Delaware Banker

Fall 2020
Vol. 16 No. 4

Sustainable & Impact Investing

Considerations for Delaware Trustees

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Delaware Bankers Association
The Delaware Bankers Association
P.O. Box 781
Dover, DE 19903-0781
Phone: (302) 678-8600 Fax: (302) 678-5511
www.debankers.com

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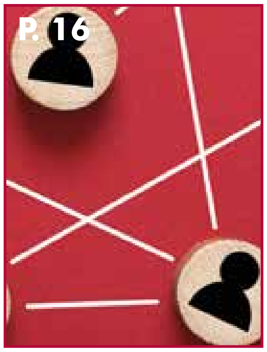

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View from the Chair

by
Joe Westcott
Market President
Capital One

Chair
Delaware Bankers Association

"Delaware's banks have been consistent in their service to our customers and our community."

"May you live in interesting times." This phrase, often cited (erroneously as it turns out) as an ancient Chinese curse, is no less potent for being fictitious. Few of us will dispute that 2020 has been a very interesting year, and few of us will regret it being over. Many of the events that normally mark our years have been canceled or drastically changed due to the COVID-19 pandemic. As an association, the DBA has canceled some events and held others "virtually." I am pleased to report that our annual Delaware Trust Conference could be held on a virtual platform with an even greater number of sessions than in usual years.

One tradition has continued, though its impact may have been lost in the "interesting times." I refer to our annual Community Brochure. This publication typically comes out in the spring and is premiered at the DBA annual dinner. This year, the brochure appeared as a supplement to the expanded summer issue of the magazine. The brochure highlights the contributions that Delaware's banks make to the vitality of the First State.

I may be preaching to the choir, but it bears repeating. Delaware's banks provide jobs (over 47,600 in the financial services category). In FY 2019, banks paid over $100 million in franchise taxes to the state. Our employees were good corporate citizens too, volunteering over 218,000 hours to community non-profit agencies. In my previous column, I detailed the vital service banks provided in handling the unprecedented job of processing Paycheck Protection Program loans.

As mentioned, 2020 has been a year like no other in recent memory. But while times have been unusual, to say the least, Delaware's banks have been consistent in their service to our customers and our community. In the past year, Delaware's banks donated over $17 million in grants and contributions to local charities and non-profit organizations. Banks help support the work of hospitals, schools, homeless shelters, and many other agencies. Rather than a banker using a magazine page to praise his colleagues, I prefer to let Delaware Senator Chris Coons offer his comments. Recently, on the floor of the United States Senate, Senator Coons was speaking during a debate on proposed changes to the Community Reinvestment Act when he used Delaware's banks as a testimony of the act's effectiveness.

> *In Delaware, I've seen the benefits of the CRA first hand. I've seen investments in affordable housing, homeownership opportunities, and economic and small business development as a result. Discover Bank, for example, partnered with the Delaware State Housing Authority to provide mortgages to low- and moderate-income borrowers throughout the state by purchasing loans originated by DSHA. WSFS made a one-and-a-half-million-dollar investment in NCALL's Restoring Central Dover initiative, and a half-a-million-dollar line of credit to help build homes for new homeowners who are low- and moderate-income, and gave a million-dollar low-interest loan for economic development in our capital city. And Capital One recently made a 20-million dollar loan to finance the Community Education Building in downtown Wilmington where Kumba Academy resides.*
>
> - Sen. Chris Coons, October 19, 2020

Had he more time, the Senator could have shared dozens more examples of what Delaware's banks do every day not just to meet the letter of the regulations, but to fulfill the spirit and promise of them. Thank you all for your service to Delaware and Delaware's banking industry. May we all enjoy a slightly less interesting 2021!

Joe

President's Report

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

"A pivot was precisely what was required to present the fifteenth annual Delaware Trust Conference virtually. "

One of my favorite comedy TV shows from the '90s is *Friends,* which aired for ten seasons and chronicled the lives of 6 friends living in New York. If you are a *Friends* fan, you surely have a favorite episode or scene. For me, one of the more iconic moments occurs in the episode titled "The One with the Cop." Ross buys a new couch and decides to carry it up to his apartment so he would not have to pay the delivery fee. Ross sketches out how, with Rachel and Chandler's help, they can navigate the couch up the narrow stairway. Ross shouts out instructions as they begin moving the couch up the stairs. As they reach the first full turn, Ross instructs Rachel and Chandler to start pivoting, leading to Ross screaming "pivot" repeatedly. Needless to say, the pivot did not work out well.

Fast forward to today when the word "pivot" has taken on an entirely new meaning. According to *Entrepreneur*, "pivot" has become a buzzword referring to a significant business change - ranging from mild to dramatic. A pivot is usually intended to help a business recover from a challenging period or survive after experiencing new competition or other factors that make the original business model unsustainable."

And yes, a pivot was precisely what was required to present the fifteenth annual Delaware Trust Conference virtually. Under the leadership of The Executive Committee comprised of Chair Todd Flubacher, Partner, Morris Nichols Arsht & Tunnell LLP; Co-Chair; George Kern, Managing Director, Bessemer Trust; Past-Chair; Mark Oller, CTFA, President - Family Wealth Delaware, Wilmington Trust Company and Trust Committee Chair Cynthia Brown, President, Commonwealth Trust Company, the decision was made early on to transform the Conference to a new virtual format. And not just any format, but a virtual venue that would provide attendees with the look and feel of attending the Conference in person.

Enter Corinne Stayton, DBA Event Technologist, and Greg Koseluk, Vice President, DBA Marketing and Public Relations, who worked tirelessly to investigate and select the right virtual platform, and then spent countless hours recording and editing each session to ensure the best quality product was delivered. Renee Rau, DBA Education Coordinator, worked diligently to ensure online registration (first time for that too!) worked well and ensured attendees received continuing education credits for their attended sessions.

We would also like to acknowledge and thank the Trust Conference Committee made up of Delaware's top trust, legal, and wealth management professionals who selected topics and speakers to highlight many of the unique, time-tested advantages provided by the Delaware product. Each presentation featured renowned experts on a wide array of topics ranging from ethical issues in planning for the modern family, to perspectives from in-house trust counsel, to the past year's most significant, curious, or downright fascinating fiduciary cases! Thank you to all the speakers for sharing so freely their subject matter expertise.

Last but not least, we thank all of our sponsors, exhibitors, and attendees for investing in this year's Trust Conference. With their generous support, all things were possible. On behalf of the entire DBA team, thank you to all who ensured the pivot to the virtual format worked out well!

Sarah

What's New at the DBA

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Theresa L. Hughes
Professional Individual Trustee

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Fax: 302-737-3362
Email: thughes@piniondelaware.com
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In affiliation with Santora CPA Group, Pinion is a Professional Individual Personal Trustee in Delaware, providing a smart alternative solution available to attorneys, financial advisors, corporate trust providers... and directly to clients. The name, Pinion, recalls the feathers of a bird's wing responsible for the freedom of flight. The freedom to choose the way trusts are administered is Pinion's mission. Pinion understands that personal trusts and the families associated with them often have unique and complex needs that require innovative and flexible solutions.

Sustainable & Impact Investing: Considerations for Delaware Trustees

by
John F. McCabe
Chief Fiduciary Counsel,
The Glenmede Trust Company, N.A.,
and Chief Fiduciary Counsel & Secretary,
The Glenmede Trust Company of Delaware
and
Mark Hays
Director of Sustainable & Impact Investing,
The Glenmede Trust Company, N.A.

Consider the following request that a current beneficiary of a multi-generational, non-charitable, Delaware trust might submit to a trustee. The beneficiary asks the trustee to incorporate sustainable and impact investments into the trust's portfolio, and to specifically include investments that are consistent with her values or beliefs. How should a trustee presented with this type of request go about determining whether such investment actions would be consistent with the trustee's duties under Delaware law?[1]

Before considering how these investment strategies would be treated under Delaware law, we'll start with a few definitions. Then, we'll discuss issues for consideration under the Uniform Prudent Investor Act. Finally, we'll review Delaware's approach.

Sustainable & Impact Investing

Although there is a lack, at present, of precise and uniformly accepted definitions for these investment strategies, for purposes of this article, "Sustainable and Impact Investing" describes a spectrum of investment approaches that consider environmental, social, and/or governance (ESG) factors and/or the potential impact when making investment decisions. This spectrum of approaches can enable an investor to position portfolios for a transforming world – a world experiencing important and significant environmental and social changes, including rising wealth inequality, and racial and gender inequity, among others. These long-term, transformative issues not only pose challenges for society and the world, but, they can affect an investment portfolio's holdings from both a risks or opportunities standpoint.

On one end of this spectrum of investment approaches is sustainable investing, which is rooted in the utilization of ESG information as part of the investment process to help enhance investment decision making. While impact may be a by-product of the investment approach, the primary focus of utilizing ESG information is to help avoid potential risks that can arise from poor ESG practices, or, to position towards growth opportunities that can arise from strong ESG practices. In the purest form of sustainable investing, there is no focus on impact generation, only risk/return. On the other end of the spectrum is impact investing, which is the utilization of ESG information as part of the investment process, the primary goal of which is to achieve impact. In the purest form of impact investing the primary goal is some form of societal benefit, to the potential detriment of financial returns. We describe sustainable and impact investing as a spectrum of approaches because in between these two purest forms of sustainable and impact investing are some approaches that seek a double bottom line – both impact and risk/return, to differing degrees. Taken together, these strategies can enable investors to invest capital in a way that suits their goals of either impact or returns, and to help position their portfolios towards a transforming world.

