DISTRIBUTION PROVISIONS:
SAY WHAT YOU MEAN – MEAN WHAT YOU SAY

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- Discretionary Distributions – Mean What you Say and Say What you Mean, Houston Attorneys in Tax and Probate 2015; Texas Bar Association Real Estate Probate and Trust Law Section Drafting Seminar 2014.

- Personal Trust Administration from the Corporate Trustee Perspective, Texas State Bar Annual Advanced Estate Planning & Probate Course, 2003; Midland Business & Estate Planning Council 2004; Corpus Christi Estate Planning Council 2004; San Antonio Estate Planning Council 2005; Fort Worth Estate Planning Council 2006; Texas Bankers Association Trust School 1999-2015.

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DISTRIBUTION PROVISIONS: SAY WHAT YOU MEAN – MEAN WHAT YOU SAY

Even the most conscientious trustee who has gathered all the information needed to make an excellent fiduciary decision may be frustrated by a document containing fiduciary instructions that are contradictory, vague or even unintelligible. This author's intent in preparing this paper was to inspire thought and stimulate discussion regarding how to make instructions to a fiduciary say what you mean.

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. *See* Roy J. Lewicki, *Trust, Trust Development, and Trust Repair*, *in* HANDBOOK OF CONFLICT RESOLUTION: THEORY AND PRACTICE 92, 92–114 (Morton Deutsch et al. eds., 2d ed. 2006). In a trust, the expectations and parameters of the relationship (the instruction manual) *See* GERRY W. BEYER, TEXAS TRUST LAW: CASES AND MATERIALS 2 (2d. ed. 2009) [hereinafter BEYER, TEXAS TRUST LAW], are defined by three primary sources:

(1) The instrument creating the relationship;
(2) The statutes that apply to the relationship such as the Estates Code and the Trust Code; and
(3) The common law of fiduciary duty, to the extent it has not been superseded by the instrument creating the relationship or by a governing statute.

See, e.g., TEX. PROP. CODE ANN. § 113.051 (West 2007). Administrators may rely on this order of priority to make virtually all decisions, looking to the terms of the instrument first. Clear and explicit instructions allow a trustee to implement the precise intent of the grantor and the terms of the trust instrument control, unless they are contrary to public policy.[1] *See*, TEX. PROP. CODE ANN. § 112.031. The trustee should never forget that there is a mandate in the Texas Trust Code requiring the trustee to administer a trust according to its terms.[2]

There are many examples of trusts difficult to administer because the terms are unclear or demand the impossible. Distribution provisions may be perfectly clear or impossibly obtuse. They may be complicated or simple, concise or verbose. Whatever the virtues or flaws, the trustee must follow the instructions.

II. DEFINING THE TERMS

In examining distribution standards, a threshold question will be whether the trustee has discretion at all. There are many trusts that contain mandatory distribution provisions. *See* RESTATEMENT (SECOND) OF TRUSTS § 186 cmt. e (1959). These may involve certain acts of discretion as to timing or calculations of net income, for example, but when a trust has a mandatory distribution standard, it is not up to the trustee to decide whether to distribute. Where the standard for distribution in the trust document gives the trustee discretion, the trustee must first determine is how much discretion is granted and the standard for that discretion. *Id.* §§ 186–87. Distribution standards generally fall into three categories: the support trust; the discretionary trust; and the hybrid.

A. The Support Trust

A true support trust directs the trustee to pay only for the health, education, maintenance, or support (HEMS) of the beneficiary. In other words, the beneficiary may compel the trustee to make distributions in accordance with a specific standard. The distribution standard of a support trust is generally referred to as an 'ascertainable standard.' Ascertainable means specific enough to be objectively applied. *See*, RESTATEMENT (SECOND) OF TRUSTS § 154. Typically, a support standard will include HEMS, or something similar. In a personal trust, this standard is often embellished by a requirement that the trustee consider the "'standard of living' that the beneficiary enjoys at a prescribed period of time." Such embellishments may be relatively simple or elaborately complicated. An example of a support standard without embellishment is simple and straightforward:

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1. The best expressions of public policy are the declarations of the legislature, found in the 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 vague. But we leave that for another paper.

2. The general duty of the trustee is as follows:

> 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. TEX. PROP. CODE ANN. § 113.051.

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

B. The Discretionary Trust

A true discretionary trust provides that a trustee shall distribute income and principal only in an amount that the trustee, in his sole discretion, sees fit to pay. RESTATEMENT (SECOND) OF TRUSTS § 155. The trustee is authorized to make distributions in its sole discretion and not subject to any objective standard. As such, the beneficiary may not compel a distribution. The distribution "standard is nonobjective because it is not specific enough to be objectively applied." Income that the trustee does not elect to distribute to the 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 as commonly used in a scenario where the surviving spouse is the trustee for the children and there are no children by any previous relationships is as follows:

My spouse shall have complete and unfettered discretion over income and principal to make or withhold distributions to the children as she determines appropriate until such time as each child reaches age 25.

C. The Hybrid

The most common type of distribution standard found in personal trusts is a hybrid of a discretionary trust and a support trust. *Smith v. Smith*, 517 N.W.2d 394, 398 (Neb. 1994); *see also* Evelyn Ginsberg Abravanel, *Discretionary Support Trusts*, 68 IOWA L. REV. 273 (1983) (discussing hybrid trusts). In a hybrid trust, the trustee has sole discretion over income and principal and can make distributions as the trustee deems appropriate, but in making that determination, the trustee must consider other factors established by the grantor such as what is necessary for the support of the beneficiary. *First Nat'l Bank of Md. v. Dep't of Health & Mental Hygiene*, 399 A.2d 891, 895 (Md. 1979). There is little case law providing interpretive assistance for hybrid trusts. *See e.g.,* Abravanel, *supra*. The prudent trustee is charged with reviewing each request to determine if it falls within the scope of the standard of that particular instrument and under the circumstances presented. HELENE S. SHAPO ET AL., *Discretionary Trusts, in* THE LAW OF TRUSTS AND TRUSTEES §§ 201–30 (3d ed. 2007). A classic version appears in the Texas court trust statutes:

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). But many documents contain much more elaborate, detailed, and often creative instructions to the trustee. For example:

The Trustee shall distribute to the Child 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 its discretion, *the Trustee shall take into account the following factors:*

1. *The Child's standard of living at the creation of the trust;*
2. *The Child is the primary beneficiary of the trust.*
3. *The Trustee may take into consideration, in determining the Child's needs, any other income or resources known upon reasonable inquiry by it to be available to the Child for these purposes. If the Child has both an Exempt Trust and a Non-Exempt Trust administered pursuant to this Section, Settlor desires that a Child's Non-Exempt Trust be exhausted before any distributions are made to or for the benefit of the Child from the Child's Exempt Trust.*
4. *Settlor's intention to assist or enable the Child to pursue vocational, college, graduate, and/or professional education as long as in the Trustee's discretion it is pursued to the Child's advantage.*
5. *Settlor's intention to assist or enable the Child to obtain, improve, and furnish a home commensurate with the Child's standard of living.*
6. *Settlor's intention to assist or enable the Child to obtain capital to enter a business or profession.*
7. *Settlor's intention that the trust distributions not serve as a disincentive to the Child's motivation to provide for his own needs in life, and Settlor's instructions to the Trustee to reduce or terminate distributions if that objective, in the judgment of the Trustee, is served by doing so.*

The above provision contains a potpourri of special instructions to provide additional guidance to the Trustee but it is still a hybrid distribution standard.

III. DISTRIBUTIONS SHOULD BE MADE PURSUANT TO GRANTOR'S INTENT

The duty of the 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); *see also* TEX. PROP. CODE ANN. § 112.031 (West 2007). A trustee's exercise of discretion has long been held to be subject to judicial review. *Id.* § 115.001; *Rubion*, 308 S.W.2d at 9 (explaining that avoiding a situation that requires judicial review is best).

Many of the early trust cases arose from suits brought by a trustee seeking a construction from a court of a will or trust instrument. *In re Estate of Dillard*, 98 S.W.3d 386, 395 (Tex. App.—Amarillo 2003, pet. denied). This is not typical of cases being handed down today. In today's literature, most cases involve suits brought against a trustee for a breach of duty. And in general, regardless of whether the trustee or the beneficiary initiates the action, as stated very succinctly in *Coffee v. William Marsh Rice University*, courts do not like to be burdened with the trustee's job. *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.").

It is worth noting, that, in the *Coffee* case, the court ultimately held that the trustees were free to disregard a provision of the trust providing that Rice University was "to benefit the white inhabitants of the City of Houston," and the court found that, because conditions had changed significantly since the creation of the trust, the trustees were free to disregard the particular provision applicable to race to accomplish the overall intent of the settlor. *Id*. at 282. This case is an example of a change in public policy that clearly mandated a change in administration. In hindsight, it seems that this result was a foregone conclusion; things were not so clear in 1966.

Many trusts still under administration today were drafted in an era when Grantor intent would have been clearly enforceable but is much more problematic some five or six decades later. Consider how a court might construe this language today:

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

Religion seems to be a common focus for grantors who attempt to control the lifestyle of beneficiaries. In general, it is an open question as to whether such restrictions would be enforced if brought to a court today. But some authorities suggest that if a settlor wants to include such restrictive requirements today, they are best couched in terms of a class of beneficiaries. Compare the following two provisions:

- *If my son does not marry a Jewish girl by age 25, the trustee shall make no further distributions to him.*
- *The trustee may distribute income to all of my sons who are over the age of 25 and married to a Jewish girl.*

Despite the general reluctance of courts to substitute their discretion for that of a trustee, a trustee faced with a significant or difficult decision regarding a distribution, particularly one that may impact more than one class of beneficiaries, may still consider seeking a determination of the court. RESTATEMENT (THIRD) OF TRUSTS § 71 (2007). In most situations, such an action will be expensive. Far better that the drafter make the intent of the grantor as clear as possible.[3]

Trustees must be careful not to assume they have discretion to take any particular action and must read the trust instrument to determine the settlor's intent, and that the settlor has given them such decision-making power. *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).

There follows an example wherein the settlor has provided very specific language regarding intent. It is clear that the Grantor intended that the Beneficiary remain employed full time and in the event that a Beneficiary elected not to work for some period, the Trustee is mandated to not reinstate distributions until the Beneficiary has returned to work for a full year. This provision strikes the author as draconian as written because if a beneficiary lost his or her job, the trustee is required to also eliminate distributions. Then, once the beneficiary finds a new job, they must work at it for a full year before distributions are to be reinstated! But the intent of the Grantor is clear.

> (a) It is the Grantor's overriding intent in establishing the trusts hereunder to benefit his descendants, supplement their earnings

[3] The decision to request an official construction is, in and of itself, an exercise of discretion. *Keisling v. Landrum*, 218 S.W.3d 737, 743–44 (Tex. App.—Fort Worth 2007, pet. denied).

and enhance their standard of living, but only if and to the extent that his descendants remain productive members of society and continue to be gainfully employed on a full-time basis. *Full-time employment will require, at a minimum, working forty (40) hours per week, whether on a self-employed basis or for a third-party employer. It shall also be considered full-time employment if a Beneficiary is a full-time stay-at-home parent raising minor children who have been born or adopted into a lawful marriage of the Beneficiary, so long as the Beneficiary's spouse has full-time employment outside the home. The trust distributions provided for hereafter in subsection (b) shall be suspended at all times that the Beneficiary is not gainfully employed on a full-time basis*, as determined by the Trustee in the Trustee's sole discretion, unless such Beneficiary has a medical condition or disability that makes such employment unrealistic or impossible; provided that, the Trustee may rely upon the determination of the Trust Committee established under subsection X.X in a situation where the medical condition or employment status of a Beneficiary is not entirely clear. *Once the Beneficiary regains full-time employment, trust distributions under subsection x.x shall not resume until the Beneficiary has maintained such employment for twelve (12) consecutive months.* In the event that a child of the Grantor is a single parent as the result of divorce, death of a spouse, or a single parent adoption or use of assisted reproduction techniques, the Trust Committee shall determine whether the employment requirements of this subsection (a) shall be waived to allow such single-parent Beneficiary to be a stay-at-home parent and still receive the distributions authorized below in subsection (b).

