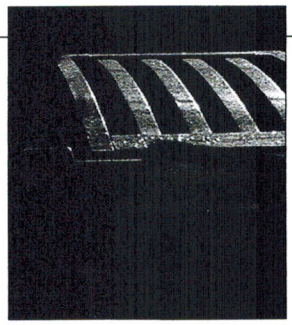

Quiet Trusts: When Mum's the Word to Trust Beneficiaries

If knowledge of a trust will likely lead the beneficiary to undesired idleness, the donor may establish a quiet trust in which the beneficiary does not know what riches await.

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Rather than giving money and fortunes outright, the wealthy have, for centuries, established trusts. Trusts are formed for many important reasons (e.g., the minimization of transfer tax). Historically, one of the most important motives has been to protect trust beneficiaries from being profligate in the aftermath of a sudden financial windfall. Put somewhat differently, trusts are intended to protect and safeguard trust beneficiaries from financial hardship without, it is hoped, simultaneously disincentivizing them from becoming productive citizens of society.

But reality sometimes conflicts with theory. When trust beneficiaries learn that they may become entitled to significant financial assets at some future date, they sometimes lose their zeal to be financially independent. To counteract this reaction on the part of some trust beneficiaries, estate planners have advocated the use of discretionary, rather than mandatory, interests in trusts, as well as "incentive trusts."[1] With discretionary trusts, there is no certainty of a financial reward; incentive trusts instead contain terms intended to inspire trust beneficiaries to behave in a certain way or achieve goals highly valued by the donor of the funds (e.g., upon graduating from medical school or marrying someone of the "right" religious affiliation, trust assets will vest in a designated beneficiary).

More recently, and with the assistance of state legislatures, estate planners have devised another method to keep trust beneficiaries motivated. Underlying this approach is the notion that the fear of possible financial hardship will steer people away from being indolent. Trust agreements are now being drafted with terms that enable trustees to keep the very existence of the trust a secret from the trust beneficiaries. In estate planning circles, these trusts are known by the moniker "quiet trusts."[2] Quiet trusts are intended to allow settlors to plan their estates using trusts while at the same time avoiding trust beneficiaries' financial reliance on the wealth commonly associated with trust formation.

The analysis that follows provides an overview of quiet trusts and their new-found role in the estate planning process.

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Background to quiet trust legislation

In the estate planning community, there was a perceived need for quiet trust legislation. While some trust settlors thought that incentive trusts

must first examine the Uniform Trust Code (UTC). The stated goal of the UTC is to standardize the law of trusts throughout the United States.[9] To date, many states have adopted the UTC,[10] but there are many variations in the actual statutory language that exist between and among the states.

Under the UTC, several salient provisions relate to quiet trusts. The first provision defines a "qualified beneficiary" as one who:

> (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.[11]

While the definition of *qualified beneficiary* is quite broad, it does not include contingent beneficiaries.

Article 8 of the UTC enumerates a trustee's duties and powers. Listed among such duties and powers is a duty to inform and report to the beneficiaries. The UTC specifically provides:

> 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.[12] [Emphasis added.]

The UTC specifically mandates that trustees must put trust beneficiaries on notice regarding a trust's existence.[13] In addition, the UTC elaborates on the nature of the obligation to keep qualified beneficiaries reasonably informed, stating, among other things:

> 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.[14]

Notwithstanding the absence of settled law, the establishment of quiet trusts continues unabated.

Under these UTC provisions, trust beneficiaries are essentially guaranteed to learn of their financial horizons vis-á-vis the trust.

The actual terms of a trust may override the UTC's provisions, subject to some important exceptions.[15] Insofar as qualified trust beneficiaries are concerned, the UTC requires that those who have attained 25 years of age *must* be notified "of the existence of the trust, of the identity of the trustee, and of their right to request trustee's reports," notwithstanding the actual trust terms.[16] Furthermore, the trust terms cannot negate requests by qualified beneficiaries for trust information.[17] Despite the foregoing, quiet trusts for trust beneficiaries under the age of 25 and for contingent beneficiaries appear to be permitted by the UTC.

In many instances, however, state legislatures have deviated from the UTC and have expanded opportunities for the existence of quiet trusts. These variations generally can be grouped into four categories:

1. No age limitations on information disclosure, effectively allowing quiet trusts for beneficiaries of any age.
2. Permitting waiver of information disclosure to trust beneficiaries while the trust settlor is still alive.
3. Requiring information disclosure to designated surrogates rather than to actual trust beneficiaries.
4. Permitting limited information disclosure to trust beneficiaries.

Illustrations of quiet trust usage

The example below illustrates the application of the general rules under the UTC and how state law variations come into play. Given the variations in state statutes, it is useful to demonstrate the application of these diverse laws in practice.

