Trust Distributions

David F. Johnson

DISCLAIMERS

- These materials should not be considered as, or as a substitute for, legal advice, and they are not intended to nor do they create an attorney-client relationship.
- Since the materials included here are general, they may not apply to your individual legal or factual circumstances.
- You should not take (or refrain from taking) any action based on the information you obtain from these materials without first obtaining professional counsel.
- The views expressed in this presentation do not necessarily reflect those of the firm, its lawyers, or clients.

WINSTEAD

Visit Blog: www.fiduciarylitigator.com

David F. Johnson
Winstead PC
300 Throckmorton, Suite 1700
Fort Worth, Texas 76102
(817) 420-8223
dfjohnson@winstead.com

Introduction

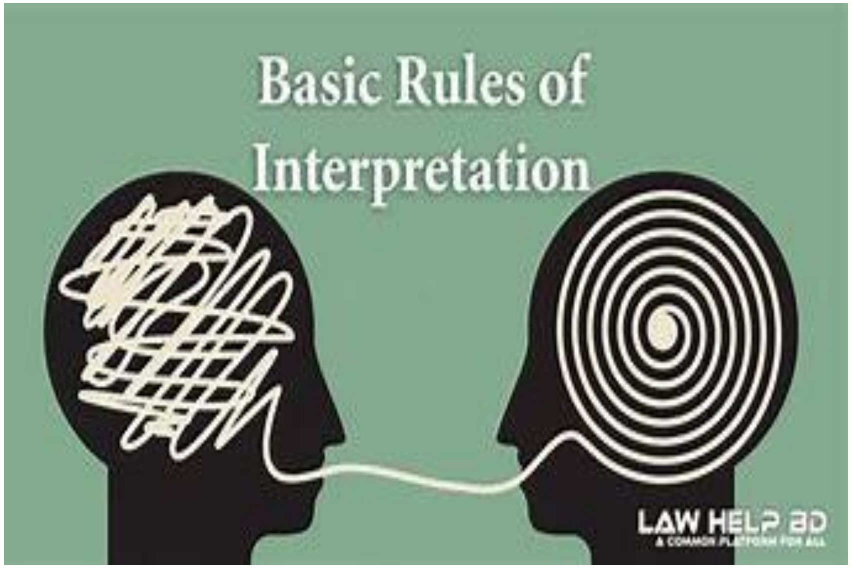
- One of the main reasons for a trust is to make distributions to beneficiaries pursuant to the settlor's intentions.
- This is a common area for disputes as beneficiaries often have insatiable wants and needs and trustees have duties to follow the trust, the settlor's intent, and be impartial as to all beneficiaries.
- The first place to look is the trust document and the settlor's intent to resolve any distribution dispute.
- This presentation will cover address many of the common issues that arise in trust distribution interpretation.

Areas of Discussion

Areas Of Discussion

- The areas we will discuss are:
  - Trust interpretation and construction guidelines;
  - Mandatory standard;
  - Pure discretionary standard;
  - Unascertainable standards;
  - Ascertainable standards;
  - Fiduciary duties;
  - Trustee/Beneficiary Issues;
  - Principal and Income Act;
  - Prudent Investor Act;
  - Loans as distributions;
  - Overdistributions; and
  - Resolving disputes.

Trust Construction



Trust Construction

- The first place to look regarding a trustee's rights and duties is the trust document itself.
- The trustee shall administer the trust in good faith according to its terms and the Texas Trust Code. Tex. Prop. Code § 113.051.
- A party should ascertain a trust grantor's intent from the language contained in the trust's four corners and focus on the meaning of the words actually used, not what the grantor intended to write.

