Demystifying Trust Distribution Standards

Fundamentals of Special Needs Trusts Administration Webinar

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I. Introduction
Traditionally, there are four standards found in trusts that are used to direct when and how a trustee should make a distribution from a trust. These standards are mandatory support, discretionary support, pure discretion and special needs. Recently, the Restatement (Third) of Trusts and the Uniform Trust Code have blurred the distinctions between the last three of these standards by taking the position that virtually all trusts are discretionary trusts, but some of them include standards that guide or limit the trustee’s discretion. This view may not have been adopted by all states.

The administration of trusts is dependant on the laws of the state that apply to the trust. It is important for a trustee to know the statutory and case law that govern the state the trustee is operating in and, if different, the law of the jurisdiction that governs the administration of the trust.

These materials are general in nature. They explain the concepts and summarize the laws that pertain to the traditional trust distribution standards and include examples of how these standards are normally worded so a trustee can recognize what type of trust is being administered. Once this is determined, the trustee should then determine how the applicable laws will apply to each type of trust the trustee is administering.

II. Two Important Concepts
Before describing the four distribution standards, it is important that a trustee understand two concepts that apply to the design and interpretation of trusts. Both of these are taken into account by courts when analyzing and interpreting trust provisions.
1. **Intent of the Settlor**

What the settlor intended the distribution requirements to be is critical when interpreting a trust. The intent of the settlor, if it can be determined from the provisions of the trust, will be carried out as long as it does not violate public policy. A court will virtually bend over backwards to try to carry out the settlor’s intent. This rule has been stated many ways by an untold number of courts. A few examples are set forth below.

“It is the cardinal rule of will construction that the intention of the testator, as expressed in the language used in the will, shall be controlling if it is not inconsistent with the rules of law. Such intention is to be gathered from everything contained within the four corners of the instrument, read in the light of surrounding circumstances.”


“The intention of the settlor of the trust will be carried out if it is not contrary to law and public policy.” *In the Matter of The Leona Carlisle Trust Created Under Trust Agreement Dated February 9, 1985*, 498 N.W.2d 260, 265 (Minn.App., 1993).

“In interpreting wills and testamentary trusts, we are guided by well settled principles: (1) the intent of the testator is the polestar and must prevail; (2) this intent, however, must be derived from (a) all of the language contained within the four corners of the will, (b) the scheme of distribution, (c) the surrounding circumstances at the time of the will's execution and (d) the existing facts; (3) we resort to technical rules or canons of construction only when the will is ambiguous or conflicting or the testator's intent is uncertain. *Anderson*, 359 N.W.2d at 480. In determining intent, the question is not what the testator meant to say, but rather what is the meaning of what the testator did say.”


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1 Citing *In re Trusteeship Created Under Will of Ordean*, 195 Minn. 120, 125, 261 N.W. 706, 708; *In re Trust Created by Will of Tuthill*, 247 Minn. 122, 76 N.W.2d 499.

2 Citing *Elkader Prod. Credit Ass'n v. Eulberg*, 251 N.W.2d 234, 238 (Iowa, 1979)
"It is our responsibility to interpret this testamentary trust so that the intention of the testator will prevail." Lang v. Com., Dept. of Public Welfare, 528 A.2d 1335, 1345 (Pa., 1987).

As a result of these rules of interpretation, it is very important that the intent of the settlor be stated in the trust instrument. It is equally important for a trustee who is administering a trust to carefully read the trust instrument to discern what the settlor intended when the trust was established. This intent should be used to enhance and clarify the words used to describe the distribution standard contained in the trust.

For example, if it is obvious from the wording of the trust that the settlor intended for the trust assets to be used to support the beneficiary and pay for the beneficiary's housing, food, medical care and the like, the trust should be viewed as a support trust. On the other hand, if it is clear that the settlor intended that the trust asset are to only be used to pay for things the beneficiary cannot receive from public assistance programs and are not to be distributed in a manner that would disqualify the beneficiary from such programs, then the trust should be viewed as a special needs trust.

2. Self-Settled Trust or Third Party-Settled Trust
All trusts are either self-settled or third party-settled. These are sometimes also referred to respectively as a “first-party trust” and a “third-party trust.”

The "settlor" of a trust is not just the person who signs the trust to establish it and is referred to in the trust document as the settlor (or grantor, trustor, or some similar title). According to well-established law, a person is considered a settlor of a trust if such person's assets are used to fund the trust.³

