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Drafting a Silent Trust

Ten ideas for avoiding complications that may arise from limiting a trustee's duty to inform

Many people prefer to keep their finances and estate plans to themselves; only upon death are these details disclosed to their children and grandchildren. The reasons for this reticence are many, including desires for personal privacy and to avoid sapping beneficiaries of incentive.

The difficulty is that sound planning often requires people to transfer assets during their lifetimes through irrevocable trusts, and, traditionally, trust law requires disclosure of a trust's existence to beneficiaries.

Recognizing this dilemma, a majority of states and the District of Columbia have enacted laws authorizing, either expressly or by implication, the creation of a "silent" or "quiet" trust. This is an irrevocable trust in which its terms direct the trustee not to notify beneficiaries of the trust's existence or not to provide information concerning the trust's administration.

The period of nondisclosure usually extends for a defined length of time, most often until a beneficiary attains a certain age.

Increasingly used

The dramatic rise in the statutory recognition of silent trusts can be traced to the promulgation of the Uniform Trust Code (UTC) in 2000, which recognized a limited exception to the common law duty to inform in the case of young trust beneficiaries. *(See "Anything but uniform" page 3.)*

At J.P. Morgan, we have seen a growing interest in silent trusts. They also appear to be getting a boost from the significant tax advantages of gifting in 2012, which are prompting many people to transfer large sums through irrevocable trusts.[1]

Silent trusts are a break from the common law and the general understanding of the fiduciary relationship between a trustee and a trust beneficiary. While the advantages of limiting the flow of information to beneficiaries may be obvious, the potential pitfalls may not be nearly as evident.

Given the growing recognition of silent trusts and the uncertainties surrounding them, we offer some thoughts and suggestions on issues to consider when drafting to limit disclosure to trust beneficiaries.

[1] Under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, the lifetime gift tax exemptions in 2012 are at historic highs—$5.12 million for an individual and $10.24 million for a married couple. This law is scheduled to sunset on December 31, 2012. For the benefits of gifting in 2012, see the Winter 2011/2012 *Perspective*, "The risks and rewards of using lifetime exemptions today."

Best practices

These 10 practices may help avoid some of the potential complications and ambiguities that can arise with a silent trust:

1 Understand the available options and applicable law

A trustee who accepts responsibility for a trust owes fiduciary duties to its beneficiaries—first and foremost, an overarching duty of loyalty. Failure to disclose the existence of a trust almost invariably will be deemed a breach of duty in the absence of an express directive in the trust and support for nondisclosure in the law governing the trust.

Many states expressly permit silent trusts by allowing grantors to waive the trustee's duty to inform beneficiaries of a trust's existence before their 25th birthdays. A few expressly permit silent trusts without regard to age; some also specify that the duty to respond to requests for information may be waived.

However, most states authorizing silent trusts do so by saying nothing. In these jurisdictions, the terms of the trust are deemed to govern fiduciary duties and beneficiary rights; the states' trust laws' stated exceptions to this general rule do not include the duty to inform.

The disparity across jurisdictions and the absence of case law mean the boundaries of a trustee's duty to inform and a beneficiary's right to receive notice and information are, at best, unsettled.

Accordingly, donors, trustees and advisors need to understand clearly what the law of a jurisdiction says, or does not say, about silent trusts. If a trust creator has concerns about disclosure, but the laws of the state of residence do not expressly permit silent trusts, the advisor may need to select a trust situs based on the availability of more favorable laws as to nondisclosure. *(See "State laws and silent trusts," page 6.)*

2 Address the duty to inform within the trust instrument

State laws authorizing silent trusts require that the direction not to inform be based on the terms of the trust or, in some cases, a written instrument delivered to the trustee by the grantor or other authorized person. Professional fiduciaries are likely to require formal, written instructions for nondisclosure in the trust document.[2]

Experience and applicable case law suggest that a trustee's withholding information about a trust is often based on an informal request from the grantor or a family member. While it is not uncommon for a friend or business associate acting as a trustee to withhold information, it is inadvisable for any fiduciary to rely on a grantor's unwritten request for nondisclosure.

Neither beneficiaries nor the courts are likely to look kindly on a trustee whose basis for nondisclosure is a grantor's informal request, or on a trustee who relies on the terms of the trust if nondisclosure is not authorized by the governing state law.

At the very least, a decision not to disclose may be misinterpreted by the beneficiary, impairing the relationship with the trustee. A trustee also may confront claims of breach of trust, and penalties ranging from removal to surcharges or denial of fees.

