

**Appendix A to  
Rights of a Trust Beneficiary's Creditors Under the Uniform Trust Code**

Kevin D. Millard

Prepared for the ABA Section of Real Property, Trust & Estate Law Spring Symposium 2008

**Provisions of the Uniform Trust Code Dealing with the Rights of  
Beneficiaries' Creditors**

**SECTION 105. DEFAULT AND MANDATORY RULES.**

(a) Except as otherwise provided in the terms of the trust, this [Code] governs the duties and powers of a trustee, relations among trustees, and the rights and interests of a beneficiary.

(b) The terms of a trust prevail over any provision of this [Code] except:

...

(2) the duty of a trustee to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries;

...

(5) the effect of a spendthrift provision and the rights of certain creditors and assignees to reach a trust as provided in [Article] 5 . . . .

**Comment**

Subsection (a) emphasizes that the Uniform Trust Code is primarily a default statute. While this Code provides numerous procedural rules on which a settlor may wish to rely, the settlor is generally free to override these rules and to prescribe the conditions under which the trust is to be administered. With only limited exceptions, the duties and powers of a trustee, relations among trustees, and the rights and interests of a beneficiary are as specified in the terms of the trust.

Subsection (b) lists the items not subject to override in the terms of the trust. Because subsection (b) refers specifically to other sections of the Code, enacting jurisdictions modifying these other sections may also need to modify subsection (b).

...

. . . Subsection (b)(5) clarifies that a settlor may not restrict the rights of a beneficiary's creditors except to the extent a spendthrift restriction is allowed as provided in Article 5.

...

**SECTION 106. COMMON LAW OF TRUSTS; PRINCIPLES OF EQUITY.** The common law of trusts and principles of equity supplement this [Code], except to the extent modified by this [Code] or another statute of this State.

#### **Comment**

The Uniform Trust Code codifies those portions of the law of express trusts that are most amenable to codification. The Code is supplemented by the common law of trusts, including principles of equity. To determine the common law and principles of equity in a particular state, a court should look first to prior case law in the state and then to more general sources, such as the Restatement of Trusts, Restatement (Third) of Property: Wills and Other Donative Transfers, and the Restatement of Restitution. The common law of trusts is not static but includes the contemporary and evolving rules of decision developed by the courts in exercise of their power to adapt the law to new situations and changing conditions. It also includes the traditional and broad equitable jurisdiction of the court, which the Code in no way restricts.

The statutory text of the Uniform Trust Code is also supplemented by these Comments, which, like the Comments to any Uniform Act, may be relied on as a guide for interpretation. *See Acierno v. Worthy Bros. Pipeline Corp.*, 656 A.2d 1085, 1090 (Del. 1995) (interpreting Uniform Commercial Code); *Yale University v. Blumenthal*, 621 A.2d 1304, 1307 (Conn. 1993) (interpreting Uniform Management of Institutional Funds Act); 2 Norman Singer, *Statutory Construction* Section 52.05 (6th ed. 2000); Jack Davies, *Legislative Law and Process in a Nutshell* Section 55-4 (2d ed. 1986).

Comment Amended in 2005.

---

## **ARTICLE 5 CREDITOR'S CLAIMS; SPENDTHRIFT AND DISCRETIONARY TRUSTS**

### **General Comment**

This article addresses the validity of a spendthrift provision and the rights of creditors, both of the settlor and beneficiaries, to reach a trust to collect a debt. Sections 501 and 502 state the general rules. Section 501 applies if the trust does not contain a spendthrift provision or the spendthrift provision, if any, does not apply to the beneficiary's interest. Section 502 states the effect of a spendthrift provision. Unless a claim is being made by an exception creditor, a spendthrift provision bars a beneficiary's creditor from reaching the beneficiary's interest until distribution is made by the trustee. An exception creditor, however, can reach the beneficiary's interest subject to the court's power to limit the relief. Section 503 lists the categories of exception creditors whose claims are not subject to a spendthrift restriction. Sections 504 through 507 address special categories in which the rights of a beneficiary's creditors are the same whether or not the trust contains a spendthrift provision. Section 504 deals with discretionary

trusts and trusts for which distributions are subject to a standard. Section 505 covers creditor claims against a settlor, whether the trust is revocable or irrevocable, and if revocable, whether the claim is made during the settlor's lifetime or incident to the settlor's death. Section 506 provides a creditor with a remedy if a trustee fails to make a mandated distribution within a reasonable time. Section 507 clarifies that although the trustee holds legal title to trust property, that property is not subject to the trustee's personal debts.

