Evaluating the Impact of Trust Business on Delaware's Economy

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EXECUTIVE SUMMARY OF FINDINGS

- Conservatively estimated, the non-Delaware trust business contributes between $600 million and $1.1 billion annually to Delaware's economy, accounting for nearly 2% of the state's economic output.
- Based on data from federal fiduciary income tax returns, Delaware trusts generate $200 million per year in fiduciary fees on non-grantor trusts alone. Estimation of the additional contribution of grantor trusts not reported to the IRS increases this figure to $300 million.
- Between $19 million and $33 million in state income tax revenue is attributable to Delaware's excess trust business.
- Delaware has ten to twenty times the trust assets and fiduciary fees that would be predicted for a state of Delaware's size and income.
- Delaware's personal trust business has grown substantially over the past decade, taking an increasingly larger share of a growing national market. With sophisticated state institutions (e.g., the Bank Commissioner and the Court of Chancery) and specialized bar, Delaware is well-positioned to continue to grow its trust business.
- Delaware mainly attracts very large trusts that pay substantial fiduciary fees.

This report evaluates the economic impact of Delaware's trust business on the Delaware state economy. Relying on different sources of data, the report demonstrates Delaware's phenomenal success in attracting trust business. Considering assets under management and fiduciary fees, Delaware greatly outperforms its nearest rivals, such as New York, on a per capita basis by a factor of ten to twenty. Compared to states of similar size, Delaware is an extraordinary special case. This success has had an economically meaningful impact on the overall state economy, as well as the state government's budget. Moreover, the trust business is growing nationally, and Delaware's share of that business has grown in recent years.

This report concludes that at least $300 million per year in fiduciary fees are paid to Delaware institutions as a result of Delaware's non-domestic trust business. Moreover, this estimate is for several reasons a lower bound of the trust business's true impact on Delaware's economy. First, the available data provide only a partial picture of the trust business, although the data permit relative comparisons to other states. Second, the management of financial assets attracted from out of state, like manufacturing, forms the base of the economic pyramid. A standard multiplier to financial sector production would increase the impact of trust business on the state economy by a factor of 2 to 3.5. In other words, out-of-state trusts are contributing, as a conservative, lower bound estimate, between $600 million and $1.1 billion per year to Delaware's economy.

The impact of the trust business on the state government's balance sheet is not quantifiable without data on employment or without making contestable assumptions about what portion of Delaware's banking business is owing to trusts. However, the payoff to the state budget is likely substantial. First, Delaware has an increasing marginal personal income-tax rate, and salaries in the financial sector tend to be high. Based on reasonable assumptions regarding the wage-share of the trust business, the lower-bound estimate of fiduciary fees alone suggests that between $19 million and $33 million in income tax collection is attributable to the trust business. Second, the trust business does not cost the state significant resources. The financial management of trusts is not a capital-intensive business that places demands on state infrastructure nor does it demand significant tax breaks that are required to lure (or retain) factories or other types of economic activity.[1] Rather, maintaining a favorable trust environment requires court time and legislative attentiveness. As this report will demonstrate, Delaware's advantage in trust business has grown over time and Delaware has attracted increasingly larger, more sophisticated trusts.

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[1] Delaware does not levy a fiduciary income tax on trusts whose beneficiaries are out of state, but continues to levy a tax on trusts with Delaware beneficiaries.

There is no single source of data that fully reflects the impact of Delaware's trust business on the Delaware state economy. Rather, I rely on three complementary sources of data for the estimation of Delaware's share of the trust business and the value of that business to Delaware: (1) Federal Deposit Insurance Corporation (FDIC) data on personal trust holdings of reporting institutions; (2) state-level data from fiduciary income tax returns made available by the IRS; and (3) data provided by cooperating institutions to help complete the picture provided by FDIC and IRS data. The FDIC data are publicly available, and the IRS data were provided to me by special request. All data and analyses are available upon request, with the exception of confidential information provided by participating institutions.

This report will also address the extent to which Delaware's trust business is attributable to Delaware's legal innovations by relying on previously published broader analyses of the national market for trust funds published in the Yale Law Journal and Cardozo Law Review by Professor Robert H. Sitkoff[2] and me. Although one should not draw particular conclusions with respect to a single state from a general study, prior work at the very least is strongly suggestive of the role of the legal framework in attracting trust business.

This report is organized as follows. Section 1 provides some background on the trust law innovations and previous work on state competition for trust business, Section 2 analyzes Delaware's excess trust business using FDIC and IRS data sources, and Section 3 discusses the impact of this excess business on the Delaware state economy. Section 4 concludes.

1. <u>Delaware and the State Competition for Trust Funds</u>

As of 2004 (the last usable year of FDIC data),[3] federally reporting institutional trustees held over $1 trillion in one million non-commercial trust accounts. In 2007, the IRS data show that $3.9 billion in fiduciary fees were deducted from personal trust fiduciary income tax returns. This substantial pool of assets, with billions of dollars in fiduciary and legal fees at stake, has not surprisingly attracted the attention of many state legislatures. For the most part, states have competed for trust funds by making a variety of legal changes favorable to testators and settlors. The most prominent innovation has been the abolition of the Rule Against Perpetuities for trust interests, but other innovations are commonly mentioned in the legal and practitioner literature as well, including (1) the validation of so-called asset protection trusts; (2) statutes governing directed trustees; and (3) modernization of trust investment law such as adoption of the prudent investor rule, unitrust statutes, and reform of principal and

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[3] As explained in greater detail below, the FDIC began to lump personal trusts and employee benefit trusts together in 2005.

income rules. Delaware, South Dakota, and Alaska have often been at the forefront of this innovation, but some larger states are also willing to alter trust law quickly in accord with changing practice (Illinois is one prominent example).

Over the course of the 1990s and early 2000s, a great deal of attention in the practitioner literature focused on competition for so-called perpetual trusts, made possible by the abolition of the Rule Against Perpetuities. Under the 1986 Tax Reform Act, a transferor was given a lifetime exemption from the GST tax, originally $1 million and raised to $5 million in 2011. This means that a transferor can fund a trust with the amount of the exemption, free of generation-skipping transfer tax, that will endure for so long as state perpetuities law permits. Crucially, the federal tax code puts no limit on the duration of the GST tax exemption. Instead Congress left it to state perpetuities law to put a limit on the duration of GST tax exempt trusts. Obviously, if a state allowed perpetual trusts, a trust could continue, free from federal wealth transfer taxation, generation after generation, *forever*.

