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Trust Company

**Modern Trust Laws and the
Evolving Trust Industry**
In Defense of the New Paradigm

Presented by: David A. Warren, JD – Co-Founder and Chairman

“Legal experts contend that there have been more changes in trust law in the last twenty years than have taken place in the prior two centuries. These changes promise to affect every aspect of how trusts are administered for years to come.”

- Joseph F. McDonald, Esq III, Trusts & Estates Magazine

Old Paradigm v. New Paradigm

Old

Legal end date to a trust

Bundled

Delegated

Conflict of interest

Asset management only

Rigid/Inflexible

Expensive

Poor service/High turnover

New

Live in perpetuity

Unbundled

Directed

No conflict/independent advisors

Non-traditional assets

Direction/Control

Cost-efficient

Boutique approach to service

“Surveys of affluent families across the country consistently indicated that this demographic has grown weary of the inflexibility, turnover, and exorbitant fees associated with institutional bank-based trust departments.”

- Joseph F. McDonald, Esq III, Trusts & Estates Magazine

Modern Trust Laws - New Paradigm

- ▶ Dynasty Trusts
- ▶ Asset Protection Trusts
- ▶ Directed Trusts
- ▶ Trust Protector
- ▶ Privacy
- ▶ Purpose Trust
- ▶ Decanting

Dynasty Trust

- ▶ **South Dakota** allowed for the first Dynasty Trust in the nation in 1983 by abolishing the rule against perpetuities.
- ▶ Beginning of Modern Trust Law.
- ▶ Definition – A trust that is not subject to the rule against perpetuities and, therefore, lives forever.
- ▶ Driven by state law.



Dynasty Trust (cont'd)

- ▶ Dynasty Trusts avoid federal taxation on trust assets forever because there is never a forced distribution of assets.
- ▶ Very important planning tool that protects family wealth over generations.
- ▶ Not all states have abolished or amended the Rule Against Perpetuity, clearing the way for Dynasty Trusts.
- ▶ State constitutional issues.
- ▶ Dynasty Trust states are not created equally.

State Trust Taxation

- ▶ Income retained in a trust is taxed in most states at applicable income tax levels.
- ▶ A handful of states do not have an income tax and, therefore, do not tax retained income in trusts, including South Dakota.
 - ▶ Kaestner Case
 - ▶ ING Trust
 - ▶ Community Property Trusts



Tax Trust Planning

A **COMPELLING** tax planning opportunity exists to:

- ▶ Avoid federal estate taxation forever through a forced distribution (Dynasty Trust).
- ▶ Avoid state taxation on capital gains low-cost basis assets (ING).
- ▶ Avoid state taxation on undistributed income.
- ▶ Reduce state insurance premium taxation.
- ▶ Obtain a 100% step-up for marital property.

SIMPLY BY SELECTING THE PROPER TRUST SITUS.

What is a Domestic Asset Protection Trust?

- ▶ A *self-settled* trust that protects assets from creditors (including future spouse).
- ▶ Strategy that legally shields assets from third party liability (future spouse) while permitting settlors to receive *income*, retain some *control* over trust assets, AND enjoy a *discretionary beneficiary interest* during their lifetime.
- ▶ Most states do **NOT** have an Asset Protection Trust Statute.

Domestic Asset Protection States

- ▶ Several states have passed Domestic Asset Protection Statutes.
- ▶ **South Dakota, Nevada, Alaska, and Delaware** are consistently recognized as having the most robust and powerful Asset Protection Statutes in the nation.*

** **Best Situs for DAPTs in 2023** Mark Merric and Daniel G. Worthington,
Trusts & Estates Magazine, December 2022*

Domestic Asset Protection States (cont'd)

- ▶ Very compelling planning tool for high-risk individuals and pre-marital planning.
- ▶ Not all Domestic Asset Protection Statutes are created equally.
- ▶ Fraudulent Conveyance (look-back):
 - ▶ South Dakota – 2 years
 - ▶ Delaware – 4 years
 - ▶ Wyoming – 4 years
- ▶ Best of both worlds – domestic and offshore asset protection in one instrument.



