

# **EXERCISING DISCRETION AND MANAGING INTERGENERATIONAL CONFLICTS**

*Great Expectations: Charles Dickens*  
*Diminished Expectations: Trust Beneficiary*  
*Managed Expectations: Trustee*

for

**Chicago Estate Planning Council**

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by

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## I. Introduction: General Approach to Distributions of Income or Principal

A good deal of speaking and writing has been done in the last ten years on the subjects of (1) modern portfolio theory and total return investing, (2) the Uniform Principal and Income Act (1997) with its power to make equitable adjustments and (3) the various statutes enacted in many states permitting a trustee of an income trust to convert it to a unitrust. Far less attention has been given in published writings to designing trusts to be as flexible as possible regarding discretion to pay trust income or principal to a beneficiary or a class of beneficiaries. If the trustee is to have a “wide open” power without restrictions, then the grantor should be educated to the breadth and depth of the discretionary area and encouraged to focus on the financial objectives for the trust. It is key that the trustee be familiar with the grantor’s objectives. While some professional trustees prefer to have stated standards in the governing instrument, others favor giving the trustee as much flexibility as possible regarding the circumstances under which payments may be made. In a fully discretionary trust, the purposes for which the power may be exercised are not restricted in any manner and the trustee is not limited by any specific language, such as maintenance and support. Account may then be taken of all facts and circumstances in existence at the particular time a determination is made, some of which may not have been contemplated by the grantor. The creation of a discretionary trust has the same effect as a spendthrift provision since no beneficiary is entitled to a fixed amount and creditors of a beneficiary cannot reach the trust property. The selection of the trustee for a discretionary trust will require careful consideration of tax consequences so that discretionary powers are vested in “disinterested” trustees. Clearly, there is a danger for the trustee in accepting wide discretionary powers.

It is hornbook law that exculpatory provisions are not always fully effective. Complete flexibility places a heavy burden on the trustee who is the ultimate decision-maker/steward.<sup>1</sup>

## II. Reasons for Creating Discretionary Powers

In drafting inter vivos and testamentary trusts to be funded in the future, consideration should be given to the lack of flexibility in income-only trusts, by creating trusts which include discretionary powers over income and principal by appropriate combinations of appointive and discretionary provisions. These powers can be used to determine present and future benefits under a governing instrument and to decide which beneficiaries are to enjoy these benefits. Discretionary powers require focusing on two issues: (1) avoiding unwanted tax consequences by understanding the scope and nature of each power and (2) selecting the appropriate powers to fulfill the grantor’s objectives.

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Discretionary provisions are favored to give the trustee as much flexibility as possible in:

1. Providing for a beneficiary's, or class of beneficiaries', well-being, including all of the reasons of health, education, support, capital needs for a home or a business or otherwise, and differences in income. Such provisions have also been used for "family control", e.g., to discipline beneficiaries for family abandonment, matrimonial problems, divorce, use of abusive substances, and other non-pecuniary situations.
2. Providing protection for spendthrifts, i.e., giving beneficiaries protection from claims by creditors by prohibiting the voluntary or involuntary assignment or alienation of a beneficiary's beneficial interests.
3. Providing for minors.
4. Providing tax savings or tax deferral through a plan of favoring or bypassing individual beneficiaries or generations based on need (the corollary is favoring or bypassing based upon comparative tax brackets).
5. Insulating trust assets from being countable assets that would disqualify a beneficiary from receiving governmental benefits.
6. Providing for mandatory distributions of capital when beneficiaries reach designated ages, but permitting the trustee to "holdback" if the beneficiary is unexpectedly disabled, incapable of management or otherwise likely to be deprived of the enjoyment of the property.

### III. Tax Consequences

- A. Trust income in a discretionary trust may be taxed to the beneficiary, the trustee, the grantor or another (non-grantor).
  1. The beneficiary is taxed on amounts distributed to him to the extent of the trust's distributable net income and in accordance with the "tier" distribution rules. I.R.C. §662.
  2. The trust is taxed on accumulated income and these accumulations are no longer subject to the "throwback rule" (which was repealed by Section 507 of The Taxpayer Relief Act of 1997 (P.L. 105-34)). I.R.C. §665-667. The trust is also taxed on capital gains.
  3. Grantor Taxed on Trust Income

The grantor is treated as the owner of any portion of trust property and taxed on trust income to the extent that beneficial enjoyment of income or principal is subject to a power of disposition

exercisable by a nonadverse party without the consent of an adverse party. I.R.C. §674(a). There are exceptions to this general rule. Thus, if a grantor creates a discretionary trust (and he is not the trustee), trust income will not be taxed to the grantor if one of the exceptions in I.R.C. §674(c), 674(b)(5), 674(b)(5)(A) or 674(d) is satisfied.

- a. The grantor is not taxed on *income* of a discretionary trust if the grantor is not a trustee and no more than half the trustees are related or subordinate parties [a term defined in I.R.C. §672(c) as any nonadverse party who is the grantor's spouse (if living with the grantor), the grantor's father, mother, issue, brother or sister and certain other persons]. I.R.C. §674(c).
  - b. When the trustee is a related or subordinate party and has discretion to distribute *corpus*, the grantor is not taxed on trust income provided the trustee's power is limited by a "reasonably definite standard" in the will or trust agreement. I.R.C. §674(b)(5) and I.R.C. §674(b)(5)(A).
  - c. When the trustee is a related or subordinate party (other than the grantor or grantor's spouse living with the grantor) and has discretion to distribute or accumulate *income*, the grantor is not taxed on trust income provided the trustee's power is limited by a "reasonably definite external standard" in the trust instrument. I.R.C. §674(d) and Reg. §674(d)-1 and Reg. §1.674(d)-1.
4. IRC §2036 and Support Trusts

The grantor is taxed on trust income if it may be used for the benefit of grantor or grantor's spouse. I.R.C. §677(a).

- a. This includes the possible use of income to discharge a legal obligation of grantor or grantor's spouse.
- b. If the legal obligation is the obligation of support, the grantor is taxed only if income actually is used to discharge the support obligation. I.R.C. §677(b).
- c. Treas. Reg. §20.2036-1(b)(2) provides:

The "use, possession, right to the income, or other enjoyment of the transferred property" is considered as having been retained by or reserved to the decedent to the

extent that the use, possession, right to the income, or other enjoyment is to be applied toward the discharge of a legal obligation of the decedent, or otherwise for his pecuniary benefit. The term "legal obligation" includes a legal obligation to support a dependent during the decedent's lifetime.

The regulation applies if the payment by the trustee for the support of a dependent of the decedent-grantor is mandatory but does not apply if the payment by the trustee is discretionary. In letter ruling 8504011, a National Office Technical Advice Memorandum, the trust provided:

[T]he independent Trustees, acting together, are further authorized from time to time in their sole discretion to pay to a beneficiary of any separate trust such sums, first from accumulated income, and then from principal of that trust as the independent Trustees consider necessary for the support, maintenance in health and reasonable comfort, and education, including college and professional education, of such beneficiary and his or her descendants, taking into consideration all other cash resources available to such beneficiary for such purposes from all sources known to such Trustees.

The ruling holds that IRC Sec. 2036(a)(1) was not applicable because payments from the trust for the support of a minor child of the decedent were discretionary with the independent trustees.

#### 5. The Non-Grantor May Be Taxed on Trust Income

The non-grantor will be treated as the owner of any portion of a trust with respect to which the non-grantor has a power, exercisable solely by himself or herself, to vest the income or corpus from the trust in himself or herself. I.R.C. §678. The section does not state that an exception applies for a power subject to an ascertainable standard. Nevertheless, if the non-grantor, who is serving as trustee of a trust for his or her benefit, has discretion to distribute income or principal limited to an ascertainable standard, cases hold that the trustee will not be taxed on the trust income under I.R.C. §678 (a). See, e.g., De Bonchamps v. U.S., 278 F. 2d 127, 130 (9th Cir. 1960). The non-grantor is taxed on trust income which is expended for a beneficiary whom the non-grantor has a legal obligation to support if the non-grantor has the power as trustee to so apply the income. I.R.C. §678. The Internal Revenue Service takes the position that trust income applied to

discharge a non-grantor's support obligation is taxable to the non-grantor, even when the non-grantor is not a trustee. Reg. 1.662(a)-4.

6. College Expenses

Cases on the subject of whether college expenses of a child fall within the support obligation of a parent are numerous, and the determination must be made under applicable state law.

- a. After 1968 the general rule in New York appeared to be that a father is not obligated to provide a private school education for his minor child without "special circumstances" and the factors to be considered include: (1) the educational background of the parents, (2) the child's academic abilities and (3) the father's financial ability to provide the necessary funds. Kaplan v. Wallshein, 57 A.D. 2d 828, 394 N.Y.S. 2d 439 (2nd Dept. 1977). See Frankel v. Frankel, 82 A.D.2d 796, 439 N.Y.S. 2d 218 (2d Dept. 1981) ordering a very wealthy parent to pay his children's college expenses. In 1989 the Child Support Standards Act (CSSA) was enacted and a court, within its discretion, could determine to award educational expenses where it was in the "best interests" of the children and appropriate to the circumstances. Cohen v. Cohen, NYLJ April 22, 1994, p. 25 col. 5, Romans v. Romans, NYLJ May 3, 1994, p. 27 col. 2 and Cassano v. Cassano, 203 A.D. 2d 563. For an interesting recent case, see Matter of Wallens, 9 N.Y.3d 117 (2007)
- b. In Frederick C. Braun, Jr., 48 TCM 210 (1984), the Tax Court held that under New Jersey law a parent has a legal obligation to pay (1) college expenses of a child age 18 and over and (2) private school expenses of a child under age 18.
- c. The Supreme Court in Florida held that a parent has no legal duty to provide a college education for an adult child (a child over 17). Grapin v. Grapin, 450 So.2d 853 (1984).
- d. The Pennsylvania Court concluded in Griffin v. Griffin, 558 A.2d 75 (Pa. Super. 1989) that (1) in determining the support obligation for a child over age 18, the child's own resources may be taken into account but he or she may not necessarily be required to contribute as much as possible or required to attend a state institution rather than a more expensive private college, and (2) only in exceptional

cases, will the parent's obligation to pay college expenses continue after the child becomes 23.

