

MEMORANDUM

From: Frank Hill
To: OBF CUTC Revisions Subcommittee
Subject: Chair's 10/11/2022 Status Report

This report covers actions of our subcommittee taken during our last (virtual) meeting on **9/14/2022**, as well as revisions made, and contributions received in preparation for our next (virtual) meeting on 10/12/2022.

Much of our work has been in the rev tst [Form 350], the will [Form 361], and the Appx A - Gen and Adm Prov - Notes on Use extracts (and in specific numbered paragraph selections taken from them). When parallel paragraph reference numbers are given below, the first one will be to the rev tst [Form 350] extract and the second one will be to the will [Form 361] extract. Within all extracts,

BLACK typeface: **Original text** as it currently exists in the Orange Book Forms (or in a contributor's proposal);

GREEN typeface: **Approved changes** made to that original text by the subcommittee; and

RED typeface: **Proposed changes** suggested to be made to original text or our prior work.

THIS MONTH, due to the enormous amount of interest developing around several HOT TOPICS, we're going to delve right into those hot topics first on our agenda. Then, after everyone has had a chance to weigh in on those, we'll turn to the more mundane review of approved past changes and then proceed with reviewing more mundane but essential proposed changes.

First up:

Definition of "Education"

16.6 & 11.6 Education: Many months ago, Corina had suggested that our definition of "Education" was written in and for a different era. So, thinking that a Band-Aid might do, in both our rev tst and will extracts, I had inserted the word "electronically." This was unanimously received as woefully inadequate. So, to get the ball rolling on building a new definition that might be far more relevant to current conditions, Connie offered to send a suggested definition for our consideration.

Connie's 6/8/22 proposal:

EDUCATION: Under this agreement, distributions for education may, in trustee's discretion, include, but are not limited to, the cost of tuition, fees, books, supplies, living expenses, travel and other reasonable expenses related to study or instruction at public or private schools, colleges, trade schools or other institutions of learning.

Carl's 9/14/22 proposal for an additional sentence to be added to Connie's proposal, above:

A trustee may exercise discretion to distribute for unorthodox or untraditional educational opportunities in the best interests of the beneficiary.

Marianne's 9/14/22 proposal picked up the theme of "...the best education commensurate with a beneficiary's abilities and interests" from the "Guidelines to Trustee" paragraph in the "Family Trust" article:

Under this agreement, the trustee may make distributions for education to provide for the best education commensurate with a beneficiary's abilities and interests, such as payment of tuition, fees, books, supplies, living expenses, and travel.

Lastly, preferring not to proffer any suggested text for our consideration, on 9/26/22, Gene wrote to express his concern that we not overlook the importance of clear guidance for one of our HEMS standards and attached four articles deserving our attention as we try to resolve this issue. Although I have previously forwarded his email with attachments to you, it is attached once again for your convenience. *Be sure to check out the attachments in Gene's email.* See, [Education definition – Gene Zuspahn \(9-26-22\).msg](#), attached.

Trust Amendments, Removals, and Revocations

As Mike Holder points out in his 9/22/22 email attached, CUTC § 5-602(3) provides for quite a bit of latitude regarding amendment and revocation of a trust. He suggests that that kind of latitude, while convenient, may only lead to family discord and expensive litigation in the future. Perhaps we should consider, as a best practice for our readers, “tightening up” on just how settlors, (usually in their later years when they may be the most vulnerable to subtle pressure from family members) might be required to amend or revoke their trusts, for the protection of their previously-well thought-out estate plan. See [Trust Revocation – Mike Holder \(9-22-22\).msg](#), and [Trust Revocation – MDH \(9-22-22\).pdf](#), attached.

Removal of Trustee and Replacement of Trustee Appx A – Gen and Admin Prov – Note on Use 22

Appx A - Note on Use 22: In Appendix A – General and Administrative Provisions – Note on Use 22 is one of the longest Notes on Use in the OBF running some two and a half pages. While it touches on an important issue, it was originally proffered for use in the OBFs back during a time when we were living under the shadow of Rev. Rul. 79-353 and its progeny. The result was a mini law review article, well beyond the mission of an OBF Note on Use, i.e., comment on suitability, alternate approaches, or raise an issue for the drafter’s attention, and recommend where the drafter could get more in-depth treatment of the issue.

Tony volunteered to take a crack at “ginning down” the Note on Use. He has tried to preserve the kernel of the discussion of the crucial issue which is the center of its focus. His intent is to give it the treatment that it needs, but do it in about a page or less, if possible. See Note on Use 22 in the 10/11/22 extract of Appx A, attached.

Appx A – Note on Use 25C: This is Carolyn’s Note on Use regarding our new Trust Situs provision in our rev tst and will forms. I had inadvertently forgotten to include it in the extract of Appx A distributed for our June mtg. So, during our 9/14/22 mtg, we approved her Note on Use with the deletion of the phrase, “to be contained” in the first line. Now see the final version of Carolyn’s Note on Use 25C in the 10/11/22 extract of Appx A attached.

“First Tier” QBs and “First Tier Plus” QBs Appx A – Gen and Admin Prov – Note on Use 22

Please check your own Appx A Note on Use to see if it should be modified in view of our recent decision to limit notice to “First Tier Plus” QBs and action to “First Tier” QBs.

15.12 & 9.14 Release of Powers: Because the Chair’s use of extracts, this provision was inadvertently overlooked in previous months in the flurry of discussion about giving notice to the qualified beneficiaries or just to First Tier and First Tier *Plus* qualified beneficiaries. During our 9/14/22 mtg, **we approved** the proposed revision to ¶ 15.12 in the 9/12/22 extract of the rev tst, except that **we also decided** to delete the rest of the first sentence after “, or if none ...,” as well as the entire last sentence. See the final version in the 10/11/22 extract of the rev tst, attached.

Also, during our 9/14/22 mtg, **we approved** the exact same changes to be made to ¶ 9.14 in the 9/12/22 extract of the will form. However, **we also decided** not to change the reference in the will version from “fiduciary” to “trustee,” but to leave it as is. See the final version in the 10/11/22 extract of the will form, attached.

Also, Alison opined that perhaps a Note on Use regarding the tax implications of this provision may be appropriate, so she volunteered to compose one for us.

“Professional Fiduciary” definition, and its Ramifications

16.13 & 11.12 Professional fiduciary: During our 9/14/22 mtg, **we approved** the inclusion of the definition of “Professional fiduciary” as it appears in C.R.S. § 15-23-103(14). See ¶¶ 16.13 and 11.12 in the “General Provisions” articles in the 10/11/22 extracts of the rev tst and will forms attached.

14.3 & 8.2 Designation of Additional Trustee: During our 9/14/22 mtg, **we decided** to delete references to *any* type of trustee. See updated versions of these paragraphs in the 10/11/22 extracts of the rev tst and will forms attached.

14.5 & 8.4 Rights of Successor Trustee: During our 9/14/22 mtg, **we decided** to delete references to *any* type of trustee in the first sentence. Furthermore, **we decided** not only to use the new term in the second sentence, but also to *retain* the second sentence lest succeeding to the trust business of a professional trustee through purchase, merger, whatever be regarded as an event triggering a move down to the next successor trustee. See updated versions of these paragraphs in the 10/11/22 extracts of the rev tst and will forms attached.

14.8 & 8.7 Replacement of Trustee: During our 9/14/22 mtg, **we decided** to delete the last sentence entirely, eliminating the need to describe *any* type of trustee in the paragraph. See updated versions of these paragraphs in the 10/11/22 extracts of the rev tst and will forms attached.

15.11 & 9.13 Custody: During our 9/14/22 mtg, we decided to use out new term in the first sentence, which is the only sentence actually addressing “custody.”

The second sentence addresses signature authority and, as written now conflicts with our new 15.9 & 9.11 *Single Signature Facility* which, in the absence of a written delegation agreement among cotrustees, gives a professional fiduciary single signature authority *only* over the trust’s bank account.

Since none of the representatives of professional fiduciaries who are members of our subcommittee were in attendance, we decided to table the blanket removal of this second sentence till our next meeting. Alison said she would try to reach out to some of them for their input. We hope that Carl and Gene will also weigh in on this discussion this month.

9.17 Ancillary Fiduciary: We ran out of time before we could get to this one. We need to either approve use of our new term in the second sentence, or simply delete the second sentence as we have done with so many of these paragraphs above, on the grounds that it is not necessary to describe *any* type of fiduciary to be an ancillary PR

Important Clean Up as the End of This Project Begins to Appear in the Distance

Clean-Up #1: Appoint vs. Designate: Throughout our rev tst form and our will form, when speaking of naming someone to act for the trust, we currently rather inconsistently interchange the terms “appoint” and “designate.” But in CUTC, there is no such inconsistency. CUTC uses:

“Appoint” *Always* used when an actor (be it settlor, testator, another trustee, court, or authorized beneficiaries) is naming someone to act for the trust as trustee, successor trustee, or additional trustee. (*Never* “designate.”)

“Designate” *Always used in the past tense* when referring to someone who has been named in an instrument (will, agreement, terms of the trust, court order) as trustee, successor trustee, or additional trustee to act for the trust. (*Never* “appointed.”)

I suggest that we should be scrupulously consistent with the use of these terms in our rev tst and will forms, and also be consistent with CUTC’s use of those terms (follow CUTC’s lead). Accordingly, please see these suggested revisions in the 10/11/22 rev tst and will extracts:

14.1 & 6.4	Designation of Successor Trustee
14.3 & 8.2	Designation of Additional Trustee
14.8 & 8.7	Replacement of Trustee

Next Month

Yours truly simply ran out of time (and knew that you all would have run out of patience with me) to continue with the list of clean-ups still crying out for our attention. So, I won't go into them in detail, here, just list them so you'll know where I think we should be headed:

Clean-Up #2: Serve vs. Act:

Clean-Up #3: Then-acting Trustee vs. Trustee:

Clean-Up #4: Legalese vs. Plain English:

Clean-Up #5: Restructure & Reorganize Administrative Articles:

Stay tuned as, together, we continue to bring CUTC's improvements and best practices to the administrative articles of our OBF will and trust forms.

ARTICLE 14 - TRUSTEESHIP

14.1 DESIGNATION OF SUCCESSOR TRUSTEE: If _____ ceases to serve as trustee, settlor appoints _____ of _____ as trustee.

See Appx A Note on Use A

14.2 ACCEPTING OR DECLINING TRUSTEESHIP:

- a) Except as otherwise provided in **paragraph 14.2(c)** of this article, a person designated as trustee accepts the trusteeship:
 - i) By delivering written consent as follows:
 - A) to settlor; but if settlor is incapacitated or deceased, then to any acting legal representative of settlor, and
 - B) To the ~~qualified beneficiaries~~ distributees and permissible distributees of trust income or principal, ~~and to other qualified beneficiaries who request it,~~ and
 - C) To all other acting trustees; or
 - ii) By accepting delivery of trust property, exercising powers or performing duties as a trustee, or otherwise indicating acceptance of the trusteeship.
- b) A person designated as trustee who has not yet accepted the trusteeship may reject the trusteeship. A person designated as trustee who does not accept the trusteeship within a reasonable time after knowing of the designation is deemed to have rejected the trusteeship.
- c) A person designated as trustee, without accepting the trusteeship, may:
 - i) Act to preserve trust property if, within a reasonable time after acting, the person sends a rejection of the trusteeship as follows:
 - A) To settlor; but if settlor is incapacitated or deceased, then to any acting legal representative of settlor, and
 - B) To a qualified beneficiary, and
 - C) To any acting trustee; and
 - ii) Inspect or investigate trust property to determine potential liability under environmental or other law or for any other purpose.

See Appx A Note on Use 2

14.3 DESIGNATION OF ADDITIONAL TRUSTEE: If for any reason trustee is unwilling or unable to act as to any property of the trust, or with respect to any provision of this agreement, trustee may ~~designate~~ appoint in writing an ~~individual or bank or trust company to serve as~~ additional trustee as to such property or with respect to such provision, and may revoke any such designation at will. Each additional trustee so serving shall exercise all fiduciary powers granted by this trust unless expressly limited by trustee in the instrument designating such additional trustee.

~~14.4 EXONERATION OF TRUSTEE: No trustee shall be obligated to examine the accounts, records, or acts, or in any way or manner be responsible for any act or omission to act on the part of any previous trustee or of the personal representative of settlor's probate estate. No trustee shall be liable to settlor or to any beneficiary for the consequences of any action taken by such trustee which would, but for the prior removal of such trustee or revocation of the trust created hereunder, have been a proper exercise by such trustee of the authority granted to trustee under this agreement, until actual receipt by such trustee of notice of such removal or revocation. Any trustee may acquire from the beneficiaries, or from their guardians or conservators, instruments in writing releasing such trustee from liability which may have arisen from the acts or omissions to act of such trustee, and indemnifying such trustee from liability therefor. Such instruments, if acquired from all then living beneficiaries, or from their guardians or conservators, shall be conclusive and binding upon all parties, born or unborn, who may have, or may in the future acquire, an interest in the trust.~~

See Appx A Note on Use ????

14.4 LIABILITY OF TRUSTEE; BENEFICIARY RIGHTS:

- a) Exoneration of Trustee; Duties Regarding Previous Fiduciaries: A trustee is not liable for an act or omission of a former trustee or of the personal representative of settlor's estate. Also, trustee has no duty to examine the accounts, records, or acts of any former trustee or of the personal representative of settlor's estate. But trustee shall take reasonable steps to redress a breach of trust known to trustee to have been committed by a former trustee.
- b) Exoneration of Trustee Actions: Trustee is not liable to settlor or to any beneficiary for the consequences of any action taken by that trustee which would, but for the prior

removal of that trustee or revocation of the trust, have been a proper exercise by that trustee of the authority granted to trustee under this agreement, until actual receipt by that trustee of notice of the removal or revocation.

- c) Beneficiary's Consent, Release, or Ratification: A trustee may acquire from the beneficiaries instruments in writing releasing that trustee from liability which may have arisen from the acts or omissions of that trustee and indemnifying that trustee against liability. The instruments are conclusive and binding upon all parties who execute them or who may have or acquire an interest in the trust.

14.5 RIGHTS OF SUCCESSOR TRUSTEE: Any successor trustee at any time serving hereunder, ~~whether corporate or individual~~, shall have all of the title, rights, powers, and privileges, and be subject to all of the obligations and duties, both discretionary and ministerial, as herein and hereby given and granted to the original trustee hereunder, and shall be subject to any restrictions herein imposed upon the original trustee. Any fiduciary succeeding to the trust business of any ~~corporate trustee~~ professional fiduciary acting as trustee shall become the successor trustee under this agreement with like powers, duties, and obligations.

~~14.6—RESIGNATION: Any trustee may resign by giving written notice to settlor, if living, to any adult beneficiary and to the parents of any minor beneficiary then eligible to receive current income, and to any other trustee then serving. The resignation shall become effective only upon the acceptance of appointment by the successor trustee.~~

See Appx A Note on Use 22A

14.6 RESIGNATION: A trustee may resign:

- a) By giving at least 30 days' written notice effective upon acceptance of appointment by a successor trustee if this instrument requires a successor trustee, as follows:
- i) To settlor; but if settlor is incapacitated or deceased, then to any acting legal representative of settlor, and
 - ii) To the ~~qualified beneficiaries~~ distributees and permissible distributees of trust income or principal, and to other qualified beneficiaries who ~~request it~~ have sent the trustee a request for notice, and

- iii) To all other acting trustees; or
- b) With the approval of the court.

See Appx A Note on Use.22

14.7 REMOVAL OF TRUSTEE: Any trustee may be removed, without cause, by settlor, or if settlor is deceased or incapacitated, by settlor's spouse, or if settlor and settlor's spouse are both deceased or incapacitated, by a majority of the ~~beneficiaries then eligible to receive income who have attained the age of 21 years and are not incapacitated~~ **qualified beneficiaries distributees and permissible distributees of trust income or principal**, by giving written notice to such trustee and to any other trustee then serving, effective in accordance with the provisions of the notice.

14.8 REPLACEMENT OF TRUSTEE: If any trustee fails or ceases to **serve act** and no designated successor trustee serves, settlor, or if settlor is deceased or incapacitated, settlor's spouse, or if settlor and settlor's spouse are both deceased or incapacitated, a majority of the ~~beneficiaries then eligible to receive income who have attained the age of 21 years and are not incapacitated~~ **qualified beneficiaries distributees and permissible distributees of trust income or principal** may ~~designate~~ **appoint** a successor trustee. If any vacancy is not filled within thirty days after the vacancy arises, then any **qualified beneficiary or the resigning trustee** may petition a court of competent jurisdiction to ~~designate~~ **appoint** a successor trustee to fill such vacancy. By making such designation, such court shall not thereby acquire any jurisdiction over the trust, except to the extent necessary for making such designation. ~~Any successor trustee designated hereunder may be an individual or may be a bank or trust company authorized to serve in such capacity under applicable federal or state law.~~

ARTICLE 15 - ADMINISTRATIVE PROVISIONS

15.1 COURT PROCEEDINGS: The trust estate shall be administered expeditiously ***

See Appx A Note on Use 17A

15.2 NO BOND: No trustee acting under this trust shall be required to furnish any bond for the faithful performance of such trustee's duties, but if bond is ever required by any law or court rule, no surety shall be required on such bond.

See Appx A Note on Use 3A

15.3 COMPENSATION: Trustee shall be entitled to reasonable compensation commensurate with services actually performed and to be reimbursed for expenses properly incurred.

15.4 INALIENABILITY: No beneficiary shall have any right to anticipate, sell, assign, ***

15.5 UNDISTRIBUTED INCOME AT DEATH OF BENEFICIARY: Except as ***

15.6 PROTECTION AGAINST PERPETUITIES RULE: Every trust hereunder, and every ***

~~15.7 REPRESENTATIVE OF BENEFICIARY: The conservator of the estate or, if none, the guardian of the person of a beneficiary may act for such beneficiary for all purposes under this agreement or may receive information on behalf of such beneficiary.~~

15.7 REPRESENTATIVE OF BENEFICIARY: The following persons, in order of priority, may act for a beneficiary for all purposes under this agreement and may receive information on behalf of the beneficiary: (a) the conservator of the beneficiary's estate; (b) the beneficiary's guardian; (c) the beneficiary's attorney-in-fact acting under a durable power of attorney; or (d) the person who has custody of the beneficiary.

~~15.8 MAJORITY CONTROL: Except where otherwise expressly provided, in all matters pertaining to the administration of any trust under this agreement, when more than two trustees are serving, the concurrence and joinder of a majority of such trustees shall be required; but if only two trustees are serving, the joinder of both of them shall be required. If a trustee has released or is prohibited from exercising any power under any other provision of this agreement with respect to any action or property, then with respect to such action or property such trustee shall not be counted in the application of the preceding sentence and the other trustee or trustees then serving may exercise such power. Any trustee, however, may dissent or abstain from a decision of the majority and be absolved from personal liability by registering such dissent or abstention in the records of such trust, but such trustee shall thereafter act with the other trustees in any way necessary or appropriate to effectuate the decision of the majority.~~

See Appx A Note on Use 2

15.8 MAJORITY CONTROL:

- a) Cotrustees who are unable to reach a unanimous decision may act by majority decision; if only two cotrustees are acting, the joinder of both is required.
- b) If a vacancy occurs, the remaining cotrustees may act for the trust.
- c) If a cotrustee is unavailable to perform duties because of absence, illness, disqualification, or other temporary incapacity, and prompt action is necessary to achieve the purposes of the trust or avoid injury to trust property, the remaining cotrustee or a majority of the remaining cotrustees may act for the trust.
- d) A trustee who does not join in an action of another trustee is not liable for the action, except that each trustee must exercise reasonable care:
 - i) To prevent a cotrustee from committing a serious breach of trust, and
 - ii) To pursue a remedy, at trust expense, for a cotrustee's serious breach of trust.
- e) A dissenting trustee who joins in an action at the direction of the majority of the trustees and who notified any cotrustee of the dissent at or before the time of the action is not liable for the action unless the action is a serious breach of trust.

15.9 SINGLE SIGNATURE FACILITY: When two or more individuals are serving in a fiduciary capacity, an individual fiduciary may act alone on any deposit account maintained by the fiduciaries at a bank or other financial institution if authorized to do so under a written delegation agreement. The bank or other financial institution may act on the signature or instruction of any individual named as fiduciary on the account without regard to the terms of any document governing the fiduciary's actions. But when a professional fiduciary is serving, the professional fiduciary is the only fiduciary authorized to act alone on any deposit account maintained by the fiduciaries.

15.10 DELEGATION: Any trustee may delegate to any other trustee the exercise of any powers, discretionary or otherwise, unless it is a function settlor reasonably expected to be performed jointly. Unless a delegation is irrevocable, the delegating trustee may also revoke it. The delegation and revocation must be in writing executed by the delegating trustee and delivered to the other trustee. While the delegation is in effect, any of the delegated powers may be exercised or action may be

taken by the trustee receiving the delegation with the same force and effect as if the delegating trustee had personally ~~joined in the exercise of such power or the taking of such action~~ exercised the power or taken the action. Anyone dealing with trustee may rely upon the written statement of the delegating trustee relative to the fact and extent of the delegation.

15.11 CUSTODY: Whenever a ~~corporate trustee is serving, such corporate trustee~~ professional fiduciary is acting as trustee, the professional fiduciary shall be the custodian of the trust property and of the books and records of the trust. ~~It may perform all ministerial acts necessary for the acquisition and transfer of personal property and money, including the signing and endorsement of checks, receipts, stock certificates, and other instruments. No person need inquire into the propriety of any such act.~~

15.12 RELEASE OF POWERS: Any trustee may release, in whole or in part, temporarily or permanently, any power, authority, or discretion conferred by this agreement by a writing delivered to each cotrustee and to ~~each beneficiary then eligible to receive income distributions from any trust~~ the distributees and permissible distributees of trust income or principal, and to other qualified beneficiaries who have sent the trustee a request for notice, ~~or, if none, to all ascertainable beneficiaries. Such renunciation or release shall not affect the grant of power, authority, or discretion renounced or released.~~

15.13 ~~REPORTS: Trustee shall report no less frequently than annually to settlor, to all adult beneficiaries and to the parents of any minor beneficiaries then eligible to receive current income, all the receipts, disbursements, and distributions during the reporting period, and property then held as the principal of the trust. The records of the trust shall be open at all reasonable times to inspection by settlor and by the beneficiaries of the trust and their representatives.~~

See Appx A Note on Use 25A

15.13 TRUSTEE'S DUTIES TO INFORM AND TO NOTIFY:

- a) After trustee acquires knowledge that the trust created under this instrument has become irrevocable, trustee shall keep the ~~qualified beneficiaries of the trust~~ distributees and permissible distributees of trust income or principal, and other

qualified beneficiaries who ~~request it~~ have sent the trustee a request for notice, reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests [§ 813(1)].

- b) Within 60 days after the date trustee acquires knowledge that the trust created under this instrument has become irrevocable, trustee shall notify the qualified beneficiaries of:
 - i) Settlor's identity [§ 813(2)(c)];
 - ii) The existence of the trust [§ 813(2)(c)], [§ 105(2)(h)];
 - iii) Trustee's acceptance of the trust [§ 813(2)(b)];
 - iv) Trustee's name, address, and telephone number [§ 813(2)(b)], [§ 105(2)(h)];
 - v) Their right to request portions of the trust instrument that describe or affect the requesting beneficiary's interest [§ 813(2)(c)]; and
 - vi) Their right to request reports as provided in **paragraph 15.14 (Trustee's Duties to Report and to Respond)** of this article [§ 813(2)(c)], [§ 105(2)(h)].
- c) Trustee shall notify the ~~qualified beneficiaries~~ distributees and permissible distributees of trust income or principal, and other qualified beneficiaries who ~~request it~~ have sent the trustee a request for notice, in advance of any change in the method or rate of trustee's compensation [§ 813(2)(d)].

See Appx A Note on Use 25B

15.14 TRUSTEE'S DUTIES TO REPORT AND TO RESPOND:

- a) At least annually and at the termination of the trust, trustee shall send to the distributees and permissible distributees of trust income or principal, and to other qualified beneficiaries who request it [§ 813(3)(a)], [§ 105(2)(i)], a report containing:
 - i) A list of the assets comprising the property of the trust, and if feasible, their respective market values [§ 813(3)(a)(I)], [§ 813(3)(a)(II)];
 - ii) The liabilities of the trust, if any [§ 813(3)(a)(I)];
 - iii) The trust's receipts and disbursements during the period covered by the report [§ 813(3)(a)(I)]; and
 - iv) The amount and source of trustee's compensation [§ 813(3)(a)(I)].

- b) If no cotrustee remains in office upon the occurrence of a vacancy in the trusteeship, the former trustee shall send a report as described in **paragraph 15.14(a)** of this article to the ~~qualified beneficiaries~~ distributees and permissible distributees of trust income or principal, and to other qualified beneficiaries who request it. Should the former trustee be deceased or incapacitated, the former trustee's legal representative may send the report [§ 813(3)(b)].
- c) Upon request of a qualified beneficiary, trustee shall:
 - i) Respond promptly with information related to the administration of the trust, unless unreasonable under the circumstances [§ 813(1)], [§ 105(2)(i)]; and
 - ii) Furnish promptly a copy of the portions of the trust instrument that describe or affect the requesting beneficiary's interest [§ 813(2)(a)].

15.15 LITIGATION POWERS: Trustee, in its discretion and at the expense of the trust estate, ***

15.16 POWERS OF INSURED TRUSTEE: No trustee, other than settlor, may exercise any ***

15.17 LIMITATIONS ON POWER OF INTERESTED TRUSTEE: No individual trustee, ***

15.18 DIGITAL ASSETS: To the extent permitted by applicable law, trustee may (i) access,***

ARTICLE 16 - GENERAL PROVISIONS

16.1 ADOPTED CHILDREN: A child adopted by any person and the descendants by blood or adoption of such child shall be considered the descendants of such adopting person and of such person's ancestors if the adoption is by legal proceeding while the child is under the age of 21 years.

16.2 APPLICABLE LAW: The validity and construction of this agreement shall be determined by the laws of Colorado. Questions of administration of any trust established under this agreement shall be determined by the laws of the situs of administration of such trust. The laws of Colorado shall govern the creation, revocation, or amendment of a power of appointment created by this trust and the exercise, release, disclaimer, or other refusal of such a power of appointment.

See Appx A Note on Use 25C

16.3 TRUST SITUS: The State of Colorado is the original situs of any trust created under this agreement. However, the domiciles of the beneficiaries, the location of trustees, changes in the laws relating to trusts and taxation, or other circumstances relevant to the purposes of the trust, the administration of the trust, or the interests of the beneficiaries may make it desirable at some time in the future to transfer the situs of a trust created under this agreement. Accordingly, following notice as containing the information required by law to the ~~qualified beneficiaries~~ distributees and permissible distributees of trust income or principal, and to other qualified beneficiaries who ~~request~~ ~~have~~ sent the trustee a request for notice, trustee may transfer the situs of a trust at any time and to any place in the discretion of the trustee.

16.4 BY REPRESENTATION: Whenever property is to be distributed or divided ***

16.5 CONSTRUCTION: Unless the context requires otherwise, words denoting the singular ***

16.6 EDUCATION: Under this agreement, distributions for education may, in trustee's discretion, include the cost of tuition, fees, books, supplies, living expenses, and travel, to the extent they are reasonable. The term "education" means:

- a) Study or instruction at, or under the auspices of, an accredited educational institution (the term "accredited educational institution" means a public or private elementary or secondary school; a college or university granting undergraduate or graduate degrees; or a trade school or other institution for specialized, vocational, or professional training; if such school, college, university, trade school, or other institution provides an academic curriculum, employs a full-time faculty, offers classes **electronically or** on a campus, and enjoys a currently effective accreditation from a generally recognized accreditation board); and
- b) Study or instruction which trustee, in its discretion, considers appropriate for a beneficiary who has special needs or abilities which are not likely to be served by an accredited educational institution.

16.7 FIDUCIARY: As used in this agreement, "fiduciary" means an original, additional, or

successor personal representative, conservator, agent, or trustee.

16.8 HEADINGS AND TITLES: The headings and paragraph titles are for reference only.

16.9 INCAPACITY: For the purposes of this agreement, an individual may be treated as being incapacitated if so declared or adjudicated by an appropriate court; or if a ~~guardian, conservator, or other personal representative of such~~ legal representative of the individual's person or estate or both has been appointed by an appropriate court; or if certified in writing by his or her personal physician to be unable to properly manage his or her financial affairs; or if such individual is a minor.

16.10 I.R.C.: I.R.C. shall refer to the Internal Revenue Code of the United States. Any ***

16.11 OTHER DEFINITIONS: Except as otherwise provided in this agreement, terms are as defined in the Colorado Uniform Trust Code, and if not, then in the Colorado Probate Code, or, with regard to powers of appointment, in the Colorado Uniform Powers of Appointment Act, as any are amended after the date of this agreement.

~~16.12 PERSONAL REPRESENTATIVE: For the purposes of this agreement, the term "personal representative" shall include an executor, administrator, guardian, conservator, or any other form of personal representative, depending upon the context in which such term occurs.~~

16.12 LEGAL REPRESENTATIVE: As used in this agreement, "legal representative" includes an individual's attorney-in-fact acting under a durable power of attorney, a conservator of the individual's estate, an individual's guardian, a personal representative, executor, or administrator of the individual's decedent's estate, or any other form of legal representative, depending upon the context in which the term occurs.

16.13 PROFESSIONAL FIDUCIARY: As used in this agreement, "professional fiduciary" means an individual or entity that is in the business of acting as a fiduciary.

See Appx A Note on Use 20A

16.14 QUALIFIED BENEFICIARY: As used in this agreement, “qualified beneficiary” means a person who:

- a) has a present or future beneficial interest in the trust, vested or contingent, or holds a power of appointment over property of the trust in a capacity other than that of trustee, and who;
- b) on the date the beneficiary’s qualification is determined:
 - i) is a distributee or permissible distributee of trust income or principal;
 - ii) would be a distributee or permissible distributee of trust income or principal if the interests of other distributees or permissible distributees then receiving or eligible to receive distributions of trust income or principal terminated on that date without causing the trust to terminate; or
 - iii) would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.

As used in this paragraph, “person” does not include an appointee under a power of appointment unless and until the power is exercised and trustee has knowledge of the exercise and the identity of the appointee.

16.15 SURVIVORSHIP: If settlor’s spouse in fact survives settlor by any period of time or ***

~~16.16 TRUSTEE DEFINITION: As used throughout this agreement, the word “trustee” shall always refer to the original trustee as well as to any successor, replacement or additional person, corporation or other entity from time to time serving, whether in fact there shall be one or more trustees serving from time to time.~~

16.16 TRUSTEE: As used in this agreement, “trustee” includes an original, additional, and successor trustee, and a cotrustee.

16.17 COUNTERPARTS: This agreement may be executed in counterparts and each such counterpart shall constitute one and the same agreement.

16.18 SEVERABILITY: If any part of this agreement shall be adjudicated to be void or invalid, the

ARTICLE 6 – DESIGNATION AND SUCCESSION OF FIDUCIARIES

- 6.1 PERSONAL REPRESENTATIVE: I nominate my spouse as my personal ***
- 6.2 GUARDIAN: If appointment of a guardian of a minor child of mine becomes ***
- 6.3 CONSERVATOR: I nominate the guardian of any minor child of mine as ***
- 6.4 TRUSTEE: I appoint _____ of _____ as trustee of any trusts under my will. If _____ fails or ceases to act as trustee, I appoint _____ of _____ as trustee.

ARTICLE 7 – POWERS OF FIDUCIARIES

- 7.1 GRANT: My fiduciaries may perform every act reasonably necessary to administer ***
- 7.2 FIDUCIARIES' POWERS ACT: In addition to all of the above powers, my ***
- 7.3 DISTRIBUTION ALTERNATIVES: My fiduciaries may make any payments under ***

ARTICLE 8 – TRUSTEESHIP

See Appx A Note on Use A

- 8.1 ACCEPTING OR DECLINING TRUSTEESHIP:
- a) Except as otherwise provided in **paragraph 8.1(c)** of this article, a person designated as trustee accepts the trusteeship by:
- i) Delivering written consent as follows:
- ~~A) To my personal representative, if acting,~~
- ~~B) To the qualified beneficiaries, if my personal representative is no longer acting, and~~
- A) To my personal representative; but if my personal representative is not acting, then to the distributees and permissible distributees of trust income or principal, ~~and to other qualified beneficiaries who request it,~~ and

- B) To all other acting trustees; or
- ii) Accepting delivery of trust property, exercising powers or performing duties as a trustee, or otherwise indicating acceptance of the trusteeship.
- b) A person designated as trustee who has not yet accepted the trusteeship may reject the trusteeship. A person designated as trustee who does not accept the trusteeship within a reasonable time after knowing of the designation is deemed to have rejected the trusteeship.
- c) A person designated as trustee, without accepting the trusteeship, may:
 - i) Act to preserve trust property if, within a reasonable time after acting, the person sends a rejection of the trusteeship as follows:
 - A) ~~To my personal representative, if acting~~
 - B) ~~To a qualified beneficiary, if my personal representative is no longer acting, and~~
 - A) To my personal representative; but if my personal representative is not acting, then to a qualified beneficiary, and
 - B) To any acting trustee; and
 - ii) Inspect or investigate trust property to determine potential liability under environmental or other law or for any other purpose.

See Appx A Note on Use 2

8.2 DESIGNATION OF ADDITIONAL TRUSTEE: If for any reason my trustee is unwilling or unable to act as to any property of any trust hereunder, or with respect to any provision of my will, my trustee may ~~designate~~ **appoint** in writing an ~~individual or bank or trust company to serve as~~ **additional** trustee as to such property or with respect to such provision, and may revoke any such designation at will. Each **additional** trustee so serving shall exercise all fiduciary powers granted by my will unless expressly limited by my trustee in the instrument designating such **additional** trustee.

~~8.3 EXONERATION OF TRUSTEE: No trustee shall be obligated to examine the accounts, records, or acts, or in any way or manner be responsible for any act or omission to act on the part of any previous trustee or of the personal representative of my estate. No trustee shall be liable to~~

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~~my personal representative or to any beneficiary for the consequences of any action taken by such trustee which would, but for the prior removal of such trustee, have been a proper exercise by such trustee of the authority granted to trustee under my will, until actual receipt by such trustee of notice of such removal. Any trustee may acquire from the beneficiaries, or from their guardians or conservators, instruments in writing releasing such trustee from liability which may have arisen from the acts or omissions to act of such trustee, and indemnifying such trustee from liability therefor. Such instruments, if acquired from all then living beneficiaries, or from their guardians or conservators, shall be conclusive and binding upon all parties, born or unborn, who may have, or may in the future acquire, an interest in the trust.~~

See Appx A Note on Use ????

8.3 LIABILITY OF TRUSTEE; BENEFICIARY RIGHTS:

- a) Exoneration of Trustee; Duties Regarding Previous Fiduciaries: My trustee is not liable for an act or omission of a former trustee or of the personal representative of my estate. Also, my trustee has no duty to examine the accounts, records, or acts of any former trustee or of the personal representative of my estate. But my trustee shall take reasonable steps to redress a breach of trust known to my trustee to have been committed by a former trustee.
- b) Exoneration of Trustee Actions: My trustee is not liable to any beneficiary for the consequences of any action taken by that trustee which would, but for the prior removal of that trustee, have been a proper exercise by that trustee of the authority granted to my trustee under my will, until actual receipt by that trustee of notice of the removal.
- c) Beneficiary's Consent, Release, or Ratification: My trustee may acquire from the beneficiaries instruments in writing releasing that trustee from liability which may have arisen from the acts or omissions of that trustee and indemnifying that trustee against liability. The instruments are conclusive and binding upon all parties who execute them or who may have or acquire an interest in the trust.

8.4 RIGHTS OF SUCCESSOR TRUSTEE: Any successor trustee at any time serving hereunder, ~~whether corporate or individual~~, shall have all the title, rights, powers and privileges,

[Extract] 0361-Mar Ded Will (2022-10-11).doc

and be subject to all of the obligations and duties, both discretionary and ministerial, as herein and hereby given and granted to the original trustee hereunder, and shall be subject to any restrictions herein imposed upon the original trustee. Any fiduciary succeeding to the trust business of any ~~corporate trustee~~ professional fiduciary acting as trustee shall become my successor trustee under my will with like powers, duties, and obligations.

~~8.4 RESIGNATION: Any trustee may resign by giving written notice to my personal representative, if serving, to any adult beneficiary and to the parents of any minor beneficiary then eligible to receive current income, and to any other trustee then serving. The resignation shall become effective only upon acceptance of appointment by the successor trustee.~~

See Appx A Note on Use 22A

8.5 RESIGNATION: A trustee may resign:

- a) By giving at least 30 days' written notice effective upon acceptance of appointment by a successor trustee if this instrument requires a successor trustee, as follows:
 - i) To my personal representative, if acting,
 - ii) To the ~~qualified beneficiaries~~ distributees and permissible distributees of trust income or principal, and to other qualified beneficiaries who ~~request~~ ~~have sent the trustee a request for notice, and~~
 - iii) To all other acting trustees; or
- b) With the approval of the court.

See Appx A Note on Use.22

8.6 REMOVAL OF TRUSTEE: Any trustee may be removed, without cause, by my spouse, or if my spouse is deceased or incapacitated, by a majority of the ~~beneficiaries then eligible to receive income who have attained the age of 21 years and are not incapacitated~~ qualified beneficiaries distributees and permissible distributees of trust income or principal, by giving written notice to such trustee and to any other trustee then serving, effective in accordance with the provisions of the notice.

8.7 REPLACEMENT OF TRUSTEE: If any trustee fails or ceases to ~~serve act~~ and no designated successor trustee~~s~~ serves, my spouse, or if my spouse is deceased or incapacitated, a majority of the ~~beneficiaries then eligible to receive income who have attained the age of 21 years and are not incapacitated~~ ~~qualified beneficiaries distributees and permissible distributees of trust income or principal~~ may ~~designate appoint~~ a successor trustee. If any vacancy is not filled within thirty days after the vacancy arises, then any ~~qualified beneficiary or the resigning trustee~~ may petition a court of competent jurisdiction to ~~designate appoint~~ a successor trustee to fill such vacancy. By making such designation, such court shall not thereby acquire any jurisdiction over the trust, except to the extent necessary for making such designation. ~~Any successor trustee designated hereunder may be an individual or may be a bank or trust company authorized to serve in such capacity under applicable federal or state law.~~

ARTICLE 9 – ADMINISTRATIVE PROVISIONS

9.1 COURT PROCEEDINGS: Any trust established under this instrument shall ***

See Appx A Note on Use 17A

9.2 NO BOND: I direct that no fiduciary shall be required to give any bond in any jurisdiction, and if, notwithstanding this direction, any bond is required by any law, statute, or rule of court, no sureties be required.

See Appx A Note on Use 3A

9.3 COMPENSATION: Any fiduciary under this instrument shall be entitled to reasonable compensation commensurate with services actually performed and to be reimbursed for expenses properly incurred.

9.4 INALIENABILITY: No beneficiary shall have any right to anticipate, sell, ***

9.5 UNDISTRIBUTED INCOME AT DEATH OF BENEFICIARY: Except as

9.6 BENEFITS PAYABLE TO TRUSTEE: The trustee of any trust established under ***

[Extract] 0361-Mar Ded Will (2022-10-11).doc

9.7 PROTECTION AGAINST PERPETUITIES RULE: Every trust hereunder, and ***

9.8 DISTRIBUTION TO INCAPACITATED PERSONS OR PERSONS UNDER 21: ***

~~9.9 REPRESENTATIVE OF BENEFICIARY: The conservator of the estate or, if none, the guardian of the person of a beneficiary may act for such beneficiary for all purposes under my will or may receive information on behalf of such beneficiary.~~

9.9 REPRESENTATIVE OF BENEFICIARY: The following persons, in order of priority, may act for a beneficiary for all purposes under my will and may receive information on behalf of the beneficiary: (a) the conservator of the beneficiary's estate; (b) the beneficiary's guardian; (c) the beneficiary's attorney-in-fact acting under a durable power of attorney; or (d) the person who has custody of the beneficiary.

~~9.10 MAJORITY CONTROL: Except where otherwise expressly provided, in all matters pertaining to the administration of any trust under this instrument, when more than two trustees are serving, the concurrence and joinder of a majority of such trustees shall be required; but if only two trustees are serving, the joinder of both of them shall be required. If a trustee has released or is prohibited from exercising any power under any other provision of this instrument with respect to any action or property, then with respect to such action or property such trustee shall not be counted in the application of the preceding sentence and the other trustee or trustees then serving may exercise such power. Any trustee, however, may dissent or abstain from a decision of the majority and be absolved from personal liability by registering such dissent or abstention in the records of such trust, but such trustee shall thereafter act with the other trustees in any way necessary or appropriate to effectuate the decision of the majority.~~

See Appx A Note on Use 2

9.10 MAJORITY CONTROL:

- a) Cofiduciaries who are unable to reach a unanimous decision may act by majority decision; if only two cofiduciaries are acting, the joinder of both is required.
- b) If a vacancy occurs, the remaining cofiduciaries may act for my estate or for any

trust under this instrument.

- c) If a cofiduciary is unavailable to perform duties because of absence, illness, disqualification, or other temporary incapacity, and prompt action is necessary to avoid injury to property of my estate, achieve the purposes of a trust or avoid injury to trust property, the remaining cofiduciaries or a majority of the remaining cofiduciaries may act for my estate or for any trust under this instrument.
- d) A trustee who does not join in an action of another trustee is not liable for the action, except that each trustee must exercise reasonable care:
 - i) To prevent a cotrustee from committing a serious breach of trust, and
 - ii) To pursue a remedy, at trust expense, for a cotrustee's serious breach of trust.
- e) A dissenting trustee who joins in an action at the direction of the majority of the trustees and who notified any cotrustee of the dissent at or before the time of the action is not liable for the action unless the action is a serious breach of trust.

9.11 SINGLE SIGNATURE FACILITY: When two or more individuals are serving in a fiduciary capacity, an individual fiduciary may act alone on any deposit account maintained by the fiduciaries at a bank or other financial institution if authorized to do so under a written delegation agreement. The bank or other financial institution may act on the signature or instruction of any individual named as fiduciary on the account without regard to the terms of any document governing the fiduciary's actions. But when a professional fiduciary is serving, the professional fiduciary is the only fiduciary authorized to act alone on any deposit account maintained by the fiduciaries.

9.12 DELEGATION: Any fiduciary may delegate to its cofiduciary the exercise of any powers, discretionary or otherwise, unless it is a function I reasonably expect to be performed jointly. Unless a delegation is irrevocable, the delegating fiduciary may also revoke it. The delegation and revocation must be in writing executed by the delegating fiduciary and delivered to the other cofiduciary. While the delegation is in effect, any of the delegated powers may be exercised or action may be taken by the cofiduciary receiving the delegation with the same force and effect as if the delegating fiduciary had personally ~~joined in the exercise of such power or~~

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~~the taking of such action~~ exercised the power or taken the action. Anyone dealing with my fiduciaries may rely upon the written statement of the delegating fiduciary relative to the fact and extent of ~~the~~ delegation.

9.13 CUSTODY: Whenever a ~~corporate fiduciary is serving, such corporate fiduciary professional fiduciary is acting as personal representative or trustee,~~ the professional fiduciary shall be the custodian of my estate and trust property and of the books and records of my estate or trust. ~~It may perform all ministerial acts necessary for the acquisition and transfer of personal property and money, including the signing and endorsement of checks, receipts, stock certificates, and other instruments. No person need inquire into the propriety of any such act.~~

9.14 RELEASE OF POWERS: Any fiduciary may release in whole or in part, temporarily or permanently, any power, authority, or discretion conferred by my will or trust by a writing delivered to any cofiduciary and to ~~each beneficiary then eligible to receive income distributions from any trust~~ the distributees and permissible distributees of trust income or principal, and to other qualified beneficiaries who have sent the trustee a request for notice, ~~or, if none, to all ascertainable beneficiaries. Such renunciation or release shall not affect the grant of power, authority, or discretion renounced or released.~~

~~9.15 REPORTS: My trustee shall report no less frequently than annually to all adult beneficiaries and to the parents of any minor beneficiaries then eligible to receive current income, all the receipts, disbursements, and distributions during the reporting period, and property then held as the principal of the trust. The records of the trust shall be open at all reasonable times to the inspection of the beneficiaries of the trust and their representatives.~~

See Appx A Note on Use 25A

9.15 TRUSTEE'S DUTIES TO INFORM AND TO NOTIFY:

- a) My trustee shall keep the ~~qualified beneficiaries of the trust~~ distributees and permissible distributees of trust income or principal, and other qualified beneficiaries who ~~request it~~ have sent the trustee a request for notice, reasonably informed about the administration of the trust and of the material facts necessary

- for them to protect their interests [§ 813(1)].
- b) Within 60 days after accepting the trusteeship, my trustee shall notify the qualified beneficiaries of:
- i) My identity as settlor of the trust [§ 813(2)(c)];
 - ii) The existence of the trust [§ 813(2)(c)], [§ 105(2)(h)];
 - iii) My trustee's acceptance of the trust [§ 813(2)(b)];
 - iv) My trustee's name, address, and telephone number [§ 813(2)(b)], [§ 105(2)(h)];
 - v) Their right to request portions of the trust provisions of my will that describe or affect the requesting beneficiary's interest [§ 813(2)(c)]; and
 - vi) Their right to request reports as provided in **paragraph 9.16 (Trustee's Duties to Report and to Respond)** of this article [§ 813(2)(c)], [§ 105(2)(h)].
- c) My trustee shall notify the ~~qualified beneficiaries~~ distributees and permissible distributees of trust income or principal, and other qualified beneficiaries who ~~request it~~ have sent the trustee a request for notice, in advance of any change in the method or rate of my trustee's compensation [§ 813(2)(d)].

See Appx A Note on Use 25B

9.16 TRUSTEE'S DUTIES TO REPORT AND TO RESPOND:

- a) At least annually and at the termination of the trust, my trustee shall send to the distributees or permissible distributees of trust income or principal, and to other qualified beneficiaries who request it [§ 813(3)(a)], [§ 105(2)(i)], a report containing:
- i) A list of the assets comprising the property of the trust, and if feasible, their respective market values [§ 813(3)(a)(I)], [§ 813(3)(a)(II)];
 - ii) The liabilities of the trust, if any [§ 813(3)(a)(I)];
 - iii) The trust's receipts and disbursements during the period covered by the report [§ 813(3)(a)(I)]; and
 - iv) The amount and source of my trustee's compensation [§ 813(3)(a)(I)].
- b) If no cotrustee remains in office upon the occurrence of a vacancy in the

trusteeship, my former trustee shall send a report as described in **paragraph 9.16(a)** of this article to the ~~qualified beneficiaries~~ distributees and permissible distributees of trust income or principal, and to other qualified beneficiaries who request it. Should my former trustee be deceased or incapacitated, my former trustee's legal representative may send the report [§ 813(3)(b)].