WINSTEAD

Trust Construction

- In interpreting a trust, a court will "(1) [c]onstrue the agreement as a whole; (2) give each word and phrase its plain, grammatical meaning unless it definitely appears that such meaning would defeat the parties' intent; (3) construe the agreement, if possible, so as to give each provision meaning and purpose so that no provision is rendered meaningless or moot; (4) [ensure that] express terms are favored over implied terms or subsequent conduct; and (5) [note that] surrounding circumstances may be considered—not to determine a party's subjective intent—but to determine the appropriate meaning to ascribe to the language chosen by the parties."
- A party "must be particularly wary of isolating individual words, phrases, or clauses and reading them out of the context of the document as a whole."

Trust Construction

- Precatory versus mandatory: precatory language means that the settlor expresses his or her desire that the trustee consider some factor but does not require the trustee to do so.
- The following words “want,” “wish,” “request,” and “desire” are ordinarily precatory in their ordinary sense and do not impose a legal obligation.
- This issue is resolved by looking to the settlor’s expressed intent as evidenced by the context of the document and surrounding circumstances, and words which are precatory in their ordinary meaning will nevertheless be construed as mandatory when it is evident that such was the testator's intent.

Trust Construction

- Can trustees consider the settlor’s intent outside of the trust document?
- Trusts can contain provisions giving them absolute discretion to interpret the trust document. Are those provisions enforceable?

Distribution Standards

WINSTEAD

Distribution Standards

- There are three general types of standards for distributions:
- Mandatory or nondiscretionary distributions,
- Complete and unfettered discretionary distributions, or
- Limited discretionary distributions (unascertainable standards and ascertainable standards).

Mandatory Standards

Mandatory Standards

- Some trusts provide that a trustee shall distribute income or principal to beneficiaries.
- When the trust document states that a trustee shall make a distribution, the trustee generally breaches its duty by failing to comply with the trust’s terms.

Mandatory Standards

- Where a trustee is directed to pay the trust's income to a beneficiary for life or a designated period, the trustee is under a duty to pay the beneficiary the net income of the trust property at reasonable intervals.
- The trustee can properly withhold a reasonable amount of income receipts to meet present or anticipated expenses that are properly chargeable against income, or temporarily for the trustee's and beneficiaries' protection where there is reasonable doubt as to the amount of income properly payable to the income beneficiary.

Mandatory Standards

- Under this standard, a trustee is not allowed to accumulate income unless it is specifically authorized in the trust instrument, court order, or release agreement by beneficiaries.
- One important aspect of mandatory income distributions is that the trustee may still have discretion regarding the trust's investments and consideration should be given regarding the power to adjust and the Prudent Investor Act.
- So, even though the trustee has little or no discretion on making distributions of net income, it can have substantial discretion in determining net income.

WINSTEAD

Mandatory Standards

- Settlors can also provide that a trustee shall distribute portions of principal to a beneficiary.
- For example, it is common for a trust to provide that a trustee must distribute a portion of the trust's principal to a beneficiary upon certain age attainments.
- Where a trust provides that a trustee must make certain principal distributions, a trustee must make those distributions unless the trustee obtains judicial relief to the contrary or the beneficiary consents and releases the trustee from that duty.

Mandatory Standards

- It should be noted that a trustee needs the beneficiary to assist it in making the mandatory distribution.
- The trustee may need a directive or request, information on where to send the assets, information on whether the assets should be liquidated or transferred in kind, etc.
- Until a beneficiary complies with these reasonable requests, a trustee may not have a duty to transfer the assets.

Mandatory Standards

- Generally, trust distributions are considered the separate property of the beneficiary.
- However, trust income received by a married beneficiary is community property if the receiving spouse "is entitled, or becomes entitled" to distributions of trust corpus.
- A settlor should consider the community property implications that arise when a trustee has a mandatory duty to make income or principal distributions.

WINSTEAD

Discretionary Standard

WINSTEAD

Discretionary Standard

- A settlor may want to imbue a trustee with the ultimate discretion on whether to make a distribution.
- Historically, courts in Texas have uniformly held that where a trustee has complete discretion in making distributions, a beneficiary cannot sue the trustee for breach of fiduciary duty for not making a distribution.
- In a discretionary trust situation, a court cannot substitute its discretion for that of a trustee.

