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**STATE THIRD-PARTY DISCRETIONARY
AND SPENDTHRIFT TRUST STATUTES**

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STATE THIRD-PARTY DISCRETIONARY AND SPENDTHRIFT TRUST STATUTES

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I. INTRODUCTION

A client may protect interests in a trust that he or she creates for others (“third-party trust”) from claims by the beneficiaries’ creditors by making such interests discretionary or by subjecting them to spendthrift clauses. The degree of protectiveness of discretionary trusts and spendthrift trusts differs from state to state,¹ and the underlying concepts have been threatened by the Third Restatement of Trusts.

II. DISCRETIONARY TRUSTS

A. Second Restatement Approach

The Second Restatement of Trust’s protection of a beneficiary’s interest in a discretionary trust from creditor claims rests on two foundations—one is based on the nature of the beneficiary’s interest; the other is based on limiting a court’s ability to interfere with a trustee’s exercise of discretion.

First, § 155(1) of the Second Restatement of Trusts provides that:²

[I]f by the terms of a trust it is provided that the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his uncontrolled discretion shall see fit to pay or apply, a transferee or creditor of the beneficiary cannot compel the trustee to pay any part of the income or principal.

A trust described in § 155 is a “discretionary trust” not a “spendthrift trust” or a “support trust.”³ The beneficiary’s protection results from the nature of the

¹ I would like to thank Mark Merric, Esquire, Merric Law Firm, LLC, Denver, Colorado, for his substantial contribution to my understanding of this subject.

² Restatement (Second) of Trusts § 155(1) (1959).

³ Id. cmt. b.

interest and is available whether or not the trust contains a spendthrift clause.⁴ A creditor may not reach the beneficiary's interest because the beneficiary cannot force the trustee to make a distribution.⁵

Second, § 187 of the Second Restatement provides that:⁶

Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion.

Comment d to § 187 enumerates factors for a court to consider when deciding whether a trustee has abused its discretion,⁷ and subsequent comments provide that a court will interfere with a trustee's exercise or nonexercise of discretion only if the trustee acts dishonestly or with an improper motive, fails to exercise judgment, or acts beyond the bounds of a reasonable judgment, even though the court would have acted differently.⁸ If the trustee's action is subject to a standard by which its conduct may be judged, the court may interfere if the trustee acts unreasonably.⁹ If the trust contains no such standard, though, the court will interfere only if the trustee acts dishonestly or with an improper motive.¹⁰ Inclusion in the trust of language that gives the trustee absolute, unlimited, or uncontrolled discretion relieves it from the duty to act reasonably even if the trust contains a standard by which the trustee's conduct may be judged.¹¹

B. Third Restatement Approach

Sections 50 and 60 of the Third Restatement of Trusts undermine both foundations.¹² This erosion poses a serious threat to the security of trusts in jurisdictions with no discretionary trust statute.

With respect to the first foundation, comment e to § 60 begins innocuously enough as follows:¹³

A transferee or creditor of a trust beneficiary cannot compel the trustee to make discretionary distributions if the beneficiary personally could not do so.

⁴ Id.

⁵ Id.

⁶ Restatement (Second) of Trusts § 187 (1992).

⁷ Id. cmt. d.

⁸ Id. cmts. e–h.

⁹ Id. cmt. i.

¹⁰ Id.

¹¹ Id. cmt. j.

¹² Restatement (Third) of Trusts §§ 50, 60 (2003).

¹³ Id. § 60 cmt. e.

But, in the very next sentence, it continues that:¹⁴

It is rare, however, that the beneficiary's circumstances, the terms of the discretionary power, and the purposes of the trust leave the beneficiary so powerless.

With respect to the second foundation, the Third Restatement makes it much easier for a court to interfere with a trustee's exercise or nonexercise of discretion. Thus, comment b to § 50 provides that:¹⁵

It is not necessary . . . that the terms of the trust provide specific standards in order for a trustee's good-faith decision to be found unreasonable and thus to constitute an abuse of discretion.

Comment d continues as follows:¹⁶

Reasonably definite or objective standards serve to assure a beneficiary some minimum level of benefits, even when other standards are included to grant broad latitude with respect to additional benefits. . . . Sometimes trust terms express no standards or other clear guidance concerning the purposes of a discretionary power, or about the relative priority intended among the various beneficiaries. Even then a general standard of reasonableness, or at least of good-faith judgment, will apply to the trustee . . . based on the extent of the trustee's discretion, the various beneficial interests created, the beneficiaries' circumstances and relationships to the settlor, and the general purposes of the trust.