- c) Upon request of a qualified beneficiary, my trustee shall:
 - i) Respond promptly with information related to the administration of the trust, unless unreasonable under the circumstances [§ 813(1)], **[§ 105(2)(i)]**; and
 - ii) Furnish promptly a copy of the portions of the trust provisions of my will that describe or affect the requesting beneficiary's interest [§ 813(2)(a)].

9.17 **ANCILLARY FIDUCIARY:** In the event ancillary administration shall be required or desired and my domiciliary personal representative is unable or unwilling to act as an ancillary fiduciary, my domiciliary personal representative shall have the power to designate, compensate, and remove the ancillary fiduciary. The ancillary fiduciary may ~~either be a natural person or a corporation~~ **be an individual or a professional fiduciary**. My domiciliary personal representative may delegate to such ancillary fiduciary such powers granted to my original personal representative as my personal representative may deem proper, including the right to serve without bond or surety on bond. The net proceeds of the ancillary estate shall be paid over to the domiciliary personal representative.

9.18 **CONSOLIDATION OF TRUSTS:** My trustee may consolidate and merge for all ***

9.19 **EARLY TERMINATION:** If my trustee shall determine, in its discretion, that a ***

9.20 **DISTRIBUTIONS FREE FROM TRUST:** Any property of my estate or of any ***

9.21 **LITIGATION POWERS:** My fiduciaries, in their discretion and at the expense of ***

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9.22 POWERS OF INSURED TRUSTEE: Any individual trustee hereunder is prohibited ***

9.23 LIMITATIONS ON POWER OF INTERESTED TRUSTEE: Notwithstanding ***

9.24 ADDITIONS TO SEPARATE TRUSTS: If on the termination of any separate trust ***

9.25 DIGITAL ASSETS: To the extent permitted by applicable law, my fiduciary may ***

ARTICLE 10 – TAX PROVISIONS

10.1 TAX APPORTIONMENT: I direct that all estate, inheritance, and succession ***

10.2 TAX ELECTIONS: In exercising any permitted elections regarding taxes, my ***

ARTICLE 11 – GENERAL PROVISIONS

11.1 ADOPTED CHILDREN: A child adopted by any person and the descendants by ***

11.2 APPLICABLE LAW: The validity and construction of my will shall be determined by the laws of Colorado. Questions of administration of any trust established under my will shall be determined by the laws of the situs of administration of such trust. The laws of Colorado shall govern the creation, revocation, or amendment of a power of appointment created by this trust and the exercise, release, disclaimer, or other refusal of such a power of appointment.

See Appx A Note on Use 25C

11.3 TRUST SITUS: The State of Colorado is the original situs of any trust created under my will. However, the domiciles of the beneficiaries, the location of trustees, changes in the laws relating to trusts and taxation, or other circumstances relevant to the purposes of the trust, the administration of the trust, or the interests of the beneficiaries may make it desirable at some time in the future to transfer the situs of a trust created under my will. Accordingly, following notice as containing the information required by law to the ~~qualified beneficiaries~~ distributees and permissible distributees of trust income or principal, and to other qualified beneficiaries who ~~request it~~ have sent the trustee a request for notice, my trustee may transfer the situs of a trust at

any time and to any place in the discretion of my trustee.

11.4 BY REPRESENTATION: Whenever property is to be distributed or divided ***

11.5 CONSTRUCTION: Unless the context requires otherwise, words denoting the ***

11.6 EDUCATION: Under this instrument, distributions for education may, in the trustee's discretion, include the cost of tuition, fees, books, supplies, living expenses, and travel, to the extent they are reasonable. The term "education" means:

- a) Study or instruction at, or under the auspices of, an accredited educational institution (the term "accredited educational institution" means a public or private elementary or secondary school; a college or university granting undergraduate or graduate degrees; or a trade school or other institution for specialized, vocational, or professional training; if such school, college, university, trade school, or other institution provides an academic curriculum, employs a full-time faculty, offers classes **electronically or** on a campus, and enjoys a currently effective accreditation from a generally recognized accreditation board); and
- b) Study or instruction which the trustee, in its discretion, considers appropriate for a beneficiary who has special needs or abilities which are not likely to be served by an accredited educational institution.

11.7 FIDUCIARY: As used in this instrument, "fiduciary" means an original, additional, or successor personal representative, conservator, agent, or trustee.

11.8 HEADINGS AND TITLES: The headings and paragraph titles are for reference only.

11.9 I.R.C.: I.R.C. shall refer to the Internal Revenue Code of the United States. Any ***

11.10 OTHER DEFINITIONS: Except as otherwise provided in this instrument, terms **are** as defined in the Colorado Probate Code, **or, with regard to trust provisions, in the Colorado Uniform Trust Code**, or, with regard to powers of appointment, in the Colorado Uniform Powers of Appointment Act, as **any are** amended after the date of this instrument.

11.11 LEGAL REPRESENTATIVE: As used in this instrument, “legal representative” includes an individual’s attorney-in-fact acting under a durable power of attorney, a conservator of the individual’s estate, an individual’s guardian, a personal representative, executor, or administrator of the individual’s decedent’s estate, or any other form of legal representative, depending upon the context in which the term occurs.

11.12 PROFESSIONAL FIDUCIARY: As used in this instrument, “professional fiduciary” means an individual or entity that is in the business of acting as a fiduciary.

See Appx A Note on Use 20A

11.13 QUALIFIED BENEFICIARY: As used in any trust under this instrument, “qualified beneficiary” means a person who:

- a) has a present or future beneficial interest in the trust, vested or contingent, or, holds a power of appointment over property of the trust in a capacity other than that of trustee, and who;
- b) on the date the beneficiary’s qualification is determined:
 - i) is a distributee or permissible distributee of trust income or principal;
 - ii) would be a distributee or permissible distributee of trust income or principal if the interests of other distributees or permissible distributees then receiving or eligible to receive distributions of trust income or principal terminated on that date without causing the trust to terminate; or
 - iii) would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.

As used in this paragraph, “person” does not include an appointee under a power of appointment unless and until the power is exercised and my trustee has knowledge of the exercise and the identity of the appointee.

11.14 SURVIVORSHIP: For purposes of this will, if my spouse in fact survives me by ***

11.15 TRUSTEE: As used in this instrument, “trustee” includes an original, additional, and

successor trustee, and a cotrustee.

11.16 SEVERABILITY: If any part of this instrument shall be adjudicated to be void or invalid, the remaining provisions not specifically so adjudicated shall remain in full force and effect.

I, **[testator's name]**, sign my name to this instrument on _____, 20____, and being first duly sworn, do hereby declare to the undersigned authority that I sign and execute this instrument as my will and that I sign it willingly (or willingly direct another to sign for me), that I execute it as my free and voluntary act for the purposes therein expressed, and that I am eighteen years of age or older, of sound mind, and under no constraint or undue influence.

Testator

We, _____ and _____, the witnesses, sign our names to this instrument, being first duly sworn, and do hereby declare to the undersigned authority that **[testator's name]** signs and executes this instrument as **[his][her]** will and that **[he][she]** signs it willingly (or willingly directs another to sign for **[him][her]**) and that **[he][she]** executes it as **[his][her]** free and voluntary act for the purposes therein expressed, and that each of us, in the conscious presence of **[testator's name]**, hereby sign this will as witness to **[his][her]** signing, and that to the best of our knowledge **[testator's name]** is eighteen years of age or older, of sound mind, and under no constraint or undue influence.

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Estate Planning Journal

2015

Volume 42, Number 11, November 2015

Articles

Get HEMS Straight: Tailor the Right Distribution Standard, Estate Planning Journal,
Nov 2015

ASCERTAINABLE STANDARD

Get HEMS Straight: Tailor the Right Distribution Standard

Complying with the commonly used "health, education, maintenance, and support" standard for making trust distributions can present challenges for trustees.

Author: CHRISTIAN S. KELSO, ATTORNEY

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[pg. 3]

What is the big deal about ascertainable standards in trusts? The very term "ascertainable" implies something that is definitive, quantifiable, and discoverable. Yet, the actual meaning of the most common ascertainable standard in American trust law remain amorphous, undefined, and poorly understood—even by most practitioners. The discussion that follows seeks to fill this gap with guidelines for trustees (and the people who advise them).

Although much of trust law hinges on state statutes, some concepts have federal tax and other broader application. The discussion that follows uses state court cases and statutes to

illustrate points. Of course, practitioners should consult the laws of their own states when advising clients.

Defining the problem

The spectrum of trust distributions standards stretches from the level of uncontrolled or unfettered distributions to the level of required or mandatory distributions. In other words, a given trustee may have complete discretion to make distributions, the trustee may be required to make distributions, or the trustee may have a level of discretion somewhere in between.

Ascertainable standards lie in that between zone. These typically allow distributions for a beneficiary's health, education, maintenance, or support (HEMS). The beneficiary of a trust with this language may, so the theory goes, compel the trustee to make distributions in accordance with a specific standard and prevent the trustee from making distributions that are outside of the standard.

Additionally, some trusts contain unascertainable distribution standards. These should be the same as unfettered trustee discretion because a court cannot interpret them sufficiently to compel (or forbid) a distribution. Of course, this may or may not be the fact in practice, but that is the theory. This stands to reason because the function of an ascertainable standard is to provide a beneficiary, whether present or contingent, with an interest in trust property that a court can determine and on which it might ultimately rule. At the same time, however, the standard must also provide the trustee with enough discretion so that he or she can evaluate future facts and circumstances that are unknown at the time the trust instrument is created, but which must be addressed in order to achieve the goals of the trust's grantor.

Meaning and purpose

The concept of the ascertainable standard stems from a tax law problem. If a trustee of a given trust

[pg. 4]

is also its beneficiary and he or she may indiscriminately make distributions to himself or herself, then the Internal Revenue Code will treat the beneficiary as having a general power of appointment over trust property, which in turn would make all of the trust's assets includable in his or her estate. However a primary purpose of many trusts is keeping assets out of their beneficiaries' estates.

Therefore, the Code has set out the ascertainable standard as a kind of safe harbor within which a trustee/beneficiary may take refuge and avoid inclusion for estate tax purposes. As stated in Reg. 20.2041-1(c)(2):

A power to consume, invade, or appropriate income or corpus, or both, for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is, by reason of section 2041(b)(1)(A), not a general power of appointment.

On the settlor's side, several court cases and IRS rulings have held that, if the settlor is the trustee or controls the trustee of a trust, then the trustee's possession of a power to make distributions to or for the benefit of a beneficiary of the trust, if limited by an ascertainable standard relating to the beneficiary's health, education, support, or maintenance, will not cause the trust property to be included in the gross estate of the settlor/trustee for federal estate tax purposes under the Code.¹

In addition, Reg. 20.2041-1(c)(2) lists different powers that are limited by an ascertainable standard. Among these powers are the following:

- (1) Support in reasonable comfort.
- (2) Maintenance in health and reasonable comfort.
- (3) Education, including college and professional education.
- (4) Medical, dental, hospital, and nursing expenses, and expenses of invalidism.²

Also, the lapse or other release or exercise of such a power limited by such an ascertainable standard is not a taxable gift for federal gift tax purposes by the beneficiary who held the power.³

Similarly, where a trust beneficiary holds a fiduciary power during his or her lifetime to make distributions to or for the benefit of another beneficiary of the same trust, and the power is limited by an ascertainable standard relating to the other beneficiary's health, education, support, or maintenance, Reg. 25.2511-1(g)(2) provides that he or she will not be deemed to have made a taxable gift for federal gift tax purposes upon exercising (or failing to exercise) such power. This same regulation, however, states that "if a trust instrument provides that the determination of the trustee shall be conclusive with respect to the exercise or non-exercise of a power," then the power is not considered to be limited by the requisite standard.

Furthermore, even if such a power is subject to an ascertainable standard, property distributable to a person for whom the beneficiary/trustee has a legal obligation to support

could be included in the beneficiary/trustee's gross estate for federal estate tax purposes, unless the trustee is prohibited from making any distributions to a beneficiary that would satisfy the trustee's individual legal obligation to support such beneficiary.⁴

The prevalence of HEMS standards has prompted the states to draft clarifying legislation for local, nontax purposes. For example, if a beneficiary of a trust, as trustee or otherwise, holds a power to make distributions to himself or herself (or for his or her benefit), an issue can arise regarding the ability of the beneficiary's creditors to satisfy claims against the beneficiary from the beneficiary's interest in the trust. When, however, the trust has a spendthrift provision and the beneficiary's power is limited by an ascertainable standard relating to the beneficiary's health, education, support, or maintenance, a creditor in Texas generally cannot attach the beneficiary's interest on the basis that the beneficiary holds a distribution right or power.⁵

Intent: the prime directive

The terms of a trust, as set forth in the governing instrument, generally govern its administration. But it is important to remember that the written language in a given trust instrument exists only as an imperfect expression of its grantor's intent, and this intent is paramount when administering the trust itself. To determine the intent of the grantor, a court looks primarily to the text of the written instrument establishing the trust.⁶ Every trust

[pg. 6]

is different, however, and a well-crafted instrument will allow the trustee to determine the settlor's goals from the content of the trust document. This underscores the notion that there is no bright-line test when it comes to the properness of any single distribution.

Specific distribution standards and their meaning

Although the possibilities are literally limitless, a handful of distribution standards are used rather commonly. These fit neatly across the distribution standard spectrum described above and are addressed below in order of increasing restriction.

Absolute, uncontrolled, or unfettered trustee discretion. In many instances, a trustee may properly be given complete discretion to administer trust assets and make distributions. This may be styled in terms of "absolute," "uncontrolled," "sole," or "unfettered," discretion. In particular, where a beneficiary will not become trustee of his or her own trust, broad discretion may be handed over without concern. Alternatively, where the need for flexibility is

at a premium and tax or creditor protection concerns are low, unfettered trustee discretion may be appropriate.

On its face, allowing a trustee to make distributions in his or her absolute discretion seems simple. Such a trustee should be authorized to properly make distributions whenever and however he or she pleases. But all is not as it seems. A fundamental and unwaivable aspect of every trust is that the trustee must be trusted to manage, use, and distribute the trust's assets for the benefit of the beneficiaries. Thus, at some point, a court must be able to step in and declare the actions of a trustee as being improper.

All trustees must make discretionary decisions, including decisions regarding distributions, investments, principal and income allocations, as well as expenditures, to name a few. A trustee must exercise a discretionary power reasonably and in the best interests of the beneficiaries. The beneficiary of a pure discretionary trust may not compel the trustee to make trust distributions.⁷ In extreme circumstances, a beneficiary may be able to convince a court that a trustee's refusal to exercise a pure discretionary distribution power is so unreasonable as to be a breach of trust or to justify removal.

Unascertainable standards. Rather than provide a trustee with unfettered discretion, a grantor may prefer to use other unascertainable standards by which distributions can be made. A distribution standard will typically be considered unascertainable when there is no objective manner by which to determine whether a distribution (requested or made) fits within the distribution standard of the instrument.

Unascertainable standards may be used when the settlor is less concerned about maintaining the trust principal for the remainder beneficiaries or when he or she wants the trustee to have more flexibility in making distributions. Due to the potential tax and creditor protection implications, these standards should be used with caution and only with an independent (i.e., nonbeneficiary) trustee.

While there is no clear definition of what terms result in an unascertainable distribution standard, terms such as "comfort," "happiness," "benefit," and "welfare" have been defined to create one.⁸ This is perhaps one of the most frustrating aspects of all trust law in the U.S. After all, what actual difference is there (at least in practice) between allowing a trustee to make distributions for the beneficiaries' "welfare and benefit" versus their "maintenance and support"? What makes the former pair unascertainable and the latter ascertainable? What follows is a short examination of each term in order.

[pg. 7]

- *Comfort*. A distribution standard that includes “comfort” as a basis has generally been held to create an unascertainable standard.⁹
- *Welfare*. A distribution standard that includes “welfare” has also been found to create an unascertainable standard.¹⁰
- *Happiness, benefit, best interest*. While the words “happiness” and “benefit” are described in Reg. 20.2041-1(c)(2) as unascertainable standards, the Restatement (Third) of Trusts §50, Comment d(3) (2003) provides just a little more insight:

Although one effect of authorizing distributions for the “benefit,” “best interests,” or “welfare” of a beneficiary is to suggest a support standard, these terms tend also to authorize discretionary expenditures that fall beyond the usual scope of a purely support-related standard. For example, a “benefit” standard might make it reasonable for a trustee to make substantial distributions to provide a beneficiary with capital needed to start a business. ... Terms of this type, however, lack the objective quality of a term such as “support.” Thus, they may not facilitate a beneficiary's efforts to obtain judicial intervention to compel distributions by the trustee. On the other hand, the presence of less objective terminology in a discretionary standard may diminish the relevance of the beneficiary's other resources, except a parent's obligation to support a minor beneficiary.

The terms of a discretionary standard occasionally include stronger language, such as the word “happiness.” Such language suggests an intention that the trustee's judgment be exercised generously and without relatively objective limitation. Although “happiness” alone expresses no objective minimum of entitlements (which to some extent may nevertheless be readily implied), the primary effect of such a term is to immunize from challenge by remainder beneficiaries almost any reasonably affordable distributions. This does not mean, however, that the trustee cannot properly resist any reasonable request by the beneficiary, because the decision remains one within the fiduciary discretion of the trustee.

Ascertainable standards. HEMS standards are not the only ascertainable standards. Any standard that a court can interpret sufficiently to compel a distribution will qualify, at least for tax purposes. HEMS standards are typically viewed as being at the outer boundary of permissible discretion, so any language that further limits a trustee's discretion will only serve to make a given standard “more ascertainable,” for lack of a better term. Sometimes, HEMS

language is specifically reigned in, as when a trust provides for medical care only in emergency situations. Other times, completely different language might be used.

Consider for example a trust in which the trustee is directed to provide all the money or other assets reasonably necessary to fund the beneficiary's hobby of collecting and painting fine art. This is clearly an ascertainable standard because, if a distribution is made

[pg. 8]

for some other purpose (e.g., the beneficiary's health insurance), a remainder beneficiary can sue the trustee for abuse of discretion.

Still, HEMS standards remain—well, the standard—and practitioners are advised not to deviate from this language without explicitly stating that any deviation is intended as a further limitation.

Element of the HEMS standard

Each of the HEMS standards is described in more detail below.

Support and maintenance. The terms “support” and “maintenance” are generally considered to be similar. In fact, Restatement (Third) of Trusts § 50 Comment d (2003) treats these terms as synonymous.

When the distribution standard includes the terms support and maintenance, a trustee's discretion is not unbridled discretion.¹¹ Rather, the trustee's discretion must be, in the words of a Texas court, “reasonably exercised to accomplish the purposes of the trust according to the settlor's intention and his exercise thereof is subject to judicial review and control.”¹²

The Restatement provides a nonexclusive list of examples including “regular mortgage payments, property taxes, suitable health insurance or care, existing programs of life and property insurance, and continuation of accustomed patterns of vacation and of

[pg. 9]

charitable and family giving.”¹³ Courts have held that “[t]he needs of a married man include not only needs personal to him, but also the needs of his family living with him and entitled to his support.”¹⁴

Exhibit 1 contains a list of other possible expenditures that may be covered under a support and maintenance standard. These examples are not meant to be exhaustive. Some of these

items may seem frivolous, particularly for small trusts, but that provides further support for the rule that individual circumstances must be considered. Under all circumstances, however, support probably means more than the bare necessities.¹⁵

Exhibit 1. Expenditures That May Be Payable Under HEMS Standard

The following is a list of some expenditures that might be properly payable under a HEMS standard. It is not intended to be exhaustive, nor should it be read to imply that every item will always be appropriate in every case.

Health:

- Emergency and regular medical treatment.
- Routine healthcare examinations.
- Health, dental, or vision insurance.
- Unconventional medical treatment.
- Extended vacations to relieve tension and stress.
- Rehab for physical problem or addiction.
- Health-related home renovations.
- Specialized cleaning services to remove allergens.
- Cosmetic surgery.
- Home health care.
- Gym, spa, or golf memberships.
- Dental and orthodontics.
- Golf club memberships.
- Psychiatric treatment.
- Eye care.
- Handicap transport.
- Lasik surgery.

Education:

- Grammar, secondary, and high school tuition.
- Medical school, law school, or other professional school.
- College in Europe as part of a study-abroad program.

- Costs for long-term studies or “career students.”
- Support of beneficiary while in school.
- Support of beneficiary between semesters.
- Graduate and post-graduate school tuition and expenses.
- Extracurricular activity fees, expenses, and paraphernalia.
- Tutoring; speech or reading therapy.
- Graduation costs, proms, and class rings.
- Books, computers, supplies, etc.
- Study abroad.
- Technical school training.
- Career training.
- Day care.
- Uniforms and school clothes.
- Room and board.

Maintenance and support:

- Mortgage payments and down payment on a home.
- Continuation of accustomed patterns of vacation.
- Property/casualty/liability insurance for home, auto, etc.
- Support for beneficiary engaged in charitable endeavors.
- Continuation of family gifting.
- Life insurance.
- Charitable gifting.
- Rent payments.
- Automobiles.
- Property taxes.
- Home repair and maintenance.
- Support of family members.
- Assistance starting a business.
- Legal fees.

The Texas Supreme Court in *Rubion*¹⁶ recognized several factors that should be considered by a trustee exercising its discretion in a “support” or “maintenance” trust. They include:

- (1) The size of the trust estate.
- (2) The beneficiary's age, life expectancy, and condition of life.
- (3) The beneficiary's present and future needs.
- (4) The other resources available to the beneficiary's individual wealth.
- (5) The beneficiary's present and future health, both mental and physical.

Other courts have identified similar factors.¹⁷

Support has also been held to include the educational expenses of the beneficiary's dependents. For instance, in *First National Bank of Beaumont v. Howard*,¹⁸ the Texas Supreme Court held that the fact that the settlor had paid for his daughters' college education indicated that he considered the expense of a college education for a dependent a “necessary” expenditure.

The changes in a beneficiary's standard of living or the value of trust assets can affect the level of support that is proper.¹⁹ Thus, if a beneficiary's standard of living increases (e.g., due to external factors not involving the trust) or if the trust's assets appreciate in value, then more liberal distributions should be permissible. Presumably, the converse would also be true, so trustees should be careful.

The needs of the beneficiary both present and future are to be considered by the trustee. But when the trust is potentially insufficient to provide for both needs, the trustee is faced with a difficult decision. Unfortunately, few courts that have addressed this issue, and those that did address it have not held consistently. For example, in *Rubion*, the Texas Supreme Court ruled that the trustee had abused his discretion by refusing to invade the principal of the trust to make payments for the beneficiary's care while she was in a state mental hospital. The trustee argued that he was within his discretion to withhold payments of principal because the corpus of the trust should be preserved for her support if she were ever discharged from the hospital, and further, that if the trust corpus were used to pay all of her medical care it would completely destroy the trust. Disagreeing, the court held the trustee abused his discretion by withholding the entire principal and the trustee should have determined what amount could have been distributed while still preserving the long-term health of the trust.

In *Penix v. First National Bank of Paris*,²⁰ the appellate court ruled that a trustee was within its discretion to withhold principal as well as *income*, in order to meet the future needs of the

beneficiary. The trustee argued successfully that, because the beneficiary was only nine years old, the income produced from the trust was well in excess of what was needed for her current support, and that any excess above the beneficiary's current needs

[pg. 13]

should be held in reserve for emergencies. The court found that the trustee was within its discretion, relying heavily on the language granting the trustee the power to carry out the terms of the trust "free from any supervision by the probate or other courts." The court discounted any significance of the word "shall" within the grant.

While the results in each case were different from the respective trustee's perspectives, *Penix* and *Rubion* adhere to the same rule. When exercising discretion in a support trust, a trustee should consider both the present and future needs of the beneficiary.

Education. Without limiting or expanding provisions, education is considered to include living expenses, tuition, fees, books, and other cost of higher education or technical training.²¹ As such, education would appear to be easy to define; many cases, however, demonstrate ambivalence in the courts. For instance:

- In *S. Bank & Trust Co. v. Brown*,²² a South Carolina court held that education did not include post-graduate studies but was limited to education, up to and including a bachelor's degree.
- In *Lanston v. Children's Hospital*,²³ a District of Columbia case, the court found that the trustee had discretion to refuse to fund the further education of a beneficiary who was 42 years old, well-educated, and had a "large income."
- A Massachusetts court adopted a similar definition of "college" as the Second Circuit in the context of a divorce case in *Steeves v. Berit*.²⁴
- In *Epstein v. Kuvin*,²⁵ a New Jersey court held that the term "college education" did not include medical school.

A list of common requests classified by corporate trustees and others as "education" is provided in Exhibit 1.

Health. The term health typically includes distributions for health as would be implied from a support standard alone.²⁶ Difficult decisions for distributions related to health may involve alternative treatments, such as acupuncture or homeopathic remedies, as well as elective medical procedures such as plastic surgery, laser eye surgery, cosmetic dentistry, non-

diagnostic full body scans, over-the-counter lab tests (such as tests for sexually transmitted diseases), tattoo removal, and concierge medicine. Some examples are included in Exhibit 1.

In drafting a distribution to cover health, attorneys may want to consider *In re Stonecipher*,²⁷ where the court found that it was not an abuse of the trustee's discretion to refuse to invade trust principal for in-home nursing care for the present beneficiary given the consideration of her income from other sources, the remaindermen beneficiaries, and extensive gifting, some of which was made from personal funds.

It is unusual for a settlor to specify or preclude certain distributions related to healthcare in the terms of a document but there are some interesting examples. A grantor's desire to exercise control from the grave and micromanage the determination of an appropriate distribution for health is an interesting exception. Some grantors may wish to limit health distributions to situations that do not result from "self-inflicted" problems, as might be caused by substance abuse or risky behavior (see Exhibit 2). Additionally, a grantor may wish to limit all distributions to emergency situations of some sort in order to encourage some behavior or other result.

For instance, trust funds might be distributable to a grantor's children for emergency health purposes only during any time they are married but without a marital property agreement in place. The same

[pg. 14]

trust might further provide that the children may receive full HEMS distributions once their respective spouses have signed the property agreement.

Exhibit 2. Sample Drafting Language

The following are examples of language which may be useful for drafters in the situations indicated, whether as form language or for perspective. No comment is intended with regard to the legal merit, practical effect, or overall desirability of any specific example.

Encouraging employment

(a) It is the Grantor's overriding intent in establishing the trusts hereunder to benefit his descendants, supplement their earnings, and enhance their standard of living, but only if and to the extent that such descendants remain productive members of society and continue to be gainfully employed on a full-time basis. Full-time employment will require, at a minimum, working forty (40) hours per week, whether on a self-employed basis or for a third-party

employer. It shall also be considered full-time employment if a Beneficiary is a full-time stay-at-home parent raising minor children who have been born or adopted into a lawful marriage of the Beneficiary, so long as the Beneficiary's spouse has full-time employment outside the home. The trust distributions provided for hereafter in subsection (b) shall be suspended at all times that the Beneficiary is not gainfully employed on a full-time basis, as determined by the Trustee in the Trustee's sole discretion, unless such Beneficiary has a medical condition or disability that makes such employment unrealistic or impossible; provided that, the Trustee may rely upon the determination of the Trust Committee established under subsection x.x in a situation where the medical condition or employment status of a Beneficiary is not entirely clear. Once the Beneficiary regains full-time employment, trust distributions under subsection x.x shall not resume until the Beneficiary has maintained such employment for twelve (12) consecutive months. In the event that a child of the Grantor is a single parent as the result of divorce, death of a spouse, or a single parent adoption or use of assisted reproduction techniques, the Trust Committee shall determine whether the employment requirements of this subsection (a) shall be waived to allow such single-parent Beneficiary to be a stay-at-home parent and still receive the distributions authorized below in subsection (b).

(b) With regard to each trust administered under this Article with respect to which the Beneficiary is under the age of fifty (50) years, the Trustee may distribute to each Beneficiary, if the Trustee, in the Trustee's sole discretion, determines it to be in the Beneficiary's best interests, any amount not exceeding the lesser of (i) twice the annual earned income of the Beneficiary, or the Beneficiary's spouse in the event that the Beneficiary is a stay-at-home parent (as reflected on the Beneficiary's federal income tax return for the prior year) or (ii) the annual annuity amount defined below. Any distributions under this subsection shall be made in quarterly installments at the end of each calendar quarter. The annuity amount as to each trust is an amount equal to five percent (5%) of the average of the net fair market values of such trust as of the end of the prior two calendar years (except as provided in subsection (c) below for the first four years of the trust).

Posthumous continuation of support and encouragement

I have always encouraged my children to build useful and fulfilling lives. I have provided the means to allow them to choose a career, business, or profession about which they may be passionate and to pursue whatever education is required to excel in their chosen field. It is my intent that my trustee, in his discretion, will use these funds to provide health, education, maintenance, and support as reasonable and necessary to continue to encourage them to pursue these goals and support them in these endeavors as I have done up until the time of my death. Accordingly, to the extent that funds are available and the trustee, in his discretion

deems it prudent, I encourage my trustee to consider requests for the purchase of a residence, to facilitate the start of a business or enter a profession, to obtain additional education or for travel in a manner that expands the knowledge, creativity, and sophistication of my children in order that they may continue to do meaningful work for profit or charity.

Describing factors that may be important and encouraging productive behavior

In an effort to provide the Trustee with guidance in making distributions under the standards provided in subsection X above, the Trustee may consider such circumstances and factors as the Trustee believes are relevant, including but not limited to the following: (a) the other income and assets known to the Trustee to be available to the distributee, and the advisability of supplementing such income or assets, (b) the tax consequences of any such distribution, (c) the character and habits of the distributee, including the diligence, progress, and aptitude of the distributee in acquiring an education and advancing his or her career goals, the ability of the distributee to handle money usefully and prudently, and to assume the responsibilities of adult life and self-support, (d) the extent to which any such distribution could contribute to the development of negative attitudes in the distributee, such as entitlement, complacency, or narcissism, (e) external factors and circumstances which may threaten the distributee's financial security or progress toward financial maturity and independence, and (f) the distributee's cultivation of a life plan and goals which are both challenging and realistic in terms of intellectual prowess, emotional maturity, and career and/or family development.

Discouraging bad behavior

My Trustee shall NOT distribute any trust income or principal to my son for his emergency or serious medical needs if he has employer medical benefits or if such needs arise from his participating in risky or irresponsible activity, as determined in the sole discretion of my Trustee, which determination shall be binding on all parties. For purposes of this Will, "risky or irresponsible activity" shall include but shall not be limited to drunken driving, illicit drug use, unprotected sex, and any illegal actions.

Describing education

"Education" as used herein shall include the best education a beneficiary is capable of absorbing, such as study at private schools and colleges, and graduate studies, if such beneficiary desires to pursue such studies.

Encouraging employment and payment of insurance

(a) If the Grantor's son is employed on a full-time basis (35 or more hours per week), the Trustee shall distribute to the Grantor's son monthly (for each month that the Grantor's son is employed on a full-time basis) an amount equal to ten percent (10%) of the annual compensation of the Grantor's son from the calendar year immediately preceding the year in which such distributions are to be made (as determined by reference to the Form W-2, Form 1099-Misc, or similar form received by the Grantor's son for such year); provided, however, that the 10% distribution rate shall be increased by the inflation rate for the calendar year immediately preceding the year in which such distributions are to be made, as determined by the Consumer Price Index;

(b) If the Grantor's son is not working at all (as an employee or independent contractor), the Trustee shall distribute to the Grantor's son seventy-five dollars (\$75) per day for a period lasting no longer than six (6) consecutive months; provided, however, that such distributions shall not begin until the unemployment benefits to which the Grantor's son is entitled expire; provided, further, that the \$75 per day distribution rate shall be increased for inflation, as determined by the Consumer Price Index, using the year of execution of this Will as the base year;

(c) If the Grantor's son is below the age of sixty-five (65) years, the Trustee shall pay on behalf of the Grantor's son the premiums on a disability insurance policy with the Grantor's son named as the insured and beneficiary and with the maximum benefit level available elected;

(d) The Trustee shall pay on behalf of the Grantor's son the premiums on an insurance policy covering the personal items (including expensive computers and electronics) of the Grantor's son (kept inside his apartment, home, or other domicile) to protect against damage/loss due to theft, fire, and similar hazards; provided, however, to allow the Trustee to purchase the appropriate amount of insurance coverage, the Grantor's son must provide annually to the Trustee a complete inventory of his possessions, supported by pictures; provided, further, that if the Grantor's son fails to provide the required inventory and supporting pictures, the Trustee shall not purchase such insurance;

(e) If the Grantor's son owns his own home, the Trustee shall pay on behalf of the Grantor's son the premiums on a homeowner's insurance policy with terms and coverage standard at that time;

(f) If the Grantor's son and his spouse are both unemployed or if neither the employer of the Grantor's son nor the employer of the spouse of the Grantor's son pays for his health insurance premiums, then the Trustee shall pay on behalf of the Grantor's son the premiums

on a secondary health insurance policy (with a \$5,000 deductible, indexed for inflation) for the Grantor's son with terms and coverage standard at that time; provided, however, that the Grantor's son shall be responsible for premium payments on any primary health insurance policy;

(g) The Trustee shall pay on behalf of the Grantor's son any medical expenses incurred by the Grantor's son (only after attaining the age of sixty years) that are not covered by his health insurance policy, Medicare, Medicaid, Social Security, or any other similar benefit plans;

(h) If the Grantor's son has biological or adopted children, then the Trustee shall purchase and pay the premiums on a term life policy insuring the life of the Grantor's son with the trust named as beneficiary; provided, however, that the Trustee, with the assistance of a professional financial advisor, shall determine the appropriate amount of life insurance to cover the future health, support, maintenance, and education of such children;

(i) The Trustee shall pay on behalf of or reimburse the Grantor's son for educational expenses only under the following guidelines: If the expenses relate to the current occupation of the Grantor's son, then the Trustee shall cover such expenses only if the employer of the Grantor's son refuses to cover such expenses; or if the expenses are unrelated to the current occupation of the Grantor's son, then the Trustee shall reimburse the Grantor's son for such expenses only after the Grantor's son provides proof of a passing grade, graduation, or a certificate of passing.

Discouraging drug use

If my Trustee reasonably believes that a beneficiary is abusing drugs or alcohol and that the resources of the Trust, if distributed, would facilitate continued abuse, my Trustee may establish a discretionary trust with all or any portion of the share which would otherwise be distributed to a beneficiary. For the purposes of this section, the term "drugs" would include legal and illegal substances, whether or not prescribed by a physician, upon which the beneficiary has become dependent and/or uses regularly to his/her detriment. In establishing such discretionary trust, the Trustee may select a trustee, co-trustee, and/or successor trustees, and shall include all provisions determined to be reasonable and necessary by the Trustee after consultation with a qualified attorney. It is my intent that any discretionary trust established pursuant to this provision be drafted and managed so as to (1) prevent the resources in the Trust from being used to purchase drugs or alcohol in situations where the purchase of same would work a detriment to the beneficiary, as perceived by the Trustee, (2) provide a platform from which the trustee could implement treatment for the beneficiary, and

(3) prevent the resources in the Trust from enabling a beneficiary to continue a self-destructive lifestyle as a result of his/her drug and/or alcohol use and/or dependency. Trustee may demand, and the appointed Trustees of the discretionary trust established in accordance with this paragraph may demand, that a beneficiary participate in testing to determine if drug and alcohol use is occurring, demand a beneficiary participate in drug or alcohol counseling or rehabilitation, and charge the beneficiary's share for all costs incurred in such testing and treatment. The remainder beneficiaries of any discretionary trust established pursuant to this provision shall be the descendants of the lifetime beneficiary, by right of representation, or if none, the estate of said beneficiary.

Encouraging drug rehab

John Doe Trust. The gift to the trustee of the John Doe Trust (the "John Doe Trust") shall constitute the initial trust estate of a trust for the benefit of John, subject to the following conditions:

Distributions for John. No distributions shall be made to John or on behalf of John, other than payment for the treatment described below, unless and until (i) John has attended "Survivors' Week" at the Happy Hills Rehabilitation Clinic, located at 123 ABC St., Shangri-La, or its successor institution or organization; provided however, if either Survivors' Week or Happy Hills is not then in existence, the trustee, in the trustee's discretion, may require John to attend a similar program from a similar institution as a condition precedent to the termination of this trust; and (ii) John has received two hundred fifty (250) hours of psychotherapy from a therapist licensed and trained in compulsive and addictive disorders and specializing in childhood trauma, family of origin issues, and abuse recovery. The Survivors' Week and psychotherapy requirements shall be collectively referred to herein as the "Treatment." The trustee shall pay for the Treatment by making payments directly to the psychotherapist or Happy Hills (or its successor institution or organization or such similar institution, as the case may be, if a successor or similar institution is providing the Treatment). No distributions shall be made directly to John during the term of this trust.

Termination. The trust shall terminate upon the first to occur of (i) John's completion of the Treatment; (ii) John's failure to complete the Treatment within six (6) years from the date of my death, or (iii) John's death. Upon termination as a result of John's completing the Treatment, the trust estate shall be distributed to John, subject to the Contingent Trust provisions. Upon termination as a result of John's failure to complete the Treatment within six (6) years of my date of death, or as a result of John's death prior to the date which is six (6) years after my date of death, the trust estate shall be distributed as follows:

If any of my grandchildren or the descendants of any of my grandchildren are then living, to the trustee of the Descendants Trusts created herein. If none of my grandchildren or the descendants of any of my grandchildren are then living, to the University of Nevada at Las Vegas.

Statement of Trust Purposes. My primary concern in establishing this trust is for the benefit of John, if John agrees to follow the Treatment described above. The trust shall be managed accordingly

Factors to consider; encouraging productivity

In making any discretionary distributions to a descendant of mine from any trust under this Article, the trustee of such trust shall have discretion to consider all relevant facts and circumstances, including the nature and size of the trust estate, tax aspects, the maturity of such descendant, and the particular situation of such descendant in his or her personal life. In exercising this discretion, the trustee shall consider my desire that such descendant seek to develop his or her talents and abilities through personal effort and become financially responsible and a credit to our family and the community. The trust estate shall be used only to help support a constructive life of good character and responsibility on the part of each beneficiary of such trust. My trustee shall make distributions in such a manner as to encourage each to reach his or her potential and to lead a productive and self-sufficient life.

Encouraging productivity

It is the intention of the Settlor, that no such payment of income to such child shall be made if, in the judgment of the Independent Trustee, the ambition or incentive of such child to provide for such child's own support would be retarded or destroyed thereby; provided, however, that the fact that a beneficiary hereunder has become successful by such beneficiary's own endeavors, shall not cause the Independent Trustee to withhold any such payment from that beneficiary.

General considerations for HEMS standards. In certain circumstances, it can be easy to confuse ascertainable standards with unascertainable standards. Typically, one "bad" word will spoil the bunch, which is to say providing for a beneficiary's "health, support, and comfort" causes the trust to be subject to an unascertainable distribution standard, theoretically because the addition of "comfort" expands the standard beyond the point at which it is ascertainable. However, "support in reasonable comfort" is still considered ascertainable, as is "maintenance in health and reasonable comfort."²⁸ Thus, adding one wrong word can taint an otherwise ascertainable standard, making it unascertainable.

Furthermore, the examples above leave much to chance where a trustee is in the position of contemplating a potential distribution. For example, what if a beneficiary requests a distribution to pay for yoga classes arguing that, as "classes" they qualify as "education"? What if the request is for a course in preparation of reaching the next level in scientology? Is crystal healing properly paid for as a health expense?

Fortunately, some of these concerns may be assuaged by the fact that a distribution request might fall into another category than that first put forth. If, for example, yoga and crystal healing do not qualify as education and health, respectively, either might fit into a support or maintenance standard. Still, this problem underscores how drafters should, where possible, provide clarification as to the intent of each grantor.

Mandatory distributions

A mandatory distribution requires the distribution of income or principal in a manner that does not require the exercise of a trustee's discretion. The most common mandatory distribution requires the distribution of all the trust's income. Qualified terminable interest property (QTIP) trusts are just one example of the kind of trust with a mandatory distribution. IRC Section 2056(b)(7) mandates that QTIP trusts distribute income at least annually in order to qualify for the estate tax marital deduction.

As with completely discretionary distributions, one might think that a mandatory one involves little intellectual machination, but that is not always the case. A mandatory trust distribution must be triggered by some event or set of facts because, absent the trigger, the beneficiary's gift would simply be outright (i.e., not in trust). Sometimes these triggers are easy to determine and sometimes they are more difficult.

Consider, for example a trust that allows distributions upon the beneficiary's attainment of, say, age 30. There the trigger is the beneficiary's 30th birthday. But what if the beneficiary is disabled? In that case, an exception will typically allow the trustee to continue holding the trust assets for so long as the incapacity continues.

On the other hand consider the QTIP trust, which requires annual income distribution. What is income and how is it determined? This is a more complicated question than most might think. Trust income differs from financial accounting income and taxable income. Unlike financial income and taxable income, which may be based on accrual principles, trust income generally is computed on a cash basis.

Modifying language

In addition to the terms described above, trust instruments typically have modifying language that affects how distributions are to be made. These complicate the problem of interpreting trust language in much the same way as additional wheels on German Enigma machines scrambled letters for coded radio communication in World War II. That is to say, changing the modifiers can lead to a different result with regard to the same external facts and distribution language. This alone makes it very difficult to find a case on point for a given scenario because it creates too many permutations.

Still, some guidance is available, and the following are some (but certainly not all) such modifiers that trustees might want to consider:

[pg. 15]

Shall vs. may. The term “may” means maybe and implies discretion.²⁹ If a trustee *may* make distributions for HEMS, the fact that a beneficiary needs funds for a mortgage payment does not compel the trustee to make a distribution. The trustee can still determine properly that the distribution should be withheld. On the other hand, the term “shall” means that something is mandatory.³⁰

Typically, a trust will require that a trustee *shall* make a distribution to (or for the benefit of) a given beneficiary's health, education, maintenance, and support. Thus, if the trustee determines that the distribution is within the standard (HEMS), he or she must make the distribution, even if the trustee objects on other grounds. In practical terms, however compelling a distribution on these grounds is difficult for a beneficiary because he or she will typically have a very difficult time disproving the trustee's determination.

On a more theoretical front, a “may” modifier effectively creates an upper limit to permissible distributions. A trustee who *may* make distributions for HEMS, might never make any distribution at all. On the other hand, a “shall” modifier triggers every distribution that falls within the standard. Because it therefore makes the related distribution standard more ascertainable, a “shall” standard is preferred when tax is a prime consideration.

Accustomed standard of living. Trust instruments frequently direct trustees to allow beneficiaries to maintain their particular standard of living. The standard of living of the beneficiary is usually determined as of the time of the grantor's death or when the trust became irrevocable. The implication that support is to be interpreted at that time is in keeping with interpreting the trust according to the settlor's intent.

Even without specific language, a distribution for support is to be made according to the beneficiary's station in life.³¹ Whether this accustomed style is expressed or implied, however, a lower level of distributions may be justifiable if the trust estate is modest relative to the probable future needs of the beneficiary.³²

Other sources of support. When making discretionary distributions, a trustee should consider whether he or she is obligated to consider the beneficiary's other resources. If the settlor has provided guidance in this area, the settlor's intent will control. Also, all rules are tempered by the grantor's intent as reflected in the overall purpose of the trust.³³

If the trust document is silent, a trustee should generally consider other resources but he or she may have some discretion in determining the impact of the resources on the distributions to be made from the trust.³⁴ The consideration of other resources, however, involves balancing of the intent of the grantor regarding the treatment of the beneficiary and the other purposes of the trust. Furthermore, these considerations may change the general rule.

The Restatement, however, sets out at least two qualifications to the general rule as follows:

[pg. 16]

(1) If the discretionary power is one to invade principal for (or to distribute additional income to) a beneficiary who is entitled to all or a specific part of the trust income, or to an annuity or unitrust amount, the trustee must take the mandatory distributions into account before making additional payments under the discretionary power. Where a beneficiary is entitled to payments from another trust created by the same settlor (e.g., nonmarital and marital deduction trusts for a surviving spouse), or as a part of coordinated estate planning with another (such as the settlor's spouse), required distributions from the other trust—and the purposes of both trusts—are to be taken into account by the trustee in deciding whether, in what amounts, and from which trusts discretionary payments are to be made.

(2) To the extent—and for as long as—the discretionary interest is intended to provide for the support, education, or health care of a beneficiary (i.e., while a beneficiary probably was not expected to be self-supporting), the usual inference is that the trustee is not to deny or reduce payments for these purposes because of a beneficiary's personal resources.

Other resources normally include the beneficiary's other income, but not principal available to the beneficiary. In *Keisling v. Landrum*,³⁵ the Texas appellate court held that a beneficiary was not required to exhaust all her assets, other than a house and car, in order to receive

distributions from a trust that required (“shall”) the trustee to distribute trust income when the beneficiary’s “own income and other financial resources from sources other than this trust [were] not sufficient” to maintain her standard of living. In reaching its decision, the appellate court found that “other financial resources” were limited to “income and other periodic receipts, such as pension and other annuity payments and court-ordered support payments.”

The forgoing notwithstanding, the principal of the beneficiary may yet be relevant, depending on the terms and purpose of the trust. Once again, the determination of what resources to consider includes:

- (1) The settlor’s relationships both to the current beneficiary and the remainder beneficiaries.
- (2) The liquidity of the beneficiary’s assets.
- (3) The purposes of the trust, both tax and nontax.

Support vs. supplement. Another particularly vexing problem for a trustee is determining whether a given grantor intended to support a beneficiary or merely supplement the person’s lifestyle. As discussed in more detail below, trust language will sometimes restrict distributions for “nonproductive” beneficiaries (or even prohibit distributions to them altogether). Also, a trustee who is affirmatively directed to take other sources of support into consideration is likely to have intended that the trust at issue merely supplement where needed. Although rules of construction mandate a presumption that both the grantor and his or her attorney were both familiar with and understood the terms of the trust instrument at execution, from a practical standpoint, most practitioners know that this is seldom the case.

The problems are that (1) people’s opinions differ significantly in this regard and (2) slightly different standards can result in completely opposite results for various beneficiaries. For example, a testator may create a trust for his or her children and further issue with the intent of preserving assets in the family for as long as possible, providing supplemental support as needed and as available. But another testator might establish a very similar trust with the intent that the children enjoy the benefits thereof, even if that means the grandchildren do not eventually inherit. In the latter example, it may be the testator’s intent that his or her children provide for further descendants through their own estate planning.

Experience has shown that clients really do “fall all over the map” in this regard. Thus, it is extremely difficult for trustees to decipher intent from the four corners of an instrument, particularly in the modern world of endless boilerplate language.

