Mary Vandenack provides the transcript from Legal Visionaries podcast on Converting “Loud” Trusts and Key Insights on “Silence”

TRANSCRIPT:

Mary: On today's episode, my guest is Vincent Thomas. Vincent is a partner at Young Conaway Stargatt & Taylor, LLP. I asked Vincent to participate in this episode to discuss a topic that we decided to title Converting a Loud Trust to a Silent Trust and Key Issues in Drafting Silent Trusts. We did a previous episode where Vincent explained what a silent trust is and why it matters. Thanks for joining me again today.

Vincent: Yeah. Thanks, Mary, and I just want to reiterate again, as I said in the last session, it's quite an honor to be here with you. You're such an esteemed member of our national trusts and estates board that I'm honored to be here, and I say that genuinely.

Mary: Thank you. I very much enjoy it when we have connected at various events, and I'm hoping I'll see you at one again soon. As we start, can you just do a brief reminder of the concept of the silent trust?

Vincent: Yeah. Sure. Silent trust, or some people call it a quiet trust, is just a trust where the trustees and other fiduciaries have no obligation to provide any information to the beneficiaries concerning the trust or its assets. In most of the 50 states or, I think, all of the 50 states for that matter, the default rule is that information must be provided to the beneficiaries. The 50 states differ, as we talked about in the last session, about how much and what are the default rules, and then some states allow you to take it a step further and override the default rule and make the trust a silent or quiet trust so that no information has to be provided to the beneficiaries.

Mary: If a client has a trust that's a loud trust, are there strategies that they can use to silence it?

Vincent: There are. I would say it is not easy and it creates a little bit of a dicey situation, but, with the right factual situation and the right jurisdiction, I think there are some ways to take a loud trust and make it a silent trust.

Mary: Can you talk about what the methods are?

Vincent: Yeah. There are usually six options to consider, and it all depends upon the jurisdiction you're in. I think really one option often tends to be the preferred option, which is the decanting, and if the state statute permits the decanting in whatever jurisdiction you're in or, if it doesn't, you can move it to a jurisdiction like Delaware, Nevada or South Dakota. One of those jurisdictions that permit decanting, also have silent trusts. The other five would be merger, nonjudicial settlement agreement, nonjudicial modification agreement, a court petition and then, in Delaware, there's this Section 3343, allocation of trustee duties. Again, decanting tends to be the best option, which we can explain in a few minutes.

Mary: Yeah, so let's do talk about decanting. Can you give an example of that that will help listeners understand what that process means?

Vincent: Yeah. Sure. Let's just start with what is a decanting in general, and I'm flying at 30,000 feet here. It's a little bit more complex than this, but generally speaking, if a trustee has a right to invade principal for the benefit of a beneficiary, so maybe dad created a trust for three kids and it says, "The trustee could distribute income and principal to the three kids in the trustee's discretion." What the decanting statutes say in most jurisdictions is that, if the trustee can invade the principal and distribute to the beneficiary outright, instead of doing that, they could take the same principal and distribute it into a new trust for the same beneficiaries. In some jurisdictions, you can remove beneficiaries. Most of the times, you can't add beneficiaries.

If we're looking to do something like create a silent trust, what we could do is take all the assets in trust A with the three kids and move them into trust B, have the same beneficial terms, but the new term would be a silent trust feature and turn off the notice to those three kids. Where we see it come into play, and I'm talking about it in the context of our prior podcast, is to take the trust example where I said, "Client is doing estate planning." Kids are eight and nine, and they're moving a $100 million business into a trust through sale techniques or other techniques and using the now $13.61 million exemption and, fast-forward, they create that trust in a jurisdiction that isn't a silent trust jurisdiction. Now, the client is faced with the eight, nine-year-old who are now 17 and 16, and the trustee comes to the client and says, "Oh, by the way, your 17-year-old daughter, she needs to get notice about this next year when she turns 18," and the client is very upset about that, and now the $100 million trust is $200 million. In those situations, those clients are looking to move it. What would happen in the

decanting is you'd move that client to a jurisdiction that allows decanting's and also allows silent trusts so we'd change the status of the trust and then the administrative law that state should apply and that decanting statute should apply. If we're talking about Delaware, Delaware's decanting statute would apply if a Delaware trustee was appointed onto that trust. At that point, that trustee could then exercise its discretion to take the assets from trust A and put them in trust B, and trust B has a silent trust provisions that we're looking for.

