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The Effect of the UTC on the Asset Protection of Spendthrift Trusts

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With the spiraling divorce rate of over fifty percent in the United States, as well as the increasing number of lawsuits, creditor protection is often the most important objective of our clients. An irrevocable trust set up by someone other than a beneficiary provides the ultimate in creditor protection. As the asset protection maxim goes -- "If you don't own it, nobody can take it away from you."[1] Historically, the general rule has been that the creator of the trust can dictate who may receive the beneficial enjoyment of the property and the extent and circumstances under which this enjoyment may be obtained. As a result, unless trust property is distributed to a beneficiary, it will generally be protected from the beneficiary's creditors.

Unfortunately the Uniform Trust Code (“UTC”) may have significantly weakened the asset protection that was formerly available for discretionary trusts in states that have adopted it. Because of the issues surrounding the UTC, planners should consider moving all trusts and the underlying liquid assets intended to be creditor-protected out of UTC states.

The general rule is that through accepted legal remedies a creditor of a debtor stands in the shoes of the debtor and may exercise any property or other right that the debtor may exercise. So does this mean that a creditor may attach a beneficiary’s trust interest or force the trust to make a distribution to the creditor in satisfaction of a beneficiary’s debt? Further, could a creditor lien or attach a remainder interest? If this is the general rule, does an estranged spouse have more rights to attach a beneficial interest under domestic relations law than an ordinary creditor? Does a discretionary trust

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provide stronger creditor protection than a support trust? This article will answer these questions and others.

Creditor Remedies Prior to the UTC

To the extent a trust beneficiary has a "property right" certain "exception creditors" may attach the beneficiary's interest. These "exception creditors" are generally the following exception creditors specifically listed in the Restatement Second of Trusts:

(1) Alimony and child support;

(2) Necessary expenses of a beneficiary (i.e., governmental claims for medical expenses); and

(3) Governmental claims.[2]

There is a fourth exception creditor listed in the Restatement Second - a creditor for expenses incurred to preserve a beneficial interest (i.e., attorneys' fees).[3] However, most states have not adopted this fourth exception creditor.

Exception creditors are allowed to attach the beneficial interest of a trust pursuant to the distribution standard in the support trust (e.g., health, education, maintenance and support).[4] Since the beneficiary has a right to force a distribution pursuant to the distribution standard, the exception creditor also succeeds to such a right. In this respect, the exception creditor is able to reach part or all of the assets necessary to satisfy the creditor's claim directly from the trust property.

Current Distribution Analysis – Non-UTC State

In general, a current distribution interest is an interest where the trustee may make a mandatory distribution, a discretionary distribution, or a distribution based on a support standard. Generally, if the beneficiary does not have a property interest (i.e., an enforceable right[5]), a creditor has absolutely no right of recovery. The theory is that if the beneficiary does not have a right of recovery that he may enforce, the creditor can obtain no more rights than the beneficiary has over the trust assets. This rule that prevents recovery by a creditor is not dependent upon spendthrift provisions. Rather, a creditor cannot compel the trustee to pay anything because the beneficiary cannot compel a payment.[6] Therefore, so long as the governing law of the trust is not that of a state that has adopted the UTC, absent control issues, or, in a few states, certain divorce issues, if a beneficiary has no property interest, the analysis is generally concluded and the creditor has no right of recovery.

However, not all state courts use a direct property analysis in determining whether a creditor may reach a beneficial interest. Rather, some courts will examine whether the beneficiary's interest has an ascertainable value.[7] In essence, the analysis is the same. If

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the beneficiary's interest has no value, then there is no interest or enforceable right that a creditor may attach.

On the other hand, if the beneficiary has a property interest, then the trust must be reviewed to determine whether it contains a spendthrift clause. Almost all trusts have such a clause. In general, a spendthrift clause protects a beneficiary's interest from attachment by a creditor.

However, under the Restatement Second, there are four types of creditors that may attach a beneficiary's interest regardless of the spendthrift provisions. These creditors are referred to as exception creditors. Most states have adopted three of the four exception creditors. The exception creditor for expenses required to protect a beneficial interest (i.e., attorney fees) has not been adopted by many states.

In addition, even if a the creditor is not an exception creditor, or even if the trust is a discretionary trust, if the beneficiary holds too much control over the trust, a creditor will still be able to attach to the beneficiary's interest and reach the trust's assets. For example, if the beneficiary is the sole trustee and sole beneficiary of a trust, then the trust assets may be available to a creditor.[8]

With respect to alimony and child support claims, a former spouse and minor children are exception creditors, and the former spouse may attach a current beneficial interest of a support trust on behalf of minor children. However, except for states that have adopted the UTC or Restatement Third, a spouse generally does not have any claim against a discretionary trust.

A flowchart for non-UTC states for creditor recovery of a current beneficial interest, including recovery by an estranged spouse, is provided in Exhibit A.

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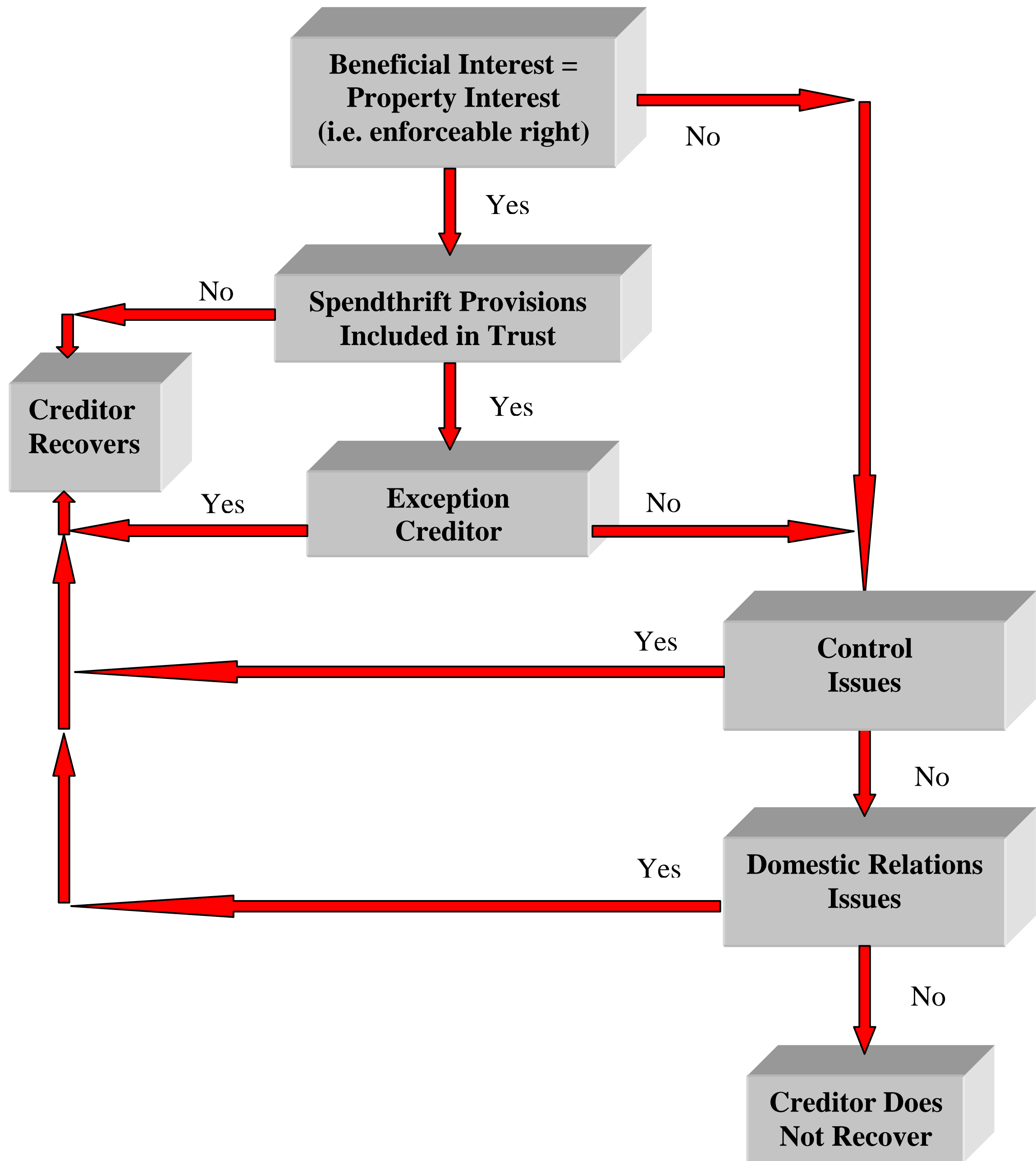
Exhibit A



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Remainder Interest Analysis - Non-UTC State

The remainder interest analysis varies from the current distribution analysis in a few key areas. First, similar to a current beneficial interest, one must first determine whether the interest is a property interest. However, the Restatement Second adopts a different approach than that which is used in the current beneficial interest analysis. If an interest is created for a group of persons, it is inseparable and a creditor cannot reach it.[9] For example, a dynasty trust is a trust in which an interest never vests in anyone. Hence, an interest in a dynasty trust would not be a property interest and would be "inseparable" as defined in the Restatement Second.

The Restatement Second also provides that if an interest of a trust "is so indefinite or contingent that it cannot be sold with fairness to both the creditors and the beneficiary, it cannot be reached by his creditors."[10] If this is the case, a creditor should not be able to recover from the trust. However, if this is not the case, then the analysis shifts to whether the trust has a spendthrift provision.

Similar to the analysis for a current distribution interest, spendthrift protection must be analyzed within the confines of the four exception creditors. Here again, a former spouse is an exception creditor who may attach a remainder interest for child support or alimony.

The control issue analysis is substantially identical for a current beneficial interest and a remainder interest. Even if a the creditor is not an exception creditor or even if the trust is a discretionary trust, if the beneficiary holds too much control over the trust, a creditor will still be able to attach to the beneficiary's interest and reach the trust's assets.

