

THE CIRCLE OF
TRUST: THE USE OF
THE FLORIDA
DIRECTED TRUST
ACT TO KEEP
BUSINESS
DECISIONS IN
YOUR CIRCLE

Presented by:

*Miranda M. Weiss
Dean Mead*

&

*Kristin A. Philips
BMO Wealth Management*



WHAT IS A DIRECTED TRUST AND WHY DID WE NEED A DIRECTED TRUST ACT

- Typically, the trustee is charged with all the duties and liabilities relating to Trust administration. This single role carried out the investment decisions, distribution decisions, and management responsibilities
- A directed trust bifurcates the traditional roles of a single trustee and applies when a person other than a trustee has a power over some aspect of the trust
- Many trusts were already giving a non-trustee the ability to direct a trustee regarding certain decisions
- Some guidance existed (adopted from Uniform Trust Code Section 808) but the roles and responsibilities of the trustee and non-trustee become blurred and unclear – when does the trustee have to follow the direction of the non-trustee and who is liable?
- The Uniform Directed Trust Act aims to clarify the roles and responsibilities of the trustee and the person giving the trustee direction (the trust director)
- In the context of the family business, this gives the settlor the ability to specifically designate trusted individuals to make distributions relating to that asset when owned by the trust

THE UNIFORM DIRECTED TRUST ACT: OVERVIEW

- Florida Uniform Directed Trust Act (“FUDTA”) is found in Part XIV of the Florida Trust Code
- Effective July 1, 2021, it replaced Florida Statutes section 736.0703(9) and 736.0808
- Our own version of the Uniform Directed Trust Act (“UDTA”), which was approved and recommended for enactment in all states in 2017
- As of August 2023, the UDTA has been enacted in 16 states, including: Arkansas, Colorado, Connecticut, Florida, Georgia, Indiana, Kansas, Michigan, Montana, Nebraska, New Mexico, Utah, Virginia, Washington, and West Virginia and introduced in California, District of Columbia, and Vermont
- Notable states that have not adopted the UDTA: Alaska, Delaware, Nevada, New Hampshire, South Dakota, Tennessee, Wyoming

BASIC TERMS – SECTION 736.0103, FLORIDA STATUTES

- (6) “Directed trust” means a trust for which the terms of the trust grant a power of direction
- (7) “Directed trustee” means a trustee that is subject to a trust director’s power of direction
- (25) “Trust director” means a person who is granted a power of direction by the terms of a trust to the extent the power is exercisable while the person is not serving as a trustee.
 - A person can fall within the definition of a trust director even if the terms of the trust do not specifically refer to them as a trust director and even if the person is a beneficiary or settlor
 - Other common terms may include “trust adviser, trust director, trust protector”

APPLICATION OF THE FLORIDA UNIFORM DIRECTED TRUST ACT

- Applies to any trust, *whenever created*, having its principal place of business in Florida
 - If the trust was created before the enactment of FUDTA (July 1, 2021), it applies to decision or actions occurring after that date
 - If the principal place of administration is changed to Florida after the enactment of FUDTA, it applies to decisions or actions occurring after the date of change
 - The terms of the trust designating Florida as the principal place of administration is valid if the trust director is located in Florida (as a Florida resident or having its principal place of business in Florida)

EXCLUSION OF THE APPLICATION OF THE FLORIDA UNIFORM DIRECTED TRUST ACT

Unless the terms of the trust specifically provide otherwise with reference to Florida Statute Section 736.1405, the Act does not apply to a person holding:

- A power of appointment;
- A power to remove or appoint a trustee or trust director;
- A power of the settlor while the trust is revocable;
- A power of a beneficiary over a trust to the extent the power affects the beneficial interest of that beneficiary or another beneficiary represented by that beneficiary;
- A power over a trust if the terms provide the power is held in a nonfiduciary capacity; or
- A power to add or release a power under the trust if the power for grantor trust purposes.