- e. Does payment of college expenses of a child over age 17 paid from trust income result in a parent being taxed on such income in California? Section 3900 of the California Family Code states that a father and mother have an equal responsibility to support and educate their minor child in the manner suitable to the child's circumstances and Section 6900 defines a minor child as a daughter or son under the age of 18. See Jones v. Jones, 225 Cal. App. 3d 1011 (Cal. App. 2 Dist. 1986) and Stone v. Comm'r., 54 TCM 462 (1987), aff'd. without published opinion 867 F. 2d. 613 (9th Cir. 1989), and Sharon v. Comm'r., 57 TCM 1562 (1989).

7. Techniques to reduce or shift the income tax burden include:

- a. evaluating the investment guidelines to ascertain whether or not non-income producing assets are appropriate investments for the trust;
- b. comparing income tax brackets of beneficiaries (and their parents, when appropriate); and
- c. ascertaining the desirability of establishing a "defective" grantor trust. This is a trust which is a completed trust for gift tax purposes, i.e., the grantor has no "strings" which would cause it to be subject to estate tax, but the grantor does have a "string" which causes all of the income earned by the trust to be taxable to the grantor even though it is accumulated or distributed to the beneficiaries (who are, typically, children or grandchildren). I.R.C. Section 671.

B. The estate tax consequences should be considered when a beneficiary, trustee or grantor is given a discretionary power to distribute income or principal.

1. Avoidance of General Power

A "wide open" discretionary trust should not be used where the beneficiary participates in the exercise of the power because an unrestricted power will be a general power of appointment under I.R.C. 2041 and the trust property will be included in the beneficiary's gross estate.



a. If the beneficiary or power holder has a power restricted to an ascertainable standard related to health, education, maintenance or support, the trust property will not be included in the gross estate. I.R.C. §2041(b)(1)(A) and Reg. §20.2041-1(c)(2). See also I.R.C. §2514(c)(i) and Reg. §25.2514-1(c)(2).

(1) The Regulations state that "support in his accustomed manner of living" is an ascertainable standard. Yet the IRS ruled that a power to invade corpus "to continue the donee's accustomed mode of living" is a general power of appointment. Rev. Rul. 77-60, 1977-1 C. B. 282 (See quote at (3) infra).

(2) The Uniform Trust Code ("Code"), adopted by 21 states to date, provides in Section 814(b)(1):

a person other than a settlor who is a beneficiary and trustee of a trust that confers on the trustee a power to make discretionary distributions to or for the trustee's personal benefit may exercise the power only in accordance with an ascertainable standard [which is defined in Section 103(2) of the Code as] relating to the trustee's individual health, education, support, or maintenance within the meaning of Section 2041(b)(1)(A) or 2514(c)(1) of the Internal Revenue Code of 1986.

Under the Code, a power that is too broad is automatically limited to one that is subject to an ascertainable standard, and may be so exercised. See also Florida, Fla. Stat. § 736.0814, Pennsylvania, 20 Pa.C.S. § 7504, North Carolina, N.C. Gen. Stat. § 36C-8-814, and Missouri, §456.8-814 R.S.Mo. While this outline does not survey all 50 states, it is interesting to note that the author has found several states which have not adopted the Code but have enacted statutes which also automatically limit the discretion to an ascertainable standard. See California, Cal Prob Code §16081, New Jersey, N.J. Stat. §3B:11-4.1, and New Hampshire, RSA 564-A:3.

(3) The New York statute, EPTL 10-10.1, which was modified in 2003, formerly prohibited any exercise by a trustee of a discretionary power to distribute to himself, even where the trust instrument authorized the exercise subject to an ascertainable standard.

Laws 2003, ch 633, § 1, Laws 2004, ch 82 § 1. As amended, the New York statute now contains an exception when the trust instrument allows exercise for "a power to provide for such person's health, education, maintenance or support within the meaning of sections 2041 and 2514 of the Internal Revenue Code, or any other ascertainable standard." This is not quite as liberal as the Code provision. As stated above, under the Code a power that is too broad is automatically limited to one that is subject to an ascertainable standard, and may be so exercised. Under EPTL 10-10.1, such a power would not fall within the statutory exception to prohibition of exercise and could not be exercised. Other states follow this approach. See Connecticut, Conn. Gen. Stat. §45a-487, Wisconsin, Wis. Stat. §701.19, and Colorado, C.R.S. 15-1-1401.

- (4) In Garfield v. United States, 80-2 USTC 13,381 (D.C. Mass. 1980) the court held that the common law in Massachusetts prohibits the beneficiary-power holder from participating in the exercise of the power and Armington v. Meyer, 103 R.I. 211, 236 A.2d 450 (1967) holds that in Rhode Island the beneficiary-holder must obtain court approval of the exercise of the power for his benefit.
- (5) The scope of the principal invasion language is determined under applicable state law and the words used may or may not create an ascertainable standard. The courts held ascertainable standards were created in: Estate of Wood v. Comm'r, 398 T.C. 919 (1963): "support, maintenance, welfare and comfort;" Estate of Bell vs. Comm'r, 66 T.C. 729 (1976): "well-being and maintenance in health and comfort;" Estate of Gokey v. Comm'r, 72 T.C. 721 (1979): "support, care, welfare and education." The courts have held ascertainable standards were not authorized in Miller v. United States, 387 F.2d 866 (3rd Cir. 1968): "comfort and well-being;" Lehman v. United States, 448 F.2d 1318 (5th Cir. 1971): "comfort and welfare;" and in Strite v. McGinnes, 300 F.2d 234 (3rd Cir. 1964): "benefit." See also Rev.Rul. 77-60, 1977-1 C.B. 282 where the I.R.S. said, "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)(A)...."

- (6) The potential tax problem exists only when a person may exercise the power (or participate in the exercise) for his own benefit.
- b. If a trustee-beneficiary has a legal obligation to support another beneficiary (as where the trustee's minor child is also a beneficiary), and the support obligation may be satisfied by a distribution from the trust in the trustee's discretion, the power of the trustee to participate in a decision to distribute, even if measured by an ascertainable standard, is a general power. Reg. 20.2041-1(c)(1). A sentence in Reg. 25.2514-1(c)(1) provides to the same effect.

Consider including an "upjohn" clause which prohibits the trustee from making distributions that would have the effect of discharging the trustee's legal obligations, including the obligations of the trustee to support his children or obligations to other creditors. Upjohn v. U.S., 72-2 U.S. Tax Case (CCH) ¶12,888 W.D. Mich 1972. Consider the gift tax consequences of a beneficiary-trustee's exercise of a discretionary power for the benefit of another beneficiary.

## 2. Exercise of Power by One Beneficiary for Another Beneficiary

Treas. Reg. §25.2511-1(g)(2) states that if a trustee has a beneficial interest in trust property a transfer from the trust is not subject to gift tax provided the power is limited by a reasonably fixed or ascertainable standard set forth in the trust. The regulation also states such a standard does not exist when the trust provides the determination of the trustee regarding the exercise or nonexercise is conclusive. The regulation implies that absent a fixed or ascertainable standard the trustee will be deemed to make gift, but no case authority supports this result when the trustee-beneficiary does not have a present interest. Any gift made will qualify for the gift tax annual exclusion.

3. A power of appointment includes all powers which are in substance and effect powers of appointment regardless of the nomenclature used. Reg. §20.20401-1 (b)(1). These powers may

include the power in a donee to remove or discharge a trustee and appoint a successor trustee.

- a. In Rev. Rul 79-353, 1979-2 C.B. 325 the decedent-grantor's unrestricted power to replace a corporate trustee of an irrevocable trust with another independent trustee caused the powers of that trustee to be attributed to the grantor for estate tax purposes. The Tax Court, in Estate of Wall v. Comm'r., 101 T.C. 300 (1993), rejected the holding of the Revenue Ruling. (After this decision, the estate brought a proceeding under IRC §7430(a) for its reasonable litigation costs. To succeed it had to show that the IRS position was not "substantially justified," a difficult task with a case of first impression. The Tax Court held the test was not met. 102 T.C. 13 (1994).) In Rev. Rul. 95-58, 1995-2 C.B. 191 the Service reconsidered its position and revoked Rev. Rul. 79-353 and Rev. Rul. 81-51, 1981-1 C.B. 458, holding that if the grantor possessed the power to remove the trustee and appoint an individual or corporate successor trustee that was not related or subordinate (for purposes of §672(c)), the grantor has not retained a trustee's discretionary control over trust income.
- b. Ltr. Rul. 199909016 deals with a Florida statute concerning the beneficiary's power to remove and/or replace trustees. The ruling is important in indicating that a failure to satisfy the requirement that the appointment of a successor trustee be restricted to a person who is not covered by IRC §672(c) does not automatically result in estate taxation, but rather requires a factual inquiry regarding inclusion. (The Florida statute at issue was §737.402(4)(a) which was repealed effective July 1, 2007.)
- c. Consideration should be given to imposing restrictions on the removal right. Letter ruling 9303018 relates to the proposed construction and modification of a 1978 trust as to which additions were made through 1983. The trust authorizes certain family trustees who are beneficiaries to remove and replace any other trustee and states that no fiduciary power (including the removal and replacement power) be exercised to benefit the trustee. The trustees proposed to construe and modify by court order certain provisions of the trust. The family trustee's removal and replacement power could only be exercised for "cause." The trust agreement listed 13 grounds for removal.

