

# MODERNIZING IOWA'S WEALTH TRANSFERS THROUGH DIRECTED TRUSTS AND DECANTING

## ABSTRACT

*Wealth transferring methods similar to trusts have been around for hundreds of years, but the state of Iowa adopted its first rendition of trust code just 23 short years ago, in the year 2000. Practitioners, legislatures, and laypersons alike have sought a more flexible and advanced trust code to accommodate an ever-changing society. The Uniform Trust Code came along and revolutionized the estate planning industry with its progressive tone. Many states have used the Uniform Trust Code to model their own trust code enactments. This Note seeks to flesh out the origins of trusts, modern wealth transfer trends like decanting and directed trusts, and compare Iowa's and South Dakota's modern trust code.*

*Decanting, a commonly known term deriving its meaning from removing impurities from wine, is a process that has made its way into progressive renditions of trust codes in the United States, and more recently, in Iowa. Decanting is a process by which an irrevocable trust's income and principal may be transferred into a second trust due to unforeseen administrative impracticability by the settlor and drafters. This transfer gives the trust's income, principal, and beneficiaries new life, as it allows the trustee to navigate around administrative hurdles that otherwise would prevent the trustee from carrying out the settlor's original intentions. Iowa's 2020 trust code update expressly provides for decanting, which provides similar flexibility in trust administration that trustees in South Dakota have benefitted from for years. Despite this step forward within Iowa, South Dakota still leads the way with broader power for trustees to decant irrevocable trusts into new instruments.*

*Directed trusts were also enacted with Iowa's 2020 trust code update. Our world continues to modernize, and our estate planning techniques need to evolve along with society in providing greater flexibility for wealthy individuals that have intricate planning needs. As such, directed trusts allow traditionally trustee-only duties to be delegated to professionals, committees, or individuals who have special familiarity with a trust's beneficiary situation. Investment trust directors have authority to carry out trust investment decisions, while distribution trust advisors have authority to make distribution decisions in accordance with the underlying trust instrument. This delegation of traditional trustee authority provides settlors and trustees alike with peace of mind knowing that other individuals, professionals, or committees can carry out onerous and specialized trust responsibilities. Iowa's directed trust provisions, much like South Dakota's, were a necessary step forward in modernizing Iowa's trust code.*

*Finally, this Note will show that South Dakota's trust code and tax advantages still outpace Iowa, even with the most recent 2020 update. There are many arguments surrounding why trust codes should be tougher on wealthy individuals, or why they should continue to become more progressive to allow individuals to maintain control and discretion over their fortunes. Despite this, one thing is clear, if Iowa wants to retain ultra-wealthy or multifaceted estate planning business within its jurisdiction, it must continue to modernize its tax laws and trust code to provide practitioners and settlors with the flexibility they need to efficiently and effectively administer trusts in accordance with new and ever-changing needs.*

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## I. INTRODUCTION

This Note will describe the origins of wealth transfers throughout the world and the United States. Then, it will briefly address modern trust law trends with directed trusts and decanting. It will then discuss justifications, benefits, and consequences of modern trust governance. Finally, a comparison of Iowa's and South Dakota's trust code progression will be laid out as the focus of this Note.

## II. HISTORY OF WEALTH TRANSFERS

### A. English Common Law Roots

The predecessor to modern trusts began in the medieval era. Trust history has been traced to the thirteenth century England.<sup>1</sup> Lower level members of society, referred to as friars, were unable to own property.<sup>2</sup> To alleviate this problem, benefactors conveyed land to those who were qualified to own property to hold for the benefit and use of the friars.<sup>3</sup>

### B. Early U.S. Traditions

U.S. trust law is strongly influenced by the Restatements of Trusts, which is produced by the American Law Institute and Uniform Law Commission along with estate planning practitioners across the country.<sup>4</sup> Much of trust and estate law is driven by competition between banks, trust companies, and estate-planning practitioners.<sup>5</sup> Most efforts for change are fueled by a state's desire to attract or retain trust business within their respective jurisdictions.<sup>6</sup> Prior to any uniform bodies of law, many states varied greatly on their approach to trust and estate laws, causing interpretation confusion among practitioners.<sup>7</sup>

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1. JESSE DUKEMINIER & ROBERT H. SITKOFF, WILLS, TRUSTS, AND ESTATES 386 (Wolters Kluwer 10th ed. 2017).

2. *Id.*

3. *Id.*

4. *Id.* at 388.

5. *Id.*

6. *Id.*

7. Robert Paine, *The Uniform Trust Code – What Is It and How It Will Impact This Blog?*, MATTERS OF TR. (Mar. 18, 2016), <https://www.mattersoftrustlaw.com/2016/03/uniform-trust-code-will-impact-blog/> [https://perma.cc/JYF3-9LVZ].

Finally, in 2000, the Uniform Law Commission promulgated the Uniform Trust Code (UTC).<sup>8</sup> This was the first nationwide codification of U.S. trust law, and by the end of 2016, it was enacted in 32 jurisdictions.<sup>9</sup> The Uniform Law Commission compiled the prevailing common law rules of U.S. trust law along with compiling their own tweaks and innovations in creating the UTC.<sup>10</sup> The purpose of the UTC was to provide “precise, comprehensive, and easily accessible guidance on trust law questions.”<sup>11</sup> The UTC finally gave practitioners and academics the ability to utilize uniform rules where issues in different states conflict.<sup>12</sup> Iowa and South Dakota are among the several states that have not adopted the UTC.<sup>13</sup>

