

DISCRETIONARY DISTRIBUTIONS: OLD RULES, NEW PERSPECTIVES

*by Leslie Kiefer Amann**

I.	BEGIN WITH THE UNDERSTANDING THAT A TRUST IS A RELATIONSHIP	182
II.	DEFINING THE TERMS.....	184
	<i>A. The Support Trust</i>	184
	<i>B. The Discretionary Trust</i>	185
	<i>C. The Hybrid</i>	185
III.	DISTRIBUTIONS SHOULD BE MADE PURSUANT TO GRANTOR'S INTENT	185
IV.	READ THE DOCUMENT.....	186
V.	MATHEMATICAL CALCULATIONS VS. FIDUCIARY DECISIONS.....	189
VI.	DETERMINE PRIMARY PURPOSE OF THE TRUST	190
VII.	CONSIDER CIRCUMSTANCES SUCH AS STANDARD OF LIVING	192
VIII.	CONSIDER OTHER SOURCES OF SUPPORT	193
IX.	CONSIDER THE DUTY OF LOYALTY (IF IT IS EASY, YOU AREN'T DOING IT RIGHT)	194
X.	DOES THE DOCUMENT REFLECT A PREFERENCE FOR A CLASS OF BENEFICIARY?	195
XI.	WHEN THE DOCUMENT SAYS TO DISTRIBUTE ALL INCOME	196
	<i>A. Is the Adjustment Power Available?</i>	197
	<i>B. If Available, Should an Adjustment Be Made to Income This Year?</i>	199
	<i>C. What Issues Should the Trustee Consider?</i>	199
	<i>D. If an Adjustment Is Made This Year, How Much Should It Be?</i>	200
	<i>E. When Not to Exercise</i>	203
XII.	THE SPENDTHRIFT CLAUSE	203
XIII.	COMMUNICATE WITH THE BENEFICIARY.....	204
XIV.	KEEP EVERY SCRAP OF PAPER (OR DIGITAL DATA)	205
XV.	WHAT TO PAY?.....	205
	<i>A. Health</i>	206
	<i>B. Education</i>	207
	<i>C. Maintenance and Support</i>	208

* Sr. Vice President/Chief Fiduciary Officer, Sentinel Trust Company LBA.

Any opinions expressed herein are those of the author alone and not those of her employer or any other organization.

XVI.	CONSIDERING OTHERS OBLIGATED TO SUPPORT THE BENEFICIARY	209
XVII.	WHO TO PAY.....	210
XVIII.	WHEN TO PAY?	213
XIX.	SOME SPECIAL CONSIDERATIONS FOR INDIVIDUAL TRUSTEES AND CO-TRUSTEES	215
XX.	COUNSEL FOR THE FIDUCIARY	216
XXI.	TERMINATING DISTRIBUTIONS.....	217
XXII.	CONCLUSION	218
XXIII.	MAKING DISTRIBUTIONS AND AVOIDING THE COURTS	218
XXIV.	CHART A.....	220
XXV.	CHART B.....	220

The “discretion” exercised by a trustee includes all aspects of administration, but making payments out of a trust—the discretionary distribution—often seems to be the greatest challenge. This material was originally created for the Texas Bankers Association Annual Graduate Trust School. Over a period of nearly fifteen years, it has been gradually expanded to include illustrations and materials from other states; however, the primary focus remains on the information needed to make excellent fiduciary decisions and draft clear fiduciary instructions under Texas law.

Although many of the citations are to Texas law, some principles are universally applied, and regarding those, this article will draw on the case law of other states and sources.¹

I. BEGIN WITH THE UNDERSTANDING THAT A TRUST IS A RELATIONSHIP

In any relationship, a healthy understanding between the parties as to what each expects of the other is critically important.² In a trust, the expectations and parameters of the relationship are defined by three primary sources:

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

Administrators may rely on this order of priority to make virtually all decisions, looking to the terms of the instrument first, then to the applicable

1. Any trustee faced with a significant decision must check the specific state law that applies to the trust being administered.

2. 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).

3. See, e.g., TEX. PROP. CODE ANN. § 113.051 (West 2007).

statute, and finally, to common law.⁴ The terms of the trust instrument control, unless they are contrary to public policy—the best expressions of public policy are the declarations of the legislature, found in the statutes.⁵

On the surface, administering a trust seems easy enough; after all, a trust comes with written instructions.⁶ To provide the best possible service to our clients, trustees should understand not just what to do but also why we do things. And 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 and in good faith.⁷

Over the last century, the National Conference of Commissioners on Uniform State Laws has promulgated a number of default trust statutes.⁸ Some of these statutes, such as the Uniform Principal and Income Act and the Uniform Prudent Investor Act, are familiar.⁹ Others are less well known but may be widely adopted in many states, such as the Uniform Trust Code, the Uniform Prudent Management of Institutional Funds Act, Uniform Power of Attorney Act, and the Uniform Securities Act.¹⁰ There are other helpful sources of which trustees should be aware, despite the fact that they are not binding authority, including the Restatements of Trust, different treatises, and various Uniform Codes and their commentary.¹¹

Among the uniform statutes, there are a handful that Texas has adopted as default and mandatory provisions.¹² Mandatory provisions are sections of the Trust Code that affect administration, and they cannot be overridden by a trust document; the Trust Code contains a list of items where the legislature has dictated that it would be against public policy to allow a trust document to supersede the statute.¹³ Default provisions are those that prevail when the

4. *See id.*

5. *See id.* § 112.031.

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

7. TEX. PROP. CODE ANN. § 113.051. 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.

Id. (emphasis added). A fiduciary acts in good faith when he believes his defense is viable and reasonable in light of existing law. *See* Lee v. Lee, 47 S.W.3d 767, 795 (Tex. App.—Houston [14th Dist.] 2001, pet. denied). In a trustee relationship, bad faith is “acting knowingly or intentionally adverse to the interest of the trust beneficiaries.” *Interfirst Bank Dall., N.A. v. Risser*, 739 S.W.2d 882, 897 (Tex. App.—Texarkana 1987, no writ).

8. *See generally* Acts, UNIFORM L. COMMISSION, <http://www.uniformlaws.org/Acts.aspx> (last visited June 20, 2014) (containing the acts that have been promulgated, including the default trust statutes).

9. *See id.*

10. *See id.*

11. *See, e.g.*, GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, THE LAW OF TRUSTS AND TRUSTEES (rev. 3d ed. 2013) [hereinafter BOGERT]; AUSTIN WAKEMAN SCOTT ET AL., SCOTT AND ASCHER ON TRUSTS (5th ed. 2010).

12. *See* TEX. PROP. CODE ANN. § 111.0035.

13. *See id.*

document is silent or vague on a particular matter.¹⁴ While the rule is to look to the instrument first, the prudent trustee must be aware of the mandatory rules—those few items where the statute prevails, even when the document recites something else.¹⁵

II. DEFINING THE TERMS

In any distribution decision, a threshold question will be whether the trustee has discretion to make the decision at all.¹⁶ There are many trusts that contain mandatory distribution provisions.¹⁷ 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.¹⁸ 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.¹⁹ Distribution standards fall into three categories: the support trust; the discretionary trust; and the hybrid.²⁰

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.²¹ In other words, “the beneficiary may compel the trustee to make distribution[s] in accordance with a specific distribution standard. The distribution standard of a support trust is generally referred to as an ‘ascertainable standard.’”²² Ascertainable means specific enough to be objectively applied.²³ Typically, a support standard will include HEMS, or something similar, and a support standard may even require that the trustee consider the “‘standard of living’ that the beneficiary enjoys at a prescribed period of time.”²⁴

14. *See id.*

15. *See id.* (containing mandatory provisions that administrators should be aware of). Section 111.0035(c) is the only portion of this section that directly impacts distributions. *See id.* § 111.0035(c).

16. *What Every Trustee Ought to Know*, KAREN S. GERSTNER & ASSOCIATES P.C., at 4, <http://www.gerstnerlaw.com/images/docs/Trustee.pdf> (last visited June 20, 2014) [hereinafter GERSTNER].

17. *See* RESTATEMENT (SECOND) OF TRUSTS § 186 cmt. e (1959).

18. *See id.*

19. *See id.* §§ 186–87.

20. *See infra* Part II.A–C.

21. *See* RESTATEMENT (SECOND) OF TRUSTS § 154.

22. Frank N. Ikard, Jr., *Trust Litigation—Suing and Defending a Trustee*, TEXASPROBATE.NET, <http://www.texasprobate.net/articles/trustlit.htm> (last modified Mar. 31, 1996).

23. *Id.*

24. *Id.*

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.²⁵ In other words, “the trustee is authorized to make distributions in his sole discretion[,] which is not subject to any objective standard.”²⁶ As such, the beneficiary may not compel a distribution.²⁷ The distribution “standard is nonobjective because it is not specific enough to be objectively applied.”²⁸ Income that the trustee does not elect to distribute to the beneficiary typically is accumulated, and thus, the exercise of discretion may result in it being paid to another class of persons (remaindermen).²⁹

C. The Hybrid

The most common personal trust is a hybrid of a discretionary trust and a support trust.³⁰ 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 what is necessary for the support of the beneficiary.³¹ Unfortunately, there is little case law providing interpretive assistance for hybrid trusts.³² 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.³³

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 intention[,]” which must be within the mandates of public policy and is subject to judicial review.³⁴ 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.³⁵ However, this is not

25. RESTATEMENT (SECOND) OF TRUSTS § 155.

26. Ikard, Jr., *supra* note 22.

27. *See id.*

28. *Id.*

29. *See id.*

30. *See Smith v. Smith*, 517 N.W.2d 394, 398 (Neb. 1994); *see also generally* Evelyn Ginsberg Abravanel, *Discretionary Support Trusts*, 68 IOWA L. REV. 273 (1983) (discussing hybrid trusts).

31. *See First Nat’l Bank of Md. v. Dep’t of Health & Mental Hygiene*, 399 A.2d 891, 895 (Md. 1979).

32. *See e.g.*, Abravanel, *supra* note 30.