- i. The legal incapacity of a trustee.
- ii. The willful or negligent mismanagement by the trustee of the trust's assets.
- iii. The abuse or abandonment of, or inattention to, the trust by the trustee.
- iv. A federal or state charge against the trustee involving the commission of a felony or serious misdemeanor.
- v. An act of stealing, dishonesty, fraud, embezzlement, moral turpitude, or moral degeneration by the trustee.
- vi. The use of narcotics or excessive use of alcohol by the trustee.
- vii. The poor health of the trustee such that the trustee is physically, mentally, or emotionally unable to devote sufficient time to administer the trust.
- viii. The failure by the trustee to comply with a written fee agreement or other written agreement in the operation of the Trust.
- ix. The failure of a corporate trustee to appoint a senior officer with at least five (5) years of experience in the administration of trusts to handle the trust account.
- x. Changes by a corporate trustee in the account officer responsible for handling the trust account more frequently than every five (5) years (unless such change is made at the request of or with the acquiescence of the other trustee).
- xi. The relocation by a trustee away from the location where the trust operates so as to interfere with the administration of the trust.
- xii. A demand from the trustee for unreasonable compensation for such trustee's services.

- xiii. Any other reason for which a [state] court of competent jurisdiction would remove a trustee.

The IRS ruled the family trustee did not have or release a general power of appointment either before or after the construction.

- d. Consideration should be given to giving the removal right to:
  - i. the spouse-beneficiary of a marital deduction trust;
  - ii. a beneficiary to whom the trustee cannot currently distribute principal; or
  - iii. an individual who is not a beneficiary

#### C. Chapter 13; Tax on Certain Generation-Skipping Transfers

When there is a splitting of trust benefits among younger generation beneficiaries assigned to two or more generations, tax payment under Chapter 13 may arise in a discretionary trust with power to pay income or principal among a class of beneficiaries. In general, a distribution of income or principal to a grandchild or more remote descendant will be a taxable distribution under Chapter 13 unless if made by an individual it would not be treated as a taxable gift under I.R.C. §2503(e). See I.R.C. §2611(b)(2).

#### IV. Property Law Considerations

- A. What standards for distribution of income and discretionary invasion of principal, if any, are desirable? Powers to use principal for the beneficiary's comfort, welfare, happiness or best interests are fairly broad, but how is a trustee to know whether the terms "support and maintenance," "use," "benefit," "emergency," and "need" are to be interpreted liberally or conservatively in the applicable jurisdiction? The use of these words may cause uncertainty regarding the circumstances under which the power to invade principal may be exercised.
  - 1. When the language allows for an invasion due to an "emergency" and the beneficiary is a trustee, the I.R.S. takes the position that the trustee/beneficiary has a general power of appointment. However, the courts have not found "emergency" to be broadening language in Warner v. Trust Co. Bank, 250 Ga. 204, 296 S.E. 2d 553 (1982), Estate of Sowell v. Comm'r., 74 T.C. 1001 (1980), rev'd, 708 F. 2d 1565 (10th cir. 1983) (where the opinion stated: "The key

characteristic of the meaning of "emergency" is that of need. The Tax Court also erred in concluding that the concept of an "emergency" included broader uses than for support or maintenance.") and Hunter v. United States, 597 F. Supp. 1293 (D.C. Pa. 1984) (where the opinion, referring to Reg. §20.2041-1(c)(4) stated: "allowing invasion in order to support the beneficiary in his accustomed manner of living [as does the regulation] is surely a more liberal standard than that embodied in the term 'emergency.' We can envision no emergency which would not be reasonably measurable in terms of health or to support a beneficiary's standard of living".)

2. The terms "support" and "maintenance" mean different things to different people. Depending upon the governing jurisdiction, it may or may not be helpful to use modifiers such as "comfortable" or "generous".
  - a. The terms are interpreted to mean more than the bare necessities of life. Hartford-Connecticut Trust Co. v. Eaton, 36 F. 2d 710 (2d Cir. 1929). The terms may be exercised taking into account the beneficiary's station in life. Hill v. Comm'r, 88 F.2d 941 (8th Cir. 1937), In re Levinson's Will, 5 Misc. 2d 979, 162 N.Y.S. 2d 287 (N.Y. Sur. Ct. 1957) and Equitable Trust Co. v. Montgomery, 44 A.2d 420 (Del. Ch. 1945).
  - b. When a trustee is authorized to invade principal for the support of the beneficiary, most jurisdictions hold that the trustee is also authorized to invade for expenses of the beneficiary's dependents, including spouse and children. In re Sullivan's Will, 144 Neb. 36, 12 N.W. 2d 148 (1943); Robinson v. Robinson, 173 Misc. 985, 19 N.Y.S. 2d 44 (N.Y. Sur. Ct. 1940); and Seattle-First National Bank v. Crosby, 42 Wn. 2d 234, 254 P.2d 732 (1953). But see Cavett v. Buck, 397 P. 2d 901 (Okla. 1964) where the court limited distributions for the support of the beneficiary alone, and not for the support of his wife and dependent children.
3. It is often uncertain whether the trustee has the authority to invade principal to enable the income beneficiary to make gifts.
  - a. The court refused to permit such an invasion in a marital deduction trust where the will authorized an invasion "for the spouse or for her use" In re Mandel's Will, 46 Misc. 2d 850, 261 N.Y.S. 2d 110 (N.Y. Sur. Ct.1965). Similarly, the

court denied an invasion to enable the wife to make gifts to her children pursuant to a clause which authorized "in the absolute discretion of my Trustee [an encroachment on corpus as] shall be appropriate and to the best interest of my wife...." In re Estate of Howard, 236 S.E. 2d 423 (S.C.1977).

- b. In Estate of Hartzell v. Comm'r, the IRS took the position that the exercise of an invasion power over property held in an IRC §2056(b)(5) trust was invalid and the surviving spouse's gifts of property should not be recognized. The will authorized invasions of principal as follows:

“In addition thereto, the trustees are given the right, in their sole and absolute discretion, to use the principal of Trust A or any part thereof, even to the exhaustion thereof, for the comfort, maintenance, support and general well being of said Miriam H. Hartzell, or to continue the standard of living to which she is accustomed, or to aid her in the event of any accident, injury, illness or other emergency affecting her.”

The Tax Court rejected the IRS contention. 68 TCM 1243 (T.C. 1994).

In Estate of Halpern v. Comm'r, the invasion language for the spouse was more limited than in Hartzell. Invasions could be made if the surviving spouse had an illness or other emergency requiring a distribution of principal to ensure her maintenance and welfare. The trustee of the marital trust made distributions of principal to the spouse pursuant to an invasion power and the spouse then made gifts with the distributed property. The IRS asserted that the invasions were not authorized and that the gift property should be included in the spouse's estate. The Tax Court held that distributions made to the spouse from the trust before her incompetency were not subject to estate tax, but that post-incompetency distributions were taxable. 70 TCM 229 (T.C. 1995).

Similar facts were involved in letter ruling 9337001, a National Office Technical Advice Memorandum.

- c. Often the spouse desires to make gifts to descendants and, particularly, to children. The marital deduction regulations make clear that authorizing the trustee to make payments to



the remaindermen with the spouse's consent will result in disqualification under IRC Sec. 2056(b)(7). Treas. Reg. §20.2056(b)-7(c)(1). Similarly, authorizing an invasion for the spouse to make gifts of the distributed property causes disqualification if the spouse is legally obligated to make the gifts. However, authorizing an invasion for this purpose when the authorization is accompanied by language stating that no legal obligation to make the gifts shall be deemed to exist should be permissible. Of course, if an invasion for gifts is made in one year and the spouse does not make the gifts the trustee would be unlikely to exercise the power in the future. An IRC Sec. 2056(b)(5) trust may permit gifts to be made from principal with the spouse's consent. See Rev. Rul. 72-154, 1972-1 Cum. Bull. 310. However, in such a trust the spouse must be given a general power of appointment.

- B. Whether or not the trustee must consider other income or resources available to the beneficiary before exercising discretion to invade principal is a frequently litigated issue.
1. The general rule is that a trustee is to consider a beneficiary's other resources but has some discretion in the matter. "The presumption is that the trustee is to take the beneficiary's other resources into account in determining whether and in what amounts distributions are to be made, except insofar as, in the trustee's discretionary judgment, the settlor's intended treatment of the beneficiary or the purposes of the trust will in some respect be better accomplished by not doing so." Restatement (Third) of Trusts, §50, comment e (2003).
  2. In New York the standard is based on whether the testator/grantor created a trust to provide for the support of the beneficiary (*i.e.*, a support trust is an absolute gift without regard to the beneficiary's outside resources) or whether the instrument authorizes the trustee to invade principal for the beneficiary's support if the income is insufficient for the beneficiary's needs. *In re Martin's Will*, 269 N.Y. 305, 129 N.E. 491 (1936). Courts disagree on the application of the New York rule, and use of the words "need," "insufficiency," or "necessary" may or may not be determinative, so that prior cases may have minimal precedential value.
  3. The term "other resources" is ambiguous and gives little guidance to the trustee as to what resources must be considered.

