South Dakota's Situs Advantages Over Tennessee

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THE POWER OF INDEPENDENT THINKING℠

Attorney's and advisors to the HNW and UHNW stay continuously informed of changes in state law that may represent a benefit to their clientele, specifically as it relates to the ever widening field of trust friendly jurisdictions and the significant impact that situs may have on the client's legacy. South Dakota has long been an undisputed top tier jurisdiction, but a number of other states are vying for their piece of the trillion dollar trust industry pie. Tennessee has quietly and consistently strengthened its trust laws over the last few years, effectively throwing its hat into the proverbial ring with South Dakota, Delaware, Nevada, and Alaska as a top destination for establishing trusts.

Interestingly, the Tennessee Banker's Association has been the driving force in promulgating the various trust related changes to the Tennessee code. Unfortunately there appears to be a slight disconnect between the bankers, attorneys, and lawmakers that has led to some confusion and uncertainty surrounding pieces of the newly enacted legislation.

Decanting

Decanting involves the transfer of all or some of an existing trust's assets to a wholly different trust, and has been an integral tool in trust administration and estate planning over the last 25 years. South Dakota is consistently ranked the top trust jurisdiction for decanting due to its explicitly clear statutory language and a superior amount of control and flexibility for settlors and their families. Tennessee also has a decanting statute, however, there are serious questions that many Tennessee lawyers are unable to reconcile with total certainty, and the most recent legislative updates leave questions remaining.

One of those questions is whether the decanting power is exercisable only to the extent of the trustee's principal invasion powers. Proponents of the limited power to decant point to the word "*such*" in the statutory language implying that the decanting power is derived from the invasion power and is therefore limited by the invasion power.

"A trustee who has authority, under the terms of a testamentary instrument or irrevocable inter vivos trust agreement, *to invade the principal of a trust* to make distributions to, or for the benefit of, one or more proper objects of the exercise of the power, may *instead exercise* **such** *authority* by appointing all or part of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created or under the same instrument; provided, however, that the *exercise of such authority…* " (Section 12, Tenn. Code Ann. § 35-15-816(c))

Consider the significance of the distinction. Interpreting the decanting power as derivative from the invasion power permits a trustee with the discretion to distribute principal to A to the exclusion of B to decant principal into a trust of which A and not B is a beneficiary. If a trustee's exercise of discretion over distributions is limited by an ascertainable standard, may the trustee decant the entire trust? And if the trustee's invasion power is limited, must the new trust contain the same limitations? The answer is unclear as the new legislation places those mandatory limitations only on trustees who are also beneficiaries, which implies by inference that there are no such limitations for trustees who are not beneficiaries.

Trust Modification after Grantor's Death

Tennessee law allows substitution of the trustee for the court to supervise the trust's material purpose after the death of the Grantor. What if the trustee(s) are also beneficiaries and join with other qualified beneficiaries to modify a trust in a way that the grantor would view as violating its material purpose? Could a subsequent beneficiary challenge the modification by claiming that the modification was a violation of the material purpose of the trust? This scenario is presumably exclusive to trusts with individual trustees, save for a corporate trustee that agrees to modifications that contravene the grantor's intent to appease current beneficiaries and ensure continuity of the existing relationship. Tennessee courts have yet to address these questions and a challenge to the law is almost certainly forthcoming.

Marital Asset Protection Trusts

Tennessee statute permits spouses to transfer property held in tenancy by the entirety to a trust and the trust retains the protection from creditors provided by the TBE classification. [T.C.A. § 35-15-510]. A previous version of the statute provided that following the transfer to the trust, the property "shall no longer be held by the husband and wife as tenants by the entirety," articulating that the property rightfully and lawfully belongs to the trust and not to the spouses. The statute as updated in 2021 reads that the transferred property "is tenancy by the entirety property held by husband and wife subject to this section…" but how can this be when the trust property has been transferred to the trustee? The 2021 change was reportedly suggested by the Tennessee Banker's Association to address an issue with bankruptcy but the whack-a-mole result requires clarification, specifically for title attorneys and others trying to make sense of the language.