33. HELENE S. SHAPO ET AL., *Discretionary Trusts*, in *THE LAW OF TRUSTS AND TRUSTEES* §§ 201–30 (3d ed. 2007).

34. *See, e.g.*, *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. *See, e.g.*, *id.* § 115.001; *Rubion*, 308 S.W.2d at 9 (explaining that avoiding a situation that requires judicial review is best).

35. *See, e.g.*, *In re Estate of Dillard*, 98 S.W.3d 386, 395 (Tex. App.—Amarillo 2003, pet. denied).

the typical posture of the cases being handed down in modern times.³⁶ In today's literature, most cases involve suits brought against a trustee for a breach of duty.³⁷ And in general, regardless of whether the trustee or the beneficiary initiates the action, courts do not like to be burdened with the trustee's job.³⁸

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.³⁹ In most situations, the trust committee determines whether a matter requires judicial interpretation.⁴⁰ Trustees must be careful not to assume they have discretion to make any particular decision.⁴¹ They must first read the trust instrument to determine the settlor's intent and to make sure that, in that particular instrument, the settlor has given them such decision-making power.⁴²

IV. READ THE DOCUMENT

It is important that trustees read the trust instrument carefully, even if they are sure that it is unambiguous and can perfectly recollect what it says.⁴³ All trust administrators should make it a practice to review the relevant distribution provisions in the trust document each time they consider making a distribution, and at least once a year, they should review the entire trust instrument—a good time is during the annual review.⁴⁴ Not only should trust administrators review the terms of the trust instrument, but they should also review any extrinsic

36. *See id.*

37. *See, e.g., id.* at 390.

38. *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, however, that, in this 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 a perfect example of a change in public policy that impacted a change in administration. *See id.*

39. *See, e.g.,* RESTATEMENT (THIRD) OF TRUSTS § 71 (2007).

40. *See, e.g.,* GERSTNER, *supra* note 16, at 1. The decision to request an official construction is, in and of itself, an exercise of discretion. *See Keisling v. Landrum*, 218 S.W.3d 737, 743–44 (Tex. App.—Fort Worth 2007, pet. denied).

41. *See Keisling*, 281 S.W.3d at 744.

42. *See 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.)); *see also* *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).

43. *See Coffee*, 408 S.W.2d at 272–74.

44. *See GERSTNER, supra* note 16, at 4.

evidence in the file that clarifies the settlor's intent or that further explains any circumstances that might be relevant.⁴⁵

Sometimes, the trust administrator must gather basic information.⁴⁶ For example, a file might contain a memo from a previous trust administrator, letters from the settlor, or written trust modifications; this information could be useful in interpreting the document.⁴⁷ Additionally, it is often appropriate to understand the settlor's circumstances when the trust was executed and in testamentary trusts, the circumstances existing at the time of the settlor's death.⁴⁸ The trust administrator should look to the trust document to see if the settlor provided express instructions or included a direct statement of the purpose of the trust.⁴⁹ The trust administrator may be able to infer the purpose of the trust from its structure, and there may be an expression of preference between current and future beneficiaries.⁵⁰ Some basic rules of construction have evolved to help in the interpretation of discretionary distribution clauses, or for that matter, any part of a trust agreement.⁵¹

(1) Every trust is different. Trust administrators must try to determine the settlor's goals from the content of the trust instrument and must try to implement these goals.⁵² Trust administrators must be sure to carefully read the entire instrument.⁵³

(2) Trust administrators must draw the settlor's intent from the instrument.⁵⁴ They should clear their mind of what they think the document says or what they want it to say, and read what it actually says.⁵⁵

(3) Trust administrators cannot "correct" the work of a testator, a settlor, or counsel.⁵⁶ "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."⁵⁷

45. See *id.* While extrinsic material may not be binding, prudence and ignorance of its purpose do not coexist. See, e.g., *Coffee*, 408 S.W.2d at 273–74, 283–84; *Reilly v. Huff*, 335 S.W.2d 275, 279–80 (Tex. Civ. App.—San Antonio 1960, no writ).

46. See *Coffee*, 408 S.W.2d at 273–74.

47. See *id.*

48. See *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).

49. See *Coffee*, 408 S.W.2d at 282–83.

50. See *id.*

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

52. See, e.g., *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.")

53. See *Coffee*, 408 S.W.2d at 273–74.

54. See *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).

55. See *In re Estate of Dillard*, 98 S.W.3d at 391–93.

56. See *Huffman*, 339 S.W.2d at 889.

57. *Id.* "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

(4) This is not math—trust administrators cannot add to or subtract from anything that appears in the instrument.⁵⁸ If the instrument is unambiguous, courts do not admit other evidence for the purpose of interpreting the trust.⁵⁹ 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.⁶⁰

(5) There is no reason to be afraid of the dictionary—use it.⁶¹

(6) 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.⁶²

(7) The term “may” means maybe—use discretion.⁶³ The term “shall” means mandatory—just do it.⁶⁴

(8) When interpreting a document, certain legal presumptions may be useful.⁶⁵

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.)).

58. *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).

59. *See id.* For purposes of administration, however, it is often 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.).

60. *See, e.g., 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).

61. *See, e.g., Patrick v. Patrick*, 182 S.W.3d 433, 436 (Tex. App.—Austin 2005, no pet.); *see also 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.” 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. Do not be afraid of the dictionary.

62. *See, e.g., Coffee*, 408 S.W.2d at 272–75.

63. *See* TEX. GOV’T CODE ANN. § 311.016 (West 2013).

64. *See id.*; *see also 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).

65. *See, e.g.,* 10 GERRY W. BEYER, TEXAS PRACTICE: TEXAS LAW OF WILLS § 47.18 (3d ed. 2002) [hereinafter BEYER, TEXAS PRACTICE] The following presumptions apply only if there is no specific contradiction of them found in the document:

- a. By leaving a will or trust the testator did not intend for property to revert to his estate or pass in intestacy. *See id.*
- b. By leaving a will or trust the testator intended to confer some benefit on the beneficiary. *See id.*
- 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. *See* BEYER, TEXAS PRACTICE, *supra*.
- e. All persons in a given class and all classes of beneficiaries are treated equally. *See id.*

(9) Be certain to have knowledge of what rules may apply that do not appear in the document. In Texas, exculpatory clauses may not have any effect at all.⁶⁶

For most decisions, the trustee will not find a “bright line” rule.⁶⁷ In *In re Will of Flyer*, the Court held that:

Although the decisions in this area of the law place emphasis on the precise verbiage found in the provision creating the trust, close analysis reveals that they take into consideration more than such verbiage alone. . . . [W]e educe [the testator’s] design not only from the language employed but from a ‘sympathetic reading of the will as an entirety and in view of all the facts and circumstances under which [its] provisions were . . . framed.’⁶⁸

When trustees are working with a document that a court has created, modified, or reformed, they should read the order establishing the trust, and the agreement itself, as carefully as they would any other trust document, even if they think they know what it says.⁶⁹

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.⁷⁰ A charitable remainder unitrust, for example, may simply require the trustee to exercise discretion in the choice of investments and apply a formula to determine how much to distribute.⁷¹ It is not uncommon for a trust to fix the amount of such a distribution but to require the trustee to exercise discretion in

f. Every word a testator or grantor uses is important; nothing is there for no reason. *See id.*

g. The testator intended the law in effect at that time should apply. *See id.*

66. *See* TEX. PROP. CODE ANN. § 111.0035 (West 2007).

67. *See, e.g.,* Sankel v. Spector, 819 N.Y.S.2d 520, 524 (1st Dep’t 2006).

68. *In re Flyer*, 245 N.E.2d 718, 720 (N.Y. 1969).

69. *See* TEX. PROP. CODE ANN. § 112.054 (containing the provisions for judicial modification or termination of trusts). As an example, for trusts created under 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. *Id.* Technically, a departure from the statutory language of § 142 is an abuse of discretion. *Id. 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. *Id.* 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. *See id.*

70. *See, e.g.,* Treas. Reg. § 1.664-3 (2012).

71. *See id.*

the choice of the charity that will receive the distribution.⁷² This would still require the trustee to read the instrument and file carefully to determine what charitable purposes the grantor or testator intended to accomplish.⁷³ In trusts requiring the mandatory distribution of income, the trustee is required to exercise discretion in the decision whether to use the adjustment power (discussed below), rather than make specific distributions for specific purposes.⁷⁴ In each instance, however, determining the intent of the grantor remains important.⁷⁵

VI. DETERMINE PRIMARY PURPOSE OF THE TRUST

Individual personal trusts generally have no mandated statutory language; accordingly, the variance between trusts is nearly unlimited.⁷⁶ One of the first things a trustee should do when interpreting a personal trust is review it to determine its purpose.⁷⁷ While there are several reasons why a person might establish a discretionary trust, the following reasons are some of the most common: for tax planning purposes; to facilitate the orderly transfer of wealth, in accordance with someone's 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.⁷⁸

When a trust is established for federal tax purposes, it should be drafted to comply with the Internal Revenue Code's "ascertainable standard."⁷⁹ 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.⁸⁰ When considering distributions, it is helpful to consider some of the language that courts have scrutinized when determining whether a power is appropriately limited for tax purposes.⁸¹

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:

72. *See id.*

73. *See discussion supra* Part IV.

74. Treas. Reg. § 1.664-3.

75. *See discussion supra* Part IV.

76. *See* RESTATEMENT (THIRD) OF TRUSTS § 50 (2007).

77. *See id.*

78. *See, e.g.,* BEYER, TEXAS TRUST LAW, *supra* note 6, at 3–5. While the purpose of allowing someone to exercise control from the grave is not realistic, occasionally, this is a factor in one's decision to establish a trust. *See, e.g.,* 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.).

79. *See* Anthony F. Vitiello & Daniel B. Kessler, *The Fully Discretionary Ascertainable Standard*, TRUSTS & ESTATES MAG., Mar. 2010, available at http://www.connellfoley.com/sites/default/files/Trusts%20&%20Estates%20Article%200310_AVitiello%20DKessler.pdf.