The provisions of this article relating to the validity and effect of a spendthrift provision and the rights of certain creditors and assignees to reach the trust may not be modified by the terms of the trust. *See* Section 105(b)(5).

This article does not supersede state exemption statutes nor an enacting jurisdiction's Uniform Fraudulent Transfers Act which, when applicable, invalidates any type of gratuitous transfer, including transfers into trust.

Comment Amended in 2004

**SECTION 501. RIGHTS OF BENEFICIARY'S CREDITOR OR ASSIGNEE.** To the extent a beneficiary's interest is not subject to 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.

#### **Comment**

This section applies only if the trust does not contain a spendthrift provision or the spendthrift provision does not apply to a particular beneficiary's interest. A settlor may subject to spendthrift protection the interests of certain beneficiaries but not others. A settlor may also subject only a portion of the trust to spendthrift protection such as an interest in the income but not principal. For the effect of a spendthrift provision on creditor claims, see Section 503.

Absent a valid spendthrift provision, a creditor may ordinarily reach the interest of a beneficiary the same as any other of the beneficiary's assets. This does not necessarily mean that the creditor can collect all distributions made to the beneficiary. The interest may be too indefinite or contingent for the creditor to reach or the interest may qualify for an exemption under the state's general creditor exemption statutes. *See* (Third) of Trusts §56 (2003); Restatement (Second) of Trusts §§147-149, 162 (1959). Other creditor law of the State may limit the creditor to a specified percentage of a distribution. *See, e.g.,* Cal. Prob. Code Section 15306.5. This section does not prescribe the procedures ("other means") for reaching a beneficiary's interest or of priority 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 the 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 circumstances of a beneficiary and the beneficiary's family. *See* Restatement (Third) of Trusts Section 56 cmt. e (Tentative Draft No. 2, approved 1999).

**2005 Amendment.** A 2005 amendment changes "protected by" to "subject to" in the first sentence of the section. No substantive change is intended. The amendment was made to negate an implication that this section allowed an exception creditor to reach a beneficiary's interest even though the trust contained a spendthrift provision. The list of exception creditors and their remedies are contained in Section 503. Clarifying changes are also made in the comments and unnecessary language on creditor remedies omitted.

#### **SECTION 502. SPENDTHRIFT PROVISION.**

(a) A spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest.

(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.

#### **Comment**

Under this section, a settlor has the power to restrain the transfer of a beneficiary's interest, regardless of whether the beneficiary has an interest in income, in principal, or in both. Unless one of the exceptions under this article applies, a creditor of the beneficiary is prohibited from attaching a protected interest and may only attempt to collect directly from the beneficiary after payment is made. This section is similar to Restatement (Third) of Trusts § 58 (Tentative Draft No. 2, approved 1999), and Restatement (Second) of Trusts §§ 152-153 (1959). For the definition of spendthrift provision, see Section 103(15).

For a spendthrift provision to be effective under this Code, it must prohibit both the voluntary and involuntary transfer of the beneficiary's interest, that is, a settlor may not allow a beneficiary to assign while prohibiting a beneficiary's creditor from collecting, and vice versa. *See* Restatement (Third) of Trusts § 58 cmt. b (Tentative Draft No. 2, approved 1999). *See also* Restatement (Second) of Trusts § 152(2) (1959). A spendthrift provision valid under this Code will also be recognized as valid in a federal bankruptcy proceeding. *See* 11 U.S.C. § 541(c)(2).

Subsection (b), which is derived from Texas Property Code § 112.035(b), allows a settlor to provide maximum spendthrift protection simply by stating in the instrument that all interests are held subject to a “spendthrift trust” or words of similar effect.

A disclaimer, because it is a refusal to accept ownership of an interest and not a transfer of an interest already owned, is not affected by the presence or absence of a spendthrift provision. Most disclaimer statutes expressly provide that the validity of a disclaimer is not affected by a spendthrift protection. *See, e.g.*, Uniform Probate Code § 2-801(a). Releases and exercises of powers of appointment are also not affected because they are not transfers of property. *See* Restatement (Third) of Trusts § 58 cmt. c (Tentative Draft No. 2, approved 1999).

A spendthrift provision is ineffective against a beneficial interest retained by the settlor. *See* Restatement (Third) of Trusts §58(2), approved 1999. This is a necessary corollary to Section 505(a)(2), which allows a creditor or assignee of the settlor to reach the maximum amount that can be distributed to or for the settlor’s benefit. This right to reach the trust applies whether or not the trust contains a spendthrift provision.

