PLANNING WITH DIRECTED TRUSTS

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Agenda

- Clarify the importance of directed trusts in modern estate planning.
- Identify the legal evolution of directed trusts.
- Distinguish the Uniform Directed Trust Act from statutory structures.
- Identify the common roles of advisers/directors.
- Review the varying types of liability of trustee and advisers/directors.
- Consider practical uses of directed trusts.

OVERVIEW OF DIRECTED TRUSTS

What Is a Directed Trust

- Directed trusts are a trust design that separates fiduciary functions so that different people or institutions control different aspects of the trust while an "administrative" or "directed" trustee carries out those directions.
- The structure is widely used in private wealth planning to pair a corporate trustee's administrative strength with family or specialist control over key decisions.
- In a directed trust, the trust instrument allocates authority to one or more "directors" (sometimes called trust advisers, investment advisers, distribution advisers, or a trust protector) to issue binding directions to a trustee.
- The trustee's role is largely administrative—holding title to assets, keeping books and records, filing tax returns, and implementing the director's decisions.

Why Do Directed Trusts Matter

Directed trusts are a significant evolution in trust law.

Modern Wealth is complex.

Clients Want Control and Flexibility.

Trustees Want Risk Mitigation.

Regulatory and Fiduciary Clarity Exists.

Directed Trusts Enhance Interdisciplinary Collaboration.

Family Dynamics are Evolving and Generational Planning is Commonplace.

New and unique asset classes and technologies are emerging.

Traditional Trusts

- In traditional trusts, a single trustee (or co-trustees) holds full responsibility for all aspects of trust administration.
- Structure of traditional trusts:
  - Settlor
  - Trustee
  - Beneficiary
- Trustees of traditional trusts have fiduciary duties.
- Some states have additional statutes (Prudent Investor rule; principal and income acts.

Limitations of Traditional Trusts

- In the modern world, there is often conflict between some of the fiduciary duties and real world structure and family dynamics.
- Today's families are often blended families.
- Families are often engaging in multi-generational planning.
- A trustee may lack investment expertise or family insight.
- Trustees may be hesitant to retain concentrated or illiquid assets.
- The all-or-nothing fiduciary structure may deter corporate trustees from accepting appointments with complex risk.
- Trustees can be caught between family governance expectations and strict fiduciary duties.

Directed Trusts Create Options

- Directed Trusts divide fiduciary roles among a variety of specialists.
  - investment or distribution decisions can be directed to individuals who have expertise or family knowledge.
- The use of a directed trust can resolve some of the fiduciary duties that arise in traditional trusts.
  - A directed trust facilitates holding family businesses, concentrated stock, real estate, or alternatives without dealing with a corporate trustee unwilling to assume investment liability.
- Some statutes provide for advisers versus directors.
- Directed Trusts allow administrative efficiency and choice of situs.
- Directed trusts can allow settlors to take advantage of jurisdictional arbitrage.

Directed Trusts Create Options (cont.)

- A directed trust allows a settlor to name an investment adviser and authorize holding illiquid, complex, or mission-driven assets whereas the traditional trustee would be bound to invest and administer in accordance with the prudent person rules.
- Many trusts created today are multi-generational in nature.
  - A directed trust clarifies decision making across generations.
  - A traditional trust required the trustee to balance the interests of income and remainder beneficiaries. A directed trust can allow advisers to favor a particular generation of beneficiaries.
- Some jurisdictions allow silent trusts. These rules may prevent discord where there are multiple beneficiaries with differing interests. Transparency can be tiered.
- Directed Trusts Provide more flexibility and customization.

Directed Trusts vs. Delegated Trust

- **Directed Trust**
  - Settlor grants independent adviser authority to direct trustee.
  - Authority is expressly provided in trust instrument.
  - Adviser controls decisions. Trustee must follow.
  - Trustee is liable only for willful misconduct when following directions.
  - Director/Adviser is fiduciary by default.
  - No duty for the trustee to monitor the director/adviser.

Directed Trust vs. Delegated Trust

- Delegated Trust
  - Trustee voluntarily delegates a function to an agent.
  - Power of agent is as a result of trustee authority to delegate.
  - Trustee remains ultimately responsible for agent actions.
  - Trustee liable for imprudent delegation.
  - Agent owes duties under contract and trustee must select, instruct, monitor.
  - Duty to monitor.

