BUT IT'S GOING TO BE IRREVOCABLE: DESIGNING NEW IRREVOCABLE TRUSTS TO ACHIEVE FLEXIBILITY IN LIGHT OF AN UNCERTAIN TAX PLANNING ENVIRONMENT

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I. INTRODUCTION

On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act of 2017 (the "2017 Act"). The 2017 Act increased the exemptions for federal estate tax, gift tax and generation-skipping (GST) tax to $11,180,000 per person for 2018. The exemptions are indexed for inflation, which for 2025 means that the exemptions are $13,990,000 per person. The tax rates on estates, gifts, and GST transfers above the exemption is forty percent (40%).

The 2017 Act contains a sunset provision. The exemptions for federal estate tax, gift tax and GST tax are scheduled to revert to the 2017 amounts effective January 1, 2026. As a result of the 2017 Act clients are presented with an estate planning opportunity to transfer significant amounts of wealth out of their estate without the imposition of transfer taxes. Dynasty trusts have become a popular tool for clients interested in using the increase in exemption to transfer assets out of their estate.

This outline will discuss the typical structure of a Dynasty Trust. The outline will also address the income taxation of Dynasty Trusts, flexible provisions to include in Dynasty Trusts, Completed Gift Asset Protection Trusts and the use of Quiet Trust language in Dynasty Trusts.

II. WHAT IS A DYNASTY TRUST?

A. Overview. A Dynasty Trust is simply a trust that perpetuates from one generation to the next without the requirement of terminating on a set date. For example, a mother may create a Dynasty Trust for the benefit of her son and his descendants. Upon the death of son the remaining assets in the Dynasty Trust would be divided into shares, per stirpes, for son's descendants and continue in further trust for their lifetime benefit. Upon the death of a descendant of son such descendant's trust would divide, per stirpes, for the descendant's descendants and continue in further trust.

B. Statutory Recognition. Many jurisdictions have either abolished the common law rule against perpetuities applicable to trusts by allowing the creation of true perpetual trusts or otherwise extending the common law rule against perpetuities applicable to trusts so that trusts may stay in existence for a very long period of time. (i.e., one thousand years). For instance, Delaware abolished the common law rule against perpetuities applicable to trusts in 1986 and enacted legislation allowing perpetual trusts in 1995. 25 Del. C. § 503. Under Delaware law, a trust may have a perpetual existence. 25 Del. C. § 503. There is a limitation for real estate held by deed in trust name that applies a one hundred and ten (110) year rule against perpetuities to the real estate. 25 Del. C. § 503(b). However, the statute expressly excludes real estate held as an intangible through an entity such as a "corporation, limited liability company, partnership, statutory trust, business trust or other entity" where the entity ownership interest is held by the trust instead of the real estate itself. 25 Del. C. § 503(e).

C. Use of Limited Powers of Appointment. As previously explained, a true Dynasty Trust perpetuates from one generation to the next without any direction from a beneficiary as to the ultimate disposition of the Dynasty Trust assets. For flexibility purposes it is often desirable to include testamentary limited powers of appointment to allow each generation to redirect the disposition of the Dynasty Trust assets upon his or her death. Provided below is sample language we typically include in our Delaware Dynasty Trusts granting beneficiaries testamentary general powers of appointment for tax planning purposes and testamentary limited powers of appointment for flexibility purposes:

> (i) The Trustee shall distribute that portion of the assets of such Primary Beneficiary's separate trust, which if included in such Primary Beneficiary's taxable estate for federal estate tax purposes would result in a reduction of the overall transfer taxes (including Generation-Skipping Transfer tax) determined without regard to the marital and charitable deductions imposed on such trust, to such Primary Beneficiary's creditors or the creditors of his or her estate, in such manner as such Primary Beneficiary may appoint by specific reference to this power in his or her Last Will and Testament admitted to probate or pursuant to an instrument executed by such Primary Beneficiary during his or her lifetime and delivered to the Trustee, provided that the exercise of such power of appointment shall not take effect until such Primary Beneficiary's death. The Trustee shall have no duty to determine whether including any portion of the assets of the trust in the Primary Beneficiary's taxable estate will

result in a reduction of overall transfer taxes. Instead, the Trustee shall rely on written direction from the personal representative of the Primary Beneficiary's estate as to whether including any portion of the trust assets in the Primary Beneficiary's taxable estate will result in a reduction of transfer taxes.

(ii) The Trustee shall distribute the unappointed (including the portion not appointed above) remainder of such Primary Beneficiary's separate trust estate in such manner as such Primary Beneficiary may appoint by specific reference to this power in his or her Last Will and Testament admitted to probate or pursuant to an instrument executed by such Primary Beneficiary during his or her lifetime and delivered to the Trustee, provided that the exercise of such power of appointment shall not take effect until such Primary Beneficiary's death, upon such conditions and terms including outright or in further trust, to the limited class of beneficiaries consisting of the Grantor's descendants (other than such Primary Beneficiary), and the spouses of the Grantor's descendants (including such Primary Beneficiary's spouse) provided, however, that the interest of a spouse may not exceed net income for the lifetime of such spouse. In no event shall the power of appointment conferred upon a Primary Beneficiary in this section be construed as a power in such Primary Beneficiary to appoint such Primary Beneficiary's trust to himself or herself, his or her creditors, his or her estate or the creditors of his or her estate. Notwithstanding the foregoing or any other provisions of this Agreement, no limited power of appointment held pursuant to this Agreement may be exercised over a trust which is exempt from the generation-skipping transfer tax to trigger the application of Section 2041(a)(3) or Section 2514(d) of the Code.

III. HOW IS THE INCOME EARNED IN DYNASTY TRUSTS TAXED?

A. <u>Overview</u>. A trust may be taxed as a grantor trust for federal income tax purposes under Sections 671 – 678 of the Internal Revenue Code ("IRC") or a non-grantor trust for federal income tax purposes. In a grantor trust all of the Dynasty Trust income flows through to the grantor and is reported on the grantor's personal income tax return. In a non-grantor trust the Dynasty Trust is a separate taxpayer and responsible for the payment of its own income tax liability.

B. Advantages to Structuring a Dynasty Trust as a Grantor Trust.

1. Revenue Ruling 2004-64 (the "2004 Ruling).

(a) The 2004 Ruling held that the grantor of a trust, which is taxed as a grantor trust for income tax purposes, is not treated as making an additional taxable gift to the trust by virtue of paying the trust's income tax liability.

(b) The 2004 Ruling creates an incredibly powerful tool for grantors with large taxable estates. The grantor's payment of the income tax liability associated with the Dynasty Trust income will reduce the grantor's estate in a very transfer tax friendly manner by allowing the grantor to pay the Dynasty Trust income tax liability without being treated as making additional gifts. Furthermore, the fact that the Dynasty Trust itself is not paying the income tax liability allows the assets in the Dynasty Trust to grow at a rapid pace.

(c) Furthermore, even if a distribution is made out of the Dynasty Trust to one of the beneficiaries, the beneficiaries will receive such distribution free of any income tax liability as the grantor is responsible for the income tax liability of the Dynasty Trust.

C. Advantages to Structuring a Dynasty Trust as a Non-Grantor Trust.

1. Grantor Not Responsible for Income Tax Liability. In many situations a grantor may feel that he or she has done enough by creating the Dynasty Trust and gifting assets into the Dynasty Trust for the benefit of the grantor's descendants. The grantor does not want to be responsible for the income tax liability associated with the income earned by the Dynasty Trust. Instead, the grantor would like the Dynasty Trust itself to be responsible for the income tax liability.

2. Avoidance of State Income Tax. Many clients structure non-grantor Dynasty Trusts in jurisdictions that do not have a state income tax or otherwise exempt trusts created by non-residents from the imposition of the state income tax in order to avoid paying state income tax on the income and capital gain that is accumulated in the Dynasty Trust. For example, while Delaware does have a

state income tax, Delaware does not tax that portion of trust income and capital gains accumulated and set aside for future distribution to non-resident beneficiaries. 30 Del. C. § 1636(a). If all of the beneficiaries of the Delaware non-grantor trust are non-residents, the trust pays no Delaware state income tax at all, which creates the possibility of eliminating state income tax on the income and capital gain earned in the Dynasty Trust. Many residents from high income tax jurisdictions such as, California, New York, New Jersey and Massachusetts create Delaware non-grantor trusts to avoid state income tax that would otherwise apply.

3. QSBS "Stacking". Section 1202 of the Internal Revenue Code allows shareholders of certain C corporations to exclude the greater of $10 Million or 10 times basis from the imposition of Federal capital gains tax upon the sale of the C corporation shares. Many taxpayers are interested in using non-grantor trusts to engage in what is commonly referred to as QSBS "stacking". For example, founder of a C corporation may create three separate non-grantor Dynasty Trusts, one for the benefit of each of the founder's three children and their future descendants. Founder will then gift shares of the C corporation to each of the three Dynasty Trusts. When each Dynasty Trust sells its founder's shares it should be able to exclude the gain from the imposition of Federal capital gains tax in the same way that founder could have sheltered the gain if the founder were the one selling the shares.

D. How to Create Grantor Trusts and Non-Grantor Trusts and Flexible Provisions to Include in such Trusts.

1. Grantor Trusts.

(a) "True" Grantor Trusts. In certain situations a Dynasty Trust will automatically be structured as a grantor trust for income tax purposes under Section 677(a)(1) of the IRC due to the fact that income can be distributed to the grantor or the grantor's spouse without the consent of an adverse party. This is most common in a SLAT (Spousal Lifetime Access Trust) or Completed Gift Asset Protection Trust, both of which will be discussed later in this outline.

(b) Intentionally Defective Grantor Trusts. Many grantors are establishing intentionally defective grantor trusts for income tax purposes, i.e., a trust that includes powers that will cause the income to be taxable to the grantor even though neither the grantor nor the grantor's spouse has a beneficial interest in the Dynasty Trust. The most common grantor trust power that is utilized in Dynasty Trusts is the ability to substitute trust assets by reacquiring assets of equivalent value. Where the power to substitute is chosen to create an intentionally defective grantor trust, Delaware law provides that notwithstanding the terms of the governing instrument, the fiduciary responsible for investment decisions has a fiduciary duty to determine that the substituted property is of equivalent value to the property reacquired. 12 Del. C. § 3316.

(c) Sample Language. Provided below is sample grantor trust language that we typically include in our Dynasty Trusts structured as intentionally defective grantor trusts:

Grantor Trust Status. It is the intention of the Grantor to create a "Grantor Trust" for income tax purposes as that term is defined under Section 671 of the Code. The Grantor understands that the Grantor will be treated, for income tax purposes only, as the owner of the property in the Trust and acknowledges that even if the Grantor is liable for income taxes with respect to the taxable income of the Trust, the Grantor shall not be entitled to reimbursement for any such taxes. In this regard, the following powers and rights shall apply to the Trust.