In 1995, Delaware became the first state to abolish the Rule Against Perpetuities for trusts in response to the 1986 Tax Reform Act.[4] However, Delaware had long been a trust-friendly jurisdiction. As Professor Sitkoff and I demonstrate in a paper in Cardozo Law Review (using FDIC data), Delaware was a leading trust jurisdiction in the 1970s and 1980s. Between 1969 and 1985, Delaware had between $14,000 and $16,000 more per capita in trust assets than any comparable state—a roughly eight-fold advantage in per capita funds relative to the average state.[5] Undoubtedly, much of this advantage is attributable to Delaware's outstanding Court of Chancery, but Delaware had also altered trust law prior to 1995 in a manner favorable to testators and settlors. For example, Delaware tweaked—but did not abolish—its perpetuities law to create tax and other advantages to settling a trust in Delaware.[6] As this report will demonstrate, Delaware's advantage in trust assets under management has grown substantially over time.

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[4] For reasons unrelated to the GST tax, South Dakota, Idaho, and Wisconsin had previously abolished the Rule Against Perpetuities.

[5] Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust, 27 Cardozo Law Review 2465 (2006) (see especially Tables 1A and 1B, pages 2498-2501). Dollar figures are adjusted for inflation to reflect year 2000 dollars.

[6] In 1986, Delaware reconfigured the Rule as applied to interests in trust into a 110-year limitation on trust duration. Act of July 3, 1986, ch. 422, 65 Del. Laws 831. Previously, in 1933, Delaware enacted legislation providing that a new perpetuities period would begin on the exercise of a power of appointment, which remains good law in Delaware today. See Del. Code Ann. tit. 25, § 501. Hence, Delaware made possible a perpetual trust free of federal transfer taxes long before 1995. However, Congress effectively foreclosed this option with I.R.C. § 2041(a)(3), which makes the extension of the perpetuities period under §501 a taxable event for all trusts created in or after 1942. See Jonathan G. Blattmachr & Jeffrey N. Pennell, Adventures in Generation-Skipping, or How We Learned To Love the "Delaware Tax Trap," 24 Real Prop. Prob. & Tr. J. 75 (1989).

The synopsis to the 1995 act that abolished Delaware's Rule Against Perpetuities for trusts of personal property laid out the underlying reasons behind the legislature's move to abolish the Rule:

> Several states, including Idaho, Wisconsin and South Dakota, have abolished altogether their rules against perpetuities, which has given those jurisdictions a competitive advantage over Delaware in attracting assets held in trusts created for estate planning purposes. . . .Delaware's repeal of the rule against perpetuities for personal property held in trust will demonstrate Delaware's continued vigilance in maintaining its role as a leading jurisdiction for the formation of capital and the conduct of trust business.[7]

In the sixteen years since Delaware abolished the Rule, an additional twenty-five American jurisdictions followed suit by abolishing the Rule or permitting trusts of extremely long duration. In a paper published in the Yale Law Journal using FDIC data on the personal trust holdings of federally reporting institutions,[8] Professor Sitkoff and I studied the effect of abolishing the Rule Against Perpetuities using well-accepted econometric techniques. We found that after a state abolished the Rule, its trust assets increased by nearly *$6 billion* relative to states that did not abolish the rule. This is a *20% increase* on average. Given that 16 states abolished the rule within the time frame of the sample, we concluded that roughly $100 billion in trust assets have been sited so as to take advantage of the abolition of the Rule. This represents 10% of the sample's total trust assets in 2003. Moreover, this figure understates the popularity of perpetual trusts. The FDIC data include only trust funds held by federally regulated entities, but non-professional trustees and non-reporting entities may also hold trust assets. A second important result of the study was that a state's trust business only increased if the state did not levy a fiduciary income tax on trusts attracted from out of state. In other words, a state would both have to abolish the Rule and not levy a fiduciary income tax to attract out-of-state trust business. This makes perfect sense, as perpetual trusts are formed (at least in part) to minimize taxation.

The Yale Law Journal article concluded that the competition for trust funds was real and intense. However, as with all empirical studies that generate an average effect, one should not take the general result and particularize it to an individual state. Moreover, the figures estimated are essentially the response of the average state's business to abolition of the Rule, and do not reflect other important factors that affect a state's trust business--for example, the quality of the state's judiciary.

The time frame of the Yale Law Journal study was 1985 through 2003. It therefore did not draw conclusions about the effect of more recent innovations, such as asset protection trusts and directed trustee statutes. In the new century, additional legal

[7] 1995 DE H.B. 245 (SN) (May 18, 1995), enacted on July 7, 1995.

[8] Robert H. Sitkoff & Max Schanzenbach, Jurisdictional Competition for Trust Funds, 115 Yale L.J. 356 (2005).

innovations have perhaps intensified this competition, and the anecdotal evidence from practitioners is that these new margins of competition are increasingly important. Moreover, now that lawyers and clients are accustomed to establishing trusts governed by another state's law, the study suggests that situs is likely to be increasingly influenced by state legal regimes.

The study also left some questions open. A key question was the extent to which the competition for funds created benefits for the state. After all, if there is no fiduciary income tax levied on the trust funds attracted, how does the state benefit? While not directly addressing the issue, the article concluded that the motivation must come from the indirect benefits, such as fiduciary fees paid:

> [I]t is commonly assumed that states seek to maximize tax and related revenues, and this in turn supplies the incentive to compete for business against other states…. We have shown that in the competition for trust business, states respond to competitive pressures, but it is impossible to link their incentive for doing so to immediate tax or other direct revenue increases. To repeat, only those states that did not levy an income tax on trust funds attracted from out of state experienced an increase in trust business from abolishing the Rule Against Perpetuities….[However,] in states that did not tax such trusts [state] revenue may have increased indirectly owing to taxes paid by financial institutions, their employees, and local lawyers.[9]

Although left unaddressed in the Yale study, the payoff of trust business to state budgets and the state economy can be estimated under a reasonable set of conservative assumptions. As stated, these benefits will be, for the most part, indirect.