Now, I'll tell you, the practical problem with this and the reason why I said, "Maybe," when I said, "Could you modify?" is really dealing with what the trustee is going to require to take that act. I think most prudent trustees would be very concerned with taking an action, a discretionary action. That means it's their decision and, making that decision to move the assets into a trust, that strips the beneficiary of a fundamental right. I could make a decent argument that the right to notice is the most fundamental right because, if you don't know about the trust, how can then you take advantage of distributions for the trust or anything, any other benefit from the trust?

I would tell you, most prudent trustees are very concerned about that. They'd say, "Well, am I breaching my fiduciary duty by doing this decanting and removing the most fundamental right?" When faced with this, Delaware has a unique statute. I had the privilege of participating in drafting it, and we drafted it for this purpose. I'm not aware of any other jurisdiction that has a statute like this. It's connected to our silent trust statute, ironically enough, through the designated representative. What the statute allows is it allows a trustor of a trust to appoint a designated representative for the beneficiary even if there isn't silent trust language. Let's go back to that example client. The client, they formed a trust in a non-silent trust state like California and the beneficiary is about to turn 18. We moved that trust to Delaware, and we were looking to decant it to make it silent, and we appoint any bank. I'll pick Bank of America today. Bank of America or some other bank is the trustee, and they say, "Well, we're not going to do this because we're concerned about getting sued because we removed or we're removing a fundamental right to notice." They say, "Well, we'll do it if we get it released from all the beneficiaries." Now, the client is probably going to say, "Well, that's great. How am I going to get a release from the two kids that I don't want to tell about it?" The Delaware statute would allow us to appoint a designated representative for those two beneficiaries, and that designated representative can then sign off on a release for those two

beneficiaries. Now it's going to put the designated representative in a little bit of a pickle in how they get comfortable signing off on removing notice, but I think, with the right facts and the right documentation, you may be able to get there. I think, if we can document good reasons why we think it's in the best interest of the beneficiaries to remove the notice obligation and what beneficiary safeguards have been put in place during the silent trust period, maybe you can get a designated representative comfortable with the approach.

I would tell you, most trustors are appointing a designated representative that they know and are comfortable with. Under our statute, it cannot be someone related or subordinate to the trustor or the beneficiary. It is going to have to be an independent, but things that we'll do in this situation to demonstrate is we would say, "Hey, the trust has $200 million. If Sally, the 17-year-old, gets notice, which is 18, we think it will have this effect on it. These are the reasons why, but we're willing to give her notice when she turns 25. In the meantime, we're going to have this person serve as designated representative and get notice on her behalf and protect her interests and make sure nothing untoward is happening."

Under those circumstances, maybe you get a designated representative to sign off on it, and then they would release the bank or trust company that would be doing the decanting. That's typically the process. Again, we're seeing most folks flock to Delaware to engage in that process given our unique statute. That statute for any tax geeks like me is 3339 and, the statute 3339-A4, that allows for the appointment of a designated representative. In these limited circumstances, I would tell you, in most states, you can only appoint a designated representative when you have a silent trust and, obviously, this would be appointing a designated representative before the trust is silent which, fortunately, our statute now allows.

This is only going to work if you have the trustor living. That's how we justified it. For anybody thinking, well, how did Delaware get comfortable? Well, we had our legislature get comfortable with that. When I was drafting the statute, Delaware's hallmark is trustor intent controls. The whole concept was, well, if the trustor, once appointed designated representative for the beneficiaries, he or she should be able to do that. That's how Delaware got comfortable with that. I think it works and, in the right circumstances, I think that's the pathway to modifying a non-silent trust or a loud trust and making it a silent trust.

Mary: I just have to ask what the strategy is if the trustor is deceased and we have these minor children? Let's just say they're wild children, who it's really clear we have one kid has major serious drug problems, the other's got serious mental health issues. I have a trust in Nebraska because, I will tell you, that we are a loud trust state, and so I want to move it to Delaware, but my trustor is dead. Are there any solutions?

Vincent: Yeah. I mean, we can still go through the same process of a decanting. It just becomes a practical issue of will the bank or trust company or whoever the trustee is or fiduciary controlling the decanting, maybe we can put that in a distribution advisor if we have a directed trust, will they exercise discretion and move the assets into a new trust that strips the beneficiary of notice? I think, under the facts that you presented, I could make a pretty compelling argument that the fiduciary's exercise of discretion to do that was justified and warranted. It wasn't an abuse of discretion. I just see most trustees getting really uneasy about it. It puts them in a difficult position.

