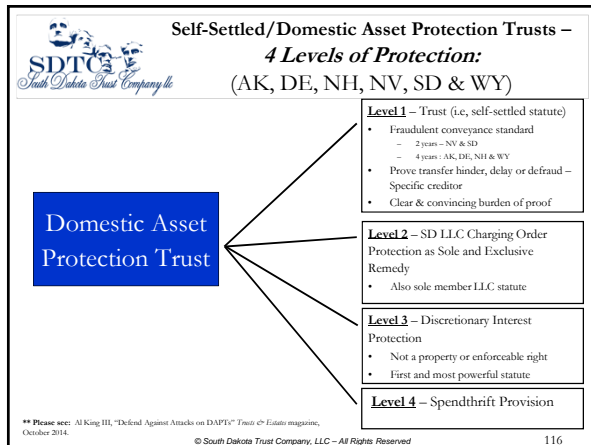
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Four Major Types of Self-Settled Trusts:

	<i>Option #1</i> Self-Settled Dynasty DAPT	<i>Option #2</i> Third Party/ Self-Settled Hybrid Dynasty DAPT	<i>Option #3</i> Tax Neutral Self-Settled DAPT (Not a Dynasty Trust)	<i>Option #4</i> Incomplete Gift Non-Grantor Trust (Not a Dynasty Trust) (AKING, DING, NING, SDING*)
Main Purpose	Estate planning Asset protection	Estate Planning Asset protection	Asset protection	State income tax savings (depends upon state)
Self-Settled (Grantor Permissible Discretionary Beneficiary)	Yes	Grantor not initially a beneficiary (Trust protector can add and remove grantor as beneficiary)	Yes	Yes
Complete or Incomplete Gift?	Completed gift using gift tax exemption (PLR 9837007)	Completed gift using gift tax exemption (PLR 9837007)	Incomplete gift – Grantor holds power of appointment	Incomplete gift – see PLRs 2013, 2014
Estate Tax	Excluded from estate? (PLR 200944002 & IRC Section 2036)	Excluded from estate? (Generally excluded)	Included in estate	Included in estate
Generation-Skipping Transfer (GST) Tax	GST exempt? (PLR 200944002 & IRC Section 2036)	GST exempt? (Generally exempt)	N/A	N/A
Income Taxes	Grantor or non-grantor trust	Grantor or non-grantor trust	Grantor trust	Non-grantor trust NY – Grantor Trust (2014)
Wealth Preservation/ Asset Protection	Yes	Yes	Yes	Maybe/maybe not?

***** Please note: Trust protector power to add grantor as a beneficiary may toggle on and off grantor trust status.
***** Please note: Trust protector power to remove grantor as a beneficiary prior to three years of death may avoid any possible IRC Section 2035 issues.


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Protection Level #1
In Order to Have Successful DAPT, Cannot have a Fraudulent Conveyance to the trust:

- Fraudulent Conveyance Definition:**
 - The fraudulent conveyance **statute of limitations** is the **period of time after** which a **cause of action or claim for relief** with respect to a **transfer of a grantor's assets to a DAPT is extinguished** (i.e., the creditor may not be able to reach the assets)
 - Creditors need to prove** intent to **hinder, delay or defraud**
 - Subject to a statute of limitations**
 - South Dakota and Nevada – 2 Years
 - Alaska and Delaware – 4 Years
- Discovery:** Existing creditors at time of transfer
 - Discovery period:** 6 months (South Dakota) (SDCL § 55-16-10)
 - Please note:** The 6 month discovery period **only applies to existing creditors**, and **not future creditors**
 - Example:** Under SD law, an **existing creditor** has the **later of 2 years** from the date of the transfer or **6 months** from the **time the transfer is** or reasonably could have been **discovered by the creditor**
 - Notice**
 - South Dakota and Nevada – 6 months
 - Alaska and Delaware – 1 year
- Burden of proof:** **Clear and convincing** or **preponderance of evidence**
 - Depends upon state statute


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 *Protection Level #1*
Example - Fraudulent Conveyance – 2 Years (South Dakota):

- **Two Steps:**
 1. **Step one:**
 1. **Action to defraud** creditor
 2. **Becomes creditor** and **action** is **brought** within **2 years**


↓
 2. **Then step two**
 - **Transfers of property** made to **defraud** that **specific creditor**
 - **Clear & convincing** – Burden of proof

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 *Protection Level #1*
Exception Creditors:

- **Self-settled trust statutes** allow a **grantor** to be a **permissible discretionary beneficiary**
- **Generally**, if structured properly, **creditors cannot reach** the **assets** in the **self-settled trust**
- However, **many state's self-settled trust statutes** have **exceptions to this rule**, also known as **exception creditors**
 - If the **creditor fits within** the **type/class** of creditor **proscribed** by the **statute**, then that **creditor may be able** to **reach** the self-settled trust's **assets**.

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 *Protection Level #1*
Exception Creditors:

- **Generally**, if structured properly, **creditors cannot reach** the **assets** in the **self-settled trust**
- However, **many state's self-settled trust statutes** have **exceptions to this rule**, also known as **exception creditors**:
 - If the **creditor fits within** the **type/class** of creditor **proscribed** by the **statute**, then that **creditor may be able** to **reach** the self-settled trust's **assets**
 - **South Dakota (SDCL § 55-16-15):**
 - **Child support** (preexisting at the time of the transfer)
 - **Alimony/maintenance** (preexisting at the time of the transfer)
 - **Division/distribution of property incident to divorce:**

Exceptions:

 - ❖ Unless DAPT funded prior to marriage
[or]
 - ❖ Proper notice given to spouse with transfer of marital property during marriage
[or]
 - ❖ Transfer of non-marital separate property during marriage

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Protection Level #1
DAPT – Exception Creditor Statutes:

- **Torts:**
 - **Delaware** (if cause of action occurred prior to transfer)
 - Person who suffers death, personal injury, property damage
 - On or before disposition
 - If settlor, or someone else for whom the settlor is vicariously liable, causes the injury
- **Divorcing Spouse - Property Settlement:**
 - **Alaska** - No problem, unless DAPT funded within 30 days of marriage or during marriage
 - **Delaware** – No problem, if funded prior to marriage
 - **Nevada** – Silent (if funded before or after marriage)
 - **South Dakota** – No problem, if funded prior to marriage
 - **Funded after marriage:** Notice to spouse required to transfer marital property to trust (2014); Notice not required for separate non-marital property after marriage

Please note:

- Many courts award divorcing spouse marital property outside of the trust to make up the deficiency
- Many divorcing spouses argue that marital property was transferred after marriage without their consent. **Possible public policy issue.**
 - Confusion over what constitutes marital and separate property


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Protection Level #1
DAPT: South Dakota – Spouse Exception Creditor:

- **Spouse Definition:** “Spouse” and “former spouse” – only persons to whom the transferor was married to at or before the time the qualified disposition is made
 - If **single** at the time of transfer
 - Never an exception creditor
 - If **divorced** or **legally separated** [and] have a **judgment** at the time of transfer
 - Always an exception creditor
 - If **married** at the time of transfer [and] transfer **separate property**
 - 2 year look back only
 - If **married** at the time of transfer [and] transfer **marital property** but **provide notice to spouse**
 - 2 year look back only
 - If **married** at the time of transfer [and] transfer **marital property** but **do not provide notice to spouse**
 - Always an exception creditor
- **Compare with “silent” states for transfer of marital assets post marriage:**
 - Possible public policy arguments
 - **Not silent** regarding **judgments at time of transfer**
 - See **Dahl v. Dahl, 2015 UT 23, Supreme Court of the State of Utah (January 30, 2015)**


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Protection Level #1
DAPT – Exception Creditor Statutes (cont'd):

- **Divorcing Spouse of Grantor - Child Support & Alimony:**
 - Both **Alaska** and **Nevada** are silent as to child support and alimony [but]
 - **Not protected if court judgment before trust funded:**
 - ALASKA STAT. § 34.40.110
 - NEV. REV. STAT. ANN. § 166.170(3)
 - **Delaware** has child support and alimony as exception creditors
 - **South Dakota** – Not an issue if no pending judgment before funding trust.
 - **Please Note:** Many **litigators feel child support and alimony are difficult to avoid** and can upset the courts in the resident state of the grantor, if attempt to avoid.
 - **Courts** often **even up property** in **resident state of client**
 - **Public policy?**

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Protection Level #2

Asset Protection - LLC's and LP's:


- One may want to **hold a trust's assets within an LLC or LP for asset protection purposes** as well as **ease of administration**
- **Best LLC Statute: "Sole Remedy Charging Order" as the exclusive remedy** [versus] **"Judicial Foreclosure Sale"**
 - **NY & CA** judicial foreclosure
- Sole remedy charging order statute states for both LLC's and LP's:

<ul style="list-style-type: none"> • Alaska* • Arizona • Delaware* • Florida • Nevada • New Hampshire* • New Jersey (LLC only) 	<ul style="list-style-type: none"> • Oklahoma • South Dakota* • Texas • Virginia • Wyoming (LLC only)*
---	---

*Also Dynasty Trust, Directed Trust and No State Income Tax on Trust State

- Need **sole member LLC** statutes: AK, DE, NV & SD
- **Please See:**
 - Mark Merric "Updated LLC Asset Protection Planning Table" *See Leiberg's Asset Protection Newsletter, January 21, 2012.*
 - Mark Merric "Charging Order What Does Sole or Exclusive Remedy Mean?" *Trusts & Estates Magazine, April 2010.*
 - Mark Merric "Forum Shopping for Favorable FLP and LLC Legislation" *See Leiberg's Asset Protection Planning Newsletter, August 8, 2007.*