The 2007 edition of the Scott treatise explains the difference between the approaches of the Second and Third Restatement as follows:¹⁷

Under the Second Restatement, the relevant inquiry seems to have been whether 'reasonable men might differ' on the propriety of the exercise of the power.

¹⁴ Id.

¹⁵ Id. § 50 cmt. b.

¹⁶ Id. cmt. d.

¹⁷ Austin W. Scott, William F. Fratcher & Mark L. Ascher, Scott and Ascher on Trusts § 18.2.6 at 1361 n.2 (5th ed. 2007) (citations omitted).

The inference is that the trustee's decision should stand, in the absence of a judicial finding that no reasonable person could conclude that the trustee had acted reasonably. Under the Third Restatement, the relevant inquiry seems to be whether 'the trustee's decision is one that would not be accepted as reasonable by persons of prudence.'

C. UTC Approach

With respect to the first foundation, § 504 of the Uniform Trust Code ("UTC") provides as follows:¹⁸

- (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.

¹⁸ UTC § 504 (2005).

- (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.

With respect to the second foundation, § 814(a) provides as follows:¹⁹

- (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.

Many states modified the above provisions when they enacted their versions of the UTC.

D. State Statutes

The undermining of the creditor protection that traditionally was afforded by discretionary trusts is of particular concern in a state that has no discretionary trust statute because a court is free to embrace the Third Restatement's approach. In recognition of this concern, states such as Delaware and South Dakota have enacted statutes that confirm the Second Restatement's view. Eighteen states have adopted variations of one or both of the UTC provisions. Six states developed their own approaches. The appendix contains citations for state discretionary trust statutes.

III. SPENDTHRIFT TRUSTS

A. Second Restatement Approach

¹⁹ Id. § 814(a).

The Second Restatement of Trusts defines a “spendthrift trust” as follows.²⁰

A trust in which by the terms of the trust or by statute a valid restraint on the voluntary and involuntary transfer of the interest of the beneficiary is imposed is a spendthrift trust.

If a third-party trust enjoys spendthrift protection, a beneficiary’s right to current income or future principal distributions is not subject to voluntary or involuntary transfer in most circumstances.²¹ Even if such a trust contains a spendthrift clause, though, creditors may reach the beneficiary’s interest to pay claims for spousal or child support, alimony, necessary services or supplies, costs incurred to protect the beneficiary’s trust interest, or governmental obligations.²² The beneficiary’s interest also may be reached to pay claims dictated by public policy (e.g., a claim resulting from the beneficiary’s commission of a willful tort).²³

B. Third Restatement Approach

The Third Restatement of Trusts defines “spendthrift trust” in substantially the same manner as does the Second Restatement.²⁴ Creditors may reach a beneficiary’s interest in such a trust for the support of a child, spouse, or former spouse; for necessary services and supplies provided to the beneficiary; and for costs incurred to protect the beneficiary’s trust interest.²⁵ The beneficiary’s interest also may be reached to pay governmental claims.²⁶ Ominously from the beneficiary’s perspective, the interest might be reachable in the following circumstances:²⁷

The exceptions to spendthrift immunity stated in this Section are not exclusive. Special circumstances or evolving policy may justify recognition of other exceptions, allowing the beneficiary's interest to be reached by certain creditors in appropriate proceedings

C. UTC Approach

UTC §§ 502 and 503, respectively, describe spendthrift protection and exceptions

²⁰ Restatement (Second) of Trusts § 152(2) (1959).

²¹ Id. §§ 152(1), 153(1).

²² Id. § 157, id. § 157 cmts. b–e.

²³ Id. § 157 cmt. a.

²⁴ Restatement (Third) of Trusts § 58(1) (2003), id. cmt. a.

²⁵ Id. § 59, id. § 59 cmts. b–d.

²⁶ Id. cmt. a(1).

²⁷ Id. cmt. a(2).

to it as follows:²⁸

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.

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.

²⁸ UTC §§ 502–503 (2005).

As with discretionary trusts, states sometimes modified these provisions in enacting their versions of the UTC.

D. State Statutes

The third-party spendthrift trust statutes of the various states differ significantly. For example, Delaware long has enforced spendthrift trusts. Under Delaware's statute, a creditor of a beneficiary of such a trust has only such rights to the trust property as are afforded the creditor by the terms of the instrument and no limit is placed on the amount that may be sheltered from creditors' claims.²⁹ Although the courts created an exception for obligations to support a spouse,³⁰ Delaware law provides virtually complete protection from claims of creditors of a beneficiary. Delaware law bars a creditor from seizing the interest of a beneficiary even when the beneficiary commits a willful tort.³¹

Delaware and states with similar laws might offer more protection than the laws of other states. For example, Georgia permits a creditor to reach spendthrift trust assets if he or she is the victim of a willful tort committed by a beneficiary.³² California permits spendthrift trust assets to be reached to pay claims for spousal or child support, restitution for commission of a felony, and public support,³³ and it limits the amount that may be protected.³⁴ Oklahoma permits income distributable to a beneficiary of a spendthrift trust to be reached for child- and spousal-support claims and claims for necessities and limits the annual income that may be protected from garnishment to \$25,000.³⁵

The appendix gives citations for state third-party spendthrift trust statutes.

