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Drafting Irrevocable Silent Trusts: Preserving Privacy of Trust Assets from Spendthrift Beneficiaries

Balancing Fiduciary Duties, Selecting Trust Situs and Type, Protecting Trust Assets, and More

TUESDAY, FEBRUARY 25, 2014

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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The presentation and materials are for tutorial purposes only and are not to be construed as legal advice.

Scope of Presentation

- Today's presentation is intended for a nationwide, multi-jurisdictional audience.
- I have done my best to remove my inherent "Maine" slant from each section.
- ***The presentation and materials are for tutorial purposes only and are not to be construed as legal advice.*** Please check your State's applicable rules, regulations and statutes before incorporating any of today's information into your practice.

Threshold Note: Client Capacity

- Any elder law or estate planning attorney knows he or she must always be cognizant of where a client may have diminished capacity.
- Can the potential client enter into the attorney-client relationship?
- Check your jurisdiction's rules regarding "informed consent"
- Recommended reading:
 - *Assessment of Older Adults with Diminished Capacity: A Handbook for Lawyers* (2005) – a joint publication of American Psychological Association and American Bar Association
 - *"Capacity and Decision Making"* - National Academy of Elder Law Attorney presentation by Professor Peter Margulis

I. Background

- Congress passed revised rules on January 1, 2013 which allow individuals up to \$5,250,000 – or \$10,500,000 for couples (not subject to estate tax)
- Tax rate for funds over and above exemption increased to 40%, up from 35% the previous year.
- Estate and gift tax remain unified, meaning individuals and couples can use the entire exemption to make inter vivos gifts.
- If Congress had not passed these measures, exemptions would have dropped to \$1M and \$2M, respectively, for individuals and couples; and the residual tax rate would have increased to 55%
- *Last month, this was further increased and the present exclusion amount is now **\$5,340,000** for individuals.*

A. Silent / Quiet Trusts, explained

- These significant statutory changes have opened the proverbial floodgates for silent trusts (also known as quiet trusts).
- While traditional law requires the disclosure of a trust's existence to beneficiaries , **silent trusts allow the trustee to manage the trust without the beneficiaries' knowledge of the trust's existence or any information pertaining to it until a specified date or event.**
- At its core, a silent trust is an estate planning tools like any other and its purpose is to distribute assets among an estate's heirs and beneficiaries.
- However, **irrevocable trusts** break from the traditional definition and rubric of the fiduciary relationship between a trustee and trust beneficiaries through specific instruction for a period of non-disclosure that will last for a defined period of time.
- A majority of jurisdictions have enacted laws which expressly or through implication authorize the existence of such trusts and they are commonly viewed as a way to significantly increase the value of estates for wealthy families.

II. Why Silent Trusts?

- A. Clients may have any number of different reasons for inquiring about silent trusts, including, but not limited to:
 - i. Shielding assets from divorce or other legal actions
 - ii. Setting up inheritances for heirs and beneficiaries while maintaining some level of control because of certain fears:
 - Children may grow up without a sense of fiscal responsibility
 - A guaranteed tax-free inheritance of \$10.5M may dissuade a child from working hard and striving for his/her own self-made success

Practice tips:

- Understand the client's reasons for a silent trust from the onset of representation
- Encourage clients to consider how their heirs and beneficiaries will feel and react when the trust is ultimately revealed to them.
- Recommend that clients consider drafting letters to be given to his or her beneficiaries at the time of disclosure and include therein a specific discussion of why a silent trust was chosen.

III. Silent Trusts and UTC

A. Silent Trust and the Trustee

To understand the [unique challenges and opportunities](#) of silent trusts, there must first be a understanding of the fundamental duty to inform which stems from common law and is now outlined more formally in the [Uniform Trust Code](#).

The Uniform Trust Code is a codification of the law of trusts and has been enacted, either wholly or in part, in more than half of the country's jurisdictions. Please see "Exhibit A" at the end of these materials for a list of jurisdictions that have enacted the Uniform Trust Code.

Section 813 of the UTC – Duties

7 distinct duties for trustees:

- i. Duty to keep beneficiaries reasonably informed (see 813(a))
- ii. Duty to respond to beneficiaries' reasonable requests for information (see 813(a))
- iii. Duty to promptly provide a copy of the trust instrument upon request (see 813(b)(1))
- iv. Duty to notify beneficiaries of acceptance of trusteeship within sixty (60) days of acceptance (see 813(b)(2))
- v. Duty to notify beneficiaries of trust existence and beneficiary rights within sixty (60) days after the trustee acquires knowledge of the creation of an irrevocable trust (or acquires knowledge that a revocable trust has become irrevocable) (see 813(b)(3))
- vi. Duty to notify beneficiaries of change in compensation (see 813(b)(4))
- vii. Duty to provide reports (see 813(c))

Other Duties Outlined in the UTC – Duties to Disclose and Respond

- The **duty to disclose** is addressed in Section 105(b)(8) and precludes a trust instrument from waiving the duty to inform a qualified beneficiary that had attained the age of twenty-five (35).
- The **duty to respond** is addressed in Section 105(b)(9) and equally precludes a trust instrument from eliminating a trustee's duty to respond to a qualified beneficiary's request for a report or other trust administration information.