From a drafting perspective, it may behoove a grantor to specify how distributions are to be made by using language such as “generously” or “adequately.” Such language can be used in conjunction with a HEMS or other ascertainable standard without negatively affecting the tax result.³⁶

Legal duty to support. Many trusts will contain a prohibition on a trustee acting in such a manner as to relieve himself or herself of a legal duty under applicable law. Generally, this means that a trustee/parent cannot make distributions which he or she is obligated to make under state law, although there might be other situations where such a prohibition might come into play. This type of language is often buried in the boilerplate of the trust instrument such that it might easily be missed. Furthermore, distributions outside of the duty are typically permitted, but understanding where to draw the line can be a daunting task.

[pg. 17]

For example, a parent must provide a child with food, clothing, and shelter, but this obviously does not mean steak dinners, designer labels, and a swanky uptown apartment with servants and a view. The trustee must determine where to draw the line, and he or she is well-advised to seek legal counsel when doing so.

Other considerations

In addition to a trust's terms and explicit modification language, trustees frequently face external factors worth consideration. A few (but, again, not all) are discussed below.

Determining a beneficiary's needs. A threshold issue for any independent trustee will be to determine whether a given beneficiary, in fact, needs a contemplated distribution. Does this mean that the trustee must (or may) require access to bank accounts, tax returns, and other personal information? Generally, the answer is no, but there are exceptions. The key to this question is reasonableness. According to the Restatement (Third) of Trusts § 50 Comment e (1) (2003):

The trustee has a duty to act in a reasonable manner in attempting to ascertain the beneficiary's needs and, under the usual rule of construction, other resources that may be appropriately and reasonably available for purposes relevant to the discretionary power. The trustee generally may rely on the beneficiary's representations and on readily available, minimally intrusive information requested of the beneficiary. This reliance is inappropriate, however, when the

trustee has reason to suspect that the information thus supplied is inaccurate or incomplete.

Thus, a trustee must obtain reliable information from a beneficiary in order to make informed, reasonable distribution decisions. The trustee should solicit information from the beneficiary regarding his or her financial needs, wants, resources, and standard of living. Appropriate documentation will vary from case to case, but generally will include items such as:

- Income and cash flow information.
- Financial statements.
- All trust instruments under which the beneficiary has a right to receive or request a distribution.
- Income tax returns.
- Tuition statements or estimates and agreements relating to the beneficiary's education.
- Receipts or invoices as to any amounts to be reimbursed.
- Information regarding the beneficiary's employment status and efforts to obtain employment.
- Status of the beneficiary's housing, transportation, and any other relevant information regarding support.
- Status of the beneficiary's medical insurance and anticipated health care needs.
- Debts of the beneficiary and status of any litigation related thereto.
- Standing with regard to taxes, particularly where the beneficiary owes back taxes or penalties.
- Notification of any significant changes in any beneficiary's housing, education, development, or medical needs.
- History of assistance previously supplied by the grantor to the beneficiary.

Admittedly, information gathering in this regard may be more art than science. Some trustees desire to obtain extensive information from the beneficiary to "paper" their file. This however, can lead to feelings of ill-will and invasion of privacy by the beneficiary. Other trustees go to the opposite extreme and request no information. This can lead to claims of breach of fiduciary duty against the trustee by other beneficiaries who may eventually request that the trustee justify his or her prior distributions.

Furthermore, a trustee should be prepared to do more than simply approve or deny a distribution request. Communicating with a beneficiary about the merits of his or her request

(as well as the requests of other beneficiaries) may avoid future problems. If, for example, a distribution can be made only by liquidating assets and triggering a severely adverse tax consequence, the better trustee will be happy to take as much time as may be needed to explain to the beneficiary why the distribution would do more harm than good.

Multiple beneficiaries. Trusts will almost always have more than one beneficiary, and the trustee is always tasked with the duty of balancing their various rights. A trust instrument that categorizes certain persons as “primary” or otherwise preferred beneficiaries is easier for the trustee to administer, and “pot trusts” (i.e., trusts with more than one current beneficiary) make the trustee’s work more difficult.

When no such intent is expressly provided in the trust instrument or implied by its terms, state law may provide that such an intent cannot be otherwise inferred. For instance, the Texas Trust Code provides that a trustee must act impartially as to all beneficiaries.³⁷ Note that the Restatement suggests inferences with regard to prioritizing multiple beneficiaries.

Another problem exists where a beneficiary has minor children. Under Texas law, for example, a parent has a legal obligation to support his or her minor children. Such a duty of support includes the duty

[pg. 18]

to provide a child with clothing, food, shelter, and medical and dental care.³⁸ This duty of support must be considered when making distributions from a trust. Unfortunately, no clear guidance is provided as to the extent to which a trustee must consider a parent/beneficiary’s obligation of support.

Beneficiaries often seek or use distributions to support their family. This raises the issue of whether a trustee may take into account the needs of a beneficiary’s family, or his or her obligation of support when making distributions.

Regardless of the grantor’s intent, however, a trustee of a support or discretionary trust may be required to make distributions for support of a beneficiary’s child when the beneficiary has been ordered to make child support payments. The extent of the payments depends on whether the trust is a support trust or a discretionary trust.

A trustee of a support trust may be required to make distributions for the support of the beneficiary’s child. A trustee of a purely discretionary trust may be ordered to make child support payments for the benefit of the child only from income but not principal.

Encouraging or discouraging behavior. Although somewhat less common than in years previous, the occasional grantor still intends to encourage behavior viewed as “good” and discourage what the grantor considers to be “bad” behavior. Such intent is generally to be respected. Thus, language forbidding distributions to beneficiaries who fail drug or alcohol tests are generally acceptable, as are requirements that beneficiaries make themselves somehow productive in society.

On the other hand, language that is against public policy is unenforceable, and courts will generally order it ignored. Perhaps unsurprisingly, the case law in this particular area seems always to center around personal relationships. For example, language discouraging a beneficiary from marrying someone of a particular race may be verboten. Additionally, terms that encourage divorce are typically considered to be against public policy.³⁹

Sometimes, however, a seemingly impermissible requirement will nonetheless be permitted if the proper intent can be found. As Professor Gerry Beyer put it:

As a general rule, conditions that a beneficiary must be divorced to receive a benefit have been found to be contrary to public policy. Courts, recognizing the importance of the family unit in an organized, harmonious society, seek to protect the familial bond from injurious outside influences. In Texas, however, a provision requiring divorce as a precursor to receipt of a benefit was upheld where the testator's dominant motive was to provide support for the beneficiary if the beneficiary became divorced or widowed. When deviating from the norm, it is necessary that proper intent, i.e., the intent to provide support if the beneficiary loses the support of a spouse, be shown and that the provision be drafted carefully to demonstrate this good intent.⁴⁰

For the trustee, this means that advice and counsel should be sought whenever this sort of restrictive provision arises.

Taxes. Traditionally, taxes have been a significant (if not the primary) motivating force behind estate planning as an industry. The Restatement of Trusts provides as follows:

It is normally appropriate, and often necessary, for a trustee to take tax considerations into account in determining what discretionary distributions to make.... An often more troublesome question is whether distributions can properly be made purely for tax reasons to selected beneficiaries under a flexible power.... An appropriate answer may require careful consideration of the other resources of the various beneficiaries, as well as their income-tax and estate-tax

positions, the tax circumstances of the trust, and the underlying purposes of the settlor.⁴¹

Note that this language was adopted in 2003, when tax rules were very different than they are now. With the applicable exclusion amount now over \$10 million for a married couple, transfer tax (i.e., estate, gift, and generation-skipping transfer tax) is far less of a concern, and capital gains tax is an increasing problem. Under traditional estate planning techniques (i.e., those from 2012 and before), married couples would seek to gain an estate tax advantage by implementing a "credit shelter" or "bypass" trust as part of their estate plan. Such a trust was generally available for a surviving spouse, but, because it would not be counted as part of his or her gross estate for transfer tax purposes, its assets would not receive a step up in basis under IRC Section 1014.

Thus, taxpayers were encouraged to endure the expense of capital gains tax (really, it was their children who endured it) in order to lessen their exposure to the more expensive estate tax. Although this made sense in a world where the applicable exclusion amount was

[pg. 19]

\$1 million, \$2 million, or even \$3.5 million, the current exclusion exceeds the value of all but the small percentage of very large estates. Therefore, traditional planning may subject a taxpayer to capital gains tax even though no estate tax would apply, and many trusts which were primarily designed to lessen the amount of overall tax borne by their respective families are now in a position of causing increased taxation.

The trustee's fiduciary duty in this respect remains unclear, but it underlies the point that he or she should, in any event, take into consideration the tax impact that distributions from a particular trust will have.

Another example might be where trusts are created for children and grandchildren, some of which are grandfathered or otherwise exempt from generation-skipping taxes and others of which are not. The trustee should obviously strive to make distributions to the children's generation (as well as distributions to the grandchildren for tuition or medical expenses that will also be protected from those taxes) from the non-exempt trust, while preserving the exempt trust (where possible) for the grandchildren and younger generation beneficiaries. Likewise, a trustee should generally make distributions to a surviving spouse from a marital trust that will be included in the spouse's estate, before making distributions to the spouse from a bypass or credit trust.

Thus, once again, trustees are well-advised to seek out professionals who know and understand these rules.

Best practices: a conclusion of sorts

The ascertainable standard remains elusive to trustees and their advisors. At the very least, however, a few general rules can be identified.

Be flexible. Flexibility is a hallmark of the American trust. It is at once its greatest asset and its greatest hindrance. Beneficiaries have problems that they want solved, and they may not realize that a particular solution might come in any form other than a check. Particularly where multiple competing interests are involved, the trustee should consider alternate avenues of satisfying a beneficiary's need as expressed by a distribution request.

Loans are a fine example of this principle. A trustee may consider loaning funds to a beneficiary for certain purposes instead of making a distribution. In a multiple beneficiary or "pot" trust, this is sometimes seen as a way to satisfy a beneficiary's needs, without giving one beneficiary "too much" of the trust estate. For a trust that will divide into shares at some date (i.e., at a surviving spouse's death, or when the youngest child reaches a certain age), it is sometimes intended that the loan will simply be offset against the beneficiary's ultimate share. Yet, if funds are needed to serve more pressing needs of another beneficiary, the loan may often be called in by the trustee.

Still, the trustee should be as cautious about making loans to beneficiaries as making distributions. Before loaning trust funds, the trustee should first determine if the trust document permits loans to beneficiaries, and if permitted, the trustee should determine whether interest must be charged to the beneficiary. If permitted, the trustee should evaluate the security for the loan and the beneficiary's ability to repay the loan. Too often decisions to loan funds to beneficiaries in fact become decisions to make a distribution, because the beneficiary cannot or will not repay the loan. The trustee who loans trust funds to a beneficiary must be prepared to deal with default, if it occurs. All loans should be properly evidenced by a note, with any appropriate security agreements executed as well.

To the extent permitted, interest-free loans may create a balance between a secondary or tertiary beneficiary's desire to enjoy the trust's benefits while protecting the superseding interest of a primary beneficiary. If an interest-free loan is made, however, the trustee should note that the forgone interest is itself a distribution from the trust. On the other hand, interest that is paid by the beneficiary is taxable to the trust as ordinary income.

Other ideas for flexibility might include buying property instead of making distributions for its rental,

[pg. 20]

or vice versa. For example, if a beneficiary needs housing for college, the trustee may consider buying a condo or house in which the beneficiary can live. This might generate rental income for the trust as well as gain if the property increases in value.

On the other hand, if a beneficiary prefers to drive a new car every few years, it may make more economic sense for the trust to lease a vehicle (or distribute cash to the beneficiary so he or she can make lease payments). Of course, this will involve an analysis of the trust's terms and economic status, but even if trust assets are sufficient to easily afford to buy a new car every couple of years, the trustee should not frivolously agree to an uneconomical arrangement.

Establish a process and follow it. Finally, as stated above, the exercise of discretion, whether absolute or under an ascertainable standard, involves reasonableness on the part of the trustee, but reasonableness is itself amorphous. Clearly, though, a trustee cannot act reasonably if the trustee does not act at all. Therefore, almost any procedure for evaluating distributions will be better than none. A trustee that establishes a process for determining which distributions are to be made is less subject to challenge than a trustee distributing far less or far more with no process in place. Trustees that can present a well thought out and reasonable decision-making process are often victorious.

The trustee should maintain contemporaneously prepared documents identifying all information considered, copies of documents considered, and other steps involved in the investigation conducted by the trustee in making the decision.

It is an abuse of discretion for a trustee to fail to exercise judgment at all, no matter how broad the standard.⁴² The trustee's discretion must be "reasonably exercised to accomplish the purposes of the trust according to the settlor's intention and his exercise thereof is subject to judicial review and control."⁴³

The importance of reading and re-reading the trust instrument with regard to distributions cannot be overstated. The trust instrument should be read when the trustee initially begins serving, and also at each yearly review. In addition, the trustee should review the distribution provisions of the trust at any time a distribution request is being evaluated. The trustee should not only review the portion of the trust that actually grants the distribution powers, but

should also review the entire trust instrument for other statements and clauses (i.e., modifiers) that indicate the settlor's intent with regard to distributions and the relative priority or preference to be given to different beneficiaries.

When reviewing the merits of a given distribution request, a trustee may wish to note (and record) some or all of the following:

- Specifics of the beneficiary's request, including the amount, purpose, and method of the distribution (i.e. direct payment to third party, cash distribution to beneficiary, loan, etc.).
- Date the distribution is needed.
- Other distributions to all beneficiaries to date.
- Financial situation of all beneficiaries.
- Alternatives to the requested distribution (i.e., is a Cadillac within the grantor's intent or would a Buick be more appropriate, particularly given the other circumstances of the trust?).
- Anticipated distributions to all beneficiaries.
- Description of the distribution standard, including any modifiers, and reasons why the distribution would fit within such standard (or not).
- Description of the beneficiary's lifestyle or standard of living.
- Whether the distribution is requested from income or principal.
- Tax impact to the beneficiary.
- Tax impact to the trust and other beneficiaries.
- Other assets and sources of income available to the beneficiary.
- Beneficiary's obligations to the family and obligations of the family to the beneficiary
- Any other relevant factors

Once the trustee has made his or her review, the decision should be communicated to the beneficiary promptly and in writing. Furthermore, the trustee should be willing to discuss the decision with the beneficiary in depth, upon request.

Trustees who have disputes with beneficiaries will generally find the courts much more accommodating when the trustees can show good processes and thorough record keeping. Remember, the beneficiary's case will be just as hard to prove as the trustee's. But by keeping better records, the trustee can show how and why decisions were made. Thus, even if a particular court disagrees with a particular decision, its ability to find that decision unreasonable will be significantly curtailed.

¹ Estate of Budd, 49 TC 468 (1968), *acq.* 1973-2 CB 1; Estate of Frew, 8 TC 1240 (1947); Rev. Rul. 73-143, 1973-1 CB 407; Ltr. Ruls. 200213013, 200123034, 200011055, 200011054, 199903025, and 9527025.

² See also, Estate of Vissering, 71 AFTR 2d 93-2190 990 F2d 578 93-1 USTC ¶¶60133 (CA-10, 1993) (explaining that the term “comfort” does not make the standard unascertainable, so long as the beneficiary already leads a lifestyle that is at least reasonably comfortable; this, of course, appears to circle back to a previous standard of living).

³ Section 2514(c)(1); Reg. 25.2514-1(c)(2).

⁴ Reg. 20.2041-1(c)(1).

⁵ Texas Trust Code §112.035.

⁶ See, e.g., *Nowlin v. First National Bank*, 908 SW2d 283 (Tex. App.—Houston 1995).

⁷ See *Burns v. Miller, Hiersche, Martens & Hayward, P.C.*, 948 SW2d 317 (Tex. App.—Dallas, 1997, *writ den.*); *Bogert on Trusts* § 228.

⁸ See Reg. 20.2041-1(c)(2) (“A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard.”); see also Reg. 1.674(b)-1(b)(5)(i) (a power to distribute corpus for pleasure, desire, or happiness of beneficiary is not limited by a reasonably definite standard).

⁹ Reg. 20.2041-1(c)(2); *First Virginia Bank*, 33 AFTR 2d 74-1436 490 F2d 532 74-1 USTC ¶¶12968 (CA-4, 1974) (“In the absence of [state] law limiting [a beneficiary’s] power to consume the proceeds from the sale of the stock to an ascertainable standard relating to her health, support, or maintenance, the value of the stock must be included in her gross estate. While the power to consume need not be limited to the bare necessities of life, the Regulations specifically state: A power to use the property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard.”); but see *Estate of Strauss*, TC Memo 1995-248 RIA TC Memo ¶¶95248 69 CCH TCM 2825 (court held under Illinois law, “comfort” is ascertainable standard); *Pyle*, 56 AFTR 2d 85-6521 766 F2d 1141 85-2 USTC ¶¶13626 (CA-7, 1985) (government argued comfort ascertainable under state law); *Rock Island Bank & Trust Co. v. Rhoads*, 187 NE 139 (Ill. 1933) (comfort ascertainable under Illinois law as it refers to maintaining

someone in station of life to which that person is accustomed and because station in life is known, standard is measured and hence ascertainable.)

¹⁰ See Reg. 20.2041-1(c)(2); *First Virginia Bank*, 33 AFTR 2d 74-1436 490 F2d 532 74-1 USTC ¶12968 (CA-4, 1974) ("In the absence of [state] law limiting [a beneficiary's] power to consume the proceeds from the sale of the stock to an ascertainable standard relating to her health, support, or maintenance, the value of the stock must be included in her gross estate. While the power to consume need not be limited to the bare necessities of life, the Regulations specifically state: 'A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard.'").

¹¹ See *State v. Rubion*, 308 SW2d 4 (Tex. 1957) (citing *First National Bank of Beaumont v. Howard*, 229 SW2d 781 (Tex. 1950)); *Anderson v. Menefee*, 174 SW 904 (Tex. Civ. App.—Fort Worth, *writ refused, writ ref'd*); Frathcer, *Scott on Trusts*, Vol. 2, §187, page 986.

¹² *Kelly v. Womack*, 268 SW2d 903 (Tex. 1954); *Powell v. Parks*, 86 SW2d 725 (Tex. 1935); *Davis v. Davis*, 44 SW2d 447 (Tex. Civ. App.—Texarkana 1931, *no writ*).

¹³ Restatement (Third) of Trusts § 50 comment d(3) (2003).

¹⁴ *Robison v. Elston Bank & Trust Co.*, 48 NE2d 181 (Ind. App. 1943).

¹⁵ *Hartford-Conn. Trust Co. v. Eaton*, 8 AFTR 9900 36 F2d 710 (CA-2, 1929).

¹⁶ Note 11, *supra*.

¹⁷ See *In re Gruber's Will*, 122 NYS2d 654 (N.Y. Sur. 1953) (age and condition of beneficiary, amount of trust fund, and other factors); *Hanford v. Clancy*, 183 A 271 (N.H. 1936) (size of fund, present situation of beneficiary, present and future needs, other resources, and future emergencies); *Falsey's Estate*, Sur., 56 NYS2d 556 (N.Y. Sur. 1945) (age of beneficiary, physical and mental health of beneficiary, size of trust compared to beneficiary's life expectancy).

¹⁸ 229 SW2d 781 (Tex. 1950).

¹⁹ Restatement (Third) of Trusts §50 Comment d(2) (2003).

²⁰ 260 SW2d 63 (Tex. Civ. App.—Texarkana, *writ ref'd*).

- ²¹ See Restatement (Third) of Trusts § 50 Comment d(3) (2003).
- ²² 246 SE2d 598 (S.Car. 1978).
- ²³ 148 F2d 689 (CA-D.C., 1945).
- ²⁴ 832 NE2d 1146 (Mass. App. Ct. 2005), *abrogated by* Halpern v. Rabb, 914 NE2d 110 (2007).
- ²⁵ 95 A2d 753 (N.J. Super. Ct. App. Div. 1953).
- ²⁶ See Restatement (Third) of Trusts § 50 comment d(3) (2003).
- ²⁷ 849 NE2d 1191 (Ind. Ct. App. 2006).
- ²⁸ Reg. 20.2041-1(c)(2).
- ²⁹ See Texas Government Code § 311.016.
- ³⁰ Keisling v. Landrum, 218 SW3d 737 (Tex. App.—Fort Worth 2007, *pet. den.*); Roberts v. Squyres, 4 SW3d 485 (Tex. App.—Beaumont 1999, *pet. den.*).
- ³¹ Restatement (Third) of Trusts § 50 Comment d(2) (2003).
- ³² *Id.* See also, Estate of Miller, 230 Cal App 2d 888 41 Cal Rptr 410 (1964), *appeal after remand* 259 Cal App 2d 536 66 Cal Rptr 756 (1968) (the trustee is to maintain the beneficiary “in the social and economic position in which the latter had been living at the time of the creation of the trust, and give him the comforts and necessities to which he had become accustomed and not merely ... the bare necessities of life”). A pair of New Hampshire cases treated references to such words as “needs,” “necessities,” and “necessary” as the substantial equivalent of support in the beneficiary’s accustomed manner, rather than being limited to what is essential; Amoskeag Trust Co. v. Wentworth, 111 A2d 198 (1955), and Orr v. Moses, 52 A2d 128 (1947). *Compare* Huntington National Bank v. Aladdin Crippled Children’s Hosp. Ass’n, 157 NE2d 138 (1959); and Wright v. Trust Company Bank of Nw. Ga., 396 SE2d 213 (1990).
- ³³ See Restatement (Third) of Trusts § 50 Comment e (2003).
- ³⁴ *Id.*
- ³⁵ 218 SW3d 737 (Tex. App.—Fort Worth 2007, *pet. den.*).

³⁶ See. Restatement (Third) of Trusts § 50 Comment d(3) (2003) (“On the other hand, stronger language, such as ‘generous’ support, may permit and encourage the trustee to allow, and may even require, some reasonable enhancement of the beneficiary’s lifestyle; but it falls short of a ‘happiness’ standard (infra) in that the benefits still must normally be support-related.”).

³⁷ Texas Trust Code §116.005(b).

³⁸ See Texas Family Code § 151.001.

³⁹ E.g., *Southwestern Bell Tel. Co. v. Gravitt*, 551 SW2d 421 (Tex. Civ. App.—San Antonio 1976, *writ den.*).

⁴⁰ 9 Texas Practice Series §21.4 (3d Ed.), citing *Hunt v. Carroll*, 157 SW2d 429 (Tex. Civ. App.—Beaumont 1941, *writ ref’d.*).

⁴¹ Restatement (Third) of Trusts, Comment e(5) (2003).

⁴² *Scott on Trusts* § 187.3.

⁴³ *Id.* at §§187.1-3.

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Notes on Use

- A) **ACCEPTING OR DECLINING TRUSTEESHIP:** The Colorado Uniform Trust Code (C.R.S. § 15-5-701) contains the default for acceptance of the trusteeship. The terms of the trust may specify different method(s) to accept or decline. However, if a method to accept or decline is intended to be exclusive, it must be expressed in language manifesting the intent that the acceptance or declination may not be by any other method (e.g., “sole,” “exclusive,” “only”).

* * *

- 2) ~~**APPOINTMENT OF COTRUSTEE OR SUBSTITUTE TRUSTEE:** The practitioner should consider the inclusion of the substitute trustee provision to provide flexibility in handling assets of the trust that require special expertise in handling, such as oil and gas leases or other mineral interests. A clause which allows the appointment of a substitute trustee would also be useful in the case where trust assets include environmentally tainted real property. Many corporate trustees and individual trustees will refuse to accept the appointment as trustee if they must hold real property which may be subject to EPA action. A clause allowing a substitute trustee to hold the tainted assets or the appointment of a substitute trustee to hold the non-tainted assets may be helpful in persuading reluctant trustees.~~

~~In addition, the ability to appoint a substitute trustee or cotrustee is useful in the case where the original trustee may trigger an income or estate taxable event through the exercise of trustee discretion. By the use of a substitute trustee or cotrustee, and a renunciation of the power by the original trustee, the original trustee could be protected from such tax liability.~~

~~Finally, corporate trustees who utilize pooled funds which are regulated by the Comptroller of the Currency Reg. 9 cannot use these pooled funds in customer account unless the corporate trustee is serving in a fiduciary capacity. The ability to appoint a cotrustee would allow the utilization of corporate trustee pooled funds without the necessity of a court appointment as cotrustee.~~

- 2) **DESIGNATION OF ADDITIONAL TRUSTEE:** The practitioner should consider including the additional trustee provision to provide flexibility in handling trust assets which require special expertise, such as oil and gas leases or other mineral interests. Or consider providing for the designation of an additional trustee to handle property over which the trustee is unable or unwilling to act, such as real property located in another state or jurisdiction. A clause that allows the appointment of an additional trustee would also be useful where trust assets include environmentally tainted real property. Many trustees will refuse to accept appointment as trustee if they must hold tainted real property. A clause allowing an additional trustee to hold either the tainted assets or the non-tainted assets may be helpful in persuading reluctant trustees.

The practitioner should consider clearly specifying the additional trustee’s duties and powers in the designating document. Also, the document could specify a method for the acceptance and resignation of the additional trustee.

If the designating document specifies that the additional trustee is only to report to and inform the designating trustee, the document should also specify that the designating trustee remains responsible for all of the trustee's regular duties to report to and inform the beneficiaries, including as to the activities of the additional trustee.

Generally, any time there is more than one trustee, each trustee has fiduciary duties to use reasonable care to prevent another trustee from committing a breach of trust and to seek redress if a trustee commits a breach. C.R.S. § 15-5-703(7). Under the Colorado Uniform Directed Trust Act, the terms of the trust may relieve a trustee from these duties to the same extent that the terms of a directed trust may relieve the directed trustee from liability for acts of a trust director. C.R.S. § 15-16-812. Because an additional trustee is relieved from these duties only as provided by the terms of the trust or of the delegating instrument, the drafter should consider whether to include express language to that effect in the terms of the trust or in the delegating instrument.

C.R.S. § 15-5-802(9) allows a court to appoint a special fiduciary to make a decision about a proposed transaction which might violate the trustee's duty of loyalty. Provision in the will or trust which allows the trustee to designate an additional trustee to handle the transaction may eliminate the need for court involvement under this statute.

* * *

- 3A) COMPENSATION: Compensation of personal representatives, guardians, and trustees in Colorado is subject to the Compensation and Cost Recovery Act, C.R.S. § 15-10-601, *et seq.* Under the Colorado Uniform Trust Code, if the terms of a trust specify the trustee's compensation, the trustee is entitled to be compensated as specified, but the court still retains the power to adjust that compensation if it determines such compensation is unreasonably high or low. *See* C.R.S. §§ 15-5-708(2) and 15-5-105(1)(g).

* * *

- 6) DELEGATION and MAJORITY CONTROL: The practitioner should note that common law requires a unanimous vote of cotrustees while the Colorado Probate Code defaults to the same for personal corepresentatives under C.R.S. § 15-12-717. The Majority Controls and Delegation clauses are offered for the practitioner's consideration to promote efficiency in handling conflicts between fiduciaries. This approach is contrary to common law and the inclusion of these provisions should only be made after due consideration of the overall effect. To develop an understanding of matters of liability of the delegating fiduciary, see C.R.S. § 15-12-717, and *Scott on Trusts*, §§ 171-171.4, 194, and 224.2.

When only two fiduciaries are serving, their joinder is required for them to act. Should they be unable to reach agreement, they may, if appropriate under the circumstances, delegate the decision to an agent. Alternatively, the practitioner may choose to draft a provision in the instrument that addresses a deadlock circumstance. Options may include designating a third party to break the deadlock – such as a trust protector – or by including language either suggesting or requiring the fiduciaries to seek some form of alternative dispute resolution such as mediation or arbitration. *See*, C.R.S. § 15-1-804(2)(x) for personal representatives, and

C.R.S. §§ 15-5-807 and 113 for trustees. See also, the Colorado Dispute Resolution Act, C.R.S. § 13-22-301, et seq.

* * *

- 17A) NO BOND: Under the Colorado Uniform Trust Code the court retains the power to require, dispense with, modify or terminate any bond, notwithstanding the terms of a will or trust directing otherwise. See C.R.S. §§ 15-5-105(1)(f) and 15-5-702.

* * *

- 18) OTHER DEFINITIONS: This provision incorporates definitions in the Colorado Probate Code, the Colorado Uniform Trust Code regarding trust provisions of the instrument, and the Colorado Uniform Powers of Appointment Act with regard to powers of appointment “*as any are amended after the date of this instrument and after my death.*” ~~The practitioner should be aware that UPC II changed certain definitions. See C.R.S. § 15-10-201.~~

* * *

- 20A) QUALIFIED BENEFICIARY: The term “qualified beneficiary” appears throughout the Colorado Uniform Trust Code (CUTC) and was adopted directly from the Uniform Trust Code (UTC). The purpose of establishing the category is to distinguish between beneficiaries to whom the trustee has a duty to report and those beneficiaries who are remote and contingent, and whom the trustee, even with reasonable efforts, may have difficulty identifying. Generally, those remote and contingent beneficiaries have been categorized as “nonqualified beneficiaries.” Though the UTC does not define a nonqualified beneficiary, the term is occasionally used in the text of some UTC provisions. This provision was crafted by combining the substance of CUTC § 103(4) with that of CUTC § 103(16).

By adopting the term “qualified beneficiary”, the CUTC has defined those beneficiaries to whom the trustee has a clear duty to report and keep informed, to notify them of material facts necessary for them to protect their interests, to promptly respond promptly to qualified beneficiary’s requests for information related to the trust, and to notify qualified beneficiaries ~~over the age of 25~~ within 60 days of accepting the trusteeship and include in the notice the trustee’s name, address, and telephone number. C.R.S. §§ 15-5-813(1), 15-5-102(i), 15-5-813(2)(b), and 15-5-105(2)(h).

* * *

- 22) REMOVAL OF TRUSTEE and REPLACEMENT OF TRUSTEE: The power to remove a trustee, for whatever reason, can be an important way to provide flexibility, but may have tax implications. The regulations under I.R.C. §§ 2036 and 2038 provide that, if the decedent has the unrestricted right to remove a trustee and appoint himself or herself as successor trustee, the decedent is considered to have the powers of the trustee. Treas. Reg. §§ 20.2036-1(b)(3) and 20.2038-1(a)(3). The regulations do not specifically address the result if the decedent ~~can~~

has the power to remove and replace the trustee, ~~but may not appoint himself or herself as the successor trustee.~~

Following the tax court's decisions in *Estate of Wall v. Commissioner*, 101 T.C. 300 (1993) and also *Estate of Vak v. Commissioner*, 973 F.2d 1409 (8th Cir. 1992) it has been settled that the settlor can retain the power to remove and replace the trustee. However if the settlor appoints himself as the successor trustee the trust will likely be included in the settlor's estate. Also see Rev. Rul. 95-58, 1995-2 C.B. 191 which provides that a settlor who possesses the power to remove the trustee can also have the power to appoint a successor trustee, who is not a related or subordinate party, as defined in I.R.C. § 672(c).

If the trust document provides that the beneficiary may remove and replace the trustee, the IRS has indicated in Ltr. Rul. 9607008 that it will apply the same standard to beneficiary powers as those applied to trustees. That is, if the beneficiary may only appoint a trustee who is not a related or subordinate party, then the beneficiary will not be treated as having the powers of the trustee for purposes of applying I.R.C. § 2041.

~~In Rev. Rul. 79-353, 1979-2 C.B. 325, the settlor of a funded irrevocable trust retained the power to remove the corporate trustee and to substitute another corporate trustee. The settlor could not appoint himself as trustee. The trustee had broad discretion to distribute trust income and principal among the settlor's children. The IRS ruled that the settlor's power to remove and replace the corporate trustee was tantamount to the settlor's directly retaining all of the trustee's powers. Under the facts of the ruling, those powers were broad, the trust was therefore includible in the settlor's gross estate under I.R.C. §§ 2036 and 2038. Rev. Rul. 79-353 does not apply, however, to a transfer or addition to a trust made before October 29, 1979 (the publication date of Rev. Rul. 79-353), if the trust was irrevocable on October 28, 1979. Rev. Rul. 81-51, 1981-1 C.B. 458.~~

~~In the opinion of most estate planners, Rev. Rul. 79-353 was wrong. Nevertheless, the ruling raised serious questions about whether a settlor should retain the right to remove and replace a trustee. In addition, the IRS took the position in letter rulings that the theory of Rev. Rul. 79-353 also applied in the context of I.R.C. §§ 2041 and 2042. That is, if a beneficiary had the right to remove and replace a trustee, the beneficiary would be deemed to have the powers of the trustee. Therefore, the beneficiary would have a general power of appointment over the trust unless the trustee's discretion to distribute to the beneficiary was limited by an ascertainable standard relating to the beneficiary's health, education, support, or maintenance. See Note on Use 17 and Ltr. Ruls. 8916032 and 8926066. Similarly, if the insured settlor of an irrevocable life insurance trust retained both the right to remove and to replace trustees, the insured settlor would be deemed to have the powers of the trustee, and therefore to have incidents of ownership in the life insurance policies held in the trust, causing estate taxation under I.R.C. § 2042(2). TAM 8922003.~~

~~The IRS's position in Rev. Rul. 79-353 was addressed by the tax court in *Estate of Wall v. Commissioner*, 101 T.C. 300 (1993). See also *Estate of Vak v. Commissioner*, 973 F.2d 1409 (8th Cir. 1992). In *Wall*, as in Rev. Rul. 79-353, the taxpayer created an irrevocable trust and retained the right to remove the trustee and appoint a successor, but the successor had to be a~~

~~corporate trustee. The court found the IRS's position in Rev. Rul. 79-353 to be "supported neither by cogent argument nor by cited cases supporting the conclusion reached," refused to follow the Revenue Ruling, and held that the trust was not includible in the decedent's gross estate because of her retained power to change trustees. In response to *Wall*, the IRS finally reversed its position, and issued Rev. Rul. 95-58, 1995-2 C.B. 191. That ruling revoked Revenue Rulings 79-353 and 81-51, and adopted the position that a settlor who possesses the power to remove the trustee and appoint a successor trustee who is not a related or subordinate party, as defined in I.R.C. § 672(e), will not be treated as possessing the discretionary powers of the trustee. The use of the "related or subordinate party" standard is curious, in that I.R.C. § 672(e), which defines this term, is an income tax section, not an estate tax section, and the IRS does not explain why that standard of independence should be used in this context. The IRS will apparently continue to take the position that the settlor should be treated as having the discretionary powers of the trustee if the settlor can remove the trustee and appoint a trustee other than the settlor, if the replacement trustee could be a related or subordinate party.~~

~~Rev. Rul. 95-58 does not deal with the issue of whether a trust *beneficiary* who has the power to change trustees will be treated as having the powers of the trustee, and therefore possibly having a general power of appointment. However, the logic of *Wall* should apply in that context as well, and the IRS has indicated in Ltr. Rul. 9607008 that it will apply the same standard to beneficiary powers to change trustees. That is, if the beneficiary may only appoint a trustee who is not a related or subordinate party, then the beneficiary will not be treated as having the powers of the trustee for purposes of applying I.R.C. § 2041.~~

[Tony asks: Should more of the remaining Note on Use be modified or deleted? Probably so, but perhaps a note should be added to any notes on the Life Insurance Trust forms.]

Rev. Rul. 95-58 also does not deal with the issue of whether, if the settlor of an irrevocable life insurance trust retains both the power to remove and to replace the trustee, the settlor will be deemed to have incidents of ownership in the life insurance policies held in the trust under I.R.C. § 2042. Again, the logic of *Wall* would seem to apply in this context, but there is not yet even a letter ruling applying the approach of Rev. Rul. 95-58 in the context of I.R.C. § 2042. Until there is some indication that the IRS will take the same approach for purposes of I.R.C. § 2042 as it does for purposes of I.R.C. §§ 2036 and 2038, it may be prudent not to give the settlor of an irrevocable life insurance trust both the power to remove and to replace trustees.

In view of the foregoing analysis of relevant authorities, it appears that generally in an irrevocable trust setting, the settlor's retention of power to remove a trustee should not run the risk of having the trust's assets be deemed to be included in the settlor's estate, while the settlor's retention of a power to replace a trustee would be fraught with much greater uncertainty and attendant risk. Accordingly, in the forms the process of changing trustees has been bifurcated through the use of separate "Removal of Trustee" and "Replacement of Trustee" provisions. In the case of the irrevocable life insurance trusts, on the basis of trying to maintain some flexibility for the settlor within the latitude apparently permitted by the foregoing authorities, the "Removal of Trustee" provisions provide that the settlor retains the

right to remove a trustee. However, in the “Replacement of Trustee” paragraphs, the language of those provisions only gives the power to replace a trustee to the beneficiaries. And, in the case of the Section 2503(c) Trust (Form 1610), neither the power to remove nor the power to replace a trustee has been included due at least in part to the additional uncertainty and perceived risk of the beneficiary being regarded as a settlor, should the trust be drafted to permit continuation after the beneficiary attains the age of 21 and elects not to terminate the trust. *See* Notes on Use 4 and 5 of Section 2503(c) Trust (Form 1610).

Because with few exceptions the trustee’s discretion to make distributions is limited by ascertainable standards in these forms, a beneficiary having the powers to remove and to replace trustees should not create a problem. However, if the attorney using these forms changes the distribution provisions so as to eliminate the ascertainable standards, then the beneficiaries’ powers to remove and to replace trustees should either be eliminated, or should be modified so as to fall within the safe harbor of Rev. Rul. 95-58, by requiring that the replacement trustee may not be a related or subordinate party. ~~Of course, the client may, in some cases, want to restrict the choice of successor trustees for non-tax reasons as well.~~

If the instrument creating a trust does not contain trustee removal provisions, the Colorado Uniform Trust Code contains a section which provides qualified beneficiaries removal alternatives, all of which involve the court. *See* C.R.S. § 15-5-706. *See also* C. Eyster and C. Stevens, “The Colorado Uniform Trust Code,” 48 *Colo. Law.* 36, 41 (March 2019).

* * *

- 22A) RESIGNATION: The 30-day notice is the default provision in the Colorado Uniform Trust Code. *See* C.R.S. § 15-5-705. The previous version of this provision provided that a resignation would be effective only upon the acceptance of appointment by a successor trustee. However, in most cases the occasion of a temporary vacancy would not be considered sufficient cause to require a trustee who wishes to resign to remain in office, especially since there are other events that may cause a temporary vacancy (*e.g.*, death or incapacity of the trustee).

* * *

- 25A) TRUSTEE’S DUTIES TO INFORM AND TO NOTIFY: Some practitioners may prefer to tailor these provisions, for the sake of brevity, or to limit “other qualified beneficiaries” to those who have attained 25 years of age, or for reasons discussed with the client regarding how much information the client wanted shared with qualified beneficiaries. For convenience, both the trust version and the will version of the provision are replicated below with bracketed citations to the Colorado Uniform Trust Code in italics. References to items which the statute requires to be included are indicated in ***bold italics***. *See* K. Millard, “The Trustee’s Duty to Inform and Report Under the Uniform Trust Code,” 40 *Real Property, Probate and Trust Journal* 373; *see also* C. Eyster and C. Stevens, “The Colorado Uniform Trust Code,” 48 *Colo. Law.* 36 (March 2019).

TRUSTEE’S DUTIES TO INFORM AND TO NOTIFY [Trust version]:

- a) After trustee acquires knowledge that the trust created under this instrument has become irrevocable, trustee shall keep the distributees and permissible distributees of trust income or principal, and other qualified beneficiaries who ~~request it~~ have sent the trustee a request for notice, reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests [§ 813(1)].
- b) Within 60 days after the date trustee acquires knowledge that the trust created under this instrument has become irrevocable, trustee shall notify the qualified beneficiaries of:
 - i) Settlor's identity [§ 813(2)(c)];
 - ii) The existence of the trust [§ 813(2)(c)], [§ 105(2)(h)];
 - iii) Trustee's acceptance of the trust [§ 813(2)(b)];
 - iv) Trustee's name, address, and telephone number [§ 813(2)(b)], [§ 105(2)(h)];
 - v) Their right to request portions of the trust instrument that describe or affect the requesting beneficiary's interest [§ 813(2)(c)]; and
 - vi) Their right to request reports as provided in paragraph __.__(Trustee's Duties to Report and to Respond) of this article [§ 813(2)(c)], [§ 105(2)(h)].
- c) Trustee shall notify the distributees and permissible distributees of trust income or principal, and other qualified beneficiaries who ~~request it~~ have sent the trustee a request for notice, in advance of any change in the method or rate of trustee's compensation [§ 813(2)(d)].

TRUSTEE'S DUTIES TO INFORM AND TO NOTIFY [Will version]:

- a) My trustee shall keep the distributees and permissible distributees of trust income or principal, and other qualified beneficiaries who ~~request it~~ have sent the trustee a request for notice, reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests [§ 813(1)].
- b) Within 60 days after accepting the trusteeship, my trustee shall notify the qualified beneficiaries of:
 - i) My identity as settlor of the trust [§ 813(2)(c)];
 - ii) The existence of the trust [§ 813(2)(c)], [§ 105(2)(h)];
 - iii) My trustee's acceptance of the trust [§ 813(2)(b)];
 - iv) My trustee's name, address, and telephone number [§ 813(2)(b)], [§ 105(2)(h)];
 - v) Their right to request portions of the trust provisions of my will that describe or affect the requesting beneficiary's interest [§ 813(2)(c)]; and
 - vi) Their right to request reports as provided in paragraph __.__(Trustee's Duties to Report and to Respond) of this article [§ 813(2)(c)], [§ 105(2)(h)].

- c) My trustee shall notify the distributees and permissible distributees of trust income or principal, and other qualified beneficiaries who ~~request it~~ have sent the trustee a request for notice, in advance of any change in the method or rate of my trustee's compensation [*§ 813(2)(d)*].

25B) TRUSTEE'S DUTIES TO REPORT AND TO RESPOND: Some practitioners may prefer to tailor these provisions, for the sake of brevity, or to limit "other qualified beneficiaries" to those who have attained 25 years of age, or for reasons discussed with the client regarding how much information the client wanted shared with qualified beneficiaries. For convenience, both the trust version and the will version of the provision are replicated below with bracketed citations to the Colorado Uniform Trust Code in italics. References to items which the statute requires to be included are indicated in ***bold italics***. See K. Millard, "The Trustee's Duty to Inform and Report Under the Uniform Trust Code," 40 *Real Property, Probate and Trust Journal* 373; see also C. Eyster and C. Stevens, "The Colorado Uniform Trust Code," 48 *Colo. Law.* 36 (March 2019).

TRUSTEE'S DUTIES TO REPORT AND TO RESPOND [Trust version]:

- a) At least annually and at the termination of the trust, trustee shall send to the distributees and permissible distributees of trust income or principal, and to other qualified beneficiaries who request it [*§ 813(3)(a)*], [***§ 105(2)(i)***], a report containing:
 - i) A list of the assets comprising the property of the trust, and if feasible, their respective market values [*§ 813(3)(a)(I)*], [*§ 813(3)(a)(II)*];
 - ii) The liabilities of the trust, if any [*§ 813(3)(a)(I)*];
 - iii) The trust's receipts and disbursements during the period covered by the report [*§ 813(3)(a)(I)*]; and
 - iv) The amount and source of trustee's compensation [*§ 813(3)(a)(I)*].
- b) If no cotrustee remains in office upon the occurrence of a vacancy in the trusteeship, the former trustee shall send a report as described in paragraph __.__(a) of this article to the distributees and permissible distributees of trust income or principal, and to other qualified beneficiaries who request it. Should the former trustee be deceased or incapacitated, the former trustee's legal representative may send the report [*§ 813(3)(b)*].
- c) Upon request of a qualified beneficiary, trustee shall:
 - i) Respond promptly with information related to the administration of the trust, unless unreasonable under the circumstances [*§ 813(1)*], [***§ 105(2)(i)***]; and
 - ii) Furnish promptly a copy of the portions of the trust instrument that describe or affect the requesting beneficiary's interest [*§ 813(2)(a)*].

TRUSTEE'S DUTIES TO REPORT AND TO RESPOND [Will version]:

- a) At least annually and at the termination of the trust, my trustee shall send to the distributees and permissible distributees of trust income or principal, and to other qualified beneficiaries who request it [§ 813(3)(a)], [§ 105(2)(i)], a report containing:
 - i) A list of the assets comprising the property of the trust, and if feasible, their respective market values [§ 813(3)(a)(I)], [§ 813(3)(a)(II)];
 - ii) The liabilities of the trust, if any [§ 813(3)(a)(I)];
 - iii) The trust's receipts and disbursements during the period covered by the report [§ 813(3)(a)(I)]; and
 - iv) The amount and source of my trustee's compensation [§ 813(3)(a)(I)].
- b) If no cotrustee remains in office upon the occurrence of a vacancy in the trusteeship, my former trustee shall send a report as described in paragraph __.__(a) of this article to the distributees and permissible distributees of trust income or principal, and to other qualified beneficiaries who request it. Should my former trustee be deceased or incapacitated, my former trustee's legal representative may send the report [§ 813(3)(b)].
- c) Upon request of a qualified beneficiary, my trustee shall:
 - i) Respond promptly with information related to the administration of the trust, unless unreasonable under the circumstances [§ 813(1)], [§ 105(2)(i)]; and
 - ii) Furnish promptly a copy of the portions of the trust provisions of my will that describe or affect the requesting beneficiary's interest [§ 813(2)(a)].

25C) TRUST SITUS: The information required in a trustee's notice of transfer of trust situs appears in C.R.S. 15-5-108(5). *See*, R. Schroer and M. Edwards, "Selecting a Trust Situs," 50 *Colo. Law.* 38 (October 2021). *See also*, C. Eyster and C. Stevens, "The Colorado Uniform Trust Code," 48 *Colo. Law.* 36 (March 2019).

DRAFTING DISTRIBUTION STANDARDS IN CHANGING TIMES

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INTRODUCTION

Below is a review of Colorado law, common law, the Restatement (Second) of Trusts, the Restatement (Third) of Trusts and the Uniform Trust Code regarding trustee discretion and distribution standards. Often, common terms are viewed differently under the various regimes. That being the case, what responsibility does the drafter have to try to ensure that the meaning contemplated by the drafter and the settlor is likely to be the same meaning attached to the words not only by a future trustee but also by any court that may be called upon to review the trustee's exercise of discretion? Should the drafter add a clause to the document explaining that it is the settlor's intent to have the terms interpreted as discussed under a particular regime, as in Restatement Third? What if the courts in that jurisdiction have not officially adopted the Restatement Third? What if the trust eventually changes situs to a jurisdiction regulated by the Uniform Trust Code or a jurisdiction with common law that interprets a particular distribution standard differently?