[2] Trustees who think they are doing a simple favor by honoring a request for nondisclosure may find themselves on the defensive and confronting the consequences of their actions and omissions. See, e.g., *McNeil v. McNeil*, 798 A. 2d 503 (Del. 2002) (corporate trustee was removed and all trustees were surcharged for failing to inform and thereby misleading a grantor's child of his current beneficial interest in a family trust); *Fletcher v. Fletcher*, 253 Va. 30, 480 S.E. 2d 488 (1997) (beneficiary has an absolute right to complete copies of trust and all amendments, despite trustee's claim that mother who created the trust had requested that it remain confidential).

3 Limit a beneficiary's right to distributions as well as to disclosures

During any period in which a grantor may want distributions made to the trust beneficiary, the grantor should not instruct the trustee to withhold disclosure of a trust's existence from a trust beneficiary.

Most trustees will want the terms of a silent trust to include provisions requiring the accumulation of income during the period when the existence of the trust is not to be disclosed. After all, a beneficiary who is not made aware of a trust's existence cannot request a distribution.

Similarly, if a beneficiary is not to be informed of the existence of a trust, and the trustee has no ability to initiate or maintain contact with the beneficiary, it will be difficult for a trustee to make mandated income distributions or to exercise discretionary power to distribute from principal for a beneficiary's health or education.

Though these points may seem obvious, such issues may be overlooked if nondisclosure is treated as a simple add-on feature to a standard irrevocable trust. Instead, the issue should be carefully considered and discussed with a grantor prior to drafting the trust.

ANYTHING BUT UNIFORM

Provisions of the Uniform Trust Code (UTC) preventing grantors from waiving disclosure requirements have been so controversial that their adoption has varied widely across jurisdictions.[3]

UTC Section 813 requires trustees of irrevocable trusts to:

- Keep qualified beneficiaries reasonably informed of facts necessary for them to protect their interests
- Respond to requests for information
- Provide specific notices, including disclosure of a trust's existence

A qualified beneficiary is defined as a beneficiary who is a current recipient or permissible recipient of trust income or principal, or who would become a recipient or permissible recipient on the cessation of the current beneficiary's interest or termination of the trust.

The controversial provisions

Although the UTC's provisions are primarily default standards, the terms of a trust generally prevail over contrary provisions of the UTC. However, UTC Section 105(b) enumerates certain rules that a grantor cannot override in the trust instrument. The mandatory rules include:

- **Duty to disclose**—Section 105(b)(8) precludes a grantor from waiving the duty to inform qualified beneficiaries "who have attained 25 years of age" of the existence of an irrevocable trust, the trustee's identity and the beneficiary's right to request reports.
- **Duty to respond**—Section 105(b)(9) forbids the trust instrument from eliminating a trustee's duty to respond to a qualified beneficiary's request for reports or other information related to the administration of the trust.

Some commentators thought UTC Section 105(b)(8) liberalized the common law of trusts to allow for the waiver of the duty to inform young adult beneficiaries of a trust's existence. But others viewed the provisions of Sections 105(b)(8) and 105(b)(9) as unduly restricting a grantor's intent. As a consequence, most enacting states have rejected or substantially modified Sections 105(b)(8) and 105(b)(9).

Indeed, in 2004, the commissioners on uniform state laws placed brackets around each provision to recognize the lack of consensus. *(See "State laws and silent trusts," page 6.)*

[3] A "waiver" is generally defined as the knowing relinquishment of a right. The term therefore would not seem to apply to a grantor limiting the rights of a trust beneficiary. However, many of the relevant state laws employ the word "waiver" to describe the grantor's elimination or modification of the duty to inform.

4 Carefully define the trigger date for future disclosure

Silent trust laws allow varying degrees of flexibility in defining the period during which a trust will not be disclosed.

The quintessential silent trust is likely envisioned in the Uniform Trust Code, in which the period of nondisclosure extends only to a beneficiary's 25th birthday. A few states go further to allow a trust instrument to include a waiver of the duty to inform while the grantor or the grantor's spouse is living, or while the grantor retains legal capacity to act. In each of these cases, the law acknowledges traditional parental prerogatives, and the grantor's ability to restrict or eliminate the duty to inform is relatively limited.

Other statutes provide much broader powers to a grantor to direct nondisclosure. Be cautious with open-ended conditions and consider building in fail-safes. Difficulties with open-ended triggers can be as varied as the contingencies. For example, triggers can:

- **Be too narrowly drawn—**If a grantor is concerned with sapping a beneficiary's incentives to pursue an education, and conditions disclosure on the beneficiary's completion of college, what happens if the beneficiary leaves school to pursue another worthy goal that does not require a university degree?

