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WHY IS EVERYONE TALKING ABOUT DELAWARE TRUSTS?

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I. INTRODUCTION

Delaware is a trust friendly state. For more than a century, Delaware has assisted wealthy families in accomplishing objectives such as teaching younger generations about the responsible stewardship of wealth and philanthropy while simultaneously maximizing the investment return on family assets, protecting family wealth from creditors and saving income taxes. See, R. Nenno, *Perpetual Dynasty Trusts: Tax Planning and Jurisdiction Selection*, ALI-ABA Planning Techniques for Large Estates, 509-651 (Apr. 2007), available at www.ali-aba.org.

It is for these reasons and the reasons set forth in this outline that almost every major institutional trustee is either based in Delaware or has opened an office to provide trust services there. It is also for these reasons that many wealthy families have established their own trust companies (limited purpose trust companies) in Delaware. A list of institutional trust companies and limited purpose trust companies may be found at www.banking.delaware.gov. It should be obvious to the reader that nearly all national institutional trustees are open in Delaware for trust business.

However, it is not the purpose of this outline to deliver a sales pitch for Delaware trust business. Rather, it is the purpose of this outline to explain why so many institutional trustees and family offices have moved trust operations to Delaware and why so many trust attorneys are working with their wealthy clients to change the situs of existing trusts to Delaware. The explanation may lead many to work on trust legislation in their own states. The explanation will also demonstrate that it is not necessary for wealthy trustors to abandon their relationships with local advisers and trust attorneys to avail themselves of the many advantages of Delaware Trust law.

So, why is everyone talking about Delaware trusts?

II. FREEDOM OF DISPOSITION

A. Statutory Provisions. Delaware trust law is based on the premise that a trustor has the legal right to control the investment decisions, management decisions and trust distribution decisions of trusts created by a trustor and funded with the trustor's assets. This fundamental principle of Delaware trust law allows a trustor to modify the duty to diversify trust investment, and to permit the trustee to hold high risk portfolios, closely held business interests, and overly concentrated stock positions in the stock of family businesses gone public without fear of liability. It allows for the enforceability of subjective distribution standards in the trust document, including those common in incentive trusts, and the ability of the trustor to determine the trust functions that will be performed by the institutional trustee and those that will be performed by others (trust advisers) so that the administration of the trust will be more economical. Rachel Emma Silverman, *How Many Trustees Do You Need?* Wall St. J., July 12, 2007, at B5. See, also EXHIBIT A to this outline (Role and Function Provisions of Various Advisory Positions for Delaware Trusts.

1. Trust Instrument Controls. Delaware law gives maximum effect to the wishes of the trustor as expressed in the governing instrument. 12 Del. C. § 3303(a). This specific statutory provision states that the terms of a governing instrument may expand, restrict, eliminate or otherwise define the rights of beneficiaries, including the right of a beneficiary to be informed of the existence of the trust, the grounds for the removal of a fiduciary, and the fiduciary's powers, duties and standard of care. Id.

§ 3303. Effect of provisions of instrument

(a) Notwithstanding any other provision of this Code or other law, **the terms of a governing instrument may expand, restrict, eliminate or otherwise 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, the grounds for removal of a fiduciary, the circumstances, if any, in which the fiduciary must diversify investments, and a fiduciary's powers, duties, standard of care, rights of indemnification and liability** to persons whose interests arise from that

instrument; provided however, that nothing contained in this section shall be construed to permit the exculpation or indemnification of a fiduciary for the fiduciary's own willful misconduct or preclude a court of competent jurisdiction from removing a fiduciary on account of the fiduciary's willful misconduct. The rule that statutes in derogation of a common law are to be strictly construed shall have no application to this section. **It is the policy of this section to give maximum effect to the principle of freedom of disposition and to the enforceability of governing instruments**. [Emphasis added].

The purpose of the statute is plain. The trustor has the freedom to dispose of his or her assets in any way the trustor chooses. Trustor's intent is paramount.

For example, prior to the enactment of § 3303, the Delaware Supreme Court upheld a Chancery Court decision removing and surcharging PNC Bank as trustee of a trust for, among other things, failing to inform a person that he was the beneficiary of a trust and rebuffing that person's attorney in his efforts to obtain information about the trust. *McNeil v. McNeil*, 798 A.2d 503 (Del. 2002). Section 3303 clearly reverses *McNeil* on the issue of notice if the trust document includes language allowing the trustee to hold the trust, and information about the trust, secret for some period of time.

2. Trustee's Reliance on Trust Instrument. The trustor's statutory right to "expand, restrict, eliminate or otherwise vary... a fiduciary's powers, duties [and] standard of care" by the express terms of the governing instrument, subject only to the fiduciary's duty not to engage in "willful misconduct" would have little meaning were it not for the trustee's statutory right to rely on the terms of the trust instrument. In this regard, 12 Del. C. § 3586 states:

§ 3586. Reliance on trust instrument

A trustee who acted in good faith reliance on the terms of a written trust instrument is not liable to a beneficiary for a breach of trust to the extent the breach resulted from the reliance. 12 Del. C. § 3586.

Similarly, 12 Del. C. § 3302(e) states:

§ 3302. Degree of care; authorized investments

(e) Any fiduciary acting under a governing instrument shall not be liable to anyone whose interests arise from that instrument for breach of fiduciary duty for the fiduciary's good faith reliance on the express provisions of such instrument. The standards set forth in this section may be expanded, restricted or eliminated by express provisions in a governing instrument.

It is the trustee's right to rely on the express terms of the trust instrument that allows the trustee to administer a trust without fear of retribution by disgruntled beneficiaries.

B. Trustee Protection. To ensure the enforceability of the provisions of the trust agreement, Delaware enacted legislation to protect a trustee acting in accordance with the trust instrument. Key parts of the legislation include a shortened claims period limiting the time during which a Delaware trustee may be sued and an extension of the "virtual representation doctrine" so that those with a future interest in the trust may be bound by others with an identical preceding interest.

1. Contesting the Trust. Delaware law provides that a judicial proceeding to contest whether a trust was validly created may not be initiated later than the first to occur of: (i) 120 days after the date the trustee notified the potential claimant of the existence of the trust, the trustee's name and address, whether the person is a beneficiary and the time allowed for initiating the judicial proceeding to contest the trust (the foregoing provision allows the trustor of a revocable trust to confront a potential contestant during the trustor's lifetime); (ii) two years after the trustor's death; (iii) if the trust was revocable at the trustor's death and the trust is specifically referred to in the trustor's Will, the time in which a petition for review of the Will could be filed in Delaware; and (iv) the date the potential claimant's right to contest was otherwise precluded by adjudication, consent or other limitation under Delaware law. 12 Del. C. § 3546(a). Under Delaware law, the period of time during which a trustor's

Will may be contested is generally six months after the filing of the Will in the Register of Wills Office for purposes of subsection (iii) above. 12 Del. C. § 1309(a).

(a) The concept of "pre-mortem validation" has gained popularity in recent years. The idea that a person should be permitted to defend an estate plan while alive and mentally alert, rather than relying upon attorneys to defend it after death, is just good sense. Delaware has permitted the form of pre-mortem validation set forth in subsection (i) of the above quoted statute since 2003. The Delaware Supreme Court upheld the pre-mortem validation statute and process in the *Ravet* case: *Matter of Restatement of Declaration of Trust Creating the Survivor's Trust Created Under the Ravet Family Trust Dated Feb. 9, 2012*, No. CIV.A. 7743-VCG, 2014 WL 2538887 (Del. Ch. June 4, 2014), *aff'd sub nom. Ravet v. N. Trust Co. of Delaware*, No. 369, 2014, 2015 WL 631588 (Del. Feb. 12, 2015).

(b) Delaware also accepts the validity of "no contest" clauses in trust instruments. 12 Del. C. § 3329(a). Coupling the pre-mortem validation provision with a no contest clause in a trust is an effective way to avoid litigation after the trustor's death over the validity and effectiveness of the trust instrument.

2. Limitation on Actions Against a Trustee. Delaware law provides that a beneficiary may not initiate a proceeding against the trustee for breach of trust after the first to occur of: (i) two years following the date the beneficiary was sent a report that adequately disclosed the facts constituting a claim or (ii) the date the proceeding was otherwise precluded by adjudication, release, consent or other limitation under Delaware law. 12 Del. C. § 3585(a). The two year claims period applies to minor, incapacitated and unborn persons and persons whose identity or location is unknown whose interest is represented under Delaware's virtual representation statute. 12 Del. C. § 3547. In 2008, 12 Del. C. § 3585 was amended by the Delaware legislature to add a new five year statute of repose for breach of trust actions. In cases where the two-year limitation period does not apply, the new limitations period absolutely

bars breach of trust claims five years following the first to occur of (i) the removal, resignation or death of the trustee; (ii) the termination of the beneficiary's interest in the trust; or (iii) the termination of the trust.

3. Beneficiary's Consent. Delaware law provides that a beneficiary may not hold a trustee liable for a breach of trust if the beneficiary consented to the conduct constituting the breach, released the trustee from liability for the breach or ratified the transaction constituting the breach unless the beneficiary was so induced by improper conduct of the trustee or the beneficiary did not know at the time the beneficiary's rights or material facts the trustee knew or should have known. 12 Del. C. § 3588.

4. Virtual Representation. Delaware law provides that the interest of "a minor, incapacitated, or unborn person, or a person…. whose identity or location is unknown and not reasonably ascertainable" may be represented and bound by another with substantially identical interests. 12 Del. C. § 3547(a). Virtual representation applies for all purposes including judicial proceedings and such non-judicial matters as releasing the trustee, consenting to the conduct of the trustee or ratifying a transaction engaged in by the trustee. 12 Del. C. § 3588. In the case of a minor or incapacitated beneficiary, a custodial parent or guardian may represent and bind the beneficiary. 12 Del. C. § 3547(c). A "presumptive remainder beneficiary" (one who would take if the trust terminated at that time without regard to the exercise or non-exercise of a power of appointment) may represent and bind contingent remainder beneficiaries including adults and charities. 12 Del. C. § 3547(b). The custodial parents may sign on behalf of a minor or incapacitated beneficiary only if "there is no material conflict of interest between the minor or incapacitated beneficiary and either of such beneficiary's parents with respect to the particular question in dispute". 12 Del. C. § 3547(c). The foregoing provision often avoids the need to appoint a guardian ad litem.

III. FAVORABLE TRUST LAW

A. Statutory Provisions. Delaware has developed a substantial body of favorable trust law. The trust law is consistently monitored by a select group of the

Delaware Bar Association that continually reviews and modifies the law to maintain Delaware's preeminent position in the field of trust law.

1. Perpetual Trusts. 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 perpetual existence. 25 Del. C. § 503. There is a limitation for real estate held by deed in trust name that applies the old 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). As a result:

   (a) Many trustors are establishing "dynasty trusts" in Delaware to which they allocate their GST exemption so that the trust may continue in perpetuity free of federal estate and federal generation skipping taxes and free from the claims of creditors of the beneficiaries. Non-exempt trusts are also often established as perpetual trusts while the federal estate tax rate and the generation skipping transfer tax rate are the same. The viability of this planning technique, and the others discussed below, will depend upon the provisions of any laws that change the federal estate tax and the federal generation skipping transfer tax.

   (b) Many trustors are establishing dynasty trusts funded with large life insurance contracts insuring the trustor's life and in some cases the joint lives of trustor spouses, allocating GST exemption to the premium payments thereby leveraging GST exemption to create family wealth that will be administered in perpetuity through the dynasty trust.

   (c) Many trustors 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 trustor. The trustor will then gift "seed money" to the trust and allocate a portion of the trustor's

applicable exclusion amount and lifetime GST exemption. The trust will then purchase an asset from the trustor (typically an asset the trustor expects will appreciate substantially) in exchange for a promissory note with interest at the appropriate applicable federal rate. The sale of the assets to the trust will not cause the trustor to recognize gain because, for income tax purposes, the trustor and the trust are the same entity. If the purchased assets appreciate at a rate faster than the interest rate on the note, the trustor will have successfully transferred the appreciation out of his or her estate and allocated GST tax exemption so that the trust may continue in perpetuity.

(d) Where the power to substitute is the power chosen to create an intentionally defective income trust, Delaware law confirms that, notwithstanding the terms of a 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 withdrawn. 12 Del. C. § 3316. This provision was added to ensure compliance with the Internal Revenue Service position on this issue.

2. Favorable Income Tax Laws. Delaware does not tax that portion of trust income and capital gains accumulated and set aside for future distribution to nonresident beneficiaries. 30 Del. C. § 1636(a). If all of the beneficiaries of a Delaware trust are nonresidents, the trust pays no Delaware state income tax at all and is not even required to file a Delaware state income tax return. Id; 30 Del. C. § 1605(b)(1)a.2. Many non-resident trusts (including many from New York) have been moved to Delaware to avoid state income tax that would otherwise apply. See, for example, N.Y. Tax Law § 605(b)(3)(D) exempting resident trusts from New York income tax where all of the trustees are domiciled in a state other than New York, the entire trust corpus is located outside the State of New York and all income and gain of the trust are derived from or connected with sources outside the State of New York. Clients with existing trusts in high income states often move their trusts to Delaware in anticipation of a transaction that will result in a substantial capital gain (i.e., a sale of a block of low-basis stock) in order to avoid the state

income tax that would be imposed as a result of the transaction. Delaware does not have a tax on intangible personal property and there are no other franchise taxes, gross receipts taxes or hidden fees that apply to Delaware trusts.

3. Prudent Investor Rule. Delaware adopted its version of the uniform Prudent Investor Act in 1986. 12 Del. C. § 3302(b). Delaware permits a trustee to acquire virtually every kind of investment and judges the trustee's investment performance based upon the performance of the entire portfolio of the trust and not on an asset by asset basis. 12 Del. C. § 3302(c). Where the terms of a governing instrument direct the fiduciary to retain specified trust property as a trust investment, the duty of diversification otherwise applicable to the fiduciary with respect to such property shall be deemed to be waived and the fiduciary shall be exonerated from liability for retaining the property except in the case of willful misconduct proved by clear and convincing evidence in the Court of Chancery. 12 Del. C. § 3304.

4. Asset Protection – Trust Beneficiary. Delaware has always provided strong asset protection against creditors of a non-trustor beneficiary. 12 Del. C. § 3536. A creditor of a beneficiary of the trust has only such rights against the beneficiary's interest in the trust as shall be expressly granted to such creditor by the terms of the trust instrument or by the laws of the State of Delaware. Id.

   (a) State law specifically protects a beneficiary's interest in a trust from actions, at law or in equity, against the trustee or the beneficiary that seek to: (i) compel the trustee or the beneficiary to notify the creditor of a distribution from the trust; (ii) compel the trustee or the beneficiary to make a distribution from the trust; (iii) prohibit a trustee from making a distribution from the trust to or for the benefit of a beneficiary; and (iv) compel a beneficiary to exercise a power of appointment or a power of revocation over the trust. 12 Del. C. § 3536(a).

   (b) A beneficiary may not waive the spendthrift protection of the Delaware statute and the interest of a trust beneficiary is fully

protected until actual distribution of the trust property is made to the beneficiary. Id. Regardless of whether a beneficiary has an outstanding creditor known to the trustee, a trustee may make direct payment of any expense on behalf of the beneficiary, as permitted by the trust instrument, and is not liable to any creditor for paying the expenses of a beneficiary. Id.

(c) Where the trustor is also a beneficiary of a trust, a spendthrift provision will not prevent the trustor's creditors from satisfying their claims against the trustor's interest in the trust to the extent of the trustor's contributions to the trust unless the trust falls within the Delaware Qualified Dispositions in Trust Act that protects self-settled trusts. 12 Del. C. § 3536(c). For purposes of the statute, if a trustor' sole retained beneficial interest in the trust is the right to receive discretionary distributions to reimburse the trustor's income tax liability attributable to the trust, that discretionary beneficial interest in the trust is protected. 12 Del. C. § 3536(c)(2)..

(d) A beneficiary of a trust is not considered to be a trustor merely because of the lapse of a right of withdrawal (Crummey power) in any calendar year. 12 Del. C. § 3536(c)(1) and (2).

(e) A creditor of a beneficiary has no right against the beneficiary's interest in a trust solely because the beneficiary has a limited or general power of appointment exercisable in a manner that will only take effect upon the beneficiary's death unless the beneficiary actually exercises the power in favor of the beneficiary, the beneficiary's creditors, the beneficiary's estate or the creditors of the beneficiary's estate, but then only to the extent the power is so exercised. 12 Del. C. § 3536(d)(1).

(f) Where the beneficiary has a power to appoint during lifetime, the same rule applies. The beneficiary's creditors have no right against the interest of the beneficiary unless the beneficiary exercises the lifetime power to appoint the property to the beneficiary's creditors, the beneficiary's estate or the creditors of

the beneficiary's estate and then only to the extent of the exercise. 12 Del. C. § 3536(d)(2).

(g) Delaware law permits the beneficiary of a charitable remainder trust the right to release such beneficiary's interest, notwithstanding the spendthrift provision in the trust, in whole or in part, to a charitable organization that has a succeeding beneficial interest in the trust. 12 Del. C. § 3536(e).

(h) A QTIP or other marital trust will not be treated as a self-settled trust if the trustor's spouse holds a general or limited power of appointment over the trust even if the trustor becomes a beneficiary of the trust subsequent to the death of the trustor's spouse. 12 Del. C. § 3536(c)(1).

(i) The asset protection provisions of trusts that are not self-settled are effective regardless of the nature or extent of the beneficiary's interest in the trust, whether or not such interest is subject to an exercise of discretion by the trustee and are effective regardless of any action taken or that might be taken by the trust beneficiary. 12 Del. C. § 3536(a). Moreover, where discretion is conferred upon the trustee, the trustee's exercise of discretion shall be considered proper unless a court determines that the discretion has been abused within the meaning of Section 187 of the Restatement (Second) of Trusts not §§ 50 and 60 of the Restatement (Third) of Trusts. 12 Del. C. § 3315(a). A creditor of a beneficiary may not directly or indirectly compel the distribution of a discretionary interest in a trust except to the extent expressly granted by the terms of the governing instrument or Delaware law. 12 Del. C. § 3315(b). A beneficiary eligible to receive distributions from a trust in the trustee's discretion has a discretionary interest within the meaning of the statute. Id.

(j) Accounts held in Delaware banks, trust companies, savings institutions and loan associations are exempt from state law attachment under Delaware law. 10 Del. C. § 3502(b). This provision of Delaware law protects trust companies, among others,

from the nuisance of complying with attachment orders. Once the beneficiaries of a Delaware trust deposit a trust distribution into a Delaware bank account, the distribution is protected from attachment attributable to state law claims.

(k) There is a judicial exception to the spendthrift provision relating to a beneficiary's obligation to provide separate maintenance to a spouse. *Garretson v. Garretson*, 306 A.2d 737 (Del. 1973). The Garretson case involved a wife seeking to compel a husband who deserted her to provide support to the wife and dependents from a third party trust. Id. at 740. The Delaware Supreme Court ruled in favor of the wife noting that the result may be "entirely different" if the parties were divorced and the wife lost her status as wife. Id. at 742. Delaware goes so far as to bar a creditor from attaching the interest of a beneficiary even when the beneficiary commits a willful tort. *Parsons v. Mumford*, 1989 WL 63899 (Del. Ch. 1989); *Gibson v. Speegle*, 1984 Del. Ch. LEXIS 475 (1984).

