Delaware Banker

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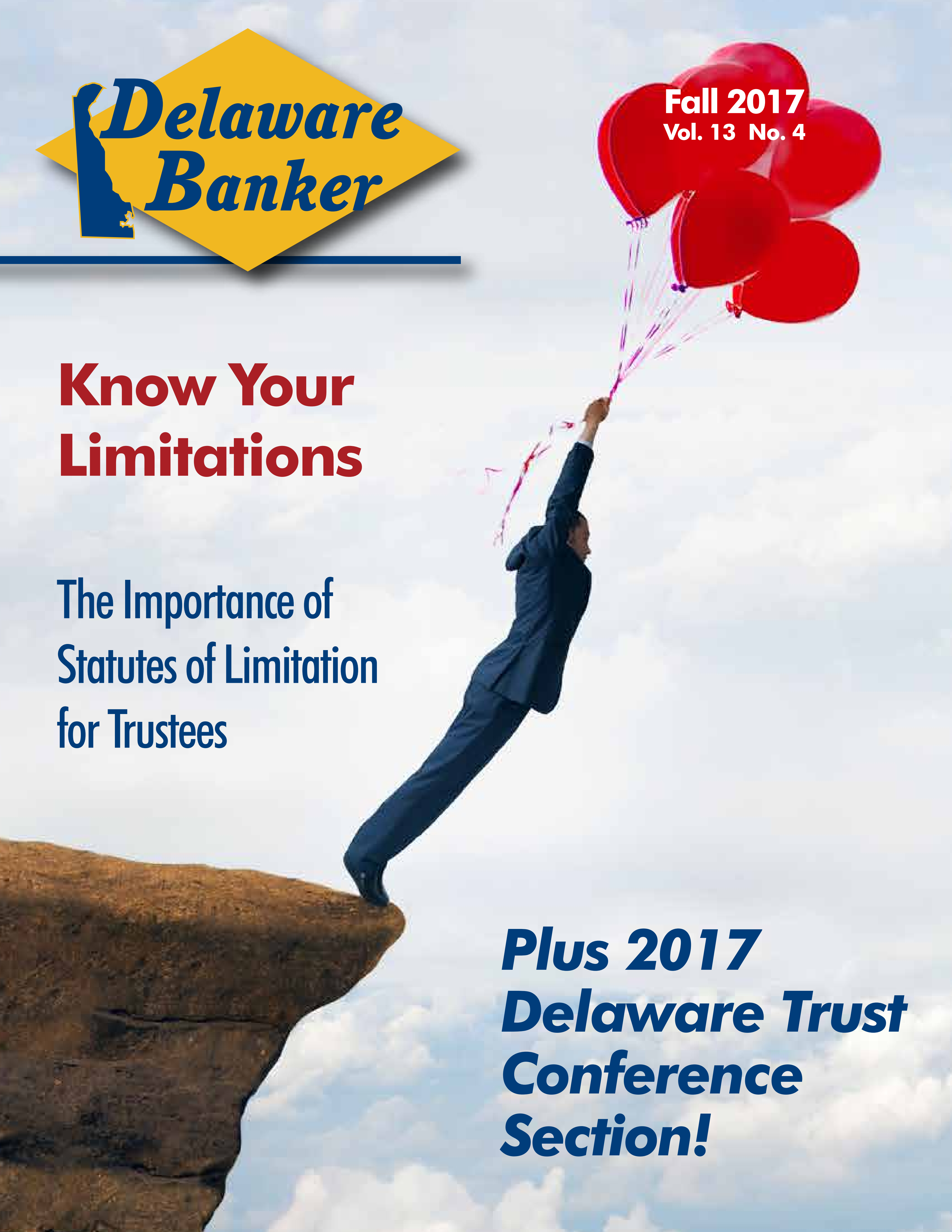

Know Your Limitations

The Importance of Statutes of Limitation for Trustees

Plus 2017 Delaware Trust Conference Section!

Congratulations to our esteemed colleague!

We are pleased to share that our leading Delaware trust law expert, Dick Nenno, recently celebrated his 35th anniversary with Wilmington Trust.

To further commemorate this milestone, Dick was recognized at the Delaware Trust Conference on October 24, where he held a meet-and-greet with attendees. Dick provided copies of his newest book, *Delaware Trusts 2017*, which is the 15th edition of this invaluable resource on Delaware trust law updates.

We welcome the opportunity to work with you to help your clients take advantage of Delaware's beneficial trust laws. To learn more, please contact Tony Lunger today at 302.651.8743 or via email at alunger@wilmingtontrust.com.

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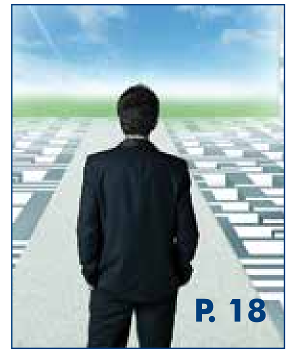

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Delaware Banker welcomes news items from members of the Delaware Bankers Association. The Editors reserve the right to refuse any advertising or editorial copy deemed unsuitable for publication. The Editors reserve the right to set the publication date in accordance with the Association's needs. Direct submissions to Greg Koseluk at greg.koseluk@debankers.com

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View from the Chair

by
P. Randolph Taylor
EVP & Director of Private Banking
Fulton Bank

Chair
Delaware Bankers Association

"The regulation, had it been allowed to stand would have been a windfall to trial lawyers at the expense of consumers."

With the World Series over the country can return to the new Great American Pastime: the lawsuit. Suits, threats of suits, and class action suits seem to be lurking behind everything we do. Personally, I have found it upsetting that as a child I was able to enjoy the thrill of galloping on horseback, yet today it is impossible to find a place in the country that allows you to even trot on a trail ride because of the fear of a lawsuit.

But there's a glimmer of hope on the horizon. By now I'm sure you've already heard, but it's good news that bears repeating: on November 1st President Trump signed the Congressional Review Act resolution invalidating the Consumer Financial Protection Bureau's (CFPB) final rule that had effectively banned the use of mandatory arbitration for consumer financial products and services. The regulation, had it been allowed to stand would have been a windfall to trial lawyers at the expense of consumers. This puts a healthy check on wielding their threat of excessive litigation against the nation's financial services industry.

The American Bankers Association (ABA), state banking associations, and banks led the charge against the rule, first proposed in 2015. The effort gained momentum this past summer when the CFPB approved the anti-arbitration rule. The rule was put in place despite reports from the OCC and Treasury Department citing its potentially detrimental effects. The OCC report estimated that the rule would have likely increased the cost of credit by up to 25 percent. The rule also went ahead despite the CFPB's own study that found arbitration was more fair, faster, more economical, and on the whole more beneficial to consumers than the class action litigation that would have become the only option available.

As ABA President and CEO, Rob Nichols and U.S. Chamber of Commerce President and CEO, Tom Donohue pointed out in a recent op-ed in *The Hill*: "Arbitrations are independent, neutral legal processes commonly used to ensure that disputes are resolved quickly and fairly. They have been long employed and recognized by the Supreme Court. Not all banks and credit unions use it, but when they do, consumers find it more convenient, cheaper, and faster than filing a lawsuit. Under the American Arbitration Association's procedures, consumers who don't want to arbitrate can still take their cases to small claims court. That system works pretty well for everyone, except the class action trial bar."

The piece went on to point out that in cases where arbitrators found for consumers the average award was over $5,300. On the other hand, 87 percent of class action settlements resulted with consumers receiving nothing. In the remainder of cases only 4 percent of class members received payments, and then the average was only $32.35; not exactly protecting the consumer.

Congratulations to the banks, state associations and the American Bankers Association for waging this successful opposition to a rule that would have imposed significant costs on both consumers and financial institutions of all sizes.

Randy

President's Report

by
Sarah A. Long
President, CEO & Treasurer
Delaware Bankers Association

"The 12th annual Delaware Trust Conference was filled with memorable moments highlighting the unique advantages provided by the Delaware Product."

Another Trust Conference Win!

In the game of musical chairs, no one wants to be the last one standing when the music stops. Similarly, no one wants to participate in an activity where items or people are shuffled around without a clear view toward a successful outcome. Winning the wealth management game is no trivial pursuit. Participants must continually raise their game to master winning strategies for their clients.

In the area of wealth management it takes just the right combination of players and pieces to produce quality trust products. These include: the right legislative climate; attention to detail in drafting and updating trust laws; along with skilled professionals to guide clients and manage assets with prudence and wisdom. When playing to win, challenges can be overcome by evaluating alternatives and planning for best-case outcomes. When employed by seasoned trust professionals this leads to desirable client outcomes.

The 12th annual Delaware Trust Conference: Winning the Wealth Management Game, was filled with memorable moments highlighting the unique advantages provided by the Delaware Product. This year's edition featured game changing presentations on the current state of trust legislation and litigation; effective trust drafting techniques; cybersecurity; selection between multiple jurisdictions; managing risk; ethics issues; and more! In addition to the information on Delaware trusts for which the conference is renowned, this year included concurrent sessions on how best to utilize Delaware for international clients.