Example. Bea, a trust settlor, wishes to establish a lifetime trust for the benefit of her 18-year-old daughter, Kay, and fund it with $10 million. Kay has just started her freshman year in college and has previously shown a propensity to be a spendthrift. In addition, like most 18-year-olds, Kay's financial abilities are not yet fully formed (at least in Bea's eyes). The trustee of the trust is Que, Inc., a financial institution.

In order to analyze the UTC and its variations, consider the following questions:

1. What are Que's duties and obligations of disclosure to Kay?
2. What right, if any, does Kay have to trust information?

9 English, "The Uniform Trust Code (2000): Significant Provisions and Policy Issues," 67 Mo. L. Rev. 143 (2002).

10 See http://uniformlaws.org/Act.aspx?title=Trust%20Code (listing those states that have adopted the UTC and those considering adoption).

11 UTC § 103(12).

12 UTC § 813(a).

13 UTC § 813(b).

14 UTC § 813(c).

15 UTC § 105(b).

16 UTC § 105(b)(8).

17 UTC § 105(b)(9).

would suffice to inspire trust beneficiaries to reach their full potential, other trust settlors thought that such trusts fell short of meeting their intended objectives. Still others thought incentive trusts were too inflexible. Instead, these trust settlors believed that simple nondisclosure of a trust's existence would be a far better means to accomplish these ends, namely to motivate (or at least not de-motivate) trust beneficiaries to fulfill their roles as productive citizens of the community.

The essence of quiet trusts, however, stands in direct contravention of a longstanding tenet of trust law that requires information disclosure by trustees to trust beneficiaries. This body of law demands that trustees keep trust beneficiaries informed and vests trust beneficiaries with rights and access to important trust information.

First, consider the obligations trustees have to keep trust beneficiaries informed. There is a long and extensive history underlying the common law notion that trustees have a general duty to inform and account to trust beneficiaries.[3] Depending on the state of formation and its governing law, this obligation is either found in the common law or in a specific state statute.[4] As a practical matter, trustees often fulfill this disclosure obligation by providing trust beneficiaries with annual trust accountings or copies of trust account statements.

Second, consider the rights trust beneficiaries have to trust information. Depending on applicable state common law and statutes, trust beneficiaries historically have been able to demand:

1. Trust accountings.
2. Access to communications between trustees and investment advisors.
3. The basis on which trust distributions have been made (or not made) and may (or may not) be made in the future.[5]

The scope of these rights to information not only extends to current trust beneficiaries, but also may extend to future and contingent trust beneficiaries.[6]

Quiet trusts are intended to avoid trust beneficiaries' financial reliance on the wealth commonly associated with trust formation.

The underlying purpose of communication with trust beneficiaries and access to information is generally to ensure proper trust administration. The rationale is simple: If trustees' derelictions are allowed to remain hidden, the administration of the trust and the benefits intended to be available to the beneficiaries may be cast into jeopardy. Conversely, by making trust information readily accessible, the prospects for proper trust administration are greatly enhanced. For centuries, this foundation proved persuasive as wide channels of communication between trustees and beneficiaries seemed entrenched. Beneficiary knowledge was perceived to be an unadulterated good that was to be fostered and cultivated.

Not all trust settlors, however, subscribed to this principle of trust law. Instead, many trust settlors observed first-hand the damage this knowledge caused in the form of trust beneficiaries who had lost their drive in life, waiting to be pampered and showered with financial allotments.[7] Other trust settlors witnessed the abuses of unreasonable information, investment, and distribution demands from overzealous trust beneficiaries.[8] It was these trust settlors who demanded that communication—the tacit "checks-and-balances" system of trust administration—between trustees and trust beneficiaries be silenced.

State legislation that sanctions quiet trusts

State legislatures have been responding to a push for change from the estate planning community. Many have instituted a series of legislative initiatives designed to foster the use of quiet trusts. This legislation comes in numerous forms and varieties, several of which are enumerated below.

In order to understand what state legislatures have enacted, one

1 See "incentive trust" definition offered in *Wikipedia*, "In American estate planning parlance, an *incentive trust* is a trust designed to encourage or discourage certain behaviors by using distributions of trust income or principal as an incentive" (emphasis in original), available at http://en.wikipedia.org/wiki/Incentive_trust (last visited 3/11/2013).

2 Kozusko, "In Defense of Quiet Trusts," 143 Tr. & Est. 20 (March 2004).

3 Hill, *A Practical Treatise on the Law Relating to Trustees, Their Powers, Duties, Privileges, and Liabilities* 382 (1845).

4 Restatement (Second) of Trusts, § 173.

5 Lewin, *A Practical Treatise on the Law of Trusts and Trustees* 599 (3d ed., 1857).

6 Restatement (Second) of Trusts, § 173 cmt. c ("Although the terms of the trust may regulate the amount of information which the trust must give and the frequency with which it must be given, the beneficiary is always entitled to such information as is reasonably necessary to enable him to enforce his rights under the trust or to prevent or redress a breach of duty.").