In the domestic relations area, courts have granted a former spouse greater rights than an ordinary creditor or an exception creditor. As noted above, a spouse is an exception creditor, but only for the purposes of alimony or child support. However, in many states, courts have allowed a spouse to attach a remainder interest as part of a property settlement.

A flowchart for non-UTC states for creditor recovery of a remainder interest, including recovery by an estranged spouse, is provided in Exhibit B.

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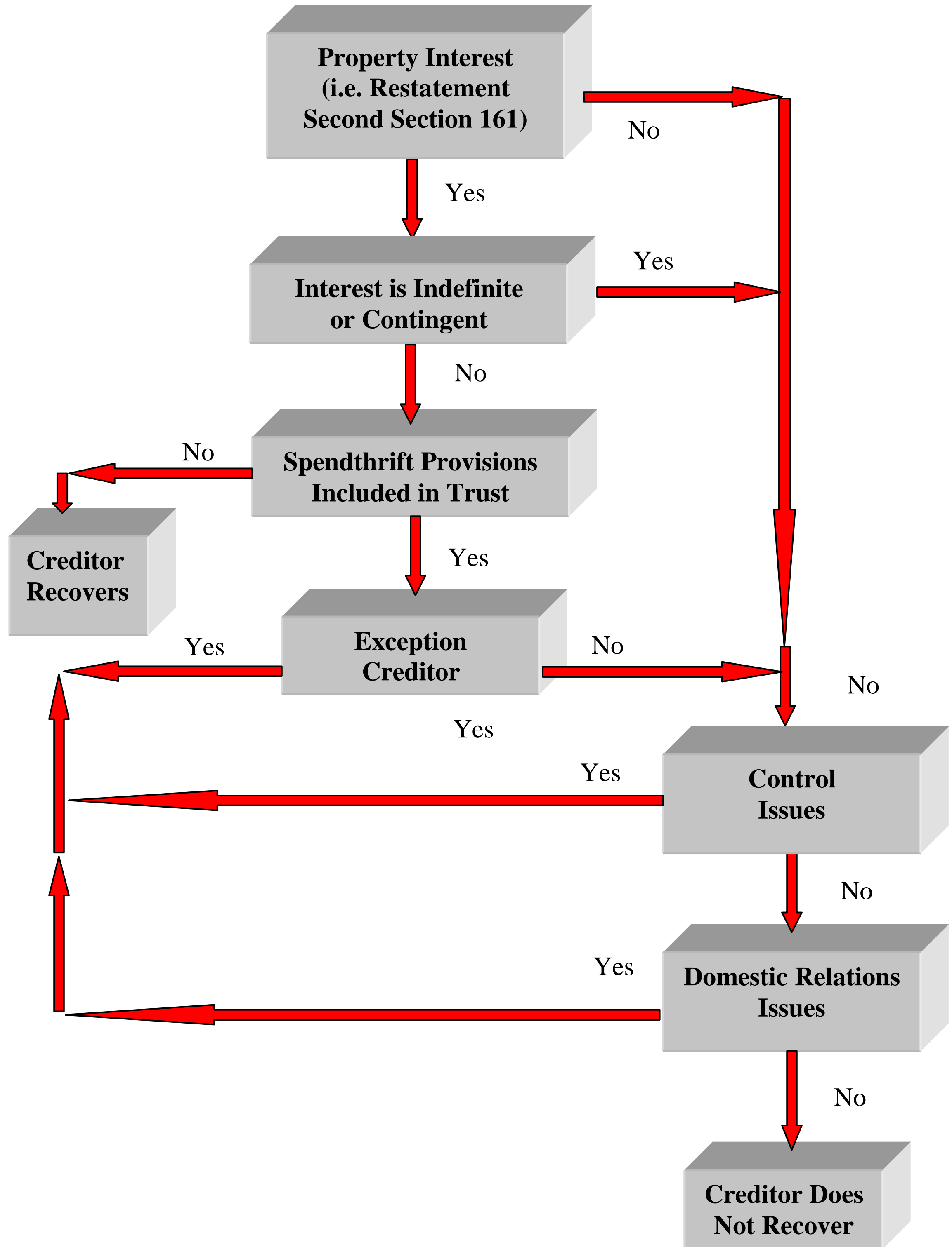
Exhibit B



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Support Trusts Versus Discretionary Trusts

A trust is generally drafted as either: (1) a mandatory distribution trust, (2) a support trust (i.e., distributions pursuant to an ascertainable standard), or (3) a discretionary trust. Additionally, since many attorneys tend to combine the language of a support trust with the language of a discretionary trust, a handful of states have created a fourth type of trust called a hybrid trust.

1. Mandatory Distribution Trust

A mandatory distribution trust is a trust in which the trustee *must* make the distribution required by the terms of the trust agreement. The trustee may not withhold or accumulate a mandatory distribution. Some examples of mandatory distribution trusts include marital deduction trusts, grantor retained annuity trusts, charitable remainder trusts and charitable lead trusts. The trusts in these examples require mandatory distributions in order to qualify for certain tax benefits. However, many trusts are drafted with mandatory distributions even though there is no tax reason to do so. This often makes some or all of the trust assets available to the beneficiary's creditors and divorcing spouses for no reason but that the trust scrivener was using a trust "form" which was inadequate for planning purposes.

2. Support Trust

A support trust is created by the settlor to support one or more beneficiaries. A support trust directs the trustee to apply the trust's income and/or principal as is necessary for the support, maintenance, education, and welfare (or other standard) of a beneficiary.[11] The beneficiary of a support trust can compel the trustee to make a distribution of trust income or principal merely by demonstrating that the money is necessary for the beneficiary's support, maintenance, education, or welfare,[12] or whatever other standard is contained in the trust.

Following is an example of language creating a support trust:

> "The Trustee shall make distributions of income or principal for the beneficiary's health, education, maintenance and support."

Implicit in this support language are two components: (1) a command that the trustee "shall" make distributions, and (2) under what standard or circumstances (i.e., health, education, maintenance and support) distributions are to be made.

A support trust typically includes mandatory language that the trustee "shall" make distributions.[13] However, there are a few cases in which a trust has been classified as a support trust even though the discretionary word "may" or the words "discretion," and even "sole discretion," were used instead of the mandatory word "shall." The standard for distributions often contains words such as "health, education, maintenance and support." However, the standard may also include terms such as "comfort and

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welfare."[14] A support trust gives the trustee discretion only with respect to the time, manner, or size of distributions needed to achieve a certain purpose, such as support of the beneficiary.[15]

For example, in *McElrath v. Citizens and Southern Nat. Bank,* the language "[t]he Trustee shall use a sufficient amount of the income to provide for the grandchild's support, maintenance and education" [emphasis added] was held to be a support trust.[16] Similarly, in *In re Carlson's Trust*, the language "[t]he trustee shall pay…[to the settlor's] daughters such reasonable sums as shall be needed for their care, support, maintenance, and education" [emphasis added] was determined to be a support trust.[17] Finally, in *McNiff v. Olmsted County Welfare Dept.*, the court decided that the language "[t]he trustee shall administer the trust estate for the benefit of my wife and my said daughter, or the survivor of either, and the trustee shall apply the income in such proportion together with such amounts of principal as the trustee, it its discretion, deems advisable for the maintenance, care, support and education of both my wife and my said daughter" [emphasis added] created a support trust.[18]

3. Discretionary Trust

A discretionary trust allows the trustee complete and uncontrolled discretion to make allocations of trust funds if and when it deems appropriate.[19] Because the trustee is given such broad powers, the beneficiary can only compel the trustee to distribute funds if it can be shown that the trustee is abusing its discretion by failing to act, acting dishonestly, or acting with an improper purpose in regard to the motive in denying the beneficiary the funds sought.[20]

Following is an example of language creating a discretionary trust:

> "The Trustee may distribute as much or more of the net income and principal as the Trustee, in its sole and absolute discretion, deems appropriate to or among any beneficiary or beneficiaries. The Trustee, in its sole and absolute discretion, at any time or times, may exclude any of the beneficiaries or may make unequal distributions among them."

Implicit in this magical discretionary language are three components: (1) a discretionary statement that the trustee "may" make a distribution, (2) the trustee has the "sole and absolute" discretion to determine whether a distribution shall be made and, if so, how much shall be distributed, and (3) the ability to exclude distributions from other beneficiaries.

A discretionary trust generally uses permissive language such as the word "may" instead of the word "shall."[21] However, as noted below, there are a few cases where the courts have held that the word "shall" when combined with the words "sole and absolute" discretion still resulted in a discretionary trust.[22]

The permissive word "may" is still generally further qualified by granting the trustee unfettered discretion using words such as "sole and absolute discretion," "absolute

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and uncontrolled discretion" or "unfettered discretion." In some cases, explicit language that permitted the trustees to exclude or discriminate between beneficiaries when making distributions was a major factor the court considered when determining whether a trust was a discretionary trust.[23]

For example, in *In re Matter of Leona Carlisle Trust,* the court determined that the language "[t]he Trustee shall expend such sums from the principal of the trust for the benefit of [appellant]…as the trustee, in its full discretion, deems advisable," [emphasis added] and it "is expressly understood the trustee is under no obligation to make any expenditures," created a discretionary trust.[24] Furthermore, the trust language provided that the trustee shall not make any distributions for appellant's "basic necessities as provided or to be provided by any governmental unit," and the trustee "shall make distributions only to supplement and not to supplant such public assistance available for maintenance, health care or other benefits."[25]

Similarly, in *Zeoli v. Commissioner of Social Services*, the court found that the language "[t]o pay or apply so much of the net income to or among either one or both of my daughters as shall be living from time to time during the term of such trust, and in such proportions and amounts as my trustee shall determine in his absolute and uncontrolled discretion..." [emphasis added] created a discretionary trust. The language in that case continued, "[m]y trustee shall not be required to distribute any net income of such trust currently and may, in his absolute and uncontrolled discretion, accumulate any part or all of the net income of such trust, which such accumulated net income shall be available for distribution to the beneficiaries as aforesaid.[26] [Emphasis added.]

