



CIBC PRIVATE WEALTH

# Delaware Trust Planning



## Fulfill the promise of your ambitions

What's your vision for success? We've learned that success often means achieving a sense of satisfaction and joy about the use of your wealth for yourself, your family and causes you hold dear.

It also means having peace of mind about your financial affairs, trusting that your wealth advisor is managing the complexities of wealth ownership. Additionally, for some, it means that plans are in place to realize your vision for broader community impact and a lasting family legacy.

CIBC Private Wealth can be your partner for all of your investment, wealth planning and private banking needs. Our professionals are dedicated to delivering exceptional performance and service with an unwavering focus on you and your best interests.

We hope the information on the following pages will inspire you to articulate your own vision for your wealth. It would be our privilege to help you bring your ambitions to life.



CIBC PRIVATE WEALTH

Delaware Trust Planning

# Advantages of Delaware



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Delaware has long been a jurisdiction of choice for grantors of trusts—for generations, the state has built a trust-friendly body of legislation and has supported its laws with a knowledgeable and effective court system. What makes Delaware law so special, and how can it benefit you and your family?

When creating a trust for your own benefit or the benefit of your family members, there are many things to consider. Carefully crafted terms of distribution for beneficiaries and a trustworthy trustee are on the top of the list for most people. Another decision that should be considered carefully is the choice of the state law to govern the trust. Trust law is not the same in all states, and choosing the right jurisdiction can have multiple benefits for the grantor, as well as the trust beneficiaries. Delaware is favored among many grantors and advisors—here's why.

## Perpetual trusts

Under traditional trust law inherited from English common law, trust creators were prohibited from creating trusts that lasted into perpetuity.

The intent of the common law Rule Against Perpetuities—"lives in being plus 21 years"—is that property should vest in and be owned by a living person at some point in time. From a transfer tax perspective, the impact of outright ownership of property is the imposition of a transfer tax as the property passes from one owner to the next. Under U.S. transfer tax law, there are three different transfer taxes that may be imposed:

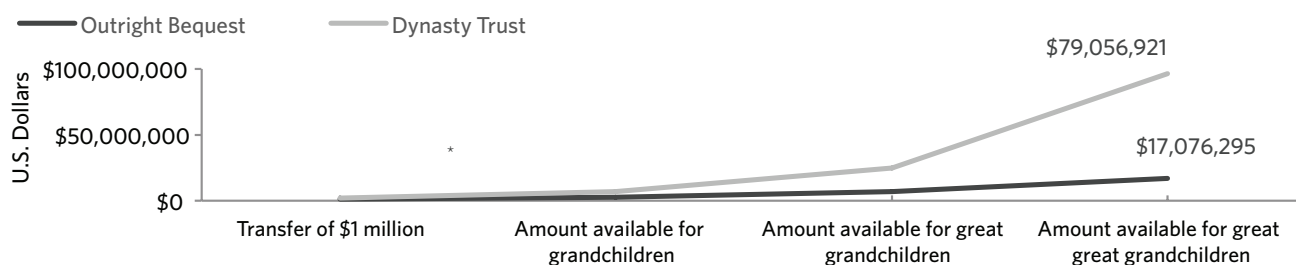
- **Gift or estate taxes** are imposed upon the value of transfers made during the giver's lifetime or at death in excess of the lifetime exemption, which is \$15 million per person (\$30 million for a married couple) for 2026.
- **Generation-skipping tax (GST)** is a separate tax imposed on the value of any assets you transfer to grandchildren or to more remote generations in excess of the exemption, which is \$15 million per person (\$30 million for a married couple) for 2026.

By avoiding the outright ownership of property, you can avoid the imposition of transfer taxes. Delaware abolished the common law Rule Against Perpetuities in 1986 and enacted legislation allowing perpetual trusts in 1995. (There is a limitation of 110 years for real estate held in trusts.) Many high net worth families are turning to Delaware to establish "dynasty" trusts because a dynasty trust's assets, including any appreciation and accumulated income, can pass from one generation to the next, in perpetuity, free from gift, estate and GST taxes.

A properly structured and funded dynasty trust can be a powerful tool in achieving significant transfer tax savings across generations. There are many strategies for funding a dynasty trust, including using the lifetime gift exemption, selling assets to grantor trusts or implementing multiple-year funding plans using the annual gift exclusion.

