

ADDRESSING THE UNIFORM TRUST CODE CONTROVERSY

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THE KANSAS VERSION OF THE “UNIFORM TRUST CODE” IN LIGHT OF THE NATIONAL CONTROVERSY:

After modifications and amendments, the Kansas Version of the UTC stands on its own.

In 2002, Kansas was the first of the fifty states to adopt the Uniform Trust Code, albeit with significant modifications to the proposed draft promoted by the UTC Committee of the NCCUSL, and this was accomplished at the State Capital in Topeka without much fanfare, discussion or debate, among most practicing members of the bar. Based upon the changes evident in Article Five of the “code,” it is apparent that those members of the bar who were included or participated in amending the proposed draft prior to passage of the law, worked heroically to salvage as much good creditor protection for Kansans as they could in light of the problems evident in the proposed NCCUSL draft. Special effort was put forth by those involved to ensure the continued “spendthrift” protection offered under Kansas law. As would be expected, amendments have been made each year to the Kansas version of the UTC (Chapter 58a of the Kansas Statutes Annotated) in an attempt to clean up remaining problems that have become evident.

Subsequent to the passing of the Kansas version of the UTC, and as the proposed UTC has been considered in other states, a fire-fight of sorts, at least in written articles and in open debate, has occurred and continues as a result of the belief of several experts and commentators that the Uniform Trust Code weakens existing trust law as it pertains to asset protection. As more and more practicing attorneys become involved in the open discussion and debate, it seems that more and more concerns are raised. Every state that has adopted a version of the UTC has made significant modifications to the proposed draft. These changes and modifications made on a state to state basis are not uniform and

address concerns in different and often conflicting manners. Active members of the bar in some states have become vocal opponents, and as a result, some states (Oklahoma, for example) have refused to adopt or even consider the UTC after estate planning and elder law attorneys within the state organized and communicated at length with key legislators considering it. Arizona adopted the UTC, and then repealed it after contemplating nearly 80 pages of changes to a 100 page law. Much concern was raised in Arizona that the state might lose many trusts that have that state as their situs if the UTC was adopted. Currently, the Missouri legislature is looking at a lengthy set of modifications in House Bill No. 1184 sponsored by Representatives Stevenson and Ruestman for this next legislative session (2006).

Nationally, much of the debate stems from proposed changes to existing trust law, both, as it has developed through case law in the various states, and as it has been embodied in the Restatement (Second) and (Third) of Trusts. Examples of the growing laundry list of concerns regarding the NCCUSL's draft (many of which were addressed in the Kansas version when it was adopted) include the following claims:

1. The proposed UTC draft eliminates the common law distinction of a discretionary trust as well as the discretionary/support distinction used in the Special Needs and Medicaid areas.
2. It appears the proposed UTC has been drafted with intent to greatly increase litigation in this area of the law, and even promotes litigation by allowing a judge to award attorney fees for beneficiaries and exception creditors standing in the shoes of beneficiaries to seek attorney fees from a trust.
3. The proposed UTC draft significantly reduces the protection provided by traditional spendthrift provisions.
4. The proposed UTC draft adopts a "good faith" standard for the review of a trustee's exercise of discretion, which is not consistent with existing law.
5. The proposed UTC draft adopts a minority view that allows a creditor to attach a general power of appointment and exercise it in favor of the creditor. This would have a detrimental effect for trusts utilizing hanging Crummey powers.

6. The proposed UTC draft invades the privacy of many clients with its notice and financial disclosure provisions, particularly in the charitable trust arena.
7. Existing trusts would require extensive amendments if the proposed UTC draft is adopted.
8. The proposed UTC draft adopts a minority position for resolving “conflict of law” issues by utilizing a “most significant relationship” test.
9. The proposed UTC draft is tied in significant places to the Restatement of Trusts 3rd, which has not been adopted by most states as has its predecessor.
10. The proposed UTC draft is one step away from allowing the State to identify numerous “exception” creditors.

See generally: M. Merric, R. Gillen and M. Osborne, After the Uniform Trust Code, Does an FLP Provide More Asset Protection than a non-self Settled Trust?, CCH Incorporated, Journal of Passthrough Entities, March-April 2005.

Asset Protection and Creditor Claims in Kansas

As mentioned, the Kansas legislature, in the process of adopting the Uniform Trust Code (UTC) in Kansas in 2002, accepted and approved a significant number of modifications to the Proposed Draft of the Uniform Trust Code, as it was proposed in 2002 by the NCCUSL. (Note-even the NCCUSL has continued to make changes to their proposed draft of the “Code” and have done so as recently as February 2005) The most significant changes to the proposed draft by the Kansas legislature are found in Article Five of the Code (CREDITOR’S CLAIMS; SPENDTHRIFT AND DISCRETIONARY TRUSTS), having to do with Creditor rights. The Kansas draft shows evidence of a clear intent to develop and support the concept of “spendthrift” provisions as it concerns creditor’s rights.

What was adopted and what wasn’t adopted from the proposed draft as it relates to Article Five of the UTC?

First, what wasn’t adopted in Kansas:

SECTION 503. EXCEPTIONS TO SPENDTHRIFT PROVISION

(a) In this section, “child” includes any person for whom an order or judgment for child support has been entered in this or another State.

(b) Even if a trust contains a spendthrift provision, a beneficiary’s child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance, or a judgment creditor who has provided services for the protection of a beneficiary’s interest in the trust, may obtain from the court an order attaching present or future distributions to or for the benefit of the beneficiary.

(c) A spendthrift provision is unenforceable against a claim of this State, subdivisions thereof, or the United States to the extent a statute of this State or federal law so provides.

NOT ADOPTED: SECTION 504. DISCRETIONARY TRUSTS; EFFECT OF STANDARD.

(a) In this section, “child” includes any person for whom an order or judgment for child support has been entered in this or another State.

(b) Except as otherwise provided in subsection (c), whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee’s discretion, even if:

(1) the discretion is expressed in the form of a standard for distribution; or

(2) the trustee has abused the discretion.

(c) To the extent a trustee has not complied with a standard of distribution or has abused a discretion:

(1) a distribution may be ordered by the court to satisfy a judgment or court order against the beneficiary for support or maintenance of the beneficiary’s child, spouse, or former spouse; and

(2) the court shall direct the trustee to pay to the child, spouse, or former spouse such amount as is equitable

under the circumstances but not more than the trustee would have been required to distribute to or for the benefit of the beneficiary had the trustee complied with the standard or not abused the discretion.

- (d) This section does not limit the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution.

Here is a review of Article Five of the Uniform Trust Code as adopted in Kansas.

Article 5. CREDITOR'S CLAIMS; SPENDTHRIFT AND DISCRETIONARY TRUSTS

58a-501. Rights of beneficiary's creditor or assignee.

To the extent a beneficiary's interest is not protected by a spendthrift provision, the court may authorize a creditor or assignee of the beneficiary to reach the beneficiary's interest *by attachment of present or future distributions to or for the benefit of the beneficiary or other means. The court may limit the award to such relief as is appropriate under the circumstances.*

Kansas Comment to 5-501

This section generally conforms to Kansas law. See *Wilcox v. Gentry*, 254 Kan. 411, 413-16, 867 P.2d 281 (1994) (absent spendthrift provision, payments made by trustee to or on behalf of beneficiary are subject to creditor's garnishment).

NCCUSL General Comment to 5-501

Other creditor law in the state may affect or limit the creditor as to what or how much may be recovered. This section does not prescribe the procedures for reaching a beneficiary's interest among claimants, leaving those issues to the enacting State's laws on creditor rights. The section does clarify, however, that an order obtained against the trustee, whatever state procedure may have been used, may extend to future distributions whether made directly to the beneficiary or to others for the beneficiary's benefit. By

allowing an order to extend to future payments, the need for creditor periodically to return to court will be reduced.