These materials include a discussion of topics such as: (1) the meaning of commonly used terms in trusts giving direction and discretion to trustees, (2) the meaning of expanded discretion, (3) whether a trustee must consider the other resources of a beneficiary before exercising discretion, and if so, what resources should be considered, (4) how to consider liabilities of the beneficiary and (5) when it is appropriate to use ascertainable standards to limit the trustee's discretion. In addition to the information provided in these materials, a trustee should consider all relevant circumstances before making a discretionary distribution, including the trust terms, intent of the settlor, and general fiduciary duties such as the duty of impartiality and the duty of loyalty.

Case law is cited throughout these materials to support the general rules regarding the meaning of trust language. It is important to keep in mind that every instrument is different. In most cases, the Courts will also consider the intention of the settlor and whether the trustee is acting in a state of mind contemplated by the settlor.

SPECIFIC TRUST TERMS

“SUPPORT, MAINTENANCE AND HEALTH”

Generally, under all the various authority a court may consider, “support” and “maintenance” are considered synonymous and typically mean the distributions necessary to maintain the beneficiary in the beneficiary’s accustomed standard of living. The Third Restatement includes examples of appropriate expenses that can be paid under a support standard, such as regular mortgage payments, property taxes, suitable health insurance or care, existing programs of life and property insurance, and continuation of accustomed patterns of vacation and of charitable and family giving.

Pursuant to the Third Restatement, “support and maintenance” generally includes support of members of the beneficiary’s household and the costs of a suitable education for the beneficiary’s children. The standard also includes reasonable amounts for the support of a current spouse and minor children that reside elsewhere, but for whom the beneficiary either chooses to support or is required to support. Support for a former spouse would usually be within the trustee’s discretion. Pursuant to common law, support of the beneficiary’s family members is likely appropriate. One case held that support of a spouse following a divorce (alimony) was not an appropriate trust distribution, but continued support of the minor child from the trust was appropriate because the child was still a family member.

Generally, the term “health” does not add anything to the terms “support and maintenance,” because the money necessary for the beneficiary’s healthcare is typically included under “support and maintenance.”

Colorado Law

- The Trustee was granted discretion to provide for the comfortable support, medical care, and other benefits of settlor’s spouse and to provide settlor’s spouse with the standard of living to which he was accustomed. Such language was determined to mean maintaining the surviving spouse’s standard of living based upon the years that the spouses were together. *Goss v. McCart*, 847 P.2d 184 (Colo. App. 1992).

Common Law - General

- “Support” means to allow the beneficiary to live in his or her customary lifestyle or station in life. *Hartford-Connecticut Trust Co. v. Eaton*, 36 F.2d 710 (2d Cir. 1929).

- "Health, maintenance and support" means the beneficiaries' standard of living at the time of the testator's death. *Barnett Banks Trust Co. v. Herr*, 546 So.2d 755 (Fla.App.1989).
- "Comfortable support and maintenance" means maintaining the beneficiary in accordance with his or her standard of living when he or she became a beneficiary of the trust. *Marsman v. Nasca*, 30 Mass. App.Ct. 789, 573 N.E.2d 1025, review denied, 411 Mass. 1102, 579 N.E.2d 1361 (1991).
- Including the word "necessary" before "support, care and health" does not mean that the beneficiary's assets must be depleted before making a distribution. *Estate of Lindgren*, 268 Mont. 96, 885 P.2d 1280 (1994).
- Distributions for "needs and necessities" refer to what might be reasonably necessary to meet the personal needs of the beneficiary in his accustomed standard of living at the time of the death of the testatrix. *Amoskeag Trust Co. v. Wentworth*, 99 N.H. 346, 111 A.2d 198 (1955).
- Distributions were authorized "to meet such need or needs of my daughter." Need was interpreted to mean the beneficiary's health, maintenance, and support consistent with the beneficiary's accustomed manner of living. Distributions for the beneficiary's investment purposes were not appropriate. *Wright v. Trust Company Bank of Nw. Ga.*, 260 Ga. 414, 396 S.E.2d 213 (1990).
- Distributions for "living expenses" included distributions of principal for property taxes and premiums for fire and liability insurance for the house which was devised to the beneficiary by the testator if her income from the estate is not sufficient. *Orange First Nat. Bank v. Preiss*, 2 N.J.Super. 486, 64 A.2d 475 (Ch. 1949).
- "Support and maintenance" does not include amounts to augment beneficiary's estate. *In re Ward's Estate*, 342 Mich. 172, 69 N.W.2d 187 (1955).
- Beneficiary had the right in his absolute discretion to use any part or all of the principal of the trust for his own use and maintenance. This did not permit him to invade the trust and transfer the assets to another trust. *Matter of Estate of Watts*, 167 A.D.2d 725, 562 N.Y.S.2d 888 (1990).

Common Law - Support of Surviving Spouse:

- In the case of a surviving spouse, the appropriate standard is what the beneficiary was accustomed to while living with the testator. *Barnett Banks Trust Co. v. Herr*, 546 So.2d 755 (Fla.App.1989).
- When examining the life of the testator and surviving spouse, the Court considered the testator's frugal tendencies during the period from the execution of his will until his death. *Hicks v. Jones*, 138 N.J.Eq. 280, 47 A.2d 894 (1946).
- Distributions of principal and income for "care, support, comfort and welfare" required trustees to pay attorney's fees for defense of criminal charges against beneficiary's wife, because a husband is bound to provide necessaries for his wife. *Citizens and Southern Nat. Bank v. Orkin*, 223 Ga. 385, 156 S.E.2d 86 (1967).
- "Necessary for the benefit of my wife" refers to what is necessary to the wife's accustomed way of living and payments made to contribute to the wife's

happiness and peace of mind were not intended. *Orr v. Moses*, 94 N.H. 309, 52 A.2d 128 (1947).

Common Law - Support of those dependent on the beneficiary:

- Beneficiary's children were sick and distributions for "sickness or other misfortune" included distributions due to the sickness of beneficiary's children. *Garvey v. Garvey*, 150 Mass. 185, 22 N.E. 889 (1889).
- Necessary for "support and maintenance" included distributions for the wife and minor children of the beneficiary. *In re Sullivan's Will*, 144 Neb. 36, 12 N.W.2d 148 (1943).
- Distributions for the "sole benefit" of son for "support, care, and maintenance" included distributions to wife and minor children of son (who was insane). *Gardner v. O'Loughlin*, 76 N.H. 481, 84 A. 935 (1912).
- College education of the beneficiary's children was included in a support standard. *First Nat. Bank of Beaumont v. Howard*, 149 Tex. 130, 229 S.W.2d 781 (1950).
- All income was to be distributed to beneficiary and under such direct and unequivocal language, this did not include the payment of some portion of the income to the beneficiary's former wife and child. *Burrage v. Bucknam*, 301 Mass. 235, 16 N.E.2d 705 (1938).
- Distributions permitted for "beneficiary's needs." Support payments to former wife were not included because divorce severed her relationship as a family member. Child was included because even if there is a divorce and loss of custody, the child is still a family member. *Eaton v. Eaton*, 82 N.H. 216, 132 A. 10 (1926).
- Support payments authorized for "children" may be made to the children who remained in the parental home as members of the widow's family and who may be dependent (because of physical or mental affliction), regardless of age. *Citizens' Bank of Lancaster v. Foglesong*, 326 Mo. 581, 31 S.W.2d 778 (1930).
- "Support and education of children" included children as long as they needed to be educated and lived with the beneficiary. *Easton v. Demuth*, 179 Mo.App. 722, 162 S.W. 294 (1913).
- If the trust document is silent regarding the use of trust income for a child's support, the child's resources can be expended only if the parents cannot meet their obligation to provide for the child's basic needs. There are only two circumstances in which resort to the child's estate may be proper; when it is authorized by the instrument creating the estate and where it is authorized by statute. *Armstrong v. Armstrong*, 15 Cal.3d 942, 126 Cal.Rptr. 805 (1976).
- The trustee "shall use a sufficient amount of the income to provide for the grandchild's support, maintenance and education. . ." was considered a mandatory direction to the trustee to use the income for the support, maintenance and education of the minor children regardless of parental obligation of support. *McElrath v. Citizens & Southern National Bank*, 229 Ga. 20, 189 S.E.2d 49 (1972).

- A minor child is to be maintained by the parents in a manner consistent with their standard of living. *Singer v. Singer*, 7 Cal.App.3d 807, 87 Cal.Rptr. 42 (1970).

Restatement (Second) of Trusts

- §128, comment e: When the trustee has discretion to pay so much of the income or principal for the education or support of the beneficiary, the beneficiary cannot compel the trustee to pay to him or to apply for his benefit more than the trustee in the exercise of a sound discretion deems necessary for his education or support.
- §128, comment i: The interpretation of the word "support" regarding distributions of principal depends on the trust language and may range from only the sums the trustee reasonably believes to be necessary for his support or the trustee may be authorized to require the payment of all of the principal without any limitation on the power.

Restatement (Third) of Trusts

- § 50, comment d(2): "Support" and "maintenance" are synonymous. They refer to maintaining the manner of living that was ordinarily enjoyed by the beneficiary at the time of the settlor's death or at the time an irrevocable trust is created. The distributions may increase for inflation and subsequent increases in needs resulting from situations such as deteriorating health or added burdens from the needs of another. An increase in distributions may be appropriate in light of the productivity of the trust and if otherwise the remainder beneficiaries would benefit over the current beneficiary to an extent not intended by the settlor.
- Examples of appropriate expenses are regular mortgage payments, property taxes, suitable health insurance or care, existing programs of life and property insurance, and continuation of accustomed patterns of vacation and of charitable and family giving. A special vacation of the type not normally taken by the beneficiary may be borderline, even with the grant of extended discretion.
- Support and maintenance do not include payments to enlarge the beneficiary's estate or enable the giving of extraordinary gifts.
- Support and maintenance generally includes support of members of the beneficiary's household and the costs of a suitable education for the beneficiary's children. Also includes reasonable amounts for the support of a current spouse and minor children that reside elsewhere but for whom the beneficiary either chooses to support or is required to support. Support for a former spouse would usually be within the trustee's discretion.
- Comment d(3): Terms such as health and medical care without elaboration provide for the same health and medical benefits that would be appropriate under a support standard.
- §50, comment e(3): In regard to a child, the presumption is that the trustee should take into account the parental duty to support the child under state law. If the trustee makes a distribution for the benefit of the child, it is really benefiting the parent. The trustee may exercise discretion to distribute for benefits that fall

outside the parental obligations. This is particularly the case if the parent is a trustee or co-trustee. This is also to avoid potential tax consequences to the parent as trustee (which is discussed elsewhere in these materials). This presumption is not applicable if the child's only parent is a widow or a widower at the time the trust is created and the settlor's intention determined through interpretation is that the beneficiary's full support come from the trust, and thus to assist and benefit the parent directly. An exception to these principles is parental support obligations that result from the adoption of a discretionary beneficiary after the creation of the trust. The presumption is the opposite - the trustee should not consider these parental obligations for a number of reasons. In this situation, the settlor likely intended that the trust would provide for the beneficiary's support and other needs through the period of the trust, and the trust terms should no have the effect of discouraging any adoption by imposing what might be prohibitive, added financial burden on a potential adoptive family. This presumption is rebuttable and would not apply if the adopted child subsequently inherits property or become a trust beneficiary. In this case, there would be no inference that the settlor's purpose was to meet the child's basic support requirements or to assist the adoptive family.

Uniform Trust Code

- Nothing directly on point.

"EDUCATION"

Pursuant to common law, the definition of "education" varies from being lifelong or limited only to the education of a minor. While the Second Restatement tends to follow the trustee's own particular determination of what is "education," no matter whether broad or restrictive, the Third Restatement specifically includes higher education as well as payment of living expenses and costs while in school in its definition of "education." As with all discretionary standards, the breadth of the term "education" depends on which authority the court relies upon and the circumstances of each case.

Colorado Law

- Nothing directly on point.

Common Law

- Education does not extend to an adult obtaining further education. *New Britain Trust Co. v. Stoddard*, 120 Conn. 123, 179 A. 642 (1935). In *New Britain*, a trust was created when the children were ages two and four and vested in the children's mother "to best assist in the education of my grandsons." The Court held that it is not appropriate to make distributions once the grandsons were no longer under parental control. The children were twenty-nine and twenty-seven years old at the time in question.

- In *Lanston v. Children's Hospital*, 148 F.2d 689 (D.C.Cir.1945), it was within the Trustee's discretion to distribute for education and the trustee declined to do so. The Court said the declination was justified. The beneficiary was forty-two years old, well educated and had a large income.
- Distributions were allowed to "defray the reasonable expense of a college education" and this language was held to allow the invasion of corpus to pay for high school because high school was preparation for college. *Security Trust Co. v. Smith*, 284 Ky. 611, 145 S.W.2d 512 (1940)
- In *Epstein v. Kuvin*, 25 N.J.Super. 210, 95 A.2d 753 (1953), education only included a bachelor's degree and not medical school.
- Distributions for "the proper education of my brother" were considered to be lifelong. *In re Wolfe's Estate*, 164 Misc. 504, 299 N.Y.S. 99 (Sur. Ct. 1937).
- "Support" included education of a minor. *In re Wells' Will*, 165 Misc. 385, 300 N.Y.S. 1075 (Sur. Ct. 1937).

Restatement (Second) of Trusts

- §128, comment e: When the trustee has discretion to pay so much of the income or principal for the education or support of the beneficiary, the beneficiary cannot compel the trustee to pay to him or to apply for his benefit more than the trustee in the exercise of a sound discretion deems necessary for his education or support.

Restatement (Third) of Trusts

- § 50, comment d(3): Education generally includes the payment of living expenses as well as fees and other costs of attending an institution of higher education, or the beneficiary's pursuit of a program of trade or technical training, as may be reasonably suitable to the individual and to the trust funds available for that purpose.

Uniform Trust Code

- Nothing directly on point.

"COMFORT"

"Comfort" is generally a broader term than "support," although some courts have interpreted it to be similar to "support and maintenance." Pursuant to the Third Restatement, if the beneficiary's lifestyle was already comfortable, then "comfort" adds nothing to the standard of support. Specifically, "generous" support may be broader than "support".

Colorado Law

- Nothing directly on point.

Common Law

- Generally, "comfort" means that the settlor intended to provide for the maintenance of the beneficiary in the social and economic position in which he or she had been living at the time of the creation of the trust. *Amoskeag Trust Co. v. Wentworth*, 99 N.H. 346, 111 A.2d 198 (1955) and also see *Rock Island Bank & Trust v. Rhoads*, 353 Ill. 131, 187 N.E. 139 (1933).
- Where settlor was well-to-do, "comfort" was considered to mean more than the necessities of life. *Gulf Nat. Bank v. Sturtevant*, 511 So.2d 936 (1987).
- "Comfort" is defined as 'a state of tranquil or moderate enjoyment, resulting from the satisfaction of bodily wants and freedom from care or anxiety; a feeling or state of well-being, satisfaction, or content.' *Equitable Trust Co. v. Montgomery*, 28 Del.Ch. 389, 44 A.2d 420 (1945).
- "Comfort" is broader than necessity. *Estate of Curtis*, 253 Wis. 119, 33 N.W.2d 193 (1948).

Restatement (Second) of Trusts

- Nothing directly on point.

Restatement (Third) of Trusts

- § 50, comment d(3): Comfort adds nothing to the usual standard of support for a beneficiary whose lifestyle is reasonably comfortable. It may elevate the standard of living for a beneficiary whose standard is modest. "Generous" support may imply something more than a support standard but falls short of "happiness."

Uniform Trust Code

- Nothing directly on point.

"BENEFIT, HAPPINESS, WELFARE AND CONVENIENCE"

"Benefit" and "happiness" grant the broadest discretion compared to the other terms discussed in these materials. A trustee may even be able to terminate a trust if granted discretion to distribute for the benefit of a beneficiary, according to a Rhode Island court.

According to Restatement Third, "happiness" is so broad it will likely protect the trustee from challenge by a remainder beneficiary for almost any reasonably affordable distribution. Even so, a Delaware court in 1984 held that the addition of the word "benefit" to a support standard did not justify a request for a \$4.5 million personal jet. Would that request be viewed differently today?

Colorado Law

- Nothing directly on point.

Common Law

- "Happiness" is a broader standard than "support and maintenance." *Merchants Nat. Bank v. C.I.R.*, 320 U.S. 256, 64 S.Ct. 108 (1943) and *Combs v. Carey's Trustee*, 287 S.W.2d 443 (Ky.1955).
- "As she may desire" and "comfort" is broader than necessity. *Estate of Curtis*, 253 Wis. 119, 33 N.W.2d 193 (1948).
- "Benefit" is broader than what is required for support. *In re Rachlin's Will*, 133 N.Y.S.2d 151 (1954).
- "Convenience" of the beneficiary is a broader standard than support and includes freedom from difficulty, trouble or annoyance and whatever promotes ease or advantage. *Boston Safe Deposit & Trust Co. v. Stebbins*, 309 Mass. 282, 34 N.E.2d 616 (1941).
- Trustee was authorized to make whatever payments they deem wise, whether because of "insufficiency of income personal need or otherwise." "Or otherwise" was considered to enlarge the possible circumstances to include every conceivable situation outside those stated. *In re Bisconti's Will*, 306 N.Y. 442, 119 N.E.2d 34 (1954).
- "Or otherwise for his benefit" was enough to allow the trustee to pay over the entire trust principal in one payment. The trustee was also granted the authority to exercise his discretion in his sole and uncontrolled judgment. *Lees v. Howarth*, 85 R.I. 321, 131 A.2d 229 (1957).
- "Comfort, maintenance, support and general well being" would allow payments to permit beneficiary to make gifts for tax purposes. *Estate of Hartzell v. C.I.R.*, T.C. Memo. 1994-576.
- The addition of "benefit" to a support standard did not include a request for a \$4.5 million personal jet plane. *Stuart v. Wilmington Trust Co.*, 474 A.2d 121 (Del.1984).
- Distribution for gift to charity was not included under "benefit," even when the trustee had "sole absolute and unimpeachable discretion." The testator had included charitable gifts in his will and therefore, his intent was not to have the distributions to his wife then go to charity. *In re Estate of May*, 112 N.Y.S.2d 847 (Sur. Ct. 1952), *aff'd*, 283 A.D. 786, 129 N.Y.S.2d 229 (1954).
- Widow remarried and expenses of their common life were covered when the widow was permitted to use the property for her "benefit," which is a broader term than support. *Colburn v. Burlingame*, 190 Cal. 697, 214 P. 226 (1923).
- For a discussion of words such as "benefit," "comfort" and "happiness" on the effectiveness of the ascertainable standards for tax purposes, see the section on ascertainable standards.

Restatement (Second) of Trusts

- Nothing directly on point.

Restatement (Third) of Trusts

- § 50, comment d(3): The terms "benefit" and "welfare" imply something beyond a support standard. Although "benefit," "welfare," and "happiness" may imply something beyond support, they are less objective standards of support and may

inhibit the ability of a beneficiary to compel a distribution. "Happiness" implies that the trustee's discretion should be exercised generously. Happiness may protect the trustee from challenge by remainder beneficiaries for almost any reasonably affordable distributions. The trustee can still resist a request from a beneficiary because the distribution is in the trustee's discretion.

Uniform Trust Code

- Nothing directly on point.

RESTRICTIVE TERMS ("EMERGENCY" AND "HARDSHIP")

Terms such as "emergency" and "hardship" tend to be a more restrictive grant of discretion as compared with a support standard. Generally, "emergency" is limited to something that was unexpected or unforeseen.

Colorado Law

- Nothing directly on point.

Common Law

- Living expenses for a college student were not considered an "emergency" or "hardship." *Griffin v. Griffin*, 463 So.2d 569 (Fla.App.1985).
- "Emergency" is a restrictive term. *Warner v. Trust Company Bank*, 250 Ga. 204, 296 S.E.2d 553 (1982).
- "Emergency" is an unexpected happening which calls for immediate action. *In re Tone's Estate*, 240 Iowa 1315, 39 N.W.2d 401 (1949), *Sowell's Estate v. C.I.R.*, 708 F.2d 1564 (10th Cir. 1983) and *Hunter v. U.S.*, 597 F.Supp. 1293 (WD Pa. 1984).
- "Sickness or other casualty" was considered a limitation to something unforeseen. *Pyne v. Payne*, 152 Neb. 242, 40 N.W.2d 682 (1950).
- In a matter with a self-settled trust where settlor was also the life beneficiary, "emergency" was considered broadly to include some basic source of livelihood. *Application of Sabol*, 20 Misc.2d 112, 191 N.Y.S.2d 773 (Sup.Ct.1959).

Restatement (Second) of Trusts

- Nothing directly on point.

Restatement (Third) of Trusts

- §50, comment d(4): Terms such as "emergency," "severe hardship," and "disability" authorize distributions only when the described conditions or circumstances arise, and then only to the extent appropriate to alleviate the emergency, hardship or special need.

Uniform Trust Code

- Nothing directly on point.

TRUSTEE'S CONSIDERATION OF OTHER RESOURCES

DUTY TO CONSIDER OTHER RESOURCES OF THE BENEFICIARY:

In Colorado, if the distributions are limited to the beneficiary's needs, the implication is that the beneficiary's other resources should be considered before the trustee exercises discretion. Surprisingly, the Second Restatement is more liberal on this topic from the beneficiary's perspective than the Third Restatement. The Second Restatement infers that the beneficiary's other resources do not need to be considered. The Third Restatement advocates the opposite. Pursuant to common law, the cases run the gamut from requiring the trustee to consider other resources to directing the trustee not to consider other resources.

Colorado Law

- The trustee had discretion to distribute "as may be necessary to provide him with the necessities of life." The trustee was required to consider other resources. *Dunklee v. Kettering*, 123 Colo. 43, 225 P.2d 853 (1950).

Common Law - Trustee required to consider the beneficiary's other resources:

- The Trustee may consider beneficiary's income, but not the beneficiary's non-income producing assets. *Barnett Banks Trust Co. v. Herr*, 546 So.2d 96 (Fla.App.1989).
- Trustee should consider other resources before making a distribution of principal. The trustee had discretion to distribute principal for the beneficiary's "needs, cares and comforts." Settlor's intent was to preserve the corpus for the remaindermen unless it was called upon for his daughter's needs. *In re Ferrall's Estate*, 41 Cal.2d 166, 258 P.2d 1009 (1953).
- In determining a beneficiary's "need" or "emergency," the trustee has a duty to consider undisclosed assets which are not reasonably required to maintain the beneficiary's standard of living. *Austin v. U.S. Bank of Washington*, 73 Wash.App. 293, 869 P.2d 404 (1994).
- The trustee should consider all surrounding circumstances before making a distribution, including what resources the beneficiary may have for her support. *Hanford v. Clancy*, 87 N.H. 458, 183 A. 271 (1936).
- Distributions were permitted for the beneficiary's "personal necessities and needs." Other resources of the beneficiary should be considered. *Amoskeag Trust Co. v. Wentworth*, 99 N.H. 346, 111 A.2d 198 (1955).
- Other resources should be considered if the discretionary standard includes the language "if necessary." *Emmert v. The Old Nat. Bank of Martinsburg*, 162 W.Va. 48, 246 S.E.2d 236 (1978).
- The separate income of the beneficiary (and the income from the trust) is to be considered unless the language of the trust indicates otherwise. The trust language granted the trustee the discretion to distributed as "necessary for her support, health and maintenance." Before making a distribution, the trustee must consider separate income, but the exhaustion of beneficiary's separate estate was

not necessary. *Sibson v. First Nat. Bank & Trust Co.*, 61 N.J.Super. 88, 160 A.2d 76 (Ch.), modified, 64 N.J.Super. 225, 165 A.2d 800 (App.Div.1960).

Common Law - Trustee required or allowed to disregard the beneficiary's other resources:

- Trustee had discretion to make distributions "as may be necessary for her [the surviving spouse's] support, health and maintenance." Court found that the trustee was required to pay for the surviving spouse's support, health and maintenance irrespective of her independent income. The court stated that whether a trustee can consider the personal income of a beneficiary depends on the trust language and the surrounding circumstances. *Godfrey v. Chandley*, 248 Kan. 975, 811 P.2d 1248 (1991).
- Trustee allowed to disregard the beneficiary's other resources despite the word "necessary" in provision for support of spouse because the testator's intent was to provide for the surviving spouse's total care from the time of his death until her death. *Estate of Lindgren*, 268 Mont. 96, 885 P.2d 1280 (1994).
- The trustee was not required to consider the personal income of the beneficiary when distributions were to be made for her "benefit." *In re Rachlin's Will*, 133 N.Y.S.2d 151 (1954).
- Whether to consider individual resources depends on the intent of the settlor. In this case, the "comfortable support and maintenance" of the beneficiaries was considered an absolute gift. *Hoops v. Stephan*, 131 Conn. 138, 38 A.2d 588 (1944).
- Trustee authorized to make distributions of principal for surviving spouse's comfortable support and care in sickness and health if trust income is not sufficient. Provisions that benefit a surviving spouse should be construed liberally. The sources of the widow need not be considered. *In re Leonard's Estate*, 115 Vt. 440, 63 A.2d 179 (1949).

Common Law - Trustee has discretion to choose whether to consider the other assets.

- Trustee had discretion to distribute principal for health, education, maintenance and support as necessary or advisable and could consider the private income of the beneficiary. *Hertell v. Nationsbank, N.A.*, 37 S.W.3d 408 (Mo.App.E.D. 2001).
- Trustee did not abuse discretion to inquire about beneficiary's other income before exercising discretion to invade principal. *NCNB Nat. Bank v. Shanaberger*, 616 So.2d 96 (Fla.App.1993).
- It is within the trustee's discretion whether to consider the beneficiary's other resources. *In re Davis' Will*, 195 Misc. 213, 88 N.Y.S.2d 192 (Sur. Ct. 1949).

Common Law - Duty to inquire about other resources

- Trustee has a duty to inquire into the beneficiary's standard of living and to inform the other beneficiaries about the invasion of principal. *Feibelman v. Worthen Nat. Bank*, 20 F.3d 835 (8th Cir. 1994).

- Trustee is entitled to beneficiary's financial statements where the testator's intention was that the beneficiary's other resources be considered before making discretionary distributions. *Matter of Estate of Winston*, 205 App. Div. 2d 922, 613 N.Y.S.2d 461 (1994).
- Trustee should inquire into financial circumstances of all discretionary beneficiaries before making distributions to one. *Estate of Winograd*, 65 Ohio App.3d 76, 582 N.E.2d 1047 (1989).
- A trustee must make an independent determination of a beneficiary's need and not rely solely on the beneficiary's representation. *In re Murray*, 142 Me. 24, 45 A.2d 636 (1946).

Restatement (Second) of Trusts

- §128, comment e: It is a question of interpretation but the inference is that the beneficiary is entitled to support out of the trust funds even though he has other resources.

Restatement (Third) of Trusts

- §50, comment e:
 - a. When the trust terms are silent: The overall presumption is that the trustee is to take the beneficiary's other resources into account in deciding whether to make a discretionary distribution, unless the settlor's intent will be better accomplished by not doing so. One qualification is that if the beneficiary is entitled to mandatory distributions of income, etc. then such mandatory distributions must be taken into account before considering additional discretionary distributions. Also, if the beneficiary is entitled to payments from another trust with the same settlor or as part of a coordinated estate plan with another, the trustee should take into consideration the required distributions from the other trust and the purposes of both trusts before making a discretionary distribution. In addition, if the discretionary distributions are intended to provide for the support, education or health care of the beneficiary for periods in which the beneficiary was not expected to be self-supporting, then the inference is that the trustee should not deny discretionary distributions. When there are nonobjective standards such as "benefit" and "happiness," other resources have less direct relevance than with an objective support standard but other resources may have a bearing on the overall reasonableness of the exercise of discretionary authority.
 - b. When the trust terms expressly state or imply whether to take other resources into account: A statement such as "only if and as needed" to maintain an accustomed standard of living, suggests that the trustee should take other resources into account. However, the phrase "necessary for support" does not alone imply the trustee should consider other resources.
 - c. The grant of extended discretion does not necessary imply one way or the other but may suggest that the trustee has greater latitude in exercising discretion.

Uniform Trust Code

- Nothing directly on point.

WHAT RESOURCES SHOULD BE CONSIDERED?

If other resources are to be taken into account, depending on the circumstance, the trustee should consider the beneficiary's independent income, annuity payments, court-ordered support payments, income payments from the trust and/or the principal of the beneficiary's estate. Some courts have held that the beneficiary is not required to liquidate other assets before receiving discretionary distributions. However, some courts have held that a beneficiary must exhaust all assets before receiving discretionary distributions.

Colorado Law

- Nothing directly on point.

Common Law

- Beneficiary was required to use at least some of his or her independent income. *In re Murray*, 142 Me. 24, 45 A.2d 636 (1946) and *Offutt v. Offutt*, 204 Md. 101, 102 A.2d 554 (1954).
- Beneficiary's annuity was considered as a resource. *Smith v. Gillikin*, 201 Va. 149, 109 S.E.2d 121 (1959).
- Income from the trust itself should be considered. *Sibson v. First National Bank & Trust Co.*, 61 N.J.Super. 88, 160 A.2d 76 (Ch.), modified, 64 N.J.Super. 225, 165 A.2d 800 (App.Div.1960)
- Beneficiary is not required to liquidate other assets:
 - The trustee was required to consider other income but the beneficiary was not required to liquidate non-income producing assets. *Barnett Banks Trust Co. v. Herr*, 546 So.2d 96 (Fla.App.1989).
 - The decedent did not intend for the beneficiary to liquidate her other assets. Beneficiary should not have to sell or lease her property. *In re Patten's Estate*, 217 Cal.App.2d 167, 21 Cal.Rptr. 767 (1963).
- The intention of the settlor and surrounding circumstances may allow the trustee to consider not only the income of the beneficiary, but the personal estate of the beneficiary before making a discretionary distribution. *Lumbert v. Fisher*, 245 Mass. 190, 139 N.E. 446 (1923) and *In re Willey's Estate*, 139 N.J.Eq. 118, 48 A.2d 789 (1946).
- Requirement that personal assets be depleted did not mean exhausted. *In re Woods's Trust Estate*, 181 Kan. 271, 311 P.2d 359 (1957).
- Trustee granted discretion to distribute principal if necessary for the surviving husband's comfortable maintenance and support. The remainder was to pass to the decedent's brothers. The trustee was not permitted to make distributions of principal unless the surviving husband's personal assets were exhausted. If the surviving husband was permitted to receive distributions, then the trust created

by his first wife would allow him to preserve his estate for his second wife instead of the decedent's brothers when his estate passed to his second wife upon his death, frustrating the settlor's intent. *Matter of Hogeboom*, 219 A.D. 131, 219 N.Y.S. 436 (1927).

Restatement (Second) of Trusts

- Nothing directly on point.

Restatement (Third) of Trusts

- §50, comment e(2): The resources to be considered normally include the beneficiary's income and other periodic payments, such as a pension, annuity or court-ordered support payments. Depending on the terms and purposes of the discretionary power, other purposes of the trust, the settlor's relationships and objectives with respect to the all the beneficiaries of the trust, the trustee may have a duty to take into account the principal of the beneficiary's personal estate. The trustee should also consider the income, estate and other tax purposes of the trust and the liquidity of the discretionary beneficiary's assets.

Uniform Trust Code

- Nothing directly on point.

UNEMPLOYED OR UNDEREMPLOYED BENEFICIARY

A question arises when the trustee should consider the independent income of the beneficiary before making a discretionary distribution. What if the beneficiary is unemployed or underemployed? Should this be considered before making a discretionary distribution? According to the Third Restatement, it depends on the circumstances.

Restatement (Third) of Trusts

- §50, comment e(5): The scenario of the unemployed or underemployed beneficiary cannot be properly addressed by rules of construction or constructional preferences. Therefore, absent some guidance from the settlor, this is determined on a case-by-case basis.

LIABILITIES OF THE BENEFICIARY

The trustee should consider whether the beneficiary has any creditors that will be entitled to the distribution before exercising discretion to make a distribution.

Restatement (Third) of Trusts

- §50, comment e(5): Discretionary distributions to an insolvent beneficiary would likely run afoul of the settlor's purposes and may violate the duty of impartiality to the other beneficiaries. The duty may depend on the identity of the creditor.

For example, whether the creditor is a person whose needs the settlor would normally expect to be met, albeit indirectly, by distributions to the beneficiary.

TAX CONSIDERATIONS

In considering the intent of the settlor and the meaning of discretionary distribution standards, various tax considerations may be appropriate. For example, the courts may consider the overall tax purposes of the trust and the tax ramifications related to the distribution.

Common Law

- "Comfort, maintenance, support and general well being" would allow payments to permit beneficiary to make gifts for tax purposes. *Estate of Hartzell v. C.I.R.*, T.C. Memo. 1994-576.

Restatement (Third) of Trusts

- §50, comment e(5): Discretionary distributions to beneficiaries purely for tax reasons under a flexible power. This may require careful consideration of the other resources of all of the beneficiaries, as well as their income tax and estate tax positions, the tax circumstances of the trust, and the underlying purposes of the settlor.
- §50, comment g(2): An understanding of the trust's underlying purposes in the estate planning context, including the settlor's intentions regarding tax planning, is important in resolving issues of interpretation.

EFFECT OF EXPANDED DISCRETION ("sole, absolute, unlimited and uncontrolled")

Generally, the grant of extended discretion does not relieve the trustee from acting in good faith and in a state of mind contemplated by the settlor. Also, the trustee cannot act dishonestly or from an improper motive. Pursuant to the Second Restatement, the grant of expanded discretion eliminates the need for the trustee to act reasonably. The Third Restatement does not go as far to say that expanded discretion dispenses with the standard of reasonableness, but states that it simply gives the trustee more latitude.

Colorado Law

- The trustee was granted discretion in its "sole judgment" to sell trust property. The trustee did not have unlimited or absolute discretion, as he must still act reasonably and within the bounds of prudent judgment. Even if the trustee was expressly granted absolute and uncontrolled discretion, the trustee cannot act recklessly or with a willful abuse of discretion. *Rippey v. Denver U.S. Nat. Bank*, 273 F.Supp. 718, 736 (D.Colo 1967).

Common Law

- Decision of trustee to determine values of property was “final and conclusive” but such language does not prevent the trustee from having to act in good faith and with fidelity to the trust. *In re Wickman's Will*, 289 So.2d 788 (Fla.App.1974).
- Trustee granted discretion to make distributions that they in their “absolute discretion think proper” for support and maintenance. It was considered an abuse of discretion not to distribute to the beneficiary in need of the necessities of life, including food, clothes, housing and medical expenses. Even though there is absolute discretion granted, the trustee cannot pay less than a reasonable person could think necessary for the beneficiary's support. *Conlin v. Murdock*, 137 N.J.Eq. 12, 43 A.2d 218 (1945).
- The exercise of “uncontrolled discretion” still has to be in a state of mind contemplated by the testator and must be consonant with the testator's purpose. *In re Kaminester's Will*, 16 Misc.2d 1071, 184 N.Y.S.2d 237 (Sur. Ct. 1959).
- The trustee was directed to “expend so much of the net income and principal thereof for the comfortable maintenance, support and education of my said daughter as he . . . shall, in his . . . sole discretion, deem advisable. . .” “Sole” discretion does not mean absolute discretion because the testator also included the standard of “comfortable maintenance, support and education.” *Kolodney v. Kolodney*, 6 Conn.App. 118, 503 A.2d 625 (1986). See *Matter of Estate of Mayer*, 176 Misc.2d 562, 672 N.Y.S.2d 998 (Sur.Ct. 1998) for a similar conclusion.
- The terms “final” and “conclusive” do not vest an unlimited discretion in the trustee. The trustee must still act in a state of mind contemplated by the settlor. The state of mind of the settlor can be established by considering the circumstances both as to the estate and the parties existing when the will was made and when the testator died. *First Nat. Bank of Beaumont v. Howard*, 149 Tex. 130, 229 S.W.2d 781 (1950).
- Beneficiary's request for distribution is not enough to support the exercise of the trustee's “sole” or “uncontrolled” discretion. *In re Mendelson's Estate*, 391 Mich. 706, 220 N.W.2d 33 (1974).
- “Sole discretion” did not relieve the trustee from the reasonable exercise of discretion for the beneficiary's “comfort.” *Gulf Nat. Bank v. Sturtevant*, 511 So.2d 936 (Miss.1987).
- Even though a trustee is granted broad discretion, the trustee must not act in bad faith or dishonestly. *Caswell v. Lenihan*, 163 Ohio St. 331, 126 N.E.2d 902 (1955).
- In a trust which does not include standards, such as “maintenance and support” and distributions may be made as the trustee sees fit, the standard is one of reasonableness. *Rowe v. Rowe*, 219 Or. 599, 347 P.2d 968 (Ore. 1959).
- The trustee must exercise independent judgment and not blindly make a distribution when a beneficiary makes a request for such distribution, even if they are granted “absolute discretion.” *In re Murray*, 142 Me. 24, 45 A.2d 636 (1946).

- Trustee was granted “full and uncontrolled discretion,” which dispensed with the usual standard of reasonableness, consistent with §187 of the Restatement (Second) of Trusts, but the trustee cannot ignore the testator’s desire that the trust provide for the beneficiary’s support and maintenance (cannot fail to exercise judgment). *In re Sullivan’s Will*, 144 Neb. 36, 12 N.W.2d 148 (Neb. 1943).
- Trustee was considered to have unfettered dominion and control when the trust language indicated that distributions could be made as the trustee determines they are required or desirable for health, maintenance and support. *In re McCoy*, 274 B.R. 751 (Bankr.N.D.Ill.2002), *aff’d*, 2002 WL 1611588.
- Distributions were authorized for illness or incapacity and trustee had “uncontrolled discretion.” The court held that it was up to the trustee when such illness or incapacity exists and the amount of principal to be consumed. *Huntington Nat. Bank v. Aladdin Crippled Children’s Hosp. Ass’n*, 108 Ohio App. 234, 157 N.E.2d 138 (1959).

Restatement (Second) of Trusts

- §187, comment j: The settlor may manifest an intention that the trustee’s judgment need not be exercised reasonably, even where there is a standard by which the reasonableness of the trustee’s conduct can be judged. Words such as “absolute” or “unlimited” or “uncontrolled” discretion are ordinarily construed as merely dispensing with the standard of reasonableness. The trustee must still act in a state of mind contemplated by the settlor. The trustee cannot act dishonestly or from some motive other than the accomplishment of the purposes of the trust, or ordinarily to act arbitrarily without an exercise of judgment.
- §128, comment d: If the trustee’s discretion is “uncontrolled,” the beneficiary cannot compel the trustee to make any payments to him or for his benefit, if the trustee does not act dishonestly or arbitrarily or from an improper motive.

Restatement (Third) of Trusts

- Comment c: The grant of extended discretion is not a complete relief of accountability. The trustee must still act in good faith and in a state of mind contemplated by the settlor. Extended discretion tends to grant the trustee more latitude in the exercise of discretion and it is a matter of interpretation as to what degree the settlor’s use of the language extends the discretion.

Uniform Trust Code

- §814(a) - “Notwithstanding the breadth of discretion granted to a trustee, including the use of terms such as ‘absolute,’ ‘sole,’ or ‘uncontrolled,’ the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.”

DISCRETIONARY DISTRIBUTIONS FOR MULTIPLE BENEFICIARIES

When a trust has multiple beneficiaries, the trustee must deal with them impartially. Pursuant to common law, there is a wide range of holdings. One court held that a trustee must give every beneficiary something and not exclude one specific beneficiary. This may be different if the trust language specifically authorized the trustee to exclude a certain beneficiary. The Third Restatement allows the trustee to make inferences regarding the preferred beneficiaries if the trust is silent. For example, the top of a line of descendants is favored over his or her issue. The Uniform Trust Code, however, requires impartiality among the beneficiaries, but does allow their varied interests to be considered. Overall, a trustee is safest considering all beneficiaries and treating them impartially. Impartially does not necessarily mean equally, but equitably in light of the purposes of the trust.

Colorado Law

- Nothing directly on point.

Common Law

Appropriate considerations for the trustee when the trustee has discretion to make distributions to multiple beneficiaries are mentioned throughout the case law cited these materials. Below are the cases that have not been mentioned previously.

- The settlor intended that a certain beneficiary be the primary beneficiary out of a class of beneficiaries, but the needs of all the beneficiaries should be considered. *In re Estate of Winograd*, 65 Ohio App.3d 76, 582 N.E.2d 1047 (1989).
- The trustee was granted the discretion to make unequal distributions and "shall pay . . . whatever part or all of the net income or principal . . . to the individual members of the said family group." The trustee had discretion to determine how much to give each member of the discretionary group, but it was not within the trustee's discretion to give a beneficiary nothing. *Magavern v. U.S.*, 550 F.2d 797 (2d Cir.1977).
- The trustee must consider how the actions toward one beneficiary would affect another when exercising discretion. *Snyder v. Dept. of Public Welfare*, 528 Pa. 491, 598 A.2d 1283 (1991).

Restatement (Second) of Trusts

- §128, comment f: When there is a definite class of persons, the interests of the beneficiaries depends on the intention of the settlor. If the group of beneficiaries includes a widow for her benefit and the support of her children until they are of age, the inference is that the children are entitled to compel their mother to afford them out of the trust property reasonable support until they come of age, and mother's beneficial interest in the property is subject to this obligation.
- §183: When there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them. Comment a: This rule applies when there are multiple beneficiaries entitled to interests in trust property simultaneously or

successively. The terms of the trust may give the trustee discretion to favor one beneficiary over another and the court will not interfere except to prevent an abuse of discretion.

Restatement (Third) of Trusts

- §50, comment f: This is a case by case analysis, considering things such as the terms of the discretionary powers, the purpose and size of the trust, the beneficiaries' circumstances and their relationship to one another and the settlor. Structure and context often suggest that one beneficiary has a "favored status." The inferences that can be made are as follows:
 - The beneficiary at the top of a line of descendants is favored over his or her own issue, with the settlor's spouse also so favored whether or not an ancestor of the others (e.g. settlor's issue by prior marriage).
 - Among multiple lines of descent, there is an inference of priorities *per stirpes*, that is, that (i) the various lines are entitled to similar, impartial but not necessarily equal, treatment, with disparities to be justified on a principled basis consistent with the trust purposes, and that (ii) the inference of favored status within a descending line begins with the person(s) at the top (e.g. the settlor's child or the children of a deceased child). (This inference applies to the typical family trust for the support and education of minor or youthful beneficiaries following the death of one or both of their parents, with a preference for a common standard of living and similarity of opportunity to be balanced against usually modest funding and almost inevitably different beneficiary needs, capacities and interests.)
- Favored status simply means that in absence of compelling considerations, the trustee is to give priority to providing what the beneficiary with favored status needs to continue her lifestyle and to have appropriate care and other suitable benefits.
- The trustee may also consider tax implications when making distributions between a group of a surviving spouse and issue. It may make sense to give little or no principal distributions to the surviving spouse and make principal distributions to a child or grandchild.
- See also §79 of Restatement (Third) of Trusts on the Duty of Impartiality.

Uniform Trust Code

- Section 803: "If a trust has two or more beneficiaries, the trustee shall act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries' respective interests." The comment to this section indicates that this duty does not mean that the trustee must treat the beneficiaries equally, but rather, equitably in light of the purposes and terms of the trust.

COURT INTERVENTION WITH TRUSTEE'S DISCRETION

Generally, the courts will not interfere with a trustee's exercise of discretion unless the trustee has abused that discretion. Usually, this means the trustee has acted in bad faith, from an improper motive or in a state of mind not contemplated by the settlor.

Colorado Law

- A court will not interfere with the trustee's discretion unless there is an abuse of that discretion or the trustee makes an arbitrary decision or a decision from an improper motive. *Goss v. McCart*, 847 P.2d 184 (Colo. App. 1992).
- A trustee may not act recklessly and regardless of the extended discretion given to the trustee under the terms of the trust, the trustee does not have absolute discretion. *Rippey v. Denver United States Nat'l Bank*, 273 F.Supp. 718 (D. Colo. 1967).

Common Law

The case law cited throughout these materials indicates the bounds within which the trustee's discretion may be exercised without court interference. To avoid repetition, those cases are not listed again in this section.

Restatement (Second) of Trusts

- § 187: Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion.
- § 187 Comment d. Factors in determining whether there is an abuse of discretion. In determining the question whether the trustee is guilty of an abuse of discretion in exercising or failing to exercise a power, the following circumstances may be relevant: (1) the extent of the discretion conferred upon the trustee by the terms of the trust; (2) the purposes of the trust; (3) the nature of the power; (4) the existence or non-existence, the definiteness or indefiniteness, of an external standard by which the reasonableness of the trustee's conduct can be judged; (5) the motives of the trustee in exercising or refraining from exercising the power; (6) the existence or nonexistence of an interest in the trustee conflicting with that of the beneficiaries.

Restatement (Third) of Trusts

- § 50: (i) A discretionary power conferred upon the trustee to determine the benefits of a trust beneficiary is subject to judicial control only to prevent misinterpretation or abuse of the discretion by the trustee. (2) The benefits to which a beneficiary of a discretionary interest is entitled, and what may constitute an abuse of discretion by the trustee, depend on the terms of the discretion, including the proper construction of any accompanying standards, and on the settlor's purposes in granting the discretionary power and in creating the trust.

Uniform Trust Code

- Section 801: "Upon acceptance of a trusteeship, the trustee shall administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries, and in accordance with this [Code]."
- Section 803: "A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution."
- Exculpatory clause in trust agreement:
 - Section 1008: "(a) A term of a trust relieving a trustee of liability for breach of trust is unenforceable to the extent that it: (1) relieves the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries; or (2) was inserted as the result of an abuse by the trustee of a fiduciary or confidential relationship to the settlor.
 - (b) An exculpatory term drafted or caused to be drafted by the trustee is invalid as an abuse of a fiduciary or confidential relationship unless the trustee proves that the exculpatory term is fair under the circumstances and that its existence and contents were adequately communicated to the settlor."

USE OF ASCERTAINABLE STANDARDS FOR TAX REASONS

If a trustee is also a beneficiary of the trust, often called an "interested trustee," there are potential tax issues which need to be addressed. If the interested trustee has the ability to make discretionary distributions to or for the trustee's own benefit, under IRC Section 2041 the trustee will have a general power of appointment over the trust, causing inclusion of the trust in the trustee's gross estate. There is an exception if the trustee's discretion is limited by ascertainable standards which are health, education maintenance and support of the beneficiary, (IRC Section 2041(b)(1)(A)). Another exception would apply if the discretion can only be exercised in conjunction with another person having a substantial interest in the trust that is adverse to the exercise of discretion in favor of the beneficiary who is also the trustee (IRC Section 2041(b)(1)(C)(ii)). Most drafters utilize ascertainable standards to bring the exception into play to avoid inclusion of the trust property in the beneficiary-trustee's estate. However, variations from the approved language can lead to unexpected results and illustrated below.

Another problem also arises if the trustee may make distributions that would satisfy a legal obligation of the trustee. For example, if a parent is the trustee of the trust and as such makes distributions to her child (who is a minor beneficiary of the trust) in way that satisfies the trustee's legal obligation of support to the child, the trust will be considered to have a general power of appointment over the trust. Treas. Reg.