2. Estimating Delaware's Excess Trust Business and Fiduciary Fees

I will measure the impact of Delaware's trust business on the state economy by focusing primarily on fiduciary fees paid out of such trusts. This misses some important contributions such trusts may make to Delaware's economy, such as legal fees. However, fiduciary fees comprise the largest portion of trust expenses and can be estimated in a straightforward manner.

Two data sources are used to estimate Delaware's excess fiduciary fees. First, I estimate total trust assets in Delaware institutions based on reports made to the FDIC. Because fiduciary fees are paid based on corpus, a reasonable estimate of fiduciary fees can be backed out of an estimate of total assets. Moreover, the FDIC data demonstrate Delaware's predominance in the trust business and also that Delaware tends to attract very large trusts. Though quite useful, the FDIC data have some limitations. The data are created from reports filed by banking institutions with trust powers and

[9] Id. at 416-17.

consequently non-bank trust companies and individual fiduciaries are not captured by the data. In addition, the data cannot be used after 2004 as the FDIC stopped separately reporting personal trusts as of that year, but lumped employee benefit and personal trusts together.

Second, I use IRS data on personal trusts at the state level. These state-level data are aggregated from individual fiduciary income tax returns (Form 1041). The data are aggregated to the state level to protect privacy and contain most lines on Form 1041, including total fiduciary fees deducted. The IRS data also have limitations. Not all trusts have to file a fiduciary income tax return (e.g., grantor trusts). In addition, the data will not include trusts that are managed by Delaware institutions but have a fiduciary who files with a return address in a different state.

In sum, the two approaches do not capture all fiduciary fees deducted in Delaware and reflect different underlying pools of assets. It is therefore important to bear in mind that the estimates arrived at will be conservative, lower-bound estimates since not all trust assets under management are reflected in the data. Nonetheless, both data sources yield surprisingly similar estimates—based on what one would expect for a state of Delaware's population, both data sources suggest that between 90% and 95% of Delaware's trust business is due to its attraction of trusts settled by non-residents as opposed to its domestic trust business.

a. *Excess Trust Business in Delaware – FDIC Data*

All banks and other financial institutions that are regulated by a federal banking authority must file an annual report detailing their trust holdings, including total assets and number of accounts. Federal statutes make these filings mandatory.[10] Based on this data, from 1968 until 2001, the Federal Financial Institutions Research Council published annual reports of trust holdings by regulated entities, summarizing the results by state.[11] Since 2001, the FDIC has been publishing these reports, which are available online organized by individual institution and by state.[12] To my knowledge, this is the only national database on personal trust funds. The data make clear that Delaware has gained an astonishingly disproportionate advantage in the competition for trust funds. For example, in 2004, Delaware institutions held 2.8% of all trust assets

[10] 12 U.S.C. §1817 (FDIC); 12 U.S.C. §§248(a), 1844(a) (Federal Reserve System); 12 U.S.C. §§1464, 1725, & 1730 (Federal Home Loan Bank Board); 12 U.S.C. §§161, 1817 (Office of Comptroller of the Currency).

[11] Federal Financial Institutions Examination Council, Trust Assets of Financial Institutions, 1985-2000.

[12] An interactive site allows one to obtain new data, state by state at http://www2.fdic.gov/sdi/main.asp. Older reports, from 1996 through 2000, may be obtained at http://www2.fdic.gov/structur/trust/index.asp.

held by reporting institutions in the United States, despite Delaware having only 0.28% of the U.S. population.[13]

The trust data come from annual reports collected by the four federal agencies charged with banking regulation:[14] The trust holdings of regulated entities are reported in categories entitled "Employee Benefit," "Personal Trusts," and "Estates." This report examines only "Personal Trusts," a category that includes both private and charitable trusts, but that excludes commercial trusts and employee benefit plans. Prior to 1985, federal authorities only collected information on actively managed personal trusts (meaning trusts for which the regulated entity had discretionary investment authority), and neither savings and loan institutions nor savings banks with trust powers were required to report.[15] As mentioned, in 2005, the FDIC stopped separately collecting data on employee benefit accounts and personal trust accounts. To ensure consistency, only data from 1985 through 2004 are used in analyses.

Figures 1 through 3 below detail the evolution of Delaware trusts over time and relative to national trends and some comparison states. Table 1 displays total reported assets in Delaware in the aggregate and as a percentage of national assets. Delaware's share of the national trust business has grown from averaging under 2% in the late 1980s to averaging over 3% since 2000. The IRS data show that this advantage has continued to increase.

The years 1990 and 1991 bear mentioning since reported assets spike in these years. Based on conversations with the FDIC, I have concluded that there was likely a reporting error these years (possibly a reporting institution included some large employee benefits accounts), but, in the interests of transparency, no interpolation or adjustment was made to these years. Data in these years probably should be ignored by the reader. Another point that bears mentioning is that Delaware trusts seemed relatively more affected by the economic downturn in 2001. This fact, also evident in Figures 2 and 3, is likely due to Delaware's attraction of large trusts whose beneficiaries likely have more risk tolerance and, because a fair portion of these trusts may be perpetual, are invested with a relatively longer time horizon.

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[13] I could also estimate based on per capita income, as richer states should have more trust funds. However, this does not change the results because Delaware's per capita income is almost exactly the U.S. average. Thus, based either on population or total state income, one would expect Delaware to have about 0.28% of total trust assets.

[14] Four federal agencies are vested with bank regulatory authority: (1) the Federal Deposit Insurance Corporation; (2) the Federal Reserve System; (3) the Office of Thrift Supervision; and (4) the Office of the Comptroller of the Currency.

[15] See Federal Financial Institutions Examination Council, Trust Assets of Financial Institutions-1987, at 2 for a discussion.

