Delaware Incomplete Gift Non-Grantor Trusts

Executive Summary

- DINGs are irrevocable trusts designed to save state income taxes for persons who live in a high tax state
- DINGs do not achieve estate tax savings
- DINGs can be an effective tool to protect assets from creditors

What is a DING?

A Delaware Incomplete Gift Non-grantor Trust (DING) is an irrevocable trust created by a non-Delaware resident naming a Delaware trustee and administered under Delaware law. The trust is a separate entity for tax purposes but is "incomplete" for estate and gift tax purposes, meaning that the trust pays its own income taxes but is still considered property belonging to the settlor for estate and gift tax purposes. Individuals create DINGs when they are able to identify a pool of assets, often a portfolio of low-basis securities or a closely-held business, likely to attract significant state capital gains or income tax in the settlor's home state of residence. DINGs do not avoid state income tax resulting from business operations in the states where the company operates.

To create a DING, the settlor must be willing to relinquish control of the assets as described below. The settlor and the spouse can be permissible beneficiaries while distributions from the trust and investment decisions are most often determined by a "distribution committee" and "investment committee" respectively, as named in the instrument.

Reduction of state income tax

Each state has a different statute defining the circumstances by which a trust is taxed. Some look to the residence of the settlor, others look to the location of the assets, where the trust is administered, where the beneficiaries and trustees reside or some combination of all factors.

The DING is a separate tax-paying entity located in the State of Delaware. The trustee must reside in Delaware and all administration of the trust will occur in Delaware. Delaware does not impose income tax on a trust assuming no current or future beneficiaries reside in Delaware. Delaware's statute provides that irrevocable trusts that accumulate income and gains for later distribution to a non-Delaware resident beneficiary are exempt from state income tax. DINGs have been successful for residents of many different states, including New Jersey and California. Unfortunately, if a settlor resides in a state that treats all trusts created by state residents as "resident trusts," a DING will not avoid taxation in the settlor's state of residence. Residents of New York cannot use DINGs effectively because New York enacted special legislation bringing this type of trust back into the orbit of New York taxation. It is important to consult an attorney in the settlor's state of residence to understand the implications of state laws for each settlor, beneficiary and fiduciary.

Settlors must take care to fund a DING well in advance of an anticipated asset sale to avoid challenge by taxing authorities asserting the trust was created solely for tax avoidance. Further, assets likely to be sold shortly after the funding of a trust are, by their nature, suspect, as are distributions back to the settlor shortly after a sale. The settlor should retain assets outside the DING to support lifestyle needs and avoid questioning of the transaction.

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Control issues

If a trust is reachable by the settlor's creditors, or if the settlor holds certain powers over trust property, the trust is deemed a grantor trust under Federal law. The settlor must avoid having the DING taxed as a grantor trust for income tax purposes. Grantor trust status would negate any tax advantage and leave the settlor responsible for payment of all income tax on the federal and state personal tax return.

On the other hand, a DING is intended to be an incomplete gift. The assets in the DING Trust will receive a step up in cost basis upon the settlor's death and be subject to estate tax in the settlor's estate. To render a gift to the DING incomplete, the settlor will retain just enough control over trust assets to trigger an incomplete gift but avoid grantor trust status. The settlor's retained control is often in the form of a limited lifetime or testamentary power of appointment or a limited consent or veto power over trust distributions. In addition, the settlor may serve as part of a distribution committee, comprised of the Trustee, a Trust Protector and other trust beneficiaries with interests opposed to the settlor's. These discretionary distributions may also escape the imposition of state income tax in the settlor's or beneficiary's state of residence if structured as a distribution of principal made in a year subsequent to the year in which the income was received.

Creditor protection

Delaware's self-settled spendthrift trust statute provides significant protection against creditor claims. The state's history of robust creditor protection legislation interpreted by trust-friendly courts may provide effective creditor protection for the settlor.

Implementation

The decision to implement a wealth plan incorporating a DING is complicated. It requires the services of an estate planning attorney and a fulsome understanding of the benefits and possible risks associated, including tax and control issues. Most importantly, it should fit squarely within the Goal-Based framework Glenmede devises for each client.

Our services

The Glenmede Trust Company of Delaware is a Delaware limited purpose trust company offering trust services for DINGs and other irrevocable trusts which can benefit from Delaware's long history of forward-thinking trust law and state taxation. If you're interested to explore how Glenmede Trust Company of Delaware can assist you, please do not hesitate to discuss a DING or other trust structure with your Relationship Manager.