5. Asset Protection Trust – Trustor. Delaware enacted a self-settled asset protection trust law "The Qualified Dispositions in Trust Act" in 1997. Please see EXHIBIT B to this Outline (The Use of Asset Protection Trusts for Tax Planning Purposes) for a discussion on Asset Protection Trusts. The creditor protection of a Delaware self-settled asset protection trust was upheld by the Court of Chancery in the *Matthews* case; *TrustCo Bank v. Matthews*, 2015 WL 295373 (Del. Ch. Jan. 22, 2015).

6. Total Return Trust. Delaware was the first state to adopt total return legislation when it enacted 12 Del. C. § 3527 on June 21, 2001. The total return statute creates a simplified procedure that allows a "Disinterested Trustee" (such as a corporate fiduciary) to convert an income only trust to a total return trust without court proceedings. 12 Del. C. § 3527(b). The statute was enacted before the regulations under Internal Revenue Code § 643(b) became final. However, the drafters of the Delaware statute anticipated the regulations under § 643(b) and, accordingly, minimal revisions were required to the statute after those regulations became final. The statute allows a trustee to establish a unitrust rate from 3% to 5% in lieu of trust income and to allocate to the unitrust payment tax

characteristics such as short-term and long-term capital gain. 12 Del. C. § 3527(h). The power of a trustee to convert an income trust to a total return trust or a total return trust to an income trust is, by statute, a law pertaining to the administration of a trust and is available to any trust administered in Delaware. 12 Del. C. § 3527(1).

(a) Many older Delaware trusts have already converted from income only trusts to total return trusts.

(b) The situs of many out of state trusts has been moved to Delaware specifically for the purpose of allowing the Delaware trustee to convert an income only trust to a total return trust.

7. The Power to Adjust. Delaware law permits a trustee to adjust between principal and income to the extent the trustee considers necessary taking into account the nature, purpose and duration of the trust, the intent of the trustor, the identity and circumstances of the beneficiaries, the need for liquidity and preservation and appreciation of capital, the assets in the trust, the actual and anticipated effect of economic conditions and the anticipated tax consequences of the adjustment. 12 Del. C. § 6113(a) and (b). The power to adjust is, by statute, a law pertaining to the administration of a trust and is available to any trust that is administered in Delaware. 12 Del. C. § 6113(g).

8. Charitable Trust. In furtherance of its policy of giving maximum effect to the wishes of the trustor as expressed in the governing instrument, Delaware law prohibits a court from changing the purposes of a trust created for religious, charitable, scientific, literary or educational purposes unless "the purposes of the trust have become unlawful" under the constitution of the State of Delaware or the constitution of the United States or the trust no longer serves a charitable purpose. 12 Del. C. § 3303(b). This statutory standard for court intervention in a charitable trust matter should be compared with the traditional cy pres standard applicable in most jurisdictions. The cy pres standard generally allows a court to intervene when the charitable trust purposes become "impractical, impossible to achieve or wasteful" similar to the previous Delaware law. 12 Del. C. § 3541. Under Delaware law, a trustor has standing to maintain

an action to enforce the charitable purposes of the trust and may designate another, whether that person is alive at the time of such designation or subsequently born, to enforce the charitable purposes of the trust. 12 Del. C. § 3303(b). Moreover, the Attorney General's Office of the State of Delaware is charged with protecting the interest of the people relative to charitable trusts. The Attorney General's Office typically maintains a hands off policy toward charitable trusts.

9. Purpose Trust. Delaware law permits the creation of a perpetual, non-charitable purpose trust. 12 Del. C. §§ 3555 and 3556. A purpose trust is one that is valid even though it may not have a charitable purpose and no identifiable beneficiary. Purpose trusts are often used for the care of pets, the preservation of collections, such as antique cars or trains, and the preservation and maintenance of a family compound. Delaware provides the same protection to a trustor of a non-charitable purpose trust it gives to the trustee of a charitable trust, providing standing to the trustor and the trustor's designee to enforce the purposes of the trust. 12 Del. C. § 3303(b).

10. Decanting. Delaware law authorizes a trustee, that has authority under the terms of the trust instrument (the first trust) to invade principal for the benefit of one or more beneficiaries, to exercise such authority by appointing all or a portion of the principal subject to the power of invasion in favor of a trustee of a trust under a separate trust instrument (a second trust). 12 Del. C. § 3528(a). Please see EXHIBIT C to this Outline (How to Modify Irrevocable Trusts Under Delaware Law) for a discussion on decanting.

11. Delaware Statutory Trust. Delaware law provides for the creation of a special business trust, known as a "Statutory Trust". 12 Del. C. § 3801 et seq. Family investments in virtually every kind of property may be managed through a statutory trust as an alternative to a limited partnership, a limited liability company, a corporation or other form of business entity. 12 Del. C. § 3801(a). A statutory trust may be taxed as a corporation, association, partnership, trust or otherwise in accordance with the provisions of the Internal Revenue Code and the manner elected by the trustee. 12 Del. C. § 3809. Statutory trusts provide limited liability to the

trustee and the beneficiaries. 12 Del. C. § 3803. The governing instrument is paramount in determining the powers, duties and indemnity rights of the trustee and the classes of beneficial interest and rights of all of the beneficiaries. 12 Del. C. § 3823. Every Delaware statutory trust is required to have at all times at least one trustee which, in a case of a natural person, is a resident of the State of Delaware, and in all other cases is an entity with its principal place of business in Delaware. 12 Del. C. § 3807(a).

12. In Terrorem Clauses. A provision in a will or trust that would reduce or eliminate the interest of a beneficiary who initiates an action to contest the validity of the will or trust is enforceable under Delaware law with certain limited exceptions. 12 Del. C. § 3329(a). Unless the beneficiary bringing the contest substantially prevails, the beneficiary's interest in the will or trust may be eliminated on account of the contest.

13. Confidentiality. Delaware law places great emphasis on the confidentiality of matters relating to Delaware trusts. A trustor may direct the trustee (for a period of time) not to inform the beneficiary of the beneficiary's interest in the trust. 12 Del. C. § 3303(a). Please see EXHIBIT D to this Outline (The Trustee's Duty to Inform: What Must the Trustee Tell Which Beneficiaries and When?) for a discussion on quiet trusts. Delaware courts do not supervise the administration of trust unless called upon by an interested party to do so. 10 Del. C. § 6504. When issues of confidentiality and privacy are paramount to the parties, it is easy to obtain a court order to seal the record thereby keeping the trust agreement, the parties and their dispute private. Ch Ct R 5(g)(3). In addition, routine trust petitions are filed in the Court of Chancery as "C.M.s" or Civil Miscellaneous matters and are not generally open to the public, even absent a court order sealing the record.

14. Excellent Court System. Delaware trust administration and trust interpretation cases are exclusively within the jurisdiction of the Delaware Court of Chancery and, upon appeal, the Delaware Supreme Court. The Court of Chancery is the same court that has exclusive jurisdiction over corporate law matters. Well educated, highly trained and specialized judges (called the Chancellor and Vice Chancellors) decide all disputes

concerning trusts. There is no jury participation. Proceedings in the Court of Chancery (and upon appeal to the Delaware Supreme Court) are handled in a timely and efficient manner and counsel for the parties involved are expected to conduct themselves professionally and to respond promptly to the court and to court imposed deadlines.

15. Excellent Relationship Between the State Bar and the State Legislature. There is an excellent relationship between the Delaware Bar Association and the Delaware state legislature. The Delaware Bar Association handles all of its work through substantive committees which propose legislation to the Executive Committee of the Bar Association. Upon approval of the Executive Committee, the legislation is delivered to the Bar Association's lobbyist. The Estates and Trusts Section of the Delaware Bar Association proposes legislation annually. The legislation is generally supported by the Delaware Bankers Association. In nearly all cases, the proposed legislation is passes and becomes law.

16. Directed Trusts. One of the most important reasons for trusts moving to Delaware is the Delaware directed trust statute. Delaware recognizes directed trusts and limits the liability of a trustee who acts upon the direction of an adviser appointed in the trust agreement to make an investment decision, a distribution decision or other decisions. 12 Del. C. § 3313. Directed trusts are discussed in more detail in Part IV of this outline.

17. Disabling Statute. In 2008, the Delaware legislature added a "disabling statute" patterned upon Section 814 of the Uniform Trust Code. 12 Del. C. § 3314. The statute provides in general that various powers held in a fiduciary capacity (such as the power to appoint trust property to the fiduciary personally or to the fiduciary's estate or creditors or the creditors of the fiduciary's estate) that might, absent the statute, be treated as general powers of appointment for federal transfer tax purposes, may only be exercised by the fiduciary for the fiduciary's health, education, support or maintenance or by a special trustee who is an independent trustee. 12 Del. C. § 33314(e)(2). The statute is designed to prevent the inclusion of the trust assets in the estate of a fiduciary holding certain powers that would be deemed general powers of appointment over the trust property.

B. Trustee Protection. To ensure the full benefit of favorable Delaware trust law, Delaware enacted legislation to protect trustees acting in accordance with the trust instrument.

1. Life Insurance Trusts. A trustee has no liability for determining whether a contract of life insurance remains a proper investment for a trust, investigating or failing to investigate the financial strength of a life insurance company issuing a policy owned by the trustee, making a determination whether to exercise policy options, making a determination whether to diversify life insurance contracts or inquiring about changes in the health or financial condition of the insured. 12 Del. C. § 3302(d). When the trustee discloses this limitation of liability to the insured in its governing instrument or by separate writing delivered to the insured, the trustee is fully protected from liability. Id.

2. Total Return Trusts. A trustee has no liability for failing to convert an income trust to a total return trust. 12 Del. C. § 3527(m).

3. Acts of Predecessor. A trustee has no liability for the acts or omissions of a predecessor trustee absent actual knowledge of a breach of trust or information concerning a possible breach of trust that would cause a reasonable person to inquire and has no duty to examine the accounts and records of a predecessor trustee. 12 Del. C. § 3544.

4. Asset Protection Trusts. A trustee has no liability to a creditor or any other person for counseling, drafting, preparation, execution or funding of a Delaware asset protection trust under both Delaware trust law and the Delaware Uniform Fraudulent Transfer Act. 12 Del. C. § 3572(d); 6 Del. C. § 1307(c).

5. Prudent Investor Rule. Delaware adopted the Prudent Investor Rule for trustees with certain enhanced protections. 12 Del. C. § 3302. Delaware trustees are authorized to acquire "every kind of investment" and the propriety of an investment decision must be judged as part of the overall investment strategy and not on an investment by investment basis. 12 Del. C. § 3302(b). A Delaware trustee has no liability to a beneficiary for a

loss or depreciation in the value of a trust absent proof of breach of trust. 12 Del. C. § 3583(b).

6. Personal Liability for Trust Obligations. Delaware law provides that: (i) a trustee is not personally liable on a contract properly entered into by it in its capacity as trustee if the contract discloses the fiduciary capacity; (ii) a trustee is not personally liable for the debts, obligations and liabilities incurred by reason of the ownership or control of property held in a fiduciary capacity, including liability incurred as a general or limited partner, or for violation of environmental law and such liability is enforceable only against the fiduciary fund; and (iii) a trustee is not liable for torts unless the fiduciary is personally at fault on account of the fiduciary's own willful misconduct proven by "clear and convincing evidence". 12 Del. C. § 3328.

7. Spendthrift Trusts. Delaware law provides that the trustee of a non-self-settled spendthrift trust is protected against the creditor of a trust beneficiary. The law provides that a creditor shall have no claim against a trustee seeking any remedy affecting the beneficiary's interest in the trust and may not compel the trustee to notify the creditor of a pending distribution from the trust, compel the trustee to make a distribution from the trust (whether or not pursuant to an ascertainable standard) or prohibit a trustee from making distribution from the trust in payment of an expense of the beneficiary. 12 Del. C. § 3536(a)(i). A trustee administering a spendthrift trust under Delaware law may directly pay any expense of the beneficiary of the trust permitted by the governing instrument and may exhaust the income and principal of the trust for the benefit of the beneficiary even if the beneficiary has an outstanding creditor. 12 Del. C. § 3536(a)(iv). The statute was revised by the Delaware legislature in 2008 to provide even greater protection against claims made by creditors of trust beneficiaries. The revised statute provides that a creditor of a beneficiary has only such rights against the beneficiary's interest as are expressly granted to the creditor by the terms of the trust instrument or Delaware law. As a result of the modification to the statute, a beneficiary's interest in a Delaware trust is now protected against creditor claims even if the trust instrument does not include traditional spendthrift clause language denying creditors' rights in the trust.

8. Discretionary Trust Distributions. In 2008, the Delaware legislature enacted 12 Del. C. § 3315 which provides that a trustee's exercise of a discretionary distribution power may not be overturned by a court except on account of "abuse of discretion" within the meaning of § 187 of the Restatement (Second) of Trusts. 12 Del. C. § 3315(a). Moreover, a creditor of a beneficiary, eligible to receive discretionary distributions from a trust, may not directly or indirectly compel the distribution of a discretionary interest. 12 Del. C. § 3315(b).

IV. DIRECTED TRUSTS – EXPORTING FAVORABLE DELAWARE TRUST LAW

A. Introduction. Directed trusts are not new. Delaware (for example) has statutorily recognized the power of the trustor of a trust to restrict a trustee's authority to dispose of or otherwise deal with specified trust assets for more than twenty years. 12 Del. C. § 3313 (65 Laws 1986, ch. 422, § 5). Prior to the statute, going back to the early 1900s, Delaware adopted the practice of allowing directed trusts to accommodate its wealthiest families.

In its earliest form, directed trusts tended toward the limitation of a trustee's power to sell specific trust assets without the consent or written direction of a person not serving as trustee. Today the limitations on a trustee's authority to deal with certain trust assets often affect all of the trustee's discretionary powers over the assets including voting decisions, management decisions, distribution decisions and other decisions previously solely within the realm of the trustee's discretion.

The desire of wealthy families to preserve their control over the stock of the corporation founded by their ancestors and the recognition that today's trusts often hold new kinds of unique trust investments have driven the issue of directed trusts. In fact, trustees faced with the fiduciary duty to diversify trust assets and deal impartially with income beneficiaries and remainder beneficiaries welcome the ability to limit their liability through the use of directed trusts.

The result has been the creation of a statutory framework authorizing a trustor (or the trustee and the trust beneficiaries through appropriate trust modification proceedings) to include in trust instruments a new regime for the administration of

specific trust assets. In addition to the traditional trustee, the new regime often includes trust advisers. See, Rachel Emma Silverman, *How Many Trustees Do You Need?* Wall St. J., July 12, 2007, at B5.

B. Definition. A directed trust is a trust that removes one or more powers or discretions traditionally held by the trustee and vests that power or discretion in a person who is either a special trustee or not a trustee at all. The power or discretion can relate to investment decisions, management decisions, distribution decisions and any other decision affecting the administration of the trust. The starting point for the creation of directed trusts is the statutory framework that permits them coupled with the carefully worded language of the trust instrument.

C. Statutory Recognition of "Advisers". A trustor's statutory power to dictate the rights and obligations of the beneficiaries and trustee through the express terms of a trust instrument and the trustee's statutory right to rely in good faith on the terms of the trust instrument for protection from liability are essential to the effective use of directed trusts. Three different approaches are illustrated below.

1. UTC. Section 808(b) of the Uniform Trust Code states:

> If the terms of a trust confer upon a person other than the trustee of a revocable trust power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power **unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty** that the person holding the power owes to the beneficiaries of the trust. [emphasis added]

2. Third Restatement. Section 75 of the Third Restatement of Trusts states:

> ...[I]f the terms of a trust reserve to the settlor or confer upon another a power to direct or otherwise control certain conduct of the trustee, the trustee has a duty to act in accordance with the requirements of the trust provision reserving or conferring the power and to comply with any exercise of that power, **unless the attempted exercise is contrary to the terms of the trust or power or the trustee knows or has reason to**

believe that the attempted exercise violates a fiduciary duty that the power holder owes to the beneficiaries. [emphasis added]

3. Delaware Provisions. The foregoing provisions for directed trusts should be compared with the more protective provisions adopted by Delaware and a few other states.

(a) Delaware law recognizes a broad class of advisers including direction advisers, consent advisers and trust protectors. Where one or more persons are given authority by the terms of a governing instrument to direct, consent to or disapprove a fiduciary's actual or proposed investment decisions, distribution decisions or other decisions of the fiduciary, such persons shall be considered to be advisers and fiduciaries when exercising such authority unless the governing instrument otherwise provides. 12 Del. C. § 3313(a).

(b) When a trustee acts in accordance with the directions of a trust direction adviser, the trustee will only be liable for its "willful misconduct".

Direction Provision

If a governing instrument provides that a fiduciary is to follow the direction of an adviser, and the fiduciary acts in accordance with such a direction, then **except in cases of willful misconduct on the part of the fiduciary so directed, the fiduciary shall not be liable** for any loss resulting directly or indirectly from any such act. 12 Del. C. § 3313(b). [emphasis added] The term willful misconduct means intentional wrongdoing and not mere negligence, gross negligence or recklessness. 12 Del. C. § 3301(g) and 12 Del. C. § 3301(h)(4). The term wrongdoing means malicious conduct or conduct designed to defraud or seek an unconscionable advantage. 12 Del. C. § 3301(g).

(c) The statutory standard of care required of a fiduciary acting on the consent of a Consent Adviser is only somewhat broader. When a

trustee acts with the consent of a Consent Adviser, the trustee will only be liable for its "willful misconduct" or "gross negligence".

Consent Provision

If a governing instrument provides that a fiduciary is to make decisions with the consent of an adviser, then **except in cases of willful misconduct or gross negligence on the part of the fiduciary, the fiduciary shall not be liable** for any loss resulting directly or indirectly from any act taken or omitted as a result of such adviser's failure to provide such consent after having been requested to do so by the fiduciary. 12 Del. C. § 3313(c). [emphasis added]

(d) In all cases, there may be an adviser who is a "trust protector".

Trust Protector

... the term "adviser" shall include a "protector" who shall have all of the power and authority granted to the protector by the terms of the governing instrument, which may include but shall not be limited to:

(i) The power to remove and appoint trustees, advisers, trust committee members, and other protectors;

(ii) The power to modify or amend the governing instrument to achieve favorable tax status or to facilitate the efficient administration of the trust; and

(iii) The power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the governing instrument. 12 Del. C. § 3313(f).

(e) The statutory protection afforded trustees of directed trusts would be diminished if advisers or beneficiaries could sue the trustee on the theory that the trustee had a duty to keep them informed and to

impart to them knowledge affecting their interests in the trust so they could perform their duties as advisers or otherwise protect their beneficial interests in the Trust.