- **Never occur—**Concerns about a child's financial or emotional maturity may lead a grantor to condition disclosure on the trustee's receiving instruction from a trust protector or advisor. Unless an alternative is provided, however, such as disclosure at a certain age, these conditions may never occur, resulting in ambiguities and potential problems.

- **Deprive the beneficiary of the trustee's assistance—**Issues may arise if disclosure is conditioned on a beneficiary's cessation of destructive or unproductive behaviors. If a trust is unknown, the opportunity for a trustee to work with or provide direction to a beneficiary is inhibited, and assistance that might help a beneficiary overcome an obstacle may be unavailable.

Allowing too much time to expire between the creation of a trust and its disclosure to a beneficiary also can create potential problems, as there is no way a beneficiary will know that the trust exists or that a trustee has potentially breached a duty to inform.

It is not difficult to imagine a trustee—particularly a nonprofessional without tracking and reporting systems—failing to disclose the existence of a trust to a beneficiary with whom there has been no communication since the funding of the trust 10, 20 or even 50 years earlier.

5 Nondisclosure should not be left to the discretion of the trustee or grantor

The power to determine when notice will be provided can be delegated to a trust protector or advisor. When this is done, steps should be taken to assure the person who holds this power has reason to know and to stay engaged with the beneficiary, and that the office will not be subject to vacancy due to death, disability or resignation.

Trustees may find it difficult to exercise a discretionary power to trigger disclosure of the trust, and likely will be uncomfortable relying on a general statement in the trust stating that the trustee need not inform the beneficiary of the trust's existence.

For example, a trustee with discretion to inform a beneficiary of a trust's existence may be caught in an awkward position, as the duty of loyalty states that the beneficiary's interests must be put first, above those of the grantor or anyone else. Likewise, if disclosure is left to the trustee, it may be difficult to consider the well-being of a beneficiary with whom the trustee cannot effectively communicate.

The grantor should not retain the discretion to trigger disclosure. As distributions will be practically or expressly unavailable during the silent period, the grantor's possession of the power to cause disclosure and distributions may raise issues under Internal Revenue Code Sections 2036 or 2038.

6 Consider appointing a beneficiary surrogate

Critics of silent trusts question how a beneficiary who is unaware of a trust's existence can enforce the trustee's compliance with applicable fiduciary duties. A solution may lie in appointing a surrogate to receive accountings and other information on a beneficiary's behalf.

Many state laws permit a custodial parent to represent a minor child, or one beneficiary to stand in another's stead under the doctrine of virtual representation. A few statutes also specifically authorize appointing an information surrogate to receive notices and reports for a beneficiary, irrespective of the beneficiary's age. While some laws allow the representative to enforce and bind a beneficiary's legal interests, to date the extent of an information surrogate's powers remains largely unexplored.

States that give grantors broad powers to vary fiduciary and beneficial rights also would, presumably, authorize the designation of a surrogate in the trust instrument and the delegation to that person of the right to represent and bind a beneficiary's legal interests. However, in the absence of an express statute or judicial review of this arrangement, it remains unsettled whether a court would allow a grantor to assign another person the power to enforce a trust beneficiary's potential claims against a trustee.

Additionally, if a surrogate identifies issues that would require the construction of trust terms or enforcement of a trustee's duties, it is questionable whether a trustee or designated beneficiary surrogate could bring a judicial action without having to provide procedural notices to beneficiaries.

7 Consider the potential impact of a change of situs or multistate fiduciaries

If a trust is created in a state that allows silent trusts, and all fiduciaries reside in that state, nondisclosure will likely raise no legal issues. Problems may arise, however, if the situs is moved or if the co-trustee, successor trustee or other office holder—such as a trust protector, advisor or beneficiary representative—is situated in a state where the law does not authorize silent trusts.

Alternatively, if a trust was formed in a state that does not authorize nondisclosure, moving the trust to a jurisdiction where nondisclosure is permitted may not resolve all issues. Nor may decanting to a silent trust be feasible, as a trustee may be uncomfortable when a proposed decanting would reduce a beneficiary's rights.

STATE LAWS AND SILENT TRUSTS

At least 35 jurisdictions have laws addressing the ability to alter or eliminate the duty to inform, most by adopting, rejecting or modifying UTC Sections 105(b)(8) and 105(b)(9), and others by broadly authorizing a grantor to restrict or limit a trustee's duties and beneficiary's rights.