³ Restatement (Second) of Trusts, §3 and §17; 42 U.S.C. §1396p(d)(2)(A); POMS § SI 01120.200.B.2; Masterson v. Department of Social Services, Division of Family Services, 969 S.W.2d 746 (Mo. En Banc, 1998); Forsyth v. Rowe, 266 Conn. 818, 629 A.2d 379, (Conn.,1993); Cohen v. Commissioner of Div. of Medical Assistance, 423 Mass. 399, 668 N.E.2d 769, (Mass., 1996); Striegel v. South Dakota Dept. of Social Services, 515 N.W.2d 245 (S.D., 1994); Strand v. Rasmussen, 648 N.W.2d 95 (Iowa, 2002); In re Hertsberg Inter Vivos Trust, 457 Mich. 430, 578 N.W.2d 289 (Mich., 1998); In re Johannes Trust, 479 N.W.2d 25 (Mich.App., 1991).
As stated by the court in *Guaranty Trust Co. of New York v. New York Trust Co.*, 74 N.E.2d 232 (N.Y., 1947),

"There can be no doubt that the person who furnishes the consideration for the creation of a trust is the settlor, even though, in form, the trust is created by another."\(^4\) *Id.* at 234

It is important to distinguish between self-settled trusts and third party-settled trusts, particularly if the trust is a special needs trust. Potential creditors, public assistance programs and the courts treat these types of trusts very differently.

**A. Self-Settled Trust:**

1) **Definition:** A self-settled trust is a trust that holds any assets formerly owned by the beneficiary of the trust. This is true even if the beneficiary did not sign the trust as the person establishing it. In other words, in a self-settled trust the settlor and beneficiary are the same person. In addition, for Medicaid and SSI purposes a trust is deemed to be self-settled if any assets of the beneficiary's spouse are transferred to the trust.\(^5\) The only exception to this is if the spouse establishes the trust by his or her Last Will and Testament.\(^6\)

Also, even though a guardian or conservator sign the papers to establish a trust for the benefit of a ward, since the ward’s assets are put into the trust the ward is deemed to be the true settlor of the trust.\(^7\) For persons with

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\(^5\) 42 U.S.C. §1396p(d)(2)(A) and §1396p(e)(1); POMS § SI 01150.110.E.


disabilities, this was codified at 42 U.S.C. §1396p(d)(2)(A) when Congress enacted the Omnibus Budget Reconciliation Act of 1993 (OBRA-93). Since the settlor and beneficiary of a self-settled trust are the same person, a self-settled trust is always established during the settlor’s lifetime, and is therefore always a “living trust,” sometimes referred to as an “inter vivos trust.” Upon the establishment of a living trust the settlor will either reserve the rights to amend and revoke the trust (a “revocable trust”) or will not reserve such rights (an “irrevocable trust”). Either way, the settlor should expressly state in the trust document whether such rights are retained or not. The state law that governs a trust will control the details of the trust, and the states differ on whether a trust that does not say anything about the right to revoke is presumed to be revocable or irrevocable. For those states that have adopted the Uniform Trust Code, §6-602(a) states that unless the terms of a trust expressly provide that the trust is irrevocable, the settlor may revoke or amend the trust.

Most of the legislation concerning trusts and Medicaid or SSI eligibility enacted in recent years by Congress and the various state legislatures have been aimed at self-settled trusts. Congress wants to limit a person’s ability to transfer their own assets to a trust that benefits them or their spouse and then allows them to qualify for Medicaid or SSI. Extreme caution should be taken by a trustee when administering a self-settled trust.

2) Impact on Eligibility for Public Assistance:

Rule: Self-settled trusts are “countable resources” for SSI and Medicaid eligibility purposes unless they qualify for one of the OBRA-93 exceptions.

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If a trust is self-settled, then the trust assets will be deemed to be a countable resource for SSI and Medicaid eligibility purposes unless the trust fits into one of the three exceptions found in 42 U.S.C. §1396p(d)(4). Theses are:

a. d4A Trust (a/k/a Self-Settled Special Needs Trust or Medicaid Payback Trust) (42 U.S.C. §1396p(d)(4)(A));

b. Qualifying Income Trust (Miller Trust) (42 U.S.C. §1396p(d)(4)(B)); and

c. Pooled Trust (42 U.S.C. §1396p(d)(4)(C)).

B. Third Party-Settled Trust: A third party-settled trust is a trust that is not executed as "settlor" by the beneficiary of the trust and is not funded with any assets that belong to the beneficiary, or for Medicaid and SSI purposes, belong to the beneficiary’s spouse.

An example of a third party-settled trust is when a parent transfers the parent's assets to a trust for the benefit of the parent's child. This will typically occur at the parent's death as part of the parent's estate plan, but such a trust could also be established and funded during the parent's lifetime. Other examples are a grandparent establishing a trust for a grandchild, or a person establishing a trust for the benefit of his parent, grandparent, sibling or other relatives.

Technically, it is also a third party-settled trust when a person establishes a trust with the person's separate assets for the benefit of his or her spouse. However, unless established by the Will of the person, such a trust is deemed to be self-settled for both SSI and Medicaid purposes. Both of these programs deem all assets of either spouse to be available to the other spouse. Of course, the only

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way a person can establish a trust by his or her Will is for the person to die and the probate court order the establishment of a testamentary trust based on the provisions of the decedent’s Will.