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

IV. READING THE INSTRUCTIONS

As a drafter constructs a trust, he should expect that a prudent trustee will read the trust instrument carefully and will apply basic rules of construction as he or she does so. Good trust administrators make it a practice to review the relevant distribution provisions in the trust document each time they consider a request. It is nearly always appropriate to understand the beneficiary's current circumstances and in testamentary trusts containing a standard of living clause, the circumstances existing 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). The trust administrator 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 of purpose, the trustee may have to infer the purpose of the trust from its structure.

Some basic rules of construction have evolved to help in the interpretation of discretionary distribution clauses or any part of a trust agreement.[4]

(1) Every trust is different. A well-crafted instrument will allow the trustee to determine the settlor's goals from the content of the trust document. *Keisling v. Landrum*, 218 S.W.3d 737, 741 (Tex. App.—Fort Worth 2007, pet. denied); *Coffee*, 408 S.W.2d at 273 ("The cardinal principle to be observed in construing a trust instrument is to ascertain the settlor's intent with the view of effectuating it.").

(2) 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).

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[4] *Hurley v. Moody Nat'l Bank of Galveston*, 98 S.W.3d 307, 310 (Tex. App.—Houston [1st Dist.] 2003, no pet., stating, "The rules of construction of wills and trusts are well settled."

(3) The administrator should 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.

(4) A trustee cannot "correct" the work of a testator, a settlor, or drafting counsel. *See Huffman*, 339 S.W.2d at 889. "The very purpose of requiring a will to be in writing is to enable the testator to place it beyond the power of others . . . to change or add to [it,] or to show that he intended something not set out in . . . his will." "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). "If 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.) (citing *Jewett v. Capital Nat'l Bank of Austin*, 618 S.W.2d 109, 112 (Tex. App.—Waco 1981, writ ref'd n.r.e.).

(5) This is not math—the 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 interpreting the trust. For purposes of administration, however, it may be appropriate to consider outside circumstances. *See Coffee v. William Marsh Rice Univ.*, 408 S.W.2d 269, 283 (Tex. Civ. App.—Houston 1966, writ ref'd n.r.e.).

(6) If, however, the document is truly unclear, courts may consider extrinsic evidence to determine what a settlor or a testator intended by using or including a particular word or phrase. *Reilly v. Huff*, 335 S.W.2d 275, 279 (Tex. Civ. App.—San Antonio 1960, no writ) (accepting evidence that the testator was a person of solid business experience and that because the testator's attorney drafted the instrument, the term "descendant" should be construed in its legal sense).

(7) There is no reason to be afraid of the dictionary—use it. *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 unto said Trustee all powers of Trustees set forth in the statutes and to ... make advancements to or for the benefit of said trust estates unto the beneficiaries thereof for such purposes as said Trustee may deem desirable or proper . . . and charge against the interest of said beneficiary to whom such advances are made.*" However, a different part of the instrument stated the following: "*Except as noted elsewhere herein, the trustee shall not borrow nor lend.*" There was no other mention of authority to borrow or lend. So, 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 the growth or progress of; (3) to raise to a higher rank; and (4) *to supply or furnish in expectation of repayment.* The 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, trust administrators should choose the expression that least conflicts with the general intent. *Coffee*, 408 S.W.2d at 272–75. An example of this that is very common would be: *It is my intent that the trustee in its discretion 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. *See* TEX. GOV'T CODE ANN. § 311.016 (West 2013). The term "shall" means mandatory—just do it. *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). Accordingly, if the drafter intends that the trustee exercise discretion, do not use the word "shall".

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

a. By leaving a will or trust the testator did not intend for property to 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* 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 given class and all classes of beneficiaries are treated equally.
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.

Whether drafting or interpreting, be certain you know what rules may apply that do not appear in the document. In Texas, exculpatory clauses may not have any effect at all. *See* TEX. PROP. CODE ANN. § 111.0035 (West 2007). And, when drafting a trust, be certain that you understand what is mandatory under the relevant statute. As an example, for trusts created under the Texas Property Code § 142, the statute mandates a "health, education, support or maintenance" distribution standard. TEX. PROP. CODE ANN. § 142.005(b)(2). But it is not unusual for the attorneys involved in the creation of a court trust to depart from the terms of the statute and for a judge to approve a trust containing such a departure. Technically, a departure from the statutory language of §142 is an abuse of discretion. *Aguilar v. Garcia* states that "[t]he clear language of the statute requires that the trustee have sole discretion to determine what is reasonably necessary for the health, education, support, or maintenance of the beneficiary." *Aguilar v. Garcia*, 880 S.W.2d 279, 281 (Tex. App.—Houston [14th Dist.] 1994, no writ). The *Aguilar* court said it is mandatory to follow the statutory language. The legislature amended this statute again in 2007 to make it clear that the only acceptable reason for a court to depart from this distribution standard is to qualify the beneficiary for government benefits as in a supplemental needs trust. *See* TEX. PROP. CODE ANN. § 142.005. Nevertheless, there are many court trusts that specifically mandate items such as the purchase of a residence or a fixed amount for support.

V. MATHEMATICAL CALCULATIONS VS. FIDUCIARY DECISIONS

Because some trusts call for distribution by virtue of a specific formula, the trustee may not distribute under a traditional discretionary standard. Treas. Reg. § 1.664-3 (2012). In trusts requiring the mandatory distribution of income, the trustee is required to exercise discretion in the decision whether to use the adjustment power, rather than make specific distributions for specific purposes. Treas. Reg. § 1.664-3. And increasingly, trust documents are drafted with complicated formulaic distribution provisions. Following is an example from a recently drafted document:

> The following provisions shall apply during the Beneficiary's life:
>
> *Base Distribution. The Trustee shall distribute to the Beneficiary an amount up to Sixty Thousand Dollars ($60,000) per year, as adjusted below (the "Base Distribution"), for the Beneficiary's health, education, maintenance and support. The Trustee may distribute the Base Distribution in a single lump sum or in two or more installments, in the discretion of the Trustee. The Base Distribution shall be increased by a cost-of-living adjustment calculated from January of 2008 going forward, as set forth below.*
>
> *If separate trusts (such as a GST Exempt Trust and GST Non-Exempt Trust) are established under this Article for the same Beneficiary, then the Base Distribution shall be made only once, so that the total dollar amount distributed from all trusts for the same Beneficiary does not exceed the amount of one Base Distribution. No Base Distribution shall be made from a GST Exempt Trust unless the GST Non-Exempt Trust established for the same beneficiary is fully exhausted.*
>
> *Adjustment to Base Distribution and Relevant Definitions. For purposes of calculating the cost-of-living adjustment to the Base Distribution, the following definitions and procedures shall apply:*
>
> *"Average Index" shall mean the aggregate of the Price Index for all of the months of the calendar year (the "Prior Year") immediately preceding the current calendar year (the "Current Year"), divided by 12. For purposes of this Article, the first Prior Year shall be the year 2010, and the first Current Year shall be the year 2011.*
>
> *"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, as illustrated below, 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 and commencing as of January 2011, 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 shall be 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 the Base Distribution payable during any Current Year be less than the 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 intentions with respect to the adjustment provided for in this paragraph. If one assumes 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. By further way of example, if a Beneficiary's Descendants Trust is funded upon the First Decedent's death in the year 2020, then the first Base Distribution to that Beneficiary in 2020 should reflect annual adjustments to the Base Distribution beginning as of January 2011 and continuing through January of 2020.*

It is interesting to note that despite the fact that this provision appears to leave very little in the discretion of the trustee, the first sentence indicates that the *"Trustee shall distribute to the Beneficiary an amount* ***up to*** *Sixty Thousand Dollars ($60,000) per year, as adjusted below (the "Base Distribution"), for the Beneficiary's health, education, maintenance and support.* Thus apparently requiring the trustee to calculate the current amount that would be due under the formula, determine that the resulting adjusted base amount is truly needed for HEMS and revert back to $60,000 in the event that the calculation or the need exceeded that amount.

Here is another complicated example:

> *For all purposes of this Will, the "Required Monthly Distribution" amount shall be as calculated in this section. One of my primary intentions is that at all times during the life of my wife the value of the principal in the trusts created under my Will (including the trust administered pursuant to this Article, the "John Doe Marital Deduction Trust," and the trust administered pursuant to Article VI, the "John Doe Family Trust") not fall below FIVE HUNDRED THOUSAND DOLLARS ($500,000). Accordingly, the "Required Monthly Distribution" shall be as follows:*
>
> *(a) If the combined value (as of 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 "Required Monthly Distribution" for each month of such calendar year shall be zero dollars ($0);*
>
> *(b) If the combined value (as of 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 "Required Monthly Distribution" for each month of such calendar year shall be EIGHT THOUSAND THREE HUNDRED THIRTY THREE DOLLARS ($8,333); provided, however, that the "Required Monthly Distribution" 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 (as of 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 "Required Monthly Distribution" for each month of such calendar year shall be TEN*

THOUSAND DOLLARS ($10,000); provided, however, that the "Required Monthly Distribution" 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 (as of 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 "Required Monthly Distribution" 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 (as of 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 "Required Monthly Distribution" 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 (as of 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 "Required Monthly Distribution" 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) For the year of my death only, values determined under sections (a) through (f) above shall be based on the values as of my date of death instead of the values as of January 1.

(h) 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 my wife from all other sources known to my Trustee (excluding the Article VI trust property), 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 my wife is 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 (including reasonable security from future attacks) at the time of my death.* Additionally, my Trustee shall distribute (in addition to all net 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 my wife from all other sources known to my Trustee, to provide for *any emergency or serious medical needs* of my wife.

Such a cumbersome and complicated set of formulas suggests that the grantor has little confidence that the trustee will exercise appropriate discretion and make prudent decisions regarding the discretion to make a distribution. And, by imposing a rigid format on the calculation process, the trustee's ability to adapt to changing market conditions, and unexpected changes in circumstances for the beneficiaries, economy, or governing law is severely restricted.

VI. DECLARING THE PURPOSE OF THE TRUST

Individual personal trusts generally have no mandated statutory language; accordingly, the variance between trusts is nearly unlimited. *See* RESTATEMENT (THIRD) OF TRUSTS § 50 (2007). One of the first things a trustee does when reviewing a personal trust for administration is to determine its purpose. While there are a myriad of reasons why a person might establish a discretionary trust, the most common are: for tax planning purposes; to facilitate the orderly transfer of wealth in accordance with specific wishes; to protect the assets of those who are unable to protect themselves; to accommodate for parental deficiency; or to allow someone to exercise control from the grave. *See, e.g.*, BEYER, TEXAS TRUST LAW, *supra*, at 3–5. While the intent of control from the grave is not realistic, occasionally, this is a factor in the decision to establish a trust. *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.).

When a trust is established for federal tax purposes, it should be drafted to comply with the Internal Revenue Code's "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 it generally is not includable in the beneficiary's federal gross estate. *See id;* but note that the referenced article makes the point that the ascertainable standard alone will likely not provide creditor protection for the beneficiary. To accomplish that that the Trustee must have full discretion. Put another way, the Beneficiary must not have a right to receive property 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 is appropriately limited for tax purposes. RESTATEMENT (THIRD) OF TRUSTS § 50 (2003) (containing an extensive discussion of this precedent).