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Protection Level #2

Sole Remedy Charging Order:

- **Only right to distribution** (when and if made)
 - Rather than allowing creditor to attach all rights of an LLC or LP Interest
- **No method to force a distribution**
 - No voting rights
- **Waiting game**
- **Sole and exclusive remedy** - No other legal or equitable remedies
- **Use two LLCs**
 - Rainy Day
 - Expenses, if needed

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Protection Level #3

Discretionary Trusts:

- **Self-settled** (also Third Party Trusts)
- **Asset Protection following Restatement Second and Common Law:**
 - **Discretionary Interest in trust is not:**

{	Property Interest
}	Enforceable Right


 - Rather a "mere expectancy"
 - Same with **limited power of appointment** and **remainder interest**
 - **Statutes** - South Dakota, Alaska, Nevada, and Delaware
 - **Case Law:** Limited + Few States
- **Restatement Third** - Most Other States

Source: "Where Should You Situate Your Trust? A Look at South Dakota's New Third Party Discretionary - Support Statute" by Frances Becker, Mark Merric and Pierce McDowell III, *See Leiberg's Asset Protection Planning Newsletter, May 2007.*

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Protection Level #4

Spendthrift Clause:




- Currently **17 jurisdictions** have **self-settled domestic asset protection trust** statuses
- **All trust jurisdictions** offer asset protection through the incorporation of the **spendthrift clause** to a trust
- **Spendthrift Clause:**
 - Prevents the attachment or assignment of a beneficiary's interest in a trust
 - Prevents all but exception creditors from attaching the trust
- **Spendthrift Clause Exception Creditors:**
 - Alimony
 - Child Support
- **Problem Cases:**
 - **Florida case:** *Beltiger v. Casalbey*, 38 Fla. L. Weekly D 2482 (Fla. Dist. Ct. App. Nov. 27, 2013); companion case *Beltiger v. Casalbey*, 38 Fla. L. Weekly D 2480 (Fla. Dist. Ct. App. Nov. 27, 2013) (**Appendix C**)
 - **Massachusetts case:** *Pfannstahl v. Pfannstahl*, Mass. App. Ct., Nos. 15-P-906, 15-P-686 & 13-P-1385, August 27, 2015, (**Appendix D**)
- **Please note:** Court determines if beneficiary has property interest under state law [or] whether the interest has any value
- **Solution to spendthrift clause exception creditors:**
 - Discretionary interest in trust is not a property right statute (AK, DE, NV & SD)
 - Floating spouse clause (i.e. "spouse I am living with and married to")

Please see: A.W. King "The Trust Spendthrift Provision—Does it Really Protect?" *Trusts & Estates*, December 2016. © South Dakota Trust Company, LLC – All Rights Reserved

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Other Miscellaneous Statutes Helpful to Maximize DAPT's Benefits:



- **Exclusive Jurisdiction** over DAPTs:
 - **Yes:** Alaska, Delaware, Nevada & South Dakota
 - See *Toni I Trust v. Walker* 2018 Alas. Lexis 27 (March 2, 2018)– Appendix E
- **Automatic Removal of Trustees:**
 - **Yes:** Delaware & South Dakota
 - **No:** Alaska & Nevada
- **Protection of Advisors:**
 - **Yes:** Alaska, Delaware, Nevada & South Dakota
 - **Affidavits of Solvency** – *Goldberg vs. Rosen* – Demonstrates they can benefit the planner

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Other Miscellaneous Statutes Helpful to Maximize DAPT's Benefits (cont'd):



- **Reimbursement of Attorney Fees:**
 - **DE & SD:** Any prevailing party
 - If DAPT is sued and lawsuit unsuccessful, the trust is reimbursed for legal fees
 - **AK:** Only if trust is void or set aside
 - **NV:** Only to prevailing petitioner (petitioner must be beneficiary or trustee)
- **Privacy** – (National trend is public):
 - **AK:** Up to a court
 - **DE:** Up to a court (limited 3 years)
 - **NV:** Up to a court (not perpetual)
 - **SD:** Automatic seal in perpetuity


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DAPT State	Exception Creditors									
	Fraudulent Conveyance/Standard of Proof	Tort Preceding Creditor	Divorcing Spouse	Alimony & Child support	Statutory Award - Alimony, Pensions to Trustee	Lawsuit Privacy	Discretionary Interest Next Property	LLC & LP Sole Remedy Changing Order	Beneficiary Quiet Trust	Rule Against Perpetuity (RAP)
Alaska	4 Years/ Clear and convincing	No	No problem, unless DAPT set up within 30 days before marriage or after marriage	Silent, but possible issue if transfer occurs after marriage or within 30 days before marriage	No (only if trust voided)	Generally Open (left to courts)	Yes (3 levels) (New)	Yes	Yes	Partial. Maple case since 1990 (year PA&A 1997, 2000)
Delaware	4 Years/ Clear and convincing**	Yes, Preexisting Torts (Problem)	No problem, except if DAPT set up after marriage	Yes, issue	Yes (any prevailing party)	Generally open but not limited to 3 years	Yes (2 levels)	Yes	Yes	Maple case since 1995
Nevada	2 Years/ Clear and convincing	No	Silent	Silent, but possible issue if transfer violates "a contract or a valid court order"***	No (only prevailing petitioner)	Generally Open (left to courts)	Yes (3 levels)	Yes	Yes (2015)	315 year term statute (2005) - Problematic
South Dakota	2 Years/ Clear and convincing to specific creditor	No	No problem, set up after marriage and marital property, then ok if notice	No problem, if not awarded prior to setup of trust	Yes (any prevailing party)	Yes, Automatic Total Seal in Perpetuity	Yes (4 levels) - First & most powerful statute	Yes	Yes, even after death/disability of settlor or perpetual	Powerful 1990 Maple case statute

*Alaska Stat. § 34.40.110(f); **But see Del. Code Ann. tit. 12, § 3574 ("preponderance of the evidence"); *** Nev. Rev. Stat. § 166.170(3).
 Please note: South Dakota, Alaska, Delaware and Nevada all have statutes providing that they have **exclusive jurisdiction** over the DAPT. Also **Protection of Advisors** statutes (see *Goldberg vs. Root*).
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SDTC <i>South Dakota Trust Company, LLC</i>		Possible Attacks on DAPTs:
<ul style="list-style-type: none"> • Improperly drafted trust • Improper titling of trust property • Fraudulent conveyance • Exception creditor • Lack of strong discretionary interest protection • Insufficient situs – lack of substantial presence <ul style="list-style-type: none"> • "Straw man" trustee • Jurisdiction issues • Trust → Sham/alter ego of settlor • Public Policy Issues • Privacy issues • UVTA – Uniform Voidable Transactions Act • Possible constitutional issues • Super Creditors – tax and security claims and environmental • Bankruptcy § 548(e) • Other 		
Please note: "Defend Against Attacks on DAPTs" by Al W. King III, <i>Trusts & Estates</i> magazine, October 2014 © South Dakota Trust Company, LLC - All Rights Reserved 131		


SDTC <i>South Dakota Trust Company, LLC</i>		"Selecting a Domicile for Family Trusts (Alaska, Delaware, Nevada, New Hampshire, South Dakota & Wyoming)"
<p>Main Factors to Consider</p> <ul style="list-style-type: none"> • Approach taken by state to abolish or modify its Rule Against Perpetuities (RAP) • Directed Trust statutes (investments and/or distributions) <ul style="list-style-type: none"> - Trust Protector statutes and/or recognition - Family Advisor - Special Purpose Entities/Trust Protector Companies • Modification, Reformation and Decanting statutes • Virtual Representation • Privacy statutes • Beneficiary quiet statutes • Beneficiary No Contest/In Terrorem statute • Domestic Asset Protection Trusts (DAPT)/Self Settled Trust Laws • State income taxation of trusts <ul style="list-style-type: none"> - State premium taxes - Community Property Trust - Purpose Trust statute - Private Family Trust Company statutes - International family planning and statutes 		
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Popular No Income Tax Trust Situs States:

- **Alaska**
- **Delaware** (Exception: Tax on residents)
- **Florida**
- **Nevada**
- **New Hampshire** (Exception: Dividends & Interest Tax on Residents)
- **South Dakota**
- **Wyoming**


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Factors Affecting Taxes on a Trust:

- Domicile of the Settlor
- The State in which the trust is created
- The Location of trust property
- The Domicile of the Beneficiaries
- The Domicile of the Trustees
- The Location of the Administration of the trusts

Please See: Appendix F - Taxation Based Upon Domicile of Person Creating Trust
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“Selecting a Domicile for Family Trusts (Alaska, Delaware, Nevada, New Hampshire, South Dakota & Wyoming)”

Main Factors to Consider

- Approach taken by state to abolish or modify its Rule Against Perpetuities (RAP)
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Selected State Premium Tax Rates On Both Trusts and LLCs:

Alaska	8 bpts. (trusts and LLCs)
Arizona	200 bpts.
California	235 bpts.
Connecticut	175 bpts.
Delaware	200 bpts. (LLCs), 0 bpts. (trusts)
Florida	175 bpts.
Georgia	225 bpts.
Hawaii	275 bpts.
Illinois	50 bpts.
Massachusetts	200 bpts.
Minnesota	200 bpts.
Nevada	350 bpts.
New Hampshire	125 bpts.
New Jersey	210 bpts.
New York	200 bpts.
North Dakota	200 bpts.
Ohio	140 bpts.
Pennsylvania	200 bpts.
South Dakota	8 bpts. (trusts and LLCs)
Washington	200 bpts.
Wyoming	75 bpts.