Power to Substitute Property. The Grantor, while he is living and competent, followed by the Trust Protector upon the Grantor's incapacity, shall have the power and the absolute right, exercisable in a non-fiduciary capacity and without the approval or consent of any person in a fiduciary capacity, to reacquire any property constituting the Trust estate by substituting therefor other property of equivalent value; provided, however, that this power shall not apply to any interest in a life insurance policy insuring the life of the Grantor, to any residence that was contributed to the Trust from a Qualified Personal Residence Trust of the Grantor and to any voting stock of a controlled corporation as to the Grantor within the meaning of Section 2036(b) of the Code. The Grantor or Trust Protector may exercise such power by an instrument in writing signed by the Grantor or Trust Protector and delivered to the Trustee and Investment Direction Adviser, provided that the Grantor or Trust Protector must certify to the Investment Direction Adviser and/or the Trustee, depending on who then holds the investment power (for purposes of this Article "Substitution Fiduciary"), in such instrument that the substituted property and the Trust property for which it is substituted are of equivalent value. Notwithstanding the foregoing, if the Grantor, or an entity the Grantor controls, is the Substitution Fiduciary, the Grantor shall appoint a person or entity that is not related or subordinate to the Grantor within the meaning of Section 672(c) of the Code to serve as Substitution Fiduciary. If the Substitution Fiduciary does not agree that the assets or property proposed to be substituted are of equivalent value with the property to be acquired by the Grantor or Trust Protector, the Substitution Fiduciary may independently determine such values, including seeking a judicial determination by a Court of competent jurisdiction that the requirement of equivalent value is satisfied. The reasonable expenses of such independent determination, including any judicial determination, shall be borne by the Grantor. To the extent that the Grantor's power under this Article would result in the inclusion of the Trust estate in the Grantor's gross estate for federal estate tax purposes under Section 2036 or Section 2038 of the Code, the Grantor shall not have such power and instead, the Trust Protector shall have the power.

Trust Protector's Ability to Terminate Powers. Notwithstanding the provisions of section (a) above as well as any other provision of this Agreement, the Trust Protector shall have the power, exercisable in a non-fiduciary capacity and without the approval or consent of any person in a fiduciary capacity, to terminate the power conferred upon the Grantor or Trust Protector pursuant to section (a) of this Article SECOND to reacquire Trust property by providing written notice to the Grantor and the Trustee to this effect.

(d) Tax Reimbursement Provision.

(i) The 2004 Ruling also addressed the estate tax consequences if, pursuant to the governing instrument or applicable local law, the grantor of the trust may or must be reimbursed by the trust for the income tax.

(ii) The 2004 Ruling held that assuming there is no understanding, expressed or implied between the grantor and the trustee regarding the trustee's exercise of its discretion to reimburse the grantor for the income tax liability, the trustee's discretion to satisfy such obligation will not alone cause inclusion of the trust assets in the grantor's gross estate for federal estate tax purposes.

(iii) However, the 2004 Ruling specifically states that the trustee's discretion to reimburse the grantor for the income tax liability combined with other factors including, but not limited to: (i) an understanding or pre-existing arrangement between the grantor and the trustee regarding the trustee's exercise of its discretion; (ii) a power retained by the grantor to remove the trustee and name a successor trustee; or (iii) applicable local law subjecting the trust assets to claims of the grantor's creditors may cause inclusion of the trust assets in the grantor's gross estate for federal estate tax purposes.

(iv) For flexibility purposes we typically include a provision in our Dynasty Trusts that are structured as grantor trusts which would permit an independent Trustee or Distribution Adviser to reimburse the grantor for the income tax liability in any given year. In general a grantor may be comfortable with paying the income tax liability of the Dynasty Trust on an annual basis. However, there could be a particular year where there is a large capital gain in the Dynasty Trust which would flow through to the grantor and the grantor would like the ability to make a discretionary request to be reimbursed for a portion or all of the income tax liability resulting from such gain. It is important to be cognizant whether including such a tax reimbursement provision in the governing instrument for the Dynasty Trust could subject the assets of the trust to creditor claims of the grantor which could result in estate tax inclusion. Delaware has a specific provision which states that the grantor's retention of the discretionary ability to be reimbursed for the income tax liability is not considered a retained beneficial interest in the trust. 12 Del. C. § 3536(c)(2). Provided below is sample tax reimbursement language that we include in our Dynasty Trusts:

Income Tax Reimbursement. Notwithstanding any other provisions of this Agreement to the contrary, the Trustee is authorized in its sole and absolute discretion to distribute income or principal from the Trust estate to the Grantor for the sole purpose of reimbursing the Grantor for that portion of the Grantor's income tax liability arising from the Trust's income being taxable to the Grantor. The Trust Protector shall have the power, exercisable in a non-fiduciary capacity and without the approval or consent of any person serving in a fiduciary capacity, to terminate the Trustee's power to distribute Trust income and principal to the Grantor in accordance with the provisions of this section (d) of this Article THIRD by providing written notice to the Grantor and the Trustee to this effect. To the extent the Trustee's power to distribute income or principal of the Trust estate to the Grantor to reimburse the Grantor for income taxes would result in the inclusion of the Trust estate in the Grantor's gross estate for federal estate tax purposes, the Trustee shall not have such power.

2. Non-Grantor Trusts.

(a) Grantor or Grantor's Spouse Retaining Beneficial Interest In Dynasty Trust. As previously mentioned, a Dynasty Trust will typically be structured as a grantor trust for income tax purposes if the grantor or the grantor's spouse retains a discretionary beneficial interest in the Dynasty Trust. This is due to the fact that Section 677(a)(1) of the IRC provides that if income can be distributed to the grantor or the grantor's spouse without the consent of an adverse party the Dynasty Trust will be taxed as a grantor trust. It is possible for the grantor or the grantor's spouse to retain a beneficial interest in the Dynasty Trust and still have the Dynasty Trust taxed as a non-grantor trust for income tax purposes. The trust instrument must provide that distributions can only be made to the grantor or the grantor's spouse with the consent of an adverse party as defined in Section 672(a) of the IRC.

(b) Avoiding Grantor Trust Powers. Even if the grantor or the grantor's spouse do not retain a beneficial interest in the Dynasty Trust the trust agreement must be drafted to prevent the Dynasty Trust from being taxed as an intentionally defective grantor trust under the provisions of Sections 671 – 678 of the IRC. A trust agreement could inadvertently confer a power upon the grantor or another person that causes the Dynasty Trust to be taxed as a grantor trust.

(c) Sample Language. We typically include language in our Dynasty Trusts structured as non-grantor trusts specifically stating that it is the grantor's intent that the Dynasty Trust be taxed as a non-grantor trust for income tax purposes and that all provisions of the trust agreement shall be construed and administered to carry out the grantor's intent that the Dynasty Trust be taxed as a non-grantor trust for income tax purposes. Provided below is sample non-grantor trust language that we typically include in our Dynasty Trusts structured as non-grantor trusts:

Non-Grantor Trust. Notwithstanding any other provision of this Agreement, the Trustee shall not make any distribution from the Trust estate to, or for the benefit of, the donor of any funds to the Trust. It is intended that no part of the income, deductions, or credits of any trust created hereunder shall be attributed to the donor of any funds to the Trust under the so-called "Grantor trust" rules of subpart E of subchapter J of subtitle A of the Code and, accordingly, this Agreement shall be construed and the trusts hereunder administered in accordance with and to carry out that intent and that any provision of this Agreement to the contrary shall be of no effect. Furthermore, none of the powers granted the Trustee shall enable the donor of any funds to the Trust to buy, exchange, or otherwise deal with trust principal or income for less than adequate and full consideration in money or money's worth. None of the powers granted the Trustee shall enable the donor of any funds to the Trust to borrow the principal of the trust, directly or indirectly, without adequate interest and security. None of the powers granted to the Trustee shall enable anyone to require the Trustee to exchange trust property by substituting other property of equal value.

IV. FLEXIBLE PROVISIONS TO INCLUDE IN DYNASTY TRUSTS.

A. Beneficial Provisions.

1. Who should be the Beneficiaries of the Dynasty Trust?

(a) Dynasty Trusts are typically created for the benefit of the grantor's descendants. However, it is very popular, particularly for Dynasty Trusts structured as grantor trusts for income tax purposes, to include the grantor's spouse as a discretionary beneficiary of the Dynasty Trust. This creates the flexibility of allowing distributions to be made to the grantor's spouse during his or her lifetime which could in turn be used for the marital unit in the event it becomes desirable to do so. These Dynasty Trusts are typically referred to as SLATs (Spousal Lifetime Access Trusts). The beneficiary spouse could also be granted a testamentary limited power of appointment which would allow the beneficiary spouse to appoint assets in further trust for the benefit of the grantor spouse in the beneficiary spouse predeceases the grantor spouse. Under Delaware law the grantor's retention of the possibility of receiving assets contingent upon surviving the grantor's spouse is not considered the retention of a beneficial interest in the Dynasty Trust that would result in the grantor's creditors being able to reach the assets of the Dynasty Trust or otherwise result in the Dynasty Trust assets being includible in the grantor's estate for federal estate tax purposes. 12 Del. C. § 3536(c)(3). Furthermore, under Delaware law if a person who otherwise would be considered grantor of a trust becomes a beneficiary of the trust created by the exercise of a testamentary limited power of appointment held by another person, such person shall be treated as a beneficiary of such trust and shall not be treated as the grantor of the trust. 12 Del. C. § 3536(c). For example, assume that husband creates a SLAT for the benefit of wife and descendants which grants wife a testamentary limited power of appointment exercisable in favor of the descendants of the husband's parents. In the event wife were to exercise the testamentary limited power of appointment to appoint the assets of the SLAT in further trust for husband's benefit upon her death, husband is not considered the grantor of the continuing trust created by wife's exercise of her testamentary limited power of appointment.

(b) As a starting point, the grantor must determine how the trust assets will be held and administered for the benefit of the beneficiaries. Typically grantors will create the Dynasty Trust for the benefit of their lineal descendants without favoring one generation over the next. However, it is possible to designate a particular individual or a generation of individuals as the primary beneficiaries of a Dynasty Trust and to provide that each fiduciary responsible for making distributions decisions is to consider the needs of the primary beneficiary over the needs of the other beneficiaries.

2. Distribution Standard.

(a) Another issue for grantors to consider is the distribution standard that will be contained in the Dynasty Trust. I advise clients to allow distributions to be made to the beneficiaries for any purpose in the sole and absolute discretion of the fiduciaries responsible for making such distributions. The Dynasty Trust is structured as a perpetual trust and therefore will last for a very long period of time. For this reason, I think it is best to keep the distribution provisions as flexible as possible.

(b) It is also possible to specifically direct how and when the assets of the Dynasty Trust will be distributed to the beneficiaries. For example, it is possible to provide that the beneficiaries are to receive distributions upon reaching certain milestones (i.e., graduation from college, marriage, birth of a child). It is also possible to add provisions which reward beneficiaries for certain behavior (i.e., distributions for academic accomplishments, W-2 matching provisions) and punish beneficiaries for bad behavior (i.e., substance abuse clauses which prevent distributions to beneficiaries with substance abuse problems, provisions that prohibit distributions if beneficiaries are not productive members of society).

3. Statement of Intent and Letter of Wishes.

(a) I often include a statement of intent in the Dynasty Trusts I draft, particularly those that allow for broad distribution discretion, which states the reasons why the grantor created the trust and how the grantor expects beneficiaries to conduct themselves and how distributions should be made to the beneficiaries. In some situations I do not include a statement of intent within the Dynasty Trust Agreement itself but instead include a provision indicating that the grantor may provide the fiduciaries with a Letter of Wishes in the future to guide them with respect to discretionary distribution decisions. Delaware recently codified this concept by enacting a Letter of Wishes statute. 12 Del. C. §§ 3301 & 3315. Provided below is sample statement of intent language that we include in our Dynasty Trusts:

Statement of Intent. The following Statement of Intent shall apply to the Grantor's descendants. It is the Grantor's desire that the Trust estate provide a safety net for the Grantor's descendants that enhances the life and wellbeing of the Grantor's descendants without removing any descendant's ability to become and remain a mature, independent, productive member of the world's community capable of making his or her own living. Furthermore:

Goal. The Grantor does not intend for any beneficiary to have an expectancy of any kind from any trust created by or pursuant to this Agreement that shall cause that person to become dependent on the trust's resources and fail to pursue an education or a career that would otherwise have enabled that person to become industrious and self-supporting or otherwise become a productive member of society. However, it is not intended that the Distribution Fiduciary (as defined in section (f) of Article TWENTIETH of this Agreement) place undue emphasis on the amount a descendant earns if he or she is actively engaged in a worthwhile pursuit.