Challenges with Directed Trusts

- **Coordination risk:** Divided authority can lead to gaps or delays if responsibilities and timelines are not clearly defined.
- **Ambiguity in roles:** Poorly drafted scopes of authority can create disputes over who is authorized to make what decision.
- **Liability expectations and insurance:** Directors may underestimate their fiduciary exposure. E&O coverage, indemnities, and compensation should be addressed.
- **Beneficiary communications:** Multiple fiduciaries can complicate reporting and privacy; the trust should define who reports what to whom.

STRUCTURAL AND LEGAL FOUNDATIONS

Legal Foundations and Framework

- Common Law Evolution.
- Codification Under Uniform Directed Trust Act ("UDTA").
- State Specific Statutes (Delaware, Nevada, South Dakota, Alaska, Tennessee, Wyoming).
- Most state specific statutes are modelled on Delaware act.
- UDTA promotes balanced fiduciary accountability.
- Delaware emphasizes settlor autonomy.

Basic Structure of Directed Trust

- Administrative Trustee – The administrative trustee is the fiduciary of record and holds title to assets (often held within an LLC), handles administration, and follows directions from advisers. In the directed trust context, the administrative trustee has limited or no responsibility for investment selection or distribution decisions if those decisions are assigned to a director.
  - Many long-term trusts provide that a general trustee (sometimes the administrative trustee) will fill director roles when they are vacant.
- Various Advisers

Typical Types of Advisers

- Investment Direction Adviser
- Special Holdings Direction Adviser
- Distribution Adviser
- Charitable Adviser
- Trust Protector

Investment Adviser

- Investment adviser may be an individual or a committee.
  - The investment adviser/director holds authority to make investment decisions.
- A special holdings investment adviser may be appropriate in certain situations.
  - Settlor may want to retain investment control but there may be certain assets (life insurance, stock in a controlled corporation) that will create an issue under IRC Section 2036(b) if the settlor retains control.
- Historically, the most common reason for using a directed trust structure related to the desire to name an Investment Direction Adviser.

Distribution Adviser/Committee

- Another common use of the directed trust structure is to appoint a Distribution Adviser who has the ability to direct the trustee when and how the beneficiaries will receive distributions from the trust.
- There may be family members for non-tax sensitive distributions and an independent trustee for tax sensitive distributions.
- Settlor may have reasons (child with mental health issues) and wants to have someone with intimate knowledge of the family and their circumstances involved in making decisions.

Trust Protector

- A trust protector is an individual or entity granted defined powers under the trust instrument to monitor, direct, or modify aspects of the trust's administration or terms without serving as trustee.
- Typical powers:
  - Terminate the trust.
  - Modify or reform the trust.
  - Veto or direct distributions.
  - Change trust situs.
  - Appoint and replace successor directors/advisers, trustees & fiduciaries.
  - Tax & compliance powers.
  - Consent to decanting and mergers.
  - Add a beneficiary.

Charitable Adviser

- A Charitable Adviser may be utilized to consider the objectives of the settlor and direct philanthropic gifts to particular charitable causes, which may or may not be limited to tax deductible gifts.
- A Charitable Adviser may serve the purpose of creating a charitable drain. A settlor may be concerned about the amount of wealth available to beneficiaries and desire to create a way to redirect some of the wealth.
- A Charitable Adviser might have an advisory role only and work in conjunction with a Distribution Adviser (or Director) who serves on Distribution Committee.