Duty to Monitor, Communicate and Inform

Whenever a governing instrument provides that a fiduciary is to follow the direction of an adviser with respect to investment decisions, distribution decisions, or other decisions of the fiduciary, then, except to the extent that the governing instrument provides otherwise, **the fiduciary shall have no duty to:**

(i) **monitor the conduct of the adviser;**

(ii) **provide advice to the adviser or consult with the adviser; or**

(iii) **communicate with or warn or apprise any beneficiary or third party concerning instances in which the fiduciary would or might have exercised the fiduciary's own discretion in a manner different from the manner directed by the adviser**. 12 Del. C. § 3313(e). [emphasis added]

* * *

Absent clear and convincing evidence to the contrary, the actions of the fiduciary pertaining to matters within the scope of the adviser's authority (such as confirming that the adviser's directions have been carried out and recording and reporting actions taken at the adviser's direction), shall be presumed to be administrative actions taken by the fiduciary solely to allow the fiduciary to perform those duties assigned to the fiduciary under the governing instrument and such administrative actions shall not be deemed to constitute an undertaking by the fiduciary to monitor the adviser or otherwise participate in actions within the scope of the adviser's authority. Id.

(f) Recognizing the multiple roles played by different fiduciaries, Delaware adopted 12 Del. C. § 3317 in 2010. The statute states that, except as provided in the governing instrument, each trust fiduciary (including trustees, advisers, protectors, and other fiduciaries) has a duty to keep the other fiduciaries reasonably informed about the administration of the trust with respect to the specific duty or function being performed by that fiduciary. The statute further provides that a fiduciary who requests and receives such information has no duty to monitor the conduct of the other fiduciary, provide advice or consult with the other fiduciary or provide information or communicate or warn any beneficiary or third party concerning instances in which the fiduciary receiving the information would or might have exercised the fiduciary's own discretion in a different manner. 12 Del. C. § 3317.

(g) One aspect of the directed trust structure that is often overlooked is the potential liability of the adviser appointed to direct the trustee with respect to investment decisions, distribution decisions or other decisions of the trustee. Absent express language in the governing instrument such adviser is deemed to serve in a fiduciary capacity and will be held to the prudent person standard. However, Delaware law permits a trust agreement to exculpate and indemnify a fiduciary (including an adviser) for all acts other than those committed with willful misconduct. 12 Del. C. § 3303(a).

D. Directed Trusts – The Language of the Trust Instrument. Once the statutory framework is in place, the focus shifts to the specific language of the trust instrument. A sample trust instrument, including the most common directed trust provisions, is included in the appendix.

1. Trust Adviser Language. The particular adviser language included in the trust instrument depends upon the purpose for which the trust is created and the reason why the adviser is appointed. There are innumerable reasons why trustors create directed trusts and it would be impossible to include in this outline all of the language used over the years creating trusts with trust advisers. Most directed trusts do, however, fall into certain categories and the most common are illustrated below.

(a) Investment Direction Adviser. The most common form of directed trust is one that is directed with respect to investment decisions. Often trustors find it desirable to bifurcate traditional trustee responsibility through the appointment of an Investment Direction Adviser that has the ability to direct the trustee with respect to the investment of the trust assets.

The most common reasons for the use of an Investment Direction Adviser are: (1) the trust will be funded with a concentrated position that a corporate trustee would be uncomfortable holding or (2) the trustor would like to appoint a trustee to administer the trust and be responsible for the distribution of all of the trust assets while allowing the trustor's financial advisor to make all investment decisions for the trust. By designating a trustee in a jurisdiction that allows directed trusts the trustor is able to bifurcate these traditional trustee responsibilities and vest all investment authority in the third party adviser. Sample Investment Direction Adviser language is included in the Appendix.

(b) Special Holdings Direction Adviser. Another common use of the directed trust structure is the bifurcation of investment responsibilities only with respect to a certain class of assets. For example, the trust may be funded with a combination of marketable securities as well as an ownership interest in the trustor's family business. The trustor would like the corporate trustee to manage and invest the marketable assets however neither the trustor nor the corporate trustee want the corporate trustee to participate in any decisions relating to the trustor's family business. It is possible to appoint an adviser (i.e. Special Holdings Direction Adviser) that has the ability to direct the trustee as to the special assets while at the same time allowing the trustee to be responsible for the investment and management of the marketable securities held in the trust.

Another reason to include the position of Special Holdings Direction Adviser applies when the trustor wants to retain

investment control over the trust by serving as the Investment Direction Adviser of the trust. It is possible that if the trust is funded with certain assets (i.e. life insurance policies insuring the trustor's life or voting IRC Section 2036(b) stock) the trustor's retention of investment control over the trust assets could result in the trust assets being includible in the trustor's estate for Federal Estate Tax purposes. In this situation it is desirable to carve out the problematic assets and define them as "Special Holdings." The trustor can retain the ability to direct investments with respect to the non-Special Holdings and a third party adviser can be appointed to direct the trustee as to the investment of the Special Holdings.

(c) Distribution Adviser. Another common use of the directed trust structure is to bifurcate distribution responsibility through the appointment of a Distribution Adviser who has the ability to direct the trustee as to when and how the beneficiaries will receive distributions from the trust based on the standards contained in the trust instrument. Often a trustor will want a corporate trustee to be responsible for the investment and administration of the trust assets but will want someone who is more familiar with the beneficiaries and their particular needs to decide when distribution should be made to the beneficiaries. This may be particularly true where the beneficiaries have special needs or substance abuse issues. It is also a desirable tool in situations where the trustor has specific ideas about how and when distributions will be made to the beneficiaries. The trustor could appoint a family member or trusted adviser, who will have much more intimate knowledge of the family and their circumstances than the corporate trustee, to direct the trustee regarding trust distributions. Sample Distribution Adviser language is included in the Appendix.

(d) Trust Protector. One of the more powerful positions that can be created in the directed trust structure is that of Trust Protector. Often the Trust Protector is vested with key powers that will allow the trust instrument to remain flexible as circumstances change over time. Typical Trust Protector powers include the following.

(i) The ability to amend the trust for administrative and tax purposes;

(ii) The power to change the situs and governing law of the trust;

(iii) The power to appoint, remove and replace the trustee and other trust advisers;

(iv) The ability to convert the trust from a grantor trust into a non-grantor trust for income tax purposes; and

(v) The power to expand the permissible class of beneficiaries of the trust.

One issue that often arises is whether the Trust Protector should serve in a fiduciary or non-fiduciary capacity. Under Delaware law, a Trust Protector is deemed to serve in a fiduciary capacity unless the terms of the governing instrument provide otherwise. 12 Del. C. § 3313(a). It is common practice to have the Trust Protector serve in a fiduciary capacity. However, there are certain powers that may be conferred upon the Trust Protector which could only be exercised in a non-fiduciary capacity (i.e. the ability to convert the trust from a grantor trust into a nongrantor trust for income tax purposes and the power to expand the permissible class of beneficiaries of the trust). Sample Trust Protector language is included in EXHIBIT A.

E. Definition. Purely administrative trustees provide only trust administration services. Example: A wealthy New York resident wishes to create a perpetual trust in Delaware with marketable securities for tax purposes. The trustor already has a sophisticated team of financial planners and investment advisers. The trustor creates a Delaware limited liability company ("LLC") to which he transfers marketable securities. The trustor then creates a Delaware dynasty trust naming a Delaware trustee as a Purely Administrative Trustee. The only asset held by the Delaware trustee is the LLC units. The language of the trust instrument includes a Special Holdings Direction Adviser to direct the trustee with respect to all matters concerning the LLC units held in trust. Because the trust may one day hold investment assets, the trust is a directed trust with an Investment Direction Adviser named to direct the trustee with respect to all matters concerning trust investments. There is a Distribution Adviser to direct

the trustee with regard to trust distributions. A Trust Protector provision is included allowing the Trust Protector to remove and replace the trustee, the Special Holdings Direction Adviser, the Investment Direction Adviser and the Distribution Adviser. The Trust Protector may also change the situs of the trust as well as the law governing its administration and modify the language of the trust instrument to obtain favorable tax treatment or facilitate the efficient administration of the trust.

1. Administrative Trustee Duties. The only duties performed by the Administrative Trustee are to hold the LLC units, maintain trust records, prepare or otherwise arrange for the preparation of fiduciary income tax returns, keep account records, facilitate communications with trust beneficiaries, and maintain an office for its business in the state. The trustee has no liability for actions taken or not taken by the Special Holdings Direction Adviser, the Investment Direction Adviser, the Distribution Adviser and the Trust Protector absent the trustee's willful misconduct.

F. Trustee Fees. Administrative trustees, recognizing the limited role they play, offer low fees for trust services. Typically, administrative trustees will serve for annual fees of anywhere from $3,500 to $10,000 per trust. To illustrate the fee structure, below are actual fee quotes from two Delaware trust companies for providing trust services in different capacities for a trust with assets valued at $7.5 million.

Bank I

1. Where we hold only an LLC interest, our fee is $5,000 per year.

2. Where we hold liquid assets, subject to direction on investments, our fee is $24,000 per year.

3. Where we hold liquid assets, but have full discretion as to investments, our fee is $77,000 per year.

Bank II

1. Bank II is hired as trustee. Under this scenario, there is no direction adviser. Bank II is trustee and manages the investment portfolio at its discretion, subject to the terms of the trust document. The fee schedule is as follows:

Fee Schedule	Rate	Balance	Fee
First $2,000,000 of principal value	0.500%	$2,000,000	$10,000
Next $3,000,000	0.375%	3,000,000	11,250
Next $5,000,000 of principal value	0.350%	2,500,000	6,250
Total		**$7,500,000**	**$27,500**

2. Bank II is hired as trustee. The trust holds LLC units only and Bank II, the administrative trustee, is directed to hold the LLC units in the trust.

   $6,000 for the first $10 MM of assets held in the LLC

   $10,000 for assets valued between $10 MM and $20 MM in the LLC.

G. Fully Directed Trusts. Purely administrative trustees evolved from the carefully crafted language of trust instruments that define the duties and responsibilities of various advisers to the trust. The combination of Direction Advisers and Distributions Advisers coupled with the power of the Trust Protector resulted in the development of a trust concept where the formerly fully responsible corporate trustee now serves only in an administrative capacity while all of the duties and responsibilities traditionally vested in the corporate trustee rest now in the hands of advisers and protectors to the trust. Sample Administrative Trustee language is included in EXHIBIT A.

H. Liability Issues. Can directed trusts protect fiduciaries from liability? Will the statutory framework previously discussed and the language of the trust instrument

really work? Two state court decisions on the matter may be helpful in answering these questions: One is a Delaware decision and the other is a Virginia decision. Both involve Investment Direction Advisers.

1. The Delaware Decision. In *Duemler v Wilmington Trust Co.*, C.A. No. 20033 N.C. (Del. Ch. 2004), the corporate trustee was sued by an individual co-trustee who was the sole Investment Direction Adviser of a trust established by his family. The Investment Direction Adviser chose not to tender a bond owned by the trust when he had the option to do so. The issuer of the bond defaulted and the Investment Direction Adviser sued the corporate trustee alleging the corporate trustee breached its fiduciary duty to the trust by, among other things, failing to provide the Investment Direction Adviser with appropriate financial information to allow the Investment Direction Adviser to make an informed decision. The case was litigated in the Delaware Court of Chancery.

   (a) The Ruling. The Court decision is not reported. The Court was so certain of the proper outcome of the case that it ruled from the bench. A copy of the transcript of the decision may be obtained by email request to pgordon@gfmlaw.com. Relevant quotes are set forth below.

   THE COURT: I'm in a position to rule. I'm not going to require that the parties expend additional resources on this. The matter is abundantly clear to me. (Tr. P. 3, L. 2-5).

   * * *

   ...Mr. Duemler was the investment adviser for a high-risk approach to investing of particular - of assets under a particular trust. Had he wished for Wilmington Trust to be investment advisor to run a high-risk portfolio - I'm sure Wilmington Trust likes to make money. It would be willing to do it. It costs a lot more. (Tr. P. 3, L. 10-16).

   Finding that the trust held "a nondiversified portfolio with extremely risky assets" (Tr. P. 11, L. 22-23), the court stated: I

think in terms of the division of trust responsibilities, it was absolutely clear that this was on Mr. Duemler's side of the ledger. (Tr. P. 12, 9-11).

The Court held that the proximate cause of the loss was "the breach of fiduciary duty by Mr. Duemler" who had the primary responsibility for being the investment adviser. (Tr. P. 13, L. 4-13).

(b) Significance of the Decision. The Court upheld the statutory defense under 12 Del. C. § 3313(b) (Delaware's directed trust statute) and noted that the case was "an apt instance for its application" because there was "absolutely no evidence of willful misconduct" on the part of Wilmington Trust Company. (Tr. P. 15, L. 12-16). Moreover, the court admonished the investment direction adviser for arguing that the trustee was responsible for failure to provide relevant information. The court stated: And you don't get to come in and hang your fellow fiduciary on that unless they engaged in willful misconduct. There is none there. And if I were to rule that, 'oh, no. What the problem is here is the failure to provide information or to make sure that the fiduciary making the decision knew what they were doing,' I think that would gut the statute. (Tr. P. 16, L. 5-12).

The court's clear recognition of the intent and purpose of the directed trust statute and its firm ruling upholding the statute is a clear indication that Delaware courts will enforce directed adviser provisions in a trust instrument based on the statutory framework that permits them.

2. The Virginia Decision. In *Rollins v Branch Banking and Trust Company of Virginia*, 2001 W.L. 34037931 (Va. Cir. Ct.), the plaintiffs were children and grandchildren of the grantors of two trusts created in 1977 for their benefit. The plaintiffs were suing the corporate trustee for breach of fiduciary duty, in particular, the trustee's failure to diversify trust investments. The trusts were funded primarily with shares of stock in two textile corporations. At the inception of the trusts, the trustee "obtained

the written authority of the beneficiaries to over-concentrate the trust" with textile stocks. *Rollins*, at *1. The trust remained over concentrated in the textile stock until 1997 (20 years later) when the stock was sold. The beneficiaries sued the trustee for $25 million, the amount they claim they lost due to the trustee's failure to diversify the trust investments. The trustee, citing the Virginia directed trust statute, filed the equivalent of a motion for summary judgment contending that when, as here, the trust vests the power to make investment decision exclusively in persons other than the trustee, the trustee cannot be liable for the loss resulting from the retention of the investment. *Rollins*, at *2.

(a) The Ruling. The court ruled in favor of the corporate trustee citing the Virginia directed trust statute and quoting the specific language of the trust instrument. The Virginia trust statute (which has since been changed to a version closer to the UTC provision) then provided:

> § 26-5.2. Liability of a fiduciary for actions of cofiduciary. Whenever the instrument under which a fiduciary or fiduciaries are acting reserves unto the trustor, testator, or creator or vests in an advisory or investment committee or any other person or persons, including a cofiduciary, to the exclusion of one or more of the fiduciaries, authority to direct the making or retention of investments, or any investment, the excluded fiduciary or cofiduciary shall be liable, if at all, only as a ministerial agent and shall not be liable as fiduciary or cofiduciary for any loss resulting from the making or retention of any investment pursuant to such authorized direction. Va. Code § 26-5.2.

The court found that: "The trustee's power to diversify, however, was limited by the express language of Article X of the trust instruments" which stated "investment decisions as to the retention, sale, or purchase of any asset of the Trust Fund shall likewise be decided by such living children or beneficiaries, as the case may be". *Rollins*, *2.

(b) Significance of the Decision. Like *Duemler*, the plaintiffs in *Rollins* argued that the trustee had a duty to keep them informed and to impart to them any knowledge affecting their interest in the trust. *Rollins* at *4. However, the court was not persuaded:

> The plain language of the instrument, however, clearly contradicts the beneficiaries' argument. The beneficiaries, alone, had the power to make investment decisions. **The statute enacted by the General Assembly recognizes the basic principal (sic) that the court cannot hold a trustee, or anyone else, liable for decisions that it did not and could not have made**. The statute clearly applies in this instance and the beneficiaries have not stated a cause of action against the trustee for failing to diversify the trust assets. The demurrer is granted as it relates to all claims for failure to diversify. *Rollins*, at *2. [emphasis added]

The court's clear recognition of the intent and purpose of the directed trust statute and its firm ruling upholding the statute is a clear indication that Virginia courts will enforce directed adviser provisions in a trust instrument based on the statutory framework that permits them.

3. Trust Protector - Case Law. Perhaps because the concept of trust protector is so new in the United States or because cases are settled or are otherwise disposed of, there appear to be no reported decisions dealing with the subject of fiduciary liability for an administrative trustee following the direction of a Trust Protector. There have been at least two Trust Protector cases in Delaware in which the author's law firm was involved. One case is a matter of public record. The other was sealed by the court during the proceedings to protect the privacy of the parties.*2.

(a) The Friedman Case. In Friedman v. *U.S. Trust Company of Delaware*, C.A. No. 20205 NC (2003 Del. Ch.), an elderly California resident was the beneficiary of a credit shelter trust established in 1970 by his late wife. He was about to marry for the fifth time. All of the residuary trust assets were held in more than 25 limited liability companies. The resident's son persuaded his

father to move the residuary trust to Delaware "for asset protection purposes" prior to the marriage. U.S. Trust Company of Delaware agreed to serve as administrative trustee. A routine proceeding was conducted in the Court of Chancery to have Delaware accept jurisdiction over the trust, recognize U.S. Trust Company of Delaware as the trustee, declare that Delaware would thereafter govern the administration of the trust and modify the trust to include direction adviser provisions including the appointment of the son as a Trust Protector. The father resigned as trustee of the residuary trust. The father and son had a falling out. The son informed the father that the son, as Trust Protector, was now in charge of all of the business assets held in the 25 limited liability companies. When the father realized he had lost control of the residuary trust assets, he filed suit in Delaware seeking to open the judgment transferring the trust situs and appointing the son as Trust Protector. The reformed trust document defined the role of the Trust Protector as follows:

The Trustee shall not exercise any of its rights, powers or privileges under the Trust, or take any action under the Trust ...except upon written direction of the Trust Protector.

(b) The Ruling. The court was deeply concerned with certain procedural matters. In particular, no notice of the change of situs of the trust had been given to the father's other three children who were remainder beneficiaries of the trust. The court also struggled with the concept of a purely administrative trustee and the role of the Trust Protector as evidenced by the following excerpt from the transcript of a hearing before the court.

The Court: Trust Protector... sounds like a super hero, or something like that. Is that something under California law that's developed as a concept? ...Why do we need a trustee when you have the omnipotent-

Attorney: In this case, that's a good question. Virtually all of the powers are vested in [the son], as Trust Protector.

* * *

The Court then questioned the attorney for the Trust Company to determine how the father lost control of the trust assets in the process.

Trust Co.: We simply did not have any knowledge of those facts that created this. My client was a facilitator. And under these instruments, if they are to govern, we are Administrative Trustee... that's our limited role. We are at the direction of the Trust Protector.

The Court: You are not really - - you are almost a pure Administrative Trustee. Right?

Trust Co.: I would say we are a pure Administrative Trustee.

The Court: Not even a money managing trustee, or anything like that.

Trust Co.: That's correct.

Immediately following the hearing, the court opened and vacated the order appointing the son as Trust Protector and the trust company as Administrative Trustee. The action was stayed pending further proceedings. In the interim, the parties agreed to litigate their dispute in California where the trust had been administered for more than thirty years.

(c) Significance of the Outcome. The court did not assess any liability against the corporate fiduciary and all of the corporate fiduciary's legal fees were paid by the trust.