As yet another example, in *Simpson v. State Dept. of Social and Rehabilitation Services,* the trustees were required to distribute trust income and assets to any one or more of this group of beneficiaries as the trustees "in their absolute discretion" may determine from time to time. The instrument further provides that "the Trustees shall have the absolute discretion, at any time and from time to time, to make unequal payments or distributions to or among any one or more of said group and to exclude any one or more of them from any such payment or distribution."[27] [Emphasis added.]

4. Hybrid Trust or "Discretionary Support Trust"

There are three states and possibly a fourth (Iowa, Nebraska, North Dakota, and possibly Pennsylvania) that have taken the position that there is an additional type of trust – a "discretionary support trust". This type of trust includes elements of both a support trust and a discretionary trust.[28] A discretionary support trust is created when the settlor combines the explicit discretionary language "with language that, in itself, would be deemed to create a pure support trust."[29] Under the case law of these three or four states, the hybrid trust covers the middle ground between a classic support trust and a classic discretionary trust.[30] If a trust is neither a traditional support trust nor a traditional discretionary trust, these courts have followed one or the other of the following two approaches. They have either (a) allowed extrinsic evidence to determine the classification as either a discretionary or a support trust, or (b) required the trustee to

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carry out the purposes of the trust based on a "good faith" standard and required the trustee to make minimal distributions.

For an example of a court allowing extrinsic evidence to make the determination, in *Bohac,*[31] the provisions of the trust allowed the trustee to distribute principal as the "Trustee may deem necessary" for the beneficiary's "support, maintenance, medical expenses, care, comfort, and general welfare." [Emphasis added.] The court noted that the trust provisions created a hybrid trust, but decided that extrinsic evidence must be admitted to determine the settlor's intent with respect to whether the trust was a support trust or a discretionary trust. Even though the court noted that the words "comfort and general welfare" may result in the classification of the trust as a discretionary trust, the court held the trust was a support trust.

As another example, in *Kryzsko v. Ramsey County Soc. Services,*[32] the trustee was given sole discretion to invade trust principal for the "proper care, maintenance, support, and education" of the beneficiary. The court held that the trustee did not have unfettered discretion and must follow a standard of providing proper support. The court noted that unlike a discretionary trust, which fixes no standard on the trustee's absolute discretion as to whether to pay income or principal to a beneficiary, a support trust gives the trustee discretion only as to the time, manner, and size of the payments needed to achieve a certain purpose such as support of a beneficiary.

As yet another example, in *Lang v. Com., Dept. of Public Welfare,*[33] the terms of the trust provided that "the trustee shall pay the income periodically to or for the support, maintenance, welfare, and benefit of my son or may, in the trustee's discretion, add part or all of the income or principal to be invested as such." [Emphasis added.] The trust continued, "[t]he trustee may distribute such part of the income not necessary for the support of my son, in equal shares to my children." After looking at extrinsic evidence suggesting that it was the settlor's intent to preserve trust assets, particularly where public benefits were available to the beneficiary, the court held that the trust was discretionary.

In contrast, in *Smith v. Smith,*[34] the Nebraska Supreme Court held that the trustee of a discretionary support trust can be compelled to carry out the purpose of the trust in good faith. The trust provided that "[T]he trustee shall pay over to, or for the benefit of one or more of the living members of a class composed of my son Richard and his issue, so much of the net income and principal of the trust as the Trustee shall deem to be in the best interests of each such person, from time to time. Such distributions need not be made equally unto all members of the class. In determining the amount and frequency of such distributions, the Trustee shall consider that the primary purpose of the trust is to provide for the health, support, care, and maintenance of my son Richard during his life." [Emphasis added.] The court determined that the above language constituted a "hybrid trust" where the trusts were not only created to support the primary beneficiary, but also to grant the trustee greater liberty in decision-making than that of a trustee of an ordinary support trust.

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A few courts have held that the effect of a discretionary support trust is to establish the minimal distributions a trustee must make in order to comport with the settlor's intent of providing basic support, while retaining broad discretionary powers in the trustee.[35] In these cases, the courts held that the minimum distribution may be reached by a creditor.[36]

In *Bureau of Support in Dep't of Mental Hygiene & Correction v. Kreitzer*,[37] the Ohio Supreme Court, without using the term "hybrid trust," found the trust language to create neither a purely discretionary trust nor a purely support trust. Therefore, the court held that the trust should be governed by a "reasonableness" standard that would not permit the beneficiary to become destitute. The result was that the governmental agency could recover against the trust assets under the exception for necessary expenses of a beneficiary. Further, the Ohio Supreme Court seemed to lean further toward becoming a "hybrid trust" state when it stated in a subsequent case that "[a] trust conferring upon the trustees power to distribute income and principal in their absolute discretion, but which provides standards by which that discretion is to be exercised with reference to the needs of the trust beneficiary for education, care, comfort, or support is neither a purely discretionary trust nor a strict support trust."[38]

This Ohio Supreme Court ruling is particularly troubling because it used a "reasonableness" standard. For over a hundred years, the strong majority view has been that the appropriate standard is bad faith or abuse (i.e., the trustee acts dishonestly with an improper motive or fails to act).[39] Further, the purpose of a discretionary trust is to prevent the courts from reviewing the "sole and absolute" discretion of the trustee. With a discretionary trust, the settlor has chosen to put his faith in the trustee rather than the courts. However, a support trust takes the opposite approach. With a support trust, the settlor wants the beneficiary to have a right to enforce the ascertainable trust terms if the trustee does not follow the standard drafted into the trust agreement.

By using a standard less than that of bad faith and closer to reasonableness, the Ohio Supreme Court has now given the beneficiary of this hybrid type of trust the right to sue the trustee for unreasonably not making a distribution or not distributing enough. Furthermore, this legal right will most likely be a property right (i.e., a right enforceable under state law) that can cause the creditor to stand in the shoes of the beneficiary.

What is a Property Interest?

Most courts first determine whether a beneficiary has a property interest under state law.[40] Rather than using a property analysis, some courts will find that the beneficiary's interest has no ascertainable value.[41] In essence, the analysis is the same. There is no interest or enforceable right that a creditor may attach because under this analysis the beneficial interest has no value.

Assuming the property analysis approach is used, the initial step in determining whether a creditor may recover against an interest in a trust is to determine whether the interest is a property interest under state law. See the flowchart under Exhibit C.

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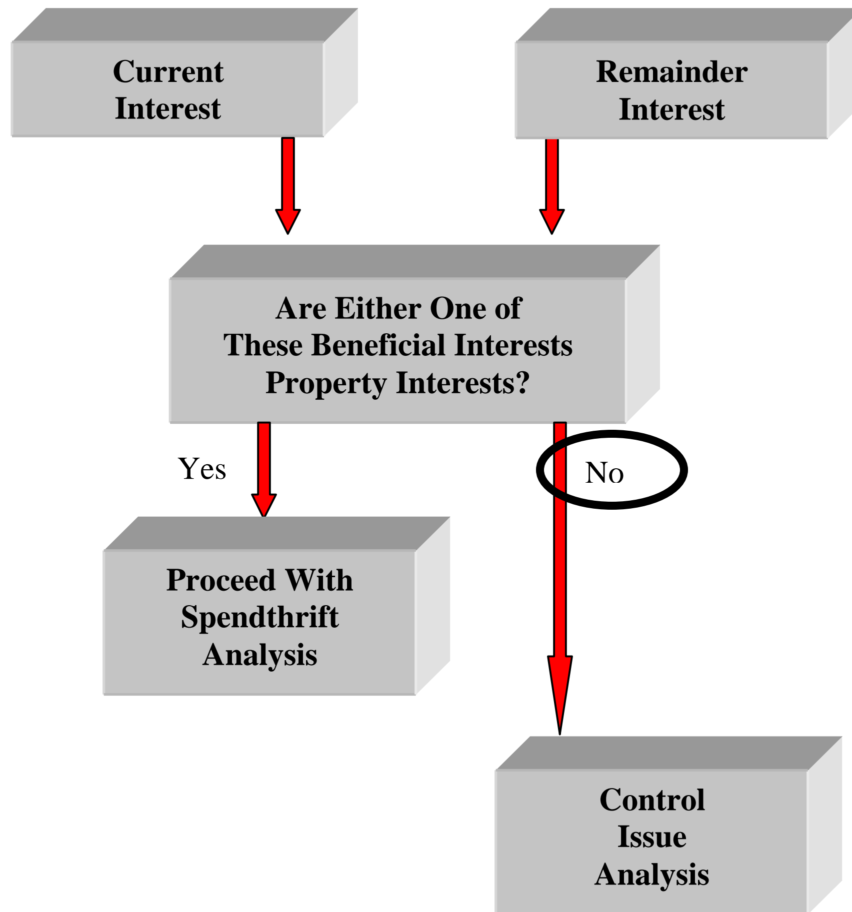
Exhibit C



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If the beneficiary's interest in the trust is not a property interest, then the analysis proceeds directly to whether the beneficiary held too much control over the trust, followed by any state nuances under domestic relations law.[42] On the other hand, if the beneficiary holds a property interest, does the creditor stand in the shoes of the beneficiary, and may the creditor enforce the beneficiary's property right? The answers to these questions depends upon whether the trust has a spendthrift provision and how much creditor protection the spendthrift provision provides.

State law determines what constitutes a property interest. While state law may vary, "property" is generally defined as everything that has an exchangeable value or which goes to make up wealth or estate.[43] An "equitable interest" in trust property is regarded as a property interest of the same kind as trust res and is more than a mere chose in action.[44] Simply, there are two methods for determining whether something constitutes property: (1) something that may be sold or exchanged, or (2) an enforceable right.

With regard to the first type of property, such property is freely alienable, and as such has a fair market value that may be determined by a market price. However, beneficial interests in trusts are generally restricted by spendthrift provisions that prevent the transfer of any beneficiary's interest. In this respect, there is no fair market value because the property cannot be sold. On the other hand, under the second test, in many situations, a beneficiary has an enforceable right (i.e., a property interest). For example, with support trusts, a current beneficiary has a right to sue the trustee to force a distribution pursuant to a standard in the trust. Also, if a beneficiary has a vested remainder interest, the beneficiary will most likely receive property at some time in the future.