80. *See id.*

81. *See* RESTATEMENT (THIRD) OF TRUSTS § 50 (2003) (containing an extensive discussion of this precedent).

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.⁸²

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”;⁸³
- (2) “[M]aintenance in health and reasonable comfort”;⁸⁴
- (3) “[E]ducation, including college and professional education”;⁸⁵ and
- (4) “[M]edical, dental, hospital and nursing expenses and expenses of invalidism.”⁸⁶

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.⁸⁷

While tax cases provide some guidance for a prudent trustee, a better guidepost is the personal trust common law.⁸⁸ In looking at personal trusts, the standard may be a clue to the purpose of the trust.⁸⁹ 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 have been for tax planning purposes.⁹⁰ 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.⁹¹

82. Treas. Reg. § 20.2041-1(c)(2) (2013) (emphasis added) (citing I.R.C. § 2041(b)(1)(A) (West 2012)).

83. *Id.*

84. *Id.*; 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).

85. Treas. Reg. § 20.2041-1(c)(2).

86. *Id.*

87. *Id.*

88. See, e.g., *Fundamental Duties of a Trustee: A Guide For Trustees in a Post-Uniform Trust Code World*, EDWARD JONES TR. COMPANY, https://www.edwardjones.com/groups/ejw_content/documents/document/web043726.pdf (last revised Oct. 6, 2008).

89. See *id.*

90. See Vitiello & Kessler, *supra* note 79.

91. See *id.* The Texas Property Code contains a Discretionary Powers and Tax Savings section. See TEX. PROP. CODE ANN. § 113.029 (West 2007).

VII. CONSIDER CIRCUMSTANCES SUCH AS STANDARD OF LIVING

There is more precedent on standard of living than nearly any other issue facing the trustee.⁹² 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.”⁹³ The “appropriate” standard of living may be important even in trusts where the beneficiary’s previous standard of living is not an issue.⁹⁴

A trustee should investigate and document the beneficiary’s activities; this might include visiting the beneficiary and following up on distributions for major expenses, vacations, and education.⁹⁵ And it might include research to determine what the grantor’s standard of living was more than a generation ago.⁹⁶ 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.⁹⁷ The trustee should monitor, record, and consider these in making maintenance and support distribution decisions.⁹⁸ The trustee must “determine the amount of trust income sufficient for the ‘suitable’ support and maintenance of the trust beneficiary.”⁹⁹ 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.¹⁰⁰ “[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.¹⁰¹

92. 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).

93. *Old Va. Brick Co. v. Comm’r*, 367 F.2d 276, 278 (4th Cir. 1966); *see also* *Independence Bank Waukesha v. United States*, 761 F.2d 442, 444 (7th Cir. 1985).

94. *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).

95. *See, e.g.,* Cynthia D.M. Brown, *Discretionary Distributions: A Trustee’s Guideline*, COMMONWEALTH TR. COMPANY, at 10 (2013), <http://www.comtrst.com/trust-our-word/wp-content/uploads/2013/05/CDMB-Presentation-re-Discretionary-Distributions-A-Trustees-Guideline.pdf>.

96. *See id.*

97. *See id.*; *see also In re Golodetz’ Will*, 118 N.Y.S.2d 707, 712–13 (N.Y. Sur. Ct. 1952).

98. *See* Brown, *supra* note 95.

99. *In re Rockefeller*, 260 N.Y.S.2d 111, 115 (N.Y. Sur. 1965).

100. *See* Steinkamp, *supra* note 94.

101. 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.’

Id.

VIII. CONSIDER OTHER SOURCES OF SUPPORT

There is also some 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.¹⁰² 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.¹⁰³ From state to state, the default approach falls into the following three broad categories:

(1) 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;

(2) The trustee must consider other means, but the beneficiary is not required to exhaust them; and

(3) The beneficiary must rely completely on his own resources for support, unless such resources prove inadequate.¹⁰⁴ Often, the settlor specifies what the trustee should consider regarding outside support.¹⁰⁵ But 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.¹⁰⁶ As noted, this is not the prevailing view everywhere.¹⁰⁷ 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.¹⁰⁸ 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.¹⁰⁹

The rationale is that to determine what amount of support is *necessary*, the trustee must consider the beneficiary's circumstances and determine *need*.¹¹⁰ In

102. See, e.g., Brown, *supra* note 95, at 9–10.

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

104. 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).

105. See *Keisling v. Landrum*, 218 S.W.3d 737, 743–45 (Tex. App.—Fort Worth 2007, pet. denied).

106. See *id.* at 739–45 (explaining that beneficiaries need not exhaust all of their financial assets or resources).

107. *In re Demitz' Estate*, 208 A.2d 280, 282 (Pa. 1965); see also Purver, *supra* note 104, 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).

108. See, e.g., Mary C. Burdette with Sarah Patel Pacheco, *What Did You Mean By That? Trust Language and Application by Trustees*, ST. B. TEX., 35TH ANNUAL ADVANCED ESTATE PLANNING AND PROBATE COURSE (June 8–10, 2011) [hereinafter Burdette with Pacheco], <http://www.dallasprobatelawfirm.com/documents/004.-What-Did-You-Mean-By-That.Universal.pdf>.

109. See *id.*; see also 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).

110. See, e.g., *First Nat'l Bank of Beaumont v. Howard*, 229 S.W.2d 781, 786 (Tex. 1950).

Howard, the court held that the requirement that the trustee consider income from any source included the family.¹¹¹ 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.¹¹² In some cases of doubt, courts have suggested the trustee should err on the side of the primary beneficiary.¹¹³ This, of course, presumes that one class of beneficiary is of primary importance.¹¹⁴ However, most trusts do not have a primary beneficiary.¹¹⁵ In fact, as noted below, in most cases the trustee has the same duty to all classes of beneficiary.¹¹⁶ This may create a conflict between the needs of the current income beneficiary and the needs of the future income or principal beneficiaries.¹¹⁷ As discussed below, this conflict is what led to the creation of the Power to Adjust.¹¹⁸

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

The Trustee’s power to adjust, found in § 116.005 of the Texas Property Code, addresses the tension created by the duty of impartiality and the duty to give due regard to the interests of both the income and the remainder beneficiaries.¹¹⁹ In making investment allocation decisions, the Property Code instructs the trustee, as a fiduciary, to act first, according to the instrument and then, according to the provisions of the statute.¹²⁰ If that result does not allow the fiduciary to comply effectively with the duty of impartiality, then the fiduciary may adjust between principal and income.¹²¹ In order to fully understand the mechanism, it is helpful to understand how that tension arises in the first place.

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.¹²² At all times, the trustee must put the interests of the beneficiaries above the interests of all others, including the trustee’s own interests.¹²³ And, as spelled out in unmistakable terms in Texas Property Code § 117.007, a

111. *See id.*

112. *Id.*

113. *See* *Munsey v. Laconia Home for the Aged*, 164 A.2d 557, 559–60 (N.H. 1960).

114. *See id.* (noting that it is frequently the life beneficiary that takes primary importance).

115. *See infra* Part IX (noting that because most trusts do not have a primary beneficiary, in most cases, the trustee has an equal duty to all beneficiaries).

116. *See infra* Part IX.

117. *See infra* Part IX.

118. *See infra* Part IX.

119. TEX. PROP. CODE ANN. § 116.005 (West 2007).

120. *Id.*

121. *Id.*

122. *Id.* § 117.007.

123. *Id.*

trustee must “manage the trust . . . solely in the interest of [all] the beneficiaries.”¹²⁴ Managing a trust impartially is frequently the most difficult aspect of a trustee’s administrative duties.¹²⁵ 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.¹²⁶ However, beware of any trustee who claims that this part of the job is easy—managing objectively is harder than an estate planning professional may imagine.¹²⁷

Managing objectively is particularly difficult when the trustee is confronted with a duty of “perfect loyalty” to two or more beneficiaries with different interests.¹²⁸ The provisions of the statute do not distinguish between classes of beneficiaries.¹²⁹ 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.”¹³⁰ “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.’”¹³¹ Section 116.002(2) specifies that the term beneficiary in a trust “includes . . . an income beneficiary and a remainder beneficiary.”¹³² Neither statute suggests favoring one class of beneficiary over another.¹³³

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.¹³⁴ 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.¹³⁵

Certainly, there are several examples of trust documents that present clear and easily interpreted preferences for either the income or remainder beneficiary.¹³⁶ Some settlors provide a clear mandate or a purpose statement.¹³⁷

124. *Id.* (emphasis added).

125. *See* Burdette with Pacheco, *supra* note 108.

126. *See id.*

127. *See id.*

128. *See id.*

129. *See id.*; *see also infra* notes 130–32.

130. TEX. PROP. CODE ANN. § 111.004(2).

131. *Id.* § 111.004(6).

132. *Id.* § 116.002(2).

133. *See id.*

134. Burdette with Pacheco, *supra* note 108.

135. *See id.*

136. *See id.*

However, in many cases, the articulated standard is not sufficiently clear.¹³⁸ If the document is silent or unclear, the trustee should turn to the standards set forth in the statutes—as noted above, the trustee must provide for the administration of the trust with the same regard for the interests of all beneficiaries.¹³⁹ In Texas, 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.¹⁴⁰

XI. WHEN THE DOCUMENT SAYS TO DISTRIBUTE ALL INCOME

In determining when to use the adjustment power, the trustee must look for three things.¹⁴¹ 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.”¹⁴²

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 under the Prudent Investor Rule, § 116.005 authorizes the trustee to make adjustments between principal and income that may be necessary.¹⁴³ When the distribution standard states “distribute all income,” what was previously a matter of discretion only as it related to investment decisions now requires fiduciary discretion in determining the amount of the distribution as well.¹⁴⁴

137. *Id.* Consider the following example of such a clear and unmistakable 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.

138. *See id.*

139. TEX. PROP. CODE ANN. § 117.007 (West 2007); *see* discussion *supra* Part IX.

140. TEX. PROP. CODE ANN. chs. 116 (Uniform Principal and Income Act), 117 (Uniform Prudent Investor Act).

141. *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.

