

Business Interests Held in Trust

Trust features to facilitate fiduciary decision making



Key takeaways

- When a business interest is the primary asset in a trust, it can create challenges for both the trustee and business owner
- The trustee's general fiduciary duty to diversify the trust's investments may not align with the business owner's goals
- Certain trust features can help to address this conflict

One of the biggest hurdles for business owners considering estate planning using personal trusts is the fear of giving up control over their most significant asset. After many years of leading their company, they are understandably reluctant to let anyone else make decisions about how it is managed as an asset.

Under most traditional trust structures, the trustee is responsible for assets placed in trust. The trustee must make decisions about how to manage these assets—which can be particularly challenging when the primary asset is a closely held business. Because of its fiduciary duty to diversify the trust's investments, a trustee may decide that a closely held business is not an appropriate investment for the trust, because it is undiversified and illiquid, and may decide to sell all or part of the ownership interest or manage it in a manner that is contrary to the family's goals. This, obviously, is not what most business owners want.

However, these issues can be addressed by establishing a trust with specific features that allow the business to remain as the trust's primary asset while a trustee performs the administrative duties required. The state law governing a trust's administration and a trustee's experience using these tools will determine a trustee's willingness and ability to administer a trust holding business assets.



Directed trust language

With a directed trust, the trust document provides that the investment advisor manages all trust investments, including business interests (see Figure 1). The investment advisor thus makes decisions on voting, retention, and sale of assets. The trustee is required to follow the written directions of the investment advisor, however the trustee is still responsible for performing the administrative functions of the trust. The trustee may need to manage the business interests if no investment advisor is serving.

Special business co-trustee language

A special business co-trustee manages the business interests for a family trust in conjunction with a primary trustee. The special business trustee can exercise voting power and make decisions regarding retention, sale, and encumbrance, while the primary trustee retains the management of all other trust assets (see Figure 2). The primary trustee is required by the trust document to implement the administrative tasks based upon the special business co-trustee's management of the business interests. Because there are co-fiduciary duties shared between the primary trustee and special business trustee, the relationship may be cumbersome. Some states, such as Delaware, provide for an "excluded co-trustee" relationship where the primary trustee may be excluded from all aspects of administering special business assets. An excluded co-trustee statute helps clarify the scope of each trustee's duties and liability.

Figure 1

Directed trust

Trustee follows directions of investment advisor

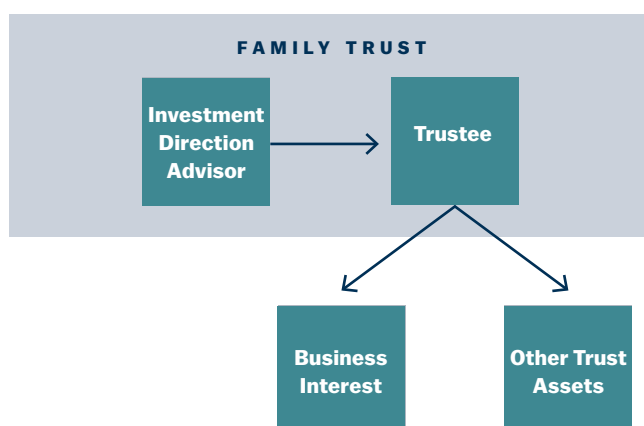
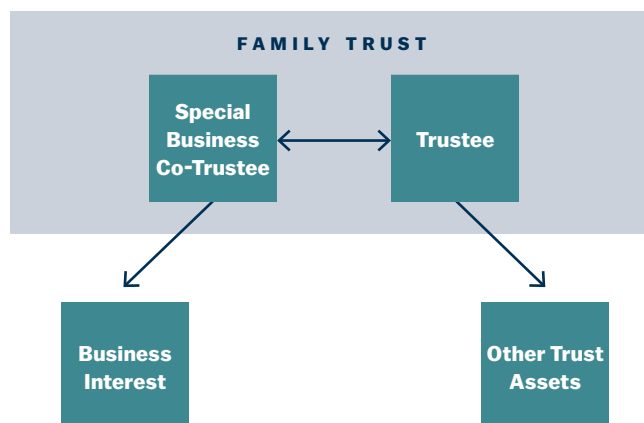


Figure 2

Special business co-trustee

Primary trustee has no responsibility over business interest



Delegation by trustee language

Trustees may also choose to delegate responsibility to a third party or to a co-trustee (see Figure 3). By exercising reasonable care in the selecting and monitoring of the delegate, the trustee is generally not responsible for the decisions or actions of the delegate. The delegate manages the business interests held in the trust. Unlike investment advisors or special business co-trustees, the trustee has the duty to periodically review the actions of the delegate. However, the beneficiaries of the trust can execute agreements to consent to the delegation and exonerate and indemnify the trustee.