The Treasury Regulations define a general power of appointment by explaining what it is not; specifically, Treasury Regulation § 20.2041-1(c)(2) states as follows:

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

Treas. Reg. § 20.2041-1(c)(2) (2013) (emphasis added) (citing I.R.C. § 2041 (b)(1)(A) (West 2012)). Upon this framework, Treasury Regulation § 20.2041-1(c)(2) sets forth a number of different powers that are limited by an ascertainable standard; such powers include, but are not limited to, the following:

(1) [S]upport in reasonable comfort;
(2) [M]aintenance in health and reasonable comfort;
(3) [E]ducation, including college and professional education, Treas. Reg. § 20.2041-1(c)(2); and
(4) [M]edical, dental, hospital and nursing expenses and expenses of invalidism.

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, of course, appears to circle back to a previous standard of living). It is important to note, however, that "[a] power to use property for the comfort, welfare, or happiness of the holder" is deemed to be outside of the ascertainable standard. That "happiness" is "unascertainable" may be a topic for an entirely different type of seminar.

While tax cases provide some guidance for a prudent trustee, a better guidepost is the personal trust common law. In looking at personal trusts, 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, for tax purposes, the trust property will not be includable in the beneficiary's gross estate—the settlor's primary purpose in establishing the trust may be safely assumed to include tax planning purposes. *See* Vitiello & Kessler, *supra.* However, if the power is too broad to be considered ascertainable, such as the right to distribute money for happiness, then the assets fall back into the beneficiary's taxable estate, and the trustee can assume that the settlor simply wished to provide for the beneficiary. *See id.* The Texas Property Code contains a Discretionary Powers and Tax Savings section. TEX. PROP. CODE ANN. § 113.029 (West 2007). It is better, however, if the testator makes his purpose clear. Consider the following clear statement of purpose:

> *It is my intent in the 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 issue facing the trustee. Treas. Reg. § 20.2041-1(c)(2) (2013) (listing "support in [the holder's] accustomed manner of living" as one of the ascertainable standards limiting the general power of appointment). This is probably 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). 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, will generally investigate and document the beneficiary's standard of living. This might include visiting the beneficiary and following up on distributions for major expenses, vacations, and education. And it might include research to determine what the grantor's standard of living was more than a generation ago. The courts consider the following factors to be relevant in various circumstances: 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. S*ee also*, *In re Golodetz' Will*, 118 N.Y.S.2d 707, 712–13 (N.Y. Sur. Ct. 1952). The trustee should monitor, record, and consider these in making maintenance and support distribution decisions. The trustee must "determine the amount of trust income 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, the prudent personal trustee should also be aware of the tax ramifications of such a standard. "[T]he power 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. In a personal trust, the issue is not how the trustee spends the money but how the trustee *could* spend the money. *See 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 'needs for health, education or support.'

A unique example of a testator who undertook to define exactly the standard of living he had provided for the beneficiaries at the time of his death follows:

> *I have always encouraged my children to build useful and fulfilling lives. I have provided the means to allow them to choose a career, business or profession about which they may be passionate and to pursue whatever education is required to excel in their chosen field. It is my intent that my trustee, in his discretion, will use these funds to provide health, education, maintenance and support as reasonable and necessary to continue to encourage them to pursue these goals and support them in these endeavors as I have done up until the time of my death. Accordingly, to the extent that funds are available and the trustee, in his discretion deems it prudent, I encourage my trustee to consider requests for the purchase of a residence, to facilitate the start of a business or enter a profession, to obtain additional education or for travel in a manner that expands the knowledge, creativity and sophistication of my children in order that they may continue to do meaningful work for profit or charity.*

Often the standard of living clause may be blended with other instructions to the trustee to consider other circumstances. Here is an example of an instruction directing review of other sources of income including earned income and requiring the trustee to also consider family life and lifestyle.

> In an effort to provide the Trustee with guidance in making distributions under the standards provided in subsection X above, *the Trustee may consider such circumstances and factors as the Trustee believes are relevant, including but not limited to the following: (a) the other income and assets known to the Trustee to be available to the distributee, and the advisability of supplementing such income or assets,* (b) the tax consequences of any such distribution, (c) the *character and habits of the distributee, including the diligence, progress and aptitude of the distributee in acquiring an education and advancing his or her career goals, the ability of the distributee to handle money usefully and prudently, and to assume the responsibilities of adult life and self-support, (d) the extent to which any such distribution could contribute to the*

development of negative attitudes in the distributee, such as entitlement, complacency or narcissism, (e) external factors and circumstances which may threaten the distributee's *financial security or progress toward financial maturity and independence,* and (f) *the distributee's cultivation of a life plan and goals which are both challenging and realistic in terms of intellectual prowess, emotional maturity, and career and/or family development*.

VIII. CONSIDER OTHER SOURCES OF SUPPORT

There is precedent available to guide trustees with regard to their obligation to consider a beneficiary's other sources of income when making maintenance and support decisions. Cases arising from situations where the trust instrument does not address whether the trustee should consider the beneficiary's outside resources are largely testamentary and vary in outcome. 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). From state to state, the default approach falls into the following three broad categories:

- The testator intended that the trust be 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
- The beneficiary must rely completely on his own resources for support, unless 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, the 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, Texas law follows the moderate path of assuming the beneficiary's other means of support should be considered, but it does not require a beneficiary to exhaust such outside resources. *Id.* at 739–45 (explaining that beneficiaries need not exhaust all of their financial assets or resources). As noted, this is not the prevailing view everywhere. *In re Demitz' Estate*, 208 A.2d 280, 282 (Pa. 1965); *see also* Purver, *supra* at 266 and cases cited therein (noting cases from a variety of jurisdictions where the beneficiary is required to exhaust outside resources in whole or in part). However, in Texas and in a majority of states, in considering distributions, the view is that 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., ANNUAL ADVANCED ESTATE PLANNING AND PROBATE COURSE [hereinafter Pacheco]. In these jurisdictions, the most important factor considered is the ultimate intent of the settlor or the testator—generally presumed to be to provide support, as necessary. *See* R.T. Kimbrough, Annotation, *Admissibility of Extrinsic Evidence to Aid Interpretation of Will*, 94 A.L.R. 26 (1935) (discussing the importance of the maker's intent).

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 that the requirement that the trustee consider income from any source included the family. It held that the 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 their sons," and income received by the sons.

In the event that the grantor wants the trustee to consider something specific, the document should specify that clearly.

> In providing for a limited fixed 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 so far as possible 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 Seven Thousand Dollars ($7,000.00) per annum. If Charles *leads a useful, respectable and reasonably provident life,* it is my desire that he should have as much or all of the additional income of his trust above said limited amount 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. I suggest that *in determining what discretionary payments of income shall be made to Charles, the Trustee take into*

> *consideration that other income and assets he has, as well as the general circumstances of his occupation, family responsibilities, and manner of living*.

This provision highlights the previous admonition that a trustee should not be afraid of the dictionary. "Provident" may mean (1) making provision for the future, (2) prudent, or (3) frugal. Substituting the word "prudent" for "provident" in the above distribution standard yields a different meaning than if you substitute the word "frugal" for the word "provident". Only the settlor could be certain whether in choosing the word "provident" she meant that Charles should be prudent or frugal. The last sentence is, however, clearer. The trustee is required to look at income, assets, his occupation, dependents and lifestyle.

Some instruments are much more concise regarding these type of instructions. For example:

> *Trustee may consider disparity of benefits received from any person, others relying upon the beneficiary for support, illness, education expense or other special talents, needs or circumstances.*

The Third Restatement of Trusts provides a check list of items to consider and could be adopted in whole or in part in the distribution provisions of an instrument. It provides that 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 that it may be appropriate to consider the non-income assets available to the beneficiary depending upon:

1) The liquidity of the assets;
2) The terms and extent of the discretionary power;
3) Other purposes of the trust such as for tax planning; and
4) The relationship of the Settlor with the beneficiaries and his or her objectives for them.

In cases of doubt, some courts have suggested 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. However, many trusts do not have a primary beneficiary. In fact, in most cases the fiduciary has the same duty to all classes of beneficiary. This may create a conflict between the needs of the current income beneficiary and the needs of the future income, principal, or remainder beneficiaries. As discussed below, this conflict is what led to the creation of the Power to Adjust.

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

The duty of loyalty may be the most important aspect of the fiduciary relationship; it demands a trustee put aside the most human of instincts—self-interest. TEXAS PROPERTY CODE § 117.007. At all times, the trustee must put the interests of the beneficiaries above the interests of all others, including the trustee's own interests. And, as spelled out in unmistakable terms in § 117.007, a trustee must "manage the trust . . . solely in the interest of [*all*] the beneficiaries." (Emphasis added.) Managing a trust impartially is frequently the most difficult aspect of a trustee's administrative duties. *See* Pacheco, *supra*. Managing a trust in the interest of all beneficiaries may be less troublesome 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 harder than a drafting attorney may imagine.

Managing objectively is particularly difficult when the trustee is confronted with a duty of "perfect loyalty" to two or more beneficiaries with different interests. The statute does not distinguish between classes of beneficiaries. Section 111.004(2) defines a "'beneficiary' [as] a person for whose benefit property is held in trust, regardless of the nature of the interest." TEX. PROP. CODE ANN. § 111.004(2). "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." *Id.* § 111.004(6). Section 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.

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

Unless a document specifically directs the trustee to favor one class of beneficiaries 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, the trustee should be comfortable with disparate treatment; drafters should remember that if the grantor wants to favor one class over another, the document must say so.

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 as noted above. An example of an effective statement of preference follows:

> The trustee from time to time may distribute such amount or amounts or none of the net income and principal to any member of the group consisting of the Beneficiary and the descendants of the Beneficiary in such manner as the trustee may determine to be advisable to provide for the health, education, maintenance or support of any such individual. *Such amounts of net income and principal 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, *the trustee shall consider the Beneficiary the preferred beneficiary of this trust*. Subject to the restrictions set forth in paragraph X and Article X, the trustee may make distributions to any non-preferred distribution 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*.

The above is an example of a trust document that presents a clear and easily interpreted preference for a first generation beneficiary. Here is another clear mandate:

> 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.

However, in many cases, the articulated standard is not clear. In some cases, the Testator creates an even greater challenge for the Trustee by misdirected attempts to clarify:

> *The issue of the Grantors in the same generation should be treated with substantial equality unless the Distribution Trustee considers unequal treatment advisable*.

As noted above, when the document does not provide any guidance, the trustee must provide for the administration of the trust with the same regard for the interests of all beneficiaries. The Uniform Principal and Income Act and the Uniform Prudent Investor Act mandate consideration of the total investment strategy, stressing short-term results for the current income beneficiaries and long-term results for the future classes of beneficiaries. TEX. PROP. CODE ANN. chs. 116 (Uniform Principal and Income Act), 117 (Uniform Prudent Investor Act).

XI. WHEN THE DOCUMENT SAYS TO DISTRIBUTE ALL INCOME

When the document says to distribute all income, the trustee may be in a position to equalize the tension between classes of beneficiary by using the adjustment power. In determining when to use the adjustment power, the trustee must look for three things. Section 116.005 details the requirements of the adjustment power as follows: (1) the 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) the trustee determines 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 or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries. [5]

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 Prudent Investor Rule, § 116.005 authorizes the trustee to make adjustments between principal and income that may be necessary. TEX. PROP. CODE ANN. § 116.005.

When the distribution standard states "distribute all income," what was previously a matter of discretion only as it related to investment decisions now requires

5. *Id.* §§ 116.004(b), .005(a). Texas Property Code § 116.005(a) reads as follows:

> (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 [§] 116.004(a), that the trustee is unable to comply with [§] 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.

fiduciary discretion in determining the amount of the distribution as well.