A valid spendthrift provision makes it impossible for a beneficiary to make a legally binding transfer, but the trustee may choose to honor the beneficiary’s purported assignment. The trustee may recommence distributions to the beneficiary at anytime. The beneficiary, not having made a binding transfer, can withdraw the beneficiary’s direction but only as to future payments. *See* Restatement (Third) of Trusts § 58 cmt. d (Tentative Draft No. 2, approved 1999); Restatement (Second) of Trusts § 152 cmt. i (1959).

### **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) A spendthrift provision is unenforceable against:

(1) a beneficiary’s child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance;

(2) a judgment creditor who has provided services for the protection of a beneficiary’s interest in the trust; and

(3) a claim of this State or the United States to the extent a statute of this State or federal law so provides.

(c) A claimant against which a spendthrift provision cannot be enforced may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary. The court may limit the award to such relief as is appropriate under the circumstances.

#### **Comment**

This section exempts the claims of certain categories of creditors from the effects of a spendthrift restriction and specifies the remedies such exemption creditors may take to satisfy their claims.

The exception in subsection (b)(1) for judgments or orders to support a beneficiary's child or current or former spouse is in accord with Restatement (Third) of Trusts Section 59(a) (Tentative Draft No. 2, approved 1999), Restatement (Second) of Trusts Section 157(a) (1959), and numerous state statutes. It is also consistent with federal bankruptcy law, which exempts such support orders from discharge. The effect of this exception is to permit the claimant for unpaid support to attach present or future distributions that would otherwise be made to the beneficiary. Distributions subject to attachment include distributions required by the express terms of the trust, such as mandatory payments of income, and distributions the trustee has otherwise decided to make, such as through the exercise of discretion. Subsection (b)(1), unlike Section 504, does not authorize the spousal or child claimant to compel a distribution from the trust. Section 504 authorizes a spouse or child claimant to compel a distribution to the extent the trustee has abused a discretion or failed to comply with a standard for distribution.

Subsection (b)(1) refers both to "support" and "maintenance" in order to accommodate differences among the States in terminology employed. No difference in meaning between the two terms is intended.

The definition of "child" in subsection (a) accommodates the differing approaches States take to defining the class of individuals eligible for child support, including such issues as whether support can be awarded to stepchildren. However the State making the award chooses to define "child" will be recognized under this Code, whether the order sought to be enforced was entered in the same or different State. For the definition of "state," which includes Puerto Rico and other American possessions, see Section 103(17).

The definition of "child" in subsection (a) is not exclusive. The definition clarifies that a "child" includes an individual awarded child support in any state. The definition does not expressly include but neither does it exclude persons awarded child support in some other country or political subdivision, such as a Canadian province.

The exception in subsection (b)(2) for a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust is in accord with Restatement (Third) of Trusts Section 59(b) (Tentative Draft No. 2, approved 1999), and Restatement (Second) of Trusts Section 157(c) (1959). This exception allows a beneficiary of modest means to overcome an obstacle preventing the beneficiary's obtaining services essential to the protection or enforcement of the beneficiary's rights under the trust. *See* Restatement (Third) of Trusts Section 59 cmt. d (Tentative Draft No. 2, approved 1999).

Subsection (b)(3), which is similar to Restatement (Third) of Trusts Section 59 cmt. a (Tentative Draft No. 2, approved 1999), exempts certain governmental claims from a spendthrift restriction. Federal preemption guarantees that certain federal claims, such as claims by the Internal Revenue Service, may bypass a spendthrift provision no matter what this Code might say. The case law and relevant Internal Revenue Code provisions on the exception for federal tax claims are collected in George G. Bogert & George T. Bogert, *The Law of Trusts and Trustees*

Section 224 (Rev. 2d ed. 1992); and 2A Austin W. Scott & William F. Fratcher, *The Law of Trusts* Section 157.4 (4th ed. 1987). Regarding claims by state governments, this subsection recognizes that States take a variety of approaches with respect to collection, depending on whether the claim is for unpaid taxes, for care provided at an institution, or for other charges. Acknowledging this diversity, subsection (c) does not prescribe a rule, but refers to other statutes of the State on whether particular claims are subject to or exempted from spendthrift provisions.