4. Sealed Case. Little can be said about the second Delaware case involving a Trust Protector. The case is under seal. However, it involved an offshore asset protection trust moved to Delaware pursuant to the

Delaware Qualified Dispositions in Trust Act by a Trust Protector. It was alleged that the beneficiary of the trust suffered from mental illness and the Trust Protector essentially directed the Delaware Administrative Trustee not to make any distribution to or for the benefit of the beneficiary who the Trust Protector viewed as uncooperative. The beneficiary petitioned the Delaware court, which had jurisdiction over the Delaware Administrative Trustee, for the payment of approximately $7,000 in certain past due bills and a stipend of only $4,000 per month from a trust with a corpus that exceeded $1 million.

(a) The Ruling. The corporate fiduciary took the position that it could not make any distributions from the trust except upon direction of the Trust Protector. There was hostility between the Trust Protector and the trust beneficiary. The court urged the parties to resolve their differences by stipulation. At one point the court wrote:

> Dear counsel:
> My in-box gives me an inclination that rationality might not be prevailing in this matter.

At the urging of the court, the parties entered into a stipulated settlement paying the beneficiary's delinquent bills and establishing a $4,000 monthly living allowance. It was stipulated that the Trust Protector would resign (as would the Delaware corporate fiduciary) and the trust would be transferred back to the offshore jurisdiction from which it came

(b) Significance of the Outcome. No liability was assessed against the corporate fiduciary who served as a purely administrative trustee. All of the corporate fiduciary's legal fees were paid by the trust.

V. CONCLUSION

So, why is everyone talking about Delaware trusts. Because Delaware has favorable trust law and you do not have to live in Delaware or work in Delaware to take advantage of the Delaware trust statutes. The directed trust provisions of Delaware trust law permit

anyone to establish a Delaware and continue to maintain existing professional relationships outside the state. Whether Delaware trust law offers advantages to you or your clients is a matter of professional judgment. All you need to know is the advantages of Delaware trust law to determine whether it is appropriate for a trust to have its situs in Delaware with either a full trust administration or under a more economical, purely administrative trustee arrangement. Hopefully this outline will make it easy for you to decide.

EXHIBIT A

Role and Function Provisions of Various Advisory Positions for Delaware Trusts

A. Investment Direction Adviser

Role and Function. The Investment Direction Adviser shall hold and exercise the full power to direct the Trustee as to the investments of the Trust, including, but not limited to, the power to direct the Trustee to purchase, sell and retain all of the Trust assets, and the power to direct the Trustee to exercise voting, subscription, conversion, option and similar rights with respect to such property and to participate in and consent to any voting trust, reorganization, merger, dissolution or other action affecting any such property. The Trustee shall follow the direction of the Investment Direction Adviser with respect to all matters relating to the management and investment of Trust assets. In the event no Investment Direction Adviser is then serving, the Trustee shall hold and exercise the full power to manage and invest the Trust assets.

B. Distribution Adviser

Role and Function. The Distribution Adviser shall hold and exercise the full power to direct the Trustee to distribute income and principal of the Trust pursuant to the standards established under this Agreement. The Trustee shall follow the direction of the Distribution Adviser with respect to all matters concerning the distribution of income or principal of the Trust. In the event no Distribution Adviser is then serving, the Trustee shall hold and exercise the full power to make discretionary distributions of income and principal of the Trust pursuant to the standards established under this Agreement.

C. Trust Protector

Role and Function. The Trust Protector shall have the following roles, powers and duties:

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

(2) To designate the law of any 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, as provided in Article _____ of this Agreement.

(3) To terminate the Grantor's or Trust Protector's power to reacquire Trust property in accordance with Article _____ of this Agreement. The Trust Protector's power to terminate the Grantor's or Trust Protector's power to reacquire Trust property shall be exercisable in a non-fiduciary capacity and without the approval or consent of any person in a fiduciary capacity.

(4) To remove and replace the Trustee as provided in Article _____ of this Agreement.

(5) To remove any Investment Direction Adviser and appoint additional and successor Investment Direction Advisers as provided in Article _____ of this Agreement.

(6) To remove any Distribution Adviser and appoint additional and successor Distribution Advisers as provided in Article _____ of this Agreement.

(7) To appoint additional and successor Trust Protectors as provided in this Article _____.

(8) To delegate any powers conferred upon the Trustee pursuant to this Agreement to an Adviser or such other person or entity as the Trust Protector so determines.

(9) To appoint a Special Fiduciary in accordance with Article _____ of this Agreement; and to remove any Special Fiduciary and appoint successor Special Fiduciaries.

(10) To enter into fee agreements with the Trustee, the Investment Direction Adviser and the Distribution Adviser.

D. <u>Special Holding Direction Adviser</u>

<u>Role and Function</u>. The Special Holdings Direction Adviser shall hold and may exercise the full power to direct the Trustee as to the management and investment of the Special Holdings, including, but not limited to, the power to direct the Trustee to purchase, sell and retain all of the Special Holdings, and the power to direct the Trustee to exercise voting, subscription, conversion, option and similar rights with respect to the Special Holdings and to participate in and consent to any voting trust, reorganization, merger, dissolution or other action affecting any Special Holding. In the event no Special

Holdings Direction Adviser is then serving, the Investment Direction Adviser, if one is serving, otherwise the Trustee shall hold and exercise the full power to manage and invest the Special Holdings.

E. <u>Administrative Trustee</u>

In the event that a corporate Trustee, is serving as Trustee of any trust created by or pursuant to this Agreement, and there is an Investment Direction Adviser, a Distribution Adviser and/or Trust Protector serving pursuant to Articles _____, _____ and _____of this Agreement, any corporate Trustee shall exercise all of its powers hereunder, except to the extent otherwise expressly provided in this Article, solely at the written direction of the acting Investment Direction Adviser, the Distribution Adviser and/or Trust Protector (the "Advisers") in accordance with the provisions of this Agreement.

(1) <u>Administrative Duties of Trustee</u>. Notwithstanding the foregoing provisions of this Article, the Trustee shall have the following exclusive administrative duties, which shall, subject to the provisions of section ___ ___ of Article _____ of this Agreement, all be performed by the Trustee in the Trustee's sole discretion and not at the direction of the Advisers:

(a) To maintain an account or accounts for the purpose of the custody and safekeeping of the Trust assets, receiving trust income and contributions and from which trust expenditures and distributions are disbursed.

(b) To maintain storage of tangible personalty and evidence of intangible Trust property.

(c) To maintain Trust records and to originate, facilitate and review Trust accountings, reports and other communications with the Notice Recipients, the Advisers and unrelated third parties, except that the Trustee shall not be responsible for the accuracy of information provided to the Trustee by any third party pursuant to an agreement into which the Advisers have directed the Trustee to enter.

(d) To maintain an office for Trustee meetings and other Trust business.

(e) To respond to inquiries concerning any trust created hereunder from the Notice Recipients, the Advisers, and unrelated third parties.

(f) To execute documents in connection with the performance of its duties under this Article.

(g) To retain accountants, attorneys, agents and other advisers in connection with the performance of the Trustee's administrative duties.

(h) To prepare and file (or arrange for the preparation and filing of) income tax returns for the Trust.

(i) To allocate receipts, expenses, and distributions to income or principal in the Trustee's discretion.

EXHIBIT B

GF&M GORDON, FOURNARIS & MAMMARELLA, P.A.

THE USE OF ASSET PROTECTION TRUSTS FOR TAX PLANNING PURPOSES

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I. Creating a Delaware Asset Protection Trust.

What follows is a summary of the relevant issues to consider when drafting a Delaware asset protection trust under the Delaware Qualified Dispositions in Trust Act, 12 Del. C. § 3570, et. seq., (the "Act"). Included are the requirements for creating a trust (a Delaware asset protection Trust) under the Act, prohibited powers which the grantor may not retain under the Act, permissible powers which the grantor may retain under the Act and who may defeat a Delaware asset protection trust.

A. Requirements To Create A Delaware Asset Protection Trust.

There are six requirements to create a Delaware asset protection trust under the Act. These requirements are as follows:

1. A disposition by a transferor by means of a trust instrument. 12 Del. C. § 3570(7).

2. The trust instrument must appoint a qualified trustee within the meaning of 12 Del. C. § 3570(8). 12 Del. C. § 3570(11).

3. The qualified trustee must maintain or arrange for custody in Delaware of at least some of the trust assets, maintain records for the trust on an exclusive or non-exclusive basis, prepare or arrange for the preparation of fiduciary income tax returns for the trust or otherwise materially participate in the administration of the trust. 12 Del. C. § 3570(8)b.

4. The trust must provide that Delaware law governs the validity, construction and administration of the trust. 12 Del. C. § 3570(11)a.

5. The trust must be irrevocable. 12 Del. C. § 3570(11)b.

6. The trust must contain a spend-thrift clause which should make reference to the Bankruptcy Code. 12 Del. C. § 3570(11)c.

B. Prohibited Grantor Powers.

There are several powers that are impermissible for the grantor to retain under the Act. These powers include:

1. The grantor may not serve as trustee of the trust. 12 Del. C. § 3570(8)a. & (8)c.

2. The grantor may not serve in an advisory position (including as a trust protector or distribution adviser) provided the grantor may serve as investment adviser for the trust. 12 Del. C. § 3570(8)d. & 12 Del. C. § 3571.

3. The grantor may not retain the power to direct distributions from the trust. 12 Del. C. § 3570(8)d. & 12 Del. C. § 3571.

4. The grantor may not demand a return of assets transferred to the trust. 12 Del. C. § 3571.

C. Permissible Powers Retained by Grantor.

The Act permits the grantor to retain a variety of powers. These powers include:

1. The grantor may serve as investment adviser for the trust and as such retain the right to consent to or direct investment decisions. 12 Del. C. § 3570(8)d.

2. The grantor may retain the power to veto distributions of income or principal from the trust. 12 Del. C. § 3570(11)b.1.

3. The grantor may appoint advisers who have authority to remove and appoint qualified trustees or trust advisers, advisers who have authority to direct, consent to or disapprove distributions from the trust and advisers described in 12 Del. C. § 3313. 12 Del. C. § 3570(8)c.

4. The grantor may retain the power to remove and replace trustees or trust advisers. 12 Del. C. § 3570(11)b.7.

5. The grantor may retain a limited lifetime or testamentary power of appointment. 12 Del. C. § 3570(11)b.2.

6. The grantor may retain the ability to receive income or principal pursuant to broad discretion or a standard as determined by Delaware trustees, non-Delaware trustees and/or advisers. 12 Del. C. § 3570(11)b.6.

7. The grantor may retain the right to receive mandatory income distributions. 12 Del. C. § 3570(11)b.3.

8. The grantor may retain an interest in a CRT or a QPRT. 12 Del. C. § 3570(11)b.4.

9. The grantor may receive up to a 5% interest in GRAT, GRUT or total-return uni-trust. 12 Del. C. § 3570(11)b.5.

10. The grantor may retain the potential or actual use of real property held under a qualified personal residence trust or the possession and enjoyment of a qualified annuity interest within the meaning of Treasury Regulations § 25.2702-5(c)(8). 12 Del. C. § 3570(11)b.8.

11. The grantor may retain the right to receive income or principal from the trust to pay income taxes due on the income of the trust provided that the trust instrument expressly provides for the payment of such taxes and the potential or actual receipt of income or principal would be at the trustee's discretion, or pursuant to a mandatory direction in the trust instrument, or the discretion of an adviser. 12 Del. C. § 3570(11)b.9.

12. The grantor may retain the right to receive income or principal from the trust to pay, after the death of the grantor, all or any part of the debts of the grantor outstanding at the time of the grantor's death, the expenses of administering the grantor's estate, or any estate or inheritance tax imposed on or with respect to the grantor's estate. 12 Del. C. § 3570(11)b.10.

D. Who May Defeat An Asset Protection Trust?

There are four categories of creditors who may defeat a Delaware asset protection trust and as such reach the trust assets to satisfy a judgment. The Act requires that any action involving a Delaware asset protection trust be brought in the Delaware Court of Chancery. 12 Del. C. § 3572(a). The following four categories of creditors may defeat a Delaware asset protection trust:

1. A creditor whose claim arose before the creation of the trust provided the claim is brought within four years after the creation of the trust or, if later, within one year after the creditor discovered (or should have discovered) the trust and the claim is proven, by clear and convincing evidence, that the creation of the trust was a fraudulent transfer. 12 Del. C. § 3572(b)(1).

2. A creditor whose claim arose after the creation of the trust provided the claim is brought within four years after the creation of the trust and the creditor proves, by clear and convincing evidence, that the creation of the trust was a fraudulent transfer. 12 Del. C. § 3572(b)(2).

3. A person whose claim results on account of an agreement or court order for the payment of support or alimony for the grantor's spouse, former spouse or children, or for a division or distribution of property in favor of the grantor's spouse or former spouse. 12 Del. C. § 3573(1). Only a spouse who is married to the grantor before the trust was created may avail himself or herself of such right. 12 Del. C. § 3570(9).

4. A person who suffers death, personal injury or property damage on or before the date the trust was created for which the grantor is liable. 12 Del. C. § 3573(2).

II. Completed Gift Asset Protection Trusts.

On January 1, 2013, President Obama signed the American Taxpayer Relief Act of 2012 (the "2012 Act"). The 2012 Act made permanent the current exemptions for federal estate tax, gift tax and generation-skipping transfer (GST) tax. The exemptions are indexed for inflation, which for 2016 means that the exemptions are $5,450,000 per person. The tax rate on estate, gift and GST transfers above the exemption was increased to forty percent (40%) from the thirty-five percent (35%) rate in effect in 2012.

As a result of the 2012 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. 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 trust in a jurisdiction such as Delaware which allows for self-settled asset protection trusts. A client can make a transfer to a trust established in such a jurisdiction, to which the client allocates gift tax exemption, that provides that the trustee may distribute income and principal from the trust to a class of beneficiaries, that includes the client, in the sole and absolute discretion of the trustee. The client can also allocate GST exemption to the trust which would allow the trust to continue in perpetuity if established in a jurisdiction such as Delaware which has abolished the rule against perpetuities. See 25 Del. C. § 503. 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 trust constitutes a completed gift for federal gift tax purposes.

1. **Is the Transfer to the 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) Revenue Ruling 76-103.

(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 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) Revenue Ruling 77-378.

(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. **Sections 2036(a)(2) and Section 2038.**

Another concern relates to whether the 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 trust by relegating the grantor's creditors to the entire property of the 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) 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 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. **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 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.

(c) 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.

(d) 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 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.

(e) 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 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. For the reasons discussed in Section II Paragraph A of this outline, Sections 2036(a)(2) and 2038 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.

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 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.

(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 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 2038power.

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.

4. It should also be possible to leverage the gift made to the trust by having the trustee purchase a life insurance policy on the life of the grantor with the proceeds gifted to the trust. This will essentially allow the grantor to still benefit from the cash value contained in the policy (at the discretion of the trustee) and have the death benefit excluded from the grantor's estate upon his or her death.

III. Incomplete Gift Non-Grantor Trusts.

It is possible for a grantor to establish a trust in a jurisdiction that allows for the creation of self-settled asset protection trusts, retain a beneficial interest in the trust and have the trust treated as a non-grantor trust for income tax purposes. Typically the grantor will also want the trust to be an incomplete gift for transfer tax purposes. In Delaware we refer to these trusts as DING trusts. The acronym stands for Delaware Incomplete Gift Non-Grantor trust.

A. Tax Structure of Trust.

1. Section 677(a)(3) of the IRC provides that the grantor shall be treated as the owner of a trust for income tax purposes if trust income, without the approval or consent of any adverse party, may be distributed to the grantor or the grantor's spouse. IRC §

677(a)(3). Therefore, in order for the trust to be a non-grantor trust for income tax purposes, the consent of an adverse party must be obtained prior to distributing assets to the grantor or the grantor's spouse.

2. The trust also must be created in a jurisdiction which allows for self-settled asset protection trusts because if creditors of the grantor can reach the trust assets the trust will be a grantor trust. Treas. Reg. § 1.677(a)-1(d).

3. The trust is structured as an incomplete gift for federal gift tax purposes through the grantor's retention of a lifetime limited power of appointment pursuant to which the grantor can appoint trust corpus to or for beneficiaries of the trust provided that the power is limited by a reasonably definitive standard (i.e. health, education, maintenance and support), a testamentary limited power of appointment over the trust and through the grantor's retention of a veto power whereby a distribution directed by any one member of the distribution committee (as explained in more detail below) must be approved by the grantor. Treas. Reg. § 25.2511-2(b).

B. The Private Letter Rulings.

1. Several Private Letter Rulings (the "PLRs") confirm that under Delaware law a grantor can create a non-grantor trust, fund the trust with contributions that are not considered taxable gifts for federal gift tax purposes and still retain the right to receive discretionary distributions of trust income and principal from the trust. See PLR 200715005; PLR 200647001; PLR 200637025; PLR 200612002; and PLR 200502014.

2. In the PLRs, the grantor created a discretionary trust for the benefit of the grantor and others (the "permissible beneficiaries"). A Delaware corporate trustee is appointed as sole trustee of the trust.

3. A committee (the "Distribution Committee") consisting of two to four of the permissible beneficiaries of the trust, has the power, by unanimous consent, to direct the trustee to distribute trust assets to or among the permissible beneficiaries. In addition, any one member of the Distribution Committee, with the consent of the grantor, may direct the trustee to make distributions. If a member of the Distribution Committee resigns or otherwise ceases to serve, a permissible beneficiary other than the grantor or the grantor's spouse is appointed as a successor Distribution Committee member.

4. The grantor retains a limited testamentary power of appointment over the trust assets to appoint the remaining trust assets to any person or organization other than the grantor, the grantor's estate, the grantor's creditors or the creditors of the grantor's estate.

5. The PLRs conclude that the grantor has not made a completed gift upon establishment of the trust due to the retention of the grantor's limited testamentary power of appointment over the trust assets. However, the grantor will be treated as making a taxable gift when a trust distribution is made to someone other than the grantor.

6. The PLRs also conclude that the Distribution Committee members have a substantial adverse interest to each other for purposes of Section 2514 of the IRC and therefore do not possess general powers of appointment over the trust. See IRC § 2514(c)(3)(B).

C. IR-2007-127 (the "2007 Notice").

1. In 2007 the IRS issued a notice calling into question the gift tax consequences to the members of the Distribution Committee. See IR-2007-127.

2. The 2007 Notice stated that the conclusions reached in the PLRs with respect to the gift tax consequences of the Distribution Committee members may not be consistent with Revenue Ruling 76-503 and Revenue Ruling 77-158 (the "Revenue Rulings"). See Rev. Rul. 76-503 and Rev. Rul. 77-158.

D. The Revenue Rulings.

1. The Revenue Rulings have facts that are identical. In the Revenue Rulings, three siblings, A, B and C owning equal one-third interests in their family business contribute their respective interests in the business to an irrevocable trust for the benefit of their descendants. The trust permits the trustees to distribute trust property to whomever they select, including themselves, in such proportions and at such times as they see fit. Each trustee has the ability to designate one of the trustee's relatives to serve as successor trustee upon the trustee's death or resignation. In the event a trustee fails to designate a successor, the oldest adult living descendant of a deceased or resigned trustee is to occupy the vacant trustee position.

2. The decedent, D, was selected by A to be one of three original trustees and D served in that position until D's death.