Some trustees assume that you almost never need to utilize the power; however, every trustee has an affirmative duty to administer every trust in good faith, and part of that duty is to consider whether the adjustment power will apply to a particular trust. §113.051. Therefore, every irrevocable trust must be reviewed at least once to determine if the power should be used going forward. Many trusts will require annual review. This analysis may be boiled down to three basic questions: (1) Whether the adjustment power is available? (2) If it is available, should an adjustment be made this year? (3) What should the trustee consider to determine the percentage of adjustment?

A. Using the Adjustment Power?

Whether the adjustment power is available is a two-part test. First, the trustee must determine if the Uniform Principal and Income Act is the governing law of the trust. Second, the trustee must be certain the document does not specifically prohibit use of the adjustment power. Even if the Principal and Income Act applies to the trust, the trust document may contain specific language prohibiting its application; if so, that specific language will govern the trust. TEX. PROP. CODE ANN. § 116.004(a)(1). Or the trust could have special circumstances that prohibit the trustee from using the adjustment power. § 116.005(c). For example, even when the Uniform Principal and Income Act applies to a trust, the adjustment power will not be available if any of the following is true:

- Language in the trust instrument prohibits the trustee from investing assets as a prudent investor. For example: *I prohibit the Trustee from ever 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 here]*.[6]
- The trust describes the amount that shall or may be distributed by referring to a specific amount, and does not refer to the income of the trust. For example: *Distribute $1,500 per month to each beneficiary* or *Distribute 3% of the market value on March 1st.*
- If a trust's distribution provision is a single discretionary standard that applies to both income and principal, the adjustment power does not apply, but it is important that the standards 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. For example: *Distribute all income and principal only in the event of an emergency*.
- A non-independent co-trustee is required by the document to participate in the adjustment power decision because no related party, subordinate party, or beneficiary may participate in the decision. *See* TEX. PROP. CODE ANN. § 116.005(c); *see also* 72 TEX. JUR. 3D *Trusts* § 123 (2007). If such a co-trustee is required, the adjustment power may not be used. 72 TEX. JUR. 3D *Trusts* § 123. If the non-independent co-trustee's participation in every decision is not required, then the non-independent co-trustee can decline to participate in the decision to exercise the adjustment power and the power to adjust can be applied to the trust. *See* TEX. PROP. CODE ANN. § 116.005.
- The trust has charitable and non-charitable beneficiaries and is taking a charitable set aside for capital gains.[7]

If a settlor wants to preclude the use of the adjustment power, the insertion of any one of the above provisions will accomplish that. However, the uniform statute was designed to allow trustees to employ the prudent investor rule without being constrained by traditional principal and income rules and to apply to trusts already in place, whose terms describe the amount to be distributed by referring to the trust's income - even those that may have included provisions prohibiting invasion of principal or equitable adjustments. Accordingly, given the broad language of the enabling statute, if a settlor wishes to forbid the use of the adjustment power, the document should refer to it specifically. Here is an example of a straightforward prohibition:

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6. *See id.* In Texas, this is often XOM. .

7. *See* TEX. PROP. CODE ANN. § 116.005(c); *see also* Medlin, *supra* at 739. This category of trusts, which have charitable remaindermen, are nonqualified trusts created prior to the 1969 tax law, which created 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. These trusts take a charitable set-aside deduction for capital gains or a proportion of the capital gains, attributable to the charitable interest. *See id.* The power of adjustment does not apply to trusts where a charitable set-aside deduction is being taken.

> *I specifically preclude my trustee from making any adjustments between traditional trust accounting income and principal under the provisions of §116.005 of the Texas Property Code entitled Trustee's Power to Adjust, or in the event that the situs or governing law of this trust should be changed, under the provisions of any similar statute or provision of law. Further, any requirement found elsewhere 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.*

But assuming that the use of the adjustment power is not specifically prohibited, by engaging in the analysis as described above, the trustee first determines if the statute governs the trust and whether the adjustment power is available. If the governing law does not include the Uniform Principal and Income Act, or if any of the above listed circumstances exist, then the trustee's analysis is complete and the power is not available.

If the use of the adjustment power is truly prohibited by the terms of an irrevocable document then a single review is enough. If the prohibition of use of the adjustment power is due to other circumstances, such as identity of a co-trustee or that the trust is not invested for total return, a trustee should have a mechanism to trigger a new review when circumstances change.

If the Uniform Principal and Income Act is the governing law of a trust and under the current circumstances and language of the trust, the adjustment power is available, then the trustee must determine whether to make an adjustment. Even in a case where the adjustment power is available to the trustee, 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, the income being produced now, and others, will influence the trustee's decision as to whether to exercise the power. And of course, the intent of the settlor as set forth in the document regarding what the trustee should consider must be followed.

The application of the Prudent Investor Rule is fundamental to the adjustment power. *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). The trustee must follow the Prudent Investor Rule when exercising the adjustment power. For example, if, in applying the Prudent Investor Rule standard, the trustee decides that the investment objectives of the trust can be met by an asset allocation that produces enough traditional income to provide the income beneficiary, with the level of benefit that beneficiary is entitled to under the trust, then no adjustment will need to be made. *See* Pacheco, *supra*. (Just because you can, doesn't mean you should.) However, if the trustee applies the Prudent Investor Rule standard and decides on an investment strategy that results in traditional income that does not provide the income beneficiary with the appropriate benefit, then the trustee may make the adjustment.

XII. THE SPENDTHRIFT CLAUSE

The interaction of a spendthrift clause and the distribution standard in a trust frequently raises difficult issues for the trustee. TEX. PROP. CODE ANN. § 112.035. Texas has little precedent on this issue but it is interesting to note that the reasons for creating a spendthrift trust need not be included in the document. *Adams v. Williams*, 248 S.W. 673, 679 (Tex. 1923), "While trusts by the terms of which the property belonging thereto is put beyond the control of the beneficiary and exempted from seizure for his debts are commonly called 'spend-thrift trusts,' it is not necessary that the instrument creating same shall assign any reasons for such provisions, nor is it necessary that the beneficiary shall be in fact improvident, incapable, or a spendthrift." Trustees should consider *Nations Bank of Virginia v. Grandy*, wherein the court held that, despite unfettered discretion to invade principal, trustees properly refused to invade corpus to pay a beneficiary's debts when the beneficiary had substantial assets outside the trust sufficient to pay. *Nations Bank of Va. v. Grandy*, 450 S.E.2d 140, 143–44 (Va. 1994). Contrast that with an Iowa case, *In re Family Trust of Windus*, a case in which the court held that an invasion of principal to pay credit card debt in excess of $60,000 was permissible under the support standard. *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 that invasion of principal to pay a $71,000 credit card debt was not within the "support standard").

In these cases, the issue before the court was a determination as to whether a beneficiary who had assets outside of the trust could refuse to utilize those and instead rely on trust principal to the detriment of the remainder interests. In each case, the court examined the language of the distribution provisions to determine whether the intent of the grantor was to create a support trust or a "discretionary support trust" – a hybrid. The two courts reached opposite conclusions based in substantial part on nuances in the language of the distribution provisions.

Trustees should be familiar with the terms of the relevant state statute regarding when a spendthrift trust is created. In Texas, TEX. PROP. CODE ANN. § 112.035 clarifies that a settlor is not considered a beneficiary of a trust solely because a trustee who is not the settlor is authorized to pay taxes for the settlor. §112.035(d)(1). Trustees should remember 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. TEX. PROP. CODE ANN. § 112.035. There is an exception to the spendthrift rule for child support. *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.). In most states, including Texas, this is now a statutory provision. TEX. FAM. CODE ANN. § 151.001 (West 2008).

XIII. COMMUNICATE WITH THE BENEFICIARY

The trustee has a duty to be informed of circumstances affecting the trust. *See* RESTATEMENT (THIRD) OF TRUSTS § 111 cmt. d (2003). The trustee should frequently communicate with the beneficiaries about individual circumstances and the general administration of the trust. Administrative decisions relating to distributions, choice of investments, taxes, and the availability and application of the adjustment power are key issues, and the communication with the beneficiaries should be accurate, complete, timely, and in writing. If a settlor chooses to limit disclosure to the beneficiaries about the trust, the drafter should review the terms of the mandatory statutes from the relevant jurisdiction that address the age at which a beneficiary is entitled to information, which beneficiaries are included and what must be disclosed very carefully.

As an example, the current statute after having been amended by the legislature several times, 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] 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). Previous Section 113.060—effective January 1, 2006 and repealed as of June 17, 2007—imposed a standard that a "trustee shall keep the beneficiaries of the trust *reasonably* informed". Questions regarding what is reasonable and whether this section would apply to an unvested or contingent remainder beneficiary had trustees—individual and professional—scurrying for counsel. The current statute still leaves some room for interpretation regarding what amount of disclosure is necessary to keep a beneficiary informed and clearly precludes a testator or grantor from mandating non-disclosure for any beneficiary twenty-five or older. In light of the terms of this statute, trustees and parents should plan for full communication to begin at age eighteen, unless the document mandates that it may be avoided until age twenty-five. TEX. PROP. CODE ANN. § 111.0035(c). Thereafter, even if the document purports to allow continued secrecy, the statute clearly requires the trustee to keep the beneficiary fully informed.

XIV. WHAT TO PAY?

At first blush, the issue of what to distribute in a trust seems easy. Health, education, maintenance, and support are all words with a common, ordinary meaning; however, circumstances affect their interpretation. The trustee must determine whether the primary purpose of a trust is to support now, conserve the assets for the future, or both. The variety of requests seems infinite; there is little guidance in case law because a lawsuit is rarely instituted to force or protest distribution for a single item. Moreover, some requests can be easily classified in more than one way.

A. Health

The term "health" typically includes many distributions that would also be permissible under a support standard alone. *See* RESTATEMENT (THIRD) OF TRUSTS § 50, cmt. d (2003). In Texas, a recent amendment to §142.005(b)(2) of the Property Code 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). The legislature added this section because trustees administering judicially created trusts found the variety of health related requests to be daunting. *See* Tex. H.B. 564, 80th Leg., R.S. (2007) (enrolled version). Difficult decisions for distributions related to health may involve alternative treatments, such as acupuncture or homeopathic remedies, as well as elective medical procedures such as plastic surgery, laser eye surgery, cosmetic dentistry, non-diagnostic full body scans, over the counter lab tests (such as tests for sexually transmitted diseases), tattoo removal, and concierge medicine. *See* RESTATEMENT (THIRD) OF TRUSTS § 50, cmt. d. Some of the obvious, and more traditional, requests that fall under the category of health include the following:

- Health, dental, life, and long-term care insurance premiums;
- Uninsured doctor, hospital, and lab costs;

- Physical therapy; occupational therapy; home health care; medically prescribed therapeutic items such as whirlpools, horses, pools;
- Psychiatric or psychological treatment or counseling; mental health and mental retardation services;
- Medical expenses of beneficiary's dependents in most cases;
- Dental and orthodontia expenses;
- Medical supplies, equipment, and batteries; and pharmaceuticals; hospital beds and specially designed furniture for the handicapped; linens and special clothing requirements;
- Eye care, eyeglasses, and contact lenses;
- Handicap transport vans and lift equipment; ramp construction, adaptation of doors, and remodeling to accommodate handicaps; including the installation of safety equipment such as handrails; and
- Specialized cleaning to eliminate allergens.