Discretionary Standard

- Some courts, however, have held that trustees do not have unfettered discretion, even if the trust document says as much.
- "Even where a trustee is vested with broad discretion, courts may assert control over the trustee's exercise of power 'to prevent the frustration of the fundamental intent of the settlor' and compel the trustee's performance of his duty."

Discretionary Standard

- In 2009, the Texas Legislature created a statutory limitation on trustee discretion.
- “Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of terms such 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.” Tex. Prop. Code § 113.029.

Discretionary Standard

- The Texas Property Code provides that the "trustee shall administer the trust in good faith according to its terms and this subtitle." Tex. Prop. Code § 113.051.
- Section 111.0035(b)(4)(B) states: "[t]he terms of a trust prevail over any provision of this subtitle, except that the terms of a trust may not limit . . . a trustee's duty . . . to act in good faith and in accordance with the purpose of the trust." *Id*. at § 111.0035(b)(4)(B).
- Accordingly, even in a discretionary trust situation, a trustee cannot act arbitrarily and must act in good faith and in accordance with the terms and purposes of the trust and for the interests of the beneficiaries.

Unascertainable Standard

WINSTEAD

Unascertainable Standard

- A settlor may want to create a trust that has some standards for distributions (more than just the sole discretion of the trustee) but which allow for broad discretion to the trustee.
- A distribution standard will usually be considered unascertainable without an objective manner to determine whether a distribution fits within the instrument's distribution standard.
- Generally, the following terms imply an unascertainable distribution standard: pleasure, desire, comfort, happiness, benefit and welfare." Treas. Reg. § 20.2041-1(c)(2) (2017) and Treas. Reg. § 1.674(b)-1(b)(5)(i).

Unascertainable Standard

- Unascertainable standards may be used when the settlor is less concerned about maintaining the trust principal for the remainder beneficiaries or when he or she wants the trustee to have more flexibility in making distributions.
- Due to the potential tax implications, these standards should be used with caution and only with independent trustees.

Unascertainable Standard

- Using an unascertainable standard will provide the trustee with as much discretion as a pure discretionary trust would provide.
- In *Lehman v. United States*, 448 F.2d 1318 (5th Cir. 1971), the Fifth Circuit held that the term "comfort" resulted in the wife/trustee possessing an "unrestricted and discretionary right—at least in the absence of evidence of actionable fraud—to consume the property, governed only by her own personal assessment of her own personal need." *Id*.

Ascertainable Standard

WINSTEAD

Ascertainable Standard

- A settlor may want to provide a trustee with less discretion and use ascertainable standards by which the trustee will determine distributions.
- Although a settlor can use other terms to create an ascertainable standard, most frequently, a settlor uses the terms health, education, maintenance and support (“HEMS”).
- There are several reasons for doing so, including limiting a trustee’s discretion and also important tax and creditor protection implications.

WINSTEAD

Ascertainable Standard: Tax Implications

- If a trustee is also as a beneficiary, and the trust gives the trustee complete discretion to make distributions to himself or herself, then the IRS will disregard the trust and consider the trust's assets as part of the trustee's estate.
- The IRS has created ascertainable distribution standards, and if those standards are in the trust document, then the assets will not be considered as part of the trustee/beneficiary's estate.
- Ascertainable standard can also impact and protect a beneficiary from gift tax liability when he or she holds the right to make distributions to others.
- If the power of a trustee to distribute corpus is limited by a "reasonably definite standard," it may not cause the trust income to be taxed to the settlor for federal income tax purposes.

WINSTEAD

Ascertainable Standard: Creditor Protections

- The Texas Trust Code provides that "When, however, the trust has a spendthrift provision and the beneficiary's power is limited by an ascertainable standard relating to the beneficiary's health, education, support, and/or maintenance, a creditor in Texas generally cannot attach the beneficiary's interest on the basis that the beneficiary holds a distribution right or power." Tex. Prop. Code § 112.035.