Administrative Trustee

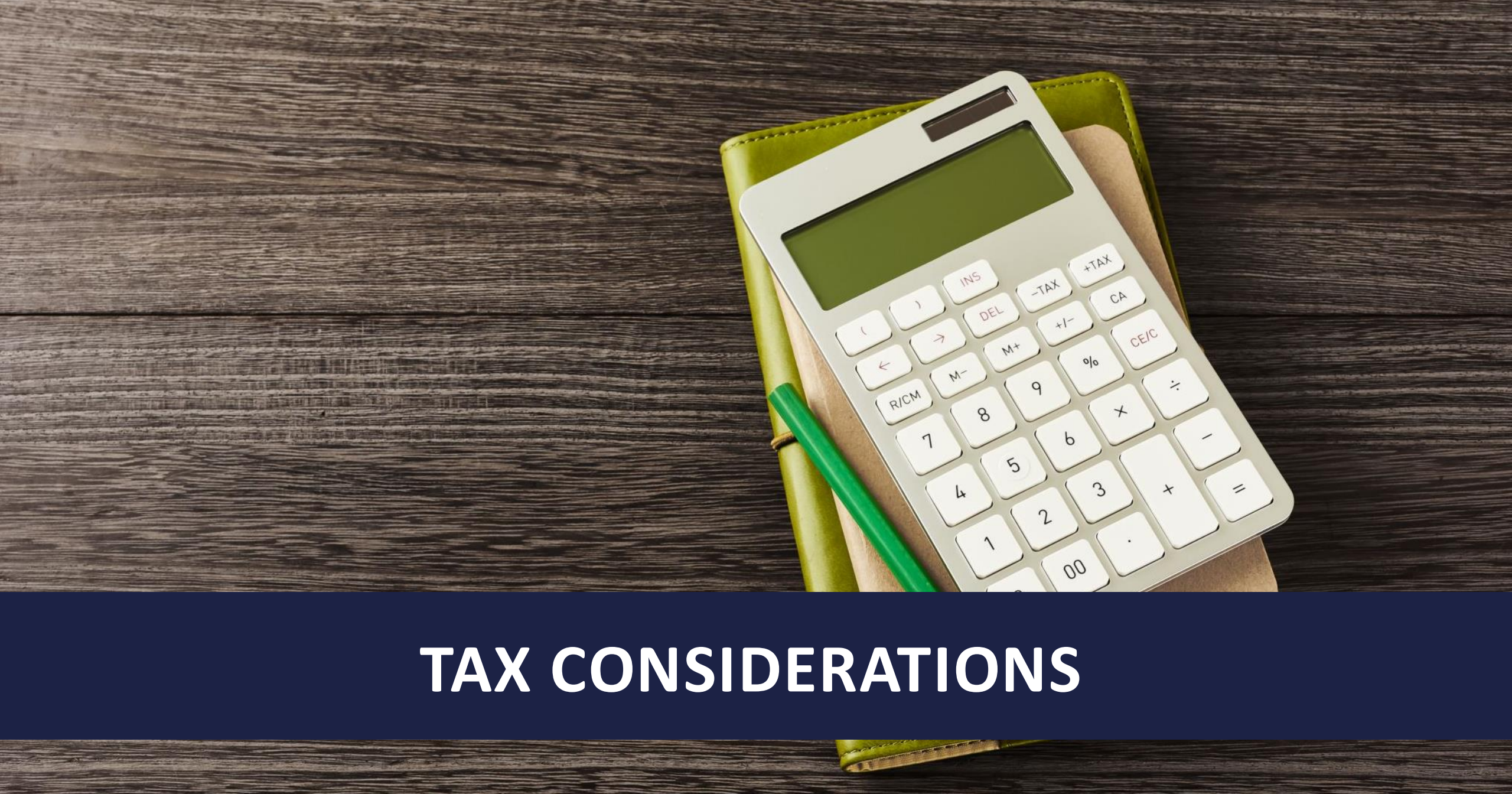
- An Administrative Trustee is the fiduciary that holds legal title to trust assets and performs the core administrative and compliance functions of the trust — *but does not exercise investment or distribution discretion* when those duties are assigned to other advisers under a directed trust statute.
- Duties:
  - Legal Ownership of Assets and Recordkeeping.
  - Tax and Regulatory Compliance.
  - Oversight and Coordination.
- Most directed trust statutes provide an administrative shield to the administrative trustee.

Delaware v. UDTA – Liability and Standard of Care

- Trustee's Duty:
  – UDTA: A directed trustee must follow direction of adviser/director unless doing so = willful misconduct (§9).
  – Delaware: Must follow direction unless doing so = willful misconduct (§3313(a)).
- Definition of 'Willful Misconduct':
  – UDTA: Undefined; interpretation left to local law.
  – Delaware: Narrowly defined; intentional wrongdoing only.
- Trust Director/Adviser Duty:
  – UDTA: Fiduciary by default (§8); same duty as trustee.
  – Delaware: Presumed fiduciary but may be non-fiduciary by drafting.
- Liability Exposure:
  – UDTA: Slightly broader due to undefined term.
  – Delaware: Narrowest; trustee shielded absent intentional wrongdoing.

Duty to Monitor and Information Sharing

- Under the UDTA and various state statutes, a directed trustee generally has no duty to monitor, warn, or advise a director and is not liable for the director's decisions when properly following directions.
  - Some non-UDTA states may impose different or heightened expectations by statute or case law.
- Trustees and directors generally must share information reasonably necessary to perform each other's functions. The trust instrument should address access to records and how confidential information is addressed.