The distinguishing factor of trusts is bifurcation of ownership.<sup>14</sup> The trustee holds legal title of the property and beneficiaries of the trust hold equitable title.<sup>15</sup> The settlor creates a trust in order to preserve assets over generations for the benefit of family or other selected beneficiaries.<sup>16</sup> A trustee holds the assets for the benefit of the beneficiaries and has special duties imposed upon them by the trust instrument as set out by the settlor.<sup>17</sup> Under many trust codes, including Iowa’s, trustees are fiduciaries.<sup>18</sup> *Black’s Law Dictionary* defines fiduciary as “[s]omeone who is required to act for the benefit of another person on all matters within the scope of their relationship; one who owes to another the duties of good faith, loyalty, due care, and disclosure.”<sup>19</sup> *Black’s* goes on to say that a fiduciary is “[s]omeone who must exercise a high standard of care in managing another’s money or property.”<sup>20</sup> Fiduciary duty is the key to ensuring the trust creator’s intent is carried out by the trustee throughout the administration of the trust.<sup>21</sup>

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8. DUKEMINIER & SITKOFF, *supra* note 1, at 389.

9. *Id.*

10. *Id.*

11. Paine, *supra* note 7 (quoting UNIF. TR. CODE prefatory note (UNIF. L. COMM’N 2000)).

12. *Id.*

13. DUKEMINIER & SITKOFF, *supra* note 1, at 389 n.6.

14. *Id.* at 393.

15. *Id.*

16. *Id.* at 392.

17. *Id.* at 395.

18. IOWA CODE § 633A.4201 (2023).

19. *Fiduciary*, BLACK’S LAW DICTIONARY (11th ed. 2019).

20. *Id.*

21. *See generally* DUKEMINIER & SITKOFF, *supra* note 1, at 395–96.

### III. MODERN TRUST LAW TRENDS AND WEALTH TRANSFERS

At the end of 2015, the Federal Reserve reported that roughly \$918 billion in assets were held in 710,000 private and charitable trust accounts.<sup>22</sup> However, this number is likely extremely low compared to true asset holdings of all trusts in the United States as the Federal Reserve's reports fail to account for trusts that are not within the Federal Reserve system, like individual trusts or trusts held in private trust companies.<sup>23</sup> South Dakota trust companies are subject to regulation by state banking authorities, and they reported more than \$226 billion in assets at the end of 2015.<sup>24</sup> South Dakota is known for towing the rope of progressive trust laws in the United States.<sup>25</sup> Tax returns in 2014 show that the IRS received income tax returns from trusts totaling "\$121.5 billion in gross income, \$4.3 billion in fiduciary fees, and \$2.65 billion in attorney, accountant, and other professional service fees."<sup>26</sup> The value of assets contained in trusts throughout the world will remain at staggering numbers as much of the world's wealthiest will continue to use the many benefits of trust ownership to facilitate and protect their wealth transfers for generations to come.<sup>27</sup>

### IV. SOUTH DAKOTA AND IOWA TRUST CODE COMPARISON

South Dakota takes a bold stance on taxes and levies no state income tax, no inheritance tax, and no capital gains tax.<sup>28</sup> Further, South Dakota eliminated the rule against perpetuities, thus allowing dynasty trusts that can endure in perpetuity.<sup>29</sup> Directed trusts and liberal decanting standards also provide huge benefits for settlors who choose to establish trusts in South

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22. *Id.* at 393.

23. *Id.*

24. *Id.*

25. Kalena Thomhave, *Why the Superrich Are Flocking to South Dakota*, NATION (Oct. 25, 2021), <https://www.thenation.com/article/society/south-dakota-trusts/> [<https://perma.cc/BZ77-CVEH>].

26. DUKEMINIER & SITKOFF, *supra* note 1, at 393.

27. Hillary Hoffower, *Dynastic Wealth May Be Fueling the Widening Gap Between America's Rich and Poor—Here's How the Wealthy Keep Their Money in the Family*, BUS. INSIDER (Mar. 6, 2019, 3:09 PM), <https://www.businessinsider.com/trust-fund-dynastic-wealth-income-inequality-2019-3> [<https://perma.cc/ERQ3-GZ5T>].

28. *Unique South Dakota Laws*, S.D. TR. CO., <https://www.sdtrustco.com/why-south-dakota/unique-south-dakota-laws/> [<https://perma.cc/D97C-ABJ2>].

29. Al W. King, III & Pierce H. McDowell, III, *A Bellwether of Modern Trust Concepts: A Historical Review of South Dakota's Powerful Trust Laws*, 62 S.D. L. REV. 266, 267 (2017).

Dakota.<sup>30</sup> South Dakota has established itself as an ultra-wealthy haven because of the favorable tax savings, progressive trust laws, and allowance of dynasty trusts.<sup>31</sup> Iowa has a lot of ground to cover to catch South Dakota, as Iowa still enforces income tax and does not allow for dynasty trusts with the rule against perpetuities still being in force.<sup>32</sup> However, the most recent trust code update, effective July 1, 2020, allowed Iowa to take a baby step closer to other states with more progressive trust codes.<sup>33</sup>

## V. DECANTING

### A. *What Is Decanting?*

The definition of decanting is set out in *Black's Law Dictionary* as “[t]o distribute (the assets of an irrevocable trust) to the trustee of a new trust with different provisions, often to correct drafting errors or to account for new circumstances.”<sup>34</sup> Decanting is derived from the common understanding of the term, which is to decant wine or other alcohols to remove impurities and improve drinking quality.<sup>35</sup>

### B. *Traditional Roots of Irrevocability*

Irrevocability stands for the principle that after the trustor's death, the trust instrument may not be modified.<sup>36</sup> Traditionally, irrevocability meant that the trust could not be modified under any circumstances.<sup>37</sup> Two types of irrevocable trusts often arise. First, in some situations, a trustor will commission an irrevocable trust during their lifetime so that the provisions of the document cannot be changed during the trustor's lifetime or after the trustor's death.<sup>38</sup> Second, a trustor will create a revocable living trust wishing to have flexibility in adapting and modifying the document to fit the trustor's

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30. *Id.* at 293.

