

Trusts Corner

Drafting Intentionally Defective Grantor Trusts as Silent Trusts: A Delaware Perspective

By Vincent C. Thomas*

Practitioners often are faced with clients who would like to minimize taxes through gifting but lack the willingness to give up control of the gifted asset. In other words, these are clients who want to make gifts to utilize their lifetime gift exemption amount but practically do not want to give up the requisite control of or information about such assets to their intended beneficiaries. To address this need, practitioners will sometimes suggest the use of an intentionally defective grantor trust (“IDGT”)—for example, the client will gift minority interests in a closely held business or other assets to the IDGT. In connection with the formation of such an IDGT, the client may prefer that the trustee offer the beneficiaries little or no information regarding the assets, or even the existence, of the IDGT. While the client’s intentions may be well founded (*e.g.*, withholding information regarding substantial wealth to keep younger beneficiaries motivated), depending upon the jurisdiction of the trust, the trustee may be faced with requirements to provide certain information to the trust beneficiaries. Accordingly, when drafting IDGTs, practitioners must consider the grantor’s willingness to provide information regarding trust assets and the applicable governing law of the trust as it relates to the trustee’s duty to keep the beneficiaries reasonably informed.

Delaware provides an excellent option for grantors who desire to alter a trustee’s duty to inform beneficiaries, given the freedom of contract approach of, and the ability to create what is known as a “silent trust” under the relevant provisions of Title 12 of the Delaware Code (the “Delaware Trust Act”). This column will first analyze the Uniform Trust Code (“UTC”), which has been adopted in some form in a majority of the states, and the notice requirements thereunder as applied to irrevocable trusts, and then will explain relevant Delaware law and certain practical drafting tips for Delaware silent trusts. This column explains the UTC as drafted—however, it must be noted at the outset that some jurisdictions have altered the UTC as it applies to a trustee’s duty to keep the beneficiaries reasonably informed.

The UTC, as drafted, places on trustees a number of notice, reporting, and other obligations to provide information to the beneficiaries of a trust subject to the UTC. Subject to Section 105 of the UTC, which is discussed below, Section



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813(a)¹ of the UTC generally provides that a Trustee must (i) keep the “qualified beneficiaries”² of the trust reasonably informed about the administration of the trust and related material facts, and (ii) unless it is unreasonable under the circumstances, promptly respond to a beneficiary’s request for information about such administration.

In addition, under Section 813(b) of the UTC, a trustee specifically must (i) furnish a beneficiary with a copy of the relevant trust agreement upon request; (ii) notify the qualified beneficiaries of the trustee’s acceptance of a trusteeship and its contact information within 60 days; (iii) notify the qualified beneficiaries of the existence of an irrevocable trust, the identity of the settlor, the right to request the trust agreement, and the right to obtain a trustee’s report within 60 days of the creation of such irrevocable trust; and (iv) notify the qualified beneficiaries regarding issues relating to changes in the trustee’s compensation structure.

In other words, these are clients who want to make gifts to utilize their lifetime gift exemption amount but practically do not want to give up the requisite control of or information about such assets to their intended beneficiaries.

Section 814(c) of the UTC provides that a trustee must prepare and disseminate an annual report to permissible distributees of income or principal (and to other qualified or nonqualified beneficiaries who request such report) regarding, among other things, the trust assets, liabilities, receipts, and disbursements. Finally, for purposes of this discussion, Section 814(d) of the UTC provides that a beneficiary may waive the right to a trustee’s report or other information that must be provided under Section 813 (and also may rescind such waiver).

Under UTC Section 105,³ however, a grantor may override the provisions of the UTC (including the provisions of Section 813) with some limited exceptions. Most importantly for present purposes, Sections 105(b)(8) and (9) provide that the relevant trust agreement cannot override the duty of a trustee to inform a beneficiary who has attained the age of 25 of the existence of an irrevocable trust, the identity of the trustee, and the right to request the trustee’s reports, and to provide a beneficiary, upon

request, with the trustee’s reports and information reasonably related to the trust’s administration.

