DRAFTING AND INTERPRETING TRUST DISTRIBUTION PROVISIONS THAT:

SAY WHAT YOU MEAN AND MEAN WHAT YOU SAY

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READING, INTERPRETING AND DRAFTING TRUST DISTRIBUTION PROVISIONS THAT: SAY WHAT YOU MEAN AND MEAN WHAT YOU SAY

It is hard to imagine any professional endeavor where the odds of success are increased by "going it alone." A coach needs a team; a director needs a cast and crew. Unfortunately, the business of wealth planning seems to have more than its share of dedicated loners unwilling or unable to collaborate with other professionals and resistant to change. That is unfortunate because clients benefit from having a team of experts who cooperate, communicate, and work together for their best interest. It is true that some clients (and advisors) find this approach uncomfortable. Often the wealth was created by a maverick entrepreneur who plunged into a venture never tried before without help. Grit and determination are rarely combined with any patience for "action by committee." The wealth generator may be reluctant to trust anyone else with control or make time for the "touchy/feely" stuff. There is a substantial difference in the skills required for the generation of wealth and those best suited to the preservation, planning, and transfer of wealth. But there is a great deal to be gained by taking the time to understand and communicate the culture and values of a client when building a wealth transfer plan.

Surprisingly, collaborative planning and implementation can reduce costs. When the entire team participates, there is: (1) less chance of miscommunication, (2) fewer meetings are required, (3) delegation between advisors is more effective, (4) chances of protracted and expensive family disputes are reduced, (5) the possibility of mistake is reduced by having more than one set of eyes review documents and transactions, and (6) when a team of dedicated professionals has worked together to craft a plan, the client is more likely to go forward, execute with confidence, and fund the plan.

But even with a team effort, it is hard to create a document that reflects a settlor's wishes and will stand the test of time. Consider how communication has changed in the last 30 years (the common measure of a generation), and that documents must address unforeseen societal changes. Investments once considered infallible (Kodak) have proven to be ephemeral instead. Technologies once considered cutting edge are now the source of humor. VCRs gave way to DVDs and then DVR.[1] Vinyl albums gave way to tapes, then to CDs, then to purchased MP3 files, and most recently, to streaming services.[2] With each of these changes, companies made and lost fortunes. Digital technology isn't the only example. South Texas has a significant number of now wealthy property owners who once believed the minerals on their property were completely played out until someone figured out how to fracture the porous shale formations and squeeze new wealth out of old assets.

We can only guess what changes our children and grandchildren might see in their lifetimes. So, it may seem unrealistically optimistic to believe we can draft documents that will remain serviceable for the next 30 years – let alone 300 (Texas) or 500 (Arizona) years. And yet, we try with every plan. Because who can tell which trusts will be depleted and terminate in one generation and which will survive and have funds to distribute after the death of every life in being plus 21 years or even in "perpetuity"? Many of the examples provided here, from case law, treatise or currently administered documents have been in use for several generations and a collaborative effort can boost the chance of success. Still, things sometimes go awry. A conscientious trustee gathering the information needed to make an excellent fiduciary decision may be frustrated by an older document containing instructions that are contradictory, vague, or even unintelligible. Studying the good, the bad, and the ugly can bring us a little levity, a fresh perspective, and just help us do better. This paper is intended to inspire thought and stimulate discussion

1 Do your children know what it means to "Be Kind and Rewind?"

2 "Guess I'll have to buy The White Album again." ~ Agent K in *Men in Black*

regarding how to help your clients consider what provisions should go into a new document and to help a trustee interpret those instructions once a trust is funded. Put another way: How to make documents "say what you mean and mean what you say".

I. A TRUST IS A RELATIONSHIP WITH AN INSTRUCTION MANUAL

In any relationship, a healthy understanding between the parties as to what each expects of the other is critically important. In a trust, the expectations and parameters of the relationship are defined by three primary sources[3]:

(1) The document that creates the relationship;
(2) Statutes that apply such as the Trust Code; and
(3) Fiduciary common law to the extent it is not superseded by the document or governing statute.

Clear instructions from these three sources allow a trustee to implement the precise intent of the settlor and virtually every state's law requires a trustee to administer a trust according to its terms.[4] So, trustees use the same process to make decisions. Trustees look first to the terms of the document which control unless they are contrary to public policy,[5] then to default and mandatory statutes, then to common law. Trusts are difficult to administer if the terms are unclear or demand the impossible. Trust terms may be perfectly clear, impossibly obtuse, complicated, or simple but in most cases, the trustee must follow the instructions provided.

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3 *See* GERRY W. BEYER, TEXAS TRUST LAW: CASES AND MATERIALS 2 (2d. ed. 2009).

4 TEX. PROP. CODE §113.051 General Duty - The trustee shall administer the trust in good faith according to its terms and this subtitle. In the absence of any contrary terms in the trust instrument or contrary provisions of this subtitle, in administering the trust the trustee shall perform all of the duties imposed on trustees by the common law.

A.R.S. §14-7402. Fiduciary duties; general principles
A. In allocating receipts and disbursements to or between principal and income, and with respect to any matter within the scope of sections 14-7405 through 14-7409, a fiduciary:
1. Shall administer a trust or estate in accordance with the terms of the trust or the will, even if there is a different provision in this article.
2. May administer a trust or estate by the exercise of a discretionary power of administration given to the fiduciary by the terms of the trust or the will, even if the exercise of the power produces a result different from a result required or permitted by this article.
3. Shall administer a trust or estate in accordance with this article if the terms of the trust or the will do not contain a different provision or do not give the fiduciary a discretionary power of administration.
4. Shall add a receipt or charge a disbursement to principal to the extent that the terms of the trust and this article do not provide a rule for allocating the receipt or disbursement to or between principal and income.
B. In exercising the power to adjust under section 14-7403, subsection A or a discretionary power of administration regarding a matter within the scope of this article, whether granted by the terms of a trust, a will or this article, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with this article is presumed to be fair and reasonable to all of the beneficiaries.
A.R.S. §14-10105 ***
B. The terms of a trust prevail over any provision of this chapter except:
1. The requirements for creating a trust.
2. The duty of a trustee to act in good faith and in accordance with the purposes of the trust.
3. The requirement that a trust and its terms be for the benefit of its beneficiaries and that the trust have a purpose that is lawful, not contrary to public policy and possible to achieve.

5 The best expressions of public policy are the declarations of the legislature, found in statutes; although, much of our statutory language is well drafted and clear, it is not unheard of for these mandates of public policy themselves to be deliberately vague. But we shall leave that for another paper.

II. DEFINING THE TERMS

A threshold question is whether a trustee has discretion at all; some trusts have mandatory distribution provisions. *See* RESTATEMENT (SECOND) OF TRUSTS § 186 cmt. e (1959); RESTATEMENT (THIRD) OF TRUSTS § 85 cmt. c(1). These may involve discretion as to timing or calculation of the amount but when a trust has a mandatory distribution standard, it is not up to the trustee to decide *whether* to distribute. Where the document's standard does give the trustee discretion, the trustee must determine how much discretion is granted and the standard for its exercise. Distribution standards generally fall into three categories: the support trust; the discretionary trust; and a hybrid. South Dakota is an exception.[6]

A. The Support Trust

In most jurisdictions, a pure support trust directs the trustee to pay for the health, education, maintenance, or support (HEMS) of the beneficiary. In other words, a beneficiary may compel a trustee to make distributions for "support" - a specific standard. The distribution standard of a support trust is generally referred to as an 'ascertainable standard' which simply means specific enough to be objectively applied. *See,* RESTATEMENT (SECOND) OF TRUSTS § 154; RESTATEMENT (THIRD) OF TRUSTS § 60. Typically, a support standard will include HEMS, or something similar. In personal trusts, this standard is often embellished by requirements that the trustee consider a 'standard of living' the beneficiary enjoys at a prescribed time or other circumstances. A simple example without embellishment is:

> *Trustee shall provide support and maintenance to my surviving spouse for so long as she lives.*

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6 An interesting exception is South Dakota where statute specifically rejects the Restatements and the Uniform Trust Code: SDCL §55-1-25. Distinction between discretionary trust and support trust--Creditor rights--Judicial review. The common law distinction between a discretionary trust and a support trust and the dual judicial review standards related to this distinction shall be maintained. In the area of creditor rights, the Restatement of Trusts (Third) and the Uniform Trust Code create many new positions of law as well as adopts many minority positions of law. The provisions of §§ 55-1-24 to 55-1-43, inclusive, affirmatively reject many of these positions. Therefore, the Legislature does not intend the courts to consult the Restatement (Third) of the Law of Trusts § 50, § 56, § 58, § 59, or § 60 as approved by the American Law Institute or Uniform Trust Code Article 5 and Section 814(a) as approved by the National Conference of Commissioners on Uniform State Laws in 2004 with respect to subject matters addressed by the provisions of §§ 55-1-24 to 55-1-43, inclusive. SL 2007, ch 280, § 2; SL 2015, ch 240, § 11. Definitions in the South Dakota Code are similar but include an extra classification, a mandatory interest, where trustee has no discretion as to amount, whether a distribution is made and the distribution timing must be within a year.

SDCL §55-1-38. Classification of distribution interest. A distribution interest can be classified in three ways:
(1) As a mandatory interest, which is a distribution interest, in which the timing of any distribution must occur within one year from the date the right to the distribution arises, and the trustee has no discretion in determining whether a distribution shall be made or the amount of such distribution;
(2) As a support interest, which is not a mandatory interest but still contains mandatory language such as "shall make distributions" and is coupled with a standard capable of judicial interpretation; or
(3) As a discretionary interest, which is any interest where a trustee has any discretion to make or withhold a distribution.

A discretionary interest may be evidenced by permissive language such as "may make distributions" or it may be evidenced by mandatory distribution language that is negated by the discretionary language of the trust, such as "the trustee shall make distributions in the trustee's sole and absolute discretion." An interest that includes mandatory distribution language such as "shall" but is subsequently qualified by discretionary distribution language shall be classified as a discretionary interest and not as a support or a mandatory interest. A discretionary interest is any interest that is not a mandatory or a support interest. SL 2007, ch 280, § 15; SL 2008, ch 257, § 6; SL 2009, ch 252, § 7. There is also a provision to accommodate a "combination" of a mandatory support provision SDCL §55-1-39. Bifurcation of trust. To the extent a trust contains any combination of a mandatory provision, a support provision, the trust shall be bifurcated as follows:
(1) The trust shall be a mandatory interest only to the extent of the mandatory language;
(2) The trust shall be a support interest only to the extent of such support language;
(3) The remaining trust property shall be held as a discretionary interest;
(4) A support interest that includes mandatory language such as "shall" but is subsequently qualified by discretionary language, shall be classified as a discretionary interest and not as a support interest. SL 2007, ch 280, §16.

B. The Discretionary Trust

A pure discretionary trust provides that a trustee may distribute income and principal in an amount that the trustee, in its sole discretion, sees fit to pay. RESTATEMENT (SECOND) OF TRUSTS § 155. Trustee is authorized to make distributions in its sole discretion and not subject to any objective standard. The beneficiary may not compel a distribution; the standard is considered 'nonobjective' or 'unascertainable' because it is not specific enough to be objectively applied. Income not distributed to the current beneficiary is typically accumulated; and thus, the exercise of discretion may result in it being paid to another class of persons – the remaindermen. An example of a true discretionary standard (often seen when a surviving spouse is trustee for the children and there are no children by any previous relationship) is as follows:

> *Trustee shall have complete and unfettered discretion over income and principal to make or withhold distributions as trustee deems appropriate appropriate until each child reaches age 25.*

C. The Hybrid

By far the most common type of distribution standard found in personal trusts is a ***hybrid*** of discretionary and support standards. *Lang v. Com., Dept. of Public Welfare,* 515 Pa. 428, 528 A.2d 1335 (1987); *Smith v. Smith*, 517 N.W.2d 394, 398 (Neb. 1994); *citing* Evelyn Ginsberg Abravanel, *Discretionary Support Trusts*, 68 IOWA L. REV. 273 (1983) (discussing hybrid trusts). In a hybrid trust, a trustee has sole discretion to make distributions as the trustee deems appropriate, but in making that determination, the trustee must consider what is reasonable or necessary for the support of the beneficiary within given parameters. *First Nat'l Bank of Md. v. Dep't of Health & Mental Hygiene,* 399 A.2d 891, 895 (Md. 1979). A prudent trustee reviews each request to determine if it falls within the scope of the particular standard in an instrument under the circumstances at the time. HELENE S. SHAPO ET AL., *Discretionary Trusts, in* THE LAW OF TRUSTS AND TRUSTEES §§ 201–30 (3d ed. 2007). Individual circumstances matter! A classic version of a hybrid standard appears in the Texas court trust statute:[7]

> *The trustee may disburse amounts of the trust's principal, income, or both as the trustee in trustee's sole discretion determines to be reasonably necessary for the health, education, support, or maintenance of the beneficiary.* TEX. PROP. CODE ANN. § 142.005(b)(2) (West 2007).

Many traditional hybrid documents contain much more elaborate, detailed, and creative instructions to the trustee. This example contains a potpourri of special instructions to provide additional guidance to the Trustee - but it is still a hybrid distribution standard:

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7 Again, South Dakota has different standards:
SDCL §55-1-40. Language resulting in classification of distribution interest. Although not the exclusive means to create a distribution interest, absent clear and convincing evidence to the contrary, the following language by itself results in the following classification of distribution interest: * * * (3) Discretionary interest:
(a) The trustee, may, in the trustee's sole and absolute discretion make distributions for health, education, maintenance, and support;
(b) The trustee, in the trustee's sole and absolute discretion, shall make distributions for health, education, maintenance, and support;
(c) The trustee may make distributions for health, education, maintenance, and support;
(d) The trustee shall make distributions for health, education, maintenance, and support. The trustees may exclude any of the beneficiaries or may make unequal distributions among them;
(e) The trustee may make distributions for health, education, maintenance, support, comfort, and general welfare.
SL 2007, ch 280, § 17; SL 2008, ch 257, § 7.

In South Dakota the term "hybrid" is defined by statute to reflect a trust with a dual purpose such as care of an animal or other lawful non-charitable purposes. See SDCL §55-1-22. SL 2006, ch 247, § 3; SL 2018, ch 275, § 14.

The Trustee shall distribute so much of the net income and principal of the trust as the Trustee deems necessary to provide for the Child's reasonable health, maintenance, support, and education. In exercising this discretion, Trustee shall consider the following factors:

1. *Child's standard of living at creation of the trust.*
2. *That child is the primary beneficiary of the trust.*
3. *Trustee may consider any income or resources known upon reasonable inquiry to be available to Child for these purposes.*
4. *Settlor's intent is to assist or enable Child to pursue vocational, college, graduate, and/or professional education as long as in the Trustee's discretion it is pursued to Child's advantage.*
5. *Settlor's intent is to assist or enable Child to obtain, improve, and furnish a home commensurate with Child's standard of living.*
6. *Settlor's intent is to assist or enable Child to obtain capital to enter a business or profession.*
7. *Settlor's intent is that trust distributions not serve as a disincentive to Child's motivation to provide for his own needs in life, and Settlor instructs Trustee to reduce or terminate distributions if, in the judgment of the trustee, that objective is served by doing so.*

III. DISTRIBUTIONS PURSUANT TO SETTLOR'S INTENT

The duty of a trustee is to reasonably exercise discretion to *accomplish the purposes of the trust according to the settlor's intent*, within the mandates of public policy and subject to judicial review. *State v. Rubion*, 308 S.W.2d 4, 9 (Tex. 1957). A trustee's exercise of discretion is subject to judicial review in most jurisdictions. *Rubion*, 308 S.W.2d at 9 (explaining that it is better to <u>avoid</u> a situation that requires judicial review). Today, cases are often brought against a trustee for a breach, but many early cases were brought by a trustee seeking court guidance in construing a document. Courts do not like to be burdened with a trustee's job regardless of who initiates the action. Despite many state statutes that specifically retain the rights of a court to modify a trust, that right is always subject to the best interest of the beneficiaries, the intent of the settlor and the discretion granted to the trustee by the instrument.[8] Stated succinctly in *Coffee v. William Marsh Rice Univ*., 408 S.W.2d 269, 284 (Tex. Civ. App.—Houston 1966, writ ref'd n.r.e.), "This Court cannot substitute its discretion for that of the Trustees and can interfere with their exercise of discretionary powers only in case of fraud, misconduct, or clear abuse of discretion."

A. General Intent of the Settlor

The *Coffee* case is still widely cited today – even outside of Texas. The court ultimately held that trustees were free to disregard certain provisions of the trust. Public policy changed and the court allowed the Trustees to depart from certain specific instructions of the Settlor due to those changes. The case presents a fascinating history and a landmark decision illuminating the resolution of conflict between the fiduciary duty of the trustee to **accomplish settlor's intent,** the **best interests of the people intended to benefit from the trust,** and the **mandates of public policy.** Trustees sought court approval to disregard specific instructions that Rice University provide <u>free</u> education to benefit the "<u>white</u> inhabitants of the City of Houston."

William Marsh Rice was 15 when he went to work as a grocery clerk in Massachusetts and bought that store at age 22. Two years later, he decided to move to Texas, but his entire inventory was lost at sea in a storm. He started over and in 20 years he was worth $750,000 (real money in 1860). He married twice

8 A.R.S. §14-10105…
B. The terms of a trust prevail over any provision of this chapter except: …
12. The power of the court to take action consistent with the settlor's intent and exercise jurisdiction as may be necessary in the interests of justice.

but had no children; so in 1891 he created a trust funded with a promissory note payable at his death in the sum of $200,000 to establish Rice University. The instrument recited the terms of the note verbatim, creating an endowment, the interest, income, and profits of which should forever be donated *"to the instruction of the white inhabitants of the City of Houston, and State of Texas, through and by the establishment and maintenance of a Public Library and Institute for the Advancement of Literature, Science and Art, to be incorporated as hereinafter provided, and to be known by such name as the (Trustees) may in their judgment select."* The next paragraph provided:

> *That as soon as the said Public Library and Institute for the Advancement of Science and Art shall have been incorporated, as herein contemplated, then the said Institute, through and by its Board of Trustees hereinafter named, shall accept from the said parties of the second part, the Endowment Fund of Two Hundred Thousand Dollars.*
>
> * * *
>
> *The Endowment Fund, herein mentioned, including all future endowments, donations and bequests that may hereafter be made to the said Institute, not otherwise provided, shall be devoted to the following objects, and purposes, to-wit:*
>
> *A. To the establishment and Maintenance of a Free Library, Reading Room, and Institute for the Advancement of Science and Art.*
>
> *B. To provide, as soon as the fund will warrant such an expenditure, for the establishment and maintenance of a thorough polytechnic school, for males and females, designed to give instructions on the application of Science and Art to the useful occupation of life; the requirements for admission to which shall be left to the discretion of the Board of Trustees.*
>
> *C. Said Library, Reading Room, Scientific Departments, and Polytechnic School, and the instruction, benefits and enjoyments to be derived from the Institute to be free and open to all; to be non-sectarian and non-partisan, and subject to such restrictions only, as in the judgment of the Board of Trustees will conduce to the good order and honor of the said Institute."*

Trustees were expressly forbidden "to permit any lien, encumbrance, debt or mortgage to be placed upon any of the property, or funds, belonging now, or that may hereafter belong to said Institute."