31. *Unique South Dakota Laws*, *supra* note 28.

32. *See* IOWA CODE § 558.68 (2023).

33. *See* Act of June 25, 2020, ch. 1076, 2020 Iowa Acts.

34. *Decant*, BLACK'S LAW DICTIONARY (11th ed. 2019).

35. *Decant*, MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY (11th ed. 2019).

36. *See* Craig J. Krogstad & Matthew P. Bock, *Modern Trust Governance*, 61 S.D. L. REV. 370, 371 (2016).

37. *See id.*

38. *See id.*

needs throughout their lifetime.<sup>39</sup> Upon the trustor's death, the revocable trust converts to an irrevocable trust and cannot be modified.<sup>40</sup>

### C. Modern Trend of Irrevocability

In modern estate planning practice, irrevocability is trending toward broader construction.<sup>41</sup> The plain language definition of irrevocable still means the trust instrument cannot be changed; however, there are ways to work around irrevocability in states that have adopted progressive trust provisions.<sup>42</sup> The UTC, that has been adopted by over 30 states, provided solutions to beneficiaries who longed for flexibility in changing poorly drafted irrevocable trusts which caused significant administrative pains for trustees and beneficiaries alike.<sup>43</sup> Under the UTC, trusts can generally be modified with consent of all beneficiaries and court approval, with court approval alone, or with consent of the trustor and all the beneficiaries.<sup>44</sup> Moreover, trust protectors are often used when drafting irrevocable trusts to provide settlors with additional solutions to administrative difficulties that the trustee does not possess the powers to mitigate.<sup>45</sup>

### D. Iowa Trust Code Decanting Updates

The recent Iowa Trust Code update provided Iowa trustees, beneficiaries, and trustors with flexibility to decant.<sup>46</sup> The trustee, so long as they have discretion under the governing trust instrument, may transfer the income or principal independently or with court approval to a trustee of a second trust.<sup>47</sup> However, the trustee's discretion is limited because the trustee must first consider whether the appointment of a trustee of the second trust and distribution of assets into the second trust are necessary after taking into account the purposes of the first trust, the terms and conditions of the second trust, and the consequences of the distribution.<sup>48</sup>

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39. *See id.*

40. *See id.*

41. *See id.* at 371–72.

42. *See* IOWA CODE § 633A.4215 (2023); S.D. CODIFIED LAWS § 55-2-15 (2022).

43. *See* Krogstad & Bock, *supra* note 36, at 372.

44. UNIF. TR. CODE §§ 410–416 (UNIF. L. COMM'N 2000).

45. *Unique South Dakota Laws*, *supra* note 28.

46. *See* IOWA CODE § 633A.4215 (2023).

47. *Id.*

48. *Id.*

Iowa Code § 633.4215A(k) permits the trustee to exercise discretion over the entire income and principal of the first trust by modifying it without an actual distribution of property, in which case the second trust is the modified first trust.<sup>49</sup> A modification in further trust pursuant to this paragraph requires that the trustee notify all beneficiaries of the trust, in writing, at least 20 days prior to the effective date of such exercise.<sup>50</sup> This is key because the trustee can, instead of transferring the income and principal into a second trust, modify the existing trust document if the trustee first provides notice to all beneficiaries.<sup>51</sup>

#### *E. Uncertainty and Questions Surrounding Update*

None of the new Iowa Trust Code provisions have been interpreted by case law. Some practitioners believe decanting was possible in Iowa without the new statutory provisions, but others differ on that opinion.<sup>52</sup> Because there are no interpretations of the black letter law, we can only look to surrounding states to see how they have interpreted similar provisions.

Decanting can be completed in South Dakota without knowledge or consent of beneficiaries.<sup>53</sup> This is distinguished from Iowa, as beneficiaries must be notified in writing at least 20 days before decanting to another trust.<sup>54</sup> South Dakota has not adopted the Uniform Trust Decanting Act but neither has Iowa.<sup>55</sup> Consent of beneficiaries is another question that will come up when decanting is at issue. The South Dakota Code is silent on consent of beneficiaries, but interpretations suggest that decanting does not require consent from the court, the settlor, or the beneficiaries of the trust.<sup>56</sup> After the new Iowa update, trustee powers to decant in South Dakota are still broader than in Iowa.<sup>57</sup> Greater trustee power certainly makes for more efficient trust management and administration; however, trustees that

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49. *Id.*

50. *Id.*

51. *See id.*

52. *See generally* Telephone Interview with Robert Hodges, Att’y, BrownWinick L. Firm (Aug. 7, 2020) [hereinafter Hodges Interview].

53. S.D. CODIFIED LAWS § 55-2-15 (2022).

54. IOWA CODE § 633A.4215 (2023).

55. Practice Law Trusts & Estates, *State Decanting Laws Chart*, THOMPSON REUTERS PRAC. L., <https://uk.practicallaw.thomsonreuters.com/w-022-0638> (last visited Dec. 18, 2022).

56. *The South Dakota Advantage*, GOOSMAN L. FIRM, <https://www.goosmannlaw.com/services/trust-law-counsel/the-south-dakota-advantage/> [https://perma.cc/X4KF-JWHU].

