

## Encounters with the Legal Obligation of Support

by Anthony D. Nicholson

The legal obligation of support of a spouse or dependent is a concept that comes up in estate planning in a number of ways. The doctrine has implications for estate and income taxes, trust beneficiaries and trustees, guardianships and Uniform Transfers to Minors Act (“UTMA”) accounts. This article summarizes the main areas where the estate planning lawyer encounters this doctrine, notes the extent of this legal obligation under North Carolina law, and makes some practical observations about the legal support obligations. Since the doctrine is grounded in family law, the non-family law lawyer may be unaware of many aspects of this legal obligation.

The issue arises when a fiduciary has control of funds for the benefit of a person while somebody has a legal obligation to support that same person. The three main contexts or relationships where this issue may arise are trustee/beneficiary, UTMA custodian/minor and guardian/ward.

### Trust Distributions

In the trust context, the North Carolina Uniform Trust Code prohibits a trustee from making discretionary distributions to satisfy a legal obligation that the trustee owes to another person. N.C.G.S. § 36C-8-814(b)(3). This rule doesn’t apply when the terms of the trust indicate otherwise or the trust is revocable. N.C.G.S. § 36C-8-814(d)(2). This is a “tax-savings statute” which is designed to avoid unintended tax consequences. This statute comes into play with irrevocable trusts, such as life insurance trusts, where the settlor or the settlor’s spouse is the trustee and the spouse and/or minor children are the beneficiaries. (Further tax issues are discussed later in this article).

An issue can also arise when the Trustee is not a spouse or a parent of the beneficiary. Can an independent Trustee make discretionary distributions for the support of a beneficiary when another person has a legal obligation to support the beneficiary? Although applicable North Carolina law is scant, the answer is generally “no,” but there are exceptions which tend to swallow the general rule. “[T]he presumption is that the trustee is to take account of a parental duty to support a youthful beneficiary . . . [and] only provide types of support or other benefits that fall beyond the parental obligation.” *Restatement (Third) of Trusts* § 50, cmt. e(3) (2001). In practice, trusts are often drafted to overcome this rule by providing that the Trustee is not required (although the Trustee may be “permitted”) to take into consideration a beneficiary’s other resources in making discretionary distributions. In addition, this rule would not apply when the terms of the trust expressly state that trust property is to be distributed for the support of the beneficiary (rather than a pure discretionary standard). In that case, the trustee would have a duty to distribute the trust property for the support of the beneficiary even if another person has a legal obligation to support the beneficiary. **Kuykendall v. Proctor**, 270 N.C. 510, 155 S.E.2d 293 (1967).

There are other exceptions to the general rule limiting the trustee’s authority to pay for basic support needs of the minor beneficiary. First, if the parent/trustee doesn’t have sufficient resources to satisfy the parent’s legal obligation to support a disabled child, then it would be appropriate (and

likely necessary) to distribute trust funds for that purpose. Second, this presumption is not applicable when the child's only parent is a widow or widower at the time the trust is created. It would make sense for this exception to apply in other single-parent situations, too. Third, the Trustee's authority and duty is shaped by the settlor's intention. There may be evidence, extrinsic or otherwise, that the settlor intended the trust property to be fully used for, or to assist with, the beneficiary's support. *Restatement (Third) of Trusts* at § 50, cmt. e(3).

The legal obligation of support issue could arise in the context of a self-settled special needs trusts where the trust is funded with a minor child's proceeds of a personal injury recovery. Self-settled special needs trusts are often drafted to give the trustee complete discretion in distributing the trust property rather than limiting the trustee's authority to distribute for "supplemental needs" only. Even though the parent is often the trustee, the trustee's duty remains the same whether the trustee is a parent or a non-parent. If the trust has a pure discretionary distribution standard, then the trustee generally should not use the trust property to provide for the basic support needs of the child. After all, the parent has a legal obligation to provide for basic support needs and the trustee should not "discharge" that obligation by using the child's trust funds.

Such a distribution might be found to be a breach of the trustee's fiduciary duty to the remainder beneficiaries. Since Medicaid is required to be paid back out of the trust property upon the death of the beneficiary, it is possible that Medicaid could have a breach of trust claim against the parent/trustee for distributing trust property to pay for items or services for which the parent was legally obligated to pay. A distribution in satisfaction of a parent's legal obligation of support might also be a violation of the "sole benefit rule" for self-settled special needs trusts which provides that trust property cannot be distributed for the benefit of anyone other than the disabled beneficiary.