Domestic Asset Protection v. Prenups

- ▶ Prior to marriage, a spouse can establish a Domestic Asset Protection Trust that is fully discretionary, receive financial benefit from the trust, and protect trust assets from a spousal claim in a subsequent divorce proceeding.
- ▶ No disclosure or timing requirements. The trust can be established any time prior to marriage and never has to be revealed to the intended spouse.
- ▶ Greatly reduces the chances of a successful attack resulting in the equitable distribution of property brought to the marriage.

Domestic Asset Protection Trusts (cont'd)

- ▶ In Re Cleopatra Cameron:
 - ▶ South Dakota Supreme Court rejected even the specter of an argument that would allow support creditors to reach trust funds protected by a spendthrift provision.
 - ▶ South Dakota declined the enforcement of a California claim in South Dakota, where the legislature has rejected such enforcement.
 - ▶ A South Dakota court is not required to submit to a California judgment to compel payments from a South Dakota trust.

“The emergence of upstart nondepository public directed trust companies is a disruptive force to be reckoned with.”

- Joseph F. McDonald, Esq III, Trusts & Estates Magazine

Directed Trusts

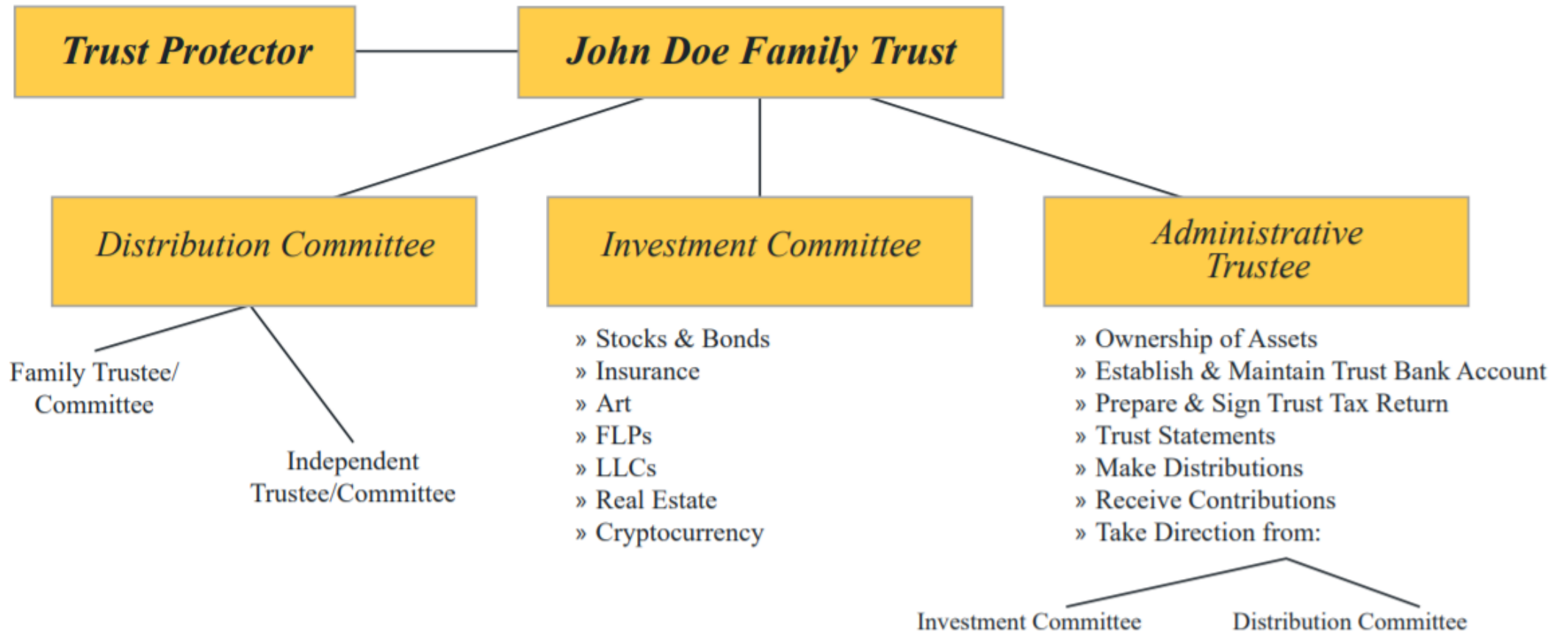
- ▶ Through **bifurcating liability**, the Directed Trust model creates a legal framework allowing trustees and beneficiaries to work with asset managers and independent trust companies of their choosing.
- ▶ Directed Trusts provide a family with maximum **flexibility and control** regarding the trust's asset allocation, diversification, investment management, and distributions.