- a. must the trustee consider only the beneficiary's other sources of income or should the beneficiary's separate estate also be considered?
  - b. must the beneficiary sell appreciated property, incurring a capital gains tax?
  - c. must the trustee consider the beneficiary's non-liquid assets?
  - d. must the trustee consider the equity in a beneficiary's home?
  - e. what kind of an investigation must the trustee undertake?
- C. If a beneficiary is eligible for or receiving public benefits or residing in a state institution, it may or may not be possible to insulate income and corpus from claims of governmental agencies for the cost of the benefits or other services furnished to the beneficiary.
1. Where the trustee has been given broad discretion as to payments and the trustee did not invade principal to pay for costs incurred while the beneficiary was receiving benefits from the state, some courts have not intervened on the ground that there was no abuse of discretion. Matter of Escher, 94 Misc. 2d 952, 407 N.Y.S. 2d 106 (1978), aff'd 75 A.D. 2d 531, 426 N.Y.S. 2d 1008 (1st Dept. 1980), aff'd 52 N.Y. 2d 1006, 420 N.E.2d 91 (1982), In re Roberts, 61 N.Y. 2d 782, 461 N.E. 2d 300 (1984), and First National Bank of Md. v. Dept. of Health, 399 A. 2d 891 (Md. App. 1979).
  2. If a beneficiary is denied needed care because of the trustee's exercise of discretion to withhold payments, the court may find an abuse of discretion and intervene. Restatement (Second) of Trusts, §187 and comments. Restat 2d of Trusts, §187 (1992) Some courts have also required payments be made even though the trustee has complete discretion. See Estate of Lackman, 156 Cal. App. 2d 674, 320 P. 2d 186 (1958); Bureau of Support in Dept. of Ment. H. & C. v. Kreitzer, 16 Ohio St. 2d 147, 243 N.E. 2d 83 (1968); and Stroudt v. Pennsylvania, 454 A. 2d 665 (Pa. 1983).
- D. In general, courts will not interfere with a trustee's exercise of discretion nor will they instruct the trustee how to exercise his discretion. In re Emmons' Will, 165 Misc. 192, 300 N.Y.S. 580 (N.Y. Sur. Ct. 1937); People's National Bank v. Jarvis, 58 Wn 2d 627, 364 P.2d 436 (1961).

1. In rare cases a court may direct an invasion of principal pursuant to a statute or its equitable powers when the instrument creating the trust does not authorize such action. In New York the appropriate statute is EPTL 7-1.6. The statute does not apply when a charity has a remainder interest in the trust for which a tax deduction is available.

## V. Wide-Open Discretion

Discretionary trusts permitting both income and unlimited principal distributions have been used for many years. The trust may have one current beneficiary or multiple beneficiaries who may be in a single family branch or in more than one branch. In general, after a grantor's death a single discretionary trust for all descendants of the creator is undesirable where more than one family branch exists. Instead, separate trusts created for each family branch is the better course.

Case law is sparse relating to the standard to be applied in deciding the appropriateness of a trustee's exercise of a power to make distributions from a trust where the discretion is unlimited.

- A. Section 814(a) of the Uniform Trust Code and §187 of the Restatement (Second) of Trusts deal with the subject of discretionary powers. Section 814(a) states:

“Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms as “absolute,” “sole,” or “uncontrolled,” the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.” Uniform Trust Code, §814 (2004)

Section 187 is shorter and provides:

“Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion.” Restat 2d of Trusts, §187 (1992). See also Section 50 of Restatement (Third) of Trusts. Restat 3d of Trusts, §50 (2003)

- B. Several states including California have statutes similar to §814(a) and §187. California Probate Code §16081 provides:

“Standard for exercise of ‘absolute,’ ‘sole,’ or ‘uncontrolled’ powers

- (a) Subject to the additional requirements of subdivisions (b), (c), and (d), if a trust instrument confers ‘absolute,’ ‘sole,’ or ‘uncontrolled’ discretion on a trustee, the trustee shall act in accordance with fiduciary

principles and shall not act in bad faith or in disregard of the purposes of the trust. Cal Prob Code §16081 (2007)

(b) Notwithstanding the use of terms like ‘absolute,’ ‘sole,’ or ‘uncontrolled’ by a settlor or a testator, a person who is a beneficiary of a trust that permits the person, either individually or as trustee or cotrustee, to make discretionary distributions of income or principal to or for the benefit of himself or herself pursuant to a standard, shall exercise that power reasonable and in accordance with the standard.”

Although subsection (a) does not, by its language, impose a reasonableness standard as does subsection (b), case law does so. See Estate of Canfield, 80 Cal. App. 2d 443, 181 P.2d 732. (Cal.Ct.App. 1947).

Compare with South Dakota, which until 2007 had a statute similar to §814(a) and §187, S.D. Codified Laws §55-3-9, but which was repealed and effectively replaced with S.D. Codified Laws §55-1-43 which states in paragraph (3):

“A court may review a trustee’s distribution discretion only if the trustee:

- (a) Acts dishonestly;
- (b) Acts with an improper motive; or
- (c) Fails to act.

It is of interest to note new South Dakota §55-1-25 which states:

“The legislature does not intend the courts to consult Restatement (Third) of the Law of Trusts Articles §50.....and Section 814(a) as approved by [NCCUSL] in 2004 with respect to subject matters addressed by §§55-1-24 to 55-1-43, inclusive.”

- C. Forms for discretionary trusts appear in Appendices D and E. In Appendix D, two different approaches for wide-open discretion are used. In the first provision, a preference is created for certain beneficiaries through the use of the words “primary consideration.” In the second provision, no preference is created.
- D. What ground rules are applicable to discretionary distributions where no preference is indicated? Case law provides little help because until very recently, no reported case dealt with the issue in a direct manner. The general rule is that since the trustees are given “sole discretion” in each of the referenced forms, their determination as to distributions cannot be upset unless they are unreasonable. A trustee also has a duty to be impartial as between beneficiaries. The forms do not waive this duty, except to the extent “primary consideration” language is used. Accordingly, the duty applies in connection with the trustees making their determinations.

1. In re Ledyard's Estate, 21 N.Y.S. 2d 860 (N.Y. Sur. Ct. 1939) aff'd, 259 A.D. 892, the Trustee had "absolute discretion" to distribute income to wife and descendants. In an accounting proceeding objections were filed because income was distributed to the wife (who had sufficient income from other sources). The court held that the trustee's exercise of discretion would not be subject to review.
2. Similarly, See Matter of Payson, NYLJ June 20, 1989, p. 26, in which the scope of the invasion language set forth in Appendix E of this outline was discussed and the opinion found no abuse of discretion by the trustee.
3. Compare the somewhat inconsistent interpretation found in In re Estate of Stillman, 107 Misc. 2d 102, 433 N.Y.S. 2d 701 (1980), where the trustees, who had "absolute and uncontrolled" discretion to invade principal for testator's grandsons, refused to invade principal and were later compelled to do so by the Surrogate.
4. Two cases involving related trusts with unlimited discretion and multiple beneficiaries have been decided by the Delaware Chancery Court and serve as a useful point of departure in analyzing how fully discretionary trusts should be drafted. McNeil v. Bennett ("McNeil II"), 792 A2d 190 (Del. Ch. July 6, 2001; Bishop v. McNeil ("McNeil I"), 1999 Del. Ch. LEXIS 186 (Del. Ch. Sept. 14, 1999.) The cases were decided by the same judge. McNeil II provides factual background.
  - a. In 1959 Henry McNeil, Sr. created five trusts and, at a family gathering, explained to his four children (Henry, Jr., Barbara, Marjorie and Robert) that he was funding each trust with \$1 million of Johnson & Johnson stock, with one trust for each child and a fifth trust (the "Lois" trust) for their mother. In the trial court's post trial opinion, under a heading "Factual Background," the court observed:

"But the focus of the meeting was on the four related trusts (the 'Sibling Trusts'). Each of the Sibling Trusts was named for one of the four children and afforded the trustees wide discretion to deploy the Trust's assets on behalf of the named child, the named child's spouse, and lineal descendants (each Sibling Trust for a 'Branch' of the McNeil Family).

The McNeil children were told by their father that their individual Sibling Trusts would give them the

freedom to pursue different vocations and to marry whom they wished without fear that they would not be affluent.”

The trusts were not activated until 1969 when the lawyers secured a favorable ruling from the Internal Revenue Service regarding generation skipping tax exemption. At another family gathering the grantor again discussed the purpose of the trusts. Their father’s remark led them to believe the Lois trust was for their mother’s benefit. In fact, the understanding of the children, as communicated by their father and one of the trustees (who was the father’s friend and a trusted legal advisor) was that each child was the primary beneficiary of his (or her) trust and that the Lois trust was “mother’s trust” and should not be used to supplement the distributions they received from their own trusts. This understanding was not reflected in the trust agreements. The trusts operated independently, but within a common group of three individual trustees. Investments were actively managed to suit the needs of the beneficiaries with the exception of the Lois trust where the trustees, who believed it was prudent to diversify, followed Mrs. McNeil’s insistence that the Lois trust hold the original Johnson & Johnson shares. The dispositive provisions concerning income and principal of the Lois trust were broadly drafted to pay out or accumulate to or among Lois, her lineal descendants and their spouses and to do so either outright or in further trust.