A third party-settled trust always benefits someone other than the settlor of the trust. It is either established and funded upon the settlor’s death (a “testamentary trust”) or during the settlor’s lifetime (a “living trust”). As with a self-settled living trust, a third party-settled living trust will be either revocable or irrevocable.

Normally a third-party settled trust that has the appropriate distribution standard will not be deemed to be an “available resource” for Medicaid and SSI eligibility purposes.

III. The Four Traditional Distribution Standards of Trusts

Every trust contains a section that tells the trustee when, what and how to distribute from the trust for the benefit of the beneficiary. These materials refer to these instructions as a “distribution standard.” Traditionally, there are four distribution standards that may be used in a trust. The two that are most commonly used are the “support” and the “discretionary support” standards. The two that are less common are the “special needs (or supplemental care)” and the “totally (or purely) discretionary” standards. Typically these last two standards are used if a beneficiary is sufficiently disabled to qualify for needs-based public assistance, such as Medicaid or Supplemental Security Income (SSI). Each of these trust distribution standards is further described below.

1. Purely or Totally Discretionary Distribution Standard:

A purely\(^{11}\) (or “totally” or “wholly”) discretionary distribution standard is a standard that grants the trustee absolute and total discretion concerning when and how to make a distribution from the trust. It does not impose any standard on the trustee, and even authorizes the trustee to not make any distributions at all.

   A. **Examples of Discretionary Distribution Clause:** An example of a purely discretionary distribution clause is:

\[\text{\textit{In re Watts v. McKay, 160 Kan. 377, 162 P.2d 82 (Kan., 1945).}}\]
“The Trustee may, in its sole, absolute and unlimited discretion, at any time and from time to time, distribute some, all or none of the trust estate to or for the benefit of the beneficiary. The Trustee shall be under no duty to distribute any of the trust estate to or for the benefit of the beneficiary, no matter what may be the circumstances of the beneficiary.”

In Simpson v. State, Dept. of Social and Rehabilitation Services\(^{12}\) the court quoted some of the discretionary language in the trust it was reviewing as,

"[T]he Trustees shall have the absolute discretion, at any time and from time to time, to make unequal payments or distributions to or among any one or more of said group and to exclude any one or more of them from any such payment or distribution."  (Emphasis added by the court)

Then the court commented on this language by saying,

"We cannot imagine a better example of a discretionary trust. No one beneficiary of the Trust has the right to any distribution. The trustees have absolute discretion as to whom they will make distributions and may exclude any one or more of the beneficiaries from any payment or distribution. The discretion placed in the trustees is total and absolute."  *Simpson*, at 178.

In the case of *In the Matter of the Leona Carlisle Trust Created Under Trust Agreement Dated Feb. 9, 1985* 498 N.W.2d 260, 264 (Minn. App., 1993) the court quoted the following trust language:

the “trustee shall expend such sums from the principal of the trust to or for the benefit of [appellant]***as the trustee, in its full discretion, deems advisable,” and

it “is expressly understood the trustee is under no obligation to make any expenditures” to appellant.

The court concluded, as a result of this language, that “This trust is a discretionary trust because the trustee has complete discretion to distribute trust assets to appellant.” Id. at 265.

B. Descriptions of Discretionary Distribution Clauses by Courts: Various courts have described a pure discretionary distribution standard as follows:

“A discretionary trust gives the trustee complete discretion to distribute all, some, or none of the trust income or principal to the beneficiary, as the trustee sees fit.” In the Matter of the Leona Carlisle Trust Created Under Trust Agreement Dated Feb. 9, 1985, 498 N.W.2d 260, 264 (Minn. App., 1993).

“The terms of a discretionary trust grant the trustee complete and unfettered discretion in determining if any of the trust’s income or principal should be distributed to the beneficiary. See Scott’s Abridgment §155. If considered a true discretionary trust, a “creditor of the beneficiary cannot compel the trustee to pay any part of the income or principal.” Restatement (Second) of Trusts §155(1) (1959).” Strojeck ex rel. Mills v. Hardin County Bd. of Supervisors, 602 N.W.2d 566, 569 (Iowa App., 1999).

C. Effect of Discretionary Distribution Clauses on Creditor Access and Medicaid Eligibility Purposes: Most courts hold that since a trustee of a trust that has a true discretionary distribution standard has total discretion whether or not to distribute trust assets to or for the benefit of the beneficiary, the beneficiary cannot compel a distribution from the trust. As a result, neither can a creditor of a
beneficiary. Because a creditor cannot compel a distribution from the trust, the trust assets are deemed to not be available to the beneficiary for the purposes of determining whether the beneficiary qualifies for Medicaid.

This has been stated by various courts as follows:

“Under a true discretionary trust, the trustee may withhold the trust income and principal altogether from the beneficiary and the beneficiary, as well as the creditors and assignees of the beneficiary, cannot compel the trustee to pay over any part of the trust funds.” Lineback by Hutchens v. Stout, 79 N.C.App. 292, 339 S.E.2d 103 (N.C.App., 1986)\textsuperscript{13}.