Figure 1: Delaware Total Reported Trust Assets

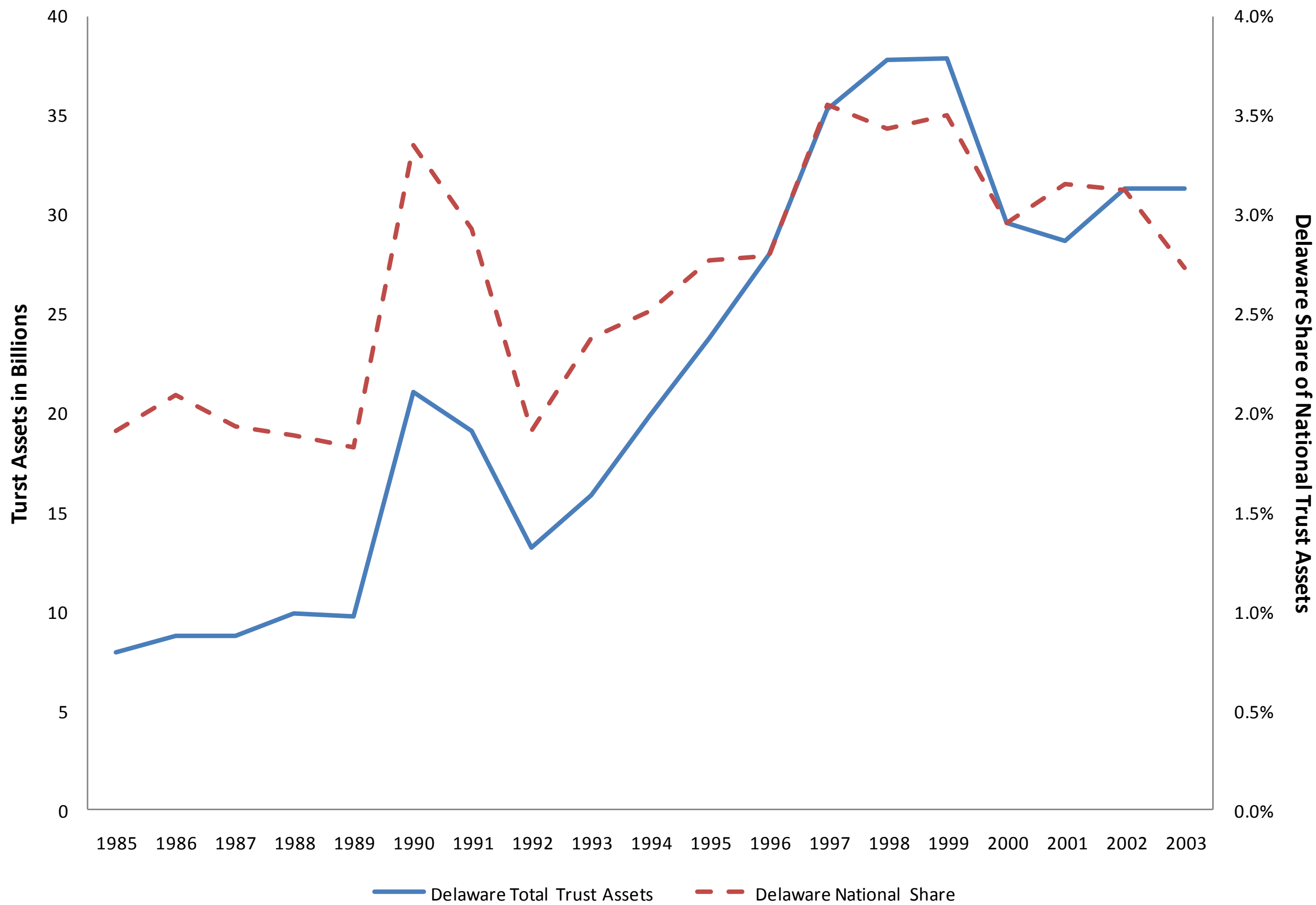
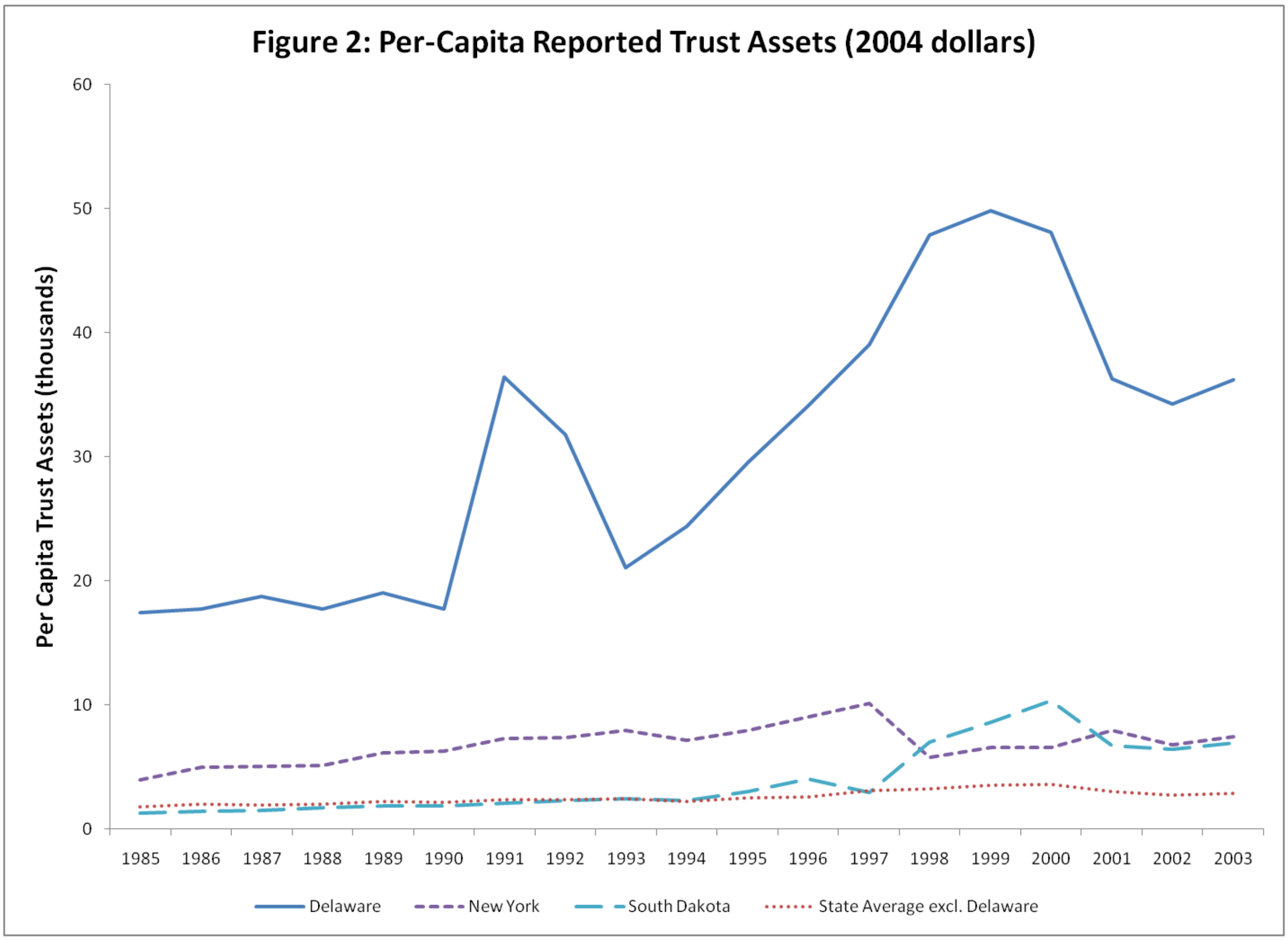