The Uniform Prudent Investor Act

The standard of care under the Uniform Prudent Investor Act is stated as follows: "A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution."[2] This general rule is supplemented by more specific factors[3] that a trustee must consider in making investment decisions, as well as more specific duties that the trustee must carry out, such as the duty to diversify.[4] In states that have adopted the Uniform Prudent Investor Act, these rules provide trustees with the rules of the road, so to speak, in carrying out their fiduciary investment responsibilities.

The Duty of Loyalty

Discussions by commentators on sustainable and impact investing by trustees focus heavily on the duty of loyalty. The duty of loyalty provision of the Uniform Prudent Investor Act states that "[a] trustee shall invest and manage the trust assets solely in the interest of the beneficiaries."[5] The duty of loyalty pre-dates the Uniform Prudent Investor Act, which was drafted in the mid-1990s. In a 1980 article addressing "social investing" by trustees, John Langbein and Richard Posner concluded that "a trustee who sacrifices the beneficiary's financial well-being for any other object breaches both his duty of loyalty to the beneficiary and his duty of prudence in investment."[6] They further stated that "[t]he duty of prudent investing … reinforces the duty of loyalty in forbidding the trustee to invest for any object other than the highest return consistent with the preferred level of portfolio risk."[7]

The focus of Langbein and Posner's analysis was on social investing by pension trustees, but they reached their conclusions under the law applicable to trustees of private trusts. Notably, Langbein and Posner defined "social investing" to mean excluding securities that are otherwise attractive investments and including securities that are otherwise unattractive if those companies are socially irresponsible or laudable, respectively.[8] In line with this view, a comment to the Uniform Prudent Investor Act notes that "[n]o form of 'social investing' is consistent with the duty of loyalty if the investment activity entails sacrificing the interests of trust beneficiaries-for example, by accepting below-market returns-in favor of the interests of the persons supposedly benefitted by pursuing the particular social cause."[9]

More recently, Professors Max Schanzenbach (Northwestern Law) and Robert Sitkoff (Harvard Law) wrote in the opinion pages of The Wall Street Journal that "a trustee must abide by fiduciary duties of loyalty and prudence, and therefore act for the 'exclusive' benefit of the beneficiaries, considering 'solely' their interests, without regard for collateral benefits, such as advancing social or environmental causes."[10] In a separate article, Professors Schanzenbach and Sitkoff draw a distinction between what they refer to as "risk-return" investing and "collateral benefits" investing.[11] They argue that ESG investing is permissible if 1) the fiduciary believes in good faith that the ESG investment program will benefit the beneficiary directly by improving risk-adjusted returns, and 2) the fiduciary's exclusive motive for adopting the ESG investment program is to obtain this direct benefit.[12] According to Schanzenbach and Sitkoff, collateral benefits ESG investing "entails consideration of interests other than the financial interests of the beneficiary" and would be a breach of the duty of loyalty.[13]

The determination of what is in the "interests" of the beneficiaries is a significant question. In 1980, Langbein and Posner commented, as noted above, that the duty of loyalty required the trustee to seek the highest financial returns, without the ability to incorporate the beneficiaries' non-financial values. A more recent commentator has noted that "nothing in the duty of loyalty requires the trustee to exclude consideration of a beneficiary's non-financial interests."[14] Additionally, one of the authors of the present article has commented that "interesting questions would be raised by a legal standard that requires the trustee to make investments that are inconsistent with the values of one or more of the beneficiaries."[15]

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Sustainable Investing

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Delaware's Approach

In recent years, Delaware has modified its law to address this issue. Specifically, the Delaware Code recognizes the concept of sustainable and impact investing in two separate statutory provisions applicable to trusts; the first relating to the degree of care applicable to a trustee and the second addressing the effect of provisions of a trust instrument. With respect to a trustee's degree of care, under 12 Del. C. §3302, when considering the needs of the beneficiaries in making investment decisions, "the fiduciary may take into account the financial needs of the beneficiaries as well as the beneficiaries' personal values, including the beneficiaries' desire to engage in sustainable investing strategies that align with the beneficiaries' social, environmental, governance or other values or beliefs of the beneficiaries."

In terms of trust instruments, under 12 Del. C. §3303, "the terms of a governing instrument may expand, restrict, eliminate, or otherwise vary any laws of general application to fiduciaries, trusts and trust administration, including, but not limited to, any such laws pertaining to … the manner in which a fiduciary should invest assets, including whether to engage in 1 or more sustainable or socially responsible investment strategies, in addition to, or in place of, other investment strategies, with or without regard to investment performance."

These two statutory provisions present an opportunity to be particularly useful when the trustee is in a position to ascertain the values or beliefs of all of the beneficiaries (as contemplated by Section 3302), or where the settlor includes relevant terms in the governing instrument, such as terms that would permit (or direct) the trustee to invest in "sustainable or socially responsible investments … without regard to investment performance" (as described in Section 3303). The latter seems to expressly recognize and permit provisions which would allow the trustee to pursue more pure impact investment strategies where the primary goal is to achieve some type of collateral benefit, rather than to maximize risk-adjusted returns.

Implementation Considerations

Returning to our initial question, how might a trustee of a multi-generational non-charitable Delaware trust proceed with a request by a current beneficiary to implement a sustainable and impact investment program? As with many questions that arise in the management of a trust, the first place to look is the governing instrument. Where the governing instrument is silent on this issue, there is support for the position that risk-return investing is permissible under trust law. This position is enhanced by the provisions of 12 Del. C. §3302.

With respect to the purest forms of impact investments (i.e., investments that may involve a concession of financial return), in the absence of language in a governing instrument as contemplated by 12 Del. C. §3303, the trustee might consider obtaining beneficiary consents under 12 Del. C. §3588, though consideration would need to be given to the virtual representation rules under 12 Del. C. §3547, and/or proceeding with a nonjudicial settlement agreement under 12 Del. C. §3338. If the trustee determines that actual changes to the governing instrument are required, the trustee may consider a trust modification under 12 Del. C. §3342, or perhaps a decanting under 12 Del. C. §3528. As interest in sustainable and impact investing by settlors and beneficiaries grows, trustees should anticipate requests to incorporate such investments and have a clear framework for how and when these strategies may be pursued.

This article is not intended as personalized advice. The authors take sole responsibility for the views expressed herein and these views do not necessarily reflect the views of the authors' employer or any other organization, group or individual. This material has been prepared for general informational purposes only, and is not intended to provide, and should not be relied on for, investment, tax, legal or accounting advice. Readers should consult their own investment, tax, legal and accounting advisors to seek advice relevant to their individual circumstances.

John McCabe serves as Chief Fiduciary Counsel of The Glenmede Trust Company, N.A. and Chief Fiduciary Counsel & Secretary of The Glenmede Trust Company of Delaware. In this role, Mr. McCabe serves as Glenmede's senior internal legal advisor on all trust, estate, and fiduciary matters. Mr. McCabe joined Glenmede in 2014. Prior to joining Glenmede, he served as managing director and senior trust officer for First Republic Trust Company of Delaware and prior to that as vice president and senior trust officer at Goldman Sachs. He began his career as an attorney in private practice in Philadelphia, Pennsylvania. He received his J.D. and LL.M. in taxation from Villanova University School of Law and his B.A. from the University of Delaware. He is a member of the board of directors of Support Center for Child Advocates, a pro bono legal services agency based in Philadelphia. He can be reached at john.mccabe@glenmede.com and (215)419-6127.

Mark Hays is Director of Sustainable and Impact Investing. In this role, he provides strategic leadership of Glenmede's sustainable and impact investing efforts. Mark and his team are responsible for the development of new investment capabilities, the creation and delivery of innovative thought leadership, and the deepening of relationships with clients and industry partners. Previously, Mr. Hays served as Vice President of Sustainable Investing for J.P. Morgan Asset Management. In this role, he developed an enhanced ESG integration framework and led its implementation for more than 25 investment teams,

while helping to create and launch three sustainable investment strategies. Before this role, he served as Vice President of Impact Investments for Flat World Partners, where he oversaw a team responsible for sourcing, investment due diligence, impact analysis, and recommendation of opportunities for sustainable thematic portfolios representing over $1 billion in institutional capital. Mark started his career at Cambridge Associates. Mr. Hays earned a Master of Business Administration from the London Business School and a Bachelor of Science degree in business from Wake Forest University. He can be reached at mark.hays@glenmede.com and at (215) 419-6941.

Notes:

1- Portions of this article have been adapted from, or appeared in, the author's prior writings on this subject, including John F. McCabe and Nina A. Farran, "Impact Investing for Trustees," *Trusts & Estates*, June 2015, and John F. McCabe, "Impact Investing: Considerations for Trustees of Pennsylvania Trusts," *Philadelphia Bar Association Probate & Trust Law Section Newsletter*, June 2019.
2- Uniform Prudent Investor Act (1994).
3- UPIA §2(c).
4- UPIA §3.
5- UPIA (1994).
6- John H. Langbein and Richard A. Posner, "Social Investing and the Law of Trusts," 79 Mich. L. Rev. 72, 96 (1980).
7- See *id*. at p. 98.
8- See *id*. at p. 73.
9- See UPIA, comment to section 5.
10- Wall Street Journal, December 10, 2018, p. A15.
11- Max M. Schanzenbach & Robert H. Sitkoff, "Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee," 72 Stan. L. Rev. 381 (2020).
12- See *id*.
13- See *id.*
14- Susan N. Gary, "Is it Prudent To Be Responsible? The Legal Rules For Charities That Engage In Socially Responsible Investing and Mission Investing," 6 NW. J. L. & Soc. Pol'y, 106, 114.
15- *See* McCabe & Farran, supra note 1.