Ascertainable Standard: Limited Discretion

- In Texas, the use of the words “support” and “maintenance” in a trust instrument evinces the creation of “support trusts.”
- A support trust does not afford trustees unbridled discretion.
- Rather, the trustee’s discretion must be reasonably exercised to accomplish the purposes of the trust according to the settlor’s intention and his exercise thereof is subject to judicial review and control.

Ascertainable Standard: Health

- The Restatement of Trusts provides that the standard of “health” is generally thought to include the following: emergency medical treatment; psychiatric treatment; psychological treatment; routine health care examinations; dental; eye care; cosmetic surgery; Lasik surgery; health, dental, or vision Insurance; unconventional medical treatment; home health care; gym memberships; spa memberships; golf club memberships; and extended vacations to relieve tension and stress.

Ascertainable Standard: Health

- A trustee has a more difficult time deciding whether a trust should pay for alternative treatment options.
- Alternative treatment options include, but are not limited to, “acupuncture or homeopathic remedies, as well as elective medical procedures such as plastic surgery, laser eye surgery, cosmetic dentistry, non-diagnostic full body scans, over the counter lab tests, tattoo removal, and concierge medicine.”

Ascertainable Standard: Education

- Under the Restatement, the standard of “education” is thought to include the following: grammar, secondary and high school tuition; graduate school; post-graduate school; medical school, law school, or other professional school; support of the beneficiary while in school; support of beneficiary while not in school (between semesters); studies for the student that makes a career out of learning; technical school training; career training; and college as part of a study abroad program.

Ascertainable Standard: Education

- The term “education,” without elaboration, is ordinarily construed as extending to payment of living expenses as well as fees and other costs of attending an institution of higher education, or the beneficiary’s pursuit of a program of trade or technical training, and the like, as may be reasonably suitable to the individual and to the trust funds available for the purpose.”
- A trustee can also make distributions for a beneficiary’s dependent’s educational expenses.

Ascertainable Standard: Support and Maintenance

- The terms “support” and “maintenance” are considered synonymous.
- The following expenses are generally included: food; transportation; regular mortgage payments; property taxes; suitable health insurance or care; existing programs of life and property insurance; continuation of accustomed patterns of vacation; continuation of family gifting; and continuation of charitable gifting.

Ascertainable Standard: Support and Maintenance

- The following expenses might be included: reasonable additional comforts or luxuries; and special vacations of a type the beneficiary had never taken before.
- The following expenses are generally not included: payments unrelated to support which merely contribute to the beneficiaries' contentment or happiness; distributions to enlarge the beneficiaries' personal estate; and distributions to enable the beneficiary to make extraordinary gifts.

Ascertainable Standard: Support and Maintenance

- A trust may use words of restriction.
- A trust may provide that distributions may only be made for support of a beneficiary where there is an emergency, hardship, or special need.
- When those words are used, they restrict the trustee's discretion to make distributions.

Ascertainable Standard: Style of Living

- "Support" and "maintenance" distribution standards extend beyond a beneficiary's bare necessities to include the beneficiary's accustomed style of living.
- Although the general starting point on which to base a beneficiary's accustomed style of living is when a trust became irrevocable, distributions for a higher standard of living over time may be appropriate.

Ascertainable Standard: Style of Living

- A trustee should investigate and document the beneficiary’s activities; this might include visiting the beneficiary and following up on distributions for major expenses, vacations, and education.
- However, a trustee may be justified in giving lower levels of distributions if the trust estate is modest in relation to the future needs of the beneficiary.