Figure 2 (below) reports trust assets per capita and includes three points of comparison: New York, South Dakota, and the national average. New York and South Dakota are included because they are the two primary competitors to Delaware (based on a review of the data). By any measure, Delaware is a success and its success is increasing. Since the abolition of the Rule in 1995, Delaware has had 10 to 15 times the national average per capita trust assets, and five to eight times that of South Dakota and New York. Delaware's lead over New York and South Dakota has increased over time, except perhaps when it faced greater relative decline in trust value in the 2001 recession. This was likely because Delaware has a higher percentage of sophisticated trusts invested further out on the risk-return curve relative to any other state—a subject to which I shall return later in the report.



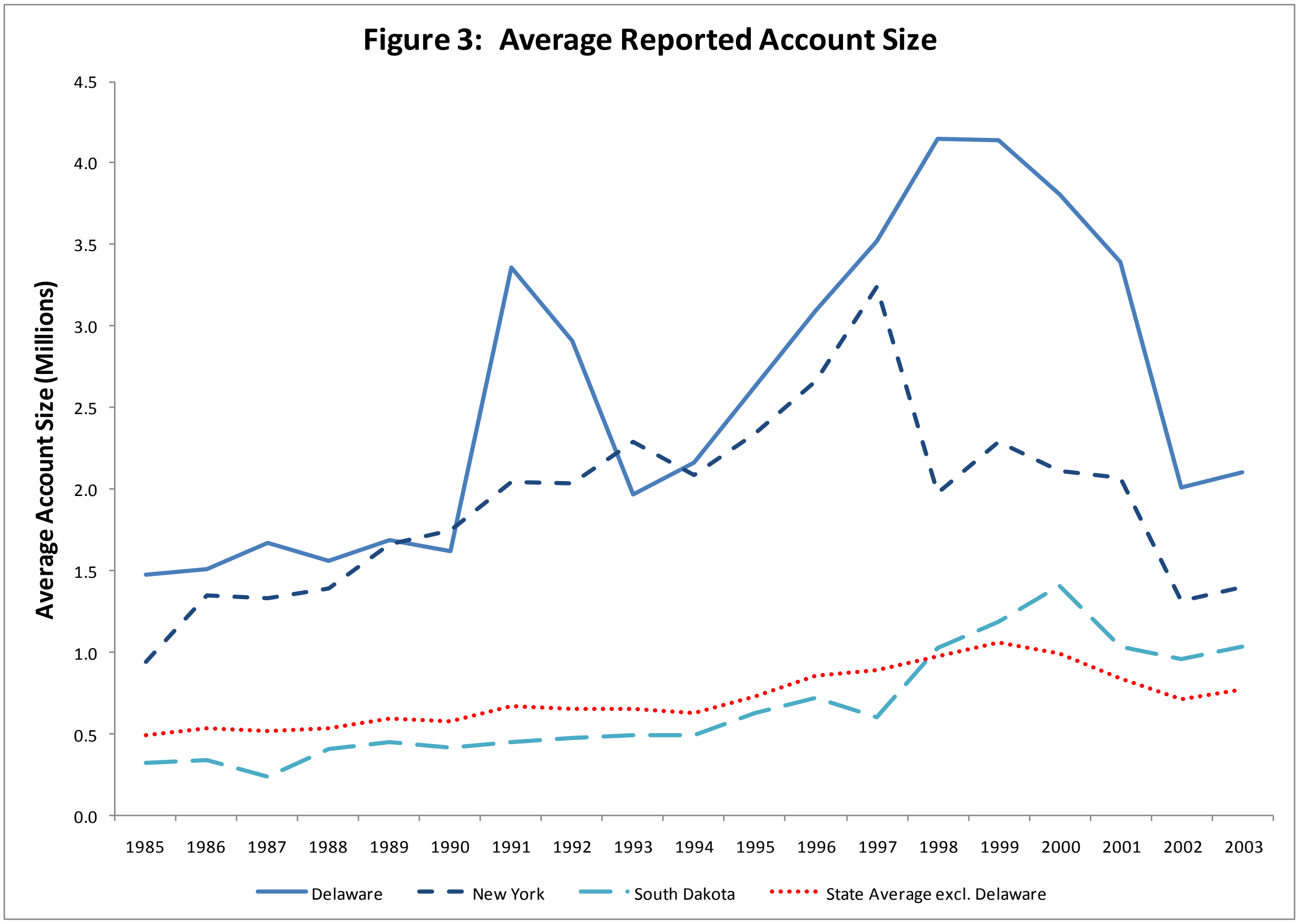


Figure 3 compares average account size between Delaware, New York, South Dakota, and the national average. Delaware attracts relatively larger trusts than any comparison group. Indeed, it has in all years the largest average trust size of any state. This is further evidence of Delaware's status as a leading trust jurisdiction—it attracts the largest trusts which are likely the most sensitive to legal regime and most likely to receive sophisticated legal advice.

