PERPETUAL DYNASTY TRUSTS: TAX PLANNING AND JURISDICTION SELECTION

Richard W. Nenno, Esquire
Wilmington Trust Company
Rodney Square North
1100 North Market Street
Wilmington, Delaware 19890-0955
Tel: (302) 651-8113
Fax: (302) 651-1981
rnenno@wilmingtontrust.com

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By

Richard W. Nenno
Wilmington Trust Company
Rodney Square North
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Wilmington, DE 19890-0955
Tel: (302) 651-8113
Fax: (302) 651-1981
rnenno@wilmingtontrust.com

I. INTRODUCTION[1]

A. Background

In recent years, a "dynasty trust" has come to mean a trust that is designed to last for several generations. In this paper, I will focus on the "perpetual dynasty trust"—a dynasty trust that may—but is not required to—last forever. Specifically, after covering some preliminaries in this Part I, I will summarize the federal-transfer and federal-income tax attributes of these trusts in Part II. I then will discuss a client's freedom to choose a jurisdiction for a new trust, the ability of courts to disregard that selection, and factors for clients to consider in making such a choice in Parts III through V. Parts VI, VII, and VIII, respectively, address ethical and practical concerns, relocating existing trusts, and the use of perpetual dynasty trusts by nonresident aliens. Appendixes A through J contain illustrations and state law charts.

B. Advisability of Creating Trusts

1. Reasons to Create Trusts

An individual might create a trust for one or more of the following reasons:

a. To provide investment management;

b. To protect assets from beneficiaries' creditors;

[1] The following sources are cited frequently in this paper: 5A Austin W. Scott & William F. Fratcher, The Law of Trusts (4th ed. 1989); George G. Bogert & George T. Bogert, The Law of Trusts and Trustees (rev. 2d ed. 1992). I would like to thank Robert H. Sitkoff, John L. Gray Visiting Professor of Law, Harvard Law School, for his helpful comments.

c. To protect assets in divorce proceedings involving a beneficiary;[2]

d. To protect a beneficiary from improvidence or designing persons;

e. To manage assets for a minor or handicapped child or for someone who becomes disabled due to illness or old age;

f. To encourage a beneficiary to act in desired ways (e.g., by providing funds only if the beneficiary earns a certain amount of income, gets married, or has children);[3]

g. To discourage a beneficiary from acting in undesirable ways (e.g., by providing funds only if the beneficiary is not addicted to drugs or alcohol);

h. To preserve the identity of separate or community property;

i. To prevent assets (e.g., stock in a close corporation) from being encumbered or sold;

j. To consolidate voting interests in closely held entities without having to deal with voting-trust restrictions; or

k. To avoid state and local income taxes.

2. Reasons Not to Create Trusts

An individual might not create a trust because he or she:

a. Does not have enough money to create one;

b. Does not obtain estate-planning advice and does not otherwise learn about trusts;

c. Obtains estate-planning advice but is not informed of this option or is counseled not to use it;

d. Does not care what happens to assets after his or her death and the death of any spouse;

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[2] See Marc A. Chorney, Interests in Trusts as Property in Dissolution of Marriage: Identification and Valuation, 40 Real Prop., Prob. & Tr. J. 1 (Spring 2005).

[3] See Joshua C. Tate, Conditional Love: Incentive Trusts and the Inflexibility Problem, 41 Real Prop., Prob. & Tr. J. 445 (Fall 2006); James E. McNair, III, Gregory S. Rupert, & Cynthia L. Gausvik, Get FIT, 145 Tr. & Est. 36 (Feb. 2006).

e. Believes that children will need to spend their inheritances;

f. Wants children to be able to decide what to do with assets regardless of the tax consequences;

g. Does not want to "tie up" assets in trust;

h. Finds the subject to be too complicated or cannot understand it;

i. Does not choose this vehicle from the wide array of available legal and financial choices;

j. Does not devote sufficient time to the subject because of demands on time by occupational, recreational, religious, or other matters;

k. Finds the documentation to be too long and too complicated; or

l. Feels that the costs of developing and implementing the plan are too high.

C. Observations

The increasing attractiveness of perpetual dynasty trusts is real. Hence, a recent study has found that:[4]

> The jurisdictional competition for trust funds is both real and intense. Since 1986 a host of states have altered their perpetuities laws to give their local banks and lawyers a competitive advantage in what our results show is a national market for trust fund services. Our estimates imply that, [from 1987] through 2003, the movement to abolish the Rule Against Perpetuities has affected the situs of $100 billion in [federally] reported trust assets—roughly 10% of the 2003 total. Not surprisingly, the trend toward abolition has accelerated in recent years.

A 2003 article that analyzes perpetual dynasty trusts concludes:[5]

[4] Robert H. Sitkoff & Max M. Schanzenbach, Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes, 115 Yale L. J. 356, 412 (Nov. 2005) (footnote omitted).
[5] Jesse Dukeminier & James E. Krier, The Rise of the Perpetual Trust, 50 U.C.L.A. L. Rev. 1303, 1339–40 (Aug. 2003). For a critique of the Dukeminier-Krier article's concerns about perpetual trusts and its legislative proposals, see Joshua C. Tate, Perpetual Trusts and the Settlor's Intent, 53 Kan. L. Rev. 595, 605–11 (Apr. 2005). See also Tate, supra, at 613–17; Gideon Rothschild, More Clients Should Choose Trusts, 143 Tr. & Est. 32 (Mar. 2004); Note: Dynasty Trusts and the Rule Against Perpetuities, 116 Harvard L. Rev. 2588 (June 2003); Stewart E. Sterk, Jurisdictional Competition to Abolish the Rule Against Perpetuities: R.I.P. for the R.A.P., 24 Cardozo L. Rev. 2097 (May 2003).

> If there is a case against perpetual trusts, it must in our judgment be found in the argument that their costs and burdens at some point become too great. As we have seen, most of the difficulties of duration can be eliminated by skillful drafting of the trust instrument: creating special powers of appointment in beneficiaries; discretionary powers in trustees; enabling beneficiaries to remove trustees and, when a trustee's office is vacant, to appoint a successor trustee; providing that trustees account to adult beneficiaries, so as to avoid judicial accountings; and so on.

Indeed, an attorney might face liability if he or she does not discuss the perpetual-dynasty-trust option with clients.[6]

II. FEDERAL TAX IMPLICATIONS OF PERPETUAL DYNASTY TRUSTS

A. Introduction[7]

1. Scope

For purposes of the federal generation-skipping transfer tax ("GST tax"), almost all trusts fall into one of the following three categories:

a. Exempt Dynasty Trust—a trust that uses an individual's GST exemption from the GST tax;

b. Grandfathered Dynasty Trust—a trust that is not subject to the GST tax because it was irrevocable on September 25, 1985; and

c. Nonexempt Dynasty Trust—a long-term trust that is not exempt or grandfathered for GST tax purposes.

2. Observations

a. My observations about the use of the three types of dynasty trusts since 1987 (when the revised GST-tax system took effect) are as follows:

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[6] See Michael J. Myers & Rollyn H. Samp, South Dakota Trust Amendments and Economic Development: The Tort of "Negligent Trust Situs" at Its Incipient Stage?, 44 S.D. L. Rev. 662 (1998/1999).
[7] See Richard B. Covey & Dan T. Hastings, The GST Tax at Twenty: A Brief Look Back and Selected Current Issues, Prac. Drafting 8351–75 (Jan. 2006); Carol A. Harrington & Frederick G. Acker, 850 T.M., Generation-Skipping Tax.

(1) Exempt Dynasty Trust—Almost immediately, the wealthy began revising their revocable estate-planning documents to provide for the use of their GST exemptions. Many have created irrevocable inter vivos trusts to use part or all of their exemptions. Unlike the use of the exemption from the federal gift tax ("gift-tax exemption"), which currently is $1 million, however, the use of the GST exemption during life or at death has not gained general acceptance among those of moderate wealth.

(2) Grandfathered Dynasty Trust—Virtually every individual with whom I have discussed the exercise of a limited power of appointment over a Grandfathered Dynasty Trust has exercised the power to maximize the benefit of the trust's grandfathered status, probably because he or she already is familiar with trusts and because doing so does not involve a loss of income during his or her life.

(3) Nonexempt Dynasty Trust—With few exceptions, the almost universal reaction following the enactment of the Tax Reform Act of 1986 was to revise estate planning documents to leave all assets in excess of the GST exemption outright to beneficiaries. In recent years, however, many individuals whose assets have grown through success in business, savvy investing, or the receipt of inheritances have begun to recognize the tax and nontax benefits of leaving assets over the GST exemption in long-term trusts.

b. Planning a dynasty trust, particularly an Exempt Dynasty Trust or a Grandfathered Dynasty Trust, requires a knowledge of arcane principles of tax, property, and fiduciary law and should be undertaken only by those with a thorough grounding in these principles. Similarly, the drafting of a dynasty trust should be undertaken with care. Far too often, such trusts contain ambiguous language (e.g., "**in equal shares** to trustor's then living issue, **per stirpes**") and do not reflect an understanding of the nature of these trusts (e.g., by omitting entire generations of beneficiaries). The job of creating a dynasty trust is not always complete with the signing of the document. In particular, it is imperative that all members of the estate planning team make sure that all requisite GST exemption allocations are made in a timely fashion.

c. In my view, the planner's bias should be in favor of creating dynasty trusts. Although the trustee may distribute assets to enable beneficiaries to avail themselves of the advantages of outright ownership, the tax and nontax advantages of trusts cannot be restored once assets have been distributed. I also believe that the planner's bias should be in favor of perpetual dynasty trusts because I see no reason to cut off the advantages of trusts at some arbitrary date (e.g., 21 years after the death of the last beneficiary who was alive when the trust was created).

B. The Exempt Dynasty Trust

1. Introduction

Section 2631(a) of the Internal Revenue Code ("IRC") gives every individual—U.S. citizen, resident alien, or nonresident alien—a $1 million GST exemption from the GST tax that the individual or the individual's executor may allocate to any property of which the individual is the transferor. Under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("2001 Tax Act"),[8] the GST exemption is $2 million in 2007 and 2008, it will increase to $3,500,000 in 2009, and it will be repealed in 2010.[9] No tax law or regulation prevents an Exempt Dynasty Trust from being perpetual, so that a client may create a perpetual dynasty trust simply by creating his or her trust in one of the many jurisdictions that permit trusts to last forever.[10] In recognition of this, the Joint Committee on Taxation proposed a legislative change early in 2005 to limit the tax-savings opportunity from an Exempt Dynasty Trust to a single generation.[11]

Some practitioners say that the 90-year Uniform Statutory Rule Against Perpetuities ("USRAP") period or the common-law rule against perpetuities period (i.e., lives in being when the trust became irrevocable plus 21 years) is "long enough." Nevertheless, I work in a jurisdiction—Delaware—in which long-term trusts have proven to be useful, and new trusts have flocked to Delaware in recent years because there is no perpetuities period.[12]

2. Illustrations

Many individuals fund an Exempt Dynasty Trust with assets equal in value to their $1 million gift-tax exemption. Appendix A compares the amount that would be in a $1 million Exempt Dynasty Trust at the end of

[8] Pub. L. No. 107–16.
[9] IRC §§ 2631(c), 2664.
[10] See Paragraph D of Part V below.
[11] Joint Comm. on Tax'n, Options to Improve Tax Compliance and Reform Tax Expenditures at 392–95 (Jan. 27, 2005), available at www.house.gov/jct/s-2-05.pdf (last visited Mar. 7, 2007).
[12] See Max M. Schanzenbach & Robert H. Sitkoff, Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust, 27 Cardozo L. Rev. 2465, 2479, 2495–96 (Apr. 2006); Sitkoff & Schanzenbach, supra note 4, at 375 n.62, 393–94.

100 years with the amount that would remain if assets simply were left from generation to generation and taxed at 45% using various rates of return and assuming that each generation would last 25 years. Assuming a 3% return, the Exempt Dynasty Trust would be worth $19,218,632 whereas the no trust arrangement would be worth only $1,758,625 at the end of 100 years. Assuming a 10% return, the Exempt Dynasty Trust would be worth $13,780,612,340 whereas the no trust arrangement would be worth only $1,261,012,158 at century's end. These examples, which are oversimplified, assume that either no distributions would be made or that an after-tax return of the indicated rate could be earned despite distributions.

Other individuals fund a charitable lead unitrust ("CLUT") with assets equal in value to their gift-tax exemption plus the federal gift-tax deduction for the charitable interest.[13] Appendix B shows the amount that can be placed in a CLUT to produce a taxable gift of $1,000,000 using various payout rates and charitable terms and assuming that the CLUT will achieve 6% annual growth. Using a 3% payout and a 5.4% IRC § 7520 rate, I calculate that a 20-year CLUT can be funded with $1,823,985 whereas a 99-year CLUT can be funded with $19,536,974. Using an 8% payout and the same IRC § 7520 rate, I calculate that a 20-year CLUT can be funded with $5,180,032 whereas a 99-year CLUT can be funded with $3,424,657,534.

C. The Grandfathered Dynasty Trust

1. Introduction

The GST tax does not apply to transfers from a trust that was irrevocable on September 25, 1985,[14] unless one of the following exceptions applies:

a. Property was added after September 25, 1985;[15]

b. The client held a power to alter, amend, revoke, or terminate the trust that would have been taxable under IRC § 2038 if the client had died on that date;[16]

c. The client possessed an incident of ownership over a policy of life insurance treated as a trust that would have been taxable under IRC § 2042 if the insured had died on that date;[17] or

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[13] Although charitable lead annuity trusts ("CLAT"s) rarely are used because of the special rule in IRC § 2642(e), they should become more popular because, under the 2001 Tax Act, IRC § 2642(a)(3) now permits trusts to be severed for GST-tax purposes.
[14] Treas. Reg. § 26.2601-1(b)(1)(i).
[15] Treas. Reg. § 26.2601-1(b)(1)(i), (iv).
[16] Treas. Reg. § 26.2601-1(b)(1)(ii)(B).
[17] Treas. Reg. § 26.2601-1(b)(1)(ii)(C).

d. The client made a constructive addition.[18]

The GST tax does not apply to:

a. A trust that was irrevocable on September 25, 1985, for which a qualified-terminable-interest-property ("QTIP") election was made before, on, or after that date;[19] or

b. Post-September 25, 1985, principal growth and income accumulations in a trust that was irrevocable on that date.[20]

A constructive addition is made to a Grandfathered Dynasty Trust if:

a. A liability of the trust is paid from another source;[21] or

b. Property remains in the trust after the possessor of a taxable power of appointment over the trust exercises or releases the power or permits it to lapse after September 25, 1985.[22]

A constructive addition is not made to a Grandfathered Dynasty Trust if federal estate tax attributable to a QTIP trust is paid from another source.[23] A constructive addition might not be made if the client pays income tax attributable to a grantor trust because the client is satisfying his or her own liability. If an addition or a constructive addition is made to a Grandfathered Dynasty Trust after September 25, 1985, a pro rata portion of subsequent distributions from, and terminations of property held in, the trust is subject to GST tax.[24]

Preserving the assets of a Grandfathered Dynasty Trust is desirable because they will not be subject to federal transfer tax as long as they remain in the trust. Although no tax law or regulation requires a Grandfathered Dynasty Trust to terminate at the end of the USRAP period or the common-law rule against perpetuities period, it is doubtful that many perpetual Grandfathered Dynasty Trusts exist because, for the most part, the move to extend or abolish the rule against perpetuities began after September 25, 1985.

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[18] Treas. Reg. § 26.2601-1(b)(1)(v).
[19] Treas. Reg. § 26.2601-1(b)(1)(iii).
[20] Treas. Reg. § 26.2601-1(b)(1)(vi).
[21] Treas. Reg. § 26.2601-1(b)(1)(v)(C).
[22] Treas. Reg. § 26.2601-1(b)(1)(v)(A), (D), Exs. 1, 3.
[23] Treas. Reg. §§ 26.2601-1(b)(1)(v)(C), 26.2652-1(a)(3).
[24] Treas. Reg. § 26.2601-1(b)(1)(iv).

2. Exercising a Limited Power of Appointment

Many Grandfathered Dynasty Trusts provide for their continuation as long as is permitted by the applicable rule against perpetuities and thereby defer the imposition of federal transfer tax as long as possible, but many do not. For example, a trust might provide for the payment of income to the client's child for life with remainder to the child's issue, per stirpes, living at the child's death. Although the principal of the trust would not be subject to federal transfer tax at the child's death, it would again be subject to the federal transfer-tax system once it is distributed to the child's issue.

Often, a trust, like the one described above, gives the child a limited power to appoint the principal at his or her death (e.g., to or in trust for his or her issue). In such a situation, the child should consider exercising his or her power to extend the grandfathered status of the trust.

The exercise of a limited power of appointment over a Grandfathered Dynasty Trust is not a constructive addition if its exercise does not:[25]

> [P]ostpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years plus, if necessary, a reasonable period of gestation (the perpetuities period). For purposes of this paragraph (b)(1)(v)(B)(2), the exercise of a power of appointment that validly postpones or suspends the vesting, absolute ownership or power of alienation of an interest in property for a term of years that will not exceed 90 years (measured from the date of creation of the trust) will not be considered an exercise that postpones or suspends vesting, absolute ownership or the power of alienation beyond the perpetuities period. If a power is exercised by creating another power, it is deemed to be exercised to whatever extent the second power may be exercised.

Thus, the IRS takes the position that a limited power of appointment may be exercised to extend a trust only until the first to occur of the expiration of the common-law rule against perpetuities or the end of 90 years from the trust's creation.[26] Practitioners should make sure that exercises of limited powers of appointment do not violate this restriction. If the GST

[25] Treas. Reg. § 26.2601-1(b)(1)(v)(B).
[26] Treas. Reg. § 26.2601-1(b)(1)(v)(D), Exs. 6–7.

tax actually is repealed, the possessor of a limited power of appointment over such a trust might be able to extend the trust indefinitely if the applicable law permits perpetual trusts.

D. The Nonexempt Dynasty Trust

1. Introduction

In my experience, interest in keeping assets that are not exempt from the GST tax in trust has grown in recent years for nontax and tax reasons. Unlike the creator of an Exempt Dynasty Trust and the donee of a limited power of appointment over an Exempt Dynasty Trust or a Grandfathered Dynasty Trust, an individual planning the disposition of nonexempt assets often is faced with the unpalatable but unavoidable choice between subjecting assets either to federal estate tax or to GST tax at the deaths of his or her children. Nevertheless, planning can produce significant savings.

No tax law or regulation limits the duration of a Nonexempt Dynasty Trust. In fact, the IRS withdrew former Treasury Regulation § 26.2652-1(a)(4) because it would have enabled a donee of a limited power of appointment over a Nonexempt Dynasty Trust to move assets down a generation free of federal transfer tax.

A typical Nonexempt Dynasty Trust might provide for the payment of income to the client's child for life, then to the child's child for life, then to that child's child for life, etc. Assuming that no GST exemption is allocated, GST tax will be payable at each generation. Each time GST tax is paid, however, the transferor will be moved down a generation so that distributions to the income beneficiary will not be taxable distributions.[27]

Paragraph B of Part I above listed some reasons to place nonexempt assets in trust. The rest of this Paragraph D discusses some federal transfer-tax advantages of leaving nonexempt assets outright, some federal transfer-tax advantages of keeping nonexempt assets in trust, and some ways of choosing between paying federal estate tax or GST tax.

Because the GST exemption and the exemption from the federal estate tax ("estate-tax exemption") now are equal at $2 million and because the GST tax rate and the estate-tax rate now are equal at 45%, the long-standing bias in favor of subjecting assets to estate tax in order to use the graduated estate-tax rates no longer applies.

[27] IRC § 2653(a).

2. Federal Transfer-Tax Advantages of Leaving Nonexempt Assets Outright

a. Annual Exclusion Gifts are Available

An individual may reduce his or her gross estate by making $12,000 annual-exclusion gifts during life.[28] There are no equivalent exclusions for taxable distributions or taxable terminations. An individual[29] and the trustee of a Nonexempt Dynasty Trust[30] both may make tax-free medical and tuition payments directly to the service provider.

b. Previously Taxed Property Credit is Available

A decedent's estate is entitled to a credit for property includable in the gross estate that was subject to federal estate tax within ten years before and two years after his or her death.[31] There is no equivalent GST tax credit.

c. Marital Deduction is Available

If a decedent makes a gift that qualifies for the federal estate-tax marital deduction, payment of federal estate tax on the property may be deferred until the surviving spouse's death, and the property will receive a stepped-up income-tax basis at the first spouse's death.[32] No such basis increase is available under the GST tax if, following a beneficiary's death, the trust continues for a beneficiary in the same or a higher generation.[33]

d. GST Exemption is Available

An individual may allocate his or her GST exemption to assets includable in his or her gross estate, but a beneficiary of a Nonexempt Dynasty Trust may not allocate GST exemption to trust assets because he or she is not the transferor.

e. Qualified Disclaimer is Possible

A beneficiary may disclaim an interest (other than in QTIP assets) that is includable in a decedent's gross estate within nine months

[28] IRC § 2503(b). To be exempt from GST tax, a gift in trust to a skip person must comply with IRC § 2642(c).
[29] IRC §§ 2503(e), 2611(b)(1).
[30] IRC § 2611(b)(1).
[31] IRC § 2013.
[32] IRC § 1014(a).
[33] IRC § 2654(a)(2).

of death.[34] A taxable termination does not begin a new qualified-disclaimer period.

3. Federal Transfer-Tax Advantages of Keeping Nonexempt Assets in Trust

a. Tax-Free Gifts Possible

If a trust is structured as a grantor trust for federal income-tax purposes, the grantor may, in effect, make tax-free gifts to the trust by paying income taxes attributable to it. The Internal Revenue Service ("IRS") initially attempted to treat such income tax payments as additional transfers to the trust but since has confirmed that it will not pursue this issue.[35]

b. Tax May Be Avoided

An interest in a Nonexempt Dynasty Trust can pass to a beneficiary in the same or a higher generation without payment of GST tax (e.g., if a child dies without issue and the trust continues for his or her siblings). If a decedent leaves assets outright to beneficiaries in any generation, federal estate tax might have to be paid.

c. Longer Tax Deferral is Possible

Payment of the GST tax may be deferred without meeting the requirements of the federal estate-tax marital deduction until no person in the same or a higher generation has an interest in a Nonexempt Dynasty Trust. No complete basis increase will be received, however, until a taxable termination occurs.

d. Tax on Double Skip is Lower

If the trustee of a Nonexempt Dynasty Trust distributes assets to the current income beneficiary's great-grandchild, only one GST tax is payable.[36] If assets are left outright, estate tax must be paid in each generation.

e. Total Tax Might Be Lower

Because the federal state death-tax credit has been repealed[37] and

[34] IRC § 2518.
[35] Rev. Rul. 2004-64, 2004-27 I.R.B. 7 (July 6, 2004).
[36] IRC § 2653(a).
[37] IRC § 2011.

replaced with a deduction,[38] many states have "decoupled" from the federal system by enacting separate estate or inheritance taxes.[39] Consequently, many estates will pay state death tax as well as federal estate tax. Although the federal state GST-tax credit also has been eliminated,[40] only four states—Kansas, Massachusetts, New York, and Vermont—have adopted a separate GST tax.[41] New York imposes its own estate tax at a rate of up to 16%[42] and its own GST tax at a rate of only 2.75%.[43] Thus, the state and federal transfer-tax burden on Nonexempt Dynasty Trusts often will be lower than on assets owned outright.

f. Assets Will Be Protected From Gift Tax and Reinstatement of Other Taxes

Under the 2001 Tax Act, the estate and GST taxes are scheduled to be repealed in 2010 but the gift tax will continue. Once assets were in trust under that regime, they could be distributed to beneficiaries free of gift tax. If the estate and GST taxes later were reenacted, irrevocable trusts in existence on the reenactment date probably would be exempt from their application.

4. Choosing Between the Federal Estate Tax and the GST Tax

If there is enough family wealth to warrant GST tax planning, it is impossible to predict if it will be better to pay federal estate tax or GST tax at a decedent's death. Consequently, an individual's estate plan should be flexible enough to permit the payment of either federal transfer tax. Although the trustee of a Nonexempt Dynasty Trust may be able to distribute enough assets to the income beneficiary to enable him or her to use the options described in Subparagraph 2 above, a trust must already be in place for the beneficiary to avail himself or herself of the benefits described in Subparagraph 3 above. Thus, the best planning course would seem to involve creating a Nonexempt Dynasty Trust and giving the trustee or the beneficiary enough discretion to minimize the federal transfer tax payable at the beneficiary's death.

A frequently suggested method for choosing between the payment of federal estate tax and GST tax is to give a trustee the power to grant and to take back a general power of appointment. This approach is an imperfect solution because, for many reasons, the trustee may not have complete

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[38] IRC § 2058.
[39] See Jeffrey A. Cooper, Wresting with Decoupling, 145 Tr. & Est. 61 (Feb. 2006); Richard B. Covey & Dan T. Hastings, Survey of State Death Taxes, Prac. Drafting App. 8428–60 (Jan. 2006).
[40] IRC § 2604.
[41] Covey & Hastings, supra note 39, at 8431–60.
[42] N.Y. Tax Law § 952.
[43] Id. § 1022.

financial information for the beneficiary. An individual trustee also must satisfy himself or herself that the exercise of such a power will not be a taxable gift.[44] The best method might involve the use of Delaware limited powers of appointment discussed in Subparagraph 4 of Paragraph D of Part V below.

E. Federal Income-Tax Implications

From a tax standpoint, it might be desirable for a dynasty trust to be a grantor trust for federal income-tax purposes.[45] The client might want grantor-trust treatment because the trust will not be depleted to pay taxes on accumulated income and capital gains or because trust income may be taxed at a lower rate if it is taxed to the grantor. In 2007, a trust will reach the 35% bracket at only $10,450 of income whereas a single taxpayer and joint filers will not do so until $349,700 of income.[46] The client might not want grantor-trust treatment, however, because he or she might not be willing and able to pay income tax on income (i.e., accumulated income and capital gains) that he or she does not actually receive and/or because creating the trust as a grantor trust might subject it to state income tax that could be avoided if it were structured as a separate taxpayer.

There are various ways to structure a dynasty trust so that it will be a grantor trust but not includable in the client's gross estate.[47] In my experience, the most common ways to do so are to give the client or a third party the power, exercisable in a nonfiduciary capacity, to reacquire trust assets by substituting property of an equivalent value[48] and to give an independent trustee the power to add charitable beneficiaries.[49]

In 2006, the IRS ruled that trusts over which the grantors possessed the power to substitute assets in a fiduciary—not a nonfiduciary—capacity were grantor trusts with respect to their income and principal.[50] In each case, it reached this result under IRC § 677(a) (because the trustee could use trust assets for the grantor's spouse) and did not consider IRC § 675(4)(C).

A planning opportunity exists for dynasty trusts that are funded with life insurance policies and with other assets. The client is treated as the owner of any portion of a trust, the income of which, without the consent of an adverse party, is

[44] See In re Estate of Goldman, 196 Misc. 2d 968 (Surr. Ct. N.Y. Co. 2003); Richard B. Covey & Dan T. Hastings, Creating General Power of Appointment to Reduce Transfer Tax, Gift by Creator of Power, Prac. Drafting 7563 (Jan. 2004).
[45] See Todd Steinberg, Jerome M. Hesch, & Jennifer M. Smith, Grantor Trusts: Supercharging Your Estate Plan, 32 Tax Mgmt. Est., Gifts & Tr. J. 66 (Jan. 11, 2007); Robert T. Danforth, The Use of Grantor Trusts in Estate Planning, 31 Tax Mgmt. Est., Gifts & Tr. J. 103 (Mar. 9, 2006); David A. Handler, The Power of Grantor Trusts, 145 Tr. & Est. 24 (Mar. 2006).
[46] Rev. Proc. 2006-53 § 3.01, 2006-48 IRB 996, 998–99 (Nov. 27, 2006).
[47] See Howard M. Zaritsky, 858-2nd T.M., Grantor Trusts: Sections 671–679 at A-79–A-90.
[48] IRC § 675(4)(C).
[49] IRC § 674(c).
[50] PLRs 200606006 (Oct. 24, 2005), 200603040 (Oct. 24, 2005).

or may be used to pay premiums on insurance policies on the life of the client or the client's spouse.[51] Because some authorities suggest that grantor-trust treatment is available for all trust income while others suggest that it is available only for income actually used to pay premiums,[52] the client should be able to select the tax treatment that best suits his or her situation. A recent IRS pronouncement, which has no precedential value, might indicate that the IRS now favors the former view.[53] In it, the writer said:

> Section 677(a)(3) of the Code provides that the grantor shall be treated as the owner of any portion of a trust whose income without the approval or consent of an adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse.
>
> Article II of B Trust Agreement authorizes the trustee to purchase life insurance on taxpayer. There does not appear to be any limit on the amount the trustee may apply to the payment of premiums. Therefore, pursuant to section 677(a)(3), taxpayer is treated as the owner of B. Because taxpayer is the grantor and the owner of B, B is a grantor trust, which is generally disregarded for Federal income tax purposes.

III. CLIENTS' ABILITY TO SELECT TRUST STATES

A. Introduction

This Part III summarizes the rules in the Second Restatement of Conflict of Laws and the Uniform Trust Code ("UTC") regarding which state's law governs various aspects of the administration of a trust.

B. Choice-of-Law Principles

To determine how much latitude a client who resides in one state ("Home State") has to select the law of another state ("Trust State") to govern a trust that he or she creates, it is necessary to analyze the conflict-of-law principles that have been developed in trust matters.[54] These matters are covered in Chapter 10 of the

[51] IRC § 677(a)(3).
[52] See Zaritsky, supra note 47, at A-79–A-82.
[53] FAA 20062701F (May 1, 2006).
[54] For convenience, I will refer to the District of Columbia and each of the 50 states as a "state."