Distribution Standard and the Current Beneficial Interest

Almost all courts will classify a beneficiary's interest as being (1) a mandatory distribution, (2) a support distribution, or (3) a discretionary distribution. However, as previously noted, there is a problem when a scrivener conflicts the elements of a discretionary trust with those of a support trust.

1. <u>Mandatory Distribution Trust</u>

When the terms of a trust require a mandatory distribution to be made, there is no question that the beneficiary has an enforceable right to this distribution. The beneficiary unquestionably may sue the trustee to force a distribution. Therefore, a fixed interest, which is an interest that creates an enforceable right in the beneficiary, is a property interest. For example, in *In re Question Submitted by the United States Court of Appeals for the Tenth Circuit*, the Tenth Circuit held that a beneficiary's future right to receive $1,000 per month was a property interest.[45]

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With respect to a mandatory distribution right, the creditor is not attaching the trust's assets. Rather, the creditor is attempting to attach to the mandatory distribution stream.[46] Since this interest is a property right, the only question is whether a spendthrift provision provides some type of protection for a mandatory distribution received from a trust.

2. Support Trust

The common law purpose of a support trust is to provide support for a beneficiary based on a "standard." The most common standard used is that of health, education, maintenance and support. Such a support standard must be definite enough for a court to be able to determine whether a trustee is following the support standard. In this respect, magical words such as health, education, maintenance and support have been determined by courts to be definite. Words such as comfort and welfare may or may not be sufficiently definite depending on state law. On the other hand, words such as joy and happiness are not capable of interpretation on a reasonable basis, and may easily result in a trust not being classified as a support trust.

As previously noted, if a trust is classified as a support trust, a beneficiary of a support trust can compel the trustee to make a distribution of income or principal merely by demonstrating that the money is necessary for the beneficiary's support, maintenance, education, or welfare,[47] or whatever other standard is used in the trust agreement. In other words, a beneficiary has a right to sue the trustee for failing to make a distribution from a support trust. If a beneficiary has the right to sue the trustee, the beneficiary most likely has a property interest under state law.[48] If this is the case, does the creditor stand in the beneficiary's shoes and have the power to sue the trustee to force the payment of the beneficiary's debt? Absent spendthrift provisions, this would definitely be the case. Therefore, whether a creditor (including an estranged spouse) may recover must be determined under the analysis in the spendthrift portion of this article.

3. Discretionary Interest

Under the Restatement Second and almost all of the case law to date, a discretionary beneficiary has no contractual or enforceable right to any income or principal from the trust, and therefore the beneficiary cannot force any action by the trustee.[49] This is because a court may only review a discretionary trust for abuse and bad faith. There is no reasonableness standard of review by a court with respect to a discretionary trust. Further, the discretionary interest is not assignable.[50] In this respect, a discretionary beneficiary's interest is generally not classified as a property interest. Rather, it is nothing more than a mere expectancy.[51] If a beneficiary has no right to force a distribution from a trust, then the same rule applies to the beneficiary's creditor. The creditor may not force a distribution.

In this respect, whether the assets of a discretionary trust are protected does not depend on spendthrift provisions with respect to the current beneficial interest. As discussed in the spendthrift section of this article, the asset protection features of a

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discretionary trust are much stronger than those of a support trust or a mandatory distribution trust that must rely on spendthrift protection.

4. Hybrid Trust or "Discretionary Support Trust"

If a judge does not classify a trust with conflicting language as either a discretionary trust or a support trust, the case law in Iowa, Nebraska, North Dakota, and possibly Pennsylvania, has indicated that it is a hybrid trust. In general, a beneficiary of a hybrid trust only has the right to sue the trustee for a minimal distribution.[52] This being the case, the hybrid trust does not provide the same degree of protection as a discretionary trust. Rather, it is more similar to a support trust than a discretionary trust, and an analysis of the spendthrift provisions must be done to determine whether the trust assets are protected.

Remainder Interest

A remainder interest has a slightly different analysis than that of a current beneficial interest. While divorce cases tend to use the word "property" in determining a remainder interest,[53] the rule under the Restatement Second, Section 160 requires a determination as to whether there are "inseparable interests." In essence, the "inseparable interest" rule functions quite similar to the property analysis used for a current beneficial interest. Further, the Restatement adds to the analysis an "indefinite" or "contingent" interest analysis as another hurdle a creditor will most likely need to cross. If the remainder interest is not a property interest, or if a creditor cannot overcome the indefinite or contingent interest rule, then the analysis proceeds directly to whether the debtor/beneficiary retained too much control. The analysis is shown in Exhibit D.

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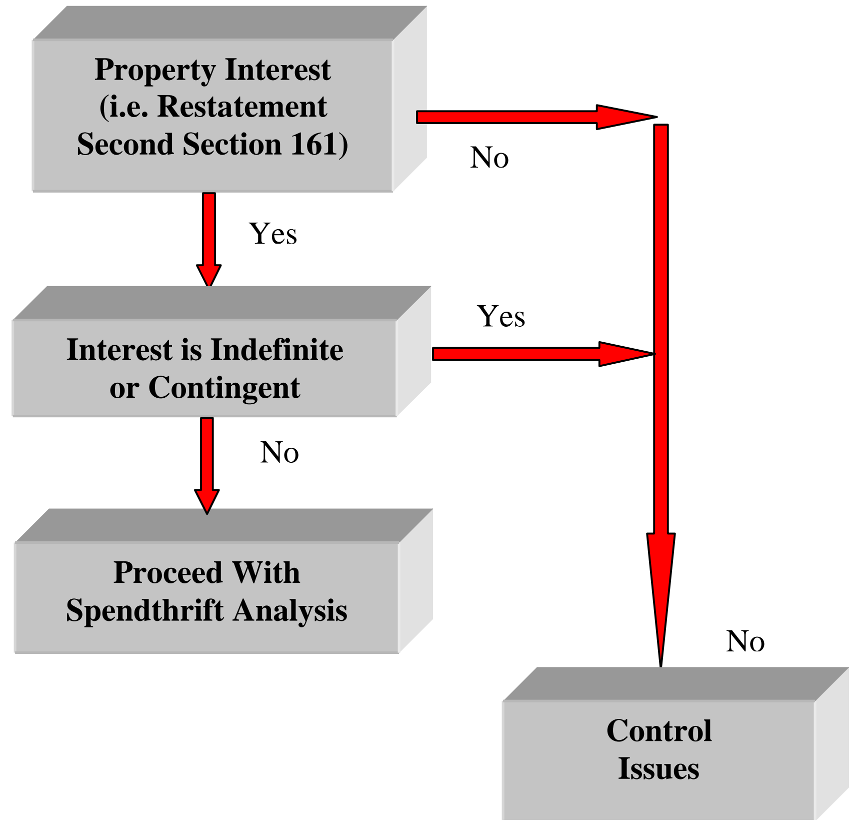
Exhibit D



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According to the Restatement Second, if a beneficial trust interest is "so indefinite or contingent that it cannot be sold with fairness to both the creditors and the beneficiary, it cannot be reached by creditors."[54] There are two parts to this rule. First, is the remainder interest indefinite? Second, can the remainder interest be sold with fairness to both the creditors and the beneficiary?

1. Indefinite and Contingent Interests

A vested interest is not a contingent interest. A vested interest is one where the debtor/beneficiary or the debtor/beneficiary's estate will take at some point of time in the future. The clear majority rule appears to be that a vested remainder interest may be sold at a judicial foreclosure sale unless it cannot be sold with fairness to both the creditors and the beneficiary, or unless the trust contains spendthrift provisions.[55] These cases follow the general property rule that a remainder interest in property may be sold even though it is a future interest.[56]

Many estate planners consider a remainder interest to be a contingent interest where either (1) one party must outlive the other party in order to take, or (2) the trust property is subject to complete divestment due to a special power of appointment. However, Restatement Second, Section 162, Illustration 1 indicates that the mere fact that a child must survive a parent in order to take the trust property is *not* too contingent, and, therefore, unless the remainder interest can be sold with fairness to both the creditors and the beneficiary, absent spendthrift protection, a creditor would be able to judicially foreclose on the remainder interest.[57]

2. Sold With Fairness

Would a willing buyer or willing seller pay much for an interest in trust that is contingent on a child outliving his parent? Most likely, the interest would be highly discounted. However, what if the interest was subject to a special power of appointment that could divest the child of the entire remainder interest? In this case, a purchaser at a judicial foreclosure sale would likely pay little for the interest when compared to the amount that would ultimately be received by the remainder beneficiary.

There are very few reported cases where anyone other than a former spouse attaches the remainder interest.[58] Most creditors do not attempt to judicially foreclose on a remainder interest because in almost all cases the "sold with fairness rule" would apply. Even if the "sold with fairness rule" does not apply, several states have passed state statutes preventing the forced sale of remainder interests.[59]

Spendthrift Provisions

A spendthrift provision is a provision in a trust agreement that provides that the beneficiary cannot sell, pledge or encumber his beneficial interest, and a creditor cannot attach a beneficiary's interest. At common law, the purpose of a spendthrift trust was to

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protect a beneficiary other than the settlor of the trust from his own spending habits. The idea was to provide for someone who could not provide for himself, and to keep such beneficiary from becoming dependent on public assistance. Therefore, if a spendthrift clause was added to a trust, the common law developed a legal principle that a creditor could not recover from the beneficiary's interest.[60] If the mere insertion of such a clause could protect a beneficiary's interest, why not include such a provision in almost all trusts? Today, this is in fact the case.[61]

A beneficiary of a discretionary dynasty trust does not need to rely on a spendthrift provision because neither the current distribution interest nor any subsequent interest is a property interest under state law. Therefore, in a non-UTC state, neither the beneficiary nor the creditors of the beneficiary have any right to force a distribution from the trust. However, as a matter of course, scriveners should nearly always include spendthrift provisions.[62] This is especially true should the UTC become law.