Ways to take advantage of a state's low premium tax:

1. Establish Alaska, Delaware or South Dakota trust with trustee in jurisdiction– Purchase policy [or]
2. Establish a Alaska or South Dakota LLC with LLC agent – Purchase policy

What if existing trust with situs outside of low premium tax state?:

1. Set up a Alaska or South Dakota LLC with LLC agent to purchase the policy [and]
2. Allocate Alaska or South Dakota LLC units to trust with situs outside of jurisdiction

Please See: "State Premium Tax Planning" June 2011 Trusts & Estates magazine

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Key Considerations for PPLI:

- **Low Premium Taxes** \leftarrow **LLC**
 \leftarrow **Trusts**
- **In-Kind Distribution Statutes** \leftarrow **Lifetime** (cash value)
 \leftarrow **Death** (death benefits)
- **Solves Investment Lock-Up Problems**
- Favorable **Insurable Interest** statutes
- Top-Rated **Trust Laws**
 - **Directed** Trusts
 - **Decanting** Insurance Policy from old trust to new trust
- Top-Rated **Privacy Laws** \leftarrow **Trusts** – court matters
 \leftarrow **Beneficiary Quiet** – no requirement to tell one or more beneficiaries any trust information
- **Four Layers of trust asset protection – unique** \leftarrow **Self-settled trust** (DAPT)
 \leftarrow **LLC** – Sole Remedy Charging Order Protection
 \leftarrow **Discretionary interest** not a property right
 \leftarrow **Spendthrift** protection
- **Reimbursement of Legal Fees to trustee** – if trust is sued unsuccessfully (DE & SD)

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SDTC
South Dakota Trust Company, LLC

LLC-Ownership Option for Owning PPLI:

- **Lowest LLC Premium Taxes** – 8 basis points (AK & SD)
- **Qualified Purchaser Rule** – Look to LLC member (owner)
- **Directed LLC**
 - Trust Company located in state – Co-Manager (Directed)
 - Owner Member
- **LLC** – Charging Order Protection – Sole Remedy
 - Cannot force a distribution
- **Existing Trust** – Utilize South Dakota LLC to purchase life insurance with funds from an existing trust in a high premium tax state.

Example:

South Dakota LLC


➡

New York GST Trust

➡

- Co-managing member South Dakota LLC
- Purchase Insurance
- 8 basis point premium tax vs California 235 basis points, New York 200 bpts, Delaware 200 bpts, Nevada 350 bpts, and Florida 175 bpts (National Average 200 bpts)

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“Selecting a Domicile for Family Trusts (Alaska, Delaware, Nevada, New Hampshire, South Dakota & Wyoming)”


Main Factors to Consider

- Approach taken by state to abolish or modify its Rule Against Perpetuities (RAP)
- Directed Trust statutes (investments and/or distributions)
 - Trust Protector status and/or recognition
 - Family Advisor
 - Special Purpose Entities/Trust Protector Companies
- Modification, Reformation and Decanting statutes
- Virtual Representation
- Privacy statutes
- Beneficiary quiet statutes
- Beneficiary No Contest/In Terrorem statute
- Domestic Asset Protection Trusts (DAPT)/Self Settled Trust Laws
- State income taxation of trusts
- State premium taxes

→ **Community Property Trust**

- Purpose Trust statute
- Private Family Trust Company statutes
- International family planning and statutes


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Community Property Trust (Income Tax Planning):

- **Community Property:**
 - 9 States - Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin
 - 3 States - **Alaska, South Dakota and Tennessee** provide an **opt-in** to legally treat certain or all marital property as community property **via a trust agreement**, which is included in the estate
- **Full Step-up in Basis at First Death:**
 - At death of first spouse, entire asset receives a full step up in basis to the FMV for the entire asset as of the date of death (IRC 2014)
 - Wholly owned and cannot be divided into his/her shares
- **Income Tax Planning - Example:**
 - **Community Property State:** Assume husband and wife living in a community property state own securities with cost basis of \$5m and FMV is now \$10m. At death of first spouse, the asset will receive a full step up in basis to the current FMV for the entire asset (\$10m). The then surviving spouse can sell the appreciated asset for the FMV (\$10m) with no tax consequences (i.e. avoiding the capital gains that would of resulted without the full step up in basis).
 - **Versus Joint Property State:** At the death of the first spouse, only the share owned by the deceased spouse (1/2 of the asset) would receive a full step up basis to the FMV; therefore, the basis in the hands of the surviving spouse would only be \$7.5m. If the surviving spouse then sold the property at FMV (\$10m), they would expose \$2.5m gain to capital gains.

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- State premium taxes
- Community Property Trust

→ **Purpose Trust statute**


- Private Family Trust Company statutes
- International family planning and statutes

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 **“Purpose Trust” Statute**
(No Beneficiaries – Protects an Asset(s)):

- **Trend:** Domestic versus offshore non-charitable purpose trusts
- **Definition:**
 - Trust that **exists** for stated (non-charitable) **purpose**
 - Established to **care** for **“something” rather than “someone”**
 - No beneficiaries
- **Trust Enforcer:**
 - Appointed to ensure the trustees carrying out their obligations in fulfilling the trust’s purpose
 - Ability to go to court
 - Also **Trust Protector**. Amend trust if needed in event circumstances change
 - May reform/modify to beneficiary trust in the future
 - May combine Trust Enforcer and Trust Protector functions
 - South Dakota: First domestic Trust Protector statute (top ranked)
- **Taxes:** Typically excluded from estate as completed gift trusts (either grantor or non-grantor)
 - Also pour over revocable purpose trust with dynasty provisions


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 **“A Trust without beneficiaries:
What is the Purpose?”**
– *The Non-Charitable Purpose Trust (Cont’d)*:

- **Term and Duration**
 - Most **states 21/25 year term** or the **life of the animal**
 - Approximately 10 states GST, **long term or unlimited duration**
 - States with **broadest and most flexible non-charitable purpose trust statutes** are: Delaware, New Hampshire, South Dakota and Wyoming*
 - DE and SD **separate Purpose Trust RAP Statutes****

Please see: Adam J. Hirsch, *Trusts for Purpose: Policy, Ambiguity, and Anomaly in the Uniform Laws*, 26 Fla. S. U. L. Rev. Vol. 913, 939 (1999)


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 **Examples of Purpose Trust Assets:**

- **Own and maintain Private Family Trust Companies**
- **Own and maintain Special Purpose Entities/Trust Protector Companies**
- **Other examples of purpose trust assets:**
 - Pet care (i.e., dogs, cats, horses, birds, tortoises, snakes, etc.)
 - Including offspring
 - Maintenance of grave sites (honorary)
 - Also supporting religious ceremonies (anniversaries, etc.)
 - Maintenance of family property (i.e., antiques, cars, jewelry, memorabilia, etc.)
 - Maintenance of an art collection
 - Maintain family homes (residence and vacation)
 - Long term maintenance of building, property or land
 - Maintain business interests
 - Royalties
 - Digital assets
 - Provide for philanthropic purpose not qualifying for a charitable deduction

Please see: A.W. King III, “Trusts without Beneficiaries – What is the Purpose?”, *Trusts & Estates* magazine, Feb 2015


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Purpose Trust - Comparison:

- **Alaska:** only honorary/pet trusts, Alaska Stat. § 13.12.907.
- **Delaware:** Does not allow for a law noncharitable purpose to be selected by the trustee (purpose must be declared in the trust), Del. Code tit. 12, §3556.
 - Dynasty Trust provisions.
- **Nevada:** Pet trusts, Nev. Rev. Stat. § 163.0075; Section 163 of NRS amended by adding: "A trust may be created for a noncharitable purpose without a definite ascertainable beneficiary or for a noncharitable but otherwise valid purpose" ("valid purpose" defined as "any purpose that is not illegal or against public policy").
- **New Hampshire:** "Except to the extent the court determines that the value of the trust property exceeds the amount required for the intended use" also does not allow for the noncharitable purpose to be selected by the trustee, N.H. Rev. Stat. §564-B:4-409.
- **South Dakota:** Allows for a lawful noncharitable purpose to be selected by the trustee (South Dakota Codified Laws section 55-1-20).
 - Also, South Dakota does not have a limit on the amount for the noncharitable purpose (see NH and WY).
 - Dynasty Trust provisions.
- **Wyoming:** "except to the extent the court determines that the value of the trust property exceeds the amount required for the intended use" also does not allow for the noncharitable purpose to be selected by the trustee, Wyo. Stat. §4-10-410.