...

Because proceedings to satisfy a claim are equitable in nature, the second sentence of this section ratifies the court's discretion to limit the award as appropriate under the circumstances. In exercising its discretion to limit relief, the court may appropriately consider the support needs of a beneficiary and the beneficiary's family. *See* Restatement (Third) of Trusts Section 56 cmt e. e (Tentative Draft No. 2, approved 1999).

58a-502. Spendthrift Provision.

- (a) A spendthrift provision is valid.
- (b) A term of a trust providing that the interest of a beneficiary is held subject to a "spendthrift trust," or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest.
- (c) A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this article, a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary.

(SECTIONS (d) and (e) were added and not part of the Draft UTC)

- (d) Whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion even if: (1) The discretion is expressed in the form of a standard for distribution; or (2) the trustee has abused the discretion.*
- (e) This section does not limit the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution.*

Note-Subsection (d) overrides or directly controverts the proposed Section 504 not adopted in Kansas, however Subsection (e) leaves intact proposed 504 (d).

58a-505. Creditor's Claim against Settlor.

(a) Except as provided by K.S.A. 33-101 et seq. and 33-201 et seq., and amendments thereto, *whether or not the terms of a trust contain a spendthrift provision, the following rules apply:*

(1) During the lifetime of the Settlor, the property of a revocable trust is subject to claims of the settlor's creditors.

(1) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

(2) After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, the homestead, homestead allowance, the elective share rights of the surviving spouse pursuant to K.S.A. 59-6a209, and amendments thereto, and statutory allowance to a surviving spouse and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses, and allowances.

(b) For purposes of this section:

(1) During the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power;

(2) Upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust only to the extent of the value of the property affected by the lapse, release, or waiver exceeds the greater of the amount specified in section 2041(b)(2) or 2514(e) of the federal internal revenue code of 1986, as in effect on December 31, 2002; or

section 2503 (b) of the federal internal revenue code of 1986, as in effect on December 31, 2002; and

- (3) This subsection shall not apply to the lapse of powers held by the spouse of a person occurring upon the death of such person.

Kansas Comment to 5-505

Subsection (a) (1) and (a)(2) generally conform to Kansas law. A person cannot create out of his own property for his own benefit a trust for himself and thereby defeat his creditors of their lawful demands. See *Herd v. Chambers*, 158 Kan. 614, 622-28, 149 P.2d 583 (1944); *In re Estate of Sowers*, 1 Kan. App. 2d 675, Syl. 7, 574 P.2d 224.

Subsection (a)(3) modifies Kansas law regarding payment of settlor's debts and expenses. The Kansas Supreme Court has held that a surviving spouse was not entitled to reimbursement for expenses and debts of the settlor of a revocable trust that she voluntarily paid upon insolvency of the settlor's probate estate. The trust language did not require the reimbursement of the claimed expenses and the surviving spouse failed to demonstrate any rights as an alleged creditor. *Taliaferro v. Taliaferro*, 252 Kan. 192, 843 P.2d 240 (1992) (surviving spouse who does not consent to revocable trust can reach assets to extent necessary to obtain her lawful distributive share of husband's estate). Also, provision that settlor may direct the source from which liabilities will be paid conforms to Kansas law. See *In re Estate of Pickrell*, 248 Kan. 247, 256, 806 P.2d 1007 (1991) (settlor may designate who or what portion of estate is to bear taxes and costs of administration).

In subsection (a), the Kansas drafting committee changed the UTC by beginning the subsection with the phrase, "Except as provided in K.S.A. 33-101 and 33-201 *et seq.*" In subsection (a)(3) the drafting committee changed the UTC by striking the phrase, "and (statutory allowances)" and inserting in lieu thereof the phrase, "the homestead, homestead allowance, all elective share rights of the surviving spouse and statutory allowance."

Subsection (b) is new.

In Subsection (b), the drafting committee changed the UTC by striking the phrase, “in each case as in effect on (the effective date of this code), (or as later amended.”

NCCUSL Comment to Section 5-505

Subsection (a)(1) states what is now a well accepted conclusion that a revocable trust is subject to the claims of the settlor’s creditors while the settlor is living. *See* Restatement (Third) of Trusts Section 25 cmt. e. E (Tentative Draft No. 1, approved, 1996). Such claims were not allowed at common law, however. *See* Restatement (Second) of Trusts Section 330. o (1959). Because a settlor usually also retains a beneficial interest that a creditor may reach under subsection (a)(2), the common law rule, were it retained in this Code, would be of little significance. *See* Restatement (Second) of Trusts Section 156(2) (1959).

Subsection (a)(2), which is based on Restatement (Third) of Trusts Section 58(2) and cmt. E (Tentative Draft No. 2, approved 1999), and Restatement (Second) of Trusts Section 156 (1959), follows traditional doctrine in providing that a settlor who is also a beneficiary may not use the trust as a shield against the settlor’s creditors. The drafters of the Uniform Trust Code, concluded that traditional doctrine reflects sound policy. Consequently, the drafters rejected the approach taken in States like Alaska and Delaware, both of which allow a settlor to retain a beneficial interest immune from creditor claims. *See* Henry J. Lischer, Jr., *Domestic Asset Protection Trusts: Pallbearers to Liability*, 35 Real Prop. Prob. & Tr. J. 479 (2000); John E. Sullivan, III, *Gutting the Rule Against Self-Settled Trusts: How the Delaware Trust Law Competes with Offshore Trusts*, 23 Del. J. Corp. L. 423 (1998). Under the Code, whether the trust contains a spendthrift provision or not, a creditor of the settlor may reach the maximum amount that the trustee could have paid to the settlor-beneficiary. If the trustee has discretion to distribute the entire income and principal to the settlor, the effect of this subsection is to place the settlor’s creditors in the same position as if the trust had not been created. For the definition of “settlor,” see Section 103(14).

This section does not address possible rights against a settlor who was insolvent at the time of the trust's creation or was rendered insolvent by the transfer of property to the trust. This subject is instead left to the State's law on fraudulent transfers. A transfer to the trust by an insolvent settlor might also constitute a voidable preference under federal bankruptcy law.

Subsection (a)(3) recognizes that a revocable trust is usually employed as a will substitute. As such, the trust assets, following the death of the settlor, should be subject to the settlor's debts and other charges. However, in accordance with traditional doctrine, the assets of the settlor's probate estate must normally first be exhausted before the assets of the revocable trust can be reached. This section does not attempt to address the procedural issues raised by the need to first exhaust the decedent's probate estate before reaching the assets of the revocable trust. Nor does this section address the priority of creditor claims or liability of the decedent's other nonprobate assets for the decedent's debts and other charges. Subsection (a)(3), however, does ratify the typical pour-over will, revocable trust plan. As long as the rights of the creditor or family member claiming a statutory allowance are not impaired, the settlor is free to shift liability from the probate estate to the revocable trust. Regarding other issues associated with potential liability of nonprobate assets for unpaid claims, see Section 6-102 of the Uniform Probate Code, which was added to that Code in 1998.