Power Up Your Clients' Year-End Giving with Special 2020 Tax Incentives

by
Joan Hoge-North
Vice President for Philanthropy
Delaware Community Foundation

In this year like no other, Delawareans statewide have stepped up with enormous generosity, helping neighbors and small businesses struggling to weather the COVID-19 and social justice storms.

At the Delaware Community Foundation – and in community foundations around the country – we have seen a dramatic uptick in generosity in the months since the virus began its march across America. Just through the DCF, hundreds of companies and individuals donated more than $5 million to help Delaware nonprofits respond specifically to pandemic-related community needs.

As we enter the traditional season of gratitude and gift-making, many of your clients may be considering ways to increase the impact of their charitable giving for both the organizations they support and for their own tax obligations. As their trusted advisor, you may be well positioned to help your clients maximize both tax advantages and impact by leveraging special charitable giving incentives established for 2020 only.

Unique Provisions for 2020

While much of the government funding for coronavirus relief has been focused on helping individuals and businesses, several lesser-known provisions aim to stimulate philanthropy through increased tax incentives around charitable giving for both individuals and corporations.

As your clients contemplate maximizing the impact of their year-end giving, they should consider taking advantage of these provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act:

- **Deduct $300 in charitable giving, even if they don't itemize.** This year, taxpayers who do not itemize can deduct up to $300 ($300 for married couples filing separately) in charitable giving "above the line," reducing their taxable income by that amount for tax year 2020. Most taxpayers do not itemize and, therefore, do not typically benefit from charitable deductions, which can lower their adjusted gross income (AGI), thereby reducing their tax base. The CARES Act changes that for 2020, making it attractive for moderate-income individuals to help nonprofits with critical needs.

- **Deduct more of their AGI.** In 2020, taxpayers can deduct up to 100 percent of their AGI for charitable cash contributions, compared to the normal 60 percent maximum. And, if an individual or couple happens to donate more than 100% of their AGI, the standard five-year carryover still applies. If they are considering making a major gift, now is the time to make it happen for a significantly increased tax benefit.

• **Deduct more of their corporate taxable income.** Similar to individual taxpayers, corporations can deduct up to 25 percent of taxable income for charitable contributions in tax year 2020, compared to the usual 10 percent.

Now is the Time to Open a Charitable Fund

Of course, even these modest incentives come with a few strings attached. First, charitable contributions in all three situations are limited to cash contributions (no in-kind gifts, appreciate stock or other real property). Second, gifts to private foundations and donor advised funds (like those held at the Delaware Community Foundation) are not eligible.

However, the DCF holds and administers several other types of charitable funds that are eligible to receive gifts that do qualify for the increased tax deductions under the CARES Act. Opening a new charitable fund at the DCF would be a particularly attractive strategy for clients who are in a position to take advantage of the increased percentage of AGI that is deductible this year. Fund types they could consider include:

• **Designated Funds:** A donor makes a tax-deductible gift to establish a fund and selects up to five charities that will automatically receive a grant from the fund each year for as long as the fund exists. This type would be ideal for clients who are already clear on which nonprofit organizations they wish to support in perpetuity. They can "set it and forget it" with the knowledge that the DCF will ensure that the fund benefits the selected charities forever.

• **Field of Interest Funds:** A donor makes a tax-deductible gift to establish a fund and defines an area of interest that they wish to support. The DCF grants committee directs grants annually to organizations working effectively in that area. This fund type is ideal for clients who have a long commitment to certain areas of need (such as environmental protection or children's literacy), but recognize that community needs and organizations change over time. A field of interest fund allows flexibility for the DCF to be able to address needs in a particular area as they evolve without being locked in to one organization whose mission and program may change over time.

• **Scholarship Funds:** A donor makes a tax-deductible gift to establish a fund that produces an annual scholarship for higher education and sets applicant parameters. The DCF scholarship committee reviews applications and selects recipients. Higher education is a world of constantly changing processes and opportunities. This fund type is for clients who want to help young people achieve their full potential through education without having to navigate the complex realities of university systems or evaluate candidates themselves. The DCF handles all of that administration for your client.

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As a nonprofit organization, the DCF is committed to empowering and growing philanthropy in Delaware. We help donors maximize the impact of their giving by using our knowledge of community issues and our deep relationships with other funders and nonprofits to identify the areas of greatest need and the strongest programs.

For your charitably minded clients who are in a position to make a significant cash gift before year-end, this may be an especially advantageous year to open a new fund at the DCF, thanks to the unique tax advantages available under the CARES Act.

Other Tax-Advantaged Giving Opportunities

Your clients can also increase the impact of their charity through collective giving to a fund at the DCF. Collective giving means your client's gift is combined with the gifts of others to create a greater resource for the community. The DCF offers four options:

- **Delaware Forever Fund:** an endowment fund producing hundreds of thousands of dollars in grants each year to address the state's greatest needs, as they evolve and emerge;

- **African American Empowerment Fund:** an endowment fund that generates grants supporting programs and projects serving the unique needs of Delaware's African-American communities, statewide;

- **Fund for Women:** an endowed fund created by a group of donors that supports a robust grants program for programs serving the needs of women and girls in Delaware.

- **The Next Generation North and South:** a pair of endowed funds (one upstate and one downstate) that generate grants for a range of community issues, while also serving as a training opportunity for young professionals.

And lastly, donors can give to any of the 180+ nonprofit organizations with endowment and reserve funds housed at the DCF. These funds help to stabilize our nonprofit sector by providing ongoing financial support and rainy-day funds, helping to ensure that they will be here to serve the community long into the future. A list of all DCF funds can be found at delcf.org/give.

Expertise in Charitable Giving

Charitable giving is a very personal act that can and should have great benefits for both the donor and the recipient. The DCF is here to help you help your clients navigate the sometimes intricate and diverse pathways to meaningful, effective philanthropy. The staff at the DCF are specialists in all types of charitable funds and are available to meet with you and your clients to talk through their charitable goals and how they can achieve them.

But time is running out – all of the special provisions of the CARES Act end on Dec. 31, 2020. If you have business or individual clients who may be able to benefit from these unique deductions or have been considering a major charitable gift, now is the time to act.

And if you personally are able to increase your giving in this year like no other, you will not only make a meaningful difference in your community, but also benefit from some tax savings.

To learn more, visit delcf.org/ways-to-give or contact us at delcf.org/build-your-community. Tax information provided here is general and educational and should not be construed as legal or tax advice. Please consult a tax advisor before making major financial recommendations or decisions.

Joan Hoge-North is the Vice President for Philanthropy at the Delaware Community Foundation. Before joining the DCF, Hoge-North was the director of museum services at the Hagley Museum and Library. During her career, Hoge-North has served as the CEO at the Delaware Historical Society, executive director at the Historical Society of Talbot County, collections manager at Chesapeake Bay Maritime Museum and project review support at the Virginia Department of Historic Resources. Contact Joan Hoge-North at jhoge-north@delcf.org or 302.504.5224.

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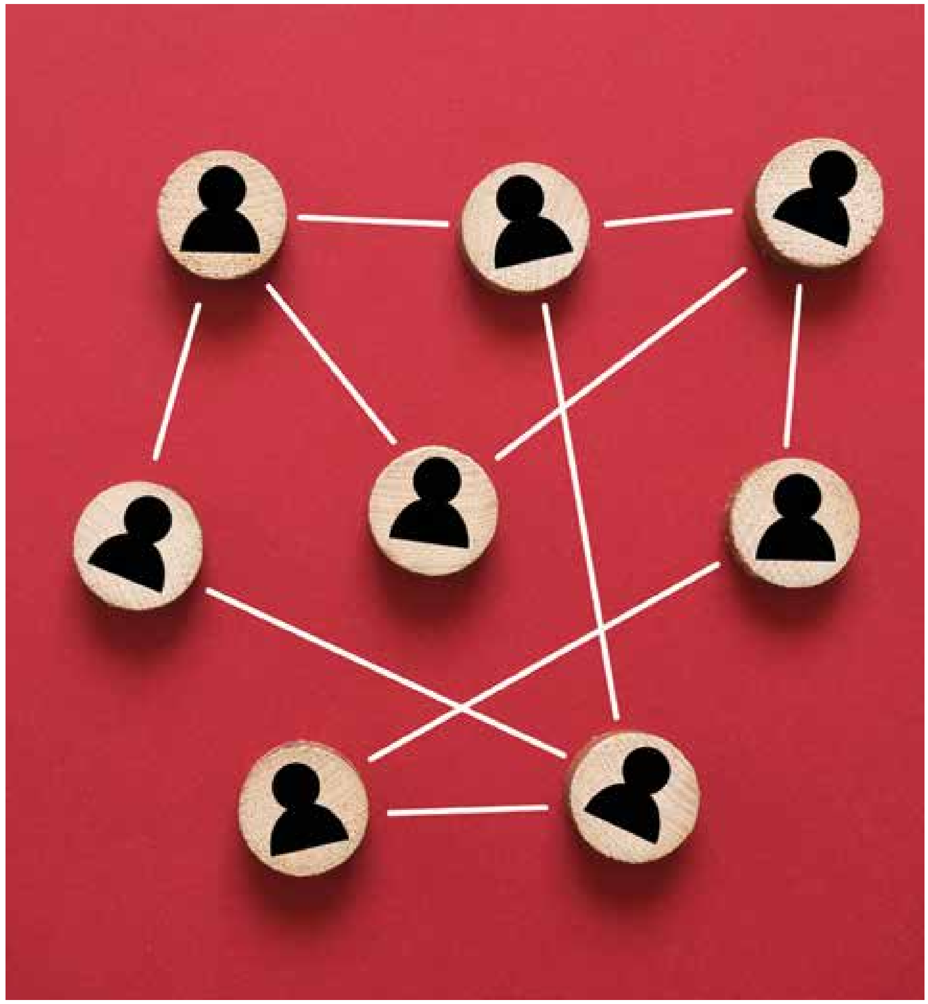
Delaware Trust Act 2020 – Expanding the Availability of Directed Trusts



