

June 22, 2006

States Court Family-Trust Business

Legislatures Race to Add Incentives to Capitalize On Growing Interest in Protecting Assets for Heirs

 By **RACHEL EMMA SILVERMAN**
June 22, 2006; Page D1

States are competing for a piece of the booming personal-trust business, and that's encouraging wealthy individuals interested in passing assets to their heirs to shop around for the most favorable state trust laws.

A growing number of states have been revising their trust codes in recent years to add features, some of which were previously available only in exotic offshore locales. In some states, trusts are exempt from state income taxes, allowing the assets to grow state-tax free for years. Elsewhere, trust laws are designed to protect your assets from creditors and lawsuits.

Alaska recently revised its trust code to make it more difficult for divorcing spouses to grab trust assets. In Delaware and South Dakota, committees of lawyers and bankers regularly advise the state legislatures on ways to update trust laws. The latest entrant in the trust wars is New Hampshire, whose governor signed into law this week a bill that seeks to surpass most other states in innovative trust features. Among the changes: New Hampshire is now one of the few states that allow so-called perpetual purpose trusts, which individuals create for a specific purpose, such as maintaining a home, business or art collection in the family, rather than to benefit an actual person.


"There has kind of been a leapfrog effect among the top jurisdictions," says Pierce McDowell, co-chief executive of South Dakota Trust Co., a private firm that administers \$2 billion in trust assets, the bulk of which is from other states. South Dakota is so intent on building its trust business that state government officials have greeted out-of-state trust clients at the airport, he says.

Although states vying for trust business often forgo taxing these assets, they are betting the increased economic activity will bring other benefits, such as job creation and corporate tax revenue collected from trust companies. State politicians are hoping to get a piece of the trillions of dollars that Baby Boomers and their parents are expected to pass to successive generations over the next few decades.

A trust is essentially an agreement to transfer your assets to the care of someone else -- a trustee -- who then minds the property for your beneficiaries. You don't have to have millions of dollars to set up a trust, though attorney fees can run into thousands of dollars and administration fees can take an annual bite of the assets. Setting up a trust in another state in some cases also can mean additional expenses.

Trusts can be created for a variety of purposes, including avoiding probate proceedings, passing on a family home to heirs, protecting money from creditors, caring for a disabled child or even providing for a pet after you die. Another common reason to set up a trust is to minimize estate taxes, though deliberations under way in Congress aimed at raising the estate-tax exemption could offset this advantage. Currently, the federal estate-tax exemption is \$2 million per person or \$4 million per married couple.

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CROSSING BORDERS

More people are setting up personal trusts in states other than their own to take advantage of varied trust laws.

- Some states don't tax assets held in a trust, although distributions might be taxable in your home state.
- Trust codes in some places seek to protect your assets from lawsuits and creditors.
- Setting up a trust in a distant location might mean added fees to hire a trustee.

Trusts have been growing in popularity, thanks to an aging population, more aggressive trust marketing by financial firms and a swelling number of wealthy individuals. In 2005, there was about \$843.3 billion in personal-trust assets held by banks, almost double the \$471.1 billion of assets a decade ago, according to an analysis of data from SNL Financial by the VIP Forum, a wealth-management research firm. Assets also are held in trust by individuals, but these data aren't publicly available.

"Jurisdiction-shopping" to find attractive trust laws has grown more common, and some individuals are even moving existing trusts to different states, says Richard Nenzo, trust counsel at Wilmington Trust in Delaware. To set up a trust outside your home state, you generally need to use a trustee located in that state, typically a trust company or a lawyer. A trustee can also be a family member, although the responsibilities of the job, including investing the assets and disbursing them, can be onerous.

In general, trust experts say that Delaware, South Dakota, Alaska and Nevada have the most attractive trust laws, while Florida and Wyoming are also good places to park a trust. New Hampshire, as the latest entrant to the trust race, is also a strong contender. One unusual feature in that state: Trustees have substantial protection from being sued by beneficiaries for not diversifying trust assets, says John P.C. Duncan, a Chicago lawyer who helped draft the New Hampshire law.

But going out of state for a trust may not always make financial sense, especially for smaller trust accounts. Since the most favorable jurisdictions might be in states where you don't know an individual trustee, you might need to hire an institutional trustee, which can cost about 1% or less of trust assets per year, depending on the size of the trust. Moving an existing trust may also involve hefty lawyers' fees of at least several thousand dollars and may require court approval, depending on how the trust was originally drafted and state law. And though improvements in technology have made people more comfortable with banking remotely, it can still be a hassle to deal with a distant trustee.