## Comparing outright gifts and dynasty trusts

	Outright Bequest	Dynasty Trust
Transfer of \$1,000,000*	1,000,000	1,000,000
Future value (25 years @ 6%)	4,291,871	4,291,871
Estate tax (at children's death @ 40%)	(1,716,748)	(0)
Amount available for grandchildren	2,575,122	4,291,871
Future value (25 years @ 6%)	11,052,093	18,420,154
Estate tax (at grandchildren's death @ 40%)	(4,420,837)	(0)
Amount available for great-grandchildren	6,631,256	18,420,154
Future value (25 years @ 6%)	28,460,491	79,056,921
Estate tax (at great-grandchildren's death @ 40%)	(11,384,197)	(0)
<b>Amount available for great-great-grandchildren</b>	<b>17,076,295</b>	<b>79,056,921</b>



\* An initial transfer of \$1 million is used. This table makes a number of assumptions regarding interest rates and future value and is for illustrative purposes only. This illustrates the potentially dramatic difference between making a \$1 million outright gift to the next generation, allowing it to grow and be subject to estate tax in each succeeding generation, and transferring that same \$1 million to a trust that lasts for several generations without being subject to estate tax. The trust can reach almost \$80 million at the end of the grant grandchildren's lives, compared with \$17 million if an outright gift is made. (Not taking into account distributions.)

## Trusts and state income taxation

Rules for taxing income earned in trusts vary from state to state. A trust established in a state that has a state fiduciary income tax will be subject to income tax at both the state and federal levels. Establishing a trust in a jurisdiction that permits a trust to grow without payment of a fiduciary income tax can provide a significant economic advantage to the trust's beneficiaries. Delaware's trust income tax laws permit a trustee to deduct income and realized capital gains that it retains for future distribution to non-resident beneficiaries. What this means for creators of trusts and their beneficiaries is that trust income will not be subject to Delaware state income tax if the beneficiaries are not Delaware residents. In fact, the trustee will not be required to file a state income tax return. Of course, any distributions made from the trust to beneficiaries may be subject to state income tax in the state where they reside, and some states may assert their own income tax even on income retained in the trust. But, retained income will not be subject to the burden of state income tax in Delaware, unless the beneficiaries are actually residents of Delaware.

Although Delaware lifts the state tax burden, it's important to be aware of the rules of other states regarding trust income tax on trusts created outside their borders and how those rules may affect the grantor, beneficiaries and co-trustees.

### Trusts with individual co-trustees

Some states treat a trust that has a co-trustee residing within the state as a resident trust for income tax purposes and impose their income tax rules accordingly. For example, if a trust is created in Delaware naming as co-trustees a Delaware trustee and a grantor's child who lives in New York, then New York will treat that trust as a resident trust and

tax the trust income. So, although it is often appealing to name a family member as a co-trustee to provide guidance or oversight or for financial education purposes, it's important to understand the trust taxation rules of the state of the individual's residence. Similarly, delegation of important trust administration duties, such as investment management, to a person or firm outside of Delaware may also result in that state imposing its own state income tax.

### Trusts that derive income from sources outside of Delaware

Although managed liquid investments will generally not be subject to Delaware income tax, if income is generated by businesses or properties physically located in another state, that state will likely assert a claim for that portion of trust income. Often, this is outside the control of the trustee if the assets transferred to the trust are family business interests or real estate holdings. However, where the trustee has discretion over asset allocation within the trust, it is important to avoid assets that might inadvertently result in another state's income taxation.

### Residence of the grantor and beneficiaries

A final note regarding state income taxation is that, although Delaware state income tax will not be imposed on Delaware trusts as long as the grantor and beneficiaries are not Delaware residents, certain states impose an income tax on a Delaware trust when the grantor and/or the beneficiaries are residents of their states. Several states define a trust as a resident of their state if the grantor resides in the state when the trust becomes irrevocable, regardless of all other evidence that the trust is settled in Delaware. And, some states impose a tax on the income of a Delaware trust if the trust beneficiaries reside in their state.

### State income tax savings - New York examples

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 a trust in New York subject to a city and state tax rate of 14.17%.

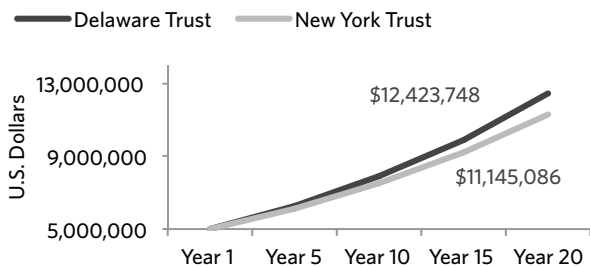
#### Example #1

	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>

#### 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>\$708,000</b>	<b>—</b>

### New York Income Tax



The above examples illustrate 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.