				STATUTORY REFINEMENTS		
STATE	EXPRESSLY ALLOWED BY LAW	ALLOWED BY IMPLICATION	EXPRESSLY DISALLOWED BY LAW	LIMITED BY AGE OF BENEFICIARY	LIMITED TO LIFE OR INCAPACITY OF GRANTOR/SPOUSE	BENEFICIARY SURROGATE LAW
Alabama		X				
Alaska	X				X	
Arizona	X					
Arkansas		X				
Delaware	X					
District of Columbia	X			X	X	X
Florida			X			
Georgia		X				
Illinois		X				
Indiana		X				
Iowa		X				
Kansas		X				
Maine	X			X	X	X
Michigan			X			
Missouri	X			X		X
Nebraska		X				
New Hampshire		X				
New Mexico	X			X		
Nevada		X				
North Carolina		X				
North Dakota		X				
Ohio	X			X		X
Oklahoma		X				
Oregon	X				X	X
Pennsylvania	X			X	X	X
South Carolina		X				
South Dakota	X					
Tennessee		X				
Texas	X			X		
Utah	X					
Vermont		X				
Virginia		X				
Washington			X			
West Virginia		X				
Wyoming		X				

COMMENTS
Rejected UTC § 105(b)(8); adopted UTC § 105(b)(9).
Trust may limit duty to inform discretionary beneficiary while grantor is living and possesses legal capacity.
Rejected UTC § 105(b)(8); adopted UTC § 105(b)(9). Modified UTC § 813 to allow waiver of general duty to keep reasonably informed of material facts.
Rejected UTC § 105(b)(8) and § 105(b)(9).
Trust may restrict, eliminate or vary beneficiary's right to be informed of interest for a period of time.
Adopted UTC § 105(b)(8) and § 105(b)(9). Trust also may waive or modify duty to inform by specifying that notice shall not be provided until age other than 25 or while grantor or spouse is living or by designating surrogate.
Adopted UTC § 105(b)(8) and § 105(b)(9), but deleted reference to age 25 in § 105(b)(8).
Trust may vary duties and rights except in limited areas; does not reference duty to inform of trust's existence.
Terms of trust governing trustee's duties and beneficiary's rights shall control where not otherwise contrary to law, notwithstanding provisions of Trusts and Trustees Act.
Trustee shall provide complete and accurate information on request unless trust provides otherwise; does not reference duty to inform of trust's existence.
Terms of the trust shall always control and take precedence over statutory duties.
Rejected UTC § 105(b)(8) and § 105(b)(9).
Adopted UTC § 105(b)(8) and § 105(b)(9). Trust also may waive or modify duty to inform while grantor or spouse is living or by designating surrogate. Provision of information to surrogate begins running of statute of limitations.
Adopted UTC § 105(b)(8) and § 105(b)(9) generally, but deleted reference to age 25 in § 105(b)(8).
Adopted UTC § 105(b)(8) and § 105(b)(9), but lowered age from 25 to 21 in § 105(b)(8). Trust also may allow permissible distributee to act as surrogate for an ancestor or lineal descendant of surrogate.
Rejected UTC § 105(b)(8); adopted UTC § 105(b)(9).
Rejected UTC § 105(b)(8) and § 105(b)(9).
Adopted UTC § 105(b)(8) and § 105(b)(9). However, grantor may waive duty to inform and report to beneficiaries only if trustee is a regulated financial service institution qualified to administer trusts.
Trust may vary beneficiary's rights and fiduciary duties in any manner not illegal or against public policy, except as otherwise provided by a specific statute, federal law or common law.
Rejected UTC § 105(b)(8) and § 105(b)(9).
Rejected UTC § 105(b)(8) and § 105(b)(9).
Adopted UTC § 105(b)(8) and § 105(b)(9). Trust also may waive or modify duty to inform by designating surrogate. Provision of information to surrogate begins running of statute of limitations.
Trust may relieve trustee of any duties that would otherwise be imposed by statute.
Trust may waive or modify duty to inform while grantor or spouse is living and financially capable or by designating surrogate.
Adopted UTC § 105(b)(8) and § 105(b)(9) with substantial modifications. Trust may waive duty to inform current beneficiary (i.e., beneficiary younger than age 18 if distributions are required or age 25 if distributions are discretionary), but only while grantor is living and not incapacitated. Grantor also may designate surrogate to receive notices.
Rejected UTC § 105(b)(8) and § 105(b)(9).
Grantor, trust advisor or trust protector may restrict, eliminate or modify beneficiary's rights to information.
Rejected UTC § 105(b)(8) and § 105(b)(9).
Trust instrument may limit duty to inform permissible distributee younger than age 25.
Rejected UTC § 105(b)(8) and § 105(b)(9). Modified UTC § 813 to allow waiver of general duty to keep reasonably informed of material facts and duty to disclose trust's existence or provide other notices.
Rejected UTC § 105(b)(8) and § 105(b)(9). Statutory comments state that duty to inform is a default rule and trust instrument may override duty.
Rejected UTC § 105(b)(8) and § 105(b)(9).
Trust instrument may not waive duty to provide notice of trust's existence and other information.
Rejected UTC § 105(b)(8) and § 105(b)(9).
Rejected UTC § 105(b)(8) and § 105(b)(9).