Asset Protection

Tennessee Investment Act Trusts, or TIST's, are designed to protect trust assets from the claims of creditors and allow an individual to create a self-settled, irrevocable trust. In order to qualify as a TIST, the trust must meet certain requirements. The trust must contain language that mandates Tennessee law rules the validity, construction, and administration of the trust. The trust must be irrevocable and must also contain spendthrift language. The law further mandates that the trust must have a qualified trustee who is either a resident of or licensed under Tennessee law. Finally, the grantor cannot also be the trustee. Prior to the 2021 legislative update, the grantor was also required to execute a qualified affidavit or affidavit of solvency before funding the trust that included numerous sworn statements related to the grantor's solvency and the legitimacy of the transfer. The 2021 language removes the requirement of a qualified affidavit from the definition of a "qualified disposition" for purposes of a TIST. In the event that the grantor chooses to execute a qualified affidavit of solvency, it creates a rebuttable presumption as to the date of the asset

transfer only, and not to their solvency or the appropriateness of the transfer. This update provides little benefit as most drafting attorney's would strongly advise their clients to execute an affidavit of solvency notwithstanding the law in order to solidify the rebuttable presumption and protect themselves from potential fraudulent transfer claims. To date, there remains a degree of uncertainty surrounding TIST's and the Tennessee Supreme Court has yet to rule on their validity.

Conclusion

Tennessee has made great strides to position itself as one of the top tier trust jurisdictions in the nation. The devil is in the details, and over time, the Tennessee Bankers Association, attorneys and lawmakers will surely iron out the ambiguities and contradictions. In the meantime, South Dakota enjoys its long standing and hard won place at the very top of the list of top tier trust jurisdictions. South Dakota's supremacy is incontrovertible and rooted in the most progressive trust laws in the nation. Some of the South Dakota advantages include zero state income tax, no rule against perpetuities, privacy protection, asset protection, directed trusts, ultra-flexible decanting, modification, and reformation statutes, low insurance premium tax, special purpose entities and fiscal soundness.

The South Dakota Governor's Task Force on Trust Administration Review and Reform adds another layer of certainty and stability unique to the state. The Governor's Task Force is a body comprised of representatives from the trust industry, recognized as experts in their field and appointed by the Governor. This body is been assembled with the goal of establishing and maintaining South Dakota's stature as the premier trust jurisdiction in the United States. Members of the Task Force were instrumental in crafting South Dakota's Trust Company Act, South Dakota Codified Law (SDCL) 51A-6A, which helped establish South Dakota as a leader in the fiduciary services industry. Members are appointed by the Governor to terms of three years. Responsibilities of the Task Force include reviewing and making recommendations for changing South

Dakota's trust administration statutes. The primary goals of the Task Force are to provide the most efficient and effective environment for the administration of trusts, and to provide a timely response to ongoing innovation and evolution in fiduciary services. This is an important factor to consider and is evidence that the trust industry is recognized as vital to the State and is supported at the highest levels of South Dakota's government.

Merriam-Webster defines 'trust' as "*assured reliance on the character, ability, strength, or truth of someone or something; one in which confidence is placed.*" If confidence can be quantified, perhaps we can look to the $352 billion in assets on deposit in the state of South Dakota as an indication of the state's trustworthiness. According to FDIC statistics, this amount is not only the highest in the nation, it is more than the second state on the list by a factor of two. South Dakota has established its character, ability, and strength to reign as the top trust jurisdiction in the nation proving time after time that there is no better trust situs than the consistently 'trust'worthy state of South Dakota.

SOUTH DAKOTA

TENNESSEE

PERPETUAL TRUSTS

In 1983, South Dakota was the first state in the nation to abolish the Rule Against Perpetuities (RAP), recognizing the advantages of dynasty trusts by allowing trusts to last perpetually for all assets. [SDCL § 43-5-8]
South Dakota was also the first to adopt a Trust Protector statute in 1997 (maximizing flexibility of the trust for generations). [SDCL § 55-1B-6]

Since 2007, Tennesseans have been able to establish dynasty trusts that can last for 360 years. In order to qualify for the longer duration, the trust must provide a testamentary limited power of appointment to at least one member of each generation of descendants who die more than 90 years after the trust is established.

STRENGTH OF STATE

South Dakota ranks second among U.S. states for fiscal health and has between 4.76 and 6.78 times the cash needed to cover short term obligations, which well above the U.S. average. South Dakota's liabilities are also better than the national average at 8 percent of total assets, or $650 per capita.

[Mercatus Research, Mercatus Center at George Mason University, Arlington, VA]

The same study ranked Tennessee third in the nation in fiscal health based on cash solvency, budgets, fiscal slack, pension and healthcare liabilities, and other debt. The state's current pension is 93% funded, its unemployment rate is 3.4%, and like South Dakota, has earned a AAA credit rating.

[Mercatus Research, Mercatus Center at George Mason University, Arlington, VA]

STATE INCOME AND CAPITAL GAINS RATES

There have been no state income taxes, personal or corporate, in South Dakota since 1942. The South Dakota Constitution prohibits any new taxes or increases in taxes without a voter initiative or two-thirds approval of both state legislative branches. [SD Constitution Article XI, 14]

There is no income tax on wages in Tennessee, and the state's flat 1 to 2% tax rate that applied to income earned from interest and dividends has been phased out. Tennessee levies tax on other items outside of income and has an average combined state and local sales tax rate of 9.55 percent.

