South Dakota's Situs Advantages Over Delaware

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INTRODUCTION

South Dakota and Delaware have long been two prevailing destinations for establishing trust situs. Attorneys and clients alike have endlessly debated which of the two are best suited for domiciling a legacy plan. While compelling arguments can be made for each state regarding premier laws and tax benefits, a closer study reveals South Dakota's superiority in several facets. The basis of these advantages lies in the details that ultimately govern how the trust is allowed to operate; far beyond the scope of simply favorable tax treatment.

Namely, clients stand to benefit more from South Dakota's parameters surrounding privacy, protection, control, and flexibility than that of Delaware. South Dakota also leads the nation in their means of regulation and industry progression. There is no other state in the country that directly involves the governor and state legislature in the oversight, regulation, and development of its trust laws.

Favorable trust laws and forethought have led the trust business in South Dakota to grow from $57.3B in assets ten years ago to $355B in assets in 2020.

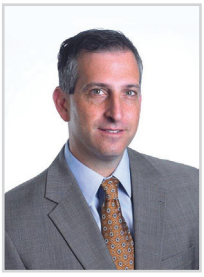
Prospects looking to optimize their trust situs can be certain of South Dakota's prominence by understanding these key, advantageous differences.

SOUTH DAKOTA 	DELAWARE 
FIRST TO BE TRUST FRIENDLY/ PERPETUAL TRUSTS	
Of the top United States trust jurisdictions, South Dakota was the first by statute in 1983 to recognize the advantages of dynasty trusts by allowing trusts to last perpetually for all assets. [SDCL § 43-5-8]. South Dakota was also the first to adobt a Trust Protector statute in 1997 (maximinzing flexiblity of the trust for generations) and a third party discretionary trust statute in 2007 (providing enhanced creditor protections). [SDCL § 55-1B-6] [SDCL § 55-1-24 through 43]	Delaware has specifically allowed perpetual trusts since 1995, but provides that the ownership of real estate in trust is limited to 110 years unless the trust holds the real estate in an entity such as a limited liability company. [25 Del. C. § 503]. Delaware provides for parties to act as "protectors" but does not specify in detail any of their powers. [12 Del. Code 3313]. Delaware also addresses a trustee's descretion in third party trust distributions but in a very general nature. [12 Del. Code 3315]
STRENGTH OF STATE	
Recent independent studies by PEW Research and Mercatus Publications rank South Dakota as the top 1 or 2 state in the country in fiscal health, stability and responsibility. Factors included in these studies are cash solvency, balanced budgets, fiscal slack, pension and healthcare liabilities, and other debt. Currently, its pension liability is 103% funded, its unemployment rate is 3.1% and its credit rating is AAA.	Delaware was ranked from 38 to 44 in such studies on its fiscal health. Currently, its pension liability is 82.8% funded, its unemployment rate is 3.8% and its credit rating is AAA.
STATE INCOME AND CAPITAL GAINS RATES	
There have been no state income taxes, personal or corporate, in South Dakota since 1942. The South Dakota Constitution prohibits any new taxes or increases in taxes without a voter initiative or two-thirds approval of both state legislative branches. [SD Constitution Article XI, 14]	Delaware taxes residents and trusts created by residents up to 6.6% and taxes corporations at 8.7%. Trusts by nonresidents for only nonresident beneficiaries pay no Delaware income tax by receiving a deduction for the income (and capital gain) accumulated or distributed to the nonresident beneficiaries. Seemingly, a state income tax return is required in Delaware per its Form 400 Instructions, which then forces disclosure of the trust income and identity of the trust beneficiaries.
PRIVACY	
There is a permanent seal of privacy in South Dakota for trust documents that would otherwise be part of the record in any judicial proceeding. This seal attaches automatically. [SDCL § 21-22-28]	For Delaware, discussions suggest the courts are “amenable” to providing a privacy seal, however, court rules provide civil proceedings are a matter of public record, a person has to take affirmative steps to otherwise request privacy of the trust, the person requesting must show “good cause” why the public interest is outweighed by the potential harm of disclosure, the burden is on the person requesting, and the seal expires after three years unless the person again shows good cause to extend the seal with a supporting brief and evidentiary basis for the particular harm relied upon. [Del. Chancery Ct. Rule 5.1]
CREDITORS CLAIMS	
If the settlor is foreseeably solvent, South Dakota trusts are shielded from new claims of creditors of the settlor after two years of a transfer to the trust. A window of six months from discovery of the transfer is provided for existing claims, if longer. For self-settled trusts (for the benefit of the settlor) that are "qualified dispositions", there are exceptions for debts of spousal/child support and the division of marital property existing before the transfer. For third party trusts (not self-settled) there are no such exceptions. [SDCL § 55-1-44] [SDCL § 55-16-10; 16]	Delaware trusts require four years for such protection and the statute excepts out to the extent of the debt, spousal/ child support claims, the division of marital property, and personal injury claims existing at the time of the transfer. A similar window, if longer, applies to other claims existing at the time of the transfer but is a one year period from discovery. All protected transfers must be “qualified dispositions,” as there is no different treatment of third party trusts (third-party and self-settled trusts are treated the same). [12 Del C. § 3572; 3573].

