South Dakota's Situs Advantages Over New York

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The whitepaper examines the differences between South Dakota and New York in terms of trust law and financial planning. South Dakota's proactive approach to trust law evolution, annual updates, and innovative trust structures demonstrate a commitment to meeting the diverse needs of trust settlors. In contrast, New York's lack of responsiveness and flexibility in trust statutes hinder its ability to keep pace with evolving legal and financial landscapes, resulting in outdated regulations and missed opportunities for improvement.

Overall, South Dakota's flexibility, innovation, and commitment to trust law evolution set it apart as a premier trust jurisdiction, offering unparalleled opportunities for families and individuals seeking to optimize their trust structures for long-term wealth preservation and financial security. In contrast, New York's shortcomings in trust law and tax planning underscore the need for comprehensive reforms to enhance its competitiveness and attractiveness as a trust situs jurisdiction.

FLEXIBILITY

South Dakota demonstrates its commitment to trust law evolution through annual updates facilitated by the Governor's Task Force on Trust Administration Review and Reform. Unique to South Dakota, this group of lawmakers and industry leaders annually survey the global trust landscape and respond to new industry techniques and trends. In contrast, New York's trust statutes lack such a mechanism for responsiveness, hindering the state from keeping pace with evolving legal and financial landscapes, leading to outdated regulations and missed opportunities for improvement .

South Dakota's introduction of innovative trust structures, such as Community Property Trusts and Purpose Trusts, reflects its proactive approach to meeting the diverse needs of trust settlors. Conversely, New York lags in providing similar flexible options, limiting individuals' ability to tailor trusts to their specific objectives and preferences .

Another demonstration of adaptability is the implementation of the Family Advisor concept in South Dakota which underscores the state's recognition of the importance of involving trusted family members in trust administration. New York's trust laws lack comparable provisions, restricting the involvement of family advisors and complicating trust management for families.

STATE INCOME AND CAPITAL GAINS RATES

South Dakota offers a compelling tax-planning opportunity for trustees and beneficiaries, where trust assets can grow free of state income tax and capital gain tax. With correct planning – combining no state income tax with trust vehicles like dynasty trusts, community property trusts, resident trusts and incomplete non-grantor trusts ("ING") – families can create substantial tax savings, extending over multiple generations.

Unlike South Dakota, New York imposes significant state income taxes on both individuals and corporations. Tax rates are among the highest in the nation, burdening residents and discouraging economic growth. New York has a graduated individual income tax, with rates ranging from 4.00 percent to 10.90 percent. There are also jurisdictions that collect local income taxes. New York has a 6.50 percent to 7.25 percent corporate income tax rate. New York has a 4.00 percent state sales tax rate, a max local sales tax rate of 4.875 percent, and an average combined state and local sales tax rate of 8.52 percent. In addition, New York has "tax benefit recapture," by which many high-income taxpayers pay their top tax rate on all income, not just on amounts above the benefit threshold. New York's tax system ranks 49th overall according to the Tax Foundation's 2023 State Business Tax Climate Index.

New York also subjects capital gains to taxation, adding to the financial burden on investors and businesses. This taxation policy reduces incentives for investment and innovation, hindering economic prosperity. Despite the need for tax reform, New York's legislative process lacks the flexibility seen in South Dakota. Tax changes require complex procedures and may face significant hurdles, impeding efforts to adapt to changing economic conditions and taxpayer needs. New York's tax policies present challenges for residents and businesses, highlighting the need for comprehensive tax reform to promote economic growth and fiscal sustainability.

PERPETUAL TRUSTS

South Dakota was one of the first states in the country to eliminate the rule against perpetuities – leading to the creation of dynasty trusts, a very powerful planning tool that preserves family wealth over generations by avoiding federal estate taxation in perpetuity. Unlike many states that have merely amended the rule against perpetuities to extend a trust's termination, a dynasty trust avoids federal taxation on trust assets forever because the trust never terminates.

