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TRUSTS & ESTATES

By **David A. Diamond**

Considering Quiet Trusts in the Larger Picture of Family Governance

Prepare beneficiaries for wealth

Although they're called "quiet" trusts, we hear about these now more than ever. By quiet trusts, I'm referring to trusts that permit keeping the existence of the trust or information about the trust from the beneficiaries. Many times, the statutes permitting quiet trusts also provide that the information can be sent to a surrogate for the beneficiary, and that surrogate will represent and bind the beneficiary. These are also called "silent trusts" or "confidential trusts," but no matter what you call them, they continue to gain in popularity. I wrote an article in 2016 for *Trusts & Estates* discussing quiet trusts, in which I mentioned that states such as Alaska, Delaware, Nevada, South Dakota and Wyoming have flexible laws including statutes that permit quiet trusts.[1] Now at least 36 jurisdictions have enacted statutes that allow some form of quiet trust.[2] Here are some experiences with quiet trusts gathered from advisors across the industry since my prior article, illustrating how quiet trusts can provide a benefit to a family as well as when they can cause difficulties, and ideas to use in the place of quiet trusts or in conjunction with quiet trusts.

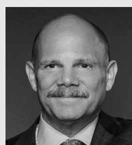
Motivations

Looking at the motivations for creating a quiet trust helps us understand the reasons for their continued growth in popularity. One reason is that clients hear about them and think that they sound like a good idea, without really having any specific reason for thinking this way. This isn't a good reason for any type of planning, and as advisors, we often spend time explaining to our clients why something that they heard about may or may not be useful for them.

Also, there were times when self-made clients didn't have a lot of wealth. They now feel that the scarcity of wealth drove them to excel and to create wealth, that they actually thrived in the environment of wanting more. They want to recreate the sense of scarcity for their children so that the children are also driven to excel. But if their children have access to the Internet, it's likely they're aware that the family has more wealth than their parents are revealing. If so, does this create mistrust on the part of the children? Most likely, clients can't genuinely reproduce the scarcity in which they thrived. Mistrust can breed in the void of information. There are other ways of creating a work ethic and a long-lasting productive family culture, which I discuss below.

Probably the most common reason for using a quiet trust is that the clients don't want their children to know they're beneficiaries of a trust until the children reach a certain age or achieve a goal, such as graduating from college. Or the client worries that their children will suffer from learning about the wealth. They worry that their children might be surrounded by individuals who only want to be their friends because they think the child is wealthy or that the wealth might lead their children to make poor decisions that they might not make otherwise. This reasoning falls into the category of a parent wanting to protect their children.

There's another reason that isn't vocalized as often, which goes like this: Clients are often advised to use their basic exclusion amount by making a completed gift during their lifetime. A long-term



David A. Diamond is president of The Northern Trust Company of Delaware in Wilmington, Del. and an advisor to The Northern Trust Company of Nevada in Las Vegas.

or dynastic trust is a very effective way to pass the wealth to children and successive generations and remove the assets from the client's taxable estate while taking advantage of the basic exclusion in the process. The alternative would be to provide the same dispositive provisions in the client's will. However, waiting to do this under a will doesn't take advantage of the basic exclusion until the client's death. With so much uncertainty over the past years about whether the basic exclusion will be reduced significantly, and the anticipated sunset of the amount in 2026, making a gift now through a trust can be a lifetime substitute for making the dispositions in a will. Following this reasoning, the client doesn't expect that distributions will be made from the trust during the client's lifetime. If the client wouldn't necessarily tell the family members what's in the will, why would they divulge the information just because they took advantage of the structure of a trust for tax purposes? So the client wants to create a trust that's a quiet trust until the client dies. If the children need distributions from the trust before the client's death, there can be provisions to allow the quiet trust treatment to be suspended or turned off all together. Similarly, sometimes the client just doesn't want to deal with the impact of disclosures during their lifetime. They might be thinking, "Why bring all of this up when it will only create problems?" I'll focus on these last two reasons in the context of modern planning.

Before addressing these reasons and possible alternatives, it's helpful to get a sense of the benefits and unanticipated pitfalls of quiet trusts.

Benefits

The benefits that I've seen over the years usually involve clients wanting to delay telling their children about the trust until the child reaches a certain age or achieves a milestone, such as graduating from college. The statute in a given state might require that the trustee provide the beneficiaries notice and information about a trust when the beneficiary reaches the age of majority, and that age of majority might be 18. The Uniform Trust Code (UTC) has mandatory and default reporting requirements, and various states that have adopted the UTC have enacted different versions of this requirement.[3] In the absence of a quiet trust, a trustee may be required to provide notice and information about the trust when the beneficiary reaches 18, 25 or some other age. Perhaps that's too early for the beneficiary to learn about the trust. Each family situation is different, but you can imagine times when it might not be appropriate for a beneficiary to learn about the wealth until a later age or stage of life.

There are also situations in which one or more of the client's children have spending problems, drug or alcohol problems, problems with creditors or romantic interests that cause the client to worry that the child will be exploited. In these instances, a quiet trust can be helpful.