Subsection (b)(1) treats a power of withdrawal as the equivalent of a power of revocation because the two powers are functionally identical. This is also the approach taken in Restatement (Third) of Trusts Section 56 cmt. B (Tentative Draft No. 2, approved 1999) that takes a position contrary to the law of almost every state that has ruled on the issue. If the power is unlimited, the property subject to the power will be fully subject to the claims of the power holder's creditors, the same as the power holder's other assets. If the power holder retains the power until death, the property subject to the power may be liable for claims and statutory allowances to the extent the power holder's probate estate is insufficient to satisfy those claims and allowances. For powers limited either in time or amount, such as a right to withdraw a \$10,000 annual exclusion

contribution within 30 days, this subsection would limit the creditor to the \$10,000 contribution and require the creditor to take action prior to the expiration of the 30-day period.

Upon the lapse, release or waiver of a power of withdrawal, the property formerly subject to the power will normally be subject to the claims of the power holder's creditors and assignees the same as if the power holder were the settlor of a now irrevocable trust. Pursuant to subsection (a)(2), a creditor or assignee of the power holder generally may reach the power holder's entire beneficial interest in the trust, whether or not distribution is subject to the trustee's discretion. However, following the lead of Arizona Revised Statutes Section 14-7705(g) and Texas Property Code Section 112.035(e)(Note-this was apparently an incorrect assertion, the proposed draft does not follow Texas – they have an anti-UTC statute), subsection (b)(2) creates an exception for trust property which was subject to a Crummey or five and five power. Upon the lapse, release, or waiver of a power of withdrawal, the holder is treated as the settlor of the trust only to the extent the value of the property subject to the power at the time of the lapse, release, or waiver exceeded the greater of the amounts specified in IRC Sections 2041(b)(2) or 2514(e) (greater of 5% or \$5,000), or IRC Section 2503(b) (annual exclusion – currently \$11,000).

The Uniform Trust Code does not address creditor issues with respect to property subject to a special power of appointment or a testamentary general power of appointment. For creditor rights against such interests, see Restatement (Property) Second: Donative Transfers Sections 13.1-13.7 (1986).

K.S.A. 58a-506. Overdue Distribution. Whether or not a trust contains a spendthrift provision, a creditor or assignee of a beneficiary may reach a mandatory distribution of income or principal, including a distribution upon termination of the trust, if the trustee has not made the distribution to the beneficiary within a reasonable time after the mandated distribution date.

K.S.A. 58a-507. Personal Obligations of trustee. Trust property is not subject to personal obligations of the trustee, even if the trustee becomes insolvent or bankrupt.

Many opponents have raised fears of what the future may hold if the UTC is adopted as proposed.

An argument that many attorneys across the country have had to the proposed draft of Article Five of the UTC relates to what is perceived as a desire to create a statutory list of “exception creditors” to whom spendthrift provisions would not apply. Even though Kansas did not adopt proposed section 504 of the UTC, significant changes have been made to Chapter 39 of the Kansas Statutes Annotated pertaining to Medicaid Eligibility. The fears of many attorneys on the national level have now been realized in Kansas, because the state legislature has made the State of Kansas an “exception creditor” as it relates to Medicaid eligibility in Kansas. However, it didn’t come through adoption of the UTC, instead it was the result of an “end run” around the good work that had been done as it relates to creditor protection in the Uniform Trust Code as adopted in Kansas.

Trust Law Changes in the Context of Medicaid Eligibility

Kansas Supreme Court cases of recent years that address Medicaid eligibility and the administration of the Medicaid program by the Kansas State Department of Social and Rehabilitation Services affirm a consensus position that Medicaid, as a “welfare” or “needs-based” program is to be last resort-to be used only when the individual has no other available resources. In furtherance of this position, special provisions have now been made in the law (through changes to K.S.A. Chapter 39) to put the State of Kansas in a position as a “super” creditor or “exception” creditor when it comes trust beneficiaries who have a need to become Medicaid eligible. It would not, however, be appropriate to say that most of these planning issues don’t or won’t remain a concern for Kansas practitioners. *See Miller v. State of Kansas Department of Social and Rehabilitation Services*, 275 Kan. 349, 64 P.3rd 395 (2003); *Brewer v. Schalansky*, 278 Kan. 734, 102 P.3d 1145 (2004); K.S.A. 39-709 (K.S.A. Supp. 2004)

Prior to the UTC, what was a “discretionary trust” and what was its effect under the laws of the state of Kansas?

The Kansas Court of Appeals, in *State Ex Rel. Secretary of SRS V. Jackson*, 15 Kan. App. 2d 126 (1990) citing an earlier Kansas Supreme Court case-explained the law in the State of Kansas relating to the effect of a trustee’s discretion as follows:

“In *Watts v. McKay*, 160 Kan. 377 (1945), the Kansas Supreme Court recognized the validity of discretionary trusts and the powers of the trustee in such cases. The plaintiff in *Watts* sought an order compelling the trustee to pay a judgment for alimony. The court determined that a discretionary trust (not a spendthrift trust) existed and stated in such a discretionary trust:

“ The beneficiary has no right, as a matter of law, to require the trustee to turn over to him the principal of the estate or any part of it . . .

The Beneficiary does not have such an interest in the corpus of the trust estate in the hands of the trustee as can be reached to satisfy the judgment for alimony and attorney’s fees, and . . . the trustee did not abuse his discretion in refusing to pay such judgment.” 160 Kan. At 385.

In *Watts*, the court cited with approval the provisions of the Restatement of Trusts Section 155 (1935), concerning discretionary trusts. The present version of this treatise contains the same language:

“Except as stated in Section 156, if by the terms of a trust it is provided that the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his uncontrolled discretion shall see fit to pay or apply, a transferee or creditor of the beneficiary cannot compel the trustee to pay any part of the income or principal.” Restatement (Second) of Trusts Section 155(1) (1957).

Comment b of this subsection of the Restatement states:

“A trust containing such a provision as is stated in this Section is a ‘discretionary trust’ and is to be distinguished from a spendthrift trust, and from a trust for support. In a discretionary trust it is the nature of the beneficiary’s interest rather than a provision forbidding alienation which prevents the transfer of a beneficiary’s interest. The rule stated in this Section is not dependent upon a prohibition of alienation by the settler (a spendthrift provision); but the transferee or creditor cannot compel the trustee to pay anything to him because the beneficiary could not compel payment to himself or application for his own benefit.”

On appeal to the Kansas Supreme Court in *State Ex Rel. Secretary of SRS v. Jackson* 249 Kan. 635 (1991), the Kansas Supreme Court determined that the distribution of income was mandatory pursuant to the terms of the trust and therefore the rule relating to discretionary trusts did not apply. However, the court did recognize the effect of a discretionary trust:

The parties stipulated that the Jackson Trust was a “discretionary trust with spendthrift provisions.” The district court and the Court of Appeals accepted this categorization of the Jackson Trust. If we are bound by this stipulation, it controls the outcome of this case, as a discretionary trust is not an available resource to the beneficiary. We recognized the validity of discretionary trusts in *Watts v. McKay*, 160 Kan. 377 (1945).

In the past, this debate relating to a trustee’s discretion, as well as support and spendthrift provisions, has arisen in the context of Medicaid Eligibility and “Special Needs” or “Supplemental Needs” trusts. A review of the law in Kansas as it relates to trusts and Medicaid eligibility is helpful in understanding how we arrived at this destination. The newly adopted K.S.A. Chapter 58a does not operate in a void.

Legislation has been passed in the context of Medicaid eligibility that affects probate transfers, non-probate transfers, probate practice, trusts and trust administration.

How has trust law been effected by changes made to Article 39 of the Kansas Statutes Annotated?

K.S.A. CHAPTER 39 – MENTALLY ILL, INCAPACITATED AND DEPENDENT PERSONS; SOCIAL WELFARE

K.S.A. 39-709. Eligibility requirements of applicants for and recipients of assistance, available resources; failure to comply with reporting and other requirements, penalties; automatic assignment of support rights; “medical assistance estate” defined; lien procedures and enforcement.