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“Selecting a Domicile for Family Trusts (Alaska, Delaware, Nevada, New Hampshire, South Dakota & Wyoming)”

Main Factors to Consider

- Approach taken by state to abolish or modify its Rule Against Perpetuities (RAP)
- Directed Trust statutes (investments and/or distributions)
 - Trust Protector statutes and/or recognition
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 - Special Purpose Entities/Trust Protector Companies
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- Beneficiary No Contest/In Terrorem statute
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- State income taxation of trusts
- State premium taxes
- Community Property Trust
- Purpose Trust statute
- **Private Family Trust Company statutes**
- International family planning and statutes

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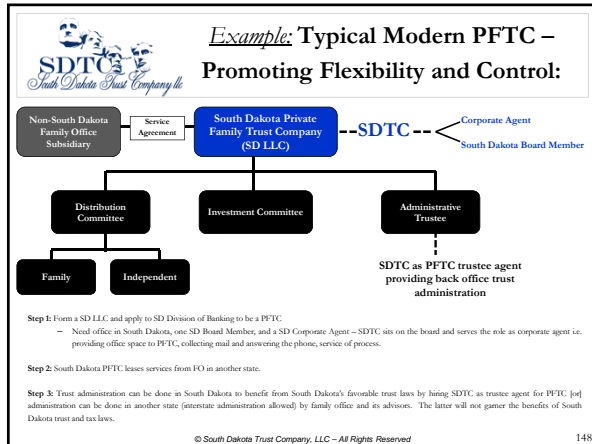


Private Family Trust Companies (PFTC) - Introduction:

- A **growing and popular trend** among **ultra wealthy families** is the **creation** of their **own Private Family Trust Company (PFTC)** to **serve as trustee** for their trusts:
 - Generally LLC authorized by state law to operate as family trust company
 - **Popular PFTC states:**
 - **Regulated:** South Dakota, Wyoming, Nevada and New Hampshire
 - **Example** - South Dakota: \$200k capital and \$75-100k total set up costs (Usually for families with net worths of \$100 million or more)
 - **Unregulated:** Nevada and Wyoming
 - **Example** - No capital requirements and \$15K-\$25K total set up costs (usually for families with net worths of \$10-25 million or more)
- **When does a family create a Private Family Trust Company:**
 - **Family members and advisors** are **named as trustees** for family's trust(s) with **personal liability** - PFTC provides D&O/E&O insurance
 - **Families experiencing issues with bank/institutional trustees**
 - **Allows for a sophisticated asset diversification** model (i.e., Yale-Endowment, FOX, IPI)
 - **Liquid assets in trust** (i.e. closely-held stock, real estate, oil & gas interests, gambling interest, etc.)
 - Provide flexibility to **not have to diversify**, i.e., ability to hold one asset in trust
 - **Governance**
 - **Privacy**
 - **SEC exemption:** Common trust funds & business trusts (Regulated Trust Company)

Please see: Al W. King III, "The Private Family Trust Company and Powerful Alternatives," *Trusts & Estates* magazine, February 2016

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- Choosing a Private Family Trust Company (PFTC) Jurisdiction:**
- PFTC laws and experience:**
 - Regulated
 - Unregulated
 - State Division of Banking:**
 - Experience
 - Conference of State Banking Supervisors (CSBS) Accreditation - (NV & NH not accredited) – Only four states not accredited
 - Corporate agent's experience:**
 - Documents in drawer vs. experienced mentor
 - Key for:** SEC exemption, audits, etc.
 - National vs. State Charter**
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Private Family Trust Companies – Regulated Versus Unregulated:

	Regulated	Unregulated
Best states	South Dakota, Nevada, New Hampshire, Wyoming	Wyoming, Nevada
Regulatory authorities	South Dakota – excellent & experienced (since 1995) Wyoming – Only a few regulated WY PFTCs (former with unregulated) Nevada – (since 2009) New Hampshire – (since 2006)	Nevada – None, unless problem (2009 Legislation) Wyoming – Minimal
State Banking Accreditation (Conference of State Banking Supervisors)	South Dakota – Yes Nevada – No New Hampshire – No Wyoming – Yes	Nevada – No Wyoming – Yes
Improve governance and protects individual family members from liability	Definitely – If structured properly	Less protection than regulated
Interstate Administration allowed	Yes, if reciprocity	Not generally available with unregulated
Investment advisors exemption	Yes (if state level of regulation acceptable to SEC)	No
Common trust funds & Business Trusts	Yes (proposals – regulation key to SEC exemption)	No (proposals – subject to SEC regulation)
Capital required	Yes: SD \$200,000 (Family & Commercial) NV \$300,000 (Family), \$1,000,000 (Commercial) NH \$250,000 (Family), \$500,000 (Commercial) WY \$500,000 (Family & Commercial)	No – but should capitalize so can't pierce corporate veil. Note: Even with capital, protection not as good as regulated
Policy & Procedures Required:	Yes	Not necessary – another opportunity to pierce corporate veil
Tax sensitive trust distributions	More protection	Less protection


Summary: Based on the factors listed above, regulated trust companies are typically a safer option than unregulated regarding the possibility of piercing the corporate veil as well as other key reasons listed above. © South Dakota Trust Company, LLC – All Rights Reserved 150



**“Selecting a Domicile for Family Trusts
(Alaska, Delaware, Nevada, New Hampshire,
South Dakota & Wyoming)”**

QUESTIONS?

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Appendix A
**Existence and Scope of
Decanting Power:**

1. **Existence of Power:**


- Statute
- Trust power
- Common law

2. **Degree of discretionary authority trustee must possess to decant:**

- **Absolute discretion to invade principal:** Florida, Illinois, Indiana, Ohio, Rhode Island
- **Any discretion to invade principal:** Alaska, Colorado, New York, Tennessee, Uniform Trust Decanting Act
- **Any discretion over principal or income:** Arizona, Delaware, Kentucky, Missouri, Nevada, New Hampshire, North Carolina, South Dakota, Virginia

Please Note: Trustee who is also beneficiary of first trust **cannot decant** unless exercise is for HEMS (SD, NV, NC, NY)

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Appendix A
**Existence and Scope of
Decanting Power (cont'd):**


3. **Consent or Notice:**

- **No state requires beneficiaries to consent** to trust decanting
 - Possible gift tax issues?
- Several states **do not require notice** to beneficiaries: Alaska, Arizona, Delaware, New Hampshire and Tennessee.
 - Nevada and South Dakota **permit** but **do not require notice**
 - Several states **require notice** to the beneficiaries of the **first trust**: Colorado, Florida, Illinois, Indiana, North Carolina and Ohio (between 20-60 days notice)
 - **New York** mandates a **copy of decanting instrument** be sent to:
 - Creator of first trust,
 - Any person with right to remove trustee of first trust; and
 - Any person interested in first or second trust.
 - **Kentucky:** Notice required to all **current beneficiaries** and **eldest generation of remaining beneficiaries** of the first trust
 - **Missouri:** Only **notify permissible beneficiaries of second trust**, not first trust
 - **Uniform Trust Decanting Act** - **Required** to give **notice** to **settlor** of the first trust (if living), **each qualified beneficiary** of the first trust, each **holder** of a presently **exercisable power of appointment** over any part or all of the first trust, each **person** who has the **right to remove or replace the authorized fiduciary**, each other **fiduciary** of the first trust and each fiduciary of the second trust.
- **Notify or not?** Duty of loyalty?
- **Virtual representation** – Unborn beneficiaries and minors
- **Decanting** from a **quiet trust?**

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Appendix A

Existence and Scope of Decanting Power (cont'd):




4. **Court Approval** – Not usually required except:

- **Ohio:** Requires **court approval** for a **testamentary trust**
- **New York:** Requires a **copy** of the **decanting instrument** be **filed with** the **court** if trust ever subject to surrogate court approval
- **Statute allows** for trustee to obtain **court approval:** Arizona, Colorado, Illinois, Nevada, New York and North Carolina, Uniform Trust Decanting Act
 - South Dakota also allows for court approval of a decant

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Appendix A

Existence and Scope of Decanting Power (cont'd):




5. **States may limit** trustee's **authority to alter beneficial interests - Power exercised to:**

- One or more of the beneficiaries of the first trust (primary and/or contingent beneficiaries): Kentucky, Missouri, South Dakota, Virginia
- For the benefit of one, more than one, or all of the current beneficiaries of the first trust and for the benefit of one, more than one, or all of the successor and remainder beneficiaries of the first trust: Illinois
- Proper object of trustee's discretion: Delaware, Tennessee – only primary beneficiaries
- One or more current beneficiaries: Nevada, New York, North Carolina, Ohio
- The beneficiaries of the second trust are the same as the beneficiaries of the first trust: Indiana
- One or more of those beneficiaries (the "second trust"): New Hampshire
- The beneficiaries of the trust: Arizona
- The beneficiaries of the invaded trust: Alaska
- One or more persons ("The beneficiaries of the second trust may include only beneficiaries of the first trust"): Rhode Island
- Beneficiaries of the second trust may include only beneficiaries of the first trust: Florida
- May not include as a beneficiary a individual who is "not a current beneficiary, presumptive remainder beneficiary, or successor beneficiary of the first trust": Uniform Trust Decanting Act

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Appendix A

Existence and Scope of Decanting Power (cont'd):



6. **No statute prohibits granting of powers of appointment to beneficiaries of new trusts**

- **Specific State Statutes:** Colorado, Delaware, Nevada, New Hampshire, New York, North Carolina, Ohio, South Dakota, Uniform Trust Decanting Act

7. **Some states limit** trustee's **ability to change distribution provisions** (Alaska, North Carolina, Arizona)