Unlike Restatement (Third) of Trusts Section 59(2) (Tentative Draft No. 2, approved 1999), and Restatement (Second) of Trusts Section 157(b) (1959), this Code does not create an exception to the spendthrift restriction for creditors who have furnished necessary services or supplies to the beneficiary. Most of these cases involve claims by governmental entities, which the drafters concluded are better handled by the enactment of special legislation as authorized by subsection (b)(3). The drafters also declined to create an exception for tort claimants. For a discussion of the exception for tort claims, which has not generally been recognized, see Restatement (Third) of Trusts Section 59 Reporter's Notes to cmt. a (Tentative Draft No. 2, approved 1999). For a discussion of other exceptions to a spendthrift restriction, recognized in some States, see George G. Bogert & George T. Bogert, *The Law of Trusts and Trustees* Section 224 (Rev. 2d ed. 1992); and 2A Austin W. Scott & William F. Fratcher, *The Law of Trusts* Sections 157-157.5 (4th ed. 1987).

Subsection (c) provides that the only remedy available to an exception creditor is attachment of present or future distributions of present or future distributions. Depending on other creditor law of the state, additional remedies may be available should a beneficiary's interest not be subject to a spendthrift provision. Section 501, which applies in such situations, provides that the creditor may reach the beneficiary's interest under that section by attachment or "other means." Subsection (c), similar to Section 501, clarifies that the court has the authority to limit the creditor's relief as appropriate under the circumstances.

**2005 Amendment.** The amendment rewrote this section. The section previously provided:

### **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 a 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 or the United States to the extent a statute of this State or federal law so provides.

## **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 of 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 amount 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.

(e) If the trustee’s or cotrustee’s discretion to make distributions for the trustee’s or cotrustee’s own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor’s claim were the beneficiary not acting as trustee or cotrustee.

### **Comment**

This section addresses the ability of a beneficiary’s creditor to reach the beneficiary’s discretionary trust interest, whether or not the exercise of the trustee’s discretion is subject to a standard. This section, similar to the Restatement, eliminates the distinction between discretionary and support trusts, unifying the rules for all trusts fitting within either of the former categories. *See* Restatement (Third) of Trusts Section 60 Reporter’s Notes to cmt. a (Tentative Draft No. 2, approved 1999). By eliminating this distinction, the rights of a creditor are the same whether the distribution standard is discretionary, subject to a standard, or both. Other than for a claim by a child, spouse or former spouse, a beneficiary’s creditor may not reach the beneficiary’s interest. Eliminating this distinction affects only the rights of creditors. The affect of this change is limited to the rights of creditors. It does not affect the rights of a beneficiary to compel a distribution. Whether the trustee has a duty in a given situation to make a distribution depends on factors such as the breadth of the discretion granted and whether the terms of the trust include a support or other standard. *See* Section 814 comment.

For a discussion of the definition of “child” in subsection (a), see Section 503 Comment.

Subsection (b), which establishes the general rule, forbids a creditor from compelling a distribution from the trust, even if the trustee has failed to comply with the standard of

distribution or has abused a discretion. Under subsection (d), the power to force a distribution due to an abuse of discretion or failure to comply with a standard belongs solely to the beneficiary. Under Section 814(a), a trustee must always exercise a discretionary power in good faith and with regard to the purposes of the trust and the interests of the beneficiaries.

Subsection (c) creates an exception for support claims of a child, spouse, or former spouse who has a judgment or order against a beneficiary for support or maintenance. While a creditor of a beneficiary generally may not assert that a trustee has abused a discretion or failed to comply with a standard of distribution, such a claim may be asserted by the beneficiary's child, spouse, or former spouse enforcing a judgment or court order against the beneficiary for unpaid support or maintenance. The court must direct the trustee to pay the child, spouse or former spouse such amount as is equitable under the circumstances but not in excess of the amount the trustee was otherwise required to distribute to or for the benefit of the beneficiary. Before fixing this amount, the court having jurisdiction over the trust should consider that in setting the respective support award, the family court has already considered the respective needs and assets of the family. The Uniform Trust Code does not prescribe a particular procedural method for enforcing a judgment or order against the trust, leaving that matter to local collection law.

Subsection (e), which was added by a 2004 amendment, is discussed below.

## **2004 Amendment**

### **Section 504(e), 103(11)**

Trusts are frequently drafted in which a trustee is also a beneficiary. A common example is what is often referred to as a bypass trust, under which the settlor's spouse will frequently be named as both trustee and beneficiary. An amount equal to the exemption from federal estate tax will be placed in the bypass trust, and the trustee, who will often be the settlor's spouse, will be given discretion to make distributions to the beneficiaries, a class which will usually include the spouse/trustee. To prevent the inclusion of the trust in the spouse-trustee's gross estate, the spouse's discretion to make distributions for the spouse's own benefit will be limited by an ascertainable standard relating to health, education, maintenance, or support.