To avoid trouble and mitigate risk, making appropriate choices can mean the difference between reaching optimal performance, or never reaching the finish line. This also applies to venue selection. This year's conference was held for the third year at the spacious Chase Center on the Riverfront, complete with exhibitor hall. Once again, a record number of attendees participated in dozens of sessions highlighting the advantages of Delaware Trusts. And, just like the perfect members on a winning team, the exhibitors were a perfect compliment to the panel presentations and provided a variety of wealth management options and solutions.

Success in most things requires a game plan. The creation of a game winning strategy takes practice and involves finding opportunities that establish and protect a sustainable advantage. Masters of the wealth management game themselves, the Delaware Trust Conference Committee led by Committee Co-Chairs Cindy Brown and Tom Forrest, drafted a team of over fifty of the nation's top trust, legal and wealth management professionals for the various panels. Each panel brought together subject matter experts who shared how to use knowledge, talent and resources to create that advantage.

Classic games combine strategic decision making, calculating probability, and exercising skill. Successfully marketing a hit game requires investors. It is a savvy investor who knows what projects to back for maximum return. We thank all of our sponsors, each seasoned players in their own right, for investing in this year's Trust Conference. Their generous support helped produce yet another winning event.

Last but not least, please join me in thanking Greg Koseluk, Corinne Stayton, Renee Rau and Margaret Cregan, the DBA team who spent countless hours looking for new ways to produce the 2017 Delaware Trust Conference while adding entertainment value to the experience!

For the win!


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What's New at the DBA

New Financial Institution Member

Principal Trust Company
Primary contact: Deborah Harris, Personal Trust Manager
1013 Centre Road, Suite 300
Wilmington, DE 19805
800-332-4015
email: sales@principaltrust.com
https://www.principal.com
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New Associate Members

Cohen Seglias Pallas and Furman PC
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1007 N. Orange Street, Suite 1130
Wilmington, DE 19801
302-425-5089
email: csantaniello@cohenseglias.com
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Depository Trust Company of Delaware, LLC
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www.delawaredepository.com
Delaware Depository is a state-chartered limited purpose trust company. It acts as a custodian of IRA and non-retirement assets, and is eligible to custody assets of SEC-regulated mutual funds. Also, it is a COMEX/NYMEX Licensed Depository for gold, silver, platinum, and palladium bullion. Security and internal controls are subject to SSAE-16 SOC-1 audit. Assets are insured under a $1 billion "all risk" policy.

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Herdeg, du Pont, Dalle Pazze, LLP
Primary contact: James P. Dalle Pazze, Partner
15 Center Meeting Road
Wilmington, DE 19807
Herdeg, du Pont & Dalle Pazze is a law firm providing legal services primarily in the areas of estate planning, business planning, decedent's estate administration, and charitable organizations.
302-655-6500
email: jdallepazze@dellaw.com

FDIC Director's College

A record number of professionals attended the 2017 FDIC Director's College, September 29th at the Atlantic Sands Conference Center in Rehoboth. The College featured an interactive program providing ongoing education on current topics of bank supervision and the ever-changing regulatory environment.

2017 CRA Community Roundtable

Over 30 Community Reinvestment Professionals convened October 12th for the 2017 CRA Community Roundtable, at the University & Whist Club in Wilmington. Attendees met and networked with CRA policy makers and examiners from the Federal Reserve, the FDIC, and the OCC. Topics included: Branches and alternative banking services; Activities to revitalize or stabilize a community; CRA credit for projects outside of assessment areas; and question & answer session. Thank you to event sponsors: Cinnaire and TD Bank.

2017 Regulatory Compliance School

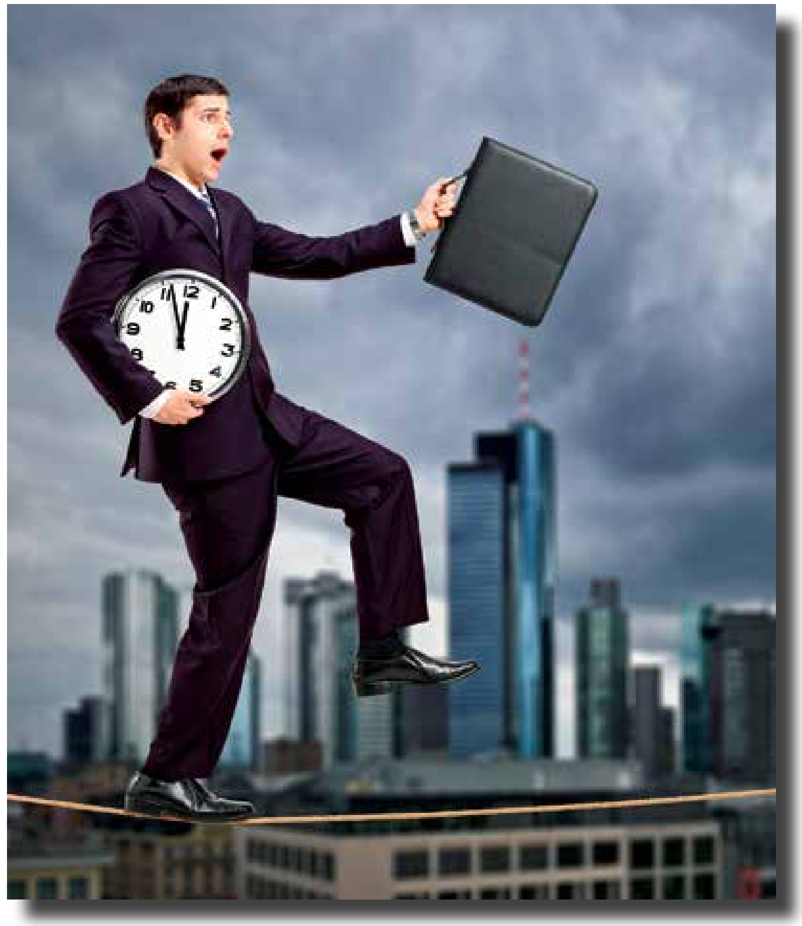
Over two dozen compliance professionals attended the 2017 Regulatory Compliance School November 14th - 16th at the University & Whist Club in Wilmington. The school, presented by the Delaware Bankers Association and CAPCO RISC Consulting, LLC, provided a comprehensive review of the federal laws and regulations affecting the financial services industry. Diane L. Banks and Elizabeth Rozsa, both Senior Consultants, CAPCO Center for Regulatory Intelligence, facilitated the sessions on Lending Compliance and Deposit Operations. Robert Cardwell, Managing Principal, Consumer Finance and Fair Lending, and Suzanne Robeson, Senior Consultant, Consumer Finance & Fair Banking, conducted the session on Credit, Debit and Prepaid Card Compliance.

A Magical Experience in Reading and Saving!

When 4th grader Sydney Holley visited her mother at work she didn't expect it to lead to a writing assignment and a magical experience. That's what happened though, at the offices of WSFS recently. Sydney read a copy of *The Great Investo and the Million Pennies* from this year's Teach Children to Save Day effort and was encouraged by Ray Abbott, SVP, Cash Management at WSFS Bank to write a review. "I loved the book," wrote Sydney, "because I like reading rhymes and that book had a bunch of rhymes. I loved it!!" Sydney's review magically got back to the Great Investo and Penny (actually it was via email) and the mystical duo later stopped by to meet Sydney, do some magic tricks, and sign copies of their adventures. There's good news for Sydney and all young savers. Another book, *The Great Investo and the Winning Ticket,* is on the way for 2018 Teach Children to Save Day. The new book, as with others in the series, is made possible by a grant from Capital One.

Cover Story

Know Your Limitations



The Importance of Statutes of Limitation for Trustees

by
Scott E. Swenson
Connolly Gallagher LLP

In the fiduciary world, risks are routinely managed and rarely eliminated. Every action or inaction carries risk, and any trustee who fails to address these risks won't be in business for long. To mitigate risk, trustees most often rely upon release or consent, adjudication or waiting until claims are otherwise precluded by law. Where the first two options are unfeasible, impossible or undesirable, a trustee should be mindful of how long its exposure endures before a risk can be duly written off. To avoid missteps, or worse, inadvertently covering over (or diving into) a pitfall, professionals must have a strong grasp of the various limitations periods applicable to claims of beneficiaries against trustees of Delaware trusts. This year, a critical new limitations period has been added under Delaware law.[1]

Claims by Beneficiaries – 2 Years, 3 Years, 5 Years or 120 Days?