PRIVACY

There is a permanent seal of privacy in South Dakota for trust documents that would otherwise be part of the record in any judicial proceeding. This seal attaches automatically and lasts in perpetuity. [SDCL § 21-22-28]

In Tennessee, all documents, briefs, applications, petitions, and motions are public record and may only be granted a privacy seal by the court under "extraordinary" circumstances and only to the extent that the record seal is "the least restrictive means." [Tenn. S. Ct. R. 15]

SOUTH DAKOTA 	TENNESSEE 
CREDITORS CLAIMS	
If the settlor is foreseeably solvent, South Dakota trusts are shielded from new claims of creditors of the settlor after two years of a transfer to the trust. A window of six months from discovery of the transfer is provided for existing claims, if longer. For self-settled trusts (for the benefit of the settlor) that are "qualified dispositions," there are exceptions for debts of spousal/child support and the division of marital property existing before the transfer. For third-party trusts (not self-settled), there are no such exceptions. [SDCL § 55-1-44] [SDCL § 55-16-10; 16]	Trust assets transferred lawfully may be set aside from creditor claims. However, if the transfer is shown by clear and convincing evidence to have been made with intent to defraud a creditor, and arose prior to the transfer to the trust, any claims must be initiated within the later of two years of the transfer being made or six months after the disposition was or could reasonably have been discovered by the creditor. If the claim arises at the same time or later than the disposition, the limitations period is two years.
ASSET PROTECTION	
South Dakota has a thorough statute with respect to the protection of trust assets and avoidance of claims, specifically addressing (i) numerous arguments made in court cases and disputes, (ii) weaknesses caused by the Restatement of Trusts (scholarly positions on legal aspect of trust law), (iii) inadvertent/ ill-advised actions of trust settlors and beneficiaries, (iv) withholding otherwise mandatory distributions from the trust to a beneficiary and (v) vulnerable provisions and drafting errors in trust documents. [SDCL § 55-1-25, 32, 33, 38, 39]	The adoption of the Tennessee Investment Service Act of 2007 (otherwise known as domestic asset protection trusts) allows individuals to create self-settled, irrevocable trusts to offer asset protection but the law is highly restrictive. In addition to the Tennessee Investment Services Trust 's (TIST) cumbersome statutory requirements, the Tennessee Supreme Court has yet to rule on their legitimacy, which creates some doubt as to their validity, and ultimately their enforceability, in the state of Tennessee.
QUIET TRUSTS	
There are detailed provisions in the South Dakota statute for the trust settlor, trust instrument and trust advisors (i.e., trust protector) to restrict or eliminate information to trust beneficiaries and to keep the trust instrument and trust actions quiet. The South Dakota statute directly addresses the ability to restrict the right of a beneficiary to receive a copy of the trust instrument and the right of the settlor, trust protector or trust advisor to retain the power to change the beneficiaries' rights to trust information. [SDCL § 55-2-13]	Tennessee Trust Code explicitly authorizes "silent trusts." In a silent trust, the trustee is permitted to withhold information about the trust from its beneficiaries, including information about the existence of the trust. The relevant rule is found in T.C.A. § 35-15-813(e), but regardless of the grantor's wishes, the silence may not continue after his or her death. South Dakota has no such limitation on the duration and a SD trust may remain silence even after the grantor's death. [T.C.A. § 35-15-813(e)]
SPECIAL PURPOSE ENTITIES	
South Dakota law specifically permits individuals to serve in trust roles (i.e., investment advisor, distribution advisor, trust protector) for a particular family through an entity (i.e., a limited liability company) for their liability protection without meeting formal Department of Banking regulations and requirements. This feature gives individuals more protection serving and taking on these advisory roles. [SDCL § 51A-6A-66]	Tenn. Code Ann. § 35-15-1301 permits the creation of 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, but the registration requirements can be burdensome. [T.C.A. § 35-15-1301]

About the authors

Antony Joffe is President of Sterling Trustees, a South Dakota chartered trust company with over $5 billion of assets under administration. Sterling acts solely as an independent trustee and does not manage any investment assets. The company has a particular focus on working with wealthy families that wish to domesticate offshore trusts to the US. Sterling Trustees is a member of STEP.

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As an attorney, Nicole Byrum brings a unique perspective to her position as trust officer – partnering with her clients and their advisors to craft strategic trust vehicles which provide asset protection, governance and long-term wealth transfer. After a brief stint practicing law, she transitioned into global trust services before joining the Sterling team at our Sioux Falls, SD, headquarters. Nicole earned a JD from the University of South Dakota School of Law and a BA from the University of Washington. She also earned the Certified Trust and Financial Advisor (CTFA) designation from the ABA.

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