“Because the ability to compel distributions from the trust is not available to the beneficiary of a discretionary trust, only those distributions of trust income or corpus actually made by the trustee may be taken into account by the Department.” Hecker v. Stark County Social Service Bd., 527 N.W.2d 226 (N.D., 1994). [Author’s Note: The “Department” is the State Medicaid agency that was arguing that the assets in the Hecker trust were countable for the beneficiary’s Medicaid eligibility purposes. The court held otherwise.]

“Under a discretionary trust, the trustee may pay to the beneficiary as much of the income or principal as the trustee in his discretion determines to be appropriate. [Citation omitted] Where the trust is discretionary and the beneficiary has no right to a disbursement from

\textsuperscript{13} The full quote from the Lineback opinion is, “A discretionary trust is a trust wherein the trustee is given the discretion to determine whether and to what extent to pay or apply trust income or principal to or for the benefit of a beneficiary. Bogert, The Law of Trusts and Trustees § 228 (rev. 2d ed. 1979); Scott, The Law of Trusts §§ 128.3, 155 (3d ed. 1967). Accord N.C.Gen.Stat. § 36A-115(b)(1) (1984). Under a true discretionary trust, the trustee may withhold the trust income and principal altogether from the beneficiary and the beneficiary, as well as the creditors and assignees of the beneficiary, cannot compel the trustee to pay over any part of the trust funds. Bogert, supra; Scott, supra, at § 155. A trust wherein the trustee has discretion only as to the time or method of making payments to or for the benefit of the beneficiary is not a true discretionary trust. Bogert, supra; Scott, supra.”
the trust other than what the trustee in his sole discretion chooses to
distribute, the beneficiary's creditors cannot compel the trustee to pay
any part of the income or principal in order that the creditors may be

D. **Does Not Apply to Self-Settled Trusts:** However, without specific statutory
authority, the above-described rule protecting assets in a discretionary trust does
not apply to a self-settled trust, which is one where the settlor of the trust is also a
beneficiary of the trust. The general rule is that a creditor of the beneficiary of a
self-settled trust can reach the trust assets and, in the Medicaid context, all of the
trust assets that the trustee could distribute for the benefit of the beneficiary or the
beneficiary’s spouse if the trustee exercised maximum discretion in favor of the
beneficiary are deemed to be “available resources” to the beneficiary for Medicaid
eligibility purposes.

This was the outcome in the *Johannes Trust* case, *id*. The court in that case said,

“The general rule that creditors cannot compel the trustee of a
discretionary trust to make a payment of income or principal applies
only in those cases where the settlor of the trust is an individual
different than the beneficiary of the trust. Under 1 Restatement
Trusts, 2d, § 156, where the settlor is a beneficiary of the trust, the
creditors can reach the maximum amount that the trustee could pay
to the beneficiary under the terms of the trust:

(1) Where a person creates for his own benefit a trust with a
provision restraining the voluntary or involuntary transfer of his
interest, his transferee or creditors can reach his interest.

(2) Where a person creates for his own benefit a trust for
support or a discretionary trust, his transferee or creditors can
reach the maximum amount which the trustee under the terms
of the trust could pay to him or apply for his benefit.” *In re
Johannes Trust*, *id*. at 28.
The *Johannes Trust* court went on to cite public policy as a justification for this rule.

“Furthermore, the rule stated in the Restatement promotes a valid public policy: A person ought not to be able to shelter his assets from his creditors in a discretionary trust of which he is the beneficiary and thus be able to enjoy all the benefits of ownership of the property without any of the burdens.” *In re Johannes Trust, Id.* at 28.

This was codified in 1993 with the enactment of 42 U.S.C. §1396p(d)(2) and (d)(3). Section (d)(3)(B)(i) says,

“if there are any circumstances under which payment from the [self-settled irrevocable] trust could be made to or for the benefit of the individual [who established the trust], the portion of the corpus from which, or the income on the corpus from which, payment to the individual could be made shall be considered resources available to the individual [for Medicaid eligibility purposes], and payments from that portion of the corpus or income—

(I) to or for the benefit of the individual, shall be considered income of the individual” [for Medicaid eligibility purposes].

(Clarifications added by the Author)

Some courts have held that the trustee must exercise its discretion in a manner that accomplishes, rather than frustrates, the purposes of the trust. Therefore, it is extremely important that the purposes of the trust and the intention of the settlor be clearly expressed in the trust instrument.

**E. One State’s Exception to the General Rule of the Discretionary Distribution Standard:** The State of Kansas has legislatively reversed the long-
standing common law in Kansas regarding the treatment for Medicaid eligibility purposes of third-party settled trusts that contain a pure discretionary distribution standard. Effective July 1, 2004, Kansas enacted K.S.A. §39-709(e)(3) which severely limits the use of a purely discretionary trust standard in a third party-settled trust that benefits a person who is receiving Medicaid benefits in Kansas. As a result of this statute, the assets in a discretionary trust are now deemed to be “available” to the beneficiary for Kansas Medicaid eligibility purposes unless the trust contains a special needs distribution standard.