Section 3585 of Title 12 of the Delaware Code generally governs the time in which a beneficiary must bring a claim against the trustee of a Delaware trust for breach of trust.[2] In most instances, the statute of limitations is two years after the beneficiary was sent a report that "adequately disclosed the facts constituting a claim.[3] In 2017,[4] however, an important exception was added for a trustee who ceases to serve, whether due to resignation, removal, termination or any other reason. If the outgoing trustee sends a report notifying a beneficiary that the trustee has ceased to serve, adequately disclosing the facts constituting a claim and notifying the beneficiary of the time limit, the beneficiary has 120 days in which to initiate a legal proceeding against the outgoing trustee.[5]

This 120-day limit is a powerful tool. It allows a trustee to end a trust rela-tionship and relinquish the trust assets without fear of liability to the beneficiaries far down the road. It also puts the onus on an aggrieved beneficiary to take decisive action – reviewing the report, finding and engaging counsel, and initiating a lawsuit – within a brisk-but-reasonable four months. By then, the trustee will have a clear picture of where it stands, and clarity in forecasting is a boon to any organization.

If neither the two-year period nor the 120-day period applies, such as when the beneficiaries have not been provided a report adequately disclosing the facts constituting a claim, the three-year statute of limitations for personal actions under Section 8106 of Title 10 of the Delaware Code may apply to claims of beneficiaries.[6] Unlike the deadlines in Section 3585, this three-year period runs from the event giving rise to the cause of action.[7] This limitations period may be suspended, however, based on circumstances, such as where the event in question is inherently unknowable or where the beneficiary reasonably relies on the competence and good faith of a fiduciary.[8] As these circumstances are frequently present in trust cases, a trustee should not count on this limitations period as a bar to claims.[9]

In any event, Section 3585 provides a backstop limitations period of five years. If neither the two-year period nor the 120-day period of Section 3585(a) applies, a beneficiary has five years to initiate a proceeding against the trustee, beginning from the earlier of the date the trustee ceases to serve or the date when the beneficiary's interest in the trust terminates.[10]

It is important to bear in mind that, for each of the limitations periods un-der Section 3585, the time to bring a claim does not run from the date of the actual event giving rise to the claim.[11] This is in sharp contrast to most other areas of the law, where, for example, the statute of limitations on a breach of contract claim generally runs from the date of the breach, or the time to bring a personal injury claim generally runs from the date of the injury.[12] In the case of a trustee who does not provide regular reports of its activity, or whose reports are not sent to certain beneficiaries, decades could pass between the time of the act causing the alleged harm and the lawsuit seeking to hold the trustee liable. This underscores the im-portance of regular and thorough reporting.

What Constitutes a "Report"?

Whether two years or 120 days, the limitations period runs from the time the trustee sends a beneficiary a "report adequately disclosing the facts constituting a claim."[13] A report adequately discloses the facts constituting a claim if it "provides sufficient information so that the beneficiary knows of the claim or reasonably should have inquired into its existence."[14]

In the case of claims pertaining to investment or disbursements, detailed financial statements would ordinarily seem sufficient to satisfy the criteria of a "report." But beneficiaries may complain of a great many things that never appear on a financial statement, which should lead a trustee to evaluate when and how it communicates with beneficiaries. Examples include a trustee's act of pledging or otherwise encumbering trust assets, which may not be evidenced on statements, or the failure to make appropriate tax elections, or taking direction from an adviser that may be beyond the scope of that adviser's authority. Even the act of resigning itself could engender liability if it causes the trust to lose its Delaware situs in a way that damages the interests of the beneficiaries.[15]

In the ordinary, ongoing course of business, a trustee should exercise discretion over how much it discloses to beneficiaries, and to whom and when the disclosures are made. After all, running the statute of limitations is only one considera-tion when dealing with beneficiaries and maintaining a relationship over a term of years. But upon resignation, removal, termination of the trust or some other event that causes a trustee to cease to serve, a trustee should open the kimono and pro-vide as much information as possible about the administration of the trust, finan-cial and otherwise. Remember, the 120-day limitations period for an outgoing trustee does not apply to all claims; rather, only those claims for which the trus-tee's report adequately disclosed the underlying facts. Accordingly, more infor-mation is better.

An important caveat, however, may be derived from the case of *Merrill Lynch Trust Co. v. Campbell*.[16] In that now-vacated decision,[17] the trustee sought judicial approval for its conduct, expressly putting at issue its investment performance during the entirety of its tenure, which stretched back more than two years.[18] At the same time, the trustee sought to partially bar the beneficiary's counterclaims that the trustee mishandled the trust's investment by asserting the 2-year statute of limitations[19] applied in light of the beneficiary's receipt of sufficient reports.[20] The Court found that the trustee's act of voluntarily submitting its conduct for review going back more than two years effectively opened up the statute of limitations.[21]

Continued on p. 12

Trusts

(continued from p. 11)

Consequently, the lesson for trustees is not to place otherwise time-barred claims of beneficiaries back in play. Whether submitting an accounting to the Court for approval or sending a final report to the beneficiaries upon resignation, removal or termination, a trustee should not go back more than two years if the trustee believes its earlier conduct was already adequately disclosed to the beneficiaries.

Limitations on the Limitations Period

It is worth noting that the limitations periods set forth in Section 3585 may apply differently to different beneficiaries depending on circumstances. Sending reports to some beneficiaries and not others may not run the limitations period for those not receiving reports. A competent adult beneficiary entitled to information about the trust will not be bound by the limitations period unless and until he or she is sent a report.[22] Thus, if the trustee has a policy of sending reports only to current beneficiaries, the 2-year limitations period will not run against competent adult remainder beneficiaries,[23] meaning their claims, if any, would remain open-ended.

In the case of a minor, unborn or unascertained beneficiary, he or she will be deemed to have been sent a report if sent to a person who may virtually represent the interests of that beneficiary under 12 Del. C. § 3547.[24] In the case of a beneficiary, competent or not, represented by a designated representative under 12 Del. C. § 3303(d), he or she will be deemed to have been sent a report if sent to the designated representative.[25]

Lastly, the limitations periods set forth in Section 3585 may be tolled where the report in question was a product of fraud or contained material misrepresentations, and do not apply to bar a beneficiary's claim to recover for fraud or misrepresentation related to the report.[26]

Takeaways for Trustees

In order to keep the 2-year limitations period rolling at all times, a trustee should send reports on a regular and frequent basis. For maximum coverage, those reports should be comprehensive, and ideally should be sent to every adult beneficiary and designated representative, regardless of the nature of the beneficiary's interest. This goes doubly when a trustee ceases to serve, but a trustee should avoid re-disclosing information already reported to a beneficiary that otherwise time-bars related claims. Keeping an eye towards applicable statutes of limitation helps the savvy trustee steer clear of trouble.

Scott E. Swenson is a partner with Connolly Gallagher LLP and the immediate past chair of the Estates & Trusts Section of the Delaware State Bar Association. He practices estate planning and administration, estate and trust litigation, and advising trustees and other fiduciaries on matters such as trust administration, trust modification and risk management. He received his bachelor's degree from the University of Maryland and his J.D. from the University of Pennsylvania Law School.

Notes

1 - Not addressed in this article are the applicable limitations periods for claims of per-sons other than beneficiaries, such as co-fiduciaries, creditors and other third parties.

2- Generally, the Court of Chancery is not strictly bound by a statute of limitations, and instead applies the doctrine of laches to determine whether an action is filed timely. *In Matter of Thomas Lawrence Reeves Irrevocable Tr. Under Agreement Dated Feb. 26, 1997*, 2015 WL 1947360 at *7 (Del. Ch. Apr. 29, 2015), *adopted sub nom. In re Thomas Lawrence Reeves Irrevocable Tr.* (Del. Ch. July 2, 2015). The doctrine serves as an equitable defense against a plaintiff who unreasonably delays pursuing a claim after learning that his or her rights were infringed upon. *Id.* However, there are occasions when a statute of limitations may apply directly to a claim filed in the Court of Chancery, and Section 3585 may such be an instance. *Id.* at n. 73. *See also Kahn v. Seaboard Corp.*, 625 A.2d 269, 271–72 (Del. Ch.1993) ("statutes of limita-tion could apply directly to causes in Chancery of every sort. It is within the constitu-tional power of our legislature to do so"). Regardless, Section 3585 would appear to set the presumptive period of what constitutes an unreasonable delay on the part of a beneficiary in bringing a claim for purposes of a laches analysis. *Reeves* at *7.

3- 12 Del. C. § 3585(a)(1).

4- 81 Del. Laws, c. 149.

5- 12 Del. C. § 3585(a)(2).

6- *See Reeves*, 2015 WL 1947360 at *7, supra n. 3.

7- 10 *Del. C.* § 8106.

8- *In re Dean Witter Partnership Litigation*, 1998 WL 442456 at *5 (Del. Ch. July 17, 1998).

9 -*See, e.g., In re the Volftsun/Landy Trust Litig.*, C.A. No. 4653–VCL (Del. Ch. Oct. 24, 2012) (TRANSCRIPT).

10- 12 *Del. C.* § 3585(d).