Section 20.2041-1(c)(1). Including ascertainable standards to limit the trustee's discretion here does not eliminate this problem. To avoid this issue, the trust document should prohibit the trustee from exercising discretion in way that would satisfy the trustee's own legal obligations.

Tax Regulations Regarding the Breadth of Ascertainable Standards: §20.2041-1(C)(2)

- *Powers limited by an ascertainable standard.* A power to consume, invade, or appropriate income or corpus, or both, for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is, by reason of section 2041(b)(1)(A), not a general power of appointment. A power is limited by such a standard if the extent of the holder's duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). As used in this subparagraph, the words "support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life. A power to use property for the "comfort, welfare, or happiness" of the holder of the power is not limited by the requisite standard. Examples of powers which are limited by the requisite standard are powers exercisable for the holder's "support," "support in reasonable comfort," "maintenance in health and reasonable comfort," "support in his accustomed manner of living," "education, including college and professional education," "health," and "medical, dental, hospital and nursing expenses and expenses of invalidism." In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised.

Colorado Law Regarding Ascertainable Standards

- *Colo. Rev. Stat. § 15-2-102(2):* A power to consume, invade, or appropriate property for the benefit of the donee of the power, which power is limited by an ascertainable standard related to the health, support, education, or maintenance of the donee, shall not be deemed a power of appointment.

Common Law Regarding Whether Standards Qualify Under IRC § 2041

State law determines the legal rights and interests created by a trust. Federal law determines the tax consequences of those rights. *Estate of Vissering v. C.I.R.*, 990 F.2d 578 (10th Cir. 1993). The Court must examine the state law of the governing instrument to interpret whether certain standards qualify as ascertainable standards under federal tax law. *Finlay v. U.S.*, 752 F.2d 246 (6th Cir. 1985).

As indicated in the cases cited below, it is difficult to anticipate whether trust language will qualify as an ascertainable standard as stated in IRC § 2041. Therefore, it is safest to include the exact language from IRC § 2041 when drafting ascertainable standards into a trust.

Common Law – Trust Language Considered an Ascertainable Standard

- Distributions as required for “continued comfort, support, maintenance or education” was enough pursuant to Florida law to be considered an ascertainable standard under IRC § 2041. *Estate of Vissering v. C.I.R.*, 990 F.2d 578 (10th Cir. 1993).
- The trustee was granted the discretion to invade the corpus of the trust “in cases of emergency or illness.” This language, as interpreted under New Mexico law, qualified as an ascertainable standard under IRC § 2041. *Sowell’s Estate v. C.I.R.*, 708 F.2d 1564 (10th Cir. 1983).
- Trustees were authorized to invade corpus “should any emergency arise.” Under Pennsylvania law this language qualified as an ascertainable standard under IRC § 2041. *Hunter v. U.S.*, 597 F.Supp. 1293 (WD Pa. 1984).
- The beneficiary had the “right to encroach” regarding the principal of the trust. The Court determined that it was the intent of the settlor that the beneficiary only take what was needed for her reasonable support and maintenance and that the discretion would be limited as such under Tennessee law. Therefore, the beneficiary was not deemed to have a power of appointment under IRC § 2041. *Finlay v. U.S.*, 752 F.2d 246 (6th Cir. 1985).

Common Law – Trust Language Not Considered an Ascertainable Standard

- Consuming principal for “her [the beneficiary’s] own use, benefit, comfort, support, and maintenance, all or any part of the corpus of my estate or proceeds thereof whenever she, in her own discretion, deems the income, rents, and revenues thereof insufficient for her support, maintenance, comfort, and welfare” was considered too broad pursuant to Texas law to be an ascertainable standard under IRC §2041. *Lehman v. United States*, 448 F.2d 1318 (5th Cir. 1971).
- “For the benefit of said wife” did not qualify as an ascertainable standard pursuant to California law. *De Oliveira v. U.S.*, 767 F.2d 1344 (9th Cir. 1985).
- Trustee’s expanded discretion to invade corpus for “whatever purpose she [the beneficiary] desires” did not qualify as an ascertainable standard pursuant to Wisconsin law. *Independence Bank Waukesha v. U.S.*, 761 F.2d 442 (7th Cir. 1985).
- Distributions for “business purposes” was broader than ascertainable standards under New York law and therefore, did not qualify as an ascertainable standard. *Estate of Penner v. C.I.R.*, 67 T.C. 864 (1977).
- The addition of the words “welfare and well-being” go beyond the ascertainable standards pursuant to New Jersey law. *Estate of Jones v. C.I.R.*, 56 T.C. 35 (1971).
- The Court considered the word “comfort” and “uncontrolled discretion” and determined that the following language did not qualify as an ascertainable standard pursuant to Pennsylvania law, “in the exercise of their uncontrolled discretion to also pay to my said wife, Ethel B. McIlvaine, such part or parts of the principal of said trust as may be necessary for her comfort, maintenance and support, or in the event of illness or emergency as the result of which she may be in need...” *Doyle v. U.S.*, 358 F.Supp. 300 (ED Pa. 1973).

- "General happiness" is broader than the ascertainable standards pursuant to California law. *Estate of Little v. C.I.R.*, 87 T.C. 599 (1986).

EFFECT OF TRUSTEE'S EXERCISE OF DISCRETION SO AS TO SATISFY HIS LEGAL SUPPORT OBLIGATIONS

Another problem also arises if the trustee may make distributions that would satisfy a legal obligation of the trustee. For example, if a parent is the trustee of the trust and as such, makes distributions to her child (who is a minor beneficiary of the trust) in way that satisfy's the trustee's legal obligation of support to the child, the trustee will be considered to have a general power of appointment over the trust. Treas. Reg. Section 20.2041-1(c)(1). Including ascertainable standards to limit the trustee's discretion here does not eliminate this problem. To avoid this issue, the trust document should prohibit the trustee from exercising discretion in a way that would satisfy the trustee's own legal obligations.

Common Law Regarding Discharge of a Legal Obligation

- The following cases are instructive regarding what may be considered a legal obligation, but note that the parent is not necessarily the trustee in each case.
- Private schooling was considered a legal obligation where parents had sent their children to a private school for at least two or three years prior to the creation of the trust. *Stone v. C.I.R.*, T.C.Memo. 1987-454.
- The tuition, room and board for higher education was considered a legal obligation of the parents. A college education was imminently reasonable considering the background, values and goals of the parents and children. *Braun v. C.I.R.*, T.C. Memo 1984-285.
- The parent does not have a legal obligation to support adult children. *Rev. Rul.* 79-154, 1979-1 C.B. 301.

SAVINGS STATUTES

Colorado Law

Colorado includes a statute that automatically limits the discretionary powers of a trustee who is also a beneficiary of the trust. Colorado's statute is included in its entirety below:

Colo. Rev. Stat. § 15-1-1401. Restrictions on exercise of certain fiduciary powers.

(1) (a) Due to the inherent conflict of interest that exists between a trustee who is a beneficiary of a trust and other beneficiaries of the trust, any of the following powers conferred upon a trustee shall not be exercised by such trustee:

(I) To make or cause to be made discretionary distributions of either principal or income to or for the direct or indirect benefit of such trustee; except that such a power may be exercised by such trustee to the extent that it may be exercised to provide for that trustee's health, education, maintenance, or support as described under sections 2041 and 2514 of the federal "Internal Revenue Code of 1986", as amended;

(II) To make discretionary distributions of either principal or income to satisfy any legal obligations of such trustee; or

(III) To make or cause to be made discretionary distributions of either principal or income to or for the direct or indirect benefit of any person who has the right to remove or replace such trustee; except that such a power may be exercised by such trustee to the extent that it may be exercised to provide for such person's health, education, maintenance, or support as described under sections 2041 and 2514 of the federal "Internal Revenue Code of 1986", as amended.

(b) Any of the powers prescribed in paragraph (a) of this subsection (1) that are conferred upon two or more trustees may be exercised by the trustees who are not so disqualified. If there is no trustee qualified to exercise such powers, any party in interest, as described in subsection (3) of this section, may apply to a court of competent jurisdiction to appoint an independent trustee, and such powers may be exercised by the independent trustee appointed by the court. Subparagraph (I) of paragraph (a) of this subsection (1) shall not prohibit a trustee from making payments, including reimbursement of and compensation of such trustee, for the protection of the trust, or the assets thereof, and for all expenses, losses, and liabilities incurred in or by the collection, care, administration, or protection of the trust or the assets thereof.

(2) This section applies to every trust unless the terms of the trust as it may be amended in accordance with its terms provide expressly to the contrary and either specifically refer to this section or otherwise clearly demonstrate the intent that this rule not apply or unless, if the trust is irrevocable, all parties in interest, as described in subsection (3) of this section, elect affirmatively, in the manner prescribed in subsection (4) of this section, not to be subject to the application of this section. Such election shall be made on or before July 1, 1999, or three years after the date on which the trust becomes irrevocable, whichever occurs later.

(3) For the purpose of subsection (1) or subsection (2) of this section:

(a) If the trust is revocable or amendable and the settlor is not incapacitated, the party in interest is the settlor.

(b) If the trust is revocable or amendable and the settlor is incapacitated, the party in interest is the settlor's legal representative under applicable law or the settlor's agent under a durable power of attorney that is sufficient to grant such authority.

(c) If the trust is not revocable or amendable, the parties in interest are:

(I) Each trustee then serving;

(II) Each income beneficiary then in existence or, if any such beneficiary has not attained majority or is otherwise incapacitated, the beneficiary's legal representative under applicable law or the beneficiary's agent under a durable power of attorney that is sufficient to grant such authority; and

(III) Each remainder beneficiary then in existence or, if any such remainder beneficiary has not attained majority or is otherwise incapacitated, the beneficiary's legal representative under applicable law or the beneficiary's agent under a durable power of attorney that is sufficient to grant such authority.

(4) The affirmative election required under subsection (2) of this section shall be made:

(a) If the settlor is not incapacitated and the trust is revocable or amendable, through a revocation of or an amendment to the trust;

(b) If the settlor is incapacitated and the trust is revocable or amendable, through a written declaration executed in the manner prescribed for the acknowledgment of deeds in this state and delivered to the trustee; or

(c) If the trust is not revocable or amendable, through a written declaration executed in the manner prescribed for the acknowledgment of deeds in this state and delivered to the trustee.

(5) A person who has the right to remove or to replace a trustee does not possess nor may that person be deemed to possess, by virtue of having that right, the powers proscribed in subparagraphs (I), (II), and (III) of paragraph (a) of subsection (1) of this section of the trustee that is subject to removal or to replacement.

(6) (a) Subparagraphs (I) and (II) of paragraph (a) of subsection (1) of this section shall not apply to a trustee with respect to trust property and the income from such property where such property would, upon the death of such trustee, be included in the gross estate of such trustee for federal estate tax purposes for any reason other than the powers proscribed by subparagraphs (I) and (II) of paragraph (a) of subsection (1) of this section.

(b) Subparagraph (I) of paragraph (a) of subsection (1) of this section shall not apply to a trustee that may be appointed or removed by a person for whose benefit the proscribed powers may be exercised to distribute trust property or the income from such property where such property would, upon the death of such person, be included in the gross estate of such person for federal estate tax purposes for any reason other than such powers to appoint or remove such trustee.

(7) The provisions of this section neither create a new cause of action nor impair any existing cause of action that, in either case, relates to any power proscribed by subsection (1) of this section that was exercised before July 1, 1996.

Uniform Trust Code: §814

The Uniform Trust Code includes a similar statute automatically limiting the discretion of the trustee who is also a beneficiary. Subsection (B) of section 814 is included below.

(b) Subject to subsection (d), and unless the terms of the trust expressly indicate that a rule in this subsection does not apply:

(1) a person other than a settlor who is a beneficiary and trustee of a trust that confers on the trustee a power to make discretionary distributions to or for the trustee's personal benefit may exercise the power only in accordance with an ascertainable standard <<-relating to the trustee's individual health, education, support, or maintenance within the meaning of Section 2041(b)(1)(A) or 2514(c)(1) of the Internal Revenue Code of 1986, as in effect on [the effective date of this [Code]] [, or as later amended]->>; and

(2) a trustee may not exercise a power to make discretionary distributions to satisfy a legal obligation of support that the trustee personally owes another person.

(c) A power whose exercise is limited or prohibited by subsection (b) may be exercised by a majority of the remaining trustees whose exercise of the power is not so limited or prohibited. If the power of all trustees is so limited or prohibited, the court may appoint a special fiduciary with authority to exercise the power.

(d) Subsection (b) does not apply to:

(1) a power held by the settlor's spouse who is the trustee of a trust for which a marital deduction, as defined in Section 2056(b)(5) or 2523(e) of the Internal Revenue Code of 1986, as in effect on [the effective date of this [Code]] [, or as later amended], was previously allowed;

(2) any trust during any period that the trust may be revoked or amended by its settlor; or

(3) a trust if contributions to the trust qualify for the annual exclusion under Section 2503(c) of the Internal Revenue Code of 1986, as in effect on [the effective date of this [Code]] [, or as later amended].

Case Law Interpreting a Savings Statute

New York has a statute similar to Colorado's statute, EPTL § 10-10.1. The New York statute was enacted to restrict the powers of a trustee so that there is no dispute regarding whether the trust is an asset of the trustee's estate. *Matter of Eberhart*, 171 Misc.2d 939, 656 N.Y.S.2d 159 (N.Y.Sur. 1997). In *Eberhart*, the Court held that it was unnecessary to modify the trust to restrict the trustee's discretion to distribute principal in order to avoid creating a power of appointment for tax purposes, because the statute already prohibits the trustee from exercising discretion in his own favor.

PRACTICE POINTERS

- ⇒ In order to clarify the settlor's intent, ask the client the following before drafting:
 - Should the trustee consider other resources of the beneficiary before making a discretionary distribution? If so, which resources?
 - If there are multiple current beneficiaries, are any of the beneficiaries preferred beneficiaries?
- ⇒ Define terms to clarify the settlor's meaning rather than leave it up to interpretation later. In particular, the definition of "education" varies significantly and it is best to define it in the trust document.
- ⇒ When drafting, stick with the language of ascertainable standards as provided in the Internal Revenue Code.
- ⇒ Know when ascertainable standards are necessary and avoid them if not required and the desire is to give the trustee broad and unfettered discretion.
- ⇒ Pay attention to governing law and situs provisions in trusts. The discretionary standards will likely be interpreted pursuant to the state law that governs the instrument.
- ⇒ More is usually better when explaining what the settler intended.
- ⇒ Think about including values statements that will help explain the settlor's perspective more fully regarding trust distributions.
- ⇒ Statements of settlor's intended purposes of the trust may also be helpful as the courts look to the state of mind of the settlor in creating the trust.
- ⇒ Remember the courts will always require the trustee to act in good faith and in the state of mind by the contemplated by the settler even if granted broad and unfettered discretion.
- ⇒ Make sure that none of the powers or directions given to the trustee contradict each other.

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Decision Making for Discretionary Distributions

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The exercise of making a discretionary distribution represents one of the most challenging aspects of trust administration. In administering a discretionary trust, a trustee has the authority to distribute principal or income in accordance with the trustee's interpretation of the grantor's intention, and to be the judge of what is in the best interest of the beneficiary or beneficiaries. A trustee's authority to make discretionary distributions encompasses many of the basic fiduciary duties: duty of loyalty, duty of prudence, duty to administer the trust in accordance with its terms, duty to deal impartially with beneficiaries, duty to seek approval from co-fiduciaries, duty to keep and provide accounts, duty to exercise reasonable care and caution, and the duty not to delegate administrative functions except in accordance with local law. While trustees often exercise discretion with many administrative powers, including investments and matters pertaining to allocation of principal and income, this outline is limited to issues that trustees face with respect to discretionary distributions of income and principal to a beneficiary in the trustee's discretion.

I. INTENT OF THE SETTLOR

In exercising their discretion, trustees are to be guided by the grantor's intentions. In Florida, the "terms of a trust" means the manifestation of the settlor's intent regarding a trust's provisions as expressed in the trust instrument or as may be established by other

¹ This presentation is based, in part, on a presentation to The American College of Trust and Estate Counsel on October 16, 2010 by Trent S. Kiziah, Esq., Donna G. Barwick, Esq., Tami Foley Conetta, Esq. and James B. Bertles, Esq. titled "Practical Issues Arising During Trust Administration."

evidence that would be admissible in a judicial proceeding.² Generally, the grantor's intentions are to be gleaned from the four corners of the governing instrument. The Florida Supreme Court, in *Lines v. Darden*³, stated:

[T]he intention of the testator, as expressed in his will, shall prevail over all other considerations, if consistent with the principles of law. The intention is every thing; and to this first and great rule, in the exposition of wills, all others must bend. With an anxious desire to secure this leading object, the courts allow no rule of construction of mere words, to control the intention, but the whole instrument is to be considered, and if possible, effect given to every part of it. The relative situation of the parties, the ties and affections subsisting between them, besides the motive which would naturally influence the mind of the testator, are proper to be considered in expounding the import of doubtful words.⁴

Unfortunately, most wills and trusts provide limited insight into the grantor's intentions, leaving trustees with little guidance in making discretionary distributions.

In a Columbia Law Review article titled "Problems of Discretion in Discretionary Trusts," Professor Edward Halbach, Jr. noted:

Too frequently trust instruments provide no guidance as to the purpose and scope of the power. Although determining and assisting in the formulation of the donor's intentions is a primary counseling function, it is apparently one of the most neglected aspects of estate planning. A poorly defined discretionary power often results.⁵

Often, the discretionary beneficiary and the remaindermen will disagree as to the settlor's intent. Absent some direction in the governing instrument, the trustee is often forced to rely on conflicting memories from the beneficiaries or, in many cases, forced to make a decision without any guidance at all.

² F.S. §736.0103(21).

³ 5 Fla. 51 (1853)

⁴ *Id* at 68.

⁵ Edward C. Halbach, Jr., *Problems of Discretion in Discretionary Trusts*, 61 Colum. L. Rev. 1424, 1434 (1961), hereinafter "Halbach, *Discretion*."

Any search for the grantor's intent must begin with a review of the discretionary language authority itself. Despite generally held belief to the contrary, the words "health, education, maintenance and support" provide limited insight into the grantor's intent, resulting in the inability to effectively implement the grantor's intent. And often, the governing instrument itself often creates conflicting messages of the grantor's intent beyond the discretionary distribution language.

II. READING THE DISCRETIONARY DISTRIBUTION LANGUAGE

The words contained in the discretionary invasion provision often provide the best, and in many cases the only, indication of the grantor's intent. But what do the words mean? While the words used should be given normal meaning to the extent appropriate, the meaning may be affected by context and the more general purpose(s) of the trust and the estate plan of which it is a part.⁶ This principle is especially true with frequently used terms contained in trusts. The settlor's frame of reference and intent becomes particularly crucial when the words "health, education, maintenance and support" (the "HEMS" standard) are used.

Halbach repeatedly stresses in his article the need for the governing instrument to provide guidance. He states:

To assure appropriate use of a discretionary power to pay over income or principal, it is essential that the power be accompanied by a standard or some other indication of its purpose and nature. The trustee will certainly be aided in exercising his judgment if the terms of the trust offer some guide for his actions, even if only by way of illustration or suggestion. He should be informed of the purposes of the trust, the factors he is to consider, and something of the general frame of mind in which the settlor wishes him to act. If a trustee must be reasonable in his decisions, in fairness he is entitled to know on what basis his reasonableness will be judged, although, as already pointed out, an express standard is not required to enable a court to impose a general standard of reasonableness.

⁶ Restatement (Third) Of Trusts §50,(2003), hereinafter the "Restatement", cmt. d(1).

Too frequently trust instruments provide no guidance as to the purpose and scope of the power. Although determining and assisting in the formulation of the donor's intentions is a primary counseling function, it is apparently one of the most neglected aspects of estate planning. A poorly defined discretionary power often results.⁷

Unfortunately, most trusts simply provide that the trustee shall distribute trust principal in the trustee's discretion for the beneficiary's "health, education, maintenance and support." The overuse of these four commonplace words has probably occurred because drafters are concerned about the beneficiary being deemed to have a general power of appointment for tax purposes. Drafters find comfort in using these words even when there are no tax reasons to include the ascertainable standard. The need for documents to provide additional guidance beyond the use of four or less words is crucial to effectuating the settlor's intent.

"Extended" discretion may be given to the trustee by providing that the trustee may act in its sole, absolute, and uncontrolled discretion. But the trustee must still act in a state of mind contemplated by the settlor, i.e., not in bad faith or for a purpose or motive other than to accomplish the purposes of the trust. The same rule applies to a trustee's failure to act. The Florida Trust Code specifically provides that the inclusion of language giving the trustee "absolute," "sole" or "uncontrolled discretion" still requires the trustee to exercise the discretionary power "in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries."⁸

A. IRS Ascertainable Standard.

Internal Revenue Code Section 2041(b) (1) (A) provides:

A power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable

⁷ Halbach, *Discretionary*, *supra* note 3 at 1433-1434.

⁸ F.S. §736.0814.

standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

Treasury Regulation Section 20.2041-1I(2) provides:

(2) *Powers limited by an ascertainable standard.* A power to consume, invade, or appropriate income or corpus, or both, for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent is, by reason, of section 2041(b)(1)(A), not a general power of appointment. A power is limited by such a standard if the extent of the holder's duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). As used in this subparagraph, the words "support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life. A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard. Examples of powers which are limited by the requisite standard are powers exercisable for the holder's "support," "support in reasonable comfort," "maintenance in health and reasonable comfort," "support in his accustomed manner of living," "education, including college and professional education," "health," and "medical, dental, hospital, and nursing expenses and expenses of invalidism." In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised.

Because the Code and the Regulations provide that the terms "health, education, maintenance and support" establish an ascertainable standard, these words have become common in many trusts. It is debatable what effect the Code and Regulation definitions should have on terms used in a governing instrument beyond the tax implications. Generally, state laws and courts construe words in a trust, while federal tax laws and regulations merely impose tax on certain transfers based on the chosen words. However, if the words are chosen to avoid the imposition of federal transfer tax, arguably, the Treasury Regulations may serve to define the chosen words.

Interestingly, the Florida Trust Code creates a set of default rules to automatically “opt in” to the Code’s ascertainable standard.⁹ Ostensibly this provision is intended to protect the less informed drafter and protect the tax status of the trust from inclusion in the trustee’s taxable estate, but with the ever-increasing exemption amount one must question the necessity of such a provision. Section 736.0814 provides that unless the terms of the trust provide otherwise, or unless there are co-trustees or other fiduciaries who can exercise broader powers, a trustee who is also a beneficiary may not:

- (i) Make discretionary distributions of either principal or income to or for the trustee’s own benefit except for his health, education, maintenance and support;
- (ii) Make discretionary distributions of either principal or income to satisfy any of the trustee’s legal support obligations; or
- (iii) Exercise any other power, including the right to remove or replace a trustee, to accomplish either of the above restricted distributions.

The restrictions do not apply to a settlor of the trust, or the spouse of the settlor who is trustee of a marital deduction trust, any trust revocable or amendable by the settlor, or an annual exclusion trust under section 2503(c) of the Code.

Given the widespread utilization of the phrase “health, education, maintenance and support,” an examination of these terms is in order.

B. Health

Treasury Regulation Section 20.2041-1 does not define the term “health” but does provide that the word “health” and the phrase “medical, dental, hospital and nursing

⁹ F.S. §736.0814.

expenses and expenses of invalidism” create ascertainable standards. The Restatement provides:

Similarly, without more, references to “health,” “medical care,” and the like in the terms of a discretionary power may be useful to inform beneficiary expectations or guide an inexperienced trustee, but presumptively they provide merely for health and medical benefit like those normally implied by a support standard. Thus, if the intention is to assure the beneficiary some special form of education, or expensive home care when not cost efficient, further elaboration would be helpful. Even a grant of extended discretion is likely to make it more difficult, if the trustee does not act generously, for a beneficiary to compel a trustee to follow a particular course of action.¹⁰

Because the term “support” generally encompasses providing for the beneficiary’s health and because the term “health” rarely appears without being accompanied by the word “support,” the Restatement cites no cases solely defining the term “health.” Does the term “health” include:

1. Routine health care examinations?
2. Elective medical treatment?
3. Unconventional medical treatment?
4. Psychiatric treatment?
5. Psychological treatment?
6. Dental care?
7. Cosmetic dental work?
8. Eye care?
9. Eye glasses, contact lenses?
10. Lasik surgery?
11. Health insurance?
12. Dental insurance?
13. Vision insurance?
14. Home-health care, such as round the clock nurses?
15. Deposit to secure a space in a continuing care facility?
16. Elective cosmetic surgery?
17. Gym memberships?
18. Golf club memberships?
19. A day at the spa?
20. Extended vacations to relieve tension and stress?

¹⁰ Restatement §50, cmt. d(3).

The following provisions may serve as a better guide to trustees than simply the word “health”:

Example 1:

The Trustee shall distribute principal to or for the benefit of any Beneficiary for such Beneficiary’s health needs, as provided below:

(a) The health needs of any Beneficiary shall be met in full, regardless of financial need, provided that when requesting such principal the Beneficiary can show that he or she (i) obtained what the Trustee considers to be adequate health insurance and such distribution covers only the cost of uncovered health expenses, or (ii) attempted to obtain health insurance and was determined to be uninsurable.

(b) Health needs shall not include elective cosmetic surgery unless such surgery is recommended as a result of an injury, accident, illness, disease or other medical reason (such as, reconstructive surgery after cancer treatment).

(c) Health needs shall include the costs incurred as the result of infertility and the costs of adoption, but only to the extent of fifty thousand dollars (\$50,000) per Beneficiary during his or her lifetime. Such dollar amount shall be adjusted, upward but not downward, for changes in the cost of living indices, as announced by the applicable governmental agency, beginning in the year after the year in which this Trust Agreement was executed.

C. Education

According to the Restatement, the “term ‘education,’ without elaboration, is ordinarily construed as extending to payment of living expenses as well as fees and other costs of attending an institution of higher education, or the beneficiary’s pursuit of a program of trade or technical training, and the like, as may be reasonably suitable to the individual and to the trust funds available for the purpose.”¹¹ Treasury Regulations Section 20.2041-1 does not define the term “education” but does provide that the phrase “education, including college and professional education” is an ascertainable standard.

¹¹ *Id.*

The term “education” has been defined as follows in various cases:

1. Paying for the education of the beneficiary during his adult life was permitted when the testator was a scholarly man himself. *In the Matter of Estate of Wolfe*.¹²
2. On the other hand, the trustee was upheld in refusing payment for further education of a 42 year old beneficiary in *Lanston v. Children’s Hospital*.¹³
3. “Education” included support in between college semesters in *Estate of Egan*.¹⁴
4. On the other hand, payment for post graduate education is not usually authorized pursuant to an ‘education’ standard according to *Southern Bank & Trust Co. v. Brown*.¹⁵

But query whether the term “education” includes:

1. Grammar, secondary and high-school tuition, fees, activity fees?
2. Post-graduate school?
3. Medical school, law school, and other professional school expenses?
4. Pre-school/early childhood education?
5. Support of the beneficiary during the school year?
6. Support of the beneficiary between semesters and between school years?
7. Extended studies for the student who makes a career out of learning?

¹² 164 Misc. 504, 299 N.Y. Supp. 99 (Sur. Ct. 1937).

¹³ 148 F.2d 689 (D.C. Cir. 1945).

¹⁴ 39 N.Y.S.2d 96 (Sur. Ct. 1942).

¹⁵ 246 S.E.2d 598 (S.C. 1978).

8. Technical school training?
9. Specialized career training such as culinary school?
10. Travel abroad as part of a university program?
11. Traveling the world as part of studying world culture?

Similar to the use of the term “health,” the term “education” without more elaboration provides limited insight into the nature and the degree of education intended by the grantor. For example, the following provisions serve as a better guide to trustees than simply the word “education:”

Example 1:

The term “education” shall include, but not be limited to, attendance at elementary, junior high, secondary, vocational, college, graduate and/or professional schools, whether public or private. The Trustees should do all things necessary to assure such beneficiary receives a reasonable education. Educational expenditures shall include, but not limited to, expenditures for tuition, books, lodging, food and a reasonable allowance. The failure of any such beneficiary to apply himself or herself to his or her studies, as evidenced by failure to attain passing grades, shall constitute sufficient cause for the refusal on the part of the Trustees to authorize further advancements from income or corpus on account of education. It is my intention that this trust pay for the expenses associated with studying abroad for one year provided it is part of an established curriculum of the college or university or graduate school the beneficiary is attending. This trust is not established to provide support for a beneficiary to attend school for his/her entire life. Eventually, the beneficiary should choose a career and begin employment.

Example 2:

The Trustee shall distribute principal to or for the benefit of any Beneficiary for such Beneficiary’s education, which shall include the following:

- (a) All education expenses of such Beneficiary from Kindergarten through the 12th grade, including, but not limited to, tuition, books, supplies, activity fees, memberships in scholastic societies and clubs. Such expenses shall not include the cost of room and board.

(b) All undergraduate education expenses including (i) college or university, (ii) any non-degreed program at an institution that is recognized for training in a particular trade (for example, the Culinary Institute of America), and (iii) continuing education courses taken at a college or university or at such non-degreed institution. Such expenses shall be paid by the Trust until graduation or for a period of six (6) years, whichever is the shorter period. These expenses shall include tuition, room and board at the school or schools (or the same amount as board, if the Beneficiary elects to live off of the campus), books, supplies and memberships in academic and professional societies and similar expenses. These expenses shall also include any additional living expenses incurred by the Beneficiary, including, but not limited to, expenses incurred when traveling to and from school, to the extent that the Trustee determines that, in his sole and absolute discretion, (i) such expenses are appropriate and reasonable; and (ii) it is in the best interest of the Beneficiary, the other Beneficiaries and the Trust to pay such expenses.

(c) All education expenses at the graduate level until the first to occur of (i) graduation from such graduate program, (ii) the expiration of the customary period for attaining a particular degree, or (iii) the expiration of twice the amount of time of the customary period for attaining a particular degree if the Beneficiary is enrolled on a part-time basis. These expenses shall include tuition, room and board at the school or schools (or the same amount as board, if the Beneficiary elects to live off of the campus), books, supplies and memberships in academic and professional societies and similar expenses. These expenses shall also include any additional living expenses incurred by the Beneficiary, including, but not limited to, expenses incurred when traveling to and from school, to the extent that the Trustee determines that, in his sole and absolute discretion, (i) such expenses are appropriate and reasonable; and (ii) it is in the best interest of the Beneficiary, the other Beneficiaries and the Trust to pay such expenses.

Example 3 (the following form is provided by Jon J. Gallo and Anne K. Hilker):

My Trustees, during any period in which any lawful grandchild of mine shall be enrolled as a matriculated student in a fully accredited four (4) year secular college or university program leading to a baccalaureate diploma and/or in a professional school or other graduate program leading to an advanced degree from a fully accredited graduate program, provided that no such college, university, graduate and/or professional school shall be affiliated with any religious group and/or organization, shall pay over

or apply so much of the income and/or principal of this trust for tuition and any other related expenses (as hereinafter defined) of such college, university, graduate and/or professional school, for any such lawful grandchild of mine, provided that no such payment(s) shall be made to or for the benefit of a grandchild of mine who has not commenced such secular education, either undergraduate or graduate, by the date such grandchild of mine has attained the age of twenty-one (21) years. As used herein, the term "related expenses" shall include, but not be limited to, books, laboratory materials, supplies, student fees and equipment, room and board if such grandchild of mine resides in a school dormitory, and reasonable rent and a food allowance if such grandchild of mine resides in non-institutional housing. In no event shall the term "related expenses" be deemed to include any health needs, business needs, marital needs or other obligations of such grandchild of mine. It is my intention that this trust fund be used solely for the aforesaid post-secondary school educational needs of my lawful grandchildren. In accordance with the terms expressed herein, my Trustee may make any such payments as they, in their sole and absolute discretion, shall determine to be necessary and proper for my lawful grandchildren, based on the individual needs of such grandchildren, and not necessarily pro rata among my said grandchildren. I further direct that my Trustees may make any such payments directly to any such grandchild of mine, or directly to the school or any person or entity providing the goods or services to said grandchild.

D. Support and Maintenance

The terms "support and maintenance" comprise two of the four terms in the commonplace HEMS standard found in most trusts. The Treasury Regulations provide the following comments:

As used in this subparagraph, the words "support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life... Examples of powers which are limited by the requisite standard are powers exercisable for the holder's "support," "support in reasonable comfort," "maintenance in health and reasonable comfort," "support in his accustomed manner of living"....¹⁶

¹⁶ Treas. Reg. §20.2041-1(c)(3).

The terms “support” and “maintenance” are normally construed as synonyms¹⁷ and are not particularly broad standards relative to other words that sometimes appears in trusts.¹⁸

The Restatement provides:

Under the usual construction of a support standard ... it would not be reasonable ..., or even a result contemplated by the settlor..., for the trustee to provide only bare essentials for a beneficiary who had enjoyed a relatively comfortable lifestyle. (This is so even though the discretionary power is couched in terms of amounts the trustee considers ‘necessary’ for the beneficiary’s support). The standard ordinarily entitles a beneficiary to distributions sufficient for accustomed living expenses, extending to such items as regular mortgage payments, property taxes, suitable health insurance or care, existing programs of life and property insurance, and continuation of accustomed patters of vacation and of charitable and family giving. Reasonable additional comforts or “luxuries” that are within the means of many individuals of like station in life, such as a special vacation of a type the beneficiary had never before taken, may be borderline as entitlements but would normally be within the *permissible* range of trustee’s judgment, even without benefit of a grant of extended discretion...

Without additional language suggesting a broader standard,...however, even with extended discretion, the terms “support” and “maintenance” do not normally encompass payments that are unrelated to support but merely contribute in other ways to a beneficiary’s contentment or happiness. Thus, these terms do not authorize distributions to enlarge the beneficiary’s personal estate or to enable the making of extraordinary gifts.¹⁹

The Restatement takes the position that the following distributions are generally encompassed in a support and maintenance standard:

1. Regular mortgage payments.
2. Property taxes.
3. Suitable health insurance or care.
4. Existing programs of life and property insurance.

¹⁷ Restatement §50, cmt. d(2).

¹⁸ *Id.*

¹⁹ *Id.*

5. Continuation of accustomed patterns of vacation.
6. Continuation of family gifting.
7. Continuation of charitable gifting.

Borderline cases are:

1. Reasonable additional comforts or luxuries.
2. Special vacations of a type the beneficiary had never taken before.

Not included in the standard, according to the Restatement, are:

1. Payments unrelated to support which merely contribute to the beneficiary's contentment or happiness.
2. Distributions to enlarge the beneficiary's personal estate.
3. Distributions to enable the beneficiary to make extraordinary gifts.

The Restatement gives the following illustration:

Following S's death his previously revocable trust has been administered for nearly a decade by T Bank, which is directed to pay income to S's widow, W, and also empowered to pay her "such additional amounts from the principal of the trust as the Trustee, in its sole and uncontrolled discretion, believes appropriate for W's comfortable support and care," with the remainder upon W's death to pass to S's then living issue. In response to requests by W, T Bank has begun to pay substantially increased amounts to her to enable her to accumulate funds from which she may aid C (her child by a prior marriage) in his plans to obtain control and expand the activities of X Co., of which C has been an officer and shareholder for a number of years. S's children petition the court to instruct T Bank that principal distributions for that purpose are improper and that it must recover amounts previously paid to W for that purpose. Nothing in relevant circumstances or in other terms of the trust indicates a broader purpose for the invasion power than the support-related ...language quoted above. The court will issue the order requested by the remainder beneficiaries. Despite S's grant of extensive discretion, and without a finding of bad faith, T's judgment is not exercised in an

appropriate state of mind, that is, for a purpose falling within the quoted standard.²⁰

According to this example, “support” does not extend to providing aid to the beneficiary’s adult child.

A question that often arises when the “support” standard appears in the governing instrument is whether the trust should provide support for the beneficiary’s family, and if so, which members. Professor Scott asserts:

When the beneficiary of a support trust is married, the usual inference is that the beneficiary is entitled to enough to support not only the beneficiary, but also the beneficiary’s spouse and minor children.²¹

Professor Halbach notes:

A discretionary power to pay over amounts needed for the support of a designated beneficiary is presumed to permit-in fact to require- payments not only for the support of such named beneficiary but also for the support of his immediate family and probably the reasonable education of his children. The attitude of the courts is aptly summarized as follows:

The needs of a married man include... the needs of his family living with him and entitled to his support. It would not be consistent with his welfare for his family to be in want and it is hardly probable that the testatrix [sic] intended to provide for his needs and let his wife and children go without.

However, this is a matter of construction. It is conceivable that a settlor did not intend to provide for the support of the beneficiary’s dependents, but without express language to that effect a court apparently would find such intent only in situations in which the beneficiary himself chose not to support dependents from whom he was separated- and even this view of the settlor’s intent would be unusual. The general interpretation is that, following divorce and loss of child custody, the trustee is obligated to make payments for

²⁰ Restatement §50, cmt. c, illustration 3.

²¹ 3 Austin W. Scott Et Al., Scott And Ascher On Trusts, §13.2.4 at 832 (5th ed. 2007).

the support of the beneficiary's children but not for the support of his ex-wife.²²

Numerous questions arise when the terms "support" and "maintenance" are used in the trust without further elaboration. For example, the following questions often arise:

1. Does "support" for the beneficiary's descendants continue after the beneficiary's child reaches majority?
2. Is the frame of reference, the standard of living the beneficiary was enjoying at the time of the grantor's demise or the standard that the grantor was enjoying at the time of the grantor's demise?
3. If the trust substantially appreciates in value, can the trustee invade the trust to increase the beneficiary's standard of living beyond that he or she was enjoying at the time of the grantor's death? Reversely, if the trust substantially decreases in value, can the trustee reduce distributions even if it results in decreasing the beneficiary's standard of living?

As illustrations, the following provisions provide additional guidance:

Example 1:

This trust is to provide for my son, whom I dearly love. At the time that I sign this will, my son is gainfully employed. I believe that it is important that my son continue his employment for both fiscal reasons and the psychological benefits a job provides. It is my intention that this trust supplement the income he receives from his employment. It is not my intention for my son to rely upon this trust as his sole source of financial support until his retirement at an age that individuals generally receive social security, currently age 65. It is my desire that this trust be primarily invested for growth rather than the production of income. It is not my intention for the assets of this trust to be conserved for the benefit of remaindermen. On the contrary, my primary purpose in creating this trust is to provide for my son. The rights and interest of remaindermen are subordinate and incidental to the interests of my son in this trust.

²² Halbach, *Discretionary*, *supra* note 2 at 1436.

Example 2:

The Trustee shall distribute principal to or for the benefit of any Beneficiary for such Beneficiary's housing needs, as provided below:

(a). Each Beneficiary who is an issue of any of the Settlor's children shall receive an amount equal to fifty percent (50%) of the median price of a four bedroom residence located in ____ County, _____, as established by the _____ County Board of Realtors as of the date of such payment, or as close to the date of such payment as is reasonably possible, but not beyond such date of payment.

(b) Such payment shall be made only once in the Beneficiary's lifetime and shall be paid on the date which is the date the Beneficiary is purchasing a house or on the date on which the Beneficiary attains the age of thirty (30) years, whichever occurs first. If the Beneficiary is purchasing a house, such amount shall be paid at the house settlement, to be applied toward such purchase.

E. Comfort

The word "comfort" often accompanies a support standard.²³ The following comment appears in the Restatement:

Whether modifying support (e.g. "comfortable support" or "support in reasonable comfort") or as an additional standard ("support and comfort"), the normal construction is the same: the language adds nothing to the usual meaning of accustomed support (supra) for a beneficiary whose lifestyle is already at least reasonable comfortable. Such terms, however, would tend to elevate the appropriate standard for a beneficiary whose accustomed lifestyle has been more modest. "Comfort," in isolation, normally has like effect, impliedly referring to a comfortable level of support. On the other hand, stronger language, such as "generous" support, may permit and encourage the trustee to allow, and may even require, some reasonable enhancement of the beneficiary's lifestyle; but it falls short of a "happiness" standard (infra) in that the benefits still must normally be support-related.²⁴

According to Treasury Regulation Section 20.2041-1(c)(2), the term "comfort" is not an ascertainable standard while used alone. However, the phrase "support in

²³ Restatement §50, cmt. d(3).

²⁴ *Id.*

reasonable comfort” and “maintenance in health and reasonable comfort” are ascertainable standards.

“Comfort” has been defined as “something more than maintenance but something less than welfare.”²⁵

In *Zumbro v. Zumbro*,²⁶ the court noted “comfort embraces a variety of things, it is not limited solely to the necessities of life but may include things which bring ease, contentment or enjoyment.”²⁷ The court in *Equitable Trust Co. v. Montgomery*,²⁸ interpreted the word “comfort” to permit payments to the beneficiary to allow the beneficiary to quit his job to experience comfort. Comfort does not include the ability to make gifts, according to *In re Estate of Howard*.²⁹ The term does not include the power to augment the beneficiary’s estate, according to *Stoker v. Foster*.³⁰

F. Best Interests

“Best interests” includes “not only the relief of poverty and distress, but may well comprehend whatever aids to the welfare and advancement, and enables them to establish themselves in life.”³¹ The term “best interests” has been interpreted to include paying off the beneficiary’s debts and to permit a down payment on a house, but did not include the power to distribute the entire corpus.³²

²⁵ *Lord v. Roberts*, 153 A. 1, 84 N.H. 517 (1931).

²⁶ 69 Pa. Super 600 (1918).

²⁷ *Id.* at 603.

²⁸ 44 A.2d 420 (1945).

²⁹ 236 S.E.2d 423 (1977).

³⁰ 178 Mass. 591, 60 N.E. 407 (1901).

³¹ *Bowditch v. Attorney General*, 242 Mass. 168, 134 N.E. 796, at 800 (1945).

³² *Kemp v. Paterson*, 158 N.Y.S.2d 870 (1956), 163 N.Y.S.2d 245 (1957), 188 N.Y.S.2d 161(1958).

G. Welfare

The term “welfare” has been considered as synonymous with the term “happiness.”³³

H. Happiness

The term “happiness” is generally interpreted broader than the term “support.” The Reporter to the Restatement notes that “happiness” “suggests an intention that the trustee’s judgment be exercised generously and without relatively objective limitations.”³⁴ A power to use property for the “welfare” or “happiness” of the holder is not a limited power according to Treas. Reg. §20.2041-1I(2).

Professor Halbach notes:

Inclusion of the word “happiness” in a standard will expand the range of benefits a trustee may bestow upon a beneficiary. It is obvious from normal usage that happiness is a broader term than support, and this is recognized in the cases. For example, although payments serving principally to enlarge a beneficiary’s estate would not be permissible under a support standard, enlargement of the beneficiary’s estate by release of his debt to the trust, though constituting a major portion of the trust assets, was permitted when, as emphasized by the court, the beneficiary’s “comfort, welfare and happiness” were express purposes of the discretionary power.... Such commonly used expressions as “welfare,” “care,” and “comfort” might conceivably add something to the scope of a discretionary support power, but when a trust estate is large enough so that support would contemplate a station-in-life test without them, it seems improbable that such words would have the effect of increasing the rights of a beneficiary whose customary mode of life has been comfortable.³⁵

Halbach asserts that the term “welfare” may not broaden the scope of discretion beyond that of support when the trust is large enough to support a beneficiary in her accustomed manner of life. His point highlights how courts interpret trust language in a factual context.

³³ *Blodgett v. Delaney*, 201 F.2d 589, 598 (1953).

³⁴ Restatement §50, cmt. d(3).

³⁵ Halbach, *Discretionary*, at 1439-1440.

I. Necessary, Necessities, Needs and Emergency

Occasionally a trust will employ the words “necessary,” “necessities,” “needs” or “emergency” as a way to further modify the words “health, education, maintenance and support.” In interpreting the phrase “respective needs,” a Federal Circuit Court has held “the term ‘needs’ is not, of course, one the content of which can be defined precisely.... The Reporter to Section 50 of the Restatement states: “[a] pair of New Hampshire cases treated references to such words as ‘needs,’ ‘necessities,’ and ‘necessary’ as the substantial equivalent of support in the beneficiary’s accustomed manner, rather than being limited to what is essential.”³⁶ In *Finch v. Wachovia Bank & Trust Company*,³⁷ the trust permitted the trustee to invade the trust for the surviving spouse to meet the “reasonable needs of Helen in her station in life – as to all of which the judgment of the Trustee shall be conclusive.” The surviving spouse requested a sum of money to make gifts. The Court held that making gifts was within the broad terms and remanded to Wachovia to determine whether it should make a distribution, noting that the ultimate decision rested with Wachovia as trustee. This decision is consistent with the Restatement’s position that the term “support” permits continuation of a family gifting program.

Professor Halbach notes:

It is by no means certain that the use of such words as “necessary,” “necessities,” or “needs” will result in a more restrictive power than if a support standard is employed. When only bare essentials are to be assured, the importance of being specific is apparent. “Emergency” and like terms accompanying discretionary powers have been much more strictly construed, importing extreme need. Since the meaning of such terms is not always clear, explanation or

³⁶ Restatement §50, Reporter’s Notes to comment d.

³⁷ 577 S.E. 2d 306 (N.C. App. Ct. 2003), *cert. denied*, 577 S.E. 2d 626 (N.C. 2003).

illustrations of what the settlor considers an emergency would be helpful.³⁸

III. APPLICATION OF FIDUCIARY DUTIES TO DECISION MAKING

A. Trustee Must Act

The principal fiduciary duty of a trustee under the Florida Trust Code is to administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries.³⁹ In discretionary trusts, the trustee must consider whether or not to exercise its discretion. It must make a determination as to whether a distribution is or is not to be made. The trustee can decide not to make a distribution, but it cannot fail to deliberate. The trustee cannot remain passive. A trustee breaches its duty to the beneficiary if it refuses to make a determination.⁴⁰

B. Trustee Must Be Informed

The trustee must be reasonably informed when making its decision.⁴¹ This includes intimate familiarity with the terms of the governing instrument. In addition, the trustee should know the specifics of the invasion request, including whether an invasion for the same or similar request has been granted or denied in the past by the grantor or by the trustee or former trustee. Often critical elements of being informed are knowing a beneficiary's standard of living and whether the beneficiary has other available resources.

1. Other Means of Support. If the governing instrument clearly speaks to the issue, then the trustee must comply. If the instrument is silent, the trustee

³⁸ Halbach, *Discretionary*, at 1440-1441.

³⁹ F.S. §736.0801. See also MTC sec. 801.

⁴⁰ Restatement §50, cmt b.

⁴¹ Restatement §50, cmt. b.

must make the determination based on statutory and common law. However, the common law does not provide clear guidance on the issue.