Directed Trusts (cont'd)

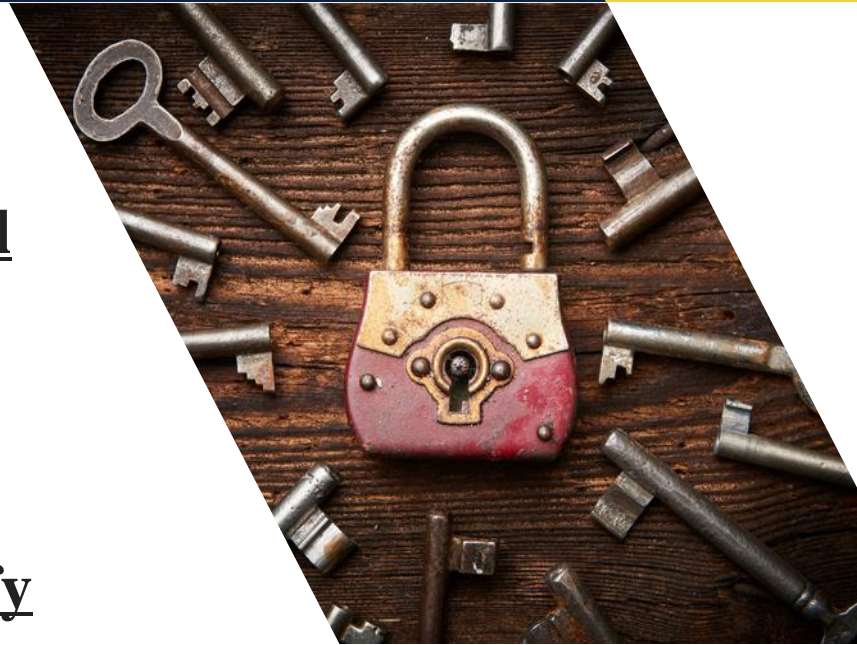
- ▶ A Directed Trust can be used by a settlor who wants to fund an irrevocable trust with a closely held company or a specialized asset, but who also wants to **place control** of such assets in the hands of a particular individual (or group of individuals) familiar with the company's operations or that type of specialized asset.
- ▶ The Directed Trust concept **unbundles** functions (asset management and trust services) that have traditionally been bundled by large bank-based corporate trustees.

Typical Modern “Directed” Trust Structure



The Trust Protector – A Super Trustee

- ▶ The Trust Protector, often used in conjunction with a **Directed Trust**, delivers far more **control** to settlors of trusts, beneficiaries, and their advisors than ever before.
- ▶ The inclusion of a Trust Protector allows the settlor, beneficiaries, and their advisors to **modify** and **control** many important aspects of the trust and provide direction to the trustee with respect to investment management, jurisdiction, and trust distributions.



The Trust Protector (cont'd)

Reasons why a settlor may wish to appoint a Trust Protector include:

- ▶ The settlor wishes for a mechanism to easily replace the trustee or change trust situs.
- ▶ Protectors allow for a great degree of **flexibility** when dealing with changes in circumstances, including both factual circumstances (death, premature divorce, previously unknown children) and legal changes (any legal changes, but most frequently changes to applicable revenue laws).