In drafting a distribution to cover health, attorneys may want to consider *In re Stonecipher*, 849 N.E.2d 1191, 1197 (Ind. Ct. App. 2006) where the court found that it was not an abuse of the trustee's discretion to refuse to invade trust principal for in-home nursing care for the present beneficiary given the consideration of her income from other sources, the remaindermen beneficiaries, and extensive gifting some of which was made from personal funds. *And see, generally* RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. d discussing the different health-related topics. It is unusual for a settlor to specify or preclude certain distributions related to healthcare in the terms of a document but there are some interesting examples. A Grantor's desire to exercise control from the grave and micromanage the determination of an appropriate distribution for "health" is an interesting exception. This testator attempted to restrict the Trustee from distributing for health expenses which he felt were "self-inflicted":

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

B. Education

Without limiting or expanding provisions in the trust document, education is usually considered to include living expenses, tuition, fees, books, and other costs of higher education or technical training. As such, education would appear to be easy to define; however, there are many cases demonstrating ambivalence in the courts. Common requests classified by corporate trustees as "education" include, but are not limited to, the following:

- Tuition for, including private school, college, graduate school, trade or vocational training;
- Study skills classes and tutoring; speech or reading therapy;
- Room and board at school;
- Summer school and summer activities;
- After school programs and extended day care;
- Costs of travel to and from school;
- Sports activities and lessons;
- Computer purchases, maintenance, and repair;
- Graduation costs, proms, class rings;
- Music lessons and instrument purchase and repair;
- Books and school supplies; and
- Uniforms and school clothes.

See RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. D, discussing the different education-related topics. Although the restatement appears to include all these categories as "education" there are some contrary decisions for review. *S. Bank & Trust Co. v. Brown*, 246 S.E.2d 598, 603 (S.C. 1978), finding that education did not include post-graduate studies but was limited to education up to and including a bachelor's degree. *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". And see, *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; and *Epstein v. Kuvin*, 95 A.2d 753, 754 (N.J. Super. Ct. App. Div. 1953), holding that the term "college education" did not include medical school.

An example of a relatively straight forward definition of "education" is:

> *The term "education" shall include, but is not limited to, education and maintenance while attending pre-school, elementary, secondary, undergraduate, graduate, post-graduate and vocational schools.*

But consider the power vested in the trustee under the following term:

> "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.

C. Maintenance and Support

The terms "maintenance" and "support" are now generally considered synonymous and may be deemed an expression of purpose, as much 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". Courts have held that "[t]he needs of a married man include not only needs personal to him, but also the needs of his family living with him and entitled to his support." *Robison v. Elston Bank & Trust Co.*, 48 N.E.2d 181, 189 (Ind. App. 1943). The terms maintenance and support have become so broad, that when the distribution standard includes these terms, a trustee's discretion is no longer considered "unbridled." *See also, 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). In general terms, maintenance and support refers to the following types of living expenses:

- Rent or mortgage payments, utilities, groceries and other routine living expenses;
- Property taxes, insurance, maintenance, and repairs (on property held outside the trust);
- Auto purchase, repair, and insurance;
- Childcare services;
- Legal fees (for items such as divorce, adoption, or criminal defense);
- Estate planning, tax preparation, tax and accounting advice;
- Requests for vacations, birthdays and holidays, and emergencies.

See RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. d (discussing the different maintenance- and support-related topics); and see, Matthew A. Levitsky, *What Does Maintenance and Support Really Mean in Trust?* EST. PLAN. & WEALTH PRESERVATION BLOG FOR TRUSTED ADVISORS (Sept. 17, 2013). 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* Levitsky *supra*. The examples above in all three categories are not meant to be exhaustive. Some of these items may seem frivolous for small trusts, which provides further support for the rule that individual circumstances must be considered; however, under all circumstances, support probably means more than the bare necessities. *Hartford-Conn. Trust Co. v. Eaton,* 36 F.2d 710 (2d Cir. 1929). Some settlors are, however, very specific:

> Notwithstanding anything herein to the contrary, my Trustee shall distribute such amounts of trust income and/or principal to my son as are necessary, when added to the funds reasonably available to my son from all other sources known to my Trustee, to provide for any emergency or serious medical needs of my son; provided, however, that *my Trustee shall not distribute any trust income or principal to my son for his emergency or serious medical needs if he has employer medical benefits*. Additionally, *after the occurrence of a Major Terrorism Event*, *my Trustee shall distribute* to my son such amounts of trust income and/or principal as are necessary, when added to the funds reasonably available to my son from all other sources known to my Trustee, to provide for his *health, support and maintenance in order to maintain him, to the extent reasonably possible, in accordance with the standard of living to which my son is accustomed at the time of my death.*

Consider whether the following example of a specific provision regarding the distribution of health, education, maintenance and support leaves any discretion to the trustee at all.

With regard to each trust administered pursuant to this Article of which the Grantor's son is the Beneficiary, after the death of the Grantor, the Trustee shall distribute the amounts directed under the following subsections:

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

in which such distributions are to be made, as determined by the Consumer Price Index;

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

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

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

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

(f) *If the Grantor's son and his spouse are both unemployed* or if neither the employer of the Grantor's son nor the employer of the spouse of the Grantor's son pays for his health insurance premiums, then *the Trustee shall pay on behalf of the Grantor's son the premiums on a secondary health insurance policy (with a $5,000 deductible, indexed for inflation)* for the Grantor's son with terms and coverage standard at that time; *provided, however, that the Grantor's son shall be responsible for premium payments on any primary health insurance policy*;

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

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

(i) The Trustee shall pay on behalf of or reimburse the Grantor's son for *educational expenses only* under the following guidelines:

> *If the expenses relate to the current occupation of the Grantor's son, then the Trustee shall cover such expenses only if the employer of the Grantor's son refuses to cover such expenses*; or
> *If the expenses are unrelated to the current occupation of the Grantor's son, then the Trustee shall reimburse the Grantor's son for such expenses only after the Grantor's son provides proof of a passing grade, graduation or a certificate of passing*.

XV. CONSIDERING OTHERS OBLIGATED TO SUPPORT THE BENEFICIARY

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). This principle may be applied to the beneficiary himself. *See id.* cmt. d. 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 numerous factors for the trustee to consider in situations where others may be obligated to support a beneficiary. These are raised most often in court-created trusts, although they certainly may be an issue in any type of personal trust. Such considerations include the following: (1) the ability of a parent, or parents, to support a beneficiary with a disability, educate the beneficiary, meet emergencies, or provide necessary training for life; (2) the age, the mental and physical condition of the beneficiary, and if incapacitated, the likely duration of the incapacity; and (3) the beneficiary's likelihood of having to continue medical needs or the beneficiary's ability to obtain insurance and to support himself. All states also have laws regarding the duty between spouses.

When a trustee asks about a third-party's obligation, beneficiaries and their family members may find such questions intrusive; others may refuse to respond. However, the information is necessary because the law charges the trustee with duties, regardless of whether the parents are satisfying their duty to support a child or whether the need for maintenance and support truly exists. *See* BOGERT , *supra* § 811. Most people would rather answer specific questions or prepare financial statements than provide tax returns and tax returns often fail to provide a clear picture of financial resources. Notwithstanding their limited value, some corporate trustees still require beneficiaries to provide tax returns. Nancy S. Freeman, *Trust Me: Practical Advice for Drafting Florida Trusts*, 83 FLA. B.J. 20, 22 n.9 (May 2009). Drafting attorneys may want to inform their clients about this practice and solicit their intent regarding the trustee's duty/necessity to inquire.

Importantly, as noted above, a court ordered child support obligation will trump a trust containing a spendthrift clause. Section 154.005 of the Texas Family Code allows a parent's trust assets to attach as follows:

> § 154.005. PAYMENTS OF SUPPORT OBLIGATION BY TRUST
>
> (a) The court may order the trustees of a spendthrift or other trust to make disbursements for the support of a child to the extent the trustees are required to make payments to a beneficiary who is required to make child support payments as provided by this chapter.
>
> (b) If disbursement of the assets of the trust is discretionary, the court may order child support payments from the income of the trust but not from the principal.

TEX. FAM. CODE ANN. § 154.005 (West 2008). 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. *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). A standard of living clause may force a trustee to maintain a beneficiary's comfortable lifestyle while he or she spends the trust assets on drugs or alcohol. This problem became so prevalent that the American College of Trust and Estate Counsel (ACTEC) asked its fellows to suggest language to address it in trust documents. The recommendation included a provision for a drug screening of all beneficiaries, regardless of whether the trustee suspected a beneficiary's drug use. This language provides some protection for the trustee against claims of abuse of discretion, but it may present additional problems and expense. The suggestions included an assertion by the settlor that by, making distributions to a beneficiary contingent on passing a drug test, the settlor intended to promote the health and well-being of the beneficiary. The ACTEC recommendation also suggested that the instrument specify the frequency and timing of such tests and address consent as a requirement. *See id.* Despite the resources expended on this project at the time, the language was not widely adopted. This author has seen only a few such documents actually funded and is not aware of any courts having been asked to interpret such a clause.

More recently, ACTEC has presented materials to its members suggesting that substance abuse and addiction should be treated as disease.

An interesting approach is to provide the trustee with the power to create a new trust in which to segregate the funds that might otherwise have been distributed to the beneficiary with the substance abuse problem. Essentially, this provision empowers the trustee to decant an interest into a trust with drug testing and other provisions that allow the trustee further discretion to address the problem.

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

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

Practitioners may also try to draft specific rehabilitation requirements into a document or restrict distributions until certain milestones are achieved in the progress toward sobriety. Consider this very specific instruction:

> <u>Dean Martin Trust</u>. The gift to the trustee of the Dean Martin Trust (the "Dean Martin Trust") shall constitute the initial trust estate of a trust for the benefit of Dean, subject to the following conditions.
>
> <u>Distributions for Dean</u>. *No distributions shall be made to Dean 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, 1655 N. Tegner Street, Wickenburg, Arizona, or its successor institution or organization; provided however, if either Survivors' Week or the Meadows is not then in existence, the trustee, in the trustee's discretion, may require Dean to attend a similar program from a similar 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, family of origin issues, and abuse recovery. The Survivors' Week and psychotherapy requirements shall be collectively referred to herein as the "Treatment."*
>
> The trustee shall pay for the Treatment by making payments directly to the psychotherapist or the Meadows (or its successor institution or organization or such similar institution, as the case may be, if a successor or similar institution is providing the Treatment). No distributions shall be made directly to Dean during the term of this trust.
>
> <u>Termination</u>. The trust shall terminate upon the first to occur of (i) Dean's completion of 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's completing the Treatment, the trust estate shall be distributed to Dean, subject to the Contingent Trust provisions*. Upon termination as a result of Dean's failure to complete the Treatment within six (6) years of my date of death, or as a result of Dean's death prior to the date which is six (6) years after my date of death, the trust estate shall be distributed:
>
> If any of my grandchildren or the descendants of any of my grandchildren are then living, to the trustee of the Descendants Trusts created herein.
>
> If none of my grandchildren or the descendants of any of my grandchildren are then living, to the University of Nevada at Las Vegas.
>
> <u>Statement of Trust Purposes</u>. *My primary concern in establishing this trust is for the benefit of Dean if Dean agrees to follow the Treatment described above. The trust shall be managed accordingly.*

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

> In making any discretionary distributions to a descendant of mine from any trust under this Article, the trustee of such trust *shall have discretion to consider all relevant facts and circumstances*, including the nature and size of the trust estate, tax aspects, *the maturity of such descendant, and the particular situation of such descendant in his or her personal life*. In exercising this discretion, *the trustee shall consider my desire that such descendant seek to develop his or her talents and abilities through personal effort and become financially responsible and a credit to our family and the community*. The *trust estate shall be used only to help support a constructive life of good character and*

> *responsibility* on the part of each beneficiary of such trust. *My trustee shall make distributions in such a manner as to encourage each to reach his or her potential and to lead a productive and self-sufficient life*.

Here is another example of what many practitioners may refer to as an "incentive clause". This one was taken from a document drafted in the 50s.