8. **Extending the term and/or duration of the trust:**


- **Term vs. Duration:** generally permissible to extend terms of a trust with a decant (i.e., Delaware, New York, South Dakota). The term is the period that the trust terminates independent of the perpetuities period:
 - Trust ends when minor attains age 21
 - Trust principle distributed 1/3 at 25, 1/3 at 30, and 1/3 at 35
- **Duration – Perpetuities period:**
 - **May extend perpetuities period:** Arizona, Nevada, New Hampshire
 - Major Issues
 - Constructive addition
 - Possible IRS scrutiny
 - **May not extend perpetuities period:** Indiana, Nevada, Ohio, South Dakota, Tennessee, Uniform Trust Decanting Act

9. **Trustee compensation:** New York prohibits increase in trustee fees; Colorado and Uniform Trust Decanting Act prohibit increase unless all beneficiaries consent or court approves

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Appendix A

Existence and Scope of Decanting Power (cont'd):



10. **Unrestricted decanting power** to a **trustee/beneficiary** when a **beneficiary** has a **power to replace the trustee**:


- May **cause** the **trust** to be **included in the estate** of the **beneficiary**
- NY and NC **prohibit decanting when** the **trustee** is also a **beneficiary**
 - FL, OH, and TN have similar prohibition in general trust law
- AK, AR, DE, MO, NV, NH, and SD provide that a **trustee/beneficiary** **may not decant unless distribution power in the second trust is limited** by an **ascertainable standard**
 - SD goes further, and removes the above limitations when the trust, trustee, and beneficiaries wouldn't be subject to U.S. estate or gift tax.
- FL, NY, NC, OH, and TN are **silent** as to decanting power when a beneficiary has the power to remove the trustee

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Appendix A

Existence and Scope of Decanting Power (cont'd):



11. If the **trustee** can **decant to a trust** that **removes the vesting conditions** for a **gift** that **qualified as a present interest** under IRC section 2503(c), there may be a **concern** that the IRS may **treat the transfer** as a **future interest** (regardless of whether the trust is ever decanted).

- **Some state statutes require a minor beneficiary's interest**, which previously qualified under section 2503(c), must vest no later than the date on which it would have vested under the first trust: SD, DE, NC, NH, NV, AZ, MO and OH.


12. **Most state statutes contain a provision** that **prohibits changing a trust term** necessary for qualifying for the marital or charitable deduction

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Appendix A

Existence and Scope of Decanting Power (cont'd):



13. **Most states mandate** that a **decanting cannot reduce a fixed income, annuity, or unitrust interest**

14. **MO, OH** and **UTDA prohibit changing trust terms necessary to qualify as an electing small business trust or qualified Subchapter S trust.**

15. **OH** also **prohibits changes** that **would jeopardize** a trust's **exemption** under the GST tax or tax treatment under IRC Section 401.

Source: Rashad Warsh & Eric Dorsch, *Decanting: A Statutory Corollary*, TRUSTS & ESTATES, Mar. 2012, at 22.

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Appendix B
Ferri v. Powell-Ferri,
476 Mass. 651 (2017)




- **Facts:**
 - Father established **irrevocable trust in Massachusetts**, governed by **Massachusetts law**; **son, beneficiary, resident of Connecticut** and other son/**brother** as one of the **trustees**
 - **Trustees may "pay to or segregate irrevocably"** trust assets for the **beneficiary**
 - After **son reached the age of thirty-five**, **son** may request certain **withdrawals** of up to **fixed percentages of trust assets**, increasing from 25% of the principal at age 35 to 100% after age 47
 - **Son divorced in Connecticut and at the time**, **son** had **withdrawal right of 25% of the trust corpus** based upon his age
 - As the **divorce proceedings** were **ongoing**, the **trustees decanted** to a **new spendthrift trust without informing the son as beneficiary** and **without his consent**
 - **No decanting statute in Massachusetts**, but see *Morse v. Kraft* 466 Mass 92 (2013)
 - **Decanted to protect the trust from the pending divorce**
 - The **new trust eliminated son's withdrawal rights**
 - Connecticut court certified **questions** to Massachusetts Supreme Court including **whether the decanting was authorized under the terms of the trust under Massachusetts law**

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Appendix B
Ferri v. Powell-Ferri,
476 Mass. 651 (2017) (Cont'd:)




- **Court Findings:**
 - **Decanting was authorized under Massachusetts law**
 - Trustee's authority to decant was a parallel but separate power to withdrawal right of son
 - Court focused on **language of the trust**
 - Trustee had power to **"pay to or segregate irrevocably"** the **income and principal for later payment to the beneficiary**
 - **Son's withdrawal power was parallel, but not separate power, to trustee's power to decant**
 - Court **focused on settlor's intent**
 - Post-decating affidavit from settlor expressing his intent that the trustees have the power to decant
- **Key: Absent a decanting statute, language of the trust and intent of the settlor are critical**
 - Advisors suggest including language in the trustee powers that clearly allow distributions to another trust "for the benefit of" one or more beneficiaries and should also include expressions of the settlor's intent that clearly contemplates the trustee's authority to make such distributions.

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Please see: Alexander A. Bove Jr. & Melissa Langa "Ferri v. Powell – Decanting with the Stars" *Lamberg Services* (June 8, 2017)

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Appendix B
Ferri v. Powell-Ferri,
SC19432, SC19433 (2017) (Cont'd:)




- **Connecticut Supreme Court (issued two opinions, one regarding the decant and one regarding the divorce)**
 - The **CT Supreme Court** followed up the MA court's ruling approving the decant with a ruling that **held that the trust assets were moved out of reach of the divorce by the decant**
 - **Assets from the 1983 Trust (original trust)** could **not be considered as part of the dissolution judgement**
 - **2011 Trust (new trust) was a spendthrift trust**, as such, it was **not considered an asset of the marital estate under CT law**
 - **Please note, however**, that while the **court could not consider the assets decanted to the 2011 Trust (new trust) for equitable distribution purposes**, it could consider the **Husband's ability to earn additional income for alimony**
 - The court found that the **trust funds had routinely supported Husband's investments**
 - Therefore, **court ordered Husband to pay Wife \$300,000 in alimony annually, despite earning only \$200,000 annually**

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Please see: Sharon L. Klein "Ferri v. Powell – Connecticut Supreme Court Finds that Trust Assets Were Moved Out of Reach of Divorcing Spouse, But Would Be Considered for Alimony Purposes" *Lamberg Services* (September 6, 2017).

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Appendix C
Berlinger v. Casselberry,
38 Fla. L. Weekly D 2482 (Fla. Dist. Ct. App., Nov. 27, 2013)



- **Florida Trust Code interpreted** so **former spouse** can **access trust** assets to **satisfy alimony**
- **Court held - Florida** state **allows court** to **order writ of garnishment against Florida discretionary trust**

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Appendix C
Berlinger v. Casselberry,
38 Fla. L. Weekly D 2482 (Fla. Dist. Ct. App., Nov. 27, 2013)
(Discretionary Interest, Spendthrift Clause)



- The **judge quoted** in the first sentence of the background section of the opinion, "**Oh what a tangled web we weave when we first practice to deceive**" (quoting Sir Walter Scott).
- **Facts:**
 - **Husband and wife divorced** and entered into a **marital settlement agreement** (2007). The **husband agreed to pay the ex-wife** (Casselberry) a **certain amount** per month.
 - In 2011, **husband** voluntarily **stopped paying**.
 - **Husband and current (new) wife** "**enjoyed a substantial lifestyle**" from **direct payments** to the husband by his **discretionary trusts**.
 - **Ex-wife filed for contempt**, but the **parties entered into settlement**. However, the **husband was still in arrears**.
 - The **husband, in 2011, transferred property into another trust**, but **never disclosed** this to the wife in any of his amended or supplemental financial disclosures. The husband even gave a **deposition** 8 days **after he made the transfer** that he **did not set up any new trusts**.
 - The **husband and new wife continued to live off of his discretionary trusts** throughout this time, **Suntrust, issued the husband a credit card**, which the trust paid the bills. The husband would pay his expenses and would get cash advances on the credit card.

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Appendix C
Berlinger v. Casselberry,
38 Fla. L. Weekly D 2482 (Fla. Dist. Ct. App., Nov. 27, 2013)
(Discretionary Interest, Spendthrift Clause)



- **Court Findings:**
 - This case follows a similar fact pattern and outcome as another Florida case, **Bacardi v. White**.
 - The court stated that *Bacardi* was controlling, and not the Florida discretionary interest statute. The court quoted *Bacardi*, "**if disbursements are wholly within the trustee's discretion, the court may not order the trustee to make such disbursements. However, if the trustee exercises its discretion and makes a disbursement, that disbursement may be subject to the writ of garnishment.**"
 - **The court also stated**, "according to **section 736.0594(2) (discretionary interest statute)**, a former spouse may not compel a distribution that is subject to the trustee's discretion or attach or otherwise reach the interest, if any, which the beneficiary may have. **The section does not expressly prohibit a former spouse from obtaining a writ of garnishment against discretionary disbursements** made by a trustee exercising its discretion. **As a result, it makes no difference that the instant trusts are discretionary**" (emphasis added).
- **Please note - State statutes:** "Discretionary interest not a property right or enforceable interest" (i.e., restatement second/common law) (AK, DE, NV & SD)
 - **Consider - Change of situs:** Reformation/modification/restatement or decanting

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Appendix E
Toni 1 Trust v. Walker
2018 Alas. Lexis 27 (March 2, 2018) (Cont'd)



Bad Facts:


- **Fraudulent Transfer in any jurisdiction** (including Alaska and other DAPT states)
- **Existing Creditors** (i.e. existing judgments/litigation at time of transfer)
- **Real Property**
- **No LLC wrapper**

