



FEATURE: FIDUCIARY PROFESSIONS

By **Griffin H. Bridgers** & **Christopher D. Harrison**

Health and Education in Trust Administration

Should trustees stick their fingers in the dam?

For decades, attorneys and trustees have relied on the definition of “ascertainable distribution standards” in Internal Revenue Code Sections 2044 and 2514. Commonly referred to as the “HEMS” standard, the terms “health,” “education,” “maintenance” and “support” have become mainstays of many trust distribution provisions. While there’s significant authority, in both case law and dicta, about the meaning of “support” and “maintenance,” attorneys and trustees often rely on very general, and liberal, definitions of the terms “health” and “education.” The result is a highly permissive attitude towards discretionary distributions of principal and income of a trust for purposes of health and education. Compare this permissive oversight to distributions for less specific purposes, which are shoehorned into definitions such as “maintenance” and “support,” which become subject to intense scrutiny by an independent trustee or beneficiaries with an adverse interest.

In many cases, trust documents provide scant defining language for trustees to limit the distribution scheme for health and education expenses. The intent of settlors, either express or implied under the trust agreement, often serves as the primary source of this permissive distribution scheme. Without the input or consent of settlors, a modification to this scheme may not be possible unless otherwise permitted by applicable state law.¹ Indeed, state laws define and limit discretionary

distributions bound by ascertainable standards,² and frequently, states offer no precedent, or precedents vary widely among states.³ Even if a modification of the distribution scheme was possible, such a modification may result in unnecessary liability for a trustee, especially in cases in which a refusal to make a distribution results in physical or financial harm to a beneficiary.

On the other hand, unrestricted distributions for health and education purposes can have a dramatic effect on the remaining trust beneficiaries. For example, a beneficiary with a catastrophic illness, whose insurance doesn’t cover all necessary treatments, could quickly drain the assets of a common sprinkle or pot trust with multiple beneficiaries. In addition, a beneficiary whose educational pursuits extend well beyond the reasonable time frame for earning a degree could, in the best case, establish a precedent for other beneficiaries and, in the worst case, also quickly drain trust assets at the expense of other beneficiaries.

The changing costs and value, of both health and education, may require trustees to take a much more proactive role in monitoring distributions for these purposes. If distributions can’t be restricted, proper counseling for beneficiaries for health care and educational decisions may be important. Attorneys, trust settlors and trustees should employ the following suggestions for drafting and administering health and education distribution standards.

Defining “Health”

In many trusts, the term “health” isn’t defined, and a settlor often hasn’t given much thought to the health goals of a trust. Sometimes, the settlor wants to maintain flexibility and avoid dead-hand control. In other cases, the attorney interviewing the settlor simply hasn’t inquired about these goals. Regardless of the reason, silence on the settlor’s intentions with respect to health

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may not provide enough flexibility to avoid catastrophic losses for the trust.

Custom definitions of "health" can fill these gaps. It's important to include language that creates flexible guidelines that can adapt to the circumstances of each individual beneficiary, as well as the economic and political environment in which the trust is administered. If the settlor desires, certain goals can be made mandatory, such as the maintenance of adequate primary health care coverage. Attorneys must include appropriate Health Insurance Portability and Accountability Act waivers to enable a trustee to exercise discretion that calls for investigating health or obtaining information as suggested herein.⁴

There are a variety of ways in which a trust can define "health," including:

- The definition of the ascertainable standard itself could limit the term. For example, distributions can be limited to purposes of unreimbursed health and medical expenses or out-of-pocket medical expenses. This approach treats the trust as last-dollar, while requiring the beneficiary to rely primarily on available health care coverage. Limiting language could permit a trustee to secure trust assets from forced distributions.
- A formal definition of "health" may require a beneficiary to obtain health care coverage for which he's eligible as a condition to receiving distributions for health purposes. The trustee could work with the beneficiary to shop for and obtain adequate coverage, with the beneficiary's share of premiums, deductibles, coinsurance and other cost-shifting mechanisms being billed to or reimbursed by the trust.
- Settlers who create trusts intended to provide for a beneficiary for the remainder of his life before passing corpus to remainder beneficiaries might encourage the trustee to consider using trust assets for the purchase of a long-term care insurance policy.
- The trust could include incentive provisions to encourage preventative health care. Distributions for health, or other purposes, could be conditioned

on the beneficiary maintaining certain health standards, such as annual checkups, acceptable markers (such as cholesterol, blood pressure), etc. Additional incentives could be provided for exercise programs, weight loss or improvement in health markers over time. However, care must be taken to design and implement incentives that are objective, ascertainable and encouraging. If, for example, a trustee informs