In contrast, New York's choice not to abolish the Rule Against Perpetuities (RAP) has had the effect of limiting the duration of trusts and prohibiting the establishment of long-term dynasty trusts. New York's outdated approach restricts asset preservation and succession planning opportunities for families and beneficiaries.

CREDITORS CLAIMS & ASSET PROTECTION

Under South Dakota law, a discretionary interest in a trust is not a property interest nor an entitlement. Additionally, limited powers of appointment and remainder interests are also not property interests – extremely advantageous from an asset protection standpoint when combined with a South Dakota self-settled trust or domestic asset protection trust. In a self-settled trust, assets can be legally shielded from third-party liability (including spouses in a divorce proceeding) and lawsuits while permitting settlors to retain some control over trust assets and enjoy a discretionary benefit during their lifetime.

Furthermore, South Dakota has one of the shortest fraudulent conveyance periods at 2 years as well as a "clear and convincing" burden of proof as to the specific creditor. An intent to hinder, delay or defraud must be proved. Additionally, South Dakota has many other beneficial asset protection statutes. For example, a statute that provides for reimbursement of legal fees to the trustee if the lawsuit is unsuccessful and top-rated LLC statutes make South Dakota a top asset protection jurisdiction.

Unlike South Dakota's protection, New York offers limited shielding of trust assets from creditors. New York's lookback period for creditors is twice as long as South Dakota's, extending the exposure of trust assets to potential claims for 4 years. This prolonged vulnerability poses considerable risks, particularly for individuals in professions prone to litigation or facing substantial life changes.

In New York, an individual cannot protect assets from creditors by creating either a revocable trust or an irrevocable trust for his or her benefit. New York law provides that where a creator retains the right to revoke the trust, they remain the absolute owner of the property, therefore, a revocable trust is not an effective asset protection device because the creator retains a beneficial interest and has too much power and control over the trust assets. In other words, if a creator has full access to the trust property, so too will a creditor, thereby allowing a creditor to levy against the trust assets to satisfy a claim.

The same result would occur if the creator established an irrevocable trust in New York for his or her benefit. The trust assets would not be protected against creditor claims because EPTL Sec. 7-3.1 clearly provides that "A disposition in trust for the use of the creator is void against the existing or subsequent creditors of the creator". This principle was first codified in 1787 and has been the firmly established law in New York State ever since.

New York falls short in comparison to South Dakota's robust asset protection mechanisms for trust assets. This leaves trust assets in New York exposed to potential legal vulnerabilities and highlights the inadequacies of New York's asset protection laws compared to those of South Dakota.

DIRECTED TRUSTEES

Only available in a handful of states across the country, directed trusts enable the unbundling of trust administration and investment management. This allows families to combine the benefits of an independent corporate trustee, the hospitable trust and tax environment of South Dakota and the ability to retain preferred investment advisors no matter where they are based. In this model, the responsibilities of the trustee are trifurcated into three areas:

Investment responsibilities, distribution responsibilities and administrative responsibilities. An investment committee, advisor or protector chooses outside investment advisors and managers to direct the trust's investment. Trustee has no fiduciary responsibility for monitoring performance of these outside investment managers. A distribution committee, advisor or protector decides when distributions are made and directs the trustee (usually through a direction letter) on how much should be distributed and to whom. The trustee handles contributions, distributions and other regular administrative functions with input from investment and distribution professionals.

Unlike South Dakota, where the directed trustee model is predominant, New York does not have a directed trust statute. Any attempt to create a directed trust in New York would be met with unpredictable results as evidenced by case law. The current uncertainty in New York law arising from a lack of legislation defining how directed trusteeships should function has led settlors to choose states other than New York to establish directed trusts. The concept of a directed trust is a necessary statutory addition so that New York can stay competitive in the trust field.