However, the same analysis is not true for a trust that is classified as a support trust. In this case, beneficiaries in many states may force a distribution from the trust pursuant to the standard provided in the trust instrument. So the question becomes, can a creditor stand in the shoes of the beneficiary and force such a distribution? The language of a spendthrift provision on its face generally prohibits a creditor from doing so. However, under what circumstances will courts make exceptions to spendthrift protection?

Except for certain types of creditors, a spendthrift provision protects the trust's assets from attachment.[63] The Restatement Second, Section 157 carves out the following four key exceptions[64] to spendthrift protection, where a creditor may attach the assets of a support trust:

1. **Alimony or child support** - Almost all, if not all, recent cases hold that a spouse may reach a beneficiary's interest for alimony or child support.[65] Therefore, if a trust is classified as a support trust, an estranged spouse may almost always reach the assets of the trust to satisfy a maintenance or child support claim. However, this exception does not apply to a division of marital property pursuant to a divorce.

2. **Necessary services or supplies rendered to the beneficiary** - Most cases in this area arise when a federal or state institution is attempting to attach a beneficiary's interest for medical services rendered on behalf of the beneficiary.[66] Further, in almost all of these cases, the drafting attorney conflicted the magical words of a discretionary trust with those of a support trust.

3. **Services rendered and materials furnished that preserve or benefit the beneficial interest in the trust** - These are generally claims by attorneys for fees incurred to either sue the trust or protect a beneficial interest. Fortunately, while the other three exceptions of the Restatement Second are almost universally applied by the states, this one is not. In other words, attorneys are frequently not allowed to recover their fees from the trust.

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4. A claim by the U.S. or a state to satisfy a claim against a beneficiary - Generally, these are tax liens. The Internal Revenue Service may often reach a beneficiary's interest in a support trust for payment of a tax lien.[67] In *First Northern Trust Co. v. Internal Revenue Service*,[68] the court noted that it is a well established legal principle that the income from a spendthrift trust is not immune from federal tax liens notwithstanding any state laws or recognized exemptions to the contrary.[69]

In summary, there are four exception creditors that can reach a support trust's assets to satisfy their claim. In a non-UTC state, these exception creditors, including the federal government, would have no claim against the trust assets if it had been drafted as a discretionary dynasty trust.

Conflicting Distribution Language

As noted above, with respect to the current distribution interest, a discretionary trust generally provides the strongest asset protection features because the discretionary distribution interest is generally not a property interest under state law. If a beneficiary does not hold a property interest, then a creditor cannot attach it.

Unfortunately, there is a tension between the asset protection features of a discretionary trust and who can be a trustee without possible estate tax inclusion issues. Generally, clients wish to have a family member, such as a spouse or child, serve as the trustee. If distributions are limited to an ascertainable standard, there are times when a spouse/beneficiary or a child/beneficiary may serve as the sole trustee of a trust without an estate tax inclusion issue.[70] On the other hand, if the spouse or child is the sole trustee and a beneficiary of a discretionary trust, the spouse or child will be considered to hold a general power of appointment, thereby resulting in estate inclusion.[71]

Many estate planners attempt to get the best of both worlds. These planners would like a trust that would be considered discretionary for state law purposes so that a creditor of a beneficiary cannot attach the trust. They also would like the trust to be deemed to have an ascertainable standard for estate and gift tax purposes, giving the client greater selection over who can be a trustee. In an attempt to accomplish both of these objectives, these planners draft distribution language that uses magical words from both a support trust and a discretionary trust. For example, the trust document may read:

> "The Trustee may, in his sole and absolute discretion, make distributions of income or principal based on health, education, maintenance and support to any beneficiary."

The magical discretionary words "*may*," and "*discretion*" have been conflicted with the trust support words "*health, education, maintenance and support.*" Furthermore, the discretionary language allowing the trustee to make distributions to one beneficiary and not the others has been implied.

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Naturally, the Service would like to argue that this language creates a discretionary trust because the distribution trustee would have a general power of appointment at death and therefore also have estate inclusion under IRC §2041.[72] Conversely, the taxpayer would like to argue that distributions are pursuant to an ascertainable standard in order to avoid the estate inclusion issue.

Furthermore, if it is a governmental agency that is the creditor of the beneficiary and is seeking to recover payment from the trust, the governmental agency will argue that distributions are pursuant to an ascertainable standard and that the trust should be classified as a support trust. The client will argue that the distributions are discretionary. The court will almost always decide that the trust is either (1) a "support" trust (i.e., ascertainable standards) or (2) a discretionary trust.

As noted, almost all non-UTC courts will decide one way or the other, but not both ways.[73] By attempting to accomplish the best of both worlds, the estate planner typically does more damage than good. The planner creates either a possible estate inclusion issue or allows a creditor to recover from the trust assets. For this reason, the trust scrivener should avoid conflicting trust language and should draft either a purely discretionary trust or a support trust (i.e., distributions based on ascertainable standards).[74]

Hybrid Trust

In the few states that recognize a hybrid trust,[75] the hybrid trust is by definition a conflicting language trust. The problem with this is that most of the states require the trustee to make a minimal distribution for the beneficiaries' needs. This being the case, a creditor for necessary expenses of the beneficiary most likely becomes an exception creditor.[76] Further, what about child support and alimony? One could easily argue that child support is a necessary expense. Similarly, are taxes a necessary expense of a beneficiary? At present, the answers to these questions are unknown. However, in the few states that recognize a hybrid trust, it seems that such a trust provides little more protection than that of a support trust.

Remainder Interest

Absent spendthrift provisions, a beneficiary may transfer the remainder interest, and a creditor may attach such interest.[77] This would include an estranged spouse as well as any other creditor.[78]

On the other hand, if spendthrift provisions are present, ordinary creditors may not attach a remainder interest. This is true even in bankruptcy court. The Federal Bankruptcy Court is required to look to state law to apply property rules.[79] For example, in *In Re Neuton*, a California state statute provided that spendthrift provisions protected 75% of the remainder interest.[80] The debtor's ordinary creditor could not recover against the amount protected by state law. However, if the creditor is one of the four exception

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creditors and the "sold with fairness" rule does not apply, the creditor may attach and/or judicially foreclose and sell the remainder interest.[81]

Control and Dominion Issues

In the event a creditor cannot attach the trust assets under one of the aforementioned theories of recovery, then a creditor may attempt to recover under the theory that the debtor/beneficiary held too much control. The purpose of a spendthrift provision is to protect the beneficiary from his own improvidence. If the sole beneficiary is the sole trustee, he cannot protect himself from his own improvidence. Therefore, in *In re Bottom,* the spendthrift provision protection was not upheld since the sole beneficiary was the sole trustee,[82] and the creditor was able to reach the assets of the trust. On the other hand, at least two courts have held that the beneficiary/trustee did not control a trust in which the beneficiary was a co-trustee and there were multiple beneficiaries.[83]

Many attorneys draft trusts with an ascertainable standard for distributions and the primary beneficiary (i.e., the child) as the sole trustee of the trust. The trust has both the primary beneficiary and the primary beneficiary's children as beneficiaries. To date, the authors of this article are only aware of one court that has directly addressed this issue, and a second court that mentioned the issue as dicta.

In *In re Schwen,* the court mentioned that if one of the beneficiaries was the sole trustee, the trustee/beneficiary's control regarding making distributions was still limited by a fiduciary duty to other beneficiaries. Therefore, the trustee/beneficiary would not have too much control.[84] It should be noted that in *Schwen* there were actually two trustees, and the court mentioned the sole trustee situation purely as dicta. Fortunately, in *In re Coumbe*, in a review of a bankruptcy case, the court provided further guidance in this area when it held that a sole beneficiary could serve as the sole trustee so long as there were different remainder beneficiaries.[85]

Nuances under State Domestic Relations Law

Until recently, in the event of divorce, almost all asset protection planners thought that a remainder interest was free from division of marital property. Most Colorado estate planners went into shock when the Colorado Supreme Court handed down the *In re Balanson* decision.[86] The Colorado Supreme Court had held that the appreciation on a vested remainder interest subject to complete divestment was marital property eligible for equitable division. Colorado law holds that an inheritance is exempt from the definition of marital property, and any appreciation on inherited property is considered marital property. Prior to this, Colorado had held that remainder interests in trusts were indivisible.[87]

The disturbing facts of *Balanson* began when the daughter married. A few years later, Mom and Dad create the standard estate plan that creates a marital trust and credit shelter trust upon the death of the first spouse. Several years later, Mom dies and the first $1 million of her assets funds the credit shelter trust, and the remainder funds the marital trust. Dad was the sole trustee of both trusts. All income of the marital trust was

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required to be distributed to Dad. However, distributions of income of the credit shelter trust and any corpus of either trust were based on an ascertainable standard. Dad was in good health and may easily live many more years. Further, Dad had a testamentary general power of appointment over the marital share that would allow him to completely extinguish the daughter's interest should he desire by appointing all of the trust property to his son. Several years after Mom dies, Daughter files for divorce. Son-in-law claims that Daughter's vested remainder interest is marital property eligible for division in the divorce.

The daughter's remainder interest was contingent since she must outlive her father. Also, the daughter's interest was subject to complete divestment because her dad may exercise his special power of appointment solely in favor of his son. However, the Colorado Supreme Court ruled that even if a vested remainder interest is subject to complete divestment, such an interest is still a property interest that can be valued for the purpose of division in a divorce. The logic behind the decision is that the Court frequently values interests that are hard to value such as retirement plans and businesses and that, therefore, each side needs to merely bring in their experts since it's only a valuation issue.