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

XVI. WHO TO PAY

It is axiomatic that trustees must make distributions to or for the benefit of the beneficiary. *See* Pacheco, *supra.* Usually, the trustee's duty of determining the identity of the beneficiaries is relatively easy. In interpreting a testamentary instrument, a question may arise as to whether the term "issue" refers to all descendants of the settlor/testator or just children. *Guilliams v. Koonsman*, 279 S.W.2d 579, 583 (Tex. 1955). Drafters use a variety of terms, even though many state statutes do not adequately define some of them.[8] Some courts have construed the terms "issue" and "children" interchangeably. *Guilliams*, 279 S.W.2d at 583. Generally, Texas case law holds that the word "issue" includes all descendants, unless there is something specific in the instrument to suggest a narrower interpretation. *Atkinson v. Kettler*, 372 S.W.2d 704, 711–12 (Tex. Civ.

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8. *See* TEX. PROP. CODE ANN. § 111.004 (West 2007). No definition of issue but includes the following: (13) "Relative" means a spouse or, whether by blood or adoption, an ancestor, descendant, brother, sister, or spouse of any of them.

   Many states define these terms more specifically; for example, the Pennsylvania statute defining the terms "heirs" and "next of kin" specifies the following:

   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). In Michigan the statute provides 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, 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). 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).

App.—Dallas 1963, writ granted), *rev'd on other grounds*, 383 S.W.2d 557 (Tex. 1964).

An example of a clause making it very clear who the Grantor intended in using the term "descendants" follows:

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

In our current advanced technological society, some definitions have become much more specific than they had to be in past generations. An example of that is found in this definition of the word "child":

> (a) "**Child**," "**children**," "**issue**," and any similar term or terms as used in this trust agreement, shall include all the Donors' children and their issue (including children and issue born after the date hereof), provided always that *such terms as so defined shall include only a child or children or issue who are 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 Donor or have been legitimated thereafter by the marriage of the parents), and any adopted child or children adopted prior to the age of twenty-one (21) but not thereafter, which adopted child or children 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 Donor's issue (or the spouse of any of the Donor's issue) as a result of artificial insemination, <u>in</u> <u>vitro</u> fertilization, or other medical technique shall be equivalent in all respects to a birth in lawful wedlock.* Whenever the term "**living child**" or *"**living child or living issue**"* or any similar term or terms are used in this trust agreement, such term or terms *shall include a child or issue of Donor which is conceived and then survives for ninety (90) days after being born*.

Once the trustee determines the identity of the appropriate beneficiary, if the circumstances require, the trustee may make payments for the benefit of, rather than directly to, the beneficiary. *See* RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. e(3) (2003). Many trusts contain a facility of payment clause, and the Texas statute specifically allows payments for the benefit of the beneficiary, instead of directly to the beneficiary. TEX. PROP. CODE ANN. § 113.021(a) (West 2007). The statutes for court trusts provide a very effective example:

> 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*."
>
> *See* TEX. ESTATES CODE ANN. § 1301.102(a)(2) (West 2014).
>
> A management trust created for a ward or incapacitated person may provide that the trustee 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).

The language of the statute clearly allows 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.

The prudent trustee may prefer to make distributions directly to providers to avoid casting a guardian or a caregiver in the role of a financial fiduciary. TEX. PROP. CODE ANN. § 113.021(a)(5) (West 2007).

XVII. WHEN TO PAY?

The trustee should pay the beneficiary promptly because a trustee may not unreasonably delay the exercise of discretion. *Boyd v. Frost Nat'l Bank*, 196 S.W.2d 497, 505 (Tex. 1946). Since the distribution standard in a personal trust often includes a requirement of necessity, delay is particularly difficult to justify. After all, if the trustee has made a determination that need exists to support the distribution in the first place it is a reasonable assumption that the beneficiary "needs" the money now. Trusts often mandate that income distributions be made monthly, quarterly, or annually. If it matters to the settlor, it should be made clear in the document.

Other considerations affect the timing of distributions. It is important for the trustee to remember that they can usually reinvest income that they do not distribute. But the trustee should not commingle principal and income investments in some circumstances. Many settlors intend by the establishment of the trust to preserve the assets as the separate property of their child. Consider this interesting example from the will of Samuel L. Clemens (Mark Twain):

> To invest and reinvest, one of such two (2) equal parts 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 without power of anticipation, and *free from any control or interference on the part of any husband she may have.*

Even trusts that incorporate the needs of a spouse generally restrict distributions to cases where the spouse remains the spouse:

> The provisions of each spousal family trust in the name of an un-remarried qualified surviving spouse of a deceased descendant of John Smith shall be identical to those of the of the original beneficiary except that *the surviving spouse shall receive one-half of the income of that trust, at least annually, until the spouse's death or remarriage.*

Or another example:

> *If the Grantor's spouse survives the Grantor, and if the Grantor and the Grantor's spouse are married and living together as husband and wife at the time of the Grantor's death, the net income deriving from this Trust shall be distributed to or for the benefit of the surviving spouse in accordance with the provisions of ARTICLE X hereof.*

Favorably, in most cases where the distribution of income is solely within the discretion of the trustee, the courts have held that the beneficiary does not acquire the property, and the trust is not subject to division on divorce. Additionally, courts have held that a spouse cannot acquire undistributed income earned by a decedent's estate of which the spouse is a beneficiary. *In re Marriage of Burns*, 573 S.W.2d 555, 557–58 (Tex. Civ. App.—Texarkana 1978, writ dism'd). The court reasoned that there was no constructive receipt of the income because the beneficiary had no present or past right to require its distribution. The trustee may elect to distribute undistributed income periodically to avoid commingling. Generally, in Texas, if the beneficiary receives discretionary income distributions from the trust during the marriage, those funds become community property. *Ridgell v. Ridgell*, 960 S.W.2d 144, 148 (Tex. App.—Corpus Christi 1997, no pet.).

The issue is somewhat easier in the case of a grantor, or self-settled, trust; in a self-settled trust, undistributed income established prior to the marriage remain 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 comprised of separate property, and so long as the income remains undistributed throughout the marriage, with no right to compel distribution, the spouse could not have acquired the income during marriage, and therefore, it remains separate trust 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 the protection of separate property and is another example of why the precise wording of the distribution standard is important.

XVIII. TERMINATING DISTRIBUTIONS

Disputes often arise between the beneficiaries and the trustee upon termination of the trust. TEX. PROP. CODE ANN. § 112.052. Terminating events may include a specified birthday; the death of a beneficiary or an individual who was a measuring life; the depletion of the trust assets to an uneconomic size; or the completion of the purpose of the trust, such as the graduation from college of the beneficiary of an education trust. *See id.* and §§ 112.059 Termination of Uneconomic Trust, and §112.054 Judicial Modification or Termination of Trusts.

An example of a typical age related distribution would be as follows:

> *The trust shall terminate upon the later to occur of (1) the death of Jane Doe and (2) neither Jack Doe or Susan Doe being younger than fifty (50) years of age.*

A graduated distribution based on age might read as follows:

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

Almost all family or "pot" trusts provide for termination to all remaining descendants per stirpes. But an unusual termination provision found in a trust from the middle of the last century contained the following provision:

> On the death of the last survivor of issue of JOHN SMITH and MARY SMITH 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 JOHN SMITH and MARY SMITH in equal parts,* ***per capita****, whether or not they then be immediate income beneficiaries of the trusts*. If there be no living issue of JOHN SMITH and MARY SMITH, the remaining trust funds shall be delivered and paid to the SMITH Foundation.

This provision has the consequence (likely intended) of providing more than the usual incentive for subsequent generations to keep all of the subsequent generations' trusts together under the management of a single trustee. An additional consequence (possibly unintended) was an incentive to produce a greater number of offspring.

XIX. A MECHANISM FOR GUIDANCE OUTSIDE THE TERMS OF THE TRUST

The trend in drafting today seems to be to move toward granting broad discretion and maximum flexibility. There are good reasons to do so. The trust drafted today, even in a jurisdiction with a traditional rule again perpetuities may last 120 years during which time the circumstances of the beneficiaries, the laws of the jurisdiction and the economics of the market place will likely change dramatically. Many settlors are anxious to create a tax efficient and flexible trust but would also like a mechanism to share their values and express their intent in a separate document. There is an increasing trend for drafters to include as part of a complete and thorough estate plan, a family value statement, wealth transfer policy statement or "letter of wishes" to provide insight into the intent of the grantor without inserting such language into the mandatory and eventually irrevocable provisions of a trust or will. The practice is hotly debated among drafting attorneys and professional trustees with proponents and detractors to be found among each.

To be clear, such a document will not generally be enforceable or even required to be considered except in a situation where a trust document was vague or unclear to such an extent as to require the admission of extrinsic evidence for interpretation by a court. In many cases, a trust may have many trustees. The initial trustee will likely receive a copy of such a document but after several different individual trustees, it may be lost, destroyed or simply overlooked in the increasingly old and voluminous records of a trust. Even a professional trustee may not have a policy for preservation of a document that is not a part of the original trust but merely correspondence directed to the trustee at the inception of the trust.

Such documents may be lengthy and contractual in language or short and chatty; they may be formal or casual. They may take the form of a letter, a memo, or simply a list of things the settlor wants the trustee to know. Whatever the form or format, they are often requested by clients today. Attached as an addendum to this paper is a presentation addressing such "letters of wishes" prepared by counsel at J.P. Morgan Chase for use to open a dialogue with clients and their counsel. Also attached is a recent newspaper article describing a VERY specific set of instructions to beneficiaries requiring them to meet certain conditions in order to claim their inheritance of $20 million.

XX. CONCLUSION

The distribution provisions associated with personal trusts are more art than science—experience and judgment matter—and often, as the adage goes, the most valuable experiences arise out of an exercise of bad judgment. In some cases, a mistake can result in a very painful lesson for a trustee. To draft a good trust requires the same skills required to be a good trustee: education, skill, attention to detail, the ability to plan carefully and execute meticulously, patience, judgment, and a little luck.

Perspective

Intelligence for professional advisors

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A better understanding of settlors' intentions

Letters of wishes may help trustees align decisions with a settlor's values and concerns. Insights from J.P. Morgan Private Bank.

Settlors of long-term trusts often grant the trustees broad discretion over distributions, relying on the trustees' judgment to make decisions based on facts and circumstances that evolve over time. Many settlors may be concerned that trustees might not fully share or understand their values or particular outlook on financial and familial issues. Given these concerns, settlors are increasingly expressing their wishes in separate, non-binding written documents that are referred to as "letters of wishes," "statements of intent" or "family values statements."

In this piece, we discuss perspectives of trust creators, trustees and practitioners in the creation and use of letters of wishes.

Driving the trend

The increasing use of letters of wishes may be attributable to a number of factors:

- **The rush in 2011 and 2012 to create new trusts to take advantage of a high gift tax exemption amount that was scheduled to expire on December 31, 2012.**[1] Many settlors want to ensure that the trustees understand their intentions in a manner that may not be fully conveyed in the trust instrument itself.

- **A proliferation of multigenerational or perpetual trusts.** While settlors often designate close friends or relatives as the initial trustees, successor trustees may not have known the settlors well, if at all. This lack of familiarity with the settlor and circumstances in which the trust was established will only increase over time.

- **A cultural shift, as more "baby boomers" fund trusts and opt for higher levels of expertise to assist future generations.** At J.P. Morgan, we are finding some of our most sophisticated clients are creating letters of wishes because, as one trust officer explained, "they want the benefit of an independent fiduciary along with the personal touch of explaining their values to us."

- **Increased globalization.** The growth of multinational families and advisors fluent in cross-border issues is also a factor. For years, separate letters of wishes have been routinely included with non-U.S. trusts. In England and the Commonwealth jurisdictions, letters of wishes are widely used as a supplement to both wills and lifetime trusts because, as one British solicitor specializing in trusts and

[1] The number of new trusts and accompanying letters of wishes may remain elevated, as the American Taxpayer Relief Act signed into law on January 2, 2013, kept the exemption high, at $5.25 million, and made the gift tax rate relatively low, at 40%.

