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Saving State Income Taxes with a Delaware Trust

Consider establishing your trust in the First State

Recent federal legislation made significant changes to many areas of federal tax law and highlighted the importance of income tax planning. Personal trusts, where individuals establish trusts for their own benefit or the benefit of other individuals, are common estate and gift tax planning vehicles. However, some of the changes under the current federal law have increased the importance of these trusts as tools for mitigating a family's federal and state income tax liability.

Key takeaways

- Changes in federal tax laws have created a renewed focus on state income taxes and strategies available to help mitigate these taxes
- While personal trusts are common estate and gift tax planning tools, they may now have increased importance as vehicles for mitigating a family's federal and state income tax liability
- If you live in a high-tax state, there may be opportunities to reduce or eliminate state taxes on some of your income by establishing a new trust in Delaware or moving an existing trust to the First State

State income tax mitigation using personal trusts

Using Delaware as a trust planning jurisdiction may be similar to using states that don't have any state income tax. Although Delaware has a state fiduciary income tax on income accumulated in a "non-grantor" trust where the trust itself, and not the grantor, is taxed on income earned by the trust, there is a full exemption from this tax if the income is accumulated for beneficiaries who are not current Delaware residents.* Due to the state's low population and the fact that many trusts coming into Delaware have no other ties to the state, most trusts administered in Delaware are not subject to Delaware state income tax.

Holding family wealth inside a trust may limit the ability of your home state to tax the trust's income and provides flexibility in customizing the income tax cost basis step-up upon death. Your family's asset "location" (where your assets are held in trust) instead of asset "allocation" (how your assets are invested) is now a primary driver of wealth by seeking to reduce or eliminate the drag of income taxes. The following strategies may provide opportunities for your family to mitigate income taxes by making the First State the home state for your assets.

* 30 Del. C § 1636

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Virtually any trust may be administered in Delaware regardless of where it was created or administered previously.

As state income taxes become a more significant percentage of your overall tax burden, if you live in a high-tax state there may be opportunities to reduce or eliminate state taxes on some of your income. Regardless of your state of residence, you may create a new trust in Delaware, and many existing irrevocable trusts may be moved into Delaware for ongoing administration.

How do I establish or move a trust to Delaware?

Creating a new trust requires engaging an attorney who drafts the trust agreement to meet your specific planning goals. You select the beneficiaries of the trust, often your immediate family members, which could include a spouse, and determine when and how they may benefit from the assets held in trust. Finally, you select the assets to place in trust that you want to shield from your home state's income tax. Importantly, while real estate located in your home state and other assets that produce source income in your home state generally cannot escape your state's tax, you may be able to shield most other assets, including certain marketable securities, from state taxes.

A few of the tools and techniques that may shield certain assets from income taxation in your home state are:

Changing your trustee to potentially save state taxes
If you live in a high-tax state and created a trust, or you are the beneficiary of a trust, it may be as simple as changing from a trustee located in your home state to one in a low or zero-tax state to reduce the trust's state income tax burden. Each state has unique laws regarding how the state taxes (i) a trust established by its residents, (ii) a trust with resident beneficiaries, and/or (iii) a trust administered in the state. For convenience or cost savings, many trusts use an individual family member, trusted advisor, or local financial institution as the initial trustee to get the structure up and running. Consequently, you may not have considered the state tax burden that the trustee's location has on the trust's ongoing administration. In many cases, changing the location of the trustee to Delaware may be sufficient for the trust to eliminate or defer paying state taxes on income accumulated in the trust.

Appoint a successor trustee in a tax-friendly jurisdiction
During your lifetime, some trusts are best administered by you or other family members. Common examples are an irrevocable life insurance trust (ILIT) used to remove a life insurance policy's death benefit from the taxable estate, or a revocable lifetime trust used to avoid the probate process at death. These are generally "grantor" trusts where the trust's income is taxed to the person who created the trust, so the location of the trustee has no impact on the tax burden. However, these trusts generally become their own taxpayer (or a non-grantor trust) following the grantor's death. At this same time, the trust may receive significant value from the

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death benefit of a life insurance policy or significant, complex assets requiring ongoing administration following settlement of the estate. Appointing a successor corporate trustee in a tax-friendly state like Delaware can offer professional management of these assets at the same time state taxes may be eliminated or deferred on income accumulated in the trust.