Id. § 116.005(a).

142. *Id.* §§ 116.004(b), .005(a).

143. *Id.* § 116.005.

144. *Id.*

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.¹⁴⁵ Therefore, every irrevocable trust must be reviewed at least once to determine if the power should be used going forward.¹⁴⁶ Many trusts will require annual review.¹⁴⁷ This analysis may be boiled down to three basic questions: (1) Is the adjustment power available? (2) If available, should an adjustment be made to income this year? (3) What issues should the trustee consider?¹⁴⁸

A. Is the Adjustment Power Available?

Whether the adjustment power is available is a two-part test.¹⁴⁹ First, the trustee must determine if the Uniform Principal and Income Act is the governing law of the trust.¹⁵⁰ Second, the trustee must be certain the document does not specifically prohibit use of the adjustment power.¹⁵¹ 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.¹⁵² Or the trust could have special circumstances that prohibit the trustee from using the adjustment power.¹⁵³ 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:

(a) Language in the trust instrument prohibits the trustee from investing assets as a prudent investor.¹⁵⁴ 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].”¹⁵⁵

(b) 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.¹⁵⁶ For example: “Distribute \$1,500 per month to each beneficiary” or “Distribute 3% of the market value on March 1st.”

(c) If a trust’s distribution provision is a single discretionary standard that applies to both income and principal, the adjustment power does not apply,

145. *Id.* § 113.051.

146. *See* Burdette with Pacheco, *supra* note 108.

147. *See* GERSTNER, *supra* note 16, at 4.

148. *See infra* Part XI.A–C.

149. *See* Burdette with Pacheco, *supra* note 108.

150. *Id.*

151. *Id.*

152. TEX. PROP. CODE ANN. § 116.004(a)(1).

153. *Id.* § 116.005(c).

154. *Id.*

155. *See id.* In Texas, this is often XOM. *Id.*

156. *Id.*

but it is important that the standards be identical.¹⁵⁷ Beneficiaries with access to both principal and income, but under different circumstances, may be eligible for adjustment.¹⁵⁸ For example: “Distribute all income and principal only in the event of an emergency.”

(d) A non-independent cotrustee 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.¹⁵⁹ If such a cotrustee is required, the adjustment power may not be used.¹⁶⁰

(e) The trust has charitable and noncharitable beneficiaries and is taking a charitable set aside for capital gains.¹⁶¹

Engaging in this analysis, the trustee first determines if the statute governs the trust and whether the adjustment power is available.¹⁶² 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.¹⁶³ All that remains for the trustee to do is to make certain that analysis is documented in the file and coded to the trust accounting system.¹⁶⁴

If the use of the adjustment power is truly prohibited by the terms of an irrevocable document, that single review is enough.¹⁶⁵ If the prohibition of use of the adjustment power is due to other circumstances, such as identity of a cotrustee or simply that the current income beneficiary does not need or want any income, a trustee should have a mechanism to trigger a new review when circumstances change.¹⁶⁶ This can be as simple as a tickler in the software system, or it may be done in conjunction with each year’s annual review.¹⁶⁷

157. See *id.*; see also S. Alan Medlin, *Limitations on the Trustee’s Power to Adjust*, 42 REAL PROP. PROB. & TR. J. 717, 726–47 (2008).

158. See Medlin, *supra* note 157.

159. See TEX. PROP. CODE ANN. § 116.005(c); see also 72 TEX. JUR. 3D *Trusts* § 123 (2007).

160. 72 TEX. JUR. 3D *Trusts* § 123. If the nonindependent cotrustee’s participation in every decision is not required, then the nonindependent cotrustee 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.

161. See TEX. PROP. CODE ANN. § 116.005(c); see also Medlin, *supra* note 157, 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. See *id.* 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. See Medlin, *supra* note 157, at 739.

162. See Medlin, *supra* note 157, at 726.

163. See *id.*

164. See RESTATEMENT (THIRD) OF TRUSTS § 83 (2003).

165. *Id.* § 111.

166. See *id.*

167. See *id.*

B. If Available, Should an Adjustment Be Made to Income This Year?

If the Uniform Principal Act is the governing law of a trust and under the current circumstances of the trust, the adjustment power is available, then the trustee must determine whether to make an adjustment.¹⁶⁸ 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.¹⁶⁹

The application of the Prudent Investor Rule is fundamental to the adjustment power.¹⁷⁰ The trustee must follow the Prudent Investor Rule when exercising the adjustment power.¹⁷¹ 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.¹⁷²

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.¹⁷³

C. What Issues Should the Trustee Consider?

Making this adjustment analysis is a valuable opportunity for the trustee to make a wholesale review of all of the circumstances of the trust.¹⁷⁴ Most corporate trustees have created a form comprised of relevant questions; the trust officer completes the form and submits it to a trust committee to aid in the decision.¹⁷⁵ The form's details are less important than ensuring a detailed investigation.¹⁷⁶ Crucial questions to include in the investigation are:

- What is the purpose of the trust, and what is the primary intent of the settlor?¹⁷⁷ What is the expected duration of the trust?¹⁷⁸
- What are the names, ages, and any special circumstances of the beneficiaries?¹⁷⁹

168. See Medlin, *supra* note 157, at 726–27.

169. See *id.* at 745–46.

170. 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).

171. See *id.*

172. See Burdette with Pacheco, *supra* note 108. Just because you can, doesn't mean you should. See *id.*

173. See *id.*

174. See *id.*

175. See *id.*

176. *Id.*

177. TEX. PROP. CODE ANN. § 116.005(b)(1)–(2) (West 2007).

178. *Id.* § 116.005(b)(1).

- What are the liquidity needs?¹⁸⁰ Reviewing past expenditures is important, but the trustee should also consider the foreseeable future—including education, health, age of retirement, and other assets that may be coming to the beneficiaries.¹⁸¹
- Does the document allow a trustee to invade principal?¹⁸² Does the document allow for the accumulation of income?¹⁸³
- How are the assets invested, including non-financial assets of the trust such as oil and gas, timber, rental property, and closely held businesses?¹⁸⁴
- How will the other provisions of the Uniform Principal and Income Act affect the net amount allocated to income from oil and gas, timber, and fees?¹⁸⁵
- What effect would an adjustment to income have on the tax situation of the trust and the beneficiaries?¹⁸⁶

D. If an Adjustment Is Made This Year, How Much Should It Be?

After considering the factors discussed above, the trustee must exercise discretion when deciding whether to adjust between principal and income.¹⁸⁷ The adjustment amount, which should be reconsidered every year, will likely differ for various trusts administered by a trustee.¹⁸⁸ A primary concern for the trustee will be the historical returns on the investments in this trust.¹⁸⁹ After the trustee considers the actual returns and the appropriate level of beneficial enjoyment, if there is a difference between those amounts, the trustee may make an adjustment between principal and income.¹⁹⁰

Many trustees only review a few years of historical information—but a longer review is better.¹⁹¹ For example, consider a hypothetical \$2 million trust

179. *Id.* § 116.005(b)(3).

180. *Id.* § 116.005(b)(4).

181. *Id.*

182. *Id.* § 116.005(b)(7).

183. *Id.*

184. *Id.* § 116.005(b)(5).

185. *Id.* § 116.005(b)(6).

186. *Id.* § 116.005(b)(9). Remember that trust accounting and tax accounting are not the same thing. Sonja Pippin, *Income Tax Accounting for Trusts and Estates*, J. ACCT. (Oct. 2010), <http://www.journalofaccountancy.com/issues/2010/Oct/20102933.htm>. Funds that the trustee distributes as income may or may not be treated that way for tax purposes. *Id.*

187. *Id.*

188. See Burdette with Pacheco, *supra* note 108.

189. *Id.*

190. *Id.* Above all, remember that a trustee may not “increase or decrease the degree of beneficial enjoyment to which a beneficiary is entitled under the terms of the trust; rather, . . . the trustee [can] make adjustments between principal and income that may be necessary if the income component of a portfolio’s total return is too small or too large because of investment decisions made by the trustee under the [P]rudent [I]nvestor [R]ule.” UNIF. PRINCIPAL & INCOME ACT § 104 cmt. (amended 2008).

191. See, e.g., *infra* notes 192–201.

invested in various asset classes with five year average returns as set out below, in Chart A.¹⁹² In Chart A we see that, during this period, by allocating less of the portfolio to traditional fixed income assets, the traditional income (shaded gray on the chart) decreased but the total return increased.¹⁹³ To be fair to both classes of beneficiaries (and assuming that the chart represents an appropriate level of beneficial enjoyment), adjustment considerations might be as follows: (1) prior to the Uniform Principal and Income Act: traditional income is \$73,000; (2) after the Uniform Principal and Income Act, when account is invested for total return: traditional income is \$ 61,000; (3) adjustment in this year should be no more than \$ 12,000.¹⁹⁴

Assuming that the trustee elected to include the entire difference as the adjustment amount, this would result in an annual distribution of 3.65% of the \$2 million fair market value of the trust.¹⁹⁵ When fees are taken in accordance with the statute, for example, a fee of 1% or \$20,000—taken equally from income and principal—applies and the adjustment calculation remains at \$12,000; the actual amount distributed would be \$63,000, and the percentage received by the beneficiary is 3.15%.¹⁹⁶ Trustees who assured beneficiaries that they could rely on “a flat 4%” should worry because that amount may not be sustainable.¹⁹⁷

Varying the five-year period used—perhaps something like January 1, 2004 to December 31, 2008—can produce alarming results.¹⁹⁸ In the second illustration, Chart B, we see the negative impact of having allocated less of the portfolio to traditional fixed income assets at a time when equities were outperforming—a severe decline in equity performance leads to a loss in the principal revenue of the trust.¹⁹⁹ To be fair to both classes of beneficiaries (and assuming that the chart represents an appropriate level of beneficial enjoyment), the trustee may now prefer to utilize only the traditional income calculation.²⁰⁰ Some trustees might consider an adjustment re-categorizing income as principal—essentially distributing the loss to both categories of beneficiary.²⁰¹