The UTC, as previously drafted, did not specifically address the issue of whether a creditor of a beneficiary may reach the beneficial interest of a beneficiary who is also a trustee. However, Restatement (Third) of Trusts §60, comment g, which was approved by the American law Institute in 1999, provides that the beneficial interest of a beneficiary/trustee may be reached by the beneficiary/trustee's creditors. Because the UTC is supplemented by the common law (see UTC Section 106), this Restatement rule might also apply in states enacting the UTC. The drafting committee has concluded that adoption of the Restatement rule would unduly disrupt standard estate planning and should be limited. Consequently, Section 504 is amended to provide that the provisions of this section, which generally prohibit a creditor of a beneficiary from reaching a beneficiary's discretionary interest, apply even if the beneficiary is also a trustee or

cotrustee. The beneficiary-trustee is protected from creditor claims to the extent the beneficiary-trustee's discretion is protected by an ascertainable standard as defined in the relevant Internal Revenue Code sections. The result is that the beneficiary's trustee's interest is protected to the extent it is also exempt from federal estate tax. The amendment thereby achieves its main purpose, which is to protect the trustee-beneficiary of a bypass trust from creditor claims.

The protection conferred by this subsection, however, is no greater than if the beneficiary had not been named trustee. If an exception creditor can reach the beneficiary's interest under some other provision, the interest is not insulated from creditor claims by the fact the beneficiary is or becomes a trustee.

In addition, the definition of "power of withdrawal" in Section 103 is amended to clarify that a power of withdrawal does not include a power exercisable by the trustee that is limited by an ascertainable standard. The purpose of this amendment is to preclude a claim that the power of a trustee-beneficiary to make discretionary distributions for the trustee-beneficiary's own benefit results in an enforceable claim of the trustee-beneficiary's creditors to reach the trustee-beneficiary's interest as provided in Section 505(b). Similar to the amendment to Section 504, the amendment to "power of withdrawal" is being made because of concerns that Restatement (Third) of Trusts Section 60, comment g, otherwise might allow a beneficiary-trustee's creditors to reach the trustee's beneficial interest.

The Code does not specifically address the extent to which a creditor of a trustee/beneficiary may reach a beneficial interest of a beneficiary/trustee that is not limited by an ascertainable standard.

For the definition of "ascertainable standard," see Section 103(2).

#### **SECTION 505. CREDITOR'S CLAIM AGAINST SETTLOR.**

(a) 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.

(2) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount 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.

(3) 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, and [statutory allowances] 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; and

(2) upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust only to the extent 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 Internal Revenue Code of 1986, or Section 2503(b) of the Internal Revenue Code of 1986, in each case as in effect on [the effective date of this [Code]] [, or as later amended].

### Comment

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 (Tentative Draft No. 1, approved 1996). Such claims were not allowed at common law, however. *See* Restatement (Second) of Trusts Section 330 cmt. 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(15).

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 first to 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 pourover 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). 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), 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) [\$10,000 in 2001].

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).

## SECTION 506. OVERDUE DISTRIBUTION.

(a) In this section, “mandatory distribution” means a distribution of income or principal which the trustee is required to make to a beneficiary under the terms of the trust, including a distribution upon termination of the trust. The term does not include a distribution subject to the exercise of the trustee’s discretion even if (1) the discretion is expressed in the form of a standard of distribution, or (2) the terms of the trust authorizing a distribution couple language of discretion with language of direction.

(b) 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 designated distribution date.

### Comment

The effect of a spendthrift provision is generally to insulate totally a beneficiary’s interest until a distribution is made and received by the beneficiary. *See* Section 502. But this section, along with several other sections in this article, recognizes exceptions to this general rule. Whether a trust contains a spendthrift provision or not, a trustee should not be able to avoid creditor claims against a beneficiary by refusing to make a distribution required to be made by the express terms of the trust. On the other hand, a spendthrift provision would become largely a nullity were a beneficiary’s creditors able to attach all required payments as soon as they became due. This section reflects a compromise between these two competing principles. A creditor can reach a mandatory distribution, including a distribution upon termination, if the trustee has failed to make the payment within a reasonable time after the designated distribution date. Following this reasonable period, payments mandated by the express terms of the trust are in effect being held by the trustee as agent for the beneficiary and should be treated as part of the beneficiary’s personal assets.