Ascertainable Standard: Other Resources

- Settlors often state that a trustee is to consider a beneficiary's other resources in determining whether to make a support distribution and how much of a distribution to make, but sometimes the trust is silent on this issue.
- There are three approaches: (1) ignore other resources, (2) consider them but not require the beneficiary to exhaust them, or (3) beneficiary must rely completely on their own resources unless they are inadequate.
- Texas law follows the moderate path of assuming the beneficiary's other means of support should be considered, but it does not require a beneficiary to exhaust such outside resources.

Ascertainable Standard: Other Resources

- A trustee may also take into account public benefits or the obligations of others to support the beneficiary.
- "When a trustee asks about a third-party's obligation, beneficiaries and their family members may find such questions intrusive; others may refuse to respond. However, the information is necessary because the law charges the trustee with duties, regardless of whether the parents are satisfying their duty to support a child or whether the need for maintenance and support truly exists."
- *Keisling v. Landrum*, 218 S.W.3d 737, 739 (Tex. App.—Fort Worth 2007, pet. denied) ("other financial resources" meant income and cash flow from other sources).

Ascertainable Standard: Due Diligence

- A trustee has a duty to investigate and have a factual basis for any discretionary act.
- A trustee has a duty to investigate the needs of the beneficiary and to make support distributions, and that duty arises when a trustee accepts the appointment.
- A beneficiary has a duty to provide the trustee with the information necessary to assist it in making the determination on distributions.

Ascertainable Standard: Due Diligence

- The trustee should solicit information from the beneficiary regarding his or her financial needs, wants, resources, and standard of living, and may seek underlying documents.
- The trustee generally may rely on the beneficiary’s representations and on readily available, minimally intrusive information requested of the beneficiary. This reliance is inappropriate, however, when the trustee has reason to suspect that the information thus supplied is inaccurate or incomplete.

Ascertainable Standard: Catch-Up Distributions

- If a trustee has incorrectly withheld support distributions or calculated them wrong, then a beneficiary may be entitled to a catch-up distribution.
- For example, in *Keisling v. Landrum,* the court held that the trial court had a duty to go back and "determine what that standard of living was and then make trust distributions to compensate [the beneficiary] from the date of [her husband's] death." *Id.* at 745.
- So, the trustees had to make the beneficiary whole by paying her for prior years when she was not distributed appropriate amounts.
- Catch-up distributions may not apply in all circumstances.

Ascertainable Standard: Beneficiary's Dependents

- Distributions made for the support of a beneficiary's spouse and minor child can be considered a HEMS distribution for the beneficiary parent because the beneficiary parent has an obligation to support his or her spouse and minor child.
- *First Nat'l Bank of Beaumont v. Howard*, 229 S.W.2d 781 (Tex. 1950) (HEMS distributions to a parent beneficiary was held to include the educational expenses of the beneficiary's dependents).
- Texas law provides that a trustee subject to a HEMS distribution standard may be required to make distributions for the support of the beneficiary's child where there is a child support obligation. Tex. Fam. Code § 154.005.
- Generally, a trustee may make direct distributions to the non-beneficiary parent for the benefit of the minor beneficiary.

Trustee’s Duties

Duties of a Trustee

- Good-faith administration
- Loyalty
- Impartiality
- Prudent investment and preservation of assets
- Disclosure and accounting
- Management of costs
- Exercise care and skill

Trustee's Duties

- Trust distributions implicate many of a trustee's fiduciary duties to the trust's beneficiaries:
  - The duty to disclose;
  - The duty of confidentiality
  - The duty of loyalty;
  - The duty of impartiality; and
  - The duty of proper management.

Duty to Disclose

Duty to Disclose

- A trustee also has a duty of full disclosure of all material facts known to it that might affect the beneficiaries' rights.
- There is a debate in Texas regarding whether a trustee has a passive duty to disclose or an affirmative duty to disclose.
- In other words, does a trustee have a duty to disclose certain information only where a beneficiary asks for the information (passive duty) or a duty to affirmatively disclose certain information even if the beneficiary does not ask (affirmative duty).

