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State Law Allows Settlors to Tailor Trust Investment Objectives

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The trust law of the various US states has traditionally required trustees to administer trust property solely in the best interests of the beneficiaries, to preserve the property and make it productive. A trustee under English trust law has a similar duty. The Uniform Trust Code, enacted in whole or in part by 15 states, modernizes the traditional trust law by affording the settlor considerable latitude to shape the relationship between the trust property and beneficiaries. As a result, the settlor may use a carefully drafted trust to serve purposes other than the traditional objective of prudent management by a trustee for the benefit of beneficiaries.

Beneficiaries' Best Interests

In general, state trust laws support a settlor's decision to authorize or even direct a trustee to retain inception assets. The terms of the trust may even modify the trustee's duty to diversify the trust portfolio. However, the trustee is not ordinarily justified in retaining such assets if, under the circumstances, retention would be imprudent. Nor is the trustee permitted to act recklessly or in disregard of the fiduciary duty of loyalty. The trustee may not be justified in retaining assets if such compliance would be injurious to the interest of the beneficiary or subject the beneficiary's interest to an unreasonable risk of loss.

Under traditional trust law standards, the trustee must continually address the following question: when does the risk of loss become so high from a directed retention of assets that the result would be imprudent, reckless or injurious to the interests of the beneficiary? The Uniform Trust Code, as enacted by the states, provides the means for the settlor to shift the purpose of the trust and relieve the trustee from liability when holding trust property subject to the higher risk of loss caused by lack of diversification and liquidity. Although the settlor's intent is still not given absolute primacy (eg, capricious or illegal trust purposes will not be honoured), the Uniform Trust Code adopts an approach that clearly favours the settlor's intentions.

Settlor Alteration of Traditional Investment Objectives

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. The code is primarily a default statute. It provides general trust provisions on which a settlor may wish to rely, but the settlor is generally free to override these provisions and prescribe the conditions under which his or her particular trust is to be administered. The duties and powers of a trustee, relations among trustees, and the rights and interests of a beneficiary may, with limited exceptions, be specified in the terms of the trust (for further details please see "State Law Allows Settlors to Modify Trustee Duty to Inform and Report").

The Uniform Trust Code provides that the terms of a trust prevail over any provision of the code, with certain exceptions. The exceptions are enumerated in Section 105(b) of the code, which states in part:

> "*The terms of a trust prevail over any provision of this [code] except:*
>
> > *(1) the requirements for creating a trust;*
> >
> > *(2) the duty of a trustee to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries;*
> >
> > *(3) the requirement that a trust and its terms be for the benefit of its beneficiaries, and that the trust have a purpose that is lawful, not contrary to public policy and possible to achieve;*"

The Uniform Trust Code does not alter the basic tenet that to be valid, all trusts, including purpose trusts, must have a purpose that is lawful, not contrary to public policy and possible to achieve. The methods to accomplish the purpose will not be enforced if they fail to meet the same criteria. According to the comments to the code, the relevant criteria can be found in the common law cases invalidating trust terms that, for instance, defraud creditors or otherwise encourage criminal or tortious conduct, restrict the exercise of religion or the freedom to marry, are racially discriminatory or are purely capricious, so that no benefit is provided by performance of the trust terms (eg, bricking up the windows and doors of a house in trust for a period of 20 years).

However, within these limits the Uniform Trust Code allows a settlor to alter the traditional objective of maximizing trust benefits for the beneficiary through prudent management and diversified investments.

Non-charitable purpose trusts

Under the terms of the Uniform Trust Code, the trust need not benefit ascertainable, individual beneficiaries. Under common law, a disposition of money for specified purposes, unless interpreted as charitable, is only honourary and does not create a trust. However, in addition to charitable trusts and trusts for the care of animals, the code authorizes non-charitable purpose trusts without ascertainable beneficiaries, subject to a maximum duration of 21 years. In enacting the code, states may select a different time limit. A non-charitable purpose trust may be enforced by a person appointed in the terms of the trust or, if no person is appointed, by a person appointed by the court.