But the best way to obtain truly fair results is to utilize a longer view—ten, twenty, or even thirty years—because long term data provides a greater

192. See *infra* Chart A.

193. *Id.*

194. *Id.*

195. *Id.*

196. *Id.*

197. See *id.* For this reason, in those states where the statute supports a “unitrust” type calculation, trustees should recalculate annually to be sure it is a sustainable percentage and should communicate carefully with beneficiaries. See generally Ted R. Batson, Jr., *Net Income with Make-up Charitable Remainder Unitrusts and the Trustee’s Power to Adjust Under Indiana’s Uniform Principal and Income Act*, 45 IND. L.R. 841 (2012) (discussing unitrusts in Indiana). In those situations precluding recalculation, trustees should carefully chose the percentage. *Id.*

198. See *infra* Chart B.

199. See *id.*

200. *Id.*

201. See RESTATEMENT (THIRD) OF TRUSTS § 111 cmts. (2003).

smoothing effect on the calculations.²⁰² For this purpose, a “market cycle” is clearly something longer than five years.²⁰³ And it is important for the trustee to utilize that actual historical data for the individual trust.²⁰⁴ A large trust utilizing multiple asset classes and including alternative investments will look very different than the simple allocation presented here.²⁰⁵

Assuming the trust opts for the traditional income approach, under the above example, the difference between the traditional income prior to a reallocation and after being invested for total return is still \$12,000, but because there is no gain—assuming no adjustment—this situation would result in an annual distribution of 3% of the \$2 million fair market value of the trust.²⁰⁶ When fees are taken in accordance with the statute, for example the same fee of 1% or \$20,000 taken equally from income, and principal the actual amount distributed would be \$51,000 and the percentage the beneficiary would receive is 2.55%.²⁰⁷ As noted above, a trustee who promised beneficiaries a 4% return every year is now in a very difficult situation.²⁰⁸

Of course, in a real market situation, the actual market value of the trust would certainly vary and likely be reduced from the \$2 million starting point.²⁰⁹ In that event, the unitrust calculation is, of course, applied to the reduced number.²¹⁰ For example, if the value of the trust is down 15% resulting in a total market value of \$1.7 million and the 3.65% number from our first calculation is applied, the resulting distribution would be \$62,050 (which is very close to the traditional income amount).²¹¹

It is important to note that there is no single solution. A prudent trustee must consider and address each set of circumstances.²¹² However, there is a constant formula for avoiding mistakes—that the trustee establishes prudent policies, follows those policies scrupulously, obtains thoughtful advice, and documents the process in every case.²¹³

In a corporate trust department, the various forms that gather information specific to the particular account, calculations (some institutions have devised software to perform these), a recommendation by the trust officer, and review and approval by a trust committee usually accomplish the procedure described above.²¹⁴

202. *See id.*

203. *See id.*

204. *See id.*

205. *See id.*

206. *See id.*; *see also supra* notes 195–97.

207. *See* RESTATEMENT (THIRD) OF TRUSTS § 111 cmts.; *see also supra* notes 195–97.

208. *See* RESTATEMENT (THIRD) OF TRUSTS § 111 cmts.; *see also supra* notes 195–97.

209. *See* RESTATEMENT (THIRD) OF TRUSTS § 111 cmts.

210. *See* RESTATEMENT (THIRD) OF TRUSTS § 111 cmts.; *see also supra* notes 192–97.

211. *See* RESTATEMENT (THIRD) OF TRUSTS § 111 cmts.; *see also supra* notes 192–97.

212. *See* Burdette with Pacheco, *supra* note 108.

213. *See generally* GERSTNER, *supra* note 16 (explaining how a trustee can avoid mistakes).

214. *See id.*

E. When Not to Exercise

The Act provides several limitations on the power to adjust a trust.²¹⁵ The limitations are mainly designed to preserve tax benefits that may have been important to the purpose for creating the trust, preventing other adverse tax consequences, and removing the potential for conflict of interest by denying the power to adjust to any beneficiary.²¹⁶

Specifically, Texas Property Code § 116.005(c), which enumerates the limitations, reads as follows:

- (c) A trustee may not make an adjustment:
 - (1) that reduces the actuarial value of the income interest in a trust to which a person transfers property with the intent to qualify for a gift tax exclusion;
 - (2) that changes the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets;
 - (3) from any amount that is permanently set aside for charitable purposes under a will or the terms of a trust unless both income and principal are so set aside;
 - (4) if possessing or exercising the power to make an adjustment causes an individual to be treated as the owner of all or part of the trust for income tax purposes, and the individual would not be treated as the owner if the trustee did not possess the power to make an adjustment;
 - (5) if possessing or exercising the power to make an adjustment causes all or part of the trust assets to be included for estate tax purposes in the estate of an individual who has the power to remove a trustee or appoint a trustee, or both, and the assets would not be included in the estate of the individual if the trustee did not possess the power to make an adjustment;
 - (6) if the trustee is a beneficiary of the trust; or
 - (7) if the trustee is not a beneficiary, but the adjustment would benefit the trustee directly or indirectly.²¹⁷

XII. THE SPENDTHRIFT CLAUSE

The interaction of a spendthrift clause and the distribution standard frequently raises difficult issues for the trustee.²¹⁸ Texas has little precedent on

215. TEX. PROP. CODE ANN. § 116.005(c)(1)–(7) (West 2007).

216. *Id.* § 116.005(c)(1)–(5)

217. *Id.* § 116.005(c); *see also* UNIF. PRINCIPAL & INCOME ACT § 104(c) (amended 2008). The Texas Legislature amended the Uniform version of the Uniform Principal and Income Act, repealing § 104(c)(1), which specifically limited an adjustment “that diminishe[d] the income interest in a trust that require[d] all of the income to be paid at least annually to a spouse and for which an estate tax or gift tax marital deduction would be allowed, in whole or in part, if the trustee did not have the power to make the adjustment.” *Compare* TEX. PROP. CODE ANN. § 116.005(c), *with* UNIF. PRINCIPAL & INCOME ACT § 104(c). Presumably, this was in response to Internal Revenue Service’s adoption of Treasury Regulation § 1.643. *See generally* Treas. Reg. § 1.643 (2013) (discussing distributable net income and deductions for distributions).

this issue.²¹⁹ 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.²²⁰ 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.²²¹

Trustees should be familiar with the terms of the relevant state statute regarding when a spendthrift trust is created.²²² In Texas, Property Code § 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.²²³ Trustees should remember that the spendthrift protection terminates with the trust.²²⁴ Once in the hands of the beneficiary, funds are fair game for creditors.²²⁵ The next section discusses an exception to the spendthrift rule for child support.²²⁶ In most states, including Texas, this is now a statutory provision.²²⁷

XIII. COMMUNICATE WITH THE BENEFICIARY

The trustee has a duty to be informed of circumstances affecting the trust.²²⁸ The trustee should frequently communicate with the beneficiaries about individual circumstances and the general administration of the trust.²²⁹ Administrative decisions regarding 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.²³⁰

Many states that have adopted the Uniform Principal and Income Act have also adopted a provision that requires the trustee to give notice to any beneficiaries of the proposed adjustment and then provides for a limited time in which to object.²³¹ The Texas Legislature decided not to include such a

218. TEX. PROP. CODE ANN. § 112.035.

219. *See id.*

220. *Nations Bank of Va. v. Grandy*, 450 S.E.2d 140, 143–44 (Va. 1994).

221. *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”).

222. *See, e.g.*, TEX. PROP. CODE ANN. § 112.035.

223. *Id.* § 112.035(d)(1).

224. *Faulkner v. Bost*, 137 S.W.3d 254, 260–61 (Tex. App.—Tyler 2004, no pet.).

225. TEX. PROP. CODE ANN. § 112.035.

226. *See infra* Part XVI; *see also* *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.).

227. TEX. FAM. CODE ANN. § 151.001 (West 2008).

228. *See* RESTATEMENT (THIRD) OF TRUSTS § 111 cmt. d (2003).

229. *See id.*

230. *See id.*

231. *See, e.g.*, NEV. REV. STAT. ch. 164 (2010) (containing the provisions relating to the notice required).

provision because statutory and common law already provide adequate notice protection for beneficiaries.²³²

Despite the fact that there is no separate statutory mandate, trustees should educate beneficiaries about this tool and its application to their trust.²³³ Trustees should give the beneficiaries information about the process they utilize to make these discretionary decisions.²³⁴ Given the technical nature of discretionary decisions, trustees should use non-technical language, when possible, and they should encourage questions, so beneficiaries understand the terms and administration of their trust.²³⁵ Additionally, trustees should document the process.²³⁶

XIV. KEEP EVERY SCRAP OF PAPER (OR DIGITAL DATA)

When the trustee makes the decision to not pay a requested distribution, it is important to properly document the reasons for declining in the file and to then convey the decision to the appropriate parties quickly.²³⁷ Documenting discretionary action is essential and should include payment of expenses, distributions to beneficiaries, and decisions regarding investments or the use of the adjustment power.²³⁸ If a dispute between the beneficiary and trustee requires a determination of reasonableness, the proof required will be that which would be required to make the same determination by decree.²³⁹ File documentation could become courtroom evidence.²⁴⁰

XV. 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.²⁴¹ The trustee must determine whether the primary purpose of a trust is to support now, conserve the assets for the future, or both.²⁴² The variety of requests seems

232. See generally TEX. PROP. CODE ANN. chs. 116–17 (containing the provisions of Texas’s Uniform Principal and Income Act and its Uniform Prudent Investor Act).

233. See *id.*

234. Sarah Patel Pacheco, *Fiduciary Litigation: Avoiding (or Minimizing) the Traps, Tribulations, and Trials*, 5 EST. PLAN. & COMM. PROP. L.J. 95, 134 (2012) [hereinafter Pacheco, *Fiduciary Litigation*].