> It seems that the later in life the beneficiaries learn about the trust, the higher the chance that complications and misunderstandings can arise.

Unanticipated Consequences

Now that quiet trusts have been in existence for close to 20 years,[4] we've had opportunities to see when unanticipated consequences can arise. Some issues can be avoided with careful planning and drafting. For example, I see occasions in which *Crummey* powers are included in the trust instrument potentially requiring notice to the beneficiaries, along with quiet trust provisions included toward the end of the trust instrument. Also, I've seen an instance in which payments were made directly to a college to pay tuition on behalf of a beneficiary of a quiet trust. These payments carried out distributable net income (DNI) to the beneficiary, and the beneficiary needed to report that DNI on a personal income tax return. The beneficiary received no other income and wouldn't otherwise file an income tax return, and the family didn't want the trustee to send a K-1 to the beneficiary. Again, these are two issues that can be addressed ahead of time with careful planning.

Potential actions of the beneficiaries can cause some issues. For example, if the trust provides that beneficiaries learn about the trust at a certain age, and if there's more than one beneficiary, when the oldest beneficiary reaches that age, the reality is that they may tell their younger siblings that they're all beneficiaries of a trust that none of them knew about. Also, there's the general concern that a beneficiary might be unhappy when the trust is no longer a quiet trust, and they learn about the trust later on. They'll likely be happy to learn that they're a beneficiary of a trust, but they may also say that they would have relied on the trust assets to make different life choices had they known that they had access to trust funds. The older the beneficiary is when they learn about the trust, the more likely this could be an issue.

> Getting the financial literacy process started keeps the children from "learning on the job" only after they inherit the wealth.

So on balance, experience has shown that quiet trusts can serve a very valuable role, but care needs to be taken in the planning, and consideration should be given to the length of time the trust remains quiet. Put simply, it seems that the later in life the beneficiaries learn about the trust, the higher the chance that complications and misunderstandings can arise.

Modern Planning Alternatives

Let's turn to some alternatives to quiet trusts or ideas that can be used in conjunction with quiet trusts. All of the reasons discussed above for a client not telling their children about a trust center around delaying addressing the issue rather than dealing with it and involving the children in the discussion. The following ideas are helpful to share with our clients when they're deciding whether to create a quiet trust, and if so, for what period of time the trust will be quiet.

Research shows that nearly 70% of wealth transfers fail by the third generation, with "failed" defined as the receiving generation losing control of the funds.[5] Generally this isn't due to poor wealth planning or poor investing, but to a lack of trust, transparency and, on the part of the succeeding generation, lack of preparedness.[6] So before thinking about quiet trusts, it makes sense for the client to take a look at the larger picture of family governance and prepare their children for the wealth they'll ultimately receive. I'm suggesting that rather than thinking of the quiet trust as a lifetime substitute for the will, our clients consider involving their children in discussions about the family wealth at appropriate ages for their children. What the appropriate age is really depends on the family, but it's often earlier than the client is thinking and most likely earlier than on the client's death.

Drawing on the experience of The Northern Trust Institute, I'm dividing planning for wealth transfer among family members into the categories of traditional planning and modern planning.[7] See "Hallmarks of Successful Families," p. 39, for a summary.

In traditional planning, the client and their attorney would handle the estate documents, such as the will and any trusts. In modern planning, this process would include the client modeling financial behavior for their children and looking for teachable moments to help their children learn about financial decision making. This would also include creating a Statement of Wealth Transfer Intent, which clearly explains the purpose of the client's estate plan as guidance for family members and fiduciaries working with the family members.

In traditional planning, financial education is linked to disclosure of the family wealth and financial assets. This disclosure is delayed until the parents think that their children are ready or need to know. The risk is that financial literacy for the children is left to chance, rather than being carefully planned and coordinated. In modern planning, financial literacy and financial disclosure don't

Hallmarks of Successful Families

Traditional vs. modern planning

Traditional Planning	Modern Planning
Draft will and revocable trust	**Purposeful parenting**
New parents draft basic documents and name guardians for their young children.	Intentionally modeling financial behavior and leveraging teachable moments to teach children about financial decision making.
Draft irrevocable trusts	**Statement of grantor intent**
Parents work with their attorney to draft technical estate-planning documents.	Create a plain language statement articulating the purpose behind your estate plan as guidance for beneficiaries and trustees.
Financial disclosure	**Financial literacy**
Financial education is typically linked to disclosure of financial assets and delayed until children are "ready" or "need to know." Financial literacy is left to chance.	Separate financial literacy from financial disclosure so we can empower young learners with the basics of personal finance, investments and wealth transfer to get them started on the right foot.
Limited family engagement	**Cornerstone statement**
Business-minded family members are tapped to run the family business or manage joint assets. This is an all-consuming endeavor for some family members, while leaving others unengaged.	Broaden the path to engagement by inviting all adult family members to co-create a long-term vision of success. Based in shared values, family members find a common purpose for today.
Reading of the will	**Share your estate plan**
Estate plans were historically divulged after the grantor passed at a time when grief was driving tensions. Family members were left guessing as to goal of the plan and their own financial future.	Share the details of your estate plan with your beneficiaries so they can understand your objectives and priorities. Give adult family members the information they need to do their own planning.
Succession planning	**Succession planning**
Just-in-time succession planning takes place when a succession is imminent, or perhaps, after an unexpected succession. Tensions are high, and disruption is likely.	Engage the whole family and key advisors to objectively identify roles and responsibilities prior to succession events. Put a plan in place to prepare successors for their future roles.
Silent trust	**Transparency**
Using available statutes to prevent beneficiaries from knowing about trusts.	Transparent estate planning allowing opportunities to prepare inheritors for their roles and responsibilities.