11- Moreover, Section 3585 does not cover all beneficiary claims against trustees. For example, a beneficiary may bring claims against a trustee for something other than breach of trust, such as a removal action under 12 Del. C. § 3327(2) or (3), which would not be subject to the time limitations of 12 Del. C. § 3585. See *du Pont v. Wilmington Trust Co.*, 2017 WL 4461132 (Del. Ch. Oct. 6, 2017). See also *Merrill Lynch Trust Co., FSB v. Campbell*, 2007 WL 2069867 (Del. Ch. July 11, 2007), vacated by *Campbell v. Merrill Lynch Trust Co., FSB*, 12 A.3d 1153 (Del. Feb. 3, 2011) (suggesting that a beneficiary's claims of fraud and negligent misrepresentation against a trustee surrounding the circumstances of the trust's creation are governed by the 3-year limitations period of 12 Del. C. § 8106).

12- The apparent rationale is that a trustee, as a fiduciary, owes the highest duty to a beneficiary, much higher than the duties between contracting parties or colliding motorists.

13- 12 *Del. C.* § 3585(a). However, it is important to note that the limitations period with respect to a claim always ends on the earliest to occur of the expiration of two years or 120 days, as applicable, or the date on which the claim was otherwise precluded by adjudication, release, consent, limitation or pursuant to the terms of the governing instrument. *Id.*

14- 12 *Del. C.* § 3585(b).

15- The damage could be particularly acute in the case of a Delaware asset protection trust, or where the situs defaults to a state that then taxes the trust's income.

16- 2007 WL 2069867, supra n. 12.

17- See *Campbell*, 12 A.3d 1153, supra n. 12. Although the Delaware Supreme Court vacated this 2007 opinion and order of the Court of Chancery entirely, the Supreme Court appeared primarily concerned with the applicability of a laches defense to claims regarding the formation of the trust. *Merrill Lynch Trust Co., FSB v. Campbell*, 2011 WL 383928 (Del. Ch. Jan. 24, 2011). There is no indication in the record that the Supreme Court found fault with the Court of Chancery's reasoning as to why the trustee's statute of limitations defense must fail.

18- *Campbell*, 2007 WL 2069867 at *4.

19- 12 *Del. C.* § 3585(a)(1).

20- *Campbell*, 2007 WL 2069867 at *4.

21- *Id*.

22- 12 *Del. C.* § 3585(c)(1).

23- This could include even takers in default of the exercise of a power of appointment. *See Estate of Tigani*, 2016 WL 593169 at *14 (Del. Ch. Feb. 12, 2016).

24- 12 *Del. C.* § 3585(c)(2).

25- 12 *Del. C.* § 3585(c)(3).

26- 12 *Del. C.* § 3585(e).

Post-Mortem Tax Planning

A Guide After the Client Has Passed

Part 2 of a 2-Part Series

by
Jordon N. Rosen, CPA, AEP®
Belfint, Lyons & Shuman, P.A.

While estate planners generally focus on helping their clients with their estate plan while the client is still alive, there are many elections and opportunities to consider after the client has passed.

In part 1 we discussed elections relating to the decedent's final income tax return, administrative elections and various tax elections available to the fiduciary. Part II continues with other relevant tax elections available to the fiduciary, including those when the decedent was a partner in a partnership or shareholder in an S corporation, the use of QSSTs and ESBTs, deferring estate taxes, the use of alternate valuations, special use valuation elections and GST planning. These issues were also the topic of a session at the recent 2017 Delaware Trust Conference.

- 65-Day Rule. Section 663(b) generally allows the fiduciary to elect to have any or all of an income distribution made within 65 days after the close of the estate or trust's yearend to be treated as if made on the last day of the preceding tax year of the estate or trust. The election must be made on a timely filed return, including extensions (although there may be Section 9100 relief if an amended return is filed within 6 months) and is irrevocable after that date. If no return is required to be filed, the election can be made on a statement filed with the IRS. The election can be a valuable tool to assist executors/trustees to determine whether the income is best taxed to the trust or the beneficiary for the current or subsequent tax year, for both regular income tax and net investment income tax (Section 1411) purposes. It also is a great tool if the trustee forgot to make a distribution before the end of the estate/trust's tax year.

• Deducting Administrative Expenses. In general, amounts allowed under Sections 2053 relating to administrative expenses and 2054 relating to losses during administration which are used to reduce the taxable estate may not also be taken as deduction on the estate's income tax return. The executor/trustee can make an election, however, to claim such deductions on the income tax return and waive the deduction on Form 706. This especially makes sense if there is no taxable estate. The election and statement detailing the specific deductions and losses must be filed in duplicate with the return on which they are being claimed, including a statement that such deductions will not be claimed on the decedent's estate return. The election can cover all or a portion of the deductions and can be made up until the running of the statute of limitations for filing the income tax return. Taxes, interest and business deductions at the time of death which are claims against the estate can be deducted on BOTH the 706 and income tax return.

• Qualified disclaimers. Under Section 2518, a beneficiary can refuse to accept or have the power over property to which the individual is otherwise entitled. Valid uses of disclaimers include avoiding estate tax inclusion and overfunding a marital trust. The disclaimer must be irrevocable and unqualified, in writing and identify the property being disclaimed, signed by the disclaimant and delivered to the transferor not later than 9 months after the death creating the transfer occured, or if under age 21, within 9 months after turning age 21. In addition, with certain exceptions for surviving spouses and cases of joint tenancy which may be unilaterally severed, the property must pass without direction on the part of the disclaimant and the disclaimant must not have accepted the property or any of its benefits.

• Allocation of estimated taxes to beneficiaries. An allocation can be made by the executor/trustee to treat any portion of the estimated taxes paid by the estate or trust as a payment made by the beneficiary. The election (Section 643(g)) must be made on or before the 65th day after the close of the taxable year and in the case of an estate, is only available in the estate's final year. The estimated payments are treated as estimates made by the beneficiary on January 15th of the following year.

• Charitable contributions made in succeeding year. If a charitable contribution is paid after the close of a tax year, but before the close of the following tax year, the trust or estate can elect to treat the contribution as paid in the preceding tax year, but only with regard to amounts paid or permanently set aside for charitable purposes. The election, which is irrevocable, is made by filing a statement with the tax return for which the deduction is being claimed (Reg. Section 1.642(c)-1(b)(3)). The election can be made up until the due date, including extension, of the succeeding year's return and can be made on and amended return if filed within this time frame.

• Net operating losses. The executor may elect to forego the carryback of a net operating loss.

• Property distributions. The executor may elect to treat tier-two in-kind property distributions as a taxable event (Section 643(e)(3)) which, although the beneficiary would be picking up additional income, he or she would have a higher basis in the distributed property and the character of the estate's taxable income could change from ordinary to capital, resulting in lower taxes on the estate's income tax return.

Business Related Elections

The executor or administrator needs to be aware if the decedent, at the time of his or her death, was a partner in a partnership or a shareholder in an S corporation and of the elections available to the estate.

Partnerships

• If the decedent was a partner in a partnership, two elections need to be considered. The first is the Section 754 election. This election can only be made by the partnership and is made on a timely filed partnership return, including extensions. The election is attached to the partnership return for the year of the partner's death. Once made, the election is irrevocable and can only be revoked with the consent of the IRS and is effective for all subsequent years. The effect of the election is to allow for a step-up in basis to be assigned to the assets inside of the partnership which effectively reconciles the succeeding partner-in-interest's inside and outside basis in the partnership property and is most beneficial where the partnership owns depreciable or amortizable property. The downside to the election is that it is irrevocable and binding on all partners for all future years unless revoked, which could include a year where there is a "step-down" in basis.

• The second election to consider comes under Section 732(d), which is similar to Section 754, but made by the estate, rather than by the partnership, so it has no effect on the remaining partners. The election allows for a date-of-death basis step-up and applies to property distributed to the estate within 2 years of the partner's death. This may be an alternative if the partnership is unwilling to make the 754 election.

S Corporations

• An estate can own S corporate stock indefinitely, but only certain trusts can own S corporate stock. A testamentary trust can own S corporate stock for 2 years after the date of death, with the exception of a Qualified Subchapter S Trust (QSST). (Section 1361(d)). To qualify, the trust must meet all of the following requirements.

• The trust can only (and is required to) distribute all income annually to only one beneficiary, who must be a U.S. citizen or resident

• Only the income beneficiary can receive principal distributions

(continued on p. 16)

Tax Planning

(continued from p. 15)

- The income beneficiary's interest must terminate upon the earlier of the death of the income beneficiary or the termination of the trust
- Upon termination, all trust assets must go the income beneficiary
- The income beneficiary must elect to be treated as the owner of that portion of the trust consisting of the S corporation stock
- The QSST status will terminate at the time any of the above requirements are not satisfied

A separate election is required for each S corporation owned by the trust and must be made within 2½ months after the S corporate stock is transferred to the trust or from the time the S election is made. Once made, the QSST election is irrevocable and it covers all successive beneficiaries unless they affirmatively refuse to consent within 2½ months of becoming an income beneficiary. Since the estate is the owner, beneficiaries of the estate who may otherwise be ineligible S corporation shareholders, do not negate the S status. Furthermore, the estate can defer income to its beneficiaries if it is on a fiscal year.