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%.

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.

## Asset protection trusts

Traditionally, an individual could not create an irrevocable trust from which he or she could benefit—called a “self-settled trust”—and protect assets from claims by creditors. This meant if you created an irrevocable trust and gave the trustee discretion to use the income and principal for your own benefit, your creditors could reach the assets in the trust.

However, this changed in 1997, when Delaware enacted the Qualified Dispositions in Trust Act and created the Delaware Asset Protection Trust (APT). Professionals and high net worth families have been using Delaware Asset Protection Trusts ever since to obtain asset protection, protect existing trusts and, in some cases, maximize tax advantages.

A Delaware Asset Protection Trust can help protect your family’s wealth and manage unforeseen risks:

- Professionals in highly litigious fields such as law and medicine often establish APTs to shield their assets in the event of malpractice claims. In addition, corporate officers and directors, now under more scrutiny and involved in shareholder-related litigation and investigations, may benefit by shielding some of their assets in an APT.
- Business owners and entrepreneurs can shield personal assets from future creditor claims and business reverses.
- APTs are effective tools to help protect your children’s assets from future spouses and creditors. Starting at the age of majority, children can place assets that they earn or receive in APTs.
- The Delaware Act can also provide creditor protection for estate planning strategies such as grantor retained annuity trusts (GRATs), charitable remainder trusts (CRTs) and qualified personal residence trusts (QPRTs).

Even if you already have a self-settled trust in another jurisdiction, it can be moved to Delaware. APTs should be viewed as risk management tools for your family, and, as a general rule, with any risk prevention tool, the earlier, the better. APTs are most effective before there is a risk of incurring a claim, so before you start that business or accept a board seat, discuss with your relationship manager whether a Delaware APT makes sense for your family. But beware—while APTs can shield your assets from many types of claims, there are certain “super creditors,” such as the Internal Revenue Service, the Securities and Exchange Commission and minor children seeking child support that may reach the assets of an APT. In addition, tort claims that occur prior to the creation of the APT and certain family-related claims, such as a divorce decree or alimony award, may reach an APT.

## Quiet trusts

Delaware trust law gives maximum freedom to the wishes of the grantor, as expressed in the trust documents. Under Delaware trust law, a trust instrument can expand, restrict, eliminate, reduce or otherwise vary the rights of beneficiaries, as well as the trustee’s powers, duties, standard of care and liability. These broad provisions include the right of a beneficiary not to know about his or her interest in a trust for a period of time.

Many high net worth families struggle with how to share their assets with their beneficiaries without creating a sense of entitlement. Or, they fear that knowledge of significant wealth may undermine productivity or otherwise harm, rather than help, a beneficiary. Unfortunately, this wish to keep the existence of a trust from a beneficiary is contrary to traditional trust law, which requires a trustee to inform the beneficiary of his or her interest in a trust, so that interest can be protected. Delaware has responded to the concerns of trust creators by providing that trustees do not have to inform a beneficiary of his or her interest for a period of time specified in the trust agreement. Trusts containing these types of provisions are often referred to as “quiet trusts.”

While Delaware clearly permits this type of provision, it does not define “a period of time,” so the terms and duration of a quiet trust can run along a very broad spectrum. “A period of time” is generally understood to mean a specific age or defined number of years, although it is possible to extend to future generations. Many grantors who employ this type of

provision seek to delay knowledge until a beneficiary reaches a particular age or other clearly defined restriction, to give effect to the wishes of the parents and grandparents who understand their children best.

### Case study: James and Jennifer Jones

**Client Situation:** James and Jennifer Jones have created significant wealth and now wish to set aside a large portion of that wealth in a trust. While they hope the trust will be used primarily for the education and welfare of future generations, they still wish to provide currently for their children as needed. One of their children, Sam, has struggled with personal issues in the past, but currently appears to be on a constructive path. They fear that knowledge of the significant wealth set aside for him could derail his progress.

**Why Delaware:** In Delaware, grantors may create trusts that last for multiple generations, even in perpetuity. In addition, although trust law generally requires trustees to keep a beneficiary informed about trusts for their benefit, Delaware allows grantors to create a “quiet trust” by restricting this information for a period of time.