An interesting Florida case is *Barnett Banks Trust Company, N.A. v. Herr*.⁴² The trust contained the following provision:

The trustee shall pay to or for the benefit of my wife such part of the principal of the Residuary Trust as the Trustee, in its discretion, shall consider necessary or advisable for her health, maintenance and support, taking into consideration the standard of living to which she is accustomed at my death and all other income available to her from all sources known to the Trustee...”

The court affirmed that the language was properly construed by the lower court to mean that when the wife requests a principal distribution, the trustee is required to compare her standard of living (discussed below) at the time of the request with the standard of living she enjoyed at the time of her husband’s death. If her standard of living is less, then the trustee should pay principal for her benefit. In determining her standard of living, the trustee could only consider other sources of income available to her from all sources. The trustee could not consider her other income-producing assets. The court specifically ruled that the trustee could not, despite its arguments to the contrary, force the wife to sell her non-income producing assets to create more non-trust income for her use.⁴³

⁴² 546 So.2d 755 (Fla. 3rd DCA 1989).

⁴³ *Id* at 756, citing *Sarasota Bank & Trust Co. v. Reitz*, 297 So.2d 91, 92 (Fla. 2d DCA 1974); *In re Johnson’s Estate*, 46 Misc.2d 52, 258 N.Y.S.2d 922 (Surr. Ct. 1951); *In re Robinson’s Will*, 105 N.Y.S.2d 491 (Surr.Ct. 1951).

Many other cases and the Restatement (Second) of Trusts have concluded that the settlor intended to support the beneficiary even if the beneficiary has other resources.⁴⁴ The Restatement (Third), however, takes a contrary position. It provides:

It is important to ascertain whether a trustee, in determining the distributions to be made to a beneficiary under an objective standard (such as support standard), (i) is *required* to take account of the beneficiary's other resources, (ii) is *prohibited* from doing so, or (iii) is to consider the other resources *but has some discretion* in the matter. If the trust provisions do not address the question, the general rule of construction presumes the last of these.

Specifically, with several qualifications (below), the presumption is that the trustee is to take the beneficiary's other resources into account in determining whether and in what amount distributions are to be made, except insofar as, in the trustee's discretionary judgment, the settlor's intended treatment of the beneficiary or the purposes of the trust will in some respect be better accomplished by not doing so.... A grant of extended discretion...does not relieve the trustee of a duty to take into account, or of a duty to disregard, a beneficiary's other resources, although the extended discretion is a factor to be considered in the process of interpretation (emphasis in text).⁴⁵

Bogert doesn't reach any conclusion, stating in his treatise:

Numerous cases, based on a wide variety of evidence, can be found both in favor of and against, a consideration of the beneficiary's other means of support, including state or local public assistance.⁴⁶

As in the case of a discretionary trusts to pay income, when the discretion applies to the distribution or use of trust principal there is a question whether in deciding whether the income of the trust is so inadequate as to justify the use of principal and means of support of the beneficiary outside the trust or should the trustee ignore evidence on that question. On a variety of wordings and circumstances some courts have held that the trustee should examine into other sources of support, while others have reached

⁴⁴ Restatement §50, cmt. b.

⁴⁵ Restatement §50, cmt. e.

⁴⁶ Bogert On Trust And Trustees §811 (2nd ed.rev.).

an opposite conclusion. No definite rules for construction can be laid down.⁴⁷

Professor Halbach asserts:

No trust involving dispositive discretion in the trustee should be drafted without providing at least a basic answer to this inevitable question [whether the trustee must consider the beneficiary's other resources].⁴⁸

Ideally, the Trust should provide whether the trustee must consider the beneficiary's other means of support, and if so:

- a. Is the trustee only to consider the beneficiary's income producing assets?
- b. Should the trustee consider the beneficiary's marketable securities that could easily be sold or converted into assets producing more income?
- c. Should the beneficiary be required to sell assets before the trust is invaded?
- d. Should the trustee consider that the beneficiary is employable but simply refusing to work?
- e. Should the trustee consider the beneficiary's spouse's financial resources or the beneficiary's parent's legal obligation of support?
- f. What documentation can the trustee rely upon from the beneficiary and what information must be gathered?⁴⁹

⁴⁷ *Id.* at §812.

⁴⁸ Halbach, *Discretionary*, *supra* note 2 at 1442.

⁴⁹ Comment (e)(1) of the Restatement §50 provides “[t]he trustee generally may rely on the beneficiary's representations and on readily available, minimally intrusive information requested of the beneficiary. This reliance is inappropriate, however, when the trustee has reason to suspect that the information thus supplied is inaccurate or incomplete.”

- i. Income tax returns?
- ii. Financial statements?
- iii. Budget?

If the beneficiary's other resources may be considered, then under what circumstances should they be considered?

If the beneficiary's other resources are not to be considered, then is the trustee to consider how the beneficiary is using distributions the trust has already made to the beneficiary? For example, if the trust mandates income be distributed to the beneficiary, permits invasion of principal for the beneficiary's health, education, maintenance and support, and specifically provides the beneficiary's other resources are not to be considered, then is the trustee required to consider whether the mandatory income is sufficient to maintain the beneficiary's standard of living?

If the beneficiary's other resources are not to be taken into consideration, is the trustee to disregard even the legally enforceable obligation of another to support the beneficiary?

In the following example, the trustee is directed not to examine the beneficiary's other resources:

This trust is established to provide for the education of my newly born granddaughter. It is my desire that this trust provide for all of my granddaughter's education which is not provided by scholarships. My son has a legal obligation to provide an education for my daughter while she is a minor. He can satisfy his legal obligation by providing a public education with little cost. It is my desire that my granddaughter have a private education at quality schools. It is my desire that this trust pay for my granddaughter's attendance at every private school she attends beginning at pre-school through professional schools. This trust should pay for the tuition, fees, and all expenses for attending these private programs and schools. The trustees shall ignore my granddaughter's income and other resources, including that of her parents, when making a distribution. Before

making a distribution, the trustees should consider scholarships that have been awarded to my granddaughter. I recognize that this trust may prevent my granddaughter from qualifying for scholarship aid.

In the following example, the trustee is directed to consider the beneficiary's other resources:

In determining the necessity of a principal invasion, the trustee shall take into consideration the beneficiary's other resources, including the beneficiary's current income and principal resources which are reasonable available for these purposes, such as the beneficiary's readily marketable securities and rental properties. In addition, the trustee shall take into consideration the resources of those who are legally obligated to support the beneficiary. It is my intent that the beneficiary look to the beneficiary's own income and resources (including the resources of those legally required to support her) to maintain the beneficiary's standard of living at the time of my death before this trust is invaded.

Trustees often face a situation where the beneficiary is uncooperative, or may be suspected of being dishonest. To what extent should the trustee investigate the information provided? The following language may be useful to provide a trustee with some comfort when the beneficiary is less than forthcoming with the requested information, or the information may appear unreliable:

In determining the advisability and amount of any payment, the trustee may, but need not, rely on a statement of any beneficiary's or distributee's assets, signed by such beneficiary or distributee, or any parent, guardian, or similar fiduciary of such beneficiary or distributee.

2. Standard of Living

Trusts often provide that a trustee may invade income and principal for the beneficiary to maintain the beneficiary's "accustomed manner of living" or the beneficiary's "standard of living" or the beneficiary's "station-in-life." Use of that phrase begs the question of when and how the standard is to be determined. Possible

interpretations include as of the effective date of the will or trust, as of the death of the settlor/testator, or at the time the distribution is being requested.

The Restatement takes the position that if the instrument is silent, the beneficiary's accustomed standard of living is generally determined to be that at the time of the settlor's death or the time the governing instrument became irrevocable.⁵⁰ The Comments to the Restatement provide:

The accustomed manner of living for these purposes is ordinarily that enjoyed by the beneficiary at the time of the settlor's death or at the time that an irrevocable trust is created. The distributions appropriate to that lifestyle not only increase to compensate for inflation but also may increase to meet subsequent increases in the beneficiary's needs resulting, for example, from deteriorating health or from added burdens appropriately assumed for the needs of others.... Also, if a beneficiary becomes accustomed over time to a higher standard of living, that standard may become the appropriate standard of support if consistent with the trust's level of productivity and not inconsistent with an apparent priority among beneficiaries or other purpose of the settlor. Furthermore, distributions allowing the beneficiary an increased standard of living may be appropriate if, in light of the productivity of the trust estate, the eventual result would otherwise favor the remainder beneficiaries over the present beneficiary to a degree unlikely to have been intended by the settlor. "Productivity" for these purposes refers not only to trust income but also to a pattern of appreciation beyond maintenance of purchasing power, such as might result from a growth-oriented investment program.⁵¹

The Restatement gives the following illustration:

6. S's will left her residuary estate to T, in trust, to pay or apply "as much of the income and principal as T deems appropriate for the support of my [adult] daughter B," remainder to B's issue. Except during a brief period while her children were in college, B has received no distributions from S's trust and has relied on her own earnings and those of her husband, H, to enjoy an increasingly comfortable standard of living until the time of H's death and her retirement shortly thereafter. The trust estate is now sufficient to permit a level of distributions that will enable B to maintain the standard of living to which she has become accustomed. This standard, although considerably beyond what she enjoyed at the time

⁵⁰ Restatement §50, cmt. d(2).

⁵¹ *Id.*

of S's death, is appropriate to the reasonable exercise of T's discretion.⁵²

Illustration 6 specifically provides that the standard of living that B had become accustomed to after S's death was considerably beyond what she enjoyed at the time of S's death. According to the illustration, the beneficiary can increase her standard of living and at a future time request the trust to maintain that new lifestyle.

The following example clearly sets forth the time at which the standard of living is to be determined:

Example 1:

The trustee shall pay or apply to or for the benefit of my granddaughter, at any time and from time to time, such amounts of the principal of the trust, as the Trustee deems appropriate for her health, education, maintenance and support to maintain her in the standard of living she was enjoying at the time the trust was created. It is my intention that this trust will maintain my granddaughter's standard of living when she is no longer gainfully employed or employable in the her current profession.

If the standard is to be determined at the time of the settlor/testator's death, however, the surviving spouse can be disadvantaged under certain circumstances. For example, a couple's standard of living is frequently substantially impacted during a spouse's long period of incapacity. The healthier spouse foregoes lavish vacations and other expenditures to stay home and take care of the unhealthy spouse. If the standard is fixed to that which the couple enjoyed at death, the surviving spouse is penalized for his/her dedication to the unhealthy spouse.

A practical problem often arises with respect to establishing the beneficiary's standard of living, especially if it relates to a prior point in time. Most parties do not maintain detailed accountings of their expenditures on an ongoing basis. In this case, it

⁵² *Id.*

may be useful to consult documented resources such as federal income tax returns, gift tax returns, an estate tax return, and even bank account and credit card statements.

In second marriages, it's even more difficult to determine how the spouses allocated expenses between them. It may be grossly inaccurate to assume that one spouse fully supported the other simply because he or she had much greater wealth.

An historical analysis of the couple's expenses during marriage also does not take into consideration their ability to maintain that lifestyle over time. Some couples live well beyond their means, while others are very frugal. Some couples spend more lavishly when stock markets or real estate values are high, sensing a perceived level of wealth that may not hold true. Elderly couples often resort to bond or fixed income portfolios for security reasons. While they assert that "they are only living off their income" and "never touch their principal," in reality inflation erodes the buying power of the principal. If the surviving spouse continues the same level of consumption, the trust principal may be exhausted.

If the standard of living is not well documented, as is often the case, trustees often look to family members (who often have biased perspectives and a conflicting interest in the trust assets) to reconstruct the settlor's standard of living. Their opinion may be clouded by disapproval of the lifestyle, or more commonly, the surviving spouse.

The same reconstruction of the standard of living issue arises with respect to trusts for children. The issue is compounded, however, because the grantor's standard of living is usually not the appropriate standard; rather, it is typically the standard the child was enjoying at the time of the grantor's death. In some cases, the settlor may well have intended to increase the child's standard of living. If the standard is that which the child

enjoyed, then the additional income stream provided by the child's trust may defer an examination into the child's standard of living. Many years, and in some cases decades, may pass before the beneficiary makes a principal invasion request. If, as the Restatement notes, the standard is the child's standard of living that she/he has been enjoying in the last few years, then reconstruction is a much easier task. But perhaps the settlor disapproved of the child's spendthrift ways. Clearly it is better to provide the trustee some direction in the trust instrument.

The following provides an example of what documentation should be obtained to support the approval or denial of the requested discretionary distribution:

1. The written request for the distribution, including the reason for the request. If the beneficiary is a minor, the request should be from the minor's parent or guardian.
2. A written confirmation by the beneficiary if the request was made by telephone or in a meeting. In some cases, it may be more convenient to summarize the client's request in a letter to the client that the client signs and returns.
3. Detailed information as to the reason for the request. For example, if the request relates to education, the amount should clearly identify what amount is for tuition, room and board and books and other expenses. If the expense has already occurred, a statement from the university or if paid and the beneficiary is seeking reimbursement, a copy of the receipt from the beneficiary.

4. Any supporting documentation used to make a decision. Other documentation may include financial information such as tax returns financial statements and budgets for the person making the request.
5. If there are multiple beneficiaries, it may be appropriate to document the assessment of the respective needs of the beneficiaries to ensure that the process is compatible with the duty of impartiality.
6. Written approvals of any co-trustee or co-fiduciary or trust protector involved with authority to approve or deny distributions.

C. Trustee Must Act Impartially

A trustee has a duty to administer the trust in a manner that is impartial with respect to the various beneficiaries of the trust.⁵³ This duty extends to impartiality when making distributions from the trust.⁵⁴ Florida Trust Code §736.0803 provides: “[i]f a trust has two or more beneficiaries, the trustee shall act impartially in administering the trust property, giving due regard to the beneficiaries’ respective interests.”⁵⁵ The comments to the corresponding section of the Uniform Trust Code (Section 803) provide:

The differing beneficial interests for which the trustee must act impartiality include those of the current beneficiaries versus those of beneficiaries holding interests in the remainder; and among those currently eligible to receive distributions....The duty of impartiality does not mean that the trustee must treat the beneficiaries equally. Rather, the trustee must treat the beneficiaries equitably in light of the purposes and terms of the trust. A settlor who prefers that the trustee, when making decisions, generally favor the interests of one beneficiary over those of others should provide guidance in the terms of the trust.

Without any specific direction, the trustee will seek to exercise discretionary authority in a way that benefits the current beneficiary, but without causing harm to the

⁵³ Restatement §79(1).

⁵⁴ Restatement §79(1)(a).

⁵⁵ Similarly, see MTC sec. 803.

remainder beneficiaries' interests. The trust should clearly set forth the settlor's preferences, if any, among the beneficiaries. For example, if the trust is primarily for the benefit of one or more current beneficiaries, the trust should indicate the settlor's lesser preference for the remainder beneficiaries, indicating that their entitlement is limited to any amount (if any) remaining after the preferred beneficiary's death. It is also helpful to indicate that the trustee may deplete the trust principal in furtherance of the interests of the preferred beneficiary, even to the entirety, and even to the detriment of any other beneficiaries.

Preferences should also be stated when there are multiple beneficiaries currently entitled to discretionary distributions, the "pot" or "sprinkle" trust. For example, if the trust is for the benefit of a spouse and descendants, are the needs of the spouse to be given paramount consideration, even to the point of depleting principal? Likewise, where a trust is for a child and his or her issue, should the inclusion of the child's issue change once the issue are adults and self-sufficient?⁵⁶

Ideally, a well drafted trust provision would clarify:

- (i) among the class of beneficiaries, who has first priority;
- (ii) whether the trustee should treat all beneficiaries equally in making distributions, or, in fact, may favor one or more based on the trustee's evaluation of certain considerations;
- (iii) whether the trustee may deplete the trust principal if the trustee deems it necessary after review of the particular standard and the pertinent considerations; and

⁵⁶ *Id.*

(iv) whether distributions may be made at any time the trustee determines appropriate and need not follow any recurring time patterns such as, for example, quarterly or monthly payments.

IV. COURT INTERVENTION

A court will intervene only to prevent misinterpretation or abuse of discretion by the trustee.⁵⁷

The Restatement §50 provides:

Sec. 50. Enforcement and Construction of Discretionary Interests

(1) A discretionary power conferred upon the trustee to determine the benefits of a trust beneficiary is subject to judicial control only to prevent misinterpretation or abuse of the discretion by the trustee.

(2) The benefits to which a beneficiary of a discretionary interest is entitled, and what may constitute an abuse of discretion by the trustee, depend on the terms of the discretion, including the proper construction of any accompanying standards, and on the settlor's purposes in granting the discretionary power and in creating the trust.

Comment (b) to Section 50 of the Restatement notes:

A court will not interfere with a trustee's exercise of a discretionary power when that exercise is reasonable and not based on an improper interpretation of the terms of the trust. Thus, judicial intervention is not warranted merely because the court would have differently exercised the discretion. On the other hand, a court will not permit abuse of discretion by the trustee.... Court intervention may be obtained to rectify abuses resulting from bad faith or improper motive, and to correct errors resulting from mistakes of interpretation. Absent language of extended (e.g. "absolute" or "uncontrolled") discretion..., a court will also intervene if it finds the payments made, or not made, to be unreasonable as a means of carrying out the trust provisions....

⁵⁷ Restatement §50(1).

The Florida Trust Code provides some direction for the courts:

A court shall not determine that a trustee abused its discretion merely because the court would have exercised the discretion in a different manner or would not have exercised the discretion.⁵⁸

The trustee's duty to act in good faith in making discretionary distribution decisions should be the standard by which a court assesses the exercise, not the actual result. In Scott's treatise, he distinguishes between the court's need to interfere when the trustee "acts dishonestly or in bad faith, or where he acts from an improper motive, and lack of interference when the trustee "acts in good faith and does not act capriciously."⁵⁹

V. BEST PRACTICES FOR TRUSTEES

1. Read the governing instrument.
2. Ascertain the standard for making a discretionary distribution.
3. Communicate with the beneficiaries regarding their needs.
4. Analyze trust assets and beneficiary circumstances.
5. Determine whether or not the beneficiary's request falls within the discretionary standards outlined in the trust agreement.
6. Are there other factors that must or should be taken into consideration?
 - a. Other resources
 - b. Standard of living
 - c. Restrictions on distributions triggered by substance abuse provisions, special needs trust provisions, creditors' claims, divorce, etc.
 - d. Conditions precedent – college graduation, age attainment
7. Consider the size and duration of the trust. Be aware of "wasting" trusts.

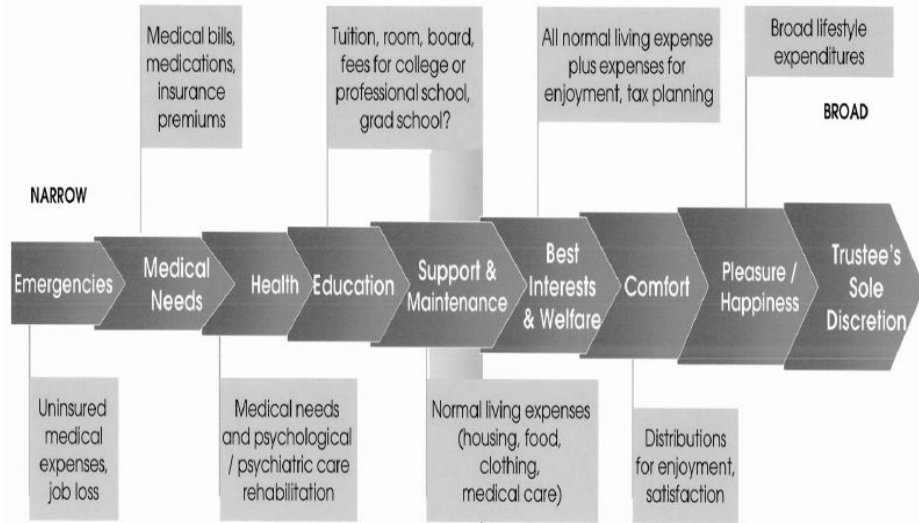
⁵⁸ F.S. §736.0814(1). Note that the UTC sec. 814 does not include this language.. This provision was included to incorporate existing Florida case law.

⁵⁹ 3 Austin W. Scott and William F. Fratcher, *The Law of Trusts*, Section 187.2 (4th Ed.).

8. Consider tax consequences if assets must be sold to raise cash, GST implications
9. Consider the intended prioritization among different classes of beneficiaries and the respective financial needs of all potential beneficiaries.
10. Remain impartial.
11. Document, document, document.
12. Review your strategy for discretionary distributions with the investment manager in light of the investment objective and asset allocation of the trust.
13. Seek co-trustee approval, if appropriate.
14. Review applicable state law for equitable adjustment parameters, criteria and exceptions where appropriate.
15. Consider whether a loan to the beneficiary would be more appropriate.

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Discretionary Distribution Standards



Scenario 1:

1. A beneficiary has requested that the trust company distribute \$100,000 to him so he can purchase a Mercedes.

The Trust provides:

“The trustee may in its sole and absolute discretion distribute the income and principal of the trust to my grandson for his health, education, maintenance and support.”

Should you make the distribution?

Scenario 2:

1. Mother’s will established trust for her son.
2. Son was 56 when mother died.
3. All of mother’s assets valued at \$3 million passed into trust for her son.

The Trust provides:

“Trustee may in its sole and absolute discretion distribute the income and principal to my son for his health, education, maintenance and support to sustain him in the standard of living he was accustomed to at the time of my death considering all of his other means of support.”

During mother’s lifetime, she did not provide her son any support. He has worked and has supported himself and his family by being gainfully employed. Should we make any current distributions to the son since he had become accustomed to a certain standard of living. Was the settlor essentially establishing a trust for his retirement?

Scenario 3:

Educational Pot Trust for five grandchildren from 2 different families.

The Trust provides:

“It is not the desire of the Grantor that a parent be asked or expected to seriously deplete his or her own resources for this purpose. It is the Grantor's hope that educational costs would include special educational assistance for both mentally advanced children as well as for those who require supplemental learning assistance. It is the further hope of the Grantor that students supported under the trusts created hereunder would be enrolled in an accredited school, college, university or program whether public or private, would maintain at least a "C" average grade or the

equivalent, and the Distribution Trustee would be satisfied that the student has a serious attitude toward a stated planned program and that there is a specified and defined, reasonable and justified time period for the same. The Distribution Trustee should consider education costs to include tuition, fees, costs of books, supplies and equipment which are normal and usual, transportation costs for travel to and from home and school as would be usual and reasonable, and the cost of room and board of a reasonable and usual quality. The Grantor believes that funds for spending allowance, clothing and an automobile may also be appropriate. Each beneficiary should be expected to make a dedicated effort to be as self-sufficient and self-reliant as is possible and reasonable.”

1. Is it first come first serve?
2. Do you limit amount to each child based on a fraction of children living?
3. Do you count on other children?
4. How long do you keep the class open?
5. Do you consider the parent's possibly non-legal obligation to pay for college education?
6. Do you permit larger distributions to those attending Ivy Schools versus state supported or do you provide the same to all?
7. Do you limit to 4 years?
8. Do you pay for post-graduate education?
9. Do you pay for trade school, etc?

Orange Book Form

EXISTING LANGUAGE

2.5 TRUST ADDITIONS AND REMOVALS: Settlor reserves the power to add to the trust estate at any time by delivering to the trust additional property which is acceptable to trustee. Settlor reserves the power to remove all or any part of the property from the trust at any time by notifying trustee of such removal in writing.

2.6 AMENDMENT AND REVOCATION: Settlor reserves for settlor's lifetime the following powers which settlor may exercise at any time or times:

- a) To revoke the trust by a writing;
- b) Upon trustee's consent, to amend the trust, in whole or in part, by a writing; and
- c) To direct, by a memorandum which settlor may leave at settlor's death, distribution by trustee on settlor's death of any of settlor's tangible personal property, together with any insurance policies covering such property and claims under such policies.

PROPOSED LANGUAGE

2.5 TRUST ADDITIONS AND REMOVALS: Settlor reserves the power to add to the trust estate at any time by delivering to the trust additional property which is acceptable to trustee. Settlor reserves the power to remove all or any part of the property from the trust at any time by notifying trustee of such removal ~~in~~ ONLY BY A SEPARATE SIGNED writing OTHER THAN A DEED OR OTHER DOCUMENT OF CONVEYANCE, AND REFERRING TO THE TRUST.

2.6 AMENDMENT AND REVOCATION: Settlor reserves for settlor's lifetime the following powers which settlor may exercise at any time or times:

- a) To revoke the trust ONLY by a SEPARATE SIGNED writing REFERRING TO THE TRUST;
- b) Upon trustee's consent, to amend the trust, in whole or in part, ONLY by a SEPARATE SIGNED writing REFERRING TO THE TRUST; and
- c) To direct, by a memorandum which settlor may leave at settlor's death, distribution by trustee on settlor's death of any of settlor's tangible personal property, together with any insurance policies covering such property and claims under such policies.

Notes:

1. We want not to destroy the ability to establish an oral trust. There seems to be an emotional pull toward a concept that says, “If you can form a trust by parol, you should be allowed to revoke one by parol.” Somehow, that seems related to the equal dignities rule.

C.R.S. 15-5-407. Evidence of oral trust. Except as required by a statute other than this article 5, a trust need not be evidenced by a trust instrument, but the creation of an oral trust and its terms may be established only by clear and convincing evidence.

Perhaps it is kind of like common law marriage which you can commence without a formal declaration or writing, but requires a legitimate divorce for termination. The Trust Code does provide for termination of a trust by parol, if shown by clear and convincing evidence.

2. There is some reluctance to use language like “the publication of a deed, alone, shall not be evidence of ...” That seems to leave too much up to the fact finder and does not address the problem of *post mortem* litigation over one’s intention.

3. We are aware that in order to transfer real property which is titled in the name of a trust, a Statement of Authority is generally required. However, if the central issue in litigation is whether there has been a revocation of the trust, in whole or in part, it could be reasonably argued that the requirement of a Statement of Authority becomes moot. Hence, the proposed requirement that a separate document be provided to establish the chain of title. Recording such a separate document would seem to be the better practice, and might even be required to establish clear title.

Trust Advisors Forum - 2018

Current Issues with Distribution Standards: Can They Come Back to Bite You?

Tuesday, February 27, 2018
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The McGuireWoods LLP Private Wealth Services Group welcomes your questions or comments about these seminar materials. Please feel free to contact any member of the Group.

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TABLE OF CONTENTS

	<u>Page</u>
I. Introduction.....	1
II. Use of Trusts in Estate Planning and Property Management and Succession.....	1
III. Particular Standards of Distribution: What Does the Trust Language Mean?.....	5
IV. Providing Additional Guidance to the Fiduciary	34
V. Incentive Trusts.....	40
VI. Treatment of Multiple Beneficiaries and the Duty of Impartiality	44
VII. Selection of Trustees and Division of Fiduciary Responsibility Among Trustees	58
VIII. Conclusion	68

Current Issues with Distribution Standards: Can They Come Back to Bite You?

I. Introduction

- A. The involvement of the trustee or trust officer, attorney, and advisor with distribution standards takes place on two levels.
 - 1. The professional may have an opportunity to be involved at the planning stage, in educating the client about the standards to be used for determining what distributions are appropriate and the impact of various alternatives.
 - 2. He or she also faces the practical application of those standards during the administration of a trust. The trust professional, often with the assistance and guidance of a discretionary distribution committee, will have to apply his or her judgment to the beneficiaries' situations, and determine if a distribution is appropriate.
- B. Both levels require an understanding of the common meanings given to the distribution language used in trusts. These materials review the judicial interpretations of common distribution provisions, and suggest alternative provisions that can be used to provide more guidance. The materials also examine various ways in which lawyers are trying to provide greater flexibility in trusts, and to respond creatively to the demands of settlors, trustees, and beneficiaries.
- C. The materials also discuss recent state law changes in the treatment of income and principal. These changes, such as Principal and Income Act provisions allowing trustees to provide current beneficiaries with a unitrust interest instead of an income interest, are a response to total return investment concepts. At its core, though, these developments are also responses to clients' demands for greater flexibility and for more flexible trusts.
- D. The heart of the trust business is service. Good service requires an understanding of trust distribution standards and a willingness to work with unique versions of those standards.

II. Use of Trusts in Estate Planning and Property Management and Succession

- A. Benefits of Placing Property in Trust
 - 1. Individuals often believe that they need nothing more than a simple will if their estates are below the applicable exclusion amount and will escape federal estate tax at their death and their spouse's death. A simple will, that leaves all the assets to the spouse and, upon the spouse's death, divides the assets equally among the children, is often considered sufficient to protect the family adequately. A closer look points out the risks inherent in such a plan.

- a. If an individual leaves even modest amounts of money to a spouse who has never had any experience with financial management and investment decisions, he or she may be placing an unfair burden upon the spouse. This type of burden translates into anxiety instead of security.
 - b. The surviving spouse may remarry, and all or a portion of the assets originally intended to go to children may end up in the hands of the new spouse, or children of the second marriage.
 - c. Even if the surviving spouse does not remarry, he or she may be put in the position of saying “no” to a child who wishes to use the inherited wealth for a risky new business venture or some speculative investment. Depending upon the relative strengths of the child and surviving spouse, imprudent decisions may be made which could rapidly dissipate the property left for the family.
 - d. A surviving spouse who has been insulated from financial matters may, upon receiving an inheritance, simply become overwhelmed by the immediate feeling of wealth and independence and live in a manner that could quickly exhaust the remaining estate.
2. By using trusts to transfer property, either during life or at death, the donor is able to maintain an element of control over the property. The donor can designate under what circumstances and for what purposes a beneficiary will receive that property or its income. Trusts also permit the donor to determine who will manage the property as trustee.
 3. Other advantages of trusts include the following:
 - a. Retention of property in trust with a professional trustee preserves the benefits of the investment and management skills of the trustee.
 - b. A trust can protect assets from the claims of third-party creditors of the beneficiary, such as the plaintiff in a lawsuit or a spouse in a failed marriage. Generally, a creditor or litigant cannot gain access to assets set aside in a properly drafted trust by someone other than the beneficiary. The same is generally true with respect to a divorcing spouse, although state law varies on the degree to which courts can consider the existence of trust assets in determining the division of assets upon divorce.
 - c. Children who have not fully matured may rapidly dissipate an outright inheritance, whereas a trust can provide for incremental distribution of inheritances.
 - d. Large outright distributions, or trusts that do not contain thoughtful and deliberate distribution provisions, may interfere with a child’s

personal and professional development. Put simply, large gifts may spoil children and destroy their incentive to provide for self-support.

- e. A well-drafted trust can also be flexible enough to allow a capable beneficiary to take advantage of entrepreneurial business opportunities.

B. Examples of Trust Provisions

- 1. The trust may be drawn narrowly so that during a child's minority, the trust's assets can be used only for the basic health, support, and education needs of the child. With this type of standard, the trustee cannot use the trust funds for expensive trips or cars, or other extravagances.

SAMPLE TRUST PROVISION: Until the Termination Date (as later defined), the Trustee shall pay to or for the benefit of the Child as much of the net income and principal of the trust, even to the extent of exhausting principal, as the Trustee may deem necessary for the support, health, and education of the Child.

- 2. On the other hand, if the client prefers, the trust may be drawn very broadly so that the trust property would be available for virtually any purpose. Language making the trust property available for the "welfare and best interests" of the child leaves the trustee very great latitude to use the trust property for most any purpose believed appropriate.

SAMPLE TRUST PROVISION: Until the Termination Date (as later defined), the Trustee shall pay to the Child from time to time such portion or portions of the net income and principal of the trust as the Trustee shall deem desirable for the benefit of such Child.

- 3. There are numerous alternatives to these trust provisions, as discussed in more detail below.

C. Trusts for Multiple Beneficiaries: the "One-Pot Trust" or Separate Trusts

- 1. When more than one child is a beneficiary of a trust, a choice must be made between two basic trust structures, the one-pot approach or separate-trust approach.
- 2. The several-trust structure divides the trust assets (usually equally) among the children at the death of both parents, and each child's share is held and administered exclusively for the benefit of that child and his or her family, with no child receiving assets from another child's share during the life of the other child.

- a. In many cases, as each child reaches a designated age, he or she is then entitled to receive his or her share outright.
 - b. The income from the share may be required to be distributed to the child or may be distributable at the discretion of the trustee.
 - c. Similarly, the principal of the trust can be made available to be distributed for the benefit of the child in accordance with the standards provided in the trust.
 - d. In estates with adult children, division into separate pots immediately upon the death of both parents is common in order to allow separate children to act independently of each other on investment and distribution decisions.
3. The one-pot structure postpones the division of trust property, either for an indefinite period, or until all children have reached some stated age, such as 21 or 25, at which point the one-pot trust can be divided.
- a. During the one-pot period, the entire trust can be used according to the relative needs of the children without limiting each child to a particular share. In most cases, this structure more closely approximates the way a family normally conducts its affairs, and it is especially appropriate when priorities must be established because of concern that money will not be available for everything.
 - b. For example, in the event of a major illness of one child, it may be appropriate to use all the trust's resources for the medical care of that child, even though this ultimately will reduce the inheritances of the other children.
 - c. The one-pot trust also is perceived as a fairer approach before all the children have completed their educations. If separate trusts are created immediately, and one child has completed college while another has not started, the younger child's trust is burdened with a cost that the parents paid for the older child.
4. Whether a one-pot or several-pot approach is adopted, an age for trust division or direct distribution to beneficiaries must be selected, or the trust assets can remain in trust for the beneficiary's or beneficiaries' lifetimes. Some choose installment payments, such as one-half at age 25 and the remainder at age 30, which provides a reserve for a child who unwisely dissipates the first installment and learns from the experience to handle the second installment more prudently.
5. Another alternative to direct distribution to a child in a several-pot approach is to grant the child a power of withdrawal over the property in his or her trust when he or she reaches a certain age or ages.

SAMPLE TRUST PROVISION: First Power of Withdrawal. When the Child reaches age twenty-five (25) (or, at the time the trust is created, if at that time the Child has reached age twenty-five (25) but has not reached age thirty (30)), the Child shall have the right at any time to withdraw one-third (1/3) of the principal and any undistributed income of the trust. Upon any addition to the trust after the Child reaches age twenty-five (25) but before the Child reaches age thirty (30), the Child shall have the right to withdraw one-third (1/3) of such addition.

- a. This allows the child to leave the property in the trust and continue to take advantage of the benefits the corporate fiduciary can offer.
- b. Once the child has withdrawal rights, the child is treated as the owner of any property in the trust subject to his withdrawal rights and will be directly taxed for any income or capital gain from such property.
- c. If partial withdrawals are permitted at different ages, however, an unexpected tax trap is associated with this approach.
 - (1) Distributions to a grandchild from a trust established for his or her parent, when they are made after the date the parent can make his first withdrawal from the trust, will be considered gifts from the parent unless care is taken in the document to limit such distributions. This is because, for tax purposes, the parent will be considered the owner of any property subject to a power of withdrawal, just as if it had been distributed to him or her outright.
 - (2) To avoid this, the trust should direct that distributions to a grandchild be made from the portion of the trust not subject to a power of withdrawal.

D. Below, these materials discuss the numerous alternatives to these general types of provisions.

III. Particular Standards of Distribution: What Does the Trust Language Mean?

A. Distribution Standards

1. One of the key functions of a trustee is to make appropriate distributions to beneficiaries of the trust. The terms of the trust will provide guidance to the trustee of when and how to make such distributions, and what factors to consider when doing so.

2. Distribution provisions fall into two general categories: an “ascertainable standard” and a “non-ascertainable standard”.

B. Ascertainable and Non-Ascertainable Standards.

1. Ascertainable Standard

- a. An “ascertainable standard” provides specific guidance to the trustee, which a beneficiary can sue to enforce. Typically, these provisions allow distributions for a beneficiary or beneficiaries’ “health, education, maintenance, and support.”
- b. The Uniform Trust Code defines an “ascertainable standard” as “a standard relating to an individual’s health, education, support, or maintenance within the meaning of Section 2041(b)(1)(A) or 2514(c)(1) of the Internal Revenue Code of 1986.” UTC § 103(2). This definition was added to the Uniform Trust Code in a 2004 amendment, in recognition of the appearance of this term in various places in the Uniform Trust Code. UTC § 103, comment.
- c. Below is an example of a trust provision containing such a standard:

SAMPLE TRUST PROVISION: During the Beneficiary’s lifetime, the Trustee shall pay to or for the benefit of the Beneficiary and any descendant of the Beneficiary as much of the net income and principal of the trust, even to the extent of exhausting principal, as the Trustee may deem necessary for the support, health, and education of the Beneficiary and any such descendant of the Beneficiary.

- d. The general principle of an ascertainable standard is that the standards such as “health” or “support” of a beneficiary could be reasonably determined by a third party, so a beneficiary could petition a court to resolve whether the trustee was properly administering the trust. For example, if a beneficiary argued that his needs for “support” were not being met, the beneficiary could request that the court order that the distributions be increased to meet the appropriate level of support. See generally Restatement (Third) of Trusts § 50, comments a, d.

2. Non-Ascertainable Standard

- a. A “non-ascertainable standard” provides general guidance to the trustee, without giving specific terms which a beneficiary could

enforce, such as allowing distributions for a beneficiary's "best interests," "happiness," or similar terms.

- b. Below is an example of a trust provision containing such a standard:

SAMPLE TRUST PROVISION: The Trustee shall pay to the Child from time to time such portion or portions of the net income and principal thereof as the Trustees shall deem desirable for the best interests and welfare of such Child.

- c. For a non-ascertainable standard, judicial review is very limited. The judge would be unlikely to interfere and to determine whether distributions were sufficient to meet a beneficiary's "best interests" or "happiness." Instead, the court would only review to determine whether the trustee was generally acting in good faith. See generally Restatement (Third) of Trusts § 50, comment d.

3. Implications of Ascertainable Standard

- a. As noted in more detail below, whether a standard qualifies as "ascertainable" or "non-ascertainable" can have important implications, particularly for tax purposes and purposes of creditor protection.
- b. Creditor Protection
 - (1) Limiting distributions to an ascertainable standard can allow a beneficiary to serve as trustee or co-trustee, without making the trust assets subject to creditor claims.
 - (2) Under the Uniform Trust Code, a creditor may not reach the interest of a beneficiary who is also a trustee or a co-trustee, if the trustee's discretion to make distributions for the trustee's own benefit is limited by an ascertainable standard.
- c. Transfer Taxes
 - (1) A beneficiary's service as trustee can also have important implications for purposes of estate and gift tax.
 - (2) A trustee who has the discretionary power to distribute trust property to himself as a trust beneficiary possesses a general power of appointment unless the discretionary power is limited by an ascertainable standard related to his

or her health, education, support or maintenance. IRC §§ 2041(b)(1)(A); 2514(c)(1).

- (3) IRC § 2041(b)(1)(A) (regarding estate tax) and IRC § 2514(c)(1) (regarding gift tax) provide that property subject to a general power of appointment is included in a decedent's estate for estate tax purposes, but provides that the following is not a general power of appointment: "A power to consume, invade, or appropriate property for the benefit of [the individual] which is limited by an ascertainable standard relating to the health, education, support, or maintenance of [the individual]."
- (4) The Regulations provide the following elaboration on this definition of "ascertainable standard":

A power is limited by [an ascertainable] standard if the extent of the possessor's duty to exercise and not to exercise the power is reasonably measurable in terms of his needs for health, education, or support (or any combination of them). As used in this subparagraph, the words "support" and "maintenance" are synonymous and their meaning is not limited to the bare necessities of life. A power to use property for the comfort, welfare, or happiness of the holder of the power is not limited by the requisite standard. Examples of powers which are limited by the requisite standard are powers exercisable for the holder's "support," "support in reasonable comfort," "maintenance in health and reasonable comfort," "support in his accustomed manner of living," "education, including college and professional education," "health," and "medical, dental, hospital and nursing expenses and expenses of invalidism." In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised.

Treas. Reg. § 25.2514-1(c)(2); see also Treas. Reg. § 25-2041-1(c)(2).

d. Modification of Trusts with Ascertainable Standards: Decanting

- (1) The presence or absence of an ascertainable standard can also affect the extent to which the distribution provisions of a trust can be modified.
- (2) One method of modifying a trust is through a process called “decanting.” Decanting can be authorized by the common law, statutory law, or the terms of the trust.
- (3) Decanting is a process by which a trustee of one trust transfers the assets of a trust to a new trust, which is either already in existence or which was formed by the trustee of the first trust during the decanting process. This transfer is referred to as “decanting,” after the example of pouring wine from one container to another.
- (4) Currently, twenty-five states authorize decanting by statute; under those statutes, decanting must meet specific procedural and substantive requirements.
- (5) If the original trust can make distributions only based on an ascertainable standard, then most states’ decanting statutes would require the second trust to contain the same or a substantially similar ascertainable standard.
- (6) This requirement also exists under the Uniform Trust Decanting Act, promulgated in 2016 and currently enacted in Colorado, New Mexico, North Carolina, Virginia, and Washington. See Uniform Law Commission, “Trust Decanting.”
- (7) Under the Uniform Trust Decanting Act, if a trust’s distribution provisions are subject to “limited distributive discretion” (that is, a distribution power subject to “an ascertainable standard or a reasonably definite standard”), then a decanting to a second trust, “in the aggregate, must grant each beneficiary of the first trust beneficial interests which are substantially similar to the beneficial interests of the beneficiary in the first trust.” UTDA § 12.

C. Structuring the Distribution Provisions

1. In light of the above, differences between ascertainable and non-ascertainable standards, and differences between specific terms without those trust provisions, can have important implications for creditor protection, taxes, and the distributions from the trust.

2. But settlors, trustees, and beneficiaries often ask:
 - a. What, for example, is the real difference between “support and maintenance” and “best interests and welfare” in terms of what access the beneficiaries will have to the trust assets?
 - b. Or, what factors related to the beneficiary’s other resources, lifestyle, etc. will the trustee take into account in making distributions?
3. Most attorneys have a standard procedure for addressing these issues and answering the client’s questions. For instance, many clients have been told that “support and maintenance” allows the beneficiary to maintain his or her accustomed standard of living, whereas “best interests and welfare” could include distributions for luxury items—a Mercedes Benz or a trip to Europe.
 - a. Attorneys typically answer these questions briefly, for very practical reasons—many clients cannot afford to have the attorney spend hours exploring the client’s goals and drafting unique, specific provisions governing distributions. However, some can afford, or do expect, that type of tailoring. In these situations, trusts are likely to contain very customized distribution provisions.
 - b. Any decision regarding the appropriate distribution standard for a trust must take into account the creditor protection and transfer tax consequences of using the distribution standard, which are discussed above.
 - c. Most draftspersons include provisions in trust documents to limit the distribution powers of a beneficiary/trustee to purposes that fall within an ascertainable standard. This is done directly, by specifically giving broader distribution powers only to an independent trustee, or it is done indirectly, with a savings clause that provides that the powers of any trustee who also is a beneficiary are cut back to purposes that fall within the ascertainable standard.
 - d. Many states also have statutes that prevent a beneficiary/trustee from exercising discretionary distribution powers or cut back the powers to ascertainable purposes. The Uniform Trust Code provides that, with certain exceptions (including express contrary direction in the trust), “a person other than the settlor who is a beneficiary and trustee of a trust that confers on the trustee a power to make discretionary distributions to or for the trustee’s personal benefit may exercise the power only in accordance with an ascertainable standard.” UTC § 814(b)(1). The provision also

states that a trustee may not exercise a discretionary distribution power to satisfy a personal legal obligation to support another. UTC § 814(b)(2).

4. The interpretation of terms which set out a standard of distribution, such as “best interests,” “support” and “comfort,” is governed by state law. Therefore, the meaning of a particular term may be more or less restrictive, depending on the law of the state that governs the interpretation of the instrument.
5. In general, if the trustee’s authority to make distributions is discretionary, and the trustee uses its judgment and makes a reasonable decision, a court will not disturb the trustee’s decision to distribute or withhold trust assets unless there has been evidence of bad faith or an abuse of discretion. The Restatement (Third) of Trusts describes the trustee’s powers and the court’s oversight obligations as follows:

§ 50. Enforcement and Construction of Discretionary Interests

(1) A discretionary power conferred upon the trustee to determine the benefits of a trust beneficiary is subject to judicial control only to prevent misinterpretation or abuse of the discretion by the trustee.

(2) The benefits to which a beneficiary of a discretionary interest is entitled, and what may constitute an abuse of discretion by the trustee, depend on the terms of the discretion, including the proper construction of any accompanying standards, and on the settlor’s purposes in granting the discretionary power and in creating the trust.

6. The commentary to the Restatement explains that a court will not interfere with a trustee’s exercise of discretion merely because the court would have exercised the discretion differently. The court will act, however, to prevent an abuse of discretion. “What constitutes an abuse depends on the terms of the trust, as well as on basic fiduciary duties and principles.... Of particular importance are the purposes of the power and the standards....” Restatement Third § 50, cmt b.
7. The commentary states that intervention is appropriate to “rectify abuses resulting from bad faith or improper motive,” to correct errors in interpretation, or to address a situation where the trustee failed to exercise his or her judgment or did so without inquiring into the relevant circumstances. Id.
8. One court recently confirmed that a court may review a trustee’s actions as arbitrary or as an abuse of discretion:

[S]tatutes and jurisprudence provide that, notwithstanding a broad grant of discretion or one specifically limited only by bad faith, fraud or dishonesty, a court is vested with the authority to evaluate whether the trustee's actions were consistent with the terms and purposes of the trust and in the best interests of the beneficiaries, and if they were not, to overrule the decision of the trustee as arbitrary and an abuse of discretion.

Rafalko v. Georgiadis, 777 S.E.2d 870 (Va. 2015).

D. Discretion of Trustee in Making Distributions

1. A trustee exercises discretion in determining whether to make distributions to beneficiaries.
2. A trustee may be vested with varying levels of discretion, such as “sole and absolute discretion” or “uncontrolled discretion.” But case law and the Restatement indicates that using such adjectives does not indicate substantively greater discretion than another. As stated in the Third Restatement of Trusts, “the difference between extended and simple discretion is one of degree more than of kind.” See Restatement (Third) of Trusts § 87, at 254 (2007).
3. In making distributions, the trustee must balance various factors, including, but not limited to, the following:
 - a. The terms of the trust;
 - b. The needs of current beneficiaries of the trust;
 - c. The need to retain assets of the trust for future needs of current beneficiaries;
 - d. The need to retain assets of the trust for future needs of future and remainder beneficiaries; and
 - e. Other factors that may influence the retention of assets in the trust for the benefit of the beneficiaries, such as income tax implications of distributions to beneficiaries rather than retaining those assets in trust.

E. Consideration of the Beneficiary's Other Assets

1. Of particular concern, a trustee must determine whether it can, should, or must consider other resources of a beneficiary before making a distribution.

