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Who Is a Qualified Beneficiary?

*John P. Edgar**

The Uniform Trust Code ("UTC") definition of "qualified beneficiary"[1] has caused confusion among trustees, especially the application of the definition's subsection (C). What constitutes the "trust"? When has the trust "terminated," and who are the distributees if it does? These questions arise in many fact patterns, particularly in dynasty trusts. This article considers the common questions as well as answers that have been suggested by practitioners and the courts. This article also suggests possibilities for reform.

The Comment provides in part,

> The qualified beneficiaries consist of the beneficiaries currently eligible to receive a distribution from the trust together with those who might be termed the first-line remaindermen. These are the beneficiaries who would become eligible to receive distributions were the event triggering the termination of a beneficiary's interest or of the trust itself to occur on the date in question. Such a terminating event will typically be the death or deaths of the beneficiaries currently eligible to receive the income.[2]

The Comment implies only two categories, lumping subsections (B) and (C) together, and not providing much guidance for the interpretation of (C). Since the definition has three parts, not two, perhaps the Comment should add a third category: "those who might be termed last-line remaindermen." But is that the best rule?

Assume a trust says income to A for life, then income to B for life, then principal to C. There is no provision for terminating the trust while A or B is alive. Clearly, A is a qualified beneficiary under subsection (A), and B is one under subsection (B). Whether C is one under subsec-

* Baltimore, Maryland.

[1] "Qualified beneficiary" means a beneficiary who, on the date the beneficiary's qualification is determined: (A) is a distributee or permissible distributee of trust income or principal; (B) would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in subparagraph (A) terminated on that date without causing the trust to terminate; or (C) would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date. Unif. Trust Code § 103(13) (Unif. Law Comm'n 2010).

[2] *Id.* § 103.

tion (C) is more difficult. Who receives the principal if the trust terminates depends on the circumstances of termination.

When a trust terminates because of unanticipated circumstances or inability to administer the trust effectively under UTC Section 412(c),[3] or because it is uneconomic under UTC Section 414(c),[4] its assets are distributed in a manner consistent with the purposes of the trust. According to the Comments, this typically means to the qualified beneficiaries in proportion to the actuarial value of their interests. This is circular: the qualified beneficiaries are those who receive something if the trust terminates, and if the trust terminates it is distributed to the qualified beneficiaries.

Or does the meaning of "if the trust terminated on that date" require us to assume the death of all beneficiaries for whom the assets will be held in trust? In our hypothetical, the assets are held in trust only during the lives of A and B, so when they die, the trust terminates, and the distributee is C. But that conclusion requires adding multiple facts (two deaths) to a test that is supposed to occur "on the date the beneficiary's qualification is determined." Also, the Comment says the terminating event will typically be the death or deaths of the beneficiaries *currently* eligible to receive the income, not all beneficiaries. What if there are serial income interests for A, B, C, D, and E before it passes to F. Is a F a qualified beneficiary, but not C, D and E?

The application of subsection (C) is especially difficult in dynasty trusts, where termination is remote (or never). Assume a trust that is not subject to the rule against perpetuities permits distributions to all of the settlor's descendants. The trust ends only if they all die, in which case it goes to contingent takers such as charity or collateral heirs. The contingent takers are distributees if the trust terminates, but should they be qualified beneficiaries? The UTC, which was written before such trusts were commonly drafted, does not address this issue clearly. One possible answer is no, on the grounds that if the trust terminated, the distributees would be the then-living descendants. But the fact pattern does not say that.

Mississippi says yes. In the process of enacting its version of the UTC, including Section 103(13) without change,[5] the Mississippi Secretary of State Trust Code Study Group, with the assistance of members of the Uniform Law Commission, prepared several examples of the definition of "qualified beneficiary." Example 4 is a dynasty trust for all of the settlor's descendants, with discretionary income and principal distributions until the end of the rule against perpetuities period, at which time

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[3] *Id.* § 412(c).
[4] *Id.* § 414(c).
[5] MISS. CODE. ANN. § 91-8-103(21) (2019); *see* UNIF. TRUST CODE § 103(13).

the trust will be distributed to the settlor's then-living descendants, per stirpes. If the descendants die out before then, the assets go to a charity. At the testing date, the settlor had seven descendants. The Example states that the seven descendants are qualified beneficiaries under subsection (A). There are none under subsection (B), because if all the descendants died, the trust would terminate. Finally,

> The charity is a qualified beneficiary of the trust from sub-paragraph C, because the trust will terminate upon the earlier of the death of all of the descendants or the end of the rule against perpetuities, and if the trust terminates upon the death of all the descendants, the trust assets are distributed to the charity. Unborn descendants are not qualified beneficiaries.[6]

Another possible interpretation is that the dynasty trust must divide at some point into new trusts, in which case the prior trust has "terminated," and thus you look only at the next level of distributees, who will also be among A's descendants. But the fact pattern does not say that there will be a termination of the old trust. Can trust terminations be assumed to occur at some point? If so, how is trust termination defined?