3. The Revenue Rulings address whether any of the trust assets are includible in D's gross estate under Section 2041 of the IRC under the view that D had a general power of appointment over the trust assets held jointly with the other two co-trustees. The Revenue Rulings conclude that one-third (1/3) of the value of the trust as of the date of D's death is includible in D's gross estate under Section 2041 of the IRC as property subject to a general power of appointment. In reaching the conclusion the

Revenue Rulings focused on the language of Section 2041 of the IRC. Section 2041(b) of the IRC sets forth the definition for a general power of appointment. Section 2041(b)(1)(C)(ii) of the IRC provides that a power that is not exercisable by the decedent except in conjunction with a person having a substantial adverse interest in the property subject to the power is not a general power of appointment. IRC § 2041(b)(1)(C)(2).

4. The Revenue Rulings determined that the Section 2041(b)(1)(C)(ii) safe harbor did not apply to D because the remaining co-trustees did not have a substantial adverse interest to D. The terms of the trust provide that upon D's death a successor trustee is to be appointed in D's place. The remaining co-trustees do not receive the entire power of appointment upon D's death. Instead, the surviving co-trustees must continue to share the power with D's replacement. The Revenue Rulings determined that this does not put the surviving co-trustees in a better economic position after D's death and as such their interest is not substantially adverse to D.

5. In reaching this conclusion, the Revenue Rulings also focus on the regulations under Section 2041 of the IRC. See Treas. Reg. § 20.041-3(c)(2) and (3). The Revenue Rulings state that had the trust been drafted so that upon D's death the power of appointment would vest solely in the remaining co-trustees, the co-trustees' interests would be substantially adverse to that of D and D would not have a general power of appointment resulting in the inclusion of one-third (1/3) of the trust assets in D's estate under Section 2041 of the IRC.

E. Comparing the PLRs to the Revenue Rulings.

1. The PLRs are similar to the Revenue Rulings in that upon the resignation of any Distribution Committee member, a permissible beneficiary is to be appointed as a successor Distribution Committee member in place of the resigning Distribution Committee member. Therefore, the distribution power does not vest in the remaining Distribution Committee members but instead must be shared with a successor Distribution Committee member. This does not put the remaining Distribution Committee members in a better economic position after the resignation of a Distribution Committee member.

2. However, there is an important fact which distinguishes the PLRs from the Revenue Rulings. The PLRs conclude that the transfer to the trust by the grantor is an incomplete gift and that a distribution from the trust to any person other than the grantor would be a completed gift. In the Revenue Rulings, A, B and C irrevocably transferred their interests in the family business to the trust upon its creation at which time they made a taxable gift to the trust. Distributions from the trust to the beneficiaries would not be considered taxable gifts by A, B or C.

3. If the rationale of the Revenue Rulings were applied to the PLRs, distributions from the trust would constitute completed gifts by the Distribution Committee members. This would produce unprecedented gift tax results. For instance, a distribution from the trust to the grantor would constitute a taxable gift to the grantor of property which the grantor is already treated for federal transfer tax purposes as owning. Furthermore, a distribution to any other person besides the grantor would constitute a taxable gift of the same property to the same person at the same time by both the grantor and the Distribution Committee members.

F. Recent Rulings Affecting Use of DING Trusts

1. **CCA 201208026 (the "CCA").**

   (a) In 2012 the IRS issued an opinion relating to the gift tax ramifications associated with a transfer of property into a trust where the grantor retains a testamentary limited power of appointment.

   (b) In the trust at issue in the CCA, parents transferred property in trust with Child A as trustee. The trust beneficiaries were Child A, Child B, spouses and other lineal descendants. The parents reserved a testamentary limited power of appointment. The trust provided that if the limited power of appointment was not exercised, the trust would terminate at the death of the survivor of the parents and the remaining trust assets would be distributed to Child A and Child B. The trust provided that the trustee had the discretion to distribute trust assets to the beneficiaries for broad purposes.

   (c) The IRS determined that the gift into the trust should be severed into two components, the term interest and the remainder interest. The IRS further determined that the term interest was not subject to change by the exercise of the parents' retained testamentary power of appointment and therefore the gift of the term interest constituted a completed gift.

   (d) The IRS did rule that the gift of the remainder interest was an incomplete gift due to the retention of the testamentary limited power of appointment, but that the gift was valued at zero (0) under Chapter 14 of the IRC meaning that the value of the gift was the full fair market value of the property transferred into the trust.

2. **PLR 201310002 (the "2013 PLR").**

   (a) In the 2013 PLR the grantor created a trust for the benefit of himself and his issue. During the grantor's lifetime, the trustee is required to distribute such

amounts of the net income and principal to the grantor and his issue as directed by the Distribution Committee and/or the grantor, as follows:

(i) At any time, the trustee, pursuant to a direction of a majority of the Distribution Committee members, with the written consent of the grantor, is required to distribute to the beneficiaries such amount of the net income or principal as directed by the Distribution Committee ("Grantor's Consent Power");

(ii) At any time, the trustee, pursuant to the direction of all of the Distribution Committee members, is required to distribute to the beneficiaries such amount of the net income or principal of the trust as directed by the Distribution Committee; and

(iii) At any time, the grantor, in a non-fiduciary capacity, may, but shall not be required to, distribute to any one or more of the grantor's issue, such amounts of the principal (including the whole thereof) as the grantor deems advisable to provide for the health, maintenance, support and education of the Grantor's issue ("Grantor's Sole Power").

(b) Upon the grantor's death, the remaining trust assets are to be distributed to or for the benefit of any person or persons or entity or entities, other than the grantor's estate, his creditors, or the creditors of his estate, as the grantor may appoint by his Last Will and Testament. In default of the grantor's exercise of his limited power of appointment ("Grantor's Testamentary Power"), the balance of the trust will be distributed, per stirpes, to the grantor's then living issue in further trust.

(c) The 2013 PLR concluded as follows:

(i) The grantor's retention of the Grantor's Consent Power caused the transfer of property into the trust to be wholly incomplete for federal gift tax purposes;

(ii) The grantor's retention of the Grantor's Sole Power also caused the transfer of the property into the trust to be wholly incomplete for federal gift tax purposes; and

(iii) The grantor's retention of the Grantor's Testamentary Power caused the transfer of property into the trust to be incomplete with respect to the remainder interest in the trust for federal gift tax purposes.

3. **PLR 201550005 (the "2015 PLR").**

(a) The 2015 PLR has similar facts to the 2013 PLR with a few important distinctions:

(i) In the 2015 PLR, the grantors (husband and wife) as co-grantors created a trust for the benefit of themselves, their issue, the spouses of their issue and a separate California irrevocable trust (the "Investment Trust") created for the benefit of their issue;

(ii) The grantors resided in a community property state (California) and all property contributed to the trust was community property;

(iii) The trust created a Power of Appointment Committee (the "Committee") initially consisting of the grantors' four minor children, the Investment Trust and the grantors;

(iv) The voting power of the minor children on the Committee is exercised during their minority by a "Guardian" appointed by the grantors, acting together, or by the survivor of them;

(v) As long as the Committee consists of two or more members, other than the grantors, the Committee by unanimous consent, including the grantors, can add a trust beneficiary who is not on the Committee to the Committee;

(vi) The Committee ceases to exist upon the death of the surviving grantor, the membership of the Committee falling to one member other than the grantors or the resignation of all of the Committee members whereupon the trustee has the power to make distributions to the grantors and the beneficiaries in its discretion;

(vii) At any time, the Trustee, pursuant to the direction of a majority of the Committee members, other than the grantors, with the written consent of either grantor, is required to distribute to the beneficiaries such amounts of the net income or principal as directed by the Committee ("Grantor's Consent Power");

(viii) At any time, the Trustee, pursuant to the direction of all of the Committee members, other than the grantors, is required to distribute to the beneficiaries, such amount of the net income or principal of the trust as directed by the Committee ("Unanimous Member Power");

(ix) At any time, either grantor, in a non-fiduciary capacity, may, but shall not be required to, distribute to any one or more of the grantors' issue, such

amounts of the principal (including the whole thereof) as the grantor deems advisable to provide for the health, maintenance, support and education of the grantors' issue ("Grantor's Sole Power"); and

(x) Upon the death of each grantor, such grantor's half of the community property is to be distributed to or for the benefit of any person or persons or entity or entities other than the grantor's estate, the grantor's creditors or the creditors of the grantor's estate as the grantor may appoint by his or her last will and testament and in the event the grantor fails to exercise the testamentary limited power of appointment such grantor's share is distributed 10% to the Investment Trust and the balance to the issue of the grantors, per stirpes.

(b) The 2015 PLR reached the same conclusions as the 2013 PLR relating to the gift tax consequences to the grantors in contributing property to the trust. As such, the 2015 PLR concluded that the grantors' retention of the Grantor's Consent Power and the Grantor's Sole Power caused the transfer of property into the trust to be wholly incomplete for federal gift tax purposes. The 2015 PLR also concluded that upon the deaths of the grantors their respective interests in the trust would be includable in their gross estates for federal estate tax purposes.

(c) The 2015 PLR also analyzed whether the distribution of trust property by the Committee to any beneficiary of the trust, other than the grantors, would be treated as a completed gift subject to federal gift tax, by any member of the Committee and whether upon the death of any Committee member any portion of the trust property would be included in his or her estate because such Committee member is deemed to have a general power of appointment within the meaning of Section 2041 of the IRC. The 2015 PLR reached the following conclusions on these issue:

(i) The powers held by the Committee under the Grantor's Consent Power are powers that are exercisable only in conjunction with the creators of the trust (i.e. the grantors) and accordingly under Sections 2514(b) and 2041(a)(2), the Committee members do not possess general powers of appointment by virtue of holding the power. The powers held by the Committee members under the Unanimous Member Power are not general powers of appointment for purposes of Sections 2514(b) and 2041(a)(2) based on the examples in Sections 25.2514-3(b)(2) and 20.2041-3(c)(2) of the Treasury Regulations as the Committee members have substantial adverse interests in the property subject to the power. As such, any distribution made from the trust to a beneficiary, other than the grantors, pursuant to the exercise of the powers held by the Committee members are

not gifts by the Committee members and instead are gifts by the grantors; and

(ii) The powers held by the Committee members are not general powers of appointment for purposes of Section 2041(a)(2) and accordingly the possession of these powers by the Committee members will not cause the trust property to be includable in any Committee member's gross estate under Section 2041(a)(2) of the IRC.

(d) Finally, the 2015 PLR reached an important conclusion relating to the income tax basis of the community property held in the trust. The 2015 PLR concluded that the basis of all community property (i.e., 100% of the property) in the trust on the date of death of the first grantor to die will receive an adjustment in basis to the fair market value of such property at the death of the first grantor assuming that the Committee is in existence at the time of the death of the first grantor, such that the trust is not treated as a grantor trust as to either grantor.

4. **Analysis.**

(a) The CCA called into question whether the mere retention of the testamentary limited power of appointment by a grantor will be sufficient to cause a transfer of property into a trust to be incomplete for federal gift tax purposes.

(b) The 2013 PLR and 2015 PLR offer additional guidance on what is required to cause a grantor's transfer of assets into a trust to be incomplete for federal gift tax purposes. It seems clear from the 2013 and 2015 PLRs that the retention of a testamentary limited power of appointment will only cause the transfer of property into a trust to be incomplete with respect to the remainder interest in the trust for federal gift tax purposes. As a result, a grantor is required to retain additional powers over a trust to cause the transfer of property into the trust to be wholly incomplete for federal gift tax purposes.

(c) The 2013 and 2015 PLRs provide that the retention of the Grantor's Consent Power and the Grantor's Sole Power are each sufficient, in and of themselves, to cause the transfer of property into a trust to be wholly incomplete for federal gift tax purposes.

(d) Some commentators have suggested that the retention of the Grantor's Sole Power is required in order to cause the transfer of trust property into the trust to be wholly incomplete for federal gift tax purposes. This would mean that the DING structure would no longer work in any self-settled asset protection trust jurisdiction which prohibits a grantor from retaining a lifetime limited power of appointment. At the time the 2013 PLR was issued Delaware's

self-settled asset protection trust statute did not permit a grantor to retain a lifetime limited power of appointment. However, the statute was modified in February of 2014 to permit a grantor to retain a lifetime limited power of appointment. 12 Del. C. § 3570(11)b.2.

(e) As previously explained, the 2013 and 2015 PLRs clearly state that the grantor's retention of the Grantor's Consent Power is sufficient to cause the transfer of property into a trust to be wholly incomplete for federal gift tax purposes and as such the DING structure should work in any self-settled asset protection trust jurisdiction which permits a grantor to retain the right to consent to trust distributions. Notwithstanding, it is advisable for a client to establish the trust in a jurisdiction such as Delaware or Nevada, which permit the retention of a lifetime limited power of appointment, so as to cause the trust to squarely fall within the structure described in the 2013 and 2015 PLRs.

(f) The 2015 PLR provides additional guidance on the gift and estate tax consequences to the members of the Distribution Committee.

(g) The 2007 Notice called into question whether the members of the Distribution Committee were truly adverse to one another in which case the Distribution Committee members would possess general powers of appointment within the meaning of Sections 2514 and 2041 of the IRC. This would result in distributions from the trust to any of the beneficiaries, other than the grantor, being treated as taxable gifts by the members of the Distribution Committee and the trust assets being includable in the estates of the Distribution Committee members upon their deaths.

(h) The 2015 PLR confirms that the members of the Distribution Committee do not possess general powers of appointment for either gift or estate tax purposes notwithstanding the fact that in the event only two Distribution Committee members (other than the Grantor) are serving, the Distribution Committee members, by unanimous vote, could appoint other beneficiaries of the trust to the Distribution Committee.

(i) The 2015 PLR also clarifies that it is permissible to have minors serve on the Distribution Committee provided that their interest as Distribution Committee members is voted by a Guardian during their minority. It is important to note that the grantor or the grantor's spouse may not serve as the Guardian for the minor beneficiaries for purposes of voting their interest as the Distribution Committee members.

(j) Finally, the 2015 PLR provides guidance on the income tax consequences associated with a contribution of community property to a trust by husband and wife. The 2015 PLR clearly provides that upon the death of the first grantor to die all of the community property held in the trust will receive a full step up in basis.

G. Conclusion.

1. Incomplete gift non-grantor trusts present a unique opportunity for individuals residing in states such as California, New Jersey, Kentucky, Massachusetts, Michigan and Missouri to minimize or avoid state income tax.

2. The 2013 and 2015 PLRs further substantiate the use of DING trusts.

3. The 2013 and 2015 PLRs clearly state that the grantor's retention of the Grantor's Consent Power causes the transfer of property into the trust to be wholly incomplete for federal gift tax purposes, meaning a grantor should not be required to retain a lifetime limited power of appointment in order to cause the transfer of property into the trust to be wholly incomplete for federal gift tax purposes. However, it is advisable for clients to establish DING trusts in jurisdictions such as Delaware or Nevada which allow for the retention of a lifetime limited power of appointment so as to model the structure contained in the 2013 and 2015 PLRs.

4. The 2015 PLR also confirms that the members of the Distribution Committee are truly adverse to one another and as such do not possess general powers of appointment within the meaning of Sections 2514 or 2041 of the IRC and therefore distributions from the trust to beneficiaries other than the grantor will not result in the members of the Distribution Committee making taxable gifts and the assets of the trust will not be includable in the estates of the Distribution Committee members upon their deaths.

EXHIBIT C

HOW TO MODIFY AN IRREVOCABLE TRUST UNDER DELAWARE LAW

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I. Overview.

A typical estate plan often includes the use of one or more irrevocable trusts. However, as a result of the passage of time and change in circumstances, trustees and beneficiaries are often frustrated by the constraints imposed by the trust instrument. Trust law has greatly changed over time and the terms of an existing irrevocable trust agreement may lack the flexibility necessary to adjust to unforeseeable changes in law or other circumstances. Furthermore, the terms of the trust agreement may no longer satisfy the grantor's intent.

There are several tools that are available to practitioners to amend and irrevocable trust agreement to better fulfill the objectives of the grantor and the beneficiaries. The purpose of this outline is to highlight some of the key methods available for modifying the terms of an irrevocable trust under Delaware law.

II. Decanting.

The word decant means to pour a liquid from one vessel to another. In the trust context, the liquid is the trust assets and the vessels are the trust instruments.

Under the common law of certain jurisdictions, a trustee who has the ability to distribute principal outright from a trust to or for a beneficiary may instead exercise such authority by distributing the assets in further trust for the beneficiary. Phipps v. Palm Beach Trust Company, 142 Fla. 782 (1940); *Wiedenmayer v. Johnson*, 254 A.2d 534 (N.J. Super. Ct. App. Div. 1969), *In re: Estate of Spencer*, 232 N.W.2d 491 (Iowa 1975). Several states have codified the common law concept of decanting.

In 1992, New York became the first state to enact a decanting statute specifically authorizing a trustee in certain situations to pour the principal of one irrevocable trust into another trust. NY Estates, Powers & Trust Law § 10-6.6(b). Since then, at least twenty other states have also enacted decanting statutes. These states include Alaska, Arizona, Delaware, Florida, Illinois, Indiana, Kentucky, Michigan, Missouri, Nevada, New Hampshire, North Carolina, Ohio, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Wyoming and Virginia.

The various state statutes that permit a trustee to exercise a decanting power vary in their details but all operate off of the same fundamental premise. If a trustee has the ability to invade principal for a beneficiary under the terms of a trust agreement, the trustee may, in the exercise of its principal invasion power, appoint the principal to a new trust for the benefit of some or all of the beneficiaries of the first trust. Although the concept behind the decanting statute is fairly simple, its implications are immense.

Decanting statutes can be used to update the terms of a governing instrument by pouring over all of the assets from a trust governed by an outdated instrument to a new trust that contains modern administrative provisions that will afford more flexibility to the trustee and beneficiaries. The decanting statute can also be used in certain situations to alter the beneficial interests in a trust.

A. Requirements for Use of Decanting Statute.

The various statutes all have different requirements that must be satisfied in order for a trustee to be able to avail itself of the benefit of the state's statute. However, there are common themes which run throughout the majority of the state's statute.

1. **Principal Invasion Right.**

As a starting point, the trustee of the first trust must have the ability to invade principal for the benefit of one or more of the beneficiaries of the trust. The various states differ in their requirements with respect to the principal invasion right. For instance, Delaware, Alaska, New York and Tennessee permit a trustee that has the authority to invade principal to decant the assets into a new trust even if the principal invasion power is limited by a standard. Florida and Indiana on the other hand require the trustee to have an absolute power to invade principal which is not limited pursuant to an ascertainable standard.

South Dakota appears to have the only decanting statute which does not require that a trustee have some principal invasion right in order to utilize the statute. Under South Dakota law, a trustee can decant income from one trust to another. S.D. CODIFIED LAWS § 55-2-15. The South Dakota statute therefore expressly authorizes distribution of income from one trust to another trust.