Marriage. The Grantor supports the institution of marriage and hopes that the Grantor's descendants have happy, healthy marriages. The Grantor also recognizes the potential risk to the Trust estate if a beneficiary's marriage ends in divorce. Accordingly, it is the Grantor's desire that a descendant of the Grantor who wishes to marry (i) enter into a legally binding agreement prior to marriage (a "Prenuptial Agreement") with his or her betrothed which provides (a) all property that the descendant receives from the Trust (including any increase, appreciation, income, dividends or residuals from such property), and any reinvestments thereof, shall maintain its character as separate property and (b) such Grantor's descendant's betrothed waives any and all rights that he or she may have to any portion of the Trust estate and to all distributions under this Trust Agreement by virtue of his or her marriage to the descendant of the Grantor and (ii) deliver to the Distribution Fiduciary a signed copy of the Prenuptial Agreement. Where any doubt exists as to the specific language or requirements of the Prenuptial Agreement, the sole discretion of the Distribution Fiduciary shall control and shall be final and binding. In the event a descendant of the Grantor fails to enter into a Prenuptial Agreement, or, in the event a descendant of the Grantor who has executed a Prenuptial Agreement repudiates it or otherwise attempts to cause any portion of it related to the Trust to be void, the Distribution Fiduciary, upon knowledge of same, may immediately suspend all discretionary distributions to such descendant of the Grantor otherwise authorized in

Article SECOND of this Agreement. Such distributions may remain suspended until such time as the Distribution Fiduciary is satisfied, upon written opinion of legal counsel, that the descendant's betrothed (or spouse) has no legal claim whatsoever to any portion of the Trust estate or to any distribution hereunder. For example, if a descendant of the Grantor fails to enter into a Prenuptial Agreement, such descendant of the Grantor may subsequently (i) enter into a Postnuptial Agreement with the descendant's spouse pursuant to which such descendant's spouse provides that (a) all property that the descendant receives from the Trust (including any increase, appreciation, income, dividends or residuals from such property), and any reinvestments thereof, shall maintain its character as separate property, and (b) such Grantor's descendant's spouse waives any potential claim over the Trust estate or any distribution of the Trust estate to the descendant and (ii) deliver to the Distribution Fiduciary a signed copy of the Postnuptial Agreement, at which time the Distribution Fiduciary may resume discretionary distributions to the descendant of the Grantor.

Letter of Wishes. The Grantor may provide the Distribution Fiduciary with a "Letter of Wishes" (which may be modified, amended, supplemented, restated and/or revoked from time to time) that will provide the Distribution Fiduciary with additional guidance regarding distributions to the beneficiaries.

No Legal Obligation. The Grantor realizes that distribution decisions will be made by the Distribution Fiduciary in its sole and absolute discretion, and it is not the Grantor's intent that the foregoing create or impose any legal obligations on or binding standards for the Distribution Fiduciary in performing and fulfilling its duties and obligations under this Agreement.

B. Built-in Decanting Power. Many states have enacted decanting statutes which permit a trustee who has the authority to distribute principal from a trust to or for the benefit of one or more of the beneficiaries to instead exercise such principal invasion power by distributing the assets in further trust for the benefit of one or more of the trust beneficiaries. I always recommend including a built-in decanting provisions in Dynasty Trusts for flexibility purposes even if the laws of the jurisdiction governing the Dynasty Trust specifically permit a decanting via the enactment of a state statute. It is possible that the Dynasty Trust could be moved to another jurisdiction which does not authorize a decanting and thereby having specific language in the trust agreement itself would allow the trustees to exercise the authority under the terms of the trust agreement as opposed to local law to effect the decanting. Provided below is sample built-in decanting language that we typically include in our Dynasty Trusts:

> Subject to the provisions of Article TENTH of this Agreement relating to the Distribution Adviser, with regard to any trust created by or pursuant to this Agreement of which the Trustee has the power to invade the principal of the trust to make distributions to or for the benefit of one (1) or more persons (the "First Trust"), the Trustee may instead exercise the power by appointing all or part of the principal of the First Trust subject to the power in favor of the Trustee of another trust (the "Second Trust"), provided, the beneficiaries of the Second Trust must also be one or more of the beneficiaries of the First Trust. Notwithstanding the foregoing, the Second Trust may have dispositive and/or administrative provisions that differ from the First Trust. The Trustee must obtain the written consent of the Trust Protector prior to exercising the power conferred pursuant to this section (p) of this Article SEVENTH.

C. <u>Limited Amendment Power</u>. I always recommend conferring upon an independent fiduciary the power to amend a Dynasty Trust for administrative and tax purposes. This will allow the Dynasty Trust to remain flexible as circumstances change in the future particularly as they relate to changes in the tax law. Provided below is sample amendment language that we typically include in our Dynasty Trusts:

> To amend the administrative and technical provisions with respect to any trust created by or pursuant to this Agreement in accordance with this Agreement, at such times as the Trust Protector may deem appropriate for the proper administration of the Trust and for tax purposes.

D. <u>Broad Amendment Power</u>. For many clients I recommend conferring upon an independent fiduciary, such as the Trust Protector, a broad power of amendment to amend the Dynasty Trust for any purpose, include for purposes of amending the dispositive and beneficial provisions of the Dynasty Trust, during the lifetime of the grantor and after providing 60 days advance written notice. This will allow for the Dynasty Trust to be amended, not just for administrative provisions but also for beneficial provisions, as circumstances change in the future. It also creates the possibility of making substantial changes to the Dynasty Trust Agreement through the exercise of the Trust Protector's broad amendment power, which is typically held in a non-fiduciary capacity, without exposing beneficiaries to any potential negative gift tax consequences that might otherwise arise if they were required to participate in the modification in some fashion. Provided below is sample broad amendment language that we often use in our Dynasty Trusts:

> Until the death or incapacity of the Grantor and after first providing sixty (60) days advance written notice to the Grantor and the Trustee (unless the Grantor, on a case by case basis, waives or reduces such notice requirement pursuant to a written instrument delivered to the Trust Protector and the Trustee) of the Trust Protector's

intent to exercise this amendment power, the Trust Protector is authorized to modify or amend any of the provisions of any trust created by or pursuant to this Agreement, including the beneficial provisions of such trust, as the Trust Protector may deem appropriate in its sole and absolute discretion by providing written notice of such modification to the Trustee and the Notice Recipients. Notwithstanding the foregoing, at no time may the Trust Protector amend this Agreement so as to add the Trust Protector, the Trust Protector's estate, the Trust Protector's creditors, the creditors of the Trust Protector's estate, or anyone related or subordinate to the Trust Protector under Section 672(c) of the Code, as a beneficiary of any trust created by or pursuant to this Agreement. The Trust Protector's power under this section __ of this Article ______ shall be exercisable in a non-fiduciary capacity and without the approval or consent of any person in a fiduciary capacity.

E. <u>Transfer of Situs and Change of Governing Law</u>. The Dynasty Trust will be created in accordance with the laws of the particular jurisdiction. For example, the Dynasty Trust could be drafted in accordance with Delaware law and provide that Delaware law shall govern the validity, construction and administration of the Dynasty Trust. It may become desirable in the future to move the situs of the Dynasty Trust to another jurisdiction and change the law governing the administration of the Dynasty Trust. While state law may contain specific provisions allowing for such a change it is advisable to include language in the trust agreement specifically allowing a power holder, such as an independent Trustee or a Trust Protector, to move the situs of the Dynasty Trust from one jurisdiction to another and to change the law governing administration of the Dynasty Trust. Provided below is sample transfer of situs and change of governing law language that we typically include in our Dynasty Trusts:

<u>Controlling Law</u>. This Agreement creates a Delaware trust and all matters pertaining to its validity, construction and administration shall be determined in accordance with the laws of the State of Delaware subject only to the following provisions:

(a) The Trust Protector shall have the power to designate the law of any other jurisdiction (under which the terms of any trust created by or pursuant to this Agreement shall be capable of taking effect) to be the governing law of any trust created by or pursuant to this Agreement, and to declare:

(1) that such trust shall thereafter be governed by and take effect according to the laws of the jurisdiction so designated, the courts of which shall become the forum or situs for the administration of such trust, as well as all matters applicable to the administration thereof; or

(2) that, to the extent permitted by law, such trust shall thereafter be governed by and take effect according to the laws of the jurisdiction so designated, but that the forum or situs for the administration of such trust shall be a different jurisdiction designated by the Trust Protector.

(b) Such designation and/or declaration shall be set forth in a deed or other written instrument delivered to the Trustee and the Notice Recipients that shall contain the powers and provisions that are necessary to enable such trust to be capable of taking effect under the laws of such jurisdiction(s), and that may also contain such other powers and provisions as the Trust Protector may determine to be in the best interest of the beneficiaries, provided that such powers and provisions do not infringe upon any rule against perpetuities that is applicable to such trust.

(c) Upon the declaration by the Trust Protector that any trust created by or pursuant to this Agreement shall be governed by and administered in accordance with the laws of a new jurisdiction, the rights of all persons, parties, and entities, and the construction, effect, and administration of each and every provision of such trust shall be subject to and construed only according to the laws of the designated jurisdiction(s).

V. COMPLETED GIFT ASSET PROTECTION TRUSTS.

As previously discussed, the 2017 Act presents clients with the unique estate planning opportunity to transfer significant amounts of wealth out of their estate without the imposition of transfer taxes. However, even the wealthiest clients are often concerned with giving such large amounts of money away based on the fear that they may need to access the assets in the future.

One option that clients may have is to create a Dynasty Trust in a jurisdiction which allows for self-settled asset protection trusts. A client may make a transfer to a Dynasty Trust established in such a jurisdiction, to which the client allocates gift tax exemption and GST exemption and provide in the trust agreement that the trustee may distribute income and principal from the Dynasty Trust to a class of beneficiaries, that includes the grantor, in the sole and absolute discretion of the trustee. What follows is a summary of the relevant issues to consider when creating a completed gift asset protection trust.

A. Grantor's Retention of Control.

The first issue to address is whether the transfer of assets to the Dynasty Trust constitutes a completed gift for federal gift tax purposes.

1. Is the Transfer to the Dynasty Trust a Completed Gift?

(a) A transfer is incomplete for federal gift tax purposes if the grantor retains sufficient dominion and control over the property. Treas. Reg. § 25.2511-2(b).

(b) If an individual creates a self-settled trust in a jurisdiction where his or her creditors may attach the assets, the grantor has retained sufficient dominion and control over the assets because under local law the grantor is able to relegate his or her creditors to the assets of the trust. See Rev. Rul. 76-103; Rev. Rul. 77-378; and Paolozzi v. Commissioner, 23, T.C. 102 (1954). As such, the trust must be established in a jurisdiction that allows for self-settled asset protection trusts thereby preventing the grantor from being able to relegate his or her creditors to the assets of the trust.

(c) <u>Revenue Ruling 76-103</u>.