Another type of trust that can have an estate as a beneficiary is an Electing Small Business Trust (ESBT). The election to be a small business trust must be made by the trustee within 2½ months of the later of the S stock being transferred to the trust or the beginning of the first tax year which the election is effective (Reg. Section 1.1361-1(m)(2)). Unlike a QSST, an ESBT may have more than one beneficiary, sprinkle income among various beneficiaries and accumulate income. The tax treatment is also different in that it has an S portion which consists solely of S corporate stock which is subject to the highest rate of tax and a portion consisting of other property. Although a ESBT can convert to a QSST and vise versa, a trustee will need to consider the stark differences between the QSST and ESBT, especially to cost/benefit of accumulating income in the ESBT when deciding how to structure the trust.

Elections Specific to Larger Estates

More than 99 percent of all estates will not be subject to the federal estate tax. For those estates in excess of the exclusion amount at the time of death ($5,490,000 in 2017) which are required to file a federal estate tax return, certain elections may be available that could reduce the overall taxable estate or defer the payment of estate taxes.

- Alternate valuation (Section 2032). The election to use the alternate value date which is 6 months after the date of death can only be used if the estate is subject to the estate tax, must lower the overall federal estate tax and must be used to value all assets in the estate other than those that were disposed of through sale or distribution within the six-month period. If qualified appraisals were obtained, a copy at the date of death and at the 6-month alternate valuation date must be attached to the estate return. Factors to consider before using the alternate valuation date include (1) whether the use of the marital deduction would render a better result, (2) the effect of a lower basis for depreciation in the hands of the beneficiary and (3) whether the beneficiaries plan to sell the assets in the immediate future.
- Special use valuation (Section 2032A). In general, property is valued for estate tax purposes at its highest and best use value. However, if certain criteria are met, an executor may elect under Section 2032A to value qualified real property based on the current use for which it qualifies. The aggregate reduction cannot exceed $1,120,000 in 2017, (indexed annually for inflation). The business must have been owned by the decedent for 5 out of the 8 years prior to death, disability or retirement of the decedent, transferred to qualified heirs and if sold to a third party within 10 years after death, the tax benefit could be lost. Furthermore the value of the real property must have been at least 50% of the decedent's gross estate and the business real property must have been at least 25% of the adjusted gross estate
- Estate tax deferral (Section 6166). In short, Section 6166 allows a qualifying estate to pay interest only on the estate tax liability for 5 years and then interest and principal in equal installments over the next 10 years. This allows the estate of a decedent who owned a closely held family businesses avoid having to sell-off assets to pay the federal estate tax. To qualify, there must be an active trade or business, sole proprietor or partnership/corporation with 45 or fewer owners or the decedent having at least a 20% capital interest or

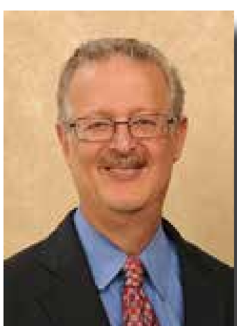
voting stock ownership, respectively, and the value of the business must generally be more than 35% of the adjusted gross estate. Payment may be accelerated if there are missed installment payments or if there is a disposition or withdrawal of 50% or more of the money or assets of the business. The interest rate if set by formula (2% on the first $596,000 in 2017 and then 45% of the IRS underpayment rate on the balance), but no deduction is permitted.

• GST planning. Although beyond the scope of this article and worthy of its own dissertation, a few points on the generation skipping transfer planning need to be mentioned.

  o GST allocation. Can be allocated at any time up until the due date, including extension, of the federal estate tax return. The allocation can be made either by formula or by using the automatic allocation rules.

  o Use of Reverse QTIP (Section 2652(a)(3)). If elected, the decedent is treated as transferor for GST purposes, allowing the use of the decedent's GST exemption. This could be advantageous if the decedent's unused GST exclusion amount would otherwise be wasted.

Author's Note: In Part 1, an incorrect reference to Form 706 (Federal Estate Tax Return) was made with regard to the filing of Form 4810 to request a prompt assessment of tax. The correct reference should have been to a fiduciary tax return, Form 1041.



Jordon Rosen, CPA, MST, AEP® is a Director at the Wilmington, DE CPA firm of Belfint, Lyons & Shuman, P.A. where he heads the firm's estate and trust section. He is a past president of the National Association of Estate Planners and Councils and is a member of the AICPA technical resource panel on trust, estate and gift taxes. He can be contacted at jrosen@belfint.com or at 302.573.3911.

Evolution and Challenges of the Trust Industry

The Trust Industry: a Brave New World

by
Jeffrey C. Wolken
National Director of Wealth and Fiduciary Planning
Wilmington Trust, N.A.

Over the past half-century, the role of trustees has evolved rapidly along with the trust industry itself. We have seen a transition in the investment standards guiding trustees from a "prudent man" using legal lists to a "prudent investor" employing modern portfolio theory. Jurisdictional considerations for a wealthy family have progressed from inter-state to multinational during this time as well; trustees are now required to understand concepts of foreign taxation and foreign property law regimes and remain compliant with strict federal Know Your Customer laws put in place to combat money laundering and terrorist financing.

There has also been an unbundling of the trustee's role where co-fiduciaries take on the responsibility for directing certain aspects of a trust's administration in a directed trust. Finally, today's beneficiaries often request their inheritances in trust to obtain protection from creditors and to minimize transfer taxes by holding inherited assets in trust. These changes have spurred the evolution of the trust industry and presented new challenges to continued growth and profitability.

Increased Complexity of Trust Investments

Historically, trust laws evolved with the development of the common law as each new fiduciary issue was resolved by the courts. A trustee's duties and obligations were often determined based upon standards of prudence and loyalty litigated after the fact. The result of judging fiduciary conduct using 20/20 hindsight was that a trustee's default standards of care were very conservative. Statutes that attempted to modify the common law were strictly construed and, ultimately, may not be enforced by the court if there were appropriate grounds for the court to craft an exception. These circumstances required the trust industry to maintain a very conservative approach.

In the investment realm, the investment process was initially driven by "legal lists" of permissible investments including government bonds and first mortgages. By the 1940s, legal lists were replaced in most states by the prudent man rule which characterized investment in "speculative" stocks, discounted bonds, or buying any securities on margin as presumptively improper. Not until the late 1980s did states begin to repeal their prudent man rules in favor of a prudent investor rule that embraced modern portfolio theory. Until this time, it was generally not seen as prudent to invest in a diverse portfolio of securities.

Modern Trust Laws Require a Sophisticated Trustee

Trust-friendly laws allowing for directed trustees and perpetual trusts are not new concepts, but their proliferation in recent years and broad acceptance in many states have expanded the scope of trustees who must administer these complex structures. Starting in the mid-1980s, states began to compete for trust business using favorable trust laws as a lure to bring trust assets into their states. Many states began to repeal their common law rules against perpetuities to allow for perpetual trusts and to codify laws allowing the role of the trustee to be unbundled so advisors could direct how the trustee exercised its fiduciary powers, the so-called directed trust. Beginning with Alaska and Delaware in 1997, certain states began to apply spendthrift protections to self-settled trusts allowing for the creation of domestic asset protection trusts. Until this time, wealthy individuals had to use offshore asset protection trusts if they wanted creditor protection while retaining access to their assets.

During this period of evolution in the trust laws, differences in state income tax laws created opportunities for residents of one state to explore the use of personal trusts administered in another trust-friendly state for the purpose of minimizing their overall state income tax burden. The situs of trust administration became a compelling reason to seek a trustee located in a favorable jurisdiction like Delaware, South Dakota, or Alaska. State income tax arbitrage lead to complex trust structures used to minimize taxes upon the recognition or receipt of income (a so-called "ING" trust) so the taxpayer remains a resident of his or her high-tax home state while exporting the assets to a trust in a low or no-tax jurisdiction to limit state income taxes.

One challenge in the trust industry today is distinguishing between complicated trust structures that require a robust trustee who is fairly compensated for these services versus trusts that may be serviced by a thinly-staffed trustee for the purpose of essentially renting administrative situs in a preferred jurisdiction. Describing and demonstrating the value proposition regarding the services being performed may be a challenge for a corporate trustee because many families face the decision of whom to select as their trustee only once and don't appreciate the downside to picking the lowest-cost provider. Advisors who regularly counsel families on these decisions understand the value a sophisticated trustee brings and can help families find the right fit. Trustee services are not a commodity because each trust relationship is unique.

Multinational Families Are Utilizing More Trusts

A generation ago, inter-state planning was a complicating factor when structuring a family trust. Today, it is common to do trust planning for multinational families impacted by the laws and taxes of multiple countries. The variety of domestic and foreign tax laws involved when planning for the multinational family requires sophisticated tax counsel and a fiduciary partner able to meet the ongoing and evolving demands of these complex trust structures. Some multinational families seek efficient methods for importing their wealth to the United States after their children come to the U.S. for an education and then remain in the U.S. following marriage or to pursue professional opportunities in the states. Others seek a safe-haven for family wealth because their home country may be financially or politically unstable, with the United States seen as the "offshore" jurisdiction of choice. Finally, U.S. estate tax laws encourage the use of trusts to hold U.S.-based real estate by non-resident aliens to avoid U.S. estate taxes upon their death.