Second Restatement of Conflict of Laws,[55] Chapter 14 of the Scott treatise,[56] and Chapter 16 of the Bogert treatise.[57] The client's latitude in this regard is a function of whether the trust is an inter vivos trust or a testamentary trust, whether the trust contains personal property or real property, and whether the issue in question involves the trust's "validity," "construction," or "administration."

C. Definitions

Questions involving the "validity"[58] of trust provisions relate to matters such as whether the trust violates the rule against perpetuities or a rule against accumulations.[59] Questions involving the "construction"[60] of a trust relate to matters such as the identity of the beneficiaries, their respective interests, and, in most cases, allocations between principal and income.[61] Questions of trust "administration"[62] involve matters such as the powers and duties of the trustee, trust investments, compensation of the trustee and its right to indemnity, liability for breach of trust, and the power of the beneficiaries to terminate the trust.[63]

D. Designation of Governing Law

When creating a new trust, a client may and should designate the law of the Trust State that will govern matters of validity, construction, and administration. The

[55] Restatement (Second) of Conflict of Laws §§ 267–282 (1971).
[56] 5A Scott & Fratcher, supra note 1, §§ 553–666.
[57] Bogert & Bogert, supra note 1, §§ 291–301.
[58] See Restatement (Second) of Conflict of Laws § 269 (1971), 5A Scott & Fratcher, supra note 1, §§ 555, 587–596A, Bogert & Bogert, supra note 1, § 296 (testamentary trusts of personal property); Restatement (Second) of Conflict of Laws § 270 (1971), 5A Scott & Fratcher, supra note 1, §§ 555, 587, 597–603, Bogert & Bogert, supra note 1, § 297 (inter vivos trusts of personal property); Restatement (Second) of Conflict of Laws § 278 (1971), 5A Scott & Fratcher, supra note 1, §§ 643, 649–651, Bogert & Bogert, supra note 1, § 296 (testamentary trusts of real property); Restatement (Second) of Conflict of Laws § 278 (1971); 5A Scott & Fratcher, supra note 1, §§ 643, 652, Bogert & Bogert, supra note 1, § 297 (inter vivos trusts of real property).
[59] Restatement (Second) of Conflict of Laws § 269 cmt. d (1971), Bogert & Bogert, supra note 1, § 293 at 253–54.
[60] See Restatement (Second) of Conflict of Laws § 268 (1971), 5A Scott & Fratcher, supra note 1, §§ 555, 574–578, 581–586, Bogert & Bogert, supra note 1, § 296 (testamentary trusts of personal property); Restatement (Second) of Conflict of Laws § 268 (1971), 5A Scott & Fratcher, supra note 1, §§ 555, 574–576, 578–586, Bogert & Bogert, supra note 1, § 297 (inter vivos trusts of personal property); Restatement (Second) of Conflict of Laws § 277 (1971), 5A Scott & Fratcher, supra note 1, §§ 643, 648, Bogert & Bogert, supra note 1, § 296 (testamentary and inter vivos trusts of real property).
[61] Restatement (Second) of Conflict of Laws § 271 cmt. a, § 268 cmt. h (1971), Bogert & Bogert, supra note 1, § 293 at 252.
[62] See Restatement (Second) of Conflict of Laws § 271 (1971), 5A Scott & Fratcher, supra note 1, §§ 555, 604–609, 622, Bogert & Bogert, supra note 1, § 296 (testamentary trusts of personal property); Restatement (Second) of Conflict of Laws § 272 (1971), 5A Scott & Fratcher, supra note 1, §§ 555, 604, 610–612, 622, Bogert & Bogert, supra note 1, § 297 (inter vivos trusts of personal property); Restatement (Second) of Conflict of Laws § 279 (1971), 5A Scott & Fratcher, supra note 1, §§ 643, 659, Bogert & Bogert, supra note 1, § 296 (testamentary trusts of real property); Restatement (Second) of Conflict of Laws § 279 (1971), 5A Scott & Fratcher, supra note 1, §§ 643, 659, Bogert & Bogert, supra note 1, § 297 (inter vivos trusts of real property).
[63] See Restatement (Second) of Conflict of Laws § 271 cmt. a (1971), Bogert & Bogert, supra note 1, § 293 at 253.

Bogert treatise summarizes the effect of such a designation under the Second Restatement of Conflict of Laws as follows:[64]

> (A) As to interests in <u>personal property</u> held in a <u>testamentary trust</u>:
>
> 1. A testator may designate the local law to govern the <u>validity</u> of the trust, except that (a) his designation will not control if application of the designated law would be contrary to a "strong public policy" of the state of his domicile at death and (b) the designated state must have a "substantial relation" to the trust. A substantial relation exists when the designated state is that in which the trust is administered or in which the trustee has his place of business or his domicile at his death, or is the state of the domicile of the beneficiaries.
>
> 2. A testator may designate the state whose local law is to govern <u>construction</u> of the terms of the trust, and it is not required that the designated state have any connection with the trust.
>
> 3. A testator may designate the local law of one state to govern <u>administration</u> of the trust even though that state has no relation to the trust, except that on public policy grounds certain matters of administration cannot be controlled by the trust terms. These matters include attempts to grant the testamentary trustee exoneration from liability for failure to exercise prudence or for acts of self-dealing, or a power to fix the value of trust assets for all purposes.

[64] Bogert & Bogert, <u>supra</u> note 1, § 301 at 332–33 (emphasis in original).

(B) As to interests in personal property held in a living trust:

1. The settlor of a living trust may designate the local law of one state to govern the validity of the trust (a) if that state has a substantial relation to the trust and (b) if application of its local law does not violate a "strong public policy of the state with which as to the matter at issue the trust has its most significant relationship."

2. As in the case of a testamentary trust, a settlor may designate the state whose local law is to govern construction under the terms of the trust; the designated state need not have any connection with the trust.

3. Except where matters of administration cannot be controlled by the trust terms on public policy grounds, a settlor may designate the local law of one state to govern administration of the trust even though that state has no relation to the trust.

(C) As to trust interests in real property:

The opportunity of a testator or settlor of a trust of land to effectively designate a local law of a state other than that of the situs of the land to govern the validity and administration of a trust of land is more limited. The effectiveness of such a designation will depend upon whether the situs courts recognize the designated state as having a more significant relationship to the particular issue than the situs state.

Generally speaking, questions relating to the validity or administration of a trust of land, whether living or testamentary, will be

> governed by the law that would be applied by the courts of the situs state, in most cases (but not necessarily) its own local law. The "legal effect" of a trust of land, as that term has been defined hereinabove (section 293), will depend upon the local law of the situs of the land. As in the case of a trust of personal property, the courts will give effect to a provision in the trust instrument that the trust of land should be construed in accordance with the rules of construction in effect in a particular state, whether or not those of the situs state.

E. Matters of "Strong Public Policy"

As mentioned above, the designation of a Trust State's law to govern the validity of a trust that holds personal property will be honored unless the issue in question contravenes a "strong public policy" of the testator's domicile, in the case of a testamentary trust, or the state with which, as to the matter at issue, the trust has its most significant relationship, in the case of an inter vivos trust. Authorities suggest that strong-public-policy questions involve trust provisions designed to defeat a surviving spouse's right of election and that violate a state's restrictions on testamentary gifts to charity (few, if any, of which still exist).[65] The designation of a Trust State's law to govern the duration of a trust does not violate a strong public policy of the Home State.[66]

F. UTC Approach

Section 107 of the UTC provides in relevant part that:[67]

> The meaning and effect of the terms of a trust are determined by:
>
> (1) the law of the jurisdiction designated in the terms unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue . . . .

[65] Restatement (Second) of Conflict of Laws § 269 cmts. c, i, § 270 cmts. b, e (1971); 5A Scott & Fratcher, supra note 1, § 601; Bogert & Bogert, supra note 1, § 294 at 268–70, § 297 at 298–99, § 301 at 330.
[66] Restatement (Second) of Conflict of Laws § 269 cmt. i (1971).
[67] UTC § 107(1) (2005). The current text of the UTC and the jurisdictions that have adopted the UTC are available at www.utcproject.org (last visited Feb. 6, 2007). Appendix C gives citations for the statutes of the state's that have enacted the UTC.

Unlike the Second Restatement of Conflict of Laws, a designation of a governing law for questions of validity under the UTC requires no other connection with the Trust State.[68] The UTC intentionally does not specify the strong public policies that will invalidate a designation.[69]

Under UTC § 108(a),[70] terms of a trust designating the principal place of administration will be honored if a trustee's principal place of business is located in or a trustee is a resident of the designated state or if all or part of the administration occurs in such state.

IV. HOME STATE COURTS' ABILITY TO DISREGARD SELECTION OF TRUST STATES[71]

A. Introduction

Clients might be concerned that courts in their Home States might be able to disregard the Trust State laws that the clients choose to govern their trusts. Home State courts must overcome at least four substantial legal obstacles before they can do so.

B. Obstacle 1: Home State Court Might Lack Jurisdiction

1. Introduction

Comment a to § 104 of the Second Restatement of Conflict of Laws states in relevant part:[72]

> Due process forbids the rendition of a judgment within the United States unless the State of rendition has judicial jurisdiction. . . . A judgment rendered in violation of these requirements is void in the State of rendition itself, and due process forbids the recognition and enforcement of such a judgment in sister States.

Hence, a Home State court may render a valid judgment against a trustee of a trust only if that court has jurisdiction. Such jurisdiction might be based on in rem jurisdiction over trust assets or personal jurisdiction over a trustee.

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[68] Id. cmt.
[69] Id.
[70] Id. § 108(a).
[71] I would like to thank John E. Sullivan, III, Esquire, of Sullivan & Sullivan, Ltd., Cleveland, Ohio, for his substantial contributions to my understanding of the material covered in this part.
[72] Restatement (Second) of Conflict of Laws § 104 cmt. a (1971) (citation omitted). See Wilkes v. Phoenix Home Life Mut. Ins. Co., 902 A.2d 366, 382 (Pa. 2006); Estate of Waitzman, 507 So. 2d 24, 25 (Miss. 1987).

2. In Rem Jurisdiction

A Home State court will have in rem jurisdiction over trust assets that are held in the court's jurisdiction.[73] To prevent a Home State court from having in rem jurisdiction over a trust, the trustee should hold all assets in the Trust State. Because "[a] court sitting in [one state] . . . cannot assert jurisdiction over the corpus of a trust with a situs outside the State."[74]

3. Personal Jurisdiction—General Principles

Courts may exercise personal jurisdiction over a defendant only if constitutional due process requirements are satisfied.[75] The classic International Shoe test is whether a nonresident defendant has "certain minimum contacts with [the forum state] such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice."[76] A court may satisfy this test under either of two theories.[77] The first theory is known as the "general jurisdiction" theory. Under it, a nonresident defendant's ongoing contacts with the forum state may be so pervasive that jurisdiction is appropriate even in connection with suits over matters separate and distinct from those contacts.[78] A defendant's contacts with the forum must be "a continuous and systematic, [even if] limited, part of its general business."[79]

The second theory is the "specific personal jurisdiction" doctrine. Under it, jurisdiction is established if: (a) there is a nexus between the defendant, the forum, and the matter in dispute;[80] and (b) the nonresident defendant's link to the forum arises from the defendant's "purposefully avail[ing] itself of the privilege of conducting activities within the forum state."[81]

Courts consider various factors to determine whether sufficient minimum contacts exist to establish personal jurisdiction. These are catalogued, in part, in World-Wide Volkswagen and include the following acts in the forum state:

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73 Hanson v. Denckla, 357 U.S. 235, 246 (1958).
74 Walker v. W. Mich. Nat'l Bank & Trust, 324 F. Supp. 2d 529, 534 n.3 (D. Del. 2004), aff'd, 2005 U.S. App. Lexis 16829 (3d Cir. 2005).
75 See, e.g., Ins. Corp. of Ireland v. Compagnie Des Bauxites, 456 U.S. 694 (1982); World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286 (1980); International Shoe Co. v. Washington, 326 U.S. 310 (1945). This discussion assumes that local long-arm statutes have also been satisfied, which is another prerequisite for the exercise of personal jurisdiction over out-of-state defendants by a state court or a federal court sitting in diversity. See, e.g., Walker, 324 F. Supp. 2d at 529.
76 International Shoe, 326 U.S. at 316 (internal quotation marks omitted).
77 See generally Helicopteros Nacionales de Columbia v. Hall, 466 U.S. 408, 414 (1984).
78 See, e.g., Rose v. Firstar Bank, 819 A.2d 1247, 1250 (R.I. 2003).
79 Helicopteros Nacionales, 466 U.S. at 415 (citations and internal quotation marks omitted).
80 Rose, 819 A.2d at 1251.
81 Id. See also Walker, 324 F. Supp. 2d at 533.

a. Closing sales;

b. Performing services;

c. Soliciting business;

d. Availing themselves of the privileges and benefits of the forum state's law;

e. Indirectly, through others, serving or seeking to serve the forum state's market; and

f. Delivering products into the stream of commerce with the expectation that they will be purchased by consumers in the forum state.[82]

However, not all acts within a state create an adequate nexus for jurisdiction. As a general proposition, occasional trips into a state or receipt of payments issued from inside a state will be insufficient.[83] And, as shown in the trustee-specific cases discussed below, the fact that "several bits of trust administration"[84] may be carried on is also routinely inadequate to establish jurisdiction.

4. Personal Jurisdiction—Trustee Concerns

A Home State court might be able to adjudicate a matter if it has personal jurisdiction over a trustee. One way that a client may avoid this pitfall is to use only trustees with little or no contact with the Home State. This gives courts in the Home State substantially less basis to assert general jurisdiction over the trustees, and the court may be able to assert only specific personal jurisdiction over the trustee. This, however, isn't always an easy task. Although the issue turns on the specific facts of each case, many opinions show that specific personal jurisdiction can't be established over an out-of-state trustee merely because of routine trustee activities like mailings and phone calls from the defendant trustee's state into the plaintiff's state.

The leading case in this area is Hanson v. Denckla,[85] which involved a controversy concerning the right to part of the principal of a trust established in Delaware by a Pennsylvania trustor who subsequently moved to Florida. The U.S. Supreme Court held that a Delaware court was under no obligation to give full faith and credit to a judgment of a

[82] World-Wide Volkswagen, 444 U.S. at 295–98.
[83] See Helicopteros Nacionales, 466 U.S. 408.
[84] Hanson, 357 U.S. at 252.
[85] Id. at 253.

Florida court that lacked jurisdiction over the trust's assets and the trustee. The court discussed the jurisdictional issues as follows:[86]

> [I]t is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws. The settlor's execution in Florida of her power of appointment cannot remedy the absence of such an act in this case.

Hanson remains controlling precedent, as shown by the following recent cases.

a. In re Estate of Ducey (1990)[87]—The Montana Supreme Court held that Montana lacked jurisdiction over a Nevada corporate trustee that conducted no business in Montana. The court reached this conclusion even though the Nevada trustee mailed payments to the deceased Montana beneficiary and also telephoned the decedent in Montana in connection with modifications to her estate plan, including changes designed to benefit other Montana residents.

b. In re Frumkin (1993)[88]—The Tennessee Court of Appeals held that Tennessee lacked jurisdiction over a Florida corporate trustee that had insufficient Tennessee contacts. The court so ruled even though the Florida trustee mailed some checks and letters to the Tennessee beneficiary.

c. Dreher v. Smithson (1999)[89]—The Oregon Court of Appeals held that Oregon lacked jurisdiction over individual trustees of a Massachusetts trust who had insufficient Oregon contacts. The court so ruled even though the trustees: (a) accepted the trusteeship knowing that the trust had an Oregon beneficiary; (b) wrote and telephoned the beneficiary in Oregon; and (c) mailed distribution checks to the Oregon beneficiary.

d. Rose v. Firstar Bank (2003)[90]—The Rhode Island Supreme Court held that Rhode Island lacked jurisdiction over an Ohio corporate trustee that conducted no purposeful activity in Rhode Island. The court so ruled even though the trustee: (a) mailed checks, statements, and other trust documents to Rhode Island; and (b)

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[86] Id. at 253–54 (citation omitted).
[87] In re Estate of Ducey, 878 P.2d 749, 752 (Mont. 1990).
[88] In re Frumkin, 874 S.W.2d 40 (Tenn. Ct. App. 1993), and 912 S.W.2d 138 (Tenn. App. 1995).
[89] Dreher v. Smithson (In re George M. Naylor Revocable Ins. Tr.), 986 P.2d 721 (Or. Ct. App. 1999).
[90] Rose, 819 A.2d at 1255.

periodically communicated with the Rhode Island beneficiaries.

e. Nastro v. D'Onofrio (2003)[91]—A Connecticut federal district court held that it lacked jurisdiction over the trustee of a Jersey, Channel Islands, trust. The court found insufficient contacts between Connecticut and the trustee, even though the trust was funded with stock in Connecticut corporations.

f. Walker v. West Michigan National Bank & Trust (2004)[92]—A Delaware federal district court lacked jurisdiction over a Michigan corporate trustee with insufficient Delaware contacts, even though the trustee filed income-tax returns for the trust. The court noted that a plaintiff's "mere beneficial interest in a trust is insufficient to assert personal jurisdiction over a nonresident trustee."[93]

g. Walker v. The Northern Trust Company (2004)[94]—In a companion case to Walker v. West Michigan National Bank & Trust, another Delaware federal district judge ruled that the court lacked jurisdiction over an Illinois corporate trustee with insufficient Delaware contacts.

h. Andreas v. Stisser (In re Estate of Stisser) (2006)[95]—A Florida intermediate appellate court held that Florida courts did not have jurisdiction to adjudicate the claim by the personal representative of a Florida decedent against the trustees of the Minnesota trust that she created while she resided in Minnesota for funds to pay estate expenses. The court did so because the trustees were indispensable parties over which Florida courts lacked personal and in rem jurisdiction.[96]

5. Implications

If the trustee of a trust has extensive contacts in the Home State, the Home State court will have jurisdiction, but if all trustees and trust assets are located in the Trust State and if the trustees have insufficient contacts in the Home State, the Home State court will fail to have jurisdiction over the trust. Admittedly, the minimum-contacts issue can provoke sharp debate, but this is still a significant hurdle for plaintiffs to overcome.

[91] Nastro v. D'Onofrio, 263 F. Supp. 2d 446, 453 (D. Conn. 2003).
[92] Walker, 324 F. Supp. 2d 529.
[93] Id. at 534.
[94] Walker v. N. Trust Co., 2004 U.S. Dist. Lexis 15012 (D. Del. 2004), aff'd, 2005 U.S. App. Lexis 16829 (3d Cir. 2005).
[95] Andreas v. Stisser (In re Estate of Stisser), 932 So. 2d 400 (Fla. Dist. Ct. App. 2006).
[96] Id. at 402.

Nonetheless, although the facts may sometimes be murky, the law is very clear: courts from Home States can't enter valid orders or judgments against a trustee unless the court has personal jurisdiction over the trustee, nor can it enter orders or judgments against trust assets that are safely beyond the forum state's borders. This will indeed be a serious obstacle in many cases. But even if jurisdiction is good, the court's analysis is only beginning.

C. Obstacle 2: Home State Court Should/Must Decline Jurisdiction

Section 267 of the Second Restatement of Conflict of Laws provides that the administration of a trust of interests in movables is usually supervised by the courts of the state in which the trust is administered.[97] Thus, if such a trust is created with a trust company as trustee and that trustee is organized and does business in the Trust State, the courts of the Trust State will have primary supervision over the administration of the trust and may exercise jurisdiction as to all questions that may arise in the administration of the trust.[98]

If the Home State court has jurisdiction over the trustee or the trust, comment e to § 267 suggests that it should defer to the Trust State's courts:[99]

> A court of a state other than that of the testator's domicil or that in which the trust is to be administered will not exercise jurisdiction if to do so would be an undue interference with the supervision of the trust by the court which has primary supervision. Whether there is such interference depends on the relief sought. Thus, if a court acquires jurisdiction over the trustee it may entertain a suit to compel him to redress a breach of trust, even though the trustee has qualified as trustee in a court of another state or the administration of the trust is in another state. It may compel the trustee to render an accounting or it may even remove the trustee. On the other hand, it will ordinarily decline to deal with questions of construction or validity or administration of the trust, leaving these matters to be dealt with by the court of primary supervision. Thus, it will not ordinarily give instructions to the trustee as to his powers and duties.

[97] Restatement (Second) of Conflict of Laws § 267 (1971). The comparable provision for trusts that hold interests in real property is Restatement (Second) of Conflict of Laws § 276 (1971). See 5A Scott & Fratcher, supra note 1, § 571 at 178–79.
[98] Restatement (Second) of Conflict of Laws § 267 cmt. e (1971).
[99] Id.

The Scott treatise summarizes the applicable principles as follows:[100]

> The administration of a trust is ordinarily governed by the law of the state of primary supervision, and the rights of the parties should not be dependent on the fact that a court of some other state happens to have acquired jurisdiction. That court may give a judgment based upon the application of its local law, or it may attempt to apply the law of the state of primary supervision but mistake that law.

These principles have been codified in some states. Section 7-203 of the Uniform Probate Code ("UPC") provides as follows:[101]

> The Court will not, over the objection of a party, entertain proceedings under Section 7-201 involving a trust registered or having its principal place of administration in another state, unless (1) when all appropriate parties could not be bound by litigation in the courts of the state where the trust is registered or has its principal place of administration or (2) when the interests of justice otherwise would seriously be impaired.

Currently, § 7-203 is in effect in the above form in at least eight states[102] and Florida's version does not even contain the interests-of-justice exception.[103]

The Florida statute was considered in Meyer v. Meyer.[104] There, a beneficiary of a trust, which was created by a New York resident but which was governed by Florida law, brought suit in Florida to obtain funds to which she allegedly was entitled. As permitted by the trust, the trustee had relocated the trust from Florida to New York. The court reversed the lower court and held:[105]

> [W]hen there is a possibility of litigating in more than one forum, section 737.203 recognizes that trust litigation should proceed in the most appropriate forum. This is the interpretation given similar statutory provisions adopted in other states.

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[100] 5A Scott & Fratcher, supra note 1, § 573 at 190.
[101] UPC § 7-203 (1974).
[102] Alaska Stat. § 13.36.045; Ariz. Rev. Stat. § 14-7205; Colo. Rev. Stat. § 15-16-203; Haw. Rev. Stat. § 560:7-203; Idaho Code § 15-7-203; Mich. Comp. Laws § 700.7203; N.D. Cent. Code § 30.1-33-03; Utah Code Ann. § 75-7-204.
[103] Fla. Stat. Ann. § 737.203, to be replaced by Fla. Stat. Ann. § 736.0205 on July 1, 2007.
[104] Meyer v. Meyer, 931 So. 2d 268 (Fla. Dist. Ct. App. 2006).
[105] Id. at 270–71 (citations and internal quotation marks omitted).

> Here, the trust is being administered in New York where the trustee resides. None of the parties has any connection with the state of Florida, and we note that the petition filed by Laurie does not contain any factual allegations showing that venue properly lies in this state. Because a proper objection has been filed by parties who are beneficiaries of the trust protesting the proceedings by the Florida court concerning a trust registered or having its principal place of administration in New York, the trial court should have properly applied the dictates of section 737.203 . . . . Accordingly, we reverse the order denying the motion to dismiss and remand for the purpose of allowing the trial court to determine whether all interested parties could be bound by litigation in New York. If the trial court finds the parties may be bound by New York litigation, the court shall continue, stay, or dismiss the suit filed by Laurie. If the parties are not bound, the court may deny the motion to dismiss.
>
> We note, parenthetically, that although the trust agreement contains a choice of law provision, it does not designate Florida as the principal place for administration of the trust. Unless specified in the trust agreement, the principal place of administration of a trust is the trustee's usual place of business where the records pertaining to the trust are kept or, if he or she has no place of business, the trustee's residence. Accordingly, New York is the principal place for administration of the trust because the trustee is a resident of that state and the trustee's attorney for legal matters pertaining to the trust is also in New York. In any event, the trust agreement provides the trustee discretion to remove the principal place of the trust from Florida to another state if he or she desires. Since the trustee has chosen New York, the choice of law provision in the trust agreement does not present a sufficient legal basis for affirmance.

Case law confirms that courts are cautious about construing trust questions governed by the laws of other states, and that consequently they often abstain from exercising jurisdiction. For example, in Bartlett v. Dumaine,[106] the New Hampshire Supreme Court deferred to Massachusetts courts in a suit regarding the duties of trustees of a Massachusetts trust to account to its beneficiaries, even though the New Hampshire court had personal jurisdiction over all interested parties. The Scott treatise cites other cases from California, Illinois, Massachusetts, New Jersey, New York, Pennsylvania, and Texas that reached comparable results.[107]

D. Obstacle 3: Home State Court Should Apply Trust State Law

1. Restatement Approach

a. Section 270—Validity

Section 270 of the Second Restatement of Conflict of Laws provides in relevant part:[108]

> An inter vivos trust of interests in movables is valid if valid . . . under the local law of the state designated by the settlor to govern the validity of the trust, provided that this state has a substantial relation to the trust and that the application of its law does not violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in § 6 . . . .

The "validity" of trust clauses addresses matters such as whether or not the trust violates the rule against perpetuities or a rule against accumulations.[109]

When analyzing the validity of a trust provision under § 270, it is necessary to answer the following three questions:

(1) Does the Trust State have a substantial relation to the trust?

(2) Does the trust provision in question violate a strong public policy of the Home State?

[106] Bartlett v. Dumaine, 523 A.2d 1, 14–15 (N.H. 1986).
[107] 5A Scott & Fratcher, supra note 1, § 570 at 176 n.29.
[108] Restatement (Second) of Conflict of Laws § 270 (1971). See 5A Scott & Fratcher, supra note 1, §§ 555, 587, 597–603; Bogert & Bogert, supra note 1, § 297. For the rules that apply to inter vivos trusts that hold interests in real property, see Restatement (Second) of Conflict of Laws § 278 (1971); 5A Scott & Fratcher, supra note 1, §§ 643, 652; Bogert & Bogert, supra note 1, § 297.
[109] Restatement (Second) of Conflict of Laws § 269 cmt. d (1971); Bogert & Bogert, supra note 1, § 293 at 253–54.

(3) Does the Trust State or the Home State have the most significant relationship to the matter at issue?

b. Substantial Relation to the Trust

The Trust State has a substantial relation to the trust if, inter alia, the trustor designated it as the place of the trust's administration, the trustee lives or does business in the Trust State when the trust is created, or the trust assets are located in the Trust State at that time.[110]

c. Strong Public Policy

According to the authorities, the strong-public-policy issues that justify a departure from § 270's general rule involve trust provisions designed to defeat a surviving spouse's right of election and that violate a state's restrictions on testamentary gifts to charity,[111] but they do not include jurisdictional differences in the rule against perpetuities.[112] Moreover, the spousal elective share exception is not always followed as a matter of common law, and courts have sometimes allowed deceased spouses from one state to establish inter vivos trusts under the law of another state to defeat their surviving spouse's elective shares.[113]

d. Most Significant Relationship to the Matter at Issue

Section 270 refers to § 6 of the Second Restatement of Conflict of Laws on this issue.[114] Section 6(2) provides in pertinent part that:

> [T]he factors relevant to the choice of the applicable rule of law include
>
> (a) the needs of the interstate and international systems,
>
> (b) the relevant policies of the forum,
>
> (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,

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[110] Id. cmt. b.
[111] Restatement (Second) of Conflict of Laws § 269 cmts. c, i, § 270 cmts. b, e (1971); 5A Scott & Fratcher, supra note 1, § 601; Bogert & Bogert, supra note 1, § 294 at 268–70, § 297 at 298–99, § 301 at 330.
[112] Restatement (Second) of Conflict of Laws § 269 cmt. i (1971).
[113] See Paragraph M of Part V below.
[114] Restatement (Second) of Conflict of Laws § 6(2) (1971).

(d) the protection of justified expectations,

(e) the basic policies underlying the particular field of law,

(f) certainty, predictability and uniformity of result, and

(g) ease in the determination and application of the law to be applied.

Section 6's comments describe the above factors.[115] I discuss this subject in detail below with respect to the UTC.

e. Section 268—Construction

A testator's or trustor's designation of the law of a state to govern questions regarding the construction of a trust that holds personal property will be respected, even if the designated state has no connection with the trust.[116] As noted above, construction questions involve the identity of the beneficiaries and, generally, decisions involving allocations between principal and income.

f. Section 272—Administration

A trustor's designation of a state's law to govern questions regarding the administration of an inter vivos trust of personal property will be respected, even if the designated state has no connection with the trust.[117] As noted above, administration questions involve the duties, powers, and liability of the trustee; trust investments; the trustee's right to compensation and indemnity; the replacement of the trustee; and the beneficiaries' power to terminate the trust.

g. Section 273—Creditor Claims

For trusts that hold personal property, the analytical starting point for determining whether creditors may reach trust assets is § 273 of the Second Restatement of Conflict of Laws, which states in pertinent part:[118]

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[115] Id. cmts. d–j.
[116] Restatement (Second) of Conflict of Laws § 268 (1971).
[117] Id. § 272.
[118] Id. § 273. See 5A Scott & Fratcher, supra note 1, §§ 625–628; Bogert & Bogert, supra note 1, § 293 at 260–61.

> Whether the interest of a beneficiary of a trust of movables is assignable by him and can be reached by his creditors is determined . . . in the case of an inter vivos trust, by the local law of the state . . . in which the settlor has manifested an intention that the trust is to be administered . . . .