Duty to Disclose

- Certainly, distributions from a trust to one beneficiary may materially impact another beneficiary’s rights: should a trustee disclose all distributions to all beneficiaries?
- The general duty to disclose to some beneficiaries may conflict with a trustee’s duty of loyalty to other beneficiaries.
- The duty of loyalty includes a duty to maintain the confidentiality of a beneficiary’s information.

Duty to Disclose

- “This duty of confidentiality ordinarily does not apply to the disclosure of trust information to beneficiaries or their authorized representatives…”
- “Even in providing information to or on behalf of beneficiaries, however, the trustee has a duty to act with sensitivity and, insofar as practical, with due regard for considerations of relevancy and sound administration, and for the personal concerns and privacy of the trust beneficiaries.”
- “Conversely, the trustee’s duty to keep beneficiaries reasonably informed, together with the trustee’s duty of impartiality, entitles the beneficiaries to disclosure of the bases upon which the trustee’s discretionary decisions concerning distributions have been or will be made. Appropriate disclosure can usually be provided in general terms that allow reasonable protection for confidential, private, or sensitive information.”

Duty to Disclose

- A trust document may provide some limitations on disclosure obligations.
- However, a trust may not limit a duty to keep a beneficiary of an irrevocable trust who is at least 25 years old informed at any time during which the beneficiary: (1) is entitled or permitted to receive distributions from the trust; or (2) would receive a distribution from the trust if the trust were terminated.
- Further, a beneficiary can seek an accounting, which would disclose distributions to beneficiaries.
- Disclosure is a good thing: it will start the statute of limitations and also preclude a fraudulent concealment claim.

WINSTEAD

Duty of Impartiality

Duty of Impartiality

- A trustee has a duty to treat all beneficiaries with impartiality.
- Texas law has not codified a duty of impartiality with regard to distributing the trust estate generally, but provisions found in the Uniform Principal and Income Act and the Uniform Prudent Investor Act do reference the trustee's duty to act impartially as between beneficiaries with respect to adjustments between principal and income, and with respect to investing and managing the trust assets.
- The Texas Trust Code adopts the common law.

WINSTEAD

Duty of Impartiality

- There is very little authority in Texas that discusses the duty of impartiality.
- A trustee should be impartial regarding investments, management, and distributions. Uniform Trust Code 803.
- The duty to act impartially does not mean that the trustee must treat the beneficiaries equally.
- Rather, the trustee must treat the beneficiaries equitably in light of the purposes and terms of the trust.

Duty of Impartiality

- A trustee should follow a settlor's directions in the trust document regarding favoring some beneficiaries over others.
- In *Paschall v. Bank of Am., N.A.*, the trust stated that "Such distribution need in no way be equal among descendants of a grandchild." 260 S.W.3d 707, 709 (Tex. App.—Dallas 2008, no pet.).
- The court noted that the inclusion of such language demonstrated the settlor understood the grandchildren may receive unequal distributions and that descendants of a grandchild may not necessarily be treated equally.

Duty of Impartiality

- Absent direction by the settlor, a trustee can follow certain inferences as starting points.
- Relationship to the settlor is relevant, leading in the most common situations to an inference that the beneficiary at the top of a line of descendants is favored over his or her own issue.
- The settlor’s spouse is also favored whether or not an ancestor of the others.

Duty of Impartiality

- Among multiple lines of descent there is an inference of priorities per stirpes; that the various lines are entitled to similar, impartial treatment, with disparities to be justified on a principled basis consistent with the trust purposes.
- Overall, a trustee should be “fair” to all beneficiaries, taking into consideration the settlor’s wishes, the trust’s assets, the beneficiaries’ needs, and the beneficiaries’ other resources.