235. *Id.*

236. *Id.*

237. See generally *id.* (noting the significance of documenting attempts to protect separate property).

238. See *id.* at 106–07.

239. *In re Martin’s Will*, 199 N.E. 491, 495 (N.Y. App. Div. 1936).

240. See generally FED. R. EVID. 1002 (requiring an original to prove the content of a writing, recording, or photograph). For example, if a beneficiary submits his or her grade report to demonstrate an aptitude for art and then requests a distribution for a semester in France, the trustee should treat that grade report as if it were worth a few months in Europe—it will be if there is future litigation surrounding the decision to distribute. See *id.*

241. See Pacheco, *Fiduciary Litigation*, *supra* note 234, at 111.

242. *Id.*

infinite, and there is little guidance in case law because a lawsuit is rarely instituted to force or protest distribution for a single item.²⁴³ Some requests can be easily classified in more than one way.²⁴⁴

A. Health

The term “health” typically includes many distributions that would also be permissible under a support standard alone.²⁴⁵ 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.”²⁴⁶ The legislature added this section because trustees administering judicially created trusts found the variety of health related requests to be daunting.²⁴⁷ 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, un-prescribed lab tests (such as tests for sexually transmitted diseases), tattoo removal, and concierge medicine.²⁴⁸ 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;
- Home health care;²⁴⁹
- Physical therapy;
- Psychiatric treatment/Psychological counseling;
- Mental health and mental retardation services;
- Occupational therapy;
- Medical expenses of beneficiary’s children where a duty to support exists;
- Dental and orthodontia expenses;
- Medical supplies, equipment, and batteries;
- Pharmaceuticals;
- Medically prescribed therapeutic items such as whirlpools, horses, pools;
- Hospital beds and specially designed furniture for the handicapped;
- Eye care, eyeglasses, and contact lenses;

243. *See id.* at 135–36.

244. *See infra* Part XV.A–C.

245. *See* RESTATEMENT (THIRD) OF TRUSTS § 50, cmt. d (2003).

246. TEX. PROP. CODE ANN. § 142.005(b)(2) (West 2007).

247. *See* Tex. H.B. 564, 80th Leg., R.S. (2007) (enrolled version).

248. *See* RESTATEMENT (THIRD) OF TRUSTS § 50, cmt. d.

249. *See In re Trust Created Under Last Will & Testament of Stonecipher*, 849 N.E.2d 1191, 1197 (Ind. Ct. App. 2006) (finding 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).

- Linens and special clothing requirements;
- Handicap transport vans and lift equipment;
- Ramp construction, adaptation of doors, and remodeling to accommodate handicaps;
- Installation of safety equipment such as handrails; and
- Specialized cleaning to eliminate allergens.²⁵⁰

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.²⁵¹ As such, education would appear to be easy to define; however, there are many cases demonstrating ambivalence in the courts.²⁵² 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.²⁵³

250. See generally RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. d (discussing the different health-related topics).

251. See *id.*

252. See *id.* Although the restatement appears to include all these categories as “education” there are some contrary decisions for review. See *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”); *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); *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).

253. See generally RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. d (discussing the different education-related topics).

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.²⁵⁴ In fact, when the distribution standard includes these terms, a trustee’s discretion is no longer considered “unbridled.”²⁵⁵ In general terms, maintenance and support refers to the following types of living expenses:

- Rent or mortgage payments and utilities;
- Property taxes, insurance, maintenance, and repairs (on property held outside the trust);²⁵⁶
- Auto purchase, repair, and insurance;
- Childcare services;
- Funeral costs;
- Legal fees (for items such as divorce, adoption, or criminal defense);
- Estate planning, tax, and accounting advice;
- Tax preparation and payment; and
- One time requests for vacations, birthdays, Christmas, and emergencies, etc.²⁵⁷

This list was compiled over a relatively short time frame in conjunction with requests made for trusts, which almost all exclusively contained a plain HEMS standard, and it is not meant to be exhaustive.²⁵⁸ 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.²⁵⁹

254. *See id.* In many sources, the term “support” has been interpreted very broadly. *See id.* (providing 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).

255. *See First Nat’l Bank of Beaumont v. Howard*, 229 S.W.2d 781, 785 (Tex. 1950); *In re Estate of Dillard*, 98 S.W.3d 386, 395 (Tex. App.—Amarillo 2003, pet. denied).

256. Matthew A. Levitsky, *What Does Maintenance and Support Really Mean in Trust?*, EST. PLAN. & WEALTH PRESERVATION BLOG FOR TRUSTED ADVISORS (Sept. 17, 2013), <http://estateplanning.foxrothschild.com/2013/09/articles/wills-and-trusts/what-does-maintenance-and-support-really-mean-in-a-trust>; *see also* RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. d. 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.*

257. *See generally* RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. d (discussing the different maintenance- and support-related topics).

258. *Id.*

259. *Hartford-Conn. Trust Co. v. Eaton*, 36 F.2d 710 (2d Cir. 1929).

XVI. 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.²⁶⁰ There are numerous factors for the trustee to consider in situations where others may be obligated to support a beneficiary.²⁶¹ These are raised most often in court-created trusts, although they certainly may be an issue in any type of personal trust.²⁶² 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.²⁶³ All states also have laws regarding the duty between spouses.²⁶⁴

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.²⁶⁵ 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.²⁶⁶ Most people would rather answer specific questions or prepare financial statements than provide tax returns—tax returns often fail to provide a clear picture of financial resources.²⁶⁷ Notwithstanding their limited value, some corporate trustees still require beneficiaries to provide tax returns.²⁶⁸

Importantly, as noted above, a court ordered child support obligation will trump a trust containing a spendthrift clause.²⁶⁹ 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.

260. 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. See *id.*

261. See Burdette with Pacheco, *supra* note 108.

262. See *id.*

263. See *id.*

264. See *id.*

265. See *id.*

266. See BOGERT, *supra* note 11, § 811.

267. See Burdette with Pacheco, *supra* note 108.

268. Nancy S. Freeman, *Trust Me: Practical Advice for Drafting Florida Trusts*, 83 FLA. B.J. 20, 22 n.9 (May 2009).

269. See *supra* Part XIII.

(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.²⁷⁰

While it is an unfortunate fact in modern society that substance abuse is found at every level of affluence, substance abuse is occasionally addressed in trust documents.²⁷¹ A standard of living clause may force the trustee to maintain a comfortable lifestyle for the beneficiary while the beneficiary spends the trust assets on drugs or alcohol.²⁷² 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.²⁷³ The recommendation included a provision for a drug screening of all beneficiaries, regardless of whether the trustee suspected a beneficiary's drug use.²⁷⁴ This language provides some protection for the trustee against claims of abuse of discretion, but it may present additional problems and expense.²⁷⁵

XVII. WHO TO PAY

It is axiomatic that trustees must make distributions to or for the benefit of the beneficiary.²⁷⁶ Usually, the trustee's duty of determining the identity of the beneficiaries is relatively easy.²⁷⁷ 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.²⁷⁸ Drafters continue to use a variety of terms, even though the Texas statute does not adequately define many of them.²⁷⁹ Some courts have construed the terms "issue" and "children"

270. TEX. FAM. CODE ANN. § 154.005 (West 2008).

271. 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), <http://www.actec.org/Documents/misc/MorseUniqueDraftingProblems.pdf>.

272. See *id.*; see also generally RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. a (2003) ("The trustee may have discretion . . . only to determine the time, manner, and amount of distributions, pursuant to a particular standard of otherwise.").

273. See Morse, *supra* note 271.

274. *Id.*

275. *Id.* The recommendation included an assertion by the settlor that by, making distributions to a beneficiary contingent on passing a drug test, the settlor promoting the health and well-being of the beneficiary. See *id.* ACTEC 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. See *id.* 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.

276. See Burdette with Pacheco, *supra* note 108.

277. See *id.*

278. See *Guilliams v. Koonsman*, 279 S.W.2d 579, 583 (Tex. 1955).

279. See TEX. PROP. CODE ANN. § 111.004(13) (West 2007). 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

interchangeably.²⁸⁰ 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.²⁸¹

Once the trustee determines the appropriate beneficiary, if the circumstances require, the trustee may make payments for the benefit of, rather than directly to, the beneficiary.²⁸² 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.²⁸³ The statutes are also clear for court trusts.²⁸⁴ In all cases, Texas trust law clearly allows distributions to a parent, guardian, or caregiver.²⁸⁵

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).

280. *Guilliams*, 279 S.W.2d at 583.

281. *Atkinson v. Kettler*, 372 S.W.2d 704, 711–12 (Tex. Civ. App.—Dallas 1963, writ granted), *rev’d on other grounds*, 383 S.W.2d 557 (Tex. 1964).

282. *See* RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. e(3) (2003).

283. TEX. PROP. CODE ANN. § 113.021(a) (West 2007).

284. *See* TEX. ESTATES CODE ANN. § 1301.102(a)(2) (West 2014); *see also* TEX. PROP. CODE ANN. § 142.005(c)(2). Under § 1301.102 of the Estates Code, a management trust 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

As noted above, all distributions should be carefully documented.²⁸⁶ Policy for distributions to parents or caregivers should include faithful documentation of the purpose of each reimbursement, including receipts or copies of cancelled checks.²⁸⁷ Monthly maintenance and support distributions should be supported periodically—at least annually is preferred—by documentation of need and of expenses gathered.²⁸⁸ This might include parents' financial information, if they retain a duty to support the beneficiary.²⁸⁹ The trustee should look to the Texas Family Code to determine when a parent's duty to support a child terminates.²⁹⁰ Currently, for a child who is not disabled, the law requires support until age eighteen or until graduation from high school.²⁹¹ The parent of a child suffering from a disability may be required by law to support that child indefinitely.²⁹² Accordingly, despite the common misconception among laypersons, it is important for the trustee to be aware that child support does not necessarily end at age eighteen.²⁹³

Incapacitated adults should accommodate similar documentation of expenses, and 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.²⁹⁴ Situations in which an extremely low-income household may be caring for a beneficiary with a substantial sum in trust—as is often the case in a court-created trust—may require special procedures.²⁹⁵ In a supplemental needs trust, the trustee should not make distributions directly to the beneficiary, even if the distributions are not for prohibited items.²⁹⁶ Trustees should frequently reference the instrument, and if questions arise, trustees should conduct research or seek the advice of counsel.