IV. SUBSEQUENT PROTECTION

Comment j to § 152 of the Second Restatement of Trusts provides that:³⁶

After the income of a spendthrift trust has been paid to the beneficiary it can be transferred by him and can be reached by his creditors.

²⁹ Del. Code Ann. tit. 12, § 3536.

³⁰ Garretson v. Garretson, 306 A.2d 737 (Del. 1973).

³¹ Parsons v. Mumford, 1989 Del. Ch. Lexis 70 (Del. Ch. 1989); Gibson v. Speegle, 1984 Del. Ch. Lexis 475 (Del. Ch. 1984).

³² Ga. Code Ann. § 53-12-28(c).

³³ Cal. Prob. Code §§ 15305, 15305.5, 15306. See Ventura County Dept. of Child Support Services v. Brown, 117 Cal. App. 4th 144 (Cal. Ct. App. 2001) (involving § 15305). Contra Young v. McCoy, 147 Cal. App. 4th 1078 (Cal. Ct. App. 2007) (involving § 15305.5).

³⁴ Id. §§ 15306.5–15307.

³⁵ Okla. Stat. Ann. tit. 60, § 175.25B.

³⁶ Restatement (Second) of Trusts § 152 cmt. j (1959). See Restatement (Third) of Trusts § 58 cmts. d, d(2) (2003).

Some states offer protection from creditor claims for funds distributed from discretionary and spendthrift trusts. In Delaware, for example, creditors may not attach assets held by banks (including as trustee)³⁷ to satisfy their claims.³⁸

V. APPLICABLE LAW

The law that determines whether or not creditors may reach a beneficiary's interest in a trust is the law designated by the trust instrument.³⁹ Consequently, clients' designations of other states' laws to govern the ability of creditors to reach the assets of third-party trusts should stand.

VI. MOVING A TRUST TO PROVIDE GREATER PROTECTION FROM CREDITOR CLAIMS

As discussed above, some states provide more protection than other states against creditor claims for beneficiaries of a third-party trust. Because a trustee has a fundamental duty to use reasonable care to protect a trust from unnecessary exposure to risk of loss,⁴⁰ trustees of certain third-party trusts might have an obligation to explore moving them to more protective jurisdictions.⁴¹

³⁷ Provident Trust Co. v. Banks, 9 A.2d 260 (Del. Ch. 1939).

³⁸ Del. Code Ann. tit. 10, § 3502.

³⁹ Restatement (Second) of Conflict of Laws §§ 273, 280 (1971); 5A Austin W. Scott & William F. Fratcher, The Law of Trusts §§ 625–628, 660 (4th ed. 1989); George G. Bogert & George T. Bogert, The Law of Trusts and Trustees § 293 (rev. 2d ed. 1992).

⁴⁰ Restatement (Second) of Trusts § 176 (1959).

⁴¹ See In re Joseph Heller Inter Vivos Trust, 613 N.Y.S.2d 809 (Surr. Ct. N.Y. Co. 1994) (trustee petitioned court to divide trust in order to protect cash and securities from liabilities from realty).