Figure 3

Delegation by trustee

Trustee delegates authority for delegate to manage business interests

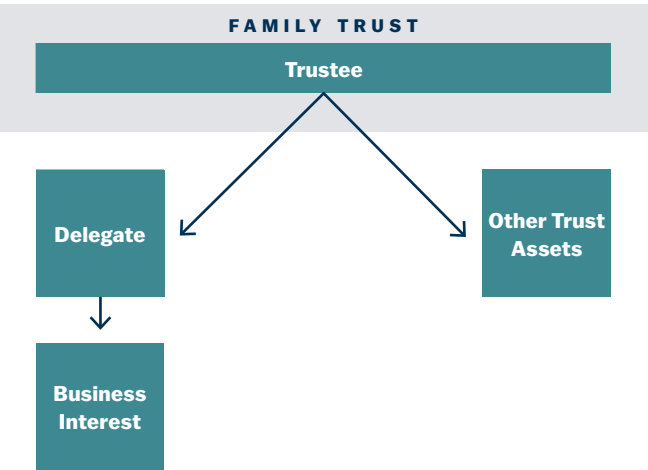


Figure 4

Managing the trustee's duty to diversify

A trustee's willingness and ability to utilize these tools to hold business interests will depend upon applicable state law as well as the trustee's experience and risk tolerance

Tools for trustees to manage duty	What it means	Duty of trustee	Liability of trustee	Issues
Retention Clause (in document)	Trust document instructs trustee to retain business interest	Trustee retains business interest—implied duty to monitor performance	In accordance with state law; trustee cannot act in bad faith or with gross negligence and generally must monitor asset	Trustee generally requests beneficiaries to waive diversification and requires beneficiaries to ratify retention
Exculpation Clause (in document)	Document relieves trustee from liability for retention	Trustee retains business interest	In accordance with state law; trustee generally cannot act in bad faith or with gross negligence	Trustee requests beneficiaries to exonerate trustee for not diversifying
Delegation	Trustee delegates authority to delegate	Trustee must use reasonable care in selecting delegate; trustee must monitor delegate	Delegate (not trustee) is liable for failure to exercise reasonable care regarding retention of assets	Trustee may require beneficiaries to release trustee from liability for delegating
Structured Out-Voting or Business Co-Trustee	Co-trustees vote to retain interest	Trustee follows decision of co-trustees	Trustee presumably not liable if dissent documented	Verify if corporate trustee is held to higher standard than non-corporate trustee
Approved Breaches, Consent, and Ratification	Beneficiaries approve decision to not diversify	Trustee follows instructions as approved	Trustee presumably not liable	Obtaining appropriate consents and virtual representation
Directed Trustee (in document)	Investment advisor manages business interest/other assets; trustee is directed to perform administrative functions	Trustee follows direction of advisor as provided in trust document	Trustee generally not liable other than trustee's own willful misconduct	Trustee may be liable for willful misconduct; trustee may need to manage business if no investment advisor is serving
Business-Imposed Retention under Buy-Sell Agreement	Buy-sell agreement requires trustee to retain interest	Trustee follows language in buy-sell agreement	Trustee not liable for following terms of buy-sell agreement	Trustee may wish to keep beneficiaries informed

Utilizing the Delaware advantage.

The state of Delaware provides some special advantages to business owners who establish personal trusts under its laws, such as control, asset protection, and confidentiality regarding the family business. While not all of these advantages are unique to the state of Delaware, utilizing them with a trust located in Delaware affords the business owner access to other benefits that this trust-friendly state has to offer. Talk to your advisor about whether a Delaware trust might be beneficial for your individual circumstances.



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Note that a few states, including Delaware, have special trust advantages that may not be available under the laws of your state of residence, including asset protection trusts and directed trusts.

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