Delaware's decanting statute provides that the trustee's exercise of the decanting power must comply with any standard imposed by the first trust. 12 Del. C. § 3528(a)(5). For example, if the first trust provides that the trustee may only distribute trust principal to the beneficiaries for their health, education, maintenance and support, the second trust must limit distributions to the beneficiaries only for their health, education, maintenance and support. Delaware's statute would allow the second trust to further restrict the purposes for which distributions could be made, but the distribution standard may not be broadened. For example, the second trust could provide that distributions shall only be made to the beneficiaries for their education, but it could not allow distributions to be made for any purpose not related to the standard contained in the first trust.

2. **Permissible Beneficiaries.**

The state decanting statutes impose limitations on a trustee's ability to exercise the decanting power. All of the statutes require that the trustee's exercise of the decanting power be in favor of one or more of the beneficiaries of the first trust. As such, the decanting statute cannot be used to add beneficiaries to the second trust that are not beneficiaries of the existing trust.

In certain states the decanting statute may be used to eliminate beneficiaries of the existing trust. For instance, assume trust one provides that the trustee can distribute trust principal to A, B and C in its sole and absolute discretion. The trustee may be able to utilize its decanting power to distribute the trust assets to trust two which only benefits B and C. This provision may be beneficial if a trustee desires to divide a pot trust into separate trusts for the beneficiaries of the first trust.

Some state decanting statutes permit the new trust to grant beneficiaries of the existing trust powers of appointment not otherwise set forth in the original trust. For instance, both Delaware and Nevada permit the new trust instrument to grant a beneficiary of the existing trust a general or limited power of appointment, thereby allowing the decanting to indirectly add beneficiaries to the first trust by granting beneficiaries of the second trust powers of appointment not otherwise contained in the first trust. This seems consistent with the basic concept behind decanting which is that if the trustee could distribute trust assets outright to the beneficiary, the trustee should be able to exercise such principal invasion power by distributing the assets in further trust which such further trust grants the beneficiary a power of disposition over the trust assets.

3. **Elimination of Beneficiaries' Rights in Trust.**

Some state decanting statutes prohibit the decanting from eliminating certain rights a beneficiary may have over the trust. For instance, New York, Alaska and Tennessee prohibit the decanting power from reducing any fixed income interest a beneficiary may have in the trust. Under Delaware law, the decanting power may not be used to eliminate a fixed income right with respect to a trust that qualifies for the marital deduction. 12 Del. C. § 3528(a)(5).

Delaware's decanting statute can be used to eliminate a fixed income right with respect to a trust that does not qualify for the marital deduction. For instance, assume the terms of trust one provide that all of the income is to be distributed to A during her lifetime and also gives the trustee the ability to distribute principal to A for her health, education, maintenance and support. Under Delaware's decanting statute, the trustee could decant all of the assets of trust one to trust two which eliminate A's mandatory income interest in the trust and instead allows the trustee to distribute income and principal to A in its sole and absolute discretion for her health, education, maintenance and support.

Another issue that often arises in a decanting is whether the decanting can eliminate a beneficiary's right of withdrawal over the trust property. Some states, such as North Carolina, provide that if a beneficiary has a power of withdrawal over trust property in trust one, the terms of trust two must provide the beneficiary with an identical right of withdrawal or sufficient property must remain in trust one to satisfy the outstanding power of withdrawal. N.C. Gen. Stat. § 36C-8-816.1.

Other states, such as Delaware, permit a decanting to eliminate a beneficiary's right of withdrawal over trust property as long as the right of withdrawal is not presently exercisable. 12 Del. C. § 3528(a)(4). For example, assume the terms of the first trust provide that the trustee may distribute income and principal of the trust to or for the benefit of A in its sole and absolute discretion and that upon attaining the age of thirty-five (35), A shall have the ability to withdraw all of the trust assets. As long as A has not attained the age of thirty-five (35) prior to the decanting, the decanting statute of certain states would permit trust two to eliminate A's right to withdraw the assets upon attaining the age of thirty-five (35).

4. **Notification to Beneficiaries.**

Most of the decanting statutes provide that the authority to decant is in the sole and absolute discretion of the trustee and that it is not necessary to obtain beneficiary consent in order for a trustee to exercise its decanting power. Some states such as Arizona, Nevada, New York and North Carolina permit a trustee to seek judicial approval for a decanting.

5. **Governing Law Considerations.**

Another issue that often arises in a decanting relates to whether the law of the particular jurisdiction must govern the first trust in order for the trustee to avail itself of the benefits of that particular jurisdiction's decanting statute. For instance, assume that trust one provides that Kansas law governs the validity, construction and administration of the trust and there is no mechanism contained in the trust instrument to transfer the situs of the trust or otherwise change the administrative laws governing the administration of the trust. Is it possible for a trustee to be appointed in another jurisdiction that has a decanting statute, such as New York, transfer all of the assets to the New York trustee and then have the New York trustee decant the trust assets under New York's decanting statute notwithstanding the fact that Kansas law continues to govern the validity, construction and administration of trust one?

Several state decanting statutes provide that the use of the statute to decant shall be considered the exercise of a limited power of appointment. For instance, Delaware's statute

specifically states that the trustee's decanting power shall be considered the exercise of a limited power of appointment. 12 Del. C. § 3528(c).

Many states make it clear that the validity of the exercise of a limited power of appointment is governed by the law where the trust is sitused at the time the power is exercised. Therefore, if a trust is originally created outside of a state that has enacted decanting legislation, the trustee should be able to decant pursuant to the state's decanting statute once the trust is sitused in that particular state notwithstanding the fact that another jurisdiction's laws govern the validity, construction and the administration of the trust. Delaware codified this concept in its decanting statute which provides that Delaware's decanting statute is available to any trust that is administered in the State of Delaware, notwithstanding that another jurisdiction's laws may govern the trust. 12 Del. C. § 3528(f).

B. Implication of the *Peierls* decisions on Decanting.

The Delaware Supreme Court recently issued three separate related *en banc* opinions for the *Peierls* matters. *In the Matter of the Peierls Family Inter Vivos Trusts*, 2013 WL 5539329 (Del. Oct. 4, 2013); *In the Matter of the Peierls Family Testamentary Trusts*, 2013 WL 5526239 (Del. Oct. 4, 2013); and *In the Matter of the Ethel F. Peierls Charitable Lead Unitrust*, 2013 WL 5526243 (Del. Oct. 4, 2013). The opinions were authored by Chief Justice Steele, resulting from the appeal of three opinions of the Delaware Court of Chancery. The Delaware Supreme Court opinions in *Peierls* provide significant insight into various legal issues, including how to determine the administrative law, situs and jurisdiction of trusts.

The most critical holding in the *Peierls* opinions relates to the effect of changing the place of administration of the trust on the law that governs the administration of the trust. The Supreme Court concluded, contrary to the Chancery Court's analysis, that even if the trust contains a choice of law provision, and even if that choice of law provision references "administration", under the principles set forth in the Restatement (Second) of Conflicts of Laws the law governing the administration of the trust will change when the place of administration of the trust changes via a proper appointment of a successor trustee, unless the settlor has specifically stated his or her intent that a state's laws shall always govern the administration of the trust. This holding opens the door for the use of nonjudicial methods to modify trusts, such as decanting, when a trust is moved to a jurisdiction that permits the use of such a statute through the appointment of a successor trustee located in that jurisdiction.

C. Common Modifications Achieved by Decanting.

1. Change in Governing Law.

It is possible to utilize a state decanting statute to change the governing law for the original trust. For example, a trustee could utilize a decanting statute to distribute all of the assets of a trust governed in accordance with Delaware law into a new trust governed by Nevada law. As explained in more detail below, care must be taken to ensure that such a decanting does not have any negative implications on the generation-skipping transfer tax status of a GST exempt trust.

2. Bifurcation of Trustee Responsibilities.

Many states permit bifurcation of traditional trustee responsibilities through the appointment of trust advisers that have the ability to direct the trustee as to investment decisions, distribution decisions or other decisions typically held by the trustee. It is possible to utilize state decanting statutes to distribute all of the assets from a fully managed trust into a directed trust. The directed trust could create the position of investment adviser to direct the trustee with respect to investment decisions and distribution adviser to direct the trustee with respect to distribution decisions, while allowing the trustee to continue to be responsible for all administrative powers.

3. Modification to Beneficial Terms.

In certain situations it is desirable to utilize a state decanting statute to modify the beneficial provisions of a trust. As previously explained, many state decanting statutes permit a trustee to utilize the decanting power so as to reduce or eliminate certain rights and interests the beneficiaries have in the existing trust. For example, it may be possible to utilize a state decanting statute to eliminate a beneficiary's fixed income right or a beneficiary's right of withdrawal. As explained in more detail below, care must be taken in such a situation to ensure that no negative tax consequences result as a result of the reduction or elimination of the beneficiaries' rights or interests in the trust.

4. Addition of Quiet Trust Language.

Certain jurisdictions permit a trust instrument to eliminate a trustee's duty to inform beneficiaries of the existence of the trust for a period of time. For example, under the laws of certain jurisdictions a trust instrument could prohibit a trustee or other fiduciary from informing any beneficiary under the age of thirty-five (35) of the existence of the trust. This is often referred to as a "quiet trust."

It is possible to utilize certain state decanting statutes to convert a trust into a quiet trust. The new trust into which the assets of the existing trust are decanted would prohibit the trustees and other fiduciaries from disclosing the existence of the trust to the beneficiary for a period of time.

5. **Conversion of Trust for Income Tax Purposes.**

It may be possible to utilize a state decanting statute to convert a grantor trust into a non-grantor trust for income tax purposes or vice versa. This is often desirable for state income tax savings purposes. Certain jurisdictions do not tax income and capital gains accumulated in trust for ultimate distribution to beneficiaries that reside outside of such jurisdiction. By converting a grantor trust into a non-grantor trust it may be possible to reduce or eliminate any state income tax on the income and capital gain accumulated in trust for ultimate distribution to the beneficiaries.

6. **Division of Pot Trust into Separate Trusts.**

Often clients will create a single trust for the benefit of multiple beneficiaries (i.e. children) and grant the trustee discretion to distribute trust income and principal among such class of beneficiaries in the sole and absolute discretion of the trustee without equalizing distributions amongst the beneficiaries. Pot trusts can work well if the beneficiaries are in similar financial positions and have the same ideas regarding how and when distributions should be made from the trust. However, pot trusts can also cause a lot of resentment if a particular beneficiary is receiving larger discretionary distributions to the detriment of the other beneficiaries. State decanting statutes can be utilized to sever pot trusts into separate trusts for the benefit of individual beneficiaries so that the needs of one particular family line or beneficiary do not deplete the trust to the detriment of the other beneficiaries.

7. **Including Credit Shelter Trust in Beneficiary's Estate.**

Due to the increase in the federal estate tax exemption amount, it has become desirable in many situations to force the inclusion of a credit shelter trust in the surviving spouse's estate in order to provide for a step up in basis of the credit shelter trust's assets and therefore minimize income taxes upon the subsequent sale of those assets. For example, assume that husband died in 2001 leaving a credit shelter trust for the benefit of his surviving spouse which now has a value of approximately $2 million. Further assume, that the assets in the credit shelter trust have a very low basis compared to their fair market value and that the total combined value of the assets that wife has which would be includable in her gross estate for federal estate tax purposes is under $3 million meaning that wife's estate can absorb the $2 million credit shelter trust without the imposition of any federal estate tax which would allow the beneficiaries who receive the assets of the credit shelter trust upon wife's death to receive a step up in basis on such assets.

As previously mentioned, certain state decanting statutes permit the new trust to grant beneficiaries of the existing trust powers of appointment (including general powers of appointment) not otherwise set forth in the original trust. It could be possible for the trustee to

exercise its authority under a state decanting statute to distribute all of the assets from the credit shelter trust into a new trust that is identical in all respects from a beneficial standpoint but which grants wife a testamentary general power of appointment over the trust assets. As a result of such general power of appointment, the trust assets will be includable in wife's estate for federal estate tax purposes and the assets will therefore receive a step up in basis upon wife's death.

D. Trustee Liability.

The decision to decant is typically in the sole and absolute discretion of the trustee. However, often it is the beneficiaries who have the desire to modify the terms of the governing instrument and who approach the trustee with a request to decant. This can put the trustee in a difficult position in that the trustee wants to accomplish the beneficiaries' goals but at the same time is concerned about the potential liability associated with the decanting.

For example, assume the beneficiaries approach the trustee with a request to decant all of the assets into a new trust which contains the same beneficial provisions but provides for an investment adviser to direct the trustee with respect to the investment of the trust assets. In the event the trust portfolio declines as a result of the investment performance by the investment adviser, the trustee could face a breach of fiduciary duty action from the beneficiaries as it was the trustee's sole discretion to decant the assets to a new trust which was no longer managed by the trustee.

Typically a trustee will require that all of the interested parties sign consent, release and indemnity agreements in connection with a decanting. However, there could be situations where it is not desirable from a tax standpoint to have a beneficiary consent to a particular decanting. The trustee must then decide whether it is willing to decant the assets as requested by the beneficiary in light of the potential liability.

E. IRS Action.

The Internal Revenue Service has recognized that decanting is an emerging issue with tax consequences that are not entirely clear under current law. In 2011 decantings were added to the "no ruling list" pursuant to Rev. Proc. 2011-3.

The Internal Revenue Service recently issued a notice (IRS Notice 2011-101) requesting comments on the tax implications of trust decantings that result in a change in the beneficial interests in the trust. For purposes of the notice, a change in beneficial interests occurs when the interests of one or more beneficiaries of the first trust are changed or terminated under the second trust and/or when the second trust adds a beneficiary who did not have any interest under the first trust.

Several organizations, including the Delaware Bar Association, through the Estates & Trusts Section, and the Delaware Bankers Association, have filed responses to IRS Notice 2011-101. Provided below is a list of the tax issues the IRS is requesting comment on:

1. **Income Tax Issues:**

   i. Whether the existence of a decanting power causes the trust to be treated as a grantor trust under Internal Revenue Code ("IRC" or "Code") § 671.

   ii. Whether the distribution of property from one trust to another trust through a decanting should be treated as a distribution requiring the calculation of distributable net income ("DNI").

   iii. Whether the distribution from one trust to another will cause the trust to recognize gain under IRC § 1001, if the trust holds appreciated assets.

   iv. Whether the distribution from one trust to another will cause any beneficiary of the distributing trust to recognize gain under IRC § 1001.

   v. Whether a trust that receives all of the assets of the decanted trust receives the tax attributes of the first trust.

2. **The Gift and Estate Tax Issues:**

   i. Whether a beneficiary whose interests are diminished as a result of the decanting has made a taxable gift.

   ii. Whether a beneficiary whose interests are diminished as a result of the decanting has made a transfer for purposes of IRC § 2036 or § 2038.

   iii. Whether the existence of a decanting power in a trust that otherwise qualifies for an estate or gift tax marital deduction under IRC § 2056(b)(7) will cause the trust to fail to qualify for the marital deduction.

   iv. Whether a beneficiary who consents to a decanting (either voluntarily or as a condition of the decanting) or acquiescences in the decanting has made a taxable gift.

3. **The GST Tax Issues.**

i. Whether a trust that has, by a decanting, received property from another trust that is a grandfathered trust for GST purposes continues to maintain its grandfathered trust status.

ii. Whether decanted trust property that has an inclusion ratio of zero (0) or less than one (1), will have the same inclusion ratio in the trust receiving the decanted property.

iii. Whether a trust that is not exempt from GST tax may be decanted so as to permit effective allocation of GST exemption to only a portion of the original trust.

The notice also seeks guidance (i) in how "decanting" should be defined, (ii) whether there should be additional tax consequences if the decanting is from a U.S. trust to a foreign trust or vice versa and (iii) whether a new Employer Identification Number should be required where all of the principal of the Trust is distributed to another trust.

F. Income Tax Considerations.

1. **Grantor Trust Issues.**

IRC § 674(a) provides that a trust will be treated as a grantor trust for income tax purposes if the income or principal of the trust is subject to a power of disposition by any person without the consent of an adverse party. There are several exceptions to the adverse party rule. However, none of the exceptions apply if any person has the power to add a beneficiary to the trust.

A question that arises in a decanting is whether the new trust into which the assets of the old trust are decanted is considered a beneficiary. If so, the trust could fail to qualify for the exceptions under IRC § 674 because the trustee of the original trust would be treated as holding the power to add a beneficiary to the original trust.

The term beneficiary or beneficiaries for purposes of IRC §674 should be limited to the persons for whose benefit the trust is held and not the trust itself. The power to distribute trust property to another trust via the decanting should not disqualify the trust from the exceptions to IRC § 674(a) as long as the decanting power does not permit the new trust to include persons as beneficiaries that were not beneficiaries of the original trust.

Delaware's decanting statute specifically provides that the beneficiaries of the new trust must also be beneficiaries of the original trust. 12 Del. C. § 3528(a)(1). Therefore, Delaware's decanting statute prohibits beneficiaries to be directly added to the trust via the decanting. The

addition of beneficiaries is also prohibited under the other state decanting statutes. Delaware's decanting statute does, however, permit the new trust to grant beneficiaries of the existing trust powers of appointment not otherwise set forth in the original trust, which can indirectly lead to the addition of new beneficiaries not present in either the original or the new trust pursuant to the beneficiary's exercise of the power of appointment. 12 Del. C. § 3528(a).

2. **Identity of the Grantor of the Second Trust.**

Another issue that may arise when property is decanted from one trust to another trust is determining who the "grantor" of the second trust is for income tax purposes. If the second trust is viewed as a continuation of the first trust, then the same person should be considered to be the grantor of both the first and the second trust.

The Illinois decanting statute specifically addresses the identity of the grantor of the second trust by providing that the grantor of the first trust is considered "for all purposes" to be the grantor of any second trust established pursuant to the statute. 760 ILCS 5/§ 16.4(t). If the second trust has other assets, then the grantor of the first trust is considered the grantor of the second trust only with respect to the assets that are actually transferred from the first trust to the second trust. Id.

The Illinois statute is consistent with the Treasury Regulations. Treas. Reg. § 1.671-2(e)(5) provides that if a trust makes a gratuitous transfer of property to another trust, the grantor of the transferor trust generally will be treated as the grantor of the transferee trust.

An exception arises where property is distributed from the first trust to the second trust pursuant to the exercise of a general power of appointment. In such a case, the person exercising the power of appointment will be treated as the grantor of the second trust.

3. **DNI and Transfer of Tax Attributes.**

It is possible through a decanting to decant all of the assets of the original trust into the new trust or only a portion of the assets of the original trust into the new trust. There appears to be a difference of opinion as to whether in a complete decanting the new trust is a continuation of the old trust and should therefore continue to operate under the old trust's employer identification number or whether the new trust should obtain a new employer identification number. There are Private Letter Rulings which suggest that the new trust is merely a continuation of the old trust. PLR 200607015 and PLR 200736002.

IRC § 661 permits a trust to deduct in the calculation of its taxable income distributions the trust is required to make and distributions actually made that are permitted distributions. IRC §

662 requires beneficiaries who receive distributions to include such amount in their gross incomes for the year.

The Code does not specifically include a trust which can receive distributions from another trust within the definition of beneficiary for purposes of IRC §§ 661 and 662. However, case law suggests that one trust can be a beneficiary of another trust for purposes of IRC §§ 661 and 662. *Lynchburg Trust and Savings Bank v. Commissioner*, 68 F.2d 356 (4th Cir. 1934); *Duke v. Commissioner*, 38 BTA 1265 (1938).