POWERS OF THE TRUST DIRECTOR

- Explicit powers: Powers of a trust director are limited to those granted to them under the terms of the Trust
- Implicit powers: unless the terms of the Trust provide otherwise, the powers of the trust director also include any additional powers necessary to carry out the exercise of a power explicitly granted
- No default powers under FUDTA (or UDTA)
- Compare to Delaware, Nevada, or South Dakota that provide default statutory powers

ACTION OF MULTIPLE TRUST DIRECTORS

- Examples of multiple trust directors:
 - The settlor wants both of his children to agree on the investment decisions relating to the family business.
 - The settlor wants to prepare the next generation and wants an adult representative from each generation.
 - The settlor wants a representative from each family line.
- Default: majority decision
- Terms of the Trust may provide otherwise
- If acting unanimously, consider tie-breaker when evenly divided

LIMITATIONS ON TRUST DIRECTOR

A trust director is subject to same rules as trustee regarding the payback provision to comply with Social Security Act reimbursement requirements and charitable interest in the trust

DUTY AND LIABILITY OF TRUST DIRECTOR

- A trust director has the same fiduciary duty and liability as a trustee in a like position under similar circumstances
- Trust terms may vary the trust director's duty or liability to the same extent as it may do so for a trustee
- The trust terms may impose additional duty or liability
- Minimum duty: to act in good faith and in accordance with the terms and purposes of the trust and interests of the beneficiaries

EXCULPATION OF TRUST DIRECTOR

- A trust director is subject to the same rules as a trustee with regard to the exculpation or exoneration clause
- Cannot relieve a trust director for breach of trust committed in bad faith or with reckless indifference to the purpose of the trust or interests of the beneficiaries
- Cannot be included as a result of abuse of a fiduciary or confidential relationship between the trust director and settlor
- Cannot be drafted or caused to be drafted by the trust director unless:
 - The trust director proves it is fair under the circumstances
 - The existence of the clause and its contents were adequately communicated directly to the settlor or the independent attorney for the settlor

DUTY AND LIABILITY OF DIRECTED TRUSTEE

- Minimum: a directed trustee shall take reasonable action to comply with the trust director's direction and the trustee is not liable for such reasonable action unless such action would result in *willful misconduct*
- The terms of the trust may impose additional duty or liability on a directed trustee
- A directed trustee may not comply with the trust director's direction to the extent complying would engage in willful misconduct
- Before complying with the trust director's direction, the trustee shall determine if the exercise is within the scope of the trust director's power
- If the directed trustee has reasonable doubt about its duty, it may apply to the court for instructions with attorney's fees and costs to be paid from the trust assets

DUTY TO PROVIDE INFORMATION

- A trustee shall provide information to a trust director to the extent the information is reasonably related to the powers or duties of the trust director
- The trust director shall provide information to the trustee or another trust director to the extent the information is reasonably related to the powers or duties of the trustee or other trust director
- A trustee or trust director that acts in reliance on the information provided is not liable for breach of trust to the extent of such reliance absent willful misconduct
- A trust director shall provide information within the trust director's knowledge or control to a qualified beneficiary upon written request to the extent the information is reasonably related to the powers or duties of the trust director

DEFAULT: NO DUTY TO MONITOR, INFORM OR GIVE ADVICE

- Unless the terms of the trust provide otherwise, a trustee does not have a duty to monitor a trust director or inform or give advice to a settlor, beneficiary, trustee or trust director concerning an instance in which the trustee might have acted differently from the trust director
- Unless the terms of the trust provide otherwise, a trust director does not have a duty to monitor a trustee or another trust director or inform or give advice concerning an instance in which the trust director might have acted differently from a trustee or another trust director

APPLICATION TO CO-TRUSTEE

- FUDTA has the same application if the direction comes from a co-trustee instead of a trust director
- The terms of the trust must manifest an intent that the act apply to certain powers granted to a co-trustee
- A co-trustee that takes direction from another co-trustee is subject to the same reasonable action and willful misconduct standards as if the direction came from a non-trustee
- Other provisions of FUDTA would apply with regard to the powers under the direction of a co-trustee (narrower duty to share information and no duty to monitor)