by
Daniel R. Stanek
Connolly Gallagher

Each year, a group of dedicated attorneys and trust professionals work together in an effort to maintain Delaware's position as the premier jurisdiction for trusts. They do so by closely reviewing the marketplace and legislative landscape to identify ways to improve Delaware law as it relates to all things associated with trust planning and administration. They seek out ways to make Delaware more attractive as a jurisdiction for trust grantors and beneficiaries, as well as for trustees. This year, their efforts resulted in the passage of House Bill 334, or "Trust Act 2020," which was signed into law by Governor Carney on August 6, 2020. A main focus of Trust Act 2020 was Title 12, section 3343 of the Delaware Code, regarding the authority to appoint additional trustees and to allocate duties among them.

Section 3343 was first added to the Delaware Code just in 2019. It provides, generally, that absent language in a trust instrument to the contrary, those with the authority to appoint a successor trustee, or to remove and replace an existing trustee, inherently have the authority to appoint multiple successor trustees, and to allocate powers among them. Importantly, the statute enables those with the authority to appoint a trustee to effectively modify the trust instrument to create a directed trust without actually undertaking a modification by other means – such as nonjudicial settlement agreement, decanting, modification with grantor's consent/non-objection, etc.

Changes to section 3343 in 2020 sought: (i) to clarify the circumstances under which the statute may be used, (ii) to clarify the interplay between sections 3343 and 3313A of Title 12 and enhance protections for trustees when a trustee's duties and powers have been modified via section 3343, and (iii) to add a requirement that the existing trustee be notified before changes made under this section take effect.

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Circumstances Under Which Title 12, Section 3343 May Be Used

Subsection (a) of section 3343 has been revised to clarify the circumstances under which section 3343 may be used. The 2019 version of the statute provided that the power to appoint successor trustees included the additional inherent power to appoint multiple successor trustees, and to allocate powers among them. Some felt that ambiguity in the 2019 version of the statute left open the possibility that one could avail himself of section 3343 at any time—in other words, without a vacancy actually existing and with the appointing person not possessing a removal power. The 2020 changes make clear that the underlying power to appoint a successor trustee, as granted by the trust instrument, must itself be "presently exercisable"—meaning it can be employed at the current time—before one can appoint multiple successor trustees under section 3343. The 2020 version also makes clearer that, where authorized by the trust instrument to remove a trustee and appoint a successor, an individual may remove a trustee and appoint multiple successor trustees in its place.

Interplay Between Title 12, Sections 3343 and 3313A

Subsection (c) has been revised to more clearly state the interplay between sections 3343 and 3313A by expressly referencing sections 3313A(a)(1) and 3313A(a)(2) and providing that the authority to allocate duties and responsibilities applies to the establishment both of directed trustees and of excluded trustees. Section 3313A(a)(1) provides that where a governing instrument empowers a co-trustee to direct certain actions of the trustees, to the exclusion of certain other co-trustees, the excluded trustee(s) have no liability when acting at the direction of the directing co-trustee, unless such acts constitute willful misconduct. Section 3313A(a)(2) provides that where a governing instrument grants the exclusive authority to exercise certain powers to a co-trustee, the excluded co-trustee(s) have no liability with respect to the exercise of such power.

Doing so in accordance with section 3313A, the 2019 version of section 3343, subsection (c) provided for the allocation of duties and liabilities as between the authorized co-trustee and the excluded co-trustee. The 2020 version expands on the 2019 version, and more specifically provides for the allocation of duties and liabilities as provided under sections 3313A(a)(1) and 3313A(a)(2).

The 2019 version of section 3343, subsection (c) provided:

> "Notwithstanding the provisions of subsection (b) of this section, in accordance with section 3313A of this title, a trustee to whom powers have been exclusively allocated under subsection (a) of this section shall be a fiduciary only

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> with respect to the powers so allocated, and a trustee excluded from exercising powers shall have no liability for, nor any duty to monitor, the actions of any trustee to whom any such powers, duties, and responsibilities are so allocated."

The current version of section 3343, subsection (c) provides:

> "Notwithstanding the provisions of subsection (b) of this section, if an appointment under this section confers upon a cotrustee, to the exclusion of another cotrustee, the power to take certain actions with respect to the trust, including the power to direct or prevent certain actions of the trustees, then: (1) The duty and liability of the excluded trustee and the cotrustee holding the power, whether that be the powers of an excluded trustee or cotrustee described under § 3313A(a)(1) or § 3313A(a)(2) of this title, shall be as set forth under § 3313A of this title; and (2) The excluded trustee shall have the rights of a trustee that has been removed as trustee of the trust under applicable law and the terms of the governing instrument, to seek, with respect to the power and authority so excluded as a result of an appointment under this section, a judicial proceeding or nonjudicial matter, as defined in § 3303(e) of this title."

Existing Trustee Must Be Notified Before Changes Made Under Section 3343 May Take Effect

Lastly, subsection (d) was added to section 3343 to provide that where any appointments are made under section 3343 that will modify the duties and responsibilities of an existing trustee, such modifications shall not become effective until thirty (30) days after receipt by the existing trustee of a written notice detailing such modifications. The thirty (30) day notice period may be waived by the existing trustee. This notice period provides trustees the opportunity to consider whether it is advisable to continue in service as trustee and whether renegotiation of their fee arrangement is appropriate.

Practical Application

The addition of section 3343 to the Delaware Code in 2019, and the revisions to it made in 2020, are vitally important as the use of directed trusts becomes more commonplace. As with any burgeoning industry practice, it is crucial that practitioners keep pace with the marketplace and legislative landscape. In order to fully avail themselves of new opportunities, they must understand current developments of practice and law, both from the legislative perspective and the practical one. Accordingly, to more fully understand and appreciate the utility of section 3343, we will look at some practical examples.

A directed trust is one in which one other than the trustee is empowered to instruct the trustee with regard to responsibilities which would otherwise belong to the trustee. This bifurcation of duties and authority initially came about for two reasons: (1) as a way for grantors to circumvent trustees' potential unwillingness to take various actions which might expose them to liability (such as, for example, managing an investment portfolio with a concentrated position, which might fall outside the limitations of the prudent investor rule), and (2) as a way for cost-conscious grantors to tamp down trustee fees by: (a) allocating certain of a trustee's responsibilities to other, non-fee charging parties, and (b) reducing the areas of potential liability to which a trustee might be exposed – that is, with reduced risk should come reduced fees.

Example 1 – The Directed Trust, Generally

> Individual investor "X" has developed an algorithm which relies on historical fluctuations in equity valuations to predict future stock prices. X has utilized his algorithm to produce tremendous returns in each of the preceding five years and now wishes to contribute a sizable portion of the earnings to an irrevocable trust for the benefit of his children. Of course X intends that the trust assets be invested using his algorithm. Y, a corporate trustee, would be happy to add X's trust to its assets under management, but X's investment strategy violates the terms of Y's internal investment policies, which were implemented in order to avoid potential liability. In order for Y to accept the trust without being exposed to the potential liability associated with X's unique investment strategy, X and Y enter into an arrangement whereby X assumes all duties and liability associated with the investment of trust assets, and Y, acting only at X's direction, is similarly relieved of all such duties and liability (other than for its own willful misconduct).

In the preceding example, the grantor was able to avail himself of the benefits of directed trusts by establishing his trust as such from the outset. But what should happen where an interested party to an existing trust, which does not include direction provisions, wishes to avail himself of such benefits? Section 3343 makes available such opportunities to irrevocable trusts already in existence which do not otherwise include direction provisions.

Example 2 – 3343 Directed Trust

In this case, X's mother leaves a testamentary trust for the benefit of X's children, to be administered by Y. Under the testamentary trust instrument, X is afforded the authority to remove and replace Y as trustee for any reason, or for no reason at all. X would like the trust's assets to be invested using his algorithm, but since the trust is already in existence, he is unable to write directed trustee provisions into the trust instrument. Additionally, there exist extenuating circumstances which make it impossible to rely upon other methods for modifying irrevocable trust instruments (suppose the trust instrument forbids decanting, and remainder beneficiaries refuse to cooperate for purposes of a nonjudicial settlement agreement). Without the availability of section 3343, X's only option might be to go searching for a trustee willing to assume the risk associated with X's investment strategy. However, because X's mother's testamentary trust is administered in Delaware, X can avail himself of section 3343 to appoint himself as investment trustee, which by the interplay of sections 3343 and 3313A, will authorize him to direct Y (now the institutional co-trustee rather than sole trustee) with regard to investment of the trust's assets.