(i) In Revenue Ruling 76-103, the grantor created an irrevocable trust which provided that during the grantor's lifetime the trustee could distribute income and principal of the trust in its sole and absolute discretion to the grantor. The trust further provided that upon the death of the grantor, the remaining principal of the trust was to be distributed to the grantor's issue. The trust was determined to be a discretionary trust under the laws of the state in which the trust was created and the entire property of the trust was subject to the claims of the grantor's creditors.

(ii) Revenue Ruling 76-103 concluded that as long as the trustee continues to administer the trust under the laws of the state subjecting the trust assets to the claims of creditors, the grantor retained dominion and control over the trust property. As such the grantor's transfer of the property to the trust does not constitute a completed gift for federal gift tax purposes.

(iii) Revenue Ruling 76-103 also concluded that if the grantor were to die before the gift becoming complete, the date of death value of the trust property would be includible in the grantor's gross estate for federal estate tax purposes under Section 2038 of the IRC because of the grantor's retained power to, in effect, terminate the trust by relegating the grantor's creditors to the entire property of the trust.

(d) <u>Revenue Ruling 77-378</u>.

(i) In Revenue Ruling 77-378, the grantor created an irrevocable trust which provided that the trustee was empowered to pay to the grantor such amounts of the trust's income and principal as the trustee determines in its sole and absolute discretion. Under the applicable state law, the trustee's decision whether to distribute trust assets to the grantor was entirely voluntary. Furthermore, the grantor was prohibited from requiring that any of the trust assets be distributed to the grantor nor could the creditors of the grantor reach any of the trust assets.

(ii) Revenue Ruling 77-378 concluded that the grantor had parted with dominion and control over the property that the grantor transferred into the trust. Although the trustee had an unrestricted power to pay trust assets to the grantor, the grantor could not require that any of the trust assets be distributed to the grantor nor could the grantor utilize the assets by going into debt and relegating the grantor's creditors to the trust. Revenue Ruling 77-378 therefore concluded that the grantor's transfer to the trust was a completed gift for federal gift tax purposes.

2. <u>Sections 2036(a)(2) and Section 2038</u>.

Another concern relates to whether the Dynasty Trust assets will be includible in the grantor's estate under Sections 2036(a)(2) and Section 2038 of the IRC because of the grantor's retained power to terminate the Dynasty Trust by relegating the grantor's creditors to the entire property of the Dynasty Trust.

(a) Section 2036(a)(2) of the IRC provides that a decedent's gross estate includes property transferred in trust other than for full and adequate consideration if the decedent retained the right to designate the persons who shall possess or enjoy the property or income therefrom. IRC § 2036(a)(2).

(b) Section 2038 of the IRC provides that a decedent's gross estate includes property transferred in trust other than for full and adequate consideration if the decedent retained the right to alter, amend or revoke the trust. IRC § 2038.

(c) Both Sections 2038(a) and 2036(a)(2) of the IRC have been used to cause a self-settled trust whose assets are subject to the claims of the grantor's creditors to be included in the grantor's estate. See Rev. Rul. 76-103; Estate of Paxton, 68 TC 785 (1986).

B. Grantor's Retained Beneficial Interest.

Another issue to address is whether the grantor's mere retention of a discretionary beneficial interest in the Dynasty Trust will cause the assets to be included in the grantor's gross estate under Section 2036(a)(1) of the IRC.

1. Section 2036(a)(1).

(a) Section 2036(a)(1) of the Internal Revenue Code provides that a decedent's gross estate shall include property transferred in trust other than for full and adequate consideration if the decedent retained the right to income from the property. IRC § 2036(a)(1).

(b) The use, possession, right to income or other enjoyment of the transferred property is considered as being retained by the decedent to the extent the use, possession, right to the income, or other enjoyment is to be applied toward the discharge of a legal obligation of the decedent. Treas. Reg. § 20.2036-1(b)(2).

(c) The right to the income need not be express but may be implied. Treas. Reg. § 20.2036-1(1)(i).

2. The 2004 Ruling.

(a) As previously discussed, the 2004 Ruling specifically states that the trustee's discretion to reimburse the grantor for the income tax liability combined with other factors including, but not limited to: (i) an understanding or preexisting arrangement between the grantor and the trustee regarding the trustee's exercise of its discretion; (ii) a power retained by the grantor to remove the trustee and name a successor trustee; or (iii) applicable local law subjecting the trust assets to the claims of the grantor's creditors may cause inclusion of the trust assets in the grantor's gross estate for federal estate tax purposes.

(b) The 2004 Ruling seems to address the concern raised in the completed gift asset protection trust context regarding whether the grantor's mere retention of a discretionary beneficial interest is sufficient to cause inclusion of the trust assets in the grantor's estate under Section 2036(a)(1) of the IRC. Following the rationale contained in the 2004 Ruling, the trustee's mere ability to distribute assets to the grantor should not alone cause inclusion of the assets in the grantor's gross estate for federal estate tax purposes.

C. The Private Letter Rulings.

Two Private Letter Rulings have been issued addressing the transfer tax consequences associated with self-settled asset protection trusts. See PLR 9837007 and PLR 200944002. Both Private Letter Rulings involved the use of Alaska trusts established by Alaska residents.

1. PLR 9837007 (the "1998 PLR").

(a) In the 1998 PLR the grantor created a trust for the benefit of herself and her descendants. The trustee could, but was not required to, distribute income and/or principal from the trust to any of the beneficiaries.

(b) The 1998 PLR concluded that the transfer to the trust would be a completed gift for federal gift tax purposes because a creditor of the grantor would be precluded from satisfying claims out of the grantor's interest in the trust. However, it expressly did not rule on whether the assets would be included in the grantor's estate for federal estate tax purposes.

2. PLR 200944002 (the "2009 PLR").

(a) In the 2009 PLR the grantor created a trust for the benefit of himself, his spouse and descendants. Distributions of income and principal could be made to the beneficiaries of the trust in the sole and absolute discretion of the trustee.

(b) The 2009 PLR again concluded that the transfer to the trust was a completed gift for federal gift tax purposes. However, the 2009 PLR also concluded that the trustee's discretionary authority to distribute income and/or principal to the grantor does not by itself cause the trust to be includable in the grantor's estate for federal estate tax purposes under Section 2036(a)(1) of the IRC.

(c) The analysis contained in the 2009 PLR is based primarily on the 2004 Ruling. Both the 2004 Ruling and the 2009 PLR conclude that the assets will not be included in the grantor's estate under Section 2036(a)(1) under the theory that the trustee's discretionary authority to distribute assets to the grantor will not by itself result in estate tax inclusion. However, neither the 2004 Ruling nor the 2009 PLR address whether Sections 2036(a)(2) or 2038 of the IRC will cause inclusion in the grantor's estate under the theory that the grantor could terminate the trust by relegating the grantor's creditors to the entire property of the trust. Sections 2036(a)(2) and 2038 of the IRC should not cause the assets to be included in the grantor's estate as long as the trust is created in a jurisdiction allowing for self-settled asset protection trusts as the grantor will be prohibited from relegating his or her creditors to the assets of the trust.

D. Creditor Exceptions.

1. All states that have self-settled trust legislation, other than Alaska or Nevada, allow certain creditors to access the trust. For example, the Delaware Qualified Dispositions in Trust Act allows for certain family claims, including child support and alimony, provided that with respect to an alimony claim the spouse must have been married to the grantor before the trust was created. 12 Del. C. §§ 3573(1) and 3570(9).

2. A question has arisen as to whether the mere fact that a family creditor could reach the trust assets is enough to cause the transfer to the trust from being an incomplete gift or otherwise cause the trust assets to be included in the grantor's gross estate under Sections 2036(a)(2) and 2038 of the IRC.

3. The reason for this concern stems from language contained in the 2004 Ruling. The 2004 Ruling expressly states that the trustee's discretion to distribute trust assets to a grantor to satisfy the grantor's income tax liability combined with other factors, such as applicable local law subjecting the trust assets to the claims of the grantor's creditors, may cause inclusion of the trust assets in the grantor's estate for federal estate tax purposes.

4. Proponents of Alaska and Nevada law have argued that the mere existence of the family claim exception contained in statutes of other jurisdictions, such as Delaware, would be enough to cause the assets to be includible in the grantor's estate under Sections 2036(a)(2) and 2038 of the IRC and therefore a grantor should only establish a trust in Alaska or Nevada if the grantor desires for the trust assets to be excluded from his or her estate.

5. However, what is overlooked in this argument is the theory of acts of independent significance, which is discussed in the next section of this outline.

E. Acts of Independent Significance.

1. The theory of acts of independent significance is applied when determining whether the grantor retained a power which rises to the level of a power which will cause inclusion in the grantor's gross estate under Sections 2036(a)(2) or

2038 of the IRC or otherwise result in an incomplete gift. If the retained power allows the grantor the ability to act in such a way so as to affect the beneficial interest of the trust, but the possibility of such action occurring is so de minimis and speculative, the power will be found to be an act of independent significance. See Estate of Tully, 528 F.2d 1401 (1976); Ellis v. Commissioner, 51 T.C. 182 (1968), judgment aff'd, 437 F.2d 442; Rev. Rul. 80-25; and PLR 9141027.

2. Courts have ruled that the possibility of divorce is an act of independent significance. See Estate of Tully, 528 F.2d 1401; PLR 9141027.

   (a) Estate of Tully.

      (i) In the Estate of Tully case the Court addressed whether death benefits paid directly to the decedent's widow by his employer should be included in the decedent's estate under Section 2038 of the IRC.

      (ii) The decedent and his business partner entered into an agreement which provided that upon the decedent's death the company would pay the decedent's widow a death benefit equal in amount to twice the annual salary which the company had paid to the decedent for the year immediately preceding the date of his death.

      (iii) One of the arguments made by the Internal Revenue Service was that the decedent retained a Section 2038 of the IRC power to revoke or terminate the transfer of the death benefits to his wife by virtue of the possibility that he could have divorced his wife prior to his death.

      (iv) The Court held that the possibility of divorce is so de minimis and so speculative rather than demonstrative, real, apparent and evident that it cannot rise to the level of a Section 2038 power.

3. Courts have also determined that acts of independent significance include failure to support a spouse as well as the ability to have or adopt children. Ellis v. Commissioner, 51 T.C. 182 (1968), judgment aff'd, 437 F.2d 442; and Rev. Rul. 80-255.

   (a) Revenue Ruling 80-255.

(i) In Revenue Ruling 80-255, the decedent created an irrevocable trust which provided that the income was to be paid in equal shares to the decedent's children and principal was to be distributed twenty-one (21) years after the creation of the trust in equal shares to the decedent's children, per stirpes. The trust instrument also provided that the decedent's children, born or adopted after the creation of the trust, were to be additional beneficiaries.

(ii) The issue addressed in Revenue Ruling 80-255 was whether the decedent retained a power to change the beneficial interest of the trust for purposes of Sections 2036(a)(2) and 2038 of the IRC because the trust provided that children born or adopted after the creation of the trust were to become beneficiaries and the decedent had the ability to bear or adopt additional children.

(iii) Revenue Ruling 80-255 determined that the act of bearing or adopting children is an act of independent significance. Revenue Ruling 80-255 held that although the decedent's act of bearing or adopting children will automatically result in adding the child as a beneficiary to the trust, such result is merely a collateral consequence of bearing or adopting children and is not equivalent to the decedent's retention of a power to designate or change beneficial interest within the meaning of Sections 2036(a)(2) and 2038 of the IRC.

F. Conclusion.

1. Completed gift asset protection trusts present a unique planning opportunity for clients who want to utilize the increase in gift tax and GST exemption to transfer assets out of their estate but are concerned with the possibility of needing access to the funds in the future.