57. *See* S.D. CODIFIED LAWS § 55-2-15 (2022); IOWA CODE § 633A.4215 (2023).



exercise their powers inappropriately have greater opportunity to act adversely to beneficiary interests and breed litigation.<sup>58</sup> It is likely that Iowa courts will interpret the new decanting statutes similarly to South Dakota, since much of the language adopted in the new Iowa decanting provisions is modeled after the South Dakota decanting provisions.<sup>59</sup> Iowa has moved the ball forward with the new decanting update, but South Dakota continues to lead the rest with its broader and more flexible rendition of decanting statutes.<sup>60</sup>

## VI. DIRECTED TRUSTS

### A. Why Directed Trusts Are Necessary

Traditionally, trustees are forced to take on all aspects of trust functions—investment, administration, and distribution of trust assets.<sup>61</sup> As estate planning situations continue to gain complexity in regard to assets, family situations, and technology challenges, trustees are faced with enormous responsibility that comes with potential exposure to liability from beneficiaries.<sup>62</sup> Directed trust models were created to make for more efficient and effective trust administration through delegation of duties for trustees and settlors.<sup>63</sup>

### B. Delegating Traditional Trustee Duties

Directed trusts provide flexibility in the administration of complex trusts by allowing the trustee to limit their liability through the delegation of key trust functions to experts in their respective areas.<sup>64</sup> Directed trust models provide that trustors may appoint third party advisors to delegate traditional trust functions to other specialized third parties, such as financial planners.<sup>65</sup> Investment functions can be overseen by professional investment advisors known as investment trust directors.<sup>66</sup> Investment trust directors have the power, in a fiduciary capacity, to direct the trustee to authorize the

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58. See Krogstad & Bock, *supra* note 36, at 374.

59. Hodges Interview, *supra* note 52.

60. See Mary Akkerman, *Decanting: A Practical Roadmap for Modernizing Trusts in South Dakota*, 61 S.D. L. REV. 413, 417 (2016).

61. See Krogstad & Bock, *supra* note 36, at 372.

62. *Id.*

63. See *Unique South Dakota Laws*, *supra* note 28.

64. See Krogstad & Bock, *supra* note 36, at 372.

65. See *id.* at 373.

66. See *id.*

retention, purchase, or sale of investments.<sup>67</sup> An added benefit for trustees is that they do not have to manage the decisions or processes of the investment function any longer, rather, they take direction from the investment trust director who has determined how trust assets will be invested.<sup>68</sup>

Distribution duties can be overseen by a distribution trust director who is authorized to direct the trustee to make distributions to trust beneficiaries pursuant to the limits of the governing trust instrument.<sup>69</sup> Again, this is a great benefit to trustees because their workload is decreased.<sup>70</sup> Instead of managing and making distribution determinations, the distribution trust director directs the trustee to make distributions as they determine necessary and proper according to the governing trust instrument.<sup>71</sup>

Finally, a trust protector, who acts in a non-fiduciary capacity unless otherwise prescribed by the trust instrument, is authorized to modify or amend the trust, terminate the trust, appoint or remove trustees, and serve as an advisor to the trustee or trustees.<sup>72</sup> This produces a great benefit for both trustees as they are no longer on the hook for making decisions that are contrary to their fiduciary duty as trustee, like determining whether a beneficiary is incapacitated or an addict.<sup>73</sup>

### *C. Progression and Benefits of Iowa Directed Trust Model*

Prior to the July 1, 2020, Iowa Trust Code update, directed trust models did not exist in the state.<sup>74</sup> Settlor's were still able to delegate trustee duties, but could not absolve the trustee of the responsibility related to the delegation as the trustee still had to keep watch over the individual or entity charged with managing investments or distributions.<sup>75</sup> Now with the new directed trust model, the settlor can direct that another individual, entity, or committee take on the trustee's traditional task of distributions and investments through distribution trust directors and investment trust

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67. *See id.* at 374.

68. *See id.*

69. *See id.*

70. Robert Hodges & Haley Van Loon, Att'ys, BrownWinick L. Firm, ITA Fall Webinar Series – Directed Trusts (Sept. 29, 2020) (presentation slides on file with author).

71. *See id.*

72. *See* Krogstad & Bock, *supra* note 36, at 374.

73. Hodges & Van Loon, *supra* note 70.

74. IOWA CODE § 633A.1102 (2023).

75. Hodges & Van Loon, *supra* note 70.

directors.<sup>76</sup> With proper drafting of the trust instrument that incorporates the new Iowa Trust Code provisions, the settlor can take advantage of newfound efficiencies and take pressure off of the trustee by keeping them from shouldering the traditional trustee duties of administration, investment, and distribution.<sup>77</sup> Distribution and investment trust directors are bound by fiduciary duty pursuant to their respective statutory provisions, which lends confidence to settlors that the directors will still act in the best interest of beneficiaries.<sup>78</sup>

Iowa Trust Code § 633A.4810 sets out the powers for the newly defined distribution trust advisor.<sup>79</sup> Distribution trust directors have the sole and absolute discretion to direct the trustee to make distributions to the beneficiaries.<sup>80</sup> An individual, committee, or entity can serve as a distribution trust director as determined by the settlor in the governing trust instrument.<sup>81</sup> Section 633A.4810 also provides that the director may direct the trustee with regard to appointments and notification of qualified beneficiaries.<sup>82</sup> The only hurdles to making mandatory and discretionary distribution decisions are the director's fiduciary duty to the beneficiaries and the distribution limitations the settlor prescribed in the trust instrument.<sup>83</sup> A common distribution directive set out by a settlor is that discretionary distributions shall be made to a beneficiary for the health, education, maintenance, and support of the beneficiary.<sup>84</sup> Because the distribution trust director has the sole and absolute discretion regarding distributions, the trustee is not responsible for the traditional distribution function when administering the trust instrument.<sup>85</sup> Now, the trustee only has to administer the distributions at the director's direction and avoids making distribution determinations.<sup>86</sup>

Iowa Trust Code § 633A.4809 sets out the powers of an investment trust director.<sup>87</sup> The settlor can designate an individual, committee, or entity

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76. *Id.* § 633A.1102.