39-709 (e) Requirements for medical assistance for which federal moneys or state moneys or both are expended.

(4) Resources from trusts shall be considered when determining the eligibility of a trust beneficiary for medical assistance. Medical assistance is to be secondary to all resources, including trusts that may be available to an applicant or recipient of medical assistance. *If a trust has discretionary language, the trust shall be considered to be an available resource to the extent, using the full extent of discretion, the trustee may make of any of the income or principal available to the applicant or recipient of medical assistance.* Any such discretionary trust shall be considered an available resource unless:

- (1) The trust is funded exclusively from resources of a person who, at the time of the creation of the trust, owed no duty of support to the applicant or recipient; and
- (2) the trust contains specific contemporaneous language that states intent that the trust is supplemental to public assistance

and the trust makes reference to Medicaid, medical assistance or title XIX of the social security act.

Now apply this to the typical or traditional discretionary language prior to the effective date of the above statute (as shown below):

In the example below, the discretionary language causes trust to become an available resource based on the theory that the trustee must exercise all possible discretion in favor of the beneficiary receiving income and principal from the trust.

Intent to Supplement Needs of Beneficiary

The intent of this trust is to supplement any benefits received (or for which the beneficiary may be eligible) through or from various governmental assistance programs and not to supplant any such benefits, *unless my Trustee, in its sole and absolute discretion, determines that the government assistance is inadequate*. All actions of my Trustee shall be directed toward carrying out this intent and the discretion granted my Trustee under this agreement to carry out this intent is absolute. Under no circumstances shall the beneficiary be considered to have access to principal or income of the trust.

Under the Kansas statute, it would appear that the “discretionary language” must be removed completely in order to not cause the trust to be considered an available resource to the extent that the discretion could be exercised.

Intent to Supplement Needs of Beneficiary

The intent of this trust is to supplement any benefits received (or for which the beneficiary may be eligible) through or from various governmental assistance programs, *including but not limited to Medicaid, medical assistance or Title XIX of the Social Security Act*, and not to supplant any such benefits. Under no circumstances shall the beneficiary be considered to have access to principal or income of the trust.

Note the “magic language” requirement of K.S.A. 39-709(e)(4) is met in the above example.

Is special drafting with “magic” words now necessary? Consider the following proposed provision for a dynasty type trust:

Trustee has No Discretion Principal or Income until Determination of Beneficiary’s Special Needs

With the exception of providing hereunder for the benefit of my spouse or any minor child that I might have, the trustee hereunder *shall not have any discretion to make any distribution of principal or income for the benefit of any beneficiary of any trust or trust share created hereunder*, other than for the limited purposes and in such limited amounts as set forth below, until such trustee has first conducted an evaluation and determined whether or not any such beneficiary is, because of his or her health, including his or her age, or his or her physical or mental condition likely to have a need for assistance with the activities of daily living, and in particular, to have the ability to qualify for assistance through any available governmental programs, after considering the other assets and resources that might be made available to such beneficiary. I hereby specifically express and state my intent that the trust be supplemental to public assistance, specifically including, but not limited to the following: Medicaid, medical assistance or title XIX of the social security act. The trustee shall have the limited discretion to distribute to or for the benefit of any such beneficiary a sum not to exceed \$2,000.00 prior to making a determination in writing as to whether or not such beneficiary shall be considered a “Special Needs Beneficiary,” which determination shall take place prior to the end of 12 months from the creation of the trust share or trust for such beneficiary. In the event no such determination is made in writing by the trustee, upon the passage of 12 months from the creation of the trust, the beneficiary shall be deemed to not be a “Special Needs Beneficiary.” In the event that a written determination has been made that a beneficiary is a “Special Needs Beneficiary” then all of the trustee discretion shall be subject to the provisions set forth in Article X relating to “Special Needs Beneficiaries.”

What was the “discretionary” – “support” distinction in the law prior to the adoption of the UTC in Kansas?

Prior to the enactment of the above legislation making available all resources a trustee can access and provide through the exercise of “discretion,” the courts looked to whether or not a trust was a “support” trust or a “discretionary” trust. *See Miller v. Kansas Department of Social and Rehabilitation Services*, 275 Kan. 349, 64 P. 3d 395 (Kan. App. 3/7/2003). In reviewing the history of this topic, the court stated:

“Frequently the salient issue has been whether a trust is a support trust or a discretionary trust. *A support trust exists when the trustee is required to inquire into the basic support needs of the beneficiary and to provide for those needs.*” *Myers*, 254 Kan. at 471. Eligibility for Medicaid depends on the assets “available” to the applicant, and the support trust is always considered such an available asset. *Williams*, 258 Kan. at 165 (citing U.S.C. Section 1396a(a)(17) (1988); *Myers*, 254 Kan. at 471.

If the trust is not a third party beneficiary trust; or if the trust is funded with assets of the beneficiary, then the discretionary/support argument is no longer an issue because trusts (formerly considered Self-Settled Medicaid Qualifying Trusts-MQT’s) which are funded with assets of a beneficiary are considered as an available resource subject to spend down requirements.

Prior to the recent revision of K.S.A. 39-709, the distinction of a “discretionary” trust from a “support” trust was as follows:

By contrast, a discretionary trust exists when the beneficiary has no right, as a matter of law, to require the trustee to turn over to him or her the principal of the estate or any part of it. *Jackson*, 249 Kan. at 639-41 (citing *Watts v. McKay*, 160 Kan. 377, 162 P.2d 82 (1945)). Because the trustee has complete authority to withhold trust assets, a discretionary trust is often not considered an asset/resource

available to the beneficiary for determining Medicaid eligibility. See *Myers*, 254 Kan. at 471; *Jackson*, 249 Kan. at 639.

The effect of the Kansas law (K.S.A. 39-709(e)(4)) is to result in a denial of Medicaid for any applicant for assistance who is the beneficiary of a discretionary trust, regardless of whether or not it has spendthrift provisions, unless the magic language requirement is met. However, the law has not been modified so that a Trustee of such a discretionary trust can actually be directed to exercise the discretion to the extent the trust directs or allows. It is quite apparent that the intent of the law is to assist in denying Medicaid eligibility. Further, it would appear possible that the State of Kansas (through the provisions of the UTC) has now put an individual who is the beneficiary of a discretionary trust in a position to claim the trustee is acting in “bad faith” by refusing to exercise the discretion granted. See K.S.A. 58a-814. (Conceivable the applicant could be refused assistance and at the same time the trustee of a such a discretionary trust could refuse to pay for the costs of long-term care, putting the beneficiary in an impossible situation where he or she truly cannot pay his way nor obtain assistance.

Discretionary Trusts distinguished from Spendthrift Trusts

The Kansas Supreme Court in the *Jackson* case cited 76 Am. Jur.2d, Trusts Section 164 pp. 401-402 as follows, to distinguished discretionary trusts from spendthrift trusts:

“A trust protective against the grantees or assignees and against the creditors of a beneficiary by virtue of a provision vesting discretion in the trustee to determine the time, amount, or manner of payments to a beneficiary generally, is recognized to be valid. The protection of such a trust result’s from the nature of the beneficiary’s interest, and not from any restraint on alienation. The question in cases involving such trusts is not one of the power, but of the intention, of the testator or grantor to prohibit the anticipation or exclude the creditor or alienee, and if the court is satisfied of the intention in that respect, it will enforce it. Such a discretionary trust is sometimes called a spendthrift trust, although ordinarily it

is distinguished from a true spendthrift trust. The discretion of the trustee may relate to payments for support or maintenance. But the fact that a trustee has a discretion to apply so much of the income as may be necessary for the support of the beneficiary and for other purposes does not remove the trust funds from liability for debts of the beneficiary, if the trustee has no right to exclude the beneficiary from the benefit thereof.”