In a situation where all of the assets are decanted from the original trust to the new trust the tax attributes from the original trust should be carried over to the new trust. IRC § 642(h) provides that in the final year of a trust, its capital loss and net operating loss carry forward and its deductions in excess of gross income for the year will be allowed as deductions to the beneficiaries who receive the trust property. In either case, the tax attributes from the original trust should carry over to the new trust.

4. **Recognition of Gain.**

As a general rule the distribution of appreciated assets from one trust to another trust pursuant to a decanting should not result in recognition of gain to the trust or any of the trust beneficiaries. At the trust level, if a distribution of appreciated assets is made from one trust to another trust, IRC § 643(e) would protect the distributing trust from recognizing gain unless the trustee of the distributing trust elects to recognize the gain.

IRC § 662(a) provides that a beneficiary may experience income by reason of a trust distribution only to the extent of the trust DNI. In a decanting the DNI from the original trust is not being distributed to the beneficiary. If anything, the DNI is being distributed to the new trust.

One area of possible caution is where the decanted property includes negative basis assets, such as property with debt in excess of basis or is a partnership or limited liability company interest with a negative capital account. In such a case, gain may be triggered under the authority of *Crane v. Commissioner*, 331 U.S. 1 (1947). It is not clear if *Crane* applies to a distribution from a non-grantor trust. IRC § 643(e) provides that gain generally is not recognized on a distribution of appreciated property from a non-grantor trust.[1] Whether *Crane* trumps IRC § 643(e) is not clear. However, regardless of whether *Crane* trumps IRC § 643(e), if all of the assets of a first trust are distributed to a second trust that is considered to be a continuation of the

[1] Code § 643(e) does not apply where the first trust is a grantor trust. Where property encumbered with debt in excess of basis or a partnership or LLC interest with a negative capital account is transferred from a grantor trust to a non-grantor trust or to a grantor trust deemed owned by a different person, gain may be recognized under *Crane*.

first trust, or if both the first trust and the second trust are grantor trusts deemed owned by the same person, no gain should be recognized on the distribution.

G. Gift and Estate Tax Considerations.

1. **Beneficiary's Consent to Decanting.**

It is possible through a decanting to reduce, or in some cases eliminate, a beneficiary's interest in the original trust. Delaware's decanting statute can be used to eliminate a fixed income right with respect to a trust that does not qualify for the marital deduction. 12 Del. C. § 3528(a)(3). Delaware's decanting statute can also be used to eliminate a beneficiary's power to withdrawal trust assets provided such power is not presently exercisable. 12 Del. C. § 3528(a)(5). An issue that arises is whether a beneficiary has made a taxable gift to the new trust when the beneficiary's interest in the old trust is reduced pursuant to the decanting.

In order for a gift to occur there must be an act of transfer. In the decanting context a beneficiary is not affecting the transfer of the assets from the original trust to the new trust. The trustee causes the transfer of the assets from the original trust to the new trust. The beneficiary therefore should not be treated as having made a taxable gift when a trustee exercises the decanting power to reduce the beneficiary's interest in the trust unless the beneficiary has a legal right to object to the exercise of the authority to decant. Under Delaware's decanting statute it is not necessary to obtain a beneficiary's consent to decant the trust assets or even to notify the beneficiary of the decanting. The beneficiary's mere acquiescence to the decanting should not rise to the level of a taxable gift.

A more difficult issue involves whether the beneficiary's consent to a decanting which eliminates or reduces a beneficiary's interest in the old trust rises to the level of a taxable gift. For instance, assume the terms of the governing instrument permit the trustee to distribute income and principal to A for any purpose and provide that upon attaining the age of thirty-five (35) all of the assets are to be distributed outright and free of trust to A. Further assume that the trustee decants all of the assets to a new trust which extinguishes the trustee's requirement to distribute the remaining trust assets to A upon her attaining the age of thirty-five (35) and instead provides that all of the trust assets shall remain in further trust for A's lifetime.

If A consents to the decanting, the IRS could argue that A's right to receive the assets upon attaining the age of thirty-five (35) is equivalent to a general power of appointment and A's consent to the decanting is a lapse or release of a general power of appointment. This would result in the new trust becoming a self-settled trust with respect to A either upon the decanting or upon A attaining the age of thirty-five (35).

If the Grantor consents to the decanting, or provides the decanting trustee with a release and/or indemnification, the IRS could argue that the grantor retained substantial control over the trust assets under IRC §§ 2036 or 2038 in an attempt to include the trust assets in the grantor's estate.

2. **Trustee/Beneficiary.**

In certain situations a beneficiary may be serving as a co-trustee of the trust and participate in the decanting. Typically if a beneficiary is serving as a trustee, the trustee will be restricted in how the trust assets may be distributed to the beneficiary. For instance, the trustee/beneficiary will only be permitted to distribute trust assets to the trustee/beneficiary for his or her health, education, maintenance and support. A distribution in further trust which continues to restrict how the assets may be utilized for such beneficiary should not result in any negative gift tax consequences to the trustee/beneficiary.

Delaware law makes it clear that the trustee's exercise of the decanting power must comply with any standard imposed by the first trust. 12 Del. C. § 3528(a)(5). If a trustee is constrained in making distributions pursuant to an ascertainable standard under the terms of the first trust, the new trust must also limit distributions pursuant to an ascertainable standard.

3. **Marital Deduction Trusts.**

Another question that arises in a decanting is whether a decanting power contained in a trust that qualifies for the marital deduction under IRC §§ 2523 or 2056 causes the trust to fail to qualify for the marital deduction. The question is whether the trustee could exercise the decanting power to distribute assets from the original trust that qualifies for the marital deduction into a new trust that would not qualify for the marital deduction.

If the authority to decant is held in a fiduciary capacity it would seem that the terms of the trust or applicable law governing the trust would prohibit the fiduciary from exercising a power over the original trust in a manner that would be adverse to the interest of the beneficiaries or violate a material purpose of the trust. It would seem that the fiduciary could not then exercise the power to decant into a trust that does not qualify for the marital deduction because doing so would not be in the best interest of the beneficiaries of the trust. Delaware's statute makes it clear that a trustee may not exercise its decanting power over a trust that qualifies for the marital deduction to distribute the assets of such trust into a new trust that reduces any income interest of any income beneficiary of such trust. 12 Del. C. § 3528(a)(3).

4. **Estate Tax.**

As a general matter, no adverse federal estate tax consequences should arise as a result of the decanting. As previously mentioned, Delaware's decanting statute permits a decanting to grant a beneficiary of the original trust with a power of appointment not otherwise contained in the original trust. This power of appointment may be a general power of appointment or a limited power of appointment. 12 Del. C. § 3528(a). To the extent the new trust grants a beneficiary of the original trust a general power of appointment, the assets would be includable in the beneficiary's estate upon his or her subsequent death.

5. **The Delaware Tax Trap.**

IRC § 2041(a)(3) and its gift tax counterpart, IRC § 2514(d), are known as "the Delaware Tax Trap." The Delaware Tax Trap applies where the holder of a limited power of appointment (the "first power") exercises the power by creating another power (the "second power") that under applicable local law can be validly exercised so as to postpone the vesting of the trust property or suspend the absolute ownership or power of alienation of such property for a period ascertainable without regard to the date of creation of the first power.

In such a case (i) the holder's exercise of the first power will be deemed a transfer subject to gift tax under IRC § 2514(d) (this is the case regardless of whether the second power is exercised) and (ii) the property subject to the decedent's exercise of the first power will be includible in the decedent's gross estate for estate tax purposes under IRC § 2041(a)(3) (which treats the decedent's exercise of a limited power of appointment as if it were the exercise of a general power of appointment).

The key to springing the Delaware Tax Trap is the exercise of the first power to create a second power that has the effect of postponing the period of the rule against perpetuities applicable to the trust that created the first power. This results in the conversion of the non-general power of appointment into a taxable general power.

As previously noted, a number of state decanting statutes, including Delaware's decanting statute, permit the second trust to grant a power of appointment to a trust beneficiary. The question is whether this will this trigger a taxable gift if the vesting period does not relate back to the perpetuities period applicable to the first trust. Most commentators believe the Delaware Tax Trap rules were designed to apply to beneficiary powers of appointment, not fiduciary powers of appointment.

Where the second trust grants a beneficiary a limited power of appointment and the beneficiary exercises that power in further trust during his lifetime to create another power that can extend the perpetuities period applicable to the second trust, the beneficiary's exercise of the

power would constitute a taxable gift under IRC § 2514(d). Similarly, if the beneficiary of the second trust is granted a testamentary limited power of appointment and exercises that power, in further trust, by creating another power that can delay the vesting of trust property beyond the perpetuities period applicable to the second trust, the property subject to the exercise of the power will be included in the beneficiary's estate under IRC § 2041(a)(3).

To avoid the application of the Delaware Tax Trap in Delaware, the Delaware Legislature enacted 25 Del. C. § 504 in 2000. The statute provides that in the case of a limited power of appointment over property held in trust (the "first power"), if the trust is not subject to the generation-skipping transfer tax, or has an inclusion ratio of zero for purposes of the generation-skipping transfer tax, then every estate or interest in property, real or personal, created through the exercise, by Will, deed or other instrument, shall be deemed to have been created at the time of the creation of, and not at the time of the exercise of, the first power.

Delaware's decanting statute provides that the use of the statute to decant shall be considered the exercise of a limited power of appointment and shall be subject to the provisions of Chapter 5 of Title 25 of the Delaware Code concerning the time at which the permissible period of the rule against perpetuities begins and the law which determines the permissible period of the rule against perpetuities. 12 Del. C. § 3528(c). Therefore, the trustees' exercise of their authority under Delaware's decanting statute to decant assets into new trusts is treated as the exercise of a limited power of appointment.

Delaware law would prevent a decanting which occurs in accordance with the Delaware statute from springing the Delaware Tax Trap. Under Delaware law a limited power of appointment over a generation-skipping transfer tax exempt trust cannot be exercised without relating back to the creation of the first power thereby prohibiting the application of the Delaware Tax Trap.

H. GST Tax Considerations

1. GST Exempt Status of a Trust.

Trusts can be exempt from GST tax in two ways: (1) per Treas. Reg. § 26.2601-1(b), a trust is exempt from GST tax if it is a "grandfathered trust" meaning, generally, that it became irrevocable on or before September 25, 1985 (which is the effective date of the GST Code sections); or (2) the transferor allocated GST exemption to the trust (such trusts are also sometimes referred to as "non-grandfathered trusts" or "zero inclusion ratio trusts") .

Treas. Reg. § 26.2601-1(b)(1) provides that a trust can lose GST exempt status if an actual or constructive addition is made to the trust after the effective date. With respect to decanting, the

concern is that the decanting may be viewed as an addition or modification to a trust that causes it to lose its GST exempt status.

Interestingly, the Treasury Regulations provide a set of rules and "safe harbors" for grandfathered trusts in order to ensure that a decanting or modification of a grandfathered trust does not jeopardize its GST exempt status, but currently there are no rules or safe harbors specifically relating to non-grandfathered trusts.

2. **Decanting as the Exercise of a Limited Power of Appointment.**

Many states that have adopted decanting statutes, treat the trustee's power to decant as the exercise of a limited power of appointment. Delaware's decanting statute specifically notes that the exercise of a trustee's decanting power shall be considered to be the exercise of a limited power of appointment. 12 Del. C. § 3528(c).

There is a specific Treasury Regulation that deals with the effect of the exercise of a limited power of appointment over the assets of a grandfathered trust. Treas. Reg. § 26.2601-1(b)(1)(v)(B) provides that the exercise of a limited power of appointment over the assets of a grandfathered trust will not cause a trust to lose its GST exempt status unless the exercise of the power of appointment violates the federal perpetuities period.

For purposes of this Treasury Regulation, the permissible perpetuities period under federal law will not be deemed to violated as long as the vesting or absolute ownership of an interest in trust property is not delayed beyond: (1) a life in being when the trust was created plus 21 years; or (2) 90 years from the date of the creation of the trust.

Thus, Treas. Reg. § 26.2601-1(b)(1)(v)(B) would lead us to believe that if decanting is deemed to be the equivalent of exercising a limited power of appointment, then as long as the vesting of beneficial interests in the "decantee trust" (i.e., the trust to which the assets of the original trust are distributed) is within the proscribed perpetuities period, the decantee trust can differ substantively from the original trust without loss of GST exempt status.

Unfortunately, regardless of how Delaware (or other states) may treat the power to decant, the IRS concluded in PLRs 9848043 and 9849007 that Treas. Reg. § 26-2601-1(b)(1)(v)(B) was not directly relevant when considering a trustee's decanting power under a state statute requiring the participation or concurrence by the court and/or the trust beneficiaries. This is unfortunate because, as we will see, Treas. Reg. § 26-2601-1(b)(1)(v)(B) would allow for broader changes in the new trust than allowed under the safe harbors contained in the other relevant Treasury Regulations.

3. The "Discretionary Distribution" Safe Harbor for Grandfathered Trusts.

Treas. Reg. 26.2601-1(b)(4)(i)(A) is sometimes known as the "discretionary distribution" safe harbor and provides guidelines for determining when the distribution of trust assets from a grandfathered trust to a new trust could cause the loss of GST exempt status.

The discretionary distribution safe harbor essentially provides that decanting will not cause a grandfathered trust to lose GST exempt status if the following three requirements are met:

(1) When the trust became irrevocable, either the terms of the trust instrument or local law (i.e., a statute or common law) authorized the trustee to distribute trust property to a new trust;

(2) Neither beneficiary consent nor court approval is <u>required</u> for the trustee's exercise of such power; and

(3) The new trust will not delay the vesting of an interest in the trust beyond the permissible perpetuities period under federal law. For purposes of this Treasury Regulation, the federal perpetuities period is (1) a life in being when the trust <u>became irrevocable</u> plus 21 years; or (2) 90 years from the <u>date the trust became irrevocable.</u>

The first requirement of the discretionary distribution safe harbor is particularly interesting because no state had a decanting statute at the time of the effective date of the GST tax in 1985. As such, in order to comply with the discretionary distribution safe harbor, if the terms of the trust do not authorize distribution to a new trust, you would need to rely on the common law of the state in which the trust is located to authorize the decanting. Some commentators suggest that most, if not all, states authorize decanting via common law principles, but only the courts of Florida, New Jersey and Iowa have explicitly recognized a common law authority to decant.

The second requirement does not appear to prohibit a trustee from obtaining beneficiary consent or court approval of the decanting. Delaware's decanting statute does not require beneficiary consent or court approval for the trustee's exercise of its decanting power, although the trustee and other parties involved may choose to obtain beneficiary consent or court approval before decanting to a new trust.

With respect to the third requirement, when utilizing Delaware's decanting statute to decant the assets of a grandfathered trust, the attorney drafting the decantee trust (or the trust officer reviewing such trust on behalf of the trustee) should be as careful as possible to ensure that the new trust contains a provision limiting the vesting period to comply with the federal perpetuities

period described in the Treasury Regulations. I believe that best practice is to cite the Treasury Regulation itself in the decantee trust and provide that the intent is to comply with the aforementioned federal perpetuities period.

Under the discretionary distribution safe harbor, what changes can be made without jeopardizing the trust's GST exempt status? If decanting only changes administrative terms of the trust, there should be no loss of GST exempt status (PLR 200607015). However, it is important to consider what provisions are merely administrative in nature and what changes may be viewed as affecting the substantive or beneficial terms of the trust.

4. **The "Trust Modification" Safe Harbor for Grandfathered Trusts.**

Treas. Reg. § 26-2601-1(b)(4)(i)(D) is sometimes known as the "trust modification" safe harbor. The trust modification safe harbor is seen as a "catch-all" that applies when all of the requirements set forth in the discretionary distribution safe harbor cannot be met.

The trust modification safe harbor provides that a modification to a grandfathered trust will not cause loss of GST exempt status as long as:

(1) The modification will not shift a beneficial interest in the trust to a beneficiary occupying a lower generation than the persons holding the beneficial interest in the original trust; and

(2) The modification will not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Regarding the first requirement, note that beneficial interests can be shifted across the same generational level or to a higher generational level than the persons holding the interest in the original trust. However, it is important to be extremely careful when shifting beneficial interests, because the Treasury Regulations and their attendant examples provide that if a trust modification results in either an increase in the amount of a GST transfer or creates a new GST transfer, there is deemed to be a shift in a beneficial interest to a lower generation beneficiary. Additionally, if the effect of a modification cannot be determined immediately after the modification is made, there is a deemed to be a shift in a beneficial interest to a lower generation.

5. **Non-Grandfathered Trusts.**

There are no Code sections or Treasury Regulations that deal directly with the decanting or modification of non-grandfathered trusts. However, the IRS suggested in PLR 200743028 that the Treasury Regulations applicable to grandfathered trusts should also apply to non-grandfathered trusts.

An interesting example would involve a trust to which the grantor allocated GST exemption after the state in which the trust is sitused enacted a decanting statute. If the Treasury Regulations that apply to grandfathered trusts also apply to this non-grandfathered trust, then presumably a Delaware trustee could decant pursuant to Delaware's decanting statute, and the decantee trust could shift beneficial interests in the trust to lower generations as long as no beneficiary consent or court approval is required (per the discretionary distribution safe harbor).

If the IRS ultimately decides that the GST Regulations for grandfathered trusts should not apply to non-grandfathered trusts (a result most commentators find unlikely), one could argue that Treas. Reg. § 26-2601-1(b)(1)(v)(B) relating to limited powers of appointment should apply.

6. **Effect of Loss of GST Exempt Status.**

PLR 9522032 suggests that if a trust loses its GST exempt status, there are no immediate gift tax implications, but the grantor of the trust will become the transferor for GST tax purposes.

Logically, although there is no authority directly on point, the loss of GST exempt status should not result in all future distributions from the trust being subject to GST tax. A GST tax should only be imposed when a distribution is made to someone that could not have received a distribution from the original trust without being subject to GST tax.

III. Trust Reformation Actions, Trust Modification Actions, Mergers, Nonjudicial Settlement Agreements and Trust Protectors.

A. Trust Reformation.

A trust reformation typically involves a resolution of an ambiguity or mistake contained in the trust instrument. Typically the reformation is needed to clarify the settlor's intent. Typical mistakes that may be addressed pursuant to a trust reformation include scrivener errors such as misidentifying a beneficiary or failing to provide that all of the income in a marital trust is to be distributed to the surviving spouse.

A reformation action will normally relate back to the date of trust execution. In order to reform a trust instrument, all beneficiaries whose interest would be affected must be a party to the action or otherwise notified of a court proceeding. One of the burdens that must be proven is that the reformation is consistent with the settlor's intent.

The Delaware Court of Chancery has the exclusive authority to reform a trust as "reformation is an equitable remedy and an ordinary remedy for a mistake in the terms of the trust instrument." 90 C.J. Trusts § 92. The Delaware Supreme Court has expressly supported the general principle that a unilateral mistake on the part of the settlor of the trust is sufficient to warrant the reformation of such trust. *Roos v. Roos*, 203 A.2d 140, 142 (Del. Ch. 1964) (citing Scott on Trusts § 333.4; Restatement of Trusts § 3333; *In re Trust Estate of LaRoca*, 411 Pa.