The opinion commented on a key provision:

“Mr. McNeil, Sr. coupled the broad discretion he gave to the Trustees under all the Trust Instruments with provisions giving the Trustees maximum freedom to carry out their duties from the fear of judicial second-guessing and the threat of monetary liability. Therefore, Article III(e) of the Lois Trust states that “Any decision or action of the [Trustees] shall be final and binding upon all persons and not subject to judicial review.” And Article IV(c) provides that any “action taken by the trustees in good faith shall be proper, and I relieve the trustees of all personal liability except for gross negligence or willful wrongdoing.”

(1) The McNeil II opinion discusses the events of the last twenty years which generated the current dispute and lawsuit under several headings:

(a) Henry’s estrangement from his family

- (b) Mr. McNeil, Sr. dies and excludes Henry from equal treatment under the will
  - (c) The trustees perpetuate the family divide until Lois McNeil's death
  - (d) Henry learns his true status as a current beneficiary of the Lois trust
  - (e) Henry's struggle with the trustees of the Henry trust and his own children
  - (f) The value of the Lois trust increases enormously from 1987 to 1997 [the growth, to \$230,235,724 from \$32,647,014, largely tracked Johnson & Johnson's market performance; by June 30, 2000 the trust's value was over \$317 million].
  - (g) Henry makes a distribution request from the Lois trust
  - (h) The trustees propose a division of the Lois trust into four equal parts
  - (i) Lois dies and does not exercise a power of appointment in Henry's favor
  - (j) The trustees come up with a more concrete plan to divide the trust
- (2) The contentions of the parties in McNeil II include:
- (a) Henry's complaints that:
    - the trustees breached their fiduciary duties by failing to inform him of his interests in the Lois trust
    - he is entitled to a substantial make-up distribution
    - in the alternative, he should receive more than the 5% unitrust payout proposed by the trustees
    - the trustees should be removed and surcharged, and

- Henry should be awarded fees and costs
- (b) The trustees, who had decided to divide the Lois trust into four equal parts and agreed to annually distribute 5% of the Lois trust's fair market value, opposed all the relief Henry sought.
- (3) The court's legal analysis follows.
- (a) The court in discussing the applicable standard, said:

"The present case is complicated by the fact that all of the past, present, and proposed distributional and investment decisions of the Lois Trustees could have been made consistently with the terms of the Trust Instrument, *had those decisions resulted from a sufficiently informed and impartial decision-making process*. That is, the law is clear that the fact that a trust instrument provides discretion to trustees does not vest in the trustees unfettered authority to act in any manner they see fit. In deciding this case, I am mindful of the protections Mr. McNeil, Sr. gave to his trustees.

Therefore, my review of the actions of the Lois Trustees is heavily influenced by a reluctance to interfere with their decisions, unless there is evidence that they acted in a manner that cannot be written off as mere inadvertence or a simple mistake. To that end, I have scrutinized the record to determine whether the Lois Trustees committed breaches of their fiduciary duties that were persistent and in conflict with obvious principles of proper trust administration. In particular, I have focused on whether the Lois Trustees engaged in a long-standing pattern of improper behavior that rises to the level of gross negligence."

- (b) The court's findings include the determination that the trustees breached their fiduciary duties by failing to inform the beneficiaries of their status and by providing some siblings with greater access to information than others. The court said:



“The fact that the Lois trustees **might** have properly decided to choose the same course of action had they engaged in an unbiased and adequately informed process does not excuse how they went about reaching their course of action.”

- (c) The court’s remedies include:
- granting Henry and his adult children a make-up distribution from his branch’s aliquot share of the Lois trust
  - surcharging the trustees for one-fifth of their commissions for a nine year period
  - removing one of the trustees and replacing the institutional trustee [this determination was reversed on appeal, where the Delaware Supreme Court said, as to the replacement, the terms of the trust which provided for successor trustees should be followed; McNeil v. McNeil (“McNeil III”), 798 A.2d 503, 2002 Del. LEXIS 327 (Del 2002) and;
  - rejecting Henry’s challenge to the trustee’s decision to divide the Lois trust into four equal resulting trusts for each family branch.

b. In McNeil I, decided by the same judge, the court upheld the trustee’s decision declining Henry’s request for a \$28 million distribution, which was about half the trust’s value, and discusses the trustee’s decision to move to a five percent unitrust payment of which Henry would receive four-sixths and his two adult children would each receive one-sixth.

5. Hinrichs et al. v. Gifford, No. 99-209T (D.C.R.I. September 7, 2001) involved the exercise of a discretionary power to distribute income and principal by an individual trustee in his “absolute discretion” among a class of beneficiaries. The trust was created by Walter Beineke, Jr. in December of 1962. The trustee was a close friend of the grantor, Clarence H. Gifford, Jr. who was then president of Rhode Island Hospital Trust National Bank. The grantor had three children at creation, and a fourth child was born in 1963. The class of principal beneficiaries included the grantor’s then wife Mary Ann and the grantor’s issue (descendants) which

included the grantor's issue by a prior marriage. The trustee also had "absolute discretion" to distribute income to the individuals who could receive principal and also to his wife's four children (the Hinrichs children) by a prior marriage. The trustee's distribution authority included the right to "exclude any one or more of the persons to whom distribution may be made" and to "make distribution in equal or unequal proportions." The trust was to terminate upon the death of the last to die of Mary Ann, the Hinrichs children and the grantor's children. The distinction between income and principal beneficiaries was unusual but understandable.

- a. The trust was funded with cash which was used to purchase shares of non-voting stock of a closely-held company in which the grantor was a principal. For many years the company had financial problems and produced no income for the 1962 trust.
  - b. By the mid 1970's the Beineke children and the Hinrichs children were dissatisfied with the lack of information about the family businesses and other family trusts which held interests in these businesses.
  - c. The trustee of the 1962 trust distributed all the trust assets in 1978 and 1979 to Mary Ann and the Beineke children, effectively terminating the trust and (prematurely) extinguishing the Hinrichs children's interest as "spray" income beneficiaries.
  - d. The trustee was surcharged \$8.7 million as a consequence of his terminating the trust by making distributions to some but not all of the beneficiaries. The case has been appealed to the First Circuit.
- E. What should be the standard of review when the trustee has "sole" or "absolute" discretion? An answer to this question is needed to address how discretionary trusts should be drafted.
1. In McNeil II the opinion states: "I cannot upset the judgment of the trustees in exercising their discretion under Article 2(a) unless I find that they 'acted in bad faith or in an arbitrary or unreasonable manner.' In re Couch Trust, 723 A. 2d 376, 382-383 (Del. Ch. 1998)."
  2. Comments i and j under Restatement §187 make clear that if no standard is created for the exercise of a discretionary power to distribute income or principal, a reasonableness test is not imposed upon the trustee if he is given absolute,

unlimited sole or uncontrolled discretion. It is unclear whether this result would occur under §814(a) of the Uniform Trust Code. Comments under §187, but not under §814, do provide specific guidance as to its meaning (see Comments e, i, j and k in Appendix B). In combination, Comments i and j make clear that if no standard is created for the exercise of a discretionary power to distribute income or principal, a reasonableness test is not imposed upon the trustee if he is given absolute, unlimited, sole or uncontrolled discretion. Whether this result would occur under §814(a) is unclear. Suppose the trustee is given absolute discretion to make distributions for the “best interests” of the beneficiaries. Do those two words create a standard?

3. A discretionary trust may create a noncumulative power of withdrawal or a testamentary power of appointment in a beneficiary (see Appendix B). What is the effect of such a power? With respect to a testamentary power, the answer is that it has no direct effect because it does not interfere with actions by the trustees during the beneficiary’s life. However, it has a significant indirect effect because the other beneficiaries will be less likely to complain about distributions to the power holder. With respect to a power of withdrawal, the power holder in effect has a preference, but the trustee can take account of any withdrawals in deciding what discretionary distributions to make to the power holder.
4. The discretionary forms (see Appendices C and D) also contain language providing that the trustee may distribute the entire trust property and may take account of or ignore other assets of a beneficiary in deciding how much to distribute to that beneficiary. The language is also used in forms where a single beneficiary is the income beneficiary and may also receive principal in the discretion of the trustees. The purpose of the language is to clarify the broad discretion that is given to the trustees. Could the trustees take into account one beneficiary’s other assets and ignore them for another beneficiary? The answer should be yes provided that a reasonable basis exists for making such a distinction.
5. McNeilI, McNeil II and Hinrichs are useful in providing a focus for drafting discretionary payment provisions and suggest for consideration use of one of the following two approaches:

I have not created any standard as to the purposes for which distributions shall be made. The exercise of the discretionary power by my trustees shall be final unless my trustees shall have acted dishonestly. I recognize and intend that an effect of the preceding sentence is to eliminate the application of a reasonableness standard to my trustee's determinations.

or

The exercise of the discretionary power shall be subject to the provisions of section 187 of the Restatement of Trusts (Second), including the Comments to that Section. I recognize and intend that an effect of the preceding sentence is to eliminate the application of a reasonableness standard to my trustee's determinations.

The first approach provides the maximum amount of finality to a trustee's determinations that is permissible under §187. The word "dishonestly" is taken from Comment i under that section. The second approach introduces a second qualification, namely, the trustee must not have acted from an "improper motive." There is a fuzziness to the meaning of these words. However, the sentence regarding the elimination of any reasonableness standard prevents those words being used to "back door" use of such a standard.

