October 13 2005

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State Law Allows Settlors to Modify Trustee Duty to Inform and Report

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Application

The laws of several US states enable a trust settlor to restrict disclosure to beneficiaries, adapting the trust form to offer a choice reflecting contemporary concerns about the confidentiality and management of wealth transfers. A settlor who wants a so-called 'quiet trust' (ie, a trust that speaks to the beneficiary only if and when needed) has an alternative to English law trusts requiring disclosure. A quiet trust can be classified as foreign for US federal tax purposes under the government's two-part test, even when it is established under the laws of a state within the United States (for further details please see "Taxation of Offshore Trusts and Impact of New Lower Tax Rates").

Trustee's Duty to Inform and Report

As under English trust law, the trust law of the various US states has traditionally imposed on the trustee a duty to inform beneficiaries of the existence of the trust. In general, the trustee is also required to provide beneficiaries with the following on request and at an appropriate time:

- a copy of the trust agreement;
- information regarding trust assets; and

- a trust accounting.

The scope of these duties and the extent to which a settlor may modify or waive them come into focus if the settlor expressly intends to prevent certain (or all) of the beneficiaries from learning about the trust - or at least the details of its terms and holdings - believing instead that the trustee will make the best decisions without the beneficiaries' intervention or knowledge. In some cases the settlor may wish to permit disclosure, but to leave it to the trustee's judgement as to timing and degree. With regard to such quiet trusts, over the years a gap has developed between the rule of law and actual practice (or at least preference) as to how much information should be made available, and to whom and when - especially where disclosure conflicts with the settlor's intentions.

Uniform Trust Code Duty to Inform and Report

The Uniform Trust Code is a model drafted by the National Conference of Commissioners on Uniform State Laws as a recommended statute for states to enact - ideally, with few changes - in order to promote uniformity among state trust laws. To date, it has been enacted in whole or in part by 15 states. The code re-states and revises many longstanding trust law rules and proposes new solutions to age-old questions. As originally proposed, the code prohibits quiet trusts by requiring trustees: (i) to notify qualified beneficiaries of an irrevocable trust who have attained 25 years of age of the existence of the trust, of the identity of the trustee and of their right to request trustee reports; and (ii) to respond to the request of a qualified beneficiary of an irrevocable trust for trustee reports and other information reasonably related to the administration of a trust.

Under the original code provisions, these requirements are mandatory and cannot be altered by the terms of the trust, although some variation was expected in the specified age of 25 years. Most importantly, a 'qualified beneficiary' is defined to include not only primary, but also contingent beneficiaries (ie, a current distributee or permissible distributee of trust income or principal, and one to whom the trustee would or may distribute upon termination of the interests of the primary beneficiaries or the trust). Therefore, a beneficiary who receives trust income until he or she is 40, at which time he or she receives the entire trust fund outright, is a qualified

beneficiary; but so too are his or her children, who would receive distributions if their parent died prematurely. The list of disclosures required by the code is extensive and includes a copy of the entire trust document whenever requested and complete financial accounts at least annually.

State Modification Allowing Settlor Choice

The code drafters supported the ban on quiet trusts on the grounds that the trustee's duty to account to beneficiaries is an essential ingredient of a trust, promoting trustee responsibility and responsiveness and a healthy beneficiary relationship. However, modern US trust laws have moved towards giving choices to the settlor, so that each trust can be fashioned to the needs of its users and the method by which accountability is assured can be written into the trust document.

Indeed, the legislative trend in the United States has moved towards fewer restrictions on trusts and especially on what provisions may be chosen by the settlor. State trust laws have liberalized the restrictions on perpetual trusts, the procedures for changing irrevocable trusts and settling trust controversies, and the customary prohibitions against delegation and an express allocation or division of fiduciary responsibilities. Other changes have opened up the trust investment process and reduced the cost of regulation surrounding wealth transfers by liberalizing probate laws and embracing the prudent investor rule. Many of these new developments are actually incorporated in the model code and in general the code allows the settlor great latitude in specifying the trust terms. However, the code took a more traditional course in prohibiting quiet trusts.

Accordingly, in enacting the code, several states decided to reject its model provisions, and modified the duties to inform and report imposed on trustees, most notably allowing the settlor to specify a different standard or method for controlling information (ie, a quiet trust). In particular, the approach of the District of Columbia allows for quiet trusts without allowing the settlor completely to eliminate the duties to inform and report.

The District of Columbia's version of the code provides the following ways in which a settlor, in the trust instrument or other writing delivered to the trustee, may waive or modify the trustee's duties to give notice, information and reports to the beneficiaries:

- The settlor may waive or modify such duties during the settlor's life or the life of the settlor's surviving spouse;

- The settlor may specify a different age at which a beneficiary or class of beneficiaries must be notified; and

- The settlor may designate a surrogate person or persons (eg, a protector) to act in good faith to protect the interests of beneficiaries and to receive any notice, information or reports in lieu of providing such to the beneficiaries themselves.

The versions of the code enacted in Oregon and Maine also provide for a surrogate. Seven other states (Kansas, Tennessee, Utah, Wyoming, Arkansas, Virginia and South Carolina) have taken a more extreme step and completely deleted the code provisions that prohibited quiet trusts, apparently allowing the settlor entirely to waive the duties to inform and report. In these states, thoughtful settlors can select the same structure as the District of Columbia simply by writing the protector's role into the trust document as a condition of the waiver of the duty.

The trend of allowing the settlor freedom to modify the trustee's duty to inform and report is likely to continue in the United States - even if the code is enacted in more states - because the model statute has now been amended to reflect that enacting states may choose to allow quiet trusts in some way.

Application

The structure permitted by the law of the District of Columbia could be adapted in a wide variety of quiet trusts to fit individual circumstances. For instance, management of substantial funds in a quiet trust during a long period of time could provide for a review by a respected third party (eg, an independent professional trustee) every few years or for an accounting or both. The review would help to discourage neglect and collusion, and would assure trustees that their stewardship of the trust is unlikely to be challenged later.

In the event of a court proceeding, the un-informed beneficiary could be given such information, if any, as the protector saw fit, and any decisions could be made, if necessary, by a guardian *ad litem* (for the suit) acting for the beneficiary. Local law or court procedures that provide for the sealing of the court record on personal trust and estate matters, usually upon a showing of good cause, would allow the protector to maintain the intended confidentiality.

The option of a quiet trust would also provide creative uses of confidential gifts in trust. The founder of a privately owned business might wish to make transfers of stock into the trust, but not to encourage a debate over the direction of the business with more assertive younger family members, who are the intended beneficiaries and just learning the business. Using non-voting stock for the gift would be unlikely to provide enough reassurance and a quiet trust of non-voting stock would be far more reliable.

Settlors would also be free to create trusts for siblings intended purely as safety nets, to be used only if needed. In addition, they would be more free to use shifting and discretionary trust interests that applied different terms at different times, depending on the circumstances, for friends and family members of all degrees. A quiet trust arrangement would eliminate the potential embarrassment of having to tell almost every beneficiary about those parts of the document that were once operative but became obsolete for various personal reasons.

Quiet trusts that are more flexible and available would have less traditional disclosure, but be better suited to manage wealth transfers across a spectrum of different needs and family circumstances. Innovations of this kind help to keep the trust model adaptive and useful, and encourage further evolutionary improvements in trust governance while protecting the beneficiaries from breaches of trust.

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