Section 273 and its comments do not contemplate that a different rule might apply if the law of the Trust State violates a strong public policy of the Home State. Consequently, the law that governs a trust should be determinative with respect to the ability of creditors to reach its assets without further inquiry.

The Scott treatise suggests that there might be a strong-public-policy exception to the rule in § 273. It says:[119]

> If the settlor creates a trust to be administered in a state other than that of his domicil, the law of the state of the place of administration, rather than that of his domicil, ordinarily is applicable. Thus a settlor domiciled in one state may create an inter vivos trust by conveying property to a trust company of another state as trustee and delivering the property to it to be administered in that state. In that case the law of that state will be applicable as to the rights of creditors to reach the beneficiary's interest.
>
> This permits a person who is domiciled in a state in which restraints on alienation are not permitted, to create an inter vivos trust in another state where they are permitted and thereby take advantage of the law of the latter state. It would seem, however, that there is nothing objectionable in this, at least if there is no strong public policy forbidding it in the state of his domicil.

But, it takes the position that a difference in the effectiveness of spendthrift clauses should not justify a departure from the general rule:[120]

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[119] 5A Scott & Fratcher, supra note 1, § 626 at 419 (footnote omitted).
[120] Id. at 414 (footnote omitted).

> It would seem that the policy of a state, whether it be to restrain alienation in order to protect the beneficiary, or to permit alienation in order to protect creditors and assignees, is not so strong as to preclude the application of the law to the contrary prevailing in another state.

Indeed, the Scott treatise criticizes dictum in Erdheim v. Mabee,[121] which suggested that forum courts should have more latitude, as follows:[122]

> If this means that any court that acquires jurisdiction over the trust property can properly apply its own law as to the rights of creditors to reach the trust property, regardless of the law of the situs of the trust, it is submitted that this dictum cannot be supported.

The Scott treatise summarizes the applicable principles as follows:[123]

> There are conflicting policies in the various states as to the rights of creditors of a beneficiary of a trust of movables to reach his interest and as to the rights of assignees of his interest. There is a policy in some states to protect the beneficiary; there is a policy in other states to protect the creditors and assignees; and in some states there is a policy that, within limits, protects them both. Where more than one state is involved, the question is which state's law will be applied.
>
> Although the matter is not entirely clear, it is submitted that the applicable law should, ordinarily at least, be the law of the state of the situs of the trust. To the extent that under that law a beneficiary's interest cannot be reached by creditors or assignees, it cannot be reached in any state . . . .

[121] Erdheim v. Mabee, 113 N.E.2d 433 (N.Y. 1953).
[122] 5A Scott & Fratcher, supra note 1, § 626 at 417 (footnote omitted).
[123] 5A Scott & Fratcher, supra note 1, § 628 at 434.

> If under the law of the state of the situs of the trust a beneficiary's interest cannot be reached, it should be immaterial in what state the proceeding to reach it is brought; the law of the forum, merely because it is the law of the forum, should not be applied. It should be immaterial in what state the beneficiary was domiciled, in what state his creditor or assignee was domiciled, or in what state the debt was incurred or the assignment made.

When the Scott treatise was written, some states did not respect spendthrift trusts at all, whereas others did so to one degree or another. It nevertheless suggested that differences between these laws did not constitute differences of "strong public policy."

2. UTC Approach

a. Section 107—Meaning and Effect—General

Section 107(1) of the UTC[124] permits a trustor to choose the law to govern the meaning and effect of the terms of his or her trust, unless such designation is contrary to a strong public policy of the state that has the most significant relationship to the matter at issue. The UTC intentionally does not specify the strong public policies that will invalidate a designation.[125] As just noted, under the UTC, a Home State's strong public policy cannot bar application of the Trust State's law unless that Home State has the "most significant relationship" to the trust.[126]

As a general rule of trust law, the overriding principle of construction is that courts should discern and honor a trustor's intent whenever possible.[127] This rule applies in choice-of-law

[124] UTC § 107(1) (2005).
[125] Id. cmt.
[126] Id.
[127] Domo v. McCarthy, 612 N.E.2d 706, Syl. ¶ 1 (Ohio 1993)("A court's purpose in interpreting a trust is to effectuate, within the legal parameters established by a court or by statute, the settlor's intent"); Central Trust Co. of Northern Ohio, N.A. v. Smith, 553 N.E.2d 265, 270 (Ohio 1990) ("[I]t is axiomatic that the intent of the testator, grantor, or settlor will be ascertained and given effect wherever legally possible."); Dickinson v. Wilmington Trust Co., 734 A.2d 605, 609 (Del. Ch. 1999), aff'd, 734 A.2d 642 (Del. 1999) ("The cardinal rule of law regarding construction of trust provisions is that the settlor's intent controls the interpretation of the language."); Scharlin v. Superior Court, 11 Cal. Rptr. 2d 448, 451–52 (Cal. Ct. App. 1992) (similar).

issues as well,[128] and "[t]he jurisdiction selected need not have any other connection to the trust."[129] Any other considerations are typically just factors used to divine a trustor's intent when it is not expressed.[130] This rule honoring a trustor's intent is well established in Delaware:[131]

> In an agreement inter vivos the element of domicile lacks the importance which practical considerations have accorded it in the law of wills. There is more room for the play of intent. I can see no reason why the intent of a donor should not be allowed full play in the matter of selecting the jurisdiction under which the validity of a trust inter vivos is in all respects to be determined, provided, of course, the property composing the corpus be delivered to a trustee in the selected jurisdiction and there administered . . . . If it be suggested that to permit a person to subject his personal property to the laws of a jurisdiction other than that of his domicile would be in substance to allow him the selective power of legislation with respect to his own affairs, it is a sufficient answer to say that there is nothing in the concept of domicile that entitles it so rigidly to fix a man in the caste of a local status that he can in no case whatever subject his personal property to rules that lie outside the restrictions of that caste. Suppose a person domiciled in New York should travel by train to Delaware, carrying with him a sum in

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[128] Rudow v. Fogel, 426 N.E.2d 155, 160 (Mass. Ct. App. 1981) ("In estate or commercial planning areas, the intentions of the settlor-testator or the contracting parties are significant both for local law and choice-of-law decisions."); The First Nat'l Bank of Mount Dora v. Shawmut Bank of Boston, 389 N.E.2d 1002, 1008 (Mass. 1979) ("In construing a trust instrument and rights and obligations under it, the law of the situs of the trust would often be given recognition, particularly when, as here, the trust expressly so directs."); National Shawmut Bank v. Cumming, 91 N.E.2d 337, 341 (Mass. 1950) (noting that Vermont settlor "had expressed an intent in the trust instrument that it should be construed and interpreted according to the laws of this Commonwealth [of Massachusetts]"). See also Conflict Of Laws As To Trusts Inter Vivos, 139 A.L.R. 1129, 1130 (1942) ("There is also apparent in the more recent cases a tendency to give effect to any expressed or necessarily implied intention or desire of the creator of the trust to have the trust governed by the law of a particular jurisdiction with which one or more of the elements of the trust are connected.").

[129] See UTC § 107 cmt. (2005).

[130] Conflict of Laws, 139 A.L.R. at 1130 ("Indeed, it may be said that any rule referring the validity, interpretation, or effect of the trust to the law of the situs of particular elements of the trust, such as the law of the donor's domicil or the law of the situs of the administration of the trust, is not an absolute or primary rule, but a secondary rule based upon the presumed intention of the donor, in the absence of indications to the contrary, that the law of that jurisdiction be the governing law of the trust.").

[131] Wilmington Trust Co. v. Wilmington Trust Co., 186 A. 903, 907–08 (Del. Ch. 1936), modified on rehearing on other grounds, 15 A.2d 153 (1940), aff'd, 24 A.2d 309 (Del. 1942).

> cash, and in Delaware deposit his money with a Delaware resident under a specified trust to be there held and administered, and should then return to the state of his domicile, it would seem out of all reason to say that the law of New York rather than that of Delaware should govern the validity of the trust. If it were not so, domicile would become a straitjacket. There can be no reason in refusing to permit him to remain on New York soil for the perfecting of arrangements which he might by a short railroad journey accomplish with efficacy.

b. Section 107—Meaning and Effect—Specific

When intention is not expressed or when there is a potential strong-public-policy exception to the trustor's chosen law, the UTC sets the following guidelines for determining which state has the most significant relationship to a trust:[132]

> Factors to consider in determining the governing law include the place of the trust's creation, the location of the trust property, and the domicile of the settlor, the trustee, and the beneficiaries. Other more general factors that may be pertinent in particular cases include the relevant policies of the forum, the relevant policies of other interested jurisdictions and degree of their interest, the protection of justified expectations and certainty, and predictability and uniformity of result.

These factors can be managed or addressed in ways that maximize the Trust State's relation to a trust and/or minimize the Home State's relation.

(1) Place of Trust's Creation

A trust executed by a trustee inside a particular state is typically deemed to be created in that state.[133] Accordingly, so long as a trustee executes its trust in the Trust State, the "place of creation" test is satisfied. To be

[132] UTC § 107 cmt. (2005) (citations omitted).
[133] See, e.g., Cumming, 91 N.E.2d at 341 (referring to "the completion of the trust agreement by final execution by the trustee"); In re Gower, 184 B.R. 163, 164 (Bankr. M.D. Fla. 1995) (noting that decedent "created and executed [trust] in Colorado").

safe, the trustor could also execute the trust in the Trust State.[134] Because a prudent client should meet with his or her trustee in any event, a trip to the trustee's place of business is hardly a serious burden. Additionally, a trust's situs, which arises from the creation of a trust, is based on the trustee's domicile and the trust's place of administration.[135] Hence, accepting and administering a trust from inside the Trust State will also in many cases be the same as creating the trust in the Trust State.

(2) Location of Trust Property

"[T]he situs of intangibles is often a matter of controversy."[136] The common-law maxim is that "movables follow the person,"[137] and hence personalty is situate where the legal title holder is located.[138] Although this view has been somewhat displaced in recent years by the notion that property is situate where it is physically located,[139] personal property is still often considered situate with the owner.[140] In keeping with this rule, personalty can be situated in a Trust State simply by retitling it in the name of a trustee.[141]

Situs selection may be reinforced by good planning. Certain tangible assets (such as valuables held in a safe deposit box) are easily located within the Trust State. Cash, securities, and comparable assets can be placed into accounts maintained in the Trust State.

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[134] See, e.g., Toledo Trust Co. v. National Bank of Detroit, 362 N.E.2d 273, 278–79 (Ohio Ct. App. 1976) (trustor's execution of trust in Toledo, Ohio, helped establish that trust had its "most significant contacts with . . . Ohio").
[135] Warner v. Florida Bank & Trust Co., 160 F.2d 766, 771 (5th Cir. 1947) ("Matters of administration are determined by the law of the situs or the seat of the trust, and the domicile of the trustee of intangible personal property including shares of stock is usually the seat of the trust."). See also 90 C.J.S. § 221 (2002).
[136] Hanson, 357 U.S. at 246–47.
[137] Appraisal Review Board of Galveston County v. Tex-Air Helicopters, Inc., 970 S.W.2d 530 (Tex. 1998); Delaware v. New York, 507 U.S. 490, 503 (1993).
[138] Zanes v. Mercantile Bank & Trust Co. of Texas, 49 S.W.2d 922, 926 (Tex. Civ. App.—writ refused 1932). See also Sadler v. Industrial Trust Co., 97 N.E.2d 169, 170 (Mass. 1951) (noting that trust "consist[ed] entirely of personal property which was transferred to the trustee by the settlor at the times the trusts were executed" and that trust property was in Rhode Island).
[139] See, e.g., 16 Am. Jur. 2d Conflict of Laws § 52; Bogert & Bogert, supra note 1, § 291 at 229 ("The word 'situs' usually refers to the state in which trust assets are physically located . . . .").
[140] See id.
[141] Cf. Cumming, 91 N.E.2d at 339 (noting that trustor executed trust in Vermont while trustee executed trust in Massachusetts).

(3) Trustee's Domicile

The fact that a trustee is located, incorporated, or organized in the Trust State will make this factor weigh in the Trust State's favor.[142]

(4) Trustor's Domicile

A trustor's domicile in the Home State admittedly lessens the Trust State's relation to a trust. However, in an increasingly mobile society, the weight accorded to a trustor's domicile, which may be transient, can often be considered a less important consideration, and hence given less weight, than the trustee's domicile, particularly that of an institutional trustee with a more-or-less permanent presence in the Trust State. The impact of a trustor's domicile may be further lessened by other considerations.

(5) Other Beneficiaries' Domiciles

Not all beneficiaries will necessarily live in the Home State. A scattered group of beneficiaries residing in multiple states dilutes the relationship of any one beneficiary's Home State to the trust. And, if the beneficiaries are also mobile, then the permanency and primacy of the trustee's relationship is further heightened. This dilution effect is also manipulable to an extent. A trustor can always name charitable or institutional beneficiaries that reside outside his or her Home State, and perhaps even one or more who reside in his or her Home State. Such planning will reduce the impact of any one beneficiary's state.

(6) Forum State—Trust State Not the Forum

This factor's impact is clearly based on which state is the forum for a dispute. If someplace other than the Trust State is the forum, then the Trust State's relation to the trust is arguably diminished, and a local judge may conclude that his or her state—and hence its policy, if any, has a greater relation to the trust.

[142] See, e.g., Toledo Trust Co., 362 N.E.2d at 278–79 (trustee's incorporation in Ohio helped establish that trust had its "most significant contacts with . . . Ohio"); Cumming, 91 N.E.2d at 339 (trustee's domicil and place of business in Massachusetts supported application of Massachusetts law).

(7) Forum State Policies—Trust State as the Forum

If the Trust State is the forum, then that state's relation to a trust, and hence the interest in advancing its policies, is obviously enhanced. This, in turn, suggests that trustors expecting challenges to their trusts might preemptively sue in that state. A preemptive suit could take the form of an action for a declaratory judgment that the Trust State's law applies.

Preemptive suits might raise nettlesome questions of whether the prospective challenger is a necessary or indispensable party to the suit, whether the Trust State had good jurisdiction over him or her, and whether a case has become ripe for adjudication. Nonetheless, if a preemptive suit can be filed in the Trust State, then it should. This will plainly enhance the Trust State's relation to the trust and give that state's law the legal advantage as to the forum state's policies.

A preemptive suit may also create a very practical advantage—Trust State judges are likely to think long and hard before finding that their own state's relation to a trust is somehow displaced by another state's interest. If this smacks of forum shopping, then so be it. Plaintiffs show no remorse over this practice; there is no reason why trustees or trustors should be less willing to use this tool to their advantage.

(8) Non-Forum States' Policies

The forum court should consider the relevant policies of other interested states and the degree of their interest. Thus, a Home State court must consider the Trust State's policies and interests. The reverse, of course, is also true—a Trust State court must consider the policies and interests of the Home State. As suggested above, there will sometimes be little conflict between the laws and policies of the Trust State and the Home State. In other instances, there might. Such conflict merely means that the competing policies may cancel out each other as factors regarding which state has the most significant relation to a trust, which leaves the outcome determined by other factors, most of which strongly cut in the Trust State's favor.

(9) Justified Expectations, Certainty, Predictability, and Uniformity of Results

These final factors strongly weigh in favor of a Trust State being deemed the state with the most significant relationship to a trust.

As noted above, the primary duty of a court is to discern and apply a trustor's intent. If a trustor intended a trust to be governed by the Trust State's law, to contain property legally situate in the Trust State, and to be administered by a Trust State trustee, then it seems fairly conclusive that the trustor intended that the Trust State have the most significant relationship with the trust. Moreover, these factors also show that both the trustor and the trustee have an expectation that the law will govern.

Considerations of certainty, predictability, and uniformity also point to finding the Trust State's relationship more significant than the Home State. Although Home State courts may only occasionally deal with the Trust State's law in question, Trust State trustees and their many trustors and beneficiaries have a constant need to know which body of law governs their rights and duties. The knowledge that trusts are governed by Trust State law will facilitate stability, predictability, and uniformity in connection with trust planning and administration. In contrast, an ad hoc, results-oriented approach will create much uncertainty, unpredictability, and inconsistency. Such chaos simply is not good for interstate commerce and transactions. As noted by a Massachusetts court:[143]

> [T]he interests of our interstate system . . . are furthered by applying a single law in determining whether a given situation creates a fiduciary relationship. It is desirable that the same law apply to all property involved in the same transaction wherever situated.

c. Comments

In sum, then, it will be very hard to deny that the Trust State is the state with the most significant relationship to a trust, even if the

[143] Rudow, 426 N.E.2d at 160.

Home State has a strong public policy regarding the matter at issue.

The application of another state's law is not unique to trust matters. For example, the Supreme Judicial Court of Massachusetts, reversing the lower court, has held that California (not Massachusetts) law determined ownership rights in the California joint account of a Massachusetts resident, even though the result would have been different under Massachusetts law.[144] The court noted that the result would have been the same for non-Massachusetts real estate.[145]

d. Section 105—Rights of Creditors

Article 5 of the UTC[146] covers the ability of creditors to reach the assets of third-party and self-settled spendthrift trusts, and UTC § 105(b)(5)[147] prohibits a governing instrument from departing from that rule. This does not necessarily mean that a trustor whose Home State has adopted the UTC may not utilize a Trust State's spendthrift rules because, as just discussed, § 107(1) of the UTC[148] permits a trustor to choose the law to govern the meaning and effect of the terms of his or her trust in most circumstances and because it appears that § 105(b)(5) does not "trump" § 107(1).[149]

E. Obstacle 4: Trust State Court Might Not Have to Give Full Faith and Credit to Judgment of Home State Court

In this country, "Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State."[150]

1. Respect Due Statutes

The Full Faith and Credit Clause applies to both the statutes and judgments of another state, but it does not operate in the same manner with respect to them. The Supreme Court examined the Full Faith and Credit Clause's application to state statutes in Franchise Tax Board v. Hyatt,[151] in which the Court unanimously held that the Nevada Supreme Court's refusal to extend full faith and credit to California's statute immunizing its tax-collection agency from suit did not violate the Full

[144] Barboza v. McLeod, 853 N.E.2d 192, 196–97 (Mass. 2006).
[145] Id. at 196.
[146] UTC §§ 501–507 (2005).
[147] Id. § 105(b)(5).
[148] Id. § 107(1).
[149] Richard B. Covey & Dan T. Hastings, The Uniform Trust Code—Part I, Prac. Drafting 7420, 7425 (Oct. 2003).
[150] U.S. Const. art. IV, § 1.
[151] Franchise Tax Board of California v. Hyatt, 538 U.S. 488 (2003).

Faith and Credit Clause. In contrasting the application of the Full Faith and Credit Clause to statutes and to judgments, the Court stated:[152]

> [O]ur precedent differentiates the credit owed to laws (legislative measures and common law) and to judgments. Whereas the full faith and credit command is exacting with respect to a final judgment . . . rendered by a court with adjudicatory authority over the subject matter and persons governed by the judgment, it is less demanding with respect to choice of laws. We have held that the Full Faith and Credit Clause does not compel a state to substitute the statutes of other states for its own statutes dealing with a subject matter concerning which it is competent to legislate.

Although the Full Faith and Credit Clause does not compel a court in one state to adopt a statute of another state, a court may not simply ignore a sister state's law and apply its own, and it must satisfy two criteria before its statute may constitutionally displace another state's statute. First, as noted above, a state must be "competent to legislate" regarding the subject matter in question. This criterion is usually easy to satisfy in the absence of some form of preemption or constitutional prohibition. Second, full faith and credit and due process require "that for a State's substantive law to be selected in a constitutionally permissible manner, that State must have a significant contact or significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary nor fundamentally unfair."[153] It's often a close question whether, and to what extent, a state court may apply its own law to the exclusion of another state's law that is arguably more applicable, and, as a constitutional matter, states will be given significant leeway in developing local conflict-of-law rules that satisfy the broad constitutional mandates.[154] Nonetheless, one state cannot disregard another state's statutes when the other state had sufficiently significant contacts to the issues being litigated and the first state's interest was weak.[155]

2. Implications

Although the Home State court often will have constitutional discretion to apply or ignore the Trust State's statutes, the facts of some cases will strongly suggest, or perhaps require, as in Phillips Petroleum Co. v.

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[152] Id. at 494 (citations and internal quotation marks omitted).
[153] Allstate Ins. Co. v. Hague, 449 U.S. 302, 312–13 (1981). Accord, Hyatt, 538 U.S. at 494.
[154] See, e.g., Hague, 449 U.S. 302.
[155] See, e.g., Phillips Petroleum Co. v. Shutts, 472 U.S. 797 (1985) (Kansas not allowed to apply its statutes to oil and gas lease controversies involving properties located in Texas, Oklahoma, and elsewhere).

Shutts,[156] the application of another Trust State's law rather than the Home State's law. On the one hand, a forum court in a defendant's home state may have a strong argument for applying forum law because of the defendant's residence and because the plaintiff, whatever his or her residence, chose the forum. On the other hand, the argument for applying forum law is weaker when a defendant's contact with the forum is limited and the defendant's conduct took place outside the forum state. This has potentially significant impact for out-of-state trustees with limited and minimal ties to the forum state. Even if the Constitution doesn't mandate adherence to a Trust State's statute, someone arguing against application of Trust State law must still satisfy the choice-of-law rules that will often weigh in the Trust State's favor, as outlined above.

3. Respect Due Judgments

As noted above, "the full faith and credit command 'is exacting' with respect to a final judgment . . . rendered by a court with adjudicatory authority over the subject matter and persons covered by the judgment."[157] However, this "exacting" requirement has its limits.

To begin, Trust State courts may disregard judgments entered against trustees by Home State courts if the judgment did not satisfy the requirements of due process.[158] Hence, any failure to join a trustee in an action regarding a trust, or any defect in service on or jurisdiction over a trustee, can open a Home State court's judgment to collateral attack.

Further, a Trust State court might not have to give full faith and credit to a judgment rendered by a Home State court. In this regard, § 103 of the Second Restatement of Conflict of Laws states:[159]

> A judgment rendered in one State of the United States need not be recognized or enforced in a sister State if such recognition or enforcement is not required by the national policy of full faith and credit because it would involve an improper interference with important interests of the sister State.

Section 103's comments emphasize that it has an extremely narrow scope of application,[160] and would probably include such things as one state refusing to respect a judgment from another state that "purport[s] to

[156] Id.
[157] Hyatt, 538 U.S. at 494.
[158] Hanson, 357 U.S. at 255–56. See also Nastro v. D'Onofrio, 822 A.2d 286, 292–94 (Conn. 2003).
[159] Restatement (Second) of Conflict of Laws § 103 (1971). Accord Bartlett, 523 A.2d 1.
[160] Id. cmts. a–b.

accomplish an official act within the exclusive province of that other State or interfere[s] with litigation over which the ordering State had no authority."[161] Nevertheless, authorities indicate that § 103 might apply if a Trust State court is asked to give full faith and credit to a judgment rendered by a Home State court.

The Scott treatise frames the issue as follows:[162]

> In some situations, however, the court that has primary supervision over the administration of the trust may regard the judgment as an undue interference with its power to control the administration. It may take the position that the court in rendering the judgment applied its local law, whereas it should have applied the law of the state of primary supervision, or that, if it had attempted to apply the law of the state of primary supervision, it had mistaken that law. The question then is whether the court of primary supervision is bound to give full faith and credit to the judgment. The final determination of this question rests, of course, with the Supreme Court of the United States.

As noted above, Hanson v. Denckla held that Delaware did not have to give full faith and credit to a judgment of a Florida court that lacked jurisdiction over the trustee and the trust property. The Scott treatise states that:[163]

> It seems clear that the Florida court in applying its local law and in holding that the Delaware trust and the exercise of the power of appointment thereunder were invalid was unduly interfering with the administration of the trust by the Delaware courts.

It describes the implications of the above observation as follows:[164]

> Since the Delaware court could properly regard the judgment of the Florida court as an undue interference with the administration of the trust that was fixed in Delaware, it should not be bound by

[161] Baker v. General Motors Corp., 522 U.S. 222, 235 (1998).
[162] 5A Scott & Fratcher, supra note 1, § 573 at 191.
[163] Id. at 193.
[164] Id. at 194 (footnote omitted).

> that judgment although the Florida court had jurisdiction over some or all of the beneficiaries. Indeed, it may well be argued that the Delaware court would not be bound by the Florida judgment even though the Florida court had jurisdiction over the trustee also. A court might acquire jurisdiction over an individual trustee who happened to be in the state or over a corporate trustee that happened to have such connection with the state as to give the state jurisdiction over it, or the trustee might appear in the action. It is submitted that the judgment would nevertheless be an undue interference with the administration of the trust by the Delaware courts.
>
> It might, indeed, be held that not only would the Delaware courts not be bound to give full faith and credit to the Florida judgment but that the Florida judgment would be such an interference with the administration of the trust that it would be invalid as a denial of due process of law.

The Scott treatise suggests that the same principle should apply in other contexts:[165]

> In Hanson v. Denckla the issue was as to the validity of the disposition of the trust property. A similar question may arise as to the effect of a judgment rendered by a court other than the court that has primary supervision, giving instructions to the trustee as to his powers and duties or authorizing or directing the trustee to deviate from the terms of the trust. These matters are certainly ordinarily for the determination by the court that has primary supervision over the administration of the trust. Certainly in most cases the courts of other states would decline to exercise jurisdiction even though they happened to acquire jurisdiction over the trustee or some of the beneficiaries. If, however, such a court does exercise jurisdiction, the Supreme Court might well hold that the court of primary supervision is not bound to give full faith and credit to the judgment. Indeed, it might hold the judgment to be invalid even in the state that rendered it on the ground that it is an undue

[165] Id. at 195.

> interference with the administration of the trust and a denial of due process of law.

In the related case of Lewis v. Hanson, the Delaware Supreme Court unequivocally stated that Delaware courts would not have been required to give full faith and credit to the Florida judgment even if the Florida courts had jurisdiction over the trustee and/or the trust property. It declared:[166]

> [W]e think the public policy of Delaware precludes its courts from giving any effect at all to the Florida judgment of invalidity of the 1935 trust. We are dealing with a Delaware trust. The trust res and trustee are located in Delaware. The entire administration of the trust has been in Delaware. The attack on the validity of this trust raises a question of first impression in Delaware and one of great importance in our law of trusts. To give effect to the Florida judgment would be to permit a sister state to subject a Delaware trust and a Delaware trustee to a rule of law diametrically opposed to the Delaware law. It is our duty to apply Delaware law to controversies involving property located in Delaware, and not to relinquish that duty to the courts of a state having at best only a shadowy pretense of jurisdiction.

The Supreme Court of New Hampshire applied the above principles in a 1986 case—Bartlett v. Dumaine.[167] There, the beneficiaries of a New Hampshire trust (the Dumaine Trust) and a Massachusetts trust (the Dexter Trust) brought claims against the trustees of the two trusts. After affirming findings that the claims against the trustees of the New Hampshire trust were meritless,[168] the court, citing § 103 of the Second Restatement of Conflict of Laws and pertinent sections of a prior edition of the Scott treatise, dismissed the request for an accounting for the Massachusetts trust, even though it had personal jurisdiction over all interested parties. The court reasoned as follows:[169]

> In determining whether the superior court should have exercised or declined to exercise its jurisdiction in this case, we consider the relationships which New Hampshire and Massachusetts have with the Dexter Trust. New

[166] Lewis v. Hanson, 128 A.2d 819, 835 (Del. 1957) (citation omitted).
[167] Bartlett, 523 A.2d 1.
[168] Id. at 14.
[169] Id. at 14–15 (citations omitted).

> Hampshire's interest in the proper administration of Dexter is substantial because Dumaines, a New Hampshire trust, has the vested remainder interest in Dexter. Nevertheless, we cannot help but conclude that Massachusetts' interest in the administration of Dexter is greater. Both the petitioners and the respondents acknowledge that Dexter is a Massachusetts trust which is administered in Massachusetts, and which is governed by the trust law of that commonwealth. The question we are asked to decide is whether the Dexter trustees need only account to the Dumaines' trustees under the Massachusetts general rule that in matters involving the trust and the outside world the trustees represent the beneficiaries, or whether the Dexter trustees must account directly to the Dumaines' beneficiaries under exceptions to the general rule which govern when certain conflicts of interest exist. It is our conclusion that the Massachusetts courts, and not those of New Hampshire, are the courts of "primary supervision" over the Dexter Trust and the satellite trusts, and that this question should be left to a Massachusetts court to decide.
>
> Both New Hampshire and Massachusetts jealously seek to preserve jurisdiction over their own trusts. Both States also willingly decline jurisdiction over another State's trust. Both practices are sound. Although there is a strong policy favoring an end to litigation, there is an equally strong policy favoring the orderly administration of trusts.

The court further stated:[170]

> A final consideration stays our hand from divining the law of Massachusetts in this area; namely, what effect that Commonwealth is likely to give any judgment we might render. A judgment rendered in one State of the United States need not be recognized or enforced in a sister State if such recognition or enforcement is not required by the national policy of full faith and credit because it would involve an improper interference with importance interests of the sister State. There is

[170] Id. at 15 (citations and internal quotation marks omitted).

ample evidence that the Massachusetts Supreme Judicial Court would consider a decision by this court regarding the Dexter trustees' duty to account as improper interference with the Commonwealth's important interests.

V. FACTORS TO CONSIDER IN SELECTING A TRUST STATE

A. Introduction

Some attorneys do not look beyond the states in which they are admitted to practice when they advise clients on the creation of trusts. But, as shown in Paragraph C of Part I, other attorneys actively work with clients to find the best state for their trusts.

This Part V summarizes some factors that attorneys and clients should consider in choosing Trust States.