7 Indeed, trust settlors who had seen the effects of mandatory income trusts on "trust babies" likely led the movement towards trusts with mostly discretionary interests rather than mandatory ones. Langley, "You Worked to Earn Your Millions. But Will Your Kids Be Spoiled Trust Babies?," Austin Am.-Statesman, 1/8/2000, page D1.

8 See, e.g., Zimmerman v. E. Zirpolo Trust, Slip Copy, 2012 WL 346657 (Ohio App. 5 Dist., 2012) (trustee had statutory duty to respond to a beneficiary's request for information, despite settlor's intention to withhold information); In the Matter of the Mashburn Marital Trusts, 52 So.3d 1136 (La.App. 1 Cir., 2010) (beneficiaries of marital trusts and family trusts brought action against trustees seeking distribution of their share of trust income).

3. What proactive measures, if any, can Bea take during the trust drafting process to minimize required trust disclosure?

In a situation in which the UTC controls, Que does not have to disclose the existence of the trust to Kay until she attains age 25.[18] Once Kay attains age 25, however, the normal trust disclosure rules specified in the UTC would apply.

Now consider the following variations found in applicable state statutes:

- *Nondisclosure permitted.*[19] Assume Bea incorporates terms in the trust instrument requiring nondisclosure and, assume further, that governing state law permits nondisclosure notwithstanding the beneficiary's age. In this situation, Que never has an obligation to disclose the existence of the trust to Kay.[20]
- *Waiver of disclosure during settlor's lifetime.*[21] Assume Bea incorporates terms in the trust instrument that require nondisclosure during Bea's lifetime and, assume further, that the governing law of the state permits such nondisclosure. Que would have to make trust disclosure to Kay only on Bea's demise (assuming, at the time, Kay has then attained at least age 25).
- *Disclosure to trust surrogates.*[22] Assume that the trust instrument executed by Bea incorporates terms that require disclosure to designated trust surrogates, but precludes trust disclosure to Kay. Under this scenario, Que would regularly have to report to the designated trust surrogates, but no similar reporting obligation would extend to Kay.
- *Limited disclosure to trust beneficiaries.*[23] Assume that Bea establishes a trust in a jurisdiction that does not mandate complete disclosure to trust beneficiaries, but instead requires that trust beneficiaries be kept reasonably informed of "material" facts. Under these circumstances, Que might release only material information (e.g., the salient trust terms) to Kay until such time as she is either financially secure or, alternatively, has adopted more moderate spending habits.

These variations in state law illustrate the vast nondisclosure opportunities for trust settlors to explore. Estate planners should discuss these opportunities with trust settlors and, in particular, determine whether a quiet trust is the "right" approach based on the particular needs and desires of a client. If a quiet trust is to become part of an estate plan, the drafters should consider the applicable governing law of the trust instrument in order to determine the options available to satisfy the trust settlor's desires for nondisclosure.

Conclusion

Quiet trusts are a relatively new tool in the estate planner's arsenal and, consequently, one that has virtually no track record. To date, few adjudicated cases pertain to quiet trust existence and, within this context, explore the permissible boundaries of communication (or noncommunication) between a trustee and trust beneficiaries. It will take years before a better legal picture of the implications associated with quiet trust usage will be obtained. Furthermore, there is no empirical evidence showing that the establishment of quiet trusts serves one of its intended purposes, namely to keep trust beneficiaries motivated to pursue their financial aspirations without being sidetracked by the lure of trust wealth. Quiet trusts do, however, provide the settlor with the opportunity, in appropriate circumstances, to prevent overzealous beneficiaries from placing unreasonable demands on trustees with respect to distributions, investment strategies or information gouging.

Notwithstanding the absence of settled law, the establishment of quiet trusts continues unabated.[24] Indeed, many trust settlors are increasingly committed to concealing the existence of the trusts they establish. Such commitment on the part of trust settlors suggests that not only are quiet trusts here to stay, but also that they will become increasingly popular in the future in jurisdictions where quiet trusts are a permissible facet of trust law. ■

18 E.g., N.M. Stat. § 46A-1-105.

19 E.g., N.H. Rev. Stat. Ann. § 564-B:1-105.

20 The fact that the trustee does not have to disclose the existence of the trust to the beneficiary obviously makes the settlor's choice of trustees even more critical than the choice of trustees for a normal trust.

21 E.g., 20 Pa. Cons. Stat. §§ 7780.3(b) through (e).

22 E.g., Fla. Stat. Ann. § 736.0306.

23 E.g., Neb. Rev. Stat. § 30-3805(b)(8).

24 Dale, "Quiet Trusts Popular Amid Gifting Boom," Wall St. J., 11/20/2012.