Proper Planning and Structuring are Key:

- **Court held only that Alaska could not block other courts with jurisdiction to decide matters relating to transfer**
- **NOT that DAPTs are invalid or would allow creditors of the grantor access to the trust's assets**

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Appendix F
Selected List of High Income Tax States for Trusts




Arizona 4.54%	Illinois 3.75%	Minnesota 9.85%	Rhode Island 5.99%
California 13.30%	Iowa 8.98%	Missouri 6%	South Carolina 7%
Colorado 4.63%	Kansas 4.6%	New Jersey 8.97%	Tennessee 6% Dividends & Interest Only (TN Beneficiaries)
Connecticut 6.7%	Louisiana 6%	New York 8.82% New York City 3.876% Total 12.696%	Utah 5%
Georgia 6%	Maryland 5.75%	North Carolina 5.75%	Virginia 5.75%
Hawaii 8.25%	Massachusetts 5.10%	Ohio 4.997%	D.C. 8.95%
Idaho 7.4%	Michigan 4.25%	Oregon 9.90%	Wisconsin 7.65%

Source: Steven J. Oshins, "2nd Annual Non-Grantor Trust State Income Tax Chart" (updated April 2016), http://www.oshins.com/images/State_Income_Tax_Chart.pdf

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Appendix F
Key Trust Taxation:



- **Florida** – Intangibles Taxes Trust if:
 - Repeal effective 1/1/07 (left statute in place?)
 - For tax year 1/1/06 – 5 basis points on intangible assets
 - \$250k exemption per person
 - Specific asset exemptions: Florida Munis, retirement plans, life insurance, annuities
 - FLINT Trust
- **California** – (Pro Rata Test):
 - 3 Possible Methods of Taxing a Non-Resident California Trust
 - California Fiduciaries/Trustees
 - California Source Income:
 - California Business Income
 - California Real Estate Income
 - California Non-Contingent Beneficiaries

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Appendix F
Quill Corp. vs. North Dakota
U.S. Supreme Court - 504 U.S. 298 (1992)



- **Both CT & D.C. cases based upon Quill.**
- **Supreme Court upheld “use tax” statute for goods shipped to ND customers.**
 - Pursuant to due process clause
- **Court Held** – State may tax a taxpayer if “minimum contacts” with taxing state.
- **Rationale:**
 - Imposed same test for state taxation under due process clause.
 - Previously applied to questions of state court jurisdiction for non-residents.
 - Test de-emphasized physical contacts with state.
 - Created extremely broad constitutional justification for imposing state income tax on trusts.

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Appendix F
Illinois, Pennsylvania, Minnesota –
Recent Tax Payer victories:



- **IL, PA and MN** – Attempts to reach trust if settlor was resident when trust became Irrevocable (**PA**: or when trust was created)
- **IL** – *Linn v. Department of Revenue (The Pritzker Case) (2014)*
 - II. Statute – If grantor is a resident at the time trust becomes irrevocable, trust subject to IL income tax; A.N. Pritzker was an Illinois resident when established.
 - Trustee properly distributed and removed trust property to a new Texas trust. The IL Dept. of Rev. determined trust was still a resident for tax purposes.
 - **Court Held:** The court sided with the trustee based on due process grounds
 - No non-contingent trust beneficiary resided in Illinois, no trust officeholder resided in Illinois, all trust assets were outside Illinois; and Illinois law wasn't referenced in the trust instrument.
 - Inter vivos trust's connections with a state are more attenuated than in the case of a testamentary trust.


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Appendix F
Illinois, Pennsylvania, Minnesota (cont'd) –
Recent Tax Payer victories:



- **PA** – *McNeil v. Commonwealth of Pennsylvania (2013)*
 - PA grantor created two trusts governed and administered under DE with DE trustee and DE assets.
 - PA Dept. of Rev. applied its 'single controlling factor' test, and it assessed state income tax because the trust was created by a Pennsylvania resident.
 - **Court Held:** Imposing PA income tax unconstitutional because it violated Commerce Clause; only three of four prong test met (SCOTUS Complete Auto 1977).
 - “Substantial nexus” in PA not created by grantor's and discretionary beneficiaries presence.
 - “Fair apportionment” prong of the test not met, concluding that the assessments were out of proportion to the trusts' activity in the state.
 - “Fairly related” prong, determining that there was no relationship between the burden of taxes on the trusts and any benefits they received from the state.

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Coffee Break




PERSONAL GOODWILL IN ASSET TRANSACTIONS

Frank Agostino, Esq.
Agostino & Associates, P.C.


Mark Sklarz, Esq.
Green & Sklarz LLC


Mark Campbell, CPA/ABV
Scout Valuations LLC

Jason Marsh, Esq.
Green & Sklarz LLC



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INTRODUCTION

BACKGROUND:

The purpose of this presentation is to address personal goodwill, an aggressive but valuable tax technique that enables a shareholder or shareholders of a closely held C corporation (or S corporation with built in gains) to manage tax consequences upon an asset sale by distinguishing personal goodwill from corporate/enterprise goodwill and carving out the value of that intangible asset from the corporation. Such personal goodwill is thereby transferred directly from the individual shareholder or shareholders to the purchaser to avoid two tier taxation.

- Asset class of personal goodwill traditionally applied to service corporations (medical, dental).
- With repeal of "General Utilities" doctrine in 1986, technique has expanded to commercial business transactions when it can be demonstrated that personal relationships and individual expertise is owned by shareholder and never transferred to the corporation.

DEFINITIONS

▪ **Goodwill** – The value of a trade or business attributable to the expectancy of continued customer patronage due to the name or reputation of a trade or business or other factor. There are two types:

- **Personal Goodwill** – An intangible asset associated primarily with an individual based on reputation, expertise or contacts which are of value to the business but not transferred by the shareholder to the corporation.
- **Enterprise Goodwill** – The value of earnings or cash flow directly attributable to the enterprise's characteristics or attributes. It is a function of the earnings from repeat business that will patronize the business, as opposed to the individual, new consumers who seek out the business and new referrals that will be made to the business.

TAX BENEFITS

▪ **Double taxation is avoided and goodwill characterized as capital gain at shareholder level.**

- Prior to repeal of the General Utilities doctrine in 1986, upon the sale of assets, a corporation, by complying with the election procedures of §337 of the Internal Revenue Code could, within twelve (12) months of a sale of assets, liquidate and avoid tax at the corporate level.
- With the change of law, if a buyer is not willing to purchase shares of stock (whether due to liability exposure or desire to obtain basis step up for depreciation and amortization), the sale of assets of a "C" corporation or "S" corporation with built-in gains or earnings and profits will result in double taxation (i.e.-tax on sale of assets at corporate level and on stock redemption by shareholder upon dissolution).
- If all or a portion of the goodwill can be characterized as "personal goodwill" owned by shareholder and transferred outside the corporation, it will avoid double tax and be characterized as capital gain at the shareholder level. (Note: If buyer purchases stock, allocation of portion of price attributable to shareholder goodwill will allow buyer to amortize that portion over 15-year period).

TAX BENEFITS continued...

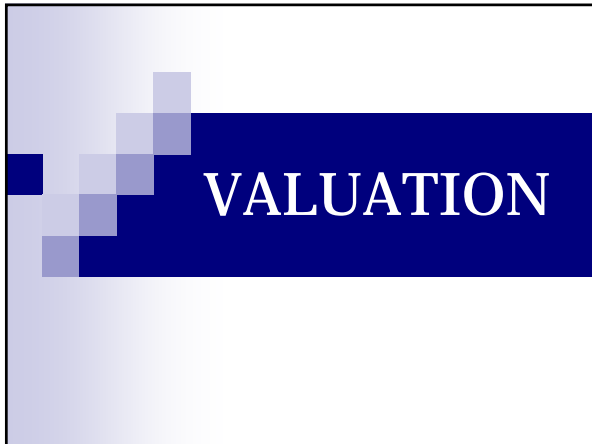
- Upon dissolution and liquidation of assets of corporation, personal goodwill will not be taxed since it is not an asset owned by the liquidating corporation.
- Buyer will receive a step up in basis to extent of consideration paid for corporate assets for depreciation and amortization purposes and will be able to amortize amount allocated to personal goodwill.

TAX BENEFITS continued...

- Personal goodwill will be taxed to individual shareholders at lower capital gains rates.
- Personal goodwill sold by individuals allows allocation away from accrual basis entity to cash basis owner and enables availability of installment sale method.

	Without Goodwill Allocation	With Goodwill Allocation
Asset Transaction Relating to a C Corporation		
Allocation to Sale of Assets	10,000,000	6,000,000
Allocation to Personal Goodwill		4,000,000
First Tier Tax At Corporate Level		
Allocation to Sale of Assets	10,000,000	6,000,000
Basis in Assets	2,000,000	2,000,000
Gain Recognized and Realized	6,000,000	4,000,000
Taxable Income to C Corporation	8,000,000	4,000,000
Corporate Level Tax	21%*	21%*
C Corporation Tax	1,680,000	840,000
Second Tier Tax At Individual Level		
Sales Price Allocated to Personal Goodwill		4,000,000
Capital Gain on Liquidating Distribution Assuming 0-Basis	8,320,000	5,160,000
Subtotal	8,320,000	9,160,000
Capital Gains Tax	15%	15%
Personal Tax	\$ 1,248,000	\$ 1,374,000
Total Tax	\$ 2,928,000	\$ 2,214,000
Total Cash Flow Available After Tax	\$ 7,072,000	\$ 7,786,000

* 21% corporate tax rate may sunset in 2025
 Note - The above calculation omits State Income Taxes



Allocation of Goodwill Between Personal and Enterprise

The difference between personal goodwill and enterprise goodwill is easy to define conceptually, but sometimes difficult to measure.