ACTIONS AGAINST THE TRUST DIRECTOR

- Limitations: An action against a trust director must be commenced in the same limitation period for an action for breach of trust against a trustee
 - A trust accounting or other written report has the same effect on the limitation period for an action against a trust director
- Defenses: A trust director may assert same defenses in an action for breach of trust as a trustee
- Jurisdiction: Acceptance of appointment is enough to submit to personal jurisdiction
 - All other methods of obtaining jurisdiction continue to apply

APPLICATION OF FLORIDA TRUST CODE PROVISIONS

Unless the terms of the trust provide otherwise, a trust director is considered a trustee for the following (in part):

- Prohibition on a trustee acting as a designated representative;
- Acceptance or declination of a trusteeship;
- Filling vacancies;
- Resignation;
- Court removal;
- Reasonable compensation and reimbursement;
- Limitations on a trustee's discretionary powers (tax savings);
- Remedies and damages available for a breach of trust;
- Immunity from liability if there is no breach of trust;
- Court-awarded attorney fees and costs for breach of trust challenges
- Limitations on a trustee's exculpation of liability under the terms of a trust;
- The release of a trustee from liability with consent, the release or ratification of a beneficiary, and the limitations on such actions.

TAX CONSIDERATIONS WHEN USING DIRECTED TRUSTS

- A trust director is a fiduciary under FUDTA.
- When analyzing the powers of the trust director, run through the analysis as you would if a trustee had those powers.
- Evaluate each role to determine income, gift, estate and GST tax consequences:
 - Will the appointment of an individual as a distribution advisor cause that individual to have a general power of appointment? (consider the default application of Florida Statute section 736.0814 but be explicit in the trust document to limit the powers instead of relying on this as a fallback).
 - Will the ability to vote shares in the family business have an adverse tax consequence to the settlor?
 - Will the ability for an individual to remove and replace the trust director have adverse tax consequences?

INCOME TAX CONSIDERATIONS

- Evaluate the roles and responsibilities of the trust director and directed trustee
- Consider if the allocation of powers will have any unwanted income tax consequences to the settlor, trust, or beneficiaries.
- Do any roles make it a grantor trust for income tax purposes – is this status desired?
- For purposes of evaluating the grantor trust rules, a fiduciary power held by a trust director is generally evaluated in the same manner as held by a trustee.
- Do we have state income tax considerations due to a non-FL resident acting in a fiduciary capacity?
 - Did we make the trust a resident trust for income tax purposes?
 - Where do the trust directors reside?
 - Certain states impose income tax on a trust if a fiduciary is a resident of that state (even if just one of the fiduciaries resides in that state).

GIFT TAX CONSIDERATIONS

- If the settlor is gifting interest in the business to an irrevocable trust, is the intent to treat the gift as a completed gift or an incomplete gift?
- Are there any powers held by a trust director that could cause the transfer to the trust to be an incomplete gift?

ESTATE TAX CONSIDERATIONS

- Does a power cause a trust director to possess a general power of appointment?
 - Who has the power to make distribution decisions?
 - To whom may those distributions be made and under what standard?
 - The default provision under FUDTA opts into the tax savings provision of 736.0814. Is it enough?
- Does a power cause inclusion under 2036?
 - Who has the power to vote stock in the closely held business?
 - Who has the power to remove and appoint the person who votes the stock?
- Other estate tax considerations for the settlor or trust director.

