Keep the Change, Ya Filthy Animal!

Considerations for Review of Discretionary Distribution Language

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"Think positive, Frank!" – Peter McCallister (John Heard)

"You be positive. I'll be realistic!" – Frank McCallister (Gerry Bamman)

There will always be a difference in what is drafted in trusts (see "positive" above) and how trusts are actually administered (see "realistic" above). Oftentimes, a trustee never spends much time with the settlor of a testamentary trust, so they must rely heavily on the drafter to properly reflect the settlor's wishes and intent. As such, trustees must rely on the trust document, state and federal statutes, case law and industry standards that are sometimes at odds with each other when determining the appropriateness of discretionary distributions from a trust. Drafters must rely on these same principles coupled with settlor intent when writing the trust instrument. Uninformed decisions by either the trustee or the drafter can quickly subject them to enhanced scrutiny and potential litigation. This article reviews Colorado law and the Restatement (Third) of Trusts to provide practice tips for both the drafter and the fiduciary. This article is an abbreviated supplement to the authors' presentation at the 2017 CBA Estate Planning Retreat - *"Don't Leave Your Clients In Dire Straits With Outdated Discretionary Distribution Language"* - which used a 1980s theme to convey more robust material. Given the timing of this article (December 2018), the authors instead chose to use references from the family favorite comedy movie "*Home Alone*" (1990).

SUPPORT AND MAINTENANCE

"I took a shower washing every body part with actual soap, including all my major crevices; including in between my toes and in my belly button, which I never did before but sort of enjoyed. I washed my hair with adult formula shampoo and used cream rinse for that just-washed shine. I can't seem to find my tooth brush, so I'll pick one up when I go out today. Other than that, I'm in good shape." - Kevin McCallister (Macaulay Culkin)

Generally, the terms "support" and "maintenance" are treated as synonymous and are interpreted to mean "distributions necessary to maintain the beneficiary in the beneficiary's

accustomed manner of living." *See Treas. Reg.* §20.2041-1(c)(3). The Restatement Third of Trusts ("Restatement Third") expands on this principle to include support of the beneficiary's children, payment of household expenses and providing for the costs of a suitable education for the beneficiary's children. *Restatement (Third) of Trusts,* §50 (Am. Law. Inst. 2003). It also allows for other appropriate expenditures such as "regular mortgage payments, property taxes, suitable health insurance or care, existing programs of life and property insurance, and continuation of accustomed patterns of vacation and charitable and family gifting." *Id*. There are numerous court cases supporting these broad definitions of support and maintenance and two examples follow:

- Customary lifestyle or station in life. *Hartford-Connecticut Trust Co. v. Eaton*, 36 F.2d 710 (2d Cir. 1929).
- "Needs and necessities" reasonably necessary to meet personal needs of beneficiary in accustomed standard of living at time of death of settlor**.** *Amoskeag Trust Co. v. Wentworth,* 111 A.2d 198 (N.H.1955).

But how does a trustee go about establishing a baseline for a beneficiary's "accustomed manner of living?" Fortunately, in Colorado there is a court case that provides a methodology to do so. In *Goss v. McCart*, the Colorado Court of Appeals found that the trustee had access to extensive financial information to be able to determine how to maintain standard of living distributions derived from the beneficiary's and settlor's financial life together. *Goss*, 847 P.2d 184 (Colo. App. 1992). A simple review and annualized average of the beneficiary and settlor's expenditures and income over a four year span provided ample documentation and confirmation of beneficiary's "standard of living." *Id*. *Goss* also contemplates using the same formula to encompass the discretionary distribution standard of "comfort." *Id*. This type of methodology was also confirmed by courts in Massachusetts and Florida. *See Marsman v. Nasca*, 573 N.E.2d 1025 (Mass. 1991); *Barnett Banks Trust Co. v. Herr*, 546 So.2d 755 (Fla. App. 1989).

When such information is readily available or can be obtained, the trustee should follow this methodology when considering a discretionary distribution request. Planners should discuss these issues and the appropriate language to include in the settlor's estate plan to accomplish the settlor's goals. In addition, planners should consider that "distributions may increase for inflation and subsequent increases in needs resulting from situations such as deteriorating health or added burdens from the needs of another" and discuss them with their clients. *Restatement (Third) of Trusts*, §50 cmt. d(2).

