Delaware Trust Advantages for Business Owners

Control, protection, and privacy for your most important asset

By Jeffrey C. Wolken
National Director of Fiduciary Strategies
Wilmington Trust, N.A.

Key Points

• Business owners face special challenges in structuring estate plans because of their unique need for control, asset protection, and confidentiality

• Delaware trusts offer many of the advantages of other trust-friendly states, along with unique elements that make it a pre-eminent jurisdiction
The state of Delaware has long been one of the most favorable places to establish a business. But what many business owners don’t recognize is that Delaware is also an excellent place to create a personal trust for estate planning or asset protection purposes, even if neither the business nor the business owner resides in Delaware.

Business owners face special challenges in structuring estate plans because of their unique need for control, asset protection, and confidentiality regarding their main asset, the family business. Fortunately, Delaware provides some special advantages to business owners who establish personal trusts under its laws. While not all of these advantages are unique to the state of Delaware, utilizing them with a trust located in Delaware affords the business owner access to other benefits that this trust-friendly state has to offer.

Directed trusts let business owners maintain control of their greatest asset: the business

One of the biggest hurdles for business owners considering estate planning using personal trusts is the fear of giving up control over their most significant asset. After many years of successfully leading their company, they are understandably reluctant to let anyone else make decisions about how it is managed as an asset.

Under most traditional trust structures, the trustee becomes responsible for assets placed in trust. The trustee has to make regular decisions about how to manage these assets—which can be particularly challenging when the primary asset is a closely-held business. Because of its fiduciary duty to diversify the trust’s investments, a trustee may decide that a closely-held business is not an appropriate investment for the trust, because it is undiversified and illiquid, and may decide to sell all or part of the ownership interest or manage it in a manner that is contrary to the family's goals. This, obviously, is not what most business owners want. However, these issues can be addressed by establishing a trust with a directed trustee feature. With this feature, the business owner may designate one or more advisors to make investment decisions for the trust that holds the business as its main asset, while having a Delaware administrative trustee perform the remaining duties of a trustee.

Delaware has recognized a “directed trust” structure for over a century. Delaware’s directed trust law provides:
• Freedom to engage in estate planning or asset protection planning using illiquid assets, such as stock in the family business, real estate, or hedge fund/private equity investments, when a trustee may otherwise be reluctant to hold these types of assets

• Flexibility for a trusted advisor or family member to retain control over a trustee’s investment or distribution decisions so that they can do what is best for the family/beneficiaries

Essentially, the directed trust splits fiduciary responsibilities, allowing the person who establishes the trust, often referred to as the settlor or grantor, to name his or her own investment advisor to manage the assets, while the trustee is responsible for other aspects of administering the trust. In many cases, the business owner-settlor may serve as his or her own investment advisor. The trustee can’t be held liable for the investment advisor’s actions unless the trustee engages in willful misconduct related to the investment process. This structure is particularly beneficial for business owners who do not wish to divest the business interests held in the trust.

The directed trust feature provides significant flexibility since it can be added to virtually any type of trust structure in Delaware. Whether the goal is asset protection or a perpetual trust to save estate taxes, these trusts can be set up with an investment advisor directing the holdings and investment process.

**Asset protection trusts offer security**

Another beneficial planning option is the trust structure commonly referred to as an “asset protection trust,” which allows business owners to take some of their winnings off the table and protect them from creditors. In 1997, Delaware was among the first states to allow this type of trust, which enables the person who creates the trust to remain as a beneficiary and to have the trust assets protected from the claims of his or her creditors.

Under the terms of an asset protection trust, which is irrevocable, the business owner would place the assets he wants to protect into a trust in the state of Delaware. Within the limits provided by Delaware law, he or his beneficiaries can receive payments of income or principal from the trust. Properly structured and administered, creditors will generally not be able to gain access to these assets.

Another benefit of the asset protection trust is to provide the business owner with a “rainy day” fund. For instance, say that an entrepreneur has successfully taken one company public and plans to use some of the new liquidity to fund another venture. While willing to risk some of the gains, he or she may want to hold some back in case of an unexpected business reversal, an emergency, or for unplanned expenses.

**Quiet trust provisions keep business interests confidential**

Another aspect of Delaware trust law that can be beneficial to business owners who want to transfer assets to children or grandchildren without disclosing the gift immediately is the so-called “quiet trust” law. Consider a family business owner with grandchildren in their early teens. The business owner worries that if the grandchildren know that they are to inherit several million dollars in business assets, they may not work as hard in school.

In most states, including Delaware, trustees have an obligation to keep beneficiaries informed of their interests in the trust. If there’s an event that affects the beneficiaries’ interests, the trustees have to tell them about it. In fact, many states require regular reporting to beneficiaries including quarterly updates on how much the assets are worth and what is being done to manage them. The trustees also have to inform beneficiaries about when they will receive control of the assets, perhaps at age 21 or on graduation from college or some other life event.

The flexibility in Delaware is that Delaware trusts can contain “quiet” provisions that tailor notice or disclosure provisions to the settlor’s requirements. The settlor can...
instruct the trustee to keep the trust confidential until a certain age is attained or a certain milestone occurs. Consequently, the business owner, as settlor, can transfer assets to a trust for asset protection or estate planning purposes with the comfort that beneficiaries only receive notice or information upon terms set by the business owner. Even if the business owner is a resident of another state or the business is in another state, these Delaware advantages should be available to him or her.

**Delaware is the pre-eminent state for trusts**

For the complex estate planning needs of entrepreneurs and multigenerational business owners, Delaware is a trust-friendly state. Directed trusts, asset protection trusts, and quiet trusts are just a few of the ways that Delaware trusts can be used to achieve a business owner’s unique goals. In addition, Delaware has more than 100 years of established trust law, provisions for perpetual trusts, favorable tax laws, and flexible distribution rules. Of course, every situation is different. To find out how a Delaware trust could work to meet specific goals, talk to a Wilmington Trust Company advisor.

Jeff is responsible for developing trust planning strategies for wealthy individuals and families throughout the United States and abroad. He works closely with his clients’ legal, tax, and investment advisors to construct and implement appropriate trust structures that take advantage of the state of Delaware’s unique trust and tax laws. He earned his JD (summa cum laude) and MBA (with honors) from Syracuse University and holds a bachelor’s degree in economics from Northwestern University. He is a frequent lecturer on topics involving the use of Delaware trusts for asset protection, state income tax minimization, and investment management for unique trust assets.

Jeffrey C. Wolken  
National Director of Fiduciary Strategies  
Wilmington Trust, N.A.

302. 651.8192  
jwolken@wilmingtontrust.com