This section is similar to Restatement (Third) of Trusts Section 58 cmt. d (Tentative Draft No. 2, approved 1999).

**2001 Amendment.** By amendment in 2001, “designated distribution date” was substituted for “required distribution date” in subsection (b). The amendment conforms the language of this section to terminology used elsewhere in the Code.

**2005 Amendment.** The amendment adds a clarifying definition of “mandatory distribution” in subsection (a), which is based on an Ohio proposal. The amendment:

- tracks the traditional understanding that a mandatory distribution includes a provision requiring that a beneficiary be paid the income of a trust or receive principal upon termination;
- correlates the definition of “mandatory distribution” in this section to the broad definition of discretionary trust used in Section 504. Under both Sections 504 and

- 506, a trust is discretionary even if the discretion is expressed in the form of a standard, such as a provision directing a trustee to pay for a beneficiary's support;
- addresses the situation where the terms of the trust couple language of discretion with language of direction. An example of such a provision is "my trustees shall, in their absolute discretion, distribute such amounts as are necessary for the beneficiary's support." Despite the presence of the imperative "shall," the provision is discretionary, not mandatory. For a more elaborate example of such a discretionary "shall" provision, see *Marsman. Nasca*, 573 N.E. 2d 1025 (Mass. Ct. App. 1991).
  - is clarifying. No change of substance is intended by this amendment. This amendment merely clarifies that a mandatory distribution is to be understood in its traditional sense such as a provision requiring that the beneficiary receive an income or receive principal upon termination of the trust.

---

#### **SECTION 814. DISCRETIONARY POWERS; TAX SAVINGS.**

(a) 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.

...

#### **Comment**

Despite the breadth of discretion purportedly granted by the wording 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), a trustee's exercise of discretion must be in good faith. Consistent with the trustee's duty to administer the trust (*see* Section 801), the trustee's exercise must also be in accordance with the terms and purposes of the trust and the interests of the beneficiaries. "Interests of the beneficiaries" means the beneficial interests provided in the terms of the trust. *See* Section 103(8). Subsection (a) does not otherwise address the obligations of a trustee to make distributions, leaving that issue to the caselaw. Regarding the standards for exercising discretion and construing particular language of discretion, with numerous case citations, 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). Under these standards, whether the trustee has a duty in a given situation to make a distribution depends on the exact language used, whether the standard grants discretion and its breadth, whether this discretion is coupled with a standard, whether the beneficiary has other available resources, and, more broadly, the overriding purposes of the trust. For example, distilling the results of scores of cases, the Restatement (Third) of Trusts concludes that there is a presumption that the "trustee's discretion should be exercised in a manner that will avoid either

disqualifying the beneficiary for other benefits or expending trust funds for purposes for which public funds would otherwise be available.” Restatement (Third) of Trusts Section 50 cmt. e & Reporter’s Notes (Tentative Draft No. 2, 1999).

Subsection (a) requires a trustee exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries. Similar to Restatement (Second) of Trusts Section 187 (1959), subsection (a) does not impose an obligation that a trustee’s decision be within the bounds of a reasonable judgment, although such an interpretive standard may be imposed by the courts if the document adds a standard whereby the reasonableness of the trustee’s judgment can be tested. Restatement (Second) of Trusts Section 187 cmt. f (1959).

The obligation of a trustee to act in good faith is a fundamental concept of fiduciary law although there are different ways that it can be expressed. Sometimes different formulations appear in the same source. Scott, in his treatise on trusts, states that the court *will not* interfere with the trustee’s exercise of discretion if the trustee “acts in good faith and does not act capriciously,” but Scott then states that the trustee *will* interfere if the trustee “acts dishonestly or in bad faith, or where he acts from an improper motive.” 3 Austin W. Scott & William F. Fratcher, *The Law of Trusts* Section 187.2 (4th ed. 1988).

Sometimes different formulations are used in the same case:

[If] the “sole discretion” vested in and exercised by the trustees in this case . . . were exercised fraudulently, in bad faith or in an abuse of discretion, it is subject to . . . review. Whether good faith has been exercised, or whether fraud, bad faith or an abuse of discretion has been committed is always subject to consideration by the court upon appropriate allegations and proof.

*In re Ferrall’s Estate*, 258 P.2d 1009 (Cal. 1953).

An abuse by the trustee of the discretion granted in the terms of the trust is a breach of trust that can result in surcharge. *See* Section 1001(b) (remedies for breach of trust). The standard stated in subsection (a) applies only to powers which are to be exercised in a fiduciary as opposed to a nonfiduciary capacity.

...