

## Title

Legislative appropriations that are deceptively marketed as trusts: The sagas of the Federal Social Security Trust Fund and South Carolina's Education Scholarship Trust Fund

## Text

Many of my JDSUPRA postings, a full catalog of which may be found below, are about the doctrinal incoherence that is being inflicted on the institution of the trust by legislative intrusions into equity doctrine, intrusions such as the Uniform Trust Code. The theme of this posting is the legislative fiscal machination that entails a misappropriation of the trust label, another example of legislative malpractice in the trust space, although in this case the legislative malpractice is deception-based rather than incompetence-based. There are many examples of legislative misappropriation of the trust label. We have the Leaking Underground Storage Tank Trust Fund, the Violent Crime Reduction Trust Fund, and the Highway Trust Fund, all of which are trusts in name only. The focus of this posting is on the so-called Federal Social Security Trust Fund and South Carolina's so-called Education Scholarship Trust Fund (ESTF). Each has the "veneer" of a trust; neither, however, is a "true" trust; and in each case, the absence of true-trust-status has been confirmed judicially in no uncertain terms.

The Federal Social Security Trust Fund is not a true trust. This has been confirmed by two U.S. Supreme Court decisions. See generally my July 8, 2011 JDSUPRA posting: <https://www.jdsupra.com/legalnews/social-security-legally-is-just-a-govern-31751/>. Or flip to sub-sub section 9.9.3 of *Loring and Rounds: A Trustee's Handbook* (The heading of sub-section 9.9 is "False Trusts").

Neither is South Carolina's Education Scholarship Trust Fund (ESTF) a true trust. See *Eidson v. South Carolina Department of Education*, 906 S.E.2d 345 (S.C. 2024), a case in which the Supreme Court of South Carolina was called upon to adjudicate whether the ESTF is a true trust, and if it is whether its enforcement would violate South Carolina's Constitution. It is most likely not a true trust; but even if it were, its enforcement would be unconstitutional in that ESTF is funded with public monies. The ESTF enabling legislation provides that ESTF scholarships may be used for private school tuition. Article XI, Section 4 of the South Carolina Constitution provides that "no money shall be paid from public funds nor shall the credit of the State or any of its political subdivisions be used for the *direct benefit* of any religious or other private educational institution."

The court was "skeptical" that the ESTF was a true trust. The enabling legislation had failed to designate a trustee. "When examining the actual mechanics of the ESTF, it most resembles a government budget allocation tool, where public funds are earmarked for specific government spending projects and therefore 'trusts' in name only." The Federal Social Security Trust Fund is such a legislative "budget allocation tool."

In principle may a South Carolina legislature "deploy a trust to avoid constitutional limits on the use of public funds"? Would a private educational institution be only indirectly benefited

by an ESTF scholarship award if title to the scholarship funds passes from the State of South Carolina to a trustee-intermediary, and from the trustee-intermediary to the institution, but only at the “sole and explicit direction” of the pupil’s parent? The majority determined that the institution would still be directly benefited in substance by the ESTF scholarship, though not necessarily in form. As an aside, under general principles of equity an ESTF-type trust might well be constructively void *ab initio* as the legislature’s purpose in employing a trustee-intermediary is to neuter a constitutional proscription. See generally §6.2.12 of *Loring and Rounds: A Trustee’s Handbook* (2025), reproduced in the appendix below.

#### Appendix

### **§6.2.12 *Duty Not to Comply with Provisions That Are Unlawful or Violate Public Policy*** [from *Loring and Rounds: A Trustee’s Handbook* (2025)].

*In determining whether a trustee should have known that a provision was unlawful or contrary to public policy, or should have investigated the provision’s validity, among the relevant factors for a court to consider are the particular trustee’s experience, familiarity with trust law and practice, and representations concerning competence to serve as trustee.*<sup>863</sup>

The trustee’s duty to carry out the terms of the trust is covered in §6.1.2 of this handbook. “A trustee ... [however]... has a duty not to comply with a provision of the trust that the trustee knows or should know is invalid because the provision is unlawful or contrary to public policy.”<sup>864</sup> It is obvious that the trustee has a duty not to commit a crime or a serious tort even if instructed to do so by the terms of the trust. It is also obvious that a trustee may not comply with a provision that instructs the trustee to, say, erect a building that violates local zoning laws or will constitute a public nuisance.<sup>865</sup> This duty on the part of the trustee not to engage in “illegal” activity, however, also encompasses activity that merely violates public policy,<sup>866</sup> an “unruly horse” that is not all that easy to corral.<sup>867</sup> While it may not violate public policy for a parent to disinherit a child who chooses to marry, for example, a trust provision that cuts off the child’s equitable interest if the child marries at all very well might.<sup>868</sup> For a discussion of some incentive provisions that are likely to violate public policy, see §9.24 of this handbook.<sup>869</sup> A provision that runs afoul of the applicable rules against perpetuities<sup>870</sup> or the applicable rule against accumulations<sup>871</sup> also would violate public policy. These are all public policy-based proscriptions that, ostensibly, at least, are of some interest to the community. The focus, in other words, is to some extent external to the trust relationship itself.