I could tell you we've had some success convincing some financial institutions to do it and sort of pressured them into that situation and, really, the argument has been not doing this is more of a breach of fiduciary duty than doing it, and it's for the reasons you said. You have those wild kids. They have substance abuse issues. If they get notice at 18, it's going to be wildly detrimental to their situation. Some of the things we've done to try to get trust companies comfortable would be to get letters from a psychologist. We even had one where the beneficiary was working with a social worker in a group home, and that social worker said, "If they get this information, it is going to be catastrophic to their development and really make things go sideways," and then we sent that to the trustee and suggested that they should participate in decanting and were successful doing it. Then, also, along the same lines, we're baking in those protections of adding a designated representative, making sure that the silent trust period can be terminated if their situation resolves itself. Maybe they get treatment and they're doing well. In that case, then the reason for making it silent has disappeared and so should the silent trust period, and then also terminating it at a particular age. I think, with those safeguards in place, hopefully you can get a trustee comfortable. That trustor living approach just created a mechanism to really take the trustee out of it because, pretty much, any trustee I've worked with will do it if they get an adequate release. It's the situation where you can't provide the release. The strategy of the decanting will work even if the trustor is not living. You just won't be

able to probably give the trustees a release for the beneficiaries whose notice rights is being stripped.

Now, one other point there to think about, Delaware or other states have virtual representation. The other way we've sometimes gotten around that release issue is having the parents of those minors step in under Delaware's virtual representation statute and represent them. The issue I see is, typically, those parents are the same persons pressing to make the trust silent and they're the same people trying to protect the information inside the trust. If they have a conflict of interests, their virtual representation is invalid under Delaware law. It's a real gray area whether a conflict exists.

I can tell you there's an unreported case in Delaware. It wasn't my case. I just happened to be sitting in the courtroom that day waiting for my case. A lawyer was arguing with the then-chancellor in Delaware that there was no conflict of interest by virtue of the parent representing their kids and trying to make a trust silent, and the court didn't buy that argument. Ultimately, the lawyer just withdrew the petition, so there's no case law on it, but at least that chancellor said, "Look, I don't buy that there's not a conflict of interest between the parent who wants to trust to be silent and the 17-year-old who would take the opposite position. They will say, 'No. I want notice.'" He was viewing it more, yeah, as sort of subjective views.

Definitely, the avenues if you don't have the trustor living, I think, you just have to deal with the practicality of, "Can you get a trustee on board that'll do decanting?". One of the things I mentioned is the bifurcation of trustee responsibilities, and that's 3343. That's a pretty unique statute to Delaware that allows a party that has the ability to remove and appoint a trustee.

Let me take a step back. Let's say we have a trustee, full fiduciary, they do everything, investments, distributions, all decisions. Delaware will allow the person that has the ability to remove that trustee and remove them and then appoint them and say, "Hey, your new role is only going to be investments, and I'm going to appoint trustee X to handle distributions." That's bifurcating the duties. We could also bifurcate the duties and say, "Trustee Y is going to handle decanting decisions," and maybe trustee Y is someone you know that will take this particular action of decanting and moving it to a silent trust so you can try to bifurcate and get the bank away from the process because banks tend to be conservative on this issue. If you don't have the situation where you can give them a release, maybe trustee Y is the best approach.

I think it all stems back to decanting, and the reason I say that the other ones I mentioned, the trust merger, nonjudicial settlement agreement, nonjudicial modification agreement, all of those require participation by the beneficiaries. Other merger, not just settlement agreement, modification agreement, require that participation of the beneficiaries to have a valid act. Unless you have someone representing them, you're not going to be able to use those. Trust merger, I would just say most people don't love that because most state statutes on merger say something to the effect of, "The beneficial interests have to be substantially the same or similar."

Now it begs the question of is taking away notice substantially altering the beneficial interest? For that reason, I think most people would just use the decanting to steer clear of whether you've altered beneficial interest by making a trust silent.

Mary: I just have to tell you a funny story, because I serve on a legislative committee in my home state and I'm a bit of an advocate of the silent trust. We don't have a silent trust statute here. Somebody introduced legislation to change that last year. I supported it and mentioned the fact that I move a lot of trust to different states because some of the laws here aren't that favorable to trustor intent. I have to tell you, it was like I had a lot of lawyers standing up yelling at me about how important it was to have notice to beneficiaries. It was a lesson for me that there's significantly different opinions on that. I think you raised a really good point. As much as you'd like to think the trustee will cooperate, they clearly have a fiduciary duty that they have to consider. I like the point you made that that could go other way. Either way, if we have those irresponsible beneficiaries, then it's really something to be looked at. What I do want to do is shift to talking a little bit about some of the suggestions you have on drafting a silent trust. If we actually have the opportunity now today and we've had the conversation with the client and said, "Let's talk about the duties to notify," and they're like, "Oh, yeah, that concerns me a lot to think about that 17 or 18-year-old knowing these details." Do you have some suggestions on drafting the silent trust? What do we need to include?