Driving Forces Behind the Expansion of the Trust Industry

As trust and tax laws changed and investments became more complex, successful families sought the services of professional fiduciaries located in favorable jurisdictions who were adept at navigating these complex trust laws and able to take advantage of these modern investment options. The demand for fiduciary services made trust departments an attractive source of revenue to financial institutions and some states began to compete to attract trust assets into their states. Some innovations in trust laws that states used to bring assets into their state (such as perpetual trusts, directed trustees, and self-settled spendthrift trusts (asset protection trusts, or APTs)) made the role of a trustee so complex that only a professional fiduciary skilled at navigating these complex trust laws is able to carry out the basic duties of the fiduciary. However, as the sophistication in the role of the trustee evolved to this point, pricing demands created by fierce competition for this fiduciary business put a strain on operating margins.

While some people improperly view the role of the directed trustee as an easy and passive job, the workload (and sometimes the risk) of the directed trustee is often greater than when a trustee holds all of the duties and responsibilities of a traditional trustee. Each new directed transaction carries with it a unique set of facts. The trustee must ensure that the directed transaction is proper – i.e., the investment is permitted by the trust agreement, it is legal, and the trust qualifies to make the investment. For example, some unique circumstances can arise when a federally-regulated financial institution is directed to invest in a marijuana production business that may be legal under state, but not federal law. The directed trustee must also understand whether it is an accredited investor when directed to purchase securities that are not registered with financial authorities. While the role of the directed trustee may appear passive on paper and in concept, a trustee with a deep bench of fiduciary professionals is required to properly administer most directed trusts.

(continued on p. 20)

(continued from p. 19)

Conclusion

The evolution of the trust industry has highlighted the fact that modern trusts require the services of robust professional trustees adept at navigating complex legal, tax, investment and regulatory issues. Sophisticated wealth planners demand the use of sophisticated trustees in preferred jurisdictions who have in-house legal, tax, and administrative talent to deliver these complex fiduciary services. One challenge resulting from the proliferation of investment-directed trusts and thinly-staffed trust companies willing to serve as trustee in name only is to put pricing pressure on these services when they are viewed as a commodity in the market. However, trustees with the depth of talent required to administer trusts for multinational families, trusts holding unique investments, or trusts created in support of complex planning goals, may still be paid adequately for their services if they are able to detail and demonstrate the value of their robust fiduciary services. In the end, the trust industry continues to thrive and meet the needs of wealthy multinational families in this brave new world.

Jeffrey C. Wolken is responsible for developing trust planning strategies for wealthy individuals and families throughout the United States and abroad. He works closely with his clients' legal, tax, and investment advisors to construct and implement appropriate trust structures that take advantage of the state of Delaware's unique trust and tax laws.

This article is not designed or intended to provide financial, tax, legal, accounting, or other professional advice.

2017 Delaware Trust Conference

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Winning the Wealth Managment Game!

Trust Professionals Get Their Game On for a Record Conference

Attendees fill the Chase Center's Wilmington Hall for a plenary session of the 2017 Delaware Trust Conference

A record number of Trust and Wealth Management professionals attended the 2017 Delaware Trust Conference: Winning the Wealth Management Game, October 24th and 25th at the Chase Center on the Riverfront in Wilmington. For the twelfth year the unique advantages of the favorable Delaware Trust environment were showcased with over fifty of the nation's top trust, legal and wealth management experts providing the latest information on Delaware trusts. In addition to the information on Delaware trusts for which the conference is renowned, this year included concurrent sessions on utilizing Delaware for international clients.

Thank you to all speakers, liaisons, and attendees for another great Delaware Trust Conference. Special thanks to the sponsors and exhibitors (see page 23 for a complete listing) for their support!

The Delaware Bankers Association thanks the members of the trust conference planning committee who helped make the 2017 Delaware Trust Conference a success:

Committee Chairs: Cynthia D.M. Brown, Esq., President, Commonwealth Trust Company*; and, Thomas M. Forrest, CPA, President & CEO, U.S. Trust Company of Delaware.
Committee: Lisa K. Berry, Managing Director, PGB Trust & Investments of Delaware*; Bridget Boyd, MBA, CFTA, SVP & Senior Trust Officer, Citi Trust Delaware*; Anne Booth Brockett, Vice President, BMO Delaware Trust Company; Timothy Carroll, Esq., COO, New York Private Trust; Jennifer A. Cuva, Sr. Manager, Trust Administration, Charles Schwab Trust Co. of DE; Matthew P. D'Emilio, Esq., Director, Cooch & Taylor, P.A.; Mark E. Doyle, J.D., LL.M., Senior Vice President, Bessemer Trust Co. of DE; William Dugdale, Senior Advisor, Brown Advisory; Charles J. Durante, Partner, Connolly Gallagher LLP*; Robert W. Eaddy, President & CEO, The Bryn Mawr Trust Company of Delaware; Todd A. Flubacher, Partner, Morris Nichols Arsht & Tunnell LLP*; John S. Harrison, Vice President, The Bryn Mawr Trust Company of DE; Daniel F. Hayward, Esq., Director, Gordon, Fournaris & Mammarella, P.A.;

Francis J. Hazeldine, Managing Director, Trust Administration, Charles Schwab Trust Co. of DE; Maria Iversen, CTFA, SVP, Sr. Trust Advisor and Team Lead, The Northern Trust Company of DE; George W. Kern, Esq., Managing Director, Bessemer Trust Company of DE; Carlo Lombardi, Esq., Vice President, Wilmington Trust Company*; Darlene M. Marchesani, J.D., LL.M., Chief Trust Officer & Trust Counsel, Evercore Trust Co. of DE*; M. Lisa Meehan, CCTS, VP, Group Manager, Personal Trust, Christiana Trust, A Division of WSFS*; Glenn J. Morley, Vice President, Brown Brothers Harriman Trust Company*; Mark V. Purpura, Esq., Director, Richards, Layton & Finger, P.A.; Isabel A. Pryor, CEO & Director, Key National Trust Company of Delaware; Jordon Rosen, CPA, AEP®, Director – Estates & Trusts, Belfint Lyons & Shuman, P.A.*; Nicole M. St. Amand, CTFA, Assistant Vice President, Wilmington Trust Company*; Vincent C. Thomas, Esq., Partner, Young Conaway Stargatt & Taylor, LLP*; Lizzie Vannote, VP & Trust Officer, J.P. Morgan Trust Company of Delaware; Lynn Welch Watson, CFP, EA, VP, Sr. Trust Officer, Brown Brothers Harriman Trust Company of Delaware*; Kalimah Z. White, Vice President, TD Bank*; and, Kevin A. Worsh, Senior Wealth Director, BNY Mellon Wealth Management.

**Trust Conference Panel Liaison*

Thanks also to liaisons Jessica Mojica, CTFA, Assistant Vice President, Christiana Trust; and, Nicole E. Krajewski, Trust Officer, Wilmington Trust Company, Wealth Advisory.

A Special thank you to our 2017 Delaware Trust Conference Ambassadors: Beth Albano, Executive Vice President, Artisans' Bank; DBA Director; Anne Booth Brockett, Vice President, BMO Delaware Trust Company; Cindy Brown, President, Commonwealth Trust Company, DBA Chair-Elect, Delaware Trust Conference Co-Chair; Chuck Durante, Partner, Connolly Gallagher LLP; Todd Flubacher, Esquire, Morris Nichols Arsht & Tunnell; Tom Forrest, President & Chief Executive Officer, U.S. Trust Company of Delaware, DBA Director; Delaware Trust Conference Co-Chair; Donna Mitchell, President & Chief Executive Officer, DBA Director-At-Large; Isabel Pryor, CEO & Director, Key National Trust Co. of Delaware; Jim Roszkowski, President, Discover Bank; DBA Director-At-Large; Lynn Welch Watson, Vice President, Brown Brothers Harriman Trust Co. of Delaware.

The DBA Ambassador Program is a member relationship program. The objective of this program is to build a solid relationship with Members, New Members, First Timers (first event attendees) and the DBA. This program helps New Members and First Timers feel welcomed and educated about the Delaware Bankers Association, its events and its member family.

Let the games begin! The 2017 Delaware Trust Conference opens with a review of what's new in trusts with (l. to r.) James R. Brockway, Esq., Partner and Joint Wealth Planning Practice Group Leader, Withers Bergman LLP; George Karibjanian, Esq., Partner, Franklin Karibjanian & Law, PLLC; and, Norris Wright, Esq., Director, Gordon Fournaris & Mammarella, P.A.

Unveiling the Secret Sauce of Delaware Trusts...(l. to r.) Charles J. Durante, Esq., Partner, Connolly Gallagher LLP; Anne Booth Brockett, Vice President, Chief Trust Officer, BMO Delaware Trust Company; and, George W. Kern, Esq., Managing Director, Bessemer Trust Company of Delaware, N.A.