TAX CONSIDERATIONS

Grantor v. Non-Grantor Trust Status

- Grantor trust – grantor continues to pay the income tax on trust income.
- Non-Grantor trust (Trust or beneficiaries pay the tax.)
- A directed trust does not become grantor or non-grantor by virtue of being a directed trust.
- Grantor status depends on retained powers and interests under Internal Revenue Code §§671-679 (e.g., powers to substitute assets, certain distribution controls, or powers held by related/subordinate parties).
- A distribution director who is an "adverse party" can affect grantor analysis.

State Income Tax and Situs

- Using a directed trustee for a non-grantor trust in a favorable jurisdiction can impact state taxation of undistributed income.
- Multiple factors (trustee location, administration, and sometimes director residency) can impact state nexus for income tax purposes.

Draft with Estate and Gift Tax Issues in Mind

- The current federal estate tax exemption may or may not remain at $15,000,000.
- 18 states have either a state estate tax or state inheritance tax At lower thresholds than the federal estate tax.
- Powers of appointment and broad amendment or removal powers held by the settlor or non- adverse parties can trigger estate tax inclusion.
- Keep transfer tax provisions in mind when drafting.

CONSIDERATIONS AND DRAFTING

Common Uses of Directed Trusts

- High Net Worth Families
- Unique Family Situations for Clients of Moderate Wealth
- Business Succession Trusts
- Philanthropic and Charitable Trusts
- International Trusts
- Family Office Integration

Drafting – Fiduciary Duties

- Be specific as to which functions are directed, the standards of conduct and any limits on the authority provided.
- Clarify the manifestly contrary/serious breach test by mirroring governing statute language to create a guide as to when a trustee may refuse a direction.

Drafting – Compensation and Indemnification

- Address when a family member or related adviser can serve as director and include conflict-of-interest and compensation disclosures.
- Include separate fee schedules and indemnification terms for trustees and directors; address advancement of expenses and access to trust assets for defense costs consistent with applicable law.
- Include tie-breakers, consent/consultation requirements, mediation/arbitration clauses, and a forum clause consistent with the chosen situs.

Drafting – Removal and Succession

- Provide clear mechanisms for vacancies, removals, and replacements of both trustees and directors without court involvement, and coordinate with protector powers.
- Example:
  - Define “Distribution Fiduciary” to refer to “Distribution Director” or “General or Administrative Trustee” if no Distribution Director is acting.

Drafting – Clarifying Roles and Authority

- Define each role and scope of the role at the beginning of the document with a section on fiduciary roles.
- Specify that the administrative trustee holds legal title, performs administration and must follow proper directions from specified directors within their scope of authority subject to only limited refusal rights.
- The investment director/adviser typically has **exclusive** authority over acquisition, retention, disposition, and management of trust assets, including any special assets expressly enumerated.
- The distribution director/adviser typically has **exclusive** authority to direct distributions pursuant to the distribution standard. The distribution standard should be clear. Specify whether administrative trustee may make tax required distributions if distribution director/adviser is not immediately available.
- Define powers that are supervisory (replace fiduciaries, change situs, amend administrative provisions) and specify whether the protector is a fiduciary.

Drafting – Tax Authorities and Coordination

- Assign authority to elect tax treatments (e.g. QSBS, 754 elections) to the trustee or director that is best positioned to make such election.
- Clarify grantor and non grantor income tax objectives. If a director is an adverse party for grantor trust purposes, specify the same and align provisions with Internal Revenue Code definitions.
- Specify who will approve any tax reserves, estimated payments and who signs returns.

Drafting – Coordination with Other Planning Structures

- Client objectives should always be clearly defined in relation to all estate planning structures.
- Common objectives may include probate avoidance, protection of a family business, asset protection, tax arbitrage, philanthropic legacy, and establishing family legacy in the form of family guidance.
- Asset titling and beneficiary designations should be synchronized throughout the estate plan.
- Governance should be coherent.
- Choose situs and nexus deliberately.

APPLICATIONS

Directed Trust – Standard Revocable Trust

- Using a directed-trust architecture for a standard revocable trust can materially improve governance, continuity, and flexibility—especially at incapacity and after death.
  - The approach separates administrative custody and recordkeeping (the trustee) from specialized decision-making (investment/distribution directors or advisers), so you can keep the client's advisers in place, hold special assets, and pre-wire the post-death transition.
- Directed trust can result automatically after the settlor passes away. While these settlor is alive and has capacity, the settlor can serve in all roles. On incapacity or death, the directed succession is already in place.
- If a client owns a closely held business, concentrated stock, real estate, digital assets, or other alternative assets, a directed trust structure can assign exclusive authority to someone knowledgeable over the specific assets and diversification requirements can be waived.