B. Currency of Trust Legislation

Some states update trust legislation regularly, others revise their trust laws deliberately, and still others update trust laws if and when political circumstances permit. In some states, legislators take an active role in crafting legislation whereas, in other states, legislatures approve legislation developed by bar and banker groups essentially unchanged. For instance, Delaware updates legislation on an ongoing basis, but its statutes are not always as aggressive as those of states such as Alaska and Nevada.

C. Clients' Objectives

1. Introduction

Some clients want their trusts to further definite objectives (e.g., to prevent a concentrated block of publicly traded stock from being diversified, to prevent stock in a closely held company from being sold except in specified circumstances, or to prevent a beneficiary from being provided with details about trusts until he or she reaches a "responsible" age). Such clients want assurance that the provisions in question will be respected.

2. Permitted Provisions

The UTC contains certain provisions and forbids a testator or trustor who creates a trust in that state from departing from them. For example, the UTC specifies instances in which creditors may reach the assets of a third-party spendthrift trust,[171] prohibits a client from creating an effective asset-protection trust ("APT"),[172] and prevents resident testators and trustors from adopting different terms.[173] Similarly, the UTC requires a trustee to furnish a beneficiary with certain information by age 25[174] and suggests that a client not be able to override that requirement.[175]

Regarding the disclosure of information to beneficiaries, a 2005 article notes that:[176]

> [S]tates with statutes regarding the responsibility of a trustee to provide information and reports to a beneficiary vary considerably and are often unclear concerning the ability of the creator to negate the statutory requirements. The Delaware statute provides the creator with the greatest flexibility.

The Delaware statute referred to above provides in pertinent part that:[177]

> (a) Notwithstanding any other provision of this Code or other law, the terms of a governing instrument may expand, restrict, eliminate or otherwise vary the rights and interests of beneficiaries, including the right to be informed of the beneficiary's interest for a period of time, the grounds for removal of a fiduciary, and a fiduciary's powers, duties, standard of care, rights of indemnification and liability to persons whose interests arise from that instrument; provided however, that nothing contained in this section shall be construed to permit the exculpation or indemnification of a fiduciary for the fiduciary's own wilful misconduct or preclude a court of competent jurisdiction from removing a fiduciary on account of the fiduciary's wilful misconduct.

Accordingly, in Delaware, the terms of a trust instrument will be carried out regardless of other statutes or laws. Thus, a client may set an age before which beneficiaries will not be notified of their interests in a trust.

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[171] UTC § 503 (2005).
[172] Id. § 505(a)(2).
[173] Id. § 105(b)(5).
[174] Id. §§ 813(b), 105(b)(8).
[175] Id. § 105(b)(8). See Kevin D. Millard, The Trustee's Duty to Inform and Report Under the Uniform Trust Code, 40 Real Prop., Prob. & Tr. J. 373 (Summer 2005).
[176] Richard B. Covey & Dan T. Hastings, Notice, Disclosure and Trustee Reporting Requirements Under Various State Laws and Trust Codes, Prac. Drafting app. B at 8001 (Jan. 2005).
[177] Del. Code Ann. tit. 12, § 3303(a).

Because a trustee's duty to keep beneficiaries informed is a matter of trust administration,[178] the trust instrument's designation of the law of a state, such as Delaware, on this issue should be respected.

Hence, testators and trustors who want to accomplish specific goals that might be thwarted in their Home States should consider creating trusts in Trust States, such as Delaware, where their wishes will be honored.

3. Beneficiaries' Ability to Amend or Terminate Trusts

The UTC[179] and certain states[180] authorize beneficiaries to amend or terminate trusts in certain circumstances. Clients who want trust terms to be respected should choose Trust States that do not give beneficiaries such powers and should include language in trust instruments that prevent trusts from being moved to more permissive states.

4. Suggested Language

If a trustor wants a trust to be governed by the law of a particular state, he or she might include the following language:

> This agreement creates a [Trust State] trust, and all matters pertaining to the validity, construction, and application of this agreement or to the administration of the trusts created by it shall be governed by [Trust State] law.

If the trustor wants the law that governs questions of administration to change if the trust's situs is moved to another state, the following sentence might be inserted after the above sentence:

> However, if the successor trustee hereunder is located in any state other than the State of [Trust State], the situs of such trust shall become that of the location of the successor trustee, and thereafter the laws governing the administration of such trust shall be those of the new situs.

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[178] Restatement (Second) of Conflict of Laws § 271 cmt. a (1971).
[179] UTC § 411(b) (2005).
[180] See, e.g., Wash. Rev. Code §§ 11.96A.210–11.96A.250.

D. Trust Duration

1. Introduction

A client should be able to create a trust in a Trust State which has a different perpetuities rule from that of his or her Home State because the determination of whether a trust violates the rule against perpetuities is a matter of trust validity,[181] because the trust instrument may designate the law of a state that governs matters of validity that will be effective unless such a matter offends a strong public policy of a state that has a closer connection to the trust,[182] and because no strong public policy is involved in differences in the rule against perpetuities.[183]

2. Perpetuities Statutes

As shown in Appendix D, 18 states permit perpetual trusts, six states permit very long trusts, 17 states follow the USRAP, nine states follow the common-law rule against perpetuities, and one state—Louisiana—requires the immediate vesting of interests.[184]

In 1995, Delaware enacted legislation that permits stocks, bonds, and other personal property to remain in trust forever.[185] Although a parcel of real property may stay in trust for only 110 years,[186] this limitation may be avoided by putting the property in a limited-liability company or a family limited partnership because, under Delaware law, an interest in such an entity is personal property.[187]

3. Rule Against Accumulations

When a client creates a trust, the attorney must ensure that he or she will not violate the rule against accumulations, which forbids the accumulation of income beyond the rule against perpetuities.[188] Delaware abolished the rule against accumulations when it abolished the common-law rule against

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[181] Restatement (Second) of Conflict of Laws § 269 cmt. d (1971).
[182] Id. §§ 269–270.
[183] Id. § 269 cmt. i.
[184] See Joel C. Dobris, Undoing Repeal of the Rule Against Perpetuities: Federal and State Tools for Breaking Dynasty Trusts, 27 Cardozo L. Rev. 2537 (Apr. 2006); Susan F. French, Perpetual Trusts, Conservation Servitudes, and the Problem of the Future, 27 Cardozo L. Rev. 2523 (Apr. 2006); Mary Louise Fellows, Why the Generation-Skipping Transfer Tax Sparked Perpetual Trusts, 27 Cardozo L. Rev. 2511 (Apr. 2006); Shanzenbach & Sitkoff, supra note 12; Robert H. Sitkoff, The Lurking Rule Against Accumulations of Income, 100 Nw. U.L. Rev. 501, 507–08 (2006); Tate, supra note 5 at 603–05.
[185] Del. Code Ann. tit. 25, § 503.
[186] Id. § 503(b).
[187] Id. § 503(e).
[188] See Sitkoff, supra note 184.

perpetuities in 1986.[189]

4. Exercising Limited Powers of Appointment

a. Introduction

As interest in long-term trusts has grown over the last several years, practitioners have inquired about the implications of the Delaware tax trap for trust planning. The Delaware tax trap is of concern for a trust that is created in any state in which the trust might last beyond the common-law rule against perpetuities or the USRAP period, not just for a Delaware trust.

b. History

Under Delaware law, the exercise of a limited or general power of appointment usually begins a new perpetuities period.[190] When the predecessor to this provision was enacted in 1933,[191] it offered the possibility, through the exercise of limited powers of appointment in successive generations, of having a perpetual trust without the imposition of federal transfer tax. To prevent this from happening, the predecessor to IRC § 2041(a)(3) (Delaware tax trap) was enacted in 1951.[192]

Under IRC § 2041(a)(3), a trust will be subject to federal estate tax at the death of a beneficiary who has a limited power of appointment over the trust if the beneficiary:

> [E]xercises a power of appointment created after October 21, 1942, by creating another power of appointment which under the applicable local law can be validly exercised so as to postpone the vesting of any estate or interest in such property, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.

The legislative history to IRC § 2041(a)(3) makes clear that the Delaware power of appointment statute was Congress's target.[193]

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[189] Del. Code Ann. tit. 25, § 506.
[190] Del. Code Ann. tit. 25, § 503(c).
[191] 38 Del. Laws 198.
[192] The corresponding federal gift-tax provision is IRC § 2514(d).
[193] S. Rep. No. 82-382 (1951).

c. Analysis

For a trust to be includable in the gross estate of the donee of a limited power of appointment created after October 21, 1942, the donee must:

(1) Exercise the power of appointment;

(2) Exercise the power of appointment to create another limited power of appointment; and

(3) Exercise the power of appointment to create another limited power of appointment that, under the applicable local law, can be validly exercised to do one of the following for a period ascertainable without regard to the date of the creation of the first power:

(a) Postpone the vesting of any estate or interest in such property; or

(b) Suspend the absolute ownership or power of alienation of such property.

The determination as to whether the donee springs the Delaware tax trap is based on:

(1) The instrument that created the power of appointment;

(2) The instrument that exercises the power of appointment; and

(3) Applicable local law.[194]

d. The Murphy Case

The only reported case that considered IRC § 2041(a)(3) is Estate of Murphy v. Commissioner,[195] in which the Tax Court held that the exercise of a limited power of appointment to create another limited power of appointment did not spring the Delaware tax trap because, under applicable Wisconsin law, the exercise of a limited power of appointment did not commence a new perpetuities period.

[194] Treas. Reg. § 20.2041-3(e).
[195] Estate of Murphy v. Comm'r, 71 T.C. 671 (1979), acq., 1979-2 C.B. 2.

e. Application to Nonexempt Dynasty Trusts

The Delaware tax trap provides an interesting planning option for a Nonexempt Dynasty Trust. An individual's federal transfer-tax liability sometimes might be lower if trust assets are subject to estate tax and sometimes might be lower if they are subject to GST tax. Various mechanisms have been suggested to minimize a trust beneficiary's total transfer-tax liability, but they usually depend upon the inclusion of a formula by the client in the original trust instrument or the exercise of discretion by a trustee who might possess less than complete information.[196]

The Delaware tax trap might provide the ideal mechanism because it gives the beneficiary (rather than the client or trustee) the ability to choose between estate tax and GST tax. Thus, if a trust beneficiary's transfer-tax liability will be lower if the trust is subject to estate tax, he or she may exercise a limited power of appointment to create another power in a way that springs the Delaware tax trap. Conversely, if the beneficiary's transfer-tax liability will be lower if a trust is subject to the GST tax (which might be the case if he or she lived in a state that has "decoupled" its death tax from the federal system), he or she may refrain from exercising the limited power of appointment or exercise it in a way that does not spring the trap.[197]

f. Application to Exempt Dynasty Trusts

As discussed above, the donee of a limited power of appointment over a Delaware Exempt Dynasty Trust or Grandfathered Dynasty Trust should not create federal gift- or estate-tax liability if he or she does not exercise the power or includes appropriate limiting language in the Will or instrument by which the power is exercised. To eliminate all doubt, Delaware adopted legislation in 2000 which provides that the perpetuities period applicable to the exercise of a limited power of appointment over a Delaware trust that is exempt or grandfathered for GST tax purposes is measured from when the original trust was created and not from when the power is exercised.[198] Thus, it now should be impossible to spring

[196] See James P. Spica, A Practical Look at Springing the Delaware Tax Trap to Avert Generation Skipping Tax, 41 Real Prop., Prob. & Tr. J. 165 (Spring 2006); Jonathan G. Blattmachr & Jeffrey N. Pennell, Adventures in Generation-Skipping, or How We Learned to Love the "Delaware Tax Trap," 24 Real Prop. Prob. & Tr. J. 75 (Spring 1989).
[197] See Ellen K. Harrison, Generation-Skipping Planning in Light of EGTRRA, 39 U. Miami Inst. on Est. Plan. ¶ 1004.2 at 10-68 (2005); Jonathan G. Blattmachr & Jeffrey N. Pennell, Using the "Delaware Tax Trap" to Avoid Generation-Skipping Taxes, 68 J. Tax'n 242, 246 (Apr. 1988).
[198] Del. Code Ann. tit. 25, § 504.

the Delaware tax trap in a Delaware Exempt Dynasty Trust or Grandfathered Dynasty Trust.

Nevertheless, some practitioners suggest that the Delaware tax trap makes it impossible for beneficiaries to exercise limited powers of appointment over Exempt Dynasty Trusts created in certain states that have abolished the rule against perpetuities without adverse tax consequences.[199] As a result of this concern, Florida places a 360-year limitation on the duration of trusts created by the exercise of powers of appointment,[200] Nevada places a 365-year limitation on the duration of such trusts,[201] and Alaska, Colorado, and Utah place a 1,000-year limitation on the duration of such trusts.[202] These commentators suggest that, in a state such as Delaware, if a beneficiary wishes to exercise a limited power of appointment over an Exempt Dynasty Trust, he or she would have to place a finite ending period on the trusts created by the exercise of the power. Oddly enough, this argument assumes that IRC § 2041(a)(3) requires the existence of a "period" to avoid its application. In fact, by its terms, IRC § 2041(a)(3) only applies to a second power that can be exercised to suspend vesting for one type of period—a "period ascertainable without regard to the date of the creation of the first power." If the second power could be exercised to suspend vesting indefinitely and this is not a "period," the statute literally does not apply.

Even if avoidance of IRC § 2041(a)(3) does require a "period" to demonstrate such period was ascertainable with regard to the date of the creation of the first power, the Delaware rule does have such a period—an indefinite one. The notion that a period may be indefinite is consistent with dictionary meanings of the word. For example, the Oxford English Dictionary[203] defines "period" as both "an indefinite portion of time" and as "any specified portion or division of time."

In any event, it is difficult to distinguish in any practical sense among Delaware with its indefinite period and states such as Alaska, Colorado, and Utah (1,000-year periods), Nevada (365-year period), or Florida (360-year period) with their definite

[199] Stephen E. Greer, The Alaska Dynasty Trust, 18 Alaska L. Rev. 253, 276 (Dec. 2001); Stephen E. Greer, The Delaware Tax Trap and the Abolition of the Rule Against Perpetuities, 28 Est. Plan. 68 (Feb. 2001); Richard B. Covey & Dan T. Hastings, IRC Secs. 2041(a)(3) and 2514(d), Change in Delaware Law, Prac. Drafting 6260, 6260–63 (Oct. 2000); Bruce Stone, Modification of the Rule Against Perpetuities in Florida—A Movement Currently Underway, 22 Actionline 9 (Nov. 1999–Feb. 2000).
[200] Fla. Stat. § 689.225.
[201] Nev. Rev. Stat. § 111.1031.
[202] Alaska Stat. §§ 34.27.051, 34.27.100; Colo. Rev. Stat. § 15-11-1102.5; Utah Code Ann. § 75-2-1203.
[203] Oxford English Dictionary (24th ed. 1985).

periods of such inordinate length that they might as well be indefinite. Note that the foregoing greatly exceed the IRS's "safe harbor" periods (either the common-law rule against perpetuities or the USRAP period) in the constructive addition regulations for the exercise of limited powers of appointment over Grandfathered Dynasty Trusts. Treasury Regulation § 26.2601-1(b)(1)(v)(B)(2) applies to any exercise of a power and not just to a power creating a second power. The regulation suggests, however, that if an ending period is essential to avoid the application of IRC § 2041(a)(3), the IRS will require such ending period to be no longer than the traditional period or 90 years. No tax policy would be served by a different tax result under state laws with "phony" periods and states with indefinite periods. In informal discussions, IRS representatives confirmed this view with me.

The Florida approach to extending the rule against perpetuities is itself flawed because it creates uncertainties regarding the application of the GST tax, because it presents its own Delaware-tax-trap issues, and because its unique approach might discourage wealthy clients from creating Florida trusts that cannot be moved to another state as readily as trusts created in other states.[204]

E. State Income Tax[205]

1. Introduction

a. Background

Most states impose a tax on the income of trusts. With proper planning, this tax may be minimized or avoided in many instances. Conversely, without proper planning, the income of a trust might be subject to tax by more than one state. Because the ordinary income and capital gains of a trust that is treated as a grantor trust for federal income-tax purposes generally are taxed to the trustor, because distributed ordinary income of a nongrantor trust generally is taxed to the recipient, and because source income of a trust (e.g., income attributable to business activity) generally is taxed by the state where the activity occurs,[206] this paragraph will focus on the

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[204] Daniel G. Worthington, Is Florida's New Rule Against Perpetuities a Generation-Skipping Transfer Tax Trap for the Unwary?, 139 Tr. & Est. 12, 16 (Dec. 2000).

[205] For discussions of this subject, see Virginia F. Coleman, State Fiduciary Income Tax Issues, ALI-ABA Planning Techniques for Large Estates 93–127 (Nov. 2006), available at www.ali-aba.org; Bradley E. S. Fogel, State Income Taxation of Trusts, 19 Prob. & Prop. 36 (July/Aug. 2005); Philip J. Michaels & Laura M. Twomey, How, Why, and When to Transfer the Situs of a Trust, 31 Est. Plan. 28 (Jan. 2004); Max Gutierrez, Jr., The State Income Taxation of Multi-Jurisdictional Trusts, 36 U. Miami Inst. on Est. Plan. ¶ 1300 (2002).

[206] In In re Ittleson, N.Y. DTA 819283 (Aug. 25, 2005), the New York State Tax Appeals Tribunal ruled that nonresidents' gain from the sale of a painting was New York source income.

tax-savings opportunities for accumulated nonsource ordinary income and capital gains of nongrantor trusts.

b. Problem

In some instances, minimizing state fiduciary income tax will not be important, but in others proper planning will produce large tax savings.

For example, if a trust, which has a California trustee, incurs a $1,000,000 long-term capital gain, the trust must pay $240,829 of tax—$91,023 of California income tax, $136,137 of federal income tax, and $13,669 of federal AMT. If the trust has a Washington trustee, however, the trust must pay only $149,806 of tax—$0 of state tax, $149,791 of federal income tax, and $15 of federal AMT, a $91,023 savings.

Similarly, if a trust, which was created by a New York State resident and is subject to New York State tax, incurs a $1,000,000 long-term capital gain, it must pay $226,798 of tax—$76,992 of New York State tax, $138,242 of federal income tax, and $11,564 of federal AMT. If the trust had been structured to avoid New York State tax, however, it must pay only $149,806 of tax—$0 of state tax, $149,791 of federal income tax, and $15 of federal AMT, a $76,992 savings.

Even though state tax is deductible for federal purposes, the deduction is worthless in the above examples due to the AMT.

c. Scope

The rest of this paragraph will summarize:

(1) The circumstances in which each of the states will tax the nonsource accumulated ordinary income and capital gains of a nongrantor trust (Resident Trust) based on state statutes, regulations, and fiduciary income-tax return instructions;

(2) Pertinent cases and rulings;

(3) The taxation schemes of particular states; and

(4) Planning and other issues.

2. Rules for Taxation of Trusts

a. Introduction

Seven states—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—do not tax the income of trusts. Before 2007 Florida imposed an intangible personal property tax on certain trust interests.[207]

As noted above, if a trust is a grantor trust, all ordinary income and capital gains will be taxed to the trustor, making planning difficult if not impossible while that status continues. Of the 44 states that tax trusts, only Arkansas and Pennsylvania do not follow the federal grantor-trust rules.

b. Bases of Taxation

All of the taxing states tax based on one or more of the following five criteria:

(1) If the trust was created by the Will of a testator who lived in the state at death;

(2) If the trustor of an inter vivos trust lived in the state when he or she placed assets in the trust or when the trust became irrevocable;

(3) If the trust is administered in the state;

(4) If one or more trustees live or do business in the state; or

(5) If one or more beneficiaries live in the state.

Louisiana taxes an inter vivos trust if the trust specifically provides that Louisiana law governs, but it does not tax such a trust if the trust specifies that the law of another state applies. North Dakota considers the designation of North Dakota law as a factor in determining whether a trust is a Resident Trust. Otherwise, the designation of a state's law to govern a trust has no bearing on its classification.

In some states, a trust might be a Resident Trust under more than one category (e.g., because the trust was created by the Will of a resident and because the trust is administered in the state). In some

[207] See 4e below.

other states, one or more of the above criteria will lead to the classification of a trust as a Resident Trust only in combination with other factors.

Because statutes that tax trusts on the same basis are not identical, it is imperative to analyze the statute in question. A trust might be treated as a Resident Trust by more than one state based on the residence of the testator or trustor, the place of administration, the residence of the trustees, and the residence of the beneficiaries.

Appendix E summarizes the criteria that the 44 taxing states employ in taxing trust income.

c. Trust Created by Will of Resident

Nineteen states—Arkansas, Connecticut, the District of Columbia, Illinois, Iowa, Louisiana, Maine, Maryland, Michigan, Minnesota (trusts created or first administered in state after 1995), Nebraska, Ohio, Oklahoma, Pennsylvania, Utah, Vermont, Virginia, West Virginia, and Wisconsin—tax a trust created by the Will of a resident. New Jersey and New York tax on this basis in certain circumstances; Idaho and Montana tax if this is one of several factors; Delaware, Missouri, and Rhode Island tax if the trust has at least one resident beneficiary; and Massachusetts taxes if the trust has at least one resident trustee. Effective for 2005, Alabama taxes on this basis if a trust has a resident fiduciary or current beneficiary.

d. Inter Vivos Trust Created by Resident

Thirteen states—Arkansas, the District of Columbia, Illinois, Maine, Maryland, Minnesota (trusts created or first administered in state after 1995), Nebraska, Oklahoma, Pennsylvania, Vermont, Virginia, West Virginia, and Wisconsin (trust created or first administered in state after October 28, 1999)—tax an irrevocable trust created by a resident. New Jersey and New York tax on this basis in certain circumstances; Connecticut, Delaware, Michigan, Missouri, Ohio, and Rhode Island tax if the trust has at least one resident beneficiary; Massachusetts taxes if the trust has at least one resident trustee and at least one resident beneficiary; and Idaho and Montana tax if this is one of several factors. Effective for 2005, Alabama taxes on this basis if a trust has a resident fiduciary or current beneficiary.

e. Trust Administered in State

Fifteen states—Colorado, Georgia, Hawaii, Indiana, Kansas, Louisiana (inter vivos trusts unless trust designates law of another state), Maryland, Minnesota (trusts created or first administered in state before 1996), Mississippi, New Mexico, Oregon, South Carolina, Utah (inter vivos trusts only), Virginia, and Wisconsin (inter vivos trusts created or first administered in state before October 29, 1999)—tax a trust if it is administered in the state. Idaho, Iowa, Montana, and North Dakota tax on this basis if it is combined with other factors. Oregon provides guidance on whether a corporate trustee is administering a trust in the state.

f. Resident Trustee

Nine states—Arizona, California, Georgia, Hawaii, Kentucky, New Hampshire, New Mexico, Oregon, and Virginia—tax if one or more trustees reside in the state. Idaho, Iowa (inter vivos trusts only), Montana, and North Dakota tax on this basis when combined with other factors. Arizona, California, and Oregon provide guidance on whether a corporate trustee is a resident. If some, but not all, of the trustees of a trust are California residents, California taxes only a portion of the income. Delaware taxes on this basis only if the trust has one or more resident beneficiaries.

g. Resident Beneficiary

Four states—California, Georgia, North Carolina, and Tennessee—tax a trust if it has one or more resident beneficiaries, and North Dakota taxes a trust on this basis when combined with other factors. If a trust is taxed on this basis, California and Tennessee tax only income attributable to resident beneficiaries.

3. Determining Whether Imposition of Tax is Constitutional

a. Introduction

Notwithstanding the rules described above, a state may tax the income of a trust only if doing so will not violate either the Due Process Clause[208] or the Commerce Clause[209] of the U.S. Constitution. The Due Process Clause provides that:

[208] U.S. Const. amend. XIV, § 1.
[209] U.S. Const. art. I, § 8, cl. 3.

> No State shall make or enforce any law which shall . . . deprive any person of life, liberty, or property, without due process of law . . . .

The Commerce Clause provides that:

> The Congress shall have Power . . . [t]o regulate Commerce . . . among the several States . . . .

b. Trust Under Will of Resident

Although they did not involve the income taxation of trusts, two U.S. Supreme Court cases are relevant to this discussion.

(1) In Safe Deposit & Trust Co. v. Virginia,[210] the Court held that a Virginia tax on the value of an inter vivos trust, which had Virginia beneficiaries but a Maryland trustee, violated the Due Process Clause. The Court said:[211]

> Here we must decide whether intangibles—stocks, bonds—in the hands of the holder of the legal title with definite taxable situs at its residence, not subject to change by the equitable owner, may be taxed at the latter's domicile in another State. We think not.

(2) In Quill Corp. v. North Dakota,[212] the Court considered the constitutionality of North Dakota's use tax on an out-of-state mail-order business that had no outlets or sales representatives in the state. At the time, about $1 million of the business's $200 million of annual sales were made to about 3,000 North Dakota residents.[213] Regarding the Due Process Clause, the Court held that:[214]

> In this case, there is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the

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[210] Safe Deposit & Trust Co. v. Virginia, 280 U.S. 83 (1929).
[211] Id. at 93.
[212] Quill Corp. v. North Dakota, 504 U.S. 298 (1992).
[213] Id. at 302.
[214] Id. at 308.

benefits Quill receives from access to the State. We therefore agree with the North Dakota Supreme Court's conclusion that the Due Process Clause does not bar enforcement of that State's use tax against Quill.

Regarding the Commerce Clause, however, the Court reaffirmed prior decisions that a business must have a physical presence in a state to justify the imposition of a use tax.[215]

The following decisions involve the constitutionality of taxing trusts on this basis:

(1) In Harrison v. Commissioner of Corps. & Taxation,[216] the Supreme Judicial Court of Massachusetts held that Massachusetts could not tax the income of a testamentary trust that had a Massachusetts trustee because New York, where the decedent lived at death, had the right to tax.

(2) In First Nat'l Bank v. Harvey,[217] the Supreme Court of Vermont held that Vermont could tax a trust created by the Will of a Vermont resident even though the trust was administered in Massachusetts.

(3) In Taylor v. State Tax Comm.,[218] a New York appellate court held that the Due Process Clause prevented New York from taxing the sale proceeds of Florida real estate by non-New York trustees, even though the trust was created by the Will of a New York resident.

(4) In Pennoyer v. Taxation Div. Dir.,[219] the New Jersey Tax Court held that it would violate due process for New Jersey to tax a trust created by the Will of a New Jersey resident because the trust was administered in New York and had only New York trustees and beneficiaries.

[215] Id. at 318–19. But, in Tax Comm'r of W. Va. v. MBNA Am. Bank, N.A., 2006 W. Va. Lexis 132, 27–28 (2006), the Supreme Court of Appeals of West Virginia held that, under the Commerce Clause and Quill, physical presence in a state is not required to justify the imposition of the state's business franchise and corporation net income tax. Contra J.C. Penney Nat'l Bank v. Johnson, 19 S.W.3d 831 (Tenn. Ct. App. 1999).

[216] Harrison v. Commissioner of Corps. & Taxation, 272 Mass. 422 (1930).

[217] First Nat'l Bank v. Harvey, 111 Vt. 281 (1940).

[218] Taylor v. State Tax Comm., 445 N.Y.S.2d 648 (3d Dept. 1981).

[219] Pennoyer v. Taxation Div. Dir., 5 N.J. Tax 386 (1983).

(5) In In re Swift,[220] the Supreme Court of Missouri held that it would violate the Due Process Clause for Missouri to tax a trust created by the Will of a Missouri resident because the trust was administered in Illinois and had no Missouri beneficiaries. The court said that:[221]

> In determining whether this state has a sufficient nexus to support the imposition of an income tax on trust income, we consider six points of contact: (1) the domicile of the settlor, (2) the state in which the trust is created, (3) the location of trust property, (4) the domicile of the beneficiaries, (5) the domicile of the trustees, and (6) the location of the administration of the trust. For purposes of supporting an income tax, the first two of these factors require the ongoing protection or benefit of state law only to the extent that one or more of the other four factors is present.

(6) In Westfall v. Director of Revenue,[222] the Missouri Supreme Court held, however, that Missouri could tax a Missouri testamentary trust that held some Missouri real estate, might benefit a Missouri charity, and might have a Missouri successor trustee.

(7) In District of Columbia v. Chase Manhattan Bank,[223] the District of Columbia Court of Appeals, following Quill, denied a District of Columbia income-tax refund to the trustee under the Will of a resident of the District.

(8) In Chase Manhattan Bank v. Gavin,[224] the Supreme Court of Connecticut denied the trustees' request on constitutional grounds for Connecticut income-tax refunds in four testamentary trusts.

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[220] In re Swift, 727 S.W.2d 880 (Mo. 1987).
[221] Id. at 882.
[222] Westfall v. Director of Revenue, 812 S.W.2d 513 (Mo. 1991).
[223] District of Columbia v. Chase Manhattan Bank, 689 A.2d 539 (D.C. 1997).
[224] Chase Manhattan Bank v. Gavin, 249 Conn. 172 (1999).

c. Inter Vivos Trust Created by Resident

The two Supreme Court cases cited in b. above also are relevant here, and the following decisions involve the constitutionality of taxing trusts on this basis:

(1) In Mercantile-Safe Deposit & Trust Co. v. Murphy,[225] the New York Court of Appeals held that New York could not tax an inter vivos trust created by a New York resident that had a non-New York trustee and out-of-state administration, even though the primary beneficiary was a resident.

(2) In Potter v. Taxation Div. Dir.,[226] the New Jersey Tax Court held that New Jersey could not tax a trust created by a New Jersey trustor where the trust had non-New Jersey trustees, current beneficiaries, and administration.

