



## DELAWARE TRUST PLANNING

# Transferring your privately held business to a trust?

### Three reasons why a Delaware trust may be ideal for your business interest.

Trusts can be used in a variety of ways to manage wealth and plan for the future. They offer broad flexibility for structuring and managing assets, can help reduce administrative costs and delays at death, and often provide substantial estate and gift tax savings. If you're considering transferring your interest in a privately held business to a trust, you'll need to decide where to establish that trust. Delaware is often considered an ideal choice for the governing law of a trust that owns an interest in a privately held business. There are three primary reasons that Delaware may be your trust's ideal governing law.

#### 1) Directed trusts

Delaware permits a grantor to create a directed trust, which bifurcates the traditional responsibilities of a trustee between two or more fiduciaries. This approach has several benefits for owners of privately held business interests, including:

- Control over the retention and sale of the privately held business interests
- Ability to direct the trustee on certain decisions without trustee oversight or challenge

#### 2) Flexibility

Delaware trust law offers flexibility to the grantor, beneficiaries and trustees, making it a relatively flexible jurisdiction for trusts for several reasons, including:

- Its decanting statute allows for relatively easy, cost-effective trust modifications
- Delaware "dynasty" trusts generally allow the trust assets to accumulate for the benefit of one generation to the next, in perpetuity, without the imposition of transfer taxes
- Delaware "purpose" trusts allow grantors to establish perpetual, non-charitable trusts

#### 3) State income tax

Transferring an interest in a privately held business to a trust governed by favorable state income tax rules can provide a significant economic advantage to the trust beneficiaries upon the sale of that interest. Delaware offers many tax advantages upon the sale of a privately held business interest, including:

- Proceeds from the sale may not be subject to Delaware state income tax if the trust beneficiaries are not Delaware residents
- The trust may not need to file a Delaware state income tax return

However, it's important to note that beneficiaries who receive trust distributions may still be subject to taxation, and the trust may be taxed in the grantor's home state depending on its rules. You should consult with your tax advisor to determine the impact to your tax situation.

# Case study: Saving on taxes while retaining control

## Client situation

- Resident of high-income tax state
- Successful business with significant income
- Desire to transfer business to family but wants to retain control

## Why Delaware

- State income tax benefits
- Directed trust

## Planning outcome

- Business interests transferred to Delaware trust
- Business income not taxed in Delaware; no tax upon sale of business
- Client retains control over management of business

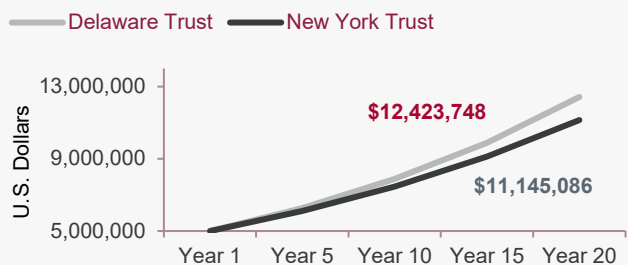
## Benefits of not incurring state income tax

If you are able to establish a trust in Delaware that is not subject to Delaware or New York state income tax, the charts below illustrate the potential savings as compared to establishing a trust in New York subject to city and state tax at a rate of 14.17%.

### EXAMPLE #1

	Delaware Trust	New York Trust
Year 1	\$5,000,000	\$5,000,000
Year 5	\$6,277,557	\$6,109,397
Year 10	\$7,881,544	\$7,464,947
Year 15	\$9,895,369	\$9,121,265
<b>Year 20</b>	<b>\$12,423,748</b>	<b>\$11,145,086</b>

### NEW YORK INCOME TAX



The above example illustrates a gift of \$5 million to a trust, which produces a 6% annual rate of return. It is assumed that: 2% of the return is ordinary income, taxed at 43.4%; 2% of the return is realized capital gains and is taxed at 23.8%; and 2% of the return is unrealized gains that will not be taxed until realized. The blended federal income tax rate on the total return is 22.4%. In addition, the combined New York City and New York state income tax rate is 14.17%. Consult with your attorney or tax advisor if considering creating a Delaware Trust.

Any distributions from the trust to the beneficiaries may be subject to state income tax in the beneficiaries' state of residence. Further, certain states impose an income tax on a Delaware trust if the grantor or beneficiaries are residents of their state. Contact your tax advisor to determine the consequences to you in your state of residence.

### EXAMPLE #2

	Sale in Delaware Trust	Sale in New York Trust
Sales Proceeds	\$5,000,000	\$5,000,000
Tax Cost	(\$0)	(\$0)
Gain on Sale	\$5,000,000	\$5,000,000
Federal Tax	(\$1,190,000)	(\$1,190,000)
State Tax	(\$0)	(\$708,500)
Net Proceeds After Tax	\$3,810,000	\$3,101,500
<b>Delaware Benefit</b>	<b>\$708,500</b>	<b>—</b>

*This table illustrates the potential tax savings of selling a long-term appreciated asset with zero-basis inside a Delaware trust versus a trust held in New York. Assumptions: Federal capital gains rate: 20% plus Medicare Surtax 3.8%; Combined New York City and New York state income tax rate: 14.17%*

If you're transferring your business interest to a trust, there are several reasons why Delaware is attractive as the state law for that trust. **For more information about whether Delaware is the right choice given your circumstances and objectives, visit our [Delaware Trust Planning](#) resource page.**

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