77. *See id.* § 633A.4809; *id.* § 633A.4810.

78. *Id.* § 633A.4810; *id.* § 633A.4809.

79. *Id.* § 633A.4810.

80. *Id.*

81. Hodges & Van Loon, *supra* note 70.

82. *Id.* (citing *id.* § 633A.4810).

83. Hodges & Van Loon, *supra* note 70.

84. *Id.* § 633A.4214.

85. *See id.* § 633A.4810.

86. *See id.*

87. *Id.* § 633A.4809.

to serve as the investment trust director.<sup>88</sup> When a trust holds a closely held entity that the settlor wants to keep in the family, the settlor can assign a family member or committee of family members that are involved in the business to be the investment trust director.<sup>89</sup> Managing an investment portfolio to match the needs of beneficiaries of the trust can be a daunting task for a trustee that lacks any formal investment experience.<sup>90</sup> Having the ability to empower an investment trust director lends confidence to a settlor that their intent and the interest of the beneficiaries will be at the forefront of the investment function of administering the trust.<sup>91</sup>

The investment trust director has the sole and absolute discretion to direct the trustee and bind the trust with investment related decisions.<sup>92</sup> Section 633A.4809(1) states that the investment trust director has the power to do all of the following: “Direct the trustee with respect to the retention, purchase, sale, [or] exchange . . . of trust investments. These powers include the pledge or encumbrance of trust property, lending of trust assets, . . . and the investment and reinvestment of principal and income of the trust.”<sup>93</sup> The legislature clearly had flexibility in mind when drafting the investment trust director’s powers, as they are broad enough to handle all facets of investing a trust’s assets.<sup>94</sup>

Along with establishing investment and distribution trust directors, the update also provides for “excluded fiduciaries.”<sup>95</sup> The legislature framed the trust code such that excluded fiduciaries—like an administrative trustee that takes direction from an investment trust director, distribution trust director, or both—is limited from liability that arises from an investment or distribution trust director’s investment or distribution decision.<sup>96</sup> Section 633A.4802 sets out the liability limits of an excluded fiduciary.<sup>97</sup> The section states, “An excluded fiduciary is not liable, either individually or as a fiduciary,” and that an excluded fiduciary is not liable for losses resulting from complying with a trust director’s direction.<sup>98</sup> This would seem to

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88. *See id.*

89. Hodges & Van Loon, *supra* note 70.

90. *Id.*

91. *See id.*

92. *Id.* § 633A.4809.

93. *Id.*

94. *See id.*

95. *Id.* § 633A.1102(8).

96. *Id.* § 633A.4802.

97. *Id.*

98. *Id.* § 633A.4802(1)(a)–(c).

suggest that the administrative trustee would not be liable if the investment trust director directs them to make a poor investment decision, or if the distribution trust director directs them to make a distribution that does not comply with the trust instrument.<sup>99</sup> Further, the excluded fiduciary does not have an obligation to “review or evaluate” any direction from an investment trust director, nor does the excluded fiduciary have to conduct inquiries or investigations with respect to any investments over which the investment trust director has sole and absolute discretion.<sup>100</sup> Contrary to the previous provisions, the excluded fiduciary will be held liable to the beneficiaries for conduct that constitutes “gross negligence or willful misconduct.”<sup>101</sup> This provision is necessary so that there is a liability impediment that holds the administrative trustee accountable to beneficiaries.<sup>102</sup> Lastly, in order to hold an excluded fiduciary liable pursuant to this section, the proponent of the action must prove the matter by “clear and convincing evidence,” making it even harder to hang liability on an excluded fiduciary or administrative trustee.<sup>103</sup> Including the excluded fiduciary in the directed trust provisions was necessary to ensure that trust directors could act with full authority over their respective designations.<sup>104</sup> Further, settlor’s intentions are carried out by allowing their selected trustee to avoid liability from decisions that are not within the trustee’s area of expertise, hence why the settlor appointed trust directors in the first place.<sup>105</sup>

Trust protector powers were also established with the new trust code update.<sup>106</sup> Unlike the trust director roles, trust protectors are non-fiduciary positions, meaning they are able to make decisions that are contrary to beneficiary interests.<sup>107</sup> Utilizing a trust protector in the trust instrument can be a very powerful tool for settlors and estate planning attorneys alike.<sup>108</sup>

Iowa Trust Code § 633A.4805 sets out the powers of a trust protector.<sup>109</sup> The section generally states that the powers of a trust protector are provided by the governing trust instrument and may be exercised “in the sole and

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99. *See id.*

100. *Id.* § 633A.4802(2).

101. *Id.* § 633A.4802(1)(c).

102. *See id.* § 633A.4802.

103. *Id.* § 633A.4802(5).

104. *See id.* § 633A.4802.

105. *See* Hodges & Van Loon, *supra* note 70.

106. *Id.* § 633A.4805; *id.* § 633A.1102.

107. *Id.* § 633A.1102(24).