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- a beneficiary that he's visibly gained weight, this revelation may discourage the beneficiary and could cause irreparable harm to the relationship between the beneficiary and trustee.
- Remedies associated with Eastern health care warrant consideration as practices like acupuncture, herbal medicines, cupping, massage and aromatherapy gain more awareness and acceptance by Western cultures.
- A trust could set mental health guidelines and permit a trustee to make distributions for counseling, rehabilitation and substance abuse programs. Again, this expansive and often misunderstood area of a person's health can leave a trustee guessing at the settlor's intent. Moreover, psychiatric well-being needs to represent an area of health often unmet by traditional health insurance policies.
- A trust could limit the types of distributions that can be made for health purposes. For example, a settlor may wish to prohibit distributions for purposes of unnecessary cosmetic surgery, in vitro fertilization, adoption, family planning, hormone replacement or gender reassignment surgery.



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Defining "Education"

Many trusts contain a definition of "education" which, at a minimum, requires a beneficiary to enroll in an accredited educational institution and pursue a course of instruction leading to an undergraduate or graduate degree or specialized or vocational training and certification. While these requirements are still practical, this boilerplate definition ignores common political and economic issues with education.⁵

First, commonly accepted standards for accreditation have changed, especially in the wake of highly publicized scandals and shutdowns involving for-profit colleges such as ITT Technical Institute. Even law schools and non-profit educational institutions haven't been immune

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to these troubles, with schools such as Charlotte School of Law, Whittier Law School and Minnesota Music College recently shutting their doors. While there's no universal standard for accreditation within most trusts, the question of whether an educational institution is eligible to receive the proceeds of aid, such as federal grants and loans from the Department of Education, often serves as the sole criterion. With Congress debating the eligibility of institutions to receive aid, this assumption may no longer be practical.⁶

Second, the traditional path to earning a bachelor's or graduate degree has evolved. For example, in the past, the timeframe for earning a college degree usually involved eight semester hours of credits, taken over a 4-year period, with summers off to seek employment experience and internships. Many students, however, now have expanded options to reduce this timeframe. Internships can be used to earn credit hours, summer school can accelerate the traditional 4-year timeframe and some institutions may even follow a cooperative model to alternate classroom instruction and on-the-job training. Many schools offer activities such as study

abroad programs, structured social and athletic dorms and communities and Greek life. Ultimately, these opportunities may not align with a trust settlor's vision of college education for trust beneficiaries.

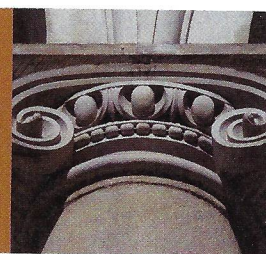
Third, higher education costs have skyrocketed. On average, the cost of college education has outpaced inflation by 3.2 percent to 4.4 percent over the last three decades.⁷ The payment of the face amount of tuition for one or more trust beneficiaries can rapidly deplete the trust estate, while leaving few remaining assets to satisfy the beneficiary's other needs. However, the limitation of educational opportunities for a beneficiary who would otherwise have the means through a trust can have a chilling effect on the beneficiary's livelihood, confidence and experience.

While these illustrations provide a snapshot of the common current issues, it's important not to focus myopically on present issues. Different issues may ultimately be relevant when beneficiaries of a trust begin attending college. Accordingly, drafting educational standards must strike a balance between being reactive and forward thinking. For example, some states now subsidize community college or the pursuit of a bachelor's degree for residents.⁸ If a beneficiary qualifies for state or private assistance, such as scholarships or grants, the practical approach for a trust is to maximize such assistance before making distributions.

In addition, beneficiaries who don't receive funding from their own efforts or from the trust have the option to seek federal and private student loans. Given this option, the language of a trust should take into account the practicalities of education finance. For example, could a trust pay off a beneficiary's student loans incurred prior to the death of his parents? Could the trust provide a loan to the beneficiary for education with favorable payment terms on completion of a degree and attainment of employment? Encouraging the beneficiary to get some "skin in the game" can yield stronger beneficiary commitment to the educational program. Trust language can address troubling issues head-on and enable the trustee to incentivize beneficiaries and hold them accountable for their educational pursuits.