Wilmington Trust's Senior Trust Counsel Dick Nenno was recognized at the Delaware Trust Conference for his 35 years of service with the Delaware company. Dick met with conference attendees at a meet-and-greet on the first day of the conference. He gave out copies of his book Delaware Trusts 2017, which is the 15th edition of the preeminent resource on Delaware trust law updates. Pictured above, Dick chats with DBA President Sarah Long during the meet-and-greet.

Cybersecurity Challenges… (at l.) Dr. Starnes Walker, Founding Director, University of Delaware Cybersecurity Initiative addresses the Conference luncheon. Next, (l. to r. below) Edward J. McAndrew, Partner, Ballard Spahr LLP; Carl N. Kunz III, Partner, Morris James LLP; and, Jeffrey A. Reising, Special Agent, Federal Bureau of Investigation, offer effective plans to combat cyber incidents.

It's The Dating Game!
Cynthia Brown sits behind the curtain as the trust bachelorette as she quizzes potential trust jurisdictions - (l. to r.) Mary A. Akkerman, Esq., Partner, Linquist & Vennum LLP;
Todd A. Flubacher, Esq., Partner, Morris Nichols Arsht & Tunnell LLP; Stephanie B. Casteel, Esq., Partner, Wallace Morrison & Casteel LLP; and, Amy K. Kanyuk, Esq., Partner, McDonald & Kanyuk, PLLC

Future Players! The first class of students from the University of Delaware's Alfred Lerner College of Business & Economics minor in Trust Management attended conference sessions on Wednesday with Jennifer Zelvin McCloskey, Director of the minor.

(l. to r.) Sarah Long, DBA President, presents Trust Committee Chairs Thomas M. Forrest, CPA, President & CEO, U.S. Trust Company of Delaware and Cynthia D.M. Brown, President, Commonwealth Trust Company with replicas of the Conference's logo: a Delaware chess piece.

"Hangman" - (l. to r.) Jere Doyle, LLM, Senior Vice President, BNY Mellon Wealth Management; W. Donald Sparks, II, Esq., Director, Richards Layton & Finger, PA; and, Jordon Rosen, CPA, Director – Estates & Trusts, Belfint Lyons & Shuman, P.A., address Post-Mortem Election Strategies.

(l. to r.) Donna Mitchell, President & CEO, Deutsche Bank Trust Company of Delaware; Susan Rodriguez, Trust Officer, New York Private Trust Company; Chuck Durante, Partner, Connolly Gallagher LLP; and, Joseph Dionisio, Managing Director, First Republic Bank, at Tuesday evening's reception.

Paul Lee, Regional Wealth Advisor, The Northern Trust Company, gives a dynamic presentation on Managing Tax Basis Today for Tomorrow.

Truth or Consequences? Daisy Medici, Managing Director of Governance & Education, GenSpring Family Offices, LLC, speaks on resolving difficult situations in family relationships.

"Trivial Pursuit" (l. to r.) Daniel F. Lindley, Fiduciary Practice Lead - Global Family Offices, The Northern Trust Company; Leigh-Alexandra Basha, Esq., Partner, McDermott Will & Emery; and, Stanley A. Barg, Esq., Partner, Kozusko Harris Duncan, Private Client/Wealth Management Counsel, discuss Managing the Domestication of Foreign Trusts as part of the conference's International Track.

Ambassador Lynn Welch Watson, Vice President, Brown Brothers Harriman Trust Co. of Delaware, chats with Cody Snyder, Vice President, U.S. Trust Company of Delaware. Ambassadors made sure that First Time and New Member Attendees understood how to make the most of event networking opportunities. Ambassadors also introduced New Member and First Time Attendees to other members and colleagues.

Compliance Focus

Getting HMDA Right is More Important Than Ever

by
Robert W. Cardwell, Jr., Esq.
Managing Principal
Consumer Finance & Fair Banking
CAPCO Finance, Risk & Compliance Solutions

"Understanding all the nuances and intricacies of HMDA can be a challenge for institutions . . . violations are the product of a complex, exacting regulation."

On August 22, 2017, the FFIEC announced new HMDA Examiner Transaction Testing Guidelines (Guidelines) for all financial institutions that report HMDA data. The Guidelines will be the first-ever uniform guidelines across all federal bank HMDA supervisory agencies (CFPB, FDIC, FRB, NCUA and the OCC) and will apply to the examination of HMDA data collected beginning in 2018 and reported beginning in 2019.

Federal supervisory agencies with HMDA authority may check the accuracy of HMDA data within a sample of an institution's reported transactions. An institution is directed to correct and resubmit HMDA data if the number of errors in the sample exceeds certain thresholds.

With the new data fields going into effect for collection beginning January 1, 2018, the Guidelines:

- Eliminate the file error resubmission threshold under which a financial institution would be directed to correct and resubmit its entire Loan Application Register (LAR) if the total number of sample files with one or more errors equaled or exceeded a certain threshold;
- For the purpose of counting errors toward the field error resubmission threshold, establish allowable tolerances for certain data fields; and,
- Provide a more lenient 10 percent field error resubmission threshold for financial institutions with LAR counts of 100 or less, many of which are community banks and credit unions.

However, there has been some industry concern that the new Guidelines create a disproportionate expectation for small volume lenders. An August 22, 2017 post in the ABA Banking Journal put it this way:

Despite coming after concerns expressed by the American Bankers Association and others about the burdens imposed by unreasonable error tolerances that require a bank to resubmit its HMDA data - in light of the vastly expanded data fields that must be reported beginning in March 2019 - the new guidelines are expected to have the opposite result, creating disproportionate expectations for smaller volume lenders.

For smaller volume lenders, this could be costly as resubmission is a strain on both resources and time. To prevent this, institutions should make sure they are performing an effective and thorough HMDA scrub prior to submission.

While enforcement actions citing HMDA violations have been declining, instances of these penalties are still present and concerning to institutions required to report under Regulation C. In the last year alone there have been multiple enforcement actions that drive home the importance of getting HMDA right the first time and every time.

In March of this year, the CFPB fined a Texas-based mortgage lender $1.75 million for violating HMDA by consistently failing to report accurate data about mortgage transactions from 2012 through 2014. The lender was also required to take the necessary steps to improve its compliance management system to prevent future violations. Weaknesses cited by the CFPB included:

- Flawed HMDA compliance systems
- Significant, preventable errors in mortgage lending data
- Failure to maintain detailed HMDA data collection and validation procedures
- Failure to implement adequate compliance procedures
- Inadequate vendor management with respect to HMDA
- Inconsistent data definitions among its various lines of business

Understanding all the nuances and intricacies of HMDA can be a challenge for institutions. These violations are the product of a complex, exacting regulation. But compliance violations are preventable. The upcoming effective dates for the new HMDA Final Rule provide a great opportunity for HMDA reporters to demonstrate their preparedness with an effective compliance management program.

This article was excerpted from Capco's Regulatory Intelligence Briefing (RIB): Ensuring Compliance with the New HMDA Requirements, September 2017. For the complete RIB or to register your colleagues to receive regular updates from Capco's Center of Regulatory Intelligence, email: **capco.cri@capco.com**

The panel answers the question: When Should a Trustee Go to Court? during "To Tell the Truth." (l. to r.) Daniel F. Hayward, Director, Gordon, Fournaris & Mammarella, P.A.; The Hon. Abigail M. LeGrow, Judge, Delaware Superior Court; and, Shawn Wilson, Managing Director, Charles Schwab Trust Co. of Delaware

"Jeopardy!" - The pitfalls of saying "No" to a Beneficiary and Navigating Potentially Improper Directions is addressed by the panel (l. to r.) Bridget V. Boyd, CTFA, SVP & Fiduciary Services Head, Citicorp Trust Delaware, NA; Francis J. Hazeldine, CTFA, Managing Director, Personal Trust Administration - Charles Schwab Trust Company of Delaware; Kalimah Z. White, Vice President, Senior Trust Advisor, Delaware, TD Wealth Private Client Group; and, Mark A. Oller, CTFA, Administrative VP, Managing Director, Wilmington Trust.

Accounting for Success

by
Emily V. Schmidt, CPA
Belfint Lyons & Shuman, P.A.

"When retirement-eligible workers cannot afford to retire, it can lead to higher labor costs due to higher compensation and increased health and disability claims..."

What About Your Health Savings Account When You Pass Away?

Health Savings Accounts (H.S.A.s) are powerful tools, particularly if you participate in a high deductible health insurance plan. H.S.A.s are essentially tax-exempt accounts to fund certain medical costs you may incur. You may deduct contributions you or an individual other than your employer makes to your H.S.A. on your behalf. A deduction for H.S.A. contributions is available to you even if you do not itemize your deductions on your return. Furthermore, your employer may also make contributions to your account. In this case, your employer's contributions are excluded from your income. You may use distributions from your account tax-free for qualifying medical expenses. Any unused funds roll over from year-to-year. Additionally, all interest and investment earnings to your H.S.A. are tax-free. You may now be familiar with the benefits of your H.S.A. while you are alive, but do you know what would happen to your H.S.A. when you die? Where do the funds go? What are the tax consequences? In essence, the fate of your H.S.A. funds will be determined based on whom you designate as the beneficiary.