2. **Support Distribution Standard:**
A support distribution standard (sometimes referred to as "mandatory support") is a standard that requires the trustee to pay for the support of the beneficiary. A trust that contains a support distribution standard is often referred to as a "support trust" or a “mandatory support trust”. This standard will almost always contain a requirement that the trustee use the trust funds for the beneficiary's "support," but it may also contain words such as "maintenance," "health care" and "education."

Use of the traditional ascertainable standard language of "support, maintenance, health care and education"\(^{16}\) coupled with the requirement that the trustee "shall" (i.e., "must") make distributions from the trust for such purposes, will make the trust a support trust. This is the type of trust that is often used for minors or other beneficiaries who do not have a disability.

**A. Example of Support Distribution Clause:** The following is an example of a mandatory support distribution standard clause:

> "The Trustee shall distribute a sufficient amount from the income and principal of the trust estate to provide for the support, maintenance, health care and education of the beneficiary."

**B. How Courts Describe Support Distribution Clauses:** Various courts and legal authorities have described a support distribution standard as follows:

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\(^{16}\) Internal Revenue Code (IRC) Reg. §20-2041-1(c)(2).
“A support trust directs the trustee to distribute trust income or principal as necessary for the support and maintenance of the beneficiary.” In the Matter of The Leona Carlisle Trust Created Under Trust Agreement Dated February 9, 1985, 498 N.W.2d 260, 264 (Minn.App., 1993), citing Restatement (Second) of Trusts §154 (1959).

"A support trust directs the trustee to apply the trust's income and/or principal as is necessary for the support, maintenance, education, and welfare of the beneficiary."17 Chenot v. Bordeleau, 561 A.2d 891, 894 (R.I., 1989).

"A support trust is one which essentially provides that the trustee "shall pay or apply only so much of the income and principal or either as is necessary for the education or support of a beneficiary."18 Hecker v. Stark County Social Service Bd., 527 N.W.2d 226, 229 (N.D., 1994).

"The terms of a support trust require the trustee to pay or apply so much of the trust's income or principal as necessary for the beneficiary's care or education." Strojek ex rel. Mills v. Hardin County Bd. of Supervisors, 602 N.W.2d 566, 568 (Iowa App., 1999).

“Language such as “the trustee shall pay for the beneficiary’s care, education, or support” is normally indicative of a support trust in that the trustee’s power to apply the trust assets is limited.” Id. at 568.

C. General Effect of a Support Distribution Clause: A support distribution standard grants the beneficiary a legally enforceable right to require the trustee to


18 Citing Restatement (Second) of Trusts § 128 cmt. I (1959) and Bohac v. Graham, 424 N.W.2d 144 (N.D., 1988).
distribute from the trust to support the beneficiary. This has been described by various courts as follows:

“The beneficiary of a support trust can compel the trustee to make a distribution of trust income or principal merely by demonstrating that the money is necessary for his or her support, maintenance, education, or welfare.” *Chenot v. Bordeleau*, 561 A.2d 891, 894 (R.I., 1989).

“A support trust permits a beneficiary to compel distributions of income, corpus, or both, for expenses necessary for the beneficiary’s support.” *Hecker v. Stark County Social Service Bd.*, 527 N.W.2d 226, 229 (N.D., 1994).

“[A] support trust can legally compel the trustee to distribute trust assets to him or her,” *In the Matter of The Leona Carlisle Trust Created Under Trust Agreement Dated February 9, 1985*, 498 N.W.2d 260, 264 (Minn.App., 1993).

### D. Effect of Support Distribution Clause on Eligibility for Public Assistance:

Since the trustee of a support trust has a legally enforceable responsibility to support the beneficiary, the assets of the trust are deemed to be “countable” to the beneficiary for public assistance benefits purposes.19 This means that they will count toward the maximum the beneficiary can own and still be eligible to participate in the Medicaid and SSI programs. If the trust assets exceed this amount, then the trust alone will disqualify the beneficiary from receiving such benefits.

This has been described by various courts as follows:

19 Although there may be a case somewhere that holds otherwise, the author could not find any published case where a support trust was not held to be an available resource for needs-based public assistance purposes.
"If the Hecker trust reasonably could have been interpreted to be a support trust, then the Department may consider it as an asset when evaluating Herman's eligibility for assistance." Hecker v. Stark County Social Service Bd., 527 N.W.2d 226, 229 (N.D., 1994).

"Courts usually conclude a support trust is an available asset,*** This is because a beneficiary of a support trust can legally compel the trustee to distribute trust assets to him or her," In Leona Carlisle Trust Created Under Trust Agreement Dated Feb. 9, 1985, 498 N.W.2d 260, 264 (Minn.App., 1993).