In *Balanson*, the Colorado case cited two other cases – *Davidson v. Davidson* (a Massachusetts case) and *Trowbridge v. Trowbridge* (a Wisconsin case)[88] and held that a vested remainder interest subject to complete divestment is eligible for marital property division. So at first blush, following in Massachusetts' footsteps, the Colorado Supreme Court appears to be crossing new legal ground. However, this does not quite appear to be the case. Rather, it appears that this is a national trend rather than just a few states with isolated occurrences. In fact, the authors believe that this issue may be similar to what has happened with retirement plans. Approximately forty years ago, most courts held that retirement plans were not divisible and therefore not subject to division in the domestic relations context. However, now all states value retirement plan interests and readily divide them in divorce settlements.

The following courts, listed alphabetically by state, have found a remainder interest to be a marital asset eligible for division in a divorce:

(1) Alaska - *Burrell v. Burrell*[89] - In 1975, the Alaska Supreme Court found a vested remainder interest subject to division.

(2) Colorado - *Balanson v. Balanson*[90] - In 2001, the Colorado Supreme Court held that any appreciation on a vested remainder interest subject to complete divestment was eligible for division as a marital asset.

(3) Connecticut - *Carlisle v. Carlisle*[91] - In 1994, the Superior Court of Connecticut found remainder interests in a credit shelter trust, marital trust, and an irrevocable trust to be marital property.

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(4) Indiana – *Moyars v. Moyars*[92] - In 1999, the Court of Appeals of Indiana distinguished *Loeb v. Loeb*.[93] *Loeb* had held that a contingent remainder interest was too remote to be considered marital property because if the husband predeceased his mother the entire trust property would pass to the husband's siblings. In *Moyars*, the husband owned a vested one-third remainder interest in real estate. The remainder interest was not contingent on him outliving his mother's life estate. Rather, the remainder interest would pass to his estate if he predeceased his mother. Therefore, the Court of Appeals held that a vested remainder interest was marital property.

(5) Massachusetts - *Davidson v. Davidson*[94] - In 1985, the Massachusetts Supreme Court held that neither uncertainty of value nor inalienability of a husband's vested remainder interest in a discretionary trust were sufficient to preclude division.

(6) Montana - *Buxbaum v. Buxbaum*[95] - In 1984, the Montana Supreme Court held that a husband who had benefited from his future interests, which were vested interests, by using them as collateral, could not construe them as a mere expectancy and preclude them from property division.

(7) New Hampshire - *Flaherty v. Flaherty*[96] - In 1994, the New Hampshire Supreme Court held that an anti-alienation clause and circumstances that the defendant's contingent remainder interest will not have value until his last parent dies did not preclude the treatment of the interest as marital property.

(8) North Dakota - *van Ossting v. van Ossting*[97] - In 1994, the North Dakota Superior Court held that when the present value of the husband's vested credit trust was subject to contingencies and was too speculative to calculate, the proper method of distribution was to award the wife a percentage of future payments.

(9) Ohio - *Martin v. Martin*[98] - In 1978, the Ohio Supreme Court found that a future interest, whether contingent or executory, is alienable.

(10) Oregon - *Benston v. Benston*[99] - In 1983, the Oregon Appeal Court found that a vested, as well as a contingent, remainder interest is subject to division.

(11) Vermont - *Chikott v. Chilkott*[100] - In 1992, the Vermont Supreme Court held that techniques of actuarial valuation of pension interests were applicable to determining the present value of the husband's vested, defeasible trust interest for the purposes of property division at dissolution.

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(12) Wisconsin - *Trowbridge v. Trowbridge*[101] - In 1962, as dictum the Wisconsin Supreme Court held that remainder interests in trust subject to conditions of survivorship, depletion of corpus, and spendthrift clause, were part of a marital estate subject to division at divorce.

To date, twelve states have held that a vested remainder interest is property that is eligible for division in a divorce. Some of these states require the property to be vested, but most of them hold that a vested remainder interest, even if subject to complete divestment, is a marital asset. In this respect, the *Balanson* case is not the shock that many people first suspected. Rather, it appears to be a common finding in many courts when all or part of a remainder interest is considered marital property.

One may ask why more states have not found a vested remainder interest to be property eligible for division. First, as noted above, a handful of states still follow the theory that a vested remainder interest is not divisible, or that it is a mere expectancy, or that it is too remote to be classified as marital property. However, the primary reason more states have not found that a remainder interest is marital property is because in most states an inheritance, including any appreciation on the inheritance, is separate property. On the other hand, many of the aforementioned states that have concluded that a remainder interest is marital property have state statutes that in general are based on one of the following types:

(1) An inheritance is classified as a marital asset.

(2) An inheritance is classified as separate property. However, the appreciation on an inheritance is considered a marital asset.

(3) There is a test using certain factors for dividing all property owned by either spouse at the time of dissolution. More specifically, based on the state statute, the judge has complete authority to give the separate property of one spouse to the other spouse for various reasons such as the length of the marriage, the contributions to the marriage of the receiving spouse, the needs of the spouse who has custody of the children, and the lower income level of the receiving spouse.

In the states that hold that a remainder interest is property eligible for division on the dissolution of a marriage, an estranged spouse has greater rights than an ordinary creditor. Under the Restatement Second, an ordinary creditor cannot generally attach the remainder interest until it is distributed because the interest is either contingent or subject to a spendthrift provision.[102] However, as noted above, a spouse is an exception creditor for purposes of child support and alimony, not with respect to the division of marital property.[103]

Furthermore, it appears from the older cases that the general rule was that a spouse attempting to receive a property settlement has a standing no better than that of any other creditor.[104] Unfortunately, in all but one of the cases cited above, the courts did

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not discuss the spendthrift issue. In one case, *Davidson v. Davidson,* however, the Supreme Court of Massachusetts did mention the spendthrift provisions. Later in the opinion, without discussing the spendthrift provisions, the Court stated that it rejected the contention that "the content of estates of divorcing parties ought to be determined by the wooded application of the technical rules of the law of property. We [the Supreme Court of Massachusetts] think an expansive approach, within the marital partnership concept, is appropriate."[105] Therefore, as applied to remainder interests, a former spouse in many states has greater rights to a remainder interest than an ordinary creditor.

In light of these issues, it is shocking that more estate planners do not create discretionary multigenerational dynasty trusts[106] as a matter of course. Presumably, this is either because most attorneys' formbooks do not have this option, or simply because many attorneys do not strive to do the best job possible for their clients. Regardless, it should be inexcusable for a planner not to recommend a multigenerational trust, and if the client chooses not to use one, then at a minimum the attorney should make note in the client's file that this option was discussed, and probably should obtain a signed waiver from the client.

Discretionary Distributions Imputed in Computing Alimony

One appellate court in Massachusetts initially appeared to have completely ignored virtually all case law on discretionary trusts. The Massachusetts Court of Appeals held that the amount of alimony could be based on imputing income from a discretionary trust.[107] As noted above, a discretionary trust is not even a property interest, and the trustee may make distributions in the trustee's "sole and absolute" discretion. A beneficiary has no right to sue for a distribution except under a bad faith standard. Therefore, how could it be possible that income would be imputed to a beneficiary who could not even sue for a distribution? This case only begins to make sense in light of the radical changes that are adopted by both the Uniform Trust Code and Restatement Third when they are compared to current trust law.

The Uniform Trust Code

Presently, nine states - Kansas, Maine, Missouri, Nebraska, New Hampshire, New Mexico, Tennessee, Utah and Wyoming - have enacted the UTC. The UTC is under review in numerous other states. The District of Columbia has also enacted the UTC. On the other hand, Arizona enacted the UTC in May of 2003. Within a year, due to the public outcry and the estate planning attorneys' strong opposition to the UTC, it was repealed by unanimous vote of both the House and the Senate. The UTC was also defeated in the Colorado legislature and killed in a Senate Committee in Oklahoma despite the support of both Bars. After intensive study in Texas, Minnesota, and Indiana, some minor portions of the UTC were adopted, but most of the provisions of the UTC were rejected. Further, the Texas Bar is currently drafting anti-Restatement (Third) of Trusts legislation. One of the principal reasons the UTC was repealed in Arizona and is receiving strong resistance in several other states is the radical departure that the UTC

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and Restatement Third take from common law regarding the traditional asset protection afforded by discretionary dynasty trusts as well as spendthrift trusts in general.

For well over four hundred years, trust law has been based on the property concept that a donor may make a gift subject to whatever restrictions he wishes. While there are some limited public policy exceptions to this rule, such as restrictions on marriage, the common law has generally allowed trusts to follow the settlor's intent. The UTC and the Restatement Third are both built on the opposite assumption.

As related to discretionary trusts, the UTC and Restatement Third are built on the assumption that the beneficiaries should have a much greater right to challenge the settlor's wishes through litigation than prior law has allowed. In addition to changing the fundamental property assumption behind trust law, both promulgations overturn one hundred twenty-five years of well-established trust law by equating the asset protection features of a discretionary trust with those of a support trust. For this reason, in the area of traditional asset protection through non-self-settled trusts, should a state legislature adopt the Uniform Trust Code or should a court decide to follow the Restatement Third, a completely separate analysis of asset protection is provided below.

Understanding the UTC

The UTC and the Restatement Third are interrelated. In fact, the comments from the UTC have over one hundred specific references to the Restatement Third's text, comments, and reporter notes. Additionally, the comment under Section 106 of the UTC implies that the Restatement Third should even be given a preference over common law when interpreting the UTC.

Furthermore, the committees of both the Restatement Third and the UTC worked hand in hand to draft several areas of new trust law. While there are minor differences in the asset protection issues between the two pronouncements, for the most part the two pronouncements read as though they were written by the same authors. With respect to traditional asset protection, the Restatement Third is for the most part not a restatement of trust law at all. Rather, it is a new and untested approach to trust law. The same is also true for Article 5 of the UTC, which appears to be an abbreviated version of the Restatement Third, Sections 50 and 56-60.[108]

Finally, if one is to read Article 5 of the UTC without reading corresponding Restatement Third Sections, one might easily conclude that the UTC is incredibly confusing and poorly drafted. However, if one reads the Restatement Third prior to reading Article 5 of the UTC, even though it is still poorly drafted, Article 5 of the UTC begins to make some sense. Therefore, in order to understand Article 5 of the UTC, the reader may wish to first read the aforementioned Sections of the Restatement Third.