Trustees should treat beneficiaries differently upon reaching age eighteen.²⁹⁷ At that time, assuming the beneficiary is not mentally incompetent, the trustee should not make distributions without the beneficiary's knowledge,

beneficiary; or (4) a service provider to the beneficiary or to the beneficiary's legal obligation. TEX. ESTATES CODE ANN. § 1301.102(a). Section 142 of the Texas Property Code provides that distributions can be made to a beneficiary's legal or natural guardian "or to the person having custody of the beneficiary or may be made directly to or expended for the benefit, support, or maintenance of the beneficiary without the intervention of any legal guardian or other legal representative of the beneficiary." TEX. PROP. CODE ANN. § 142.005(c)(2).

285. See TEX. PROP. CODE ANN. § 113.021.

286. See *supra* Part XIV

287. See GERSTNER, *supra* note 16, at 8–9.

288. See *id.* at 4–5.

289. See *id.*

290. See TEX. FAM. CODE ANN. § 151.001 (West 2008).

291. See *id.* § 151.001(b).

292. See *id.* § 154.001.

293. See *id.* § 154.002.

294. See TEX. PROP. CODE ANN. § 113.021(a)(5) (West 2007).

295. See Michael S. Kutzin, *Ten Biggest Mistakes You Can Make In Your Estate Plan*, SENIORLAW.COM, <http://www.seniorlaw.com/tenmistakes.htm> (last visited June 20, 2014).

296. See Abraham J. Perlstein, *Comprehensive Future Care Planning for Disabled Beneficiaries*, EST. PLAN., Oct. 2000, at 360, 367.

297. See Burdette with Pacheco, *supra* note 108.

and the trustee should direct statements to the beneficiary, unless the trust specifically addresses this issue.²⁹⁸ Many parents are shocked to discover that their child must be informed at eighteen (or twenty-five) years of age and may request that their child not even be told about the trust.²⁹⁹ This is not acceptable—disclosure is mandatory, except in very narrow circumstances.³⁰⁰ The current version of Texas Property Code § 111.0035(c), which became effective on June 17, 2007, 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.³⁰¹

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.³⁰² Thereafter, even if the document purports to allow continued secrecy, the statute clearly requires the trustee to keep the beneficiary fully informed.³⁰³

XVIII. WHEN TO PAY?

The trustee should pay the beneficiary promptly because a trustee may not unreasonably delay the exercise of discretion.³⁰⁴ While the court will not direct how the trustee exercises its discretion with respect to selecting charitable entities to receive distributions, the court does have the “power to order a recusant or unreasonably dilatory trustee” to make a decision.³⁰⁵ If the trustee refuses, the court may remove the trustee and appoint a successor.³⁰⁶

298. See TEX. PROP. CODE ANN. § 111.0035(c).

299. See *id.*

300. See *id.*

301. *Id.* Section 113.060—effective January 1, 2006 and repealed as of June 17, 2014—imposed a standard that a “trustee shall keep the beneficiaries of the trust *reasonably* informed . . .” Act of Jan. 1, 2006, 79th Leg. R.S., Ch. 148, § 15, sec. 113.060, 2006 Tex. Sess. Law Serv. 287, 292 (amended 2007) (current version at TEX. PROP. CODE ANN. § 111.0035(c)) (emphasis added). A question 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. *Id.* The new 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. See *id.*

302. TEX. PROP. CODE ANN. § 111.0035(c).

303. See *id.*

304. See *Boyd v. Frost Nat’l Bank*, 196 S.W.2d 497, 505 (Tex. 1946).

305. See *id.*

306. See *id.*

One advantage of a professional trustee is that they can make decisions consistently and objectively, and investment choices can be more diverse.³⁰⁷ However, when the trustee invests assets in a more diverse portfolio, the trustee must be sure that liquidity does not become an issue.³⁰⁸ Liquidity should be the trustee's problem, not the beneficiary's.³⁰⁹ With the use of modern technology, trades may now settle in a matter of hours.³¹⁰ Many institutions now use mutual funds, so the old restrictions on trading common trust funds are less relevant.³¹¹ Many alternative investments, however, are very illiquid, and in some instances, they require a year or more to opt out.³¹² The trustee should maintain sufficient liquid assets in an account to cover the beneficiary's routine needs, the trustee's own fees, and the occasional emergency.³¹³ Generally, beneficiaries who are entitled to a distribution are not sympathetic to trade dates or lock up requirements that the trustee has imposed upon them.³¹⁴

Since the distribution standard in a personal trust often includes a requirement of necessity, delay is particularly difficult to justify.³¹⁵ 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.³¹⁶

Other considerations affect the timing of distributions.³¹⁷ It is important for the trustee to remember that they can usually reinvest income that they do not distribute.³¹⁸ But the trustee should not commingle principal and income investments in some circumstances.³¹⁹ Many settlors intend by the establishment of the trust to preserve the assets as the separate property of their child.³²⁰ Upon the failure of a marriage, the issue becomes whether the spouse has "acquired" undistributed income during the marriage.³²¹ In cases where the

307. See RESTATEMENT (THIRD) OF TRUSTS § 227 cmt. i (2003) (explaining necessity of objectivity and impartiality as a trustee).

308. See *id.* § 229 cmt. a (explaining trustee's duties to restructure to achieve an acceptable level of risk and return).

309. See *id.*

310. See *id.*

311. See *id.* § 227 cmt. m (showing trend towards pools and decline of restrictions on trading common trust funds).

312. See Sameer Jain, *Alternative Investments Building Blocks: Illiquid Assets*, AM. REALTY CAP., <http://www.ipa.com/wp-content/uploads/illiquid.pdf> (last visited June 20, 2014).

313. See RESTATEMENT (THIRD) OF TRUSTS § 181 cmt. a (explaining duty to make trust property productive).

314. See *id.*

315. See *id.* § 50 cmt. d (explaining construction of necessities and other commonly used restrictions).

316. See *id.*

317. See *id.* § 111 cmt. d (illustrating various considerations affecting distributions).

318. See *id.*

319. See *id.* § 109 cmt. a (entailing possible complications arising from trustee failure to account for principal and income).

320. See *id.*

321. See *id.*

instrument provides that undistributed income “shall become principal,” the determination may be clouded.³²²

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.³²³ Additionally, courts have held that a spouse cannot acquire undistributed income earned by a decedent’s estate of which the spouse is a beneficiary.³²⁴ 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.³²⁵ The trustee may elect to distribute undistributed income periodically to avoid commingling.³²⁶ Generally, in Texas, if the beneficiary receives discretionary income distributions from the trust during the marriage, those funds become community property.³²⁷

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.³²⁸ 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.³²⁹ 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.³³⁰

XIX. SOME SPECIAL CONSIDERATIONS FOR INDIVIDUAL TRUSTEES AND CO-TRUSTEES

There are compelling reasons for an attorney or accountant to avoid serving as a trustee—particularly if he or she also performs professional services for the trust.³³¹ As noted, the duty of loyalty requires the trustee to forego any personal interest and any opportunities for gain with respect to property subject to the fiduciary relationship; the trustee must act completely in the interest of the beneficiaries.³³² This duty of fidelity forbids the trustee from placing himself in a situation where there is or could be a conflict between self-

322. *See, e.g.*, *Buckler v. Buckler*, 424 S.W.2d 514, 516 (Tex. Civ. App.—Fort Worth 1968, writ diss’d).

323. *See id.*

324. *In re Marriage of Burns*, 573 S.W.2d 555, 557–58 (Tex. Civ. App.—Texarkana 1978, writ diss’d).

325. *Id.* at 557.

326. *Id.*

327. *Ridgell v. Ridgell*, 960 S.W.2d 144, 148 (Tex. App.—Corpus Christi 1997, no pet.).

328. *Lemke v. Lemke*, 929 S.W.2d 662, 664 (Tex. App.—Fort Worth 1996, writ denied).

329. *Lipsey v. Lipsey*, 983 S.W.2d 345, 351 (Tex. App.—Fort Worth 1998, no pet.).

330. *Id.*

331. *See Interfirst Bank Dall., N.A. v. Risser*, 739 S.W.2d 882, 886–88 (Tex. App.—Texarkana 1987, no writ).

332. *See id.*

interest and the duty to the beneficiaries.³³³ This is the case even if a client receives disclosure and agrees to exculpatory provisions.³³⁴ Generally, an instrument cannot authorize self-dealing.³³⁵

Similarly, individual trustees, who, in their discretion, unreasonably distribute attorney or accounting fees to themselves or their firm, might be liable in tort.³³⁶ A trustee is entitled to reasonable fees from the funds of the trust.³³⁷ In Texas, determination of what is reasonable requires one to consider a number of factors, such as the following: the amount and character of the trust property; the character of the trustee's service and the degree of difficulty of such services; and the amount of fees that are customary in the community.³³⁸ Assume that it would be unreasonable for a trustee to engage himself for professional services and charge both the trustee and attorney or accounting fees.³³⁹ Even if the professional is merely a co-trustee, this may raise questions of self-dealing.³⁴⁰

Trustees should remember to make their capacity clear when they sign a contract or purchase request.³⁴¹ Trustee may be personally liable on a contract if they fail to stipulate to the contrary when signing.³⁴²

XX. COUNSEL FOR THE FIDUCIARY

If you are a trustee obtaining advice regarding make a discretionary decision, an issue may arise as to whom the attorney represents and whether he has a duty to the beneficiary.³⁴³ The majority of cases and ethics opinions hold that the trustee who retains counsel to represent the trustee in connection with administrative decisions in a trust or estate is the client.³⁴⁴ The client is not the trust³⁴⁵ or the beneficiaries.³⁴⁶ It is very important, however, that the beneficiaries are aware that the trustee retained the lawyer and that "the fiduciary is the lawyer's client; that while the fiduciary and the lawyer will,

333. *Id.* at 899 (citing *Slay v. Burnett Trust*, 187 S.W.2d 377, (Tex. 1945)).