2. It is extremely important that in establishing a completed gift asset protection trust there is no implied understanding between the grantor and the trustee regarding distribution from the trust to the grantor.

3. Notwithstanding the fact that all states, other than Alaska and Nevada, allow for certain creditors to access the trust, the theory of acts of independent significance should allow a grantor to establish a completed gift asset protection trust in any jurisdiction allowing for self-settled asset protection trusts and have the assets excluded from his or her estate.

VI. USE OF QUIET TRUST LANGUAGE IN DYNASTY TRUSTS

Most state laws impose requirements on trustees to keep current beneficiaries of a trust reasonably apprised of their beneficial interest in the trust which will often require the trustees to provide the beneficiaries with trust account statements on a periodic basis. This can be concerning to many grantors creating Dynasty Trusts, particularly with respect to younger beneficiaries.

Grantors fear that a beneficiary's knowledge of the wealth in the Dynasty Trust can result in a disincentive for the beneficiary to achieve their own success. This concern has resulted in the creation of the "silent trust" which eliminates a trustee's duty to inform beneficiaries of the existence of a trust for a period of time.

A. <u>Statutory Disclosure Requirements</u>.

1. <u>Uniform Trust Code</u>. The Comment to Section 813 of the Uniform Trust Code ("UTC") states that one of the fundamental duties of a trustee is to keep the beneficiaries reasonably informed of the administration of the trust. It should come as no surprise, then, that the UTC imposes broad disclosure requirements. This is, perhaps, one of the reasons why, contrary to its intended purpose, there is such a lack of uniformity among the states (including the District of Columbia, hereafter "D.C'.") that have adopted versions of the UTC

    (a) <u>Default Requirements</u>. Section 813 of the UTC imposes the following duties upon a trustee:

    (i) To keep **qualified beneficiaries** reasonably informed about the trust's administration and of material facts necessary to allow them to protect their interests. UTC § 813(a).

    a. Pursuant to UTC § 103(13) a **qualified beneficiary** is "a beneficiary who, on the date the beneficiary's qualification is determined" constitutes one of the following:

    i. A distributee or permissible distributee of trust income or principal;

    ii. A would-be distributee or permissible distributee if the interests of the current distributees or permissible distributee terminated on that date (without causing the trust to terminate); or

iii. A would-be distributee or permissible distributee if the trust terminated on that date.

a. The Comment to Section 813 makes clear that qualified beneficiaries do not include "appointees under the will of a living person . . . [or] the objects of an unexercised inter vivos power."

b. To promptly respond to a **beneficiary's** request regarding information related to the trust's administration, unless unreasonable under the circumstances. UTC § 813(a).

i. Section 103(3) of the UTC defines a **beneficiary** much more broadly as a person (including corporations, trusts, estates, partnerships, etc.) that has a present or future beneficial interest in the trust (either vested or contingent) <u>or</u> holds a power of appointment in a non-trustee capacity.

c. To promptly furnish a copy of the trust instrument to a **beneficiary** upon request. UTC § 813(b)(1).

d. Within sixty (60) days of acceptance, to notify **qualified beneficiaries** of acceptance of trusteeship. The trustee must provide his, her, or its name, address, and telephone number. UTC § 813(b)(2).

e. Within sixty (60) days after acquiring knowledge of an irrevocable trust's creation or that a revocable trust has become irrevocable, to notify **qualified beneficiaries** of the existence of the trust, the identity of the settlor(s), the right to request a copy of the trust instrument, and the right of a trustee's report. UTC § 813(b)(3).

f. To provide advance notice to **qualified beneficiaries** of a change in rate of compensation. UTC § 813(b)(4).

g. At least annually and at the termination of the trust, to send to **distributees** or **permissible distributees** of trust income or principal, as well as **qualified** or **nonqualified beneficiaries** who request it, a "report of the trust property, liabilities, receipts, and disbursements, including the source and amount of the trustee's compensation, a listing of the trust assets and, if feasible, their respective market values." In addition, upon a vacancy in trusteeship when no co-trustee remains in office, the former trustee must send such a report to **qualified beneficiaries**. UTC § 813(c).

i. This is reinforced by Section 110, which requires a trustee to give notice to any **beneficiary** who requests it whenever notice to **qualified beneficiaries** is required under the UTC.

(b) Limiting Default Requirements. Although the default requirements for notice and disclosure are rather broad, the UTC does allow a settlor to limit these requirements to a certain extent.

Section 105(b) states that the terms of a trust instrument prevail over the provisions of the UTC except for the following:

(i) A trustee's duty under Section 813(a) to respond to a request by a **qualified beneficiary** for reports and information reasonably related to the trust's administration. UTC § 105(b)(9).

(ii) A trustee's duty under Sections 813(b)(2) and 813(b)(3) to notify **qualified beneficiaries** age twenty-five (25) or older of the existence of the trust, the identity of the trust, and the right to request a trustee's report. UTC § 105(b)(8).

The Comment to Section 105 clarifies the specifics of what a settlor can and cannot waive within the terms of a trust instrument. For example, a settlor can waive the duty to provide a copy of the trust instrument to **beneficiaries** and the duty to provide **qualified beneficiaries** with annual reports. Note, however, that such duties may be required in a given situation if the information requested is reasonably related to the administration of the trust.

With respect to **qualified beneficiaries** under age twenty-five, a trust instrument can provide that a trustee not even inform such beneficiaries of the existence of the trust. If, however, such a beneficiary should learn of the existence of the trust, a trustee is still required to respond to requests for information reasonably related to the trust's administration.

Lastly, it is worth noting that neither Section 105(b)(8) nor Section 105(b)(9) apply to revocable trusts, thereby allowing a settlor to waive <u>all</u> reporting requirements. But, if a settlor does not waive such requirements, they take effect upon the settlor's incapacity. Prior to a settlor's incapacity, the duties of a trustee are owed solely to the settlor. UTC § 603.

2. <u>Restatement (Third) of Trusts</u>. Much like the UTC, the Restatement (Third) of Trusts (the "Restatement") imposes reporting requirements on trustees, but the requirements under the Restatement are not quite as extensive. In addition, Section 74 of the Restatement also makes clear that the trustee of a revocable trust generally owes duties, including reporting requirements, only to the settlor. However, the donee of a presently exercisable general power of appointment is also treated like a settlor with respect to duties owed by the trustee. Restatement (Third) of Trusts § 74.

(a) <u>Default Requirements</u>. With respect to irrevocable trusts, a trustee has the following duties:

(i) To promptly inform **fairly representative beneficiaries** of "the existence of the trust, of their status as beneficiaries and their right to obtain further information, and of basic information concerning trusteeship." Restatement (Third) of Trusts § 82(1)(a).

a. General Comment (a)(1) to Section 82 clarifies what is meant by **fairly representative beneficiaries**. According to the comment, a trustee is required to make a good-faith effort to "select and inform a limited number of beneficiaries whose interests and concerns appear . . . likely to coincide with . . . the trust's beneficiaries generally." For the most part, this limited class consists of present mandatory and discretionary beneficiaries of income or principal and first-tier remaindermen, i.e., those who would receive or would or be eligible to receive distributions of income or principal upon the termination of a present interest or the termination of the trust. Restatement (Third) of Trusts § 82, General Comment (a)(1).

1. The trustee is to inform **fairly representative beneficiaries** of "the existence, source, and

name . . . of the trust; the extent and nature . . . of their interests; the name(s) of the trustee(s), contact and compensation information, and perhaps the roles of co-trustees; and the . . . right to further information." Restatement (Third) of Trusts § 82, Comment on Subsection (1), b.

b. Interestingly, General Comment (a)(1) to Section 82 continues by adding that, on occasion, a trustee's duty to provide information can extend to a donee of a power of appointment or a person granted the power to (1) veto or direct acts of the trustee, e.g., special trustee, distribution committee; or (2) modify the trust, e.g., trust protector. Likewise, in a situation in which there is a large class of present discretionary beneficiaries, a trustee's duty to provide inform can be more limited.

(i) To inform **beneficiaries** of significant changes in their status as a beneficiary. Restatement (Third) of Trusts § 82(1)(b).

a. Section 3 of the Restatement defines a **beneficiary** as "[a] person for whose benefit property is held in trust." Section 48 of the Restatement goes on to state that a person is a beneficiary if the settlor manifests the intent to give a beneficial interest, but a merely incidentally benefitting from the performance of the trust is not enough.

(ii) "[T]o keep **fairly representative beneficiaries** reasonably informed of changes involving trusteeship and about other significant developments concerning the trust and its administration, particularly material information needed by beneficiaries for the protection of their interests." Restatement (Third) of Trusts § 82(1)(c). The trustee is to exercise reasonable judgment with respect to determining what is significant. Restatement (Third) of Trusts § 82, Comment on Subsection (1), d.

(iii) To promptly respond to a **beneficiary's** request for information concerning the trust and its administration, and to permit an inspection of the trust's documents, records, and holdings. Restatement (Third) of Trusts § 82(2). Typically, the trustee is also to furnish a copy of the trust instrument. Restatement (Third) of Trusts § 82, Comment on Subsection (2), e.

(iv) To provide **beneficiaries** with reports or accountings, upon request, at reasonable intervals. Restatement (Third) of Trusts § 83. This requires a trustee to submit an account to **beneficiaries** upon a trust's termination. Restatement (Third) of Trusts § 83, Comment b.

a. Such a report or accounting can be relatively informal, so long as it (1) reveals the trust's assets and liabilities, receipts and disbursements, and other transactions; and (2) discloses trustee compensation.

(b) <u>Limiting Default Requirements</u>. The statutory language of Section 82 of the Restatement expressly recognizes a settlor's ability to modify trust duties under the terms of the trust instrument. However, one must look to the Comments for further guidance to determine what can be modified.

(i) A **beneficiary** is <u>always</u> entitled to request information reasonably necessary to enforce his or her rights and/or prevent breach of trust, and the duty to respond is, therefore, <u>not</u> subject to modification.

(ii) A settlor <u>can</u> modify the trustee's duty to provide the information required under Restatement (Third) of Trusts §§ 82(1)(a)-(c), but not entirely or to a degree (or time) that would unduly interfere with the purposes for the information requirements. Restatement (Third) of Trusts § 82, General Comment a(2).

a. A settlor can only modify these duties by "clear language" in the terms of the trust instrument and within the limit described above.

(iii) A settlor <u>can</u> modify and limit the duty to disclose trust provisions or other information, perhaps to prevent a spendthrift beneficiary from learning of his or her interest, but, as stated above, a beneficiary is always entitled to request information. Restatement (Third) of Trusts § 82, Comment on Subsection (2), e.

(iv) The terms of a trust instrument may allow the trustee to provide accountings to a designated person, e.g., one of the **beneficiaries** (or the settlor of an irrevocable inter vivos trust), and provide that such person's approval shall discharge the trustee's liability. However, such a provision is only effective if the designated person does not act in bad faith (or disregard for the interests of other beneficiaries) in approving the accounting and the accounting discloses material information about the trustee's conduct. Restatement (Third) of Trusts § 83, Comment d.

3. Delaware Disclosure Requirements. The Delaware Code is rather silent with respect to the default duties of trustees to provide information and reports to trust beneficiaries. However, a landmark case from 2002 sets the standard for trustee disclosure. McNeil v. McNeil, 798 A.2d 503 (Del. 2002). In fact, in response to this case, the legislature enacted 12 Del. C. § 3303, which allows a settlor to modify case law/common law trustee disclosure requirements. More on that statute shortly.