108. *See id.*

109. *Id.* § 633A.4805.

absolute discretion of the trust protector and are binding on all other persons.”<sup>110</sup> Some powers set out in the section that stand out are as follows: the power to “[m]odify or amend the trust instrument to achieve favorable tax status,” the power to “[i]ncrease or decrease the interests of beneficiaries,” the power to “[m]odify the terms of any power of appointment,” the power to “[r]emove and appoint a trustee” or “trust director,” the power to “[t]erminate the trust,” the power to “[c]hange the situs of the trust,” the power to “[a]dvice the trustee on matters concerning a beneficiary,” and the power to “[i]nterpret terms of the trust instrument at the request of the trustee.”<sup>111</sup> Further, there is a catchall provision that says that other powers may be provided in the governing trust instrument.<sup>112</sup> Clearly, the powers of a trust protector were intended to be immensely broad so they can be crafted by the attorney to fit the settlor’s desires. Trust protector powers are significant because they can carry out duties that the trustee cannot—namely, tasks that are against beneficiary interests.

The new directed trust model enacted in Iowa provides settlors and estate planning attorneys with newfound flexibility.<sup>113</sup> Directed trusts are great solutions for estate planning situations that have significant amounts of assets that will last well into the future because trust protectors can amend the trust to conform with ever changing tax and beneficiary circumstances.<sup>114</sup> Adding a directed trust model to Iowa was a great step forward toward keeping more trust business within the state’s jurisdiction.<sup>115</sup>

#### D. Uncertainty and Questions Surrounding Update

The first question that arises surrounds trust protectors and fiduciary obligations. Under the Iowa Code, trust protectors are not fiduciaries, but they are charged with fiduciary-like duties.<sup>116</sup> How can they be held accountable without the fiduciary requirement when they have more power to act than a trustee?<sup>117</sup> This is not an easy issue for a settlor to plan for, but more powers and flexibility of administration also poses more risks for administrative hiccups if inexperienced individuals are vested with trust

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110. *Id.* § 633A.4805(1).

111. *Id.*

112. *Id.*

113. *See* Hodges & Van Loon, *supra* note 70.

114. *See id.* § 633A.4805.

115. Paul Morf, Att’y, Simmons Perrine Moyer Bergman PLC, Iowa Trust Council Update (Oct. 16, 2020).

116. *See id.* § 633A.4805.

117. *See id.*; *see also id.* § 633A.4214.

protector powers. It is likely that drafting accountability into the trust instrument could lend a hand in holding trust protectors accountable to beneficiaries. Case law surrounding this issue over the next few years will be essential in providing guidance surrounding the trust protector statutes.

### 1. *Conflicts of Interest Between Managers*

Would it be desirable to have one corporate trustee serve as investment director or distribution director and as administrative trustee? It certainly is not easy finding individuals or entities willing to serve in all of these different capacities for one trust instrument, as serving in a director or trustee capacity alone is a daunting task.<sup>118</sup> Iowa Trust Code § 633A.4808 allows one person or corporate trustee to serve in both roles simultaneously.<sup>119</sup> Having one corporate entity serving in both roles makes for great efficiencies, but it can also raise concerns with having all your eggs in one basket.<sup>120</sup> Further, having an individual serving both as a trust director and a trust protector creates another problem because it is hard to wear the hat of a fiduciary as a trust director while simultaneously not being bound by fiduciary duty as a trust protector.<sup>121</sup> Going forward, it will be interesting to see if any dual-hat issues arise before Iowa courts.<sup>122</sup>

### 2. *What Is an Administrative Trustee Charging a Fee for?*

Administrative trustees are charged with managing the administration of the trust by acting as custodian for the assets and taking directions from the investment advisor and distribution advisor; however, with the rest of the duties delegated and the trust protector having so much power, their role is minimized greatly.<sup>123</sup> Why would you pay a fee to them and what purpose do they truly serve that deserves a fee?<sup>124</sup> Further, with investment and distribution trust directors only being responsible for one facet of the trust administration, how much of a fee is reasonable for them to charge against the trust?<sup>125</sup> Larger entities that can afford to charge a lower fee and handle the duties delegated to them by the settlor will likely drive fee prices down

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118. See Hodges & Van Loon, *supra* note 70.

119. *Id.* § 633A.4808.

120. See Hodges Interview, *supra* note 52.

121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.*

125. *Id.*

in the marketplace toward commonly accepted baselines.<sup>126</sup> All of these considerations will likely be fleshed out by the marketplace competing for trust business within the state of Iowa.<sup>127</sup>

### 3. *Bad Investments*

What if the investment trust director makes a bad investment? Is the investment trust director held solely liable, or does the administrative trustee have a duty to review investment trust director's decisions? Who is at fault in that situation?<sup>128</sup> Both the investment trust director and administrative trustee are bound by fiduciary duties to the beneficiaries, so one would think that liability could arise for both parties.<sup>129</sup> On the other hand, section 633A.4809 places sole and absolute discretion into the hands of the investment trust director to "direct" the administrative trustee with investment decisions.<sup>130</sup> Practically speaking, if a beneficiary is suing to enforce their rights, they will likely aim to hang liability on both the administrative trustee and investment trust director, but this is made difficult by the "clear and convincing" burden of proof set out by section 633A.4802.<sup>131</sup> Looking ahead, case law is essential to determine who would be liable in a bad investment situation involving an investment trust director and administrative trustee.

## E. *South Dakota Sets the Bar*

### 1. *No State Income Tax*

South Dakota levies no state income tax against its citizens.<sup>132</sup> Eliminating state income tax is something that Iowa has neglected to address because of political implications.<sup>133</sup> South Dakota did not stop only with state income tax, it also has eliminated capital gains tax, state inheritance tax, taxes on dividends and interest, gift taxes, personal property taxes, and city

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126. Rebecca Lake, *Trustee Fees: What Are They and Who Pays?*, SMARTASSET (Mar. 7, 2022), <https://smartasset.com/financial-advisor/trustee-fees> [<https://perma.cc/ZQ4B-E9CB>].