A support trust "mandates distributions which are always considered resources for Medicaid purposes." In In re Lennon, 683 A.2d 239, 243, fn. 4 (N.J.Super.Ch., 1996).

3. Discretionary Support Distribution Standard:
A discretionary support distribution standard is a standard that gives the trustee discretion whether or not to distribute from the trust for the support of the beneficiary. It is a combination of both the purely discretionary and the support standards, and has been referred to as “an amalgamation of the two.”

A. Example of a Discretionary Support Distribution Clause: The following is an example of a discretionary support distribution standard clause:

“The Trustee may distribute to or for the benefit of the beneficiary any portion of the trust estate that the Trustee, in its discretion, may deem necessary or appropriate for the beneficiary’s support, maintenance, health care or education.”

In Chenot v. Bordeleau, 561 A.2d 891, 892 (R.I., 1989) the court quoted the following trust language,

“[t]he trustee may at any time or times pay all or any portion of the net income or principal or both net income and principal of the trust to or for the benefit of my son, Edward A. Chenot, as the said trustee, in its sole and uncontrolled discretion, shall deem necessary or advisable for his comfort, support and welfare.”

B. Description of Discretionary Support Distribution Clause: The court in Strojek ex rel. Mills v. Hardin County Bd. of Supervisors, 602 N.W.2d 566 (Iowa App., 1999) defined this type of trust as follows:

"A discretionary support trust is created when the settlor combines explicit discretionary language "with language that, in itself, would be deemed to create a pure support trust." Evelyn Ginsberg Abravanel, Discretionary Support Trusts, 68 Iowa L.Rev. 273, 279 n. 26 (1983) [hereinafter Abravanel]. The effect of a discretionary support trust is to establish the minimal distributions a trustee must make in order to comport with the settlor's intent of providing basic support, while retaining broad discretionary powers in the trustee."21

C. Effect of Discretionary Support Distribution Clause on Public Assistance Eligibility: Whether a discretionary support trust will be deemed to be a “countable resource” for needs-based public assistance such as Medicaid and SSI is extremely hard to predict, and appears to be heavily based on the actual facts of the situation. Some states do not recognize the concept of a discretionary support trust and will labor to determine if the settlor intended the trust to be a support or a discretionary trust.

For example, in Bohac v. Graham, 424 N.W.2d 144, 145 (N.D., 1988) the court said "The trust on its face includes elements of both a discretionary trust and a support trust." The actual trust language was,

"The Trustee shall distribute all the net income annually unto my sister, Anne Bohac, and is further authorized to give my said sister any portion of the Trust Property as my said Trustee may deem necessary for her support, maintenance, medical expenses, care, comfort and general welfare."

The court held that this trust was a support trust and therefore the trust estate was an available resource for Medicaid eligibility purposes. The court declined to recognize the concept of a discretionary support trust.

In contrast, the court in *Lang v. Com. Dept. of Public Welfare*, 528 A. 2d 1335 (Pa., 1987) recognized the concept of a discretionary support trust. It described the trust in question as "a discretionary trust limited by a support standard based on [the beneficiary's] situation." *Lang*, *Id.* at 1333.

When describing the difficulty other courts have in trying to determine whether a trust is a support trust (and, therefore, an available resource for public assistance purposes) or a discretionary trust (and, therefore, not an available resource), the court said:

"We believe such a rigid categorization is unwarranted and ignores the intent of a settlor who includes both support and discretionary language in a trust instrument, by substituting mechanical rules for individual facts." *Lang*, *Id.* at 1344.

The court went on to say,

"We believe a settlor is entitled to maintain some control by means of a support standard, and at the same time reasonable flexibility through a grant of considerable discretion to the trustee(s), to ensure his purpose of providing reasonable care to the beneficiary who is or may be institutionalized without effectively disinheriting the other members of his family." *Lang*, *Id.* at 1345.
The *Lang* court recognized the concept of a discretionary support trust and held that the trust assets were not available resources for Medicaid eligibility purposes.

**D. Impact of Self-Settled v. Third Party-Settled Trust on Discretionary Support Standard:** As stated earlier in these materials, every trust is either "self-settled" or "third party-settled." Whether a trust is self-settled or third party-settled will most likely impact whether a court determines that a "discretionary support" trust is a countable resource for Medicaid and SSI eligibility purposes. When courts have analyzed this, the issue is often phrased as whether the creditors of the trust beneficiary can access the trust assets for the payment of the beneficiary’s debts.

The general rule is that if the trust is self-settled, the assets held in the trust are accessible by the beneficiary’s creditors (which means the trust assets are “available” or “countable” for needs-based public assistance eligibility), and if the trust is third party-settled trust they are not (which means the trust assets are not “available” or “countable” for needs-based public assistance programs).22

For example, the court in *In re Hertsberg Inter Vivos Trust*, 578 N.W.2d 289, 291 (Mich., 1998) stated the rule this way,

"Normally, a discretionary trust cannot be reached by creditors because the beneficiary has no ascertainable interest in the assets.[citation omitted] However, where the beneficiary is also the settlor of the trust, we agree with the Court of Appeals in *In re Johannes Trust, supra*, that creditors can reach the assets of the trust."

