



**Trends in Trusts:  
Directed Trusts and Trust Decanting**

Sally Larson Sargent

FIRMA 27<sup>th</sup> National Risk Management Training Conference

May 1, 2013

---

Sally Larson Sargent  
Senior Managing Director  
Personal Trust and Guardianship Services  
MB Financial Bank, N.A.  
6111 North River Road  
Rosemont, Illinois 60018  
847.653.2158  
ssargent@mbfinancial.com

## Disclosures

IRS Circular 230 and Other Disclosures: These materials and the related presentation are intended to provide those attending the presentation with information regarding directed trusts and trust decanting. The materials and comments made by the presenter during the presentation or otherwise do not constitute and should not be treated as legal advice regarding the use of any estate planning, trust administration or other technique, device or suggestion, or any of the tax or other consequences associated with them. Although MB Financial Bank, N.A. has made every effort to ensure the accuracy of these materials and of the presentation, neither the presenter nor MB Financial Bank, N.A. assumes responsibility for any institution's or individual's reliance on the written or oral information presented in association with this material. Each attendee should verify independently all statements made in the materials and in association with the presentation before applying them to a particular fact pattern, and should determine independently the tax and other consequences of using any particular device, technique or suggestion before implementation.

# What Is A “Directed Trust”?

- A directed trust is a trust where a designated party (other than the trustee) is authorized to direct the trustee as to a particular trust function
- Directed trusts often are drafted to
  - give investment management authority to a party other than the trustee
  - give authority regarding distribution decisions to a party other than the trustee
- Trustees of directed trusts need to be concerned that they are not liable for the action/failure to act of the party who holds the power to direct the trustee

# Directed Trusts - Current Statutory Environment

- Directed trust statutes
  - identify and separate specified trust functions ordinarily exercised by a trustee, and
  - exclude a directed fiduciary from one or more fiduciary powers that are given to other parties
- Directed trust statutes generally exempt the directed trustee from liability for the acts or failure to act of another party who holds a power to direct
- Many states currently have some version of a directed trust statute

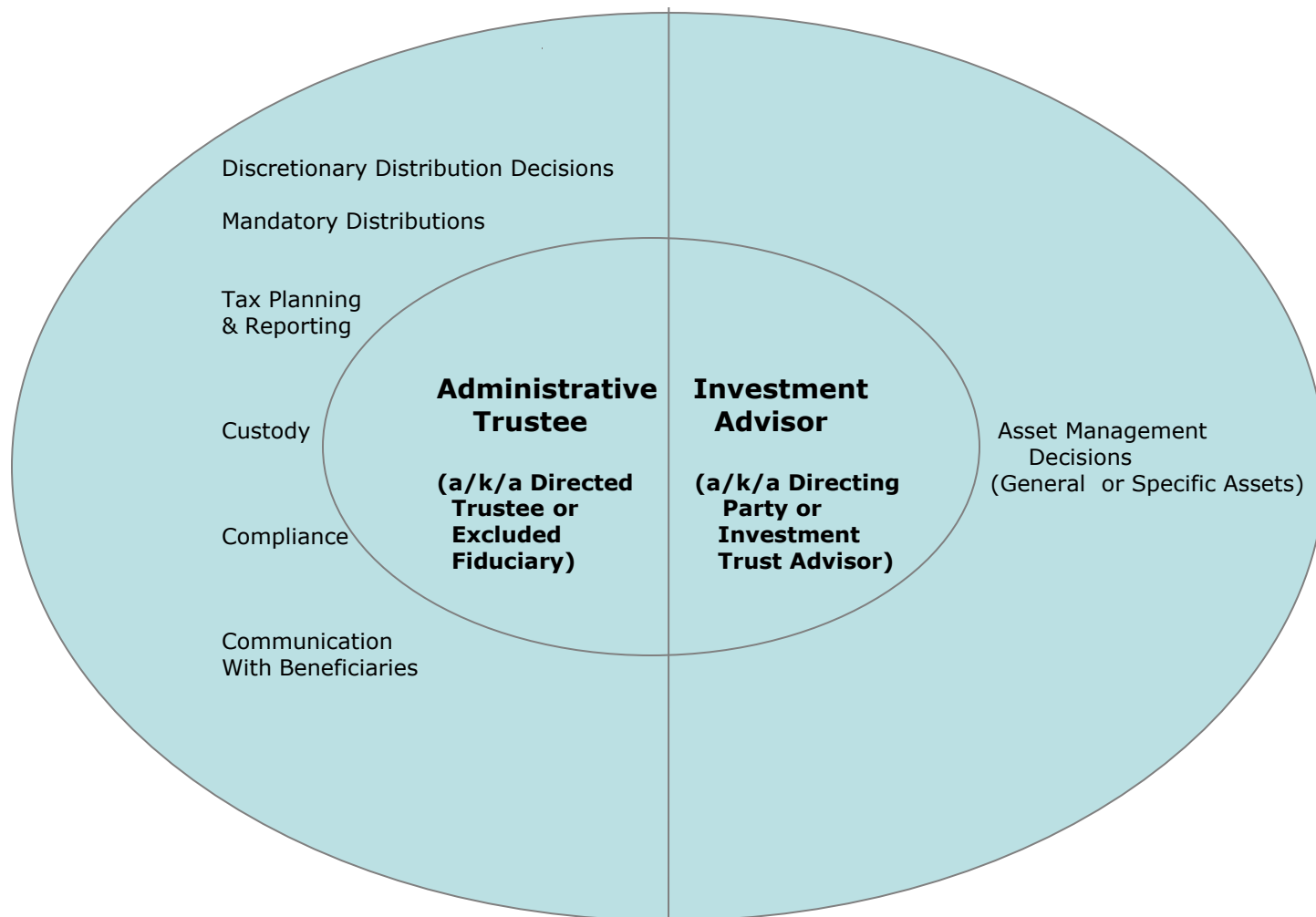
## Directed Trusts – Some Definitions

- “Directed Trustee” or “Excluded Fiduciary”
- “Directing Party”
- “Investment Trust Advisor”
- “Distribution Trust Advisor”
- “Trust Protector

