The Trust Instrument: How Trustees Interpret Common Trust Provisions

Many considerations go into the planning and drafting of a trust instrument: For what purpose do you need the trust? For whom are the assets being placed in trust? What are the tax implications of your decisions? These are just a few of the many questions that must be considered before a trust can be finalized.

One additional question to consider is, once the trust is drafted, how will it be interpreted? Specifically, how will the Trustee of a trust interpret a trust provision, and second, what effect does the absence of a provision have on the Trustee's administration of the trust? As a Delaware Directed Trust Company, Commonwealth Trust Company, analyzes trust interpretation questions in accordance with the Delaware Code and Delaware common law. The following are just a few examples of how a Trustee in Delaware may approach certain situations.

Notice Provisions –

Section 3303 of Title 12 of the Delaware Code permits settlors to expand, restrict, eliminate, or otherwise vary the rights and interests of beneficiaries of a trust. This power granted to the settlor includes the power to restrict a beneficiary's right to be informed of that beneficiary's interest in the trust for a period of time. A settlor can, for example, insert a provision in the trust instrument wherein a minor beneficiary does not have a right to

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be informed of his or her beneficial interest in the trust until the beneficiary attains a certain age or until the death of the settlor. This provision was adopted in the Delaware Code in response to a 2002 Delaware Supreme Court holding in *McNeil v. McNeil*. Importantly, the Code provision allows for the altering of a beneficiary's rights and interests in a governing instrument. However, absent such a clause being explicitly drafted in the trust instrument, a Trustee, in adherence with the holding in *McNeil*, most likely will notify an individual of their status as a beneficiary of a trust when they reach the age of majority.

Amendment Provisions –

As years pass, the circumstances of individuals can change dramatically. This can include changes in financial situations of beneficiaries, the mental or physical capacity of fiduciaries, medical needs of beneficiaries, and family composition, among others. When these changes occur, they can often cause trusts that were set up years ago to be ineffective or impractical today. When approached about a potential trust amendment, a Trustee will first look to the trust instrument for guidance. Trust instruments often contain amendment provisions to cover these types of situations. Revocable trusts give the settlor the ability to amend or revoke the trust. Amendment provisions in irrevocable trusts often contain language granting a discretionary power to amend certain provisions, or any part, of the trust instrument to a Trustee or another appointed individual, such as a Trust Protector. This power can be an unbridled or a limited power.

If an amendment to the trust instrument is not possible, a Trustee can look to the Delaware Code, which enumerates other methods for altering trust provisions. This includes decanting the original trust into a new trust, or merging the original trust with a new trust, containing the desired provisions. The Trustee can also attempt to obtain a court order or enter into a non-judicial settlement agreement to amend the trust. Each of the aforementioned methods are valuable tools for a Trustee to have for amending trust terms. For each of these procedures, the Trustee must ensure that the requirements listed in the Delaware Code are followed and that the "new" trusts contain requisite similarities to the "old" trusts.

Discretionary Distribution Provisions –

Many trusts contain a discretionary distribution provision. The Delaware Code allows for the creation of directed trusts, which permit Trustees to take direction from advisors, including a Distribution Advisor, who can be given the power to direct the Trustee to make distributions. Alternatively, a trust instrument may contain a provision giving the Trustee sole discretion over distributions to beneficiaries. When a Trustee receives a distribution request from a beneficiary, the Trustee must closely analyze the trust instrument's applicable distribution provisions. One question the Trustee must consider is whether it should, or must, consider other resources available to the beneficiary. A settlor may guide the Trustee's decision-making by inserting a clause in the trust instrument explicitly stating whether a Trustee should, or must, consider other resources available to the beneficiary when using its discretion regarding distributions. A settlor may also provide the Trustee with a non-binding letter of wishes, which gives the settlor an informal way to convey his or her intent to the Trustee, including the settlor's wishes regarding distributions. The letter of wishes can contain information such as which beneficiaries he or she would like to receive preference when making distributions or the timing of distributions. The letter of wishes is a non-

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binding document, but does provide the settlor with a flexible option to convey his or her wishes to the Trustee. Absent an explicit provision, a Trustee in Delaware may take one of several positions. Some Trustees may require detailed financial information, including personal income tax returns, in all cases. Alternatively, some Trustees may require financial information only when circumstances require a closer inspection.

The above provisions are just a sample of the multitude of provisions a Trustee is tasked with interpreting during the administration of a trust. The three aforementioned provisions were featured in this article because they are provisions that Commonwealth Trust Company encounters quite frequently. Commonwealth Trust Company is happy to discuss our interpretation of the above provisions for any prospective trusts.

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