Again, trusts are often drafted to excuse the trustee from considering other resources available to the child. However, the trustee should be wary of making distributions for goods or services which the parent has the obligation to provide. Conversely, it might be argued that the cost of providing the basic needs of a child with a disability are so much higher than for a non-disabled child that the trustee should be able to make distributions for support purposes.

Whether the trustee should distribute for the basic support needs of the child could depend on the purposes for which the settlement funds were intended to be used. Any portion of the settlement funds intended for medical care or support services during the child's minority would be appropriate for distribution by the trustee. But any portion of the settlement intended for lost wages or punitive damages should not be distributed for basic support needs unless necessary.

## **Guardianship and UTMA**

The same principal applies in the context of guardianship and UTMA accounts. A general guardian or a guardian of the estate cannot use the ward's money to support the ward if a person has a legal obligation to support the ward and is financially able to do so. **Kuykendall**, 270 N.C. at 515, 155 S.E.2d at 298. The guardian has a duty to collect all the obligations owed to the ward, including the obligation of support. Of course, some parents who are appointed guardian of the estate of a minor child may find this rule frustrating and may even find ways around it. In any event, a guardian,

whether the parent of the minor ward or not, is personally liable to the ward for diminution of the guardianship estate and/or for failure to obtain reimbursement from a person legally obligated to support the ward. *Id.* at 517, S.E.2d at 300; **Burke v. Turner**, 85 N.C. 500 (1881).

Under the UTMA, the same rule applies with respect to the custodian's duty to the minor. Parent/custodians should not use custodial property to pay for support items for the benefit of the minor unless they do not have the resources to support the minor. N.C.G.S. § 33A-14. If so, the minor has a right of reimbursement from the parent. **Kuykendall**, 270 N.C. at 517, 155 S.E.2d at 299; see Patricia Cramer Jenkins, *North Carolina Enacts the Uniform Transfers to Minors Act*, 66 N.C. L. Rev. 1349 (1988).

## Tax Issues

Perhaps the most common area where the estate planning attorney encounters the legal obligation of support doctrine is the area of taxation including income tax and estate tax. For income tax purposes, if a grantor creates a trust for the benefit of a minor child or a dependent spouse, any income of the trust distributed for the support of the minor child or dependent spouse is treated as taxable income to the parent. Treas. Reg. § 1.677(b)-1. Likewise, income from a UTMA account that is used for the support of the minor is treated as taxable income to the parent, regardless of whether the parent serves as custodian. Rev. Rul. 59-357, 1959-2 C.B. 212; 56-484, 1956-2 C.B. 23.

However, this should not happen for a couple reasons. First, as previously discussed, in the trust context, if the distribution standard of the trust is discretionary rather than a support standard, the trust terms or the tax savings statute should prevent the parent-trustee from using the income for the benefit of a minor beneficiary. N.C.G.S. § 36C-8-814(b)(3). Second, no income from a trust (unless the terms of the trust indicate otherwise) or a UTMA account should be used for the support of a minor unless the parent is unable to support the minor. This is because most states (including North Carolina) prohibit a minor's funds from being used for the support of the minor as long as a parent has a legal obligation and the means to support the minor. **Browne v. Browne**, 101 N.C. App. 617, 400 S.E.2d 736 (1991).

As for the estate tax issue, property transferred to a trust for the benefit of a grantor/trustee's dependent (or a UTMA account by the transferor/custodian for a minor) could be included in the transferor's gross estate under Section 2036 of the Internal Revenue Code of 1986 ("Code") if the income from the property is required to be used or is actually used to discharge a legal obligation of support of the dependent. Treas. Reg. § 20.2036-1(b)(2); see generally *BNA Portfolio 846-2nd: Gifts to Minors* § II.A.1.c(1) (2009). In fact, courts have found estate inclusion under Code Section 2036 in the trust and UTMA contexts even when the funds were simply *available* to be used (and not actually used) to discharge a legal support obligation.; **Estate of Prudowsky v. Comm'r**, 55 T.C. 890 (1971); **Estate of Pardee v. Comm'r**, 49 T.C. 140 (1967). This same reasoning could conceivably be applied to find estate inclusion with respect to the parent trustee/custodian who does not contribute the funds to the trust/UTMA account under Code Section 2041 as a general power of appointment. See Jeffrey N. Pennell and Corey E. Fleming, *Avoiding the Discharge of Obligation Theory*, Property & Probate, Sep./Oct. 1998, at 49.

