The Administration of Quiet Trusts And Decanting Trusts

New boundaries create challenging fiduciary decisions

In the past 15 years, many jurisdictions known for flexible trust laws such as Alaska, Delaware, Nevada, South Dakota and Wyoming have seen an increasing modernization of trust laws. This trend also seems to be spreading to many states that previously haven't been considered when thinking of flexible trust laws. Given the advent of directed trusts, decanting, quiet trusts, self-settled asset protection trusts and various other modern trust laws that began developing years ago, we now have experience with administering trusts under these flexible trust laws. We're finding that with these new horizons come issues that likely didn't exist before. Two areas that tend to go hand in hand are decanting (that is, distributing assets from an old trust to a new one) and quiet trusts (that is, keeping the existence of the trust or information about the trust from the beneficiaries). Let's focus on the realities of how these two topics can affect the administration of trusts and the decisions that corporate fiduciaries and individual trustees might face. These decisions can be particularly challenging, and there are many factors to weigh to reach a conclusion in any particular case.

Quiet Trusts
Communication with the grantor is important during the planning and drafting stage. If the grantor expects that notice will be restricted or delayed, this needs to be drafted into the trust, as discussed below. Assuming the grantor requested that the trust be drafted as a quiet trust, what issues can arise during its administration? If a beneficiary learns about the trust 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 wasn't 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'd known about the trust. Although the statute protects the trustee, there's still the possibility of a difficult client relationship with a beneficiary at a later time. A practical, and perhaps difficult, question could arise if the trustee knew that the beneficiary was in dire need of the distribution but was unable to discuss this with the beneficiary because the trust was a quiet trust, and the trustee was directed by a distribution advisor. How long should notice be delayed? There's a spectrum of fact patterns that might impact the trustee's relationship with the beneficiary when the beneficiary learns about the trust. For example, suppose the trustee is directed by quiet trust provisions in the trust agreement not to provide notice until the beneficiary reaches age 25 or completes his current college program, and that beneficiary is one or two years away from graduation. Perhaps that's a reasonable purpose and amount of time to withhold notice, and it's more likely that the beneficiary would be pleased when he learns about the trust. On the other end of the spectrum is the fact pattern in which the trustee is directed by quiet trust provisions not to provide notice to the beneficiary until a much later age or until the grantor's death. This could lead to the dissatisfied beneficiary/client described above. A practical question could arise as to whether the beneficiary's needs and property rights are being honored. It's helpful to have some guidelines, and the 2015 revisions to the Delaware statute provide guidance to the "period of time" that information can be withheld from beneficiaries. These guidelines aren't exclusive, but provide a safe harbor of sorts. The guidelines for the period that information can be withheld include: the age of a
beneficiary; the lifetime of the grantor(s); a term of years or a specific date; or a specific event that’s certain to occur.¹

One of the more obvious issues facing the trustee is the fact that there might be no beneficiary receiving statements, which means there’s no event to trigger 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 disclosed the facts constituting the claim.² 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 quiet trust, the beneficiary doesn’t receive any report to begin the statute of limitations period. However, a “beneficiary representative” might be used to address this issue.

Various jurisdictions including Delaware, Florida, Ohio, Pennsylvania and Washington, D.C. 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 didn’t receive the information.³ The purpose of these statutes is to strike a balance between the grantor’s right to privacy when creating the trust and the ability to enforce the beneficiaries’ rights concerning their interest in the trust.

Is the beneficiary representative a fiduciary? The answer varies by state. For example, the Florida statute provides that the beneficiary representative isn’t liable to the beneficiary as long as he acts with good faith, whereas the Delaware statute provides that the representative is a fiduciary unless the trust agreement provides otherwise. Who serves in this role? It’s not always easy to find someone willing to take on this responsibility. Nonetheless, if the quiet trust is created in a state that provides for this role, it might be advisable to draft the provisions into the trust so that the role can be filled at a later date.

Decanting

With decanting statutes enacted in over 24 states as of the date of this article,⁴ as well as permitted by case law in states such as Florida,⁵ New Jersey⁶ and Massachusetts,⁷ decanting has become more common over the years.

Decanting to change beneficial interests is perhaps the most difficult area to navigate. Although this could arise in many ways, two of the most common reasons for this request are: (1) grantors who’ve changed their minds about what they want their beneficiaries to receive outright, or (2) a potential new trust relationship coming to a corporate trustee, along with the grantor wanting to change some of the beneficial interests as part of the process.

Although there are various tax issues to consider, such as a generation-skipping transfer tax exemption being lost, there are instances in which the duration could be extended in a manner that won’t necessarily have adverse tax consequences.

Perhaps a beneficiary is about to reach the age of majority, and the trust is much larger than the grantor ever imagined. Many individuals created significant wealth in the various wealth cycles since the 1990s and often used good wealth transfer techniques such as placing the assets in trusts for beneficiaries. Often, these would be dynasty or other long-term trusts, but it’s also common to see trusts created for young children in which the assets are distributable outright when that child reaches a certain age (for example, 25). Now the beneficiary is 24, and his parents realize that in a year, he’ll receive a very large sum of money outright. Although “a very large sum of money” is a relative term,
one can imagine scenarios in which many would agree that it’s too much money for a 25-year-old young adult to have outright. What if the trust has been a quiet trust, the beneficiary has no idea that he’ll be entitled to these assets outright in a year and the parents ask the trustee to decant into a new trust that extends the duration to a later age? Although there are various tax issues to consider, such as a generation-skipping transfer tax exemption being lost, there are instances in which the duration could be extended in a manner that won’t necessarily have adverse tax consequences. Decanting the existing quiet trust into a new quiet trust with a longer duration could be done under the various statutes governing decanting and quiet trusts, but does this strip the beneficiary of some of his rights? On the other hand, even if it does take away rights, if the young adult is in college and about to inherit $10 million (or whatever one considers to be a very large amount of money) outright—might the trustee arguably have a duty to decant to a trust that delays this outright payment? At the same time, couldn’t the argument be made that the trustee has a duty not to decant without at least notifying the beneficiary? But, if the trustee notifies the beneficiary, has he defeated the purpose of keeping the beneficiary from being distracted from studying and working hard toward a college degree? Experience indicates that the facts and circumstances of each situation help determine these considerations, as well as the practical implications of making such a discretionary decision.