Vincent: Yeah. I would start with drafting is the key. The better the drafting, the more successful the trust would be. Bad drafting can make a bad result. First, it needs to be clear that the trustee shall not notify. That is very different from the trustee which you'll have no duty to notify. I would tell you, most, if not all, institutional trustees would interpret the latter, "the trustee shall have no duty to notify", as not a silent trust. They're going to

just say, "That means I don't have the duty, but I still have the discretion, and I'm going to exercise my discretion to provide notice in accordance with the default principles." If, however, it says, "The trustee shall not notify," that they can't do anything, the trustor has specifically said, "They shall not notify," and that will make the trust a silent trust. Certainly, under Delaware law, definitely check the jurisdictions, other jurisdictions if you're there, but that's the practice in Delaware.

Number two, be specific on the information withheld. I would tell you, in most situations where we're drafting these, it's everything. The client doesn't want to disclose anything, but we've had a limited set of cases where the client says, "Look, I don't have a problem with the client or the beneficiaries knowing the existence of the trust. I just don't want them to know what's in it," or, "I don't have a problem with them knowing about the liquid portfolio and the trust that's $10 million. I just don't want them to know about the $200 million business that's there." It can be drafted artfully to capture those situations but be specific on information withheld.

I think number three is addressing the designated representative aspect. There's a lot of things there. The appointment of the designated representative, resignation, successors. This is obviously a very important position, so you want to have some mechanism that successors can be appointed. What a lot of people rely upon on, if you think about trustee appointment, it usually defaults to the beneficiaries at the end. This isn't a situation where you're going to be defaulting to beneficiaries. Beneficiaries don't know about the trust, so you might need to default to a trust protector or maybe you're defaulting to some family member, or maybe were defaulting to older beneficiaries that have already received notice. Think through that in the drafting process.

Other items to think through, for the designated representative, standard of care, indemnification. Advancement is a big one, I'm seeing more and more. A lot of state statutes don't address advancement. I see plenty of trust agreements that provide indemnification, but we've been involved in some interesting suits lately where there's an indemnification provision for a fiduciary and that fiduciary is wrapped up in litigation, and the trustee is really concerned about distributing proceeds for legal fees for that fiduciary because they don't know if the fiduciary is liable or not. Without an advancement provision, the designated representative doesn't hold the purse strings. They're not going to get anything out of that trustee perhaps, and now they're out-of-pocket and unable to protect themselves.

A couple of things to think about, as the counsel there, I mean, sometimes we're asked to represent designated representatives before they sign on, and we're always pressing for an advancement provision, indemnification, standard of care. In Delaware, you can take it all the way to willful misconduct. That's as far as you can go, but that's effectively fraud, so we would typically look to have the DR only liable for willful misconduct, so all really important provisions. The last item to consider on the designated representative would be compensation. Should the designated representative be compensated or not? Address it one way or the other, whether it's reasonable compensation, a fixed salary or whatever the trustor prefers.

Mary: Those are great points. I really appreciate them. Any other thoughts you want to add on drafting?

Vincent: Yeah. I think there's a number of practical considerations to consider when drafting. One of the biggest ones I've talked to clients about is the consequence of distribution. If it's a silent trust, then it's a non-grantor trust and there's a distribution, and that distribution happens to be of DNI, or distributable net income. That income is flowing out to that beneficiary that just received the distribution. If that beneficiary is 22 and they participate in the tax returns that we made, let's say we made a distribution from the trust directly to their college or their educational institution or for some other personal benefit that they don't necessarily know, they got a distribution, but one was made and it happens to be income, they're then going to see it on their income tax return. You have to be really careful and make sure you've talked through this with your clients if distributions are anticipated during the silent trust period.

If it's a grantor trust on the other hand, the income tax attributes are going to flow back to the grantor, so it may be a little bit of an easier issue to deal with for grantor trust. Crummey powers, we sometimes see a mistake in drafting there where it's a silent trust, but then there's this Crummey power that provides notice to the beneficiaries. That needs to be dealt with one way or the other. I don't love including the Crummey powers in our silent trusts. If push comes a shove, we'll perhaps do it and then let the designated representative act on behalf of the beneficiary. That should work. I think it's a little bit of a gray area.