Turn off grantor trust status

When making a gift into an irrevocable trust, it is common for the trust to be structured as a grantor trust so you continue to make tax-free gifts by paying the income tax burden on the trust for the benefit of your heirs. Although the gift into trust is complete for gift tax purposes so the assets are outside of your estate, the trust is structured so you are still the owner for income tax purposes. This allows the trust's assets to grow income tax-free since you, as the grantor, are picking up the tax bill. However, the grantor trust feature can generally be turned off so the trust becomes its own taxpayer. If the trust is administered in a tax-friendly state such as Delaware, it may be possible to turn off payment of state taxes on the trust's income by simply making the trust responsible for the taxes instead of you, as the grantor. When the federal estate tax exemption was lower, paying your trust's tax bill helped reduce the amount of your family's wealth ultimately subject to death taxes. However, with some of the pressure on estate minimization relieved under the current federal tax law (the exemption is $15 million per person in 2026*), turning off grantor trust status to mitigate state taxes may be appealing in many situations.

Delaware incomplete gift non-grantor (DING) trusts

A trust structure offered in Delaware is the DING trust, where you retain ownership of the trust's assets for gift tax purposes while the trust owns the assets for income tax purposes. The trust is its own taxpayer for income tax purposes, so this allows you to shift income out of your home state into a state where the trust may not pay a state income tax. A DING trust can help mitigate state income taxes without incurring a federal gift tax. The structure of a DING trust must be tailored to the specific trust tax nexus rules of your home state but can often result in substantial income tax savings for you and your heirs. This tax savings is not available for earned income, income from real estate, or some other types of income treated as "source" income in your home state. However, a DING trust is an effective tool to consider prior to the sale of a business or concentrated stock position that may incur a large capital gain. In addition, it can be a nice way to ease the tax burden on an invested portfolio that generates significant income.

Seeking to maximize the step-up of income tax cost basis upon death using the Delaware tax trap

With estate tax exemptions set at $15 million per person and indexed for inflation starting in 2026, many trust beneficiaries may die with unused estate tax exemption while significant low-basis trust assets are held for their benefit. If the trust grants you a limited power of appointment (common in most irrevocable trusts), you can exercise the power in a way to select which trust assets should be included in your estate for tax purposes (the "Delaware tax trap") while the same assets continue in trust for asset protection and estate tax purposes. The assets that are deemed to be included in your estate should receive a step-up in their income tax cost basis, which will generally reduce the future capital gain incurred when they are eventually sold. This basis step-up could help reduce both federal and, in most cases, state income taxes. Your ability to exercise a limited power of appointment in this manner is unique to trusts administered in Delaware and not available in other trust-friendly states such as Nevada, South Dakota, or Alaska. Moreover, virtually any trust may be administered in Delaware regardless of where it was created or administered previously. If you are the beneficiary of a trust holding low-basis assets and will not be able to use all your estate tax exemption, you may want to consider adding a Delaware trustee to make this basis step-up tool available to you.

Managing your trust and its assets

With the increased use of Delaware trusts to meet income tax planning goals, it is important to understand the additional estate planning benefits and flexible administrative tools that can be incorporated into your trust structure. Some of the trust features available to you under Delaware law are the ability to: (i) create a perpetual trust that serves as a family endowment through multiple generations, (ii) the potential to protect trust assets from most of your creditors and your beneficiaries' creditors, (iii) determine when or how beneficiaries receive information regarding their interests in the trust by making your trust a "quiet trust," and (iv) retain control over investment or distribution decisions through a directed trustee structure.

*Rev. Proc. 2025-32.

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The directed trustee feature is one of the most flexible tools available under Delaware law. Delaware law provides the ability for you to name trust advisors who may direct the trust's investments, distributions from the trust, or other discretionary actions of the trust so you and your family remain in control. Delaware has recognized a "directed trust" structure for over a century.

A "quiet trust" is the common description for a trust that puts restrictions on a trustee's duty and ability to inform trust beneficiaries regarding their interests in the trust. Every state, including Delaware, imposes a default duty upon trustees to inform beneficiaries of their interests in the trust. This may be problematic as beneficiaries of large trusts become adults, or during the planning phase when you don't believe the timing is right to disclose the trust's asset information to your descendants. Delaware law allows you to place limits on when or how the beneficiaries receive this information and allows for a "designated representative" who represents their interests while the trust remains quiet. The trust's resources remain available to your descendants even if they are not actively receiving information regarding the trust.

Delaware personal trusts have historically been powerful tools for gift and estate planning, asset protection planning, and for flexible administration. However, the changes in the federal tax laws have provided a renewed focus on state income taxes and strategies available to mitigate these taxes. Delaware trusts offer several solutions ranging from simply moving a trust into Delaware by changing trustees to more sophisticated options allowing family wealth to be "exported" to Delaware via a DING trust so state tax on accumulated income may be deferred or eliminated.

Wilmington Trust has advised affluent families for generations regarding the techniques available to help meet your estate, tax, and wealth transfer planning needs. Working with your comprehensive Wealth Management team can help you implement a tax-efficient plan.

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Note that estate planning strategies require individual consideration, and there is no assurance that any strategy will be successful. Note that a few states, including Delaware, have special trust advantages that may not be available under the laws of your state of residence, including asset protection trusts and directed trusts.

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