633, 192 A. 2d 409; *Kiser v. Lucas*, 170 Md. 486, 185 A. 441; *Wright v. Goff*, 22 Beav. 208, 52 Reprint 1087).

B. Trust Modification.

A trust modification does not change the terms of a governing instrument as of the date of trust execution, but instead modifies the provisions of the trust moving forward after the entry of the order modifying the trust. Typically trust modification actions are brought to amend the administrative provisions of the trust. As with reformation actions, trust modification actions typically require the consent of all parties with an interest in the trust.

In Delaware, the judicial procedure to modify trusts is known as the "consent petition" process, and is governed by Delaware Court of Chancery Rules 100-104. In most jurisdictions, a judicial proceeding where all interested parties consent is an available option for seeking a trust modification or deviation.

1. **Requirements and Mechanics.**

(i) For an inter vivos trust that is not subject to the exclusive or continuing jurisdiction of another state, the key to utilizing the consent petition process is to ensure that a Delaware trustee is serving prior to filing the petition which will, in most cases following the *Peierls* opinions (as decided by the Delaware Supreme Court on October 4, 2013), ensure that Delaware law governs the administration of the trust.

(ii) For a testamentary trust, if there is ongoing accountability to a non-Delaware court this would likely cause such other court to have "primary supervision" over the trust, necessitating an order from such court terminating their primary supervision or transferring administrative situs of the trust to Delaware before the Delaware Chancery Court will exercise jurisdiction and consider a petition to modify the trust.

(iii) All interested parties, as defined in Chancery Court Rule 101(a)(7), must consent or not object to the relief requested pursuant to the petition. Under certain circumstances a guardian ad litem may need to be appointed by the Court to represent the interests of minor or unborn beneficiaries in the event Delaware's virtual representation statute, 12 Del. C. § 3547, cannot be used.

(iv) In general, modifying any of the administrative provisions of a trust is permitted. In some cases, modification of beneficial provisions is also possible, especially if the goal is to obtain a specific tax benefit or objective.

2. **Potential Advantages and Disadvantages.**

(i) If successful, all interested parties have consented or not objected to the modification, and the modification has been approved by a court of competent jurisdiction. This would make it difficult for a party to later challenge the modification, and in particular gives significant assurance to Trustees and other fiduciaries.

(ii) If the grantor of the trust is living, the grantor can sign an Affidavit stating that the grantor does not object or takes no position with respect to the relief requested in the petition, while also stating that the modification(1) is consistent with the grantor's intent in creating the trust, and may have even been originally included in the trust of the grantor was aware of the option, and (2) does not violate a material purpose of the trust. The Affidavit will go a long way in convincing the Court that the modification of trust would not violate the grantor's intent.

(iii) A potential issue is the treatment of minor or unborn beneficiaries. If an adult beneficiary may not virtually represent minor or unborn beneficiaries, the Court may appoint a Guardian *Ad Litem* to represent such minor or unborn beneficiaries, which can add to the time, expense and uncertainty of the outcome of the matter.

C. Merger.

There are thirty-five (35) states (including Delaware plus the District of Columbia) that allow for trust mergers without judicial involvement, and other states may permit merger via the state's common law. Merger under Delaware law is governed by 12 Del. C. § 3325(29).

1. **Requirements and Mechanics.**

(i) Delaware's merger statute is available to a trustee when Delaware law governs the administration of the trust.

(ii) The trustee is authorized to "[m]erge any 2 or more trusts, whether or not created by the same trustor, to be held and administered as a single trust if such a merger would not result in a material change in the beneficial interests of the trust beneficiaries, or any of them, in the trust."

(iii) Any changes to administrative provisions available through the consent petition process or decanting could also be accomplished by merger, including the addition of Investment Direction Adviser, Distribution Advisers and Trust Protectors.

(iv) Similar to decanting, merger is an exercise of the trustee's discretion. While not required under the statute, the trustee may seek a consent, release and indemnity from the trust beneficiaries and other interested parties before effectuating a merger.

2. **Potential Advantages and Disadvantages.**

(i) Less time and expense than typically associated with a judicial proceeding to modify the trust.

(ii) As with decanting, notice to beneficiaries is not required under the statute.

(iii) If virtual representation is not available, certain minor or unborn beneficiaries will not be represented for purposes of any consent, release, and indemnity agreement signed by all other interested parties to the trust.

D. Nonjudicial Settlement Agreements.

Section 111 of the Uniform Trust Code permits interested persons to enter into a binding nonjudicial settlement agreement with respect to any matter involving a trust provided such nonjudicial settlement agreement does not violate a material purpose of the trust. Delaware enacted a nonjudicial settlement agreement statute in 2013. Nonjudicial settlement agreements ("NJSAs") under Delaware law are governed by 12 Del. C. § 3338.

1. **Requirements and Mechanics.**

(i) Parties may utilize Delaware's nonjudicial settlement agreement statute when Delaware law governs the administration of the trust.

(ii) Requires the agreement of all "interested persons" whose consent would be needed to achieve a binding settlement in the Delaware Court of Chancery. 12 Del. C. § 3338(a).

(iii) The interested persons may enter into a binding agreement "with respect to *any matter involving a trust*…" (except with respect to charitable trusts and purpose trusts described in 12 Del. C. § 3541). 12 Del. C. § 3338(b) (emphasis added). The phrase "any matter" is inclusive rather than restrictive, suggesting that the presumption should be that any matter does fall within the proper subject matter of a nonjudicial settlement agreement rather than not, including trust modifications.

(iv) A nonjudicial settlement agreement is "only valid to the extent it does not violate a material purpose of the trust and includes terms and conditions

that could be properly approved by the Court of Chancery under this title or other applicable law." 12 Del. C. § 3338(c).

2. **Potential Advantages and Disadvantages.**

(i) Less time and expense than typically associated with a judicial proceeding to modify the trust.

(ii) If virtual representation is not available, certain minor or unborn beneficiaries cannot be represented, and arguably the statute cannot be used due to not having all "interested persons" enter into the agreement.

(iii) Any interested person may seek judicial determination to interpret, apply, enforce or determine the validity of a nonjudicial settlement agreement. 12 Del. C. § 3338(e).

E. Trust Protectors.

One of the more powerful positions that can be created in a Delaware trust is that of Trust Protector. Delaware has codified the position of Trust Protector and set forth sample powers a Trust Protector may hold. 12 Del. C. § 3313(f).

Often the Trust Protector is vested with key powers that will allow the trust instrument to remain flexible as circumstances change over time. Typical Trust Protector powers include the following:

1. The ability to amend the trust for administrative and tax purposes (and in certain situations for dispositive purposes in order to further carry out the grantor's intent);

2. The power of change the situs and governing law of the trust;

3. The power to appoint, remove and replace the Trustee and other Trust Advisers;

4. The ability to convert the trust from a grantor trust into a non-grantor trust for income tax purposes; and

5. The power to expand the permissible class of beneficiaries of the trust.

Creating the position of Trust Protector in a Delaware trust can avoid the necessity of utilizing one of the other methods explained in this outline to modify the trust. Instead, the Trust Protector can simply execute a Trust Protector Amendment to effect the desired modification to the trust agreement.

One issue that often arises in Delaware trusts is whether the Trust Protector should serve in a fiduciary or non-fiduciary capacity. Under Delaware law, a Trust Protector is deemed to serve in a fiduciary capacity unless the terms of the governing instrument provide otherwise. 12 Del. C. § 3313(a). It is common practice to have the Trust Protector serve in a fiduciary capacity. However, there are certain powers that may be conferred upon the Trust Protector which can only be exercised in a non-fiduciary capacity (i.e. the ability to convert the trust from a grantor trust into a non-grantor trust for income tax purposes and the power to expand the permissible class of beneficiaries of the trust).

EXHIBIT D

GF&M GORDON, FOURNARIS & MAMMARELLA, P.A.

THE TRUSTEE'S DUTY TO INFORM: WHAT MUST THE TRUSTEE TELL WHICH BENEFICIARIES AND WHEN?

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I. Introduction.

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, particularly with respect to younger beneficiaries.

Grantors fear that a beneficiary's knowledge of the wealth in the 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.

This outline will first focus on trustee disclosure requirements imposed by various state statutes. It will next identify the various jurisdictions that permit trust instruments to delay notification to trust beneficiaries. It will then focus on the concerns a trustee faces in administering a silent trust. Finally, it will address the difficulties of importing quiet trust language into an existing irrevocable trust which does not contain such language.

II. Statutory Disclosure Requirements.

A. Uniform Trust Code. 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

1. Default Requirements. Section 813 of the UTC imposes the following duties upon a trustee:

   (a) 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).

   (i) 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:

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

   2. 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

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

(ii) 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.

2. 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:

   (a) 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).

   (b) 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 all 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.

B. Restatement (Third) of Trusts. 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.

1. Default Requirements. With respect to irrevocable trusts, a trustee has the following duties:

   (a) 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).

      (i) 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.

      (ii) 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.

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

      (i) 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.

(c) "[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.

(d) 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.

(e) 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.

(i) 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.

2. Limiting Default Requirements. 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.

(a) A **beneficiary** is always 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, not subject to modification.

(b) A settlor can 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).

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

(c) A settlor can 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.

(d) 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.

C. 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.

1. 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.

2. 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).

III. 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.

A. 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.

B. 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).

C. 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.

D. 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).

E. 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).

F. 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.

G. 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).

H. 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.*

I. 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.

J. 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.

K. 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.

L. 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.

M. 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.

N. 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.

O. 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.

P. 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.

Q. 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).

R. 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.

S. 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).

T. 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).

U. 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.

V. 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.

W. 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.

X. 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."

Y. 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.

Z. 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.

AA. 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.

BB. 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.

CC. 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.

DD. 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.

IV. Administering Silent Trusts.

A. 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.

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

1. 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.

2. 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.

3. 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.

C. 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.

1. 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.

2. 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.

3. 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".

D. 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). 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

1. 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.

2. Is the beneficiary representative a fiduciary? As a general rule the answer is no. 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.

3. 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.

4. Note that it may be possible to have such a position even if the statute does not specifically provide for this, depending on the flexibility of the state law. An example is the Delaware statute which provides that it is the policy of the statute to give maximum effect to the principle of freedom of disposition and to the enforceability of governing instruments, 12 Del. C. §3303(a) discussed *supra*. As noted above, this is the same statute that specifically permits the terms of the trust instrument to reduce, restrict, or even eliminate the beneficiary's right to be informed of the trust. Thus under Delaware law, although the statute that permits the limitation of notice to beneficiaries does not specifically create the role of a designated representative, such a role could be drafted into the terms of the trust agreement and those terms would be controlling.

V. Importing Quiet Trust Language into Existing Trusts.

A. Introduction. For practitioners and fiduciaries located in jurisdictions that allow trusts to contain some form of quiet trust language, it is not uncommon for interested parties to want to modify an existing trust to import quiet trust provisions. This can present unique challenges because, by their very terms, quiet trust provisions restrict or eliminate a right of the beneficiaries to notice of the existence of, or information regarding, the trust at issue. However, certain options for modifying the trust as desired may be available depending on the jurisdiction. This section examines, as a point of reference, the possible methods available in Delaware to add quiet trust provisions to an irrevocable trust. However, many other jurisdictions have similar options that may be utilized in a similar manner to accomplish such changes.

B. Possible Methods for Importing Quiet Trust Provisions.

1. Judicial Proceedings. In Delaware, the judicial procedure to modify trusts is known as the "consent petition" process, and is governed by Delaware Court of Chancery Rules 100-104. In most jurisdictions, a judicial proceeding where all interested parties consent is an available option for seeking a trust modification or deviation.

   i. Requirements and Mechanics.

      (a) For an inter vivos trust that is not subject to the exclusive or continuing jurisdiction of another state, the key to utilizing the consent petition process is to ensure that a Delaware trustee is serving prior to filing the petition which will, in most cases following the Peierls opinions (as decided by the Delaware Supreme Court on October 4, 2013), ensure that Delaware law governs the administration of the trust.

      (b) For a testamentary trust, if there is ongoing accountability to a non-Delaware court this would likely cause such other court to have "primary supervision" over the trust, necessitating an order from such court terminating their primary supervision or transferring administrative situs of the trust to Delaware before the Delaware Chancery Court will exercise jurisdiction and consider a petition to modify the trust.

      (c) All interested parties, as defined in Chancery Court Rule 101(a)(7), must consent or not object to the relief requested pursuant to the petition. Under certain circumstances a guardian ad litem may need to be appointed by the Court to represent the interests of minor or unborn beneficiaries in the event Delaware's virtual representation statute, 12 Del. C. § 3547, cannot be used.

      (d) In general, modifying any of the administrative provisions of a trust is permitted. In some cases, modification of beneficial provisions is also possible, especially if the goal is to obtain a specific tax benefit or objective.

   ii. Potential Advantages and Disadvantages.

      (a) If successful, all interested parties have consented or not objected to the modification, and the modification has been approved by a court of competent jurisdiction. This would make it difficult for a party to later challenge the modification, and in particular gives significant assurance to Trustees and other fiduciaries.

      (b) If the grantor of the trust is living, the grantor can sign an Affidavit stating that the grantor does not object or takes no position with respect to the relief requested in the petition, while also stating that the addition of quiet trust provisions (1) is consistent with the grantor's intent in creating the trust, and

may have even been originally included in the trust of the grantor was aware of the option, and (2) does not violate a material purpose of the trust. The Affidavit will go a long way in convincing the Court that the addition of quiet trust provision would not violate the grantor's intent.

(c) A potential issue is the treatment of minor or unborn beneficiaries. If an adult beneficiary may not virtually represent minor or unborn beneficiaries, the Court may appoint a Guardian *Ad Litem* to represent such minor or unborn beneficiaries, which can add to the time, expense and uncertainty of the outcome of the matter.

(d) The approach that the Delaware Chancery Court would likely find most acceptable would be to add Designated Representative (or similar) position, where such Designated Representative received notice on behalf of beneficiaries under a certain age and which is acting in a fiduciary capacity.

2. Decanting. Decanting under Delaware law is governed by 12 Del. C. § 3528.

i. Requirements and Mechanics.

(a) Delaware's decanting statute is available to a trustee when Delaware law governs the administration of the trust or when the trust is administered in Delaware. 12 Del. C. § 3528(f).

(b) A trustee that has authority under the terms of the trust instrument (the first trust) to invade principal for the benefit of one or more beneficiaries, to exercise such authority by appointing all or a portion of the principal subject to the power of invasion in favor of a trustee under a separate instrument (a second trust). 12 Del. C. § 3528(a).

(c) Decanting can be utilized to make significant changes to a trust by decanting it into a new trust with the desired administrative provisions.

(d) Some of the key requirements of the decanting statute include:

- The beneficiaries of the second trust must also be beneficiaries of the first trust. 12 Del. C. § 3528(a)(1).
- The second trust may not alter the beneficial interests of beneficiaries of the first trust that are not proper objects of the exercise of the power of invasion. 12 Del. C. § 3528(a)(1).
- The second trust must comply with any standard that limits the trustee's authority to make distributions from the first trust. 12 Del. C. § 3528(a).

- A written "decanting instrument" must be signed and acknowledged by the trustee and filed with the records of the trust. 12 Del. C. § 3528(b).

(e) While the second trust may not have beneficiaries who are not also beneficiaries of the first trust, the decanting statute specifically permits the second trust to grant a beneficiary of the first trust a limited or general power of appointment thereby allowing the beneficiary to appoint trust property to a person who is not a beneficiary of the first trust. 12 Del. C. § 3528(a).

(f) Unlike consent Petitions, the trustee does not need the consent of the beneficiaries or any other interested party to exercise its decanting power. However, because decanting is an exercise of the trustee's discretion it is common practice in Delaware to have the beneficiaries consent to the decanting and release and indemnify the trustee from any liability in connection with the decanting.

ii. Potential Advantages and Disadvantages.

(a) Less time and expense than typically associated with a judicial proceeding to modify the trust.

(b) Notice to beneficiaries is not required under the statute. Therefore, in certain circumstances where it might be in the best interests of a beneficiary to delay notice of his or her interest the trust beyond the time originally specified in the trust (e.g., if a beneficiary has a severe substance abuse problem), decanting can be accomplished and the desired quiet trust provisions included in the second trust without notifying the beneficiary.

(c) If virtual representation is not available, certain minor or unborn beneficiaries will not be represented for purposes of any consent, release, and indemnity agreement signed by all other interested parties to the trust.

3. Merger. Merger under Delaware law is governed by 12 Del. C. § 3325(29).

i. Requirements and Mechanics.

(a) Delaware's merger statute is available to a trustee when Delaware law governs the administration of the trust.

(b) There are 35 states (including Delaware) plus the District of Columbia that allow for trust mergers without judicial involvement, and other states may permit merger via the state's common law.

(c) The trustee is authorized to "[m]erge any 2 or more trusts, whether or not created by the same trustor, to be held and administered as a single trust if such a merger would not result in a material change in the beneficial interests of the trust beneficiaries, or any of them, in the trust."

(d) Any changes to administrative provisions available through the consent petition process or decanting could also be accomplished by merger, including the addition of Investment Direction Adviser, Distribution Advisers and Trust Protectors.

(e) Similar to decanting, merger is an exercise of the trustee's discretion. While not required under the statute, the trustee may seek a consent, release and indemnity from the trust beneficiaries and other interested parties before effectuating a merger.

ii. Potential Advantages and Disadvantages.

(a) Less time and expense than typically associated with a judicial proceeding to modify the trust.

(b) As with decanting, notice to beneficiaries is not required under the statute.

(c) If virtual representation is not available, certain minor or unborn beneficiaries will not be represented for purposes of any consent, release, and indemnity agreement signed by all other interested parties to the trust.

(d) Possible argument that including quiet trust provisions in the surviving trust that were not included in the original trust rises to the level of a "material change in the beneficial interests of the trust beneficiaries."

4. Nonjudicial Settlement Agreements. Nonjudicial settlement agreements ("NJSAs") under Delaware law are governed by 12 Del. C. § 3338.

i. Requirements and Mechanics.

(a) Parties may utilize Delaware's nonjudicial settlement agreement statute when Delaware law governs the administration of the trust.

(b) Requires the agreement of all "interested persons" whose consent would be needed to achieve a binding settlement in the Delaware Court of Chancery. 12 Del. C. § 3338(a).

(c) The interested persons may enter into a binding agreement "with respect to *any matter involving a trust*…" (except with respect to charitable trusts and purpose trusts described in 12 Del. C. § 3541). 12 Del. C. § 3338(b) (emphasis added). The phrase "any matter" is inclusive rather than restrictive, suggesting that the presumption should be that any matter does fall within the proper subject matter of a nonjudicial settlement agreement rather than not, including trust modifications.

(d) A nonjudicial settlement agreement is "only valid to the extent it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by the Court of Chancery under this title or other applicable law." 12 Del. C. § 3338(c).

ii. Potential Advantages and Disadvantages.

(a) Less time and expense than typically associated with a judicial proceeding to modify the trust.

(b) If virtual representation is not available, certain minor or unborn beneficiaries cannot be represented, and arguably the statute cannot be used due to not having all "interested persons" enter into the agreement.

(c) Any interested person may seek judicial determination to interpret, apply, enforce or determine the validity of a nonjudicial settlement agreement. 12 Del. C. § 3338(e).