Duties in Revocable Trusts

Duties in Revocable Trusts

- The general rule is that: “[T]he duties of a trustee of a revocable trust are owed exclusively to the settlor . . . the rights of non-settlor beneficiaries are generally subject to the control of the settlor. Thus, as a general rule, the trustee cannot be held to account by other beneficiaries for its administration of a revocable trust during the settlor’s lifetime.”
- So, a trustee can take a settlor’s directions and make distributions without fear of other beneficiaries’ claims.

Trustee/Beneficiary

Trustee/Beneficiary

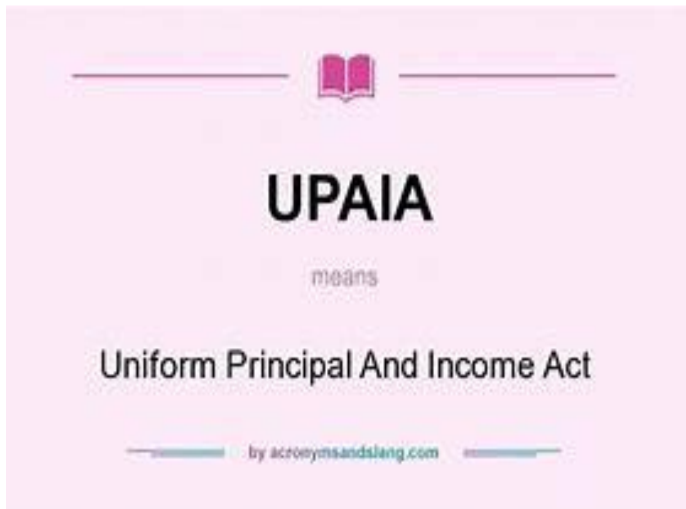
- There are often very difficult legal issues involved in a trustee also being a beneficiary and making distributions to himself or herself.
- Some trusts provide for co-trustee management, and expressly provide that a trustee cannot make decisions on self-interested distributions.
- More often, however, the trustee is left discretion in making distributions to himself or herself.

Trustee/Beneficiary

- "In these circumstances there is, on the one hand, some inference of a preference for or confidence in the trustee-beneficiary but, on the other hand, a general recognition that a trustee-beneficiary's conduct is to be closely scrutinized for abuse, including abuse by less than appropriate regard for the duty of impartiality."
- "The settlor's designation of the beneficiary-trustee may, as a matter of interpretation, suggest a "tilt" in favor of the beneficiary-trustee in the balancing of divergent interests."
- The Texas Trust Code requires that a trustee act in good faith, so there are limits on what a trustee/beneficiary can do.

WINSTEAD

Power to Adjust



Power To Adjust

- Texas adopted the Uniform Principal and Income Act in 2003.
- One aspect of this Act is to give a trustee discretion to use a power to adjust, the right to distribute principal to an income beneficiary due to the gains in value to the trust's assets.
- A trustee uses this discretion as a fiduciary and must be careful to do so impartially.

WINSTEAD

Power to Adjust

- In exercising the power to adjust, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all of the beneficiaries, except to the extent that the terms of the trust or the will clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries.
- “In simple terms, if the income component of a portfolio's total return is too small or too large because of investment decisions made by the trustee under the Prudent Investor Rule, § 116.005 authorizes the trustee to make adjustments between principal and income that may be necessary.”

Power to Adjust

- The trustee’s analysis “may be boiled down to three basic questions: (1) Is the adjustment power available? (2) If available, should an adjustment be made to income this year? (3) What issues should the trustee consider?”
- “Whether the adjustment power is available is a two-part test. First, the trustee must determine if the Uniform Principal and Income Act is the governing law of the trust. Second, the trustee must be certain the document does not specifically prohibit use of the adjustment power.”

Power to Adjust

- If the power to adjust can apply to a trust (the Uniform Principal Act governs the trust and current circumstances provide that the adjustment power is available), then the trustee must determine whether to use the power.
- Ultimately, “if the trustee applies the Prudent Investor Rule standard and decides on an investment strategy that results in traditional income that does not provide the income beneficiary with the appropriate benefit, then the trustee may make the adjustment.”

