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DELAWARE STATE SENATE  
147th GENERAL ASSEMBLY

SENATE BILL NO. 155

AN ACT TO AMEND TITLE 12 OF THE DELAWARE CODE RELATING TO FIDUCIARY RELATIONS

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF DELAWARE:

Section 1. Amend Chapter 35, Title 12 of the Delaware Code by making the insertions as shown by underlining and deletions as shown by strike through as follows:

§ 3570. Definitions.

As used in this subchapter:

(1) "Claim" means a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured.

(2) "Creditor" means, with respect to a transferor, a person who has a claim.

(3) "Debt" means liability on a claim.

(4) "Disposition" means a transfer, conveyance or assignment of property (including a change in the legal ownership of property occurring upon the substitution of 1 trustee for another or the addition of 1 or more new trustees), or the exercise of a power so as to cause a transfer of property, to a trustee or trustees, but shall not include the release or relinquishment of an interest in property that theretofore was the subject of a qualified disposition.

(5) "Person" has the meaning ascribed to it in § 302(15) of Title 1.

(6) "Property" includes real property, personal property, and interests in real or personal property.

(7) "Qualified disposition" means a disposition by or from a transferor (or multiple transferors in the case of property in which each such transferor owns an undivided interest) to 1 or more trustees, at least 1 of which is a qualified trustee, with or without consideration, by means of a trust instrument.

(8) "Qualified trustee" means a person who meets the requirements of the following paragraphs (8) a. and (8) b. of this section:

a. In the case of a natural person, is a resident of this State other than the transferor or, in all other cases, is authorized by the law of this State to act as a trustee and whose activities are subject to supervision by the Bank

Commissioner of the State, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, or the Office of Thrift Supervision or any successor thereto; and

b. Maintains or arranges for custody in this State of some or all of the property that is the subject of the qualified disposition, maintains records for the trust on an exclusive or nonexclusive basis, prepares or arranges for the preparation of fiduciary income tax returns for the trust, or otherwise materially participates in the administration of the trust.

c. For purposes of this subchapter, neither the transferor nor any other natural person who is a nonresident of this State nor an entity that is not authorized by the law of this State to act as a trustee or whose activities are not subject to supervision as provided in paragraph (8) a. of this section shall be considered a qualified trustee; however, nothing in this subchapter shall preclude a transferor from appointing one or more advisers, including but not limited to:

1. Advisers who have authority under the terms of the trust instrument to remove and appoint qualified trustees or trust advisers;

2. Advisers who have authority under the terms of the trust instrument to direct, consent to or disapprove distributions from the trust; and

3. Advisers described in § 3313 of this title, whether or not such advisers would meet the requirements imposed by paragraphs a. and b. of this subsection.

For purposes of this subsection, the term "adviser" includes a trust "protector" or any other person who, in addition to a qualified trustee, holds 1 or more trust powers.

d. A person may serve as an investment adviser described in § 3313 of this title, notwithstanding that such person is the transferor of the qualified disposition, but such a person may not serve as trustee or otherwise serve as adviser of a trust that is a qualified disposition although such person may retain any of the powers and rights described in paragraph (11)b. of this section.

e. In the event that a qualified trustee of a trust ceases to meet the requirements of paragraph (8)a. of this section, and there remains no trustee that meets such requirements, such qualified trustee shall be deemed to have resigned as of the time of such cessation, and thereupon the successor qualified trustee provided for in the trust instrument shall become a qualified trustee of the trust, or in the absence of any successor qualified trustee provided for in the trust instrument, the Court of Chancery shall, upon application of any interested party, appoint a successor qualified trustee.

f. In the case of a disposition to more than 1 trustee, a disposition that is otherwise a qualified disposition shall not be treated as other than a qualified disposition solely because not all of the trustees are qualified trustees.

(9) "Spouse" and "former spouse" means only persons to whom the transferor was married at, or before, the time the qualified disposition is made.

(10) "Transferor" means a person who, as an owner of property, as a holder of a power of appointment which authorizes the holder to appoint in favor of the holder, the holder's creditors, the holder's estate or the creditors of the holder's estate, or as a trustee, directly or indirectly makes a disposition or causes a disposition to be made.