As you can see, section 3343 enables X and Y to work together in ways which they otherwise would be unable – with X enjoying the ability to have trust assets invested as he wishes, and Y able to continue serving as trustee with an acceptable assumption of risk. By expanding the opportunities for the creation of directed trusts, section 3343 is a boon for those with interest in irrevocable trusts, and represents another step towards preserving Delaware's place as the premier jurisdiction to situs trusts.

Daniel R. Stanek is an attorney in the Trusts & Estes group at Connolly Gallagher LLP. Dan Stanek focuses his practice on trust and estate planning and administration. In addition to advising fiduciaries, Dan helps clients plan for the preservation and transfer of their assets in a cost-effective and tax-efficient manner. He also assists clients in a variety of estate planning matters, such as wills, trusts, powers of attorney and charitable giving opportunities. Prior to joining Connolly Gallagher, Dan served as the Vice President and Senior Consultant for a boutique firm providing family office and private foundation consulting services to ultra-high-net-worth individuals. He has also worked in KPMG's Global Transfer Pricing Services group, helping large, multi-national corporations organize and manage their operations. He can be reached at dstanek@connollygallagher.com or (302) 884-6591.

Using Delaware Trusts to Reduce New Jersey Income Tax

by
Richard W. Nenno
Senior Trust Counsel
and Managing Director
Wilmington Trust Company

In the fall of 2020, New York commentators observed:[1]

> The taxation of trusts is an important issue for some states. Trusts are a big and growing business, particularly in the economies of smaller states that have developed legal and tax systems with the goal of attracting trust business. Delaware is one of those states. Less than half a percent of the people in the United States live in Delaware. In 2014, fiduciary income tax returns filed by Delaware trustees reported over three percent of the income shown on the returns of all complex and simple trusts filed throughout the United States. Those returns showed that Delaware fiduciaries collected over three percent of the fiduciary fees collected by all trustees of complex and simple trusts in the United States. The fees of Delaware trustees were nearly half of the trustee fees collected in each of Texas, and New York, states whose populations were at least fourteen times the size of its own.

New Jerseyans are particularly well-positioned to save New Jersey income tax through the use of Delaware trusts. This article explains why.

Case Law

The United States Supreme Court has held that a state may tax all income of a "resident" but only source income (i.e., income attributable to real property, tangible personal property, and business activity in the state) of a "nonresident." New Jersey classifies a trust created by a New Jersey domiciliary testator or trustor as a "resident trust."[2] But, New Jersey case law holds that, in certain circumstances, a trust that meets the formal definition of "resident trust" is nevertheless taxable as a "nonresident trust." Three cases are instructive.

In *Pennoyer v. Taxation Division Director* (1983),[3] the New Jersey Tax Court held that the state could not tax undistributed income of a testamentary trust based primarily on the domicile of the testator—there were no New Jersey trustees, beneficiaries, or assets.[4] The court held:[5]

> I conclude that the creation of the subject trust in New Jersey in 1970, the probate proceeding in a New Jersey court and the jurisdiction and availability of the New Jersey courts are not sufficient contacts with the State of New Jersey to support

taxation of the 1979–1980 undistributed income of the trust, and therefore, N.J.S.A. 54A:1-2(o)(2) may not constitutionally be applied in the subject case.

Similarly, in *Potter v. Taxation Division Director* (1983),[6] the same court held that the state could not tax undistributed income of an inter vivos trust, which was funded in part during life and in part by a pourover under the decedent's Will, based primarily on the domicile of the trustor. Again, the trust had no New Jersey trustees, beneficiaries, or assets.[7] The court held:[8]

> Any benefit to the trust from the laws of the State of New Jersey relative to the distribution of assets from the estate to the trust can be accounted for in terms of the inheritance tax paid to the State of New Jersey on the assets distributed and transferred to the trust. The facts of this case indicate that the irrevocable inter vivos trust has a situs in New York, not New Jersey. The fact that contingent beneficiaries reside in New Jersey does not alter this conclusion. These beneficiaries are taxable on trust income distributed to them or on undistributed income over which they have control. The state in which a beneficiary is domiciled may tax trust income distributed to the beneficiary. The fact that contingent beneficiaries are domiciled in New Jersey does not constitute a contact sufficient to empower New Jersey to tax undistributed trust income where the contingent beneficiaries have no right to the undistributed trust income.

In *Residuary Trust A U/W/O Kassner v. Director, Division of Taxation* (2015),[9] a New Jersey intermediate appellate court held that a trust that qualified as a resident trust was not taxable on interest income or income from business activity not attributable to New Jersey. The trust was created by the Will of a New Jersey domiciliary who died in 1998 and therefore was a resident trust for New Jersey tax purposes. But, for all of 2006—the tax year in question—the sole trustee was domiciled in New York and administered the trust outside New Jersey. The trustee filed a return and paid New Jersey tax on S corporation income attributable to activity in New Jersey but not on interest income or on S corporation income allocated outside New Jersey. On audit, the Director of the Division of Taxation contended that the trustee was taxable on all undistributed income because the trust held assets in New Jersey. Unlike the Tax Court, the appellate court did not find it necessary to apply constitutional principles. Instead, it based its decision on New Jersey's square corners doctrine:[10]

> The square corners doctrine is particularly important in the field of taxation, because trusts, businesses, individuals and others must be able to reliably engage in tax planning and, to do so, they must know what the rules are. It is fundamentally unfair for the Division to announce in its official publication that, under a certain set of facts a trust's income will not be taxed, and then retroactively apply a different standard years later.

Current Rules for Taxations of Trusts

In New Jersey, a trustee of a resident trust must file a return if the trust has more than $10,000 of gross income; a trustee of a nonresident trust must file a return if the trust has New Jersey source income and more than $10,000 of gross income from all sources.[11] New Jersey treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[12] and the Garden State permits trustees of nongrantor trusts to take a distribution deduction.[13] In 2019, New Jersey taxed the New Jersey taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 10.75% (the 10.75% rate applied starting with such income over $5 million),[14] and the current rate schedule is not scheduled to change,[15] except that the threshold for the 10.75% rate has been lowered to $1 million for 2020 and later years.[16]

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New Jersey defines resident trust as a trust that is created by a New Jersey domiciliary testator or trustor as follows:[17]

> A resident . . . trust means: . . .
> (2) A trust, or a portion of a trust, consisting of property transferred by will of a decedent who at his death was domiciled in this State, or
> (3) A trust, or portion of a trust, consisting of the property of:
>
> (a) A person domiciled in this State at the time such property was transferred to the trust, if such trust or portion of a trust was then irrevocable, or if it was then revocable and has not subsequently become irrevocable; or
> (b) A person domiciled in this State at the time such trust, or portion of a trust, became irrevocable, if it was revocable when such property was transferred to the trust but has subsequently become irrevocable.
>
> For the purposes of the foregoing, a trust or portion of a trust is revocable if it is subject to a power, exercisable immediately or at any future time, to revest title in the person whose property constitutes such trust or portion of a trust, and a trust or portion of a trust becomes irrevocable when the possibility that such power may be exercised has been terminated.

A nonresident trust is a trust that is not a resident trust.[18]

New Jersey taxes all New Jersey gross income of resident trusts[19] but only New Jersey-source gross income of nonresident trusts.[20]

In New Jersey, trustees must make estimated tax payments for trusts.[21] In 2016 (the latest year for which figures are available), 84,909 fiduciary returns reported owing $173.2 million of New Jersey tax.[22]

The New Jersey taxing authorities honor the *Pennoyer-Potter* rule. Hence, a resident trust does not have to pay any New Jersey tax if it has no New Jersey trustee, asset, or source income and files an informational return as follows:[23]

> A resident . . . trust is not subject to New Jersey tax if it:
>
> • Does not have any tangible assets in New Jersey;
> • Does not have any income from New Jersey sources; and
> • Does not have any trustees . . . in New Jersey.
>
> However, the fiduciary must file Form NJ-1041 for such . . . trust, enclose a statement certifying that the . . . trust is not subject to tax, and check the box on Line 26.

Adverse Treatment of CRTs

In 2009, the New Jersey Division of Taxation announced that a charitable-remainder trust ("CRT") is taxed at the trust level for the following reason:[24]

> Only *exclusively* charitable trusts qualify for income tax exemption under the New Jersey Gross Income Tax Act. A Charitable Remainder Trust, in contrast to a charitable trust, has "noncharitable" beneficiaries and does not operate exclusively for charitable purposes. Accordingly, a Charitable Remainder Trust is not an exclusively "charitable trust" exempt from New Jersey income tax under N.J.S.A. 54A:2-1 and income that is not distributed and which is not deemed to be permanently and irrevocably set aside or credited to a charitable beneficiary is taxable income to the trust.