A trustee must take special care to not supplant the parental duty of support of a minor child through distributions to a parent - lest they run afoul of case law or other beneficiaries. This is especially true when administering a trust for the sole benefit of a minor beneficiary. *See Restatement (Third) of Trusts*, §50, cmt. e(3) ("[T]he presumption is that the trustee should take

into account the parental duty to support the child under state law. If the trustee makes a distribution for the benefit of the child, it is really benefitting the parent. The trustee may exercise discretion to distribute for benefits that fall outside the parental obligations.").

When dealing with a special needs trust (a/k/a supplemental needs trust or disability trust), the trustee and drafter have to navigate tenuous ground. In addition to the potential violation of Social Security and/or Medicaid regulations (thus potentially jeopardizing a beneficiary's public benefits), the trustee of a special needs trust ("SNT") must contend with some inconsistent case law and unpredictable interpretation of discretionary distributions by State and Federal public benefits' offices. For example, the Ramsey County District Court denied certain support and maintenance distributions that were not covered by public benefits while approving others that were covered. *In re Irrevocable Supplemental Needs Trust of Collins*, A04-1018, 2004 WL 2858079 (Minn. Ct. App. Dec. 14, 2004) (unpublished). On appeal, the Minnesota Court of Appeals reversed and wrote that the trustee "did not abuse [their] sole discretion." *Id*. Additionally, while some SNT trustees (both lay and professional) routinely deny distributions for beneficiary support and maintenance requests that are not directly related to the beneficiary's disability, the Third Circuit Court of Appeals has taken a contrary view. *Lewis v. Alexander*, 685 F.3d 325 (3rd Cir. 2012).

VACATION

"Have you ever gone on vacation and left your child home?" – Kate McCallister (Catherine O'Hara)

"No, no. But I did leave one at a funeral parlor once." – Gus Polinski (John Candy)

Restatement Third urges the trustee to exercise caution when dealing with vacations or travel by stating that "a special vacation of the type not normally taken by the beneficiary may be borderline, even with the grant of extended discretion." *Restatement (Third) of Trusts*, §50, cmt. d(2). Moreover, a trustee must consider how many family members' expenses to pay for when paying for a vacation, especially in a trust for the sole benefit of minor child. Certainly, a minor child cannot go on a vacation alone; thus there is need for the trustee to consider payment of at least one parent's expenses. When dealing with a SNT and certain types of public benefits structures, the trustee is typically only allowed to pay for the expenses of one parent/caregiver pursuant to state and federal guidelines. A prudent trustee will also always consider the effect that any distribution will have on remainder beneficiaries, longevity of the trust, potential public benefits disqualification, and the tax impact, while balancing those factors against settlor intent.

HEALTH

"Is this toothbrush approved by the American Dental Association?" – Kevin McCallister

"Well, I don't know. It doesn't say, hon." – Drugstore Clerk (Ann Whitney)

"Well, could you please find out?" – Kevin McCallister

When drafting discretionary distribution language to include the term "health," settlor intent is obvious – the trustee is to make reasonable distributions to provide for health-related items for the beneficiary. As mentioned above, Restatement Third suggests that "health" is indeed included in "support" and "maintenance" provisions by stating that "distributions may increase…[due to] needs resulting from situations such as deteriorating health or added burdens from the needs of another." *Restatement (Third) of Trusts*, §50, cmt. d(2). The comment continues, noting that "an increase in distributions may be appropriate in light of the productivity of the trust and if otherwise the remainder beneficiaries would benefit over the current beneficiary to an extent not intended by the settlor," which give the trustee extra flexibility in granting discretionary distributions for health needs. *Id*. Corporate professional trustees regularly consider the following distributions allowable under a "health" standard. Note that the trustee may consider a beneficiary's outside resources and should consider all of the relevant trust terms and circumstances before making a distribution.

- Health insurance premiums
- Co-pays
- Over the counter medication
- Prescription payments
- Long term care insurance premiums
- Medical supplies
- Dental care

However, a trustee of a SNT must exercise extreme caution before making such distributions. The same principal holds true for a trustee administering a non-SNT trust if the beneficiary receives any form of public benefits (excluding traditional Social Security and Medicare). Should the trustee make a distribution from the trust for an item that would have been covered by Medicaid, the trustee has put the beneficiary's vital public benefits in jeopardy. In these situations, there is an abundance of case law holding the trustee financially liable for the loss of a beneficiary's benefits, which can be quite expensive. If a trustee doesn't know if the beneficiary of a testamentary discretionary support trust receives public benefits and that their monthly stipend distributions or payment of beneficiary medical expenses are in direct violation of Medicaid or Social Security (Supplemental Security Income) regulations, they need to ask. Many trustees lack the necessary knowledge and expertise to properly administer SNTs. Courts, remainder beneficiaries and federal or state regulatory agencies are not likely to excuse this lack

of awareness and will try to hold the fiduciary liable for making such distributions, unwittingly or otherwise - *ignorantia juris non excusat* ("ignorance of the law excuses not").