Rice died in 1900 under mysterious circumstances. (Spoiler alert – the butler did it in the bedroom with chloroform; the butler was convicted, sentenced to Sing Sing Prison, but later pardoned.) A fake will, forged by the butler's accomplice (who had been the attorney to Rice's late wife), was presented. It purported to unwind the charitable intent. The accomplice lawyer was eventually acquitted but later committed suicide. When the litigation was completed, the Institute was funded just as Rice intended.[9]

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9 The Court took judicial notice that when signed in 1891, the University of Texas had been in operation only eight years, the number of students attending institutions of higher learning in Texas was small, and opportunities for free education at the college level were very limited. The amount of research and creative work in science and the liberal arts was insignificant and the number of people qualified by education to do such work was undoubtedly small. The need for such an institution in Texas was obvious.

As a final note of historical interest, an original Trustee signatory appointed by William Marsh Rice in 1891 was Captain James A. Baker, (1857–1941) banker and attorney from Houston. He practiced law with his father at the firm now known as Baker Botts specializing in railroad law where he developed a business relationship with Rice, as his attorney and later as overseer of Rice's business interests. Baker defended Rice's estate against the fraudulent will, provided critical evidence to the estate, helped New York authorities unravel the murder conspiracy by the valet and accomplice attorney and served as a trustee for the Rice Institute for five decades. His grandson is James Addison Baker III, a lawyer, also at Baker Botts, who was President Reagan's Chief of

In 1963, the Trustees voted to depart from the terms of the trust in two ways - to begin charging tuition and to admit other races. The decision was controversial and after allegations of breach of duty made in the media, the Trustees sought the court's advisory opinion. As noted above, the opinion scolds the Board of Trustees for asking the court to do its job but rules that circumstances and public policy had changed significantly since the creation of the trust, that the trustees may charge tuition, and that they should disregard the provision applicable to race to accomplish the overall intent of the settlor.[10] In hindsight, it might seem this result was a foregone conclusion but things were not so clear in 1966.

Many trusts being administered today were drafted in a different era. Settlor intent is tricky because, as noted, a discretionary power conferred upon a trustee is not left to a trustee's arbitrary discretion but shall be exercised "reasonably". *Rubion*, 308 S.W.2d at 9; *Estate of Nicholas*, 177 Cal.App.3d 1071, 1087 (1986). "The extent of the discretion conferred upon the trustees depends primarily upon the manifestation of intention of the settlor…that the trustee is given discretion, does not authorize him to act beyond the bounds of reasonable judgment.

Even when it is provided that a trustee shall have absolute or unlimited or uncontrolled discretion, the court may interpose if the trustee does not act 'in a state of mind in which it was contemplated by the settlor that he would act.'" *Nicholas*, 177 Cal.App.3d at 1087; *Estate of Ferrall* 41 Cal.2d 166, 176-177 (1953). See also Estate of Morgridge, Cal.App. 4th District 3rd Division (June 29, 2007) unpublished. Accordingly, language that was clearly enforceable a century ago or even a few decades ago, may be problematic today. Consider how a modern court might construe this language from a trust crafted in the early 1950s:

> *In the event that any beneficiary hereunder should be unable to prove (by affidavit or otherwise) to the complete satisfaction of the Trustee that such beneficiary is a member in good standing of a Lutheran Church, or is being trained in such Church, such beneficiary shall not receive any payments hereunder and all rights to which such beneficiary would otherwise be entitled shall cease and become null and void as if such beneficiary was then deceased.*

Religion has long been a common focus for grantors attempting to control the lifestyle of beneficiaries. Consider the case of *Maddox v. Maddox's Adm'r*, 52 Va. 804 (Va. 1854). Decided in Virginia before the Civil War, the court considered a legacy of a remainder interest to pass after the termination of a life estate to a niece "during her single life, and forever, if her conduct should be orderly, and she remain a member of the Society of Friends." The niece, whose father had held the life estate, was now receiving the remainder benefits of the legacy but married someone who was not a member of the Society of Friends. She was, therefore, under the rules of the Society, ineligible to maintain her own membership. Cousins who remained in the sect were seeking to terminate her distributions. The court took evidence that included statements that there may have been as few as three but likely no more than six single male members available for marriage in her community and then focused on the law related to unreasonable restrictions on marriage and religion. After reviewing dozens of cases from British and American courts, the Sixth Article of the United States Constitution and the Sixteenth Section of the Bill of Rights of Virginia (passed unanimously in convention on the 12th of June 1776, adopted by the convention of 1829-30, and again by that of 1850-51), and considering the history of the Mayflower Pilgrims, the Virginia Huguenots, Pennsylvania Quakers and other colonists, held that the restriction was

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Staff and Secretary of the Treasury, then Chief of Staff and Secretary of State for President George H.W. Bush and for whom is named the James A. Baker III Institute for Public Policy at … Rice University.

10 *Coffee*, 408 S.W.2d at 282.

unreasonable. The finding was based, in part, because there were so few potential mates that the restriction might prohibit marriage all together.

Contrast the Maddox case to *Shapira v. Union Nat'l Bank*, 315 N.E.2d 825 (Ohio Com. Pleas 1974), in which the testator left his estate to his three children, a married daughter living in Israel and two sons. One hundred and twenty years after *Maddox*, the court reviewed the bequests to those adult children who each had the following restriction attached to their gift:

> *(b) My son Daniel Jacob Shapira should receive his share of the bequest only, if he is married at the time of my death to a Jewish girl whose both parents were Jewish. In the event that at the time of my death he is not married to a Jewish girl whose both parents were Jewish, then his share of this bequest should be kept by my executor for a period of not longer (sic) than seven (7) years and if my said son Daniel Jacob gets married within the seven year period to a Jewish girl whose both parents were Jewish, my executor is hereby instructed to turn over his share of my bequest to him. In the event, however, that my said son Daniel Jacob is unmarried within the seven (7) years after my death to a Jewish girl whose both parents were Jewish, or if he is married to a non Jewish girl, then his share of my estate, as provided in item 8 above should go to The State of Israel, absolutely.* (When the case was decided, Daniel was 21 years of age, unmarried and a college student.)

The Ohio court examined the constitutionality and public policy arguments and reviewed many cases from both Britain and the United States handed down since the *Maddox* decision, but ultimately upheld the restriction in this case. The court noted that the restriction was only a partial restraint on marriage. Many of the cases examined were based on the constitutional right to marry and the court acknowledged that right. But it stated that the right to receive property by will is a creature of the law and is not a natural right or one guaranteed or protected by either the Ohio or the United States constitution. It found the conditions contained in decedent's will reasonable because his unmistakable testamentary plan was for his possessions to be used to encourage the preservation of the Jewish faith. The condition did not pressure plaintiff into marriage by the reward of money because the court found a seven-year time limit to be a reasonable grace period, which would give plaintiff ample time for reflection and fulfillment of the condition without constraint or oppression.[11]

The question continues to appear in the courts, even in the 21st century. *In re Estate of Feinberg*, 891 N.E.2d 549, 549 (Ill. App. Ct. 2008), and then *In re Estate of Feinberg*, 919 N.E.2d 888, 891-92 (Ill. 2009), the Court has emphasized that the right to marry is a right protected by the Fourteenth Amendment, labeling the right as "fundamental." Thus, in theory, a court enforcing such a condition could violate the Fourteenth Amendment.[12] As noted in *Shapira*, however, the right to marry must be distinguished from the right to take property. In *Magoun v. Illinois Trust & Savings Bank,* 170 U.S. 283, 288 (1898), an individual asserted that the right to inherit was a natural right but that court found that the right to take property by devise or descent is a privilege and not a natural right.

This dichotomy between rights protected by the Fourteenth Amendment and the privilege to take property by inheritance remains a difficult issue. In general, it is still an open question as to whether

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11 Shapira v. Union Nat'l Bank, 315 N.E.2d 825, 827-32 (Ohio Misc. 1974). The author suggests that Hollywood might find these cases interesting and suggests a title: *How to Find a Girl in Seven Years*.

12 Jeremy Macklin, The Puzzling Case of Max Feinberg: An Analysis of Conditions in Partial Restraint of Marriage, 43 J. Marshall L. Rev. 265 (2009).

such restrictions would be enforced if brought to court today. Some authorities suggest a settlor who wants to include such restrictions today should couch them in terms of a class of beneficiaries. This author is skeptical, but compare the following provisions:

If my son does not marry a Lutheran girl by age 25, trustee shall make no further distributions to him.

OR

Trustee may distribute income to any of my sons who are over age of 25 and married to a Lutheran girl.

Despite general reluctance of courts to substitute their discretion for that of a trustee, when faced with a significant or difficult decision regarding a distribution, particularly one that may impact more than one class of beneficiaries, trustees may still seek a determination of the court. RESTATEMENT (THIRD) OF TRUSTS § 71 (2007). But such actions are expensive - far better to draft making the intent of the settlor as clear as possible, and remember that the decision to request an official construction is also an exercise of discretion. *Keisling v. Landrum*, 218 S.W.3d 737, 743–44 (Tex. App.—Fort Worth 2007, pet. denied).

Trustees may not assume they have discretion to take a particular action. They must read the instrument carefully to determine the settlor's intent and be certain the settlor has given them the power to make such decision. *Id.* at 743; citing *Corpus Christi Nat'l Bank v. Gerdes*, 551 S.W.2d 521, 523 (Tex. Civ. App.—Corpus Christi 1977, writ ref'd n.r.e.); *Eckels v. Davis*, 111 S.W.3d 687, 694 (Tex. App.—Fort Worth 2003, pet. denied); *Wright v. Greenberg*, 2 S.W.3d 666, 671 (Tex. App.—Houston [14th Dist.] 1999, pet. denied).

Here is an example of very specific language making it clear the settlor intended the beneficiary be employed full time.

(a) It is Settlor's overriding intent in establishing this trust to benefit his descendants, supplement their earnings and enhance their standard of living, but only if and to the extent they remain productive members of society and continue to be gainfully employed on a full-time basis. Full-time employment requires, 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. Trust distributions provided for herein shall be suspended at any time 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. Once the Beneficiary regains full-time employment, trust distributions shall not resume until the Beneficiary has maintained such employment for twelve (12) consecutive months. If 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 distributions authorized in Section (b).

(b) For each trust administered under this Article with respect to which the Beneficiary is under the age of fifty (50) years, the Trustee may, if the Trustee in his sole discretion determines it to be in the Beneficiary's best interests, distribute an amount not exceeding the lesser of (i) twice the annual earned income of the Beneficiary, or the Beneficiary's spouse if 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.

If this Beneficiary elects not to work, the Trustee is required to withhold distributions until the Beneficiary has returned to work for a full year. The document says if a beneficiary loses his job, the trustee must turn off distributions. Then, once the beneficiary finds a new job, he must work at it for a full year before distributions may be reinstated. Draconian? Yes. But Settlor's intent is very clear.

B. Incentive Clauses

Sometimes settlors use trusts to offer monetary incentives to modify beneficiary behavior or mold character to accomplish the settlor's values. The incentive clause may describe a "reward" built into the distribution provisions of a trust to encourage a beneficiary to achieve a milestone or discourage sloth. Often the incentive (a "carrot") is accompanied by a punishment (a "stick") such as the example above where distributions are stopped when a beneficiary is unemployed. Economics, the study of how supply and demand or risk and reward impact the flow of wealth, is all about carrots and sticks - in society or in a family. But incentives, in the global economy and in personal trust often go wildly wrong.

Consider a classic example sometimes known as the "Cobra Effect." In colonial India, a British overlord arrived to discover that his district was infested by cobras. We can assume he was new to public service because he immediately rolled up his sleeves and set out to solve his constituents' problem by offering an incentive. He agreed to pay a cash bounty for each cobra skin presented to him. It worked well in the beginning. The poorest citizens had a new source of income and the cobra population rapidly declined. Unfortunately, as cobras became scarce, his citizens, naturally reluctant to give up their new revenue stream, began to breed, raise, and slaughter snakes to keep the cash flow … flowing. Upon discovering his bounty was being taken advantage of, the overlord rescinded it. Then the cobra farmers did the logical (and very Hindu) thing and set their livestock free. Again, the district was overrun with dangerous serpents. Good intentions and the offered incentive had made the problem worse.

This is the "Cobra Effect,"[13] a term used in psychology, politics, economics, and trust, illustrating how an ill-thought-out solution can do more harm than good. Several of the cases cited above regarding restrictions of faith discuss the possibility that a requirement of marriage in order to inherit will simply incent the beneficiary to marry, claim his or her inheritance, and then divorce – clearly not the settlor's intent. In providing incentives, you might **get what you pay for but not what you hoped for because** incentives do not work in the long term as a mechanism for behavior modification.[14] Economic principles tell us why:

- No government, corporation or drafting attorney will ever be as smart as the collective masses (and beneficiaries) working out ways to game the system.
- It is extremely difficult to anticipate the responses or change the behavior of people who think exactly as we do; why should we assume that we can anticipate how a future generation, complete strangers to us, will think or respond to our attempted motivations.
- If we are successful, and achieve the desired modification of behavior, we change the playing field making it even harder to anticipate how the next generation will respond.
- People don't like to feel they are being manipulated. They push back. If they believe they are being treated with disrespect or goaded, they push back harder.

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13 *See* "The Cobra Effect", http://freakonomics.com/podcast/the-cobra-effect-a-new-freakonomics-radio-podcast/.

14 *See*, Marjorie J. Stephens, *Incentive Trusts: Considerations, Uses and Alternatives,* AM. C. TR. & EST. COUNSEL, Volume 29, No. 1, Summer 2003 at 5–22, for an excellent discussion as to why incentive trusts do not work.

What is a settlor to do? Some general guidelines:

- Consider what people really care about, remembering it is often NOT what they SAY they care about.
- Examine any proposed incentive not just from the standpoint of its value to the recipient but also by considering the overall cost to the settlor, and to the trust.
- Pay attention to how the settlor responds, and if you have the opportunity, to how other advisors or family members respond to the proposal. Learn from those responses and adapt.
- Whenever possible, frame an incentive in terms that are cooperative – not adversarial.
- Never assume anyone will do the "right" thing just because it is the right thing. (Cynical but usually true.)
- Accept that some people will work hard to invent ways to game the system that you could not possibly have imagined. (This is easier to accept if you look past greed and applaud ingenuity.)

Some trusts just include a general statement of philosophy such as the trustee being directed not to make distributions that would be a "disincentive" for a beneficiary to be self-supporting. There may be objective standards for the Trustee to govern distributions suggesting that trust distributions should equal earned income. Wealthy clients express concern that leaving too much inheritance to their children will "spoil" them. They believe a child will not work as hard at personal achievements and having too much money will keep the child from becoming a productive member of society. There are examples of "professional heirs" and who do nothing but live lavishly on their inherited wealth and some spectacular examples of enormous inheritances spent in a matter of a few years. Warren Buffet has famously opined that the perfect inheritance is "enough money so that they feel that they could do anything, but not so much that they could do nothing." He suggests any amount over the "perfect inheritance" should go to charity or other beneficiaries. But there are also examples of beneficiaries who start from a position of privilege and accomplish great things - Warren Buffet again.

For some clients, the goal is to make sure a child finds productive employment. This is simple to say, but not so easy to draft into a trust. What if the child is in school? Is disabled? Does staying home to raise a family or care for an elderly parent constitute "productive employment"? How do we classify active volunteer service or a job that is important but pays little or nothing such as the Peace Corp or military service? What if there is an economic recession or a pandemic and jobs are just not available? It is a slippery slope because when you start down the path of specificity then all these possibilities and more may have to be addressed in the document. Full discretion accompanied by general guidance to the trustee probably works better because it is impossible to predict what the future will bring and what special circumstances may impact a trust beneficiary. But of course, the settlor must trust the trustee to implement that guidance as intended. These types of trust are difficult to draft and even more difficult to administer. To monitor objective criteria, a trustee must obtain and analyze income tax returns, medical reports, economic circumstances, and needs broad powers to investigate beneficiaries' circumstances and obtain objective proof that they are meeting the requirements. A trustee who accepts this responsibility may want additional liability protection. A failure, such as a beneficiary who becomes homeless, can result in a terrible spiral because the conditions for trust distributions have not been met.

The potential for distasteful (and usually ineffective) control is as endless as the imagination. We have already examined cases where settlors conditioned inheritance on a child not marrying a certain individual, not marrying outside the faith of the settlor, or not divorcing. Inheritance may be conditioned on one becoming a doctor or lawyer (or perhaps, not becoming a lawyer). Incentive clauses may demand a place of residence, number of children, or a lifestyle. But a beneficiary already troubled is unlikely to

be 'cured' by an incentive trust. Telling a drug addict he won't receive his inheritance unless he stops taking drugs will not stop him from using. Telling a beneficiary that she can't receive her inheritance unless she graduates from college and is making $50,000 a year may result in a college graduate who hates the field of study they chose and stops working as soon as the demands of the document are met.

It is easy to find terrifying and ludicrous examples and this author has resisted the temptation to include those. (Although we include further discussion below in the sections on Support and Substance Abuse.) Instead, to those whose clients insist on taking this approach we suggest careful consideration of the "Cobra" effect before drafting. Consider stating settlor's intent if beneficiaries are meant to be mere "stewards of the wealth" or ultimate consumers and please share if you find the silver bullet.

IV. READ THE DOCUMENT

As a drafter constructs a trust, he can expect a professional trustee to read the instrument carefully and apply basic rules of construction. Good administrators make it a practice to review all the relevant provisions in the trust document with each request because it is nearly always required to understand a beneficiary's current circumstances. In testamentary trusts with a standard of living clause, the trustee may need to know the circumstances at the time of the settlor's death. *First Nat'l Bank of Beaumont v. Howard*, 229 S.W.2d 781, 783–85 (Tex. 1950); *McReary v. Robinson,* 59 S.W. 536, 537 (Tex. 1900). A trustee looks to the trust document for express instructions or a direct statement of the purpose of the trust. *See Coffee*, 408 S.W.2d at 282–83. If there is no clear statement, a trustee may infer purpose from structure of the trust. Basic rules of construction may help to interpret distribution clauses or any part of a trust agreement.