The Trust Protector (cont'd)

Reasons why a settlor may wish to appoint a Trust Protector include (continued):

- ▶ The settlor may be concerned that the trustee may not pay sufficient attention to his wishes.
- ▶ The settlor wishes certain powers to be withheld from the trustees.
- ▶ The settlor wishes a third party to act as a main point of contact between the beneficiaries and the trustees.

“For reference, in planning, “secrecy” has historically meant that no one — not even the government — sees your affairs. “Privacy” has historically meant that the public can’t see your affairs but the government can. The days of secrecy are dead. So, we talk about privacy.”

- The Worlds Best Tax Haven: The United States, Forbes

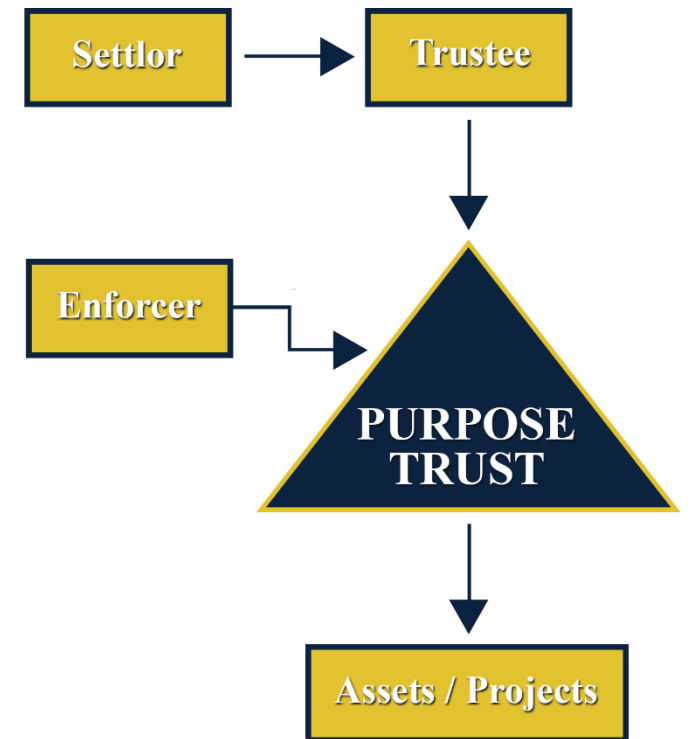
Trust Matter Privacy

- ▶ Very important issue for high-net-worth families and closely held business owners.
 - ▶ Quiet Trust – no disclosure requirement.
 - ▶ Court Seal – Keeps trust information out of the public domain.
- ▶ South Dakota – Total Seal Forever/Not Discretionary/Quiet Trust
 - ▶ Delaware – Seal for 3 years/discretionary.
 - ▶ Most states – Open to the public.



Purpose Trust

- ▶ Considered the most flexible in the nation, a purpose trust has no beneficiaries and can be established to hold and protect assets for a specific purpose and not for the benefit of beneficiaries.
- ▶ Similar to a charitable remainder trust which exists to support a particular charity or charitable intent, the Purpose Trust can be created to support or maintain a specific purpose, in perpetuity uniquely under South Dakota law.
- ▶ Examples of a Purpose Trust: *Business Interests; Private Trust Companies (PTCs); Royalties; Real Estate; Art; Cryptocurrency; Pet Care; Grave Sites; Cryogenics.*



What is Decanting?

- ▶ Decanting is the **distribution of assets** from an **irrevocable trust** into a new trust with different, and presumably more desirable and flexible provisions, leaving the unwanted provisions in the original trust and not binding on the trust assets.
- ▶ Decanting has emerged as a **powerful planning tool for planners** relative to adapting family wealth plans to changes in the wealth planning landscape and family dynamics, **without the need for court intervention.**



When to use Decanting

- ▶ Transfer trust situs to a more favorable trust jurisdiction state.
- ▶ Correct drafting errors.
- ▶ Enable trusts to be subdivided among beneficiaries.
- ▶ Switch trust from grantor trust status for tax purposes to non-grantor status.
- ▶ Include asset protection provisions.
- ▶ Change administrative terms of the trust.
- ▶ Change trustees.
- ▶ Expand trustee powers.
- ▶ Create a Directed Trust (Investment and Distribution Committees).