For practical purposes, estate inclusion is normally avoided by statute or drafting. With respect to irrevocable trusts where the parent is the trustee, unintended estate tax inclusion is avoided by the tax-savings statute found at N.C.G.S. Section 36C-8-814. This statute prevents a trustee from making discretionary distributions to satisfy a legal support obligation that the trustee owes to another person. In addition, both irrevocable and revocable trusts commonly include an “Upjohn” clause stating that the trustee is prohibited from making distributions that would have the effect of discharging the trustee’s legal obligations. **Upjohn v. U.S.**, 30 A.F.T.R. 2d. 72-5918 (W.D. Mich 1972).

A well-reasoned contrary viewpoint to gross estate inclusion in the trust and UTMA context is based on the fact that most states (including North Carolina) prohibit a minor’s funds from being used for the support of the minor as long as a parent has a legal obligation to support the minor. Since it would be illegal for the trustee or custodian to use the funds in the trust (unless the terms indicate otherwise) or a UTMA account for the support of a minor (whether the trustee or custodian is the parent or not), then there should be no automatic inclusion in the parent’s gross estate. This contrary viewpoint has yet to be adopted by the courts. *See* Jeffrey N. Pennell and Corey E. Fleming, *Avoiding the Discharge of Obligation Theory*, Property & Probate, Sep./Oct. 1998, at 49; *see also BNA Portfolio 846-2nd: Gifts to Minors* § II.A.1.c.(2).

## **The Extent of the Legal Support Obligation Under North Carolina Law**

While previous sections covered some of the issues involved with the legal obligation of support doctrine, the following sections explore how this doctrine is defined under North Carolina law. The two main relationships in which the obligation occurs are marriage and parent/minor child. However, there are some issues regarding the obligation to support disabled children and parents.

### **Obligation to Support Spouse**

In North Carolina, the duty to support a spouse is derived from both statutory and common law. The statutory duty of spousal support arises most often with respect to alimony after divorce, but it can be enforced during the intact marriage. N.C.G.S. § 50-16.1A(1). The common law duty of spousal support is contained in the doctrine of necessities. Although statutory and common law spousal support obligations traditionally were imposed on the husband only, in recent times North Carolina and other states have adopted a gender-neutral approach to the duty of support. *See N.C. Baptist Hosp., Inc. v. Harris*, 319 N.C. 347, 354 S.E.2d 471 (1987).

The duty of support requires a person to provide “necessaries” for his or her spouse and minor children. **Williams v. Williams**, 261 N.C. 48, 57, 134 S.E.2d 227, 233 (1964). Necessaries generally includes such items as food, clothing, housing and medical care. *See* Suzanne Reynolds, *Lee’s North Carolina Family Law* § 15.7d (5<sup>th</sup> ed. 1999 and Supp. 2009). However, “necessaries are not limited to those things which are absolutely necessary to sustain life,” but include items which are suitable given the socioeconomic situation of the spouse or parent. **Williams**, 261 N.C. at 57, 134 S.E.2d at 233; *See Lee’s North Carolina Family Law* at § 15.7d. Stated somewhat differently, necessities “are those things which are essential to [a spouse’s] health and comfort, according to rank and fortune of [the other spouse].” **Berry v. Henderson**, 102 N.C. 525, 9 S.E. 455 (1889).

Therefore, things “that might be a luxury to one person may very well be a necessary to another.” **Williams**, 261 N.C. at 57, 134 S.E.2d at 233. In addition, what constitutes necessities can “change with the times” as standards of living improve. *Id.*; **Alamance County Hosp., Inc. v Neighbors**, 315 N.C. 362, 365, 338 S.E.2d 87, 89 (1986). Although most of the cases dealing with necessities are about medical services, necessities can include general merchandise (including cooking stoves). *See Lee’s North Carolina Family Law* at § 5.15; **Berry v. Henderson**, 102 N.C. 525 (1889) (holding that whether a cooking stove is a “necessary” is a question of fact for the jury). Funeral expenses were once considered a necessity for which a spouse was obligated, but that was changed by statute which put the responsibility for the funeral expenses on the decedent’s estate. N.C.G.S. § 28A-19-8; *Lee’s North Carolina Family Law* at § 5.15.

