Business Interests Held in Trust

Trust features to facilitate fiduciary decision making

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KEY POINTS

• 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 successfully 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.

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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 and the trustee’s experience and risk tolerance

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<td>Trust document instructs trustee to retain business interest</td>
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<td>In accordance with state law. Trustee cannot act in bad faith or with gross negligence and generally must monitor asset</td>
<td>Trustee generally requests beneficiaries waive diversification and requires beneficiaries ratify retention</td>
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Managing the trustee’s duty to diversify
There are a few different ways to approach managing the trustee’s duty to diversify, aside from having the trustee give up investment authority over the business interests. Figure 4 illustrates the types of strategies that can be implemented to offset the trustee’s liability if diversification does not occur due to the intentional holding of mostly (or all) business interests.

By incorporating the right trust features, a business owner can take advantage of the many benefits of a trust without sacrificing control of the business.

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.

Don serves as chief fiduciary officer for Wilmington Trust’s Wealth Management division, overseeing the development and delivery of our trustee and planning services. Don earned his undergraduate degree from Villanova University and his law degree from New England Law, Boston. He also holds a master of laws (LL.M.) degree in taxation from Temple University Law School and a master’s degree in moral theology from St. Charles Borromeo Seminary in Wynnewood, Pennsylvania.

Jeff is responsible for developing trust planning strategies for wealthy individuals and families throughout the United States and abroad. He works closely with his clients’ legal, tax, and investment advisors to construct and implement appropriate trust structures that take advantage of the state of Delaware’s unique trust and tax laws. He earned his JD and MBA from Syracuse University and holds a bachelor’s degree in economics from Northwestern University. He is a frequent lecturer on topics involving the use of Delaware trusts for asset protection, state income tax minimization, and investment management for unique trust assets.