(3) In Blue v. Department of Treasury,[227] the Michigan Court of Appeals held that Michigan could not tax a trust created by a Michigan resident that had a Florida trustee, a Florida current beneficiary, and Florida assets (except a parcel of Michigan real estate).

(4) After holding that the District could tax the testamentary trust, the District of Columbia Court of Appeals acknowledged, in dictum, in District of Columbia v. Chase Manhattan Bank[228] that:[229]

> We express no opinion as to the constitutionality of taxing the entire net income of inter vivos trusts based solely on the fact that the settlor was domiciled in the District when she died and the trust therefore became irrevocable. In such cases, the nexus between the trust and the District is arguably more attenuated, since the trust was not created by probate of the decedent's will in the District's courts. An irrevocable

[225] Mercantile-Safe Deposit & Trust Co. v. Murphy, 15 N.Y.2d 579 (1964).
[226] Potter v. Taxation Div. Dir., 5 N.J. Tax 399 (1983).
[227] Blue v. Department of Treasury, 185 Mich. App. 406 (1990).
[228] District of Columbia, 689 A.2d 539.
[229] Id. at 547 n.11.

inter vivos trust does not owe its existence to the laws and courts of the District in the same way that the testamentary trust at issue in the present case does, and thus it does not have the same permanent tie to the District. In some cases the District courts may not even have principal supervisory authority over such an inter vivos trust. The idea of fundamental fairness, which undergirds our due process analysis, therefore may or may not compel a different result in an inter vivos trust context.

(5) In Chase Manhattan Bank v. Gavin,[230] the Connecticut Supreme Court denied the trustees' request on constitutional grounds for Connecticut income-tax refunds in an inter vivos trust that had a current resident beneficiary. The court's constitutional analysis is unpersuasive. In the words of one commentator:[231]

> [I]f a state elects to attempt to tax income from trusts having contacts on which the Connecticut Supreme Court supported its tax even though those same contacts would not meet the tests of the Swift line of cases, there are strong arguments to support a challenge to the enforceability of such tax.

(6) In Frances M. Rosen Irrevocable Trust v. State ex rel. Okla. Tax Comm'n,[232] the Court of Civil Appeals affirmed a decision of the Tax Commission that denied the trustee of an irrevocable trust refunds of Oklahoma fiduciary income taxes for 1994, 1995, and 1996. Although the trustor lived in Oklahoma when she created the trust in 1990, she and the trustee had moved to Nevada by 1994. The court did not consider the constitutional aspects of the matter.

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[230] Gavin, 249 Conn. 172.
[231] Gutierrez, supra note 205, ¶ 1309.2 at 13-31.
[232] Frances M. Rosen Irrevocable Trust v. State ex rel. Okla. Tax Comm'n, 2001 OK Civ. App. 114 (2001).

d. Trust Administered in State

There are no relevant Supreme Court cases; the following Wisconsin cases considered this issue:

(1) In Wisconsin Dep't of Taxation v. Pabst,[233] the Supreme Court of Wisconsin held that Wisconsin could not tax a trust because the administration of the trust did not occur in the state.

(2) In Pabst v. Wisconsin Dep't of Taxation,[234] the same court held that Wisconsin could tax the trust because administration did occur in the state.

e. Resident Trustee

In Greenough v. Tax Assessor of Newport,[235] the Supreme Court held that Rhode Island's ad valorem tax on an out-of-state trust with a Rhode Island cotrustee did not violate the Due Process Clause.

The following cases addressed this issue:

(1) In Harrison v. Commissioner of Corps. & Taxation,[236] the Supreme Judicial Court of Massachusetts held that Massachusetts could not tax the income of a District of Columbia trust on the basis that one of three trustees was a resident.

(2) In McCulloch v. Franchise Tax Board,[237] the Supreme Court of California held that California could tax a Missouri trust because a cotrustee was a resident.

f. Resident Beneficiary

There are no pertinent Supreme Court cases; the following California cases considered this issue:

(1) In McCulloch v. Franchise Tax Board,[238] the Supreme Court of California held that California could tax a

[233] Wisconsin Dept't of Taxation v. Pabst, 15 Wis. 2d 195 (1961).
[234] Pabst v. Wisconsin Dep't of Taxation, 19 Wis. 2d 313 (1963).
[235] Greenough v. Tax Assessor of Newport, 331 U.S. 486 (1947).
[236] Harrison, 272 Mass. 422.
[237] McCulloch v. Franchise Tax Board, 61 Cal. 2d 186 (1964).
[238] Id.

Missouri trust because the current beneficiary was a California resident.

(2) In In the Matter of the Appeal of The First National Bank of Chicago, Trustee for Virginia Kirk Cord Trust, et al.,[239] the California State Board of Equalization ruled that California could tax an Illinois trust that had a current resident beneficiary.

(3) In In the Matter of the Appeal of C. Pardee Erdman,[240] the California State Board of Equalization ruled that California could require a California remainder beneficiary to pay California tax that had not previously been paid by the trustee.

4. Specific State Considerations

a. New York and New Jersey

Section 605(b)(3) of the New York tax law[241] treats as Resident Trusts and taxes trusts created by New York testators and trustors, but Subparagraph (D) was added to § 605(b)(3) in 2003 to read in relevant part as follows:

> (D)(i) Provided, however, a resident trust is not subject to tax under this article if all of the following conditions are satisfied:
>
> (I) all the trustees are domiciled in a state other than New York;
>
> (II) the entire corpus of the trusts, including real and tangible property, is located outside the state of New York; and
>
> (III) all income and gains of the trust are derived from or connected with sources outside of the state of New York, determined as if the trust were a non-resident trust.

[239] In the Matter of the Appeal of The First National Bank of Chicago, Trustee for Virginia Kirk Cord Trust, et al., 1964 Cal. Tax Lexis 39 (1964).
[240] In the Matter of the Appeal of C. Pardee Erdman, 1970 Cal. Tax Lexis 50 (1970).
[241] N.Y. Tax Law § 605(b)(3).

> (ii) For purposes of item (II) of clause (i) of this subparagraph, intangible property shall be located in this state if one or more of the trustees are domiciled in the state of New York.

The above provision codifies the holdings of the New York cases cited above, which later were implemented by administrative regulations. The Technical Services Division of the Office of Tax Policy Analysis of the New York State Department of Taxation has provided guidance on whether or not the donee of a power of appointment is the "transferor" to the appointive trust for New York income-tax purposes.[242] More recently, that agency has offered general guidance on the applicability of the tax.[243] It indicates that an adviser or committee that directs the trustee on investment, distribution, or other matters or that has a veto power over the trustees actions will be treated as a cotrustee. Accordingly, a trust will be subject to New York tax if such an adviser or committee member lives in New York even if the trustee and all trust property are outside the state.

Commentators succinctly summarize the reach of the New York fiduciary income tax as follows:[244]

> Essentially, New York will not tax a trust that has no New York trustees, no New York assets, and no New York source income.

New Jersey follows New York's approach. Thus, New Jersey defines Resident Trust as follows:[245]

> A resident . . . trust means: . . .
> (2) A trust, or a portion of a trust, consisting of property transferred by will of a decedent who at his death was domiciled in this State, or
> (3) A trust, or portion of a trust, consisting of the property of:
>
> (a) A person domiciled in this State at the time such property was transferred to the trust, if

[242] TSB-A-03(6)I, 2003 N.Y. Tax Lexis 313 (Nov. 21, 2003). See Richard B. Covey & Dan T. Hastings, State Taxation of Trust Income, Effect of Exercise of Power of Appointment, Prac. Drafting 7549 (Jan. 2004).
[243] TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 (Nov. 12, 2004). See Richard B. Covey & Dan T. Hastings, State Income Taxation of Trusts, New York Law, Prac. Drafting 8228 (July 2005).
[244] Michaels & Twomey, supra note 205, at 29.
[245] N.J. Stat. § 54A:1-2(o). For a summary of the law in New Jersey, see Michaels & Twomey, supra note 205, at 29–30.

> such trust or portion of a trust was then irrevocable, or if it was then revocable and has not subsequently become irrevocable; or
>
> (b) A person domiciled in this State at the time such trust, or portion of a trust, became irrevocable, if it was revocable when such property was transferred to the trust but has subsequently become irrevocable.
>
> For the purposes of the foregoing, a trust or portion of a trust is revocable if it is subject to a power, exercisable immediately or at any future time, to revest title in the person whose property constitutes such trust or portion of a trust, and a trust or portion of a trust becomes irrevocable when the possibility that such power may be exercised has been terminated.

The instructions for the 2006 New Jersey Gross Income Tax Fiduciary Return (NJ-1041) provide in relevant part as follows:

> If a resident trust . . . does not have any assets in New Jersey or income from New Jersey sources, and does not have any trustees . . . in New Jersey, it is not subject to New Jersey tax. However, a New Jersey Gross Income Tax Fiduciary Return should be filed with a statement attached certifying the trust's . . . exempt status.

b. California

California taxes trusts based on the residence of the trustees and noncontingent beneficiaries.[246] If a Californian establishes a trust with a non-California trustee, he or she should be able to defer or avoid California taxation of accumulated ordinary income and capital gains even if the trust has one or more noncontingent California resident beneficiaries.

The California Franchise Tax Board may enter into voluntary disclosure agreements with certain trusts and nonresident beneficiaries.[247] A trustee might want to take advantage of this procedure, for example, because a trust that had not been subject to

[246] Cal. Rev. & Tax. Code §§ 17742–17745.
[247] Id. §§ 19191–19192.

California income tax now must pay such tax due to the move of a trustee or cotrustee to California.

c. Idaho and Virginia

Some states tax a trust only if it satisfies certain requirements. For example, Idaho taxes a trust only if it meets at least three of the following five conditions: the grantor lives in Idaho, the trust was created in Idaho, trust property is located in Idaho, a trustee lives in Idaho, or the trust is administered in Idaho.[248] Similarly, Virginia taxes a trust created by a Virginia resident only if a trustee, a beneficiary, or trust property is located there.[249] A resident of such a state should design a trust to be exempt from such state's fiduciary income tax.

d. Delaware

Delaware's personal income tax "piggybacks" the federal system,[250] and it applies to Resident Trusts.[251] Nevertheless, Delaware does not impose an income tax on, or require the filing of a return to report, non-Delaware source ordinary income accumulated in or capital gains incurred by an irrevocable Resident Trust, provided that no remainder beneficiary lives in the state.[252]

e. Florida

Through 2006, Florida assessed a tax on the intangible personal property of a Florida resident as of January 1 of each year. On January 1, 2006, an individual had a $250,000 exemption,[253] and property above the exempt amount was taxed at 0.5 mill ($500/$1,000,000).[254] An individual's interest in a trust was taxable and reportable by him or her (not the trustee) if the trust was a grantor trust for federal income-tax purposes or if he or she had a current right to income and either a power to revoke the trust or a general power of appointment as defined in IRC § 2041(b)(1).[255] In recent years, Florida residents created FLINT or FLITE trusts to avoid the tax. In such a trust, the taxpayer created a short-term (e.g., 2- or 13-month) irrevocable trust or relinquished

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[248] Idaho Income Tax Administrative Rule 035 (Rule 035). See Richard B. Covey & Dan T. Hastings, Income Taxation of Trust Income, Idaho Law, Prac. Drafting 6618, 6618–19 (Oct. 2001).
[249] P.D. 93-189, 1993 Va. Tax Lexis 187 (1993).
[250] Del. Code Ann. tit. 30, §§ 1101–1243.
[251] Id. § 1601(g).
[252] Id. § 1636.
[253] Fla. Stat. § 199.185(2).
[254] Id. § 199.032.
[255] Id. §§ 199.052(6), 199.023(7).

the power to revoke a revocable trust for such a period around the time of the assessment date.

In 2006, Governor Bush signed legislation that repealed Florida's intangible personal property tax for 2007 and later years.[256]

5. Planning, Ethical, and Other Issues

a. Planning for New Trusts

The state fiduciary income-tax implications of a trust should be considered in the planning stage because it is much easier not to pay a tax in the first place than to obtain a refund. In planning to avoid one state's tax, the attorney must make sure that the trust will not be taxed in one or more other states. The cases cited above show that a client will have a better chance of escaping taxation on constitutional grounds by creating an inter vivos trust rather than a testamentary trust. In uncertain cases, the attorney might request a ruling from the taxing bureau. A state that taxes based on the residence of the testator or trustor is a good place for a nonresident to create a new trust.

b. Ethical Concerns

In some instances, it will be clear to the attorney that a trust will not be taxable. In other situations, however, it will not be clear whether the tax applies to the trust or, if it does, whether imposition of the tax is constitutional in the circumstances. The ABA Committee on Ethics and Professional Responsibility has advised that:[257]

> [A] lawyer may advise reporting a position on a return even where the lawyer believes the position probably will not prevail, there is no "substantial authority" in support of the position, and there will be no disclosure of the position in the return. However, the position to be asserted must be one which the lawyer in good faith believes is warranted in existing law or can be supported by a good faith argument for an extension, modification or reversal of existing law. This requires that there is some realistic possibility of success if the matter is

[256] 2006 Fla. H.B. 209.
[257] ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 352 (1985). See Dennis J. Ventry, Jr., Lowering The Bar: ABA Formal Opinion 85–352, 112 Tax Notes 69 (July 3, 2006).

litigated. In addition, in his role as advisor, the lawyer should refer to potential penalties and other legal consequences should the client take the position advised.

c. Other Issues

In six instances,[258] the IRS has ruled that domestic APTs were nongrantor trusts. On the basis of these rulings, clients are avoiding California, Massachusetts, New Jersey, and New York income tax on accumulated income and capital gains. Such clients might later be able to get discretionary distributions of the untaxed income.

In clear cases, my firm will take the position that a state fiduciary income tax return is not due. If the issue is uncertain, we will file a return unless counsel in the relevant state provides a reasoned opinion that a return is not required.

The planning attorney should make sure that a small amount of source income will not taint an entire trust.[259]

If one resident beneficiary will cause an entire trust to be taxed, consider creating separate trusts for resident and nonresident beneficiaries.

If a resident trustee will cause an entire trust to be taxed, consider having that trustee resign in favor of a nonresident trustee or, in appropriate states, add nonresident cotrustees to reduce the tax.

I am not aware of a case in which the taxation department of one state has sued a trustee in another state to collect tax allegedly due the first state. In such a proceeding, comparable favorable cases from other states should enable the attorney to have penalties waived even if the taxation department is successful.

[258] PLRs 200647001 (Aug. 7, 2006), 200637025 (June 5, 2006), 200612002 (Nov. 23, 2005), 200502014 (Sept. 17, 2004), 200247013 (Aug. 14, 2002), 200148028 (Aug. 27, 2001). See Thomas R. Pulsifer & Todd A. Flubacher, Eliminate a Trust's State Income Tax, 145 Tr. & Est. 30 (May 2006); Bruce D. Steiner, The Accidentally Perfect Non-Grantor Trust, 144 Tr. & Est. 28 (Sept. 2005).

[259] See Michaels & Twomey, supra note 205, at 29.

F. Investment Return

All states now follow the prudent-investor rule,[260] under which a trustee may acquire virtually any type of investment and its investment performance is assessed on the whole portfolio rather than on an asset-by-asset basis. A trust should be established in a state where a trustee may hire an agent to advise it concerning trust investments.[261]

Delaware law now permits a trustee to consider beneficiaries' other trust interests and resources in establishing the investment policy for a trust and no longer requires it to determine such a policy for each trust without regard to other factors.[262]

G Division of Responsibilities

1. Introduction[263]

Clients sometimes want to appoint a corporate trustee for a trust but also want to have a cotrustee, adviser, committee, or protector (not the corporate trustee) control certain trust decisions. For example, if a trustor funds an inter vivos trust with stock in the family company, he or she might want to continue to make decisions regarding the purchase, sale, and voting of such stock. Similarly, a family that has a long-standing relationship with a successful money manager might want that manager (not the corporate trustee) to make investment decisions for trust assets. In addition, a client might want someone other than the corporate trustee to decide when to make income or principal distributions to beneficiaries. In these situations, the client wants to minimize the corporate trustee's involvement in such decisions and wants such trustee to lower its fees to reflect its reduced duties.

Unfortunately, even if a trust ("directed trust") directs the corporate trustee to make investments or distributions on the direction of someone else and relieves it from liability for following such directions, such trustee might have considerable monitoring or other responsibilities under applicable state law. Thus, the corporate trustee might be in the unenviable position

[260] The text of the Uniform Prudent Investor Act (UPIA) is available at www.law.upenn.edu/bll/ulc/fnact99/1990s/upia94.htm (last visited Mar. 8, 2007). To determine which states have enacted the UPIA, go to www.nccusl.org/nccusl/uniformact_factsheets/uniformacts-fs-upria.asp (last visited Mar. 8, 2007).

[261] See, e.g., Del. Code Ann. tit. 12, § 3322.

[262] Del. Code Ann. tit. 12, § 3302(c).

[263] See Dennis I. Belcher, Not My Fault—The Devil Made Me Do It! Responsibilities and Duties of a Delegating or Directed Trustee, 41 U. Miami Inst. on Est. Plan. 11-1 (2007); Al W. King, III, & Pierce H. McDowell, III, Delegated vs. Directed Trusts, 145 Tr. & Est. 26 (July 2006); Stewart E. Sterk, Trust Protectors, Agency Costs, and Fiduciary Duty, 27 Cardozo L. Rev. 2761 (Apr. 2006).

of being pressured to charge low fees while being subject to substantial potential liability.

For directed trusts, some states follow the approach of § 185 of the Second Restatement of Trusts,[264] other states follow § 808(b) of the UTC,[265] still other states have statutes that greatly limit a trustee's liability, and other states have no relevant statute. Appendix F contains citations for the foregoing statutes.

2. Restatement Approach

Section 185 of the Second Restatement of Trusts provides as follows:[266]

> If under the terms of the trust a person has power to control the action of the trustee in certain respects, the trustee is under a duty to act in accordance with the exercise of such power, unless the attempted exercise of the power violates the terms of the trust or is a violation of a fiduciary duty to which such person is subject in the exercise of the power.

Ordinarily, a trustee must follow the directions of someone who is given a power to direct in the trust instrument and may be held liable for not doing so.[267] If the power on which the trustee is directed is for the sole benefit of the directing person (e.g., a power in a widow to direct the sale of trust real estate), the trustee's sole responsibility is to ensure that the direction is within the terms of the trust.[268] If the power on which the trustee is directed is held by the directing person in a fiduciary capacity for the beneficiaries of the trust, however, the trustee might have to make sure that the directing person does not violate that duty and might have to petition a court for instructions in certain cases.[269] Ordinarily, the trustee may await instructions from the directing person but, in certain situations, might have to suggest that the directing person take action or to petition a court for instructions.[270]

The Scott treatise discusses the subject as follows:[271]

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[264] Restatement (Second) of Trusts § 185 (1959).
[265] UTC § 808(b) (2005). The current text of the UTC and the jurisdictions that have adopted the UTC are available at www.utcproject.org (last visited Mar. 8, 2007).
[266] Restatement (Second) of Trusts § 185 (1959).
[267] Id. cmt. b.
[268] Id. cmts. c–d.
[269] Id. cmts. c, e.
[270] Id. cmt. f.
[271] 2A Austin W. Scott & William F. Fratcher, The Law of Trusts § 185 at 574–75 (4th ed. 1987) (footnotes omitted).

Where the holder of the power holds it solely for his own benefit, the trustee can properly comply and is under a duty to comply with his directions, provided that the attempted exercise of the power does not violate the terms of the trust. But where the holder of the power holds it as a fiduciary, the trustee is not justified in complying with his directions if the trustee knows or ought to know that the holder of the power is violating his duty to the beneficiaries as fiduciary in giving the directions. The trustee cannot properly take the position that the responsibility is wholly that of the holder of the power. In such a case the trustee is under a duty similar to that which one trustee owes with respect to his co-trustees. A trustee is not always justified in complying strictly with the terms of the trust. As has been stated, where the trustee is forbidden by the terms of the trust to sell certain property, but where, owing to circumstances not known to the settlor and not anticipated by him, compliance with the provision would defeat or substantially impair the accomplishment of the purposes of the trust, he can apply to a proper court for a direction or permission to deviate from the terms of the trust, and he may be liable for failure to apply to the court, if he knew or reasonably should have known of the existence of those circumstances. It seems even more clear that where it is provided that the trustee should comply with the directions of another, but he knows or reasonably should know that the other in giving directions is violating his duty, the trustee is under a duty to the beneficiaries to apply to the court for permission not to comply with the directions.

The trustee is not necessarily justified in complying with the directions of the holder of the power merely because he does not actually know that the latter is violating his duty as fiduciary. He is liable if he should know of the violation of duty. He is ordinarily under a duty to make a reasonable inquiry and investigation in order to determine whether the holder of the power is violating his duty. Thus, if it is provided that the trustee shall make such investments as a third person shall direct, it is ordinarily the duty of the trustee to make some

> investigation into the propriety of the investment. If as a result he believes that the holder of the power is abusing the discretion conferred on him in directing the investment, he should inform him of this. If the holder of the power still insists on his making the investment, the trustee should apply to the court for instructions.

As shown in Appendix F, only two states—Indiana and Iowa—have statutes based on § 185.

Section 185 is not comforting to directed trustees because they must devote resources to ensuring that the directing person is not violating the terms of the trust or a fiduciary duty.

3. UTC Approach

For the most part, the UTC is not more helpful to directed trustees than Restatement § 185. Subsection (b) of UTC § 808 provides as follows:[272]

> If the terms of a trust confer upon a person other than the settlor of a revocable trust power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust.

Section 808's comment discusses subsection (b) as follows:[273]

> Powers to direct are most effective when the trustee is not deterred from exercising the power by fear of possible liability. On the other hand, the trustee does have overall responsibility for seeing that the terms of the trust are honored. For this reason, subsection (b) imposes only minimal oversight responsibility on the trustee. A trustee must generally act in accordance with the direction. A trustee may refuse the direction only if the attempted exercise would be manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious

[272] UTC § 808(b) (2005).
[273] Id. cmt.

> breach of a fiduciary duty owed by the holder of the power to the beneficiaries of the trust.

The comment to § 808 does continue, though, that:[274]

> The provisions of this section may be altered in the terms of the trust. . . . A settlor can provide that the trustee must accept the decision of the power holder without question. Or a settlor could provide that the holder of the power is not to be held to the standards of a fiduciary.

Again, unless the governing instrument provides otherwise, a directed trustee must devote considerable resources to ensure that the directing person's action is not "manifestly contrary to the terms of the trust" or "a serious breach of a fiduciary duty."

As shown in Appendix F, 17 states—Alabama, Arkansas, the District of Columbia, Florida, Kansas, Maine, Missouri, Nebraska, New Hampshire, New Mexico, North Carolina, Oregon, Pennsylvania, South Carolina, Texas, Virginia, and Wyoming—have statutes based on UTC § 808(b).

4. Protective Approach

As shown in Appendix F, 12 states—Colorado, Delaware, Georgia, Idaho, Indiana, New Hampshire, Ohio, Oklahoma, South Dakota, Tennessee, Utah, and Wyoming—afford more protection to directed trustees than Restatement § 185 or UTC § 808(b). For example, a Delaware trustee is liable for following a distribution or investment direction only if it engages in willful misconduct. Some other states only extend protection to directed trustees in investment matters, some require the directed trustee to carry out the direction properly, and some place no restrictions on the directed trustee's conduct.

5. No Statute

As shown in Appendix F, 23 states—Alaska, Arizona, California, Connecticut, Hawaii, Illinois, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Montana, Nevada, New Jersey, New York, North Dakota, Rhode Island, Vermont, Washington, West Virginia, and Wisconsin—have no directed trust statute.

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[274] Id.

6. Delaware's Experience

In Delaware, a trustee that makes distributions on the direction of an adviser appointed in the trust instrument is not liable to the beneficiaries for a breach of trust.[275] Based on the Delaware statute, Delaware trusts often permit individual cotrustees, advisers, and/or protectors to direct the corporate trustee regarding distribution decisions.

Delaware's statute also permits someone other than the trustee to make investment decisions for particular assets (e.g., closely held stock) or with the hope of maximizing the trust's investment performance and makes it clear that a trustee may follow the direction of an adviser authorized by the governing instrument to give such direction without breaching the trustee's fiduciary responsibility.[276] To recognize this diminished responsibility under the Delaware statute, Delaware corporate trustees customarily charge less to administer direction trusts than trusts over which they have investment duties. A 2004 case upheld the Delaware statute.[277]

H. Asset Protection—Third-Party Trusts

1. Introduction

Clients may protect interests in trusts that they create for others from creditor claims by making such interests wholly discretionary (i.e., by giving the trustee unlimited discretion over distributions) or by including spendthrift clauses. But, the protectiveness of discretionary trusts and spendthrift clauses differs from state to state. As discussed above, the law that determines whether or not creditors may reach a beneficiary's interest in a trust is the law designated by the trust instrument.[278] Consequently,

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[275] Del. Code Ann. tit. 12, § 3313.
[276] Id.
[277] Duemler v. Wilmington Trust Co., Del. Ch., C.A. 20033 NC, 2004, Strine, V.C. (Nov. 24, 2004). A 2001 Virginia case, Rollins v. Branch Banking & Trust Co. of Va., 2001 Va. Cir. Lexis 146 (Va. Cir. Ct. 2001), called the effectiveness of Va. Code Ann. § 26-5.2(C), which applied to Virginia directed trusts at that time, into question.
[278] Restatement (Second) of Conflict of Laws §§ 273, 280 (1971); 5A Scott & Fratcher, supra note 1, §§ 625–628, 660; Bogert & Bogert, supra note 1, § 293.

clients' designations of other states' laws to govern the ability of creditors to reach the assets of trusts created for others should stand.[279]

2. Spendthrift Statutes

The spendthrift statutes of the various states differ significantly. For example, Delaware long has enforced spendthrift trusts. Under Delaware's statute, a creditor of a beneficiary of such a trust has only such rights to the trust property as are afforded the creditor by the terms of the instrument and no limit is placed on the amount that may be sheltered from creditors' claims.[280] Although the courts created an exception for obligations to support a spouse,[281] Delaware law provides virtually complete protection from claims of creditors of a beneficiary. Delaware law bars a creditor from seizing the interest of a beneficiary even when the beneficiary commits a willful tort.[282]

Delaware and states with similar laws might offer more protection than the laws of other states. For example, Georgia permits a creditor to reach spendthrift trust assets if he or she is the victim of a willful tort committed by a beneficiary.[283] California permits spendthrift trust assets to be reached to pay claims for spousal or child support, restitution for commission of a felony, and public support,[284] and it limits the amount that may be protected.[285] Oklahoma permits income distributable to a beneficiary of a spendthrift trust to be reached for child- and spousal-support claims and claims for necessaries and limits the annual income that may be protected from garnishment to $25,000.[286]

Appendix G gives citations for state spendthrift trust statutes.

[279] See Charles Harris & Tye J. Klooster, Beneficiary-Controlled Trusts Can Lose Asset Protection, 145 Tr. & Est. 37 (Dec. 2006); John K. Eason, Policy, Logic, and Persuasion in the Evolving Realm of Trust Asset Protection, 27 Cardozo L. Rev. 2621 (Apr. 2006); Jeffrey A. Schoenblum, In Search of a Unifying Principle for Article V of the Uniform Trust Code: A Response to Professor Danforth, 27 Cardozo L. Rev. 2609 (Apr. 2006); Robert T. Danforth, Article Five of the UTC and the Future of Creditors' Rights, 27 Cardozo L. Rev. 2551 (Apr. 2006); Robert T. Danforth, Understanding Article Five of the UTC, 30 Tax Mgmt. Est., Gifts & Tr. J. 334 (Nov. 10, 2005); Alan Newman, Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code, 40 Real Prop., Prob. & Tr. J. 567 (Fall 2005); Suzanne Brown Walsh, et al., What is the Status of Creditors Under the Uniform Trust Code?, 32 Est. Plan. 29 (Feb. 2005).
[280] Del. Code Ann. tit. 12, § 3536.
[281] Garretson v. Garretson, 306 A.2d 737 (Del. 1973).
[282] Parsons v. Mumford, Del. Ch. No. 9077, 1989, Allen, C. (June 14, 1989); Gibson v. Speegle, Del. Ch. No. 134, 1984, Berger, V. C. (May 30, 1984).
[283] Ga. Code Ann. § 53-12-28(c).
[284] Cal. Prob. Code §§ 15305, 15305.5, 15306. See Ventura County Dept. of Child Support Services v. Brown, 117 Cal. App. 4th 144 (Cal. Ct. App. 2001) (involving § 15305). Contra Young v. McCoy, 2007 Cal. App. Lexis 224 (Cal. Ct. App. 2007) (involving § 15305.5).
[285] Id. §§ 15306.5–15307.
[286] Okla. Stat. Ann. tit. 60, § 175.25B.

3. Accounts in Banks

In Delaware, creditors may not attach assets held by banks (including as trustee)[287] to satisfy their claims.[288]

I. Asset Protection—Self-Settled Trusts

1. Introduction

As just noted, the general rule is that the law that determines whether or not creditors may reach a beneficiary's interest in a trust is the law designated by the trust instrument.[289] Hence, although the question is controversial, a client's designation of another state's spendthrift statute to govern the ability of creditors to reach the assets of a trust of which the trustor is a beneficiary should be effective.

2. State Statutes

Nine states now permit trustors to obtain protection from creditors by creating domestic APTs.[290] Appendix H gives citations for the domestic APT statutes and for statutes of other states that do not recognize them.