Decanting not available in Majority States

- ▶ New York was the first state to enact a decanting statute in 1992.
- ▶ Currently 22 states have decanting statutes:
 - ▶ South Dakota, Nevada, New Hampshire, Delaware, Tennessee, Arizona, Ohio, Alaska, Wyoming, Illinois, Virginia, South Carolina, Missouri, Kentucky, North Carolina, Texas, Rhode Island, Wisconsin, New York, Michigan, Florida, and Indiana.

Decanting Statutes are not Created Equally

- ▶ Only South Dakota allows trustees to decant from a trust with an ascertainable standard of distribution into a trust with absolute discretion to distribute and also remove a mandatory income interest.
- ▶ Only 7 states have statutes that **do not require notice** of decanting to beneficiaries.
- ▶ Selecting the proper decanting statute is essential.

Duty to Decant?

Ferri v. Powell-Ferri, SJC-12070 (Massachusetts Supreme Court)

- ▶ No notice given to beneficiary (spouse), who had right to withdraw 75%.
- ▶ Decant used to protect trust from soon to be divorced.
- ▶ Trustee had a **“duty to decant if the trustee deemed decanting to be in the beneficiary’s best interest.”**
- ▶ Does a trustee have a fiduciary duty to decant? Malpractice?

“The choice of a state in which to establish a trust is as critical as the decision to create one.”

- Elizabeth Mathieu, President of Neuberger & Berman

Trust Situs Selection

- ▶ Trust laws vary significantly from state to state.
- ▶ A few states are “in a race” to establish the most progressive trust laws in an attempt to capture trust business.
- ▶ Tier 1 Trust Jurisdictions*
 - ▶ South Dakota
 - ▶ Delaware
 - ▶ Nevada
 - ▶ Alaska
 - ▶ Wyoming?



Choosing the Correct Jurisdiction

	South Dakota	Nevada	Wyoming	Alaska	Delaware
Dynasty Trusts	Yes <i>Ranked as #1 ^[1]</i>	Yes <i>Ranked as #2 ^[1]</i> <i>State constitution prohibits modification to RAP ^[2]</i>	Yes <i>Ranked as #5 ^[1]</i> <i>State constitution prohibits modification to RAP ^[2]</i>	Yes <i>Ranked as #4 ^[1]</i>	Yes <i>Ranked as #7 ^[1]</i>
State Income Taxation	No	No	No	No <i>Future uncertain</i>	No <i>Only for non-residents</i>
Community Property Trusts	Yes ^[3]	No	No	Yes <i>Future uncertain</i>	No
Domestic Asset Protection Statute	Yes ^[4] <i>2 year statute of limitations</i> <i>Exception for child support</i>	Yes ^[4] <i>2 year statute of limitations</i> <i>No exceptions for child and spousal support</i>	Yes ^[4] <i>4 year statute of limitations</i> <i>Exception for child support</i>	Yes ^[4] <i>4 year statute of limitations</i> <i>Exception for divorcing spouse</i>	Yes ^[4] <i>4 year statute of limitations</i> <i>Exceptions for child and spousal support</i>
Trust Protector	Yes	Yes	Yes	Yes	Yes

You can access a copy of the chart at: bridgefordtrust.com/situs

* Denotes superior distinction among jurisdictions.

^[1] Attorney Steve Oshins' "9th Annual Dynasty Trust State Rankings Chart"

^[2] Worthington, Daniel G. and Merric, Mark "Which Trust Situs is Best in 2022?" *Trusts & Estates* December 2021

^[3] South Dakota Special Spousal Trusts, House Bill 1039 (2016) (Sections 29-42)

^[4] Attorney Steve Oshins' "11th Annual Domestic Asset Protection Trust State Rankings Chart"

^[5] Attorney Steve Oshins' "8th Annual Trust Decanting State Rankings Chart"

^[6] Murphy, Mary; Iyengar, Akshay; and Zhang, Alexandria "Tax Revenue Volatility Varies Across States, Revenue Streams" PEW August 2018