(a) McNeil Case. The basic facts underlying the case are that in 1959, Henry Slack McNeil, Sr. sold his pharmaceutical company to Johnson and Johnson and created a number of trusts with the sale proceeds. Four (4) trusts were established for the benefit of Mr. McNeil's children and a fifth trust was established for the benefit of Mr. McNeil's wife, Lois (the "Lois Trust"). McNeil, 798 A.2d at 506 (Del. 2002). Although the children were unaware for quite some time, the terms of the Lois Trust made each child a current discretionary beneficiary of income and principal. *Id.*

The original trustees of the Lois Trust were three (3) individual trustees and Wilmington Trust Company. *Id*. at 506-507. Thereafter, two (2) individual trustees were removed and replaced with a new individual trustee and Provident National Bank ("PNC"). *Id*. All trustees were aware of the children's status as current beneficiaries of the Lois Trust. *Id*. at 507. Ultimately, Henry Slack McNeil, Jr. ("Hank") had a falling out with his family, causing disinheritance by his father and a bequest from his mother in the amount of a "paltry" amount of two million dollars ($2,000,000). *Id*. This ultimately led Hank to seek large distributions from the trustees of his trust, who were basically the same trustees of the Lois Trust. *Id*. As a result, the trustees of Hank's trust requested that Hank's children take a position on the distributions since, like the McNeil children under the Lois Trust, they were current discretionary beneficiaries of Hank's trust. *Id*.

Although not clear as to when, Hank discovered his status as a current beneficiary in the Lois Trust and filed a complaint in the Court of Chancery seeking a make-up distribution from the Lois Trust, the removal and surcharge of the trustees of the Lois Trust, and a restructuring of the operations of the Lois Trust. *Id*.

The Court of Chancery ultimately concluded that Hank's estrangement and treatment as an outsider was continued by the trustees of the Lois Trust, but such trustees shared a great deal of information with Hank's siblings. *Id*. Further, the trustees continually rebuffed Hank in his efforts to learn about the specifics of the Lois Trust and followed Lois' wish that no principal distributions be made. *Id*.

Because the trustees of the Lois Trust breached their fiduciary duties to Hank by failing to inform him that he was a current beneficiary, by showing partiality to Hank's siblings, and by allowing the Lois Trust to operate on "autopilot," the Court of Chancery ordered a make-up distribution of seven and a half percent (7.5%) of the value of Hank's interest in the Lois Trust after her death, i.e., one quarter (1/4) of the value of the Lois Trust. *Id*. at 508. In addition, PNC was removed as trustee and all trustees were surcharged one-fifth (1/5) of their commissions received from 1987-1996. *Id*.

On appeal, the trustees of the Lois Trust claimed that the express terms of the trust agreement precluded them from breaching any duties owed to Hank. *Id*. at 509. Specifically, the trustees argued that discretionary distributions were to be made in their sole judgment, that decisions by the committee of trustees were not subject to court review, and that any good faith action taken by the trustees was to be considered proper. *Id*. Further, the trust agreement relieved the trustees of "all personal liability except for gross negligence or willful wrongdoing." *Id*.

In reviewing these provisions of the Lois Trust, the Delaware Supreme Court held that the trustees were exculpated from ordinary negligence, "but not the duty to (i) inform beneficiaries or (ii) treat them impartially." *Id*. Regardless of his intent, Mr. McNeil did not relieve the trustees of these duties. *Id.* at 509-510. The court found that Hank's repeated attempts to obtain information about the Lois Trust should have put the trustees on notice that Hank did not know about his standing as a current beneficiary. *Id*. at 510.

"A trustee has a duty to furnish information to a beneficiary upon reasonable request. Furthermore, even in the absence of a request for information, a trustee must communicate essential facts, such as the existence of the basic terms of the trust. That a person is a current beneficiary of a trust is indeed an essential fact." *Id*.

Due to the "pattern of deception and neglect over a span of many years," including denying Hank information and telling him that he was only a remainderman of the Lois Trust, the Delaware Supreme affirmed all rulings of the Court of Chancery, except for the individual who was to replace PNC as trustee, which was remanded for further proceedings. *Id*. at 515.

(b) Delaware Statute. Delaware has not adopted the UTC. Instead, Delaware has enacted statutes that allow a settlor of a Delaware trust to validly create a silent trust.

Section 3303 of Title 12 of the Delaware Code provides that the terms of trust instrument may expand, restrict, eliminate, or vary the "rights and interests of beneficiaries, including, but not limited to, the right to be informed of the beneficiary's interest for a period of time," as well as a "fiduciary's powers, duties, standard of care, rights of indemnification and liability to persons whose interests arise from that instrument." 12 Del. C. § 3303(a)(1), (4). The Section goes on to make clear that it is intended to give maximum effect to "the principle of freedom of disposition and to the enforceability of governing instruments." 12 Del. C. § 3303(a).

With respect to limiting a beneficiary's right to be informed for a "period of time," the statute provides the following non-exclusive list of examples: "(1) A period of time related to the age of a beneficiary; (2) A period of time related to the lifetime of each trustor and/or spouse of a trustor; (3) A period of time related to a term of years or specific date; and/or (4) A period of time related to a specific event that is certain to occur." 12 Del. C. § 3303(c).

Additionally, unless the governing instrument provides otherwise, during the time that a beneficiary's right to be informed is restricted or eliminated, the beneficiary may be represented and bound by a "designated representative" for both judicial proceedings, as well as nonjudicial matters. 12 Del. C. § 3303(d).

In order to be a "designated representative," such person must be authorized to act in one of the following ways: (1) by express appointment as a designated representative or by reference to the applicable section(s) of the Delaware Code in the governing instrument; (2) by authorization or direction in the governing instrument to represent or bind beneficiaries for purposes of a judicial proceeding and/or nonjudicial matter (as defined in 12 Del. C. § 3303(e)); (3) by appointment by a person expressly authorized in the governing instrument to appoint someone described in (1) or (2), above; (4) by appointment by a beneficiary to act as his or her designated representative; and/or (5) by appointment by the settlor to act as a designated representative for the beneficiar(ies). 12 Del. C. § 3339(a). In addition, the designated representative must deliver a written acceptance to the trustee. *Id*. Finally, 12 Del. C. § 3339(b) provides that a person serving as a designated representative is presumed to be a fiduciary.

Recent Delaware case law has confirmed the effect of Section 3303 of Title 12 of the Delaware Code. "Essentially, so long as an instrument does not purport to exculpate or indemnify a fiduciary for *intentional misconduct*, the language of the contract governs. Thus, any rights or responsibilities of the trustee are expressly dictated by the terms of the [trust instrument]." *In re Rohlf*, 2011 WL 3201798, Footnote 6 (Del.Ch. 2011).

B. State Statutes that Permit Trust Instruments to Delay Notification.

Due to their rising popularity among settlors, a number of other jurisdictions have enacted legislation to allow for the creation of silent trusts, including states that have adopted the UTC but have altered the default trustee disclosure requirements.

1. Alaska. Section 13.36.080(a) of the Alaska Statutes imposes notice and disclosure requirements upon a trustee, e.g., to provide information as to where the trust is registered and the trustee's name and address, provide a copy of the terms of the trust upon request, provide annual and termination accountings, etc.

However, pursuant to AS § 13.36.080(b), a settlor may exempt a trustee from these duties with respect to beneficiaries who are not annually entitled to a mandatory distribution of income or principal. Such exemption can be provided in the terms of the trust instrument, by amendment to the trust instrument, or by a separate writing. Such exemption only applies for the shorter of the settlor's life or determination of incapacity.

2. Arizona. Arizona has adopted its own version of the UTC. Chapter 11 of Title 14 of the Arizona Revised Statutes. Accordingly, the standard default

disclosure and notification provisions apply. A.R.S. § 14-10813. However, Arizona allows a settlor to modify (to an extent) the default notice requirements. A.R.S. § 14-10105(B). A settlor cannot waive either "the duty to respond to the request of a qualified beneficiary of an irrevocable trust for trustee's reports and other information reasonably related to the administration of a trust" or the notice provisions regarding charitable trusts. A.R.S. § 14-10105(B)(8).

3. Arkansas. Arkansas has also adopted its own version of the UTC. Chapter 73 of Title 28 of the Arkansas Code Annotated. Accordingly, the standard default disclosure and notification provisions apply. A.C.A § 28-73-813. However, Arkansas allows a settlor to modify or waive the default notice requirements, as the Arkansas Code does not include provisions similar to UTC §§ 105(b)(8) and 105(b)(9), i.e., the UTC Sections that prevent a settlor from modifying the default notice and disclosure requirements. A.C.A § 28-73-105. Thus, the settlor should be able to waive or modify all notice and disclosure requirements.

4. District of Columbia. D.C. is another jurisdiction that has adopted a version of the UTC. Chapter 13 of Title 19 of the D.C. Code. Accordingly, the standard default disclosure and notification provisions apply. DC ST § 19-1308.13. D.C. takes a bit of a different approach by allowing a settlor, either via the trust instrument or other writing delivered to trustee, to waive or modify the trustee notification provisions in the following ways: (1) by waiving or modifying such duties during the lifetime of the settlor or the settlor's spouse; (2) by specifying an age other than twenty-five (25) at which a beneficiary is entitled to notice; or (3) by designating a person to act in good faith on behalf of the beneficiaries to receive such notice(s).

5. Florida. Florida has also adopted its own version of the UTC. Chapter 736 of Title XLII of the Florida Statutes Annotated. Accordingly, the standard default disclosure and notification provisions apply. F.S.A. § 736.0813. Such duties cannot be waived or modified. F.S.A. §§ 736.0105(r), (s), (t). However, a settlor may appoint a surrogate to receive information on behalf of the current beneficiaries. F.S.A. § 736.0306. The trust instrument can also authorize anyone other than the trustee to appoint a surrogate. F.S.A. § 736.00306(1).

6. Kansas. Kansas has also adopted its own version of the UTC. Chapter 58A of the Kansas Statutes Annotated. Accordingly, the standard default disclosure and notification provisions apply. K.S.A 58a-813. Unlike the previous jurisdictions, the Kansas statute states that the notice provisions do not apply so long as a surviving spouse is a qualified beneficiary or holds any power of appoint over the entire trust, and where all other qualified beneficiaries are issue of the surviving spouse. K.S.A 58a-813(d).

In addition, Kansas allows a settlor to modify the default notice requirements, as the Kansas Statutes do not include provisions similar to UTC §§ 105(b)(8) and 105(b)(9), i.e., the UTC Sections that prevent a settlor from modifying the default notice and disclosure requirements. K.S.A 58a-813(b). Thus, the settlor should be able to waive or modify all notice and disclosure requirements.

7. Maine. Maine is yet another jurisdiction that has adopted a version of the UTC. Title 18-B of the Maine Revised Statutes Annotated. Accordingly, the standard default disclosure and notification provisions apply. 18-B M.R.S.A. § 813. Similar to D.C., Maine allows a settlor, by the trust instrument or other writing delivered to trustee, to waive or modify the trustee notification provisions for all qualified beneficiaries other than the surviving spouse during such spouse's lifetime, but requires a designee to act in good faith to protect the interests of a current beneficiary for whom notice was waived and to receive reports on behalf of such beneficiary. 18-B M.R.S.A. § 105(3).