DECANTING

Decanting is the process of moving assets of one trust into a brand new trust, with the power to decant trust assets usually written into the trust document. Once again, South Dakota has enacted progressive statutes. Most trusts permit trustees to pay trust principal to one or more beneficiaries also known as the power to invade the trust. South Dakota's decanting statute permits a South Dakota trustee to transfer all trust property to another trust for the same beneficiary/beneficiaries, as long as the trustee has discretion over income or principal distributions. Picking the most flexible decanting statute depends on the character of the trustee's discretionary authority. According to Steve Oshin's annual ranking of the best decanting statutes, South Dakota is consistently the number one ranked decanting statute State providing families with the flexibility to accomplish their goals.

In New York, the NY EPTL § 10-6.6(b)(1) lists four statutory prerequisites which offer a modicum of direction, but also leave many questions unanswered as it relates to decanting a trust. The first prerequisite in order to qualify for this decanting statute is that the trustee must have absolute discretionary distribution authority to invade the principal of the trust and to distribute the trust property. Therefore, this requirement will not be met where the trustee's power to distribute the trust corpus is limited by an ascertainable standard. For example, if the trustee's distribution authority is restricted to the health, education, maintenance, support or general comfort of the beneficiary, the trust cannot be decanted under the New York decanting statute.

A second prerequisite to decant the trust mandates that the exercise of the power cannot reduce any fixed income interest of any income beneficiary of the trust. This means that income beneficiaries who were specifically identified to receive income for a set amount of time must continue to receive the trust income, as defined under the terms of the original trust. The beneficiaries' interests probably do not have to be identical in both trusts, but this point has been argued in both directions.

The third criteria requires that the exercise of the trustee's power be in favor of one or more proper objects of the exercise of the power. Therefore, a donee of a power of appointment can only appoint someone who is within the class of permissible appointees, as defined by the terms of the trust. However, it is unclear to what extent the nature of the beneficiaries' interests in the old trust can be changed, especially when dealing with the rights and order of distributions of a remainderman.

The last prerequisite in the statute provides that the new trust cannot contain certain provisions which place limitations on the powers and immunities of testamentary trustees which run contrary to public policy. Thus, the trustee cannot be exonerated from his fiduciary liability for failure to exercise reasonable care, diligence and prudence. In addition, the trustee cannot be given the power to "make a binding and conclusive fixation of the value of any asset for purposes of distribution, allocation or otherwise."

Unlike NY EPTL § 10-6.6(b)(1), the robust trust decanting provisions in South Dakota facilitate efficient future planning for families, including estate, gift, and income tax considerations. New York's regulatory framework falls short in providing comparable opportunities, potentially impeding families from optimizing their trust structures for long-term wealth management and preservation.

QUIET TRUSTS

A particularly valuable feature of South Dakota privacy laws is the creation of quiet trusts. Most states require trustees to inform a beneficiary of his/her beneficial interest in a trust at age 18, including the right to see the trust document and receive trust financial statements.

Imagine an 18-year-old discovering he is a beneficiary of a trust at the exact time he may be heading off to college or starting a career…perhaps a large stumbling block when it comes to ambition or plans. Under South Dakota law, quiet trusts can be created that grant the settlor, trust protector and the investment/distribution advisor the power to expand, restrict, eliminate or modify beneficiaries' rights to discover information about a trust. South Dakota is universally considered to have the nation's most comprehensive and flexible quiet trust statutes.

New York does not allow silent trusts and sees silent trusts as a violation of fiduciary duty. This means that trustors have a legal obligation to keep their beneficiaries informed about the details of their trusts. Including the requirement that all trust beneficiaries over 18 must receive trust statements. New York's legal framework leaves trust beneficiaries with greater access to trust information in spite of their individual situation or the grantor's wishes.

South Dakota's statutes directly address the restriction of beneficiary rights to receive information. In contrast, New York's laws offer fewer mechanisms for limiting beneficiary rights, potentially exposing trust information to wider scrutiny.