Why is the elimination of a reasonableness standard important? Because the standard is "mushy" and gives a court considerable discretion to overrule a determination of a trustee. To illustrate, is a 4/6-1/6-1/6 allocation of distributions among Henry McNeil and his two older children (in McNeil I) reasonable when the terms of the trust make no distinction in their interests?

## VI. Planning Considerations

- A. When two or more trusts are created for the same beneficiary, the will or trust agreement should state how invasions are to be made (e.g., if there are two trusts for the spouse, marital and non-marital, any power of invasion of principal in the spouse's favor should be made first from the marital trust).
- B. When multiple generations will participate in benefits from one trust, consider creating a single discretionary trust for each child and his descendants because:
  - 1. It is likely that each family branch will have different needs, necessitating different investment strategies and
  - 2. Each branch of the family will expect "equal" distributions, barring the occurrence of an unforeseen and very unusual situation.
- C. Consider splitting a single trust into two or more trusts with or without prior court order depending on local law requirements. (Note: many states recently have enacted statutes permitting trust splitting to establish two or more separate trusts for federal or state income, gift, estate and/or generation skipping transfer tax purposes.)
- D. Test the administrative predictability of the language to be selected with the trustee who will administer the provisions. The current trend is away from words which limit the powers in favor of broad "absolute" powers. But when a trustee may benefit from the exercise, the power should be restricted by an ascertainable standard.
- E. The will or trust agreement should provide that the trustee in exercising a discretionary power may but need not consider any other resources of any beneficiary.

## APPENDIX A

### Section 814(a) of the Uniform Trust Code:

“Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms as “absolute,” “sole,” or “uncontrolled,” the trustee shall exercise a discretionary power in good faith in accordance with the terms and purposes of the trust and the interests of the beneficiaries.”

### Section 50 of the Restatement (Third) of Trusts:

§ 50 Enforcement and Construction of Discretionary Interests

**(1) A discretionary power conferred upon the trustee to determine the benefits of a trust beneficiary is subject to judicial control only to prevent misinterpretation or abuse of the discretion by the trustee.**

**(2) The benefits to which a beneficiary of a discretionary interest is entitled, and what may constitute an abuse of discretion by the trustee, depend on the terms of the discretion, including the proper construction of any accompanying standards, and on the settlor's purposes in granting the discretionary power and in creating the trust.**

### COMMENTS & ILLUSTRATIONS: General Comment:

*a. Scope of Section.* The powers of trustees and the discharge of trusteeship responsibilities regularly involve the exercise of discretion, or fiduciary judgment, with which courts do not interfere except to prevent abuse. On discretionary powers in trust administration generally, see § 87. On investment matters, see § 90 [§ 227 of Restatement Third, Trusts (Prudent Investor Rule)], and Comment *j* thereto; § 91 [id. § 228], Comment *g*; and § 92 [id. § 229], Comment *d*. On grants of discretion in principal-and-income accounting matters, see Chapter 23.

This Section deals with situations in which trustees are granted discretion with respect to beneficiaries' rights to trust benefits. For these situations, the terminology "discretionary trust" or "discretionary interest" is used in this Restatement whether or not the terms of the trust provide standards (see Comments *d*, *e*, and *f*) to limit or guide the trustee's exercise of the discretionary power.

Situations of this type range from the typical power to invade principal for an income beneficiary to the discretionary trust that calls for distributions or applications of income, or of income and principal, for the support of a designated beneficiary (often a surviving spouse, elderly parent, or underage child) or for the benefit of "any one or more" of a group of beneficiaries, such as the settlor's spouse and issue. The trustee may have discretion whether or not to make payments to a particular beneficiary; or the trustee may

have discretion only to determine the time, manner, and amount of distributions, pursuant to a particular standard or otherwise. A power's "discretionary" character may be implied from its being attached to a standard, such as a simple direction to pay "amounts appropriate to B's support."

The commentary that follows is concerned not only with the trustee's duties but also with the ability of beneficiaries of these discretionary interests to enforce their rights, and thus with the extent of the beneficiaries' interests. Comments *b* and *c* address the limited but important judicial authority to control a trustee's exercise of discretion, while Comments *d*, *e*, and *f* examine the meaning and effects of various standards and omissions frequently encountered in trust terms accompanying a grant of discretion.

A trustee's discretionary power with respect to trust benefits is to be distinguished from a power of appointment. The latter is not subject to fiduciary obligations and may be exercised arbitrarily within the scope of the power. That an appointment may not be made to persons who are not objects (i.e., not permissible appointees) of a power of appointment, see Restatement Second, Property (Donative Transfers) § 20.1; "fraud on powers" is discussed in *id.* §§ 20.2-20.4; and *cf.* §§ 16.1, 16.2 (on contracts to appoint). (Tax law generally does not categorize powers in this manner, and even traditional property-law distinctions between fiduciary powers and powers of appointment may be difficult to draw; this is especially so because a true power of appointment can be conferred upon one who is also a trustee, although a power that runs with the office of trustee is strongly presumed to be a fiduciary power.) Also to be distinguished are nonfiduciary powers to demand or direct trust distributions based on "ascertainable" (Internal Revenue Code § 2041) or "objective" (case law under *id.* § 2038) standards; nevertheless, the discussion in Comments *d*, *e*, and *f* may have relevance to these powers. Compare the inclusion of these powers in the discussion of "discretionary interests" in § 60 (rights of creditors). Also, on powers granted others to terminate or amend, or to direct the trustee, see §§ 64, 75, and 87.

#### **Comment on Subsection (1):**

*b. Judicial review and control of trustee's discretion.* A court will not interfere with a trustee's exercise of a discretionary power when that exercise is reasonable and not based on an improper interpretation of the terms of the trust. Thus, judicial intervention is not warranted merely because the court would have differently exercised the discretion.

On the other hand, a court will not permit abuse of discretion by the trustee. What constitutes an abuse depends on the terms of the trust, as well as on basic fiduciary duties and principles (§§ 76-83). Of particular importance are the purposes of the power and the standards, if any, applicable to its exercise (see Comments *d-f*) and the extent of the discretion conferred upon the trustee (Comment *c*). Relevant fiduciary principles include (i) the general duty to act, reasonably informed, with impartiality among the various beneficiaries and interests (§ 79) and (ii) the duty to provide the beneficiaries with information concerning the trust and its administration (§ 82). This combination of duties entitles the beneficiaries (and also the court) not only to accounting information but also

to relevant, general information concerning the bases upon which the trustee's discretionary judgments have been or will be made. See Comment *e(1)*.

Court intervention may be obtained to rectify abuses resulting from bad faith or improper motive, and to correct errors resulting from mistakes of interpretation. Absent language of extended (e.g., "absolute" or "uncontrolled") discretion (Comment *c*), a court will also intervene if it finds the payments made, or not made, to be unreasonable as a means of carrying out the trust provisions. For example, a beneficiary may be entitled to amounts sufficient to provide support, or to meet some other standard, and the amounts being paid by the trustee may be clearly excessive or inadequate for the purpose. It is not necessary, however, that the terms of the trust provide specific standards in order for a trustee's good-faith decision to be found unreasonable and thus to constitute an abuse of discretion.

Furthermore, a court will intervene where the exercise of a power is left to the judgment of a trustee who improperly fails to exercise that judgment. Thus, even where a trustee has discretion whether or not to make any payments to a particular beneficiary, the court will interpose if the trustee, arbitrarily or without knowledge of or inquiry into relevant circumstances, fails to exercise the discretion.

### **Illustrations:**

1. S's will left her residuary estate in trust to pay the income to her husband, H, and also to distribute to him "as much of the principal as the trustee deems appropriate for H's comfortable support," remainder to S's descendants, all of whom are issue by her prior marriage. She appointed H to serve as trustee "if and for as long as he is willing and able to serve," with S's and H's friend and financial advisor, T, designated as substitute or successor trustee. A few years after S's death, with H serving as trustee, two of S's children challenge the extent of H's principal invasion for his own benefit. H has a permissible, settlor-created conflict of interest, but his acts are to be carefully scrutinized for abuse (see § 37, Comment *f*, and also § 78 on the duty of loyalty). Nevertheless, the court will not substitute its judgment for H's merely because it would have exercised the discretion differently. It will, however, intervene if it finds that H has acted unreasonably, after considering in this situation not only such matters as the standards set out in the terms of the trust (see Comments *d* and *e*) but also the fact that S has trusted H to serve as trustee with the fiduciary authority to determine the amounts of principal appropriate to his own comfortable support.

2. Same facts as in Illustration 1, except that T has succeeded H as trustee. The court will interfere with T's exercise of discretion only in the event of abuse. Despite T's personal relationship with H, which was known to S, or T's possible irritation with the complaints of S's children, T's fiduciary duties include a duty of impartiality (see § 79).

When judicial intervention is required, a court may: direct the trustee to make or refrain



from making certain payments; issue instructions (§ 71) to clarify the standards or guidelines applicable to the exercise of the power; or rescind the trustee's payment decisions, usually directing the trustee to recover amounts improperly distributed and holding the trustee liable for failure or inability to do so. (On the elements of a trustee's liability for breach of trust, see Chapter 19.) The court may also deny or diminish the trustee's compensation, establish safeguards against abuse in the future, or even remove the trustee for repeated or serious abuse of the discretionary power. See § 37, Comments *e* and *g*.

