

Silent Trusts

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Take-Away: Michigan now has a silent trust statute. Is that a good thing?

Background: Michigan recently enacted a new silent trust statute, which added a new section to the Michigan Trust Code. Michigan joins a handful of other states that have adopted silent trust statutes, states that include Alaska, Delaware, Nevada, New Hampshire and South Dakota.

Silent Trust Purpose: By definition a silent trust has a beneficiary who does not know that the Trust even exists. In some jurisdictions, the settlor may designate a representative of the beneficiary to receive information that the trustee would otherwise provide directly to the trust beneficiary. In effect, this approach involves the designation of an alternate *beneficiary* of the trustee's duty to disclose material information about the Trust, which is a part of the trustee's duty of candor. A well-known reported decision, *McNeil v. McNeil*, 798 A.2d 503 (Delaware 2002) described a trustee's duty of candor when finding a trustee had failed to inform beneficiaries as “*..even in the absence of a request for information, a trustee must communicate essential facts, such as the existence of the basic trust terms of trust. That a person is a current beneficiary of a trust is indeed an essential fact.*”

Michigan Silent Trust: Michigan's version of a silent trust authorizes the beneficiary's right to be informed about the Trust to be suspended for a period of up to 25 years from the date that the Trust becomes irrevocable, or property is added to an irrevocable Trust. The Trust instrument must expressly identify what information is not to be provided to the beneficiary [existence; name; trustee; trust property; value of trust property.] At least Michigan's version of a silent trust does not go to the length of South Dakota's statute, which gives the settlor the right to eliminate the beneficiary's right to be informed of the existence of the Trust *indefinitely*.

Practical Considerations: While some settlors may like the idea of a silent trust to instill thrift in the next generation of trust beneficiaries, a silent trust can also cause some problems in the Trust's administration.

- Modern Trusts tout flexibility and the opportunity to modify the trust instrument to respond to changes in circumstances. If the Trust is a silent trust, how will the trust beneficiaries be able to participate in trust modification proceedings in probate court required by the Michigan Trust Code? If effect, a silent trust does not flexibility.
- Is the designated representative a fiduciary? A designated representative may not want to take the position if he/she is classified as a fiduciary.
- Does the presence of a silent trust provision tie the hands of the trustee that wants to change the situs of the Trust to another jurisdiction, but that other jurisdiction does not recognize silent trusts?
- The silent trust arrangement can give rise to a further fiduciary relationship between the designated representative who periodically receives information about the Trust from the trustee and the beneficiary. This new relationship adds complexity to the Trust and its administration that could disfavor the beneficiary. This addition of the representative to the Trust's administration also leads to the rhetorical question of whether the representative can protect the beneficiary's interest in the Trust as actively as the beneficiary himself?
- In a world that promotes and values 'transparency' a silent trust is just the opposite.
- At what point, or upon what event, should the beneficiaries be able to step in place of the designated representative? How will the beneficiaries even know of this right to replace the representative?
- Some beneficiaries are financially incompetent or immature at any age. For them a silent trust may not be an appropriate 'remedy.'
- From the trustee's perspective, how does the statute of limitations for claims against the trustee start if the trustee cannot keep the beneficiary informed? The beneficiary cannot consent to the trustee's conduct, for example, with a nonjudicial settlement agreement. Nor can the beneficiary

consent, or be informed as to, a decanting decision, or a decision as to how to handle a closely held asset when the beneficiary does not know about it?

- From the trustee's loss prevention standpoint, one of the main ways to prevent litigation, or at least limit its impact, is to keep beneficiaries informed.
- Trustees strive to establish positive relationships with trust beneficiaries, emphasizing frequent communication to strengthen that relationship. When the trustee intentionally keeps the trust beneficiary in the dark, a fair assumption of the trust beneficiary is that 'the trustee is up to no good.'

Example: In a case that involved the estate of former DuPont CEO Charles Holliday, Jr., his children filed a lawsuit against the trustee of a silent trust created by their father. The lawsuit alleged that the trustee had breached its fiduciary duty by failing to provide adequate information about the trust's assets and investment strategies, and by failing to consult with the trust beneficiaries about the important decisions related to the trust. The case highlights the potential for legal challenges related to the use of silent trusts for tax planning purposes.

Conclusion: While many clients might be excited about their ability to use a silent trust in Michigan, trustees will be far more anxious about their use and the challenges managing a silent trust. The lack of transparency and the perceived potential for abuse can make a silent trust that much more vulnerable to legal challenges than other types of trusts.