### **Parents’ Obligation to Support a Minor Child**

Parents have a duty to support their minor children. **State v. Robinson**, 245 N.C. 10, 95 S.E.2d 126 (1956); *see generally Lee’s North Carolina Family Law* at § 15.4. Since the age of majority is 18 in North Carolina, the parents’ duty of support ends when the child reaches age 18. N.C.G.S. § 48A-2. However, there is a statutory exception for children beyond the age of 18 who are still in primary or secondary school which provides that the duty of support ends when the child graduates, otherwise ceases to attend school on a regular basis, fails to make satisfactory academic progress, or reaches age 20, whichever occurs first. N.C.G.S. § 50-13.4(c)(2). In addition, the parental support obligation can end before the child reaches age 18 if the child is emancipated. N.C.G.S. § 7B-3507(2). The duty of support exists regardless of the parents’ marital status and continues even though a parent does not have legal custody of the child. *See Alamance County Hosp., Inc. v. Neighbors*, 315 N.C. 362, 338 S.E.2d 87 (1986). Under some circumstances, a person who assumes the role of a parent has a duty to support the child. This relationship is called *in loco parentis* and may include a step parent, foster parent, grandparent or other person. *See Lee’s North Carolina Family Law* at § 15.33.

Additionally, the support obligation exists even if the child has sufficient resources to support himself or herself, except in the unlikely event that the child is employed and supporting himself or herself. **Baucum v. Baucum**, 270 N.C. 452, 154 S.E.2d 517 (1967); **Browne v. Browne**, 101 N.C. App. 617, 400 S.E.2d 736 (1991). Therefore, if a minor child has assets held in a guardianship estate or in a UTMA account, the parents’ support obligation generally continues regardless of how much money is held in the guardianship estate or UTMA account.

### **Parents’ Obligation to Support Disabled Children Beyond Age 18**

In North Carolina, there is no parental duty to support a disabled child who reaches the age of majority, although such a duty does exist in some other states. **Jackson v. Jackson**, 102 N.C. App. 574, 402 S.E.2d 869 (1991). As discussed above, whether or not a child is disabled, the duty of support could continue until age 20 if the child is in primary or secondary school beyond the age of 18 and is making satisfactory academic progress. N.C.G.S. § 50-13.4(c)(2). What constitutes “satisfactory academic progress” is different for a disabled child than a non-disabled child. The North Carolina Court of Appeals held that a child with Down’s Syndrome was making satisfactory academic progress when it was shown that it was in his best interest for him to attend school and that

he was making satisfactory academic progress toward a non-traditional graduation. **Hendricks v. Sanks**, 143 N.C. App. 544, 545 S.E.2d 779 (2001).

### **Child's Legal Obligation to Support a Parent**

Many lawyers and others might find it surprising that, under current North Carolina law, an adult child has a legal obligation to support his or her indigent parents under some circumstances. N.C.G.S. § 14-326.1; *see generally Lee's North Carolina Family Law* at § 15.12. The statute makes it a Class 2 misdemeanor if an adult child "having sufficient income after reasonably providing for his or her own immediate family shall, without reasonable cause, neglect[s] to maintain and support his or her parent or parents, if such parent or parents be sick or not able to work and have not sufficient means or ability to maintain or support themselves. . . ." N.C.G.S. § 14-326.1.

Many states have such "filial responsibility statutes" which are derived from the common law. North Carolina's statute was added in 1955. "With the expansion of state and federal public assistance programs beginning in the late 1960s, the burden of supporting and caring for the indigent shifted in large part from families to society as a whole." *Lee's North Carolina Family Law* at § 15.12. Today such statutes are largely viewed as archaic and typically not enforced. *Id.* There are no reported North Carolina cases arising under N.C.G.S. Section 14-326.1.

In an era of increasing costs for long term care, increasing numbers of seniors needing long-term care, increasing costs for Medicare and Medicaid, and decreasing tax revenues to pay for it all, query whether the federal and state governments might consider dusting off these filial responsibility statutes as a basis for shifting some of the costs back to the children of seniors. Perhaps the income and assets of adult children (in addition to the senior's income and assets) could become a factor in determining eligibility for Medicaid payment of in-home care or care in an assisted living facility or nursing home.

The legal obligation of support doctrine is one of those issues that lurks in the background of most estate plans. Over the years many of the pitfalls have been taken care of by statute or document drafting. But the distribution and the tax issues related to the doctrine are still important to consider with respect to trusts, guardianships and UTMA accounts. Although the family law bar is on the forefront of what defines this legal obligation, the estate planning lawyer needs to be aware of the extent of this obligation and the tax effects.

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