8. Michigan. Michigan has also adopted its own version of the UTC. Article VII of Chapter 700 of the Michigan Compiled Laws Annotated. Accordingly, the standard default disclosure and notification provisions apply. M.C.L.A. § 700.7814. The bulk of such duties cannot be waived or modified. M.C.L.A. § 700.7105(i). However, a settlor may modify or waive the duty to keep qualified beneficiaries reasonably informed, the duty to promptly respond to a beneficiary's request for information regarding the administration of the trust, and the duty to provide advance notice of any change in trustee compensation. *Id.*

9. Mississippi. Mississippi has also adopted its own version of the UTC. Chapter 8 of Title 91 of the Mississippi Code. Accordingly, the standard default disclosure and notification provisions apply. Miss. Code § 91-8-813. The Mississippi Code, however, allows a settlor to modify the default notice requirements, except with respect to providing notice to first-tier remaindermen, and possibly holders of a power of appointment, upon the termination of a current interest. Miss. Code § 91-8-81(c).

With respect to the notice provisions that can be waived, a settlor, trust protector, or trust advisor may waive such duties (in a writing delivered to trustee) in the following ways: (1) by waiving or modifying such duties as to all qualified beneficiaries during the lifetime of the settlor or the settlor's spouse; (2) by specifying a different age at which a beneficiary must be notified; and (3) by designating a surrogate to receive such notice who will act in good faith to protect the interests of the beneficiary.

10. Missouri. Missouri has also adopted its own version of the UTC. Chapter 456 of Title XXXI of Vernon's Missouri Statutes. Accordingly, the standard default disclosure and notification provisions apply. V.M.S. § 456.8-813. A settlor cannot waive or modify either the duty to respond to a qualified beneficiary's request for reports and information reasonably related to the trust administration or the duty to notify each permissible distributee age twenty-one (21) or older of the trust's existence and such distributee's right to request trustee reports and other information reasonably related to the administration of the trust. V.M.S. §§ 456.1-105(2)(8), (9).

    However, pursuant to V.M.S. § 456.1-105(3), a settlor, by the terms of the trust instrument, can designate "one or more permissible distributees to receive notification of the existence of the trust and of the right to request trustee's reports and other information reasonably related to the administration of the trust in lieu of providing the notice, information or reports to any other permissible distributee who is an ancestor or lineal descendant of the designated permissible distributee." Essentially, a current beneficiary can be designated as a surrogate to receive information on behalf of other current beneficiaries that are the surrogate's ancestors or lineal descendants.

11. Nebraska. Nebraska has also adopted its own version of the UTC. Article 38 of Chapter 30 of the Revised Statutes of Nebraska Annotated. Accordingly, the standard default disclosure and notification provisions apply. Neb.Rev.Stat. § 30-3878. While a settlor can modify or waive many of these trustee duties, pursuant to Neb.Rev.Stat. § 30-3805(b)(8), a settlor cannot modify or waive the duty to keep qualified beneficiaries reasonably informed about the trust's administration and the material facts necessary to protect their interest, and the duty to respond to a request of qualified beneficiary of an irrevocable trust for reports and information reasonably related to the trust's administration.

12. Nevada. Pursuant to N.R.S. 165.160, except as provided by statute or federal or common law, a trust instrument can vary the right and interests of a beneficiary, including the right to be informed of the beneficiary's interest for a period of time and a "fiduciary's powers, duties, standard of care, rights of indemnification and liability to persons whose interests arise from the trust instrument."

    A settlor can waive or modify the duty to provide accountings under N.R.S. 165.135 and N.R.S. 165.137 and the duty to furnish a copy of the trust instrument pursuant to 165.147. However, a settlor cannot waive or modify the duty to provide an accounting under N.R.S. 165.139, which requires a trustee, upon request, to provide an annual account to a current beneficiary if the amount distributable to such beneficiary is affected by administrative expenses or the allocation of principal and income. In addition, N.R.S. 165.139 requires that a trustee provide an annual accounting, upon request, to each remainder beneficiary.

13. New Hampshire. New Hampshire has also adopted its own version of the UTC. Chapter 564-B of Title LVI of the Revised Statutes of the State of New Hampshire. Accordingly, the standard default disclosure and notification provisions apply, with some variations on the age (21) for disclosure. N.H. Rev. Stat. § 564-B:8-813. However, New Hampshire allows a settlor to modify or waive the default notice requirements, as the New Hampshire Code does not include provisions similar to UTC §§ 105(b)(8) and 105(b)(9), i.e., the UTC Sections that prevent a settlor from modifying the default notice and disclosure requirements. N.H. Rev. Stat. § 564-B:1-105. Thus, the settlor should be able to waive or modify all notice and disclosure requirements.

14. New Mexico. New Mexico is another jurisdiction that has adopted a version of the UTC. Chapter 46A of the New Mexico Statutes Annotated. Accordingly, the standard default disclosure and notification provisions apply. N.M.S.A. 1978, § 46A-8-813. However, N.M.S.A. 1978, § 46A-8-813F allows a settlor to knowingly waive the trustee's duties (in whole, in part, subject to a contingency, to only certain beneficiaries, etc.) to "respond to the request of a qualified beneficiary of an irrevocable trust for a trustee's reports and other information reasonably related to the administration of a trust," so long as the trustee is a regulated financial service institution qualified to do trust business in New Mexico. In addition, the "waiver must be conspicuous, must be contained in the terms of the trust or of a separate affidavit signed by the settlor and must state that the settlor has been informed of the risks and consequences of the waiver and that the settlor nevertheless directs that the reports and information be withheld by the trustee." N.M.S. 1978, § 46A-8-813F. Conspicuous is defined as "so written, displayed or presented that a reasonable person against which it is to operate ought to have noticed it." N.M.S. 1978, § 55-1-201(10).

Curiously, N.M.S. 1978, § 46A-1-105B(8) does not allow the terms of a trust instrument to waive a trustee's duty to notify qualified beneficiaries of an irrevocable trust who have attained age twenty-five (25) of the trust's existence, the trustee's identity, and of their right to request reports.

15. North Carolina. North Carolina has also adopted its own version of the UTC. Chapter 36C of the North Carolina General Statutes Annotated. Accordingly, the standard default disclosure and notification provisions apply. N.C.G.S.A. § 36C-8-813. However, North Carolina allows a settlor to modify or waive the default notice requirements, as the North Carolina General Statutes Annotated

do not include provisions similar to UTC §§ 105(b)(8) and 105(b)(9), i.e., the UTC Sections that prevent a settlor from modifying the default notice and disclosure requirements. N.C.G.S.A. § 36C-8-105. Thus, the settlor should be able to waive or modify all notice and disclosure requirements.

16. North Dakota. North Dakota has also adopted its own version of the UTC. Chapter 59-09 – Chapter 59-19 of Title 59 of the North Dakota Century Code. Accordingly, the standard default disclosure and notification provisions apply. NDCC § 59-16-13. However, North Dakota allows a settlor to modify or waive the default notice requirements, as the North Dakota Century Code does not include provisions similar to UTC §§ 105(b)(8) and 105(b)(9), i.e., the UTC Sections that prevent a settlor from modifying the default notice and disclosure requirements. NDCC § 59-09-05. Thus, the settlor should be able to waive or modify all notice and disclosure requirements.

17. Ohio. Title LVIII of the Ohio Revised Code appears to be based, at least in part, on the UTC. As such, the trustee has the standard duties to provide information and notice to the beneficiaries. R.C. § 5808.13. However, pursuant to R.C. § 5801.04(C), a settlor may, within the terms of the trust instrument, modify or waive the bulk of such duties with respect to current beneficiaries. The waiver can only be made by the settlor and must designate a surrogate to receive information on behalf of the current beneficiaries. The surrogate must act in good faith to protect the interests of the current beneficiaries. *Id.* In addition, a settlor can, without the need for a surrogate, waive the duty for a trustee to provide a copy of the trust instrument to a beneficiary upon request. R.C. § 5801.04(B).

18. Oklahoma. By statute, a settlor may, within the provisions of the trust instrument (or amendment to the trust instrument), relieve a trustee from "any and all duties, restrictions, and liabilities which would otherwise be imposed upon him," subject to certain duties and restrictions for corporate trustees, none of which pertain to beneficiary notice, e.g., restriction against self-lending/self-dealing, restrictions on deposits, etc. 60 Okl. St. Ann. § 175.21.

19. Oregon. Oregon has also adopted its own version of the UTC. Chapter 130 of Title 13 of the Oregon Revised Statutes. Accordingly, the standard default disclosure and notification provisions apply, with an exception that only settlor's surviving spouse need to receive disclosures under certain circumstances. O.R.S. §§ 130.710, (8). However, Oregon allows a settlor, to an extent, to waive or modify such duties. O.R.S. § 130.020(3). A settlor has the ability, within the terms of the trust instrument or another writing delivered to a trustee, to waive the duties during the period that either the settlor is living and competent or the settlor's spouse, if a qualified beneficiary, is alive and

competent. O.R.S. § 130.020(3)(a). Alternatively, a settlor may designate a surrogate, acting in good faith to protect the qualified beneficiaries' interests, to receive any disclosures. O.R.S. § 130.020(3)(b).

However, any report that contains information regarding a termination of a trust must be provided to the qualified beneficiaries or a designated surrogate. O.R.S. § 130.020(4).

20. Pennsylvania. Pennsylvania has also adopted its own version of the UTC. Chapter 77 of Title 20 of Purden's Pennsylvania Statutes and Consolidated Statutes Annotated. Accordingly, the standard default disclosure and notification provisions apply. 20 Pa.C.S.A. § 7780.3. Such duties cannot be waived or modified. 20 Pa.C.S.A. § 7705(b)(8). However, a settlor may appoint a surrogate to receive information on behalf of the current beneficiaries. 20 Pa.C.S.A. § 7780.3(k).

21. South Carolina. South Carolina has also adopted its own version of the UTC. Article 7 of Title 62 of the Code of Laws of South Carolina 1976. Accordingly, the standard default disclosure and notification provisions apply. Code 1976 § 62-7-813. However, South Carolina allows a settlor to modify or waive the default notice requirements, as the South Carolina Code does not include provisions similar to UTC §§ 105(b)(8) and 105(b)(9), i.e., the UTC Sections that prevent a settlor from modifying the default notice and disclosure requirements. Code 1976 § 62-7-105. This is further evidenced by the fact that the provisions of Code 1976 § 62-7-813 pertaining to notice and disclosure are prefaced by "[u]nless the terms of a trust expressly provide otherwise." Code 1976 §§ 62-7-813(a), (b), (c). Thus, the settlor should be able to waive or modify all notice and disclosure requirements.

22. South Dakota. Not surprisingly, South Dakota has not adopted a version of the UTC. Its notice requirements are found in SDCL §§ 55-2-13 and 55-2-14, the latter of which deals exclusively with revocable trusts. Regardless of the status of the trust as revocable or irrevocable, South Dakota allows a settlor (or trust advisor or trust protector) to modify or waive the trustee's duties with respect to notice either within the terms of a trust instrument or a separate writing. SDCL §§ 55-2-13, 55-2-14.

23. Tennessee. Tennessee has also adopted its own version of the UTC. Chapter 15 of Title 35 of the Tennessee Code Annotated. Accordingly, the standard default disclosure and notification provisions apply. T.C.A. § 35-15-813. However, Tennessee allows a settlor to modify or waive the default notice requirements, as the Tennessee Code Annotated does not include provisions similar to UTC §§ 105(b)(8) and 105(b)(9), i.e., the UTC Sections that prevent

a settlor from modifying the default notice and disclosure requirements. T.C.A. § 35-15-105. Thus, the settlor should be able to waive or modify all notice and disclosure requirements.