GST CONSIDERATIONS

- Modification, judicial construction, settlement agreement, or trustee action of a GST exempt trust to allow for bifurcation of trustee rules.
- Look to the regulations for guidance:
 - Does the modification shift a beneficial interest to a beneficiary that occupies a lower generation
 - Does the modification extend the time for vesting any beneficial interest?
 - In a recent PLR, a proposed decanting of a grandfathered trust to a trust that allowed for future appointment of (i) a distribution committee, (ii) an investment committee, and (ii) a trust protector would not result in the loss of exempt status for GST purposes. Example 10 of the regulations was considered in which a trust was modified to decrease the number of trustees, finding the modification pertains to the administration of the trust and does not shift beneficial interest to a lower generation or extend the time for vesting

FOREIGN TRUST CONSIDERATIONS

- Substantial Decisions: Does a non-US person have the authority to control substantial decisions of the trust? Substantial decisions include, but are not limited to, decisions concerning—
- Distribution decisions:
 - Whether and when to distribute income or principal
 - The amount of the distribution
 - The selection of the beneficiary
- Investment decisions (exception: if a US person hires an investment advisor and can terminate the investment advisor's powers at any time)
- Administration decisions:
 - Whether a receipt is allocable to income or principal
 - Whether to terminate the trust
 - Whether to compromise, arbitrate, or abandon claims of the trust.
- Decisions that may be applicable to any fiduciary:
 - Whether to sue on behalf of the trust or defend suits against the trust
 - Whether to remove, add, or replace a trustee
 - Whether to appoint a successor trustee
- Control Test: Consider prohibiting a non-US person from making substantial decisions or give a US person the ability to veto the non-US person's decision

BEST PRACTICES FROM A CORPORATE TRUSTEE PERSPECTIVE

- Directed Trusts: Why do we like them?
 - Dynastic Trusts: Settlers are comfortable with the certainty and stability of a corporate trustee that will be around for generations to come
 - Succession planning: Settlers can designate who is in control of what and can provide a thorough method for appointing a desirable successor for future generations
 - Combine directed trusts with the use of other trust tools to allow for easy the trust to adapt for unforeseen circumstances or changes in family dynamics
- Corporate Trustees can draw on a depth of experience working with directed trusts that can serve as guidance in Florida

CONSIDERATIONS FOR THE ROLE OF AN INVESTMENT ADVISOR

- Assets under control: can the trust director as an investment advisor with regard to all of the trust assets or only certain assets (i.e. real property, closely held business interest)? Be clear in the trust instrument if it is intended to act as a carve out for just the family business or if it applies to a greater portion of the trust assets
- Powers: be specific and detailed about the powers.
 - Understanding the goals and intent of the settlor will guide the drafter when determining what powers should be included. Is the intent to give the investment advisor complete investment authority over the trust asset(s) or a specified asset or is it limited to only directing the trustee how to vote the stock in the family business?
- Prudent investor rule: trust director in Florida is subject to the same liability for investment decisions as a trustee
 - Affirmatively opt out of the application of the prudent investor rule with respect to the interest in the closely held business (and any successors thereto)
 - Consider including language that the fiduciaries are specifically relieved for loss in value of the closely held business
 - The only default carve out for the prudent investor rule under FUDTA pertains to life insurance

CONSIDERATIONS FOR THE ROLE OF A DISTRIBUTION ADVISOR

- To whom may the distribution advisor direct distributions: all beneficiaries, a single beneficiary, or a class of beneficiaries
- Powers: are the distribution directions all-encompassing or very specific. Can the distribution advisor direct the trustee with regard to all distribution decisions or can the distribution advisor only direct if and when a specified asset or amount may be distributed to a beneficiary?
 - For example: the settlor ultimately wish for his children to receive the interest in the family business outright at a time when the distribution advisor determines, in the distribution advisor's sole and absolute discretion, that such child is prepared to receive it. The role of the distribution advisor would be very narrow and limited to only directing the trustee when to make that distribution of the business interest to the child.