On the other hand, whether or not a trustee has a duty to carry out “value-impairing investment instructions,” *e.g.*, a provision that directs the trustee to invest the entire trust corpus in shares of a single

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<sup>863</sup>Rest. (Third) of Trusts §72 cmt. c.

<sup>864</sup>Rest. (Third) of Trusts §72. Cf. §8.15.39 of this handbook (noting that the rule against capricious purposes and the rule that a trust purpose may not violate public policy are easily conflated).

<sup>865</sup>See generally 3 Scott & Ascher §16.3 (Illegality).

<sup>866</sup>See generally 3 Scott & Ascher §16.3 (Illegality).

<sup>867</sup>See *Richardson v. Mellish* (Eng. 1824) 2 Bing. 229, 252.

<sup>868</sup>See generally §9.24 of this handbook (the incentive trust).

<sup>869</sup>See also 3 Scott & Ascher §16.3.

<sup>870</sup>See §8.2.1 of this handbook (the rule against perpetuities).

<sup>871</sup>See §8.15.8 of this handbook (the rule against accumulations).

large publicly traded company, is really more a question of what makes sound general trust law.<sup>872</sup> In other words, to the extent there is a “public-policy” component, it is internally focused on the trust relationship itself. In this case, it is the extent to which the economic interests of the beneficiary should be allowed to trump the settlor’s intentions.<sup>873</sup> Thus, when it comes to a petition for equitable deviation, the test is not what is in the “best interests” of the beneficiaries; rather, the petitioners must establish that the settlor’s presumed intent is incapable of fulfillment.<sup>874</sup>

And then there are trust terms that are in the interest of neither the community at large nor the beneficiaries. An instruction to use trust assets to erect buildings in the financial and business district of a large city that are no more than three stories high, for example, would likely fall into that category.<sup>875</sup>

Whether a provision violates public policy is determined at the time of performance, not at the time of the trust’s creation.<sup>876</sup> “A trustee ‘should know’ what the trustee would have learned through the exercise of reasonable care.”<sup>877</sup> When there is reasonable doubt, the trustee at trust expense may and should petition the court for instructions.<sup>878</sup>

There is more than a technical difference between the absence of a duty to comply with a particular trust term on grounds of “illegality” and a fiduciary duty not to comply. Clearly a trustee has no duty to comply with an instruction to commit a crime or serious tort, or to violate some recognized public policy. To the extent engaging in any of these activities would constitute a breach of trust, the trustee also has an affirmative fiduciary duty *not* to comply. While the trustee may have a duty to the community at large not to erect a public nuisance with trust assets, even if instructed to do so by the terms of the trust, he also has a fiduciary duty not to do so, a duty that runs to the beneficiaries.<sup>879</sup> Thus, if the trustee were subsequently ordered by the municipality to tear the offending structure down, the trustee personally must bear the burden of the attendant costs, as well as otherwise making the trust estate whole.<sup>880</sup>

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<sup>872</sup>See, e.g., *In re J.P. Morgan Chase Bank, N.A.*, 19 Misc. 3d 337, 852 N.Y.S.2d 718 (Sur. Ct. 2008) (the court enforcing a provision in a trust restricting the trustee from selling 18 Broadway and 562 Park Avenue).

<sup>873</sup>See generally 3 Scott & Ascher §16.3 (Illegality).

<sup>874</sup>See, e.g., *In re J.P. Morgan Chase Bank, N.A.*, 19 Misc. 3d 337, 342, 852 N.Y.S.2d 718, 722 (Sur. Ct. 2008). See generally §8.15.22 of this handbook (the doctrine of equitable deviation).

<sup>875</sup>See generally 3 Scott & Ascher §16.3 (discussing *Colonial Tr. Co. v. Brown*, 135 A. 555 (Conn. 1926)).

<sup>876</sup>See generally 3 Scott & Ascher §16.3.

<sup>877</sup>Rest. (Third) of Trusts §72 cmt. c. See generally §6.1.1 of this handbook (the trustee’s duty to be generally prudent).

<sup>878</sup>See generally 3 Scott & Ascher §16.3 (Illegality); §8.42 of this handbook (the complaint (petition) for instructions versus the complaint (petition) for declaratory judgment).

<sup>879</sup>See generally 3 Scott & Ascher §16.3.

<sup>880</sup>See generally 3 Scott & Ascher §16.3.