The decision might be easier if the beneficiary has issues, such as being a spendthrift or having problems with drugs or alcohol. But even still, how does the trustee verify these issues? Can the trustee rely on the word of the parents, or does the trustee have some obligation independently to verify such a problem before taking away property rights from the beneficiary by extending the duration of the trust through a decanting?

Assume there’s nothing as dramatic as the beneficiary getting ready to inherit a trust much larger than ever imagined or a beneficiary with spendthrift tendencies or substance abuse problems. The parents just don’t think their children are ready for the money yet and ask the trustee to decant into a new trust that delays the age for distributions or has more stringent distribution provisions. The practical, yet challenging decision might be on the one hand, the parents know their children better than anyone else, whereas on the other hand, following the parents’ request takes away rights that the children had. Perhaps the parents know more now than they did when they established the trust, and if they knew then what they know now, they would never have created the same trust provisions.

Decanting Into a Quiet Trust

Putting both topics together, let’s consider issues that can arise in decanting to create a quiet trust. The grantor might request that the trustee not change the beneficial interests, but simply create a new trust in which the beneficiary won’t know about her existing property rights when she reaches the age of majority. Perhaps the grantor thought that by establishing a trust in a jurisdiction known to have flexible trust laws, the trustee automatically has the right to withhold information from beneficiaries or can be directed to withhold information from the beneficiaries—even if there’s no language in the trust agreement creating the trust. 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.

Let’s consider the issues discussed above concerning a beneficiary who begins demonstrating spendthrift tendencies, but add to the fact pattern that the current trust isn’t a quiet trust and the beneficiary would know about it in the near future unless the trustee decants into a quiet trust. Perhaps it’s best if the beneficiary not know about the trust, at least for a period of time.

Similar to the discussion regarding changing the beneficial interests, sometimes parents just decide that they no longer want their children to know about the trust when they turn 18. Maybe they want to wait until the child graduates from college, but there are no quiet
trust provisions in the trust agreement. Again, perhaps there could be an argument for decanting to a quiet trust to withhold information from the beneficiary until she graduates college.

If the trustee is being asked to decant the trust assets into a quiet trust, most likely the trustee will also be asked not to notify the beneficiary, much less ask the beneficiary to execute an acknowledgment or release. Here, the trustee has to consider whether the beneficiary is better served by not having notice or information about the trust for a period of time. Even so, the trustee would have to be comfortable not obtaining a release from the beneficiary. An alternative would be to decant the trust into one with quiet trust provisions and provisions for a beneficiary representative. The practical question becomes whether the representative is a fiduciary in relationship to the beneficiary.

Becoming a Successor Trustee
Sometimes a corporate trustee is becoming successor trustee to a family member and is asked to decant for any of the reasons discussed above. Or, the current trustee might decant directly to a new trust with a corporate trustee—with the new trust having any of the changes discussed above.

Whether the trustee is being asked to decant to change beneficial interests, add an advisor, create a quiet trust or any combination of these, the same issues could arise. What if the current trustee decants directly into a new trust with the changed provisions, and the successor trustee doesn’t exercise any discretion? The argument could be that the new trustee did nothing to change any provisions, but rather became trustee of a trust with the new provisions. But, the argument could also be made that the trustee was a willing participant in a series of steps that led to the changed trust. And, if either or both trusts are quiet trusts, the trustee likely won’t be able to get a release from the beneficiaries.

Who will settle or declare the new trust? Sometimes as part of the decanting process, the corporate trustee will be asked to declare the new trust. This might be because the settlor of the original trust has died or, for some reason, the settlor doesn’t want to settle the new trust. At first, it might not seem all that risky for the trustee to declare the new trust. Isn’t it really just an incremental amount of discretion being exercised, in addition to the decision to decant? But, assuming the new trust has some provisions that are more favorable to the new trustee, such as investment advisor language or improved indemnification language, it could be argued that the trustee is acting in a self-serving manner by declaring a new trust with these provisions.

As seen throughout these scenarios, trustees can face challenging decisions when administering trusts in the world of flexible trust laws. The decisions are largely determined on the facts and circumstances of each matter.

Endnotes
1. 12 Del. C. Section 3303(c).
2. 12 Del. C. Section 3585.
3. See, e.g., Fla. Stat. Section 736.0306, Ohio Rev. Code Ann Section 5801.04(c) (creating a “beneficiary surrogate”), 20 Pa. Cons. Stat. Section 7780.3(k), D.C. Code Ann. Section 19-1301.05(c)(3) and 12 Del. C. Sections 3303(d) and (e), and 3339.
5. Phipps v. Palm Beach Trust Co., 196 So. 299 (Fla. 1940).