Power to Adjust

- “The adjustment amount, which should be reconsidered every year, will likely differ for various trusts administered by a trustee. A primary concern for the trustee will be the historical returns on the investments in this trust. After the trustee considers the actual returns and the appropriate level of beneficial enjoyment, if there is a difference between those amounts, the trustee may make an adjustment between principal and income.”
- The power to adjust can be reviewed by a court for an abuse of discretion.
- The court can order the trustee to make additional distributions, to withhold future distributions, or to pay funds back into the trust from its personal assets.

Prudent Investor Act

Prudent Investor Act

- A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust.
- The Code provides multiple circumstances that a trustee should consider in making investments, including: “(5) the expected total return from income and the appreciation of capital; … (7) needs for liquidity, regularity of income, and preservation or appreciation of capital…”

Prudent Investor Act

- A trustee should consider a trust’s distribution standards in deciding how to invest and manage trust’s assets and should act impartially regarding same.
- This is particularly important for trust’s that have income beneficiaries and remainder beneficiaries.
- A trustee should not invest in assets that do not generate any income, but generate growth, and that solely benefit the remainder beneficiaries’ interests.
- Similarly, a trustee should not solely invest in income generating assets that favor income beneficiaries but that make the trust’s assets decrease in value.
- Of course, as described above, where a trustee as the power to adjust, these issues may be resolved in that manner.

Loans and Over-Distribution Issues

Loans As Distributions

- “Sometimes a beneficiary requests funds for a purpose that falls within the reasonable discretion of the trustee but which the applicable standard would not require the trustee to furnish. If the trustee is reluctant for some reason to make the requested distribution, and particularly if the trustee’s concern is one of impartiality, the trustee has discretion to make a loan or advance to the beneficiary.”
- “It is a form of discretionary benefit, and may be made at a market rate of interest or at low or no interest; and funds may be advanced with recourse only against the beneficiary’s interest, without personal liability.”
- When loans are not on commercially reasonable terms, or an unpaid loan is considered a distribution, the trustee and beneficiary should consider tax ramifications.

WINSTEAD

Over Distributions

- If the beneficiary obtains an inappropriate benefit from a trust, a trustee may have a claim against the beneficiary.
- Texas Property Code Section 114.031 provides: “A beneficiary is liable for loss to the trust if the beneficiary has: … (4) failed to repay a distribution or disbursement from the trust in excess of that to which the beneficiary is entitled...”
- So, if a beneficiary has received an excessive distribution, a trustee has a claim against the beneficiary, who is liable for the loss.

Over Distributions

- The Texas Property Code also has a provision that allows a trustee to offset any distributions to the beneficiary due to a loss: “Unless the terms of the trust provide otherwise, the trustee is authorized to offset a liability of the beneficiary to the trust estate against the beneficiary’s interest in the trust estate, regardless of a spendthrift provision in the trust.” Tex. Prop. Code § 114.031(b).
- Therefore, if a trustee establishes a claim against the beneficiary, the trustee can then simply payoff that debt by offsetting distributions otherwise due to the beneficiary from the trust.
- A statute of limitations might bar a lawsuit against the beneficiary, but there is recourse to the beneficiary’s interest in the trust.

Dispute Resolution

Methods to Resolve Disputes

- Beneficiaries’ consent and release
- Beneficiaries’ ratification, estoppel, and waiver
- Statute of limitations after disclosure
- Judicial modification
- Judicial approval and discharge

WINSTEAD

Conclusion

Conclusion

- There are may issues related to a trustee making distributions to beneficiaries.
- The first hurdle is to understand the standard in the trust and what it means.
- Whether mandatory, completely discretionary, or with an ascertainable standard, a trustee should act in good faith and pursuant to the terms of the trust.
- Seek advice of counsel for assistance.