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The Cornerstone of the Common Law Discretionary Trust

Under the common law, a court would only interfere with a trustee's "sole and absolute" discretion of a discretionary trust if the trustee (1) acts dishonestly, (2) acts with an improper motive, or (3) fails to use his or her judgment.[109] A beneficiary had little if any standing to sue for a distribution or question the amount of a distribution unless the beneficiary could prove one of the above factors was present. In almost all states, there was no reasonableness or good faith standard for a discretionary trust that used qualifying adjectives such as the trustee's "absolute," "unlimited" or "uncontrolled" discretion. In fact, Section 187 of the Restatement Second held that such qualifying adjectives dispensed with the standard of reasonableness.

Since the beneficiary had such a high threshold to meet, the beneficiary had virtually no enforceable right (i.e., property interest). *This lack of an enforceable right is the* ***fundamental cornerstone*** *for the asset protection behind a discretionary trust.* The principle is simple. A creditor cannot compel the trustee to pay anything because the beneficiary cannot compel payment.[110] This is the common law asset protection difference between a support trust and a discretionary trust. A support trust has a reasonableness judicial standard of review, while the judicial review of a discretionary trust is typically limited to the trustee acting dishonestly, acting with an improper motive, or failing to use his or her judgment (i.e., "bad faith" standard).

Ohio – A Tale of What Not to Do

The following analysis of Ohio law demonstrates the beginning of the problems that occur with the judicial standard of review is dropped to Ohio's possible definition of abuse, good faith or reasonableness. In Ohio, it appears that the standard of review of a discretionary trust has gradually been shifting from a bad faith type of concept to more of a reasonableness standard. In 1945, the Ohio Supreme Court held that "[w]here the terms of a trust provided that the trustee shall pay to a beneficiary only so much of the income and principal, or either, as the trustee in his uncontrolled discretion shall see fit to pay, the beneficiary cannot compel the trustee to pay him any part of the income or principal."[111] This would mean that the beneficiary would have little, if any, standing in court. However, by 1955 it appears that the standard was shifting to one of "good faith" in Ohio.[112]

Adding more confusion, in 1962, in *Culver v. Culver*[113] the Appellate Court stated that "[o]f course the courts have supervision over discretionary trusts; but the sole inquiry is whether the discretion exercised by the trustee has been abused; if the bank, in the exercise of good faith, failed to exercise its discretion, or having exercised it, was guilty of bad faith,[114] then the courts can interfere, but not before." Here the Court appears to be stating that both a good faith standard and an abuse standard apply.

In 1968, in a supplemental needs case, the Ohio Supreme Court held that even if a discretionary distribution standard utilized the qualifying adjectives of "sole and absolute" discretion, if the distribution language was coupled with an enforceable

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standard, it was an abuse of discretion if the trustee did not make minimum distributions to a destitute beneficiary.[115] The Court did not discuss what abuse standard Ohio had adopted or what category of abuse into which the above situation would fall. Rather, the Court merely held that the fact pattern constituted abuse. Further, the Court held that because of the enforceable standard, the trust was neither purely a discretionary trust nor purely a support trust. The standard was "care, comfort, maintenance, and general well-being." The result of this analysis was that the governmental agency was able to recover directly from the trust assets by forcing a distribution pursuant to the standard. This would not be the case in almost all common law states that retain the discretionary/support dichotomy.

In 1978, the Ohio Supreme Court extended the concept of *Kreitzer* to allow a spouse to recover for child support from a discretionary trust that was coupled with a standard. Further, the Ohio courts for the most part consistently continued to apply the *Kreitzer* analysis, with the result that Medicaid and governmental agencies would recover from a discretionary trust's assets.[116] The unreported 1997 and 2001 cases of *In the Matter of Trust Created by Item III of Will of Zemuda*[117] and *Buoscio v. Estate of Buoscio*[118] added further confusion to what review standard Ohio has for a discretionary trust. In these decisions, the courts used a standard of abuse requiring that the trustee act unreasonably, unconscionably, or arbitrarily. Finally, in 2001, an Ohio Appellate Court held that a discretionary trust was an available resource and it was proper that the beneficiary was denied Medicaid eligibility.[119] The Ohio Appellate Court reasoned that the beneficiary had an enforceable right under *Kreitzer*. As such, the Ohio Department of Human Services was correct in denying benefits since the discretionary trust was an available resource under Ohio's definition of abuse.

In the 1989 case, *In re Estate of Winograd*,[120] the Ohio Appellate court used a "reasonableness" standard in reviewing a discretionary trust. Unlike the *Kreitzer* line of cases where the Ohio definition of "abuse" or the "good faith" standard allowed the governmental Medicaid and special needs creditors to either recover from the trust or deny benefits, *Winograd* attacks the basis of a beneficiary controlled trust.[121]

One of the key ideas behind a beneficiary controlled trust is that the reason a beneficiary is happy to receive his share of an inheritance in trust is because should the beneficiary need the funds, the trustee may distribute all of the trust funds to him. In other words, the trustee may completely exclude any other beneficiaries from any distributions, and all amounts may be paid to the primary beneficiary if needed. In applying a reasonableness standard, the Ohio Appellate Court held that the trustee abused his discretion by distributing all of the income to the primary beneficiary.

The Court came to this conclusion even though the trust had specific language stating that the trustee could make distributions of income "to or for the benefit of any one or more to the exclusion of any one or more" of the beneficiaries, and the trustee should consider the primary beneficiary first and the primary beneficiary's descendants second in making distributions. Unfortunately, Ohio is not alone in destroying one of the

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fundamental aspects of a beneficiary controlled trust. The Restatement Third also takes the same position as the appellate court in *Winograd*.[122]

Uniform Trust Code and Restatement Third

Both the UTC and the Restatement Third expand the approach used in Ohio that caused so many problems from an asset protection perspective. The UTC makes it clear that a "good faith" standard applies, and the Restatement Third makes it clear that a "reasonableness" standard applies.

While comment b of the Restatement Third provides that "judicial intervention is not warranted merely because the court would have differently exercised its discretion," Section 50, comment b provides that "a court will not interfere with a trustee's exercise of a discretionary power when that exercise is reasonable and not based on an improper interpretation of the terms of the trust."[123] The comment continues, "[a] court will also intervene if it finds the payments made, or not made, to be <u>unreasonable</u> as a means of carrying out the trust provisions." [Emphasis added.]

The UTC does not impose a reasonableness standard. Rather, Section 814(a) provides a good faith standard. According to that Section, "[n]otwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such term as "absolute," "sole," or "uncontrolled," the trustee shall exercise a discretionary power in good faith in accordance with the terms and purposes of the trust and the interests of the beneficiaries." The Restatement Third, Section 50, comment c has a similar construction where it states that words such as "absolute," "unlimited," "sole" and "uncontrolled" discretion "are not interpreted literally." Rather, the trustee must still accomplish the purposes of the discretionary power. In essence, both the UTC and the Restatement Third use a relatively equivalent standard of review by a court, and this standard of review provides a much lower threshold for a beneficiary than the bad faith standard of prior law.[124]

When drafting discretionary trusts, many attorneys also include a broad standard for making distributions. According to the Restatement Third, an abuse of discretion depends upon "the proper construction of any accompanying standards, and on the settlor's purpose in granting the discretionary power." In other words, if a discretionary trust states that the trustee may make distributions in the trustee's sole and absolute discretion for health, education, maintenance, support, comfort, general welfare, happiness and joy, each separate standard listed may well need to be examined to determine whether the trustee's discretionary decision to distribute or not to distribute was reasonable.

On the other hand, the Restatement Third also goes to great lengths to prevent attorneys from drafting out of this problem. Many attorneys suggest that a discretionary trust should not even include a distribution standard. By eliminating any distribution standard, it would be unlikely that a judge would conclude that the trust is anything other than a discretionary trust since the judge could not mistake the trust as a support trust.

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Further, it would be unlikely that a judge would question the trustee's distribution decisions. Unfortunately, Section 50, comment b of the Restatement Third provides "[i]t is not necessary, however, that the terms of the trust provide specific standards in order for a trustee's good-faith decision to be found unreasonable and thus constitute an abuse of discretion." If a standard is omitted, the court will still apply a reasonableness or good-faith judgment "based on the extent of the trustee's discretion, the various beneficial interests created, the beneficiaries' circumstances and the relationships to the settlor, and the general purposes of the trust."[125]

Once the threshold for the judicial standard of review has been reduced to reasonableness or good faith, in almost all cases, the beneficiary should have an enforceable right to a distribution. This being the case, may a creditor stand in the beneficiary's shoes under the UTC or the Restatement Third? Even if a creditor may not stand in the beneficiary's shoes, similar to the *Metz* case in Ohio, may a governmental agency deny benefits by considering a discretionary trust as an available resource? Also, would the discretionary trust be considered an equitable factor in determining child support, alimony, and possibly an equitable division of marital property? Finally, should a beneficiary be imputed income from a trust for the purpose of computing child support and alimony? All of these issues are discussed in the following material.

Asset Protection for Discretionary and Support Trusts Now the Same?

The traditional trust analysis has explained in detail the enhanced degree of asset protection provided by a discretionary dynasty trust. The asset protection under common law afforded by a discretionary dynasty trust is based on a property analysis (i.e., whether there is an enforceable right). On the other hand, for a support trust, the asset protection is based on spendthrift protection, subject to the four exception creditors.

In addition to changing the standard of review, both the UTC and the Restatement Third again change one hundred twenty-five years of established trust law by eliminating the discretionary trust property analysis. The provisions in the Restatement Third make it clear that asset protection will be based solely on the same spendthrift protection analysis.[126] In other words, there is no property analysis for a discretionary trust under the Restatement Third or the UTC.[127] For a number reasons, this is quite a dramatic change from an asset protection perspective.