(11) "Trust instrument" means an instrument appointing a qualified trustee or qualified trustees for the property that is the subject of a disposition, which instrument:

a. Expressly incorporates the law of this State to govern the validity, construction and administration of the trust;

b. Is irrevocable, but a trust instrument shall not be deemed revocable on account of its inclusion of 1 or more of the following:

1. A transferor's power to veto a distribution from the trust;

2. Except as otherwise provided in paragraph ~~(11)b.10.~~ (11)b.9. or 10. of this section, a lifetime or testamentary power of appointment (other than a lifetime or testamentary power to appoint to the transferor, the transferor's creditors, the transferor's estate or the creditors of the transferor's estate) exercisable by will or other written instrument of the transferor ~~effective only upon the transferor's death;~~

3. The transferor's potential or actual receipt of income, including rights to such income retained in the trust instrument;

4. The transferor's potential or actual receipt of income or principal from a charitable remainder unitrust or charitable remainder annuity trust as such terms are defined in § 664 of the Internal Revenue Code of 1986 [26 U.S.C. § 664] and any successor provision thereto; and the transferor's right, at any time and from time to time by written instrument delivered to the trustee, to release such transferor's retained interest in such a trust, in whole or in part, in favor of a charitable organization that has or charitable organizations that have a succeeding beneficial interest in such trust;

5. The transferor's potential or actual receipt of income or principal from a grantor-retained annuity trust or grantor-retained unitrust as such terms are defined in § 2702 of the Internal Revenue Code of 1986 (26 U.S.C. § 2702) and any successor provision thereto or the transferor's receipt each year of a percentage (not to exceed 5 percent) specified in the governing instrument of the initial value of the trust assets (which may be described either as a percentage or a fixed amount) or their value determined from time to time pursuant to the governing instrument.

6. The transferor's potential or actual receipt or use of principal (including real property or tangible personal property) if such potential or actual receipt or use of principal would be the result of a trustee's acting:

A. In such trustee's discretion;

B. Pursuant to a standard that governs the distribution of principal and does not confer upon the transferor a substantially unfettered right to the receipt or use of the principal; or

82  
83 C. At the direction of an adviser described in paragraph (8)c. of this section who is acting: I. In such adviser's  
84 discretion; or II. Pursuant to a standard that governs the distribution of principal and does not confer upon the transferor a  
85 substantially unfettered right to the receipt of or use of principal;

86 For purposes of this paragraph, a trustee is presumed to have discretion with respect to the distribution of principal  
87 unless such discretion is expressly denied to such trustee by the terms of the trust instrument.

88 7. The transferor's right to remove a trustee or adviser and to appoint a new or additional trustee or adviser;

89 8. The transferor's ~~potential or actual use of real property held under possession and enjoyment of an interest in a~~  
90 ~~qualified personal residence trust within the meaning of such term as described in §2702(c) of the Internal Revenue Code of~~  
91 ~~1986 [26 U.S.C. §2702(c)] Treasury Regulation § 25.2702-5(c) [26 C.F.R. 25.2702-5(c)]~~ and any successor provision  
92 thereto or the transferor's possession and enjoyment of a qualified annuity interest within the meaning of such term as  
93 described in Treasury Regulation § 25.2702-5(c)(8) [26 C.F.R. 25.2702- 5(c)(8)] and any successor provision thereto;

94 9. The transferor's potential or actual receipt of income or principal to pay, in whole or in part, income taxes due  
95 on income of the trust if such potential or actual receipt of income or principal is pursuant to a provision in the trust  
96 instrument that expressly provides for the payment of such taxes and if such potential or actual receipt of income or  
97 principal would be the result of a qualified trustee's or qualified trustees' acting:

98 A. In such qualified trustee's or qualified trustees' discretion or pursuant to a mandatory direction in the trust  
99 instrument; or

100 B. ~~At~~ Pursuant to the transferor's exercise of a lifetime power of appointment or at the direction of an adviser  
101 described in paragraph (8)c. of this section who is acting in such adviser's discretion; and

102 10. The ability, whether pursuant to discretion, direction or the grantor's exercise of a testamentary power of  
103 appointment, of a qualified trustee to pay, after the death of the transferor, all or any part of the debts of the transferor  
104 outstanding at the time of the transferor's death, the expenses of administering the transferor's estate, or any estate or  
105 inheritance tax imposed on or with respect to the transferor's estate; and

106 c. Provides that the interest of the transferor or other beneficiary in the trust property or the income therefrom may  
107 not be transferred, assigned, pledged or mortgaged, whether voluntarily or involuntarily, before the trustee or trustees  
108 actually distribute the property or income therefrom to the beneficiary, and such provision of the trust instrument shall be  
109 deemed to be a restriction on the transfer of the transferor's beneficial interest in the trust that is enforceable under  
110 applicable nonbankruptcy law within the meaning of § 541(c)(2) of the Bankruptcy Code (11 U.S.C. § 541(c)(2)) or any  
111 successor provision thereto.

d. [Repealed.]