(1) Every trust is different. A well-crafted document reveals the settlor's goals from its content. *Keisling v. Landrum*, 218 S.W.3d 737, 741 (Tex. App.—Fort Worth 2007, pet. denied).

(2) The cardinal principle to be observed in interpreting a trust is to ascertain the settlor's intent with the view of effectuating it. *Coffee*, 408 S.W.2d at 273. The trustee must determine the settlor's intent from the instrument. *In re Estate of Dillard*, 98 S.W.3d 386, 391 (Tex. App.—Amarillo 2003, pet. denied); *Huffman v. Huffman*, 339 S.W.2d 885, 888–89 (Tex. 1960).

(3) An administrator must clear his mind of what he thinks the document says, or what he wants it to say, and read what it actually says. *In re Estate of Dillard*, 98 S.W.3d at 391–93. A trustee cannot "correct" the work of a testator, a settlor, or the drafting counsel. "The very purpose of requiring a will to be in writing is to … place it beyond the power of others ... to change or add to [it,] or to show that he intended something [else]." *Huffman*, 339 S.W.2d at 889.

(4) "If possible, the court should construe the instrument to give effect to all provisions so that no provision is rendered meaningless." *Myrick v. Moody*, 802 S.W.2d 735, 738 (Tex. App.—Houston [14th Dist.] 1990, writ denied). But "[i]f the language of a trust is unambiguous and expresses the intent of the settlor, it is unnecessary to construe the instrument because it speaks for itself." *Hurley v. Moody Nat'l Bank of Galveston*, 98 S.W.3d 307, 310 (Tex. App.—Houston [1st Dist.] 2003, no pet.).

(5) This is not math—a trustee cannot add to or subtract from what appears in the document. *Corpus Christi Nat'l Bank v. Gerdes*, 551 S.W.2d 521, 523 (Tex. Civ. App.—Corpus Christi 1977, writ ref'd n.r.e.); citing *Huffman*, 339 S.W.2d at 888. If the instrument is unambiguous, courts do not admit other evidence for the purpose of interpretation. For administration, however, it will be appropriate to consider outside circumstances. *Coffee*, 408 S.W.2d at 283.

(6) If the document is truly unclear, courts may consider extrinsic evidence to determine what a settlor or testator intended by using or including a particular word or phrase. In *Reilly v. Huff*, 335 S.W.2d 275, 279 (Tex. Civ. App.—San Antonio 1960, no writ) the Court accepted evidence

the testator was a person of solid business experience and because testator's attorney drafted the instrument, the term "descendant" was construed in its legal sense.

(7) There is no reason to be afraid of the dictionary. *Patrick v. Patrick*, 182 S.W.3d 433, 436 (Tex. App.—Austin 2005, no pet.); *Vinson v. Brown*, 80 S.W.3d 221, 231 (Tex. App.—Austin 2002, no pet.). By way of example, the trust instrument states: "*In connection with the management of said trusts . . . I give Trustee all powers of Trustees set forth in the statutes and to ... make advancements to or for the benefit of said beneficiaries for such purposes as the Trustee may deem desirable or proper . . . and charge against the interest of said beneficiary to whom such advances are made.*" Later, the document stated: "*Except as noted elsewhere herein, the trustee shall not borrow nor lend.*" Trustee consulted Webster's Dictionary regarding the meaning of the term "advance," which includes as follows: (1) to bring or move forward; (2) to accelerate growth or progress of; (3) to raise to a higher rank; and (4) *to supply or furnish in expectation of repayment.* A dictionary is a valuable tool.

(8) An expression of specific intent controls over an expression of general intent; if two expressions of specific intent are in conflict, the trustee should choose the expression that least conflicts with the general intent. *Coffee*, 408 S.W.2d at 272–75. Example: *Trustee shall make distributions to enable each of my five grandchildren to obtain an education; and I specifically intend that my grandson, Marcus, be afforded every opportunity to attend medical school.*

(9) The term "may" means maybe—use discretion. The term "shall" means mandatory—just do it. *Keisling v. Landrum*, 218 S.W.3d at 742 n.3; *Roberts v. Squyres*, 4 S.W.3d 485, 489 (Tex. App.—Beaumont 1999, pet. denied). Accordingly, if a grantor intends the trustee to have discretion, do not use the word "shall". (See also XIII May vs. Shall below.)

When interpreting a document, certain legal presumptions are useful. *See, e.g.*, 10 GERRY W. BEYER, TEXAS PRACTICE: TEXAS LAW OF WILLS § 47.18 (3d ed. 2002).

a. Leaving a will or trust suggests testator did not intend that property would revert to his estate or pass in intestacy.
b. By leaving a will or trust the testator intended to confer some benefit on the beneficiary.
c. Children are favored over grandchildren, descendants are favored over collateral relatives, who are favored over strangers. *See also* TEX. ESTATES CODE ANN. § 201.001 (West 2014).
d. The testator intended that the estate vest as early as possible.
e. All persons in a class and all classes of beneficiaries are treated equally unless the document specifies otherwise.
f. Every word a testator or grantor uses is important; nothing is there for no reason.
g. The testator intended the law in effect at that time should apply.

Interpreting a trust requires knowing rules that apply but are not in the document. For example, in many states, exculpatory clauses are limited, and broad limitation of trustee liability may be void. A. R. S. Chapter 11. ARIZ. TRUST CODE § 14-10105 referencing § 14- 11008; TEX. PROP. CODE ANN. § 111.0035 (West 2007). A trustee must know what is mandatory under the relevant statute.

V. MATHEMATICAL CALCULATIONS VS. FIDUCIARY DECISIONS

Some trusts call for distribution under a specific formula. For trusts that require mandatory distribution of income, the trustee's discretion is as to whether to use the adjustment power, rather than traditional trust accounting to make distributions. Or a trustee may have to choose an alternate valuation date. Treas. Reg. §1.664-3. In recent decades there has been a trend for documents to be drafted with complicated formulaic distribution provisions – likely reflecting distrust of trustees being given the power to make principal and income adjustments. These are often unreasonably complicated. Example:

Trustee shall distribute to Beneficiary an amount up to Sixty Thousand Dollars ($60,000) per year, as adjusted below ("Base Distribution"), for health, maintenance, and support. The Base Distribution shall be increased by a cost-of-living adjustment calculated as set forth below.

If separate trusts (such as a GST Exempt Trust and GST Non-Exempt Trust) are established hereunder for the Beneficiary, the Base Distribution shall be made only once. No Base Distribution shall be made from a GST Exempt Trust unless the GST Non-Exempt Trust is fully exhausted.
For purposes of calculating the cost-of-living adjustment to the Base Distribution, the following definitions and procedures shall apply:

"Average Index" means the aggregate of the Price Index for all months of the calendar year ("Prior Year") immediately preceding the current calendar year ("Current Year"), divided by 12.

"Price Index" shall mean the "Consumer Price Index for All Consumers" published by the Bureau of Labor Statistics of the U. S. Department of Labor – U. S. City Average (1967=100) or any renamed index or any other successor or substitute index appropriately adjusted. If (1) major revisions are made to the Price Index or major changes are made to the Price Index base period rendering the procedure outlined in the following paragraph impossible to implement in a manner that would give effect to the Grantor's intent regarding the cost-of-living adjustment or (2) the Price index is no longer published by the Bureau of Labor Statistics of the U. S. Department of Labor, then the Trustee, in the Trustee's sole discretion, shall select another governmental index the use of which would most closely duplicate the procedures and resulting cost-of-living adjustments described herein and shall use such index in place of the Price Index.

Effective as of January of each calendar year, the cost-of-living adjustment shall be based upon the percentage difference between the Price Index in effect as of January of the Current Year and the Average Index. If the Price Index for January of the Current Year reflects an increase over the Average Index, then the Base Distribution in effect in the Prior Year shall be multiplied by the percentage difference between the Price Index for the January of the Current Year and the Average Index, and the resulting sum added to the Base Distribution (as adjusted and in effect in the Prior Year) effective as of the first day of January of the Current Year, until it is readjusted in the year succeeding the Current Year. Notwithstanding the foregoing, in no event shall a Base Distribution payable during any Current Year be less than a Base Distribution payable in the Prior Year. By way of illustration, the following computation of the cost-of-living adjustment in the Base Distribution illustrates the Grantor's intent with respect to the adjustment provided for herein. Assuming that (1) the Base Distribution is $60,000, (2) the Average Index is 102.0, and (3) the Price Index for January of the Current Year is 105.0, then the Base Distribution for the Current Year would be calculated as follows: $60,000 x 3/102 = $1,765 + $60,000 = $61,765.

This provision appears to leave very little in the discretion of the trustee, but the first sentence states that the *"Trustee shall distribute to the Beneficiary an amount **up to** Sixty Thousand Dollars ($60,000) per year…"* Thus, apparently the trustee must research to discover the reasonable amount needed for HEMS, then calculate the current adjusted base amount under the formula, and revert back to the adjusted amount in the event that the amount needed exceeds the adjusted cap. But remarkably, we have an even more complicated example:

The "Required Monthly Distribution" (RMD) amount shall be as calculated in this section. One of my primary intentions is that during the life of my wife the value of the principal in the trusts created

under my Will (including the trusts administered pursuant to Article V and VI, (the "John Doe Marital Deduction Trust" and the "John Doe Family Trust") not fall below FIVE HUNDRED THOUSAND DOLLARS ($500,000). Accordingly, the RMD shall be calculated as follows:

(a) If the combined value (on January 1 of a year) of the John Doe Marital Deduction Trust assets and the John Doe Family Trust assets is less than FIVE HUNDRED THOUSAND DOLLARS ($500,000), the RMD for each month of such calendar year shall be zero dollars ($0);

(b) If the combined value (on January 1 of a year) of the John Doe Marital Deduction Trust assets and the John Doe Family Trust assets is equal to or greater than FIVE HUNDRED THOUSAND DOLLARS ($500,000), but less than ONE MILLION FIVE HUNDRED THOUSAND DOLLARS ($1,500,000), the RMD for each month of such calendar year shall be EIGHT THOUSAND THREE HUNDRED THIRTY THREE DOLLARS ($8,333); provided, however, that the RMD under this subsection 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 combined value (on January 1 of a year) of the John Doe Marital Deduction Trust assets and the John Doe Family Trust assets is equal to or greater than ONE MILLION FIVE HUNDRED THOUSAND DOLLARS ($1,500,000), but less than THREE MILLION DOLLARS ($3,000,000), the RMD for each month of such calendar year shall be TEN THOUSAND DOLLARS ($10,000); provided, however, that the RMD under this subsection shall be increased for inflation, as determined by the Consumer Price Index, using the year of execution of this Will as the base year;

(d) If the combined value (on January 1 of a year) of the John Doe Marital Deduction Trust assets and the John Doe Family Trust assets is equal to or greater than THREE MILLION DOLLARS ($3,000,000), but less than THREE MILLION FIVE HUNDRED THOUSAND DOLLARS ($3,500,000), the "Required Monthly Distribution" for each month of such calendar year shall be TEN THOUSAND FIVE HUNDRED DOLLARS ($10,500); provided, however, that the RMD under this subsection shall be increased for inflation, as determined by the Consumer Price Index, using the year of execution of this Will as the base year;

(e) If the combined value (on January 1 of a year) of the John Doe Marital Deduction Trust assets and the John Doe Family Trust assets is equal to or greater than THREE MILLION FIVE HUNDRED THOUSAND DOLLARS ($3,500,000), but less than FOUR MILLION FIVE HUNDRED THOUSAND DOLLARS ($4,500,000), the RMD for each month of such calendar year shall be the product of the following formula: four and one-half percent (4.5%) multiplied by the fair market value of such assets as of January 1 of such calendar year, divided by twelve (12); provided, however, that the 4.5% rate shall be increased by the inflation rate for the prior calendar year, as determined by the Consumer Price Index;

(f) If the combined value (on January 1 of a year) of the John Doe Marital Deduction Trust assets and the John Doe Family Trust assets is equal to or greater than FOUR MILLION FIVE HUNDRED THOUSAND DOLLARS ($4,500,000) and above, the RMD for each month of such calendar year shall be the product of the following formula: four percent (4.0%) multiplied by the fair market value of such assets as of January 1 of such calendar year, divided by twelve (12); provided, however, that the 4.0% rate shall be increased by the inflation rate for the prior calendar year, as determined by the Consumer Price Index.

*(g) Notwithstanding anything herein to the contrary, after the occurrence of a "**Major Terrorism Event**", my Trustee shall distribute (in addition to all income and the Required Monthly Distribution) such amounts of trust principal to my wife as are necessary, when added to the funds reasonably available to her from all other sources known to my Trustee, to provide for her health, support and maintenance in order to maintain her, to the extent reasonably possible, in accordance with the standard of living to which she was accustomed at the time of my*

> *death. For all purposes of this Will, a "Major Terrorism Event" shall be any terrorist act carried out against the United States that, in the sole judgment of my Trustee, has an effect on the ability of my wife to continue the lifestyle to which she is accustomed at the time of my death including reasonable security from future attacks. Additionally, my Trustee shall distribute to my wife (in addition to all net income and the Required Monthly Distribution) such amounts of trust principal as are necessary, when added to funds reasonably available from all other sources known to my Trustee, to provide for any* ***emergency or serious medical needs****.*

Such complicated formulae suggest lack of confidence in the trustee to exercise appropriate discretion or make prudent decisions regarding distributions. The rigid format severely restricts the trustee's ability to adapt to changing market conditions or unexpected changes in beneficiary circumstances, the economy, or governing law.

VI. DECLARING THE PURPOSE OF THE TRUST

In most jurisdictions, individual personal trusts generally do not have mandated statutory language; accordingly, the variance between trusts is nearly unlimited. *See* RESTATEMENT (THIRD) OF TRUSTS § 50 (2007). The first step when reviewing a personal trust for administration is to consider its purpose. While there are many reasons why a person might establish a discretionary trust, the most common are: tax planning; to facilitate an orderly transfer of wealth; to protect the assets of someone unable to protect themself; to accommodate for character flaws or parental deficiencies; or to attempt control from the grave. *See, e.g.*, BEYER, TEXAS TRUST LAW, *supra*, at 3–5. Control from the grave is not realistic and attempts to do so are often foiled but that hasn't stopped determined settlors. *Alamo Nat'l Bank of San Antonio v. Daubert*, 467 S.W.2d 555, 560 (Tex. Civ. App.—Beaumont 1971, writ ref'd n.r.e.).

Trusts established for federal tax purposes, are generally drafted with an "ascertainable standard." *See* Anthony F. Vitiello & Daniel B. Kessler, *The Fully Discretionary Ascertainable Standard*, TRUSTS & ESTATES MAG., Mar. 2010. If an ascertainable standard limits the trustee's power to invade the principal of a trust, then generally that trust is not includable in the beneficiary's federal gross estate. *See id.* The referenced article makes the point that the ascertainable standard alone will likely not provide creditor protection for the beneficiary. To accomplish that the Trustee must have full discretion. Put another way, the Beneficiary must not have an enforceable right to demand payment because if a Beneficiary has such a right to compel distribution – so will his creditors. When considering an ascertainable distribution standard, it is helpful to consider some of the language that courts have scrutinized when determining whether a power of appointment is appropriately limited for tax purposes. RESTATEMENT (THIRD) OF TRUSTS § 50 (2003) contains an extensive discussion of this precedent but also reminds us that a trustee's discretionary power with respect to trust benefits is distinguishable from the power of appointment by virtue of that power not being subject to fiduciary obligation. Trust distribution standards may be very broad; as noted above, the trustee can be given authority to distribute to a beneficiary in the trustee's sole discretion. Treas. Reg. 20.2041-1(c)(2) provides "a power is limited by [an ascertainable] 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)." The regulation also says that the terms "support" and "maintenance" are synonymous.

See also, Estate of Vissering v. Comm'r, 990 F.2d 578, 581–82 (10th Cir. 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 seems to circle back to a previous standard of living.) But

importantly, "[a] power to use property for the comfort, welfare, or happiness of the holder" is deemed to be outside of the ascertainable standard.[15]

Many trusts are drafted with this "safe harbor" language from the regulations: "health, education, maintenance, and support" and can provide asset protection if the trustee isn't the beneficiary. However, if the beneficiary is the trustee, it subjects trust assets to the beneficiary/trustee's creditors (at least in most states). It would also cause inclusion in the beneficiary/trustee's taxable estate. The trustee would be deemed to have a "general power of appointment" under Section 2041 of the IRC because the trustee could appoint the assets to himself as beneficiary. See discussion XIII. May vs. Shall below.

Tax cases provide some guidance for a prudent trustee, as does the common law of personal trust. When the testator has not specifically stated his or her intent, the distribution standard may be a clue to the purpose of the trust. If beneficiaries have the power, as either a co-trustee or otherwise, to make distributions to themselves or for their benefit but such power is limited by an ascertainable standard, then the settlor's primary purpose in establishing the trust may be safely assumed to include tax planning. *See* Vitiello & Kessler, *supra.* However, if the power is too broad to be considered ascertainable, such as the right to distribute money for happiness, the assets fall back into the beneficiary's taxable estate, and the trustee can assume the settlor simply wished to provide for the beneficiary. *Id.* Many states also have Discretionary Powers and/or Tax Savings statutes. For example, A. R. S. § 14-10814. Discretionary powers; tax savings; or TEX. PROP. CODE ANN. § 113.029 (West 2007). Administration is easier, however, if a settlor clearly states a purpose:

> *I intend by establishment of this trust to provide for the care, comfort, support, maintenance, health, enjoyment, and education of my daughter.*

VII. STANDARD OF LIVING CLAUSES

There is more precedent on standard of living than nearly any other aspect of discretion. Treas. Reg. § 20.2041-1(c)(2) lists "support in [the holder's] accustomed manner of living" as one of the ascertainable standards limiting the general power of appointment and there are many cases interpreting this language. This is in part because so many testamentary trusts incorporate the desire of the testator to provide support to a loved one "*in the manner to which [the loved one] has been accustomed immediately prior to my death*." *Old Va. Brick Co. v. Comm'r,* 367 F.2d 276, 278 (4th Cir. 1966); *Independence Bank Waukesha v. United States*, 761 F.2d 442, 444 (7th Cir. 1985). But the question of how much money a beneficiary needs to maintain the accustomed manner of living generally presents a fact question making it one of the few issues that feels peculiarly proper to be presented to a trial court. It is a measure made by the trustee that <u>must</u> be based upon circumstances. No set sum can be fixed as to cost of living, wages, medical expense, reasonable entertainment and a variety of other reasonably necessary expenses and no fixed amount will apply to all cases. Instead, the appropriate amount varies according to the station in life of settlor or beneficiary (or both) with each decision including consideration (and evidence) of the expenses sufficient to judge their reasonableness – by a trustee and occasionally by a court.