*c. Effect of extended discretion.* Although the discretionary character of a power of distribution does not ordinarily authorize the trustee to act beyond the bounds of reasonable judgment (Comment *b*), a settlor may manifest an intention to grant the trustee greater than ordinary latitude in exercising discretionary judgment. How does such an intention affect the duty of the trustee and the role of the court?

It is contrary to sound policy, and a contradiction in terms, to permit the settlor to relieve a "trustee" of all accountability. (Cf. § 87, and also § 76.) Once it is determined that the authority over trust distributions is held in the role of trustee (contrast nonfiduciary powers mentioned in Comment *a*), words such as "absolute" or "unlimited" or "sole and uncontrolled" are not interpreted literally. Even under the broadest grant of fiduciary discretion, a trustee must act honestly and in a state of mind contemplated by the settlor. Thus, the court will not permit the trustee to act in bad faith or for some purpose or motive other than to accomplish the purposes of the discretionary power. Except as the power is for the trustee's personal benefit, the court will also prevent the trustee from *failing* to act, either arbitrarily or from a misunderstanding of the trustee's duty or authority.

Within these limits, it is a matter of interpretation to ascertain the *degree* to which the settlor's use of language of extended (e.g., "absolute") discretion manifests an intention to relieve the trustee of normal judicial supervision and control in the exercise of a discretionary power over trust distributions.

### **Illustrations:**

3. Following S's death his previously revocable trust has been administered for nearly a decade by T Bank, which is directed to pay income to S's widow, W, and also empowered to pay her "such additional amounts from the principal of the trust as the Trustee, in its sole and uncontrolled discretion, believes appropriate for W's comfortable support and care," with the remainder upon W's death to pass to S's then living issue. In response to requests by W, T Bank has begun to pay substantially increased amounts to her to enable her to accumulate funds from which she may aid C (her child by a prior marriage) in his plans to obtain control and expand the activities of X Co., of which C has been an officer and shareholder for a number of years. S's children petition the court to instruct T Bank that principal distributions for that purpose are improper and that it must recover amounts previously paid to W for that purpose. Nothing in relevant

circumstances or in other terms of the trust indicates a broader purpose for the invasion power than the support-related (see Comment *d*) language quoted above. The court will issue the order requested by the remainder beneficiaries. Despite S's grant of extensive discretion, and without a finding of bad faith, T's judgment was not exercised in an appropriate state of mind, that is, for a purpose falling within the quoted standard.

4. S's testamentary trust grants T, as trustee, the "absolute and uncontrolled discretion to pay or apply such amounts of income or principal or both to or for the support and benefit of my wife W and any one or more of my descendants, as T may consider desirable and in their best interests." On W's death, the trust estate will be distributed to S's then living issue, if any, and otherwise to others. After a meeting with W (who does not expect to need funds from the trust), her tax accountant, and D (S's only child), T made a large distribution to D to enable her to acquire a home and to advance her career and investment objectives, and has begun to implement a plan of modest distributions to D's two children (ages 14 and 15) to develop funding for their career and personal objectives. Assuming no showing of bad faith or of settlor intention contrary to the quoted trust provisions, T has not abused the extended discretion it has in pursuing the broad standard (see generally Comment *d*) set out in S's will. (On a trustee's duties to provide information to beneficiaries and to act with impartiality, see Comment *b*.)

Extended discretion serves to discourage challenges by remainder beneficiaries to the generosity of trustees, as in Illustration 4. On the other hand, it may also make it difficult for a discretionary beneficiary to obtain judicial intervention when a trustee's judgments are highly conservative with regard to matters that fall within the settlor's authorized purposes. The overall tenor of the terms of a power may, however, in the context of the trust's more general purposes, lead to an interpretation granting the trustee ordinary discretion with respect to the benefits to which the discretionary beneficiary is minimally entitled (e.g., reasonable support), with the extended discretion applicable to the trustee's allowance of more. This "one-sided" liberalization of the discretionary authority, where a court finds the settlor's language was intended to assure generosity in favor of a life beneficiary, would thus tend to encumber the efforts of remainder beneficiaries who seek to challenge what might otherwise be excessively generous decisions by a trustee.

### **Section 187 of the Restatement (Second) of Trusts:**

“Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion.”

Excerpts from the Restatement of Trusts (Second), §187, Comment e, i, j and k (1992).

*e. No abuse of discretion.* If discretion is conferred upon the trustee in the exercise of a power, the court will not interfere unless the trustee in exercising or failing to exercise the power acts dishonestly, or with an improper even though not a dishonest motive, or fails to use his judgment, or acts beyond the bounds of a reasonable judgment. The mere fact

that if the discretion had been conferred upon the court, the court would have exercised the power differently, is not a sufficient reason for interfering with the exercise of the power by the trustee. Thus, if the trustee is empowered to apply so much of the trust property as he may deem necessary for the support of the beneficiary, the court will not interfere with the discretion of the trustee on the ground that he has applied too small an amount, if in the exercise of his judgment honestly and with proper motives he applies at least the minimum amount which could reasonably be considered necessary, even though if the matter were left to the court to determine in its discretion it might have applied a larger amount. So also, the court will not interfere on the ground that the trustee had applied too large an amount, if in the exercise of his judgment honestly and with proper motives he applies an amount not greater than a reasonable person might deem necessary for the beneficiary's support, although the amount is greater than the court would itself have awarded.

\* \* \*

*i. Reasonableness of trustee's exercise of judgment.* If there is a standard by which the reasonableness of the trustee's judgment can be tested, the court will control the trustee in the exercise of a power where he acts beyond the bounds of a reasonable judgment, unless it is otherwise provided by the terms of the trust.

\* \* \*

The nature of the power conferred upon the trustee, however, may be such that there is no standard indicated by the terms of the trust by which the reasonableness of his conduct in exercising or failing to exercise the power can be judged. In such a case, however, the court will interpose if the trustee acts dishonestly, or from some improper motive. Thus, if power is conferred upon the trustee to appoint income or principal in favor of a particular beneficiary if he so chooses, without any reference to the needs of the beneficiary, the court will not interpose if the trustee acts honestly and from proper motives. (emphasis added).

\* \* \*

*j. Interpretation of trust instrument as to extent of discretion.* The extent of the discretion conferred upon the trustee depends primarily upon the manifestation of intention of the settlor. The language of the settlor is construed so as to effectuate the purposes of the trust. The mere fact that the trustee is given discretion does not authorize him to act beyond the bounds of a reasonable judgment. The settlor may, however, manifest an intention that the trustee's judgment need not be exercised reasonably, even where there is a standard by which the reasonableness of the trustee's conduct can be judged. This may be indicated by a provision in the trust instrument that the trustee shall have "absolute" or "unlimited" or "uncontrolled" discretion. These words are not interpreted literally but are ordinarily construed as merely dispensing with the standard of reasonableness. In such a case the mere fact that the trustee has acted beyond the bounds of a reasonable judgment is not a sufficient ground for interposition by the court, so long as the trustee acts in a state of mind in which it was contemplated by the settlor that he would act. But the court will interfere if the trustee acts in a state of mind not

contemplated by the settlor. Thus, the trustee will not be permitted to act dishonestly, or from some motive other than the accomplishment of the purposes of the trust, or ordinarily to act arbitrarily without an exercise of his judgment. (emphasis added).

\* \* \*

*k. Limits of power of settlor to confer discretion.* The settlor cannot confer upon the trustee such an unlimited power that the court will not entertain a suit by the beneficiary to prevent the trustee from acting dishonestly. It is against public policy to permit the settlor to relieve the trustee of all accountability. See §172. It is true that the powers conferred upon the transferee of property may be so extensive as to indicate an intention not to create a trust but to give the beneficial interest in the property to the transferee. See §125. If, however, a trust is created, it is required by public policy that the trustee should be answerable to the courts, so far at least as the honesty of his conduct is concerned. (emphasis added).

\* \* \*

By the terms of the trust a discretionary power may be conferred on the trustee to determine questions relating to the distribution of trust property. There is no public policy which prevents the avoidance of litigation by committing the termination with finality to the trustee. Thus it may be provided that in determining what is income and what is principal the trustee's decision shall be final. See §233, Comment p. (emphasis added).

## APPENDIX B

### MODERN-STYLE DISCRETIONARY DISTRIBUTIONS: PRIMARY BENEFICIARY POSSESSES NONFIDUCIARY DISCRETION: WITHDRAWABLE-PERCENTAGE ("GIVE-ME-FIVE") UNITRUSTS.

- A. Withdrawable-Percentage ("GIVE-ME-FIVE")  
Unitrust Examples.
1. Form.
    - (1) Give-Me-Five. If**
      - a [ , after attaining thirty years of age,] the descendant is living immediately before the end of a calendar year, the Trustee shall pay to the descendant such fractional share (not to exceed one-twentieth), if any, of the trust estate as the descendant last directs in writing before the end of the year.
      - b [As soon as possible after each taxable year of the descendant, except to such extent (if any) as the Independent Trustee in its sole and absolute discretion last directs in writing before the end of the year, the Trustee shall pay to the descendant (i) the amount (if any) by which the income tax liability of the descendant for the year is increased because, as a result of one or more lapses of rights granted according to the preceding sentence, the descendant is deemed, according to Subpart E of Subchapter J of Chapter 1 of Subtitle A of the Code, to own any of the trust estate for purposes of determining the United States income tax of the descendant and (ii) the amount (if any) by which the income tax liability of the descendant is increased because the Trustee must pay according to this sentence.]
  2. Alternative version of first sentence of subparagraph (1).
    - (1) Give-Me-Five. If**
      - a [ , after attaining thirty years of age,] the descendant is living immediately before the end of a calendar year, the Trustee shall pay to the descendant so much, if any, of the trust estate, not to exceed in value five percent of the value of the trust estate as of the end of the year, as the descendant last directs in writing before the end of the year.