A disposition by a trustee that is not a qualified trustee to a trustee that is a qualified trustee shall not be treated as other than a qualified disposition solely because the trust instrument fails to meet the requirements of paragraph (11)a. of this section. Distributions to pay income taxes made under a discretionary or mandatory provision included in a governing instrument pursuant to paragraph (11)b.3., paragraph (11)b.6., or paragraph (11)b.9. of this section may be made by direct payment to the taxing authorities.

§ 3573. Limitations on qualified dispositions.

With respect to the limitations imposed by § 3572 of this title, those limitations on actions by creditors to avoid a qualified disposition shall not apply:

(1) To any person to whom the transferor is indebted on account of an agreement or order of court for the payment of support or alimony in favor of such transferor's spouse, former spouse or children, or for a division or distribution of property incident to a judicial proceeding with respect to a separation or divorce proceeding in favor of such transferor's spouse or former spouse, but only to the extent of such debt; or

(2) To any person who suffers death, personal injury or property damage on or before the date of a qualified disposition by a transferor, which death, personal injury or property damage is at any time determined to have been caused in whole or in part by the tortious act or omission of either such transferor or by another person for whom such transferor is or was vicariously liable but only to the extent of such claim against such transferor or other person for whom such transferor is or was vicariously liable.

Paragraph (1) of this section shall not apply to any claim for forced heirship, legitime or elective share.

§ 3574. Effect of avoidance of qualified dispositions.

(a) After making any payments from the trust required under subsection (b) of this section, a qualified disposition shall be avoided only to the extent necessary to satisfy the transferor's debt to the creditor at whose instance the disposition had been avoided, together with such costs, including attorneys' fees, as the court may allow.

(b) In the event any qualified disposition shall be avoided as provided in subsection (a) of this section, then:

(1) If the court is satisfied that a trustee has not acted in bad faith in accepting or administering the property that is the subject of the qualified disposition:

140           a.       Such trustee shall have a first and paramount lien against the property that is the subject of the qualified  
141 disposition in an amount equal to the entire cost, including attorneys' fees, properly incurred by such trustee in the defense  
142 of the action or proceedings to avoid the qualified disposition;

143           b.       The qualified disposition shall be avoided subject to the proper fees, costs, preexisting rights, claims and  
144 interests of such trustee (and of any predecessor trustee that has not acted in bad faith); and

145           c.       For purposes of this paragraph (1) of this subsection, it shall be presumed that such trustee did not act in  
146 bad faith merely by accepting such property; and

147           (2) If the court is satisfied that a beneficiary of a trust has not acted in bad faith, the avoidance of the qualified  
148 disposition shall be subject to the right of such beneficiary to retain any distribution made prior to the creditor's  
149 commencement of an action to avoid the qualified disposition. For purposes of this subdivision, it shall be presumed that  
150 the beneficiary, including a beneficiary who is also a transferor of the trust, did not act in bad faith merely by creating the  
151 trust or by accepting a distribution made in accordance with the terms of the trust.

152           (c)      A creditor shall have the burden of proving that a trustee or beneficiary acted in bad faith as required  
153 under subsection (b) of this section by clear and convincing evidence except that, in the case of a beneficiary who is also  
154 the transferor, the burden on the creditor shall be to prove that the transferor-beneficiary acted in bad faith by a  
155 preponderance of the evidence. The preceding sentence provides substantive not procedural rights under Delaware law.

156           (d)      For purposes of this subchapter, attachment, garnishment, sequestration, or other legal or equitable  
157 process shall be permitted only in those circumstances permitted by the express terms of this subchapter.

158           (e)      Notwithstanding any other provision of this subchapter, a creditor shall have no right against the interest  
159 of a beneficiary in a trust solely because such beneficiary has the right to authorize or direct the trustee to pay all or part of  
160 the trust property in satisfaction of estate or inheritance taxes imposed upon or with respect to the beneficiary's estate, or the  
161 debts of the beneficiary's estate, or the expenses of administering the beneficiary's estate unless such beneficiary actually  
162 directs the payment of such taxes, debts or expenses and then only to the extent of such direction.