New Jersey taxation at the trust level is undesirable when, as often is the case, a client wants to use a CRT to diversify a portfolio of low-basis securities without being taxed immediately on all capital gains.[25]

Planning

Grantor Trusts

New Jerseyans who create grantor trusts often must pay all federal and New Jersey income taxes attributable to such trusts even though they do not have access to the trusts' assets. Unless a trust gives the trustee discretion to reimburse the grantor for income taxes, grantors of such trusts have the all-or-nothing choice either to pay such taxes, which might become burdensome over time, or to release the powers that trigger grantor-trust treatment and thereby cause the trust funds to be depleted to pay them. New Jerseyans might consider establishing new trusts in or moving existing trusts to Delaware, where a statute gives trustees of grantor trusts discretion to reimburse the trustor for federal and state income taxes unless prohibited by the governing instrument.[26] Using this statutory power, the trustee might reimburse the trustor for some taxes one year, for no taxes in a second year, and for all taxes in a third year.

Nongrantor Trusts

New Jersey testators and trustors should structure their nongrantor trusts (including their CRTs) to qualify for the safe harbor quoted above. That's because the potential tax savings are substantial. For example, the potential tax reduction for the trustee of a New Jersey resident trust on a $1 million long-term capital gain incurred in 2019 was at least $74,484. Not only will this planning satisfy the trustee's duty to minimize trust expenses, but it also will improve the trustee's investment performance by eliminating the state-income-tax drag. This planning is all the more important given the recently enacted $10,000 per year limitation on the deduction of state taxes[27] and might be enhanced if, as some speculate, a Democratic administration will eliminate the stepped-up income-tax basis at death.

New Jerseyans might want to create and fund Delaware revocable trusts during life to escape the New Jersey income tax that otherwise would be payable by their probate estates.

Under the above safe harbor, a New Jersey resident trust is taxed as a nonresident trust if the trust has no New Jersey tangible asset, source income, or trustee. It should be noted, however, that, unlike New York,[28] New Jersey appears to tax a resident trust that has no New Jersey tangible asset or trustee but does have New Jersey source income only on the source income.[29] Nevertheless, out of an abundance of caution, practitioners who fear that New Jersey might move to the New York approach, might advise clients to create two trusts, one to hold assets that generate New Jersey source income and one to hold assets that do not generate such income.

Similarly, although *Potter* held that "[t]he fact that contingent beneficiaries are domiciled in New Jersey does not constitute a contact sufficient to empower New Jersey to tax undistributed trust income where the contingent beneficiaries have no right to the undistributed trust income"[30] and although the above safe harbor does not require that a trust have no New Jersey beneficiaries, some practitioners might be concerned that New Jersey will assert that trusts with New Jersey beneficiaries do not qualify. Consequently, cautious practitioners might again advise clients to create two trusts, one for New Jersey beneficiaries and one for non-New Jersey beneficiaries.

Trustees and beneficiaries of trusts that are paying New Jersey income tax should take steps to reduce or eliminate that tax. In this regard, New Jersey law stipulates that "[a] trustee is under a continuing duty to administer the trust at a place appropriate to its purposes, its administration, and the interests of the beneficiaries."[31] A change from a New Jersey trustee to a Delaware trustee might do the trick.

Given that trusts get to the top federal income-tax rate so much more quickly than individuals, some trustees are considering including capital gains in distributions to beneficiaries in order to take advantage of the beneficiaries' lower tax brackets. This might be a really bad idea for New Jerseyans thanks to the New Jersey Gross Income Tax. For example, the net tax cost of including $1 million of long-term capital gain in DNI for a New Jersey resident individual rather than taxing the gain to a New Jersey resident trust that is structured to escape tax is $40,881.

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Note that nongrantor trusts created by New Jersey domiciliaries will not have to pay Delaware income tax or file a Delaware return as long as there are no Delaware resident beneficiaries.[32]

The DING Trust Option

New Jerseyans might use a type of Delaware asset-protection trust ("APT") known as the Delaware incomplete-gift nongrantor trust ("DING Trust") to defer or eliminate New Jersey income tax on undistributed ordinary income and capital gains if they are willing to subject distributions to themselves to the control of adverse parties. In dozens of private letter rulings issued since 2013 (some of which involved trusts created by New Jersey domiciliaries), the IRS ruled that domestic APTs that followed the DING-Trust approach qualified as incomplete gifts and as nongrantor trusts.[33] The trustor of a DING Trust might be able to receive tax-free distributions of the untaxed income in later years.

Richard W. Nenno, Esquire, is a Senior Trust Counsel and Managing Director with Wilmington Trust Company, Wilmington, Delaware. He is a nationally known speaker and author on estate-planning topics, including Delaware trust law, the state income taxation of trusts, directed trusts, trust jurisdiction selection, and domestic asset-protection trusts.

Wilmington Trust Company operates offices in Delaware only. Note that a few states, including Delaware, have special trust advantages that may not be available under the laws of your state of residence, including asset protection trusts and directed trusts.

Notes:
1- Carlyn S. McCaffrey, John C. McCaffrey & Toni Ann Kruse, *Rationalizing the State Income Taxation of Trusts: Chasing Quill Feathers in the Wind*, 45 Est., Gifts & Tr. J. 298, 300 (Sept. 10, 2020) (footnotes omitted).
2- NJSA § 54A:1-2(o)(2)–(3).
3- *Pennoyer v. Taxation Div. Dir.*, 5 N.J. Tax 386 (Tax Ct. 1983).
4- *Id.* at 388.
5- *Id.* at 399.
6- *Potter v. Taxation Div. Dir.*, 5 N.J. Tax 399 (Tax Ct. 1983).
7- *Id.* at 401.
8- *Id.* at 405 (citation omitted).
9- *Residuary Trust A U/W/O Kassner v. Dir. Div. of Taxation*, 28 N.J. Tax 541 (Super. Ct. App. Div. 2015), *aff'g*, 27 N.J. Tax 68 (N.J. Tax Ct. 2013).
10- *Id.* at 548 (citations omitted).
11- Instructions to 2019 Form NJ-1041 at 1. *See* NJSA § 54A:8-3.1(a)(1)(c). *See also* N.J. Div. Tax'n GIT-12, *Estates and Trusts: Understanding Income Tax* (Dec. 2019), www.state.nj.us/treasury.
12- See NJSA § 54A:5-1(h); instructions to 2019 Form NJ-1041 at 1.
13- NJSA § 54A:5-3; instructions to 2019 Form NJ-1041 at 1.
14- NJSA § 54A:2-1(b)(6); instructions to 2019 Form NJ-1041 at 24.
15- NJSA § 54A:2-1(b)(1)–(7).
16- NJSA § 54A:2-1(b)(7).
17- NJSA § 54A:1-2(o)(2)–(3). *See* instructions to 2019 Form NJ-1041 at 1. For the meaning of "domicile" for New Jersey income-tax purposes, see instructions to 2019 Form NJ-1041 at 1. In a Letter Ruling, which will not be released for publication, the N.J. Division of Taxation determined that a trust created by a Delaware trustee via the exercise of a decanting power over three New Jersey resident trusts at the direction of a non-New Jersey adviser would be considered to be a nonresident trust for New Jersey tax purposes where the new trust did not meet the definition of resident trust.
18- NJSA § 54A:1-2(p); instructions to 2019 Form NJ-1041 at 1.
19- NJSA § 54A:5-1.
20- NJSA §§ 54A:2-1.1, 54A:5-7; instructions to 2019 Form NJ-1041 at 1–2. *See Tina Schiller Trust for Benefit Siegelbaum v. Dir., Dep't of Treasury, Div. of Taxation for State of N.J.*, 14 N.J. Tax 173, 181 (N.J. Super. Ct. App. Div. 1994) ("The disposition of the corporate stock here constitutes the nontaxable sale of the intangible asset"). *See also Hill v. Dir., State Div. of Taxation*, 2016 WL 3351959, at *5 (N.J. Super. Ct. App. Div. June 2, 2016) (Pennsylvania residents taxed on New Jersey source income distributed to them from New Jersey resident trust).
21- NJSA § 54A:8-4(m); instructions to 2019 Form NJ-1041 at 3.
22- N.J. Dep't of the Treasury, *Statistics of Income: 2016 Gross Income Tax Returns* (Aug. 2019), www.nj.gov/treasury (last visited Oct. 8, 2020).
23- Instructions to 2019 Form NJ-1041 at 1 (emphasis in original).
24- N.J. Div. Taxation Tech. Bull. 64, *Charitable Remainder Trusts*, 2009 N.J. Tax Tech. Bull. Lexis 34 (N.J. Div. Tax. June 29, 2009) (emphasis in original), www.state.nj.us/treasury.
25- *See* IRC § 664(b).
26- *See* 12 Del. C. § 3344.
27- *See* IRC §§ 164(b)(6)(B), 641(b).
28- *See* N.Y. TSB-A-20(2)I.
29- *See Residuary Trust A U/W/O Kassner v. Dir. Div. of Taxation*, 28 N.J. Tax 541 (Super. Ct. App. Div. 2015).
30- *Potter v. Taxation Div. Dir.*, 5 N.J. Tax 399, 405 (Tax Ct. 1983).
31- NJSA § 3B:31-8(b).
32- *See* 30 Del. C. § 1636.
33- *See*, e.g., PLR 202017018 (Nov. 29, 2019).

Virtually Presented... Authentically Excellent!

