

The 'Modern' Trust

Take-Away: The term *modern trust* is without any single definition, despite it frequently appearing in the new and legal journals. Recently authors have attempted to identify the key characteristics of a *modern trust*.

Background: Americans seem to be fixated on polls, whether the poll is about politics, sports, or TV ratings. Polls, apparently, also apply to trusts- or more accurately states where a trust is situated. Each year Daniel Worthington and Mark Merrick publish an article in *Trusts&Estates* that ranks state laws that provide the best situs for a trust, or other estate planning related entities. As part of their ranking are factors, or laws, that are summarized as promoting or reflecting the *modern trust*.

I have guiltily used that description over the years in many missives but, of course, have failed to provide any definition for the *modern trust*. Perhaps the best explanation is that it is a trust that can be easily modified, or adapted, without much (if any) approval by the courts, or which protect fiduciaries, or which can shield the trust and its beneficiaries from transfer tax exposure, or creditor claims is to be viewed as *modern*. What follows are a summary of the factors that Messrs. Worthington and Merric point to in determining their state trust rankings. I encourage you to read their January article if you are interested in learning more about what constitutes a *modern trust*.

Winners: The authors' 2026 ranking of states include two tiers. In the first (highest) tier are South Dakota, Nevada, Tennessee, Alaska, and Delaware. The second tier of states consists of Florida, Ohio, New Hampshire, and Wyoming. The rest of the states are somewhere 'south' of these two tiers. The factors the authors use in determining their state rankings and tiers are summarized below.

Rule Against Perpetuities: Some states have constitutional provisions that prevent a trust from violating the common law rule against perpetuities. Some states have adopted the 90-year statutory rule against perpetuities, i.e., the trust is void *only after* 90 years have passed, not invalid from its inception. Some states have statutes that expressly prevent a generation skipping tax on a perpetual trust under that state's laws. Some states follow what is known as the Murphy Rule [*Estate of Murphy v. Commissioner, 71 Tax Court 671*

(1979)], where the court held that when a trustee holds an unexercised power to sell or distribute trust assets there thus exists the potential for the trust to vest within the state's applicable perpetuities period i.e., the potential exists for the trust to satisfy the rule against perpetuities, but practically speaking the rule allows the trust to operate indefinitely.

State Taxation: Some states impose an income tax on accumulated trust income, while a handful of states do not. Some states only tax 'resident' trusts. Similarly, states impose a premium tax on life insurance policies, ranging from 0 to 400 basis points. For comparison, Delaware generally does not impose a premium tax on life insurance policies while Michigan's premium tax is 125 basis points.

Trust Migration: As states continue to update their trust laws the ease and ability to move the trust from one jurisdiction to another is viewed as extremely valuable, e.g., changing the governing law, appointing a new trustee, accessing more favorable decanting statutes, etc. The ease by which the governing law of a trust, and the receptivity of a court in granting those changes is considered to be important. Delaware with its long history of an experienced Court of Chancery, or South Dakota, which seems to bend-over backwards each year to adopt new statutes to attract trust business and/or 'water down' fiduciary duties, are touted as states friendly to trustees with a 'cooperative' judiciary when it comes to migrating a trust.

Resource Availability: Another reason for a trustee to forum-shop is whether a state's trust law requires the trustee to take into consideration other financial resources that are available to a discretionary beneficiary. Some states require that the trustee take other financial resources then available to a trust beneficiary into account when making a discretionary distribution, while other states are silent on that obligation.

Trust Modification: States that have adopted some form of the Uniform Trust Code (UTC) have varying trust modification standards, e.g., a trust cannot be modified contrary to the trust's 'material purpose.' Lenient modification standards, e.g., nonjudicial modification agreements to modify beneficial interests, are generally viewed as favorable jurisdictions. However, the focus on state laws goes even further by looking at whether the state has also adopted the Uniform Directed Trust statute and/or other enabling legislation that

recognizes a trust protector (including whether the trust protector/director must be classified as a fiduciary) and the availability of flexible decanting statutes with notice (or much notice) to trust beneficiaries.

