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What Is HEMS And Why Is It Included In So Many Trusts?

By Gary Altman

In estate planning, you may come across the acronym HEMS occasionally. HEMS stands for "health, education, maintenance, or support" and is often included in trust agreements to guide a trustee on the distributions they may make to a trust beneficiary. When a trustee is limited to this distribution standard, often called an ascertainable standard, they must make sure whatever they distribute to the beneficiaries falls within one of the four categories. Failure to do so can have various negative results, including tax consequences and loss of asset protection.

Why Use the HEMS Standard in Trusts?

Tax Purposes

One important reason the HEMS standard is often used in trusts is that, from a tax perspective, if a trust beneficiary is also the trustee, the HEMS standard prevents the value of the accounts and property in the trust from being included in the beneficiary's gross estate for federal estate tax purposes. Likewise, if a trust transfers funds and property out of its taxable estate but also wants to act as a trustee to distribute to the other trust beneficiaries, the HEMS standard if included, prevents the trust's property from being included in the taxable estate. The HEMS standard is an Internal Revenue Service (IRS) safe harbor rule. It can prevent the property in the trust from being subject to estate taxes at the beneficiary's or the grantor's death.

Asset Protection

Another fundamental reason to use a HEMS distribution standard in trusts is that, when combined with a spendthrift provision, it can prevent a beneficiary's creditors from obtaining trust property by suing the beneficiary. By limiting the purposes, the trustee can distribute to the beneficiary; the trust creator has built important asset protection features into the trust.

For example, if a beneficiary were being sued and the opposing party demanded that the trustee or beneficiary use trust property to pay the lawsuit judgment, the beneficiary, and the trustee could both refuse because the trust does not allow distributions for that purpose. A trustee would struggle to include payments to a beneficiary's creditors in the standard of allowable distributions for the beneficiary's "health, education, maintenance, or support." And because the trustee has a fiduciary responsibility to the trust beneficiary and not to the beneficiary's creditors, the HEMS standard becomes an effective tool to prevent lawsuit plaintiffs and creditors from reaching the trust property.

Practical Application of HEMS

"What exactly fits within the standard?" is a common question among trustees about limiting trust distributions to the HEMS standard. Unfortunately, there is no clear, bright-line definition of what fits and does not. Such ambiguity, while frustrating, also allows enough flexibility that a trustee can do what is in the beneficiary's best interest. Following are examples of the expenses that the HEMS standards might include:

Health

- eye care, glasses, contact lenses, vision correction surgery
- allergen cleaning services
- cosmetic surgeries
- alternative medical treatments (e.g., acupuncture, massage therapy, etc.)
- substance abuse rehabilitation programs
- extended vacations or retreats to improve mental health
- health-related home improvements or renovations
- home healthcare or long-term care expenses
- gym, spa, and golf club memberships
- exercise equipment
- healthcare supplements
- psychiatric treatments
- handicap-related transport and mobility services and items
- regular healthcare checkups and exams

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- emergency and regular medical treatment
- healthcare, dental, and vision insurance premiums
- mental health counseling

Education

- tuition for all levels of public or private schools
- graduate or professional degrees, including medical school, law school, etc.
- study-abroad programs and related travel expenses
- a beneficiary's support between semesters or during unpaid internships
- school-related expenses, including room, board, books, computer, etc.
- private tutoring
- extracurricular-activity-related expenses
- graduation costs, proms, class rings, announcements, robes, etc.
- career training
- daycare for dependents to allow a parent time to go to classes and study
- uniforms and school clothes

Maintenance and Support

- rent or mortgage payments
- down payment on a home
- living expenses and support for a beneficiary engaged in charitable work or low-income vocations that provide social and community benefits
- insurance premiums, including life, auto, disability, or homeowner's policies
- vehicles and related repairs and maintenance
- charitable contributions
- continuation of family gifting for birthdays, weddings, holidays, baby showers, etc.
- property taxes
- legal fees
- supporting family members
- continuation of typical and periodic vacations
- home repair and maintenance
- seed money to start a business

Again, the examples above are only some expenses commonly justified under the HEMS standard. A trustee must exercise some prudence when making distributions to show potential lawsuit plaintiffs, judges, and the IRS that the HEMS standard prevents the beneficiary from having complete control over the trust property.

For example, if the trustee distributes enough money for the beneficiary to buy and drive a Ferrari when the beneficiary usually drives a Toyota or to take a six-month vacation to Greece each year instead of the typical one week at Disney World that the beneficiary and their family are accustomed to, the trustee may put the trust's tax and asset protection properties at risk by disregarding its terms.

The HEMS standard is widely used in drafting trusts for good reason. Appropriately used, not only can it be a powerful and effective tool to reduce the risk of unnecessary taxation at each generation as wealth passes through the family, but it can also protect trust property from people who should not have access to it, such as creditors, divorcing spouses, and predators.

If you have questions about what qualifies as a proper distribution under the HEMS standard or wish to discuss it more, contact the attorneys at Altman & Associates with the experience and knowledge to guide you through these consequential decisions at 301 468 3220.

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