STATE THIRD-PARTY TRUST STATUTES

State	Spendthrift Trust	Discretionary Trust
Alabama	Ala. Code §§ 19-3B-502–19-3B-503	Ala. Code §§ 19-3B-504, 19-3B-814(a)
Alaska	Alaska Stat. § 34.40.110	
Arizona	Ariz. Rev. Stat. §§ 14-7701–14-7702, 14-7704, 14-7707, 14-7710	Ariz. Rev. Stat. § 14-7704, 14-7707
Arkansas	Ark. Code Ann. § 28-73-502	Ark. Code Ann. §§ 28-73-504, 28-73-814(a)
California	Cal. Prob. Code §§ 15300–15301, 15305–15309	Cal. Prob. Code §§ 15303, 15305–15308
Colorado		
Connecticut		
Delaware	Del. Code Ann. tit. 12, § 3536	Del. Code Ann. tit. 12, § 3536(f)
District of Columbia	D.C. Code §§ 19-1305.02–19-1305.03	D.C. Code § 19-1308.14(a)
Florida	Fla. Stat. §§ 736.0502–736.0503	Fla. Stat. §§ 736.0504, 736.0814(1)
Georgia	Ga. Code Ann. § 53-12-28(c)	
Hawaii		
Idaho	Idaho Code § 15-7-502	
Illinois	735 Ill. Comp. Stat. 5/2-1403	
Indiana	Ind. Code § 30-4-3-2	
Iowa	Iowa Code § 633A.2301	Iowa Code § 633A.4702
Kansas	Kan. Stat. Ann. § 58a-502	
Kentucky	Ky. Rev. Stat. Ann. § 381.180	
Louisiana	La. Rev. Stat. Ann. §§ 9:2001–9:2002, 9:2004–9:2005, 9:2007	
Maine	Me. Rev. Stat. Ann. tit. 18-B, §§ 502–503	Me. Rev. Stat. Ann. tit. 18-B, §§ 504, 814(1)
Maryland		
Massachusetts		
Michigan		
Minnesota		
Mississippi	Miss. Code Ann. §§ 91-9-501, 91-9-503, 91-9-505, 91-9-511	Miss. Code Ann. §§ 91-9-501, 91-9-507, 91-9-511
Missouri	Mo. Rev. Stat. §§ 456.5-502–456.5-503	Mo. Rev. Stat. §§ 456.5-504, 456.8-814(1)
Montana	Mont. Code Ann. §§ 72-33-301–72-33-302, 72-33-306	Mont. Code Ann. § 72-33-304
Nebraska	Neb. Rev. Stat. §§ 30-3847–30-3848	Neb. Rev. Stat. §§ 30-3849, 30-3879(a)
Nevada	Nev. Rev. Stat. §§ 166.010–166.170	
New Hampshire	N.H. Rev. Stat. Ann. §§ 564-B:5-502–564-B:5-503	N.H. Rev. Stat. Ann. §§ 564-B:5-504, 564-B:8-814(a)
New Jersey		
New Mexico	N.M. Stat. Ann. §§ 46A-5-502–46A-5-503	N.M. Stat. Ann. §§ 46A-5-504, 46A-8-814(A)
New York	N.Y. Est. Powers & Trusts Law § 7-1.5	
North Carolina	N.C. Gen. Stat. §§ 36C-5-502–36C-5-503	N.C. Gen. Stat. §§ 36C-5-504, 36C-8-814(a)
North Dakota	N.D. Cent. Code §§ 59-13-02–59-13-03	N.D. Cent. Code §§ 59-13-04, 59-16-14(1)
Ohio	Ohio Rev. Code Ann. §§ 5805.01–5805.02	Ohio Rev. Code Ann. §§ 5805.04, 5808.14(A)

STATE THIRD-PARTY TRUST STATUTES

State	Spendthrift Trust	Discretionary Trust
Oklahoma	Okla. Stat. tit. 60, § 175.25	Okla. Stat. tit. 60, § 175.25(F)
Oregon	Or. Rev. Stat. §§ 130.305–130.310	
Pennsylvania	20 Pa. Cons. Stat. §§ 7742–7743	20 Pa. Cons. Stat. §§ 7744, 7780.4
Rhode Island	R.I. Gen. Laws § 18-9.1-1	
South Carolina	S.C. Code Ann. §§ 62-7-502–62-7-503	S.C. Code Ann. §§ 62-7-504, 62-7-814(a)
South Dakota	S.D. Codified Laws §§ 55-1-24–55-1-26, 55-1-34–55-1-35, 55-1-37, 55-1-41–55-1-42	S.D. Codified Laws §§ 55-1-24–55-1-26, 55-1-38–55-1-40, 55-1-43
Tennessee	Tenn. Code Ann. §§ 35-15-502–35-15-503	Tenn. Code Ann. §§ 35-15-504, 35-15-814(a)
Texas	Tex. Prop. Code Ann. § 112.035	
Utah	Utah Code Ann. §§ 75-7-502–75-7-503	Utah Code Ann. §§ 75-7-504, 75-7-812(1)
Vermont		
Virginia	Va. Code Ann. §§ 55-545.02–55-545.03	Va. Code Ann. §§ 55-545.04, 55-548.14(A)
Washington	Wash. Rev. Code § 6.32.250(2)	
West Virginia	W. Va. Code § 36-1-18	
Wisconsin	Wis. Stat. § 701.06	
Wyoming	Wyo. Stat. Ann. §§ 4-10-502–4-10-503, 4-10-505	Wyo. Stat. Ann. § 4-10-504

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