22 *In re Lennon*, 683 A.2d 239, 243 (N.J.Super.Ch., 1996) “Most cases cited for the proposition that an SNT is not an MQT [Medicaid Qualifying Trust] relate to third party testamentary or inter vivos trusts and not self-settled trusts.” The case then cites many cases and law review articles as authority;

E. Restatement (Third) of Trusts and Uniform Trust Code Abandon Distinction Between Support and Discretionary Distribution Standards: The distinction between “support” and “discretionary” trusts described above and in Restatement (Second) of Trusts is not found in Restatement (Third) of Trusts or the Uniform Trust Code.

1) Restatement (Third) of Trusts: Restatement (Third) of Trusts says, “the so-called “support Trust,” for example, is viewed here as a discretionary trust with a support standard.”

The rational of this significant departure from the prior Restatement is explained in Comment “a” of §60. This Comment argues that the traditional distinction between “support” and “discretionary” are arbitrary and deceptive. Beneficiaries who are basically in the same situation are treated differently by the courts based on the court struggling to determine whether the settlor intended the trust to be a “support” trust (which would be available to the beneficiary’s creditors and disqualify the beneficiary from needs-based public assistance) or a “discretionary” trust (which has the opposite effect). This distinction often turned on the wording of the trust, the facts of the case, the intention of the settlor, the circumstances of the beneficiary, the type of claim being made against the trust or beneficiary, and, quite possibly, the predilection of the court. “The fact of the matter is that there is a continuum of discretionary trusts, with the terms of distributive powers ranging from the most objective…of standards (pure “support”) to the most open ended (e.g., “happiness”) or vague (“benefit”) of standards, or even with no standards manifested at all…”.

2) Uniform Trust Code: The comment to Uniform Trust Code §504 starts with the following explanation,

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23 Restatement (Third) of Trusts §60, Reporter’s Notes, Comment a.

24 Restatement (Third) of Trusts §60 cmt. a.
“This section addresses the ability of a beneficiary’s creditor to reach the beneficiary’s discretionary trust interest, whether or not the exercise of the trustee’s discretion is subject to a standard. This section, similar to the Restatement, eliminates the distinction between discretionary and support trusts, unifying the rules for all trusts fitting within either of the former categories. See Restatement (Third) of Trusts Section 60 Reporter’s Notes to cmt. a (Tentative Draft No. 2, approved 1999). By eliminating this distinction, the rights of a creditor are the same whether the distribution standard is discretionary, subject to a standard, or both. Other than for a claim by a child, spouse or former spouse, a beneficiary’s creditor may not reach the beneficiary’s interest. Eliminating this distinction affects only the rights of creditors. The affect of this change is limited to the rights of creditors. It does not affect the rights of a beneficiary to compel a distribution. Whether the trustee has a duty in a given situation to make a distribution depends on factors such as the breadth of the discretion granted and whether the terms of the trust include a support or other standard. See Section 814 comment.”

It is strongly suggested that trustees administering trusts in states that have adopted a the Uniform Trust Code review the provisions of the State’s version of Section 504 to see if the State has wholeheartedly adopted this view and, if not, what limitations the State has imposed, if any.

The impact of this change on special needs trusts makes it even more important for a trust for the benefit of a person who has a disability to contain a special needs distribution standard.

4. **Special Needs Distribution Standard:**
A special needs distribution standard is a standard that gives the trustee broad discretion to distribute trust income and/or principal for the "special needs" of the beneficiary. Special needs are usually defined as anything the beneficiary needs, or anything that would be
useful or in any way helpful to the beneficiary, if it is not paid for or provided to the beneficiary from a public assistance benefit program or some other source. The trustee is directed to distribute from the trust in a manner that "supplements but does not supplant" any public assistance the beneficiary is receiving. Trusts that contain a special needs distribution standard (a "special needs trust") are also sometimes referred to as "supplemental needs trusts," "supplemental care trusts," and similar titles.

A. Example of Special Needs Distribution Clause: In 1994 a classic special needs distribution clause was quoted by the North Dakota Supreme Court in Hecker v. Stark County Social Service Bd.\textsuperscript{25} as follows:

"Special Needs. The Trustee shall pay to or apply to the benefit of the beneficiary, for his lifetime, such amounts from the principal or income, up to the whole thereof, as the Trustee in the Trustee's sole discretion may from time to time deem necessary or advisable for the satisfaction of the beneficiary's special needs. Any income not distributed shall be added to principal. As used in this instrument, 'special needs' refers to the requisites for maintaining the beneficiary's good health, safety, and welfare when, in the sole discretion of the Trustee, such requisites are not deemed provided by any public agency, office, or department of the State of North Dakota, or of any other state, or of the United States. 'Special needs' include, but are not limited to, medical and dental expenses, clothing and equipment, programs of training, education, treatment, and essential dietary needs to the extent that such needs are not provided by any government entity."