COMFORT, BENEFIT, HAPPINESS AND CONVENIENCE

"Guys! I'm eating junk and watching rubbish! You better come out and stop me!" – Kevin McCallister

"Comfort" is generally interpreted by trustees and drafters alike to have a broader meaning than "support." A Wisconsin court held that "comfort" is "broader than necessity." *Estate of Curtis*, 33 N.W.2d 193 (Wis. 1948). However, some courts take its definition a bit farther. *See Equitable Trust Co. v. Montgomery*, 28 Del.Ch. 389, 44 A.2d 420 (1945) ("comfort" was defined as "a state of tranquil or moderate enjoyment, resulting from the satisfaction of bodily wants and freedom from care or anxiety; a feeling or state of well-being, satisfaction, or content."). However, Restatement Third states that "comfort adds nothing to the usual standard of support for a beneficiary whose lifestyle is reasonably comfortable" but notes that "it may elevate the standard of living for a beneficiary whose standard is modest." *Restatement (Third) of Trusts*, §50, cmt. d(3).

The terms "benefit" and "happiness" grant broad discretion to trustees. Restatement Third supports this conclusion by stating:

> The terms "benefit" and "welfare" imply something beyond a support standard. Although "benefit," "welfare," and "happiness" may imply something beyond support, they are less objective standards of support and may inhibit the ability of a beneficiary to compel a distribution. "Happiness" implies that the trustee's discretion should be exercised generously. *Restatement (Third) of Trusts*, §50, cmt. d(3).

In fact, this same section of Restatement Third states that "happiness may protect the trustee from challenge by remainder beneficiaries for almost any reasonably affordable distributions." *Id*. However, it also notes that the trustee "can still resist a request from a beneficiary because the distribution is in the trustee's discretion." *Id*. That said, both sides of the argument are represented in common law. Consider the following:

- "Convenience" of the beneficiary is broader than "support" and includes freedom from difficulty, trouble or annoyance and whatever promotes ease or advantage. *Boston Safe Deposit & Trust Co. v. Stebbins*, 34 N.E.2d 616 (Mass. 1941).
- The expenses of common life for a remarried widow were permitted for her "benefit." *Colburn v. Burlingame*, 190 Cal. 697, 214 P. 226 (1923).
- "Happiness" is a broader standard than "support and maintenance." *Merchants Nat. Bank v. C.I.R.*, 320 U.S. 256, 64 S.Ct. 108 (1943).

<u>*Contra*</u>:

- "Benefit" does not permit the discretionary distribution for a $4.5 million personal jet plane. *Stuart v. Wilmington Trust Co.,* 474 A.2d 121 (Del. 1984).

- "Benefit" does not permit charitable giving even when the trustee had "sole absolute and unimpeachable discretion" because the settlor had already paid charitable gifts at his death. It was therefore ruled that settlor intent was not to give the distributions to his beneficiary and who would then give them to charity. *In re Estate of May*, 112 N.Y.S.2d 847 (Sur. Ct. 1952), aff'd, 283 A.D. 786, 129 N.Y.S.2d 229 (1954).

Trustees enjoy more flexibility when such broad language is included in the trust vehicle. A cautious fiduciary may still analyze the beneficiary's financial situation and outside resources before making any distribution under these provisions. Any fiduciary will also certainly take into consideration the effect on the remainder beneficiaries of the trust before making such a distribution, the tax impact of a distribution, and any consequences to public benefit eligibility. However, drafters should take care and counsel their settlors of just how broad this language may be interpreted before inclusion into any estate plan.

EMERGENCY, HARDSHIP AND DISABILITY

"What's so funny? What are you laughing at? You did it again, didn't you? You left the water running. What's wrong with you? Why do you do that? I told you not to do it!" – Harry Lime (Joe Pesci)

"Harry, it's our calling card! […] All the great ones leave their mark. We're the Wet Bandits!" – Marv Merchants (Daniel Stern)

Language such as "emergency" and "hardship" are certainly more restrictive terms than the previously discussed discretionary distribution language. In fact, "emergency" has been specifically defined as a restrictive term. *See Warner v. Trust Company Bank*, 296 S.E.2d 553 (Ga. 1982). "Emergency" is defined by *Merriam-Webster* as "an unexpected and usually dangerous situation that calls for immediate action" and is usually additionally defined by trustees as something that was unexpected.