Todd A. Flubacher, Partner, Morris Nichols Arsht & Tunnell LLP, and Chair of the Delaware Trust Conference Planning Commitee, welcomes attendees to the conference.

In the face of the COVID-19 pandemic, the Delaware Trust Conference presented the 15th annual edition virtually on a state-of-the-art conference platform. While other wealth management events either canceled, postponed, or drastically scaled back their schedules, the 2020 Delaware Trust Conference actually expanded its agenda. Conference attendees enjoyed more sessions, including all the breakout sessions. Over 20 credit hours of information were provided with the flexibility of attending live, October 19th and 20th, as well as on-demand through November 30th.

Usually, this report features photos actually taken at the conference. This year, due to the unique format, we'll be sharing glimpses of the platform and speakers, along with comments from attendees.

Thanks always to our wonderful sponsors and exhibitors (listed on page 15). And also, thank you to the planning committee, who did an especially herculian job with this year's challenges. Here they are...

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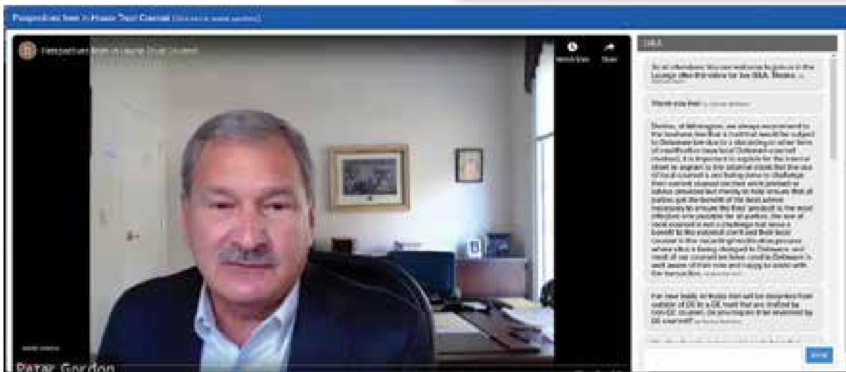
It's not the Chase Center on the Riverfront, but the virtual conference lobby offered the next best thing!

Samuel A. Donaldson, Professor of Law, Georgia State University, presents: "The Life Changing Magic of Grantor Trusts

Dana G. Fitzsimons, Jr., Principal, Senior Fiduciary Counsel, Bessemer Trust, reviews The Past Year's Most Significant Fiduciary Cases.

2020 Delaware Trust Conference

Questions? The Information Desk was always open for tech support, agenda questions, and links to Credit forms.



Peter S. Gordon, Director, Gordon, Fournaris & Mammarella, P.A., moderated the Perspectives from In-House Counsel panel. Attendees interacted with comments and questions at most sessions via the text box at right.

Sarah A. Long, President of the Delaware Bankers Association, introduced a panel.

John McCabe, Chief Fiduciary Counsel, Glenmede Trust Company; Margaret E.W. Sager, Partner, Heckscher Teilion Terrill & Sager; and W. Donald Sparks, II, Director, Richards Layton & Finger, reviewed Litigation Risks Brewing in Your Jurisdictions.

Attendees accessed all sessions, live or on-demand through the virtual session hall.

Vincent Thomas, Partner, Young Conaway Stargatt & Taylor; and George Kern, Regional Director, Bessemer Trust Company of Delaware, present a session on Designated Respresentative, one of the two on-demand sessions.

Geoffrey M. Rogers, Managing Director, Director Wilmington Office Glenmede, and President, CEO, Glenmede Trust Company of Delaware, introduces a session. Above: the Glenmede booth, one of the 18 booths in the conference's virtual exhibition hall.

Compliance Focus

CRA Modernization Gets Closer

Alice Judd, CRCM
Managing Principal
MidAtlantic Region
CAPCO I RISC Services

"Tremendous outreach and effort have gone into attempts to modernize CRA over the last several years."

The Community Reinvestment Act (CRA) of 1977 was enacted to encourage banks to meet the credit and deposit needs of communities they serve, including low and moderate income (LMI) communities, in a safe and sound manner. The last major revision of CRA was 25 years ago. Technological advances continue to evolve and change the way financial services are delivered, to whom and where. Tremendous outreach and effort have gone into attempts to modernize CRA over the last several years. We now have an OCC Final Rule and an Advance Notice of Proposed Rulemaking (ANPR) from the Federal Reserve, but questions remain. What about the FDIC? After issuing the joint NPR with the OCC in December 2019, the FDIC did not join in its final rule.

Following are some highlights of the OCC Final Rule (May 20, 2020):

- Clarifies what counts for CRA credit by issuing an illustrative list and confirmation process.
- Replaces current HMDA Data with Retail Lending Test using major product lines based on Call Report categories.
- Increases threshold of small loan and CRA eligible business from $1 million or less to $1.6 million or less.
- Updates where bank activity counts: LMI populations and areas, Indian Country, rural and distressed areas. Reduces banking deserts by providing more credit for branches that serve LMI areas. Allows no credit for loans in LMI census tracts, reducing displacement, gentrification.
- Two types of assessment area (AA) delineations. Facility-based AAs must consist of whole counties and geographies that contain a bank's main office or any of its branches. Deposit-based AAs are required if a bank receives 50% or more of its retail domestic deposits from geographic areas outside of its facility-based AAs.
- For large banks, new CRA evaluation metric derived from all qualifying activities, including community development activities and retail lending divided by deposits compared to benchmarks to be established. Retains retail lending distribution tests.
- Accommodates banks of all sizes – small bank could elect evaluation under current CRA.
- Data Collection required based on Call report categories.

Following are some considerations in the Federal Reserve ANPR (Sep 22, 2020):

- Promoting financial inclusion by proposing incentives for additional bank investments in Minority Depository Institutions (MDFIs) and Community Development Financial Institutions (CDFIs) and community development activity in designated areas of need outside of assessment areas, such as Indian Country and banking deserts.
- Clarifying the definition and criteria for CRA credit in unsubsidized, or naturally occurring, affordable housing.
- Separate exams based on bank size and business model. Small banks can elect evaluation under current CRA.
- Large retail banks would be subject to new metrics to separately evaluate retail lending and community development activity each, with subtests focused on lending/financing and services. More focus on number of loans vs loan amount.
- Small banks allowed to define facility-based assessment areas that include partial counties or portions of smaller political subdivisions, cities, or townships if at least whole census tracts.
- Study impacts of deposit-based assessment areas for large banks that deliver most products and services via mobile and internet channels, additional lending-based assessment area delineations outside of branches, and nationwide AA for internet banks.
- Expand credit for volunteer activities in rural areas unrelated to provision of financial services or community development.
- Allow CRA credit for Financial Literacy and Housing Counseling regardless of income level.

While the goals are the same, approaches significantly differ, and the impacts are difficult to project. Differences include metrics, reporting, data collection, and community development, to name a few. Will this morph into an Interagency approach? When will the FDIC weigh in? What impact will the election results have on CRA modernization efforts? Stay tuned for more to come.

For Your Benefit

Employee Benefit News and Highlights

by
Louis D. Memmolo, AIF, GBA, CHRS
Weiner Benefits Group, LLC

"During the COVID-19 public health emergency, this coverage must be provided for both in-network and out-of-network providers."

This has been a busy and historic year in many ways. As we approach the end of the year and the coming new year, there are several important highlights to keep in mind.

Guidance on COVID-19 Vaccine Coverage Requirements

As this article is being written and we are confronted with a surge in COVID-19 cases, we are anticipating the approval of two new vaccines that have been announced by pharmaceutical vendors this week.

On Nov. 6, 2020, the Departments of Labor, Health and Human Services and the Treasury Departments published an interim final rule requiring Medicare, Medicaid and private insurers to cover a COVID-19 vaccine without any cost sharing, once the Food and Drug Administration authorizes and approves a vaccine.

Coverage of qualifying COVID-19 preventive services must be provided within 15 business days after the recommendation is made.

During the COVID-19 public health emergency, this coverage must be provided for both in-network and out-of-network providers.

Final Rule on Health Care Transparency Issued

On Oct. 29, 2020, the Departments of Labor, Health and Human Services and the Treasury Departments issued a final rule regarding transparency in coverage that imposes new transparency requirements on group health plans and health insurers in the individual and group markets. These provisions only apply to non-grandfathered coverage, including both insured and self-insured group health plan sponsors.

This final rule was issued in response to an executive order issued on June 24, 2019, aimed at improving price and quality transparency in health care.

Detailed pricing information must be made public for plan years beginning on or after Jan. 1, 2022. A list of 500 shoppable services must be available via the internet-based self-service tool for plan years beginning on or after Jan. 1, 2023. The remainder of all items and services is required for plan years beginning on or after Jan. 1, 2024.

The final rule will require plans and issuers to disclose personalized price and cost-sharing information to consumers.

Final Forms and Instructions for 2020 ACA Reporting Released

The Affordable Care Act is still in force with most of its reporting requirements. The Internal Revenue Service released final 2020 forms and instructions for reporting under Internal Revenue Code Sections 6055 and 6056.

Forms 1094-B/C and Form 1095-B/C (and related instructions) will be used by providers of minimum essential coverage, including self-insured plan sponsors that are not ALEs, to report under Section 6055/6056.

IRS returns for 2020 must be filed by Feb. 28, 2021 (March 31, 2021, if filed electronically). The deadline for furnishing individual statements for 2020 was extended to March 2, 2021.