3. Crummey Powers

Because the possessor of a Crummey power has the ability to withdraw property for a period of time, he or she might be treated as contributing property to the trust when the power lapses. Several state statutes provide that a Crummey-power holder will not be treated as the trustor of the trust in these circumstances.[291]

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[287] Provident Trust Co. v. Banks, 9 A.2d 260 (Del. Ch. 1939).
[288] Del. Code Ann. tit. 10, § 3502.
[289] Restatement (Second) of Conflict of Laws § 273 (1971).
[290] See generally Adam J. Hirsch, Fear Not the Asset Protection Trust, 27 Cardozo L. Rev. 2685 (Apr. 2006); Jeffrey A. Schoenblum, In Search of a Unifying Principle for Article V of the Uniform Trust Code: A Response to Professor Danforth, 27 Cardozo L. Rev. 2609, 2610–13 (Apr. 2006); Richard W. Nenno & John E. Sullivan, III, Townley—A Totally Different Point of View, Steve Leimberg's Asset Protection Planning Email Newsltr. #87 (Aug. 1, 2006), at www.leimbergservices.com; Richard W. Nenno & John E. Sullivan, III, Delaware Asset Protection Trusts Should Survive Bankruptcy, 33 Est. Plan. 31 (Jan. 2006); Richard W. Nenno & John E. Sullivan, III, Delaware Asset Protection Trusts Create Obstacles for Creditors, 32 Est. Plan. 3 (Dec. 2005); Richard W. Nenno, Planning with Domestic Asset-Protection Trusts: Part II, 40 Real Prop., Prob. & Tr. J. 477 (Fall 2005); Richard W. Nenno, Planning with Domestic Asset-Protection Trusts: Part I, 40 Real Prop., Prob. & Tr. J. 263 (Summer 2005); Richard W. Nenno & John E. Sullivan, III, Delaware Asset Protection Trusts: Avoiding Fraudulent Transfers and Attorney Liability, 32 Est. Plan. 22 (Jan. 2005). See also Richard W. Nenno, William H. Lunger, & Mary B. Hickok, Structuring CRTs as Delaware APTs to Provide Protection from Creditors and Surviving Spouses, 31 Tax Mgmt. Est., Gifts & Tr. J. 71 (Mar. 9, 2006), or 46 Tax Mgmt. Memo. 483 (Oct. 31, 2005).
[291] See, e.g., UTC § 505(b)(2) (2005); Ariz. Rev. Stat. § 14-7705G1; Del. Code Ann. tit. 12, § 3536(d); Tex. Prop. Code § 112.035(e)(2).

J. Power to Adjust and Unitrust Statutes

1. Introduction

Treasury Regulation § 1.643(b)-1 provides in relevant part as follows:

> [A]n allocation of amounts between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust for the year, including ordinary and tax-exempt income, capital gains, and appreciation. For example, a state statute providing that income is a unitrust amount of no less than 3% and no more than 5% of the fair market value of the trust assets, whether determined annually or averaged on a multiple year basis, is a reasonable apportionment of the total return of the trust. Similarly, a state statute that permits the trustee to make adjustments between income and principal to fulfill the trustee's duty of impartiality between the income and remainder beneficiaries is generally a reasonable apportionment of the total return of the trust. Generally, these adjustments are permitted by state statutes when the trustee invests and manages the trust assets under the state's prudent investor standard, the trust describes the amount that may or must be distributed to a beneficiary by referring to the trust's income, and the trustee after applying the state statutory rules regarding the allocation of receipts and disbursements to income and principal, is unable to administer the trust impartially. Allocations pursuant to methods prescribed by such state statutes for apportioning the total return of a trust between income and principal will be respected regardless of whether the trust provides that the income must be distributed to one or more beneficiaries or may be accumulated in whole or in part, and regardless of which alternate permitted method is actually used, provided the trust complies with all requirements of the state statute for switching methods. A switch between methods of determining trust income authorized by state statute will not constitute a recognition event for purposes

> of section 1001 and will not result in a taxable gift from the trust's grantor or any of the trust's beneficiaries. A switch to a method not specifically authorized by state statute, but valid under state law (including a switch via judicial decision or a binding non-judicial settlement) may constitute a recognition event to the trust or its beneficiaries for purposes of section 1001 and may result in taxable gifts from the trust's grantor and beneficiaries, based on the relevant facts and circumstances. In addition, an allocation to income of all or a part of the gains from the sale or exchange of trust assets will generally be respected if the allocation is made either pursuant to the terms of the governing instrument and applicable local law, or pursuant to a reasonable and impartial exercise of a discretionary power granted to the fiduciary by applicable local law or by the governing instrument, if not prohibited by applicable local law.

According to the above regulation, actions taken pursuant to a power to adjust or unitrust statute are permissible for income-, GST-, and gift-tax purposes. Conversely, actions taken without statutory authority might not be acceptable for those purposes. Consequently, each state should consider enacting a power to adjust statute, a statute that permits a trustee to convert an income trust to a unitrust, and a statute that contemplates that new trusts may be created as unitrusts.

2. State Statutes

As shown in Appendix I, 45 states have adopted a statutory power to adjust, 25 states have enacted a unitrust-conversion statute, and 12 states have passed statutes that permit trustors and testators to create new unitrusts.

In 2001, Delaware enacted the first total-return unitrust conversion statute.[292] When the statute is available, the trustee may convert an income trust to a total-return unitrust with or without court approval. The trustee may select a unitrust percentage of not less than 3% nor more than 5%; decide how to account for and value illiquid assets; select the number of prior periods, if any, to use in calculating the unitrust percentage; and determine whether the current beneficiary or the trust will pay income tax attributable to capital gains incurred to make unitrust distributions. Under

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[292] Del. Code Ann. tit. 12, § 3527. See Richard B. Covey & Dan T. Hastings, State Revised Principal and Income Act (1997), Power to Adjust and Unitrust/Total Return Trust Statutes and Ordering Rules for Unitrust Payments, Prac. Drafting app. C at 8256–57 (July 2005).

the Delaware statute, the trustee is not liable if it makes the "wrong" decision. My firm has developed internal procedures and illustrative software to implement the statute.

In 2004, Delaware amended its total-return trust statute to take account of three years of experience with the statute and the above regulation that the IRS issued early that year. The 2004 amendments also added a provision to Delaware law that recognizes newly created total-return trusts.[293]

Delaware enacted the power to adjust in 2005.[294]

3. Observations

Noted commentators make several observations about the regulation quoted above. First, they emphasize the importance of state legislation:[295]

> [T]he preamble rejected a request by commentators that a unitrust or equitable-adjustment power be respected if authorized solely by the governing instrument. . . . In fact, the regulations' limited acceptance of a power to adjust and the unitrust rules will force property owners who wish their trustees to be able to administer the trust under the rules to forum shop—that is, create trusts under the laws of states that have expressly adopted those rules by legislation. And in policy terms, the regulations' overemphasis on state law will have the unintended consequence of forcing states to enact unitrust and power-to-adjust legislation to avoid the loss of trust business.

Next, they emphasize the importance of creating trusts in a state that permits trusts to be converted to unitrusts under a statute that permits the 3% to 5% range:[296]

> [I]t may be appropriate for a QDOT to be converted to a 5 percent payout. That will tend to maximize the amount that may be distributed to the surviving spouse free of estate tax. On the other hand, it might be appropriate to convert a QSST to a 3 percent unitrust where it is desirable to minimize

[293] Id. § 3527A.
[294] Del. Code Ann. tit. 12, § 6113.
[295] Jonathan G. Blattmachr & Mitchell M. Gans, The Final "Income" Regulations: Their Meaning and Importance, 103 Tax Notes 891, 896–97 (Mar. 17, 2004) (footnote omitted).
[296] Id. at 896 n.19.

> distributions to the current income beneficiary to maximize the amount in a trust that is exempted from generation-skipping transfer taxation. Similarly, if the trust must distribute all of its income currently and is not subject to state and local income tax but the income of the income beneficiary is subject to those taxes, it might be better, if a conversion occurs, to choose only a 3 percent payout percentage. Given that the choice of an optimal unitrust rate will depend on the circumstances in each case, locating a trust in a state with legislation authorizing a 3–5 percent range may prove to be advantageous. Indeed, to compete more effectively, states with fixed-rate unitrust statutes may eventually decide to adopt a more flexible 3–5 percent approach.

Finally, they note that the trustee and beneficiaries might want to consider relocating a trust and discuss relevant considerations as follows:[297]

> [T]he exercise of a power to adjust or conversion to a unitrust payment regime will be respected only if done under a state law. Similarly, the safe harbor under which a switch between methods is permitted without adverse tax consequence is available only if made under a state statute.
>
> For several reasons, it may be appropriate to change the situs of a trust to a state that has a statute permitting conversions to unitrusts or the exercise of a power to adjust. The new GSTT regulations, issued in connection with the definition-of-income regulations, contain two examples (Examples 11 and 12) that conclude that such a change in the situs of a trust from a state that has no such statute to one that does (or the reverse) will not cause any beneficiary to be treated as having made a taxable gift or as having made an income-taxable exchange.
>
> A change of situs may not necessarily alter the law governing the trust. If the instrument contains a choice-of-law provision, it may continue to control even after a change in situs. Thus, if a trust is located in a jurisdiction that does not provide for a unitrust or equitable-adjustment regime, changing

[297] Id. at 914 (footnotes omitted).

its situs to a jurisdiction that does have such a regime may not be sufficient (to permit a unitrust conversion or to exercise a power to adjust) if the instrument contains a choice-of-law provision directing that the law of the original jurisdiction is to govern. On the other hand, in the absence of a choice-of-law provision, the law of the state of administration will probably control questions concerning allocations between principal and income. Thus, if the instrument fails to contain a choice-of-law provision, it may be easier to secure tax recognition for a move to a state with a unitrust or equitable-adjustment regime. This suggests that, when possible, any court order authorizing a change in the situs of the trust should include a direction also for a change in the law that governs the determination of its income and corpus.

K. Allocation Rules

The laws of the various states differ on the allocation of receipts and expenses between income and principal. For example, some states allocate receipts from royalties, copyrights, and patents entirely to principal, some allocate them entirely to income, some allocate them partly to income and partly to principal, and some give the trustee discretion to allocate them between income and principal. These rules should be kept in mind in choosing the state for a trust.[298] Because principal- and income-questions generally are matters of trust construction,[299] a trust instrument's designation of a law to govern such issues should be effective.

L. Court System

1. Introduction

A client should establish a trust in a state where judges will render the "right" decision if the trust ends up in court. I am not aware of a ranking of probate courts, but Appendix J summarizes a recent U.S. Chamber of Commerce study that rated the liability systems of the states that should be helpful in assessing this factor.

A Delaware court will not become involved in the administration of a trust unless an interested party seeks relief. When judicial involvement is needed (e.g., when the proper interpretation of the governing instrument is uncertain or a fiduciary is believed to be acting in breach of duty), prompt

[298] Michaels & Twomey, supra note 205, at 33.
[299] Restatement (Second) of Conflict of Laws § 268 cmt. h (1971).

and efficient relief is available in the Delaware Court of Chancery and, if necessary, the Delaware Supreme Court.[300]

The Chancellor and Vice Chancellors of the Delaware Court of Chancery and the Justices of the Delaware Supreme Court (the courts that handle corporate as well as fiduciary matters in Delaware) are not elected. Instead, the Delaware Constitution requires that they be appointed by the Governor with the consent of a majority of the members of the Senate and that all Delaware judges come as equally as possible from the two major political parties.[301]

2. Administrative Costs

The client should establish his or her trust in a state that will not burden the trust with unnecessary administrative costs. Thus, by making an informed designation of the law to govern matters of administration of the trust, the client may avoid periodic court accounting requirements, statutory fee schedules for trustees, and other undesirable features that would apply if the trust were created in the Home State.[302]

For example, in Delaware, judicial accountings are not required for inter vivos or testamentary trusts unless ordered by the court.[303] In Delaware, there is little reason to have judicial accountings because they do not have res judicata effect other than for matters to which exceptions have been taken and that have been determined by the court.[304] Indeed, a trustee that files a judicial accounting simply to obtain exculpation may have to pay the cost of the accounting itself.[305]

3. Confidentiality

The client should establish a trust in a Trust State that respects confidentiality. In Delaware, for example, if a court proceeding is needed for any reason, the court may, upon request, agree to seal the record so that neither the trust instrument nor the court proceeding becomes a matter of public record.[306]

[300] See Randy J. Holland & David A. Skeel, Jr., Deciding Cases Without Controversy, 5 Del. L. Rev. 115, 118–28 (2002).
[301] Del. Const. art. IV, § 3.
[302] Bogert & Bogert, supra note 1, § 301 at 335.
[303] Del. Code Ann. tit. 12, § 3521.
[304] Del. Court of Chancery Rule 129.
[305] In re Corcoran Trusts, 282 A.2d 653 (Del. Ch. 1971), aff'd sub nom. Bankers Trust Co. v. Duffy, 295 A.2d 725 (Del. 1972).
[306] Del. Court of Chancery Rule 5(g).

4. Recourse to Highest Court

Following the Supreme Court's decision in Commissioner v. Estate of Bosch,[307] the IRS generally is bound in a tax controversy only if a matter is adjudicated by a state's highest court. Massachusetts law gives the Supreme Judicial Court original jurisdiction in such disputes.[308]

M. Surviving Spouses' Rights of Election

As mentioned above, the comments to § 270 of the Second Restatement of Conflict of Laws suggest that the designation of a law to govern an inter vivos trust might be disregarded if it would frustrate a surviving spouse's elective share rights. For a variety of reasons, such a public policy, if it ever existed, probably is not as strong as it once was.[309] Nevertheless, the Restatement, the Scott treatise, and the Bogert treatise all indicate that there should be such an exception,[310] but they cite no supporting cases and the three pertinent cases that I have found go the other way.[311]

The dichotomy between a commentator's personal views and the results actually reached by courts is demonstrated by the Scott treatise's discussion of National Shawmut Bank v. Cumming:[312]

> If . . . there is a statute in the state of the settlor's domicil that gives the settlor's surviving spouse a forced share of the property, it might well be held that for this purpose the state of his domicil, rather than the state of the place of administration, has the most significant relationship with the trust. It would seem that because the purpose of the statute is to protect the surviving spouse of the decedent, he should not be able to avoid this policy by creating a trust to be administered in another state in which no such protection is given to the surviving spouse. But it was held otherwise in National Shawmut Bank v. Cumming. In that case a resident of Vermont transferred securities to a bank in

[307] Commissioner v. Estate of Bosch, 387 U.S. 456 (1967).
[308] Mass. Gen. Laws ch. 215, § 6. See Seegel v. Miller, 820 N.E.2d 809 (Mass. 2005); Simches v. Simches, 671 N.E.2d 1226 (Mass. 1996).
[309] Ronald Z. Domsky, Till Death Do Us Part . . . After That, My Dear, You're on Your Own: A Practitioner's Guide to Disinheriting a Spouse in Illinois, 29 S. Ill. U.L.J. 207 (Winter 2005).
[310] Restatement (Second) of Conflict of Laws § 270 cmts. b, e (1971); 5A Scott & Fratcher, supra note 1, § 601 at 317–18; Bogert & Bogert, supra note 1, § 294 at 268–70, § 297 at 298–99, § 301 at 330.
[311] National Shawmut Bank v. Cumming, 91 N.E.2d 337 (Mass. 1950); Rose v. St. Louis Union Trust Co., 253 N.E.2d 417 (Ill. 1969); Johnson v. La Grange State Bank, 383 N.E.2d 185 (Ill. 1978).
[312] 5A Scott & Fratcher, supra note 1, § 601 at 317–18 (footnotes omitted).

> Massachusetts in trust to pay the income to him for life, to pay him such amounts of principal as he might direct, on his death to pay the income to certain persons, and on the death of the survivor to pay the principal to his nephews and nieces. He reserved power to amend or revoke the trust. He died domiciled in Vermont. His widow brought a proceeding in Massachusetts seeking to recover her distributive share of the trust assets on the ground that under the law of Vermont she was so entitled. It was held that the law of Massachusetts was applicable and that under the law of Massachusetts the widow was not entitled in claiming her distributive share to include the assets of a revocable trust.

The Scott treatise continues that:[313]

> It would seem, however, that the Massachusetts court might well have held that it would not apply its local law to persons who were not domiciled in Massachusetts but would apply the law of Vermont in which the settlor and his wife were domiciled.

The fact remains that the court did not.

A commentator discusses the other two pertinent cases as follows:[314]

> The courts of at least one other jurisdiction—Illinois—have embraced the principle articulated in Shawmut Bank that the law of the situs of a trust should control with respect to elective share issues. In the first Illinois case to address this issue, Rose v. St. Louis Union Trust Company, an Illinois decedent established an irrevocable trust with a Missouri corporation as trustee. The trust was administered in Missouri, and the trust instrument specified the application of Missouri law to its administration. Under these circumstances, the court ruled that the validity of the trust with respect to the surviving spouse's elective share rights would be determined under Missouri law, which it further determined precluded the spouse from having any

[313] Id. at 318.
[314] Robert T. Danforth, Estate Planning Implications of Surviving Spouse's Elective Share Rights, 22 Tax Mgmt. Est., Gifts & Tr. J. 235, 242 (Nov. 11, 1997) (footnotes omitted). See Domsky, supra note 309, at 225–30.

rights to the trust property.

In Johnson v. La Grange State Bank, the Supreme Court of Illinois extended its ruling in Rose to assets held in a revocable trust. As described earlier in this article, shortly before her death the decedent in Johnson established a revocable trust in Illinois, naming herself as trustee and La Grange State Bank, an Illinois trust company, as successor trustee. She then moved to Florida and lived there at her death. The decedent's husband brought an action in an Illinois court to set aside the revocable trust insofar as it deprived him of his elective share rights under Florida law. The Supreme Court of Illinois ruled that the trust assets were not subject to the surviving spouse's elective share claim. In reaching its decision, the court made the following comment on the relevance of Illinois law:

As our appellate court properly noted, the trust was created in this State, the corpus has remained here, the [surviving spouse] was domiciled here at the time of the decedent's death, and the principal defendants are located in this State.

Based on these factors, the court applied Illinois law and determined that the trust assets were not subject to the spouse's claim.

The surviving spouse of a Delaware decedent never has been able to reach trust assets by electing against the Will,[315] and Delaware law does not defer to the law of a decedent's domicile to determine a surviving spouse's elective-share rights.[316]

Hence, by creating a revocable or irrevocable trust in Delaware, Illinois, Massachusetts, or another state that has comparable laws, a trustor might be able to defeat his or her spouse's elective-share rights.

N. Insurable Interest of Trusts

In 2005, a federal district court in Virginia held that an insurer could rescind an insurance policy owned by an irrevocable trust following the insured's death because the applicant made misrepresentations on the application and because,

[315] Del. Code Ann. tit. 12, §§ 901(a), 908(b).
[316] Id. § 901(b).

under Maryland law, the trust lacked an insurable interest in the insured's life.[317] Although the Fourth Circuit affirmed the district court's holding on the first ground only and vacated its holding on the insurable-interest ground,[318] trustors should create an irrevocable-life insurance trust ("ILIT") in a state (e.g., Delaware, Georgia, Maine, Maryland, South Dakota, Virginia, or Washington)[319] where a trust clearly has an insurable interest in the insured's life, regardless of the identity of the beneficiaries.

O. Noncharitable Purpose Trusts

At common law, a trust created for a noncharitable purpose (e.g., to care for pets living at a decedent's death) was invalid because no one could enforce the trust.[320] Section 409 of the UTC[321] and several state statutes[322] authorize such trusts to last for 21 years. Some state statutes permit noncharitable purpose trusts to last for a longer period,[323] and others allow them to be perpetual.[324]

VI. ETHICAL AND PRACTICAL CONCERNS WHEN CREATING A DYNASTY TRUST IN A TRUST STATE

A. Background

If an attorney and a client conclude that the client should create a trust under the law of a state in which the attorney is not licensed to practice law, the attorney must determine how to implement the trust without engaging in an ethical violation, committing malpractice, or losing the client.

B. Ethical Principles

Although each state has its own rules that govern conduct by attorneys admitted to practice in the state, the ABA Model Rules of Professional Conduct ("Model

[317] Chawla v. Transamerica Occidental Life Ins. Co., 2005 U.S. Dist. Lexis 3473 (E.D. Va. 2005).
[318] Chawla v. Transamerica Occidental Life Ins. Co., 440 F.3d 639 (4th Cir. 2006). See Robert E. Madden, Lisa H.R. Hayes, & Frank S. Baldino, Current Tax Developments: Decision on Insurable Interest Vacated, 33 Est. Plan. 46, 46–48 (July 2006).
[319] Del. Code Ann. tit. 18, § 2704(c)(5); Ga. Code Ann. § 33-24-3(c); Me. Rev. Stat. Ann. tit. 24-A, § 2402(3)(E); Md. Code Ann., Insurance § 12-201; S.D. Code § 58-10-4(6); Va. Code § 38.2-301(b)(5); Wash. Rev. Code § 48.18.030(3)(c). For an analysis of these statutes, see Mary Ann Mancini & Howard M. Zaritsky, Insurable Interests: Aprés Chawla, le Deluge? 32 ACTEC J. 194, 217–24 (Winter 2006).
[320] See Alexander A. Bove, Jr., Rise of the Purpose Trust, 144 Tr. & Est. 18 (Aug. 2005); Adam J. Hirsch, Bequests For Purposes: A Unified Theory, 56 Wash. & Lee L. Rev. 33 (Winter 1999).
[321] UTC § 409 (2005).
[322] See, e.g., Ala. Code § 19-3B-409; Ark. Code Ann. § 28-73-409; Colo. Rev. Stat. § 15-11-901(1); D.C. Code Ann. § 19-1304.09; Fla. Stat. § 736.0409; Kan. Stat. Ann. § 58a-409; Mo. Rev. Stat. § 456.4-409; Neb. Rev. Stat. § 30-3835; N.M. Stat. Ann. § 46A-4-409; N.C. Gen. Stat. 36C-4-409; Ohio Rev. Code Ann. § 5804.09; 20 Pa. Cons. Stat. § 7739; Tenn. Code Ann. § 35-15-409; Utah Code Ann § 75-2-1001; Va. Code Ann § 55-544.09.
[323] See, e.g., Or. Rev. Stat. § 130.190 (90 yrs.); S.C. Code Ann. § 62-7-409 (USRAP period).
[324] See, e.g., Del. Code Ann. tit. 12, § 3555; Idaho Code § 15-7-601; Me. Rev. Stat. Ann. tit. 18-B, § 409; N.H. Rev. Stat. Ann. § 564-B:4-409; Wyo. Stat. Ann. 4-10-410.

Rules")[325] are the basis of the rules in effect in most U.S. states. Two Model Rules are of particular concern. First, Rule 5.5 of the Model Rules provides in pertinent part as follows:[326]

> (a) A lawyer shall not practice law in a jurisdiction in violation of the regulation of the legal profession in that jurisdiction, or assist another in doing so.
>
> (b) A lawyer who is not admitted to practice in this jurisdiction shall not:
>
> > (1) except as authorized by these Rules or other law, establish an office or other systematic and continuous presence in this jurisdiction for the practice of law; or
> >
> > (2) hold out to the public or otherwise represent that the lawyer is admitted to practice law in this jurisdiction.
>
> (c) A lawyer admitted in another United States jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may provide legal services on a temporary basis in this jurisdiction that:
>
> > (1) are undertaken in association with a lawyer who is admitted to practice in this jurisdiction and who actively participates in the matter; . . .
> >
> > (4) are not within paragraph (c)(2) or (c)(3) [that relate to judicial and alternative-dispute-resolution proceedings] and arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice.

Second, Model Rule 1.1 provides as follows:[327]

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[325] Model Rules of Prof'l Conduct (2002).
[326] Id. R. 5.5.
[327] Id. R. 1.1.

> A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

Neither the commentaries to the Model Rules nor the 2006 commentaries of the American College of Trust and Estate Counsel ("ACTEC")[328] on them specifically address the subject with which we are concerned.

C. Malpractice Concerns

Each state has its peculiarities. For example, an attorney drafting a Will for a Pennsylvania resident might inadvertently run afoul of the Pennsylvania statute that provides that the residuary clause of a Will exercises the testator's general powers of appointment.[329] Similarly, because the exercise of a limited power of appointment over a Delaware trust begins a new perpetuities period in certain circumstances,[330] the attorney must make sure that his or her client's exercise of such a power will not subject the trust to federal estate tax or gift tax pursuant to the Delaware tax trap.[331] Nevertheless, it would seem that the malpractice risks of creating a trust in another state may be minimized through research, experience, and/or the involvement of local counsel.

D. My Experience

In my experience, attorneys from various parts of the country draft Delaware estate-planning documents regularly without engaging Delaware counsel. Other attorneys draft such documents but insist that they be approved by local counsel prior to execution. In the latter situation, Delaware counsel always is sensitive to the existing attorney-client relationship.

VII. MOVING A DYNASTY TRUST TO A MORE FAVORABLE STATE[332]

A. Introduction

1. Background

From time to time, the beneficiaries of a trust might explore replacing a trustee or the beneficiaries and trustees of a trust might investigate whether they may change the law that governs the trust's validity, construction, or administration or the place where it is administered. The

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[328] ACTEC Commentaries on the Model Rules of Prof'l Conduct (4th ed. 2006).
[329] 20 Pa. Cons. Stat. § 2514(13). See Est. of Greve v. Comm'r, 87 T.C.M. 1201 (2004).
[330] Del. Code Ann. tit. 25, § 503(c).
[331] IRC §§ 2041(a)(3), 2514(d). See Subparagraph 4 of Paragraph D of Part V.
[332] See Michaels & Twomey, supra note 205, at 34–35.

remainder of this paragraph gives reasons why beneficiaries might want to change a trust's trustee, governing law, or situs; identifies potential roadblocks to such a change; and offers some comments. I then will focus on how changing governing law or trust situs might benefit a trust and its beneficiaries.

2. <u>Reasons to Move a Trust</u>

In descending order of frequency, here are the most common reasons why beneficiaries explore moving a trust:[333]

a. To address dissatisfaction with the current corporate trustee (whether or not a purported breach of trust is involved);

b. To avoid state income tax on the trust's accumulated ordinary income and capital gains;

c. To improve the trust's investment performance (e.g., because a new trustee will provide better investment results or because a change of governing law will enable a cotrustee or adviser to direct investments);

d. To reduce fees and administrative costs (including accounting costs);

e. To consolidate trusts at a single location;

f. To reform the terms of the trust;

g. To convert an income trust to a total-return trust;

h. To obtain more effective creditor protection for beneficiaries;

i. To extend the trust's duration;

j. To avoid burdensome state regulatory requirements (usually on charitable trusts);

k. To take advantage of a virtual representation statute in order to avoid the appointment of a guardian or trustee ad litem to represent unknown or minor beneficiaries in a court proceeding;

l. To use a statute that offers more grounds for removing a trustee;

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[333] This information is based on comments made by Carol A. Johnston, Joshua S. Rubenstein, W. Donald Sparks, II, and me at <u>The Nuts and Bolts of Changing the Situs of a Trust</u>, 40 U. Miami Inst. on Est. Plan. Special Sess. 3-B (Jan. 12, 2006).

m. To qualify for diversity jurisdiction so that a dispute may be litigated in federal district court.

3. Roadblocks to Moving a Trust

In descending order of frequency, here are the most common roadblocks to moving a trust:[334]

a. Lack of agreement among the beneficiaries;

b. Lack of appropriate language in the governing instrument;

c. Court intervention (e.g., refusal of a court to permit the move or excessive cost of a court proceeding);

d. Fee issues (e.g., principal termination fee for current trustee; excessive fees of new trustee);

e. Uncooperative trustees;

f. Accounting requirements and liability issues (e.g., releases and indemnifications);

g. Choice-of-law issues;

h. Conflict-of-interest issues;

i. Involvement of guardian or trustee ad litem who objects to the move;

j. Inability to terminate all ties to the original jurisdiction.

4. Comments

Although beneficiaries might have valid reasons to move a trust, the story might not have a happy ending because one or more of the above roadblocks might make it impossible or impractical to make the change. Accordingly, it is essential in the creation of a new trust to select the right trustees, situs, and governing law and to include appropriate language in case a change is needed in the future.

[334] Id.

5. Issues to Consider

To determine whether a trust may be moved to take advantage of another state's favorable trust and tax laws, three separate issues must be addressed:

a. Whether it is possible to move the trust, either with or without court proceedings;

b. Whether the desired benefits available are significant enough to justify the costs and risks that will be incurred as a result of the move; and

c. Whether any procedural steps are available to ensure that the trust's move will be respected by both the original state and the federal government.

To address these issues properly, the terms of the governing instrument (including any powers of appointment that may be exercised by the beneficiaries), the applicable law of the original state (including its income-tax and accounting rules), the factual circumstances of the trust (including the current status of the trust's creator, the trustee, and the trust's beneficiaries), and federal constitutional issues (including the potential application of the Commerce Clause and the Due Process Clause to the original state's statutory power to tax or reach assets in the trust) must all be considered.