A successor trustee also may be reluctant to step into a predecessor's shoes to the extent a beneficiary has not been provided with notice or accountings in contravention of the laws of the state of formation.

The common alternatives for modifying a trust—a consent petition or a nonjudicial modification, each of which requires the provision of notice to or the participation of all beneficiaries—may be unavailable or impractical when the purpose of the modification is to add silent trust provisions.

8 Address inadvertent or necessary disclosure

There is no practical way to assure inadvertent disclosure of a trust's existence will not occur over time, or that it may not become necessary or desirable later. A statement mailed to the family home may be seen by a child whose name is included in the trust title, or an older child may begin receiving distributions and—despite instructions not to do so—may "spill the beans" to younger family members.

Once a beneficiary learns or suspects a trust exists, a trustee's continued compliance with a nondisclosure directive may become difficult or impossible. If a trustee is approached by a beneficiary asking whether a trust exists, the trustee has a dilemma: Is an untruthful response a breach of the duty of loyalty? Is the only course of action to remain silent and possibly resign? Of course, the appointment of a new trustee would not resolve this issue.

Alternatively, a grantor or other family member may want or need to cause disclosure of a trust's existence before the trust dictates. For example, a beneficiary may become engaged, and it may be desirable to create a premarital agreement, which may require disclosure of each party's resources.

The trust instrument should address a trustee's duties and beneficiary's rights once a beneficiary becomes aware of a trust's existence. Provisions should address whether a beneficiary to whom nondisclosure no longer applies then acquires a right to distributions or accountings.

9 Review the need and motivations for a silent trust

Grantors should be encouraged to examine what they hope to accomplish through nondisclosure and whether a silent trust is the best option. Is the client more interested in avoiding a discussion about finances and estate planning than in protecting the well-being of beneficiaries? If so, other solutions may be more appropriate.

It may help to point out that simply because no discussion of finances has taken place, it does not mean that children will be unaware of the family's wealth. Values and information about a family's financial resources are communicated in countless ways daily; virtually every decision conveys a message, from the selection of a home and a car to where children go to school and where the family vacations.

10 Initiate dialogue with the trustee and other fiduciaries early

One should not underestimate the difficulties the trustee may confront in administering a silent trust. Some trustees may be wary, on principle, to accept a trust requiring nondisclosure to a beneficiary, even if the applicable law authorizes a waiver of the duty to inform for a period of time.

A blanket refusal to accept trusteeship of a silent trust may be an overreaction. Still, practitioners should not expect trustees will necessarily welcome limitations on a beneficiary's rights. Rather, grantors should expect trustees may have questions when a silent trust is presented. Advisors, therefore, should discuss a client's objectives with a proposed trustee before drafting a silent trust.

Charting a course

The rise of the silent trust leads drafting lawyers, trustees, beneficiaries and, inevitably, the courts into uncharted waters. Still, many parents and grandparents will want to delay disclosures to beneficiaries when they believe it is in their best interests to do so.

If a grantor understands the potential issues and still wishes to create a silent trust, the proposed trustee and other designated fiduciaries should be approached early in the process. Together, advisors and trustees should review the contemplated terms of the trust so that provisions can be structured to provide clarity and avoid potential ambiguities and conflicts.

We also encourage grantors and advisors to consider how beneficiaries will receive news of a trust's existence when it is finally revealed to them. Grantors should consider communicating —perhaps in a letter of wishes—why they believed it was in their beneficiaries' interests to create a silent trust.

Important information

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THE ADVICE LAB
AT J.P. MORGAN PRIVATE BANK

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