Other questions regarding subsection (C) arise in many trusts, not just dynasty trusts. For example, does drafting matter? In Mississippi, Example 5 provides the same facts as Example 4, except that the trust agreement provides that if the descendants die out before the termination of the dynasty trust, the assets go to the settlor's heirs-at-law, who currently would be his spouse and children. This makes the spouse a qualified beneficiary under subsection (C). By contrast, Example 6 provides the same facts as Example 5, except that if the descendants die out before the termination of the trust, the assets go to the settlor's spouse and children pursuant to state law, and the spouse is therefore not a qualified beneficiary. So drafting appears to matter.

Can a settlor cut off rights of successor beneficiaries by providing that a trust terminates before passing to them? In *Rachins v. Minassian*, the Florida court said no.[7] The trust permitted distributions only to the decedent's wife during her life. After the wife's death, the trust will "terminate" and any property remaining will be divided into a separate trust share for each of the decedent's children. The children filed a complaint against the wife about her administration of the trust as trustee. The wife argued that the children did not have standing because they were not qualified beneficiaries because the trust would terminate at her

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6 *Examples for Mississippi Uniform Trust Code on Qualified Beneficiaries*, MISS. SEC'Y OF STATE, https://www.sos.ms.gov/Policy-Research/Documents/Examples%20for%20Qualified%20Beneficiaries.pdf [hereinafter *Mississippi Examples*].

7 Rachins v. Minassian, 251 So. 3d 919, 925 (Fla. Dist. Ct. App. 2018).

death. The wife even appointed a trust protector to amend the trust to clarify that any property remaining after the wife's death would be distributed to a new trust to be created for the benefit of the children. The children countered that the trust provisions did not create a new trust, but instead created separate shares for them in the existing trust upon the wife's death. The Florida statute is similar to the UTC, except that in paragraph (C) it adds "in accordance with its terms" after "terminated."[8]

The court held that the children were qualified beneficiaries under subsection (C) because they would be distributees of trust principal if the trust terminated in accordance with its terms.[9] In a footnote, the court added that even under the original trust, the children would be qualified beneficiaries under subsection (B), since the trust would not terminate when the wife dies.[10] This was true "even though the Family Trust terminates at the wife's death and even though the children would be distributees of any remaining trust principal in the Family Trust only through a newly-created trust for their benefit," and even though "the husband may have intended to prevent the children from challenging the manner in which the wife spent the money in the Family Trust during her lifetime."[11]

By contrast, a Mississippi example treats the trustee of the new trust, not its distributees, as the qualified beneficiary of the old trust.[12] In Example 3, a decedent created a trust that permitted discretionary distributions of income and principal to his spouse and two adult children for his spouse's life, and then would be distributed outright to the two children, but if a child was then deceased, his share would be held as a separate trust. Example 3 stated that since under the provisions of the will, the trust will terminate and pass to independent and separate subtrusts for the benefit of the grandchildren, the minor grandchildren will not be qualified beneficiaries under subsection (B), and the new trustees would be qualified beneficiaries under subsection (C).

Note, however, that Example 2 reached the opposite result as Example 3, on the same facts, except that if a child was deceased at the spouse's death, his share would "remain in trust" for the benefit of his children. Example 2 stated that the grandchildren, not the trustee, are qualified beneficiaries under subsection (B) because upon the death of the qualified beneficiaries under paragraph (A), the trust does not terminate, and the grandchildren are permissible distributees. Again, draft-

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8 Fla. Stat. § 736.0103(16)(c) (2019).

9 *Rachins*, 251 So. 3d at 925.

10 *Id.* at 925 n.3.

11 *Id.* at 925.

12 *Mississippi Examples*, *supra* note 6.

ing appears to matter. Example 7 reaches the same result as Example 2 for similar reasons.