B. Determining Whether the Trust Can and Should Be Moved

The transfer of a trust's situs from one state to another might be accomplished through an express provision in the trust instrument, a pertinent statute,[335] or a court petition. Generally, the courts have permitted the transfer of a trust when there is no contrary intent expressed in the trust instrument and the administration of the trust will be facilitated and the interests of the beneficiaries will be promoted.[336] Trustees and beneficiaries should not assume, though, that courts automatically will grant petitions to transfer situs. For example, courts have denied such petitions when the accomplishment of the stated objective—the avoidance of New York income tax—did not require the change.[337]

Moving the situs of a trust, in the traditional sense of moving its principal place of administration from one state to another, does not automatically result in a change

[335] See, e.g., Cal. Prob. Code §§ 17400–17405. See also 5A Scott & Fratcher, supra note 1, § 614 at 363–65 n.26.
[336] See In re Estate of McComas, 165 Misc. 2d 947, 948 (Surr. Ct. N.Y. Co. 1995).
[337] In re Bush, 2 Misc. 3d 744 (Surr. Ct. N.Y. Co. 2003); In re Application for Judicial Approval of the Resignation of the Chase Manhattan Bank, 2 Misc. 3d 554 (Surr. Ct. N.Y. Co. 2003).

in the law that applies.[338] If the governing instrument does not specify that, upon a change in situs, the laws of the new state will apply, then a conflict-of-laws analysis is needed to determine whether the trust can avail itself of the favorable laws of the new state. That analysis is dependent on whether the question at issue involves a matter of trust validity, construction, or administration; whether the trust is an inter vivos trust or a testamentary trust; and whether the issue involves real property or personal property.[339]

As I discussed in Paragraph D of Part III above, a client's designation in a trust instrument of a state's law to govern a trust's validity, construction, and administration will be effective in most circumstances.[340] If the governing instrument is silent and if the question involves personal property:

1. Matters of validity typically are determined, in the case of a testamentary trust, by the law of the state of the testator's domicile at death[341] and, in the case of an inter vivos trust, by the law of the state with which, as to the matter at issue, the trust has its most significant relationship;[342]

2. Matters of construction typically are determined, in the case of a testamentary trust or an inter vivos trust, by the law of the state that the client probably would have desired to be applicable;[343] and

3. Matters of administration typically are determined, in the case of a testamentary trust, by the law of the state in which the trust is to be administered[344] and, in the case of an inter vivos trust, by the law of the state to which the administration of the trust is most substantially related.[345]

If the governing instrument is silent and if the question involves an interest in real property, questions involving the validity, construction, and administration of a trust, testamentary or inter vivos, generally are resolved under the law that would be applied by the courts of the state where the real property is located.[346]

The Delaware courts have looked to a number of factors in determining what governing law should apply in interpreting or administering trusts. These factors include the location of the trustee, the place where the assets in the trust are held, any governing law provisions set forth in the trust instrument, the domicile of the testator (in the case of a testamentary trust) or the domicile of the trustor (in the

338 5A Scott & Fratcher, supra note 1, § 615 at 369.
339 Restatement (Second) of Conflict of Laws §§ 267–282 (1971).
340 Paragraph C of Part III summarizes the distinction among questions of validity, construction, and administration.
341 Restatement (Second) of Conflict of Laws § 269(b)(ii) (1971).
342 Id. § 270(b).
343 Id. § 268(2)(b).
344 Id. § 271(b).
345 Id. § 272(b).
346 Id. §§ 278, 277(2), 279.

case of an inter vivos trust), and the location of the beneficiaries of the trust. In Delaware cases that involve inter vivos trusts, in the absence of an explicit governing law provision, the courts have tended to emphasize the location of the trustee and the location of the administration of the trust as the most significant factors in determining the nexus for the application of the appropriate governing law.[347]

In assessing whether it makes sense to pursue moving a trust, consideration must be given to the necessary procedures to accomplish the move, in both the old and the new state. If the governing instrument provides for the removal and replacement of the trustee without the necessity for court proceedings, the nomination of a trustee in the more favorable state may be sufficient in itself to accomplish the transfer of the situs. Similarly, the governing instrument might confer powers of appointment that may be exercised by the beneficiaries in a way that will accomplish the transfer of situs without court intervention. Frequently, however, the governing instrument is silent on the issues of removal, resignation, and replacement or does not contain powers of appointment. In such a case, the beneficiaries must either obtain the trustee's agreement to resign or convince the local probate court to remove the trustee. In this connection, § 706 of the UTC[348] or a local statute might provide courts with bases for removing a trustee.[349]

To move a trust in conjunction with the resignation or removal of a trustee, the beneficiaries or the trustee must file a petition (often accompanied by an accounting) in the local probate court. In many instances, it also is necessary to file a petition in a court in the new state seeking the court's approval of the transfer of situs and acceptance of jurisdiction over the trust prior to the proceeding in the local probate court. Thus, the local court knows of the new trustee's willingness to serve and the new court's acceptance of jurisdiction upon the local court's approval of transfer.

The means by which the trust is moved may have a bearing on which of the more favorable state's benefits can be made available. Thus, in one case, it might be possible to get perpetual duration, no state income taxation, avoidance of accounting requirements, effective spendthrift protection, a favorable total-return unitrust law, reduction in administrative costs, and a direction investment adviser. In another case, however, it might not be possible to get one or more of these benefits.

The Scott treatise describes the impact of the move of a trust that effects a change in the law that governs its administration as follows:[350]

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[347] See Lewis v. Hanson, 128 A.2d 819, 826 (Del. 1957), aff'd sub nom. Hanson v. Denckla, 357 U.S. 235 (1958).
[348] UTC § 706 (2005).
[349] See, e.g., Conn. Gen. Stat. § 45a-242; Del. Code Ann. tit. 12, § 3327; Mo. Rev. Stat. § 456.7-706.
[350] 5A Scott & Fratcher, supra note 1, § 615 at 369 (footnotes omitted). See Restatement (Second) of Conflict of Laws § 272 cmt. e (1971).

> Although a change in the place of administration is authorized, any resulting change in the applicable law will presumably include only matters of administration. The law of the new place of administration will probably be applicable to the compensation of the trustee, the scope of permissible investments, and the powers and duties of the trustee. On the other hand, the change in the place of administration will not affect those matters that pertain to the disposition of the trust property. Thus the change in the place of administration will not affect the determination of who are the beneficiaries of the trust or probably the allocation of receipts and expenses to income or principal. Presumably as to these matters the settlor or testator did not intend to make applicable the law of the place of administration nor did he intend to change the applicable law merely because he permitted a change in the place of administration.

Some states facilitate the application of their laws to the administration of trusts moved from other states. For example, a Delaware statute provides that Delaware law governs the administration of a trust unless the governing instrument or a court order provides otherwise.[351]

C. Moving to Carry Out Clients' Objectives or to Facilitate Amendment or Termination of a Trust

As discussed in Paragraph C of Part V above, states vary on the degree to which they will honor a client's wishes. Thus, if a trustee is concerned that the client's objectives might be better accomplished in another state, it might investigate moving the trust. But, the trustee and the beneficiaries might want to amend or terminate a trust, in which case they should explore moving the trust to a state where this can be accomplished readily. Washington's statutory scheme is worth investigating in such a case.[352]

D. Moving to Create a Perpetual Trust

A provocative question is whether a trust created in a state that does not countenance perpetual trusts may be moved to another state and become a perpetual trust. As I discussed in Paragraph C of Part III above, the determination of how long a trust may last is a matter of validity and the law that governs such matters rarely changes upon the move of a trust. I am aware of one instance, however, in which the trust instrument expressed the client's intent

[351] Del. Code Ann. tit. 12, § 3332(b).
[352] See Wash. Rev. Code §§ 11.96A.210–11.96A.250.

that the trust be perpetual and encouraged the trustee to consider moving the trust to achieve this objective.

The task of converting a trust into a perpetual trust should be easier if the trust confers powers of appointment. Thus, based on Delaware cases decided over half a century ago, it might be possible to turn a trust into a perpetual trust if the trust was written with sufficient flexibility and if it confers a limited power of appointment on a beneficiary.

In discussing this subject, the Scott treatise states:[353]

> Even though a testamentary trust is created to be administered at the outset in the state in which the testator is domiciled at his death, he may confer a power to appoint a substitute trustee in another state. If this power is exercised, the trust is presumably to be administered thereafter in the second state. If so, the exercise of a power of appointment contained in the trust is valid, if valid under the law of the second state. The result is the same where a trust is created inter vivos and there is a subsequent change in the place of administration.

In support of these conclusions, it discusses the venerable case of Wilmington Trust Co. v. Wilmington Trust Co.,[354] as follows:[355]

> In Wilmington Trust Co. v. Wilmington Trust Co. a resident of New York executed a deed of trust, conveying to his wife shares of stock in trust for her and for his children for their lives. The children were given a general power of appointment. By the terms of the trust the adult beneficiaries, with the approval of the trustee, were authorized to substitute as trustee a trust company of any state, which should then hold the trust estate with the same effect as though it were named as the original trustee. In pursuance of this power, they named the Wilmington Trust Company of Delaware as trustee in place of the wife. The securities were delivered to it and the trust was thereafter administered by it in Delaware. One of the children executed an instrument appointing his share to the Wilmington Trust Company in trust for his two children for life

[353] 5A Scott & Fratcher, supra note 1, § 635 at 452–53 (footnotes omitted).
[354] Wilmington Trust Co. v. Wilmington Trust Co., 24 A.2d 309 (Del. 1942).
[355] 5A Scott & Fratcher, supra note 1, § 635 at 453 (footnote omitted).

> and on their death as they might appoint. The Delaware court held that the validity of the exercise of the power of appointment was governed by the law of Delaware and not by that of New York and that the exercise of the power was valid under the law of Delaware, although it would have been invalid under the law of New York because not limited in duration to two lives.

Five years later, the Delaware Court of Chancery followed that decision in Wilmington Trust Co. v. Sloane.[356]

Consequently, a beneficiary who possesses a limited power of appointment over an irrevocable trust that is governed by the common-law rule against perpetuities or the USRAP should, in certain circumstances, be able to move the trust to a state that has abolished the rule against perpetuities so that he or she can exercise the power to make it possible for the trust to last forever.

E. Moving to Avoid State Income Tax

It is necessary to determine whether taking action (e.g., moving a trust out of a state or changing the trustee) will make it possible for the trust to stop paying an income tax. If a state assesses a tax if the trustee is located or resides in that state, moving the trust should terminate liability for the tax. If, as often is the case, however, the original state imposes its tax if the client lived in that state when he or she created the trust, whether or not that tax will continue to apply raises complex constitutional issues that were discussed in Paragraph E of Part V above. The constitutional issues involve the question of whether the state statute creating the basis on which the income tax is imposed violates various federal and state constitutional mandates, including the Commerce Clause and the Due Process Clause of the U.S. Constitution, and therefore can be safely ignored in the absence of any continuing nexus between the trust and the original state.

Trustees and beneficiaries should consider whether they can save state tax by moving trusts to another state or taking other steps.[357] At the same time, they must make sure that such a change will not subject the trust to taxation in one or more other states. If the trustee discovers that tax has been paid erroneously or that it can be escaped, the trustee should consider filing a "final" return in the year before the occurrence of a major transaction (e.g., the sale of a large block of low-basis stock). In states (e.g., Connecticut, the District of Columbia, Pennsylvania, or Wisconsin) that make it difficult to escape tax, the attorney might explore petitioning a court to transfer the trust's situs to a new state. Wisconsin

[356] Wilmington Trust Co. v. Sloane, 54 A.2d 544 (Del. Ch. 1947).
[357] See Michaels & Twomey, supra note 205, at 28–32.

recognizes that a change of situs will end a testamentary trust's liability for tax, and a Pennsylvania ruling came to this result.[358]

F. Moving to Provide More Investment Flexibility

A state's adoption of the prudent-investor rule and its explicit recognition of directed trusts may, by themselves, be sufficient reasons to move a trust. These features might be particularly attractive to trustees and beneficiaries of trusts that hold closely held business interests, lack diversification of assets, or invest in assets (e.g., limited partnerships) that traditionally were viewed as inappropriate because of the trustee's deemed delegation of its investment responsibility.

G. Moving to Provide Greater Protection From Creditor Claims

As I discussed in Paragraph H of Part V, some states provide more protection than other states against creditor claims for beneficiaries of trusts created by third parties, and, as I discussed in Paragraph I of Part V, some states offer protection from creditor claims for trustors of self-settled trusts. Because a trustee has a fundamental duty to use reasonable care to protect the trust from unnecessary exposure to risk of loss,[359] trustees of certain third-party and self-settled spendthrift trusts might have an obligation to explore moving them to more protective jurisdictions.[360]

H. Moving to Avoid Accounting Requirements and Administrative Costs

Moving a trust might avoid court-accounting requirements in the original state. If, as often is the case, the trust to be moved is an inter vivos trust, it should be possible to avoid future court accountings. Even if the trust to be moved is a testamentary trust for which judicial accountings are required, it may be possible to avoid court accountings if there is appropriate language in the governing instrument waiving the requirement. For example, the Delaware courts have demonstrated some flexibility in interpreting governing instruments to avoid the necessity for judicial intervention.

I. Moving to Use the Power to Adjust or to Convert to a Total-Return Unitrust

It might be desirable to move a trust to take advantage of a state's total-return unitrust statutes or power to adjust, particularly because there is greater assurance regarding the tax consequences of action taken pursuant to such a statute than

[358] No. PIT-01-040 (July 27, 2001).
[359] Restatement (Second) of Trusts § 176 (1959).
[360] See In re Joseph Heller Inter Vivos Trust, 613 N.Y.S.2d 809 (Surr. Ct. N.Y. Co. 1994) (trustee petitioned court to divide trust in order to protect cash and securities from liabilities from realty).

there is for action taken without statutory authority.[361] Several states' unitrust conversion statutes[362] and a few states' power to adjust statutes[363] provide that conversion of a trust to a total-return unitrust or the exercise of the power to adjust is a matter of trust administration and that the statute is available to trusts administered in that state under that state's law. Thus, if moving a trust changes the law that governs its administration, the trust will be able to take advantage of such a statute. Nevertheless, changing the situs of a trust will not automatically change the law that governs its administration. Consequently, absent an applicable statute in the new jurisdiction or specific language in the court order or the trust instrument stating that the laws governing the administration of the trust will be those of the new situs, the governing law of the original state might still apply.

Moving a Grandfathered Dynasty Trust to take advantage of another state's total-return unitrust statute[364] or power to adjust[365] will not jeopardize the trust's tax-favored status.

J. Federal Transfer-Tax Consequences of Moving

The attorney should confirm that moving the trust will not produce adverse federal transfer-tax consequences. An Exempt Dynasty Trust or a Nonexempt Dynasty Trust probably can be moved without changing its federal transfer-tax status.

Unless or until the GST tax is repealed, however, great care should be taken in moving a grandfathered trust because the IRS takes the position that a trust will lose its grandfathered status if it is moved to lengthen its duration.[366] As noted above, moving a trust to a state that has a longer perpetuities period than that of the original state will not lengthen a trust's duration if the trust instrument specifies that the trust must terminate on a particular date (e.g., at the end of the USRAP period or the common-law perpetuities period). A Delaware statute now provides that the duration of a trust does not change merely because it is moved to Delaware.[367] In addition, a beneficiary of a grandfathered trust may not exercise a limited power of appointment to create a perpetual trust and preserve the trust's grandfathered status.[368]

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[361] See Treas. Reg. § 1.643(b)-1.
[362] See, e.g., Colo. Rev. Stat § 15-1-404.5(13); Del. Code Ann. tit. 12, § 3527(1); Fla. Stat. § 738.1041(10); 760 Ill. Comp. Stat. 5/5.3(1); Iowa Code § 637.613; Neb. Rev. Stat. Ann. § 30-3119.01 (13)(b); N.M. Stat. Ann. § 46-3A-113B; S.D. Codified Laws § 55-15-12; Va. Code Ann. § 55-277.4:1J.
[363] See, e.g., Del. Code Ann. tit. 12, § 6113(g); Fla. Stat. § 738.104(11).
[364] Treas. Reg. § 26.2601-1(b)(4)(i)(E), Ex. 11.
[365] Treas. Reg. § 26.2601-1(b)(4)(i)(E), Ex. 12
[366] Treas. Reg. § 26.2601-1(b)(4)(i)(E), Ex. 4.
[367] Del Code Ann. tit. 12, § 3332(a).
[368] Treas. Reg. § 26.2601-1(b)(1)(v)(B).

But, the IRS takes the position that moving a Grandfathered Dynasty Trust to avoid state income tax[369] or to utilize (or to avoid) another state's total-return trust conversion law[370] or statutory power to adjust[371] will not cost the trust its grandfathered status.

VIII. PERPETUAL DYNASTY TRUSTS FOR NONRESIDENT ALIENS[372]

A. Federal Gift- and Estate-Tax Rules

Although a federal gift tax is imposed on gifts by any individual, resident or nonresident,[373] a nonresident alien ("NRA") is only taxed on transfers of property situated in the United States,[374] which does not include intangible property.[375] Thus, although gifts of real property and tangible personal property located in the United States are subject to gift tax if the donor is an NRA, gifts of stock, bonds, notes, or other obligations may be made by an NRA without having to file a gift-tax return. For these purposes, cash is treated as tangible personal property.[376]

The rules are much different for federal estate-tax purposes. Property situated in the United States is included in the gross estate of an NRA, and there is no parallel to the gift-tax exemption of intangible property. Thus, if an NRA dies owning shares of stock in a U.S. company, the stock is subject to federal estate taxation unless the decedent resides in a country with which the United States has an estate-tax treaty and the treaty exempts the U.S. stock. This anomaly permits an NRA to give away stock in U.S. companies free of gift tax but not to bequeath it at death free of estate tax. The planning opportunities for NRAs with U.S. beneficiaries who wish to fund dynasty trusts with U.S.-situs intangible property are obvious. If the trust is funded with assets other than real estate or tangible personal property located in the United States, no gift-tax return is required, no consumption of the gift-tax exemption occurs, and no gift tax is due.

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[369] Treas. Reg. § 26.2601-1(b)(4)(i)(D).
[370] Treas. Reg. § 26.2601-1(b)(4)(i)(E), Ex. 11.
[371] Treas. Reg. § 26.2601-1(b)(4)(i)(E), Ex. 12.
[372] See Mark W. Smith, Careful Pre-Immigration Planning Can Save Significant Taxes, 34 Est. Plan. 30 (Feb. 2007); Diana S.C. Zeydel & Grace Chung, Estate Planning For Noncitizens and Nonresident Aliens: What Were Those Rules Again?, 106 J. Tax'n 20 (Jan. 2007). For a discussion of whether the beneficiary of a foreign trust must pay U.S. income tax on distributions of income accumulated by the trust before he or she became a U.S. tax resident, see Jose L. Nunez & Andrea L. Mirabito, Just Off the Boat, Trust Fund in Hand, 144 Tr. & Est. 57 (Dec. 2005). For a description of the U.S. income-tax and reporting requirements for foreign trusts, see Michael W. Galligan, You Must Remember This, 144 Tr. & Est. 49, 52–53 (Dec. 2005).
[373] IRC § 2501(a)(1).
[374] IRC § 2511(a).
[375] IRC § 2501(a)(2).
[376] Rev. Rul. 55-143, 1955-1 CB 495, PLR 7737063 (June 17, 1977).

B. GST-Tax Rules

Because the GST tax applies to a transfer of property by an NRA to a skip person only if the transfer is subject to gift or estate tax,[377] there is no GST tax on a gift of intangible property (e.g., stock, bonds, notes, or other obligations) to a dynasty trust for the benefit of an NRA's U.S. children and grandchildren because such gift is exempt from gift taxation. If the same NRA donor bequeaths the same assets to the dynasty trust upon death, however, the transfer will be subject to the GST tax because it will be subject to estate taxation. Again, this anomaly gives rise to an opportunity for NRAs to create inter vivos dynasty trusts of unlimited amounts (the GST exemption need not be applied) for the benefit of their children and grandchildren who are U.S. citizens or residents without any gift- or GST-tax consequences.[378]

C. Property Situs

In applying the federal gift- and estate-tax rules, it often is difficult to determine with certainty where property will be deemed to be located. For example, certain types of property (i.e., deposits with U.S. banks and savings and loan associations and life insurance proceeds paid by, and amounts left at interest with, U.S. insurance companies) are clearly situated within the United States and yet deemed to have a situs outside the United States.[379] For an NRA wishing to create a U.S. dynasty trust to take advantage of the favorable gift- and GST-tax rules applicable to such a transfer, the difficult question of where property has its situs is generally avoided if neither real estate nor tangible personal property located in the United States is used to fund the trust.

D. U.S. as Trust Situs

A commentator notes that, traditionally, the United States was not an attractive trust jurisdiction for NRAs[380] but that this country now offers clear rules for determining whether a trust is a domestic or foreign trust for federal tax purposes and for determining whether a trust is a grantor or nongrantor trust for federal income-tax purposes. He also points out that it is not on any country's list of tax havens (which are subject to special tax rates and reporting requirements) and provides low income-tax rates under certain treaties and on passive income.[381] In addition, he notes that states, such as Delaware and South Dakota, afford protection from creditor claims through self-settled spendthrift trusts, permit

[377] IRC § 2663(2), Treas. Reg. § 26.2663-2.
[378] See Galligan, supra note 372, at 50.
[379] IRC § 2105. See Jane Tse & Dina Kapur Sanna, Nonresident Aliens, 144 Tr. & Est. 42 (Dec. 2005).
[380] G. Warren Whitaker, The U.S. May Be a Good Trust Jurisdiction for Foreign Persons, 33 Est. Plan. 36 (Feb. 2006).
[381] Id. at 36–39.

perpetual trusts, recognize investment and distribution advisers, and thwart forced heirship claims.[382]

Another commentator observes that:[383]

> [T]he transfer tax consequences of establishing a foreign trust and a domestic trust are identical. Thus, if there are no NRA beneficiaries, the grantor should consider establishing the trust in a U.S. jurisdiction. A suitable choice would be Delaware or another state that permits the grantor to retain a discretionary interest in the trust while shielding the assets from the reach of the grantor's future creditors. One significant advantage of doing so would be to circumvent the throwback regime and the interest charge on distributions of accumulated income to U.S. persons. Another advantage would be to avoid the reporting requirements to which any U.S. beneficiary, the trustee, or the grantor of the trust would otherwise be subject.
>
> Alternatively, the grantor may wish to establish two trusts—a foreign trust that generates foreign-source income for distribution to NRAs and a domestic trust that generates income from whatever source for distribution to U.S. persons.

For these and other reasons, an NRA should consider the United States in choosing a jurisdiction for his or her trusts.[384]

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[382] Id. at 37–39.
[383] Smith, supra note 372, at 33 (footnote omitted).
[384] Id. at 39. See Henry Steinway Ziegler, Come to America, 144 Tr. & Est. 22 (June 2005).

APPENDIX A

TRADITIONAL EXEMPT DYNASTY TRUST ILLUSTRATIONS

TRADITIONAL EXEMPT DYNASTY TRUST

Value of Property in	25 Years		50 Years		75 Years		100 Years	
ANNUAL AFTER TAX GROWTH	GST EXEMPT DYNASTY TRUST	NO TRUST OR NON-EXEMPT TRUST	GST EXEMPT DYNASTY TRUST	NO TRUST OR NON-EXEMPT TRUST	GST EXEMPT DYNASTY TRUST	NO TRUST OR NON-EXEMPT TRUST	GST EXEMPT DYNASTY TRUST	NO TRUST OR NON-EXEMPT TRUST
3%	$ 2,093,778	$ 1,151,578	$ 4,383,906	$ 1,326,132	$ 9,178,926	$ 1,527,144	$19,218,632	$ 1,758,625
4%	2,665,836	1,466,210	7,106,683	2,149,772	18,945,255	3,152,017	50,504,948	4,621,518
5%	3,386,355	1,862,495	11,467,400	3,468,888	38,832,686	6,460,788	131,501,258	12,033,187
6%	4,291,871	2,360,529	18,420,154	5,572,097	79,056,921	13,153,095	339,302,084	31,048,261
7%	5,427,433	2,985,088	29,457,025	8,910,750	159,876,019	26,599,373	867,716,326	79,401,467
8%	6,848,475	3,766,661	46,901,613	14,187,738	321,204,530	53,440,404	2,199,761,256	201,291,904
9%	8,623,081	4,742,694	74,357,520	22,493,150	641,190,893	106,678,135	5,529,040,792	505,941,789
10%	10,834,706	5,959,088	117,390,853	35,510,733	1,271,895,371	211,611,592	13,780,612,340	1,261,012,158

Note: Computations assume $1,000,000 initial gift and 45% tax imposed on assets owned outright or held in Nonexempt Dynasty Trust every 25 years.

APPENDIX B

CHARITABLE-LEAD UNITRUST ILLUSTRATIONS

CHARITABLE-LEAD UNITRUST

Annual Payout Rate to Charity	Duration of Trust				
	20 Years	40 Years	60 Years	80 Years	99 Years
3%	$ 1,823,985	$ 3,325,972	$ 6,063,105	$ 11,049,724	$ 19,536,974
4%	2,237,707	5,005,606	11,193,445	25,021,268	53,711,462
5%	2,751,099	7,565,556	20,796,939	57,149,389	149,231,458
6%	3,389,612	11,484,353	38,893,859	131,665,569	419,111,484
7%	4,185,536	17,510,682	73,227,885	306,091,215	1,190,476,190
8%	5,180,032	26,820,437	138,811,771	717,875,090	3,424,657,534

Note: Chart shows the amount that can be placed in a charitable-lead unitrust with the indicated annual payout rate to charity (with payments made annually) and the indicated term to produce a $1,000,000 taxable gift, using a 5.4% IRC § 7520 rate and assuming 6% annual growth.

APPENDIX C

UNIFORM TRUST CODE
STATE CITATIONS

UNIFORM TRUST CODE
STATE CITATIONS

STATE	CITATION
Alabama	Ala. Code §§ 19-3B-101–19-3B-1305
Arkansas	Ark. Code Ann. §§ 28-73-101–28-73-1106
District of Columbia	D.C. Code Ann. §§ 19-1301.01–19-1311.03
Florida	Fla. Stat. §§ 736.0101–736.1303
Kansas	Kan. Stat. Ann. §§ 58a-101–58a-1107
Maine	Me. Rev. Stat. Ann. tit. 18-B, §§ 101–1104
Missouri	Mo. Rev. Stat. §§ 456.1-101–456.11-1106
Nebraska	Neb. Rev. Stat. §§ 30-3801–30-38,110
New Hampshire	N.H. Rev. Stat. Ann. §§ 564-B:l-101–564-B:11-1104
New Mexico	N.M. Stat. Ann. §§ 46A-1-101–46A-11-1104
North Carolina	N.C. Gen. Stat. §§ 36C-1-101–36C-11-1103
Ohio	Ohio Rev. Code Ann. §§ 5801.01–5811.03
Oregon	Or. Rev. Stat. §§ 130.001–130.910
Pennsylvania	20 Pa. Cons. Stat §§ 7701–7799.3
South Carolina	S.C. Code Ann. §§ 62-7-101–62-7-1106
Tennessee	Tenn. Code Ann §§ 35-15-101–35-15-1103
Utah	Utah Code Ann §§ 75-7-101–75-7-1201
Virginia	Va. Code Ann. §§ 55-541.01–55-551.06
Wyoming	Wyo. Stat. Ann. §§ 4-10-101–4-10-1103

Note: The information in this appendix is derived from information that is available at www.utcproject.org (last visited Feb. 6, 2007).

APPENDIX D

STATE PERPETUITIES LAWS

STATE PERPETUITIES LAWS

PERMIT PERPETUAL TRUSTS	
State	**Citation**
Alaska	Alaska Stat. §§ 34.27.100, 34.27.051
Arizona	Ariz. Rev. Stat. § 14-2901(A)
Delaware	Del. Code Ann. tit. 25, § 503
District of Columbia	D.C. Code Ann. § 19-904(a)(10)
Idaho	Idaho Code § 55-111
Illinois	765 Ill. Comp. Stat. §§ 305/4(a)(8), 305/3(a-5)
Maine	Me. Rev. Stat. Ann. tit. 33, § 101-A
Maryland	Md. Code Ann., Est. & Trusts § 11-102(e)
Missouri	Mo. Rev. Stat. § 456.025
Nebraska	Neb. Rev. Stat. §76-2005(9)
New Hampshire	N.H. Rev. Stat. Ann. § 564:24
New Jersey	N.J. Stat. Ann. §§ 46:2F-9–46:2F-11
Ohio	Ohio Rev. Code Ann. § 2131.09(B)
Pennsylvania	20 Pa. Cons. Stat. § 6107.1(b)(1)
Rhode Island	R.I. Gen. Laws § 34-11-38
South Dakota	S.D. Codified Laws §§ 43-5-1, 43-5-8
Virginia	Va. Code Ann. § 55-13.3(C)
Wisconsin	Wis. Stat. § 700.16(1)(a)
PERMIT VERY LONG TRUSTS	
Colorado (1,000 years)	Colo. Rev. Stat. § 15-11-1102.5
Florida (360 years)	Fla. Stat. § 689.225
Nevada (365 years)	Nev. Rev. Stat. § 111.1031
Utah (1,000 years)	Utah Code Ann. § 75-2-1203
Washington (150 years)	Wash. Rev. Code § 11.98.130
Wyoming (1,000 years)	Wyo. Stat. Ann. § 34-1-139
FOLLOW USRAP	
California	Cal. Prob. Code § 21205
Connecticut	Conn. Gen. Stat. § 45a-491
Georgia	Ga. Code Ann. § 44-6-201
Hawaii	Haw. Rev. Stat. § 525-1
Indiana	Ind. Code §§ 32-17-8-1, 32-17-8-3
Kansas	Kan. Stat. Ann. § 59-3401
Massachusetts	Mass. Gen. Laws ch.184A, § 1
Michigan	Mich. Comp. Laws § 554.72
Minnesota	Minn. Stat. § 501A.01
Montana	Mont. Code Ann. § 72-2-1002
New Mexico	N.M. Stat. Ann. § 45-2-901
North Carolina	N.C. Gen. Stat. § 41-15

STATE PERPETUITIES LAWS

FOLLOW USRAP (cont'd)	
North Dakota	N.D. Cent. Code § 47-02-27.1
Oregon	Or. Rev. Stat. § 105.950
South Carolina	S.C. Code Ann. § 27-6-20
Tennessee	Tenn. Code Ann. § 66-1-202
West Virginia	W. Va. Code § 36-1A-1
FOLLOW COMMON-LAW RULE AGAINST PERPETUITIES	
Alabama	Ala. Code § 35-4-4
Arkansas	Ark. Const. art 2, § 19
Iowa	Iowa Code § 558.68
Kentucky	Ky. Rev. Stat. Ann. § 381.215
Mississippi	Miss. Code Ann. § 79-15-21
New York	N.Y. Est. Powers & Trusts Law § 9-1.1
Oklahoma	Okla. Stat. tit. 60, § 31
Texas	Tex. Prop. Code Ann. § 112.036
Vermont	Vt. Stat. Ann. tit. 27, §§ 501–503
REQUIRES IMMEDIATE VESTING OF INTERESTS	
Louisiana	La. Rev. Stat. Ann. § 9:1803

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APPENDIX E

BASES OF STATE TAXATION OF INCOME OF NONGRANTOR TRUSTS

Bases of State Taxation of Income of Nongrantor Trusts

State	Citations	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Alabama	Ala. Code §§ 40-18-1(21), 40-18-25.	✓[1]	✓[1]			
Alaska	No Income tax imposed on trusts.					
Arizona	Ariz. Rev. Stat. § 43-1301(5); P. 1 of instructions to 2006 Ariz. Form 141AZ				✓	
Arkansas	Ark. Code Ann. § 26-51-201.	✓	✓			
California	Cal. Rev. & Tax. Code §§ 17742–17745; Cal. Code Regs. tit. 18, §§ 17743–17744; P. 6 of instructions to 2006 Cal. Form 541.				✓	✓
Colorado	Colo. Rev. Stat. § 39-22-103(10); P. 3 of instructions to 2006 Colo. Form 105.			✓		
Connecticut	Conn. Gen. Stat. § 12-701(a)(4)(C),(D); Pp. 5, 7 of instructions to 2006 Form CT-1041.	✓	✓[2]			
Delaware	Del. Code Ann. tit. 30, §§ 1601(8), 1636; P. 1 of instructions to 2006 Del. Form 400-I.	✓[3]	✓[3]		✓[3]	
District of Columbia	D.C. Code Ann. § 47-1809.01; P. 6 of instructions to 2006 D.C. D-41.	✓	✓			
Florida	No income tax imposed on trusts; Florida intangible personal property tax repealed for 2007 and later years.					