PRIVACY

For wealthy families all over the world, privacy protection is paramount. Fortunately, South Dakota boasts some of the best privacy protections built into its codified trust law. South Dakota's privacy statute ensures a total seal forbidding any release of trust information, including names of settlors, beneficiaries and trust contents, to the public during litigation. Most states do not have privacy statutes specific to trusts, so privacy is not mandated or guaranteed by law as it is in South Dakota. South Dakota's statute seals all trust information from the public forever without the need to petition for a court decree. In states like Delaware, Nevada and Alaska, the court has discretion as to whether or not to seal the trust; however even if that seal is granted, unlike South Dakota, it is not in perpetuity.

In contrast to South Dakota's robust privacy provisions, New York lacks comprehensive measures to safeguard trust information. Trust documents filed as part of judicial proceedings in New York are typically accessible to the public without automatic sealing provisions. New York law generally allows public access to various court records, including trust-related filings and proceedings. Unlike South Dakota's permanent seal of privacy, New York's approach lacks stringent safeguards, potentially exposing sensitive trust details to public scrutiny.

STRENGTH OF STATE

On the basis of its solvency in five separate categories, South Dakota ranks 2nd among the US states for fiscal health. South Dakota has between 4.76 and 6.78 times the cash needed to cover short-term obligations, well above the US average. Revenues exceed expenses by 2 percent, with an improving net position of $106 per capita. In the long run, South Dakota has a net asset ratio of 0.34. Long-term liabilities are lower than the national average, at 8 percent of total assets, or $650 per capita. Total unfunded pension liabilities that are guaranteed to be paid are $13.32 billion, or 32 percent of state personal income.

In contrast, New York ranks 41st among the US states for fiscal health. New York has between 0.71 and 1.52 times the cash needed to cover short-term obligations, well below the US average. Revenues match expenses, with an improving net position of $16 per capita. In the long run, New York's negative net asset ratio of 0.24 points to the use of debt and unfunded obligations. Long-term liabilities are 58 percent of total assets, lower than the national average. In per capita terms, long-term liabilities are larger than the national average at $4,605. Total unfunded pension liabilities that are guaranteed to be paid are $422.44 billion, or 35 percent of state personal income. OPEB are $88.50 billion, or 7 percent of state personal income.

New York falls short in solvency metrics compared to South Dakota, with lower cash reserves available to cover short-term obligations. The state's cash reserves are insufficient, posing potential risks to its financial stability and ability to address immediate fiscal needs effectively. New York also struggles with revenue management, as revenues fail to consistently exceed expenses, leading to a negative net position per capita. This indicates poor fiscal management and an inability to maintain a positive financial trajectory for the state's residents. Finally, New York's long-term liabilities are notably higher in per-capita terms compared to South Dakota, raising concerns about the state's ability to manage its financial obligations effectively. The substantial unfunded pension liabilities and other post-employment benefits (OPEB) represent significant fiscal burdens on the state's economy and future budgetary planning.

New York's financial position underscores the risk of budgetary instability and challenges in addressing long-term fiscal sustainability. Failure to address these issues may lead to increased financial strain on the state and its residents over time. Overall, New York's financial strength falls short of the standards set by states like South Dakota, highlighting areas of concern and the need for comprehensive fiscal reforms.

SPECIAL PURPOSE ENTITIES

By sheltering from personal liability both the individuals serving within the directed trust structure (investment and/or distribution committee members) and the trust protector, a Special Purpose Entity safeguards against claims connected to their duties in this capacity. Most SPEs are structured as South Dakota LLCs. Therefore, the people serving in these roles are agents or employees of the South Dakota LLC versus serving individually as residents of their home state. This further ties SPE members and employees to South Dakota situs for asset protection/wealth preservation and income taxation purposes.

Additionally, SPEs may be able to get D&O and E&O insurance which may not be the case if serving in their individual capacity. All SPEs are registered with the South Dakota Division of Banking (SDDB) but are not regulated by the SDDB. All special purpose entities must work with a qualified South Dakota trust company so that the SPE can direct them on investment, distribution and trust protector decisions.