127. *See id.*

128. Hodges Interview, *supra* note 52.

129. IOWA CODE § 633A.4802 (2023).

130. *Id.* § 633A.4809.

131. *Id.* § 633A.4802.

132. *Unique South Dakota Laws*, *supra* note 28.

133. Morf, *supra* note 115.



and local taxes.<sup>134</sup> Further, South Dakota has made itself an ideal location to establish Limited Liability Companies (LLCs) and Limited Liability Partnerships (LLPs) as they do not charge state taxes on either business formation.<sup>135</sup> LLCs and LLPs can be essential tools in creating an estate plan, as settlor's holding large concentrations in real property often use LLCs or LLPs to hold those assets.<sup>136</sup> Each of the above tax categories are large factors in determining the best situs location for a client that wishes to draft a trust instrument.<sup>137</sup> Proper tax planning can save high net worth clients millions of dollars.<sup>138</sup> Because tax planning is often the driving force in formulating an estate plan, South Dakota has placed itself above Iowa and the rest of the United States with its unique tax advantages.<sup>139</sup> Tax considerations alone have brought trust business in droves to the state of South Dakota from individuals located throughout the United States.<sup>140</sup>

## 2. Eliminated Rule Against Perpetuities

Eliminating the rule against perpetuities is something Iowa lawmakers have avoided because of political and dynastic backlash.<sup>141</sup> South Dakota provides for dynasty trusts and they eliminated the rule against perpetuities in 1983.<sup>142</sup> Dynastic rule is less favorable through a public policy lens as valuable assets and property are allowed to be controlled by a deceased person's trust instrument in perpetuity, rather than being sold and distributed for other productive uses in society.<sup>143</sup> On the flip side, dynasty trusts can be essential planning tools for situations in which the settlor wants to provide for financially irresponsible family members well into future generations.<sup>144</sup> This can be achieved in many forms, but one is through an incentive clause, where the beneficiary's income received from the trust is

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134. *Unique South Dakota Laws*, *supra* note 28.

135. *Id.*

136. *See id.*

137. *See Unique South Dakota Laws*, *supra* note 28.

138. *The South Dakota Advantage*, *supra* note 56.

139. *See Unique South Dakota Laws*, *supra* note 28.

140. *The South Dakota Advantage*, *supra* note 56.

141. Morf, *supra* note 115.

142. King & McDowell, *supra* note 29.

143. Will Kenton, *Dynasty Trust: Definition, Purposes, How It Works, and Tax Rules*, INVESTOPEDIA, <https://www.investopedia.com/terms/d/dynasty-trust.asp> [<https://perma.cc/5ZVG-DTXK>] (Oct. 21, 2022).

144. *Unique South Dakota Laws*, *supra* note 28.

tied to earned wages from a job outside of the trust.<sup>145</sup> A common way to structure an incentive clause is requiring two dollars of earned income for every one dollar of trust income received by a beneficiary and then further limiting the beneficiary's power to spend trust income by only allowing it to be spent on essential or productive costs of living like healthcare or education.<sup>146</sup> This type of incentive-based provision provides for productive use of human and financial resources for society beyond the 21-year limit of the rule against perpetuities.<sup>147</sup> Many dynasty trusts also require that distributions be made directly to charitable institutions once the trust reaches certain financial thresholds, contributing significant charitable benefits to society.<sup>148</sup> Public policy arguments aside, eliminating the rule against perpetuities should be a consideration for any state seeking to draw more trust business within its jurisdiction, as it was South Dakota's original claim to fame when they dove into progressive trust laws.<sup>149</sup>

### 3. South Dakota Directed Trusts

South Dakota has one of the highest rated directed trust statutes in the United States.<sup>150</sup> Any trust can be established as a directed trust, and it can be either revocable or irrevocable depending upon the trustor's desires and needs.<sup>151</sup> Statutes in South Dakota provide trustors with flexibility as needed to handle very complex familial and asset situations.<sup>152</sup> South Dakota Trust Code provides that the trustor can divide trust responsibilities between administrative trustees, trust protectors, investment trust directors, and distribution trust advisors in section 55-1B-1.<sup>153</sup> The administrative trustee, who is not bound by fiduciary obligation, can appoint an investment advisor or committee that directs them on how the trust assets should be invested or they can hire a third party advisor to manage the trust's investments.<sup>154</sup> Allowing delegation of the investment function of the trust instrument

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145. Judith Kish Ruud & William N. Ruud, *Planning with the Dynasty Trust & Charity*, <https://www.pgdc.com/pgdc/planning-dynasty-trust-charity> [<https://perma.cc/5CVL-J9Z7>].

146. *See id.*

147. *See id.*

148. *See id.*

149. King & McDowell, *supra* note 29.

150. *Unique South Dakota Laws*, *supra* note 28.

151. King & McDowell, *supra* note 29.

152. *Unique South Dakota Laws*, *supra* note 28.