The "appropriate" standard of living may be important even in trusts where the beneficiary's previous standard of living is not an issue. *See* John G. Steinkamp, *Estate and Gift Taxation of Powers of Appointment Limited by Certain Ascertainable Standards*, 79 MARQ. L. REV. 195, 246–49 (1995). A trustee, unless specifically relieved from the responsibility by the terms of the document, should investigate and document the beneficiary's standard of living. This may include visiting a beneficiary

15 Considering that "happiness" is "unascertainable" may also be a topic for an entirely different type of seminar.

and follow up on major expenses or it may include research to determine the settlor's standard of living more than a generation ago. Courts have long held type and size of dwellings, type and expense of educational institutions attended, wardrobe, domestic help employed, number and price of automobiles, membership in recreational facilities, vacations, and everyday activities to be relevant depending on circumstances. *In re Golodetz' Will*, 118 N.Y.S.2d 707, 712–13 (N.Y. Sur. Ct. 1952); *Canfield v. Security First Nat. Bank*, 13 Cal.2d 1, 21 (1939). The trustee should monitor, record, and consider these and other circumstances to "determine the amount…sufficient for the 'suitable' support and maintenance of the trust beneficiary." *In re Rockefeller*, 260 N.Y.S.2d 111, 115 (N.Y. Sur. 1965).

Despite the broad interpretation of state courts in considering what is appropriate to distribute under an "accustomed standard of living" trust, a prudent personal trustee should also be aware of the federal tax ramifications of the distribution standard. "[P]ower to invade corpus . . . to continue an accustomed standard of living" without further limitation has been held to be outside the ascertainable standard, even if limited somewhat. Steinkamp, *supra*. Rev. Rul. 77-60, 1977-1 C.B. 282. The issue is not how the trustee spends the money but how the trustee *could* spend the money. *Id.* Revenue Rule 77-60 states:

> A power to use property to enable the donee to continue an accustomed mode of living, without further limitation, although predictable and measurable on the basis of past expenditures, does not come within the ascertainable standard prescribed in [§]2041(b)(1)(A) of the Code since the standard of living may include customary travel, entertainment, luxury items, or other expenditure not required for meeting the donee's need for health, education or support.

Every professional trustee can cite standard of living clauses that were difficult to research or interpret. For example, this standard of living clause – typical, except for the timing:

> ***Beginning thirty years from the date of my death****, Trustee shall distribute all of the net income of each trust to the Beneficiary or descendants. In addition, beginning thirty years from the date of my death, it is my desire that each Beneficiary and each descendant of such Beneficiary be provided with funds from principal of the trust set aside for such Beneficiary which will be sufficient, when added to the funds reasonably available to such Beneficiary from all other sources that are known to the Trustee, to maintain such Beneficiary or such descendant, to the extent reasonably possible* ***in accordance with the standard of living enjoyed by my grandchildren at the time of my death***.

Settlor instructed the Trustee to wait thirty years before beginning distributions but then to use the standard of living that Beneficiary enjoyed at the time of Settlor's death - thirty years before. Or consider this unique example of a testator who undertook to define exactly the standard of living he had in mind:

> *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 as much education as 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 until the time of my death. 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, that they may continue to do meaningful work for profit or charity.*

Often the standard of living clause is blended with other instructions to the trustee. Here is an example of an instruction directing the trustee to consider other sources of income, family life and lifestyle.

> *[T]o provide the Trustee with guidance in making distributions under these standards, the Trustee may consider those circumstances the Trustee believes are relevant, including but not limited to: (a) other income and assets known to the Trustee to be available to a beneficiary, (b) the tax consequences of any distribution, (c) the character and habits of a beneficiary, including the diligence, progress and aptitude of a beneficiary in acquiring an education and advancing his career goals, (d) the ability of a beneficiary to handle money usefully and prudently, and assume the responsibilities of adult life and self-support, (e) the extent to which a distribution could contribute to the development of negative attitudes in a beneficiary, such as entitlement, complacency or narcissism, (f) external factors or circumstances which threaten a beneficiary's financial security or progress toward financial maturity and independence, and (g) the beneficiary'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*.

VIII. CONSIDER OTHER SOURCES OF SUPPORT

It is a good idea to address this issue in the trust instrument itself, because (paraphrasing Ron Aucutt) "with respect to the default rules that apply where a trust is silent on these issues, the states are all over the map." According to the RESTATEMENT (THIRD) OF TRUSTS:

> **Significance of beneficiary's other resources**. It is important to ascertain whether a trustee, in determining the distributions to be made to a beneficiary under an objective standard (such as a 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. RESTATEMENT (THIRD) OF TRUSTS § 50, cmt. e (2003).

A. Default Rules

Even if default rules under the law initially governing administration are consistent with settlor's intent, a change in situs, case law or statute may result in new law as to whether and what a trustee should consider. In Georgia a trustee is under no duty to investigate beneficiary resources and is *forbidden* from doing so without an express instruction.[16] In Virginia, a trustee *may* consider the beneficiary's other resources, absent an expression of intent to the contrary.[17] When a trustee does consider and the beneficiary has other resources, how should that impact a trustee's decision? The views of the Restatements (Second) and (Third) of Trusts are somewhat inconsistent. In RESTATEMENT (SECOND) OF TRUSTS § 128, cmt. e (1992), reporter's notes include citations to numerous cases holding that a beneficiary is entitled to distributions irrespective of other resources, and other cases holding to the contrary suggesting that even if the beneficiary does have other resources, if the trustee is directed to provide for the beneficiary's support, then it does not matter whether the beneficiary has other resources. But RESTATEMENT (THIRD) OF TRUSTS § 50, cmt. e (2003), suggests that if a beneficiary has other resources it does not necessarily mean distributions from a trust would be less but implies they might be.

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16 O.C.G.A. § 53-12-245; *Hamilton Nat'l Bank v. Childers*, 233 Ga. 427, 211 S.E.2d 723 (1975).

17 *NationsBank of Va. v. Estate of Grandy*, 248 Va. 557, 450 S.E.2d 140 (1994). The RESTATEMENT (THIRD) OF TRUSTS cites this case for the proposition that other resources *must* be considered, but the court's actual holding was that it was *not improper* for a trustee to consider other resources.

Generally, cases from documents that do not address consideration of beneficiary resources are largely testamentary and vary in outcome.[18] Looking at various state's case law, the default approach falls into three broad categories:

- Settlor intended the trust as an absolute gift of support, and the trustee should not look outside the trust to determine the beneficiary's other means;
- The trustee must consider other means, but the beneficiary is not required to exhaust them; and
- Beneficiary must rely on his own resources unless and until such resources prove inadequate.

See generally Jonathan M. Purver, Annotation, *Propriety of Considering Beneficiary's Other Means Under Trust Provision Authorizing Invasion of Principal for Beneficiary's Support*, 41 A.L.R.3d 255 (1972) (discussing each of the different categories where the default rule fails). Often, a settlor specifies what the trustee should consider regarding outside support. *Keisling v. Landrum*, 218 S.W.3d 737, 743–45 (Tex. App.—Fort Worth 2007, pet. denied). When it is not specified in the instrument, most states follow the moderate path of assuming the beneficiary's other means of support should be considered, but do not require a beneficiary to exhaust such outside resources. This is not the prevailing view everywhere. *See In re Demitz' Estate*, 208 A.2d 280, 282 (Pa. 1965) and Purver's Annotation, *supra* at 266, and cases cited from a variety of jurisdictions where the beneficiary is required to exhaust outside resources in whole or in part. However, in most states, the view is there are no reasonable grounds to exclude information regarding other means of support. *See,* Sarah Patel Pacheco, *What Did You Mean By That? Trust Language and Application by Trustees*, ST. B. TEX., ADVANCED ESTATE PLANNING STRATEGIES 2016. In these jurisdictions, the most important factor to be considered is the ultimate intent of the settlor—generally presumed to be support, as necessary. *See* R.T. Kimbrough, Annotation, *Admissibility of Extrinsic Evidence to Aid Interpretation of Will*, 94 A.L.R. 26 (1935).

B. Restatement Comments

The Restatements suggest a trustee has a duty to attempt to ascertain the beneficiary's needs, and under usual rules of construction, other resources reasonably available and relevant to the discretionary power. It suggests a trustee should include the beneficiary's income and periodic receipts such as pension, annuity payments, or child support and that a trustee may have discretion or a duty to take account of a beneficiary's personal estate, including the settlor's relationships and intent for current and remainder beneficiaries. RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. e(1 and 2) (2003). But the RESTATEMENT (SECOND), (in some but not all states), suggests that, absent some expression of intent to the contrary, a settlor of a trust for support intends to provide for all the beneficiary's support needs, irrespective of whether the beneficiary may have other resources.[19] The RESTATEMENT (THIRD) suggests a trustee should consider other resources, unless a settlor's purpose is better served by not doing so.[20]

Settlors may assume the existence of other resources will encourage a trustee to reduce distributions from the trust, but the opposite result is more likely. If a trustee knows a beneficiary's other resources are adequate and the beneficiary will not need to rely on the trust for support, a trustee may be more liberal in making distributions - especially true if settlor has expressly said that the primary purpose is to provide for current beneficiaries, and rights of remainder beneficiaries are merely incidental. On the other hand, if trust resources are limited, and the beneficiary has no other sources of support, the trustee may limit distributions to ensure the trust will not be exhausted, which would leave the beneficiary

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18 Compare *In re Ferrall's Estate*, 258 P.2d 1009, 1012 (Cal. 1953), with *In re Flyer's W*ill, 245 N.E.2d 718, 720 (N.Y. 1969).

19 RESTATEMENT (SECOND) OF TRUSTS § 128, cmt. e (1992).

20 RESTATEMENT (THIRD) OF TRUSTS § 50, cmt. e (2003).

entirely without support. The rationale is that to determine what amount of support is necessary, the trustee must consider the beneficiary's circumstances and determine **need.** *First Nat'l Bank of Beaumont v. Howard*, 229 S.W.2d 781, 786 (Tex. 1950). In *Howard*, the court held the requirement that a trustee consider income from any source includes family. It held trustee must "consider all income enjoyed by the beneficiaries from any and all sources, all income enjoyed by their husbands from whatever source so long as it is available for support of the beneficiaries" and in that case, also considered income received by their sons. Because the language in the Restatement and case law can be remarkably "squishy," if a settlor wants the trustee to consider something specific, the document should say so. A simple example would be:

> *Trustee, in its sole discretion, may pay from income and principal of the trust such amounts as the trustee may deem appropriate for the health, education, and support of the beneficiary in her accustomed manner of living,* ***taking into consideration any other resources available to her known to the trustee****. In determining the advisability and amount of payments, the trustee may, but need not, rely on a statement of the beneficiary's assets, signed by such beneficiary, or any parent, guardian, or similar fiduciary of such beneficiary.*

Or consider this much more 'personal' version:

> *In providing for payment of income to my son, together with the discretionary payments to be made by the Trustee, I have done so out of a desire to protect him against the misfortune of having more spendable income than he is able to use advantageously for himself and any persons dependent upon him. I have in mind that Charles now has a vested remainder in one-half of a substantial trust created under the will of his grandfather, George, which should produce an income, if conservatively invested, of approximately Ten Thousand Dollars ($10,000) per annum. If Charles leads a useful, respectable, and reasonably* ***provident*** *life, it is my desire that he have as much or all of the additional income from his trust as the Trustee believes he can use wisely and providently for the benefit of himself and those dependent upon him and any charitable and like interests which he has. In determining what discretionary payments of income shall be made to Charles, the Trustee shall consider that other income and assets, as well as the general circumstances of his occupation, family responsibilities, and manner of living.*

This provision highlights the previous admonition that trustees should consult a dictionary. "Provident" can mean (1) making provision for the future, (2) prudent, or (3) frugal. Substituting the word "frugal" for "provident" in the above distribution standard yields a very different meaning than if you substitute the word "prudent." Only the settlor could know whether she meant that Charles should be prudent or frugal. The last sentence, however, is clear. The trustee is required to look at income, assets, occupation, dependents, and lifestyle. Some instruments are more concise. For example:

> *In exercising discretion over individual beneficiaries, the Trustee may consider disparity of benefits received from any person, others who rely on the beneficiary for support, illness, education expense, other special talents, needs, or circumstances.*

C. What to Consider?

In some states, considering outside "resources" may mean only "income". In other jurisdictions, resources may include a broader range of assets available to the Beneficiary. *In re Stonecipher*, 849 N.E.2d 1191, 1197 (Ind. Ct. App. 2006). As noted previously, the RESTATEMENT (THIRD) provides a check list of items to consider and is sometimes adopted in whole or in part in the distribution provisions of an instrument. It suggests a trustee should consider:

1) The beneficiary's independent income;
2) Annuity payments;
3) Court ordered support payments;
4) Income payments from the trust; and
5) The principal of the beneficiary's estate.

RESTATEMENT (THIRD) OF TRUSTS § 50 cmt.e(2) (2003). The section goes on to suggest it may be appropriate to consider non-income assets available to the beneficiary depending upon:

1) Liquidity of the assets;
2) Terms and extent of the discretionary power;
3) Purposes of the trust such as tax planning; and
4) Relationship of the Settlor with the beneficiaries and his objectives.

In cases of doubt, some courts suggest the trustee should err on the side of the "primary" beneficiary. *Munsey v. Laconia Home for the Aged*, 164 A.2d 557, 559–60 (N.H. 1960). This, of course, presumes that one class of beneficiary is of primary importance. In those cases where one is specified, it is usually the current income beneficiary that takes precedence, but most trusts do not have a primary beneficiary. In many states, the fiduciary has the same duty to all classes of beneficiary. This may create conflict between the needs of a current income beneficiary and those of the future income, principal, or remainder beneficiaries. As discussed below, this conflict led to the creation of the Power to Adjust.

IX. THE DUTY OF LOYALTY (IF IT IS EASY, YOU AREN'T DOING IT RIGHT)

Loyalty may be the most important fiduciary duty. It demands that a trustee put aside the most human of instincts—self-interest - putting the interests of the beneficiaries above the interests of all others, including (and especially) the trustee's own. As spelled out in unmistakable terms in nearly every state's statute, a trustee must manage the trust . . . solely in the interest of *all* the beneficiaries. Managing a trust impartially is difficult. Impartiality may be less difficult for a professional trustee than for a member of the family or close friend. However, beware of any trustee who claims that this part of the job is easy. Managing objectively is particularly hard when the trustee has a duty of "perfect loyalty" to two or more beneficiaries with competing interests.

X. DOES THE DOCUMENT REFLECT A PREFERENCE FOR A BENEFICIARY CLASS?

Unless a document specifically directs the trustee to favor one class of beneficiary over another, it is challenging to accommodate competing interests within the bounds of the duty of loyalty. If the trust instrument provides a standard for unequal treatment between classes and the terms of the instrument are followed, a trustee can be comfortable with disparate treatment. Drafters should remember that if the grantor wants to favor one class over another, the document or a statute must say so.

A. The "Primary" Beneficiary

There may be a clear expression of preference between current and future beneficiaries but if there is not, the trustee will be bound by the default statutes of the jurisdiction – generally requiring that all beneficiaries be treated equally.[21] A simple but effective statement of preference is:

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21 Provisions of statute in most states do not distinguish between classes of beneficiaries. The TEX. PROP. CODE §111.004 (2) defines a "'beneficiary' [as] a person for whose benefit property is held in trust, regardless of the nature of the interest." The term "interest" is defined separately; it includes "any interest, whether legal or equitable or both, present or future, vested or contingent, defeasible or indefeasible." TEX. PROP. CODE §116.002(2) specifies that the term beneficiary in a trust "includes . . . an income beneficiary and a remainder beneficiary." Neither statute suggests favoring one class of beneficiary over another. Similarly, in Arizona, see

Trustee shall distribute income and principal as necessary for the health, support, maintenance, and comfort of my spouse without regard for the rights of the remainder beneficiaries, even to the complete dissipation of the trust assets.

Unfortunately, sometimes an articulated standard is not so clear, as in this misdirected attempt to clarify:

Issue of the Grantors in the same generation should be treated with substantial equality unless the Trustee determines that unequal treatment is advisable.

The best that can be said for this instruction is that it might support a trustee's decision if beneficiaries challenged unequal treatment assuming the Trustee could show ample evidence that its decision was carefully considered and within its discretion. As noted, when a document does not state a preference, trustees must give the same regard to the interests of all beneficiaries. The Uniform Principal and Income and Prudent Investor Acts mandate consideration of a total investment strategy, with short-term results for current income beneficiaries <u>and</u> long-term results for future beneficiaries - simultaneously. There may be a clear expression of preference between current and future beneficiaries; but if there is not, a trustee is bound by jurisdictional default statutes that usually require all beneficiaries be treated equally.[22] This statement of preference example relies on capitalized terms not clearly defined elsewhere:

Trustee may distribute such amounts or none of the net income and principal to the Beneficiary and his descendants as the trustee determines to be advisable to provide for health, education, maintenance, or support. Such amounts may be distributed or applied without regard to equality of distribution and notwithstanding that one or more of the beneficiaries and his or her descendants may receive no benefit. Further, trustee shall consider the Beneficiary to be a preferred beneficiary of this trust. Subject to the restrictions set forth herein, the trustee may make distributions to any non-preferred beneficiary; however, the trustee (a) shall resolve uncertainties concerning income and principal in favor of the preferred Beneficiary to the exclusion of other present or future beneficiaries, and (b) shall consider the interests of the preferred Beneficiary as primary and the interests of all other beneficiaries of such trust as secondary.

B. Preference for a Class

Occasionally, preference for a beneficiary class is more insidious. Primogeniture,[23] evolved to prevent the subdivision of estates. The earliest example is the Old Testament story of Isaac's sons Esau, born

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A.R.S. § 14-10103 Definitions … 2. "Beneficiary" means a person who either: (a) Has a present or future beneficial interest in a trust, vested or contingent. (b) In a capacity other than that of a trustee, holds a power of appointment over trust property. *** 8. "Interests of the beneficiaries" means the beneficial interests provided in the terms of the trust.

22 A.R.S. §14-10803. Impartiality. 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.

A.R.S. § 14-7402. Fiduciary duties; general principles ***
B. In exercising the power to adjust under section 14-7403, subsection A or a discretionary power of administration regarding a matter within the scope of this article, whether granted by the terms of a trust, a will or this article, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. A determination in accordance with this article is presumed to be fair and reasonable to all of the beneficiaries.