## Directed Trusts – Duties of a Directed Trustee

- An “Excluded Fiduciary” is relieved of both power and liability as to the specific matter assigned to a “Directing Party”
- An “Excluded Fiduciary” must act in accordance with the trust agreement and as directed by the “Directing Parties”
- An “Excluded Fiduciary” has no duty to monitor, inquire, investigate, recommend, evaluate or warn with respect to any “Directing Party’s” exercise or failure to exercise power
- This includes any acquisition, disposition, retention, management or valuation of any asset

# Sample Design of a Directed Trust





## Directed Trusts - Risks

- An “Excluded Fiduciary” generally has no liability for carrying out a directive of a “Directing Party” unless there is “willful misconduct” on the part of the excluded fiduciary
- A “Directing Party” is a fiduciary under many state statutes and often is granted sole and absolute discretion, but
  - under some case law, decisions of fiduciaries with absolute discretion have been upheld only if not “wholly unreasonable or arbitrary”
  - A Directing Party usually has an obligation to act in good faith as the Directing Party believes to be in the best interests of the trust
- What are the standards in your state and what do the applicable terms mean?

## Directed Trusts – Risk Management

- Review and understand the terms of the trust instrument and applicable state law prior to acceptance of appointment as an “Excluded Fiduciary” or as a “Directing Party”
- Establish and follow the policies and procedures of your institution for acceptance of appointment as an “Excluded Fiduciary” or a “Directing Party”
- Clearly delineate those powers held by all Directing Parties and document the exercise of such powers in your files
- Determine and agree how communication and execution on directions will be handled (written communication, email, systems feeds?)

# What Is Trust “Decanting”?

- Assets of an existing trust are poured or “decanted” into another trust



- Depending upon state law,
  - The receiving trust may be another already existing trust or a new trust
  - The receiving trust may have been created by another party or by the trustee of the existing trust

# Trust Decanting – Current Statutory Environment

- Generally, decanting statutes give trustees who have authority to make principal distributions the power to distribute trust principal to the trustee of a second trust
- Several states now have decanting legislation
- The titles of state trust decanting statutes may vary
  - “Distribution of Trust Principal in Further Trust” is formal name for the Illinois trust decanting statutes

## Trust Decanting – Duties of the Trustees

- Generally, there is no affirmative duty to decant—the decision to decant is in the discretion of the trustee
- The trustee's discretion to decant generally must be exercised
  - in a fiduciary capacity and
  - in furtherance of the purposes of the trust
- Usually there is a presumption of good faith on the part of the trustee unless a court finds an abuse of discretion

## Trust Decanting – Scope of Ability to Decant

- The trustee's ability to decant usually is limited by state law, depending upon the discretionary standards under the trust . For example, under the Illinois statute, the trustee's decanting ability is based on its
  - Absolute discretion – can decant to a second trust for the benefit of one or more beneficiaries of first trust, may grant powers of appointment to beneficiaries of first trust as long as that beneficiary could receive trust principal of first trust outright, or
  - Limited discretion – generally can decant to second trust with same beneficiaries (current, successor and remainder), same standards for discretionary distributions of trust income and principal, same powers of appointment

## Trust Decanting – Risks to the Trustees

- A trustee cannot decant if the trust instrument prohibits decanting. Be sure you have the power!
- What are the notice requirements under the trust instrument or state law? Without proper notice, the decanting may be invalid
- Does your trust instrument or state law require any form of consent of the grantor or beneficiaries? Have you documented both notice and consents as required?
- Disinherited beneficiaries are dangerous
- Tax exposures: determine the tax impact of decanting, as generally the tax status of the first trust must be preserved in the second trust

## Trust Decanting - Opportunities

- Useful in situations where virtual representation agreements cannot be used
- Why decant?
  - Limit class of permitted beneficiaries, add/remove powers of appointment as permitted by statute in the discretion of the trustee (absolute or limited)
  - Create supplemental needs trusts for a disabled beneficiary
  - Correct, add, delete or modify administrative and investment provisions
  - Correct, add, delete or modify fiduciary appointment and succession provisions
  - Change situs or applicable law
  - Lengthen the duration of a trust
  - Add or remove spendthrift provisions
  - Adjust to changing tax law and/ or environment



# Trust Decanting – Risk Management

- Be sure that the Trustee is acting within the bounds of the statutory protection (absolute v. limited discretion)
  
- Be clear on the tax implications of decanting
  - GST tax
  - Gift tax
  - Estate tax (marital deduction qualification, scope of powers of appointment)
  - Income tax

## Conclusion- Be Careful Out There!

- Directed trusts and trust decanting can be valuable tools when used properly within the terms of the trust instruments and within the safe harbors from liability under state law.
- States that have had such laws for a number of years are more likely than states newer to these concepts to have courts and case law that will understand and inform the processes and results.
- The disaffected or allegedly disadvantaged beneficiary will not hesitate to sue if a case can be made to hold fiduciaries liable for results they don't like. Your policies, procedures and processes for such situations should be established and followed carefully to minimize potential liability.