Directed Trust – Entrepreneur's Trust - Facts

- Grantor gifts pre-IPO company shares and a minority interest in a family rental-property LLC into an irrevocable, multi-generational (GST-exempt) trust.
- Goals: preserve eligibility for potential Section 1202 (QSBS) treatment on some holdings, retain a concentrated position through liquidity events, keep family distributions needs-based with entrepreneurship incentives, and avoid saddling a corporate trustee with investment liability or closely held governance.

Directed Trust – Entrepreneur's Trust - Structure

- Administrative trustee should be a Trust Company in a directed trust jurisdiction.
- The family's RIA might serve as Investment Director and a Special Asset Director of co-Director might be named.
- The distribution director would be a two-person committee: Independent Chair and family member who knows beneficiaries.
- The trust protector would be an independent attorney or accountant.
- Possible Trust Structure:
  - Irrevocable Trust that divides into shares for beneficiaries. Structure can allow for 1202 stacking.
  - Entity agreements must be coordinated and permit the structure.
  - If pre-IPO company goes through IPO, securities issues will apply.

Directed Trust – Blended Family With Special Needs Child – Fact Pattern

- Grantor is remarried. Spouse B has two teenagers from a prior marriage. Grantor has two adult children from a prior marriage, one with a mild disability receiving means-tested benefits. Family owns:
  - 55% interest in an operating LLC (closely held)
  - A concentrated public stock position
  - A survivorship life policy intended to equalize inheritances
- Goals: keep business strategy with existing managers, protect the special-needs child's benefits, provide lifetime support for Spouse B with guardrails, and ensure fair but not necessarily equal outcomes across children.

Directed Trust – Blended Family With Special Needs Child – Directed Trust

- Administrative trustee might be a Trust Company in a favorable jurisdiction.
- The investment director might be a two-person committee. One would be the CFO of the business and the second would be the family's registered investment adviser.
  - The trust would include a specific carve out for the business and the concentrated stock.
- The distribution director would be an individual who knows the family dynamics.
- The trust protector would be an independent attorney or accountant.
- Possible Trust Structure:
  - **Marital QTIP Trust for Spouse.** Distribution director controls any invasions of principle . Investment director aligns asset allocation.
  - **Family Trust Share for Descendants.** This trust share might be divided into shares for each of four children with ability to transition share for child with disability to special needs share or for other purposes.
  - **Special Needs Share.** This share could be funded if adult child with disability is still receiving means tested benefits and doing so otherwise makes sense.

Directed Trust – Unmarried Partners, Donor-conceived child, Cross border heir

- Partners C and D are not married. They co-parent a donor-conceived minor child. C's brother (resident in the U.K.) is a remainder beneficiary. Assets include:
  - Tech company RSUs/options, crypto, and a vacation property held in a multi-member LLC.
  - Significant retirement accounts and a large term policy.
- Goals: assure co-parent stability for the minor child if either partner dies or becomes incapacitated; maintain investment strategy with the existing crypto/tech specialist; avoid cross-border tax traps for the U.K. beneficiary; and keep privacy.

Directed Trust – Unmarried Partners, donor-conceived child, cross border heir

- Administrative trustee Should be a US corporate trustee in a directed trust jurisdiction.
- The investment director Should be a specialist adviser with a named institutional backup.
- The distribution director might be a three person committee consisting of surviving partner, a pediatrician or godparent ,and an independent chair. Distributions will be focused on housing support protocols for surviving partner as guardian and milestone grants.
- The trust protector would be a cross border tax lawyer (not otherwise a fiduciary).
- Possible Trust Structure:
  - **Surviving Support Subtrust.** This share would provide modest, time limited support to the surviving partner to avoid unintentionally creating marital like rights.
  - **Child Support Trust.** This trust shareWould provide for the needs of the child as well as an authorized housing allowance to the surviving partner as the child's guardian without creating a support obligation characterization.
  - **Dynasty Trust Share for Child at Age 30.**
  - **Capped Share for UK brother.** This share would include a distribution schedule designed to avoid UK settlements and throwback charges.

QUESTIONS?

Thank you for joining me!

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