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estates said, "practitioners are often hesitant about unduly fettering a trustee's discretion in the trust document." Indeed, J.P. Morgan wealth advisors and trust officers report that letters of wishes accompany almost every trust drafted in some Asian countries today. In contrast, Latin America tends to fall somewhere in the middle of the continuum, as letters of wishes there usually only accompany multigenerational trusts.

Settlors' perspective

For settlors, the attraction of letters of wishes is clear.

While settlors often give trustees broad discretion over distribution decisions, some worry tax-driven standards commonly used in the United States (e.g., directing trustees to provide for the "health, support, maintenance and education" of beneficiaries) fail to convey the settlors' unique values and concerns. After all, one settlor's idea of "education" may be a Ph.D. in Economics, while another's may be yoga classes taken purely for health or self-discovery. Even a close friend serving as trustee might not grasp the nuances of what a parent/settlor means when he or she asks that trust funds enable the children to continue living in "the style to which they have grown accustomed." Does that mean a new luxury car every two years or a pre-owned one every 10?

Letters of wishes can provide insight without becoming part of mandatory trust language. Some letters of wishes run to 20 pages and sound like contracts; others read more like intimate family messages. They can be written when the trust is created or, as often happens, long after. Some last decades; others are repeatedly amended or supplanted. Some settlors have their lawyers do the drafting; others write the letters themselves. Prudent trust creators ask their legal advisors to review letters of wishes they author to ensure that the wording cannot be construed to suggest that it contradicts the trust agreement, let alone overrides it.

HELPING CLIENTS THINK THROUGH THE ISSUES

Wealth advisors at J.P. Morgan have developed an approach to help settlors refine their thinking about their intent regarding distributions, whether expressed in the trust document or in a letter of wishes.

Personal values

A series of short, hypothetical situations are presented to settlors, who are asked to choose among potential responses. This approach helps settlors define their values regarding productivity, family unity, education, entrepreneurship, luxury, philanthropy and other issues associated with wealth. (For examples of these questions, see "What should your trustee do?" pages 3, 4, 6 and 8.)

Distribution and spending rates

If a settlor wants to provide guidance to trustees regarding distribution and spending rates, J.P. Morgan offers "Spending: Even a great fortune can be eroded over time. Enjoy wealth without depleting it," part of the *Challenges of Wealth* series. Based on J.P. Morgan research, this paper provides direction on sustainable distribution levels, helping settlors understand the rates needed to preserve wealth on an inflation-adjusted basis, which is often a goal for multigenerational trusts. We believe that establishing annual distributions of 2.5% to 3.0% of trust assets will contribute greatly to preserving real wealth. This type of analysis also can aid the settlor in articulating spending protocols in a letter of wishes or in the trust document itself.

Trust officers' perspective

Many of our trust officers welcome well-crafted letters of wishes or other expressions of settlors' intent, but do not feel these letters should be considered essential to effective trust administration.

One trust officer said, "I like it when a settlor provides a letter of wishes, because the more information a trustee has to carry out the settlor's wishes, the better—so long as the letter doesn't intentionally or inadvertently hem the trustee in. The worst thing grantors can do for their heirs is stand in the way of flexibility. Life and the things that happen are simply unpredictable."

Another said: "A letter of wishes that tells the trustee—'here's what I was thinking,' rather than, 'here's how I want you to do your job'—is much more helpful, because it is impossible to anticipate all of the issues that might arise in the years and decades of a trust's existence, let alone how a trustee should respond to them."

Whether or not a letter is well crafted, some trust officers say they encourage a grantor to write a letter only if he or she has strong feelings about a particular issue, such as supporting descendants' ability to engage in charitable work, or helping family members see themselves as stewards of a fortune. (See "Creating a family tradition," page 5.)

"Not everyone needs a letter of wishes," said one trust officer, "because a good trustee and a good trust document are usually sufficient. A letter might serve as a helpful complement to a trust, but I certainly have never felt stymied for lack of one. While individuals are unique, human behavior and fiduciary duties have patterns, so experienced professionals are able to respond appropriately."

Practitioners' perspective

Legal advisors differ on the utility of letters of wishes. Some suggest that guidance is better placed in the trust agreement itself; others express concerns over how the letters may be interpreted by beneficiaries or tax authorities.

We have identified seven potential issues related to letters of wishes:

1 Retained control

Because a letter of wishes may be changed, some practitioners are concerned that it may appear the settlor is exercising impermissible control over the administration of trust assets.

For example: A mother created a trust for the benefit of her son, and throughout the trust agreement authorized the trustee to be extremely generous, to keep the son in a very comfortable lifestyle and to favor him over the remaindermen. Later, mother and son had a falling out. The mother grew critical of the son's life choices, friends and views. She provided the trustees with a letter of wishes expressing her wish that distributions be scaled back to a minimum.

The trustee demurred, pointing out that the level of distributions was reasonable, maintainable and within the trust's guidelines. Had the trust officer followed the mother's new instructions, his actions might be construed as an implied agreement between the settlor and trustee to follow the settlor's wishes regarding trust distributions, raising concerns about inclusion of trust assets in the settlor's gross estate under Internal Revenue Code Sections 2036 and 2038.

Neither the Internal Revenue Service nor the U.S. courts have declared a letter of wishes by itself to constitute an impermissible retention of control over an irrevocable trust, but, in several cases, the Service has argued that side

Example 1: Productivity and education

WHAT SHOULD YOUR TRUSTEE DO?

A daughter, a hardworking recent graduate of the Wharton School of the University of Pennsylvania, has put together a solid business plan to buy two tattoo parlors in Daytona Beach, Florida. She would like $500,000 in seed capital. (The trust has $5 million in assets, all liquid.)

What should your trustee do?

1. Pay $500,000 to cover the seed capital.
2. Pay the seed capital only after an outside consultant has determined that the business plan is sound.
3. Decline the funding, because the type of business is inappropriate.
4. Other, please explain:..........

Example 2: Family unity and continuity

WHAT SHOULD YOUR TRUSTEE DO?

A 25-year-old son living in Los Angeles wants a destination wedding in Hawaii for 100 people at an estimated cost of $750,000 and has asked the trustee to make a distribution for the full amount. (The trust has $10 million in assets, all liquid.)

What should your trustee do?

1. Pay 100%.
2. Pay 50%.
3. Ask the son to revise plans, as this wedding is too lavish.
4. Other, please explain:..

arrangements between a settlor and trustee constitute evidence of a settlor's retention of indirect control over trust assets, causing estate tax inclusion. But these cases were decided on the transferor's "being so able to dominate the nominal holder of the power as to make such party's individual judgment meaningless" (*Klauber v. Comm'r*) and a "side agreement" with the trustee (*Whitt v. Comm'r, Skinner v. U.S.*).[2]

The courts are generally reluctant to attribute the powers of a trustee to the trust's settlor, citing the trustee's overriding fiduciary duties to trust beneficiaries.[3] However, it is important that a settlor reiterate in any letter that the views expressed are not binding on the trustee, that the trustee retains all discretionary powers granted in the trust instrument, and that the letter is intended merely as an expression of the settlor's desires to assist the trustee if they prove helpful in the exercise of the trustee's discretion.

2 Inconsistencies

Another concern is that a letter of wishes may suggest actions inconsistent with a trust's governing provisions. For example, an issue may arise if the settlor recommends in a letter of wishes that the trustee pay for a teenage beneficiary's tuition to attend a private high school when the trust instrument restricts distributions for a beneficiary's education to college and post-graduate expenses.

A settlor's advisors can help by carefully setting expectations about what these letters can, and cannot, do. For example, letters can state that the settlor "suggests" the trustees should feel free to distribute all the funds in a trust if they feel that doing so would be in the long-term best interests of the beneficiaries. However, letters of wishes cannot suddenly change the trust provisions governing the ages at which distributions should begin or end.

When there is a conflict between a trust document and its accompanying letter of wishes, the trust document should always control. Still, to avoid the potential for such conflicts, lawyers either should write the letter of wishes with the settlor or carefully review letters settlors have drafted on their own.

3 Disclosure to beneficiaries

Hurt feelings and friction may result from beneficiaries seeing letters of wishes. Consider how a beneficiary might feel discovering through a letter of wishes that his parents were disappointed in his lifestyle and thought him incapable of handling his finances. While such an insight might be helpful to a trustee, settlors should be encouraged to consider the potential damage to the beneficiary's well-being and family relationships.

[2] *Klauber v. Comm'r,* 34 T.C. 968 (1960), nonacq. On other issues, 164-2 C.B. 8; TAM 9043074. See also *Whitt v. Comm'r* 751 F.2d 1548 (11th Cir. 1985); *Skinner v. U.S.,* 316 F.2d 517 (34d Cir. 1963).

[3] Compare *Klauber v. Comm'r* and TAM 9043074 with *Comm'r v. Douglass Estate,* 143 F.2d 961 (3rd Cir. 1944). In Estate of *Goodwyn v. Comm'r,* 32 T.C.M. 740 (1973), see *McCabe v. U.S.,* 475 F.2d 1142 (Ct. Cl. 1973).

If a beneficiary were to ask for a copy of a letter of wishes provided by the settlor, a trustee may be hard-pressed to deny the request. Trustees are generally required to provide beneficiaries, on request, with any information relevant to the beneficiaries' interest in the trust and to allow beneficiaries to inspect the trust's books and records.[4] It is unclear whether a letter of wishes, which could shed light on the grantor's intent, would be included in this list of trust documents. We have found no reported U.S. cases specifically addressing this question.[5] Presumably, though, a letter of wishes would be discoverable in litigation if it were relevant to the subject matter of the action.

A few courts outside of the United States have addressed the discoverability of letters written to a trustee. In these offshore jurisdictions, a beneficiary generally is not entitled to demand a copy of the letter of wishes, as it is thought to be related to the reasons for a trustee's use of discretionary powers and intended to be confidential. An exception is made in the United States, however, if a trustee's bad faith is suspected.[6]

Advisors should help settlors understand that there is a risk that beneficiaries may one day see the letter. It is therefore wise for settlors to write these statements with an eye toward how their beneficiaries might perceive their words. Some of the letters we see are clearly intended to serve as messages of family values, and are to be shared not only with the trustees, but also with the current beneficiaries and future generations.

4 Misuse by beneficiaries

Some practitioners are concerned that beneficiaries who have seen a letter of wishes may try to use it to claim broader distributions than those provided for in the trust document. For example, a letter may intend to provide insight into the settlor's thoughts about distributions for support by providing examples such as "going on vacation or making charitable gifts." A beneficiary then might point to these examples and request funds for luxurious vacations or extravagant charitable gifts that are far beyond the family's accustomed standard of living.

CREATING A FAMILY TRADITION

A matriarch uses a letter to convey a philosophy of "take only what you need and pass the rest on"

At a family meeting, one of our trust officers was asked to explain both the mechanics of a family's dynasty trust and the philosophy of the letter of wishes accompanying it.

The letter, written 50 years ago by the family's matriarch, conveys what our trust officer describes as an "elegant message." It asks current beneficiaries to view themselves as stewards of the trust: privileged to draw on the funds for basic building blocks, but responsible for safeguarding and conserving the assets for the next generation.

The letter asks current beneficiaries to use trust distributions only to finance their education, first homes and first businesses. After that, it asks them to use their own funds, although neither the trust nor the letter of wishes prohibits the trustee from going beyond the basics, if need be.

"The letter established a tone, setting expectations—and everybody rose to the occasion," reports the trust officer. "The family took this philosophy extremely seriously. The letter helped create a strong family tradition."

[4] Restatement (Second) of Trusts, Section 173 (1959).

[5] For a discussion of this point and an excellent article on letters of wishes, see Alexander Bove, Jr., "The Letter of Wishes: Can we influence discretion in discretionary trusts?," *ACTEC Journal,* Summer 2009.