The language of the trust in Jackson was determined to be mandatory as to the distribution of income:

“(A) During the lifetime of Carrie Conner Jackson, the Trustees, in their uncontrolled discretion, shall pay to Carrie Conner Jackson the net income of the Trust. In addition, the Trustees may pay to Carrie Conner Jackson, from the principal of the Trust from time to time, such amount or amounts as the Trustees in their uncontrolled discretion may determine is necessary for the purposes of her health, education, support and maintenance.”

In cases involving Medicaid eligibility of recovery of benefits paid by SRS, there is a clear rationale utilized by the Supreme Court of Kansas to make sure that funds through a welfare or “needs-based” program are a last resort.

The Supreme Court of Kansas stated in that case (249 Kan. at 644):

“Public assistance funds are ever in short supply, and public policy demands they be restricted to those without resources of their own. The Jackson Trust’s grantor intended that Jackson receive the income of the Trust regardless of need, and said income was an available resource under the applicable statutes and SRS regulations.”

In many cases decided under this view of the State in providing for its needy citizens, it is easy to see that the result is likely different when the creditor is the State of Kansas.

Kansas Case law regarding Spendthrift Provisions prior to the UTC (not involving Medicaid eligibility).

Jennings v. Murdock, 220 Kan. 182 (1976) is an often cited case that was filed initially as an action by beneficiaries of spendthrift trusts to compel their trustee to do their bidding in the management of trust assets.

In part, the Trustee's discretion was set forth in Article 5(g):

“In making distribution of the principal of the corpus of the trust estate, or of any part thereof, the Trustees in their uncontrolled discretion may make distribution to all or any of the beneficiaries hereunder in money and/or property of the trust estate. In making distribution in property the Trustees shall not be required to distribute to any beneficiary an aliquot part of security or property.”

and in Article 5(j):

“The Trustees are further authorized and empowered, in their discretion, to vote in person or by proxy upon all shares of capital stock held by them; to unite with other owners of similar property in carrying out any plan for the reorganization of any corporation or association whose securities form a portion of the trust estate or any part thereof; to consent to the consolidation or merger of any corporation or association whose securities are held by them, with any other corporation or association; to pay all assessments, expenses and sums of money as they may deem expedient for the protection of their interest as holder of the stocks, bonds, or other securities of any corporation or association and generally to exercise in respect to all securities held by them, all the same rights and powers as are, or may be, lawfully exercised by persons owning similar securities in their own right.”

Under such discretion, the bottom line is that a court may not control the exercise of discretion by a trustee if such discretion has been granted by the trust instrument if there is a difference of opinion as to what the trustee should do, but should only interfere when the trustee acts in bad faith or in an arbitrary or capricious manner that amounts to bad faith.

See also *In re Estate of Gustafson*, 178 Kan. 230; *Henshie v. McPherson & Citizens State Bank*, 177 Kan. 458.

The Kansas Supreme Court in the *Jennings v. Murdock* case went on to say:

“Looking first to general principles, we find: “The accepted rule is that where the instrument creating a trust gives the trustee discretion as to its execution, a court may not control its exercise merely upon a difference of opinion as to matters of public policy, and is *authorized to interfere only where he acts in bad faith or his conduct is so arbitrary and unreasonable as to amount to practically the same thing.*” (*Elward v. Elward*, 117 Kan. 458, 459.)

The American Law Institute puts the rule this way:

“Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion.” (Restatement of Trusts, Second Section 187.)

Generally speaking, the duty to administer a trust and to exercise the discretion vested in him rests on the trustee, and cannot be delegated by him to others. (Restatement of Trusts, Second Section 171; *Scott on Trusts*, Section 171.)

The Kansas court in the *Jennings v. Murdock* case cited similar decisions from a number of other jurisdictions. Numerous cases hold that the trustee has no duty to consult with

the beneficiaries before selling trust property, where the trustee holds the discretion and the trust document does not direct communication or notice requirements.

See also:

McGINLEY V. BANK OF AMERICA, 279 Kan. 472 (2005)

Trustee acting under Settlor's direction to hold ENRON Stock did not act in "bad faith" in following her directive to do so.

See also:

IN RE BREEDING TRUST, 21 Kan. App 2d 351 (1995)

MORRISON V. WATKINS, 20 Kan. App. 2d 411 (1995)

GILLESPIE V. SEYMOUR, 14 Kan. App. 2d 563 (1990)

In the case of Wilcox v. Gentry, 254 Kan. 411 (1994), the Kansas Supreme Court addressed the right of a judgment creditor to garnish a distribution made pursuant to a Trustee's discretion.

The Trustee had discretion to make distributions from the trust for Isabell Gentry as follows:

“(e) One share shall remain in trust until the death of Isabell Gentry. The trustee, in his sole discretion, may make such distributions of income and principal to her or on her behalf as the trustee deems advisable after giving due consideration to all sources of funds available to her. Upon the death of Isabell Gentry, the trust shall terminate and the balance of the trust and accumulated income shall be distributed to the then surviving beneficiaries in proportion to the beneficial interests they would have been entitled to, under D.5.(a), (b), (c) and (d) above, had Grantor died on the actual date of Isabell Gentry's death. In the event Isabell Gentry should predecease the Grantor, this share shall be equally divided between Mary Margaret Gentry and Eric Gentry, or pass fully to the survivor.”

...

“The district court and the Court of Appeals characterized the Trust provisions applicable to Isabell Gentry in (e) as being discretionary in nature. This determination is unchallenged herein and we agree we are dealing with a discretionary trust. The trust contains no spendthrift provision.”

...

“The district court held that any trustee payments directly to Isabell were subject to garnishment but that trustee payments for Isabell’s benefit were not. The propriety of the district court’s determination relative to payments made for Isabell’s benefit is the only aspect of the judgment from which an appeal was taken.”

...

In the case before us, the issue is not whether the trustee can be compelled to pay income or principal. The issue before us is, if the trustee exercises its discretion and makes a payment on behalf of the beneficiary, whether such payment is subject to the creditor’s garnishment.

This makes Restatement (Second) of Trusts Section 155(2), rather than (1), the applicable statement, as it provides:

“(2) Unless a valid restraint on alienation has been imposed in accordance with the rules stated in Sections 152 and 153, if the trustee pays to or applies for the beneficiary any part of the income or principal with knowledge of the transfer or after he has been served with process in a proceeding by a creditor to reach it, he is liable to such transferee or creditor.”

...

Comment h. to subsection (2) of 155 states:

“h. Effect of payment by trustee to a beneficiary after assignment. Although in the case of a discretionary trust a transferee or creditor of the beneficiary cannot compel the trustee to pay over any part of the trust property to him, yet if the trustee does pay over any part of the trust property to the beneficiary with knowledge that he has transferred his interest or after the trustee has been served with process in a proceeding by a creditor of the beneficiary to reach his interest, the trustee is personally liable to the transferee or creditor for the amount so paid, except so far as a valid provision for forfeiture or alienation or restraint on alienation has been imposed as stated in Section 150, 152 and 153.”