The third thing that we've seen come about a handful of times is silent trust. Let's use Sally again. Sally's got a silent trust until the age of 35, and she's 31. She's getting married. She accepts the advice of her parents and is

going to enter into a prenuptial agreement. As you know, in the prenuptial agreement, you typically have to disclose your assets. She doesn't even know she's a beneficiary of a $100 million trust. How do you deal with that issue? I don't have great answers there. The one thing is maybe you terminate the silent period that time. Maybe you have the DR participate, the designated representative that is, participate in the prenuptial and add the disclosures and work with Sally to not request additional information.

It's a real tricky situation if you want a binding prenup. I would say it's a minority of the cases because a lot of our clients have done enough planning and asset protection where Sally doesn't have to worry about a prenuptial agreement necessarily, but it has come into play. Certainly, be cognizant of that when you're representing these families and maybe participating in drafting the silent trust, and then Sally is going through the prenup, and you know about that, and Sally is not going to disclose the trust. It's something to be talked about with the family, whether they want to just let it ride and not disclose that. You should talk with the family law counsel about the impact that that may have on the enforceability of the prenuptial agreement or trying to find a way to thread the needle and provide notice and have Sally not ask anything more about it. We've had a few occasions where the parent is saying that "Sally is ready to get the information now. She's 31. She'll get to 35 anyway. Let's just terminate the period, put it in the trust, put it in the prenup and move ahead."

The last piece to think about from a practical standpoint is just the designated representative. I really want to emphasize the state income tax issues. As I said before, the designated representative is a fiduciary, so you have to be really careful with places like California, New Mexico, Oregon, Arizona which tax trusts on the basis of whether there's a fiduciary resident in those states. If you have a designated representative appointed on a Delaware trust and that designated representative happens to be a California resident, you may have just subjected that trust to California state income tax, so, again, be careful with New Mexico, Oregon, Arizona, other states to worry about there.

Be careful with conflicts of interest between the designated representative and the beneficiaries. If they exist, you can probably draft around them. Certainly, under Delaware law, you can. Actually, I just sent an update to the statute last night actually to the rest of my committee members providing that the conflict can be waived. If that gets through, you may see that next August. To Mary's point in our first podcast, that these laws are changing, make sure you're looking at the statutes regularly. When you're

appointing the designated representative, just think about the other practical issues as confidentiality. Usually, the families that we're drafting silent trust for are very wealthy and/or prominent families. The designated representative is going to get everything, so better be a trustworthy person. Make sure that that designated representative has a good relationship with the family, has the right age, capacity, et cetera, that you think about in any fiduciary situation. I think those are the real practical issues to think about when putting together a silent trust.

Mary: I would just add that I think what I've learned is that both security and privacy are really significant issues in dealing with some of your wealthy, and some of the families are just well-known, and so that's a great point. Well, we're at the end of our episode. Do you have any last thoughts?

Vincent: No. I think, as I said in the first one, I think these are great tools. I think you hit on the head of the push and pull that exists here with respect to beneficiary rights and notice being a fundamental right and shutting off that right. I lean to trustor intent. These trustor gifts and the trustor's money, they should be able to decide what they want to do with it. With that said, this tool, if not used correctly, becomes abusive actually and actually works against the trustor.

I really caution my clients not to be putting unreasonable periods of time with respect to the silent period like age 55 or age 60 because, at the end of the day, that's not going to be in the beneficiary's best interest either. I think it's likely to result in other administrative problems. This really should be used as a tool to help with educating the next generation or future generations on how to be good stewards of wealth. It's just a tool. It's not going to be served as a substitute to actually educating them and going through that process.

I'm sure Mary has many ideas on this. All of us have ideas on how you educate the next generation, but that's done over time. This allows you to control the spigot for a brief period of time. In my experience, clients that want to control the spigot forever end up doing more harm than good. I think this is a great tool in the toolbox, but it's one of the many tools to be used when educating the next generation on being good stewards of wealth.

Mary: I think that's a great point, and I'm proud to report that we have done a couple of episodes and actually recorded one on where we just had a legacy planning and how to pass on family wealth. As we reach the end of

our episode, I want to thank our sponsors, InterActive Legal, Foster Group, Veterans Victory, and Carson Private Client.

That's all for now. Thanks for listening to today's episode and stay tuned for our weekly releases.