Beneficiaries' benefits

The Uniform Trust Code requires trustees to administer trusts in the "interests of beneficiaries" but specifically defines that term to mean "the beneficial interests provided in the terms of the trust&qout;. Furthermore, according to the comments to Section 404 (on trust purposes) of the code, the requirement in Section 105(b)(3) that a trust and its terms must be for the benefit of the trust's beneficiaries implements the general purpose of trusts, which is "to benefit those beneficiaries in accordance with their interests *as defined in the trust's terms*" [emphasis added]. The comments confirm that a settlor has considerable latitude in specifying how a particular trust purpose is to be pursued, provided that the administrative and other non-dispositive trust terms reasonably relate to this purpose and do not divert the trust property to achieve a purpose that is invalid (eg, a frivolous or capricious purpose). Subject to this proviso, the terms of the trust, rather than abstract legal principles, define the beneficial interest bestowed by the settlor.

Relief of certain duties and protection from personal liability

The trust terms cannot relieve the trustee entirely of a fiduciary obligation and still establish a valid trust, but the Uniform Trust Code specifically permits a settlor to alter duties that include the following:

- to administer a trust with prudence;
- to take control of and safeguard trust property; and
- to diversify investments.

The trust terms can also be written to protect the trustee from personal liability in the event of a breach of trust, other than bad faith or reckless indifference.

Non-fiduciary with power to direct trustee

The most significant provision of the code provides that the terms of the trust may confer upon a person (individual or entity) a power to direct certain actions of the trustee. The trustee is required to act in accordance with the exercise of this power, unless the attempted direction is manifestly contrary to the terms of the trust or the trustee knows that it would constitute a serious breach of a fiduciary duty that the person holding the power owes to the beneficiaries of the trust.

However, the settlor can alter the code's provisions on powers to direct by providing that the trustee must accept the decision of the power holder without question. The trust terms can also specify that the power holder is not acting in a fiduciary capacity. Therefore, although the settlor cannot relieve the trustee of all fiduciary obligations, the power holder directing the investment of trust property need not be held to any fiduciary standard of responsibility if the terms of the trust so provide.

State Modification Supports Settlor Tailored Objectives

The legislative trend in the United States has moved towards fewer restrictions on trusts and what provisions the settlor may include. Even states that have not enacted the Uniform Trust Code have liberalized restrictions on perpetual trusts, procedures for changing irrevocable trusts and settling trust controversies, 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.

In enacting the Uniform Trust Code several states have made modifications further supporting a settlor's decision to fashion a trust that fits the individual circumstances of the trust property and beneficiaries. All but a couple of the states have omitted from Section 105(b)(2) the language regarding the interests of the beneficiaries. Therefore in these states, the terms of the trust prevail over any provision of the state code, except the duty of a trustee to act in good faith and in accordance with the purposes of the trust. Tennessee has gone even further and omits the 'in good faith' requirement.

All states enacting the Uniform Trust Code have retained the Section 105(b)(3) requirement that a trust and its terms must be for the benefit of the trust's beneficiaries, although the South Carolina Trust Code drops the requirement that the trust must not be contrary to public policy. Utah and

Missouri have gone a step further by also removing from Section 105(b)(3) the language that the trust must have a purpose that is lawful and possible to achieve.

Application to Modern Trust Planning

The Uniform Trust Code permits a settlor to create a valid trust in which the investment of trust property (eg, a business enterprise transferred to the trust by the settlor) can be governed by the standards the settlor specifies in the trust document. If clearly written, the terms will be respected even if they place the trust property at risk and thereby possibly leave the beneficiaries with no ultimate benefit.

In settling a trust in a state that has enacted the Uniform Trust Code, the settlor might utilize a purpose trust to own and operate the family business for the permitted term, during which the trustee has no beneficiaries to answer to. Alternatively, the settlor might name his or her business partner as a non-fiduciary adviser to direct the trustee with regard to the ownership of the business, but acting only as a non-fiduciary (or subject only to a duty to act in good faith). The trust can be classified as foreign (ie, not a US person for federal tax purposes under the government's two-part test), even when 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").

Even under the state-modified enactments of the Uniform Trust Code, the settlor is not permitted to create a trust which by its terms is intended to create waste or accomplish a frivolous purpose. Fortunately, that is typically not the intention of even the most strong-willed entrepreneur, but instead the goal is to give the settlor and thereafter the settlor's business associates unlimited (or at least very wide) discretion to hold the business in the face of the pronounced risk caused by lack of diversification and liquidity. Under the laws of the states that have enacted the Uniform Trust Code, this can now be accomplished in an irrevocable trust, even after the death of the settlor.

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