In IIA Scott on Trusts Section 155.1, p. 160-61 (4th Ed. 1987), and the following pertinent discussion appears:

“Although the trustee need not pay any part of the trust fund to the beneficiary or to his creditors, but may withhold it entirely, but if he does determine to pay part of it to him, he should pay it to the creditors who now stand in his shoes.” (Contrary to the English rule)

In Bogert, Trusts and Trustees Section 228, pp. 524-32 (Rev.2d Ed. 1992), distinctions between discretionary and spendthrift trusts are discussed, and the following is stated relative to a creditor’s ability to reach trust funds:

“If the trust is a true ‘discretionary trust’, the nature of the interest of the beneficiary rather than any expressed restraint on his power to alienate or the rights of his creditors, determines questions of voluntary or involuntary alienation. The beneficiary cannot secure the aid of a court in compelling the trustee to pay or apply trust income or principal to him since the terms of the trust permit the trustee to withhold payments at his will. Until the trustee elects to make a payment the beneficiary has a mere expectancy. Nor can a creditor compel the trustee to exercise his discretion to make payments. If the beneficiary attempts to transfer his

interest, or his creditors seek to take it, before the trustee has made an election to pay or apply, the transferee or creditor has no remedies against the trustee because he stands in the shoes of the beneficiary (with a mere expectancy).

....

“If, however, the trustee exercises his discretion by making a decision to pay to or apply for the beneficiary, then the beneficiary can force the trustee to confer such a benefit on him, and he can transfer his right and his creditors can take advantage of it, if the trust does not have a spendthrift clause, or a statute gives rights to the creditor as in the case where the surplus of income over that needed for support is made liable to creditors.”

How are a trustee’s discretionary powers defined under the UTC as adopted in Kansas?

“Discretionary powers” are outlined in K.S.A. 58a-814.

Uniform Trust Code:

Article 8. DUTIES AND POWERS OF TRUSTEE

K.S.A. 58a-814 Discretionary Powers

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

In an attempt to understand the thinking behind the provisions contained in the law as it has been adopted in Kansas, it is helpful to look at both the Kansas comments and the NCCUSL’s comments. *Note (The following comments, designated as either the “Kansas Comment,” or “UTC Comment,” are the actual comments presented to the Kansas legislature with the proposed draft in 2002.)

Kansas Comment to 8-814

Subsection (a) (referring to the above language) conforms to Kansas law. See *Simpson v. State Department of Social and Rehabilitation Services*, 21 Kan. App. 2d 680, 688, 906 P.2d 174 (1995) (court will not interfere with discretionary powers conferred upon trustee by trust instrument unless trustee acts in bad faith or otherwise abuses his discretion).

*Note-This new standard (requiring a trustee to exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries) which is now to be applied by the courts, has drawn much criticism and argument by many experts. A sample of that argument is as follows and was provided to the writer of this brief article by Mark Merric, a noted speaker and writer on this subject:

“ There is an entire argument of whether good faith equals bad faith.”

*The following text and related footnotes are an excerpt from a recent article by Mark Merric which discusses the subject of “good faith” and “bad faith” as a standard for review. The following is inserted with the permission of Mark Merric. He is discussing a review of cases that address the actions of a trustee under either a “good faith” or “bad faith” standard.

When courts used the term “good faith” as the standard of judicial review, the nebulous standard resulted in some discretionary trusts becoming available resources thereby allowing a governmental creditor to force a distribution.ⁱ The same does not appear to have happened when only the term “bad faith” was used by the court.ⁱⁱ However, if the court used the term “good faith” and “bad faith” synonymously, the result is often uncertain.ⁱⁱⁱ On the other hand, when courts use the standard judicial review standard of only (1) improper motive; (2) dishonesty; or (3) failure to act as defined in *Scotts* or *Bogerts*, it does not appear that trust assets are available to the beneficiary’s creditors.^{iv} There is a “bright line” where

the courts hold that a beneficiary does not have either an (1) enforceable right or (2) a property interest. Therefore, the beneficiary of an SNT does not have an available resource under this common law definition when this judicial review standard is adopted.

There is extreme uncertainty in codifying trust law. The rules of statutory construction require that each word has meaning. Even the drafters of the UTC are inconsistent in the use of the terms “good faith” and “bad faith.” If the drafters meant for the terms to be synonymous, why did they use “good faith” under §§ 105(b)(1); 801; 814(a); and 1012 and the term “bad faith” under §§ 1002(b) and 1008(a)(1). Further, in some parts of the UTC, the term “good faith” refers to specific actions.^v In other parts, the UTC references to other body’s of law for a definition of “good faith”.^{vi} Unfortunately, the use of the terms “good faith” and “bad faith” within the UTC itself confirms Black’s Laws Dictionary’s nebulous definition and our concern that a judge may interpret this term in almost any way he or she chooses.

It should also be noted that the Alaska, Delaware, and South Dakota Asset Protection Trust statutes also only use the term “bad faith,” and make no mention of the term “good faith.”

The authors are not alone in expressing concerns when using a “good faith” standard of review. North Carolina has substituted the word “bad faith” as the review standard for all trusts.^{vii} Ohio in its definition of a wholly discretionary trust defines the review standard as the trustee acting (1) dishonestly; (2) with an improper purposes; (3) failing to act; (4) or acting in bad faith.^{viii} After over four years of study, the Colorado Uniform Trust Code committee concluded in its official comments to the UTC. Part of the comment under § 504 reads:

“Colorado courts have followed the Restatement (Second) position with respect to discretionary trusts. Our courts have held that neither the beneficiary nor a creditor of a beneficiary can

compel exercise of discretion and that the interest of the beneficiary in a discretionary trust is not “property” but rather, a “mere expectancy. . . . This section [referring to UTC Section 504] may be seen as an overruling of the Colorado Supreme Court in Jones, supra. However, the Jones case left open the possibility of interference if the trustee acts dishonestly, from an improper motive, or fails to use his judgment. ^{ix}

Richard Covey and Dan Hastings^x in *Practical Drafting* discussed the problem of the UTC adopting this judicial standard of review, particularly as qualified by the words “in accordance with the terms and purposes of the trust and the interests of the beneficiaries.” Their analysis in the October 2003 issue of *Practical Drafting* is quoted below and their interpretive comments are italicized.

Section 814(a) provides:

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

Traditionally, the words “absolute” and “uncontrolled,” absent an accompanying standard that would limit their effect, have been regarded as sufficient to dispense with a “reasonable man” test in evaluating a trustee’s conduct, while preserving the requirement of good faith:

Citing Scott on Trusts (Fratcher ed.) §187.

The extent of the discretion may be enlarged by the use of qualifying adjectives or phrases such as “absolute” or “uncontrolled.” Even the use of such terms, however, does not give him unlimited discretion. A good deal depends upon whether there is any standard by which the trustee’s conduct can be judged. Thus if he is directed to pay as much of the income and principal as is necessary for the support of a beneficiary, he can be compelled to pay at least the minimum amount which in the opinion of a reasonable man would be necessary. If, on the other hand, he is to pay a part of the principal to a beneficiary entitled to the income, if in his discretion he should deem it wise, the trustee’s decision would normally be final, although as will be seen the court will control his action where he acts in bad faith. The real question is whether it appears that the trustee is acting in that state of mind in which it was contemplated by the settlor that he should act. ...

"Section 814(a) illustrates the uncertainty that codifying the trust law may create. What do the words “and in accordance with the terms and purposes of the trust and the interests of the beneficiaries” mean? Do they create a stricter limit on the discretion that may be conferred upon a trustee than the common law test set forth in the above quotation from Scott? It seems likely that courts will use them to do so in particular cases, yet their application to particular facts remains as hard to predict as that of the common law. Has anything been gained by codification?”^{xi}

In the April 2004 issue of Practical Drafting, Richard Covey and Dan Hastings again explained their conclusion regarding UTC § 814(a).