In a Kansas case, the successor beneficiary argued that the trust would terminate at the death of the current beneficiary, and that subsection (C) applied, but was unsuccessful.[13] The trust provided for distributions to Ms. Wills for life, then to her son, Mr. Kastner, for his life. Mr. Kastner, the Plaintiff, sought removal of the trustee or modification of the trust. Unfortunately for him, Kansas omits subsection (B) from its definition of "qualified beneficiary." Thus, unlike the children in *Rachins*, Mr. Kastner was arguing that his mother's trust would terminate at her death, which would make him a qualified beneficiary under subsection (C). The court did not view the death of Ms. Wills, followed by continuation of the trust for Mr. Kastner, as a termination of the trust. The court noted that Mr. Kastner is entitled to distributions only after the death of his mother. "As such, Plaintiff is not currently entitled to any distribution and would not currently be eligible for a distribution if the trust terminated on this date."[14] The court added, "Plaintiff contends that he would be entitled to distributions if the trust terminated with the death of Ms. Wills. However, the trust would not terminate on the death of Ms. Wills, but rather, it would continue on for Plaintiff's benefit."[15]

In determining when a trust terminates, when are there separate trusts, and when is there a single trust? In *Hadassah v. Melcer*,[16] the court used both the plural "trusts" and the singular "trust," as well as the ambiguous "trust(s)." In the first paragraph of the opinion, the court stated "Three sisters, the current distributees of an irrevocable trust . . . ."[17] Paragraph two stated that "The trust" was created by their mother, for the benefit of their father, and at his death the balance "was to be divided into three separate trusts for the benefit of their daughters."[18] The third paragraph referred twice to "their respective trusts."[19] Finally, paragraph four mentioned that "upon the death of each daughter, her trust terminates and the balance of the principal and any undistributed income is redistributed to the trust(s) of the remaining living daughter(s). When the last daughter dies, the trust terminates" and passes to three charities.[20] The issue was whether the trustee was re-

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13 Kastner v. Intrust Bank, No. 10–1012–EFM, 2011 WL 2149432, at *2, *3 n.22 (D. Kan. June 1, 2011), *aff'd*, 569 F. Appx. 593 (10th Cir. 2014).

14 *Id.* at *3.

15 *Id.* at *3 n.22.

16 Hadassah v. Melcer, 268 So. 3d 759 (Fla. Dist. Ct. App. 2019).

17 *Id.* at 760.

18 *Id.*

19 *Id.*

20 *Id.* at 760-61.

quired to account to one of the charities. Technically, the case was decided under Florida Statute section 736.0110(1), regarding whether a charity has the rights of a qualified beneficiary, but the definition is essentially the same.

The lower court found that

> Each daughter is the sole distributee or permissible distributee of her separate Trust. Upon the termination of each daughter's separate trust, the only distributee or permissible distributee of trust income or principal would be the "Trusts created herein for Grantor's surviving daughters, in equal shares, or to the Trust of the sole surviving daughter, as the case may be."[21]

The appellate court, however, found an error in this "sequential termination of the daughters' individual interests such that A's interest passes to B and C; then B's interest passes to C; then C's interest passes to the charities. This interpretation is contrary to the plain language of the statute."[22] It treated all three trusts as a single trust, writing,

> The statute contemplates the simultaneous termination of the interests of the distributees ("termination of the *interests of other distributees* or permissible distributees then receiving or eligible to receive distributions"). If the interests of the distributees of the trust were simultaneously terminated, all of the daughters' interests would terminate and the charities would be the distributees. Therefore, the charities are qualified beneficiaries under the plain language of the statute.[23]

The common thread of these questions is what constitutes the trust in applying subsection (C), when it terminates, and who are the distributees if it does. This raises the final question: should the definition include subsection (C), if subsection (B) applies? As noted above, the Comment implies only two categories. Interestingly, several states (Kansas,[24] Massachusetts[25] and Utah[26]) eliminated subsection (B) in enacting the definition. No state eliminated subsection (C). However, several (Maine,[27] North Dakota,[28] Oregon,[29] Tennessee[30] and Wyoming[31])

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21 *Id*. at 761.
22 *Id.*
23 *Id.* at 761-62 (emphasis in original).
24 KAN. STAT. ANN. § 58a-103 (2019).
25 MASS. GEN. LAWS ch. 203E, § 103 (2019).
26 UTAH CODE ANN. § 75-7-103 (LexisNexis 2019).
27 ME. STAT. tit. 18-B, § 103 (2019).
28 N.D. CENT. CODE § 59-09-03 (2019).
29 OR. REV. STAT. § 130.010 (2018).
30 TENN. CODE. ANN. § 35-15-103 (2019).
31 WYO. STAT. ANN. § 4-10-103 (2019).

modified the definition to limit the number of remote contingent beneficiaries who otherwise would meet the definition of "qualified beneficiary."

An alternative approach would be to change the definition to match the existing Comment. For example, eliminate subsection (C), as well as the phrase "without causing the trust to terminate" from subsection (B). Or provide that subsection (C) applies only if there is no beneficiary described in subsection (B).

The Uniform Laws Commission is planning to review the Uniform Trust Code, beginning this year, so it will have an opportunity to clarify the definition of "qualified beneficiary" to answer these questions.