The comments to Section 105 of the UTC state that Sections 105(b)(8) and (9) are bracketed because such provisions are “optional” under the 2004 amendments to the UTC. Of course, any jurisdiction is free to treat any provision of the UTC as optional when adopting such statute. Indeed, a number of jurisdictions that have adopted the UTC provide non-uniform versions of Section 813. For example, the District of Columbia has enacted a version of the UTC that provides, among other things, that the grantor may alter Section 813 by waiving or modifying the duties during the life of the grantor and grantor’s spouse, specifying a different age for notification, or designating a person to protect the interests of the beneficiary and to receive notice. Similarly, Ohio’s UTC allows for a surrogate to be appointed to receive required notice and reports for a beneficiary. Arizona has enacted a version of the UTC that provides that a grantor may contract out of the obligations to provide required notice under Section 813, but not out of the obligation to respond to a request for information from a qualified beneficiary. About half of the states that have enacted the UTC have removed Sections 105(b)(8) and (9) entirely, which effectively allows a grantor to contract out of the reporting, notification, and other information obligations of a trustee under Section 813.⁴

In states that have not altered UTC Sections 813 and 105 (referred to below as “UTC states”), a grantor must be cautious in utilizing an IDGT if one of the motivations is eliminating a beneficiary’s right to receive notice and/or information concerning the trust assets. For example, in a situation where a grantor has funded an IDGT with closely held business interests, and assuming the IDGT provides for discretionary distributions of income and principal to the grantor’s children, if the trust were created in a UTC state, Section 105 of the UTC would require the trustee to notify any beneficiaries age 25 and above of the trust’s existence, the identity of the trustee, and the beneficiaries’ right to receive reports. In addition, should a beneficiary request a report or other information related to the trust’s administration, the trustee would be required to respond. Put simply, the trustee would likely need to include information concerning the closely held business interests owned by the IDGT—information the grantor presumably desired to conceal from the beneficiaries.

As an alternative to forming a trust in a UTC state, grantors desiring silent trust status should consider a Delaware trust. The Delaware Trust Act clearly and explicitly provides for the creation of silent trusts.

Delaware common law regarding a trustee's duty to inform the beneficiaries of a trust is discussed in the 2002 Delaware Supreme Court case *McNeil v. McNeil* ("*McNeil*").⁵ In *McNeil*, among other things, a beneficiary of an irrevocable trust was not informed of his status as a beneficiary. The Delaware Supreme Court stated that "[a] trustee has a duty to furnish information to a beneficiary upon reasonable request. Furthermore, even in the absence of a request for information, a trustee must communicate essential facts, such as the existence of the basic terms of the trust. That a person is a current beneficiary of a trust is indeed an essential fact."⁶

While *McNeil* provides the default Delaware law when a trust instrument does not address a trustee's duty to notify beneficiaries, Sections 3303⁷ and 3339⁸ provide a grantor with the ability to create a silent trust. Section 3303 highlights the primacy of grantor intent and the freedom of contract principles that are the core of the Delaware Trust Act and provides explicit authority for a grantor of a Delaware trust to free a trustee from any common law notice, reporting, or other obligations to provide information to a beneficiary, and thus to create a true silent trust. Sections 3303 and 3339 of the Delaware Trust Act also make it clear that a grantor may, if he or she wishes, appoint a "designated representative" to represent any beneficiaries with regard to a silent trust. Put simply, using the freedom of contract principles in Delaware law and the aforementioned provisions of the Delaware Trust Act, a grantor of a Delaware trust has the flexibility to create the desired trust structure and ensure the beneficiaries of the trust only receive information in a manner consistent with the grantor's intentions.

When forming a Delaware silent trust, practitioners should be sure to carefully draft language consistent with the grantor's intent. Given the freedom of contract approach in Delaware, the language of the trust instrument is of primary importance. The drafting tips below should be considered when establishing a Delaware silent trust:

- a. **No Duty vs. Prohibition.** Many institutional trustees are uncomfortable with language that merely provides the trustee "has no *duty* to notify the beneficiaries." Preferred language would be the trustee "shall not notify the beneficiaries." Most trustees prefer the latter language as it is a clear direction not to notify as opposed to the former language, which could be interpreted as creating an option for the trustee. If a "silent" trust is truly desired, the trustee should not have the "option" to inform.
- b. **Specificity as to Scope.** It is important the language specify the extent to which the trust is silent. Does it extend to all matters, or simply to the trust's existence

or its holdings, *etc.*? Do the silent trust provisions apply to all beneficiaries, just the current beneficiaries, *etc.*? Using the IDGT example above, should the trustee provide the beneficiaries with any information regarding a closely held business owned by the trust? The grantor's intent should be discerned in this regard and language drafted accordingly. If the trust is to be totally silent for the particular period, the trust should have very broad language—*e.g.*, the trustee shall not notify the beneficiaries of any information regarding the trust, including, without limitation, statements, the existence of the trust, the beneficiary's interest in the trust, any trust assets or holdings (including, without limitation, any interest in any entity or information regarding such entity), *etc.*

Delaware provides an excellent option for grantors who desire to alter a trustee's duty to inform beneficiaries, given the freedom of contract approach of, and the ability to create what is known as a "silent trust" under the relevant provisions of Title 12 of the Delaware Code (the "Delaware Trust Act").