24. Texas. Texas imposes upon a trustee the duty, upon the request of a beneficiary, to deliver an accounting to each beneficiary. Such accounting is to cover all transactions since the last accounting or the trust's inception, and the trustee is not obligated to provide such an accounting more frequently than annually unless required by the court. V.T.C.A., Property Code § 113.151. For the requirements that must be included in the accounting, see V.T.C.A., Property Code § 113.152. This duty cannot be waived or modified with respect to current beneficiaries and first-tier remaindermen of irrevocable trusts. V.T.C.A., Property Code § 111.0035(b)(4).

In addition, pursuant to V.T.C.A., Property Code § 111.0035(c), "[t]he terms of a trust may not limit any common-law duty to keep a [current beneficiary or first-tier remainder] beneficiary of an irrevocable trust who is 25 years of age or older informed."

25. Utah. Utah has also adopted its own version of the UTC. Chapter 7 of Title 75 of the Utah Code Annotated. Accordingly, the standard default disclosure and notification provisions apply. U.C.A. 1953 § 75-7-811. However, Utah allows a settlor to modify or waive the bulk of default notice requirements, as the Utah Code Annotated does not include provisions similar to UTC §§ 105(b)(8) and 105(b)(9), i.e., the UTC Sections that prevent a settlor from modifying the default notice and disclosure requirements. U.C.A. 1953 § 75-7-105. This is further evidenced by the fact that the provisions of U.C.A. 1953 § 75-7-811 pertaining to notice and disclosure are prefaced by "[e]xcept to the extent the terms of the trust provide otherwise." U.C.A. 1953 §§ 75-7-811(1), (2).

Interestingly, the paragraph regarding the duty of a trustee to send a report of the trust property, liabilities, receipts, and disbursements (including trustee compensation), as well as a listing of trust assets and their fair market value (if feasible) to a requesting qualified beneficiary is not prefaced with any limiting language. U.C.A. 1953 § 75-7-811(3). However, since that paragraph is not listed among the items over which a trust instrument will not prevail, it is likely that this duty can be modified or waived. U.C.A. 1953 § 75-7-105.

26. Vermont. Vermont has also adopted its own version of the UTC. Title 14A of the Vermont Statutes Annotated. Accordingly, the standard default disclosure and notification provisions apply. 14A V.S.A § 813. However, Vermont allows a settlor to modify or waive the default notice requirements, as the Vermont Statutes Annotated do not include provisions similar to UTC §§ 105(b)(8) and

105(b)(9), i.e., the UTC Sections that prevent a settlor from modifying the default notice and disclosure requirements. 14A V.S.A § 105. Thus, the settlor should be able to waive or modify all notice and disclosure requirements.

27. Virginia. Virginia has also adopted its own version of the UTC. Chapter 7 of Title 64.2 of the Annotated Code of Virginia. Accordingly, the standard default disclosure and notification provisions apply. VA Code Ann. § 64.2-775. However, Virginia allows a settlor to modify or waive the default notice requirements, as the Annotated Code of Virginia does not include provisions similar to UTC §§ 105(b)(8) and 105(b)(9), i.e., the UTC Sections that prevent a settlor from modifying the default notice and disclosure requirements. VA Code Ann. § 64.2-703. Thus, the settlor should be able to waive or modify all notice and disclosure requirements.

28. Washington. Washington allows a settlor to waive or modify certain notice requirements, either within the terms of the trust instrument or a separate writing delivered to a trustee. RCWA 11.98.072(5). A settlor cannot, however, waive the duty of a trustee to (1) keep all qualified beneficiaries reasonably informed about the trust's administration and the material facts necessary for them to protect their interests; (2) promptly respond to any beneficiary's request for information related to the trust's administration, which can be satisfied by providing a copy of the entire trust instrument; and (3) distribute to each current beneficiary an annual accounting. RCWA 11.98.072(1), RCWA 11.106.020.

29. Wyoming. Wyoming has also adopted its own version of the UTC. Chapter 10 of Title 4 of the Wyoming Statutes Annotated. Accordingly, the standard default disclosure and notification provisions apply. W.S.1997 § 4-10-813. However, Wyoming allows a settlor to modify or waive the default notice requirements, as the Wyoming Statutes Annotated do not include provisions similar to UTC §§ 105(b)(8) and 105(b)(9), i.e., the UTC Sections that prevent a settlor from modifying the default notice and disclosure requirements. W.S.1997 § 4-10-105. Thus, the settlor should be able to waive or modify all notice and disclosure requirements.

30. Comparison of State Statutes. Because over half of the states provide some type of relief from the expansive notice requirements under the UTC and the Restatement, it is hard to pinpoint a common theme. That said, there appears to be a trend towards allowing a settlor to designate a surrogate to receive information on behalf of the beneficiary. In addition, it appears that a number of the above-listed jurisdictions continue to require an accounting, either annually or at a trust's termination, regardless of whether or not other trustee duties can be waived.

C. Administering Silent Trusts.

1. Introduction. Many of the potential issues that could arise with the use of silent trusts can be avoided through careful drafting. Also, communication with the grantor is important during the planning and drafting stage. As discussed *infra*, if the grantor expects that notice will be restricted or eliminated, this needs to be drafted into the trust.

2. Issues in administering a silent trust that can be handled with careful drafting of the trust.

(a) Crummey Powers or other powers of withdrawal. Although it seems obvious when pointed out, it is very important that any provisions restricting notice not conflict with requirements to provide notice such as those found within Crummey or other withdrawal powers. If the trust instrument provides that the trustee is directed not to provide notice of the trust, statements, or any other information to the beneficiaries, and yet the trust has standard Crummey withdrawal provisions with the required notice to the beneficiary, there is a conflict in the terms of the trust which leaves the trustee in an uncertain position. Careful planning in the drafting stage will avoid this. However, there are instances where the provisions restricting notice come toward the end of the trust agreement, the Crummey powers of withdrawal and related notice requirements are among the earlier dispositive provisions, and there is no coordination between the two provisions. In addition to the importance of careful drafting, a safety net might be to provide a trust protector with the power to change the provisions restricting notice to the beneficiaries, if needed.

(b) The trustee has discretion to withhold information. What if the trust instrument does not direct the trustee to withhold information but rather gives the trustee the discretion to withhold information? Arguably the trustee could be protected under the statute of the given state. However in many instances a trustee will not want to be in the position of exercising this discretion, even if protected by a statute allowing a trust instrument to permit notice to the beneficiaries to be reduced or eliminated. The preferred drafting would be to direct the trustee rather than provide the trustee with discretion to withhold information.

(c) There are no provisions in the trust regarding notice to beneficiaries. Many trust officers have faced the situation where the grantor tells the trust officer not to send statements or any information to a beneficiary who has reached the age of majority, even though there are no such provisions in the trust instrument. A common reaction from the grantor might be, "I thought this state allowed notice to be withheld from beneficiaries." However, if the trust instrument does not provide for this, it is likely that the trustee will have to go through the considerations described in the *McNeil* Case *supra*, or similar case or statutory law of the state where the trust is sitused. The important message here is to discuss the grantor's desires regarding notice and draft the appropriate provisions in the trust instrument if needed, rather than have this issue arise at a later time when it might be too late.

3. Issues which exist regardless of careful drafting. Even with careful drafting the trustee may still be faced with some issues when administering a silent trust.

(a) If a beneficiary learns about the trust after many years after the creation of the beneficiary's interest in the trust, the beneficiary's reaction may be surprise and perhaps anger that he or she was not informed earlier. At that point a trustee might hear from the beneficiary that the beneficiary would have purchased a house or gone to medical school if he or she had known about the trust. Although the statute protects the trustee, there is still the possibility of a difficult client relationship with a beneficiary at a later time.

(b) There is a spectrum of fact patterns which might impact the trustee's relationship with the beneficiary upon the beneficiary learning about his or her interest in the trust. For example, suppose the trustee is directed not to provide notice until the beneficiary reaches age 25 or completes his or her current college program, and that beneficiary is one or two years away from graduation. Perhaps that is a reasonable reason and amount of time to withhold notice, and it is more likely that the beneficiary would be pleased when he or she learns about the trust. On the other end of the spectrum would be the fact pattern where the trustee is directed to never provide notice to the beneficiary unless the beneficiary receives a distribution from the trust. This could lead to the dissatisfied beneficiary / client described above.

(c) One of the more obvious issues facing the trustee is the fact that there will be no beneficiary to receive statements, which means not starting any statute of limitations for a beneficiary to bring a cause of action. For example, Delaware law provides that a beneficiary may initiate a proceeding against a trustee for breach of trust until two years after the date the beneficiary was sent a report that adequately discloses the facts constituting the claim, 12 Del. C. §3585. Furthermore, under Delaware law the terms of the trust can provide a shorter period for a beneficiary to bring a cause of action. If the trust is a silent trust, the beneficiary does not receive any report to begin the statute of limitations period. However, one method that might be utilized to address this is the use of a "beneficiary representative".

4. Beneficiary Representatives. Various jurisdictions including Florida, Ohio, Pennsylvania, and the District of Columbia have statutes that specifically provide that an individual can be named to receive notice, accountings, statements or any other information concerning the trust on behalf of a beneficiary and bind that beneficiary, fulfilling the trustee's requirement to provide notice to beneficiaries and preventing the beneficiary from later claiming that he or she did not receive the information. *See e.g.*, Fla. Stat. §736.0306, Ohio Rev. Code Ann §5801.04(c) (creating a "beneficiary surrogate"), 20 Pa. Cons. Stat. §7780.3(k), and D.C. Code Ann. §19-1301.05(c)(3). As previously mentioned, Delaware has enacted a Designated Representative statute. 12 Del. C. § 3339. Under Delaware law the designated representative is authorized to represent and bind beneficiaries prohibited from receiving notice of the existence of the trust pursuant to the terms of the trust instrument for purposes of any judicial proceeding and for purposes of any nonjudicial matter. 12 Del. C. § 3303(d). The purpose of these statutes is to strike a balance between the grantor's right to privacy when creating the trust, and the beneficiaries' right to be informed of his or her interest in the trust

(a) What this accomplishes. The concept is that the trustee has fulfilled its fiduciary duty to provide information to the beneficiaries. The beneficiaries are represented and bound by the beneficiary representative. That person is looking out for the interests of the beneficiary. Any statute of limitations for bringing a cause of action after receipt of information (12 Del. C. § 3585 *supra*) begins to run with the receipt of the information by the beneficiary representative.

(b) Is the beneficiary representative a fiduciary? Most state statutes provide that the beneficiary representative is serving in a non-fiduciary capacity. However, Delaware's statute provides that the designated representative is deemed to serve in a fiduciary capacity unless the terms of the governing instrument provide otherwise. 12 Del. C. § 3339(b). Most of these statutes provide a "good faith" standard for the beneficiary representative, but provide that the beneficiary representative is not liable as long as she or he acts with good faith. Of course the trust instrument can provide that the beneficiary representative is a fiduciary.

(c) Who serves in this role? Generally the statute provides that the trustee cannot serve as a beneficiary representative. The various statutes have different requirements regarding who can fill this role, and the permissible methods of appointment. An equally important question is who actually is available and willing to serve in this role. In practice it seems that often times this role is filled by family members such as older siblings, aunts, or uncles; or a professional adviser close to the grantor. It is not always easy to find someone willing to take on this responsibility. Nonetheless, if the trust is created in a state that provides for this role, it would be advisable to draft the provisions into the trust so that the role can be filled at a later date if desired and if there is a viable candidate to fill the role.