SUCCESSOR TRUST DIRECTORS

- Include clear succession language for the trust director
- Who should have the ability to remove and replace a trust director or fill a vacancy?
- *McLean v. Ponder* – can a trust director be found liable for failing to remove a trustee and appoint a successor trustee (and vice versa)? The default to standard is no duty to monitor the actions of the other. Does granting a trust director the power to remove and replace a trustee impose additional responsibilities?
- The trust document should include specific language that the trustee is not liable for any act or failure to act by the trust director and shall have no duty to review the records of the trust director or investigate
- Although FUDTA imposes a default no duty standard, recommend specifically including language in the trust document to make it clear

VACANCY IN TRUST DIRECTOR

- In the event of a vacancy in the office of trust director, the trust instrument should provide that the trustee shall exercise all powers of the trust director
- Trustee shall be indemnified for any claims, losses, liabilities arising out of the acts of the trust director
- The trustee should have no liability for any investment decisions made by a trust director with investment authority and shall have the power to retain, sell, and invest the assets as it deems appropriate in the trustee's sole and absolute discretion

DOES THE DOCUMENT, WHEN READ AS A WHOLE, HAVE ANY CONFLICTING LANGUAGE?

- No conflicting language –make sure the provisions that pertain to the trust director do not conflict with other provisions in the trust. If there is an overlap, specifically state which provision controls when a trust director is acting.
- Case studies from other jurisdictions:
 - Shelton v. Tamposi - the terms of the trust left the administrative and distribution decisions with the trustee but appointed an investment director. The trustee was not able to raise liquidity to make a distribution to a beneficiary. The comments to the Uniform Directed Direct Act note the drafters sought to coordinate these powers by imposing a duty for the trustee to furnish information to the trust director about the effects of the investment strategy on the liquidity needs and vice versa.
 - Accident Insurance v. US Bank – acceptance of trust assets subject to condition precedent. A conflicting trust provision required the trustee to determine that such asset is a qualifying asset before accepting the asset for deposit into the trust account.

DIRECTED TRUSTEE TO ACT SOLELY AT THE DIRECTION OF THE TRUST DIRECTOR

- Consent to direction: the directed trustee should not be required or requested to consent to the direction. This could shift responsibility back to the trustee and heighten the trustee's duties and liabilities.
- May versus shall:
 - The trust terms should be clear that the Trust Director shall act with regard to its specified powers.
 - Providing that the Trust Director *may* act adds ambiguity as to the role of the trust director versus the trustee.
 - If the trust director is not acting but may act, is the trustee required to act when the trust director does not?
- Clear direction ensures that only the trust director shall act with regard to the specified powers and achieves the purpose of the directed trust.

EXONERATION AND WAIVER OF CONFLICT

- Include necessary exoneration and waiver of conflict language in the trust document
- Exoneration language should track the FUDTA language (unless a different standard is included in the terms of the trust).
- As with other trusts, it is recommended that the nominated directed trustee review the trust terms prior to execution to ensure acceptance without the need for any modification

VALUATION OF THE FAMILY BUSINESS OR OTHER SPECIAL ASSETS

- The trust terms should clearly state (i) who is responsible for the valuation of trust assets and (ii) if a specific standard of valuation should be used.
- Typically, if the trust director is acting as an investment advisor with regard to the asset(s), then the trust director should be charged with obtaining annual valuations.
- Many corporate trustees will send a periodic requests to the trust director to provide the valuation.

POWER TO PARTICIPATE OR DIRECT LITIGATION

- *Schwartz v. Wellin* : The US District Court in South Dakota dismissed a complaint for breach of fiduciary duty filed by the trust protector against the defendant trustees. The Court found the trust did not specifically confer the power to engage in litigation involving the trustee or protection of trust assets and South Dakota law did not address the trust protector's authority to bring a lawsuit on behalf of the trust.
- In the context of the family business, if the trust director is empowered to invest the interest in the business, then the trust director is likely in the best position to know when and if a suit may be necessary to protect those trust assets. Consider specifically empowering the trust director to bring a suit to protect such trust property on behalf of the trust – either directly or to direct the trustee to do so. Consider also specifically including provisions relating to attorney's fees and costs for such suits and not just relying on default provisions.