- a. At common law, the general presumption was that, unless the instrument expressly provides that the trustee may consider the beneficiary's other assets and income, the trustee may not consider those assets in determining what distributions are required for the support of the beneficiary. The beneficiary has the right to look first to the trust assets for his support. See Restatement (Second) of Trusts, § 128, comment e; Nielsen v. Duyvejonck, 236 N.E.2d 743, 747 (Ill. App. 1968); Hart v. Connors, 228 N.E.2d 273 (Ill. App. 1967); Demitz' Estate, 208 A.2d 280 (Pa. 1965); Matter of Martin, 269 N.Y. 305 (1936); Godfrey v. Chandley, 811 P.2d 1248 (Kan. 1991); In re Bedell's Estate, 92 N.Y.S.2d 70 (1949).
- b. In many cases, this rule would be disadvantageous from both a tax and a fairness standpoint, and the trend seems to be moving away from it. The Restatement Third of Trusts states that the general rule, absent specific direction to the contrary, is that the trustee has discretion to consider other resources. Restatement Third § 50, comment e.
- c. In some states, if a gift to the beneficiary is conditioned on need—for example if the trustee is directed to make distributions “for a beneficiary's support as it deems necessary” or “as the beneficiary needs” or “if there is an insufficiency”—then the beneficiary's outside assets and income must be considered. See Boston Safe Deposit & Trust Company v. Boynton, 443 N.E.2d 1344 (Mass. App. 1983); Matter of Martin, 269 N.Y. 305 (1936); Matter of A. David Bernstein, NYLJ, December 7, 1988, p.26; Stempel v. Middletown Trust Co., 15 A.2d 305 (Conn. 1940); In re Tuthill's Will, 76 N.W.2d 499 (Minn. 1956); In re Martin's Will, 199 N.E. 491 (NY 1936); In re Seacrist's Estate, 66 A.2d 836 (Pa. 1949).
- d. However, this is not a hard and fast rule, and in many cases the courts have not required the trustee to consider the beneficiary's other resources although the terms “as needed” or “necessary” were attached to the standard of distribution. See Cross v. Pharr, 221 S.W.2d 24 (Ark. 1949); Hamilton National Bank of Chattanooga, Tennessee v. Childers, 211 S.E.2d 723 (Ga. 1975); McClintock v. Smith, 29 N.W.2d 248 (Iowa 1947); Sibson v. First National Bank & Trust Co. of Paulsboro, 160 A.2d 76 (N.J. Super. 1960); In re Stern's Will, 228 N.Y.S.2d 90 (1962).
- e. Some courts have found that where the trustee was directed to pay income and principal as needed for the support of the beneficiary, the beneficiary's other income, but not his other assets, should be considered. Peoples Bank & Trust Co. v. Shearin, 219 S.E.2d 299 (N.C. App. 1975); Sibson v. First National Bank & Trust Co. of Paulsboro, 165 A.2d 800 (N.J. Super. 1960).

- f. Still other courts have concluded that even if a trustee is given extended discretion by a settlor, the trustee's judgment in making distributions "should be evaluated in light of the availability of other resources." In re Trusts of McDonald, 100 A.D.3d 1349 (N.Y. App. Div. 2012) (finding no abuse of discretion when trustee declined to make distribution for education, when beneficiary had access to additional resources, including a Section 529 plan for educational expenses and potential public assistance.
- g. Some courts have held that if the trustee is granted broad discretion in making distributions, the trustee is permitted to consider the beneficiary's other assets.
 - (1) In one case, a standard which authorized the trustee to make distributions of principal which she "in her sole discretion, determines necessary for the support and maintenance" of the beneficiary allowed the trustee to consider the beneficiary's other assets. The Pennsylvania Superior Court held that such a broad grant of discretion indicated that the trustee had the authority to withhold trust principal from a beneficiary with independent resources. In re Estate of Tahjian, 544 A.2d 67 (Pa. Super. 1988).
 - (2) However, in a New York case involving similar language, the court held that the trustees should not require the beneficiary to use his personal assets for support before looking to the trust assets. In that case, the trustees were authorized to distribute as much of the trust income to the beneficiary as they in their sole discretion deemed advisable to supplement an annuity that the settlor gave to the beneficiary. Matter of Estate of McNab, 558 N.Y.S.2d 751 (1990).
- h. If the settlor directs the trustee to consider the beneficiary's "other resources," there is still a question of which resources it may or must consider. In some circumstances, the settlor may want to specify whether the trustee is to consider only the beneficiary's liquid assets, or the beneficiary's entire estate, including non-liquid assets such as the beneficiary's home. Tax considerations also may be relevant.
- i. The settlor may wish trust property which is not needed for the beneficiary's support to remain in trust for other beneficiaries, especially if the trust property will not be taxable in the beneficiary's estate.

- j. For example, it may be desirable for the trustee of a credit shelter trust to consider the surviving spouse's marital trust and non-trust assets before making a distribution from the credit shelter trust, because those other assets will be included in the surviving spouse's gross estate, whereas the credit shelter trust assets will not.

F. Particular Standards of Distribution

- 1. The following terms or scenarios are discussed below, in this order:

- a. "Support" and "maintenance"
- b. "Standard of living"
- c. "Comfort"
- d. "Education"
- e. "Health"
- f. "Emergency" and similar "extraordinary" standards
- g. "Best interests" or "best interests and welfare"
- h. "Happiness"
- i. To enable the beneficiary to make gifts
- j. Distributions to save income taxes
- k. "Sole and absolute" discretion
- l. Special needs trusts
- m. Additional language or circumstances

- 2. "Support" and "maintenance"

- a. The terms "support" and "maintenance" normally are construed as synonyms. See Restatement Third § 50, comment d(2). They encompass more than bare subsistence. Hartford-Connecticut Trust Co. v. Eaton, 36 F.2d 710 (2d Cir. 1929). These terms include the beneficiary's normal living expenses, such as housing, clothing, food, and medical care, depending on the standard of living enjoyed by the beneficiary during the settlor's or testator's life. In re Levinson's Will, 5 Misc. 2d 979, 162 N.Y.S.2d 287 (1957); Hill v. Comm'r, 88 F.2d 941 (8th Cir. 1937); Equitable Trust Co. v. Montgomery, 44 A.2d 420 (Del. Ch. 1945).

- b. The commentary to the Restatement adds that living expenses normally would include things such as mortgage payments, property taxes, suitable health insurance or care, casualty insurance, and also items such as vacation expenses in accordance with past vacations. The Restatement suggests that a beneficiary should be able to continue past patterns of charitable and family giving; not that the trustee would cover these with distributions, but that the beneficiary should be able to make these expenditures without reduction of the support coming from the trust. Restatement Third § 50, comment d(2)
- c. The extent to which the standard of living or lifestyle of the beneficiary should be taken into account also depends on the size of the trust fund, and whether it needs to be preserved for probably future needs of the beneficiary. See Restatement Third § 50, comment d(2). In other words, the beneficiary may need to accept a less extravagant lifestyle if he or she is dependent on a trust of more limited size as his or her primary source of support.
- d. In many states, if a trustee may distribute principal for a beneficiary's support, the trustee also may distribute principal for the support of the beneficiary's spouse and children. The beneficiary's legal obligations of support are a part of his living expenses. See In re Sullivan, 12 N.W.2d 148 (Neb. 1943); Robinson v. Robinson, 173 Misc. 985, 19 N.Y.S.2d 44 (Surr. Ct. 1940); Seattle-First National Bank v. Crosby, 254 P.2d 732 (1953); Akers v. Fidelity & Columbian Trust Co., 234 S.W. 72 (1921). But see Cavett v. Buck, 397 P.2d 901 (Okla. 1964) (Court limited the permissible distributions to those for the support of the beneficiary alone, and not for the support of his wife and dependent children).
- e. If the settlor wishes to allow the trustee to make distributions to spouses of the settlor's descendants, he or she should include a specific provision in the trust instrument:

SAMPLE TRUST PROVISION: In the trustee's sole and uncontrolled discretion, the trustee also may distribute income or principal to any individual who at any time was married to a descendant of mine in such amounts as the trustee, other than the distributee, deems necessary for the distributee's health and support in reasonable comfort in light of the distributee's role within the family of that descendant of mine.

3. “Standard of living”

- a. A distribution standard, and in particular a distribution standard regarding “support,” often refers to the beneficiary’s standard of living. In most cases, it is not necessary to elaborate on this reference. However, if there is a concern about changing standards of living, the time to which the standard of living refers should be made clear.
 - (1) For example, it could refer to the standard of living when the instrument was drafted, when the instrument became effective (i.e., at the decedent’s death in the case of the will), or when the beneficiary’s interest vested.
 - (2) It may be especially important to provide guidance on standard of living in a very wealthy family. The standard of living may be quite opulent for the creator of the trust, but he or she recognizes that future generations cannot or should not be able to live that lifestyle, in particular at a younger age. This may be simply because the amounts available to descendants will be far less after reduction by estate taxes and division among multiple family members.
- b. If the beneficiary’s standard of living substantially improves or is reduced between the time the instrument is drafted and the decedent’s death, a standard of distribution tied to the beneficiary’s standard of living may not carry out the settlor’s intent.

SAMPLE TRUST PROVISION: The trustee shall distribute to my wife so much of the income and principal as it determines to be desirable for her comfortable support and reasonable health, considering our standard of living at my death and all other income currently available for such purposes.

4. “Comfort”

- a. In some states, the term “comfort” is limited to an ascertainable standard related to the beneficiary’s health and support. Estate of Vissering, 990 F.2d 578 (10th Cir. 1993).
- b. In other states, the standard is broader than “support or maintenance,” and encompasses a beneficiary’s enjoyment, pleasure, happiness, satisfaction, or peace of mind.
- c. The Restatement Third takes the position that the term “comfort”, whether used separately (“support and comfort”) or as a modifier

(“comfortable support”) adds nothing to the usual meaning of support for a beneficiary whose lifestyle already is comfortable. It may be meaningful if the beneficiary’s lifestyle has been more modest. See Restatement Third § 50, comment d(2).

- d. In applying this standard, one court allowed distributions to purchase an automobile to enable the beneficiary’s daughter to visit the beneficiary because her visits “did much to ease the mind” of the beneficiary. In re Mirfield’s Estate, 126 N.Y.S. 465 (Sur. Ct. 1953).
- e. “Comfort” has also been construed as relating to the grantor’s, rather than the beneficiary’s, accustomed standard of living. The Mississippi Supreme Court ruled that the term “comfort” should be construed according to the grantor’s understanding of the word, which could be discovered by looking at the grantor’s standard of living. Gulf National Bank v. Sturtevant, 511 So. 2d 936 (Miss. 1987).

5. “Education”

- a. In general, the term “education” includes college education, but does not include graduate level or professional education, unless specifically provided by the trust instrument. Bogert § 182; Murphy v. Morris, 141 S.W.2d 518 (Ark. 1940); Epstein v. Kuvin, 95 A.2d 753 (N.J. Super. 1953).
- b. The term “college education” has been held to include the expenses of a high school education, since a high school education is normally required to prepare the beneficiary for college. Security Trust Co. v. Smith, 145 S.W.2d 512 (Ky. 1940).

SAMPLE TRUST PROVISION: The term “education” includes, but is not limited to, the expenses of private schooling at the elementary and secondary school level, college, graduate and professional schools, and specialized or vocational training.

SAMPLE TRUST PROVISION: The term “education” includes all expenses of public and private education at any level, such as tuition, room and board, books, fees, all desirable study materials, dues, reasonable allowance and travel to and from home, as well as graduate and professional education, and specialized or vocational training.

6. “Health”

- a. The term “health” includes all routine medical care, medication, surgery and hospitalization, as well as expenditures for extended nursing care and mental health. It arguably is duplicative of support, because most states would find that reasonable health care expenses would be included within support.
- b. Some commentators have suggested that the term “medical care” may be more limited than health, because it may not cover treatment for psychological or mental health problems or addictions, which have not been universally accepted as “medical” problems. See Q. Heisler, Jr. & W. Butler, “Discretionary Distributions,” Illinois Trust Administration, p. 5-13 (Illinois Institute for Continuing Legal Education 1992).

SAMPLE TRUST PROVISION: The term “health” shall be construed liberally to include all forms of mental or physical health care, including, but not limited to, nursing or other extended care.

SAMPLE TRUST PROVISION: The term “health” includes all expenses of health care providers net of insurance benefits paid to or for the beneficiary, such as hospital charges, physician service fees, lab charges, ambulance, nursing care at any location, physical and psychological therapy, drugs and the like, health insurance premiums for a beneficiary, as well as all costs of an extended health care facility, including an entrance fee or endowment fee (whether refundable or not), interest free loan and other forms of capital charge, as well as monthly assessments and other periodic charges.

- c. In some cases, the settlor may wish to express a preference for home health care over nursing home care, and specifically to authorize distributions for that purpose.

SAMPLE TRUST PROVISION: In making discretionary distributions for me or my spouse under this instrument, the trustee shall consider my strong desire that medical care, nursing care, and other types of care and assistance that are necessary for me or my spouse be provided to me or my spouse in the familiar environment of our home to the greatest extent practicable, without regard to the additional cost of such home care and assistance.

7. “Emergency” and Similar “Extraordinary” Standards

- a. The Restatement Third categorizes “emergency” as restrictive terminology, along with terms like “severe hardship” or “special need.” Restatement Third § 50, comment d(4). Likewise, many courts interpret the term “emergency” as a very narrow and restrictive standard, which authorizes distributions only for the beneficiary’s unusual and unforeseen expenses, and not for the beneficiary’s routine or ordinary support and maintenance. See, e.g., Nardi v. United States, 385 F.2d 343 (7th Cir. 1967); Budd v. Commissioner, 49 T.C. 468 (1968).
- b. Nevertheless, the IRS has taken the position on a number of occasions that the term, by itself, does not create an ascertainable standard for federal estate and gift tax purposes.
- c. The IRS has privately ruled that a standard of “great emergencies which may arise in the lives and affairs of [the beneficiary], such as extra needed medical services or hospitalization” did not restrict distributions to emergencies relating to medical needs. The language “such as extra needed medical services or hospitalization” merely illustrated some of the types of expenditures that would qualify as emergencies, but were not intended to be an exclusive list. The IRS noted that distributions could also be made for any “sudden or unexpected happenings,” such as being stranded in a foreign country without funds to return home. Letter Ruling 8304009 (Oct. 25, 1982).
- d. The IRS has also ruled that the phrase “any other emergency condition of any exigencies” did not constitute an ascertainable standard. Letter Ruling 9044081 (July 31, 1990).
- e. However, in Letter Ruling 200028008 (July 14, 2000), the IRS gave a more favorable interpretation to the standard “proper care, support and maintenance, or in the event of any other accident, illness or other emergency.” The IRS concluded that “emergency” must be limited to the types of emergencies itemized before the word “other” and therefore constituted an ascertainable standard.
- f. Several courts have rejected the IRS position and held that a standard of distribution related to “emergency” is an ascertainable standard for tax purposes. Estate of Sowell v. Commissioner, 708 F.2d 1564 (10th Cir. 1983), rev’g 74 T.C. 1001 (1980); Wahlfeld v. United States, 47 A.F.T.R.2d (P-H) ¶ 148,432, at 81-1565 (C.D. Ill. 1980); Hunter v. United States, 597 F. Supp. 1293 (W.D. Pa. 1984). In Hunter, the court stated that it could not envision an

emergency that was not measurable in terms of the beneficiary's health or support.

- g. In another case, the Second Circuit has held that a trust provides an ascertainable standard when it allows distributions in the event of "prolonged illness or financial misfortune which the trustee deems extraordinary." Jennings v. Smith, 161 F.2d 74, 76 n.3 (2d Cir. 1947). In that case, the Court held that this language created an ascertainable and enforceable standard, and it put the right to distributions "beyond [the trustee's] control or retention by imposing conditions upon the exercise of it" which was subject to judicial oversight. Id. at 78.
- h. The Tax Court has also held to be ascertainable the apparently less strict standard of "sickness or other emergency." See Estate of Budlong v. Commissioner, 7 T.C. 758 (1946). In Budlong, the trust allowed the grantor/trustee to make distributions "in case of sickness or other emergency." Id. at 757. The Court held that this standard was ascertainable and enforceable. Id. at 761. The Court reasoned, "It is obvious that the power in question gave the trustee no absolute and arbitrary control over the corpus. On the contrary, it was conditional and limited. A definite standard—the sickness or other emergency of the respective beneficiaries—was provided to govern its exercise.... We have little doubt that ... if [the] decedent had chosen to apply principal for an income beneficiary when no sickness or emergency existed, a remainderman would have had just cause for complaint in equity." Id.
- i. To forestall the IRS's argument that the term emergency is not an ascertainable standard, the draftsperson may wish to specify the types of emergencies for which distributions are authorized: such as financial emergencies or only those related to health or maintenance.

SAMPLE TRUST PROVISION: The trustee shall distribute as much of the principal of the trust, even to the extent of exhausting principal, as the trustee from time to time determines to be required to meet the expenses of an illness or other emergency relating to the health, support and education of the Child and the Child's descendants.

SAMPLE TRUST PROVISION: In the event that the Child should suffer prolonged illness or financial misfortune which the trustee deems extraordinary, the trustee may pay to the Child so much of the net income and principal of the trust as

the trustee may deem appropriate to meet such conditions.

8. “Best interests” or “best interests and welfare”

- a. Under these standards, the trustee may make distributions to allow the beneficiary to enjoy a higher standard of living, or to have certain selected luxuries, such as extensive travel or the purchase of luxury automobiles and jewelry.
- b. The term “best interests” has been interpreted to allow distributions for more than the beneficiary’s pecuniary interests. Best interests include peace of mind, as well as financial gain. Wiedenmayer v. Johnson, 254 A.2d 534, aff’d, 259 A.2d 465 (1969). In light of the broad meaning of the term and the liberal attitude towards distributions that it encompasses, it may be appropriate to add some limitations to the standard, such as the italicized language below.

SAMPLE TRUST PROVISION: The term “best interests” with respect to distributions to any beneficiary shall be construed to provide the beneficiary with the means to enjoy a comfortable lifestyle, including recreation, cultural pursuits, and travel, but, in the case of a descendant of mine, shall not be construed so generously as to discourage the descendant from assuming the responsibilities of self-support.

SAMPLE TRUST PROVISION: The term “best interests” refers to all aspects of a beneficiary’s happiness and well-being within the context of reasonable personal and social conduct, as determined in the absolute discretion of the trustee.

- c. Although distributions are permissible for a wider variety of purposes under a best interests standard than under a standard of support, the beneficiary may be less able to compel the trustee to distribute trust assets since the beneficiary’s best interests are less easily defined. In other words, the standard is less enforceable from a beneficiary’s perspective and therefore grants the trustee greater latitude.
- d. Some courts have held that if the trustee is authorized to distribute principal under a best interests or similar standard, then the trustee has the authority to distribute the entire trust principal to the beneficiary in a lump sum, provided that such a distribution is not

an abuse of the trustee's discretion. See, e.g., Lees v. Howarth, 131 A.2d 229 (R.I. 1957). Therefore, if a best interests standard is used, but the settlor wants to preserve trust principal for the remaindermen, the trust instrument should contain language which expresses that intention.

SAMPLE TRUST PROVISION: My primary concerns during the life of the Child are to preserve trust principal for ultimate distribution to the Child's descendants while at the same time reasonably providing for the health, support, education and best interests of the Child.

- e. If the settlor does want the trustee to have the power to distribute the entire trust principal to the beneficiary, the settlor could use the following provision:

SAMPLE TRUST PROVISION: If at any time the trustee believes that it would be in my child's best interests and determines that it is otherwise appropriate under the circumstances, it may in its absolute discretion distribute to him the entire principal of his trust and terminate his trust, without regard to the interests of remaindermen. My child shall have no right to require that the trustee make any distribution that is not subject to an ascertainable standard, and the trustee is expressly exonerated from all liability to my child and all other interested parties by reason of the exercise or non-exercise of its discretionary authority in such matters.

9. "Happiness"

- a. In contrast to "emergency", the use of the term "happiness" is considered expansive of the distribution power.
- b. The Restatement Third states that the term suggests an intention that the trustee act generously and "without relatively objective limitation." Restatement Third § 50, comment d(3). It adds that the primary effect of the term is to immunize decisions from the challenge of remainder beneficiaries. At the same time, it does not create minimum entitlements for the current beneficiary, so the trustee still can legitimately decline requests. Id.

10. Distributions to Allow a Beneficiary to Make Gifts

- a. It is often uncertain whether a particular standard of distribution, such as a best interests standard, will allow the trustee to make distributions to a beneficiary for the purpose of allowing the beneficiary to make gifts. Often distributions for this purpose are desired in order to allow a surviving spouse to make annual exclusion gifts from property held in the marital trust.
- b. In one case, the trustees were given the power to invade principal under the following standard: “As in the absolute discretion of my Trustee shall be appropriate and to the best interest of my wife. . . . In determining whether or not to make these encroachments, my Trustee shall be liberal if it considers that an actual need or reasonable request of my said wife is involved.” The South Carolina Supreme Court refused to allow the trustee to distribute principal to the wife in order to permit her to make gifts to her children. The court found that principal could be invaded only if it were to be used for the wife’s own welfare. In re Estate of Howard, 235 S.E.2d 423 (S.C. 1977).
- c. Similarly, the trustee was prohibited from distributing principal to the beneficiary of a marital trust where the will authorized distributions “for the spouse or for her use.” Matter of Mandel, 46 Misc. 2d 850, 261 N.Y.2d 110 (1965).
- d. In yet another case, a trustee did not have the authority to distribute principal to a beneficiary to allow her to make gifts to relatives where the trust instrument gave the trustee power to distribute principal to the beneficiary for her needs. Flowers v. Collins, 357 S.W.2d 179 (Tex. Civ. App. 1962) (dismissed for error).
- e. A Connecticut trustee was authorized to invade principal “for any reason in its discretion for the benefit of” the beneficiary. At the request of the beneficiary, the trustee distributed the entire trust principal to the beneficiary, to be used by the beneficiary to support his stepchildren. The court construed the term “benefit” broadly, to include anything that worked to the “advantage, gain or happiness” of the beneficiary, and concluded that the distribution of principal to allow the beneficiary to support his stepchildren was for the benefit of that beneficiary. Ewing v. Ruml, 892 F.2d 168 (2d Cir. 1989).
- f. The Illinois Supreme Court has construed the terms “comfort and satisfaction” to allow the trustee to distribute principal to the testator’s wife to allow her to continue a program of charitable

contributions. Rock Island Bank & Trust Co. v. Rhoads, 353 Ill. 131, 187 N.E. 139 (1933).

- g. The IRS also has a stake in the issue of distributions for the purpose of making gifts. In Estate of Hartzell v. Comm’r., 68 T.C. Memo 1243 (1994), the IRS attempted to have distributions made from a marital trust and the gifts made by the spouse with those distributions declared invalid. The standard for principal distributions under the trust was “comfort, maintenance, support and general well being.” The court rejected the IRS position. The same issue was before the court in Estate of Halpern v. Comm’r., 70 T.C. Memo 229 (1995). The standard in the trust in this case was much more limited, but the court nevertheless approved gifts the spouse had made with distributions before her incompetency. It brought back into the estate gifts made on behalf of the spouse with trust distributions after she was declared incompetent.
- h. Trust language which defines the best interests of a beneficiary as including distributions for benefit of the beneficiary’s descendants would allow the beneficiary to make gifts of trust property.

SAMPLE TRUST PROVISION: The term “best interests” shall be construed to provide the beneficiary with means to enjoy a comfortable lifestyle and to assist the beneficiary’s descendants as the beneficiary may wish, including distributions to allow the beneficiary to make gifts to the beneficiary’s descendants.

11. Distributions to Save Income Taxes for the Trust and Beneficiaries

- a. Recent developments in tax law have made more attractive the distribution of ordinary income or capital gains to a beneficiary.
- b. Generally, ordinary income or capital gains tax that is earned by a trust is paid by the trust itself. But if that income is distributed to a beneficiary, then that income tax liability can shift to the beneficiary, and the trust is allowed a deduction for that income.
- c. Ordinary Income Tax
 - (1) Shifting the income tax liability from the trust to the beneficiary can result in overall income tax savings for the trust and the beneficiary.
 - (2) For ordinary income, the trust reaches the highest marginal tax bracket of 39.6% upon reaching \$12,500 in income for 2017. But individuals reach the highest marginal tax

bracket of 39.6% upon reaching \$415,050 for single filers, and \$466,950 for joint filers.

d. Capital Gains Tax

- (1) Capital gains are also taxed to trusts and individuals at different rates. Under current law, a trust must pay capital gains at the top marginal rate of 20% upon reaching \$12,500 in income for 2017.
- (2) A beneficiary who has not reached the highest marginal tax bracket would pay capital gains at 15% for 2017.

e. Net Investment Income Tax

- (1) The trust typically would also be subject to the 3.8% net investment income tax for taxpayers in the highest tax bracket, such that a trust's total marginal capital gains rate might be expected to be 23.8%, and a trust's total ordinary income rate might be 43.4%.
- (2) An individual is subject to the net investment income tax at \$200,000 for single filers and \$250,000 for married individuals filing jointly.

f. Capital Gains and DNI

- (1) Generally, capital gains are not included in distributable net income ("DNI") of a trust, and thus the capital gains tax is borne by the trust, not by any beneficiary.
- (2) However, if capital gains are properly allocated to income under certain circumstances, including as a result of a proper exercise of the trustee's power to adjust under the Uniform Principal and Income Act (discussed below), then capital gains can be included in DNI, the capital gains can be distributed to the beneficiary, and the tax burden of such gains can be shifted to a beneficiary. Notably, the Treasury Regulations require that such an adjustment must be made properly under local law. See Treas. Reg. § 1.643(a)-3(b)(1).

g. Step-Up in Basis

- (1) Given the increase of the estate tax exemption (which is currently \$5,490,000 per individual for 2017), a distribution of property to a beneficiary could also allow that property to pass through the taxable estate of the beneficiary without

incurring estate tax, but allowing for a step-up in basis upon that individual's death.

h. Specific Language

- (1) Generally speaking, a trustee may consider the tax consequences of a distribution. See Restatement (Third) of Trusts § 58 & comments. However, without express language in the trust authorizing distributions to save on overall income taxes, distributions for the sole purpose of saving taxes may subject the trustee to later liability to a beneficiary.
- (2) The settlor can include specific language authorizing these distributions in the trust document. However, this type of language should be included after careful consideration; these distributions might lead the trustee to exhaust the corpus of the trust prematurely, with the intent of saving taxes; that is, this type of power might lead the trustee to allow the tax "tail" to wag the trust "dog":

SAMPLE TRUST PROVISION: In addition, my Trustee may distribute income of the trust to any descendant of mine to reduce overall income taxes when considering the taxes that would be payable by such descendant if such income were distributed, as compared to the taxes that would be payable by the trust if such distributions were not made.

- (3) The settlor may also want the trustee to consider the income tax consequences to the beneficiary if the beneficiary must liquidate his own assets to meet expenses and incur capital gains tax.

SAMPLE TRUST PROVISION: In determining whether to make discretionary distributions of net income or principal to a beneficiary, the trustee may consider such circumstances and factors as the trustee believes are relevant, including the other income and assets known to the trustee to be available to that beneficiary, including funds which might be made available by enforcement of the legal obligation of any person to furnish support or education, and

the advisability of supplementing such income or assets, the tax consequences to the beneficiary of requiring the beneficiary to rely first on his or her own assets, and the tax consequences of any such distribution.

- (4) For very wealthy families, this is another area where customized guidance often is helpful. For example, there may be certain dynasty trusts in the family that pay mandatory income. The creator of a new trust may want to explicitly provide that the trustee should take that income into account before making additional distributions.

12. “Sole and absolute discretion” of the Trustee

- a. As discussed in more detail above, the trustee exercises his or her discretion in making distributions under the standards articulated in the instrument.
- b. The instrument can also expand or contract the trustee’s discretion, although, as also noted above, such differences are often considered as matters of degree, rather than of kind. For example, in one case, a court found that the discretion granted to trustees was similar in trusts that granted the trustee “sole and absolute” discretion, “absolute and uncontrolled discretion,” on the one hand, and trusts that only granted a trustee “discretion,” on the other. Citing the Restatement, the court concluded, “The adjectives that described the trustee’s discretion [in prior cases] ... do not indicate substantively greater discretion than that afforded to the plaintiff....” *Morse v. Kraft*, 992 N.E.2d 1021, 1026 n.9 (Mass. 2013) (quoting Restatement (Third) of Trusts § 87, at 254 (2007) (“difference between extended and simple discretion is one of degree more than of kind”).
- c. Nevertheless, when a trustee is granted “sole and absolute” discretion, or discretion described by similar adjectives, the trustee has wider latitude in making distributions than if the trustee’s discretion is not described by such adjectives.
- d. Under the older common law interpretation of this standard, the trustee may make distributions for any purpose or withhold funds from the beneficiary, as long as the trustee does not act in bad faith or arbitrarily. See *In re Ledyard’s Estate*, 21 N.Y.S.2d 860 (1939); *Estate of Zuckerman*, NYLJ, January 29, 1990, p. 30. Where the trustee’s discretion is “absolute” or “uncontrolled,” a court will grant the trustee’s decision even more deference. Bogert § 811.

- e. More recent guidance suggests that the courts exercise more oversight, in light of the fundamental duty to act in a beneficiary's interests. The UTC provision, UTC § 814(a), is as follows:
- (a) Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms as “absolute”, “sole”, or “uncontrolled”, the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.
- f. As noted above, the Supreme Court of Virginia has recently confirmed that a trustee's actions are subject to court review for being arbitrary or an abuse of discretion: “[N]otwithstanding a broad grant of discretion or one specifically limited only by bad faith, fraud or dishonesty, a court is vested with the authority to evaluate whether the trustee's actions were consistent with the terms and purposes of the trust and in the best interests of the beneficiaries, and if they were not, to overrule the decision of the trustee as arbitrary and an abuse of discretion.” Rafalko v. Georgiadis, 777 S.E.2d 870 (Va. 2015).
- g. The commentary to UTC § 814 states that no grant of discretion to a trustee should be absolute.
- h. Indeed, courts often impose a standard of reasonableness, even where the trustees are given “absolute and uncontrolled discretion” to invade principal.
- (1) In one case, the beneficiaries of two \$8 million trusts requested distributions of \$145,000 and \$150,000 in principal. The trustees refused the request because the money was not needed and the beneficiaries' planned use for the money was unlikely to be productive. Although the court found that the trustees had acted in good faith in refusing the request, the court found that the trustees should not have applied such considerations in determining whether or not to make the requested distribution, and directed the trustees to make the distribution. Matter of Stillman, 433 N.Y.S.2d 701 (1980).
- (2) In another case in which the trustees had the power to invade principal “as the trustees in their discretion shall deem proper,” the court held that “even where the payment of principal rests in the uncontrolled discretion of the trustee, he must not in exercising his authority act

dishonestly, or with an improper motive or fail to use his judgment or act beyond the bounds of reasonable judgment.” Estate of Joseph P. Sanders, NYLJ, April 19, 1991, p. 25.

- (3) In a Connecticut case, a trustee was given authority to distribute as much of the income as it thought advisable in its absolute discretion. The court found that the trustee could withhold income from the beneficiaries as long as it acted in good faith and without abuse of discretion. Auchincloss v. City Bank Farmers Trust Co., 70 A.2d 105 (Conn. 1949).
- (4) And in another Virginia case, the Supreme Court of Virginia held that a trustee did not abuse its discretion by refusing to invade the trust principal on behalf of a beneficiary, when the beneficiary had “substantial personal assets” that were available for satisfaction of her debts. In that case, the trustee was authorized to make distributions of principal in its “uncontrolled judgment and discretion.” NationsBank of Virginia, N.A. v. Estate of Grandy, 450 S.E. 140 (Va. 1994).
- (5) The case law indicates that the use of the words “sole and absolute discretion” will not necessarily free the trustee completely from enforceable requests for distributions. If the settlor wants the trustee to have complete latitude and the beneficiaries to have no enforceable rights against the trustee, it may be necessary to be more explicit.

SAMPLE TRUST PROVISION: My child shall have no right to require that the trustee make any distribution, and the trustee is expressly exonerated from all liability to my child by reason of the exercise or non-exercise of its discretionary power.

- (6) It is possible that a state court might declare this broad a grant of discretion void as against public policy.
 - i. A trustee’s power to make distributions in its sole discretion must be distinguished from a trustee’s power, in its sole discretion, to make distributions pursuant to a particular standard, such as for the beneficiary’s support. In one case, the trustee argued that his authority to make payments for “the comfortable maintenance, support and education [of the beneficiary] as he or it shall, in his or its sole discretion, deem advisable” authorized the trustee to

withhold any payments to the beneficiary. The court disagreed, and found that the trustee's power was limited by the standard of "comfortable maintenance, support and education," and that the trustee had the duty to make distributions in accordance with that standard. Kolodney v. Kolodney, 503 A.2d 625 (Conn. App. 1986).

- j. The Third Restatement provides the following illustration regarding the grant of uncontrolled discretion in the context of a defined standard, see Restatement Third § 50, comment c:

3. Following S's death his previously revocable trust has been administered for nearly a decade by T Bank, which is directed to pay income to S's widow, W, and also empowered to pay her "such additional amounts from the principal of the trust as the Trustee, in its sole and uncontrolled discretion, believes appropriate for W's comfortable support and care," with the remainder upon W's death to pass to S's then living issue. In response to requests by W, T Bank has begun to pay substantially increased amounts to her to enable her to accumulate funds from which she may aid C (her child by a prior marriage) in his plans to obtain control and expand the activities of X Co., of which C has been an officer and shareholder for a number of years. S's children petition the court to instruct T Bank that principal distributions for that purpose are improper and that it must recover amounts previously paid to W for that purpose. Nothing in relevant circumstances or in other terms of the trust indicates a broader purpose for the invasion power than the support-related (see Comment *d*) language quoted above. The court will issue the order requested by the remainder beneficiaries. Despite S's grant of extensive discretion, and without a finding of bad faith, T's judgment was not exercised in an appropriate state of mind, that is, for a purpose falling within the quoted standard.

13. Special Needs Trusts

- a. Distribution standards must be carefully drafted in order to allow a beneficiary to qualify for Medicaid or other needs-tested government benefits. Many states have passed laws that permit agencies to seek reimbursement and that define the assets which are available to the government agency. Put differently, depending on the distribution standard of the governing document, the assets

of a trust for the benefit of an individual may be treated by government agencies as an available resource to the individual, thereby preventing the individual from qualifying for governing benefits until those assets are exhausted.

- b. A “special needs trust” is a trust that is specifically drafted to allow the beneficiary to still qualify for those government benefits. The nuances of special needs trusts are beyond the scope of this presentation. However, some key principles are summarized below.
- c. State case law is not consistent in defining the standard of distribution that will cause trust assets to be chargeable for a disabled beneficiary’s care. In many states, a trust that allows the trustee to make distributions for the “support and maintenance” of a beneficiary will be treated as an asset of the beneficiary for the purpose of determining eligibility for public aid. However, in other cases, a state has been unable to obtain reimbursement for public aid where the trust instrument allowed the trustee to use principal for the beneficiary’s support and maintenance (especially in cases in which the trust instrument evidenced the testator’s intent that trust assets merely supplement support from other sources).

14. Relevance of Additional Language or Circumstances

- a. Other, more subtle differences in language referring to the distribution standards, or even facts and circumstances surrounding the settlor and beneficiary, can also be relevant in reviewing a trustee’s conduct or in determining a beneficiary’s right to receive distributions. But in most cases, the “the most revealing and reliable guides for resolving these types of questions are the underlying or general purposes of the trust or provision in question.” Restatement (Third) of Trusts § 50, comment g.
- b. The Restatement generally provides the following summary of additional language or circumstances that might be relevant to a distribution standard:

Many factors may be influential in a process of interpretation [of a settlor’s intent regarding a beneficiary’s interest in the trust].... Factors often cited in opinions as influential range from the particular language used in the grant of discretion (e.g., details of wording such as whether “may” or “shall” was used, whether discretion was about amounts “necessary” rather than “appropriate” to a

beneficiary's support, and whether remainder beneficiaries were to take "the principal" or "whatever principal remains") to the relationships between the settlor and one or more of the beneficiaries.... Specific language, facts, and circumstances in a situation are properly to be considered in the process of interpretation, and may overcome, alter, or reinforce a particular presumption.

Restatement (Third) of Trusts § 50, comment g.

- c. But the Restatement continues that these factors or language often "reveal little of a settlor's actual intent." The Restatement provides that these additional factors may be unreliable for a number of reasons:

The settlor may have formed no intention on the matter at issue, or whatever intention may have existed might not have been ascertained by counsel or preserved in the drafting. In any event, the significance of particular facts and circumstances is often highly speculative, or they may cut both or several ways even if judicial opinions sometimes mention but one side. Furthermore, to be influenced by and draw meaning from subtle details of wording may well ignore the realities of how drafting is done, not to mention that the words were those of one whose work product suggests inattention to the particular issue or circumstances for which it has become necessary to discover, or attribute, an intention.

Restatement (Third) of Trusts § 50, comment g.

- d. IRS Tax Levies

- (1) In particular, courts have found the specific nuances of the language used, even beyond words such as "support," to be key in determining whether the IRS may seize assets held in a trust for the benefit of an individual who is subject to an IRS tax levy.
- (2) Spendthrift provisions and other asset protection features of a trust generally are not enforceable against the government.

- (3) Instead, courts have allowed the IRS to actually seize property held in a trust for the benefit of a delinquent taxpayer. The threshold issue is whether the beneficiary's interest constitutes "property" or a "right to property" under applicable law. This inquiry is dependent on the particular language of the trust. But if the beneficiary's interest is a determined to be a property interest under applicable law, then the IRS may foreclose upon the interest in the trust. See, e.g., United States v. Delano, 182 F. Supp. 2d 1020, 1022–25 (D. Colo. 2011); see also CCA 200614006 (November 30, 2005); Rev. Rul. 55-210, 1955-1 C.B. 544 (regarding the right of the IRS to seize a beneficiary's income or principal interest).
 - (4) In considering whether the beneficiary has an actual "property" interest in the trust, which would be subject to the levy, versus a mere "expectancy," courts have closely reviewed the language of the trust. In one case, a court found it relevant whether the trust provided that the trustee "shall make" distributions subject to a standard, as opposed to providing that the trustee "may make" distributions subject to that same standard. See Duckett v. Enomoto, No. CV-14-01771 (D. Ariz. 2016); Delano, 182 F. Supp. 2d at 1022.
- e. Thus, there are certain situations in which a court might look beyond the general substance of the standard, and consider other language, circumstances, or indicators of the settlor's intent.

IV. Providing Additional Guidance to the Fiduciary

- A. It often is not sufficient to simply define for a trustee or other fiduciary the purposes for which distributions can be made. For example, if the client's goal is to make the trust fund available in a manner that will not interfere with a beneficiary's development as a productive member of society, the trustee should be given authority to consider factors related to the beneficiary's personal development in determining whether to make distributions for the purposes set forth in the trust agreement.
- B. At a minimum it is good practice to give the trustee discretion to consider the beneficiary's personal characteristics. A trustee generally cannot do this unless specifically authorized in the trust agreement.

SAMPLE TRUST PROVISION: In determining whether to make discretionary distributions of net income or principal to a beneficiary, the trustee may consider such circumstances and factors as the trustee believes are relevant, including the following:

- 1) other income and assets known to the trustee to be available to the beneficiary and the advisability of supplementing such income or assets;
- 2) the tax consequences of any such distribution; and
- 3) in the case of any descendant of mine, the character and habits of the beneficiary, the diligence, progress and aptitude of the beneficiary in acquiring an education and the ability of the beneficiary to handle money usefully and prudently and to assume the responsibilities of adult life and self-support.

C. Some practitioners advocate including more of this type of guidance in the trust agreement rather than less, focusing on guidance that describes the settlor's values and principles. In Handler and Loathes, "The Case for Principle Trusts and Against Incentive Trusts," Trusts & Estates (Oct. 2008), the authors suggest guidance that encourages the trustee to consider and reward certain desirable behaviors, such as:

1. Pursue an education at least through college;
2. Pursue gainful employment with a goal of becoming financially self-sufficient;
3. Be a law-abiding citizen;
4. Become a productive member of society, as exhibited by meaningful contributions to family, community and society;
5. Engage in entrepreneurial and/or creative activities;
6. Handle money intelligently and avoid wasteful spending;
7. Act with empathy, thoughtfulness, kindness and consideration toward others;
8. Develop healthy and meaningful relationships;
9. Make contributions of time and talent to charities; and
10. Maintain a healthy lifestyle, avoiding drugs and other harmful substances.

D. The authors advocate giving the trustee discretion to reward such behaviors rather than setting objective benchmarks that result in mandated distributions, as in some types of incentive trusts (see the discussion below). Id. The guidance of course would be personalized to reflect the particular values and beliefs of the settlor.

- E. The trust agreement also can direct the trustee to obtain certain information from a beneficiary regarding finances, spending habits, or personal activities before authorizing a distribution to that beneficiary. In many cases this information is needed to apply the guidance that the trustee is directed to consider.

SAMPLE TRUST PROVISION: In determining whether to make discretionary distributions of net income or principal to a beneficiary, the trustee shall consider the other income and assets known to be available to the beneficiary [same provisions as above] . . . adult life and self-support, it being my intent that the failure of a beneficiary in any of these areas may, in the discretion of the trustee, constitute a reason for denying a distribution. In order to make these determinations, the trustee shall request any information it deems relevant from a beneficiary (and withhold a distribution if the beneficiary refuses to provide such information), including without limitation, the following:

1. A statement of the beneficiary's assets and liabilities, and the assets and liabilities of his or her spouse;
2. Copies of bank statements, cancelled checks, credit card statements or any related material that evidences the beneficiary's spending habits;
3. Evidence that the beneficiary is enrolled in school or employed and, for a beneficiary in school, copies of transcripts;
4. A beneficiary's employment history and authorization to contact and request employment information from the beneficiary's current employer;
5. A list of the beneficiary's place of residence for whatever period of time the trustee determines to be relevant;
6. Access to medical records, blood tests, or related medical information; and
7. Information concerning travel by the beneficiary and a copy of the beneficiary's passport.

- F. One method of limiting the funds in the trust so that they do not interfere with the beneficiary's own motivation is to direct that the trustee should use the trust property for the purposes designated only as a last resort, if no other assets are available.

SAMPLE TRUST PROVISION: The primary purpose of the trust is to maintain a reserve fund to provide for the health, support and education of my descendants in situations in which all other

assets and sources of income available to a descendant of mine are insufficient for those purposes.

- G. A more common provision is one directing the trustee to make trust distributions sparingly so as to encourage self-sufficiency and avoid the development of unmotivated children or grandchildren who are content to live off their inheritance.

SAMPLE TRUST PROVISION: The primary purposes of the trust are (i) to provide for the health, support and education of the child for whom the trust is named, and (ii) to avoid use of the trust property in a manner that might impair the desire of the child or a descendant of the child to be self-sufficient. I intend for the trustee to distribute trust income and principal to the child or his or her descendants on a selective and considered basis, my concern being that the child or the child's descendants may receive too much rather than too little.

H. Letter of Wishes

1. Some practitioners are advocating that the grantor provide guidance to the trustee outside the trust agreement, through a separate written set of instructions or general statement of the grantor's views and beliefs—a "Letter of Wishes."
2. The advice is meant in particular for trusts in which the trustee is granted broad discretion to make distributions, such as under an undefined standard like "as the trustee determines" or "best interests."
 - a. The advantage of such a standard is that it gives the trustee the greatest latitude to do what is appropriate in any given situation. In addition, because it is an undefined standard, the trustee should be less subject to claims by a beneficiary who does not agree with the trustee's distribution decisions.
 - b. Such broad standards, however, leave the trustee with little guidance about what the settlor wants or believes. The initial trustee may know the settlor personally, but future trustees may not, and therefore may have little or no knowledge about the settlor's intent. See Bove, "Letter of Wishes," Trusts & Estates (Jan. 2006). As Bove points out, quoting Scott on Trusts, "The real question is whether it appears that the trustee is acting in that state of mind in which it was contemplated by the settlor that he would act." Id. (quoting Scott and Fratcher, The Law of Trusts, Section 187).

- c. A Letter of Wishes can help to clarify what the settlor intended, while still granting the trustee wide latitude to address unforeseen circumstances.
- 3. As suggested above, such guidance can be included in the trust agreement. The challenge is that, in many cases, the settlor is not prepared to provide such guidance at the time the trust is drafted, or the settlor may develop particular viewpoints after the trust has been in place for a period of time, for example because his or her children are older and the settlor now sees certain habits that he wishes to encourage or discourage.
 - 4. Some settlors also like the idea of providing private guidance to a trustee, that the trustee does not have to share with the beneficiaries or others. Unfortunately, this idea, that the trustee has guidance that is not part of the trust agreement, yet the trustee is relying on it, creates a host of potential legal issues if a dispute later arises.

a. Mandatory Disclosure

- (1) The first issue is whether the trustee has an affirmative duty to disclose the letter to beneficiaries, either under the trustee's general duty to provide complete and accurate information about the trust to beneficiaries, or as part of a request for information from a beneficiary.
- (2) The answer might depend on whether a court would categorize the letter as part of the trust agreement, or part of the books and records of the trust.
- (3) Even if the settlor wishes the Letter of Wishes be kept secret, a beneficiary might have the right to see it, if the trustee will consider the letter in determining whether to make distributions. That is, if the Letter of Wishes provides binding guidance to the trustee in how it will evaluate a beneficiary's requests, then the beneficiary might have a right to view it.
- (4) The Third Restatement of Trusts explains that this duty might override a provision in the trust that keeps the trust secret:

By the terms of the trust ... the settlor can limit the trustee's duty to disclose trust provisions or information on a reasonable basis, in order, for example, to lessen the risk of unnecessary or unwarranted loss of privacy.... Even limitations of these types, however, cannot properly prevent

beneficiaries, even underage beneficiaries (or their duly appointed representatives), from requesting and receiving information to the extent currently necessary for the protection of their interests.

Restatement (Third) of Trusts § 82, comment e.; see also Restatement (Second) of Trusts § 173; George G. Bogert & George T. Bogert, The Laws of Trusts and Trustees § 961, at 2–4 (2d ed. 1983).

- (5) Furthermore, the Restatement also suggests that a trustee should “advise discretionary distributees of information the trustee may need (or desire) regarding the beneficiaries’ circumstances, needs, resources, concerns, or wishes, as may be relevant to fiduciary judgments with respect to discretionary distributions, along with disclosure by the trustee of the bases upon which discretion will be exercised.” Restatement (Third) of Trusts § 82, cmt. d.

b. Voluntary Disclosure

- (1) The next issue is whether the trustee can disclose the letter at an appropriate time, in particular as a defense for the actions taken by the trustee.
- (2) If the letter is not binding on the trustee, and the issue relates to the actions of the trustee under unambiguous trust terms, then the letter would be extrinsic evidence that would not be relevant.
- (3) If, on the other hand, there is an ambiguity and outside evidence of the settlor’s intent is relevant, the letter would have evidentiary value.