**Planning Outcome:** James and Jennifer created a dynasty trust to last several generations, providing for health, education and support of current and future beneficiaries. The trust will divide at each generation, allowing the trusts to be invested and managed in concert with each family’s needs. In addition, the trust will remain ‘quiet’ for fifteen years, permitting Sam to reach a point in time where knowledge of the wealth will likely be constructive.

### Directed trusts

A trustee is held to the highest standard of fiduciary responsibility when dealing with the assets under its care. While almost every state’s trust law allows a trustee to delegate certain duties, such as investment management or oversight to a third party, the trustee typically remains liable for the performance of the investments and actions of third-party advisors. This often leaves trustees in the unenviable position of trying to accommodate the family’s wishes to maintain control over certain assets without compromising the trustee’s fiduciary duties, or reviewing the investment decisions of the client’s outside advisors.

Many high net worth families today find that their assets are highly concentrated, the result of a closely held family business, legacy stock, significant investments in real estate or other assets such as hedge funds and private equity funds that can be difficult to value and manage. Creating a trust is often the most effective way to facilitate the transfer of wealth to future generations and protect assets. However, many corporate trustees find their duty to manage and diversify the assets at odds with the family’s desire to retain these concentrated holdings. Families also may wish to maintain a degree of control over the assets or retain specialized investment professionals to help them manage these unique assets.

Clients seeking flexibility in the administration of their trusts often turn to Delaware, whose direction statute authorizes trustees to take investment direction from investment advisors as defined and provided in the trust agreement. This provides families with the flexibility to retain control over the investment decisions of a trust by appointing a trusted advisor or family member as investment advisor. In Delaware, this also includes the ability to override the duty of a corporate trustee to diversify trust assets. Families with concentrated holdings have the freedom to retain those assets and use them in their estate planning or asset protection planning.

The Delaware direction statute can also be used to provide flexibility in distribution decisions and vest that decision with a “distribution advisor” who knows the family and can make decisions consistent with the family’s wishes. Even the removal and appointment of trustees can be managed by appointing a “trust protector” to handle these decisions. The benefits of the Delaware direction statute can be applied to almost any type of trust structure in Delaware.

## Case study: Sally Williams

**Client Situation:** Sally Williams, a resident of a high income tax state, is the owner of a business organized as an LLC. The business is very successful and generates significant income for the business owners. Further, as the enterprise has grown, Sally is aware that a sale of the business might come to pass in the future. The success of the business and the income it generates is causing Sally to consider if there are ways to reduce the income tax liability associated with the business. In addition, she is considering whether she should transfer some interests in the business to her family; however, she does not want to give up control over her business.

**Why Delaware:** Trusts established in Delaware are not subject to state income tax if the beneficiaries are not Delaware residents. Moreover, in Delaware, trustee responsibilities may be bifurcated under the terms of the trust agreement, allowing the grantor (or other family member) to have control over the management of the trust assets while appointing another fiduciary to handle the other administrative responsibilities.

**Planning Outcome:** Sally created a directed trust in Delaware and transferred a significant interest in the LLC to the trust. This resulted in income tax savings without Sally giving up control of her business.

- Income from the business that is retained in the trust is not subject to Delaware state income tax (although it remains subject to federal income tax). Also, if there is a future sale of the business, proceeds resulting from the sale (and retained in the trust) will not be subject to Delaware state income tax.
- In addition, Delaware's directed trust statute permits Sally to retain control over management and transactions of the LLC, including the possible future sale of the business. She accomplished this by appointing herself as the business advisor and Delaware Trust Planning as the trustee for all other trust administration matters.

*Note: any distributions from the trust to the beneficiaries may be subject to state income tax in the beneficiaries' state of residence and that certain states impose an income tax on a Delaware trust if the grantor or beneficiaries are residents of their state.*

## Decanting statute

As circumstances change in the lives of trust creators and their beneficiaries, the original terms of a trust can thwart the trust's purpose. Provisions initially thought to carry out the grantor's intent can become too restrictive or too broad as the needs and behaviors of beneficiaries develop and family conditions change. Even though the trust may be irrevocable, Delaware law provides that trustees who have discretion over the distribution of trust assets may appoint those assets into another, more appropriately constructed trust agreement. This authority, referred to as "decanting" a trust, permits the modification of trust provisions with much greater ease and much less cost than the process of a judicial reformation.