Virtual Representation: As part of promoting the ability to modify a trust is a state's virtual representation statute, e.g., who must give consent to a modification. Those states that have adopted some form of the UTC have such a virtual representation law. Other states have enhanced or streamlined even further the ability to rely on virtual representation (where a limited number of consenting beneficiaries can bind other, or successor beneficiaries) in trust modification or decanting proceedings.

Privacy: Included under this factor are *silent* trusts. In addition, a couple of states authorize the automatic sealing of trust records, which wealthy and well-known families find attractive when they want to keep their names out of the court records and the press. Also included as a ranking 'positive' are states that authorize the use of a private family trust company.

Special Purpose Trusts: Some states have special purpose trusts, i.e., a trust without a beneficiary who is empowered to enforce the terms of the trust, that go well beyond a 'pet trust' provision which is part of the UTC. Purpose trusts are gaining attraction nationwide to hold family asset collections without named beneficiaries, or in rare situations, closely held business interests, e.g., Patagonia.

Asset Protection: Several different laws or common law principles appear under this ranking factor. The focus is principally on discretionary trusts.

Restatement of Trusts (Second vs. Third): As a generalization, if a state, like Michigan, defines a discretionary trust consistent with the *Restatement (Second) of Trusts*, the beneficiary of the discretionary trust is determined to hold no enforceable property interest in the trust, which is viewed as a positive in the state rankings. Other states, while adopting discretionary trusts, define the term discretionary trust somewhat differently than in the UTC, which makes the trust more vulnerable to enforcement claims brought either by the beneficiary of the discretionary trust or the beneficiary's creditors. Other states that have

adopted the UTC without modification, indirectly adopting the *Restatement (Third) of Trust* definition of discretionary trust, which effectively gives the beneficiary some right of enforcement (or the beneficiary's creditors some right of access) to the trust assets.

Self-Settled Asset Protection Trust: Over 20 states, including Michigan, now have some form of a self-settled domestic asset protection trust (DAPT) statute. These adopting states vary, however, on whether an affidavit of solvency is required by the settlor, and other 'fine-tuning' provisions, e.g., statute of limitations duration in which a creditor can challenge the transfer to the DAPT or the Uniform Voidable Transfers Act provisions which might invalidate the DAPT.

Sole Remedy Statutes: Some states have statutes that provide that the sole remedy to a creditor regarding collection against an LLC membership interest or limited partnership interest is a charging order, but not a judicial foreclosure order which could liquidate the LLC/FLP interest in satisfaction of a creditor's judgment.

Alter-Ego Statutes: Some states have adopted statutes (not part of the UTC) that intentionally address ways that trial courts have successfully attacked irrevocable trusts on the grounds that the trust is either the alter-ego of its settlor, the trust is a sham, or that the settlor retained too much dominion and control over the trust, to frustrate a trial court from 'piercing the veil' of the irrevocable trust to access trust assets to satisfy claims against the settlor. As the authors note in their companion article to their state rankings: *"These statutes have been adopted to help prevent judges with little knowledge and background in trust law from issuing bad facts cases...These jurisdictions realized that almost all trial court judges would be unfamiliar with trust law and wouldn't have time to learn it before issuing a decision."* [I wonder what a trial judge thinks when he/she reads the reasons behind these alter-ego type statutes. But I digress.]

Conclusion: Combing or extrapolating these different 'factors' results in what is commonly called the *modern* trust. There is no one, single, definition for the *modern* trust that everyone understands or applies. Some states, read these annual state rankings with an eye on attracting even more trust business, almost invariably update their trust laws- I'm looking at you South Dakota, Tennessee, or Nevada, just to be able to claim that they are high(er) on the list. Other states seem almost disinterested in attracting new trust

business. I suspect with the growing interest in dynasty trusts by the extremely wealthy, used to avoid transfer taxes for multiple generations, (Florida's rule against perpetuities permits a trust to last of 1,000 years!) that might be what prompts states to compete for trusts that hold millions, if not billions of dollars of assets. I'll refrain from sharing any personal comments on whether this is a positive trend, just understand that the competition for 'trust business' is fierce, and not going away very soon.

If you would like to read additional missives, [click here](#).