. . . we discussed Section 814(a), which provides that “[n]otwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms as ‘absolute’,

‘sole’, or ‘uncontrolled’, the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trusts and the interests of the beneficiaries.” We noted that the words following “good faith” arguably represent a tightening of the traditional formulation of the common law rule, and give the courts a new tool, of uncertain scope^{xii}, with which to control trustee discretion.^{xiii}

We (Mark Merric and his colleagues) agree with Richard Covey and Dan Hastings that the words following “good faith” arguably give the court “a new tool, of uncertain scope, with which to control trustee discretion.”^{xiv} For example, the clause “in accordance with the terms and purposes of the trust and the interests of the beneficiaries” has little, if any, meaning. We also note that this problem is further magnified by the Iowa, Ohio, Connecticut, and Pennsylvania cases^{xv} A judge need not interpret the term “good faith” as reducing the discretionary trust threshold to that of “reasonableness” to create an available resource. Rather a judge need only find that the standard of review is something slightly less than the discretionary trust common law standard. This may result in the minority discretionary-support line of cases being a national problem instead of a localized one.

Due to the several factors that are involved in defining a discretionary trust, there are no cosmetic or simple solutions to fix this problem.^{xvi} When discretionary–support distinction is arbitrarily eliminated, the statutory interpretation of over one-hundred years of case law is lost.

NCCUSL Comment to Section 8-814

Despite the breadth of discretion purportedly granted by the working of a trust, no grant of discretion to a trustee, whether with respect to management or distribution is ever absolute. A grant of discretion establishes a range within which the trustee may act. The greater the grant of discretion, the broader the range. Pursuant to subsection (a) (referring to the above language) a trustee’s action must always be in good faith, with

regard to the purposes of the trust, and in accordance with the trustee's other duties, including the obligation to exercise reasonable skill, care and caution. See 801 (duty to administer trust) and 804 (duty to act with prudence). The standard stated in subsection (a) applies only to powers which are to be exercised in a fiduciary as opposed to a nonfiduciary capacity. Regarding the standards for exercising discretion and construing particular language of discretion, see Restatement (Third) of Trusts Section 50 (Tentative Draft No. 2, approved 1999); Restatement (Second) of Trusts Section 187 (1959). See also Edward C. Halbach, Jr., *Problems of Discretion in Discretionary Trusts*, 61 Colum. L. Rev. 1425 (1961). An abuse by the trustee of the discretion granted in the terms of the trust is a breach of trust that can result in discharge. See Section 1001(b) (remedies for breach of trust).

NOTE-the proposed UTC sections 814 (b) through (d) which were not adopted in Kansas automatically allow the "rewrite" of the terms of a trust that might otherwise result in adverse estate and gift tax consequences to a beneficiary-trustee. These tax curative provisions were left out of the Kansas form of the "uniform" code.

What about the Notice Requirement of 58a-813?

First of all, 58a-103, as adopted in Kansas, identifies qualified beneficiaries as follows:

- (12) "Qualified beneficiary" means a beneficiary who, on the date of the beneficiary's qualification is determined to be either:
 - (A) A distributee of trust income or principal; or
 - (B) a distributee of trust income or principal if the trust terminated on that date.

Secondly, K.S.A. 58a-513 provides as follows:

58a-513 Duty to Inform and Report.

- (a) A trustee shall keep the qualified beneficiaries and permissible current distributees of the trust income or principal reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests. Unless unreasonable under the circumstances, a trustee shall promptly respond to a qualified beneficiary's and a permissible current distributee's request for information related to the administration of the trust.
 - (b) A trustee:
 - (1) Upon request of a qualified beneficiary or a permissible current distributee, shall promptly furnish to the qualified beneficiary or permissible

current distributee a copy of the trust instrument;

(2) within 60 days after accepting a trusteeship, shall notify the qualified beneficiaries and permissible current distributees of the acceptance and of the trustee's name, address, and telephone number;

(3) within 60 days after the date the trustee acquires knowledge of the creation of an irrevocable trust, or the date the trustee acquires knowledge that a formerly revocable trust has become irrevocable, whether by the death of the settlor or otherwise, shall notify the qualified beneficiaries and permissible current distributees of the trust's existence, of the identity of the settlor or settlors, of the right to request a copy of the trust instrument and of the right to a trustee's report as provided in subsection (c); and

(4) shall notify the qualified beneficiaries and permissible current distributees in advance of any change in the method or rate of the trustee's compensation.

(c) A trustee shall send to the distributees or permissible current distributees of trust income or principal, and to other qualified beneficiaries who request it, at least annually and at the termination of the trust, a report of the trust property including liabilities, receipts and disbursements, including the source and amount of the trustee's compensation, a listing of the trust assets and, if feasible, their respective market values, and if requested, the trust's association of investment management and research compliant rate of return. Upon a vacancy in a trusteeship, unless a cotrustee remains in office, a report must be sent to the qualified beneficiaries by the former trustee. A personal representative, conservator, or guardian may send the qualified beneficiaries and permissible current distributees a report on behalf of a deceased or incapacitated trustee.

(d) A qualified beneficiary or permissible current distributee may waive the right to a trustee's report or other information otherwise required to be furnished under this section. A qualified beneficiary or permissible current distributee, with respect to future reports and other information, may withdraw a waiver previously given.

(e) *The provisions of this section are inapplicable to persons other than a surviving spouse so long as a surviving spouse is or may be entitled to receive income or principal distributions from a trust, or holds any power of appointment therein, and where any or all qualified beneficiaries are the issue of the surviving spouse.*

(f) As used in this section "permissible current distributee" means a person presently entitled to receive, subject to the discretion of the trustee, income or principal.

History: L. 2002, ch. 133, § 70; L. 2004, ch. 158, § 13; July 1.

Paragraph (e) has been added to clear up significant concerns about the need to provide information to children when a “credit shelter” or “bypass” trust is created at the death of the first spouse to die.

THE MEDICAID ELIGIBILITY AND ESTATE RECOVERY ARENA

New Kansas law outside the UTC including new statutory terminology and definitions- “Medical Assistance Estate”

Kansas Practitioners should be aware that there is a new definition created under K.S.A. 39-709(g) affecting trusts and creditors rights (considering the Estate Recovery Unit as a “special” creditor for which the exceptions have been created):

Extending the right of recovery as being absolute to the state as a creditor while at the same time expanding the resources to which the state can recover in its role as creditor - K.S.A. 39-709(g)(3) (New Section)

- (3) By applying for or receiving medical assistance under the provisions of Article 7 of Chapter 39 of the Kansas Statutes Annotated, such individual or such individual’s agent, fiduciary, guardian, conservator, representative payee or other person acting on behalf of the individual consents to the following definitions of estate and the results therefrom:
- (A) If an individual receives any medical assistance before July 1, 2004, pursuant to Article 7 of Chapter 39 of the Kansas Statutes Annotated, which forms the basis of a claim under subsection (g)(2), such claim is limited to the **individual’s *probatable estate as defined by applicable law***; and
 - (B) If an individual receives any medical assistance on or after July 1, 2004, pursuant to Article 7 of Chapter 39 of the Kansas Statutes Annotated, which forms the basis for a claim under (g)(2), such claim shall apply to the individual’s medical assistance estate. The *medical assistance estate is defined as including all real and personal property and*

other assets in which the deceased individual had any legal title or interest immediately before or at the time of death to the extent of that interest or title. The medical assistance estate includes, without limitation, assets conveyed to a survivor, heir or assign of the deceased recipient through joint tenancy, tenancy-in-common, survivorship, transfer-on-death deed, payable on death contract, life estate, trust, annuities or similar arrangement.

