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TRUSTS AND ESTATES LAW

Expert Analysis

Now, More Than Ever, New York Needs a Directed Trust Statute

In estate planning, this year has been one of uncertainty as we all wait to see if there will be the anticipated changes to income and estate tax rates. In this climate, practitioners have utilized some creative solutions, which also provide flexibility in the face of uncertainty.

While the creation of trusts may have significant tax savings, many clients remain concerned about giving up control to one trustee. Directed trusts have become increasingly popular with clients for precisely this reason. A settlor of a trust can scatter responsibilities (and liabilities) among several individuals or entities, without having multiple trustees. This can be particularly appealing when planning with closely-held businesses and succession planning.

In recent years, various organizations have proposed legislation to enact directed trust legislation. We have addressed directed trusts and New York's need to enact a directed trust statute in prior columns. C. Raymond Radigan, Jennifer F. Hillman, *New York Needs a Directed Trust Statute*, N.Y.L.J., Nov. 20, 2012; C. Raymond Radigan, *Time for a Second Look: Revisiting New York's Proposed Directed Trust Statute*, N.Y.L.J., Jan. 8, 2018. With this in mind, we felt it was appropriate to revisit what directed trusts are, and why they are so important for New York to hold on to trust business and the revenue it creates.

By **Raymond Radigan** And **Jennifer F. Hillman**

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What Is a Directed Trust?

In a typical trust, the trustee maintains full control over the way the trust assets were invested, administered and distributed to beneficiaries. Especially in the context of a family or closely held business, this can limit the control or influence of family members or others with institutional knowledge of an entity.

In a directed trust, there is a direction from the settlor about who will handle what roles and what responsibilities, while the "traditional" trustee continues to administer the trust itself. The value of this is twofold—a settlor can sprinkle and scatter responsibilities among individuals who are best suited to manage certain trust assets, and those individuals can limit their potential liability to solely the areas that they direct.

This is completely different from delegation regarding investments as provided for under New York's Prudent Investor Act. In delegation, a trustee is allowed to hire a professional to handle specific aspects of trust management that the trustee may not have the expertise or time to effectively handle personally. However, a trustee that delegates investment responsibility still has a fiduciary duty (and the corresponding liability) as if he or she directly managed the investments themselves. A trustee receives commissions to compensate them for taking on the control (and the liability). They have little incentive to delegate that authority if they remain liable for the actions of the delegee.

In a directed trust, a settlor could name one individual responsible for trust administration, another responsible for investment strategy and/or decisions, and yet a third individual to make distributions. The settlor can direct that the trustee maintain a concentrated stock

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position, even though it may be prudent to diversify a portfolio. A settlor could also fund a trust with an interest in a closely-held business, and then direct the settlor or a specifically-named individual to continue managing the business, or otherwise direct a specific succession plan for the business. The settlor could also give family members the power to buy, sell and/or have voting rights on company stock.

With a power to direct, the trustee usually has no responsibility other than to carry out the direction when made, as well as overall responsibility for seeing that the terms of the trust are honored. A trustee must act in accordance with the direction, unless the direction would be manifestly contrary to the terms of the trust or the trustee knows the attempted exercise of the direction would constitute a serious breach of a fiduciary duty owed by the holder of the power to the beneficiaries of the trust.

Obviously, this flexibility is beneficial to both the settlor and the trustee. The trust instrument could (and should) clearly define the roles and responsibilities of each individual, and clearly delineate and define the potential liability for each party's actions, as well as the potential compensation for each.

Current New York Law

As discussed in prior columns, New York case law recognizes the ability of a trust settlor to have an advisor control the actions of the fiduciaries. See e.g., *In Re Rubin*, 143 Misc.2d 303 (Sur. Ct Nassau Cty. 1989) (Radigan, S.) (finding valid a will provision which granted specific advisors the power to direct the executors and noting "the earliest common law cases and texts recognize the right of a testator to limit, qualify, or condition the authority granted his fiduciary" which includes "limitations as to time (when the appointment shall begin or end), or place (different executors may be appointed in different geographic areas), or subject matter (one executor may be given exclusive authority over a particular asset or group of assets)."); see also *In re Rockefeller*, N.Y.L.J., Aug. 24, 1999, p. 28, col. 2 (Sur. Ct. N.Y. Cty.); *In re Winston*, N.Y.L.J., Dec. 24, 1990, p. 33, col. 3 (Sur. Ct. Westchester Cty.); *In re Langdon's Will*, 154 Misc. 252 (Sur. Ct. Westchester Cty. 1935).

However, while there is authority for a directed trust to be created under New York common law, these cases fail to address several important issues including: (1) trustee liability for losses resulting from improper investments; (2) whether the trustee will incur a reduced trustee fee based upon a limit to his or her role; and (3) issues concerning the submission of all parties to the jurisdiction of New York courts.

To remove this uncertainty from their planning, settlors have formed trusts in states with directed trust statutes and, as a consequence, New York loses business in legal services, accounting and banking related to trust to more "trust friendly" states.

While most of this lost revenue is anecdotal, a 2005 Report to the Lower Manhattan Development Corporation entitled "In re Trusts: Preserving Jobs and Taxes in New York's Personal Trust Business" was able to somewhat quantify the losses and found that while trust business continued to grow nationwide, New York's trust business has been declining, depriving New York State of significant tax revenue and jobs. See Murphy, Natalia, *Staying Competitive with a Directed Trust Statute: The Proposed Bill for New York,* Trusts and Estates Law Section Newsletter, Fall 2010, Vol. 43. No. 3, pg. 27, and LaFerlita, Joseph, *Moving Forward: Modernizing and Consolidating N.Y. Trust Law*, N.Y.L.J., Jan. 28, 2013, both citing to Appleseed, *A Matter of Trusts: Preserving Jobs and Taxes in New York's Personal Trust Business*, A Report to the Lower Manhattan Development Corporation, February 2005.

These statements are further supported by a similar review of the impact of trust business on Delaware's economy (a "trust friendly" state). In 2011 Prof. Max Schanzenbach published an article entitled "Evaluating the Impact of Trust Business on Delaware's Economy" which analyzed IRS and FDIC data to determine that "out-of-state trusts have in recent years contributed between $600 million and $1.1 billion per year to Delaware's economy, which works out to $1,700 to $3,000 per Delaware household." Schanzenbach, Max, Evaluating the Impact of Trust Business on Delaware's Economy (last visited on April 26, 2021). The same article also reported that at least $300 million per year in fiduciary fees are paid to Delaware institutions as a result of Delaware's non-domestic trust business. Id.

Clearly, it makes fiscal sense to continue to evolve New York's trust law. A directed trust statute would provide settlors with some measure of certainty that their intentions with respect to the administration of their trust will be followed by their fiduciaries, and enforced by the courts. The current uncertainty in New York law arising from a lack of legislation defining how directed trusteeships should function has led settlors to choose states other than New York to establish directed trusts.

The concept of a directed trust is a necessary statutory addition so that New York can stay competitive in the trust field.

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