These terms are some of the most difficult language trustees must interpret. While the intent of the settlor and drafter seem clear, the definition of "emergency" and "hardship" can be variable and objective. For example, isn't *every* time a beneficiary needs a distribution from their trust an "emergency" from the beneficiary's point of view? Although case law is sparse regarding these terms, some guidance is available:

- Living expenses for a college student were not considered an "emergency" or "hardship." *Griffin v. Griffin*, 463 So.2d 569 (Fla.App.1985).
- Emergencies are prolonged illnesses. *Warner v. Trust Company Bank*, 250 Ga. 204, 296 S.E.2d 553 (1982)
- Emergences are also "general inadequacy of resources and earning capacity." *Application of Sabol*, 20 Misc.2d 112, 191 N.Y.S.2d 773 (Sup.Ct.1959).

Restatement Third provides that "terms such as 'emergency,' 'severe hardship,' and 'disability' authorize distributions only when the described conditions or circumstances arise, and then only to the extent appropriate to alleviate the emergency, hardship or special need."

Restatement (Third) of Trusts, §50 cmt. d(4). In addition to the Restatement Third comment about "disability," every drafter should consider including a provision to convert the trust to or administer the trust as a SNT not only for the current beneficiary, but also for the remainder beneficiaries. Failure to do so may result in severe liability for the drafter. *See Board of Overseers of the Bar v. Ralph Brown, Esq.*, Maine Sup. Jud. Ct. Docket No. BAR-01-06 (Oct 25, 2002).

It is recommended that drafters more fully define "emergency" and "hardship" in the trust document and discuss with their settlors the difficulties that trustees encounter in administering a trust with these terms. A more thorough explanation (or, quite frankly, any guidance whatsoever) of settlor intent in the trust document would be priceless to the trustee making the discretionary distribution determination. Additionally, a letter of intent from the settlor aids a trustee in his or her interpretation of the trust document. A prudent trustee would review all of the material contained herein when contemplating a distribution for the cost of water remediation and damages incurred by a trust beneficiary after a visit from the Wet Bandits.

ENACTMENT OF COLORADO UNIFORM TRUST CODE

When drafting or interpreting a trust document, drafters and trustees need to consider all of Colorado law, including the Colorado Uniform Trust Code ("CUTC"), which becomes law on January 1, 2019. For example, Section 15-5-814(1)(a), C.R.S., requires a trustee to "exercise a discretionary power in good faith," which includes the power to make discretionary distributions. Planners and trustees considering discretionary distribution language in planning or administration should familiarize themselves with all of CUTC, but particularly with Sections 15-5-105(2)(b), 15-5-801, 15-5-804, 15-5-814 and 15-5-1008(1), C.R.S., before January 1, 2019.

CONCLUSION

"Damn. How can you give Kris Kringle a parking ticket on Christmas Eve? What's next, rabies shots for the Easter Bunny?" – Santa (Ken Hudson Campbell)

Avoidance of litigation is always a goal of both the drafter and the fiduciary. Trustees face a daunting task when considering discretionary distributions from a trust. Attorneys are tasked with the challenge of memorializing a settlor's intent for all time without being able to go back in time to restate a trust document as case law and industry standard practices change. Both the trustee and the drafter must juggle settlor intent with the needs of the beneficiary, case law, state and federal regulation, and liability/legal consequences. Drafters will never be able to predict or anticipate every eventuality. However, by properly planning for and carefully drafting discretionary distribution provisions, attorneys can preserve settlor intent and help facilitate a happy and cooperative relationship between beneficiaries and trustees. Readers may want to review the Best Practice Tips referenced in the author's aforementioned presentation so that they don't find themselves with Johnny as a client.

"I'm gonna give you to the count of 10 to get your ugly, yellla, no-good keister off my property before I pump your guts full of lead!" – Johnny – Gangster #1 (Ralph Foody)

"All right, Johnny. I'm sorry! I'm goin'!" – Snakes – Gangster #2 (Michael Guido)

"One…. Two… Ten!!" – Johnny (firing bullets into Snakes while laughing maniacally)

"Keep the change, ya filthy animal!" - Johnny

Happy Holidays from Kelly Dickson Cooper and Peter Wall!

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