2021 Limits to Know

Health Savings Account limits are going up for 2021. Your pre-tax contributions are increasing by $50 for Single Coverage to $3,600 and by $100 for Family Coverage to $7,200. Your Catch-up contributions of $1,000 are not changing.

While the 401(k) limits of $19,500 and $6,500 (catch-up) are not changing the annual limit for defined contribution plans (for example, 401(k) plans, profit sharing plans and money purchase plans) is increasing to $58,000, up from $57,000. The annual compensation limit (applicable to many retirement plans) is increased to $290,000, up from $285,000.

Please connect with Weiner Benefits Group to receive our legal briefs and newsletters on a regular basis to stay in tune with the latest updates on employee benefits, wellness and retirement plans.

Accounting for Success

Updated Life Expectancy Tables for Required Minimum Distributions

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

"The updated life expectancy tables and applicable distribution period tables reflect longer life expectancies that the former tables and result in reduced RMDs. "

No one will argue that 2020 has been consumed by our focus on the pandemic and the devastating impact it has had not only on human life, but on businesses and our personal livelihoods. And rightfully so. Consequently, much of the focus of the CARES Act has focused on the Payroll Protection Program (PPP) provision for businesses and the $1,200/$2,400 advance payment of recovery rebates to individuals. However, the CARES Act (and SECURE Act, which was passed in late 2019) provide many favorable retirement plan provisions, including (1) the ability to contribute to an IRA beyond age 70 ½, (2) a change in the required minimum distribution (RMD) age from 70 ½ to 72, (3) the waiver of 2020 RMDs, and (4) the elimination of the "stretch IRA" rule for most non-spouse beneficiaries of inherited retirement accounts. Without much fanfare, however, is the recent release by the IRS of final regulations which revise the life expectancy tables for taking RMDs.

In general, the RMD for an account owner is based on the employee's age under the Uniform Lifetime Table, which uses the life expectancy of the employee and a hypothetical beneficiary 10 years younger. If the employee's spouse is more than 10 years younger, then the applicable distribution period is based on the Joint and Last Survivor Table, which results in a longer distribution period.

Where a beneficiary has inherited a retirement account and the decedent died prior to 2020, the RMD is computed by using the Single Life Table for the beneficiary's age beginning in the year following the year of death and then reduced by 1 for each subsequent year (there are certain exceptions and options to this rule where the sole beneficiary is the surviving spouse). Under the SECURE Act, where the account owner died prior to 2020 with certain exceptions, a non-surviving spouse no longer uses the Single Life Table (the "stretch IRA") but must take distribution of the entire account balance no later than the end of the year, which includes the 10th anniversary of the account owner's death; which means that other than for the final year, there is no required distribution for the intervening years. Exceptions to the new 10-year rule include (1) a surviving spouse, (2) beneficiaries less than 10 years younger than the account owner, (3) a chronically ill or totally disabled person at the time of the account owner's death, and (4) a minor child of the account owner until they have reached the age of majority.

Recently, the Internal Revenue Service (IRS) issued final regulations updating the life expectancy and distribution period tables used for purposes of determining minimum RMDs taken by employees/IRA account owners as well as those taking RMDs from inherited accounts. The updated life expectancy tables and applicable distribution period tables reflect longer life expectancies that the former tables and result in reduced RMDs. This allows more funds to remain in the account owner's/beneficiary's retirement account for a longer period.

The final regulations apply to distribution calendar years beginning on or after January 1, 2022. For an individual who turns 72 in 2021 so that their required beginning date is April 1, 2022, the updated distribution tables would not apply to the 2021 distribution year amount, but will apply to the RMD for the individual's 2022 distribution year amount, which must be taken by December 31, 2022. A transition rule also applies for inherited retirement accounts where the account owner died prior to 2022. In such cases, the initial life expectancy used to determine the distribution period is "reset" by using the updated Single Life Table for the age of the relevant individual in the calendar year for which the life expectancy was initially set and then reduced by 1 for each subsequent year in order to determine the RMD for calendar year 2022 and all subsequent years.

Example 1: Under the former Life Expectancy Table, a 72-year old with an IRA account balance of $1 million would have a life expectancy of 25.6 years, resulting in a 2022 RMD of $39,063.50. Under the revised table, their life expectancy is 27.4 years, resulting in an RMD of $36,496.35.

Example 2: Under the former Single Life Table, a non-spouse beneficiary of an IRA owner that died in 2017 when the beneficiary was 55 years old, would have a life expectancy of 24.7 years. Under the revised table, the beneficiary's life expectancy would be 26.6 years for calculating the 2022 calendar year RMD.

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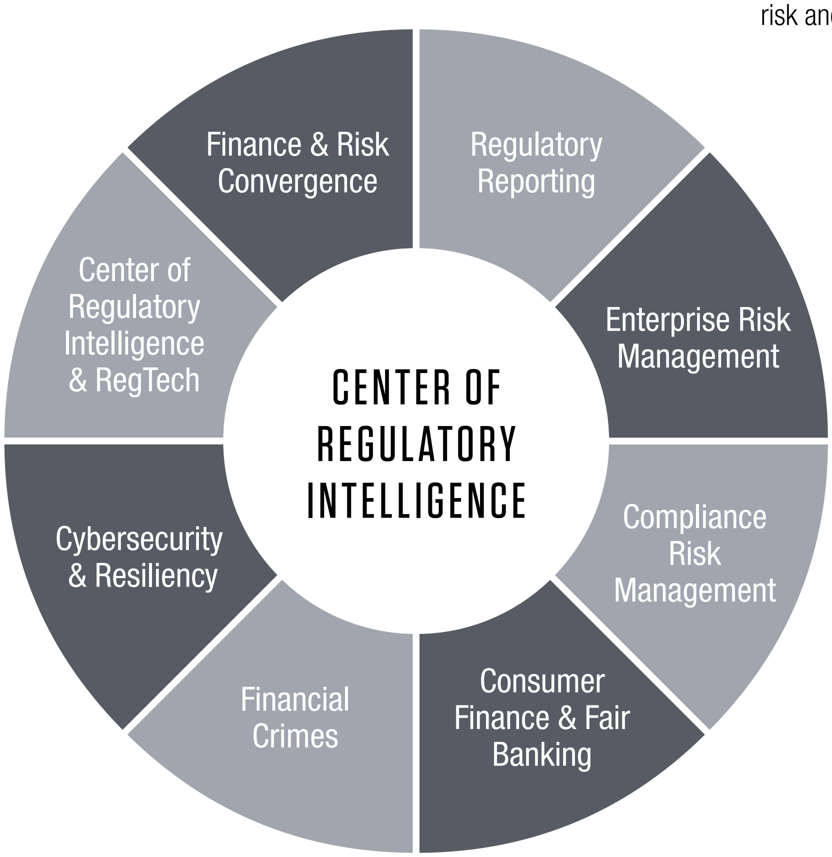

For more information email **regulatory.services@capco.com**

Lending Law Update

by
Brent C. Shaffer, Esq.
Young Conaway Stargatt & Taylor, LLP

"In Delaware, a new tool exists in helping banks achieve the coveted first mortgage lien position."

Change in Delaware Mortgage Priority Statute Benefits Banks

Real estate mortgage lending is underwritten on the value of the financed property, making the lien priority of the mortgages securing these loans paramount. In Delaware, a new tool exists in helping banks achieve the coveted first mortgage lien position.

For more years than anyone can remember, a Delaware statute has provided that mortgages from purchasers to real estate sellers that secure seller loans that finance the purchaser's payment of the purchase price of the property have special lien priority over other liens against the purchasers. This statute appears in the Delaware Code at Title 25, section 2108. An amendment signed into law by Governor Carney effective September 28, 2020 expands the scope of this "super priority" statute to mortgages in favor of lenders other than sellers, if the mortgage secures the repayment of money advanced to pay all or part of the purchase price at the time that the borrower acquires title to the mortgaged real estate. The statute applies only if the mortgage is recorded within ten days of the purchase. The qualifying "purchase money" mortgage has priority over judgments against the buyer and any other liens created or filed against the purchaser, including mechanics liens, even if recorded earlier. There can be multiple purchase money mortgages entitled to this priority; as between each other the priority is according to the time the purchase money mortgages are recorded, but they do not have a priority among themselves if they are recorded at the same time.

There is also a new provision in the statute that creates a rebuttable presumption that a mortgage qualifies as a purchase money mortgage if the mortgage states it is intended to constitute a purchase money mortgage. Given this is a rebuttable presumption, if it is proven that the money secured by the mortgage was not actually used to pay the purchase price, the super priority status is lost – but the presumption does shift the burden of proving the statute does not apply to the other lienholder challenging the priority.

Bankers should take advantage of this statute. Nearly every residential mortgage securing a loan used to acquire real property should qualify if "this is a purchase money mortgage" is added to the text of the mortgage. In the commercial loan context, bankers might consider including acquisition costs as part of the use of the mortgage loan proceeds, unless required equity or underwriting prevents it. However, note that this statute will not apply to any loans refinancing existing debt, even if the refinanced debt was used for acquisition of the mortgaged property. Of course, the lender should never rely on the statute alone, and should always require a loan title insurance policy insuring the bank's mortgage in first position and obtain subordination agreements from the holders of other mortgages encumbering the same property.