In addition to the above section (g)(3) of K.S.A. 39-709 as it relates to Medicaid eligibility, paragraphs (g)(4-7) outline the state's ability to assert and foreclose a lien on real property through the secretary of SRS. These provisions are not part of the Uniform Trust Code, but in reviewing the UTC as adopted, it is clear that these provisions in Chapter 7 of Article 39 of the Kansas Statutes Annotated establishing numerous exceptions for the state (in its role as a creditor) as it relates to Medicaid eligibility have been considered in concert with Article 5 of Chapter 58a (UTC) as they have been proposed and adopted.

Do concerns with the UTC remain, or has Kansas solved the concerns of the critics?

Many well known estate planning professionals have addressed concerns over the use of the Restatement (Third) of Trusts in the establishment and drafting of the UTC as not reflecting the current state of the law. An additional concern that has been voiced about the effect of the UTC has to do with discretionary trusts that are often multigenerational (dynasty, cascading, perpetual) in planning for families with extreme wealth. Where does this type of planning stand under current Kansas law? Apparently, trusts can be created for beneficiaries that are protected from the claims of creditors, unless that creditor happens to be the state of Kansas in its capacity through SRS as the administrator of the Medicaid program in Kansas. Although a spendthrift provision is enforceable, Kansas has already, through other legislation, done away with the distinction

between “support” trusts and “discretionary” trusts. If a beneficiary in a subsequent generation is a “special needs” child, have the assets just become available and subject to spend down requirement? It would appear so. Therefore, is it necessary to include magic language for all future children and grandchildren in the event they have “special need?”

This raises additional questions, such as-should all existing trusts be modified, or should the trustee contemplate moving the situs from Kansas? How much does a Kansas practitioner need to know about how the UTC has been modified in other states? How will the “good faith” standard of K.S.A. 58a-814(a) be interpreted. Are there potential malpractice concerns for the practitioner who is not aware of the nuances of the UTC as adopted in Kansas? It appears that the Kansas legislature may have placed more mines in the minefield for the practitioner and a clearer path for the State of Kansas to scoot past them as a creditor on Medicaid matters or in determining Medicaid eligibility.

ⁱ *The UTC Threatens Special Needs Trusts; The Effect of the UTC on Spendthrift Trusts; UTC May Reduce Asset Protection on Non-Self Settled Trusts, supra* note 1. Some UTC proponents complain about our reliance on a hand full of cases that that interpret the “good faith” standard with the standard of reasonableness. Walsh and Davis, *supra* note 2. However, their struggle to find support of their position that the good faith standard does not change anything, they incorrectly cite *In re Estate of McCart*, 847 P.2d 184 (Colo. App. 1992). This case is a classic discretionary trust case where the trustee did not make distributions to current discretionary beneficiary because the trustee was the remainder beneficiary and wanted the trust assets for himself. The Appellate Court noted: “*The trial court specifically found and concluded that Goss had abused his discretion and acted arbitrarily and capriciously. The improper motives with a clear conflict of interest as trustee seeking to conserve the trust funds for himself and his heirs as remainderman under the trust, and also in breach of his fiduciary responsibilities to act with the utmost good faith and fairness toward a beneficiary.*”

These proponents quoted only the “*in breach of his fiduciary responsibilities to act with the utmost good faith and fairness toward a beneficiary,*” and then they concluded that, because these words were used in combination with a discretionary trust, the review standard of “good faith” was the same as the discretionary common law standard. Despite these proponents careful selection of phrases to support their position, a cursory review of the case yields the opposite of their conclusion. *In re Estate of McCart* is nothing more than a classic discretionary trust case with the judicial review standard only for (1) acting dishonestly; (2) acting with an improper motive; or (3) failing to act.

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- ii Possibly without exception, when courts have used the term “bad faith” with no reference to “good faith” the courts have found that neither the beneficiary nor the creditor had an enforceable right. *SunTrust v. Children’s Hospital*, 2003 WL 21085046 (Va. Cir. Ct. 2003); *In re Estate of McInery*, 289 Ill. App. 3d 589 (Ill. App. 1997); *Simpson v. State, Dept. of Social and Rehabilitation Services*, 906 P.2d 174 (Kan.App.,1995); *First Nat. Bank of Maryland v. Department of Health and Mental Hygiene*, 399 A.2d 891 (Md. 1979); *Town of Randolph v. Roberts*, 195 N.E. 2d 72 (Mass. 1964); *In re Maeder’s Estate*, 329 N.Y.S.2d 663 (N.Y.Sup. 1972); *Greenwich Trust Co. v. Tyson*, 10 Conn. Supp. 147 (Conn. Super. 1941). According to Andy Strauss of the North Carolina UTC committee, this was the primary reason why North Carolina chose the term “bad faith” over “good faith” as the judicial review standard under UTC § 814(a). Also, Scott on Trusts appendix cites the term “bad faith” and gives several references, but no mention is made of the term “good faith.”
- iii Unfortunately, the distinction between “good faith” and “bad faith” adopted by North Carolina and Ohio UTC committees may be short lived. As noted by the proponents of the UTC (Walsh, *supra note 2*), courts have combined the terms “good faith” and “bad faith,” and these terms have been used synonymously. *In re Ferrels Estate*, 258 P.2d 1009 (Cal. 1953). *In re Ferrel*, holds the beneficiary of a discretionary trust coupled with a standard does not have an enforceable right under a good faith or bad faith standard. Therefore, a governmental agency was not allowed to force distributions from a discretionary trust coupled with a standard. On the other hand, the Court *In re Ventura County Dept. of Child Support Services v. Brown*,ⁱⁱⁱ authorized invasion of a discretionary trust coupled with a standard even though the court found that the debtor/beneficiary had no enforceable right. Again, holding that a creditor has greater rights than a trust beneficiary flies in the face of the common law definition of a common law discretionary trust but not the UTC definition.
- iv *Supra*, footnote 20.
- v UTC § 1013 official comment paragraph 4.
- vi UTC § 1012 official comment there under.
- vii Proposed N.C.S. § 36C-5-814(a).
- viii Proposed Ohio Statute § 5808.14(a).
- ix Colorado UTC official comments. At the November 19, 2004 Colorado UTC Committee, Stanton Kent, co-chair of the committee, stated that he had changed his position, and the UTC did not overrule *In Re Jones*. Kent is one of the UTC proponents criticizing the authors in two of his articles, *supra note 2*.

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- x Covey and Hastings, Practical Drafting, October 2003; Richard Covey is Senior Counsel at Carder, Ledyard & Milburn, LLP. Dan Hastings is counsel at Skadden, Arps, Meagher & Flom, LLP. Both are the primary drafters of Practical Drafting.
- xi Covey and Hastings Recent Developments in Estate, Gift and Income taxation – 2004, 39th Annual Heckerling Institute on Estate Planning, University of Miami School of Law, page 193-194.
- xii For a detailed analysis of how “uncertain the scope” might be see Merric, Stein, & Berger, *The Uniform Trust Code: A Continuum of Discretionary Trusts or a Continuum of Continuing Litigation*, *supra* note 1.
- xiii Covey and Hastings Practical Drafting, April 2004.
- xiv *Id.*
- xv *Supra* note 25.
- xvi *The Effect of the UTC on Spendthrift Trusts*, 31 ETPL 375 (Aug. 2004); Merric and Oshins, *UTC May Reduce Asset Protection on Non-Self Settled Trusts*, 31 ETPL 411 (Sept. 2004); also see part 2 of this upcoming article.