Delaware's decanting statute, first enacted in 2003, provides that a trustee, acting within his or her own discretionary authority or at the direction of an advisor appointed in the trust agreement, may distribute trust assets to a new trust agreement with different terms and provisions under certain conditions. The beneficiaries of the new trust must have been beneficiaries of the old trust. The new trust may eliminate beneficiaries of the old trust, but it may not add new ones. While the new trust generally may expand or narrow the terms of distribution to beneficiaries, certain characteristics of particular types of trust may not be changed. For example, a spouse's income interest in a marital trust may not be reduced, and a minor beneficiary's interest in a Sec. 2503(c) trust must vest and be distributable on the same date in both old and new trusts.

The trustee's authority derives from the statute and the terms of the trust agreement and does not require notice to or consent from the beneficiaries. Moreover, unlike the statutes of several states, the trustee's discretionary authority does not have to be absolute in order for the trustee to be able to exercise it in favor of the new trust. If the trustee's authority is limited to a standard, it may still exercise the power to decant, as long as it conforms to the standard in the agreement. In many cases, the authority granted to a trustee to decant assets from an old trust to a new trust will permit an effective modification of an outdated trust. Thoughtful use of Delaware's decanting statute provides desirable flexibility to ensure that a grantor's intent will be realized even as conditions change.

### Case study: John Smith

**Client Situation:** John Smith created an irrevocable trust many years ago for his family. The trust contains a provision that requires the trustee to distribute income to a beneficiary once the beneficiary reaches the age of 35. Unfortunately, one of the current beneficiaries is a responsible steward of wealth, while the other exhibits spendthrift tendencies. Because of these differing circumstances of the beneficiaries, the Smith family wishes to eliminate the mandatory income requirement. In addition, the investment provisions in the document restrict investments to certain listed categories. The family has a broad and diversified investment philosophy and wishes to be able to invest the trust assets in line with their overall, broad program.

**Why Delaware:** Delaware law allows for the trustee to decant a trust as a way to modify a trust in a cost-effective and relatively easy way. When a trustee decants a trust, the trustee distributes the assets of the trust that the family wants to modify to a new trust that meets the goals and circumstances of the family.

**Planning Outcome:** By decanting the old trust into a new one, the Smith family was able to broaden the administrative provisions to allow investment in a wide array of vehicles to complement the family's overall investment philosophy. In addition, the new trust's distribution provisions eliminate the mandatory income requirement in favor of a discretionary distribution standard for income. This allows the trustee to take into account the circumstances and needs of the beneficiaries over time and gives the trustee and family much more flexibility.

### Trust laws, legislative environment and court system

Delaware has been at the forefront of trust law since the beginning of the twentieth century. Many states, including Alaska, Nevada, and South Dakota, have followed in Delaware's footsteps to create flexible and useful environments for trust grantors. Still, the original value proposition created by Delaware remains because of its reputation as a jurisdiction with a rich history of well-developed, flexible trust and tax laws.

Delaware began building its trust infrastructure in the early twentieth century, and its state legislature continues to update and adjust trust laws to adapt to a variety of new challenges. The state legislature, governor, banking institutions and legal community work together to propose and pass new trust legislation to ensure that Delaware maintains its status as a leading trust jurisdiction. Unlike many jurisdictions that are newer to the trust scene, Delaware has a robust community of seasoned professionals, including accountants, attorneys and banking professionals, who specialize in trusts.

Moreover, Delaware has supported its laws with a knowledgeable and effective court structure. All trust administration and trust interpretation cases are exclusively within the jurisdiction of the Delaware Court of Chancery, and upon appeal, the Delaware Supreme Court. Delaware's Court of Chancery is a court of equity as opposed to a court of law. In other words, the Delaware Court of Chancery is a non-jury trial court and case holdings are based on judicial decisions.

In addition, because the Court of Chancery focuses exclusively on fiduciary and commercial matters, it does not experience the same backlog that many other state court systems do. As a result, dispute resolutions are often handled more efficiently and quickly by professionals that have experience in the area. Furthermore, Delaware has ruled favorably on a number of trust issues including asset protection trusts and directed trusts. These rulings can help individuals plan with more comfort and confidence.

While selecting a trust jurisdiction is not a one-size-fits-all decision, as a pioneer in trust law with flexible trust laws, developed case law and a cooperative legislative environment, Delaware offers a variety of unique advantages over other trust friendly states.

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