In relative terms, Delaware outperforms all states, including leading trust jurisdictions, by significant factors. In the last five years of FDIC data (2000-2004), an average of $34 billion dollars held in trust was sited in Delaware. Based on its population (or its income level) Delaware is predicted to have only $3.5 billion in trust assets. On this basis, over 90% or roughly $30.5 billion of Delaware's trust business is from trusts settled by non-residents and approximately $3.5 billion is from trusts settled by state residents.[16] Assuming annual trustee fees of .50% of corpus, this excess asset pool generates about $150 million per year in fiduciary fees.[17]

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[16] In the period 1999-2003, the national average of trust assets per-capita was $4,400, and Delaware's population in this period was around 800,000, yielding a population predicted trust asset level of about $3.5 billion. Delaware has relatively high per-capita income, however, and using this metric would

As a final note, the estimates here are lower bounds. For example, non-deposit or limited purpose trust companies are of increasing importance but are not required to report trust assets to federal authorities. Prior to Delaware's abolition of the Rule Against Perpetuities in 1995, the state had only six non-deposit or limited-purpose trust companies. By 2009, the state had thirty-four such companies employing around 400 persons.[18]

b. *Fiduciary Fees and Trust Income – IRS Data*

The IRS data are state-level summaries of personal trusts filing the 1041 Form (U.S. Income Tax Return for Estates and Trusts). The data include number of returns filed, taxable trust income, and allowable deductions from income for "complex" and "simple" trusts. The IRS made state-level summaries available to me based on the filing fiduciary's return address. The available years (at present) are 1997 and 1999-2007.[19] Individual returns are not made public. Form 1041 is also filed by the fiduciaries of decedent's estates, bankruptcy estates, disability trusts, and pooled income funds. These are excluded from the analysis.

The IRS data have some advantages over the FDIC data for the purposes of this report. First, I can measure a more direct payoff to Delaware's economy through the data on fiduciary fee deductions. Second, the IRS data include trusts managed by individuals or non-reporting institutions which would not be reported in the FDIC data. However, there are some important limitations. The IRS data report only non-grantor trusts that file using a 1041 form. Grantor trusts, which are certainly an important feature of modern wealth management, are missed by the data. In rough terms, grantor trusts are trusts over which the grantor or the grantor's spouse has control rights and hence are taxed to the grantor. The income from such trusts would typically be reported on personal income tax returns. Other trusts will also be missed, including trusts that are classified as foreign trusts for federal income-tax purposes, trusts that do not have enough income to require the filing of a federal return (e.g., because they hold closely owned stock), unfunded trusts (that nevertheless pay an annual maintenance fee), and statutory trusts.

Second, it is possible that some trusts managed by Delaware financial institutions will nonetheless report a non-Delaware address on their 1041. Because Delaware's trust

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increase the predicted trust asset level to closer to $4 billion. For the sake of this presentation, I round up and use the more conservative $4 billion predicted value.

[17] Trustee fee schedules typically start at 1% of corpus per annum and then decline. The .50% average figure was arrived at in consultation with the participating institutions.

[18] Annual Report for the Year Ended December 31, 2009, Office of the State Bank Commissioner, page 12. Employment figure is based on interview with State Bank Commissioner Robert Glen.

[19] These are filing years 1998; 2000-2008.

business is almost entirely generated by out-of-state trusts and many institutions have Delaware branches, there are some trusts in which the fiduciary files with a non-Delaware address even though the trust is managed by a Delaware institution.[20] As such, the data still paint an incomplete picture, and likely understate the amount of trust business in Delaware.

In addition to providing detailed information about sources of income and types of deductions, the IRS data also classify trusts into two distinct categories. For tax purposes, non-grantor trusts are treated as entities independent of their grantor, trustee, and beneficiaries. The tax code classifies non-grantor trusts as *simple* or *complex*. A trust is a simple trust if (a) the trust is required to pay out all the income in the year it was earned;[21] (b) the trust makes no payments out of corpus; and (c) the trust makes no payments to a charity (that is, no payments that are deductible as charitable contributions). The typical simple trust would be a trust set up to pay income to a widow/er for life with a remainder beneficiary.

I posit that most non-grantor trusts that are sensitive to state legal regimes would file as complex trusts. For example, perpetual trusts are designed to provide a tax-advantaged fund that will endure for a long time, hence the trustee is nearly always given discretion to retain trust income. In addition, income retention is more likely to make sense for wealthy beneficiaries, for whom the high fiduciary income tax rates would be less bothersome.[22]

Table 1 summarizes the IRS returns using 1997, the first available year, and 2007, the last available year, as comparison points. The first thing to note is that Delaware does not have a large number of trusts. Of the over 2 million trusts filing fiduciary income tax returns in 2007, Delaware had only 18,000--less than one percent of the total U.S. filings. Nonetheless, Delaware filing trusts deducted $213 million in fiduciary fees in 2007 or 5.5% of all fiduciary fees deducted in the United States that year. Moreover, Delaware's share of the trust business, as measured both by income share and fiduciary fees, more than doubled between 1997 and 2007. On the basis of population (Delaware has 0.28% of U.S. population), Delaware is outperforming the U.S. average fiduciary fee deductions by a factor of 20. In short, the IRS data suggest that Delaware has an excess of $200 million in fiduciary fees. These estimates are similar in magnitude to the excess assets estimated in earlier years using the FDIC data.

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[20] There is less concern that Delaware addresses are being reported for trusts that do not have a significant presence in Delaware. This could only occur if a large bank, headquartered in Delaware, had significant presence in other states but filed their returns centrally through their Delaware office. The converse is more likely--that large institutions maintain a Delaware branch or subsidiary but file the 1041 through a different state office and consequently report a different state of address even if the governing law and management of the trust operates through a Delaware branch.

[21] "Income" here refers to the distinction between income and principal under state trust fiduciary law.

[22] I suspect that many Asset Protection Trusts will be grantor trusts and hence not reflected in the data.

Table 1: Number of Returns, Total Income Reported, and Fiduciary Fees Deducted in Delaware and U.S.*

	1997	2007
Delaware		
# of Trusts	11,714	18,123
Trust Income	$2.3 billion	$8.17 billion
Fiduciary Fees	$89 million	$214 million
USA		
# of Trusts	1.7 million	2 million
Trust Income	$100 billion	$164 billion
Fiduciary Fees	$3.5 billion	$3.9 billion
Delaware's Market Share		
# of Trusts	.007	.009
Trust Income	2.3%	5.0%
Fiduciary Fees	2.5%	5.5%

*Dollar figures are in inflation-adjusted 2007 dollars

To get a better understanding of how legal innovations attract business to Delaware, Table 2 breaks the IRS data down by *simple* and *complex* trusts for the whole U.S. and Delaware. To the extent complex trusts are more sophisticated, the testators and settlors will both receive better advice about jurisdictional choice and be more likely to make use of legal innovations such as the abolition of the Rule Against Perpetuities. Delaware's increasing competitive advantage is evident. Between 1997 and 2007, Delaware's simple and complex trust business both increased, but its complex trust business has increased at three times the rate of its simple trust business as measured by income and deducted fiduciary fees. Moreover, Delaware's growth in both simple and complex trusts has substantially outpaced that of the nation even though Delaware started in 1997 from a relatively advantaged position. Delaware's performance in attracting complex trusts and large trusts is strong evidence that its legal innovations have been an attraction to out-of-state testators and settlors.