163           (f)      Where ~~a husband and a wife~~ spouses make a qualified disposition of property to 1 or more trusts and,  
164 immediately before such qualified disposition, such property or any part thereof or any accumulation thereto was, pursuant  
165 to applicable law, owned by them as tenants by the entireties, ~~then notwithstanding such qualified disposition and except~~  
166 ~~where the provisions of the trust instrument may expressly provide to the contrary, that property and any accumulation~~  
167 ~~thereto shall, while held in trust during the lifetime of both spouses, be treated as though it were tenancy by the entireties~~  
168 ~~property to the extent that, in any action concerning whether a creditor of either or both spouses may recover the debt from~~  
169 the trust, upon avoidance of the qualified disposition, the sole remedy available to the creditor with respect to such trust

property ~~that is treated as though it were tenancy by the entireties~~ property shall be an order directing the trustee to transfer the property to both spouses as tenants by the entireties.

(g) Subject to all of the foregoing provisions of this section, and except as otherwise expressly provided in subsection (f) of this section, upon avoidance of a qualified disposition to the extent permitted under subsection (a) of this section, the sole remedy available to the creditor shall be an order directing the trustee to transfer to the transferor such amount as is necessary to satisfy the transferor's debt to the creditor at whose instance the disposition has been avoided.

§ 3592. Failure of trust to dispose of all assets.

In the event that the terms of an inter vivos trust do not effectively dispose of a portion of or all of the principal and income of such inter vivos trust:

(1) If such failure occurs simultaneously with the death of the trustor, the trust principal not effectively disposed of shall be treated as though it were an additional part of the trustor's estate, and shall be disposed of in accordance with the provisions of the trustor's will, or if the trustor has no valid will, then the provisions of § 501 et seq. of this title shall govern the disposition of such principal; provided, however, that if any disposition to the trust would be treated as a qualified disposition, within the meaning of § 3570(7) of this title, if paragraph (2) of this section, rather than this paragraph (1), were applicable to the trust, then the principal of the trust shall be disposed of in accordance with paragraph (2) of this section.

(2) If such failure occurs at any time other than simultaneously with the death of the trustor, the trust income and principal not effectively disposed of shall be distributed as though the trustor had died on the date on which such failure occurred, a resident of the state of Delaware, owning the property so distributable, as though the provisions of § 501 et seq. of this title applied, but provided that if the provisions of § 502(2) or (3) of this title would apply for purposes of determining the share of a surviving spouse, the share of such surviving spouse shall be half of the personal property of the trust plus a life estate in the real estate of the trust.

Section 2. The provisions of this Act shall become effective upon enactment and shall apply to trusts whenever created.

## SYNOPSIS

Section 1 of the Act is intended to (i) clarify that a transfer to a trust will not constitute a qualified disposition within the meaning of the Qualified Dispositions in Trust Act if the transferor serves as a trustee of the trust; (ii) revise current law to provide that a transfer to a trust may constitute a qualified disposition within the meaning of the Qualified Dispositions in Trust Act even if the transferor retains a lifetime limited power of appointment (the purpose of this revision of current law is to permit the creation under Delaware law of trusts designed in the manner sanctioned by the Internal Revenue Service in a recent letter ruling holding that contributions to the trust were incomplete gifts and the trust was not a grantor trust); (iii) revise current law to provide that a transfer to a trust may constitute a qualified disposition within the meaning of the Qualified Dispositions in Trust Act even if the transferor retains a lifetime general power of appointment provided that the power may only be exercised to reimburse the transferor for income taxes borne by the transferor attributable to income earned by the trust; (iv) reorganize Section 3570 to clarify that the paragraphs following (8) b. are not part of the definition of a "qualified trustee" but rather expound upon the definition; (v) clarify that a transferor's right to remove and replace trustees and advisers subsumes within it the right to appoint additional trustees and advisers; (vi) correct cross-references and more closely align the statute with the pertinent Treasury Regulations so as to clarify that a transfer of property to a "qualified personal residence trust," as defined by the federal tax laws, may be a "qualified disposition" for purposes of Delaware's asset protection trust legislation; (vii) clarify that the reference to separation and divorce proceedings in Section 3573(1) is intended to refer to judicial proceedings; (viii) revise Subsection (f) of Section 3574 for clarity but not make a substantive change to the statute; and (ix) revise Section 3592 to prevent the possibility that the application of Section 3592 might cause a transfer, intended to constitute a qualified disposition within the meaning of the Qualified Dispositions in Trust Act, to fail to satisfy the statutory requirements for treatment as a qualified disposition.

Section 2 of the Act provides for the effective date of the Act.

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