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These provisions by Jerold I. Horn (Peoria, Illinois) are reprinted with permission.  
See also Horn, Jerold I. "Prudent Investor Rule, Modern Portfolio Theory and Private Trusts: Drafting and Administration Including the 'Give-Me-Five' Unitrust." Real Property, Probate and Trust Journal, 33 (Spring 1998), pp. 1-62.

## APPENDIX C

### **Excerpts from a Declaration of Trusts:**

#### **Article VI: Children's Trusts**

Each Trust named for a child of mine shall be administered as follows:

A. If the child for whom the trust is named is living on the division date, then commencing as of the division date and during the life of that child, the trustee shall distribute to any one or more of the child and his or her descendants living at the time of the distribution as much of the net income and principal of the trust, even to the extent of exhausting principal, as the trustee determines from time to time to be required for their respective health, support and education, and as the independent trustee, if any, believes to be desirable from time to time for their respective best interests; provided, however, that:

1. The trustee shall add any undistributed net income to principal from time to time, as the trustee determines;
2. My primary concern during the life of the child is for the child's health, support and education and the trustee need not consider the interest of any other beneficiary in making distributions to the child for those purposes under this paragraph;
3. No distribution made under this paragraph to a descendant of the child shall be charged as an advancement;
4. The trustee may distribute the net income and principal of the trust to a descendant of the child (i) only from that part of the trust not subject to a power of withdrawal by the child, or (ii) only with the written consent of the child; and
5. The trustee may make unequal distributions to the beneficiaries or may at any time make a distribution to fewer than all of them, and shall have no duty to equalize those distributions.

#### **Article XIV: Administrative Powers and Rules**

C. In determining whether to make discretionary distributions of net income or principal to a beneficiary, the trustee may (but need not) consider such circumstances and factors as the trustee believes are relevant, including the other income and assets known to the trustee to be available to that beneficiary and the advisability of supplementing such income or assets, the tax consequences of any such distribution, and, in the case of any beneficiary other than my spouse, the character and habits of the beneficiary, the diligence, progress and aptitude of the beneficiary in acquiring an education, and the ability of the beneficiary to handle money usefully and prudently and to assume the responsibilities of adult life and self-support. The trustee shall not be liable for errors in judgment in making or not making a discretionary distribution of income or principal under this instrument, absent proof of bad faith.

D. Notwithstanding any other provision of this instrument, I hereby limit the general discretionary powers of each fiduciary so that (i) no fiduciary (other than me) shall participate in any decision that would cause any portion of the trust to be includable in the estate of the fiduciary for federal estate tax purposes, and (ii) no fiduciary (other than me) may use trust income or principal to discharge the legal obligation of the fiduciary individually to support or educate a beneficiary hereunder. Where a standard for discretionary distributions or any other discretion of a fiduciary consists of two or more elements, they shall be severable for purposes of determining any fiduciary's ability to participate in a decision under this instrument.

#### **Article XVI: Interpretative Rules**

I. The term "support" means support in reasonable comfort in the beneficiary's accustomed manner of living.

J. The term "education" includes, but is not limited to, the expenses of private schooling at the elementary and secondary school levels, college, graduate and professional schools, and specialized or vocational training.

K. The term "health" shall be construed liberally to include all forms of mental or physical health care, including, but not limited to, nursing home or other extended care.

L. The term "best interests" is not defined because I intend to give the independent trustee unfettered discretion in determining what is in a beneficiary's best interests, subject only to the requirement that this discretion not be exercised in bad faith.

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These clauses are reprinted with permission from "John Doe Declaration of Trust" by Thomas Abendroth, Schiff Hardin LLP (Chicago, Illinois and New York, New York).

## APPENDIX D

### Excerpts from Practical Drafting©:

#### **Will Provisions**

[H-4b] If my spouse survives me, I give and devise my residuary estate to my trustees IN TRUST, to pay out of the net income or principal or both such amount or amounts (whether equal or unequal, and whether the whole or a lesser amount) as my trustees (other than any current beneficiary) in their sole discretion determine to such one or more of my spouse and my descendants, of whatever degree and whether or not born during my life, as my trustees (other than any current beneficiary) in their sole discretion select. In exercising this discretionary power, my trustees (other than any current beneficiary) may but need not consider any other resources of any beneficiary and shall give primary consideration to the needs and desires of my spouse and the needs of my children who are under age 21 or have not completed their education. Any net income not so paid shall be added to principal.

*(If no current beneficiary can be a trustee, omit the words “(other than any current beneficiary)” in the first and second sentences. If the testator does not desire to create a preference in favor of his spouse and certain of his children, omit everything after “other resources of any beneficiary” in the second sentence. If none of the testator's children is under age 21 and all have completed their education, omit everything after “my spouse” in the second sentence.)*

*(Unless a child has died before the testator (see IRC Sec. 2651(e)), a distribution of income or principal to a grandchild or more remote descendant will be a taxable distribution under Chapter 13 unless if made by an individual it would not be treated as a taxable gift under IRC Sec. 2503(e). See IRC Sec. 2611(b)(1).)*

#### **Trust Provisions**

[D-1a] Until the death of the last survivor of the grantor's children living on the date of this indenture (the “trust term”) the trustee may pay out of the net income or principal or both such amount or amounts (whether equal or unequal, and whether the whole or a lesser amount) as the trustee in its sole discretion determines to such one or more persons as the trustee in its sole discretion selects out of a class composed of the living descendants of the grantor, of whatever degree and whenever born. In exercising this discretionary power, the trustee may but need not consider any other resources of any beneficiary. Any net income not so paid shall be added to principal.



*(If the grantor desires to create a preference in favor of his children, the following may be added at the end of the second sentence:*

*and shall give primary consideration to the needs and desires of the grantor's children.)*

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## APPENDIX E

### **Discretionary trust to pay income and/or principal to a child with precatory advice to the trustee.**

Each share of the trust property set apart for a child of the grantor shall be held by the trustee IN FURTHER TRUST, to pay to the child so much of the net income or principal, or both, whether the whole or a lesser amount, as the trustee in its sole discretion determines. Any net income not so paid shall be added to the principal of the trust

In exercising this discretionary power, the trustee may, but need not, consider any other resources of the child and shall give primary consideration to the health, education and welfare of the child. The grantor desires, but does not direct, that the trustee take into consideration when exercising its discretion to distribute principal to the child after he reaches majority, the uses to which such property will be applied by the child, and to favorably consider distributions for such purposes as the child's continued education, purchase of an appropriate residence, an appropriate business investment or payment of appropriate family expenses that the child cannot reasonably meet. The grantor's expression of his desires does not in any way limit the trustee's discretion hereunder.

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## APPENDIX F

Findings from U.S. Trust's Survey of Affluent Americans, addressing concerns for children

### 1. Advantages of Affluence--

#### PERCENT OF CHILDREN WHO HAVE:

Sports lessons	89%
Music, art or dance lessons	87%
Summer camp	87%
Computers	79%
International travel	76%
Cars (at driving age)	68%
Privileges at a private club	54%
Large parties (Sweet 16, Bar/Bat Mitzvah, etc.)	52%
Expensive electronic equipment	42%
Psychiatric therapy	42%

### 2. Paying for their Adult Children--

#### PERCENT WHO WOULD PAY FOR:

Vacations with parents	88%
Medical expenses	86%
Down payment on a house or help with a home mortgage	76%
Expenses related to starting a business	67%
The cost of private school or college for a grandchild	67%
The cost of lessons or summer camp for a grandchild	64%

Informal survey of trust officers for types of recent requests:

- Medical care/non-traditional medicine
- Education/Home schooling
- Starting a business
- In-vitro fertilization
- Sex change operation
- Gifts
- Total return distributions (in states without statutory authority)

## APPENDIX G

### DISCRETIONARY TRUST CHECKLIST

#### Account Information

Trust Name  
Current Market Value  
Inception Value  
Inception Date  
Estimated Annual Income  
Total Income Distributions in past 12 months  
Total Principal Distributions in past 12 months

#### Request Information

Amount Requested? (From Income? From Principal?)  
Who is requesting the funds and for what purpose(s)?  
What documentation is provided? Is it sufficient?  
What are the capital gains consequences?  
What effect will payment have on income?  
Must outside resources of the beneficiary be considered and if so, what are they?  
Even if outside resources need not be considered, do you want more information?

#### Trust Provisions

What is the standard for exercising discretion?  
Are there other beneficiaries? What are their interest(s)?  
State the income, principal and remainder provisions  
Is there a co-trustee? Has he or she approved?

#### GST Considerations

Is there a direct payment of tuition or medical expenses?  
Is the trust GST protected? And, if so, is this the best source for funds?  
Is the beneficiary a skip person?

#### Additional factors to consider when exercising discretion but are not limited to:

- The intent of the settlor, if known
- The nature of the request for funds
- The size of the request compared to the value of the trust
- The history of past requests and payments
- The opinion of the co-trustee regarding the request
- Any other relevant factors based on the trust officer's knowledge of the situation- including factors specific to the beneficiary's location, community and station in life