

CONFIDENTIAL TRUSTS

TOOLS TO BALANCE WEALTH TRANSFER PLANNING WITH FAMILY CONCERNS

Many high-net-worth individuals express concerns about the ability of family members, often young adults, to handle knowledge of the family's wealth appropriately. Equally, there may be concern family members will derail their own plans and passions, choosing instead to rely upon trust funds rather than their own skills and initiative to lead meaningful and productive lives. Fear of turning loved ones into "trust fund babies" is a frequent comment when high-net-worth families contemplate giving larger gifts to family members – so they rely on the benefits of a confidential trust.

Confidential trusts mandate the trustee and other fiduciaries cannot disclose the existence of a trust to one or more beneficiaries until a definite point in time. A trust is *not* considered confidential when the trustee is given discretion to provide statements to beneficiaries.

WHY CONSIDER A CONFIDENTIAL TRUST?

Assets transferred or "gifted" to heirs during life avoid inclusion in your taxable estate. So, if you expect to have a taxable estate – currently, the top estate tax rate is 40 percent and every taxpayer is entitled to a \$5.49 million estate and gift tax exemption – it's wise to think about passing excess wealth to heirs during your lifetime rather than at death. However, families establishing irrevocable trusts to transfer wealth worry about the impact access to large sums of wealth could have on their beneficiaries.

Confidential trusts also may be referred to as "quiet trusts" or "silent trusts." The term "silent trust" is somewhat of a misnomer because there must be parties to the trust who know of its existence. Instead, we prefer the term "confidential trusts" because it best describes the nature and function of these types of trusts.

Confidential trusts can help meet goals beyond wealth transfer and tax objectives, including:

- Avoiding a decline in a beneficiary's self-motivation,
- Protecting privacy, and
- Helping a beneficiary with potential feelings of discomfort or even embarrassment regarding family resources.

Additionally, confidential trusts may protect family members with a history of substance abuse or other psychological struggles who may be influenced by less than desirable acquaintances. Keeping a trust confidential can shelter the assets in the trust from a beneficiary's creditors and minimize the risk of frivolous lawsuits against a beneficiary.

ARE CONFIDENTIAL TRUSTS PERMISSIBLE IN ALL STATES?

No. Only certain states permit them. Thirty one states have adopted laws that mandate a trustee must disclose the existence of a trust, the identity of the trustee and send annual statements to beneficiaries upon request¹ but authorize the person who creates the trust (the grantor) to postpone telling beneficiaries about the trust when they are under the age of 25.²

Several states have made a conscious decision not to adopt this approach and have express laws authorizing confidential trusts.³ These key states include Alaska, Delaware, New Hampshire, Nevada, South Dakota and Wyoming. Northern Trust has the ability to administer confidential trusts as part of its specialized trust services offering in Delaware and Nevada.

Delaware

With regard to confidential trusts, Delaware permits a grantor to eliminate or restrict telling a beneficiary about his or her interest "for a period of time."⁴

The period of time can be related to:

- The beneficiary's attainment of a stated age,
- The grantor's incapacity or death,
- A term of years,
- A specific date, or
- A specific event that is certain to occur.

Long-Term Trusts in Delaware

May last in perpetuity



Long-Term Trusts in Nevada

May last 365 years



Delaware's law allows the grantor to send information about the trust to a designated representative until the nondisclosure period ends. That designated representative also represents a beneficiary in any judicial and non-judicial matters (e.g., settlement agreements) involving the administration and investment of a trust.

Nevada

Nevada adopted language similar to Delaware allowing a grantor to restrict or eliminate informing a beneficiary about their interest in a trust for a period of time defined in the trust instrument.⁵ Although there are no express guidelines on the period of time requirement, Northern Trust recommends an approach similar to Delaware's be used to help ensure the disclosure is limited to a specific period of time.

CAREFULLY CONSTRUCTED CONFIDENTIAL TRUSTS – WHAT DO YOU NEED?

Confidential trusts should be structured to meet specific goals. Ideally, the nondisclosure period should be as short as possible and communications between the trustee and beneficiary encouraged. This achieves two purposes.

- First, the trustee can gain knowledge of a beneficiary's specific needs and circumstances in the context of the trust's purpose and the overall family wealth preservation plan.
- Second, the trustee can be part of the educational process and involved with counseling a beneficiary to understand the role of wealth in the family and how resources could be used to further the beneficiary's personal goals.

For greater flexibility, you should consider granting a third party, such as a co-trustee or trust protector, the ability to trigger disclosure earlier than the specified age or in the event the beneficiary is demonstrating maturity and an aptitude to handle money prudently.

You and your advisors need to be mindful there can be inconsistencies between a trust's terms and nondisclosure provisions. For example, assume a trust allows for distributions for educational expenses or principal distributions in the event of an emergency or illness. A beneficiary needs to know about the terms of the trust to request funds. Alternatively, what if a distribution committee or advisor makes a decision to distribute funds to a beneficiary? In both cases, the confidential nature of the trust has changed. Under these circumstances it may be better to disclose the existence of the trust and its terms to the beneficiary. This may be an instance where a beneficiary can designate a representative to receive information on his or her behalf. You should consider how you want to handle inadvertent disclosures such as an older beneficiary disclosing the existence of the trust to a younger beneficiary. An established family education and governance plan can be extremely beneficial in these situations.

When Should a Confidential Trust No Longer be Confidential?

Frequently, our clients select a specific age at which disclosure of a confidential trust will occur to allow their beneficiary the time to:

- Complete his or her education,
- Become employed, and
- Develop sound financial judgment and habits.

It's critical someone is named in the trust instrument as the beneficiary's representative during the period of nondisclosure. The individual should formally accept the role of designated representative and act in a fiduciary capacity. This representative should also receive periodic statements and ask questions to protect the beneficiary's interest. In some cases, grantors serve in this role. Consideration of family dynamics and willing candidates should be discussed with advisors.

Confidential trusts can be a useful technique to balance wealth transfer planning with the well-being and interests of family members if accompanied by careful analysis of the beneficiaries' ages, personal situations and future financial education, as well as thoughtful drafting of the trust instrument.

CONTACT US

Your Northern Trust representatives are available to discuss confidential trusts and any flexible options with you.

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END NOTES

- 1 Uniform Trust Code, § 813
- 2 Uniform Trust Code, § 105 (8) (9) with Comments
- 3 Alaska Stat. § 13.36.080 (b); 12 Del. C, § 3303 (a) and (c); N. H. Rev. Stat. §564B:1-105; NRS §163.004 (effective October 1, 2015); S.D. Code § 55-2-13; and Wyo.Stat. Ann. § 4-10-813
- 4 12 Del. C, § 3303 (a) and (c)
- 5 NRS §163.004 (effective October 1, 2015)

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Q157600 (1/17)