LETTER OF DIRECTION

- The trust terms should clearly indicate the requirements that a letter of direction be (i) in writing and (ii) delivered to the trustee.
- The letter of direction should be specific and detailed and should not leave the direction up to the discretion of the trustee.
- Custody of the letter: the directed trustee will want to keep custody of the letter but the trust director should also retain copies for their own records.

EXAMPLE OF VARIOUS ROLES UNDER A DIRECTED TRUST

Most Common bifurcation of roles:

- Investment Director
- Distribution Director
- Administrative Trustee

In the context of the family business, the most desirable power will be the power to direct the investment decisions with regard to the business interest (decisions relating to the retention of the asset, voting proxies for the securities, directing the trustee as to the value of the interest)

FACT PATTERNS APPLIED TO FUDTA

Fact Pattern 1: Settlor owns several closely held businesses. Settlor's longtime CPA and trusted advisor has guided him in business decisions throughout the years. Client has two children in their early 30s who are not yet ready to make decisions for the businesses.

- Investment Director: CPA. CPA can appoint one or more successor advisors. If CPA ceases to act without appointing a successor, then children may appoint a successor independent Investment Advisor. At age 45 (or other desired age), children may act.
- Distribution Director:
 - Option 1: Settlor wishes for businesses to remain in trust: No distribution director.
 - Option 2: Settlor wishes for children to receive the interest outright once the CPA determines they are ready, in the CPA's sole and absolute discretion. Distribution Director: CPA. CPA can appoint a successor independent distribution director.
- Directed Trustee: Trustee is tasked with administrative and decisions. If there is a vacancy in the office of investment director or distribution director, the trustee will assume the investment responsibilities.

FACT PATTERNS APPLIED TO FUDTA

Fact Pattern 2: Client owns two businesses and had two children, son and daughter. Son is very involved with business X and daughter is very involved with business Y. Client provides that Son's trust will receive the interest in business X and daughter's trust will receive the interest in business Y.

- Investment Director:
 - Son is investment director of business X and may appoint a successor. A vacancy in the office shall be filled by an adult lineal descendant of son.
 - Daughter is investment director of business Y and may appoint a successor. A vacancy in the office shall be filled by an adult lineal descendant of daughter.
- Distribution Director: None.
- Directed Trustee: Trustee is tasked with administrative and distribution decisions. If there is a vacancy in the office of investment director, the trustee will assume the investment responsibilities.

FACT PATTERNS APPLIED TO FUDTA

Fact Pattern 3: Settlor wants a representative from each generation to make the business decisions.

- Investment Committee: consists of at least 1 adult representative from each generation. Outline a mechanism for how to appoint the representative (the child is appointed by a majority of the settlor's children; the grandchild is appointed by a majority of the grandchildren, etc. or the oldest from each generations serves).
- Note: Multiple trust directors: Default under FUDTA is majority rule.

FACT PATTERNS APPLIED TO FUDTA

Fact Pattern 4: Settlor has 3 children, each child has 3 adult children, the adult grandchildren have minor children. Settlor wants an adult representative from each family line.

- Investment Committee: consists of at least 1 adult representative from each line of the settlor's children. Outline a mechanism to appoint the representative. Consider who should remove and replace the representative, if necessary.
- Note: Multiple trust directors: Default under FUDTA is majority rule.

FACT PATTERNS APPLIED TO FUDTA

Fact Pattern 5: Settlor has one living child and one predeceased child, survived by two adult children (grandchild A and grandchild B). Settlor's plan distributes half outright to the living child, 25 percent in trust for grandchild A and 25 percent in trust for grandchild B. Settlor owns closely held business interests. Settlor wishes for the living child to determine when grandchild A and grandchild B may receive their share of the business interests outright.

- Investment Committee: Adult grandchild may make investment decisions for the family business owned in his or her trust at age 30.
- Distribution director: Settlor's living child shall direct the trustee when to make a distribution of any part or all of the business interest owned by the grandchild's trust to the beneficiary.