23 Primogeniture is when a firstborn child inherits a parent's entire estate instead of a shared inheritance between all children. Agnatic primogeniture is inheritance of the whole by the first-born son; matrilineal primogeniture is all to the first-born daughter. Still

first, and Jacob, who was born second. Esau was entitled to the "birthright" but sold his right to Jacob for food.[24] Examples are found from ancient Egypt to modern day Japan. The law of primogeniture had its origins in Medieval Europe to keep the estates of feudal lords large and as united as possible to maintain social stability, wealth, and power for the ruling family as in the monarchies today. In its simplest form, the system was devised to keep a family business together and in the family. Americans associate it with nobility and title, and it is true that in many cultures a title comes with wealth and privilege. Perhaps the most famous example is the British Crown Estate, a perpetuity, and an independently managed business that belonged to Elizabeth II for the duration of her reign, estimated at ~$16 billion which passed by primogeniture to her son, Charles III.[25] Elizabeth also had significant personal wealth estimated at more than $3 billion.[26] Near the end of her life, she paid annual income

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common in Europe, especially as to inherited titles of nobility, for centuries, nearly all monarchies passed by agnatic primogeniture. First to adopt absolute primogeniture (prize goes to the first-born – male or female) was Sweden in 1980, followed by The Netherlands in 1983, Norway in 1990, Belgium in 1991, Denmark in 2009, and Luxembourg in 2011. Also, in 2011, the 16 Commonwealth realms (sovereign states which had Elizabeth II as head of state – now 15 after Barbados transitioned to a Republic in November 2021) announced the Perth agreement which came into effect by legislation on March 26, 2015 – nearly 98 years after women first voted in a UK General Election on December 14, 1918.

24 Genesis 25:25-34

25 One of the richest people in the world, Elizabeth II inherited much of her fortune but is credited with having made astute investments during her long reign. The sovereign and the wider royal family have three main sources of income – the Crown Estate, the Duchy of Lancaster and the Duchy of Cornwall – much of it derived from centuries-long ownership of land and property across the country, including in central London. The Crown Estate owns a portfolio of properties worth £15.6bn, including 241 in central London. In addition, the monarch owns the seabed and half the foreshore around large parts of England, Wales and Northern Ireland, an asset that has become increasingly lucrative since the North Sea oil boom and, more recently, auctions of plots for offshore windfarms. The Crown Estate is also responsible for managing the whole of the Windsor estate, which spans nearly 16,000 acres and includes parkland and ancient woodland, as well as the Ascot racecourse. The estate describes its role as "generating profit for the Treasury for the benefit of the nation's finances" and made a profit of almost £318m in fiscal year 2021-2022, which was an increase from the previous year as rent collection rebounded after the pandemic, and thanks to the growth in offshore wind. The monarch's ownership of the land comprising the estate dates back as far as 1066 and the Norman conquest of Britain. Since 1760 the monarch has surrendered the estate's net income to the government. This funding arrangement was made under George III, who agreed to hand over the income in return for a fixed annual payment, now called the sovereign grant. The sovereign grant was set at £86.3m for 2021-22. Prior to 2017, the Queen received 15% of the crown estate profits from the two previous years, while the remainder was kept by the government. In 2017 this was increased to 25% for the following decade, to help pay for the £370m refurbishment of Buckingham Palace. The sovereign grant is used to fund official travel, property maintenance and the operating costs of the monarch's household. But security costs are not covered by the sovereign grant and are generally paid for by the public.
The Queen was not liable for tax on the sovereign grant, but voluntarily paid tax on her private income from land owned by the Duchy of Lancaster and property she personally owned. The crown estate belongs to the reigning monarch "in the right of the crown", meaning that it is owned by the monarch during their reign by virtue of being on the throne, but is not their private property. King Charles is therefore unable to sell any of the crown estate, and revenues from the estate do not belong to him. The crown estate passed from the Queen to Charles without the requirement to pay inheritance tax, the standard rate of which is 40%, charged on the part of an estate above a certain threshold, to a maximum of £500,000 for each individual. The monarch also has assets in Scotland – including virtually all the seabed out to 12 nautical miles (22.2km), just under half the foreshore, about 37,000 hectares (91,000 acres) of rural land, rights to fish for wild salmon and sea trout, rights to naturally occurring gold and silver across most of Scotland, and some property – that make up the Scottish Crown Estate. However, since the Scotland Act 2016, the profits generated by these assets are transferred to the Scottish government for public spending.

A second, smaller pool of income goes to the sovereign from the Duchy of Lancaster. The duchy was established more than 700 years ago, and its estates have belonged to the monarch – who also carries the title of Duke of Lancaster – since 1399. The duchy owns more than 18,000 hectares of land in England and Wales, including farms, homes, and commercial properties, and has assets including shops, offices, and commercial buildings, many of which are in the Savoy area of central London, alongside some financial investments and homes. The duchy also owns limestone and sandstone quarries stretching from south Wales to North Yorkshire, which supply material to the UK's construction industry and owns rights to the foreshore from the midpoint of the River Mersey to Barrow-in-Furness. The duchy had nearly £653m of net assets under its control at the end of March 2022, which provided a net surplus of £24m to the Queen. The Queen also had personal wealth derived from assets including properties she owned, such as the estates of Sandringham in Norfolk and Balmoral in Aberdeenshire, and her stable of racehorses. Meanwhile the value of the royal stamp collection has been estimated at £100m.

26 Difficult to appraise a property like Balmoral but the offshore energy portfolio alone is estimated at $1.4 billion. The royal family's total wealth is only estimated because much of the Queen's personal wealth was kept private through legal applications that have allowed the Windsors to seal certain family wills. British wills are normally required by law to be published, but the sealing of the

and capital gains taxes of about $500 million. Estate taxes are not assessed on assets passed to the next sovereign so most of Elizabeth's personal wealth also followed the Crown Estate. Anything left to anyone else was subject to estate tax – a powerful incentive to continue the tradition and keep as much of the wealth together in the "family business" as possible.

The American Colonies followed English primogeniture laws as a default, but most were repealed at the time of the American Revolution.[27] Although true primogeniture (either agnatic or matrilinear) is rarely encountered in American documents today, various forms of "winner takes all" and gender bias still appear in trusts today. We have all seen a patriarch leave funds outright to sons and in trust for daughters, allow some descendants to serve as a sole or co-trustee but exclude others, or leave control to a child deemed worthy. In some families, that is best for the family and the business – in others perhaps not.

Recently, voting trusts have become a common method to distribute shares among a pool of beneficiaries but retain rights to control family business stock in a block – controlled by an individual or smaller class of beneficiary - usually driven by a desire to keep a closely held family business close. But it may also be used as a mechanism for gender bias as in this example:

> *Settlor transfers and delivers all shares of FamilyCo to Trustee, to be held together with all other property subject to this trust, at inception or thereafter, in all trusts created under this agreement. Trustee shall hold that stock which constitutes the shares issued by FamilyCo with voting rights, and which therefore will vest Trustee with the control of FamilyCo but said FamilyCo shares are to be held in a Voting Sub-Trust for purposes of executing the voting rights attached to them.*
>
> *The Voting Trustee shall be comprised of a <u>committee of the adult male beneficiaries</u> of the various trusts created hereunder, each such member of the committee being entitled to one vote, acting by majority vote if there be more than one, such vote to be cast by written ballot signed by such beneficiary. If a male beneficiary does not then have full legal capacity, <u>his male parent, or a legally appointed male guardian (in that order of preference)</u> shall act in his place and stead.*
>
> *The Voting Trustee shall vote FamilyCo stock as a unit, and not otherwise, and shall exercise control of the management of all affairs of Company including electing any member of the committee comprising the Voting Trustee as a director or officer of FamilyCo. ... As FamilyCo is so closely held, there has never been any trading in it; and therefore, there is no established market value for*

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royal wills has prevented the public from seeing what kind of assets – such as property, jewelry, and cash – have been passed on down the generations.

At the same time as Charles inherited the Duchy of Lancashire on accession to the throne, so the Duchy of Cornwall passed to his eldest son, William, when he became Heir to the Throne and the 25th Duke of Cornwall. The duchy's net assets were valued at more than £1bn at the end of March, and the estate paid Charles an income of £21m for the year ending 31 March 2022, according to the duchy's annual accounts. He voluntarily paid the top rate of income tax – 45% – on the duchy's earnings, after the deduction of official expenditure, but he was not considered liable for capital gains tax, and nor was the duchy considered liable for corporation tax. Charles's personal interests in areas such as architecture, sustainability and organic farming shaped the duchy's work. The question now is whether William will follow his own path, including with ongoing projects such as a residential development at Nansledan, an extension to the town of Newquay in Cornwall, where more than 4,000 homes and a high street are being built over the coming decades.

27 Winston Churchill and Franklin Roosevelt met at Placentia Bay in August 1941. Roosevelt told Churchill he did not understand British aristocracy's use of primogeniture; he intended to divide his estate equally between his five children. Churchill explained that equal distribution was nicknamed the *Spanish Curse* by British upper classes: "We give everything to the eldest and the others strive to duplicate it and found empires. While the oldest, having it all, marries for beauty, which accounts, Mr President, for my good looks". Roberts, Andrew (2009). *Masters and Commanders: Military Geniuses Who Led the West to Victory in World War II.* London: Penguin. p. 53. ISBN 978-0-141-02926-9.

the stock. Accordingly, Trustee shall hold the stock intact as one fund and not sell or transfer any shares until the stock is sold in one block at the same time, or until it is finally fully liquidated.

This is an extreme example of such gender bias. In most states, a shareholder may assign a right to vote to another person by means of a voting trust agreement or an irrevocable proxy and the purpose of such an arrangement is control. This provision did not eliminate female beneficiaries' distributions but blocked their participation in the shareholder driven decisions of the business. Voting trusts may be used to lock in a majority block by combining the voting strength of several minority shareholders to increase the power of their representation or may be a tool of oppression, where a controlling shareholder persuades or compels other shareholders to grant them the power of their votes. Often directed at those not involved or interested in the business, such as grandchildren who inherit the stock, such a scheme may be used to vote their shares against their best interests. However, even when the trust agreement gives a trustee unbridled discretion over the vote, the trustee still owes a fiduciary duty to the equitable owner, including presumably the duty to vote the stock in the best interests of all beneficiaries. A separate voting trustee that is also a beneficiary presents a greater opportunity for inequity.

As noted, in most jurisdictions, shareholders may contract among themselves to vote a certain way on specific matters—i.e., to vote as a block allowing a group of shareholders to obtain or maintain control. Such agreements are generally enforceable if they are in writing and a copy is provided and available for inspection at the principal office of the corporation. Typically, voting agreements must be conspicuously noted on the certificate or are not enforceable against a buyer for value without knowledge of the agreement. Someone who receives the stock by gift or inheritance is bound by such an agreement with adequate notice, actual knowledge, or easy recourse.[28] Without further information, it is unclear if the language from the trust set out above (drafted in the early 1970s) would be enforceable today. Counsel who sent this language to the author advises "the family wisely elected to unwind the restrictions in a trust modification" rather than litigate its enforceability.

Finally, consider this example where a settlor apparently puts the interest and health of the business above the best interest of the beneficiaries of the trusts that own that business:

Settlor declares the purpose of this Trust is to create and preserve unified ownership and control of [the company which] ... exists primarily for the benefit of its… holders and that therefore the interests of the people who put their trust in [the company] for the protection of their personal and business affairs must come first. However, when [the company] is healthy, it… will necessarily be ... to the benefit of the stockholders… The Settlor therefore urges that the Trustees familiarize themselves with the nature of [the company] that in the discharge of their trust duties they concentrate, in cooperation with the Board of Directors of [the company] and the individual whom the Board designates from time to time as Manager… to keep [the company] in the best of health… In the exercise of their unlimited discretion and in making any determination or decision relative to the ultimate purpose stated herein, the Trustees shall be entitled to assume that whatever best serves to preserve the existence of [the company] also serves the best interest of any and all beneficiaries and recipients entitled at any time to receive distribution of any Income or principal hereunder.

XI. WHEN THE DOCUMENT SAYS TO DISTRIBUTE ALL INCOME

When the document says to distribute all income, the trustee may be able to equalize the tension between classes of beneficiary by using the adjustment power. In determining when to use the adjustment power,

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28 Note: voting agreements are only valid between shareholders. In most jurisdictions, they are illegal between directors, may not be used by shareholders to constrain directors' exercise of discretion, and are not enforceable if they constitute mere buying of votes.

the trustee looks for three things: (1) that trustee invests and manages trust assets as a prudent investor; (2) the terms of the trust describe the amount that may or must be distributed by referring to the trust's income; and (3) that making an adjustment is the only way to be fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. [29]

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29. The **Texas** version, found at TEX. PROP. CODE §116.005 is typical:

TRUSTEE'S POWER TO ADJUST. (a) A trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income, and the trustee determines, after applying the rules in Section 116.004(a), that the trustee is unable to comply with Section 116.004(b). The power to adjust conferred by this subsection includes the power to allocate all or part of a capital gain to trust income.

The **Arizona** version is found at A.R.S. §14-7403. Trustee's power to adjust.

A. A trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trust's income and the trustee determines, after applying the provisions of section 14-7402, subsection A, that the trustee is unable to comply with section 14-7402, subsection B.

B. In deciding whether and to what extent to exercise the power conferred by subsection A of this section, a trustee shall consider all factors relevant to the trust and its beneficiaries, including the following factors to the extent they are relevant:
   1. The nature, purpose and expected duration of the trust.
   2. The intent of the settlor.
   3. The identity and circumstances of the beneficiaries.
   4. The need for liquidity, regularity of income and preservation and appreciation of capital.
   5. The assets held in the trust and:
      (a) The extent to which: (i) They consist of financial assets, interests in closely held enterprises, tangible and intangible personal property or real property. (ii) An asset is used by a beneficiary.
      (b) Whether an asset was purchased by the trustee or received from the settlor.
   6. The net amount allocated to income under this article and the increase or decrease in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available.
   7. Whether and to what extent the terms of the trust give the trustee the power to invade principal or accumulate income or prohibit the trustee from invading principal or accumulating income, and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income.
   8. The actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation.
   9. The anticipated tax consequences of an adjustment.
   10. Whether the trust has been converted to a unitrust pursuant to section 14-11014.

C. A trustee may not make an adjustment:
   1. That diminishes the income interest in a trust that requires all of the income to be paid at least annually to a spouse and for which an estate tax or gift tax marital deduction would be allowed, in whole or in part, if the trustee did not have the power to make the adjustment.
   2. That reduces the actuarial value of the income interest in a trust to which a person transfers property with the intent to qualify for a gift tax exclusion.
   3. That changes the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets.
   4. From any amount that is permanently set aside for charitable purposes under a will or the terms of a trust unless both income and principal are so set aside.
   5. If possessing or exercising the power to make an adjustment causes an individual to be treated as the owner of all or part of the trust for income tax purposes and the individual would not be treated as the owner if the trustee did not possess the power to make an adjustment.
   6. If possessing or exercising the power to make an adjustment causes all or part of the trust assets to be included for estate tax purposes in the estate of an individual who has the power to remove a trustee or appoint a trustee, or both, and the assets would not be included in the estate of the individual if the trustee did not possess the power to make an adjustment.
   7. If the trustee is a beneficiary of the trust.
   8. If the trustee is not a beneficiary, but the adjustment would benefit the trustee directly or indirectly.

D. If subsection C, paragraph 5, 6, 7 or 8 of this section applies to a trustee and there is more than one trustee, a cotrustee to whom the provision does not apply may make the adjustment unless the exercise of the power by the remaining trustee or trustees is not permitted by the terms of the trust.

E. A trustee may release the entire power conferred by subsection A of this section or may release only the power to adjust from income to principal or the power to adjust from principal to income if the trustee is uncertain about whether possessing or exercising the power will cause a result described in subsection C, paragraph 1, 2, 3, 4, 5, 6 or 8 of this section, or if the trustee determines that possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax burden not described in subsection C of this section. The release may be permanent or for a specified period, including a period measured by the life of an individual.

In simple terms, if the income component of a portfolio's total return is too small or too large because of investment decisions made by the trustee, the trustee may make an adjustment between principal and income to achieve fairness for the beneficiaries. Whether a trustee may use the adjustment power to calculate the income distribution requires a two-part test. First, the trustee determines whether the Uniform Principal and Income Act is the governing law of the trust. Second, the trustee must be sure the document does not specifically prohibit use of the adjustment power. Even if the UPIA applies to a trust, that trust may have special circumstances that prohibit a trustee from using the adjustment power or may contain specific language prohibiting its application. If so, that language will govern the trust. For example, the adjustment power is <u>not</u> available if any of the following is true:

- Language in the trust prohibits the trustee from investing assets as a prudent investor. Example: *I prohibit the Trustee from investing in equities*; *trustee shall only invest in those instruments backed by the full faith and credit of the United States government.* Or *Trustee may not sell the interest in [insert large concentration of stock].*[30]
- The trust describes the amount that shall be distributed by referring to a specific amount and does not refer to the income of the trust. Example: *Distribute $2,500 per month to each beneficiary.* Or *Distribute 3% of the market value for previous calendar year by March 1st*.
- The trust distribution provision is a single discretionary standard that applies to both income and principal - but the standards must be identical. *See* S. Alan Medlin, *Limitations on the Trustee's Power to Adjust*, 42 REAL PROP. PROB. & TR. J. 717, 726–47 (2008). Beneficiaries with access to both principal and income but under different circumstances, may be eligible for adjustment. Example: *Distribute all income and principal only in the event of an emergency*.
- A non-independent co-trustee is required by the trust to participate in the adjustment power decision. No related or subordinate party or beneficiary may make the decision; if such a co-trustee is required to participate, use of the power is precluded. If co-trustee's participation is not mandatory, then in some jurisdictions, a non-independent co-trustee can decline to participate in the decision to exercise and the power to adjust can be applied to the trust.
- Charitable and non-charitable beneficiaries and trust is taking charitable set aside for capital gains.[31]

If a settlor wants to preclude the use of the adjustment power in distribution decisions, using any of the above provisions accomplish that. However, the uniform statute was designed to allow trustees to employ the prudent investor rule without constraint by traditional principal and income rules and to apply to trusts already in place - even those that may have included provisions prohibiting invasion of principal or "equitable" adjustments. Given the broad language of the statute, if a settlor wants to preclude use of the power (inadvisable in this author's opinion), the document should say so explicitly. Example:

> *Trustee may not adjust traditional trust accounting income and principal under the provisions of [insert relevant state statute] entitled Power to Adjust, or in the event the situs or governing law of*

F. Terms of a trust that limit the power of a trustee to make an adjustment between principal and income do not affect the application of this section unless it is clear from the terms of the trust that the terms are intended to deny the trustee the power of adjustment conferred by subsection A of this section.

30 In Texas, this is often ExxonMobil (XOM). In Arizona, perhaps Freeport McMoRan (FCX)?

31 This category of trusts, have charitable remaindermen and are nonqualified trusts created prior to the 1969 tax law creating qualified charitable remainder trusts. *See* BORIS I BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 82.1 (3d. 1999). These pre-1969 split-interest trusts have both individual and charitable interests, with the net income being remitted to the income beneficiaries or sometimes shared with a non-profit organization. Power of adjustment does not apply a trust where a charitable set-aside deduction for capital gains is being taken.

this trust should change, under any similar statute or provision of law. Further, any requirement in this document or the relevant statute that mandates that the beneficiaries of the various trusts created herein be treated equitably shall not be construed to allow such an adjustment.