Bases of State Taxation of Income of Nongrantor Trusts

State	Citations	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Georgia	Ga. Code Ann. § 48-7-22; P. 2 of instructions to 2006 Ga. Form 501X.			✓	✓	✓
Hawaii	Haw. Rev. Stat. § 235-1.			✓	✓	
Idaho	Idaho Admin. Code R. 35.01.01.035.01, .04; P. 1 of instructions to 2006 Idaho Form 66.	✓[4]	✓[4]	✓[4]	✓[4]	
Illinois	35 Ill. Comp. Stat. 5/1501(20); Ill. Admin. Code tit. 86, § 100.3020(a); P. 3 of instructions to 2006 IL-1041.	✓	✓			
Indiana	Ind. Code § 6-3-1-12(d); Ind. Admin. Code tit. 45, r. 3.1-1-21(d).			✓		
Iowa	Iowa Admin. Code r. 701-89.3(422).	✓[4]		✓[4]	✓[4]	
Kansas	P. 2 of instructions to 2005 Kan. Form K-41.			✓		
Kentucky	Ky. Rev. Stat. Ann. §§ 141.020(1), 141.030(1).				✓	
Louisiana	La. Rev. Stat. Ann. § 47:300.10(3); P. 5 of instructions to 2006 La. Form IT-541.	✓		✓[5]		
Maine	Me. Rev. Stat. Ann. tit. 36, § 5102(4); P. 11 of instructions to 2006 Form 1041ME.	✓	✓			

Bases of State Taxation of Income of Nongrantor Trusts

State	Citations	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Maryland	Md. Code Ann., Tax–Gen. § 10-101(k)(1); P. 1 of instructions to 2006 Md. Form 504.	✓	✓	✓		
Massachusetts	Mass. Gen. Laws ch. 62, § 10(a), (c); P. 4 of instructions to 2006 Mass. Form 2.	✓[6]	✓[3, 6]			
Michigan	Mich. Comp. Laws § 206.18(1)(c); P. 2 of instructions to 2006 MI-1041.	✓	✓[7]			
Minnesota	Minn. Stat. § 290.01 Subd.7b; P. 1 of instructions to 2006 Minn. Form M2.	✓[8]	✓[8]	✓[9]		
Mississippi	P. 1 of instructions to 2006 Miss. Form 81-110.			✓		
Missouri	Mo. Rev. Stat. § 143.331; P. 1 of instructions to 2006 Form MO-1041.	✓[10]	✓[10]			
Montana	P. 1 of instructions to 2006 Mont. Form Fid-3.	✓[4]	✓[4]	✓[4]	✓[4]	
Nebraska	Neb. Rev. Stat. § 77-2714.01(6); P. 2 of instructions to 2006 Neb. Form 1041N.	✓	✓			
Nevada	No income tax imposed on trusts.					
New Hampshire	N.H. Rev. Stat. Ann. § 77:10; N.H. Code Admin. R. Ann. 902.07; P. 4 of instructions to 2006 N.H. Form DP-10.				✓	

Bases of State Taxation of Income of Nongrantor Trusts

State	Citations	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
New Jersey	N.J. Stat. Ann. § 54A:1-2(o); P. 1 of instructions to 2006 Form NJ-1041.	✓[11]	✓[11]			
New Mexico	P. 1 of instructions to 2006 N.M. F1D-1.			✓	✓	
New York	N.Y. Tax Law § 605(b)(3); N.Y. Comp. Codes R. & Regs. tit. 20, § 105.23; P. 2 of instructions to 2006 N.Y. Form IT-205.	✓[11]	✓[11]			
North Carolina	N.C. Gen. Stat. § 105-160.2; P. 1 of instructions to 2006 N.C. Form D-407.					✓
North Dakota	N.D. Admin. Code § 81-03-02.1-04; P. 2 of instructions to 2006 N.D. Form 38.			✓[4]	✓[4]	✓[4]
Ohio	Ohio Rev. Code Ann. § 5747.01(I)(3); P. 1 of instructions to 2006 Ohio Form IT 1041.	✓	✓[3]			
Oklahoma	Okla. Stat. tit. 68, § 2353(6); Okla. Admin. Code § 710:50-23-1(c); P. 2 of instructions to 2006 Okla. Form 513.	✓	✓			
Oregon	Or. Rev. Stat. § 316. 282(1)(d); Or. Admin. R. 150-316.282(3); P. 1 of instructions to 2006 Or. Form 41.			✓	✓	

Bases of State Taxation of Income of Nongrantor Trusts

State	Citations	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Resident Trustee	Resident Noncontingent Beneficiary
Pennsylvania	72 P.S. 7301(s); 61 Pa. Code § 101.1; P. 5 of instructions to 2006 Form PA-41.	✓	✓			
Rhode Island	R. I. Gen. Laws § 44-30-5(c); R.I. Code R. PIT. 90-13; Pp. 1-1, 1-3 of instructions to 2006 Form RI-1041.	✓[3]	✓[3]			
South Carolina	S.C. Code Ann. § 12-6-30(5); P. 1 of instructions to 2006 S.C. Form 1041.			✓		
South Dakota	No income tax imposed on trusts.					
Tennessee	Tenn. Code Ann. § 67-2-110(a); P. 1 of instructions to 2006 Tenn. Form Inc. 250.					✓
Texas	No Income tax imposed on trusts.					
Utah	Utah Code Ann. § 75-7-103(1)(i); Pp. 1–2 of instructions to 2006 UT Form TC-41.	✓		✓[12]		
Vermont	Vt. Stat. Ann. tit. 32, § 5811(11)(B); P. 1 of instructions to 2006 Vt. Form FI-161.	✓	✓			
Virginia	Va. Code Ann. § 58.1-302; 23 Va. Admin. Code § 10-115-10; P. 1 of instructions to 2006 Va. Form 770.	✓	✓	✓	✓	
Washington	No Income tax imposed on trusts.					

Bases of State Taxation of Income of Nongrantor Trusts

State	Citations	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in Jurisdiction	Resident Trustee	Resident Noncontingent Beneficiary
West Virginia	W. Va. Code § 11-21-7(c); P. 2 of instructions to 2006 W. Va. Form IT-141.	✓	✓			
Wisconsin	Wis. Stat. § 71.14(2),(3); P. 1 of instructions to 2006 Wis. Form 2.	✓	✓[13]	✓[14]		
Wyoming	No income tax imposed on trusts.					

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[1] Provided that trust has resident fiduciary or current beneficiary.

[2] Provided that trust has resident noncontingent beneficiary.

[3] Provided that trust has resident beneficiary.

[4] Provided that other requirements are met.

[5] Unless trust designates governing law other than Louisiana.

[6] Provided that trust has Massachusetts trustee.

[7] Unless trustees, beneficiaries, and administration are outside Michigan.

[8] Post-1995 trusts only.

[9] Pre-1996 trusts only.

[10] Provided that trust has resident income beneficiary on last day of year.

[11] Unless trustees and trust assets are outside state and no source income.

[12] Inter vivos trusts only.

[13] Trusts created or first administered in Wisconsin after October 28, 1999, only.

[14] Irrevocable inter vivos trusts administered in Wisconsin before October 29, 1999, only.

APPENDIX F

STATE DIRECTED TRUST STATUTE CITATIONS

STATE DIRECTED TRUST STATUTE CITATIONS

Follows § 185 of Second Restatement of Trusts (directed trustee liable if direction violates terms of trust or fiduciary duty of directing person)

State	Citation
Indiana	Ind. Code § 30-4-3-9(b)
Iowa	Iowa Code § 633.4207(2)

Follows § 808(b) of UTC (directed trustee liable if direction is manifestly contrary to terms of trust or trustee knows direction is serious breach of fiduciary duty of directing person)

State	Citation
Alabama	Ala. Code § 19-3B-808(b)
Arkansas	Ark. Code Ann. § 28-73-808(b)
District of Columbia	D.C. Code Ann. § 19-1308.08(b)
Florida	Fla. Stat. § 736.0808(2)
Kansas	Kan. Stat. Ann. § 58a-808(b)
Maine	Me. Rev. Stat. Ann. tit. 18-B, § 808(2)
Missouri	Mo. Rev. Stat. § 456.8-808(2)
Nebraska	Neb. Rev. Stat. Ann. § 30-3873(b)
New Hampshire	N.H. Rev. Stat. Ann. §§ 564-B:8-808(b), 564-B:12-1206–1207
New Mexico	N.M. Stat. Ann. § 46A-8-808(B)
North Carolina	N.C. Gen. Stat. § 36C-8-808(b)
Oregon	Or. Rev. Stat. § 130.685(2)
Pennsylvania	20 Pa. Cons. Stat. § 7778(b)
South Carolina	S.C. Code Ann. § 62-7-808(b)
Texas	Tex. Prop. Code Ann. § 114.003(b)
Virginia	Va. Code Ann. § 55-548.08(B)
Wyoming	Wyo. Stat. Ann. §§ 4-10-808(b), 4-10-715, 4-10-717–718

Provides Substantial Protection (directed trustee liable for deficient execution of direction, for willful misconduct, or not at all)

State	Citation
Colorado (investment decisions only)	Colo. Rev. Stat. § 15-1-307
Delaware (willful misconduct)	Del. Code Ann. tit. 12, § 3313
Georgia (investment decisions only)	Ga. Code Ann. § 53-12-194(c)
Idaho	Idaho Code § 15-7-501
Indiana	Ind. Code § 30-4-3-9(a)
Ohio	Ohio Rev. Code Ann. §§ 5808.08(B), 5815.25(B), 2109.022(B)
Oklahoma (investment decisions only)	Okla. Stat. tit. 60, § 175.19
South Dakota	S.D. Codified Laws §§ 55-1B-1–3, 55-1B-5–6, 55-1B-9–11
Tennessee	Tenn. Code Ann. §§ 35-15-808, 35-3-122–123
Utah (willful misconduct or gross negligence; investment decisions only)	Utah Code Ann. § 75-7-906(4)

Has No Directed Trust Statute

STATE	CITATION
Alaska	
Arizona	
California	
Connecticut	
Hawaii	
Illinois	
Kentucky	
Louisiana	
Maryland	
Massachusetts	
Michigan	
Minnesota	
Mississippi	
Montana	
Nevada	
New Jersey	
New York	
North Dakota	
Rhode Island	
Vermont	
Washington	
West Virginia	
Wisconsin	

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APPENDIX G

STATE THIRD-PARTY SPENDTHRIFT TRUST STATUTES

STATE THIRD-PARTY SPENDTHRIFT TRUST STATUTES

STATE	CITATION
Alabama	Ala. Code §§ 19-3B-502–19-3B-503
Alaska	Alaska Stat. § 34.40.110
Arizona	Ariz. Rev. Stat. §§ 14-7701–14-7710
Arkansas	Ark. Code Ann. § 28-73-502
California	Cal. Prob. Code §§ 15300–15309
Colorado	
Connecticut	Conn. Gen. Stat. § 52-321
Delaware	Del. Code Ann. tit. 12, § 3536
District of Columbia	D.C. Code Ann. §§ 19-1305.02–19-1305.03
Florida	Fla. Stat. §§ 736.0502–736.0503
Georgia	Ga. Code Ann. § 53-12-28(c)
Hawaii	
Idaho	Idaho Code § 15-7-502
Illinois	735 Ill. Comp. Stat. 5/2-1403
Indiana	Ind. Code § 30-4-3-2
Iowa	Iowa Code § 633A.2301
Kansas	Kan. Stat. Ann. § 58a-502
Kentucky	Ky. Rev. Stat. Ann. § 381.180
Louisiana	La. Rev. Stat. Ann. § 9:2004
Maine	Me. Rev. Stat. Ann. tit. 18-B, §§ 502–503
Maryland	
Massachusetts	
Michigan	
Minnesota	
Mississippi	Miss. Code Ann. §§ 91-9-501–91-9-511
Missouri	Mo. Rev. Stat. §§ 456.5-502–456.5-503
Montana	Mont. Code Ann. §§ 72-33-301–72-33-302
Nebraska	Neb. Rev. Stat. §§ 30-3847–30-3848
Nevada	Nev. Rev. Stat. §§ 166.010–166.170
New Hampshire	N.H. Rev. Stat. Ann. §§ 564-B:5-502–564-B:5-503
New Jersey	
New Mexico	N.M. Stat. Ann. §§ 46A-5-502–46A-5-503
New York	N.Y. Est. Powers & Trusts Law § 7-1.5
North Carolina	N.C. Gen. Stat. §§ 36C-5-502–36C-5-503
North Dakota	
Ohio	Ohio Rev. Code Ann. §§ 5805.01–5805.02
Oklahoma	Okla. Stat. tit. 60, § 175.25(G)
Oregon	Or. Rev. Stat. §§ 130.305–130.310
Pennsylvania	20 Pa. Cons. Stat. §§ 7742–7743

STATE THIRD-PARTY SPENDTHRIFT TRUST STATUTES

STATE	CITATION
Rhode Island	R.I. Gen. Laws § 18-9.1-1
South Carolina	S.C. Code Ann. §§ 62-7-502–62-7-503
South Dakota	S.D. Codified Laws § 55-1-19
Tennessee	Tenn. Code Ann. §§ 35-15-502–35-15-503
Texas	Tex. Prop. Code Ann. § 112.035
Utah	Utah Code Ann. §§ 75-7-502–75-7-503
Vermont	
Virginia	Va. Code Ann. §§ 55-545.02–55-545.03
Washington	Wash. Rev. Code § 6.32.250(2)
West Virginia	W. Va. Code § 36-1-18
Wisconsin	Wis. Stat. § 701.06
Wyoming	Wyo. Stat. Ann. §§ 4-10-502–4-10-503

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APPENDIX H

STATE SELF-SETTLED SPENDTHRIFT TRUST STATUTES

STATE SELF-SETTLED SPENDTHRIFT TRUST STATUTES

PERMIT DOMESTIC APTs	
State	**Citation**
Alaska	Alaska Stat. § 34.40.110
Colorado	Colo. Rev. Stat. § 38-10-111
Delaware	Del. Code Ann. tit. 12, §§ 3570–3576
Missouri	Mo. Rev. Stat. § 456.5-505
Nevada	Nev. Rev. Stat. §§ 166.010–166.170
Oklahoma	Okla. Stat. tit. 31, §§ 10–18
Rhode Island	R.I. Gen. Laws §§ 18-19.2-1–18-19.2-7
South Dakota	S.D. Codified Laws §§ 55-16-1–55-16-17
Utah	Utah Code Ann. § 25-6-14
PROHIBIT DOMESTIC APTs	
State	**Citation**
Alabama	Ala. Code § 19-3B-505(a)(2)
Arizona	Ariz. Rev. Stat. § 14-7705
Arkansas	Ark. Code Ann. § 28-73-505(a)(2)
California	Cal. Prob. Code § 15304
Connecticut	
Delaware	Del. Code Ann. tit. 12, § 3536(c)
District of Columbia	D.C. Code Ann. § 19-1305.05(a)(2)
Florida	Fla. Stat. § 736.0505(1)(b)
Georgia	Ga. Code. Ann. § 53-12-28(c)
Hawaii	
Idaho	Idaho Code § 55-905
Illinois	735 Ill. Comp. Stat. 5/2-1403
Indiana	Ind. Code § 30-4-3-2(b)
Iowa	Iowa Code § 633A.2302
Kansas	Kan. Stat. Ann. § 58a-505(a)(2)
Kentucky	Ky. Rev. Stat. Ann. § 381.180(7)(a)
Louisiana	La. Rev. Stat. Ann § 9:2004
Maine	Me. Rev. Stat. Ann. tit. 18-B, § 505(1)(B)
Maryland	
Massachusetts	
Michigan	
Minnesota	
Mississippi	Miss. Code Ann. § 91-9-509
Montana	Mont. Code Ann. § 72-33-305(1)
Nebraska	Neb. Rev. Stat. § 30-3850(a)(2)
New Hampshire	N.H. Rev. Stat. Ann. § 564-B:5-505(a)(2)
New Jersey	N.J. Stat. Ann. §§ 3B:11-1, 25:2-1
New Mexico	N.M. Stat. Ann. § 46A-5-505A(2)
New York	N.Y. Est. Powers & Trusts Law § 7-3.1(a)
North Carolina	N.C. Gen. Stat. § 36C-5-505(a)(2)
North Dakota	
Ohio	Ohio Rev. Code Ann. § 5805.06(A)(2)
Oklahoma	Okla. Stat. tit. 60, § 175.25(H)
Oregon	Or. Rev. Stat. § 130.315(1)(b)

STATE SELF-SETTLED SPENDTHRIFT TRUST STATUTES

PROHIBIT DOMESTIC APTs (cont'd)	
State	**Citation**
Pennsylvania	20 Pa. Cons. Stat. § 7745(2)
South Carolina	S.C. Code Ann. § 62-7-505(a)(2)
South Dakota	S.D. Codified Laws § 55-1-19
Tennessee	Tenn. Code Ann. § 35-15-505(a)(2)
Texas	Tex. Prop. Code Ann. § 112.035(d)
Utah	Utah Code Ann. § 75-7-505(1)(b)
Vermont	
Virginia	Va. Code Ann. § 55-545.05(A)(2)
Washington	Wash. Rev. Code § 19.36.020
West Virginia	W. Va. Code § 36-1-18
Wisconsin	Wis. Stat. § 701.06
Wyoming	Wyo Stat. Ann. § 4-10-505(a)(ii)

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APPENDIX I

STATE POWER TO ADJUST AND UNITRUST STATUTES

STATE POWER TO ADJUST AND UNITRUST STATUTES

STATE	POWER TO ADJUST	PROTECTION FOR TRUSTEE	UNITRUST CONVERSION STATUTE	NEW UNITRUST STATUTE
Alabama	Ala. Code § 19-3A-104	Ala. Code § 19-3A-104(f)		
Alaska	Alaska Stat. § 13.38.210	Alaska Stat. § 13.38.220	Alaska Stat. §§ 13.38.300–13.38.410	
Arizona	Ariz. Rev. Stat. § 14-7403	Ariz. Rev. Stat. § 14-7404		
Arkansas	Ark. Code Ann. § 28-70-104			
California	Cal. Prob. Code § 16336	Cal. Prob. Code §§ 16337–16338	Cal. Prob. Code §§ 16336.4–16336.7	Cal. Prob. Code § 16328
Colorado	Colo. Rev. Stat. § 15-1-404	Colo. Rev. Stat. § 15-1-405	Colo. Rev. Stat. § 15-1-404.5	
Connecticut	Conn. Gen. Stat. § 45a-542c			
Delaware	Del Code Ann. tit. 12, § 6113	Del. Code Ann. tit. 12, § 6114	Del. Code Ann. tit. 12, § 3527	Del. Code Ann. tit. 12, § 3527A
District of Columbia	D.C. Code Ann. § 28-4801.04			
Florida	Fla. Stat. § 738.104	Fla. Stat. § 738.105	Fla. Stat. § 738.1041	Fla. Stat. § 738.1041(11)
Georgia	Ga. Code Ann. § 53-12-220	Ga. Code Ann. § 53-12-222	Ga. Code Ann. § 53-12-221	
Hawaii	Haw. Rev. Stat. § 557A-104	Haw. Rev. Stat. § 557A-105		
Idaho	Idaho Code § 68-10-104	Idaho Code § 68-10-105		
Illinois			760 Ill. Comp. Stat 5/5.3	760 Ill. Comp. Stat. 5/5.3(m)
Indiana	Ind. Code § 30-2-14-15	Ind. Code §§ 30-2-14-16–30-2-14-17	Ind. Code §§ 30-2-15-1–30-2-15-26	
Iowa			Iowa Code §§ 637.601–637.615	

STATE POWER TO ADJUST AND UNITRUST STATUTES

STATE	POWER TO ADJUST	PROTECTION FOR TRUSTEE	UNITRUST CONVERSION STATUTE	NEW UNITRUST STATUTE
Kansas	Kan. Stat. Ann. § 58-9-104			
Kentucky	Ky. Rev. Stat. Ann. § 386.454		Ky. Rev. Stat. Ann § 386.454	
Louisiana	La. Rev. Stat. Ann. § 9:2158	La. Rev. Stat. Ann. § 9:2163		
Maine	Me. Rev. Stat. Ann. tit. 18-A, § 7-704	Me. Rev. Stat. Ann. tit. 18-A, § 7-706	Me. Rev. Stat. Ann. tit. 18-A, § 7-705	
Maryland	Md. Code Ann., Est. & Trusts § 15-502.2	Md. Code Ann., Est. & Trusts § 15-502.3	Md. Code Ann., Est. & Trusts § 15-502.1	
Massachusetts	Mass. Gen. Laws ch. 203D, § 4	Mass. Gen. Laws ch. 203D, § 5		
Michigan	Mich. Comp. Laws § 555.504	Mich. Comp. Laws § 555.505		
Minnesota	Minn. Stat. Ann. § 501B.705	Minn. Stat. § 501B.705, Subd. 7		
Mississippi				
Missouri	Mo. Rev. Stat. § 469.405	Mo. Rev. Stat. § 469.409	Mo. Rev. Stat. § 469.411	Mo. Rev. Stat. § 469.411(5)(1)
Montana	Mont. Code Ann. § 72-34-424	Mont. Code Ann. § 72-34-424(8)		
Nebraska	Neb. Rev. Stat. § 30-3119	Neb. Rev. Stat. §§ 30-3120–30-3121	Neb. Rev. Stat. § 30-3119.01	
Nevada	Nev. Rev. Stat. § 164.795			
New Hampshire	N.H. Rev. Stat. Ann. § 564-C:1-104	N.H. Rev. Stat. Ann. § 564-C:1-104(h), 564-C:1-105	N.H. Rev. Stat. Ann. § 564-A:3-c	
New Jersey	N.J. Stat. Ann. § 3B:19B-4	N.J. Stat. Ann. § 3B:19B-31		
New Mexico	N.M. Stat. Ann. § 46-3A-104		N.M. Stat. Ann. §§ 46-3A-105–46-3A-113	

STATE POWER TO ADJUST AND UNITRUST STATUTES

STATE	POWER TO ADJUST	PROTECTION FOR TRUSTEE	UNITRUST CONVERSION STATUTE	NEW UNITRUST STATUTE
New York	N.Y. Est. Powers & Trusts Law § 11-2.3(b)(5)	N.Y. Est. Powers & Trusts Law § 11-2.3-A	N.Y. Est. Powers & Trusts Law § 11-2.4	N.Y. Est. Powers & Trusts Law § 11-2.4(e)(1)(A)
North Carolina	N.C. Gen. Stat. § 37A-1-104	N.C. Gen. Stat. § 37A-1-105	N.C. Gen. Stat. §§ 37A-1-104.1–37A-1-104.9	N.C. Gen. Stat. §§ 37A-1-104.21–37A-1-104.26
North Dakota				
Ohio	Ohio Rev. Code Ann. § 5812.03	Ohio Rev. Code Ann. § 5812.03(G)		
Oklahoma	Okla. Stat. tit. 60, § 175.104			
Oregon	Or. Rev. Stat. § 129.215	Or. Rev. Stat. § 129.220	Or. Rev. Stat. § 129.225	
Pennsylvania	20 Pa. Cons. Stat. § 8104	20 Pa. Cons. Stat. § 8106	20 Pa. Cons. Stat. § 8105	20 Pa. Cons. Stat. § 8107
Rhode Island	R.I. Gen. Laws § 18-4-28		R.I. Gen. Laws § 18-4-29	R.I. Gen. Laws § 18-4-29
South Carolina	S.C. Code Ann. § 62-7-904			
South Dakota			S.D. Codified Laws §§ 55-15-1–55-15-14	
Tennessee	Tenn. Code Ann. § 35-6-104	Tenn. Code Ann. §§ 35-6-104(g), 35-6-106		
Texas	Tex. Prop. Code Ann. § 116.005	Tex. Prop. Code Ann. § 116.006		Tex. Prop. Code Ann. § 116.007
Utah	Utah Code Ann. § 22-3-104	Utah Code Ann. §§ 22-3-105–22-3-107		
Vermont				
Virginia	Va. Code Ann. § 55-277.4		Va. Code Ann. § 55-277.4:1	
Washington	Wash. Rev. Code § 11.104A.020	Wash. Rev. Code § 11.104A.030	Wash. Rev. Code § 11.104A.040	Wash. Rev. Code § 11.104A.040(a)(2)

STATE POWER TO ADJUST AND UNITRUST STATUTES

STATE	POWER TO ADJUST	PROTECTION FOR TRUSTEE	UNITRUST CONVERSION STATUTE	NEW UNITRUST STATUTE
West Virginia	W.V. Code § 44B-1-104	W.V. Code § 44B-1-105		
Wisconsin	Wis. Stat. § 701.20(4)	Wis. Stat. § 701.20(4c)	Wis. Stat. § 701.20(4g)	Wis. Stat. § 701.20(4j)
Wyoming	Wyo. Stat. Ann. § 2-3-804	Wyo. Stat. Ann. § 2-3-832		

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APPENDIX J

STATE LIABILITY SYSTEMS RANKING

STATE LIABILITY SYSTEMS RANKING

State	Ranking		States In Order of Ranking	Ranking
Alabama	47		Delaware	1
Alaska	36		Nebraska	2
Arizona	13		Virginia	3
Arkansas	41		Iowa	4
California	44		Connecticut	5
Colorado	8		New Hampshire	6
Connecticut	5		South Dakota	7
Delaware	1		Colorado	8
Florida	38		Maine	9
Georgia	27		North Carolina	10
Hawaii	46		Indiana	11
Idaho	18		North Dakota	12
Illinois	45		Arizona	13
Indiana	11		Minnesota	14
Iowa	4		Kansas	15
Kansas	15		Wyoming	16
Kentucky	34		Utah	17
Louisiana	49		Idaho	18
Maine	9		Ohio	19
Maryland	20		Maryland	20
Massachusetts	32		New York	21
Michigan	22		Michigan	22
Minnesota	14		Wisconsin	23
Mississippi	48		Vermont	24
Missouri	35		New Jersey	25
Montana	39		Rhode Island	26
Nebraska	2		Georgia	27
Nevada	37		Washington	28
New Hampshire	6		Tennessee	29
New Jersey	25		Oregon	30
New Mexico	40		Pennsylvania	31
New York	21		Massachusetts	32
North Carolina	10		Oklahoma	33
North Dakota	12		Kentucky	34
Ohio	19		Missouri	35

STATE LIABILITY SYSTEMS RANKING

State	Ranking		States In Order of Ranking	Ranking
Oklahoma	33		Alaska	36
Oregon	30		Nevada	37
Pennsylvania	31		Florida	38
Rhode Island	26		Montana	39
South Carolina	42		New Mexico	40
South Dakota	7		Arkansas	41
Tennessee	29		South Carolina	42
Texas	43		Texas	43
Utah	17		California	44
Vermont	24		Illinois	45
Virginia	3		Hawaii	46
Washington	28		Alabama	47
West Virginia	50		Mississippi	48
Wisconsin	23		Louisiana	49
Wyoming	16		West Virginia	50

Note: The data in the above table is taken from the State Liability Systems Ranking Study, dated Mar. 17, 2006, conducted by Harris Interactive for the U.S. Chamber of Commerce. The study was based on interviews with over 1400 practicing corporate attorneys and general counsels from November 28, 2005–Mar. 7, 2006, available at www.instituteforlegalreform.org/harris/ (last visited Feb. 13, 2007).