SOUTH DAKOTA 	DELAWARE 
ASSET PROTECTION	
South Dakota has a thorough statute with respect to the protection of trust assets and avoidance of claims, specifically addressing (i) numerous arguments made in court cases and disputes, (ii) weaknesses caused by the Restatement of Trusts (scholarly positions on legal aspect of trust law), (iii) inadvertent/ ill-advised actions of trust settlors and beneficiaries, (iv) withholding otherwise mandatory distributions from the trust to a beneficiary and (v) vulnerable provisions and drafting errors in trust documents. [SDCL § 55-1-25, 32, 33, 38, 39]	The Delaware statute addressing asset protection for such trusts is written in significantly more general terms. [12 De C. § 3536]
QUIET TRUSTS	
There are detailed provisions in the South Dakota statute for the trust settlor, trust instrument and trust advisors (i.e., trust protector) to restrict or eliminate information to trust beneficiaries and to keep the trust instrument and trust actions quiet. The South Dakota statute directly addresses the ability to restrict the right of a beneficiary to receive a copy of the trust instrument and the right of the settlor, trust protector, or trust advisor to retain the power to change the beneficiaries' rights to trust information. [SDCL § 55-2-13]	The Delaware statute also allows for the restriction of a beneficiary's right to be informed but does so with a general statement, leaving some questions as to the extent of such powers. [12 Del. C. § 3303]
SPECIAL PURPOSE ENTITIES	
South Dakota has the only state statute in the country that specifically permits individuals to serve in trust roles (i.e., investment advisor, distribution advisor, trust protector) for a particular family through an entity (i.e., a limited liability company) for their liability protection without meeting formal Department of Banking regulations and requirements. This feature gives individuals more comfort in serving and taking on these trust advisor roles. [SDCL § 51A-6A-66]	None codified.
DIRECTED TRUSTEES	
The directed trustee model is a predominant trust company structure in South Dakota, limiting trustee fees while allowing trusted family advisors to control the distributions and investment decisions of the trust assets. Per the South Dakota Department of Banking, approximately 68% of South Dakota trust business is through a directed trustee out of a total of 1.7M trust accounts.	Although Delaware has a longer standing directed trustee statute than South Dakota (1986 versus 1997), its trustee market is dominated by large full service corporate trustees who will offer directed trustee services.
RELIABILITY	
The most favorable and recent creditor protection case, In re Cameron Trust, 2019 S.D. 35, came out of South Dakota, where the South Dakota Supreme Court held for the trustees who stopped paying support claims to the ex-husband of a trust beneficiary which were awarded when the trust was previously situsted in California.	Delaware proponents hold it out as having longstanding, fast acting courts, supportive legislators, and well-established trust infrastructure, making it a very reliable situs. However, a Delaware case, IMO Daniel Kloiber Dynasty Trust, 98 A.3d 924 (Del. Ch. 2014), causes concern on such protections, where the parties settled on transferring a portion of a former husband's trust created by his father to his former wife.

SOUTH DAKOTA 	DELAWARE 
FORETHOUGHT	
South Dakota updates its trust law statutes annually through its highly effective Governor's Task Force on Trust Administation Review and Reform which is very responsive to the legal and advisor community. Examples, of new trust laws in recent years in South Dakota include Community Property Trusts (allowing nonresidents to get a full step-up in income tax basis of assets at the death of one spouse), the Family Advisor (allowing for trusted family advisors to participate on the trust advisor team without taking on the fiduciary responsibility), and Purpose Trusts of unlimited duration (trusts for pets, vacation homes, or any noncharitable purpose without a beneficiary). [SDCL § 55-17-5]	No Community Property Trusts codified for nonresidents. No Family Advisor position codified. Purpose Trusts of unlimited duration are codified. [12 Del. C. § 3555]
DECANTING	
For existing trusts, South Dakota has the most flexible and highly ranked trust decanting statute, allowing for the expansion of a trust to a fully discretionary trust (adding the ability to distribute for any reason or purpose) and allowing for the inclusion/ exclusion of any beneficiaries (both current and future can be changed). This provides much more opportunity for future planning for estate/ gift tax and income tax purposes for a family. [SDCL § 55-2-15]	Delaware requires decanted trusts to maintain the existing standard of distribution (ex., health, education, maintenance and support) and similar timing/ benefits to the current trust beneficiaries of trusts. [12 Del. C. § 3828]
PREMIUM TAX ON PRIVATE PLACEMENT LIFE INSURANCE	
For trusts that purchase private placement life insurance, South Dakota has the lowest insurance premium tax at 8 bps (.008%) on premiums in excess of $100,000 for both policies held by the trust or in an limited liability company (LLC) owned by the trust. A premium tax of 250 bps applies to the first $100,000 of premiums. [SDCL § 10-44-2]	Delaware recently amended its premium tax to reduce it to 0 bps on premiums in excess of $100,000 for trust owned policies (200 bps up to $100,000). Althought not required, many trust companies and clients prefer assets like private placement policies be held in a limited liability company managed by others. The Delaware amendment speficies policies held by the trust and does not address a policy held by a limited liability company owned by he trust, which would continue to pay 200 bps on premiums in excess of $100,000. [18 Del. C. § 702(c)3]

ABOUT THE AUTHORS



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This white paper is provided for educational purposes and does not constitute legal, tax, or investment advice. Trust siting decisions depend on the residency of the grantor and beneficiaries, the location and character of trust assets, and the specific terms of the trust instrument, among other factors. Readers should consult with qualified legal and tax advisors regarding situs selection and trust structure decisions specific to their circumstances.

One in a series of white papers co-authored by the independent trust administration firm of Sterling Trustees.

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