- c. **Reasonable Period.** While Delaware's statute does not require any particular time when the silent period should terminate, 12 Del. C. §3303(c) provides examples, and most practitioners believe a "reasonable" time period should be used. That is, a trust that provides no time period and is indefinitely silent is not the most ideal situation for a trustee, the beneficiaries, or the grantor.
- d. **Designated Representative.** The trust should include language appointing a designated representative who will represent and bind the beneficiaries during the silent period. The designated representative will "stand in the shoes" of the beneficiaries during the silent period, and any and all notice from the trustee will be delivered to the designated representative. The designated representative is presumed to be a fiduciary, and other common fiduciary language should be included: standard of care and indemnification, compensation, resignation and appointment of successors, *etc.* The trust should also include a place for the designated

representative to sign and indicate his or her acceptance (or a separate acceptance document should be drafted). In selecting the designated representative, the following should be considered:

- (1) **Conflict of Interests.** Conflicts with other fiduciaries (*e.g.*, investment advisers, distribution advisers, *etc.*) must be considered. Since the designated representative will be representing and binding the beneficiaries, it is generally wise for him or her to be independent from the other fiduciaries administering the trust. That is, the designated representative will be receiving notice on behalf of the beneficiaries, making decisions on behalf of the beneficiaries, and reviewing the work of the other fiduciaries—therefore, independence from the other fiduciaries is paramount to a successful appointment.
- (2) **State Income Tax Issues.** Since the designated representative is presumed to be a fiduciary under Delaware law, state income tax issues must be considered. The laws of the state where a designated representative resides could subject the trust to income taxes in that state. That is, some states tax trusts based upon the residency of a fiduciary, and in those cases, caution must be exercised so as to not unnecessarily subject the trust to additional state income taxes.
- (3) **Other Practical Issues.** Given the designated representative's role, in an ideal situation he or she will have some financial and trust knowledge and a relationship with the beneficiaries or the family.

- e. **Premature Knowledge of the Beneficiary.** The trust should address the situation where the beneficiary learns of the trust's existence and/or other information and then requests additional information or distributions from the trustee. For example, take a series of silent trusts a grantor creates for his three children that provide the children shall receive notice at age 35. Oldest child turns 35 and immediately shares the news with his siblings, and the younger siblings begin to ask questions of the trustee. When such circumstances arise, if the trust is silent on the issue, the trustee is in the precarious position of weighing the settlor's intent versus the beneficiaries' interests. Alternatively, if the trust instrument addresses the issue, the trustee is not faced with uncertainty. For example, methods to address the issue include (i) providing the trustee with the flexibility to terminate the silent period upon such occurrence, or (ii) upon such premature request, requiring the trustee to explain the grantor's intent in structuring the trust in such fashion, delivering a letter of wishes drafted by the grantor in such circumstances, *etc.*, and to the extent that does not resolve the issue, then providing the trustee with flexibility to terminate the silent period.
- f. **Avoiding Inconsistencies.** The trust instrument should be thoroughly reviewed to avoid any inconsistencies. Some rather obvious inconsistencies that could be overlooked include Crummey powers and withdrawal rights at particular ages. Such inconsistencies must be avoided to prevent uncertainty for the trustee in administering a silent trust.

ENDNOTES

* Among other things, Vince regularly assists national and international clients and trustees with the formation of Delaware trusts and the migration of non-Delaware trusts to Delaware. Vince would like to acknowledge the assistance of Justin Duda, Esquire, an associate with the law firm of Young Conaway Stargatt & Taylor, LLP, in Wilmington, Delaware, in connection with this column.

¹ Section 813 of the UTC provides:

(a) A trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests. Unless unreasonable under the circumstances, a trustee shall promptly respond to a beneficiary's request for information related to the administration of the trust.

(b) A trustee:

(1) upon request of a beneficiary, shall promptly furnish to the beneficiary a copy of the trust instrument;

(2) within 60 days, after accepting a trusteeship, shall notify the qualified beneficiaries of the acceptance and of the trustee's name, address, and telephone number;

(3) within 60 days after the date the trustee acquires knowledge of the creation of an irrevocable trust, or the date the trustee acquires knowledge that a formerly revocable trust has become irrevocable, whether by the death of the settlor or otherwise, shall notify the qualified beneficiaries of the trust's existence, of the identity of the settlor or settlors, of the right to request a copy of the trust instrument, and of the right to a trustee's report as provided in subsection (c); and

(4) shall notify the qualified beneficiaries in advance of any change in the method or rate of the trustee's compensation.