5. Thus, whether the Letter of Wishes must be disclosure, or can be disclosed, to a beneficiary might depend on the facts and circumstances. If a settlor is concerned about this issue, then his or her advisor should consider how best to achieve the settlor’s wishes. At the very least, it seems appropriate to recommend that the settlor address these questions of use and availability to the beneficiaries in the letter.

I. Ethical Will

1. A somewhat different way to approach the question of providing guidance is the concept of an “ethical will.”

2. An ethical will is a written document designed to “transfer” a person’s values, advice, life lessons and hopes and wishes for his or her family and loved ones. It is not a legal document of course, and it can be in almost any form. It is meant primarily for the person’s family, not as guidance to trustees, although it certainly can serve that purpose too.

V. Incentive Trusts

- A. One particular means of combining distribution standards and additional guidance to the trustee is through an “incentive trust.”
- B. If the settlor’s goal is to assist children or grandchildren without spoiling them, then it may not be adequate simply to select a responsible trustee and describe the purposes for which trust property can be used (such as “health, support, and education”). The trust agreement should give the trustee additional guidance, for example whether to treat all beneficiaries within a certain set equally or to give preferential treatment to beneficiaries based on personal characteristics and abilities. But even that guidance may not go far enough in achieving the settlor’s intent.
- C. In particular, a settlor may wish to structure the distribution provisions so that the trust provides incentives for beneficiaries to be productive or to follow a course of action the settlor would approve of, and to avoid disincentives from such a course of action.
- D. Incentive provisions can take various forms. But at the core of the concept is the use of trust property to encourage certain behavior or achievement by the trust beneficiaries or to reward beneficiaries for reaching certain benchmark goals.
 1. Incentive provisions can add specificity to the general guidance given to trustees, and can provide clearer evidence of the grantor’s intent with respect to use of the trust property.
 2. This can be particularly important for a long-term dynasty trust which the trustees will be administering many years after the deaths of the grantor and contemporaries who were familiar with the grantor’s intent.
- E. Drafting Guidance and Examples of Incentive Trust Provisions
 1. If the grantor is interested in using the trust to incentivize certain behavior, at a minimum it is good practice to give the trustee discretion to consider the beneficiary’s personal characteristics. A trustee generally cannot condition distributions upon such behavior unless specifically authorized in the trust agreement.
 2. A simple trust provision may simply authorize the trustee to take into consideration the character and habits of the beneficiary, and would

authorize the trustee to condition distributions on certain behavior of the beneficiary.

SAMPLE TRUST PROVISION: In determining whether to make discretionary distributions of net income or principal to a descendant of mine, the trustee may consider such circumstances and factors as the trustee believes are relevant, including the character and habits of the beneficiary; the diligence, progress, and aptitude of the beneficiary in acquiring an education; and the potential effect, if any, that such distribution may have on the beneficiary's motivation to pursue such goals. As the Trustee deems advisable, the Trustee may condition all or any part of a distribution under this paragraph upon such descendant pursuing an education or upon such descendant engaging in conduct that I would find laudable.

3. The guidance that a trust can provide can go much farther, to try to motivate or incentivize specific behavior. In many circumstances, it is quite appropriate to weave into the terms and conditions of trusts the provisions that will guide the next generation or generations along the lines and in accordance with the value system of the persons who have made the wealth.
4. Types of Incentive Provisions
 - a. "Matching" Distributions
 - (1) One example of such a philosophy is a trust provision directing the trustee to pay to a child of the grantor of the trust only so much of the trust income and principal as matches what the child earns from independent employment, or which is otherwise tied to the child's own contribution.

SAMPLE TRUST PROVISION: The trustee shall distribute to the Child as much of the net income and principal of the trust named for the Child as the trustee determines to be required for the health, support, education and best interests of the Child; provided, however, that after the Child for whom the trust is named reaches the age of twenty-five (25) years and until he or she reaches the age of sixty (60) years, the trustee may only make distributions of income and principal pursuant to this

paragraph to the Child in a given year not exceeding in value an amount equal to the amount of income earned by that Child in the year from gainful employment. The decision of the trustee as to what constitutes gainful employment and the amount of income earned by the Child for whom the trust is named in a given year shall be conclusive, absent bad faith.

SAMPLE TRUST PROVISION: In making a distribution to the Child to assist the Child in the purchase of a personal residence, no such distribution may exceed the amount of the down payment contributed by the Child from his or her funds, or, if applicable, by the Child and his or her spouse from their own funds.

- (2) In appropriate cases, there can be exception to the general restriction, such as for a disabled child or a child who is staying at home and raising his or her own children. Another approach is to take into account income earned by both the child and the child's spouse.

b. Distributions to Enable Certain Behavior

- (1) As suggested above, an incentive trust might be thought of negatively, as a means of discouraging non-productive behavior.
- (2) But an incentive trust may also be narrowly tailored to encourage or enable certain behavior that the grantor finds beneficial, but which the descendant may not be able to pursue on his or her own.

SAMPLE TRUST PROVISION: In addition, if the Grandchild is engaged in a profession which, in the trustee's sole discretion, the trustee deems to be a profession that I would consider as honorable and as resulting in some financial sacrifice to the grandchild, such as teaching, counseling, or a religious vocation, the trustee may distribute to the Grandchild as much or all of the net income and principal of the trust as the trustee deems to be

necessary to provide the Grandchild with sufficient financial security to permit the Grandchild to remain in that profession, notwithstanding the more limited monetary compensation therefrom.

c. Distributions at Benchmarks

- (1) Other common incentive provisions in trusts include providing a specific dollar amount to be paid to a beneficiary after the completion of college (even a particular college, such as where the grandparent attended), or upon completing graduate school, or upon entering into a particular profession, such as medicine, law, nursing, accounting, or teaching.
- (2) These types of benchmarks can be easy to envision and to apply; however, the provisions might fail to apply to an otherwise deserving beneficiary, because the beneficiary did not meet a certain benchmark.

d. Restrictions to Avoid Dependence

- (1) Some grantors wish to use the trust only as a guarantee that their descendants will be able to have food on the table and a roof over their heads.
- (2) In such a case, the grantor can direct that the trustee should use the trust property for the purposes designated only as a last resort, if no other assets are available.

SAMPLE TRUST PROVISION: The primary purpose of the trust is to maintain a reserve fund to provide for the health, support and education of my descendants in situations in which all other assets and sources of income available to a descendant of mine are insufficient for those purposes.

- (3) A concern with this approach is it may be too successful: if the beneficiaries enjoy even a modest success in life, such a policy may leave large amounts of assets in the trust, out of reach of the beneficiaries.

e. Using Trustee Discretion to Encourage Self-Sufficiency

- (1) A more common provision is one directing the trustee to make trust distributions sparingly so as to encourage self-

sufficiency and avoid the development of unmotivated children or grandchildren who are content to live off their inheritance.

SAMPLE TRUST PROVISION: The primary purposes of the trust are (i) to provide for the health, support and education of the Child, and (ii) to avoid use of the trust property in a manner that might impair the desire of the Child or a descendant of the Child to be self-sufficient. I intend for the trustee to distribute trust income and principal to the Child or his or her descendants on a selective and considered basis, my concern being that the child or the Child's descendants may receive too much rather than too little.

5. Incentive Clauses and Corporate Trustees

- a. The grantor of a trust should be made aware that many corporate fiduciaries may be reluctant to make personal judgments about beneficiaries with whom they have little contact.
- b. In these cases, it may be advisable to have a family member acting as co-trustee, so that the family member can provide personal information on the beneficiaries that will impact whether distributions should be made and in what amounts.
- c. Another option is to create a special "distribution committee" consisting of one or more family members and trusted family advisers. The committee could control all distribution decisions, with the corporate trustee focusing its attention on the investment and management of the trust funds.

VI. Treatment of Multiple Beneficiaries and the Duty of Impartiality

A. Duty of Impartiality Among Trust Beneficiaries

1. The duty of impartiality requires the trustee to balance the competing interests of differently situated beneficiaries in a fair and reasonable manner.
2. In practice, the trustee's decisions regarding investments and regarding distributions must both take into consideration the interests of the current or income beneficiaries, and the interests of the remainder beneficiaries.

3. The distribution standard contained in a trust instrument has important consequences for what the trustee's duty of impartiality will entail. The Third Restatement observes that when the trustee is given authority to invade principal for the income beneficiary's needs, rather than being limited solely to payment of income, conflict with the remaindermen over investment policy is diminished.

a. If the income beneficiary is entitled only to income in a trust accounting sense, the trustee, in fulfilling its duty of impartiality, must produce a reasonable cash flow income.

EXAMPLE: T is trustee of a trust requiring net income to be paid to the grantor's surviving spouse for life, remainder to grantor's children. During the grantor's life, the grantor, as trustee, invested the assets for growth, with a very low income yield. T's duty of impartiality requires that T make the trust reasonably productive of income in the trust accounting sense. Restatement (Third) of Trusts, § 227, illustration 16).

b. If the current beneficiary is not limited to net income, the trustee can pay less attention to whether the return to the trust is in the form of traditional income or in the form of capital appreciation. Restatement (Third) of Trusts, § 227, comment i. The trustee with discretion to distribute principal is able to pursue total return with greater flexibility and with less concern about the balance between traditional allocations to income and to principal.

EXAMPLE: Same facts as above, except the trust authorizes T to invade principal to maintain the surviving spouse's standard of living. Ordinarily, this distribution provision relaxes the standard of reasonable income productivity of the property. Restatement (Third) of Trusts, § 227, illustration 17.

c. Trustees have the greatest flexibility and freedom to pursue a total return philosophy in trusts under which the trustee has complete discretion to pay out income and principal, or in which the income beneficiary's interest is an annuity (fixed dollar amount) or a unitrust (fixed percentage payout). These types of trusts allow the trustee to be impartial while pursuing total return. Restatement (Third) of Trusts, § 227, comment i.

EXAMPLE: Same facts as above, except the trust authorizes T to distribute "such amounts of income or principal or both as T shall deem appropriate" for

the support and care of the surviving spouse. Because the trust makes no distinction between income and principal, T's duty of impartiality entails no duty to make the trust property currently productive of income. T may adopt an investment strategy focusing on total return without regard to the amount of trust accounting income included in total return. Restatement (Third) of Trusts, § 227, illustration 18.

- d. In drafting trusts, consideration should be given to the impact of income and principal distribution standards on the trustee's ability to pursue a total return strategy.
 - (1) If a trust provides the spouse with all the income and makes principal available under an ascertainable standard, the trustee will need to pay greater attention to income return than if principal is available under a non-ascertainable standard.
 - (2) Likewise, the trustee will have greater ability to pursue a total return strategy if the trust states that the trustee is to focus first on the spouse's needs in making principal distributions.

4. Priority Among Beneficiaries

- a. In light of the trustee's general duty to treat beneficiaries equally and impartially, a grantor may structure a trust to give priority to certain beneficiaries. This structure may avoid conflict by specifying in the instrument that certain individuals or interests should take priority over others.
- b. The commentary to the Third Restatement of Trusts states that "structure and terms of the interests may suggest a priority to be accorded various individuals or classes." The commentary adds that certain inferences can be identified even where the trust agreement does not specifically set priorities. For example, in a spray trust for spouse and descendants, a common inference to draw is that the spouse's needs should be accorded first priority. Similarly, it is reasonable to conclude that a child of the grantor has priority in a trust for the child and his or her descendants. See Restatement Third § 50, comment f.
- c. It is best to specifically establish priorities among the beneficiaries in a trust benefiting multiple generations.

SAMPLE TRUST PROVISION: My primary concern during the life of the Child is for the Child's health, support and education and the trustee need not consider the interest of any other beneficiary in making distributions to the child for those purposes under this paragraph.

SAMPLE TRUST PROVISION: My spouse shall be accorded clear first priority, and my children second priority (particularly those under age 25).

SAMPLE TRUST PROVISION: My primary concern during the period described in this paragraph is for the health, support and education of my children and the descendants of a deceased child of mine, rather than for the preservation of principal for ultimate distribution to my children or their descendants.

- d. Priorities may also be made explicit in the structure of the trust itself. As an example, the needs of one beneficiary can be given priority by providing that all income is to be paid to one beneficiary except for the amount not required for the beneficiary's support, and that only the excess may be used for other beneficiaries.

SAMPLE TRUST PROVISION: Commencing with the death of the last to die of me and my spouse, the trustee shall pay all of the net income of the trust to my child during his or her life. Notwithstanding the foregoing, whenever the trustee may determine that the income of the trust is partially or wholly in excess of that required for my child's support and health needs, considering his or her standard of living at my death and all other income available from time to time for such purposes, then the trustee may in its discretion withhold part or all of such excess income. Income not paid to my child may be paid in whole or in part to any one or more of his or her children, living from time to time, in such equal or unequal proportions as the trustee determines to be desirable for the support, education, health needs and best interests of each of them. Income not paid out may in the discretion of the trustee be added to principal from time to time

5. Treating Beneficiaries Differently

- a. This duty of impartiality is strong, and it can often lead to confusion. Absent authority in the trust, a trustee generally cannot treat children unequally or take into account their other financial resources, or their ability to manage assets themselves, when making distributions.
- b. However, similar to the general language above specifying which beneficiaries should be given priority, a settlor might expressly intend that the trustee should treat beneficiaries differently.
- c. Even if the grantor does not have a specific preference or order of priority, it is wise for the grantor to give the trustee specific direction whether the trustee is able to treat beneficiaries differently, and what additional factors, if any, the trustee may consider when determining whether to make a distribution to a beneficiary.
- d. Unequal Distributions
 - (1) If the client wishes to give the trustee the power to distribute unequal amounts to beneficiaries or to favor one group of beneficiaries over another, the trust agreement should specify that unequal distributions are permitted.
 - (2) While it may seem at first that the desirable course is to treat beneficiaries equally, the trustee should be authorized to make unequal distributions to take into account the children's different circumstances; for example, a child with an expensive medical problem or physical disability, or the fact that one child becomes a wealthy corporate executive and the other is a school teacher. Therefore, it is common to provide that a trustee may make unequal distributions to children.

SAMPLE TRUST PROVISION: The trustee may make unequal distributions to the beneficiaries or may at any time make a distribution to fewer than all of them, and shall have no duty to equalize those distributions.

- (3) As an alternative, the trust instrument may authorize unequal distributions, but provide that distributions for certain purposes, such as to start a business or for graduate education, will be treated as advancements.

SAMPLE TRUST PROVISION: Any distribution (i) to a child for graduate or professional education, (ii) to permit a child to enter into or engage in a business or profession, (iii) to permit a child to make a down payment on a personal residence, or (iv) to defray wedding expenses of a child, shall be charged as an interest-free advancement against the share, if any, distributable to that child or descendant of that child under [later provisions of the trust agreement].

6. Personal Characteristics and Financial Resources of Beneficiaries

- a. The fact that the beneficiaries are in different financial circumstances also may justify unequal distributions, even absent specific authority. That is, a distribution for “support” may be warranted if the beneficiary is unemployed and needs money to pay rent, whereas such a distribution may not be warranted if the beneficiary has a steady income from employment.
- b. Nevertheless, it is also often desirable to permit the trustee to consider the financial characteristics of the beneficiaries. This will remove any ambiguity of a trustee’s ability to consider those additional resources.

SAMPLE TRUST PROVISION: In making any distribution to a descendant of mine, the Trustee shall take into consideration all other sources of income and assets that the Trustee is aware are reasonably available to such descendant or for such descendant’s benefit.

SAMPLE TRUST PROVISION: In determining whether to make discretionary distributions of net income or principal to a descendant of mine, the trustee may consider such circumstances and factors as the trustee believes are relevant, including the other income and assets known to the trustee to be available to that beneficiary and the advisability of supplementing such income or assets.

- c. As noted several times above, if the trust contains such a provision, the trust should also specifically authorize the trustee to require the beneficiaries to produce documentation of their financial

resources—and should allow the trustee to condition a distribution on the beneficiary’s compliance.

SAMPLE TRUST PROVISION: The Trustee may require any such descendant to produce, or to cooperate in good faith in producing, to the Trustee reasonable documentation regarding such sources of income and assets; and as the Trustee deems advisable, my Trustee may condition all or any part of a distribution under this paragraph upon such descendant producing, or cooperating in good faith in producing, such documentation to my Trustee.

- d. In addition, it may be desirable for the grantor to allow the trustee to consider the maturity and responsibility of a beneficiary in making distributions. With such a provision, the trustee can take into account the fact that some of their children simply may be more deserving of, or better able to handle, trust assets, because they are able to manage the money more responsibly, will able to put it to more productive use, or simply have better moral characters.

SAMPLE TRUST PROVISION: In determining whether to make discretionary distributions of net income or principal to a descendant of mine, the trustee may consider such circumstances and factors as the trustee believes are relevant, including the ability of the beneficiary to handle money usefully and prudently and to assume the responsibilities of adult life and self-support.

B. Addressing Impartiality: Adjustment of Income and Principal, and Unitrusts

1. For many years, the “prudent man” standard governed a trustee’s investment actions. This standard fell out of favor as the financial world began to adopt the modern portfolio theory, which calls for an investor to look at the portfolio as a whole and balance overall risks instead of the risks of each individual investment.
2. As a result, most states have now adopted a “prudent investor” standard for investments that embraces modern portfolio theory.
 - a. In practice, this often means that a larger percentage of a trust’s assets are invested in equities to improve the “total return” of the trust’s investments, with a corresponding decrease in the income of the trust.

- b. If a trust instrument allows the trustee to make distributions of either income or principal to a beneficiary, this should not be a problem. However, if a beneficiary may only receive income, or if the standards for distribution of income and principal are different, this may raise significant issues for the trustee. The preferred investment policy for the trustee creates tension with the trustee's obligation to treat income and principal beneficiaries fairly.
- 3. State legislatures have dealt with this potential problem in at least two different ways:
 - a. Power to adjust: Statutes granting a trustee the discretion to make equitable adjustments between income and principal, in order to allocate capital gains or principal appreciation to accounting income; and
 - b. Unitrusts or total return trusts: Statutes granting a trustee the right to convert an income interest into a unitrust interest, that pays a set percentage of the trust value, determined annually, to the income beneficiary.
 - c. These are discussed in more detail, below.
- 4. The Power to Adjust
 - a. The most recent version of the Uniform Principal and Income Act (1997) specifically grants a trustee the right to make adjustments between income and principal to provide for equitable treatment of all beneficiaries.
 - b. Under this power to adjust, if, for example, a trustee invests for total return and the portfolio increases in value by 10%, but only has 2% of dividends and interest, the trustee could allocate a portion of the appreciation (either capital gains or the principal itself) to income in order to treat the income beneficiary fairly. Over 40 states have adopted UPAIA's power to adjust under § 104.
 - c. Sections 103 and 104 of the UPAIA provide that a trustee may adjust between principal and income (by allocating income to principal or principal to income) in an income trust if, after administering the trust in accordance with the governing instrument and the applicable Principal and Income Act, the trustee is unable to administer the trust impartially between the current beneficiary and the remainder beneficiary, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the governing instrument manifests an intention that the trustee favor one or more beneficiaries.

- d. Section 104(b) of the UPAIA lists the factors that the trustee must consider in determining whether and to what extent to exercise the power to adjust, including:
- (1) The nature, purpose, and expected duration of the trust;
 - (2) The settlor's or testator's intent;
 - (3) The identity and circumstances of the beneficiary;
 - (4) The needs for liquidity, regularity of income, and preservation and appreciation of capital;
 - (5) The type of assets held in the trust;
 - (6) The income as calculated before making an adjustment;
 - (7) Whether the trustee has a power to invade principal;
 - (8) The actual and anticipated effects of economic conditions, including the effects of inflation/deflation; and
 - (9) The anticipated tax consequences of an adjustment.
- e. Adjustments may not be made if they would have the following effects:
- (1) Reduce the income of a trust that qualified for the transfer tax marital deduction;
 - (2) Reduce the actuarial value of the income interest in a trust for which for a federal gift tax exclusion was taken;
 - (3) Change an amount payable to a beneficiary as a fixed annuity or fixed fraction of the assets of a trust; or
 - (4) Reduce any amount permanently set aside for charity.
- f. A trustee cannot exercise the power to adjust if doing so would cause the trust to be a grantor trust or it would cause the trust included in his or her estate for federal estate tax purposes. In addition, a trustee who is a beneficiary cannot exercise the power. These limitations may make the power unavailable in many trusts. However, if the trust permits the appointment of a co-trustee, it may be possible to name an independent co-trustee who can exercise the power.
- g. Sections 103(b) and 105 of the UPAIA provide significant protection for the trustees.

- (1) Section 103(b) of the UPAIA states that “a determination in accordance with the Act is presumably fair and reasonable to all of the beneficiaries.”
- (2) The primary remedy if the trustee abuses its discretion is to restore the income and remainder beneficiaries to the positions they would have occupied if the trustee had not abused its discretion by distributing an additional amount to the income beneficiary or withholding future distributions from the income beneficiary. The court may surcharge the trustee if restoring the income and remainder beneficiaries to their original positions is not possible.

h. Shortcomings of the Power to Adjust

- (1) Although the power to adjust under the UPAIA seems to provide an optimum solution for a trustee to invest assets prudently and then to address different beneficiaries’ interests, the power to adjust suffers from some shortcomings that limit its application and use.
- (2) Difficult to administer
 - (i) Commentators have noted that trustees may not want to exercise the discretion required on an ongoing basis to make or not make an equitable adjustment.
 - (ii) These trustees would prefer a rule that does not subject them to the hindsight of beneficiaries or the court. R. Nenno, “Where the Rubber Meets the Road: Implementing Total Return Trust Statutes,” 36th Annual Phillip E. Heckerling Institute on Estate Planning, p. 13-12 (2002).
 - (a) For example, in Matter of Orpheus, a trustee made an adjustment of several million dollars from principal to income, to compensate an income beneficiary for investments that greatly increased the principal. The Supreme Court of Nevada noted that the trustee’s notes revealed that the trustee “briefly stated that it had analyzed each of the factors listed [in the statute], but it not provide a detailed analysis of each factor.” The Court remanded the matter to the trial court to conduct a hearing

on whether the trustee had sufficiently considered these factors. In re Orpheus Trust, 179 P.3d 562, 569–70 (Nev. 2008).

(3) Income tax treatment

- (i) When the state statutes first started appearing, the income tax treatment of adjustments was unclear.
- (ii) The IRS has now issued regulations, discussed later, that help resolve many issues such as whether capital gains can be included in distributable net income. However, the regulations still leave it up to state law, or the trustee, to determine if an allocation of principal to income consists of capital gains or of nontaxable principal.

(4) Timing

- (i) Some issues and questions arise regarding the timing of an adjustment, or the timing of an adjustment based on market fluctuations.
- (ii) When does the trustee exercise the adjustment power? If the beneficiaries are used to quarterly distributions (or they are mandated), the trustee might look at adjustments each quarter.
- (iii) But what if the trustee allocates principal to income in one quarter, and the trust suffers a large drop in the market value in the next quarter?
- (iv) These types of fluctuations can make a trustee adverse to making specific adjustments between income and principal.

5. Unitrusts

- a. The alternative unitrust approach bypasses the granting of discretion to the trustee in favor of requiring a fixed percentage of the trust assets to be distributed each year as “income.”
- b. The potential conflict between income beneficiaries, on the one hand, and remainder beneficiaries, on the other hand, may ultimately injure both. That is, in a desire to generate income, the trustee will feel compelled to invest the trust in assets that generate some predictable income, such as bonds or stock that generates dividends. But if the assets are invested in such a way, then the

underlying principal of the assets may not appreciate in a way that a total return portfolio would.

- c. The preferred investment policy for the trustee creates tension with the trustee's obligation to treat income and principal beneficiaries fairly.
- d. Under most statutes, state law fixes a default unitrust percentage, but grant discretion to the parties or the court to select a different percentage. The percentage is rest annually, but applied against a rolling average (three years or 12 quarters are common) of the value of the trust assets. This is done to avoid significant fluctuation of distributions from year to year
- e. At least 30 states have adopted statutes that permit unitrust conversions. Many state statutes permit both equitable adjustments and unitrust conversions. Some states, including Illinois and Iowa, have adopted just a unitrust conversion statute.
- f. There was a significant concern initially that total return unitrusts would not necessarily qualify for the federal estate tax marital deduction. The problem could be avoided by providing in a marital trust that the spouse has the right to receive the greater of the unitrust amount or net income, as well as the right to compel the trustee to make the property productive. The IRS regulations issued in response to the state total return statutes eliminated this concern by stating that unitrusts (as well as powers to adjust) which are authorized by and in conformance with state law will qualify for the marital deduction. Treas. Reg. § 20.2056(b)-5(f)(1), § 20.2056(b)-7(d)(1).
- g. Anticipating this concern, a grantor may wish to avoid simply giving one beneficiary the right to income. Instead, the grantor may give one beneficiary the right to receive a certain percentage of the trust assets each year, also known as a "unitrust" amount. This unitrust amount would represent the amount of reasonable income that the grantor would hope to provide the beneficiary, and it would free the trustee to invest in assets that would produce a return that benefitted all beneficiaries.

SAMPLE TRUST PROVISION:

Distribution of Unitrust Amount.

During the Child's lifetime, the Child shall have the right to require that an amount up to or equal to the Distribution Amount (as defined in the following subparagraphs of this paragraph) be

annually distributed to the Child, and the Child shall have the right to require that such distributions be made quarter-annually or at intervals that are not less frequent than quarter-annually.

The term “Distribution Amount” as used in this Article for any tax year of the Child’s Separate Trust shall mean an amount equal to Four Percent (4%) of the average of the net fair market value of the Child’s Separate Trust assets for the preceding three (3) years of the Child’s Separate Trust (or, for each of the first three (3) years of the trust’s existence, such lesser number of tax years that the trust has been in existence) valued as of the first day of each taxable year.

The taxable year of the Child’s Separate Trust shall be the calendar year. The trustee shall use the same valuation methods for each taxable year. The trustee shall pay THE Distribution Amount to the child in equal quarterly installments. The Distribution Amount shall be paid first from income, and, to the extent income is not sufficient, from principal. The quarterly installments shall be paid on the last day of March, June, September, and December.

6. Preference of Adjustment Power or Unitrust

- a. An informal 2008 poll of corporate trustees by the Fiduciary Responsibilities Subcommittee of the ACTEC Fiduciary Litigation Committee indicated that corporate trustees preferred to use the power to adjust if it was available rather than the power to convert to the unitrust. Sager, “Litigation and the Total Return Trust,” 35 ACTEC Journal No. 3, at 207 (Winter 2009).
- b. The author, Margaret Sager, hypothesized that corporate trustees preferred the flexibility of the power to adjust, even though it arguably requires more ongoing oversight and discretionary decision-making than a unitrust conversion.
- c. It does not appear that the choice is being made based on perceived litigation risk.

7. Tax Treatment of Adjustments and Unitrusts

a. Final Regulations on Section 643 (January 2, 2004)

- (1) On December 30, 2003, the IRS issued final regulations that revise the definition of trust income found in Code Section 643. These regulations were issued to take account of changes in the definition of trust income under state law and to clarify when capital gains would be includable in the distributable net income of an estate or trust.
- (2) The new final regulations provide that “an allocation of amounts between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between income and remainder beneficiaries of the total return of the trust for the year.” Treas. Reg. § 1.643(b)-1. Capital gains may be allocated to income under either an equitable adjustment or unitrust approach if permitted by the terms of the governing instrument and applicable local law or if it is pursuant to a reasonable and impartial exercise in discretion by the fiduciary and is not prohibited by applicable local law. Treas. Reg. § 1.643(a)-3. If the unitrust approach is taken, a discretionary power to allocate gains to income for tax reporting purposes must be exercised consistently and the amount cannot exceed the excess of the unitrust amount over the amount of distributable net income that would otherwise have been determined.
- (3) Interestingly, the regulations specifically provided in Treas. Sec. 1.643(b)-1 that the IRS will only recognize equitable adjustments or a switch to a unitrust approach if permitted by state statute
- (4) A switch to a method not specifically authorized by state statute but valid under state law, such as a switch by a judicial decision or a binding nonjudicial settlement, may result in the imposition of capital gains tax to the trust or its beneficiaries or may result in taxable gifts, depending upon the circumstances.
- (5) An income interest subject to equitable adjustments or unitrust conversion will also be recognized for purposes of a marital deduction provided that state law permits an equitable adjustment or unitrust conversion. Absent state law specifically permitting such actions, trust provisions alone cannot qualify such a trust for the marital deduction.

Moreover, the proposed regulations make it clear that the conversion of a pre-1986 trust to a total return trust will not cause the trust to lose its grandfathered status for generation-skipping purposes.

b. Generation-Skipping Tax Regulations

- (1) There also was concern initially that the exercise of a power to adjust or conversion to a total return unitrust could cause a grandfathered GST trust to lose its grandfathered status.
- (2) The regulations now make it clear that administration of a pre-1986 trust under state law provisions regarding income will not cause a trust to lose its grandfathered status for generation-skipping tax purposes. Treas. Reg. §26.2601-1(b)(4)(i)(D)(2) and (E), examples 11 and 12.

VII. Selection of Trustees and Division of Fiduciary Responsibility Among Trustees

- A. Once the decision is made to use a trust, the donor must designate a trustee.
- B. Provisions defining the powers of the trustees, and governing their selection and removal are very important. The trustee of a trust will make investment decisions and provide for the management of trust assets. The trustee normally also is responsible for exercising discretionary distribution powers. The trustee must interpret the trust agreement to determine whether a beneficiary's need or request is within the scope of the standard for invasion defined by the grantor, applying the guidance set forth in the instrument. It is therefore a critical role, and one that may last several decades or even generations.
- C. The "Individual" or "Family" Trustee and the "Professional" or "Corporate" Trustee.
 1. There are numerous potential options for who might serve as trustee: a spouse; one or more of the beneficiaries; a family friend; a trusted advisor, such as an attorney or financial advisor; or a bank, trust company, or other entity. In fact, one of the only limits on the potential menu of naming and replacing trustees relates to tax considerations, discussed below.
 2. Many commentators find it helpful to distinguished between an "individual" trustee, who is a single person and who may already be involved with and knows the settlor, the beneficiaries, and related parties; and a "corporate" trustee, who is a bank, trust company, or other institution or entity.

3. Individual Trustee

- a. Many settlors find it appealing to name as trustee an individual, such as a member of the family, a family friend, or a trusted family advisor. This has advantages and disadvantages.
- b. Advantages of Naming an Individual Trustee
 - (1) The individual may already know the settlor and the settlor's intent, the family, its history and dynamics, and the various situations and needs of the beneficiaries.
 - (2) The individual may be willing to serve for a smaller fee or free. However, because acting as a trustee requires a fair amount of financial and tax sophistication and a substantial commitment of time, it usually is not fair or appropriate to ask a friend or relative to act as trustee without compensation. Meanwhile, if the trustee is to be paid a fee for services rendered, it is not fair to the ultimate beneficiaries of the trust to use a friend or relative in this capacity unless such individual is capable, experienced, and trustworthy.
 - (3) The individual may give more time and attention (or be perceived as giving more time and attention) to matters related to the trust.
- c. Disadvantages to Naming an Individual Trustee
 - (1) If the trustee is familiar with the family and the beneficiaries, such familiarity may not necessarily be an advantage.
 - (a) The trustee may be perceived as being biased towards one family member (most often the settlor) or one beneficiary.
 - (b) Generally, it may be problematic to name the spouse or a single beneficiary as trustee of a trust with multiple beneficiaries.
 - (c) It may be preferable not to name the spouse as trustee if that is likely to subject the spouse to pressures from children who wish greater access to trust funds.
 - (d) Likewise, if the individual has several children and names only one as trustee, the

potential for problems arising between the child/trustee and his or her siblings is obviously considerable. If all of the children are named as co-trustees, it may be difficult, administratively, to reach decisions affecting trust property.

- (2) Managing a trust requires various filings, including the preparation of regular tax returns, and an individual who is a family member or friend may be inexperienced with these duties; however, such a trustee can usually retain attorneys and accountants to assist with these duties.
- (3) Many trusts are structured to last for the lifetime of beneficiaries, or perhaps for several generations; an individual trustee will almost surely retire or die before the expiration of such a trust.

4. Corporate Trustee

- a. For these reasons noted above, in the case of a large or complex trust it is preferable in many cases to name a corporate fiduciary. A corporate fiduciary adds permanence to the choice and introduces persons who are skilled in money management, taxes, and the conservation of trust principal. The corporate fiduciary can take advantage of investment options not available to individual fiduciaries, such as proprietary funds or investment managers available through special contractual arrangements. Most corporate fiduciaries also provide custodial services for trust assets, accounting services and tax preparation as part of their services as trustee.
- b. A corporate fiduciary will not become emotionally involved in family disputes and will not be subject to the pressures that trust beneficiaries could bring to bear on a relative or family friend. Of course, a corporate fiduciary charges a fee for its services, usually determined as a percentage of the trust assets.

D. Using Co-Trustees

1. The various strengths that different trustees can bring to the administration of a trust suggest that it can be beneficial to use co-trustees. For example, an individual can name a family member and a corporate trustee as co-trustees in order to have the corporate trustee's professional management skills and the family member's involvement in an official capacity in the administration of the trust and distribution decisions. The family member and the corporate trustee working together can have the ideal combination

of personal knowledge of family needs and detached analysis for making distribution decisions. The corporate trustee can act as a shield for the family member who is being pressured by a child to make an ill-advised distribution by refusing to consent to the distribution.

2. One approach that can be very effective for trusts for children is to name the child as a co-trustee when they obtain a certain age. For example, if the trust will terminate when the child turns age 35, the trust agreement could permit the child to become a co-trustee at age 30. This gives the child an opportunity to learn more directly about managing the property with the corporate trustee's assistance, and prepares the child for becoming the direct owner.
3. The corporate trustee can be given sole discretion to make distributions for purposes not subject to an ascertainable standard, such as the welfare of the spouse or to assist a child with a business venture. This permits the entire family to benefit from the trust under a broad distribution standard without adverse tax consequences.

SAMPLE TRUST PROVISION: Commencing as of my death and until the division date (defined later in this Article), the trustee shall distribute to any one or more of my spouse and my descendants living at the time of the distribution as much of the net income and principal, even to the extent of exhausting principal, as the trustee determines from time to time to be required for such descendants' respective health, support and education, and as the trustee, other than my spouse, in the sole discretion of that trustee, determines from time to time to be required (i) for the best interests of my spouse, and (ii) to permit a child of mine to make a reasonable down payment on a personal residence.

4. Another common approach is to name a corporate trustee or other independent person as trustee of a child's trust and provide that the child will become a co-trustee upon obtaining a certain age. This provides many of the benefits noted above and can give a child an opportunity to learn how to manage his or her inheritance before the child's trust terminates and is distributed outright.

E. Dividing the Trustee's Authority among Co-Trustees or Advisory Committees

1. An important consideration often overlooked in the planning process is the division of the trustee's duties and powers among different fiduciaries. This can be especially useful in complex, multi-generation trusts, in trusts that will hold a family business or other closely held assets, or in trusts of considerable size.

2. For example, a trust holding closely held business interests could name individual family members active in the business and a corporate trustee as co-trustees and vest all decision-making authority related to the business in the family members. The corporate trustee would be in charge of all administrative functions as well as the management of other trust assets.

SAMPLE TRUST PROVISION: The corporate trustee shall not participate in any decision with respect to the purchase, sale or encumbrance of any interests in or indebtedness of a family enterprise that are part of the trust principal, or in the voting of securities in any family enterprise, and the corporate trustee shall not be responsible for the decision of the individual trustees to purchase, sell or encumber such interests in or indebtedness of a family enterprise, or for the manner in which securities in any family enterprise are voted, for any direct or indirect result of that voting, or for any failure to vote those securities. The corporate trustee shall not be accountable for any loss or depreciation in value sustained by reason of an act or failure to act of the individual trustees pursuant to the preceding provisions of this paragraph. Notwithstanding the foregoing, if at any time the individual trustees are evenly divided upon any question related to the disposition of any interests in or indebtedness of a family enterprise or the voting of securities in any family enterprise, the decision of the corporate trustee shall control.

3. The trust could name multiple co-trustees and require the trustees to designate one of their number as a “managing” trustee.
4. Many clients who wish to divide the fiduciary’s duties in this manner prefer to create a separate “committee” rather than naming multiple trustees. The most frequent use of an advisory committee is in managing closely held business assets. In some cases, the client wishes to delegate all investment authority to the advisory committee and reduce the trustee’s role to that of acting as the committee’s agent.

SAMPLE TRUST PROVISION: Despite the general powers of the trustee, the following provisions shall apply, when the context admits, to each trust from time to time held hereunder:

1. The trustee shall follow the written directions of the Advisory Committee with respect to the purchase, sale, or encumbrance of any interests in or indebtedness of a family enterprise that are part of the trust principal, and the trustee

shall not be responsible for the decision to purchase, sell or encumber such interests in or indebtedness of a family enterprise. The Advisory Committee shall have full authority to direct the trustee to take any action with respect to interests in or indebtedness of a family enterprise which the trustee is authorized to take [the articles related to financial and management powers], without limitation;

2. The trustee shall issue proxies to vote all securities in any family enterprise held by the trustee to or on the written order of the Advisory Committee, and the trustee shall not thereafter be liable for the manner in which those securities are voted, for any direct or indirect result of that voting, or for any failure to vote those securities;

3. No trustee shall be accountable for any loss or depreciation in value sustained by reason of an act or failure to act of the Advisory Committee pursuant to the preceding provisions of this paragraph and no person dealing with the trustee shall be required or privileged to inquire whether there has been compliance with those provisions. The trustee shall not be required to participate in the conduct of the business of any family enterprise or to keep itself informed about its day to day affairs;

4. For all purposes of this trust agreement and of any trust established under this trust agreement, the term “family enterprise” means any business entity, whether in existence on the date of this trust agreement or established hereafter, whether in the form of a business corporation, partnership, joint venture, or other organization, in which one-third or more of the outstanding equity interests are held, in the aggregate, directly or indirectly, by me, my spouse, my descendants, any trust for the benefit of me, my spouse or any of my descendants, or another family enterprise. For all purposes of this trust agreement and of any trust established under this trust agreement, the term “interest” in a family enterprise means (i) stocks, partnership interests (whether general, special or limited) or other evidences of equity ownership in a family enterprise, and (ii) notes, bonds or other evidences of a debt owed by such family enterprise.

5. Another role for a committee may be to take charge of discretionary distribution decisions. The use of a committee reduces the pressure on any one individual serving as a fiduciary—both the pressure involved in making proper decisions and the pressure that can be brought by

dissatisfied beneficiaries. Both these types of pressure can be significant when the trust assets are substantial.

SAMPLE TRUST PROVISION: The trustee shall follow the written directions of the Advisory Committee with respect to discretionary distributions of income and principal to the beneficiaries of the trust, and the Advisory Committee shall determine whether to make distributions in accordance with the distribution standards for the trust set forth in this instrument.

6. There are an unlimited number of ways to structure an advisory committee in a trust. It can consist solely of family members or a combination of family members and non-family members. The number of members can be fixed, or the committee can be given authority to expand or contract. The trust agreement can set forth minimum qualifications necessary for committee membership, such as minimum and maximum ages, business or professional experience, and minimum net worth or annual income.
7. The trust agreement also should contain provisions regarding appointment of successor committee members similar to those that address appointment of successor trustees. A common method for appointment of successors is to have the committee appoint successor non-family members, and have adult trust beneficiaries select successor family members to serve on the committee. Another option is to have the committee nominate successors and require a confirmation vote by adult trust beneficiaries.

SAMPLE TRUST PROVISION: The Advisory Committee shall consist initially of such of my children who are willing and able to act, and _____ and _____, who shall be the initial “independent” members (as defined below). If one of my children fails to become or ceases to be an Advisory Committee member, no successor need be appointed as long as there are at least three “family” members (as defined below) of the Advisory Committee then acting. At all times there shall be two independent members of the Advisory Committee, and at least three, but no more than five, family members of the Advisory Committee.

Any member of an Advisory Committee may resign by giving written notice to the other members of that Advisory Committee and to the trustee. A successor Advisory Committee member shall be appointed by a majority in number of my children who are not disabled. If none of my children are able to act, then a successor family member of the Advisory Committee and the successor to one

independent member position of the Advisory Committee shall be appointed by a majority in number of my adult descendants who are not disabled, otherwise by a majority in number of the beneficiaries of the trust to whom the current trust income may or must then be distributed; and the successor to the second independent member position of the Advisory Committee shall be appointed by the remaining members of the Advisory Committee.

A “family” member of the Advisory Committee must be a descendant of my parents.

An “independent” member of the Advisory Committee must be an individual who does not qualify as a “family” member, has attained the age of thirty-five years, and has at least ten years’ experience as either (i) an officer, director or principal partner of a business or professional organization, (ii) an elected or appointed official in a governmental, philanthropic or community organization, or (iii) an educator at the secondary school, college or graduate school level.

8. Many states’ laws also allow a settlor to give various trustees specific duties; one trustee may have the power to control investments; another trustee may have the power to direct distributions from the trust; and another trustee has the responsibility to administer the trust and perform tax and recordkeeping functions.

F. Removal of Trustee

1. It is also possible to give the settlor, other beneficiaries or family members, a Trust Protector, or another individual or entity the power to remove and replace a trustee.
2. For both trustees and advisory committee members, the client should consider giving designated individuals the power to remove the fiduciary. The removal power can be unlimited or for specified causes.
3. These options can often be used to address potential conflicts between the settlor, beneficiaries, and trustees.
4. However, there are transfer tax considerations that the practitioner must consider if trust beneficiaries will possess removal powers. A beneficiary who can remove a trustee and appoint himself or herself as trustee will be treated as possessing the powers of the trustee for purposes of Section 2041 of the Code. If the trustee has the power to distribute property pursuant to a non-ascertainable standard, the beneficiary will be treated as having a general power of appointment. See Treas. Reg. § 20.2041-1(b).

- a. The IRS in the past took the position that a beneficiary's power to remove a trustee and appoint a new trustee (other than the beneficiary) saddles the beneficiary with the potential Section 2041 problem. See Rev. Rul. 79-353, 1979-2 C.B. 325. Practitioners have generally agreed that the IRS's basis for this position was weak. It was decisively rejected by the Tax Court in Estate of Wall v. Comm'r, 101 T.C. 300 (1993). Subsequently, the IRS issued Revenue Ruling 95-58, 1995-2 C.B. 191, in which it revoked Revenue Ruling 79-353.
- b. However, the IRS limited its ruling to situations in which the beneficiary can only appoint an independent trustee. The Ruling suggests that a beneficiary's trustee removal power could have adverse tax consequences if the holder of that power can appoint a related or subordinate party (as defined in Code Section 672) as successor trustee. Under Section 672, a "related or subordinate party" is any nonadverse party who is the person's spouse, parent, descendant, sibling or employee.
- c. It is clear that a beneficiary can have the power to remove a trustee for cause and appoint a new trustee without fear of Section 2041. See Ltr. Rul. 9303018 (October 23, 1992).
- d. The causes that justify removal can be numerous and broad. In Letter Ruling 9303018, the trust instrument stated that a trustee could be removed for the following reasons: (1) legal incapacity; (2) willful or negligent mismanagement; (3) abuse, abandonment of, or inattention to the trust; (4) being charged with a crime; (5) a criminal act or an act of moral turpitude or moral degeneration; (6) substance abuse; (7) poor physical, emotional or mental health; (8) failing to comply with written agreements with the trust; (9) failing to appoint a senior officer with at least five years' experience to administer the trust; (10) changing the account office responsible for the trust more frequently than every five years; (11) relocating away from where the trust was located; (12) demanding unreasonable compensation; and (13) any other reason for which a [state] court of competent jurisdiction would remove a trustee.
- e. It also is possible to vest the removal and appointment powers in different individuals. Finally, if the trust distribution standards all are ascertainable, a beneficiary can hold trustee removal and appointment powers without concern about possessing a general power of appointment.
- f. If the settlor has in mind a time period when a given trustee should no longer serve, or when a beneficiary should become trustee or co-trustee, then an attractive alternative to removal provisions is to

create term limits for the fiduciaries serving under the trust agreement. This is especially useful in an advisory committee because it gives trust beneficiaries an opportunity to evaluate a committee member's performance and, if necessary, replace the member in a manner that may be easier, and less stigmatized, than removal.

G. Additional Tax Considerations for Naming a Trustee

1. If a spouse or family member who also will be a beneficiary of the trust will be designated as trustee, it is usually necessary to limit the trustee's control of the property so it will not be included in his or her gross estate.
 - a. For example, if the spouse is the trustee of a nonmarital trust, the invasion standard must be ascertainable and must relate to health, support, maintenance, and education (IRC § 2041(b)(1)(A)).
 - b. Broad invasion provisions, such as for "best interests and welfare," would result in the entire nonmarital trust being taxed in the spouse's estate, which generally would defeat the goal of the decedent's estate plan.
 - c. One common nonmarital trust provision is to permit the trust income to be "sprayed" among the spouse and descendants (or retained in trust) at the trustee's discretion. If the trustee has minor children who are trust beneficiaries, however, and the spouse as trustee can "spray" trust income or principal to them, the distribution power must be limited so distributions cannot be used to satisfy the trustee's legal obligation to provide support or education for the minor children. Otherwise, the trustee may be deemed to possess a general power of appointment over the trust to the extent of those legal obligations, causing the trust principal to be includable in his or her estate at death. Treas. Reg. § 20.2041-1(c).
2. For these and many other reasons, it may be preferable for a corporation or independent individual to act as sole trustee or as co-trustee with the beneficiary. If this is done, the independent co-trustee is given the power to make discretionary distributions of principal and income among the spouse and the descendants, or to make those distributions that a family member trustee cannot make. This permits the entire family to benefit from the trust without adverse estate tax consequences.
3. There are generally no estate tax dangers in making the spouse the sole trustee of a general power of appointment marital trust, since that property will be includable in her estate anyway. However, if a QTIP marital trust is used, it may be necessary to limit the standard for distributing trust

principal, if it is possible that a partial QTIP election will be made (so that not all the trust will be treated as marital deduction property).

VIII. Conclusion

- A. A trustee's tasks of custody, investment, and distribution decisions all work together to achieve a settlor's goals.
- B. But distribution decisions in particular can have a key impact on whether a trust achieves a settlor's goals.
- C. In establishing the distribution provisions of the trust, the settlor should be mindful of the appropriate language and distribution standards to use to ensure that the distributions of the trust meet the settlor's intended goals.
- D. In drafting and administering the trust, settlors and trustees can structure the relevant provisions related to distributions to ensure, to the extent possible, that the trust will meet the settlor's intended vision over the lifetime of the trust.