153. S.D. CODIFIED LAWS § 55-1B-1 (2022).

154. King & McDowell, *supra* note 29, at 272.

promotes diversification and flexibility in investment strategies for any situation.<sup>155</sup> Often times, settlors place family businesses in trust so that they can be managed for future generations.<sup>156</sup> In such a case, family members closely involved in the business can be appointed as investment advisors in order to properly manage the trust asset for the beneficiaries of the trust instrument.<sup>157</sup> This is an ideal situation for many families, as members of the family are likely in the best position to make decisions surrounding the management of the business assets in trust.<sup>158</sup>

A distribution trust advisor or committee can be selected to determine when trust distributions should be made to beneficiaries.<sup>159</sup> Distribution trust advisors or committee members can be made up of professionals, friends, or family members, allowing for individuals with expertise or personal knowledge of the family's situation to assist in making sound distribution decisions.<sup>160</sup> Distribution advisors can have sole and absolute discretion in making trust distributions if they are provided with such broad power by the trust instrument.<sup>161</sup> Many disputes arise when beneficiaries request discretionary distributions for purposes on the fringe of health, education, maintenance, or support of the beneficiary.<sup>162</sup> Distribution advisors help alleviate the contentions between beneficiaries and trustees clashing over whether or not to make distributions.<sup>163</sup>

Administrative trustees are not subjected to fiduciary obligations because lawmakers wanted to encourage them to follow the direction of investment or distribution advisors.<sup>164</sup> Under South Dakota's directed trust model, administrative trustees that take direction from investment or distribution advisors are considered excluded fiduciaries, much like Iowa's recent directed trust update.<sup>165</sup> Because investment and distribution advisors are considered fiduciaries under the South Dakota Code, they are held accountable for their decisions, and are more likely to invest proper time and

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155. *See id.*

156. *See Unique South Dakota Laws, supra* note 28; *The South Dakota Advantage, supra* note 56.

157. *See The South Dakota Advantage, supra* note 56.

158. *See id.*

159. *See King & McDowell, supra* note 29, at 273.

160. *See id.*

161. S.D. CODIFIED LAWS § 55-1B-11 (2022).

162. *See King & McDowell, supra* note 29.

163. *See id.*

164. *See The South Dakota Advantage, supra* note 56.

165. S.D. CODIFIED LAWS § 55-1B-2 (2022); IOWA CODE § 633A.4802 (2023).

effort into making decisions in the best interest of the beneficiaries of the trust instrument.<sup>166</sup> Delegation of core trustee duties alleviates the pressure placed upon trustees and assists them in making decisions that align with the trustor's intentions as well as beneficiary interests.<sup>167</sup>

#### 4. *South Dakota Trust Protectors*

South Dakota passed its first trust protector statute in 1997.<sup>168</sup> The reason trust protectors were created was to provide flexibility to an irrevocable trust.<sup>169</sup> Trustors can delegate powers to a trust protector that the trustee is prohibited from doing. For example, a trustor can draft into the trust instrument a provision vesting the trust protector with the power to remove a beneficiary, whereas the trustee would not be able to remove a beneficiary from an irrevocable trust instrument because of their fiduciary obligation to beneficiaries.<sup>170</sup>

Like Iowa, trust protectors are not fiduciaries.<sup>171</sup> The justification for no fiduciary role is legislators want them to act using judgment rather than being worried about fiduciary duties.<sup>172</sup> However, the default non-fiduciary role of trust protectors can be overridden by the trust instrument, as it can provide that the trust protector acts with a fiduciary obligation.<sup>173</sup> Trust protectors are not trustees, and they do not administer or hold property of the trust.<sup>174</sup> For the benefit of the trustor to retain flexibility, trust protectors are often provided with the following powers: the power to change the situs and governing law of the trust; the power of removal or replacement of the trustee; the power to add or remove beneficiaries; the power to amend the trust with both administrative and dispositive provisions; the power to terminate the trust; the power to increase or decrease the interest of any beneficiaries; the power to interpret terms of the trust instrument at the request of the trustee; and the power to advise the trustee on any matter concerning a beneficiary.<sup>175</sup> These trust protector powers provide the trustor

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166. See King & McDowell, *supra* note 29.

167. *Unique South Dakota Laws*, *supra* note 28.

168. King & McDowell, *supra* note 29, at 274.

169. *Id.*

170. See *id.* at 274–75.

171. S.D. CODIFIED LAWS § 55-1B-1 (2022).

172. See Morf, *supra* note 115.

173. King & McDowell, *supra* note 29, at 273.

174. *Id.* at 274.

175. *Id.* at 274–75; *Trust Protector*, S.D. TR. CO., <https://directedtrust.com/why-a-directed-trust/trust-protector/> [<https://perma.cc/LPG3-NJLR>].

with flexibility to deal with administrative impracticability that was unforeseen when the irrevocable trust document was written.<sup>176</sup>

#### VII. PROGRESSIVE TRUST CODE IS KING

Although modern trust governance has hiccups during initial adoption and implementation, the benefits far outweigh the initial burdens. Progressive trust laws that allow flexibility for trustors and families who seek expansive estate planning solutions will keep millions of dollars in fee revenues within state boundaries. Iowa, among many other states, has lost droves of clients to South Dakota because of the state's willingness to update its trust code to provide solutions to extremely high-net-worth individuals with complex estate planning situations.<sup>177</sup> Estate planning clients have already begun to retract from South Dakota back to Iowa due to the recent update of the Iowa Trust Code.<sup>178</sup> As Iowa continues to grow and expand its trust code into modern versions, more estate planning customers will seek out the state of Iowa as their situs.<sup>179</sup> Going forward, Iowa should consider some more extreme measures—like eliminating state income tax, eliminating the rule against perpetuities, and allowing dynasty trusts—in order to attract and keep more trust business within state lines.<sup>180</sup>

*Carter S. Albrecht\**

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176. See King & McDowell, *supra* note 29, at 274.

177. See Morf, *supra* note 115.

178. *Id.*

179. *Id.*

180. In June 2021, Iowa Governor Kim Reynolds signed Senate File 619, which repeals state inheritance tax over a four-year period. By January 1, 2025, Iowa inheritance tax will be eliminated entirely. S.F. 619, 89th Gen. Assemb. (Iowa 2021).

\* B.S., Iowa State University, 2019; J.D., Drake University Law School, 2022.