Table 2: Number of Returns, Total Income Reported, and Fiduciary Fees Deducted in Delaware and U.S. by Simple and Complex Designations*

	1997		2007		Growth Rate	
	Simple	Complex	Simple	Complex	Simple	Complex
Delaware						
# of Trusts	6,307	5,407	8,138	9,985	29%	84%
Trust Income	$1.16 billion	$1.14 billion	$2.64 billion	$5.53 billion	127%	385%
Fiduciary Fees	$55 million	$33 million	$101 million	$113 million	84%	237%
USA						
# of Trusts	1,029,000	689,000	709,000	1.3 million	(-31%)	88%
Trust Income	$57.4 billion	$44 billion	$47.8 billion	$116 billion	(-16.7)%	164%
Fiduciary Fees	$1.80 billion	$1.70 billion	$1.54 billion	$2.43 billion	(-14.5)%	43%

*Dollar figures are in inflation-adjusted 2007 dollars

Delaware's relative position can also be demonstrated by comparison with select states. As of 2007, the only states reporting more income or fiduciary fee deductions were extremely large states. Table 3 ranks the states by total fiduciary fees deducted in 2007 and also reports fiduciary fees per capita. Only six states outperformed Delaware in absolute numbers, and they are very large states. Delaware is far and away the winner in terms of fiduciary fees per capita. Not surprisingly perhaps, South Dakota is the next closest to Delaware in fiduciary fees per capita, though it remains a distant competitor.

Table 3: Top Ten States in Total Fiduciary Fee Deductions*

State	Total Fiduciary Fees Deducted 2007 (millions)	Total Fiduciary Fees Deducted Per Capita
1. New York	$428	$21.9
2. Pennsylvania	$335	$26.8
3. California	$317	$8.8
4. Illinois	$302	$24.7
5. Florida	$252	$14.0
6. Ohio	$239	$20.8
7. Delaware	$213	$247.6
8. Texas	$200	$8.5
9. Massachusetts	$192	$30
10. Michigan	$109	$10.2
19. South Dakota	$42	$50.8

*Per capita based on U.S. Census Bureau state population 2007 estimates

Delaware performs remarkably well in the competition for fiduciary fees, and this performance can be in large part attributed to Delaware's responsive and sophisticated legal environment. Even so, the figures here are an incomplete portrait of the impact of trust business on Delaware. First, grantor trusts are quite common, but are not reflected in the data. Second, attorney fees are not reflected in fiduciary deductions and are likely to be substantial.

To estimate the importance of grantor trusts, institutions participating in this study were asked to provide information on the percent of their fiduciary fees within their institutions that were attributable to grantor trusts. Six responded. The information provided suggests grantor trusts account for roughly one-third of fiduciary fees overall. Based on this information and the $200 million deducted on the Fiduciary Income Tax Returns, I conclude that $300 million in fiduciary fees were generated in 2007 by trusts filing with Delaware addresses.[23]

There is clear potential for significant legal fees as well. The IRS returns report that $115 million in attorney's fees were deducted by Delaware filing trusts in tax year 2007. These fees may reflect services provided by attorneys in other states, and it is not possible to determine what portion are attributable to Delaware counsel. However, attorney fees generated by Delaware's trust business are likely substantial. To take one example, the Delaware Court of Chancery heard 320 petitions for trust modification in 2009.[24] Fees for a modification petition average around $6,000,[25] generating nearly $2 million per year for Delaware's economy. Moreover, the typical modification petition generates roughly $1,000 in court fees,[26] which in 2009 provided $320,000 for the Court of Chancery. The number of such petitions has been growing rapidly.[27]

3. <u>The Impact of Delaware's Trust Business on the State Economy</u>

The full effect of trust business on Delaware's economy may only be estimated indirectly. I will primarily focus on the impact of fiduciary fees attributable to non-resident trusts on Delaware's economic output, or Gross State Product. GSP is estimated by the U.S. Department of Commerce's Bureau of Economic Analysis (BEA) and is roughly the state equivalent of Gross Domestic Product. GSP has been estimated by the BEA since 1963; the most recent estimates are for 2008.

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[23] To double-check the plausibility of these estimates, the participating institutions also reported their total fiduciary fees charged. The five institutions that provided fiduciary fees reported $95 million total.

[24] "Death of the Dead Hand?" remarks by Chancellor William B. Chandler of the Delaware Court of Chancery presented at the 2010 Delaware Bankers Association Trust Conference.

[25] Based on interviews with Delaware counsel.

[26] <u>*Id.*</u>

[27] In Chancellor Chandler's remarks, "Death of the Dead Hand?" (*supra* note 24), he stated that petitions for modification had tripled in the last four years.

a. *Evaluating the Full Impact of Trust Business on the Delaware Economy*

An estimate of the effect of the trust business on Delaware's GSP can be made on the basis of the previous estimates of the "excess trust business" reposed in Delaware. The FDIC data in the years 1999 through 2003 suggested about $150 million in excess fiduciary fees per year. The 2008 IRS data suggested Delaware had an excess of $200 million in fiduciary fees from non-grantor trusts, with my own estimate of grantor trust fees adding another $100 million. I take the $300 million figure as the most recent figure, and it should be noted that the IRS data from the early 2000s matched closely with FDIC-based estimates of excess fiduciary fees from that period.

However, the $300 million figure would not be adequate to describe the full economic impact of Delaware's excess trust business. The financial sector has a well-known local "multiplier effect" that has been studied by economists. Services that are traded locally (retail, repair, personal finance for state residents) do not create a strong multiplier. Delaware's trust business, however, is almost entirely external to the state and hence constitutes external trade. In other words, this business attracted from non-residents forms part of the base of an economic pyramid.