334. *Id.* at 888.

335. See TEX. PROP. CODE ANN. § 113.059 (West 2007); see also *Langford v. Shamburger*, 417 S.W.2d 438, 442 (Tex. Civ. App.—Fort Worth 1967, writ ref'd n.r.e.).

336. See *Weatherly v. Martin*, 754 S.W.2d 790, 794 (Tex. App.—Amarillo 1988, writ denied); *King v. Acker*, 725 S.W.2d 750, 754 (Tex. App.—Houston [1st Dist.] 1987, no writ).

337. TEX. PROP. CODE ANN. § 114.061.

338. *Beaty v. Bales*, 677 S.W.2d 757, 759 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.).

339. See generally *id.* (noting the complex duties of a trustee).

340. *Id.*

341. See *Nacol v. McNutt*, 797 S.W.2d 153, 155 (Tex. App.—Houston [14th Dist.] 1990, writ denied).

342. *Id.*

343. See generally *Thompson v. Vinson & Elkins*, 859 S.W.2d 617, 621 (Tex. App.—Houston [1st Dist.] 1993, writ denied) (describing privity as a contractual connection or relationship).

344. See, e.g., *id.*

345. *Id.* at 623.

346. *Huie v. DeShazo*, 922 S.W.2d 920, 926 (Tex. 1996).

from time-to-time, provide information to the beneficiaries regarding the fiduciary estate, the lawyer does not represent them.”³⁴⁷

Today, in Texas, a trustee may assert the attorney-client privilege.³⁴⁸ In other jurisdictions, however, the privilege does not attach when a trustee seeks legal advice concerning a matter impacting the interests of the beneficiary.³⁴⁹ Usually, “a fiduciary has a duty of disclosure to the beneficiaries . . . and cannot subordinate the interests of the beneficiaries, directly affected by the advice sought, to his own private interests under the *guise* of privilege.”³⁵⁰

When making a distribution to counsel, the best practice is to engage counsel that is free of any conflict of interest and to document the engagement and payments carefully, remembering that the privilege may not apply.³⁵¹ *Huie v. DeShazo* is not an absolute guarantee that a trustee’s claim of privilege will be upheld.³⁵² There are exceptions to Evidence Rule 503, including any claim wherein the trustee failed to make appropriate disclosures to the beneficiary.³⁵³ It is important for the practitioner to ensure that the trustee and attorney know who the client is.

XXI. TERMINATING DISTRIBUTIONS

Disputes often arise between the beneficiaries and the trustee upon termination of the trust.³⁵⁴ 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.³⁵⁵ A trustee can anticipate some events and ensure files are organized and documentation is gathered in advance, but there are some events that the trustee cannot anticipate.³⁵⁶ Good documentation habits ensure a trust file is ready for a terminating event and is ready for a distribution of the corpus at any time.³⁵⁷

There is a Texas statute that impacts the determination of whether a trust is uneconomic; communication with, and full disclosure to, the beneficiaries should precede a decision to terminate a trust under the uneconomic provisions

347. MODEL RULES OF PROF’L CONDUCT R. 1.2 cmt. (adopted in Texas, January 1, 1990).

348. *Huie*, 922 S.W.2d at 923.

349. *See, e.g.*, *Hoopes v. Carota*, 142 A.D.2d 906, 909 (N.Y. App. Div. 1988).

350. *Id.* at 910 (emphasis added).

351. *See Huie*, 922 S.W.2d at 924.

352. *See id.*

353. *Montgomery v. Kennedy*, 669 S.W.2d 309, 313 (Tex. 1984); *see also* TEX. PROP. CODE ANN. § 113.151(a) (West 2007) (requiring trustee to account to beneficiaries for all trust transactions).

354. *See* TEX. PROP. CODE ANN. § 112.052.

355. *See id.*; *see also id.* §§ 112.059 (Termination of Uneconomic Trust), 112.054 (Judicial Modification or Termination of Trusts).

356. *See supra* Parts XIV, XVI.

357. *See id.* Part XVII.

of the statute.³⁵⁸ The statute is relatively new—it was enacted in 2007—and there appears not to be any cases deriving from either a refusal to terminate an account that is smaller than the threshold amount set out in the statute or an attempt to terminate an account that is larger for uneconomic reasons.³⁵⁹

XXII. CONCLUSION

The distribution decisions 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.³⁶⁰ To be a good trustee requires education, skill, attention to detail, the ability to plan carefully and execute meticulously, patience, judgment, and a little luck.

XXIII. MAKING DISTRIBUTIONS AND AVOIDING THE COURTS

It is unfortunate that the path of a trustee and the attorney representing the trustee is fraught with such legal peril. The state of the law tends to increase the cost of fiduciary services and decrease the number of trustees willing to serve.³⁶¹ In the words of the esteemed Judge Learned Hand: “The law ought not make trusteeship so hazardous that responsible individuals and corporations will shy away from it.”³⁶² On the other hand, the most important aspect of the fundamental trust relationship is the protection of the beneficiaries’ rights.³⁶³ A breach of the trust must provide a punishment severe enough to provide the necessary protection for those rights.³⁶⁴ In consideration of those rights, here are some general guidelines to apply in making discretionary decisions related to a trust, which may help to minimize the chances of getting sued:

(1) Do not rely on your memory or that of a previous trustee. Re-read the instrument frequently. Check past distribution records, and keep personal information on beneficiaries (marriages, children, serious illnesses) up to date.³⁶⁵

(2) Know and follow the law. Stay current on the law of the jurisdiction and remember that changes in the default statutes may significantly affect the interpretation of a document.

(3) Assume that any exculpatory language in the agreement will not be construed in your favor.³⁶⁶

358. See TEX. PROP. CODE ANN. § 112.059.

359. *Id.*

360. See Kutzin, *supra* note 295.

361. See *Dabney v. Chase Int’l Bank of N.Y.C.*, 196 F.2d 668, 675 (2d Cir. 1952).

362. *Id.*

363. See *supra* Part V.

364. See *supra* Part IV.

365. See *supra* Part IV.

366. See *supra* Part XIX; see also *Interfirst Bank Dall., N.A. v. Risser*, 739 S.W.2d 882 (noting that an

(4) Make decisions and distributions promptly. The failure to decide can become the decision.³⁶⁷

(5) Executing transactions and efficient operations should not be the client's problem. Maintain sufficient liquid assets to cover routine needs, and ensure all trust accounting and asset entries are accurate.³⁶⁸

(6) When you make a decision *not* to pay a request, it is just as important to document the file. Even when the amount is within the officer's authority, it is a good idea to take declinations to committee. Act quickly. Document your reasons. Convey your decisions promptly.³⁶⁹

(7) If you are a successor, carefully review the trail left by your predecessor.³⁷⁰

(8) Communicate with beneficiaries, as appropriate. Educate clients regarding the terms of the trust. Establish prudent policies and let clients know how to follow them.³⁷¹

(9) Keep accurate records for your successor. Memos to the file may be discoverable but they are the best way to ensure the trustee does not have to rely on memory in justifying a decision.³⁷²

(10) Make your capacity clear when signing a contract or purchase request. A trustee may be personally liable on a contract if he fails to stipulate to the contrary when signing.³⁷³

(11) If you are a professional trustee, follow internal procedure, as reflected by your policy and procedure manuals, administrative operating guides, or other documents your institution provides.³⁷⁴

(12) If you are an individual trustee, consider establishing clear policies and procedures to facilitate and document communication with the beneficiaries and maintain excellent records.³⁷⁵

(13) If you need help, seek independent counsel who is free of any conflict of interest. Remember that the attorney client privilege may not apply.³⁷⁶

(14) The rules are not the same for every trust; exercise of discretion requires review of individual circumstances. Each trust instrument and individual beneficiary will be different.³⁷⁷

exculpatory provision does not "relieve the trustee of liability for action taken in bad faith").

367. See *supra* Part XVIII.

368. See *supra* Part XVIII.

369. See *supra* Part XVIII.

370. See *supra* Part IV.

371. See *supra* Part XIII.

372. See *supra* Parts IV–V.

373. See *supra* Part XIX; see also *Nacol v. McNutt*, 797 S.W.2d 153, 155 (Tex. App.—Houston [14th Dist.] 1990, writ denied).

374. See *supra* Part XI.

375. See *supra* Parts VII, XI.D.

376. See *supra* Part XX.

377. See *supra* Part IV.

XXIV. CHART A

Asset Type	Average return 5 years	Previous Allocation	Annual Return Income/Gain	Allocated for Total Return	Expected Annual Return
Cash	2%	5%	\$ 2,000	5%	\$ 2,000
US Bonds/ Fixed Income	5%	55%	\$ 55,000	35%	\$ 35,000
US Equities Yield	2% div	40%	\$ 16,000	60%	\$ 24,000
US Equities Gain	8% gain		\$ 64,000		\$ 96,000
Total Return		100%	\$ 137,000	100%	\$157,000
Traditional income			\$ 73,000		\$ 61,000

Charts are for illustration and discussion purposes only; they are NOT recommendations of asset allocations, representations of actual past results, or predictions regarding future returns.

XXV. CHART B

Asset Type	Average return 5 years	Previous Allocation	Annual Return Income/Gain	Allocated for Total Return	Expected Annual Return
Cash	2%	5%	\$ 2,000	5%	\$ 2,000
US Bonds/ Fixed Income	5%	55%	\$ 55,000	35%	\$ 35,000
US Equities Yield	2% div	40%	\$ 16,000	60%	\$ 24,000
US Equities Gain	-2% gain		\$ -16,000		\$ -24,000
Total Return		100%	\$ 57,000	100%	\$ 37,000
Traditional Income			\$ 73,000		\$ 61,000

Charts are for illustration and discussion purposes only; they are NOT recommendations of asset allocations, representations of actual past results, or predictions regarding future returns.