B. Two Types of Special Needs Distribution Standards: There are actually two types of special needs distribution standards.

\textsuperscript{25} Hecker v. Stark County Social Service Bd., 527 N.W.2d 226, 228 (N.D., 1994).
1) **Strict Special Needs Standard:** One type of special needs distribution standard expressly prohibits the trustee from making distributions from the trust that will cause a reduction or loss of the beneficiary’s public benefits. A trust that contains this distribution standard is referred to as a “strict special needs trust.”

An example of a strict special needs distribution standard clause is:

“The Trustee shall only distribute from the trust in such a manner that there is no reduction or loss of any public assistance the beneficiary may be receiving or entitled to receive.”

In addition, some strict special needs distribution standard clauses prohibit the distribution of trust assets for the “food or shelter” of the beneficiary. Others add “clothing” to this list. This language is drawn from SSI regulations. The purpose of prohibiting the trustee from distributing for any of these items is to make sure the trust does not cause a reduction in the beneficiary’s SSI. Unfortunately, this restriction was often included in trusts for beneficiaries who were not receiving SSI. Also, SSI regulations that became effective March 9, 2005 removed “clothing” from this list. This means that many trusts drafted prior to this regulation change (and even some drafted after the effective date) include this now needless restriction.

2) **Discretionary Special Needs Standard:** The other type of special needs distribution standard gives the trustee discretion to make distributions for the benefit of the beneficiary that may reduce or cut off public assistance benefits, if the trustee deems such distributions to be in the best interests of

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26 20 C.F.R. §416.1102, “Income is anything you receive in cash or in kind that you can use to meet your needs for food and shelter. Sometimes income also includes more or less than you actually receive (see § 416.1110 and § 416.1123(b)). In-kind income is not cash, but is actually food or shelter, or something you can use to get one of these.” 70 FR 6344, Feb. 7, 2005
the beneficiary. A trust that contains this distribution standard is referred to as “discretionary special needs trust.”

An example of a discretionary special needs distribution standard clause is:

“It is preferred that the Trustee not make distributions from the trust that cause a reduction or loss of any public assistance the beneficiary is receiving or entitled to receive. However, if the Trustee, in its sole discretion, determines that any distribution from this Trust will benefit the beneficiary and is in the beneficiary’s best interest, then the Trustee may make such distribution even if doing so will cause a reduction or loss of public assistance benefits the beneficiary would otherwise receive or be entitled to receive.”

C. Which Type of Special Needs Distribution Standard is Better? Unless the applicable state law will make such a trust a “countable resource”, it is usually better to utilize the discretionary special needs distribution standard since it allows the trustee to be more flexible in making distributions. An example would be allowing a special needs trust beneficiary to live rent free in housing paid for by the trust, even though this will cause a reduction of the beneficiary’s SSI because the payment of rent is deemed to be “in-kind support and maintenance.”

D. Effect of Special Needs Trust on Eligibility for Public Assistance: Since the trustee is not required to distribute for something that is provided by a public assistance program, the assets held in a special needs trust are not deemed to be “countable resources” for Medicaid and SSI purposes. Therefore, the trust does not disqualify the trust beneficiary from those programs.

E. A Caution to Trustees of Special Needs Trusts: A trustee administering a trust with a special needs distribution clause must know what public assistance programs the beneficiary is participating in or eligible for, and what the exact rules are for each such program. Although great discretion is granted to a trustee of a special needs trust, the trustee generally must exercise that discretion in a manner
that minimizes the loss of public assistance. This can only be accomplished by being acutely aware of the specific rules of each such program and distributing from the trust only in a manner that complies with those rules.

IV. Conclusion

In order to correctly administer a trust, a trustee must fully understand the basic structure of the trust that is being administered. This starts with determining whether the trust is a self-settled trust or a third party-settled trust.

Next, the trustee should carefully read the trust document to determine what the settlor intended the trust to accomplish when it was established. For one or more reasons the settlor made a decision that it was better for assets to be held in trust rather than owned outright by a beneficiary. Understanding why the settlor chose to use a trust and what the settlor intended to be accomplished through the trust will help the trustee decide when and how to make distributions from the trust.

In addition, the trustee must review the trust document and determine what distribution standard is being employed in the trust. Traditionally, the distribution standard options are pure discretion, mandatory support, discretionary support, or special needs, which can be either strict or discretionary. Often a trust instrument will establish multiple trusts or subtrusts so that there is a different trust for each beneficiary. In that case, the trustee needs to confirm what distribution standard is being utilized for each trust or subtrust.

Clearly understanding and following the distribution standard set forth in the trust document will not only guide the trustee when making distribution decisions, but will help protect the trustee from liability if a distribution decision is challenged.