— *Northern Trust Institute*, www.Northerntrust.com/Institute

necessarily have to be linked from the beginning. But getting the financial literacy process started keeps the children from "learning on the job" only after they inherit the wealth.

Family engagement in traditional planning is often limited to those family members who are chosen to be involved in the family business or help manage the assets that have created the family's wealth. This is an all-consuming endeavor for some of the family members, while other family members are left out. Compare this to modern planning, which suggests that the parents broaden the path to engagement by inviting all adult family members to co-create a cornerstone statement that's a long term vision of success. You don't have to be in the family business to be a part of the family's business.

Traditional planning may bring to mind a formal reading of the will, which may be the first time that family members learn about the disposition of assets. And it's done at a time when individuals can be fragile and tensions can run high. The result can be less than optimal. Modern planning suggests that the client shares the details of their estate plan with their family members during lifetime, so the family members can understand the client's objectives and priorities before there's a reading of the will. This also includes giving adult family members the information they need to do their own planning. This part of modern planning likely will give some clients pause. This is the opposite of using a quiet trust as a will substitute and keeping the information from those who'll benefit from the wealth. Succession planning is a corollary. In traditional planning, succession planning often takes place when a succession is imminent or after an unexpected succession. Again, tensions can be high, and disruption is likely. In modern planning, the client engages the whole family and key advisors to objectively identify roles and responsibilities prior to the actual succession event.

Which brings us back to the quiet trust. In traditional planning, the quiet trust is used to prevent beneficiaries from knowing about the trusts and likely to keep knowledge of the overall family wealth from the beneficiaries. Using the concepts of modern planning would include transparent estate planning allowing the family members to have opportunities to prepare for their roles and responsibilities.

The quiet trust is a very effective tool when used to help beneficiaries who might be too young to know about the trust and related wealth or who might not be ready for other reasons discussed above. But when our clients say they want a quiet trust, rather than just getting it done, we should ask the client to consider the concepts described as modern planning. These concepts and quiet trusts aren't necessarily exclusive to each other. Using quiet trusts as a transitional tool can be a part of modern planning. Or maybe, even with modern planning, there will be one or more beneficiaries who shouldn't know about the trust for various reasons. In the end, the client has the final say, and they might not be interested in these concepts. However, if we don't ask them to consider a modern planning approach when contemplating creating a quiet trust, perhaps we've left some work undone for the client and their family.

In modern planning, the client engages the whole family and key advisors to objectively identify roles and responsibilities prior to the actual succession event.

—The author acknowledges and thanks his colleagues Pamela Lucina and Amy Szostak for providing many of the ideas regarding modern planning discussed in this article.

Endnotes

1. David A. Diamond, "The Administration of Quiet Trusts and Decanting Trusts," *Trusts & Estates* (September 2016).
2. For a discussion on the history and current uses of quiet trusts, *see* Michael M. Gordon, Michaelle D. Rafferty and David C. Blickenstaff, "Silent Trusts in a Very Loud World: God's Gift? Or the Devil's Work?" ACTEC 2021 Virtual Annual

Meeting. The outline can also be found on the website for the Gordon, Fournaris & Mammarella, P.A. law firm, *www.gfmlaw.com.*

3. *See* Kent D. Schenkel "Silent Trusts Are Trending Will They Hold Trustees to Account?" *ACTEC Law Journal* (Fall 2021), at p. 107, for a discussion of how different jurisdictions have enacted the Uniform Trust Code mandatory and default reporting requirements.
4. Delaware enacted its quiet trust statute in 2003, 12 Del. C. Sect. 3303.
5. Roy Williams and Vic Pressier, *Preparing Heirs: Five Steps to a Successful Transition of Family Wealth And Values,* Robert D. Reed Publishers (2010).
6. *Ibid.*
7. For a full discussion of family governance and ways to discuss wealth with children, *see* "Overcoming Obstacles to Financial Education," Northern Trust Institute, *www.northerntrust.com/ntlanding/wm/institute/articles/overcoming-common-obstacles-to-financial-education/index.html. See also* "Five Steps for Establishing Family Governance," Northern Trust Institute, *www.northerntrust.com/ntlanding/wm/institute/articles/five-steps-for-establishing-family-governance.*

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