If the UPIA is the governing law and under current circumstances of the trust, the adjustment power is available, then the trustee must still determine whether to make an adjustment this year. Even in a case where the adjustment power is available, many factors, such as the circumstances and liquidity needs of the income beneficiary, the circumstances of the remainder beneficiaries, the size of the trust, the current asset allocation, and the income being produced now will influence a trustee's decision as to whether to exercise the power. The intent of the settlor set forth in the document regarding what the trustee should consider must be followed and the application of the Prudent Investor Rule is fundamental to the decision. *See* Richard W. Nenno, *The Power to Adjust and Total-Return Unitrust Statutes: State Developments and Tax Considerations*, 42 REAL PROP. PROB. & TR. J. 657, 669 (2008).

XII. THE SPENDTHRIFT CLAUSE

Trustees often must consider potential conflict between a trust's spendthrift clause and its distribution standard. Precedent is thin but there are some cases to review. The court in *Weinstein v. Weinstein (In re Indenture of Trust Dated January 13)*, 326 P.3d 307, 312 (Ariz. Ct. App. 2014), explores several important issues related to enforcement of a spendthrift clause. In Arizona, as in most jurisdictions, a spendthrift provision in a trust is valid only if it restrains either voluntary or involuntary transfer of a beneficiary's interest. A.R.S. § 14–10502(A). The spendthrift clause in Weinstein restrained both voluntary and involuntary transfers. In *Weinstein*, Milton, one of three sibling beneficiaries of a trust established in 1964 by his grandparents, made a deal in 2000 with the trustee (his father) to accept $75,000 paid over three years in exchange for an assignment of all his remaining interest in the trust to his sibling's children. In 2010, the trustee (his father) died, and the trust was terminated and paid. But in 2012, Milton sued to reclaim his interest in the trust asserting that the spendthrift clause negated the assignment. The court reviewed the spendthrift clause and found that it was valid, and the assignment should have been prohibited. But because Milton waited twelve years before making any claim, by which time the trust had been properly distributed and terminated, his claims were denied.

No specific language is necessary to create a spendthrift trust, so long as its terms manifest an intention to create such a trust. A.R.S. §14–10502(B); Restatement (Second) of Trusts § 152 cmt. c (1959).[32] The Restatement also suggests that a spendthrift provision restraining either the voluntary or involuntary transfer of the beneficiary's interest, but not both, would be invalid. Restatement (Second) of Trusts § 152(1) (1959). This concept is stated more explicitly in the Restatement (Third), which states that "[f]or reasons of policy, a spendthrift restraint that seeks only to prevent creditors from reaching the beneficiary's interests, while allowing the beneficiary to transfer the interest, is invalid." Restatement (Third) of Trusts § 58 cmt. b (2) (2003). Any restraint only on voluntary transfer does not protect the interest from creditors and is ineffective as to the law's general policy against restraints on alienation. And although a trustee may choose to honor an assignment made in violation of a spendthrift clause, the beneficiary retains the ability to cease all future payments that would be made pursuant to that assignment because "[a] valid spendthrift provision makes it impossible for a beneficiary to make a

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32 The purpose of a spendthrift trust is to protect the beneficiary from himself and his creditors. *Birdsell v. Coumbe (In re Coumbe),* 304 B.R. 378, 382 (B.A.P. 9th Cir.2003), quoting *Richardson v. McCullough (In re McCullough)*, 259 B.R. 509, 517 (Bankr.D.R.I.2001); *see also*, George G. Bogert & George T. Bogert, The Law of Trusts and Trustees § 222 (rev.2d ed.1980) (spendthrift provisions protect against creditors and "incompetence, imprudence, or misfortune" of beneficiaries).

legally binding transfer." Unif. Trust Code § 502 cmt. (2000); Restatement § 152 cmt. I; *Weinstein,* 326 P.3d at 312.

In Texas, reasons for creating a spendthrift trust need not be included in the document. *Adams v. Williams*, 248 S.W. 673, 679 (Tex. 1923) said that trusts by the terms of which the property put beyond the control of the beneficiary and exempt from seizure for his debts are commonly called spendthrift trusts, but it is not necessary that the trust instrument "assign any reasons for such provisions, nor is it necessary that the beneficiary shall be in fact improvident, incapable, or a spendthrift."

Most cases are very 'fact specific' but trustees should consider *Nations Bank of Virginia v. Grandy*, where the court held that, despite unfettered discretion to do so, trustees properly refused to invade principal to pay a beneficiary's debts when she had substantial assets outside the trust sufficient to pay. Ms. Grandy had been placed under guardianship due to chronic schizophrenia. An ad litem was appointed. The amount requested from the principal was for medical expenses which Grandy and her guardian had declined to pay from her outside resources. A Co-Trustee, her brother, was the contingent remainderman. The trial court ordered the trustee to invade principal, but the appellate court reversed declining to substitute its judgment for that of the Trustees and citing the need to preserve corpus considering Grandy's illness and the language of the document giving the trustees "uncontrolled judgment and discretion." *Nations Bank of Va. v. Grandy*, 450 S.E.2d 140, 143–44 (Va. 1994).

Contrast *Grandy* with *In re Family Trust of Windus*, in which an Iowa court held that an invasion of principal to pay credit card debt in excess of $60,000 was permissible under the support standard. Windus was trustee and beneficiary of a Family Trust established under her husband's Will. Credit card debts were incurred when she used them to prop up a small business left to her outside of trust. The document gave her unfettered discretion to pay sums "from principal as my trustee deems advisable" for "support and maintenance." The contingent beneficiaries, her daughters, alleged she had breached her fiduciary duty by using trust funds to support a business in which they had no interest. Noting that some credit had been obtained before decedent's death and keeping her business running reduced use of trust principal for basic living expenses, the court acknowledged her unfettered discretion and upheld the invasion of principal. *In re Family Trust of Windus*, No. 07-2006, 2008 WL 3916438, at *2 (Iowa App. Aug. 27, 2008). *But see, In re Estate of Morgridge*, No. G036463, 2007 WL 1874332, at *5–7 (Cal. App. 4th Dist. June 29, 2007) (holding an invasion of principal to pay a $71,000 credit card debt was not within the "support standard"). In each case, the court was asked to determine if a beneficiary with assets outside of trust could refuse to use them and instead rely on trust principal to the detriment of the remainder interests. Each court examined the language of the distribution provisions to determine if the grantor intended to create a support trust or "discretionary support trust" – a hybrid. The courts reached opposite conclusions based on subtle nuances in the language of the provisions. <u>How you say it matters</u>.[33]

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33 Regarding spendthrift clauses, trustees must know the relevant state law regarding when a spendthrift trust is created and that the spendthrift protection terminates with the trust. *Faulkner v. Bost*, 137 S.W.3d 254, 260–61 (Tex. App.—Tyler 2004, no pet.). Once in the hands of the beneficiary, funds are fair game for creditors. Note that in nearly every jurisdiction, child support is a statutory and enforceable exception to the spendthrift rule:

A.R.S. § 14-10503. Exceptions to spendthrift provision; definition

A. Even if a trust contains a spendthrift provision, a beneficiary's child who has a judgment or court order against the beneficiary for support or maintenance, or a judgment creditor who has provided services relating to the protection of a beneficiary's interest in the trust, may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary only for these matters.

B. The exception prescribed in subsection A is unenforceable against a special needs trust.

C. A spendthrift provision is unenforceable against a claim of this state or the United States only to the extent a statute of this state or federal law so provides.

XIII. MAY VS. SHALL

If the settlor intends that a trustee have discretion, do not use the word "shall". "May" means maybe and to use discretion, but "shall" is mandatory—just do it.[34] In considering "may" versus "shall", careful thought should be given to the use of the "ascertainable standard" (discussed above and below) which is often included in trusts automatically, without regard to whether it is the best standard, or even necessary. A HEMS standard provides a "safe harbor" providing language that makes it clear a trustee won't be considered to hold a taxable general power of appointment, so the standard is often included by default, just in case a beneficiary may serve as trustee. However, if the trustee is independent, or if there is an independent co-trustee, such a standard may not be necessary, and may be counterproductive.

An ascertainable standard may unduly limit flexibility when included where it is not necessary; it may eliminate or reduce options available in the future. For example, a marital deduction qualified trust will be included in the surviving spouse's gross estate at his or her death, so it may be beneficial, if resources permit, to make distributions from the trust to the spouse to facilitate annual exclusion gifts, tuition or medical gifts, or even taxable gifts to take advantage of the tax exclusive nature of the gift tax. However, if distributions of principal are limited to amounts needed for health, maintenance, and support, it may be difficult to justify a distribution request so that the funds may immediately be given away.

Some cases hold that to be enforceable, distributions to a beneficiary depend, at least in part, on the use of the word "shall" in the distribution provision, rather than the term "may." Therefore, unless it is necessary to mandate a distribution, such as distributions of income in a QTIP marital trust, consider avoiding "shall", "must" or "will" distribution language; and instead, provide that the trustee **may** make certain distributions. Said another way, the reason unlimited discretion avoids creditor claims is that the trustee has the discretion to distribute nothing, so the beneficiary has no enforceable right to compel distributions. The same result should be obtainable with an ascertainable standard by simply stating that the trustee is not required to make any distribution, but to the extent the trustee does distribute, the distribution must be within the limitations imposed by the standard. Such language negates any presumption of the Ascertainable Standard as an entitlement. An explanation or statement of purpose from a settlor may also prevent a court from determining that there must have been an intention to create an entitlement, by explaining that there is a valid reason for including the provision. Example:

> *To the extent that trustee's discretion to distribute income and principal is limited by a standard related to the health, education, maintenance, and support of a beneficiary, such standard shall be construed solely as a limitation on the discretion of certain trustees for the sole purpose of preventing such trustee from holding a "general power of appointment" over such trust, and shall*

D. For the purposes of this section, "child" includes any person for whom an order or judgment for child support has been validly entered in this or another state.

And

A.R.S. § 14-10504 (B) To the extent a trustee has not complied with the applicable standard of distribution or has abused the discretion regarding distributions: (1) Except as provided in section 14-10503, a distribution may be ordered by the court to satisfy a judgment or court order against the beneficiary for support or maintenance of the beneficiary's child. (2) The court shall direct the trustee to pay to the child an amount as is equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for the benefit of the beneficiary had the trustee complied with the standard or not abused the discretion.

TEX. FAM. CODE ANN. §151.001 (West 2008); *First City Nat'l Bank of Beaumont v. Phelan*, 718 S.W.2d 402, 406 (Tex. App.—Beaumont 1986, writ ref'd n.r.e.).

34 *Keisling v. Landrum*, 218 S.W.3d 737, 742 n.3 (Tex. App.—Fort Worth 2007, pet. denied); *Roberts v. Squyres*, 4 S.W.3d 485, 489 (Tex. App.—Beaumont 1999, pet. denied). With apologies to Nike™.

not be construed as imposing any duty, enforceable by or on behalf of any beneficiary, to distribute income or principal for such purposes, it being the settlor's express intent that the all trustees retain discretion to make no distributions.

If the settlor does desire to give the beneficiary certain enforceable rights, it might be possible to do so while limiting the reach of creditors by providing that:

The trustee may, but shall not be required to, distribute to a beneficiary to enable that beneficiary to make a payment to a spouse, ex-spouse, or other person in settlement of a dispute or to satisfy a legal obligation.

Some states, including Arizona, have provided a statutory savings clause:

A creditor of a beneficiary, whether or not the beneficiary is also a trustee or cotrustee, may not reach the beneficiary's beneficial interest or otherwise compel a distribution if either the trustee's discretion to make distributions for the trustee's or beneficiary's own benefit is purely discretionary or is limited by an ascertainable standard, including a standard relating to the beneficiary's health, education, support or maintenance or similar language within the meaning of section 2041(b)(1)(a) of the internal revenue code. A.R.S. §14-10504 (E).[35]

But ideally, a well drafted trust should not have to rely on a savings clause to preserve tax benefits that the settlor intended to employ.

XIV. COMMUNICATE WITH THE BENEFICIARY

A trustee has a duty to be informed, and in most cases, to communicate with beneficiaries about individual circumstances and the general administration of the trust. *See* RESTATEMENT (THIRD) OF TRUSTS §111 cmt d (2003). Discretionary decisions regarding distributions, investments, and taxes are key issues. Communication with the beneficiaries should be accurate, complete, timely, and in writing. If a settlor asks to limit disclosure to the beneficiaries about the trust, the drafter must review the relevant state mandatory statutes carefully to determine at what age a beneficiary must receive information, which beneficiaries are included and what must be disclosed. The current Texas statute reads as follows:

(c) The terms of a trust may not limit any common-law duty to keep a beneficiary of an irrevocable trust who is twenty-five (25) years of age or older informed at any time during which the beneficiary: (1) is entitled or permitted to receive distributions from the trust; or (2) would receive a distribution from the trust if terminated.

TEX. PROP. CODE ANN. § 111.0035(c). This language leaves some room for interpretation regarding what is necessary to keep a beneficiary "informed" and clearly precludes a grantor from mandating non-disclosure for a beneficiary twenty-five or older. There are some states that allow trustees to administer a trust in secrecy. (Just because you can, doesn't mean you should.)[36]

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35 A.R.S. §14-10504 also specifies exceptions for child support and proceeds of insurance payments.

36 Arizona has a separate statute defining a qualified beneficiary but the terms are very similar. *See* A.R.S. § 14-10105. Default and mandatory rules … (B) The terms of a trust prevail over any provision of this chapter except: …
8. The duty to respond to the request of a qualified beneficiary of an irrevocable trust for trustee's reports and other information reasonably related to the administration of a trust.
And A.R.S. §14-10103. Definitions. * * *
14. "Qualified beneficiary" means a beneficiary who, on the date the beneficiary's qualification is determined:
(a) Is a distributee or permissible distributee of trust income or principal.

XV. WHAT TO PAY?

Initially, the issue of what to distribute in a trust seems easy. Health, education, maintenance, and support are words with common, ordinary meanings - but circumstances matter. The trustee must determine if the primary purpose of a trust is support now, to conserve assets for the future, or both. The variety of requests seems infinite; there is little guidance in case law. Lawsuits are rarely instituted to force or protest a distribution for a single item and some requests can be classified in multiple categories.

A. Health

The term "health" typically includes items that would also be permissible under a support standard alone. *See* RESTATEMENT (THIRD) OF TRUSTS §50, cmt d (2003). Distribution requests related to health may include alternative treatments, such as acupuncture or homeopathic remedies, or elective medical procedures such as plastic surgery, laser eye surgery, cosmetic dentistry, non-diagnostic full body scans, over the counter genetic tests or lab tests, tattoo removal, and concierge medicine. In the last few years, additional categories have been added such as the purchase of masks and home Covid test kits. For big ticket or unusual items, a Texas court trust statute specifies that a "trustee may conclusively presume that medicine or treatments approved by a licensed physician are appropriate for the health of the beneficiary." TEX. PROP. CODE ANN. § 142.005(b)(2) (West 2007). Language added because trustees administering court created trusts found the variety of health-related requests to be daunting. *See* Tex. H.B. 564, 80th Leg., R.S. (2007). But in traditional personal trust, this author has found no precedent to suggest that an expense must have been "prescribed" to be appropriate under a "health" standard. Indeed, the IRS allows deduction of many non-prescribed health related expenses including most of those listed below. Some of the obvious (more traditional), requests in the category of health are:

- Insurance premiums for medical, dental, vision, pharmaceutical, and long-term care insurance
- Uninsured doctor, hospital, lab tests, dental, orthodontia expenses, and co-payments
- Preventative health measures such as dental x-rays, teeth cleaning, vaccinations, pre-natal treatment, lab tests, and childbirth classes
- Physical or occupational therapy, home health care, nursing services
- Mental health services, psychological treatment, or gender counseling
- Medical supplies and equipment, wheelchairs, crutches, back supports, hearing aids or dentures
- Eye care including routine exams, eyeglasses, and contact lenses
- Therapeutic items such as a swimming pool or whirlpool, equine therapy, or specialized cleaning to eliminate allergens or address chemical sensitivity
- Accommodations for disabilities including ramps, wheelchair transport vans or lift equipment, adaptation of doors, installation of handrails or other safety equipment
- Transportation costs for travel to see a doctor or specialist or to obtain a treatment

Consider *In re Stonecipher*, 849 N.E.2d 1191, 1197 (Ind. Ct. App. 2006), where the court found it was not an abuse of trustee's discretion to refuse to invade trust principal for in-home nursing care for the current beneficiary considering her income from other sources, her extensive gifting some of which was made from personal funds, and the identity of the remainder beneficiary. *See, generally* RESTATEMENT (THIRD) OF TRUSTS §50 cmt d discussing various health-related topics.

(b) Would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in subdivision (a) of this paragraph terminated on that date.
(c) Would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.