There are three common approaches to allocating between personal goodwill and enterprise goodwill:

1. Multi-Attributable Utility Model (including Simplified MUM)
2. With/Without Method
3. Goodwill Assessment System (GAS)

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Multiattribute Utility Method ("MUM")

Multiattribute Utility Model ("MUM") is a common method for allocating enterprise and personal goodwill that involved a generic point scoring system assigned to certain attributes of the business.

The steps in MUM are:

- Define and objective
- Establish alternatives
- Define attributes
- Measure the utility of each attribute
- Aggregate the results
- Evaluate the alternatives

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Sample – Simplified MUM Approach

<i>Personal Goodwill Attributes</i>	<i>Add to Scale</i>	<i>%</i>
Ability Skill and Judgment	1	
Age and Health	1	
Closeness of Contact	1	
Comparative Professional Success	0	
Marketing and Branding	1	
Personal Referrals	1	
Personal Reputation	1	
Personal Staff	1	
Personalized Business Name	1	
Work Habits	1	
Total Personal Attributes	9	81.8%
<i>Enterprise Goodwill Attributes</i>		
Assemblage of Assets	0	
Barriers to Entry	0	
Business Location	0	
Number of Offices	0	
Business Name	0	
Business Reputation	0	
Client Base	1	
Repeating Revenue Stream	0	
Systems and Organization	0	
Workforce in Place	1	
Total Enterprise Attributes	2	18.2%
	11	100.0%

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With/Without Method and Goodwill Assessment System (“GAS”)

With/Without Method values the business in two ways:

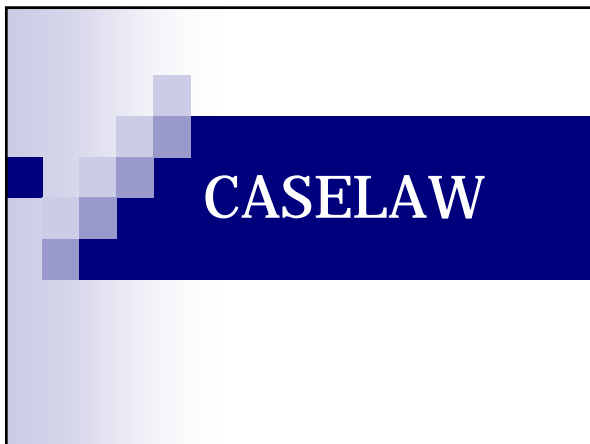
- Assuming the continued presence of the key person
- Assuming the key person was no longer present at the company and had the ability to compete against it.

The difference between these two values would be personal goodwill. Also a measure of a covenant not to compete.

Goodwill Assessment System (“GAS”)

26 factors are assessed in a survey and weighted average scores assigned.

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CASE #1

Martin Ice Cream v. Commissioner, 110 T.C. 189 (1998)

Issue: Treatment of personal goodwill as an asset class in transfer of commercial business.

Facts:

- Arnold Strassberg and son, Martin, owned all of the stock of Martin Ice Cream Co., an ice cream distributor.
- Prior to going into business with son, Arnold worked for more than a decade in own wholesale ice cream business where he developed strong business relationships with managers and owners of supermarket chains.
- After launching Martin Ice Cream, Arnold was approached by Haagen-Dazs, which desired Arnold to introduce their ice cream to supermarkets. Arnold agreed with handshake agreement.

CASE #1 continued...

Martin Ice Cream v. Commissioner, 110 T.C. 189 (1998)

Facts continued:

- In mid-1980s, Pillsbury acquired Haagen-Dazs and approached Arnold about acquiring his relationships with supermarkets so Pillsbury could become direct seller of Haagen-Dazs to those supermarkets. (Pillsbury had no interest in Martin Ice Cream or its physical assets and only had interest in Arnold's connections).
- Arnold sold to Pillsbury. To do so, he created Strassberg Ice Cream Distributors ("SIC"), a new subsidiary corporation of Martin Ice Cream. All of supermarket relationships of Martin Ice Cream were transferred to SIC and held as the subsidiary's only assets. Martin Ice Cream transferred all of the SIC shares of stock to Arnold in exchange for his interest in Martin Ice Cream. SIC then sold the relationship assets to Pillsbury for \$1.4 million and no specific allocation was made between the consideration paid to SIC and to Arnold. As part of the sale, Arnold signed a bill of sale and an assignment of rights, and both Arnold and Martin signed non-compete agreements and a three-year consulting agreement with Pillsbury.

CASE #1 continued...

Martin Ice Cream v. Commissioner, 110 T.C. 189 (1998)

Decision:

- Court held that the intangible assets embodied in Arnold's agreement with Haagen-Dazs and personal relationships with supermarket owners/managers were never corporate assets and owned at all times by Arnold.
- Arnold built the distribution business based on years of personal relationships, the success of which depended entirely on Arnold and ownership of the intangible asset could not be attributed to the corporation because Arnold never entered into a covenant not to compete or other agreement to transfer the asset to the corporation.
- Personal relationships of a shareholder-employee are not corporate assets when employee has no employment contract with corporation. Those personal assets are entirely distinct from intangible corporate asset of corporate goodwill.

CASE #2

Norwalk v. Commissioner, T.C. Memo 1998-279

Issue: Determination of personal goodwill in liquidation context.

Facts:

- > Corporation was a CPA firm with two shareholders who each signed a five-year employment contract with covenants not to compete and non-disclosure agreements to apply during term of contract.
- > Contract expired and no further employment/non-compete agreements signed.
- > Upon liquidation, Corporation distributed assets to shareholders but did not include "customer-based intangibles" as corporate assets, maintaining they were not owned by Corporation but instead owned but by shareholders.

CASE #2 continued...

Norwalk v. Commissioner, T.C. Memo 1998-279

Decision:

The Court held that the "customer-based intangibles" belonged to the shareholders, were based on their ability, skill, acquaintanship or other personal characteristics and there was not an enforceable contract restricting the practice of the accountants.

The Court emphasized the expiration of the employment and non-compete agreements.

CASE #3

Muskat v. U.S., 554 F 3rd 183 (1st Circuit Court of Appeals, 2009)

Issue: Personal goodwill not discussed during negotiations and no allocation of personal goodwill in deal documents.

Facts:

- > Sale of assets of a family-owned C corporation involved in processing and distribution of meat products to restaurant chains and other commercial entities.
- > Taxpayer was the CEO, owned 37% of the shares of stock and for 30 years had developed valuable relationships with customers, suppliers and distributors resulting in soaring increases in revenues.
- > Significant component of negotiations involved discussions of the value of the taxpayer to the business and his expectation to receive payments in addition to payment for corporate assets.

CASE #3 continued...

Muskat v. U.S., 554 F 3rd 183 (1st Circuit Court of Appeals, 2009)

Facts continued:

- Asset Purchase Agreement allocated \$34,000,000 and assumption of liabilities to corporation. Taxpayer entered into employment agreement and covenant not to compete, for which he was paid approximately \$4,000,000 over 13 years.
- Taxpayer filed a return characterizing initial non-compete payment as ordinary income, but then filed amended return claiming refund on basis that payment was consideration for personal goodwill and should have been characterized as capital gain. The District Court disallowed the refund claim and the First Circuit Court affirmed.

CASE #3 continued...

Muskat v. U.S., 554 F 3rd 183 (1st Circuit Court of Appeals, 2009)

Decision:

- The Court held that the taxpayer's attempt to alter the allocation agreed upon by the parties required "strong proof".
- The Court noted the Asset Purchase Agreement allocated almost \$16,000,000 to the corporation's goodwill and during negotiations there had been no discussion that any payment was to be considered for the taxpayer-shareholder's personal goodwill.
- Court rejected taxpayer's argument that since the non-compete agreement survived his death, it was payment for more than his promise not to compete (i.e.-his personal goodwill).

CASE #4

Solomon v. Commissioner, T.C. Memo 2008-102 (2008)

Issues: Existence of personal goodwill in a process and manufacturing business; introduction of personal goodwill as an asset class late in negotiations and substantial allocation to personal goodwill without appraisal.

Facts:

- Taxpayers were shareholders of Solomon Colors, which consisted of packaging and sale of Mather ore, a red ironed oxide mined in Upper Peninsula in Michigan. The ore division constituted 7% of sales of Solomon Colors and taxpayers were responsible for managing customer relationships.
- Shareholders sold assets of company to Prince Manufacturing Company and contended they sold a "Customer List/Goodwill" directly to buyer and were entitled to treat purchase price allocated to the customer list as long-term capital gain on the transfer of goodwill.
- Court reviewed negotiation process, including initial offer, term sheet, draft agreements, purchase price allocation and definitive agreement.

CASE #4 continued...

Solomon v. Commissioner, T.C. Memo 2008-102 (2008)

Facts continued:

- > Court noted that original discussions involved \$1,500,000 offer for ore business with no mention made of customer lists and this continued through term sheet negotiations, modifications and initial drafts of proposed purchase agreement.
- > Buyer eventually stated that covenants not to compete would be required from taxpayers and corporation's accountant was consulted, resulting in a discussion relating to the allocation of a portion of the purchase price to the taxpayers.
- > Payment schedule allocated:
 - \$100,000 to sale of ore business
 - \$210,000 to covenants not to compete (\$150,000 to corporation/\$60,000 to taxpayers)
 - \$1,190,000 to customer list (\$550,000 to corporation/\$640,000 to taxpayers)

CASE #4 continued...

