Crossing the Delaware: Directed Trusts For Complex Families

By Alex Lyden-Horn

Modern family wealth is increasingly mobile, global and entrepreneurial, often sourced in a variety of ways and allocated across a range of traditional and nontraditional investments. Families have lived through tumultuous social, economic and political times, and understand that the future is impossible to predict. Like them, their estate plans have to be adaptable.

While a well-crafted traditional trust, as described by Jeff Maurer on page 17, often makes the most sense for most families, more complex trusts established in certain trust-friendly states can provide enhanced flexibility to those with special circumstances.

Let's consider some of the key options available in these jurisdictions: bifurcation of trust functions; the ability to retain a beneficial interest in the trust; control over trust information; and flexible options for existing trusts.

BIFURCATION OF TRADITIONAL TRUST FUNCTIONS

A typical trust appoints a trustee with authority for investments and distributions. A directed trust allows for the allocation of those functions to a separate advisor or advisors. There are generally no statutory requirements for or limitations on how these roles are defined, meaning that they can be completely customized to meet specific needs.

For example, a special asset advisor can be appointed solely to oversee a closely held operating business, with the trustee continuing to provide traditional investment management services for the remaining assets. Similarly, a special distribution advisor can be appointed to control distributions for a beneficiary with special needs or substance abuse concerns, with the trustee retaining distribution authority for the remaining beneficiaries. It is also possible to appoint an advisory committee rather than a single advisor, thereby providing opportunities for family members, across multiple generations, to be involved in trust decision making (subject to any

limitations on related powerholders under the tax laws).

Directed trust statutes also permit the appointment of a trust protector, who may be given broad powers to oversee the administration of the trust and to intervene when necessary. Common powers given to the trust protector include the power to amend the trust (including dispositive provisions), the power to add or remove beneficiaries, the power to change situs, the power to remove the trustee (and other advisors) and appoint successors, the power to divide, merge, combine or decant the trust, and even the power to terminate the trust early and distribute the assets outright. With perpetual or dynasty trusts that are designed to last for multiple generations, it is important to maintain the ability to modify or adapt the trust to take into account changes in circumstances that may affect the suitability of the original plan put in place for beneficiaries. Vesting those powers in a carefully selected independent trust protector provides continuity of oversight in the event of incapacity or death and can ensure that the trust can be monitored to avoid adverse tax consequences.

RETAINING A BENEFICIAL INTEREST IN THE TRUST

Several states now have laws expressly permitting the creation of a self-settled trust, often referred to as an asset protection trust. What sets these apart from traditional trusts is that they permit an individual to name themselves as a beneficiary of their own irrevocable trust, while still having the trust assets protected from their creditors (and excluded from their estate, if properly structured as a completed gift). While, as the name suggests, these trusts are typically used for asset protection purposes, the ability for the grantor to retain a beneficial interest, while still having the trust be treated as a completed gift, adds an invaluable level of flexibility to any trust structure.

Another example, is a traditional dynasty trust, funded with an individual's entire lifetime exemption, which would ordinarily place those assets outside the reach of that individual should a financial need arise in the future, a consideration that many families find discouraging. One popular option is to include the spouse as a discretionary beneficiary, giving the grantor an indirect means to access the assets in the future. This does come with its own set of potential pitfalls, particularly if both spouses wish to establish trusts. This also isn't an option for unmarried individuals. However, in an asset protection trust jurisdiction such as Delaware, the grantor can simply name themselves as a beneficiary of the trust, without changing its status as a completed gift dynasty trust.

Some advisors may consider the creation of a self-settled trust to be an overly aggressive strategy, given the relatively unproven nature of the structure from an estate and gift tax perspective, particularly for clients living in jurisdictions that do not allow asset protection trusts. It may be highly unlikely that the grantor would ever need to access the trust assets. In that case, a more conservative option would be a hybrid approach, whereby a trust is created in an asset protection trust jurisdiction and is structured in a way that it would qualify as a valid asset protection trust, but the grantor is not included as a beneficiary from the outset. Instead, a trust protector is given the power to add beneficiaries from a class that includes the grantor. In this way, at the time of creation and unless or until the grantor is added as a beneficiary, the trust would be treated as nothing more than a traditional completed gift dynasty trust. The grantor still retains the option to be added as a beneficiary should there be an extraordinary change in circumstances that necessitates access to the trust assets.

CONTROLLING THE FLOW OF INFORMATION

When creating a trust, it may be difficult to know how much information should be shared with trust beneficiaries and at what stage of their lives. Under most states' laws, a trustee, by default, is required to inform adult beneficiaries of the existence of the trust and their status as a beneficiary. The beneficiary may then be entitled to further information, including accountings and copies of trust documents, upon reasonable request. This may be problematic, for example, if a beneficiary has a spending problem or is likely to use the availability of trust assets as an excuse to not provide for themselves.

> *A more trust-friendly jurisdiction may provide significant advantages.*

However, Delaware and similar jurisdictions allow a trust instrument to limit or eliminate a beneficiary's right to be informed of the trust for a period of time, which may be based on several factors, including the lifetime of the grantor or the age of a beneficiary. During that period, a trustee can be permitted to share limited information with specific beneficiaries, or the trust can be completely "silent" until the period has lapsed. It should be noted that a completely silent trust can create administrative complications, particularly if the intent is to make distributions during the silent period. In that instance, a trust protector may be given the authority to modify the notification restrictions if they are no longer in the best interests of the beneficiaries. In addition, depending on the specific jurisdiction, a designated representative may be appointed to represent the beneficiaries and act on their behalf in any judicial or nonjudicial proceeding (including court proceedings and nonjudicial settlement agreements) during the silent period.

OPTIONS FOR EXISTING TRUSTS

Depending on the terms of the trust and the laws of the trust's home jurisdiction, moving a trust to take advantage of the above strategies may be as simple as appointing a trustee authorized to administer the trust in the new jurisdiction, with no court proceedings required. Often, the governing law of the trust will change immediately upon the change in the place of administration. The trust can then fully avail itself of the various modification options under the new jurisdiction law, which may include decantings, mergers, nonjudicial settlement agreements, and modifications by consent.

These options are not for everyone. Establishing a trust in or moving an existing trust to a jurisdiction other than the grantor's home jurisdiction invariably involves an additional level of time and expense, and often requires the retention of separate local counsel. In addition, deviations from the traditional trust structure, whether through a directed trust, a self-settled trust or a silent trust, provide an additional level of administrative complexity that should be balanced against the potential gains, in consultation with advisors. However, for the increasing number of families with complicated estate planning needs, a more trust-friendly jurisdiction may be able to provide significant advantages, and can serve as a valuable complement to traditional trusts as part of a comprehensive estate plan.

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