It is unusual (and usually inadvisable) for a settlor to preclude specific healthcare distributions in a document. This settlor's desire to exercise control and micromanage appropriate distributions for "health" is a dramatic example of how things can go awry. This settlor attempted to restrict the trustee from distributing for health care expenses which he felt were "self-inflicted":

> *Trustee shall NOT distribute income or principal to my child ... if such needs arise from participating in risky or irresponsible activity, as determined in the sole discretion of my Trustee… "Risky or irresponsible activity" shall include but shall not be limited to drunken driving, illicit drug use, unprotected sex, and any illegal actions.*

B. Education

Absent more specific language in the document, education is usually considered to include living expenses, tuition, fees, books, and other costs of higher education or technical training. However, case law demonstrates ambivalence by courts. Common "education" requests include, but are not limited to:

- Tuition including private or parochial school, college, graduate school, trade school or vocational training, study skills classes, tutors, speech or reading therapy
- Room and board and/or travel to and from school
- After-school or summer classes, extended day care, sports activities, and music lessons
- Computer purchase, maintenance or repair, software, and instrument rental/purchase or repair
- Graduation costs, books, supplies, and uniforms

See RESTATEMENT (THIRD) OF TRUSTS §50 cmt d, discussing various education-related topics. Although the restatement appears to include all these categories as "education" there are some contrary decisions for review. *First Nat. Bank v. Howard*, 229 S.W. 2d 781 (Tex. 1950) held that suitable education of a beneficiary's children included a college education under a discretionary distribution provision for support. But in *S. Bank & Trust Co. v. Brown*, 246 S.E.2d 598, 603 (S.C. 1978), the court found that education did not include post-graduate studies but was limited to education up to and including a bachelor's degree. *Steeves v. Berit*, 832 N.E.2d 1146, 1152 (Mass. App. Ct. 2005), *abrogated by Halpern v. Rabb*, 914 N.E.2d 110 (2007), adopting a similar definition of "college" in the context of a divorce case. See also, *Lanston v. Children's Hosp.*, 148 F.2d 689 (2d Cir. 1945), finding that it was within a trustee's discretion to refuse to fund the further education of a beneficiary who was forty-two years old, well-educated and had a "large income." A relatively straight forward definition of "education" is:

> *"Education" includes, but is not limited to, tuition, expenses, and maintenance while attending pre-school, elementary, secondary, undergraduate, graduate, post-graduate and vocational schools.*

But consider the discretion vested in this trustee:

> *"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.*

A reminder to drafters to take time to understand and convey exactly what a client has in mind is found in *Epstein v. Kuvin*, 95 A.2d 753 (N.J. Super. Ct. App. Div. 1953). The testator, a grandmother, left a life estate in real property to her daughter with the remainder interest to the daughter's two sons, her grandsons. Daughter and grandsons had been living with the testatrix. One grandson, Sanford, was a freshman in college at the time of the testator's death. The residue of the estate, including significant

real estate holdings, she left to her own two sons with an instruction that they each make an annual contribution to their nephew's education from their share:

> *Should I die before my grandson, Sanford, has completed his college education, then and in that event, I direct that my son Samuel, contribute the sum of $600 per annum toward the expense of a college education for my grandson Sanford, and that my son Herbert contribute the sum of $400 per annum toward the expense of a college education for my grandson, Sanford. The sums shall be contributed as aforesaid until my grandson, Sanford, completes his college education.*

The opinion says the "sons of testatrix made the required contributions until their nephew completed his four-year undergraduate course culminating in the degree of bachelor of arts." But upon his beginning a four-year course leading to a medical degree, they refused to continue the contributions. The Court asked the questions: "…testatrix directed her sons to contribute toward the expense of her grandson's college education. What did she mean by that expression? Is the cost of medical school included?"

Over objection, the trial court heard testimony of the draftsman of the will, relating his conversations with testatrix, in which she declared her strong wish that her grandson become a doctor, and that she wanted a provision in her will requiring her sons to contribute to his education "until he became a doctor." The daughter was allowed to testify that prior to making the will, her mother told her she would "see to it that the boy got an education," and "she said it was a medical education." She also testified that after making the will, the testatrix told her she had "made provision that this boy would become a doctor." Testimony supporting this was heard from several other witnesses. Inexplicably, the draftsman offered no explanation as to why he did not reflect exactly what she requested in the Will he prepared. Had he done so, the outcome might have been different. The Appellate Court held the language in the will was not sufficiently ambiguous or vague to justify the Trial Court having considered and admitted the extrinsic evidence and "college education" did not include medical school. *Epstein*, 95 A.2d at 754.

C. Maintenance and Support

"Maintenance" and "support" are now considered synonymous and often an expression of purpose, as well as a distribution standard. In many sources, the term "support" has been interpreted very broadly. The RESTATEMENT (THIRD) OF TRUSTS 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 charitable and family giving". Under all circumstances, support means more than bare necessities. *Hartford-Conn. Trust Co. v. Eaton,* 36 F.2d 710 (2d Cir. 1929). "The 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." *Robison v. Elston Bank & Trust Co.*, 48 N.E.2d 181, 189 (Ind. App. 1943). And today, state statutes require spouses to support one another. The terms maintenance and support have become so broad, that when the distribution standard includes these terms, in some circumstances, a trustee's discretion may no longer be considered "unbridled." *See First Nat'l Bank of Beaumont v. Howard*, 229 S.W.2d 781, 785 (Tex. 1950); *In re Estate of Dillard*, 98 S.W.3d 386, 395 (Tex. App.—Amarillo 2003, pet. denied). Generally, support certainly includes:

- Rent or mortgage payments, utilities, groceries, and other routine living expenses
- Property taxes, insurance, maintenance, and repairs (on property held outside the trust)[37]

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37 Real estate held inside the trust will require that taxes, insurance and maintenance be included as expenses of the trust rather than discretionary distributions. *See* Matthew A. Levitsky, *What Does Maintenance and Support Really Mean in Trust?* EST. PLAN. & WEALTH PRESERVATION BLOG FOR TRUSTED ADVISORS (Sept. 17, 2013).

- Auto purchase, repair, and insurance
- Childcare and healthcare
- Professional fees for divorce, adoption, criminal or civil defense, estate and tax planning, preparation, and accounting advice
- Requests for vacations, special events (weddings), "one-offs" and emergencies

See RESTATEMENT (THIRD) OF TRUSTS §50 cmt d (discussing maintenance and support); and Matthew A. Levitsky, *What Does Maintenance and Support Really Mean in Trust?* EST. PLAN. & WEALTH PRESERVATION BLOG FOR TRUSTED ADVISORS (Sept. 17, 2013).

The examples above are not exhaustive. Some items seem frivolous for small trusts - further reason that individual circumstances must be considered. Some settlors are very specific. Consider whether this provision regarding the distribution of health, education, and support left any discretion to the trustee:

> *With regard to each trust herein of which the Grantor's son is the Beneficiary, the Trustee shall distribute the amounts directed under the following subsections:*
>
> *(a) If Ferris is employed full-time (35 or more hours per week), the Trustee shall distribute monthly (for each month that he is employed on a full-time basis) an amount equal to ten percent (10%) of his annual compensation from the previous calendar year (as determined by reference to the Form W-2, Form 1099-Misc or similar form received by Ferris 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 Ferris is not working at all (as an employee or independent contractor), the Trustee shall distribute to him 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 any unemployment benefits to which he 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 Ferris is below the age of sixty-five (65) years, Trustee shall pay on his behalf the premiums on a disability insurance policy with Ferris named as the insured/beneficiary and with the maximum benefit level available elected;*
>
> *(d) The Trustee shall also pay the premiums on an insurance policy covering his personal items, including any expensive computers and electronics, 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, Ferris must provide a complete inventory of his possessions each year, supported by pictures; provided, further, that if Ferris fails to provide the required inventory and supporting pictures, the Trustee shall not purchase such insurance;*
>
> *(e) If Ferris owns his own home, the Trustee shall pay on his behalf premiums on a homeowner's insurance policy with terms and coverage standard at that time;*
>
> *(f) If Ferris and his spouse are both unemployed or if neither Ferris' employer nor the employer of Ferris' spouse pays for his health insurance premiums, then the Trustee shall pay on behalf of Ferris the premiums on a secondary health insurance policy (with a $5,000 deductible, indexed for inflation) with terms and coverage standard at that time; provided, however, that Ferris shall be responsible for premium payments on any primary health insurance policy;*

(g) Trustee shall pay medical expenses incurred by Ferris and not covered by his health insurance, Medicare, Medicaid, or other benefit plans only after he has attained the age of sixty (60) years;
(h) If Ferris has biological or adopted children, Trustee shall purchase and pay premiums on a term life policy on Ferris with the trust 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 Ferris for educational expenses only if the expenses relate to his current occupation, and then only if his employer refuses to cover such expenses; or, if the expenses are unrelated to the current occupation of Ferris, then the Trustee shall reimburse Ferris for such expenses only after Ferris provides proof of a passing grade, graduation or a certificate of passing.*

Clear from these onerous restrictions - the settlor did not trust the appointed trustee or the beneficiary.

XVI. CONSIDER OTHERS OBLIGATED TO SUPPORT

The existence of a trust generally does not abrogate the duty of any other person obligated to support the beneficiary. *See* RESTATEMENT (THIRD) OF TRUSTS §50 cmt e(3). As noted, this may apply to the beneficiary himself. In a situation where maintenance and support may deplete the corpus of the trust and the settlor has not favored the current beneficiary over the remaindermen, the trustee for an able-bodied but lazy beneficiary may have to encourage that beneficiary to help himself.

There are many factors a trustee should consider in situations where others may be obligated to support a beneficiary. Raised often in court-created trusts but may arise in any personal trust, they include: (1) ability of parents to support a beneficiary with a disability, educate the beneficiary, meet emergencies, or provide necessary training for life; (2) age, mental and physical condition of a beneficiary, and if incapacitated, likely duration incapacity; and (3) likelihood of continuing medical needs, ability to obtain insurance, and support himself. As noted above, in all states there is a duty of support between spouses.

When a trustee asks about a third-party obligation, beneficiaries often find such questions intrusive and refuse to respond. But the information is required because in most cases, the trustee has a duty to be informed as to what needs exist and who is satisfying those. *See* BOGERT *supra* § 811. Most beneficiaries would rather answer specific questions or prepare financial statements than provide tax returns. Further, tax reports do not provide a clear picture of financial resources. Notwithstanding the limited value, some corporate trustees require beneficiaries to provide them. RESTATEMENT (THIRD) OF TRUSTS § 50 cmt.e(2) (2003); Nancy S. Freeman, *Trust Me: Practical Advice for Drafting Florida Trusts*, 83 FLA. B.J. 20, 22 n.9 (May 2009). Drafting attorneys should inform clients of this practice and solicit their preference regarding the trustee's duty/necessity to inquire.

A drafter should also inform a client that in many cases, a court ordered child support obligation will trump a trust containing a spendthrift clause. As noted above, in most states, a court may order trustees of a spendthrift trust to make disbursements for support of a child to the extent trustees are required to disburse to a beneficiary required to make child support payments. In Texas, if disbursement is discretionary, the court may order child support payments from the income of the trust but not from principal and court ordered child support may extend well past the 18th birthday of a child. TEX. FAM. CODE ANN. § 154.005 (West 2008).[38]

38 Arizona law requires child support to be paid until a child turns 18 years of age. If a child reaches 18 and is still attending high school or a high school equivalency program, support may be continued until the child graduates or turns 19, whichever comes first. If the child is disabled, the court may order support to be continued beyond the age of 18 or 19. A.R.S. § 25-501.

A. Substance Abuse

While it is an unfortunate fact in modern society that substance abuse is found at every level of affluence, substance abuse is only occasionally addressed in trust documents. A standard of living clause may force a trustee to maintain a beneficiary's comfortable lifestyle while he or she spends trust assets on drugs or alcohol. The problem has been so prevalent for so long that the American College of Trust and Estate Counsel (ACTEC) Fellows have suggested language to address it in trust documents. *See* William A. Morse, *Unique and Infrequent but Recurring Drafting Problems and Possible Solutions,* AM. C. TR. & EST. COUNSEL, at 14–18 (Oct. 1–3, 2004). Recommendations included provisions for drug screening of all beneficiaries regardless of whether the trustee suspected drug use. That language is intended to provide protection for a trustee against an abuse of discretion claims if a single beneficiary feels "targeted." There is also a recommendation that the document contain a statement that "by making distributions to a beneficiary contingent on passing a drug test, the settlor intended to promote beneficiary health and well-being." The materials also suggested that documents specify frequency and timing of such tests and make consent a requirement. This hasn't worked particularly well. Implementing these suggestions presents additional problems and expenses. Some trustees flatly refuse because there is no "budget" solution for this problem, and they are concerned about potential liability. Despite the resources expended on the project, the language was never widely adopted, and the author is not aware of any courts having been asked to interpret these clauses.

More recently, some of the same experts involved in the first project now suggest substance abuse and addiction should be treated as disease. As noted above, monetary incentives (carrots) are not likely to work alone but may be useful when combined with certain trustee powers (sticks) enforcing treatment. You cannot cure diabetes by offering someone money, but you can give a trustee the power to require that they take their medication, eat and rest well, and direct funds to support better lifestyle choices. A parent who has enabled bad behavior for decades is often not willing to take the difficult steps needed to address substance abuse in a serious way in planning documents. The dynamic between settlor and beneficiary may be the reason the problem exists in the first place. Unless the beneficiary is a veteran with PTSD or some other obvious tragic catalyst for dysfunction, a drafting attorney can be forgiven for assuming that family dynamics had some role in creating the monster. Siblings who have watched one child consume financial and emotional resources that would otherwise be shared between them are not usually willing to help. All these family members may have enabled the beneficiary in some way. By necessity, the attorney is drafting a document to modify family behavior - the success of which may literally have life or death consequences. Clearly, this cannot be a trust with a typical "health, education, maintenance and support" distribution standard. Medical data indicates that short-term treatment facilities rarely work; a beneficiary may recover but will return quickly into the environment that got them there in the first place - wasting time and money. Instead, what may be required is a trust to create a completely new, relatively rigid, environment for a longer term and possibly the lifetime of the beneficiary - but not necessarily the life of the trust.

Suggestions include long-term treatment as a first step and a series of milestones to be achieved after that. Unless the situation is dire enough to merit involuntary commitment, treatment must be agreed to, at least on some level, by the beneficiary. That is where an incentive may help. If a settlor is willing, a drafting attorney may wish to bring a mental health professional in to consult during the drafting stage. That professional can identify appropriate facilities, help persuade a beneficiary to sign herself in, and help design milestones after treatment (the carrots). Ideally, they will become a trusted advisor to the beneficiary and/or to the ultimate "money trustee" if a substance abuse trust is created. A settlor may provide a trustee with the power to create a new trust in which to segregate the funds that might otherwise be distributed to the beneficiary with the substance abuse problem. Even in states that do not yet have

default decanting powers for trustees, this can be drafted into the document. Essentially, this provision empowers a trustee to decant an interest into a new trust or sub-trust with drug testing and other provisions to allow the trustee (or even a special trustee) further discretion to address the problem.

> *If Trustee reasonably believes the beneficiary is abusing drugs or alcohol and that resources of the Trust, if distributed, will facilitate continued abuse, Trustee may establish a discretionary trust with all or any portion of the share which would otherwise be distributed to that beneficiary. In this section, the term "drugs" includes 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, Trustee may select a trustee, co-trustee and/or successor trustees, and shall include provisions determined to be reasonable and necessary after consultation with a qualified attorney. It is my intent that any discretionary trust established pursuant to this provision be drafted and managed to (1) prevent Trust resources from being used to purchase drugs or alcohol in situations where the purchase of same would work a detriment to the beneficiary, (2) provide a platform from which the trustee could implement treatment for the beneficiary, and (3) prevent resources of the Trust from enabling a beneficiary to continue a self-destructive lifestyle as a result of drug/alcohol use or dependency. Trustees of a trust established under this Article may demand, that a beneficiary participate in testing to determine if drug/alcohol use is occurring, require a beneficiary to participate in drug/alcohol counseling or rehabilitation, and charge the beneficiary's share for all costs incurred in testing and treatment. Remainder beneficiaries of any trust established for this purpose shall be descendants of the lifetime beneficiary.*

More complicated and perhaps less flexible is language that includes specific rehabilitation requirements in the document or restricts distributions until certain milestones toward sobriety are achieved. Consider these very specific instructions:

> *<u>Dean Martin Trust</u>. My primary concern in establishing this trust is for the health and benefit of Dean. This trust shall be managed accordingly. This gift shall constitute the initial trust estate for the benefit of Dean, subject to the following conditions.*
>
> *<u>Distributions</u>. No distributions shall be made to or on behalf of Dean, other than payment for the treatment described below, unless and until (i) Dean has attended "Survivors' Week" at the Meadows in Wickenburg, Arizona, or its successor institution; provided however, if either Survivors' Week or the Meadows is not then in existence, the trustee, in its discretion, may require Dean to attend a similar program or institution as a condition precedent to the termination of this trust; and (ii) Dean 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, and abuse recovery. The Survivors' Week and psychotherapy requirements are collectively referred to herein as the "Treatment." The trustee shall pay for the Treatment by making payments directly to the psychotherapist or the Meadows or the alternative institution as allowed above providing the Treatment. No distributions shall be made directly to Dean during the term of this trust.*
>
> *<u>Termination</u>. The trust shall terminate upon the first to occur of (i) Dean's having completed the Treatment; (ii) Dean's failure to complete the Treatment within six (6) years from the date of my death, or (iii) Dean's death. Upon termination as a result of Dean having completed the Treatment, the remaining trust estate shall be distributed to him. Upon termination as a result of Dean having failed to complete the Treatment within six (6) years of my date of death, or as a result of Dean's death prior to the sixth anniversary of my date of death, the trust estate shall be distributed for*

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

Some Grantors are specific in their intent that a Beneficiary participate in his own support and make it clear that the Trustee is not to "enable" dysfunction in a beneficiary. For example:

In making discretionary distributions, trustee shall consider all relevant facts and circumstances, including the size of the trust corpus, tax aspects, and the personal situation of and maturity of each descendant. In exercising this discretion, trustee shall encourage each descendant to develop his talents and abilities through personal effort, to become financially responsible, support a constructive life of good character and responsibility, and reach his potential to lead a productive and self-sufficient life.

Here is another example of an "intent to incent"; this one from a document drafted in the1950s:

No payment of income to such child shall be made if in the judgment of the Trustee the ambition or incentive of such child to provide for such child's own support would be retarded or destroyed thereby; however, the fact that a beneficiary has become successful by such beneficiary's own endeavors, shall not cause the Trustee to withhold payment.

B. Enforcing Personal Values (and Other Lost Causes)

It is possible for a settlor to convey his or her values to descendants but most who try to do so fail because they are too vague, too draconian, or both. Here is an example remarkable for its focus on enforcing the values of the Settlor.

Distribution Guidelines: *In making distribution decisions, the trustee has discretion to consider all circumstances, including the nature and size of the trust corpus, the implications of tax planning, the maturity of each beneficiary and the particular situation of his or her personal life. In exercising this discretion, the trustee shall also consider our desire that (a) every beneficiary develop his or her talents and abilities through personal effort (b) that each beneficiary become financially responsible (c) that our descendants comport themselves in such a manner as to be a credit to our family and the community; (d) that the trust estate be used to support a constructive and responsible life of good character; and (e) that existence of this trust not be used as excuse or reason for any descendant not to reach his or her full potential and lead a productive life. Trustee shall have full discretion in these distributions, including discretion not to make a distribution to any beneficiary. Without limiting discretion, we encourage the trustee not to distribute if any of the following conditions exist:*

(a) Beneficiary regularly and consistently leads an extravagant or heedless lifestyle, including substance abuse or gambling, to the detriment of such beneficiary and/or his or her descendants.

(b) Beneficiary is in the process of divorce or separated with the expectation of divorce.

(c) Beneficiary is involved in or under threat of litigation such that assets distributed to such beneficiary might be subject to forfeiture or seizure by a judgment creditor.

(d) Beneficiary is a debtor in bankruptcy proceedings or likely to become bankrupt.

(e) Beneficiary has been adjudged incompetent or is patently incompetent.

(f) Beneficiary has been kidnapped, is in jail, is missing or is in custody of a foreign government or hostile group and may not be able to utilize or enjoy a distribution from such trust.