[6] See, for example, England Chancery Division, *Breakspear v. Ackland,* EWHC 220, [2008] 3 WLR 698 (Ch) (the court ruled that the letter of wishes was not discoverable without showing very special circumstances that should justify overriding confidentiality, such as evidence of bad faith on the part of the trustee). Compare with New Zealand High Court case, *Foreman v. Kingstone,* [2004] 1 NZLR 841 (HC) (the court held that a memoranda of wishes was discoverable absent special circumstances.)

As the statement of intent is not part of the trust, the trustee could deny the request. Still, the settlor may want to consider the practical implications that any suggestions made in a letter of wishes might have on the beneficiaries' relationship with the trustee.

5 Trustee's ability to carry out wishes

Letters of wishes sometimes direct trustees to determine what is happening in beneficiaries' lives before making distributions. For example, a trustee may be asked to consider withholding a distribution if a beneficiary has a substance or gambling abuse problem. The difficulty is that trustees often do not have enough daily contact with a beneficiary to properly make such determinations.

Letters of intent should be carefully drafted to identify "considerations" as opposed to outright requirements. Settlors also may consider the value of appointing a co-trustee or trust "advisor" in the trust instrument who is familiar enough with the beneficiary's life and has access to information that could help the trustee make such determinations.

Example 3: Maintenance and support

WHAT SHOULD YOUR TRUSTEE DO?

A son just graduated from University of the Arts London and has secured a marketing job in New York City. He would like to rent an apartment in a safe neighborhood with two friends from his university. The friends, together, will be able to afford only a quarter of the monthly rent. The son has asked for a monthly distribution of $4,000 to cover both his portion of the rent and to subsidize his roommates. (The trust has $5 million in assets, all liquid.)

What should your trustee do?

1. Pay 100% of the rent every month because the son will be in a new city with people he knows and trusts.
2. Pay only the son's share of the rent.
3. Ask the son to find a less expensive apartment.
4. Other, please explain:..

Example 4: Maintenance and support

WHAT SHOULD YOUR TRUSTEE DO?

A 35-year-old son and daughter-in-law want to home school their three young children while sailing around the world for the year as a 360-degree learning experience. They would like to make the trip in a 75-foot sailboat with a three-person crew to cook, clean and teach the family how to operate the vessel. The son has asked that the trust fund the trip, which he estimates will cost $1 million. (The trust has $20 million in assets, all liquid.)

What should your trustee do?

1. Finance 100%.
2. Offer to pay the amount of the son's and daughter-in-law's combined replacement salaries.
3. Tell them the plan is too lavish and ask them for another plan that is more sensible.
4. Other, please explain:..

6 Impact on the trustee's duty of impartiality

Some attorneys are concerned that, with multiple beneficiaries, a letter of wishes may provide information that causes a trustee to treat beneficiaries differently. But, unless the trust itself requires uniformity in distributions, the trustee's duty of impartiality requires that beneficiaries be treated equitably, not necessarily the same.

While the information provided in a letter of wishes can be useful to trustees charged with exercising discretion over distributions, it should not direct the trustee to treat the beneficiaries unequally. Any differences in treatment should be stated in the trust document itself.

7 Multiple amendments

There is debate as to whether a statement of intent should be part of the trust document or kept separate as a side letter to the trustees. Proponents of including a statement of intent in the trust document believe that doing so would help ensure that the intentions are articulated by an attorney at the time the trust is drafted, and remain fixed. Advocates of the "side letter" option say a separate document is easier to amend and, therefore, can be adjusted as circumstances change over time.

If settlors do choose a separate letter of wishes, we find that the simpler its language, the less likely the settlors will be to make multiple amendments. J.P. Morgan wealth advisors in Asia report that clients typically review and update their letters every two to three years. In the United States, our trust officers find clients tend to update letters of wishes more as they age and they revisit their estate planning documents. As one trust officer put it: "People consider it an active part of their plan: Do they have a health proxy? Are their letters of wishes up to date?"

LETTERS WE HAVE SEEN

Excerpts of settlors' letters of wishes

When writing letters of wishes, settlors and their advisors often consider potential provisions that address five areas of common concern:

- Productivity and education
- Family unity and continuity
- Maintenance and support
- Family legacy
- Preservation of principal and loans

Productivity and education

I have given my trustees broad discretion. However, I want them to keep in mind my wish that my wealth not undermine my heirs' incentive to lead productive lives.

I encourage my trustees to make liberal distributions so that my beneficiaries may pursue education, purchase homes for use as primary personal residences, pursue careers and/or start businesses that the trustees deem to be reasonable endeavors.

Recognizing that my several beneficiaries may choose careers generating different levels of income, I encourage the trustees to consider making different levels of distributions among the beneficiaries so as to provide each the financial wherewithal to pursue legitimate careers, even if they may be less remunerative.

Family unity and continuity

Trustees should support vacations that enable the entire family to get together so they can stay connected, especially as the family becomes extended.

Maintenance and support

Appropriate distributions for housing may depend on the circumstances. This includes, for example, that a roommate can be supportive and (in the absence of compelling evidence to the contrary) the trustee should defer to the judgment of the beneficiary as to the appropriateness of a particular roommate and whether rent assistance should be expected of this roommate.

Family legacy

When appropriate, I would like the trustee to fund my heirs' efforts to build a family legacy through social networking and naming opportunities, including club memberships that enable and enhance the growth of important relationships, and donations that help build public facilities, such as schools.

Preservation of principal and loans

In determining whether to consent to a loan to one of my children, I would like the trustee to take into account that I want to encourage my children to take calculated risks when striving for profits and gains. The trustee therefore should consider itself as having the power to approve loans for high-risk or speculative projects. That is to say, the trustee should be more flexible than a commercial bank in consenting to loans.

As far as discretionary payments of principal are concerned, my wish is that the trustee's discretion be exercised liberally, as it is my clear intention that my children and grandchildren use and enjoy the trust assets. I also want the trustee to give preference in these distributions to my current beneficiaries, rather than preserve as much as possible for remaindermen. I have contemplated that this language might leave nothing for the remaindermen, and I am comfortable with that.

Note regarding sample provisions: These sample provisions above are for illustrative purposes only. J.P. Morgan and its affiliates, subsidiaries and/or employees thereof ("J.P. Morgan") do not practice law, and do not give legal, tax or estate planning advice. These provisions are not intended and should not be construed as a substitute for a drafting attorney's informed professional judgment.

Example 5: Maintenance and support

WHAT SHOULD YOUR TRUSTEE DO?

A 40-year-old daughter's lifelong friend does not have health insurance and needs a kidney transplant to avoid dialysis treatment several times a week. The daughter begs the trustee to give her the money to cover the expense. (The trust has $50 million in assets, all liquid.)

What should your trustee do?

1. Cover the expense 100% to encourage the daughter's altruism.
2. Lend the daughter the money to pay for her friend's medical procedure, setting up a schedule of repayment.
3. Simply tell the daughter that the expense is beyond the scope of the trust.
4. Other, please explain:..

Bottom line and practical considerations

Letters of wishes, common elsewhere around the world, are becoming more mainstream in the United States. To avoid future difficulties, settlors' attorneys should consider drafting or at least reviewing these letters to keep them consistent with legal standards and existing trust provisions. Because the ultimate practical application of the letter of wishes is critical, attorneys may want to consider consulting with the designated trustee early in the drafting process. Whether or not J.P. Morgan is to act as trustee, our wealth advisors and trust officers are available to provide input based on years of experience as a fiduciary. ❖

DRAFTING CONSIDERATIONS

Given the concerns and realities involved in letters of wishes, consider these best practices when drafting them:

1. Most important, the letter should clearly state that its guidelines are "precatory," "nonbinding," "intended for guidance only," or "suggestive only." Clearly reaffirm (if accurate) that "the trustee has absolute discretion."
2. Keep the letter's instructions simple and as unambiguous as possible. For example: "The trustee is free to distribute all the funds in the trust to our children without regard to the needs of their descendants."
3. If the terms in the document have subjective determination, consider whether they should be clearly defined. For example, terms such as "qualified university" or "reputable profession" leave considerable room for judgment.
4. State whether the letter should be kept confidential. Some letters are clearly written to serve as family values statements to be read to children and grandchildren.
5. Even if the letter is intended to be confidential, avoid the use of derogatory statements or comments, in case the letter is subsequently discovered by the beneficiaries.
6. Avoid creating tax or legal issues by seeking approval from the settlor on matters such as distributions or requesting the trustee behave in such a way that may be void for public policy considerations.
7. If considerations are listed to help a trustee determine if a distribution is warranted (such as whether a beneficiary has a substance abuse problem), evaluate whether the trustee will have access to the necessary information to determine if the considerations are fulfilled or if another person, such as a co-trustee or trust protector, is better suited for making that determination.
8. If the attorney is not drafting the letter, recommend that he or she review it and be consulted if the settlor makes any changes.
9. Discuss the letters of wishes with the trustee before finalizing them, if feasible. Trustees may provide a unique perspective.
10. Keep the original letter with trust records, and ensure strong recordkeeping procedures are in place when substituting with a new letter.

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THIS PAPER IS WRITTEN BY
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The Advice Lab is a team of wealth advisors who develop innovative strategies in wealth transfer, philanthropy, cross-border planning, analytics and ownership structures to maximize our global clients' wealth after taxes and across generations.

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NEW YORK POST

Daughters Inherit $20M, but there's a catch


Victoria (left) and Marlena Laboz (middle) inherited $20 million — but the money comes with conditions.

By Ross Toback and Julia Marsh **July 27, 2015**

A wealthy Manhattan landlord left $20 million to his two daughters — but they can collect only on his strict terms. Daddy Dearest real estate millionaire Maurice Laboz, who died earlier this year, doled out early-bird bonuses to his girls in his will as long as they marry right, get good jobs and don't even think about having kids out of wedlock.

The Laboz girls — Marlena, 21, and Victoria, 17 — are set to inherit $10 million apiece when they turn 35. But they can get their hands on some of the dough beforehand if they follow Daddy's rules for the straight and narrow. For example:

- Marlena will get $500,000 for tying the knot, but only if her husband signs a sworn statement promising to keep his hands off the cash.
- She nets another $750,000 if she graduates "from an accredited university" and writes "100 words or less describing what she intends to do with the funds" — with the trustees appointed by her dad to oversee her money responsible for approving her essay.
- Both daughters get a big incentive to earn decent salaries by 2020. Each young woman is guaranteed to receive an annual payout of three times the income listed on their personal federal tax return. In a not-so-subtle nod to the taxman, their checks will be cut every April 15.
- If the daughters have kids and don't work outside the house, the trustees will give them each 3 percent of the value of their trust every Jan. 1. There's one catch: The money flows only for a "child born in wedlock."
- The sisters could earn the same amount being "a caregiver" to their mother, Ewa Laboz, 58, whom their father was in the middle of divorcing. She got nothing in the will and has indicated that she will contest it.

"It's a way to control things from the grave,'' said estate lawyer Jeffrey Barr, who is not involved in the case. "You don't see a lot of it, but it happens. People do it because . . . they think it's for the good of the children.'' Estate lawyer Oshrie Zak said the move is not surprising in this case. "Accustomed to the control over others that their money affords them in life, the will is their last shot at controlling their loved ones,'' he said of Laboz and other successful people.

Maurice Laboz signed the will in April 2014, about nine months before he died at age 77. He left behind a $37 million fortune. He justified leaving his wife out of his will by citing a "prenuptial agreement, which limits her rights," according to the document. Ewa Laboz filed court papers last month contesting that, arguing she deserves a share of the pot because she was still married to her husband when he died.

The rest of Laboz's fortune is set to go to charities, including The Michael J. Fox Foundation for Parkinson's Research and Meals on Wheels.