## But What's an Ascertainable Standard?

**Clarifying HEMS distribution standards and other fiduciary considerations for trustees.**

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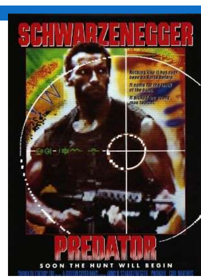
## Introduction

- Background
- General Info & Sources of Law
- Distribution Standard Spectrum
- Impact of Grantor Intent
- Specific Distribution Standards
- Modifying Language
- Other Considerations
- Best Practices

## Background




- Case law not helpful
- What is "Ascertainable"?
- Theory v. Reality?
- HEMS is cloaked
  - Know its there
  - But you can't see it
  - You kinda feel like its after you
- "We ain't got time to bleed!"

## General Info: Fiduciaries

- What is a fiduciary?
- Black's Law Dictionary:
  1. Someone who is required to act for the benefit of another person on all matters within the scope of their relationship; one who owes to another the duties of good faith, loyalty, due care, and disclosure
  2. Someone who must exercise a high standard of care in managing another's money or property

## General Info: Sources of Law

- Federal
  - IRC
- State (Texas)
  - Texas Trust Code (TTC)
  - Texas Family Code (TFC)
  - Common Law
- Other
  - Rest. 3d of Trusts (2003)
  - Uniform Trust Code (UTC)

## Distribution Standards: The Spectrum

1. Complete discretion
2. Unascertainable discretion
3. Ascertainable discretion
4. No discretion

## Distribution Standards: Meaning & Purpose

- Tax law concept
  - Addresses inclusion of trust assets in powerholder's estate
- States have copied
  - Mostly for creditor protection purposes
- HEMS is anything BUT certain, exact, or precise

## Grantor Intent

- The "Prime Directive"
- "4 corners" test
- Only a few rules of law trump grantor intent

## Absolute Discretion

- Absolute, Uncontrolled or Unfettered
  - Not what you'd expect!
  - Fiduciary duty and nonwaivable rules complicate things

## Unascertainable Standards

- Comfort
- Welfare
- Happiness
- Benefit
- Best interest

## Ascertainable Standards: Generally

- HEMS is the boundary
- Proper drafting is best way to avoid problems
- Do not need to include all to retain status
- BUT: One bad apple spoils the bunch

## Ascertainable Standards: Support and Maintenance

- Considered similar or synonymous
- Per Restatement (Third):
  - "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."
- Includes both needs of beneficiary and his or her dependents
- Courts split on balancing present and future needs

## Ascertainable Standards: Education

- Rest (Third) includes:
  - Tuition
  - Books
  - Fees
  - Living expenses
- Includes technical training and non-traditional schooling
- But many questions remain

## Ascertainable Standards: Health

- TPC §142.005(b)(2): "Trustee may *conclusively* presume that medicine or treatments approved by a licensed physician are appropriate for the health of the beneficiary."
- Even health standard lacks clarity

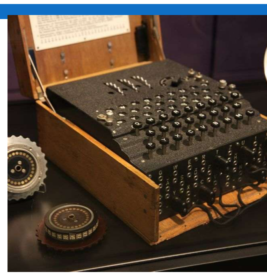
| Health | Education | Maintenance & Support |
|---|---|---|
| Emergency & regular medical treatment | Grammar, secondary and high school tuition | Mortgage payments & down payment on a home |
| Routine healthcare examinations | Medical school, law school, or other professional school | Continuation of accustomed patterns of vacation |
| Health, Dental or Vision Insurance | College in Europe as part of a study abroad program | Property/casualty/liability insurance for home, auto, etc… |
| Unconventional medical treatment | Costs for long-term studies or "career students" | Support for beneficiary engaged in charitable endeavors |
| Extended vacations to relieve tension and stress | Support of beneficiary while in school | Continuation of family gifting |
| Rehab for physical problem or addiction | Support of beneficiary between semesters | Life insurance |
| Health-related home renovations | Graduate & post graduate school tuition and expenses | Charitable gifting |
| Specialized cleaning services to remove allergens | Extracurricular activity fees, expenses & paraphernalia | Rent payments |
| Cosmetic surgery | Tutoring; speech or reading therapy | Automobiles |
| Home health care | Graduation costs, proms & class rings | Property taxes |
| Gym, Spa or Golf memberships | Books, computers, supplies, etc. | Home repair & maintenance |
| Dental & orthodontics | Study abroad | Support of family members |
| Golf club memberships | Technical school training | Assistance starting a business |
| Psychiatric treatment | Career training | Legal fees |
| Eye care | Day care | |
| Handicap transport | Uniforms & school clothes | |
| Lasik surgery | Room & board | |

## Mandatory Distributions

- No discretion
- More ascertainable

## Modifying Language: Generally

- Adds complication
- Makes cases distinguishable



## Modifying Language: "Shall" v. "May"

- EX: 'Trustee shall/may distribute trust assets for beneficiary's HEMS.'
- May → Discretion
- Shall → Mandatory
- BUT: Trustee still generally given discretion to determine whether distribution within HEMS
- NOTE: Shall/may pops up in various places
- Practical Issues

## Modifying Language: Accustomed Standard of Living

- EX: 'Distribute to Beneficiary for HEMS in his or her accustomed standard of living'
- Rest. (Third): Standard of living modifier is implied in maintenance and support unless instrument says otherwise

## Modifying Language: Other Sources of Support

- EX: 'When making distributions, Trustee shall/may consider other sources of support available to Beneficiary.'
- Absent contrary language consideration of other resources generally allowable by implication
- What other sources of support?