In contrast to South Dakota, New York's trust laws do not offer explicit legislative support for Special Purpose Entities (SPEs). This lack of clarity extends to the role of trust advisors within entity structures, which stands in contrast to South Dakota's clear provisions. The ambiguity in New York's legal framework may discourage individuals from taking on trust advisor roles due to the absence of the warrant and protection provided by South Dakota's statutes. New York's omission of SPEs in its statutes exposes individuals to the risk of adverse judicial challenges and avoidable IRS scrutiny. The absence of pure statutory guidance, akin to South Dakota's laws, may lead to increased uncertainty and regulatory scrutiny for trust structures in New York.

PREMIUM TAX ON PRIVATE PLACEMENT LIFE INSURANCE

While South Dakota imposes an insurance premium tax of 8 bps on trusts purchasing private placement life insurance, New York has one of the highest life insurance premium tax rates in the country, with a rate of 2.05%. This means that for every $100 in premiums, the policyholder pays an additional $2.05 as tax. New York's lackluster tax treatment burdens trust holders with higher premium taxes and puts them at a distinct disadvantage when compared to South Dakota.

CONCLUSION

In conclusion, the comparison between South Dakota and New York reveals significant differences in their approach to trust law and financial planning. South Dakota's proactive stance towards trust law evolution, demonstrated by its annual updates and innovative trust structures, showcases a commitment to meeting the diverse needs of trust settlors. In contrast, New York's lack of responsiveness and flexibility in trust statutes hinder its ability to keep pace with evolving legal and financial landscapes, resulting in outdated regulations and missed opportunities for improvement.

South Dakota's tax planning advantages, including no state income tax and capital gains tax on trust assets, provide substantial tax savings and wealth preservation opportunities for families. On the other hand, New York's high state income and capital gains tax rates, coupled with complex tax procedures, impose a significant financial burden on residents and discourage economic growth.

South Dakota's elimination of the Rule Against Perpetuities and robust asset protection mechanisms, such as self-settled trusts and directed trusteeships, offer families unparalleled opportunities for long-term wealth management and preservation. In contrast, New York's restrictive trust laws limit asset protection and succession planning options, exposing trust assets to potential legal vulnerabilities.

Additionally, South Dakota's comprehensive privacy protections, including the creation of quiet trusts, ensure confidentiality and privacy for trust settlors and beneficiaries. In contrast, New York's lack of stringent privacy measures exposes trust information to public scrutiny, potentially compromising the privacy and security of trust assets.

South Dakota's strong fiscal health and regulatory framework further highlight its advantages over New York, providing a stable and conducive environment for trust planning and financial management.

Overall, South Dakota's flexibility, innovation, and commitment to trust law evolution set it apart as a premier trust jurisdiction, offering unparalleled opportunities for families and individuals seeking to optimize their trust structures for long-term wealth preservation and financial security. In contrast, New York's shortcomings in trust law and tax planning underscore the need for comprehensive reforms to enhance its competitiveness and attractiveness as a trust situs jurisdiction.

About the authors

Antony Joffe is Chairman of Sterling Trustees, a South Dakota chartered trust company with over $9 billion of assets under administration. Sterling acts solely as an independent trustee and does not manage any investment assets. The company has a particular focus on working with wealthy families that wish to domesticate offshore trusts to the US. Sterling Trustees is a member of STEP.

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As an attorney, Nicole Byrum brings a unique perspective to her position as Chief Fiduciary Officer – partnering with her clients and their advisors to craft strategic trust vehicles which provide asset protection, governance and long-term wealth transfer. After a brief stint practicing law, she transitioned into global trust services before joining the Sterling team at our Sioux Falls, SD, headquarters. Nicole earned a JD from the University of South Dakota School of Law and a BA from the University of Washington. She also earned the Certified Trust and Financial Advisor (CTFA) designation from the ABA.

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