Due to the ever-evolving issues in education, it can be very difficult to draft language that's flexible enough to address all possible outcomes while also honoring the intent of the settlor. To satisfy both goals,

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it's important for advisors to create a more meaningful and efficient process for analyzing the settlor's goals. The following list contains helpful questions to facilitate this process:

- Should the trustee decline to pay for education at for-profit institutions?
- Should a more objective system for determining quality of education be used? For example, a settlor may wish to limit the choices of colleges to those that are ranked at a certain level nationally or that are accredited by specific organizations.
- Should the trust impose a dollar limit on tuition (in total or annually) and/or impose a time limitation on the achievement of a degree or certificate program?
- Should continued academic achievement or progress be incentivized? For example, should the beneficiary be required to maintain a certain grade point average (GPA) and/or complete a certain number of credit

hours each semester?

- Should the trustee work with the beneficiary to assist with the choice of college?
- Should the trust be treated as last-dollar? That is, should beneficiaries be incentivized to maximize scholarship opportunities?
- Should the trust pay for cultural experiences, such as study abroad programs?
- Should the trust pay for college preparation, such as college preparatory academies and preparation programs for college admissions tests such as the SAT or ACT?
- If a beneficiary has the potential to gain an athletic scholarship, should the trust also pay for athletic training and competition expenses?
- Should the trust provide for retroactive reimbursement of educational expenses, or student loans, incurred prior to a beneficiary's interest vesting in a trust?

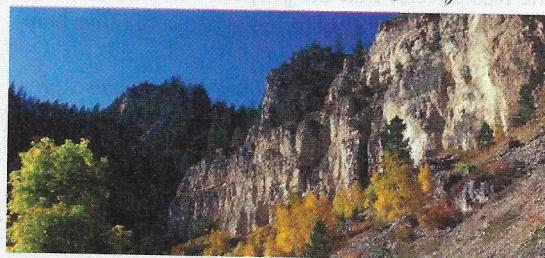


Photo courtesy of the South Dakota Department of Tourism

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- Should ancillary costs, such as room and board, be limited? For example, should a trust pay more for a single occupancy dorm room for a beneficiary, instead of a less expensive double occupancy room?
- Should social costs, such as Greek life, be subsidized in full or in part? If so, should the beneficiary also be required to submit to the trustee for drug testing or

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participate in drug and alcohol awareness and education programs?

- Should a trustee or a trust protector have the authority to adapt any of these educational guidelines to take into account changing circumstances?

In some cases, the trust instrument may not always be the appropriate place to include the settlor's wishes. Objective or rigid goals that apply to all beneficiaries, such as avoiding for-profit colleges or maintaining a certain GPA, could be included in the trust itself. In cases in which a settlor's goals are flexible or unique to a specific beneficiary, a better approach would be for a settlor to create non-binding letters of instruction to a trustee that could serve as evidence of a settlor's intent if the terms of the trust are called into question.

Health and Education Gap Fillers

Absent guidance, trust documents offer little opportunity for a trustee to limit health and education expenses. Often, the health and education terms of a trust can't be changed, due to the death of the settlor(s) and/or the

irrevocability of the trust. In this scenario, trustees may find themselves in a difficult situation. Life-and-death consequences tied to health distributions and generally accepted health care needs won't challenge trustees as much as distributions for newer health care practices or expenses associated with healthy lifestyles. Educational expenses that were acceptable yesteryear may not be acceptable in the future. A trustee acting on current standards may end up in conflict with a beneficiary who's damaged based on future standards.

As noted above, the question of whether a distribution for health or education is appropriate is primarily driven by an analysis of the settlor's intent.⁹ In the absence of ambiguity in the trust, or evidence of a mistake of law or fact by the settlor, the only source of settlor's intent is the trust instrument itself.¹⁰ This leaves very little room for extrinsic evidence to be used, by either a trustee or a beneficiary, when a question of the necessity of a distribution arises. However, this general principle of law can also provide more certainty in such a case.

Given this reality, a trustee should analyze the reasonableness of any limitation on distributions for health or educational purposes. While trustees often can't deny distributions couched as necessary for health or education, they can use some common grounds to limit them, including:

- The trustee feels that the proposed distribution will rapidly deplete the trust at the expense of other beneficiaries.
- The trustee questions whether the purposes for which a distribution is proposed will actually advance the beneficiary's health or education.
- The trustee believes that the beneficiary's own resources are sufficient so as not to require the distribution.
- The trustee fears that allowing the distribution could cause a breach of fiduciary duty.
- The trustee believes the distribution will frustrate another purpose of the trust.
- The trustee's exercise of discretion in denying the requested distribution aligns with the trustee's established and consistent prior administration.
- The trustee observes that the distribution varies from the beneficiary's accustomed standard of living prior to the settlor's death.



