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DIRECTED TRUSTS IN CONNECTICUT

A directed trust is a sophisticated planning technique that divides the traditional duties of a trustee among more than one person or institution. Unlike a standard trust with multiple co-trustees, all of whom would share the same duties, a directed trust makes each "trust director" responsible for a different type of task on behalf of the trust. More than 30 states permit some form of directed trust. The Connecticut Uniform Directed Trust Act (C.G.S. 45a-500b), which was enacted in 2020, authorized the creation of directed trusts in Connecticut, allowing Connecticut estate planners and clients to take advantage of this sophisticated planning technique.

THE TRADITIONAL ROLE AND RESPONSIBILITIES OF A TRUSTEE

The traditional role of trustee comes with three classic responsibilities: (i) administration of the trust (*e.g.*, tax filings), (ii) investment of trust assets, and (iii) distributions to beneficiaries.

Administration. A trustee is responsible for the trust's administration, including filing tax returns and providing certain types of information to beneficiaries. "Administration" also can include supervising lawyers and accountants.

Investments. A trustee is responsible for the prudent investment of trust assets. A trustee must act prudently and responsibly in making investment decisions and/or in selecting and overseeing an investment professional.

Distributions. A trustee is responsible for understanding and following the trust terms for making distributions to the beneficiaries. This can be simple and automatic. For example, a trust agreement may direct that all income shall be distributed quarterly to a beneficiary, or that 3% of principal shall be distributed annually. More often, however, a trustee is given some degree of discretion – or full discretion – over distributions, and a trustee will need to give consideration to the propriety, timing and amount of any distributions. For example, a trust agreement may instruct the trustee to make distributions to beneficiaries for their health, education, maintenance and support. A trustee may be required under the trust agreement to take into account other assets of the beneficiary before making a distribution, or to consider potential creditor risk. A trustee also could be instructed to make distributions that supplement a beneficiary's lifestyle but do not jeopardize any government benefits.

The responsibility for distributions often requires a trustee to review and respond to requests from beneficiaries.

The traditional role of a trustee comes with all of the above responsibilities, and if the trust has multiple co-trustees, then all co-trustees share these same responsibilities.

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A DIRECTED TRUST: DIVIDING THE RESPONSIBILITIES

A directed trust allows the traditional responsibilities of a trustee to be divided and fully delegated. In a directed trust, one or more "trust directors" may be empowered by the trustee or the grantor (creator) of the trust. For example, the trust may empower a trust director *for investments* (investment trust director), who is then fully responsible for directing and overseeing investments on behalf of the trust. In that case, the trustee has no responsibility for investment decisions in the ordinary course, as described further below. Absent a directed trust statute, a full delegation by a trustee of investment responsibility typically is not permissible.

The name "trust director" refers to the fact that, once empowered, the trust director directs the trustee on how to act. For example, the investment trust director, referred to above, directs the trustee to invest in a particular stock, and the trustee simply executes the trade or purchase, without assuming responsibility for investments.

Several types of trust directors are commonly utilized with directed trusts:

- **Distribution Trust Director.** A distribution trust director can be empowered to decide the amount and timing of distributions to beneficiaries. This structure can provide greater flexibility to a grantor of a trust. For example, the grantor may wish to have a trust that empowers a family member to oversee distributions, but without requiring that family member to assume responsibility for administrative matters or investing. Alternatively, a grantor may want a family member to oversee a trust, but to allocate responsibility for distributions to a neutral party to minimize the risk of family tension.
- **Investment Trust Director.** This role is perhaps most common in directed trusts. It can allow, for example, the family's investment advisor to direct the trustee's investment decisions. It also can allow the trustee to hold a concentrated position in a particular asset, which some trustees would be reluctant or unwilling to hold.
- **Special Holdings Trust Director.** The special holdings trust director can allow the investment and management of certain assets to be carved out of the responsibility of the investment trust director. This can be helpful, for example, if a corporate trustee/trust director is willing to manage a securities portfolio but is unwilling to manage a family business that has been placed into the trust. In that scenario, a special holdings trust director can assume responsibility for the family business. This may also be appropriate with collectibles, such as art, music, literary rights and automobile, where separate management may be preferable. There is a common alternative scenario: a directed trust could be created to permit the grantor to serve as the investment trust director, with the ability to direct investments of the securities portfolio; however, allowing the grantor to actively manage and vote a closely-held business that has been placed in the trust may create too great an estate tax risk. In that case, the closely-held business might be carved off from the duties of the investment trust director.

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DIRECTED TRUSTS IN CONNECTICUT

This publication is a summary of legal principles. Nothing in this article constitutes legal advice, which can only be obtained as a result of a personal consultation with an attorney. The information published here is believed accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues.

FIDUCIARY LIABILITY WITH DIRECTED TRUSTS

Under Connecticut law, a trust director, like a trustee, is a fiduciary and must act in the best interest of the beneficiaries. A trust director is subject to the same rules as a trustee in a like position and under similar circumstances in the exercise or nonexercise of a power of direction. The standard of care required of a trust director, as with a trustee, is defined by the terms of the trust and/or underlying state law.

A trustee who is acting at the direction of a trust director is a "directed trustee." A directed trustee must take reasonable action to comply with a trust director's exercise or non-exercise of a power of direction, and thus the directed trustee is not liable for the action. However, a directed trustee shall not comply with a trust director's exercise or nonexercise of a power of direction to the extent that by complying the directed trustee would engage in willful misconduct. A directed trustee can seek court approval for following the direction of the trust director. A trustee does not have a duty to monitor a trust director or inform or give advice to a grantor, beneficiary, trustee or trust director concerning an instance in which the trustee may have acted differently than the director. The terms of the trust, however, may alter or impose a duty or liability on a directed trustee in addition to the duties and liabilities imposed under the law.

PLANNING STRATEGIES UTILIZING DIRECTED TRUSTS

As we face the prospect of reduced exemptions from estate, gift, and the generation skipping transfer tax in 2026, many clients are considering making substantial gifts to irrevocable trusts. Many factors should be considered when analyzing what trust strategy to utilize, including the identity of the beneficiaries, the distribution terms, the trustees and successor trustees, and how long the trust may last. Whether to create a directed trust is another consideration.

Many states now allow directed trusts, and grantors are not always limited to their state of residence as the situs for their trusts. For Connecticut residents, the Connecticut Uniform Directed Trust Act allows this type of sophisticated planning to be done in their home state, without looking to other states historically known for their favorable trust laws, such as Delaware and South Dakota. This also may be attractive for residents of neighboring states, such as New York, New Jersey and Massachusetts, who may look to appoint a Connecticut trustee and create a Connecticut directed trust. Connecticut directed trusts benefit from other provisions of Connecticut trust laws, including expanded rule against perpetuities, income tax reimbursement provisions, asset protection planning for the grantor and/or the beneficiaries, significant enhancements for dynasty planning, and appointment of designated representatives for certain beneficiaries.

SUMMARY

A directed trust is a sophisticated and flexible planning technique that may help address an array of complex planning concerns and can allow planners to create customized and tailored trust solutions. The particular appeal of directed trusts is that they can permit a trust grantor to participate in certain types of investments, and they can allow a "trust director" to assume only those responsibilities within his or her area of expertise. Consider discussing directed trusts and other estate planning strategies with your Wiggin and Dana attorney.