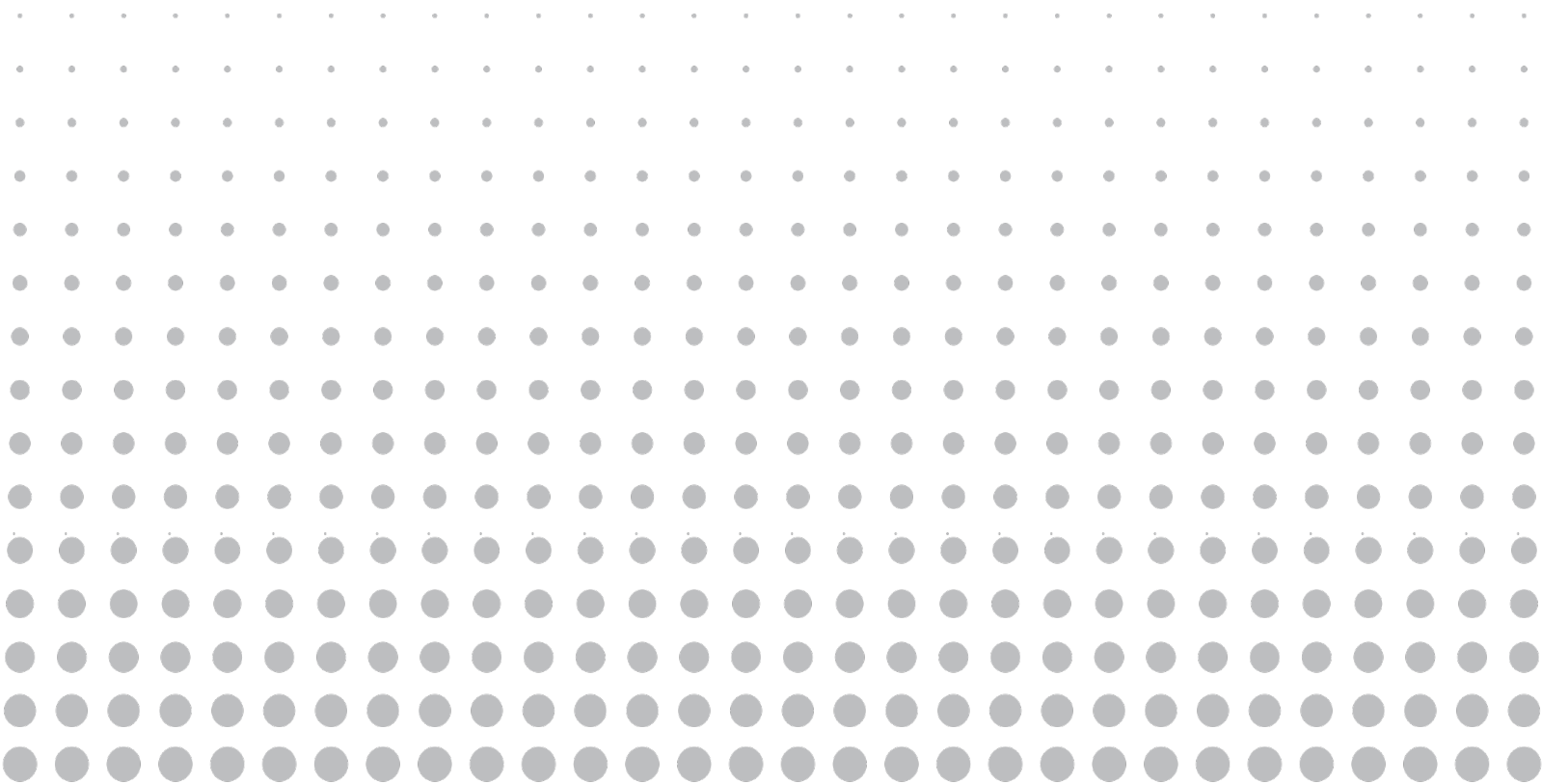




Special Purpose Entities (SPEs) May Now Serve as Trust Advisors in Tennessee



On May 10, 2019, Tennessee Governor Bill Lee signed SB 699 / HB 676 into law as Public Chapter 340. Among several changes, Public Chapter 340 adds a new Part 13 to the Tennessee Uniform Trust Code. This new Part 13 represents a significant evolution of Tennessee trust law by permitting the creation of special purpose entities, as defined in Tenn. Code Ann. § 35-15-1301(a)(6), to serve as Trust Advisors for trusts for which a Tennessee corporate fiduciary is serving as Trustee.

Directed Trust Structure

Traditionally, a trust was subject to the control and oversight of a Trustee, who was charged with all facets of trust administration. Recent statutory changes in Tennessee law, however, authorize the separation of the traditional trustee roles by allowing for the appointment of a Trust Advisor (also referred to as a Trust Protector) who can have the authority to “direct” an exercise of a power held by the Trustee, including direction concerning investment and distribution decisions. The Trust Advisor can either be an individual or structured as a committee with multiple serving committee members. Given the power of a Trust Advisor to direct the Trustee, the trust is referred to as a “directed trust.” The ability to reserve certain authority over the management of trust assets to a Trust Advisor provides significant planning opportunities.