With trust laws literally all over the map, here are some factors to consider when seeking a home for your trust funds:

Avoid state income taxes. Trust experts say one of the first factors to look for when examining where to set up a trust is whether the assets are subject to state taxes. The idea is to let trust investments grow for as long as possible free of state taxes, which can save significant sums of money, especially in high-tax states such as New York and California. (Beneficiaries, however, may be taxed on distributions, depending on whether their home state has an income tax.) Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming, for instance, are attractive because they don't impose any taxes on trust assets.

Each state has its own tax rules, and "there are all sorts of opportunities for arbitrage among them," says Joshua S. Rubenstein, national chairman of the trusts-and-estates group at law firm Katten Muchin Rosenman LLP in New York. For instance, New York won't tax a trust when the trust creator is not a resident. Delaware and New Hampshire don't impose a tax on trust assets if the beneficiaries live out of state. And California might try to tax an out-of-state trust if one of the beneficiaries lives in California. The situation can get even more complicated if you use co-trustees located in different states, or if there is real estate in the trust.

Trust Shopping

State trust laws vary widely, and consumers should compare jurisdictions for features that best suit their needs. Here are some important trust features and some locations where they can be found.

FEATURE	WHAT IT DOES	WHERE YOU FIND IT
Protect your assets	Some states allow "asset protection trusts" that seek to shield your own trust assets from lawsuits, creditors and divorce settlements.	Alaska, Colorado, Delaware, Missouri, Nevada, Oklahoma, Rhode Island, South Dakota, Utah
Trusts for the long haul	Some states allow individuals to create "dynasty trusts" that can shield assets in trust for hundreds of years or forever to benefit future generations.	Alaska, Arizona, Colorado, Delaware, District of Columbia, Florida, Idaho, Illinois, Maine, Maryland, Missouri, Nebraska, Nevada, New Hampshire, New Jersey, Ohio, Rhode Island,

Consider a "dynasty trust." Another factor to look for in comparing state laws is how long a trust can last. In recent years, a number of states have undone a centuries-old law called the "rule against perpetuities" that placed time limits on trusts, often about 90 to 120 years. Now, more states are allowing "dynasty" trusts that can last for hundreds of years or even forever. One

attraction is that, if structured properly, money inside the trust can pass through many generations without incurring estate taxes, allowing the trusts to build large gains over time. More than 20 states and jurisdictions, including Delaware, New Jersey, Wisconsin, New Hampshire, Illinois and Virginia, now allow such long-lasting trusts.

Protect your assets. Doctors, business executives and other professionals have been increasingly interested in asset-protection trusts, advisers say. With these, you transfer your money into a trust run by an independent trustee, who can give you distributions from time to time. These trusts, if set up properly, are supposed to be out of reach of creditors in legal judgments.

In the past, individuals concerned with liability flocked to create trusts in offshore locales, such as the Cook Islands and Nevis. Now, Alaska, Delaware, Rhode Island, Nevada, and South Dakota are among the states that permit these trusts. However, asset-protection trusts set up in the U.S. haven't been adequately tested in court, and it's unclear how well they will hold up, experts say.

Seek flexibility. Trusts are typically drafted to have two sets of beneficiaries -- current and future. Current recipients, often a surviving spouse, receive income distributions. Future beneficiaries, often children or grandchildren, eventually receive the trust principal, the actual assets placed in trust. In the past, that has led to fights between beneficiaries over how the trust funds should be invested. A surviving wife, for example, might want the trust assets to be invested primarily in safe, income-producing bonds or dividend-paying stocks to maximize her income, while the children might prefer a more aggressive portfolio to boost principal, says Pittsburgh trust lawyer Robert Wolf.

To prevent those conflicts, more than 40 states and jurisdictions have a "power to adjust," which gives trustees flexibility to make distributions, even if that means tapping a trust's principal. And more than 20 states, including Delaware, Alaska, California, Florida, Illinois and Pennsylvania, have statutes allowing trusts to pay beneficiaries a fixed percentage of trust assets -- often between 3% and 5%. Laws allowing for such distribution options can help prevent battles among beneficiaries down the road.

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