Spouse as a Beneficiary

A spouse is the most commonly designated beneficiary. When your spouse inherits your H.S.A. on the date of your death, the account will retain its character and legally become theirs. This transfer does not require your spouse to have an H.S.A. eligible health insurance policy. Moreover, your spouse will be able to utilize the funds to pay for medical expenses; including long term care premiums. In other words, the provisions of the H.S.A. will apply to your spouse as they had applied to you. In addition, once your spouse turns 65, account assets can be used for any type of expense without incurring a 20% penalty on the distribution. The particular expense does not have to be medically related. With that being said, it may be most advantageous for your spouse not to access the inherited H.S.A. funds until they reach the age of 65.

Non-Spouse Beneficiary

If you designate an individual who is not your spouse as the beneficiary, the H.S.A. classification of the account funds terminates upon transfer. The fair market value of the H.S.A. at your date of death becomes taxable to the beneficiary. The taxable amount will be reduced by any qualified medical expenses the beneficiary had paid for you within one year of your death.

Estate as a Beneficiary

You also have the option to designate your estate as a beneficiary. If you do not designate a beneficiary, your estate automatically becomes the beneficiary. In this case, the fair value of your H.S.A. will be reported on your final 1040. You will be able to take advantage of tax savings in the form of a deduction for estate taxes paid on the value of your H.S.A. included in your taxable estate.

In summary, you must consider all outcomes carefully when you complete your beneficiary form for your H.S.A. If you do designate a beneficiary, ensure they also understand the applicable tax implications when they receive the funds. To receive more information regarding H.S.A.s including limits and timing of contributions; please feel free to contact one of our knowledgeable tax advisors.

"Mastering the Chess Pieces" (l. to r.) Scott E. Swenson, Esq., Partner, Connolly Gallagher LLP; Matthew P. D'Emilio, Esq., Director, Cooch & Taylor, P.A.; Mark E. Doyle, Esq., Senior Vice President, Bessemer Trust Company of Delaware, N.A.; and, Vincent C. Thomas, Esq., Partner, Young Conaway Stargatt & Taylor, LLP, discuss Effectively Utilizing the Tools in the Delaware Statutes

"Deal or No Deal" (l. to r.) Emily B. Pickering, Esq., Associate, Morgan, Lewis & Bockius LLP; Jocelyn Margolin Borowsky, Esq., Partner, Duane Morris LLP; and, Richard W. Nenno, Esq., Senior Trust Counsel and Managing Director, Wilmington Trust Company discuss the Intersection of Third Party Trusts and Divorce Law

For Your Benefit

Affordable Care Act 2018

by
Louis D. Memmolo, GBA, CHRS
Employee Benefits Advisor
Weiner Benefits Group

"The ACA is alive and well and gearing up for a strong showing in 2018."

Delaware Individual Health Insurance Market

The Marketplace in Delaware is down to one carrier with a handful of options and another double-digit increase. Health insurance shoppers visiting Healthcare.gov will find higher premium costs, higher deductibles and fewer plans on the menu.

President Donald Trump's executive order signed on Oct. 12, 2017, which intended to change certain rules under the Affordable Care Act (ACA) has not yet had a full impact on the choices available in Delaware.

The order relaxes regulations on association health plans allowing individuals and small businesses to purchase health insurance policies across state lines and avoid certain ACA requirements.

The executive order also directs the Departments of Labor, Health and Human Services, and the Treasury (Departments) to consider expanding the availability of low-cost short-term, limited-duration insurance and HRAs.

In addition to the executive order, the White House also announced it could no longer legally reimburse insurers for cost-sharing reductions made available to low-income individuals through the Exchanges under the ACA, effective immediately, due to a lack of appropriations from Congress. The settlement of this issue contributes to the increase in costs for individual and marketplace health insurance.

IRS Issues Pay or Play Enforcement Guidance

The ACA's employer shared responsibility rules require applicable large employers (ALEs) to offer affordable, minimum value health coverage to their full-time employees or pay a penalty. The "employer mandate" or "pay or play" rules, only apply to ALEs, which are employers with, on average, at least 50 full-time employees and full-time equivalents.

No penalties have been assessed under the employer shared responsibility rules to date, however, employers subject to these rules are still responsible for compliance. The new guidance indicates that, for the 2015 calendar year, the IRS plans to issue letters informing employers of their potential liability for the penalty, if any, in late 2017.

The IRS plans to issue Letter 226-J to an ALE if it determines that, for at least one month in the year, one or more of the ALE's full-time employees was enrolled in a qualified health plan for which a premium tax credit was allowed (and the ALE did not qualify for an affordability safe harbor or other relief for the employee).

ALEs will have an opportunity to respond to Letter 226-J before any employer shared responsibility liability is assessed and notice and demand for payment is made. Letter 226-J will provide instructions for how the ALE should respond in writing, either agreeing with the proposed employer shared responsibility penalty or disagreeing with part or all or the proposed amount.

If the ALE does not respond to either Letter 226-J or Letter 227, the IRS will assess the amount of the proposed employer shared responsibility penalty and issue a notice and demand for payment—Notice CP 220J.

Unless Congress acts and repeals the mandates, many employers will have to begin responding to these letters and possibly paying the penalties.

DBA Calendar of Events

For more information on these and other programs visit ***www.debankers.com***
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December 6, 2017 - 12 to 3 p.m.
Staying Secure in the Cloud - A Cybersecurity Forum
University & Whist Club, Wilmington. Join a panel of experts as they discuss the latest issues surrounding cloud security for financial institutions including methods, controls, challenges, and best practices. The event will include lunch.

March 7 - 9, 2018
Delaware Bankers Association Executive Officer Washington Visit
This highly acclaimed event for top-level bank executives provides an extraordinary opportunity to meet with the key federal regulators as well as with our industry's representatives at the American Bankers Association in Washington, DC. In addition, we also meet with the entire Delaware Congressional Delegation. Sponsorships Available!

May 17, 2018
DBA Annual Meeting and Dinner
Join Delaware's top bankers at this annual event at the historic Hotel du Pont with dinner in the elegant Gold Ballroom. Sponsorships Available!

Lending Law Update

by
Eugene A. DiPrinzio, Esq.
Young Conaway Stargatt & Taylor, LLP

"Both lenders and borrowers should be fully apprised of the implications of undertaking a Swap transaction in a commercial loan."

Hedging Interest Rate Risk – "The Good, the Bad and the Ugly"

In the commercial lending world, both lenders and borrowers have a significant aversion to interest rate risk. Most lenders do not wish to maintain and hold loan obligations in their portfolio with fixed rates of interest, simply because the yield on the money lent may be higher or lower depending on market conditions. The opposite holds true for borrowers who seek to avoid rising interest rates that occur with variable rate loans. To manage this risk, the financial markets have developed derivative products called "swaps" or "hedges" that are designed to reduce risk. Interest rate swaps ("Swaps") are commonly used with commercial loans and obligations that are pegged to variable rates. The use of Swaps can be very beneficial but they also can have undesirable results if the parties are not cognizant of the good, the bad and the ugly as described below.

The "good" occurs when interest rate risk is bargained away through a Swap. In a rising interest rate environment, a borrower becomes protected with a fixed rate that can be counted on for the term of the loan. It can be a win-win situation if both the lender and the borrower get exactly what they want in negotiating the structure of the transaction.

The "bad" arises when a borrower does not understand that a Swap is a separate obligation apart from the loan. Notwithstanding this separateness, many Swaps are integrated as obligations that are required to be paid as part of the underlying loan and are sometimes secured by the same collateral as the loan. Thus, while a particular promissory note may permit prepayment, a Swap, on the other hand, may require that such a prepayment create a termination event which entitles the holder of the Swap to a breakage or termination fee. Moreover, many Swap obligations are cross-defaulted and cross-collateralized with all of the borrower's underlying debt to a particular lender. Therefore, the parties need to be acutely aware of all loan requirements along with any events which could trigger termination fees and/or prepayment penalties under the Swap.

The "ugly" rears its head when the parties do not comprehend the full implications of the underlying note and Swap obligations. For example, in a recent case entitled *Compass Bank v. Durant*, (2017 TEX.APP.LEXIS70) (dated January 5, 2017), the Second District Court of Appeals ruled that both a prepayment penalty and a termination fee were enforceable against a borrower notwithstanding the borrower's ignorance or lack of sophistication in understanding the Swap transaction. The contentious litigation that ensued could have been avoided if the parties had consulted with the proper professionals before entering into the Swap transaction.

Both lenders and borrowers should be fully apprised of the implications of undertaking a Swap transaction in a commercial loan. It is critical that the underlying terms and conditions upon which payments are made or will be prepaid are fully understood and vetted; otherwise there could be disastrous consequences for all parties involved in the transaction.

Photo: (L to R) T. Hall, C. Durante, S. Swenson, G. Weinig

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