The most recent work on local multiplier effects and so-called "tradable goods and services" suggests that such services generate up to 3.5 times the economic activity elsewhere in the state or local economy.[28] Even more conservative estimates of multipliers would at least double the effect of the excess trust business.[29] Thus, taking $300 million as a conservative estimate of Delaware's gain from trust business in direct fiduciary fees, a multiplier would increase this by a factor of 2 to 3.5 times. In other words, Delaware's trust business probably accounts for between $600 million and $1.1 billion annually of the state's economy, or $1,700 to $3,000 per Delaware household. In relative terms, Delaware's trust business, estimated on the basis of fiduciary fees alone, accounts for around 1.2% to 1.9% of Delaware's GSP.[30]

b. *Direct payoff of trust business to Delaware's state budget*

This report has focused primarily on the total benefit to the Delaware state economy of the state's trust business. The direct payoff to the state in terms of tax revenue and employment is more difficult to measure, but a reasonable estimate can be made of such gains. Moreover, the other side of the balance sheet, the cost of the business to the state of Delaware, will be considered.

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[28] Enrico Moretto, Local Multipliers, 100 American Economic Review 373 (2010).

[29] David L. Kay et al., Role of Services in Regional Economy Growth, 38 Growth and Change 419 (2007).

[30] One relevant caveat here is that, because Delaware is a small state, some of the local multipliers will benefit other states.

The direct payoffs to the state of Delaware come in two primary forms. The first is in bank franchise taxes, the second is in income taxes paid through direct and indirect economic activity surrounding trust management. Large commercial banks pay the bulk of Delaware's franchise taxes, and I lack the data to make a straightforward estimate of the trust business's impact on franchise taxes.

The second payoff of excess trust business to the state is in the form of income taxes and employment stemming from the trust business. The trust industry undoubtedly provides a substantial number of jobs directly. Unfortunately, Bureau of Labor Statistics coding is too broad to make a refined estimate of job creation from government figures.[31] However, participating institutions reported 585 employees in trust departments or separate trust tax departments in Delaware. Add to this the previously discussed estimate of 400 employees in non-deposit trust companies, and I can be confident of almost 1,000 persons employed in Delaware's trust business. This count, though woefully incomplete, suggests a huge employment effect from Delaware's personal trust business. The multiplier effect could well add another 2,000 jobs to this figure. Moreover, two institutions noted that their trust departments are supported by other departments (such as tax departments) and were unable to fully report the employment figures.

The tax payoff can also be estimated based on the fiduciary fee estimates. Taking the $600 million to $1.1 billion estimate of the trust business's impact on state GSP, I can estimate the state income tax payoff to Delaware. The standard wage share for GSP is 80%[32] and Delaware's average income tax rate on wages and salaries is about 4%.[33] Under these assumptions, between $19 million and $33 million additionally is collected in state income taxes, accounting for about 1.3% to 2.2% of total state personal income

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[31] The Bureau's state-level employment data provide the number of workers in "depository institutions" and, separately, financial "fiduciaries." Unfortunately, employment by a trust department could fall into either category, and commercial banks have a large presence in Delaware unrelated to its trust business. Moreover, "fiduciaries" would encompass a great deal of non-trust business, such as financial advisors and hedge fund managers.

[32] Though it should arguably be higher in finance, which is a service industry and not capital intensive.

[33] Delaware has an increasing marginal income tax rate (Delaware's graduated income tax scale tops out at 6.95% beginning at a taxable income of $60,000) and various deductions and allowances. Thus, the average tax rate must be approximated. The 4% figure is derived from two sources. Delaware's Department of Finance Fiscal Notebook (available at http://finance.delaware.gov/publications/ Financial_Reports.shtml.) The 2010 Fiscal Notebook reports about $1 billion collected in personal income taxes in the last five years. There was a dip in 2010 to $813 million, though the state projects a recovery to $955 million in 2011. The Bureau of Economic Affairs reports that Delaware wages and salaries varied between $24 billion and $26 billion in the period, which together with the $1 billion figure implies an average tax collection of roughly 4% of total state wages and salaries. (Bureau of Economic Affairs figures available at http://www.bea.gov/regional/spi.) In keeping with the conservative nature of the estimates here, this is likely an understatement of the real number because of the increasing marginal rates and the higher than average salaries most common in the financial sector.

tax revenue. As emphasized above, this figure is a lower bound because the data sources relied upon are incomplete.

Of course, the full fiscal picture must include an accounting of costs to the state. The two primary costs to the state are: (1) legislative attention to developments in trust law required to preserve and enhance Delaware's position, and (2) the costs to the state of trust litigation not accounted for by court fees. These costs are hard to quantify. However, Delaware's pursuit of relatively large and sophisticated trusts may mitigate these costs to some extent. The FDIC and IRS data make clear that Delaware attracts a lot of assets, but not a lot of trusts. As such, the litigation pursued in Delaware would tend to be for higher stakes and the underlying trusts would be paying substantial fiduciary and legal fees.

One possible concern is that fiduciary fees for large trusts are typically discounted, and hence Delaware's advantage is not as great as it seems because it has attracted larger trusts. The IRS data, however, suggest that Delaware's relative position in fiduciary fees is the same as its relative position in trust income. While not conclusive proof, the IRS results strongly imply that the attraction of relatively large and sophisticated trusts has not substantially diminished Delaware's gains in fiduciary fees.

As a final note, the attendant administrative costs to the state of engaging in competition for trust business, even if hard to quantify, pale in comparison to the investments in physical infrastructure or tax breaks that local governments often make to attract a single factory or sports team. To take one example, state and local governments in Georgia gave $400 million in tax breaks and other incentives to lure a Kia auto plant to the state.[34] Likewise, the demands of the financial services sector on infrastructure or the environment are relatively mild.

Summary

As an early mover in the competition for trust funds, Delaware attracted a huge volume of trust business, outperforming all other states on a per capita basis. Employing both IRS and FDIC data, out-of-state trusts have in recent years contributed between $600 million and $1.1 billion per year to Delaware's economy, which works out to $1,700 to $3,000 per Delaware household. This estimate is a lower bound because both sources of data present an incomplete picture of Delaware's trust business. Moreover, Delaware's strategy is part of a broader effort, begun thirty years ago, of attracting banking business to Delaware. In sum, Delaware has leveraged its legal infrastructure and judicial capital for a very high return from the trust business.

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[34] See story at www.nytimes.com/2009/04/22/us/22kia.html.