Choosing the Correct Jurisdiction

	South Dakota	Nevada	Wyoming	Alaska	Delaware
Directed Trusts	Yes	Yes	Yes	Yes	Yes
Decanting Statute	Yes <i>Ranked as #1 ^[5]</i>	Yes <i>Ranked as #2 ^[5]</i>	Yes <i>Ranked as #14 ^[5]</i>	Yes <i>Ranked as #9 ^[5]</i>	Yes <i>Ranked as #3 ^[5]</i>
Trust Privacy Provision	Yes - Total Privacy Seal Forever <i>Automatically attaches</i>	No Total Privacy Seal ^[2] <i>Subject to judge discretion</i>	No Total Privacy Seal ^[2] <i>Subject to judge discretion</i>	No Total Privacy Seal ^[2] <i>Subject to judge discretion</i>	Yes - Three Year Privacy Seal ^[2] <i>Subject to judge discretion</i>
Special Purpose Entity	Yes ^[2] <i>Codified by statute</i>	No	No	No	No
Family Advisor	Yes	No	No	No	No
State Fiscal Health	Ranked as #1 ^[6]	Ranked as #18 ^[6]	Ranked as #48 ^[6]	Ranked as #50 ^[6]	Ranked as #38 ^[6]

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Is There a Fiduciary Duty to Create or Move Trusts to a Top-Tier Trust Jurisdiction?

- ▶ Uniform Probate Code § 7-305 (1969)
- ▶ “A trustee is under a continuing duty to administer the trust at a place appropriate to the purposes of the trust and to its sound, efficient management. If the principal place of administration becomes inappropriate for any reason, the Court may enter any order furthering efficient administration and the interests of beneficiaries, including, if appropriate, release of registration, removal of the trustee and appointment of a trustee in another state.”

Fiduciary Duty (cont'd)

- ▶ Restatement (Third) of Trusts § 76(2)(c)
- ▶ “In administering the trust, the trustee's responsibilities include performance of the following functions: ... (c) managing the trust estate to provide returns or other benefits from trust property.”
- ▶ See also Scott on Trusts, §§ 613-615

Fiduciary Duty (cont'd)

- ▶ Comments to Restatement (Third) of Trusts § 76(2)(c)
- ▶ “A trustee's duty to administer a trust includes an initial and continuing duty to administer it at a location that is reasonably suitable to the purposes of the trust, its sound and efficient administration, and the interests of its beneficiaries.”
- ▶ “Under some circumstances the trustee may have a duty to change or to permit (e.g., by resignation) a change in the place of administration. Changes in the place of administration by a trustee, or even the relocation of beneficiaries or other developments, may result in costs or geographic inconvenience serious enough to justify removal of the trustee.”

“The trust industry is undergoing a quiet revolution that has wrested control of trust accounts away from traditional trustees – primarily in the banks and other large institutions – and back into the hands of independent trust companies and advisors.”

- Joseph F. McDonald, Esq III, Trusts & Estates Magazine

Institutionalized v. Independent Trust Companies: In Defense of the New Paradigm

- ▶ Institutionalized, international conglomerates coming to the U.S. to obtain trust powers or purchase independent trust companies in top-tier trust jurisdictions.
 - ▶ Private equity backed
 - ▶ Lack experience with U.S. law and regulatory requirements
 - ▶ Return of conflict of interest
 - ▶ No longer boutique

**NOT GOOD FOR THE U.S. TRUST INDUSTRY AND THE FAMILIES
IT SERVES ACROSS THE NATION AND AROUND THE GLOBE.**

Contact Us

As a fully independent trust company chartered in South Dakota, Bridgeford Trust Company provides conflict-free and innovative fiduciary services and progressive U.S. modern trust law solutions around asset protection, privacy, and tax planning to domestic and international families across the country and around the world.

Contact David A. Warren, JD, Co-Founder & Chairman of Bridgeford Trust Company at dwarren@bridgefordtrust.com or by calling (605) 224-9189.

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