(g) Beneficiary is having a severe bout with drugs or alcohol; provided, however, if such beneficiary is in a treatment facility or program for such problem, a holdback condition shall not exist with respect to distributions directly to the provider of such services.

(h) Beneficiary is involved with a cult or similar organization.

(i) Beneficiary could qualify for state or federal medical or nursing home assistance but for the receipt of a distribution from such trust.

(j) Any situation similar to any one or more of the foregoing, but not specifically addressed.

The trustee may develop a motivational plan for the beneficiary that may include incentives and milestones based on the beneficiary's age, character, abilities, productivity and achievements. Distributions would be made only to the extent the beneficiary is meeting the goals and obligations outlined in such plan and conducting himself in a manner consistent with these guidelines.

Interestingly, after such specific instructions clearly requiring the Trustee to thoroughly investigate the beneficiary's lifestyle and circumstances with extreme diligence, this document included the following instruction to the trustee:

No Duty to Inquire: *In exercising its discretion, the trustee shall have no duty to inquire as to any beneficiary's assets or sources of income other than the interests of such beneficiary in this Trust.*

This seems to directly contradict the distribution terms stating the trustee should consider the particular situation of the descendant in his or her personal life and the provisions requiring a holdback if the beneficiary might be subject to forfeiture or seizure by a judgment creditor, is spending extravagantly, could qualify for state or federal assistance, or is "likely to become bankrupt". Perhaps the distinction is that the trustee should consider but does not have to specifically ask about assets. Or perhaps not.

XVII. WHO TO PAY

It is axiomatic that trustees make distributions to or for the benefit of the beneficiary whose identity is usually relatively easy to determine. But in a testamentary instrument, the question sometimes arises as to whether the term "issue" refers to all descendants of the settlor/testator or just children. Drafters use a variety of terms and state statutes do not adequately define most of them.[39] Some courts construe the

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39 *See* TEX. PROP. CODE ANN. § 111.004(13) (West 2007). Many states define some terms specifically; for example, **Pennsylvania** statute defines the terms "heirs" and "next of kin": A devise or bequest of real or personal estate, whether directly or in trust, to the testator's or another designated person's "heirs" or "next of kin" or "relatives" or "family" or to "the persons thereunto entitled under the intestate laws" or to persons described by words of similar import, shall mean those persons, including the spouse, who would take under the intestate laws if the testator or other designated person were to die intestate at the time when such class is to be ascertained, a resident of the Commonwealth, and owning the estate so devised or bequeathed: Provided, however, That the share of a spouse, other than the spouse of the testator, shall not include the allowance under the intestate laws. The time when such class is to be ascertained shall be the time when the devise or bequest is to take effect in enjoyment. 20 PA. CONS. STAT. ANN. § 2514(4) (West 2005). **Michigan** has a statutory will form mandating the use of the term "descendants" and then defines the term as follows: (b) "'Descendants' means your children, grandchildren, and their descendants." MICH. COMP. LAWS § 700.2519 (2014). Under **Florida** law, "'lineal descendant' or 'descendant' . . . is defined to mean a person in any generational level down the applicable individual's descending line; it includes children, grandchildren, or more remote descendants but excludes collateral heirs." FLA. STAT. ANN. § 731.201 n.9 (West Supp. 2014). The **California** statute states the following: "'Descendants' mean children,

terms "issue" and "children" interchangeably. *Guilliams v. Koonsman*, 279 S.W.2d 579, 583 (Tex. 1955). Texas case law now holds that the word "issue" includes all descendants, unless there is specific language to suggest a narrower interpretation. *Atkinson v. Kettler*, 372 S.W.2d 704, 711–12 (Tex. Civ. App.—Dallas 1963, writ granted), *rev'd on other grounds*, 383 S.W.2d 557 (Tex. 1964). An unusual example of who is included in the term "descendants" is:

> *Settlors have a daughter, MARY, and two grandchildren, JOE and TOM. All references to "Settlors' grandchildren" shall mean and include such grandchildren and any children subsequently born to or adopted by the Settlors' daughter; and all references to a "grandchild of the Settlors" shall mean and include such grandchildren and any subsequently born or adopted grandchildren, individually. All references in this trust instrument to "descendants of the Settlors" or "the Settlors' descendants" shall include the Settlors' grandchildren and their respective descendants. For all purposes in this trust instrument, the Settlors' daughter shall NOT be treated as a descendant of the Settlors.*

In our advanced technological society, some definitions are much more specific than in past generations. For example, this definition of the word "child":

> *"**Child**," "**children**," "**issue**," or similar terms used in this trust agreement, shall include all the Settlors' children and their issue (including children and issue born after the date hereof), provided that such terms shall include only a child born in lawful wedlock (or who, if born out of wedlock are acknowledged in writing by the father or are the issue of a female descendant of Settlor or have been legitimated thereafter by the marriage of the parents), and any child adopted prior to the age*

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grandchildren, and their lineal descendants of all generations, with the relationship of parent and child at each generation being determined as provided in Section 21115. A reference to 'descendants' in the plural includes a single descendant where the context so requires." CAL. PROB. CODE § 6205 (West 2009). The **Missouri** statute states as follows: (2) "Child" includes an adopted child and a child born out of wedlock, but does not include a grandchild or other more remote descendants; (14) "Heirs" means those persons, including the surviving spouse, who are entitled under the statutes of intestate succession to the real and personal property of a decedent on his death intestate; (16) "Issue" of a person, when used to refer to persons who take by intestate succession, includes adopted children and all lawful lineal descendants, except those who are the lineal descendants of living lineal descendants of the intestate. MO. REV. STAT. § 472.010(2), (14), (16) (2013). Under **Arizona** law, A. R. S. §14-1201 Definition 12**.** "Descendant" means all of the decedent's descendants of all generations, with the relationship of parent and child at each generation. Further, §14-2708 states that Class gifts to "descendants, issue or heirs of the body" are treated the same way. If a class gift in favor of descendants, issue or heirs of the body does not specify the way the property is to be distributed among the family members who comprise that class, the property that comprises the class gift is distributed among the class members who are living when the interest is to take effect in possession or enjoyment. These class members receive shares they would receive under the applicable law of intestate succession if the designated ancestor had died intestate owning the subject matter of the class gift. In **Oklahoma**, "'[r]elative' means a spouse, ancestor, descendant, brother, or sister, by blood or adoption." OKLA. STAT. ANN. tit. 60, § 175.3 (West Supp. 2014). The **Texas** Property Code contains a definition of "relative," which includes "a spouse or, whether by blood or adoption, an ancestor, descendant, brother, sister, or spouse of any of them." TEX. PROP. CODE ANN. § 111.004(13) (West Supp. 2013); *see also In re Ellison Grandchildren Trust*, 261 S.W.3d 111, 120–26 (Tex. App.—San Antonio 2008, pet. denied) (considering the use of the word "descendants" in a Texas trust and discussing the history of trust, estate statutes, and the Texas family law). In **South Dakota** 29A-1-201 (6) "Child" includes an individual entitled to take as a child under this code by intestate succession from the parent whose relationship is involved and excludes a person who is only a stepchild, a foster child, a grandchild, or any more remote descendant. Any child of a deceased parent who is born after the decedent's death is considered a child in being at the decedent's death, if the child was conceived prior to the decedent's death, was born within ten months of the decedent's death, and survived one hundred twenty hours or more after birth. (10)"Descendant" of an individual means the individual's descendants of all generations, with the relationship of parent and child at each generation being determined by the definition of child and parent contained in this code. 29A-2-711. Interest in "heirs" and like. If an applicable statute or a governing instrument calls for a present or future distribution to or creates a present or future interest in a designated individual's "heirs," "heirs at law," "next of kin," "relatives," or "family," or language of similar import, the property passes to those persons, including the state, and in such shares as would succeed to the designated individual's intestate estate under the intestate succession law of the designated individual's domicile if the designated individual died when the disposition is to take effect in possession or enjoyment. If the designated individual's surviving spouse is living but is remarried at the time the disposition is to take effect in possession or enjoyment, the surviving spouse is not an heir of the designated individual.

of twenty-one (21) but not thereafter, which adopted child and the issue thereof shall be entitled to share hereunder in the same manner as if born in lawful wedlock to the adopting parent or parents, provided always that the birth of a child conceived during marriage by any of the Settlor's issue (or the spouse of any of the Settlor's issue) as a result of artificial insemination, in vitro fertilization, or other medical technique shall be equivalent in all respects to a birth in lawful wedlock. Whenever the term "living child" or "living issue" or similar terms are used in this trust agreement, such term shall include a child or issue of Settlor which is conceived and then survives for ninety (90) days after being born.

As comprehensive as the definition above may seem to be, it does not address a child born by use of a surrogate.

After determining the identity of a beneficiary, circumstances may require a trustee to make payments for the benefit of, rather than directly to, that beneficiary. *See* RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. e(3) (2003). Some trusts will contain a facility of payment clause and some state statutes specifically allow payments for the benefit of, instead of directly to a beneficiary. Two Texas court trust statutes provide excellent examples of easily understood facility of payment language:

A management trustee may make "distributions for the benefit of the ward without the intervention of the following individuals: (1) the guardian; (2) a person possessing physical custody of the beneficiary; (3) another person who has a legal obligation to support the beneficiary; or (4) a service provider to the beneficiary or to the beneficiary's legal obligation." TEX. ESTATES CODE ANN. §1301.102(a)(2) (West 2014).

[The trustee may] make a distribution, payment, use, or application of trust funds for the health, education, maintenance, or support of the person for whom the trust is created or of another person whom the person for whom the trust is created is legally obligated to support: (1) as necessary and without the intervention of a guardian or other representative of the ward or a representative of the incapacitated person; and (2) to the ward's guardian; a person who has physical custody of the person for whom the trust is created or of another person whom the person for whom the trust is created is legally obligated to support; or a person providing a good or service to the person for whom the trust is created or to another person whom the person for whom the trust is created is legally obligated to support. TEX. PROP. CODE ANN. §142.005(c)(2).

And the Texas Trust Code provides clear and specific language allowing a prudent trustee to pay directly to providers to avoid forcing a caregiver to act as a financial fiduciary by allowing distributions to a parent, guardian, or caregiver:

A trustee may make a distribution ... to any beneficiary in any of the following ways when the beneficiary is a minor or a person who in the judgment of the trustee is incapacitated by reason of legal incapacity or physical or mental illness or infirmity: (1) to the beneficiary directly; (2) to the guardian of the beneficiary's person or estate; (3) by utilizing the distribution, without the interposition of a guardian, for the health, support, maintenance, or education of the beneficiary; (4) to a custodian for the minor beneficiary under the Texas Uniform Transfers to Minors Act or a uniform gifts or transfers to minors act of another state; (5) by reimbursing the person who is actually taking care of the beneficiary, even though the person is not the legal guardian, for expenditures made by the person for the benefit of the beneficiary; or (6) by managing the distribution as a separate fund on the beneficiary's behalf, subject to the beneficiary's continuing right to withdraw the distribution. TEX. PROP. CODE ANN. § 113.021.

XVIII. WHEN TO PAY? PROMPTLY!

Because the distribution standard in a personal trust often includes a requirement of *necessity*, delay is difficult to justify. After all, if the trustee has determined that the need exists, it is reasonable to assume the beneficiary "needs" that money now. Trusts may mandate that income distributions be made monthly or annually. If timing matters, make it clear in the document. Other considerations affect distribution timing. A trustee may reinvest income not distributed but should consider carefully before commingling principal and income investments – particularly in community property states. Many settlors intend by the establishment of the trust to preserve the assets as the separate property of their child. Consider this language from the Will of Samuel L. Clemens (Mark Twain):

> *To invest and reinvest, ... and to pay the income therefrom on the fifteenth days of January, April, July, and October of each year to my said daughter Clara Langdon Clemens for the term of her natural life, to and for her sole and separate use, and behoof (benefit) without power of anticipation, and free from any control or interference on the part of any husband she may have.*[40]

Trusts that incorporate the needs of a spouse may restrict distributions to a spouse who remains "loyal":

> *Each trust in the name of an un-remarried qualified surviving spouse of a deceased descendant shall be identical to those of the original beneficiary except the surviving spouse shall receive one-half of the income of that trust, at least annually, until said spouse's death or remarriage.*
>
> Or
>
> *If the Grantor's spouse survives the Grantor, and if the Grantor and Grantor's spouse are married and living together as husband and wife at the time of Grantor's death, the net income deriving from this Trust shall be distributed to or for the benefit of the surviving spouse under these provisions.*

When the distribution of income is solely within the discretion of the trustee, some courts have found a beneficiary does not acquire the property. The trust is not subject to division on divorce; a trustee may elect to pay out undistributed income to avoid commingling. Generally, in Texas, if the beneficiary receives discretionary income distributions from the trust during the marriage, that income is community property. *Ridgell v. Ridgell*, 960 S.W.2d 144, 148 (Tex. App.—Corpus Christi 1997, no pet.). But in most community property states, undistributed income from a self-settled trust established prior to marriage remains separate property. *Lemke v. Lemke*, 929 S.W.2d 662, 664 (Tex. App.—Fort Worth 1996, writ denied). After a marriage, absent any fraud on the community, a spouse may create a trust with separate property, and if income remains undistributed with no right to compel distribution, the spouse could not have acquired the income during marriage, and it also remains separate property. *Lipsey v. Lipsey*, 983 S.W.2d 345, 351 (Tex. App.—Fort Worth 1998, no pet.). This makes a trust an effective planning tool for protection of separate property and is another example of why the precise wording of the distribution standard is important.

XIX. TERMINATING DISTRIBUTIONS

Disputes often arise between beneficiaries and the trustee at termination. Terminating events may be the passage of time, achieving a birthday, death of a prior beneficiary or individual measuring life,

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[40] Clemens had four children. Only his daughter, Clara, an actress and concert contralto, survived him when he died in 1910. Married twice – both husbands were musicians (Russian composers) which may account for the tone of this bequest. She took care of Clemens in later life and was a "guardian of his estate and legacy", presumably the fiduciary that followed these instructions, until she died in 1962. She was survived only by a daughter, Nina Gabrilowitsch, who died of substance abuse in 1966, leaving no children.

depletion of trust assets to an uneconomic size, or the completion of the purpose of the trust, such as graduation from college. An example of a typical graduated distribution based on age:

> *When the beneficiary attains age forty (40), Trustee shall distribute one-third of the principal of the trust then held for her benefit. When the beneficiary attains age forty-five (45), Trustee shall distribute one-half of the principal of the trust then held for her benefit. This trust shall terminate and all remaining principal shall be distributed when the beneficiary attains age fifty (50).*

Almost all family or "pot" trusts provide for termination to all remaining descendants per stirpes. But consider this unusual provision:

> *On the death of the last survivor of the issue of JOHANN and MARIA BACH in being on the date of execution of this instrument plus an additional period of twenty-one (21) years, all of the trusts created hereunder shall terminate immediately and the assets thereof be distributed; delivered and paid over to the then living issue of JOHANN and MARIA BACH in equal parts,* ***per capita****, whether or not they then be immediate income beneficiaries of the trusts. If there be no living issue of JOHANN and MARIA BACH, the remaining funds shall be paid to the BACH Foundation.*

This language has the consequence (likely intended) of being a strong incentive for future generations to keep family funds together managed by a single trustee. An additional consequence (possibly unintended) is an incentive for each branch to produce the greatest possible number of offspring.

XX. GUIDANCE OUTSIDE THE TERMS OF THE TRUST

The trend in drafting today is to move toward broad discretion and maximum flexibility. There are good reasons to do so. A trust drafted today, even in a traditional rule against perpetuities jurisdiction, may last more than 100 years during which time circumstances of the beneficiaries, laws of the jurisdiction, and economics of the marketplace will change dramatically. Settlors want to create a tax efficient and flexible trust but may also want a mechanism to share their values and express their intent. Some drafters now create a separate family value statement, wealth transfer policy statement, or "letter of wishes" as part of a complete estate plan. This provides insight into the intent of the grantor without inserting such language into the mandatory and eventually irrevocable provisions of a trust or will. Hotly debated among drafting attorneys and professional trustees, the practice has proponents and detractors on both sides. This is not a new idea and has been widely used in other countries for many years. Terms like "health, support, maintenance and education" certainly do not convey individual values or concerns. A separate statement of intent can provide insight without being part of the legalese found in the trust itself. These documents may be crafted (with an advisor's help to avoid contradicting the terms of the trust) when the plan is initially drafted or added years later. They can provide insight into a grantor's values regarding family unity, entrepreneurship, work ethic, philanthropy, and a host of other issues.

Clearly, such documents generally are not enforceable or even required to be considered unless a document is so ambiguous that extrinsic evidence is required. A trust may have multiple trustees over its lifetime. The initial trustee will get a copy of the advisory document but after several different trustees, it may be lost, destroyed, or simply overlooked in increasingly old and voluminous records of the trust. Even professional trustees may not have policies for adequate preservation of documents that is not a part of the governing documents but merely correspondence directed to the trustee at the inception of the trust - a possible solution is to make the document an asset of the trust. Practitioners worry that an advisory document may encourage a settlor to exercise impermissible control over the trust assets because a statement of intent can be changed. But trustees who reasonably follow trust parameters relying on a statement of intent only as guidance or color in the decision-making process, need not worry.

Intended to be merely advisory, a document may be lengthy and contractual or short and conversational. It may be formal or casual or may take the form of a letter, memo, or list of things the settlor wants the trustee to know. Whatever the form, because they are often requested by clients today, drafters need appropriate procedures for incorporating them into a plan. Families considering them should consider carefully who will see the document and draft accordingly. The text should be general, positive, and simple. It should never make negative comments about any individual or generation, never include language to impact a trustee's duty of impartiality, contain no derogatory language that might offend a beneficiary or suggest a lack of capacity or malice in the settlor, and be reviewed as carefully as other plan documents. Treat beneficiaries *equitably* even if the document allows them to be treated *unequally*.

CONCLUSIONS

When creating a trust, ask clients what they want, encourage them to choose a trustee they trust and provide as much discretion and flexibility as possible. Some trusts divide fiduciary responsibilities; appointment of advisors is now common. Talk to the trustees, protectors, and advisors (anyone with duties) who will eventually administer the trust and have them review it before it is signed. Professional trustees (individual or corporate) are willing to do so and to work hard to be faithful to the instructions. Despite occasionally wacky results, those whose work appears in these materials departed from the standard form books to craft language responsive to the intent of their client. They tried - kudos to them. Distribution provisions associated with personal trusts are more art than science. Drafting a good trust requires the same skills required to be a good trustee: education, attention to detail, the ability to plan carefully and execute meticulously, patience, judgment, and luck. Experience and judgment matter, and as the adage goes, the most valuable experiences may arise from an exercise of questionable judgment.