Please see "Exhibit B" at the end of these materials for specific information about each jurisdiction's treatment of these subsections.

Please also access the Uniform Trust Code via the following link:

http://www.uniformlaws.org/shared/docs/trust_code/utc_final_rev2010.pdf, specifically the full text of Section 105 "Default and Mandatory Rules" (pages 21-27) including its official Comment.

UTC Duties

- The key sections of the Uniform Trust Code often dictate whether a silent trust is allowable in a particular jurisdiction and guides both how a silent trust must be drafted and administered.

Practice tip: The first step is thoroughly research and understand the applicable laws and options in your jurisdiction for trustees. As silent trusts deviate from both common law and Uniform Trust Code standards of disclosure, **it is crucial that the trust instruments directly address the duty to inform.** Specific statutory language should be included or referenced directly in the trust instrument. The reason for this is twofold: to show grantor's intent and to delineate that the grantor's direction to withhold disclosure to the beneficiaries does not equate to trustee disloyalty or administration in bad faith.

UTC Duties

Practice tip: It is important to address the matter of inadvertent or necessary disclosure with the grantor and include specific instruction in the trust instrument. The trust should always include a provision which addresses this and usually should provide for the trustee's good faith response to such an inquiry and for the specific duties owed to a beneficiary who is prematurely informed of the trust.

IV. Tax Considerations

A properly constructed and drafted silent trust must include **tax considerations** that necessitate from the grantor's decisions and asset allocations.

- A. All applicable state and federal tax laws and rules must be considered.
- B. Instrument must be drafted to provide beneficiaries with maximum tax benefits and to ensure that all trust property is properly removed from the grantor's taxable estate.

Practice tip: Some states allow a tax-planning technique known as "decanting" which provides the trustee with the authority to move assets among and between multiple trusts. This provides an opportunity for the trustee to change the nature of beneficiaries' interests or move the trust to a different, and more favorable, jurisdiction for trust administration, accounting or tax rates and regulations. However, this technique is not allowable in all jurisdictions and those which do allow it often restrict which types of trusts may take advantage of it.

IV. Tax Considerations

- C. If the grantor is **married**, there are specific tax-planning techniques which may be considered. Trusts previously often contained "bypass" language which allowed spouses to double the estate-tax exemption. Due to law changes, this practice is much less common except in states with significantly lower tax exemptions. More frequent options include nonreciprocal spousal lifetime-access trusts which allow the surviving spouse access to a later deceased spouse's trust. Another option is an incrementally-funded spousal lifetime access trust which can include tax-free life insurance for heirs and beneficiaries.

V. Modification

- A. Irrevocable trusts cannot be modified without the consent of both the settlor and the beneficiaries.
- B. The most common alternatives to trust modification, such as a consent petition or non-judicial modification, also require notice or participation of the beneficiaries and would also stand in complete contradiction to the trust's silent provisions.
- C. Mechanisms to modify a silent trust's situs may be found within the instrument itself, in common law or in statutory provisions. Many thorough trust-instruments include the necessary provisions which permit a trustee to change "the place of administration" and thus pave the way for a modification of situs. There is also favorable case law which tends to find that public policy does not preclude the change of a trust's situs if the transfer will facilitate administration of the instrument. *See, e.g., In the Matter of Henry Weinberger, as Trustee of a Trust for Leona Pattiz*, 21 A.D.2d 780 (1964).

V. Modification

Practice tip: There are numerous jurisdictions with statutory provisions that permit trustees to change a trust's situs. It is very important to be cognizant that it is the laws of the transferor jurisdiction, and not the transferee jurisdiction, that are controlling until the process of change of situs is successful and complete. While this is a basic principle, it can often be overlooked.

Jurisdictions that have enacted the Uniform Trust Code

- Alabama
- Arizona
- Arkansas
- District of Columbia
- Florida
- Kansas
- Maine
- Massachusetts
- Michigan
- Missouri
- Montana
- Nebraska
- New Hampshire
- New Jersey (*introduced in 2013*)
- New Mexico
- North Carolina
- North Dakota
- Ohio
- Oregon
- Pennsylvania
- South Carolina
- Tennessee
- Utah
- Vermont
- Virginia
- West Virginia
- Wyoming