Common trust provisions can preclude a trustee from limiting a distribution based on these grounds. For example, provisions waiving the trustee's duties to equalize distributions to beneficiaries, or to preserve trust assets for remainder beneficiaries, may not support a trustee's objection to a distribution. On the other hand, trust provisions requiring the trustee to take into account the beneficiary's resources outside of the trust, or to limit distributions to emergencies or basic education, may serve as sufficient grounds for a denial.


If issues aren't resolved by the terms of a trust, state law and dicta may become a necessary resource. Applicable authorities may be on point if the trust is organized and administered under the laws of the same state. However, if the trust is formed in one state, but administered in another state, a trustee often must reconcile conflicting principles of trust administration. The interpretation of the terms "health" or "education" could be based on the trust's choice-of-law provision or based on the situs of the administering trustee. Variations among state laws could provide grounds for conflict between beneficiaries and trustees.

Beneficiaries and trustees may resolve these conflicts by agreeing to policies for distributions, including for purposes of health and maintenance. Unfortunately, these agreements stem from costly litigation billed to the trust. Many states permit beneficiaries and a trustee to consent, in writing, to specific actions in administering a trust.¹¹ Such policies could include, for example, a requirement that beneficiaries maintain adequate health care coverage to be paid for by the trust or a requirement that beneficiaries complete college within a certain amount of time. If the beneficiaries can't all agree on major issues, the trustee may have additional remedies to act unilaterally, such as decanting or modification of the trust in response to unforeseen circumstances.¹²

Practical considerations also abound in resolving questions of distribution. When compared to educational expenses, distributions for health tend to carry the greatest necessity and urgency. However, this reality doesn't completely discount the importance of swiftly analyzing distributions for purposes of education. If a beneficiary's tuition is due and remains unpaid by a trustee, such a delay could cause disenrollment or a loss of credit hours to a beneficiary. These risks and consequences are external to the trust, as opposed to internal (such as trust depletion). The trustee should always consider these

external risks to an individual beneficiary.

Responding to Changing Landscape

Beneficiaries of a trust have highly individualized needs, and it can be difficult to anticipate their individual health and education needs based on the information available at the time that a trust is created. Recently, both technology and public policy with regard to health and education have changed, and trusts created before these changes occurred may not provide trustees with guidance needed to implement the settlor's intent. Conflicting viewpoints in the public eye between the necessity, or luxury, of health and education have yet to stabilize and will likely continue to vacillate for the foreseeable future. More than ever, the rapidly changing health and education landscape makes it imperative for attorneys, settlors and trustees to define "health" and "education" and set distribution guidelines in trusts. 

Endnotes

1. Revenue Ruling 77-194; Philip E. Heckerling Institute on Estate Planning, Vol. 23, Section 1902.1 (1989).
2. See Uniform Trust Code (UTC) Section 107 (2000).
3. See, e.g., Carol Warnick, et al., "Drafting and Interpretation of Discretionary Distribution Standards," *Colorado Estate Planning Handbook*, Section 26.2.2 (Sixth ed.).
4. Jacqueline Myles Crain, "HIPAA—A Shield for Health Information and a Snag for Estate Planning and Corporate Documents," 40 *Real Prop. Prob. & Tr. J.* 357 (Summer 2005).
5. See, e.g., H.R. 1, Tax Cuts and Jobs Act, Section 11032, 115th Congress (2017-2018) (expanding permissible distributions of Internal Revenue Code Section 529 plans to include elementary and secondary educational expenses).
6. See, e.g., College Transparency Act, H.R. 2434, 115th Cong. (2017).
7. See The College Board, "Trends in College Pricing," at p. 3 (2017), https://trends.collegeboard.org/sites/default/files/2017-trends-in-college-pricing_1.pdf.
8. See, e.g., Tennessee Promise, which provides a 2-year scholarship to Tennessee residents for the pursuit of an associate's degree, <http://tnpromise.gov/about.shtml>.
9. See UTC, "Overview of Uniform Trust Code," Article 4 ("preserving the settlor's intent is paramount") (2000).
10. See Uniform Probate Code Section 2-805.
11. See, e.g., Section 111 of the UTC of 2010, permitting a trustee and beneficiaries to enter into a binding nonjudicial settlement agreement.
12. See Article 4 of the UTC of 2010 for the most common remedies available to a trustee; see also the Uniform Trust Decanting Act (2015).