Solomon v. Commissioner, T.C. Memo 2008-102 (2008)

Decision:

- > Court discussed lateness of consideration of customer list/goodwill being incorporated into negotiation and ultimately determined that payments to taxpayers were solely attributable to the covenants not to compete.
- > Court distinguished Martin:
 - Value of Solomon Colors was not attributable to quality of service as customer relationships developed by taxpayers, but rather on basis of processing and manufacturing. (Did not rely on personal service of shareholder/employee goodwill for success).
 - Taxpayers were not named as sellers of any assets but were parties to the purchase agreement only to guarantee they would not compete with buyer.

CASE #5

Kennedy v. Commissioner, T.C. Memo 2010-206 (2010)

Issue: Personal goodwill vs. payment for post-sale personal services and covenant not to compete when no appraisal or valuation of personal goodwill was provided and allocation of personal goodwill represented 75% of total consideration.

Facts:

- > From 1990-1995, taxpayer operated an employee benefits consulting firm as a sole proprietorship and built a loyal customer base.
- > In 1995, the business was incorporated as a C corporation with taxpayer as sole shareholder and one other full-time employee
- > Business was sold in 2000 and evidenced by three agreements:
 1. Goodwill Agreement
 2. Consulting Agreement
 3. Asset Purchase Agreement

CASE #5 continued...

Kennedy v. Commissioner, T.C. Memo 2010-206 (2010)

Facts continued:

- > IRS argued taxpayer failed to prove ownership of goodwill asset, provided no appraisal of personal goodwill and had no contracts with clients; therefore creating value only if taxpayer continued to perform services. IRS further argued the goodwill belong to the corporation, not the taxpayer.

Decision:

- > Court held that the taxpayer did not sell personal goodwill, but rather was paid for his post-sale personal services and covenant not to compete.
- > Court found lack of economic reality to the contractual allocation of payments to personal goodwill, commenting that "...the allocation of seventy five (75%) percent of the total consideration paid by Mack & Parker [the buyer] to goodwill was a tax-motivated afterthought that occurred late in the negotiations..."

CASE #6

Howard v. Commissioner, 108 AFTR 2d (RIA), 5993 (9th Circuit Court of Appeals 2011)

Issue: Transfer of personal goodwill when shareholder was subject to a non-compete agreement with seller-corporation.

Facts:

- > Taxpayer was a dentist practicing through single shareholder C corporation and had written employment agreement which included a covenant not to compete that restricted him from competing with corporation while a shareholder and for three years after termination of his shareholder relationship.
- > Dr. Howard sold practice and allocated bulk of purchase price to goodwill.

Decision:

- > Court rejected the allocation, holding that the non-compete agreement provisions transferred all goodwill to corporation.

Planning and Suggestions

PLANNING AND SUGGESTIONS

- From earliest discussions of a potential transaction, even if uncertainty whether it will ultimately be a stock or asset deal, be certain to include Personal Goodwill as an asset class in all conversations, communications, writings, memos, drafts, final letters of intent and term sheets. Failure to do so may enable the IRS to assert use of Personal Goodwill was an afterthought- a tax gimmick without business or economic reality. Remember that use of Personal Goodwill is extremely fact-sensitive and its applicability as an asset class must be established as early as possible.
- Always engage a qualified, independent appraisal company to value the Personal Goodwill and the Enterprise Goodwill with defensible facts and methodology – DO NOT BE GREEDY!!

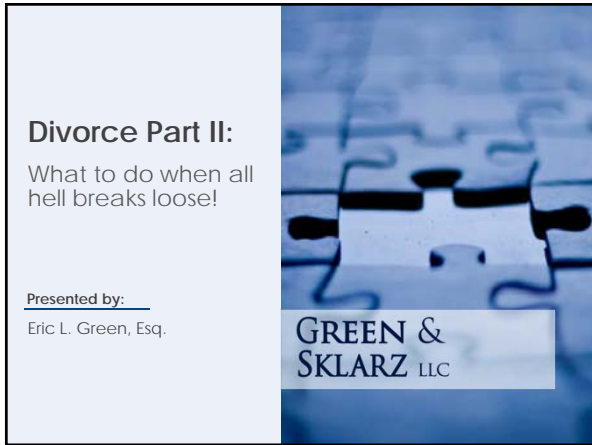
PLANNING AND SUGGESTIONS

- Personal Goodwill will be difficult to establish if there is a covenant not to compete between the shareholder and the target since that will be considered as transferring the Personal Goodwill to the corporation.
- There should be a covenant not to compete (and perhaps, an employment or consulting agreement) with the acquirer. Attribute some reasonable value to the covenant to distinguish from the sold Personal Goodwill.
- If multiple shareholders of target, specifically identify allocation and nature of Personal Goodwill among the shareholders. May be manner of allocating purchase price on a non-pro-rata basis among shareholders if desirable and agreeable.

PLANNING AND SUGGESTIONS

- Consider different agreements for APA and Personal Goodwill - not imperative but helpful, particularly if multiple shareholders with differing allocations of Personal Goodwill.
- Consider Tax Indemnity (if representing Target/Selling Shareholder). Buyer may be paying lower price and receiving benefits due to Personal Goodwill and should share in exposure if disallowed.
- Document tax planning advice and risks with the client.







Planning for the Divorce – Part 1

- Great Ideas
- Client's chose to save money
- Went to LegalZoom.com and got some basic documents done
- Now they are getting divorced, and the fun begins!

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Issues

- Ownership of the family business
- Assets left to children who find unsuitable spouses
- Valuation battles
- Hidden assets
- False returns and innocent spouse claims

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Ownership of the family business

- So husband has the wife and two children. Is running the family business he took over from his father, who started it 40 years ago
- Girlfriend number 1 lives in NYC and her car and apartment are paid for through the business
- Girlfriend number 2 is in New Jersey and is paid a salary as a sales representative
- Wife discovers all this and now files
- Claims 50% of the business...

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Ownership of the family business

1. Can she claim 50% ownership?
2. What alternatives exist?
3. What is a court likely to do?
4. What should have happened to avoid this situation

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Ownership of the family business...2

- After husband and wife get divorced, they agree to settle the issue of the business ownership by transferring it to their adult daughter
- Unbeknownst to them daughter eloped in Cancun last year
- Her new husband is in the US illegally
- Covered with gang tattoos, he explains he has many business interests along the border and needs to meet his "familia" there from time to time to accept shipments

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The new son-in-law...

- Daughter loves her new husband, who she thinks is edgy
- Gives him signature authority on the company
- They can't apply for him to get citizenship because of a murder charge in Mexico he fled

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The new son-in-law...

1. Can mom and dad do anything now?
2. What should have happened to avoid this situation

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Valuation battles

- Valuing the business
- Real estate assets
- Intellectual property
- Crypto-Currency
- Artwork

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The hidden assets

- Soon to be ex-wife contacts us
- Husband filed a financial disclosure
- Is sure there are other assets
- Where do we start?

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The questionable returns – Scenario 1

- Husband and wife are getting divorced
- They have unfiled tax returns for 15-18
- His accountant prepares the returns and submits them to her
- Returns show income reported that matches the financial affidavit and all taxes are paid
- Sign or not sign?

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The questionable returns – Scenario 2

- Husband and wife are getting divorced
- For years he, as the restaurant owner, and she as the bookkeeper, have been skimming \$100,000+ from their business
- He now submits the tax returns to establish their income for alimony
- And she suddenly has an issue with the income...

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Joint Liability

- IRC 6013 allows taxpayers to file a joint return
- There is joint and several liability for the tax due on a joint return
- MFS returns can be amended to become joint returns
- Joint returns cannot be amended to elect MFS
- What about the paragraph in the divorce agreement?

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IRC § 6015

Creates 3 types of innocent spouse relief

- B – Innocent Spouse Relief
- C – Separation of Liability Relief
- F – Equitable Relief

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IRC 6015(b) Relief

- Understatement is due to an erroneous item
- Innocent spouse did not know or have reason to know of the understatement
- Inequitable to hold them responsible for the tax
- Requested relief within 2 years of when collection activity began
- Allocation of the liability
- Refund is available if granted within 3 years of the return filing

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IR 6015(c) Relief

- Must be divorced or legally separated for at least 12 months
- No actual knowledge of the understatement of the item giving rise to the liability
- Must be requested within two years of collection activity beginning
- Will be treated as if they filed separately
- No refund available here

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IRC 6015(f) Relief

- Revenue Procedure 2013-34 lays out the IRS approach to evaluating claims for equitable relief
- Takes into account all facts and circumstances
- For underpayments you must use equitable relief
- Liability is apportioned
- Refunds are available

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Other Issues

- Did the client even sign the return?
- Did he or she have knowledge of the issue (he's been skimming for years!)
- Use IRS Form 8857 to request the relief plus all supporting documentation the taxpayer has
- Prepare for the appeal

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What is an "Injured Spouse"

- Filed a joint tax return
- Some or all of the expected refund was taken to pay the spouse's tax liability
- Need to file for the relief when you become aware the IRS intends to take the refund and use it against the other taxpayer's liability

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