For example, while a grantor may wish to utilize a corporate trustee, the grantor may prefer that investment decisions be controlled by a trusted advisor. Additionally, a grantor may wish for all administrative functions of a trust to be the responsibility of a corporate trustee while granting a specific individual(s) (e.g., family members, other advisors) the power to make discretionary distributions or veto an exercise of the Trustee’s discretion to make a distribution. Similarly, carving out responsibility for the administration of the family lake house to a family member with a separate trustee responsible for all other matters can also be an attractive option.

In recent years, as wealth has grown and grandchildren have aged, there is a trend of high-net-worth individuals seeking to impart investment acumen to their grandchildren. Therefore, a Trust Advisor could consist of an investment committee involving the grandchildren who, as committee members, could be given responsibilities intended to foster investment knowledge while ensuring oversight. Similarly, involving younger generations in decisions concerning charitable distributions is also increasingly common. An extremely powerful use of the directed trust structure is that it permits an owner of a closely held business to specifically identify a Trust Advisor who is to have sole power to vote the equity interests thereof, and thus indirectly control the management and operations of the business. For business owners concerned with succession planning, the opportunity to select trusted advisors, both inside (e.g., Directors) and outside of the business, to oversee the management of the business is invaluable. Moreover, the selection of an appropriate Trust Advisor also provides a structure to continue the business for several successive generations.

Potential Relief from State Taxation

A significant benefit of the new law is its potential to provide relief from taxation in those states which tax a trust based on the residency of the Trustee or other fiduciary within the state. In these states, the fact a Trust Advisor is a resident of such a state could be the sole justification for the state subjecting the trust to tax. The Tennessee special purpose entity, however, will be a resident of Tennessee and – provided all the special purpose entity’s activities occur solely in Tennessee (i.e., meetings, exercise of powers) – it could be possible to

avoid subjecting a trust to a state's income taxes which are imposed based solely on the residency of a fiduciary in such state. As a result, an individual resident of one these states could have a role in the special purpose entity and thus be involved in making decisions concerning the underlying trust without subjecting the trust to the state's income tax. This ability to provide relief from such aggressive state income taxing regimes could permit significant tax savings.

In addition to the foreign state tax savings, so long as the beneficiaries of the trusts are not Tennessee residents, the trust would not be subject to Tennessee tax notwithstanding the fact the trustee is a Tennessee corporate fiduciary (and/or a national bank located in Tennessee) and the Trust Advisor is a Tennessee entity. Consequently, for those trusts, the use of a Tennessee special purpose entity will not result in any additional tax burden and, in fact, could provide a significant tax savings.

Liability Protection for Trust Advisors

Another benefit of Public Chapter 340 is the ability to provide liability protection for Trust Advisors, something which might have hindered the use of Trust Advisors previously. Specifically, prior to the passage of the new law, it appeared that under state law, when a Trust Advisor was to act in a fiduciary capacity, only individuals or corporate trustees who were authorized to act as a fiduciary under state law were permitted to serve. It should be noted that under Tennessee law it is permissible to provide that a Trust Advisor is not to be subject to any fiduciary duty with respect to the powers granted to the Trust Advisor. Given that the typical grantor often desires for other individuals, rather than corporate trustees, to serve as the Trust Advisor, a common impediment to fully utilizing a directed trust structure was that these individuals serving as Trust Advisors often faced concerns of liability protection for such service. Public Chapter 340, specifically Tenn. Code Ann. § 35-15-1301, provides a solution to this liability concern as well as other benefits; provided that certain requirements are met, Tenn. Code Ann. § 35-15-1301 permits the creation a special purpose entity (which will likely be organized as a Limited Liability Company (LLC)) to serve as Trust Advisor and act with the requisite fiduciary powers.

The special purpose entity is designed to utilize Tennessee's directed trust structure by permitting the special purpose entity to serve as Trust Advisor of a trust of which a Tennessee corporate fiduciary (or a national bank with a physical presence in Tennessee) is otherwise serving as Trustee. Therefore, a grantor could establish a trust with a Tennessee corporate trustee and appoint a special purpose entity to serve as Trust Advisor. In addition, one special purpose entity could serve as a Trust Advisor for all trusts benefiting members of an extended family (up to twelve degrees of lineal kinship or eleven degrees of collateral kinship, and including spouses, some former spouses, and some family members of such spouses). So long as a Tennessee corporate trustee is serving, the special purpose entity may exercise fiduciary duties with respect to trusts benefiting all these family members without being subject to the Tennessee laws applicable to trust companies. Since the special purpose entity can be organized as either an LLC or a corporation, the owners and officers of the entity will be afforded the same general liability protection from the entity's operations as is otherwise the case with LLCs and corporations. This limited liability protection makes serving as a Trust Advisor significantly more appealing to potential prospects who are otherwise wary of the liability exposure.

For these reasons, the ability to create a special purpose entity to serve as a Trust Advisor with fiduciary powers as permitted by Public Chapter 340 represents a significant enhancement of the directed trust structure under Tennessee law and only furthers Tennessee's status as one of the preeminent jurisdictions to situs a trust.

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