## Modifying Language: Support v. Supplement

- Support → Beneficiary lives off of the trust fund
- Supplement → Trust fund available on an as-needed basis
- Best practice: Draft with terms that make intent clear

## Modifying Language: Legal Duty to Support

- Tax problem:
  - Trustee with power to discharge legal duty of support considered to have general power of appointment
- "Upjohn" clause prohibits trustee from discharging legal duty to support
- Trustees can get tripped up by these because hidden in boilerplate
  - Impacts individual trustees who are unlikely to read the trust instrument
  - Even a small violation may be grounds for removal if and when beneficiary becomes disgruntled

## Modifying Language: Legal Duty to Support

- Distributions prohibited under Upjohn clause are narrow in scope, but hard to define exactly
  - Food
  - Clothing
  - Shelter
  - Medical care
  - Education

## Modifying Language: Legal Duty to Support

- Support duties only involve most basic needs
- Upjohn prohibition is on direct discharge of obligation by trustee using trust assets
- BUT: If parent/trustee is also a beneficiary of the trust, distributions can be made to him or her so that parent (acting individually) can meet obligations

## Modifying Language: Legal Duty to Support

- Trustees subject to Upjohn clause provisions should generally avoid distributions for:

- Rent or any similar payments
- Home improvements or decor
- Homeowners insurance
- Renter's insurance
- Basic utilities for the home
- Property taxes
- Clothing
- Health Insurance
- Non-elective healthcare
- General dentistry
- Dentures
- Optometry
- Prescription glasses
- Food

## Modifying Language: Legal Duty to Support

- Trustees subject to Upjohn clause provisions generally may make distributions for:

- Cell phones
- Pets
- TV, cable or satellite service
- Internet service
- Personal accessories
- Automobiles
- Auto insurance
- Private school education
- Extracurricular activities
- Trips and vacations
- Elective health care
- Orthodontics

Note: Private school payments are allowable because the state already provides for education through the public school system

## Other Considerations: Beneficiary Needs

- Trustee generally tasked with determining beneficiary's needs
- Rest. (Third):

  "The trustee generally may rely on the beneficiary's representations and on readily available, minimally intrusive information requested of the beneficiary. This reliance is inappropriate, however, when the trustee has reason to suspect that the information thus supplied is inaccurate or incomplete."

## Other Considerations: Beneficiary Needs

- Documentation is key
- Action should fit facts and particular dynamics
- Extensive information gathering to "paper the file" can lead to feelings of ill-will and invasion of privacy
- BUT: Failure to gather enough information can lead to claims of breach for inadequate due diligence or inaction altogether

## Other Considerations: Multiple Beneficiaries

- How to you deal with multiple beneficiaries?
- Trusts almost always have multiple beneficiaries
- Absent any 'clear manifestation' to the contrary, Texas law requires trustees to act impartially towards all beneficiaries

## Other Considerations: The Dead Hand

- Grantor's attempt to influence beneficiary's behavior
- Balance grantor's freedom to dispose of assets with beneficiary's right to chose their own path in life
- Dead Hand provisions valid, unless they violate overriding rule of public policy

## Other Considerations: Taxes

- Focus has shifted away from estate tax
- This makes trustee's duty much more complex

## Best Practices: Be Flexible

- Alternates to requested distribution
  - Loans (with or without interest)?
  - Purchase or lease of property for a beneficiary?
  - Guaranteeing a loan?
  - Compensating distributions to non-requesting beneficiaries
  - Partial distributions over time rather than lump sum up front
  - Set periodic distributions to set realistic expectations

## Best Practices: Establish a Plan and Follow It

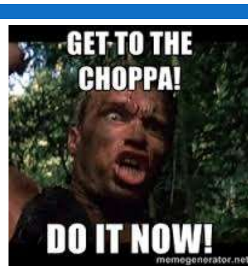
- Any plan is better than no plan
- Reasonableness at the time the plan was made
- Review trust instrument regularly
- Document decision-making process

## Best Practices: Maintain Open Lines of Communication

- Beneficiaries don't trust trustees
- Beneficiaries feel beholden and embarrassed
- Communication forces trustees to establish and follow good procedures

## Closing

- I hope this makes the Predator a little easier to spot and deal with
- Now, let's…




## Questions?