(c) A trustee shall send to the distributees or permissible distributees of trust income or principal, and to other qualified or

nonqualified beneficiaries who request it, at least annually and at the termination of the trust, a report of the trust property, liabilities, receipts, and disbursements, including the source and amount of the trustee's compensation, a listing of the trust assets and, if feasible, their respective market values. Upon a vacancy in a trusteeship, unless a cotrustee remains in office, a report must be sent to the qualified beneficiaries by the former trustee. A personal representative, [conservator], or [guardian] may send the qualified beneficiaries a report on behalf of a deceased or incapacitated trustee.

(d) A beneficiary may waive the right to a trustee's report or other information otherwise required to be furnished under this section. A beneficiary, with respect to future reports and other information, may withdraw a waiver previously given.

(e) Subsections (b)(2) and (3) do not apply to a trustee who accepts a trusteeship before [the effective date of this [Code]], to an

irrevocable trust created before [the effective date of this [Code]], or to a revocable trust that becomes irrevocable before [the effective date of this [Code]].

² Section 103(13) of the UTC defines “qualified beneficiary” as follows:

A beneficiary who, on the date the beneficiary’s qualification is determined:

- (A) is a distributee or permissible distributee of trust income or principal;
- (B) would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in subparagraph (A) terminated on that date without causing the trust to terminate; or
- (C) would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.

³ Section 105 of the UTC provides, in relevant part:

(a) Except as otherwise provided in the terms of the trust, this [Code] governs the duties and powers of a trustee, relations among trustees, and the rights and interests of a beneficiary.

(b) The terms of a trust prevail over any provision of this [Code] except:

[(8) the duty under Section 813(b)(2) and (3) to notify qualified beneficiaries of an irrevocable trust who have attained 25 years of age of the existence of the trust, of the identity of the trustee, and of their right to request trustee’s reports;]

[(9) the duty under Section 813(a) to respond to the request of a [qualified] beneficiary of an irrevocable trust for trustee’s reports and other information reasonably related to the administration of a trust;]

⁴ See, e.g., Mass. Gen. Laws ch. 203E, §105 (2017); Va. Code Ann. §64.2-703 (2017).

⁵ *McNeil v. McNeil*, 798 A2d 503 (Del. 2002).

⁶ *Id.*, at 509 (the court further opined that

“[t]he duties to furnish information and to act impartially are not subspecies of the duty of care, but separate duties”).

⁷ Section 3303 of the Delaware Trust Act provides, in relevant part:

(a) Notwithstanding any other provision of this Code or other law, the terms of a governing instrument may expand, restrict, eliminate, or otherwise vary any laws of general application to fiduciaries, trusts and trust administration, including, but not limited to, any such laws pertaining to:

- (1) The rights and interests of beneficiaries, including, but not limited to, the right to be informed of the beneficiary’s interest for a period of time, as set forth in subsection (c) of this section; ... The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this section. It is the policy of this section to give maximum effect to the principle of freedom of disposition and to the enforceability of governing instruments. ...

(c) The terms of a governing instrument may expand, restrict, eliminate, or otherwise vary the right of a beneficiary to be informed of the beneficiary’s interest in a trust for a period of time, including but not limited to:

- (1) A period of time related to the age of a beneficiary;
- (2) A period of time related to the lifetime of each trustor and/or spouse of a trustor;
- (3) A period of time related to a term of years or specific date; and/or
- (4) A period of time related to a specific event that is certain to occur.

(d) During any period of time that a governing instrument restricts or eliminates the right of a beneficiary to be informed of the beneficiary’s interest in a trust, unless otherwise provided in the governing instrument, any des-

ignated representative (as defined in § 3339 of this title) then serving shall represent and bind such beneficiary for purposes of any judicial proceeding and for purposes of any nonjudicial matter, and shall have the authority to, and is a proper party to, initiate a proceeding relating to the trust before a court or administrative tribunal on behalf of any such beneficiary.

⁸ Section 3339 of the Delaware Trust provides:

(a) For purposes of this title, the term “designated representative” means a person who is authorized to act as a designated representative in the manner described in at least 1 of the following paragraphs of this subsection (a) and who delivers to the trustee such person’s written acceptance of the office of designated representative. A person who is authorized to act as a designated representative in the manner described in this subsection:

- (1) Is expressly appointed under the terms of a governing instrument as a designated representative or by reference to this section;
- (2) Is authorized or directed under the terms of a governing instrument to represent or bind 1 or more beneficiaries in connection with a judicial proceeding or nonjudicial matter, as those terms are defined in §3303(e) of this title;
- (3) Is a person appointed by 1 or more persons who are expressly authorized under a governing instrument to appoint a person who is described in paragraph (a)(1) or (2) of this section;
- (4) Is a person appointed by a beneficiary to act as a designated representative of such beneficiary; and/or
- (5) Is a person appointed by the trustor to act as designated representative for 1 or more beneficiaries.

(b) A designated representative shall be presumed to be a fiduciary.

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