First, third-party Medicaid trust planning or special needs trust planning is based on meeting the definition of a discretionary trust under state law. Whereas a governmental agency, as an exception creditor, may recover from a support trust, a governmental agency cannot recover from a discretionary trust. Unfortunately, under the UTC and the Restatement Third, the change of the standard of judicial review, equating a discretionary trust to a support trust, and the probable expansion of exception creditors as discussed below, may soon make it possible for a governmental medical agency to recover directly from a discretionary trust.

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Second, claims of the U.S. or state governments, including the Internal Revenue Service, have never been enforced against a discretionary trust. Again, this is because a beneficiary has no right of recovery. Therefore, a creditor does not receive greater rights than the beneficiary. Third, except for the one Massachusetts Court of Appeals case, which appears to have relied on a draft of the Restatement Third for its holding, a former spouse has no right of recovery against a discretionary trust, even for alimony or child support. Fourth, attorney fees incurred on behalf of a beneficiary suing a discretionary trust for a distribution would most likely not be recovered from the trust. Therefore, under the Restatement Third and the UTC, virtually all of the asset protection of a discretionary trust is lost, and the discretionary trust is forced to rely on the much lesser protection afforded by a spendthrift trust.[128]

A flowchart for both discretionary and support trusts under this analysis would be as shown in Exhibit E.

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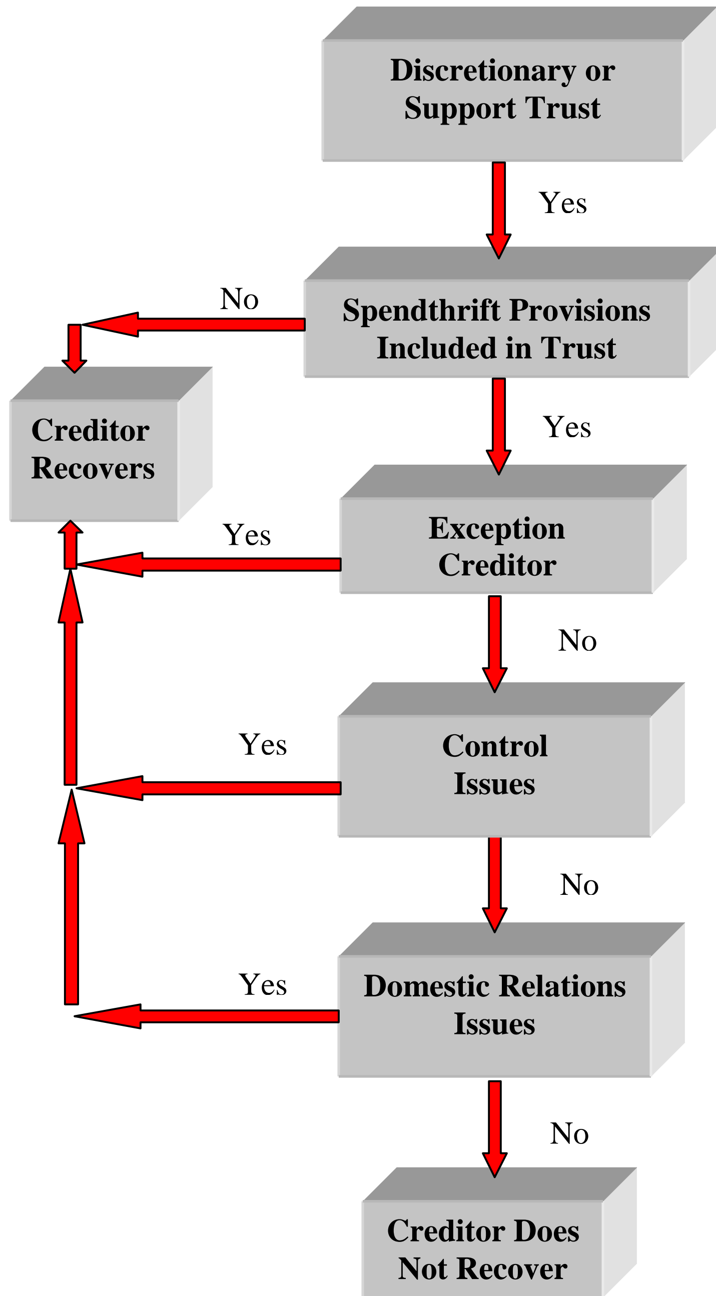
Exhibit E



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Continuum of Discretionary Trusts More Protective?

One might argue that under the UTC and Restatement Third all trusts should now receive greater asset protection because all trusts are now on a "continuum of discretionary trusts." However, this conclusion is incorrect. The reason that a creditor could not force a distribution from a discretionary trust was because the beneficiary could not do so. This was because the beneficiary had very little standing in court under the bad faith review standard.[129] As previously discussed, under the UTC the review standard has been changed to good faith, and under the Restatement Third the review standard has been changed to reasonableness. The issue is not what title (i.e., the term "discretionary") is assigned to a trust. The issue is whether the beneficiary has an enforceable right if the beneficiary can force a distribution. Unfortunately, the case law from Ohio proves this to be the case. Once the beneficiary has an enforceable right (i.e., a property interest), the following concerns are issues:

- What remedies are available to exception creditors?
- What remedies are available to ordinary creditors?
- Whether governmental aid will be denied because the trust will be considered an available resource?
- Whether the beneficiary's interest will be considered either marital property or a factor for equitable division in the divorce context?
- Whether income will be imputed to a beneficiary for the purpose of computing child support or alimony?

Expansion of Exception Creditors?

Similar to the Restatement Second, both the UTC and the Restatement Third have a list of exception creditors. Some have argued that, at least in the short term, since the UTC list of exception creditors is smaller than that of the Restatement Second, the UTC is more protective for support trusts (but not for discretionary trusts). In the short term, this may be the case. However, since the Restatement Second was promulgated almost fifty years ago, only three of the four exception creditors have been generally adopted by state courts. On the other hand, when legislators have been given the ability to determine exception creditors, the magnitude of the exception creditors appears to be much more expansive than the judicial exception creditors. Therefore, this greater asset protection for a support trust may last for only a relatively short period of time.

A. Restatement (Second) of Trusts

The Restatement Second lists the following four exception creditors:

1. Alimony and child support;
2. Reasonable needs of a beneficiary;
3. Expenses to preserve a beneficial interest; or
4. Any federal or state claim.

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The exception for expenses to preserve a beneficial interest (i.e., attorney fees for a beneficiary, or an exception creditor standing in the shoes of the beneficiary suing the trust) never gained much acceptance in the state courts. It is for this reason, in the fifty-year period since its promulgation, only three of the four exception creditors have gained acceptance by the state courts.

B. Uniform Trust Code

From an asset protection perspective, at first glance it appears that the UTC is an improvement over the Restatement Second since it reduces the number of exception creditors to three exception creditors. The exception creditor for "necessary expenses of the beneficiary" appears to have been deleted.

1. "...a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance, or
2. 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."[130]
3. "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."

However, for the most part, this is not really the case. The UTC has actually combined most of the necessary expenses of a creditor cases (i.e., Medicaid and special needs trust cases) with the third exception for claims by the federal or state government. Whereas exception creditors had no claim against a discretionary trust under common law, all exception creditors would be allowed to directly attach the assets of a discretionary trust under the UTC or Restatement Third. Furthermore, future exception creditors may now be added both judicially and legislatively.

At first glance, the UTC appears to be an improvement for Medicaid and special needs trusts over the common law of most states. This is because a state or federal government must now pass a statute in order to recover from a Medicaid or special needs trust. Governmental agencies that provide benefits are no longer automatically considered an exception creditor (i.e., the necessary expenses of a beneficiary under the Restatement Second).

Once the state government agencies realize that they no longer may recover from this type of trust, it may be only a matter of time before the state or federal government is able to convince the state legislators to add them as an exception creditor. At this time, a state or federal governmental agency would be able to recover from all trusts in a UTC state, including third party discretionary Medicaid or special needs trusts. In almost all states, the UTC is retroactive. It applies to all trusts regardless of whether they were created before or after the effective date of the UTC.

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Under UTC §504(d), a beneficiary is never limited "to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution." The term "abuse" has been redefined to mean "good faith" under the UTC or "reasonableness" under the Restatement Third. Therefore, even with respect to a discretionary trust, the beneficiary now has a right to reach the underlying assets pursuant to a good faith or reasonableness standard.

Under §541 of the Bankruptcy Code,[131] upon the filing of a bankruptcy, the bankruptcy estate receives all of the assets of the debtor. Due to the decrease in the review standard to good faith, all beneficiaries of a discretionary trust have an enforceable right that is also most likely considered to be a property interest under state law. Therefore, this discretionary beneficial interest is now part of the bankruptcy estate. Further under §541, the bankruptcy trustee stands in the shoes of the bankrupt for all purposes. Does this mean that the bankruptcy trustee may now exercise the beneficiary's rights to force a distribution pursuant to UTC §504(d)? Under §541(c)(1), any contract clause or other arrangement calling for the termination of rights upon the filing of a bankruptcy may be voided by the Bankruptcy Court. Prior to the UTC and the Restatement Third, this was not an issue with a discretionary trust because the beneficiary of a discretionary trust did not have a right to force a distribution.

Furthermore, the list of exception creditors may easily be expanded under the UTC. For example, for many years, the trial bar has attempted to create an exception for tort creditors. The Mississippi Supreme Court actually adopted this view in *Sligh v. First National Bank of Holmes County*.[132] Approximately one year from the Supreme Court rendering this landmark decision, the Mississippi legislature specifically overturned the Mississippi Supreme Court by statute due to the anticipated loss of trust business that would migrate to other states with more favorable trust legislation.[133] Under the UTC, the state legislature may easily do this statutorily by simply appending an unnoticed exception as part of any other bill that passes through the legislature.

In addition to the tort creditor exception, what if the federal bankruptcy code one day references the UTC exception creditor list? Section 503(c) provides that "[a] spendthrift provision is unenforceable against a claim of this State or the United States to the extent a statute of this state provides." The federal bankruptcy code could take advantage of this loophole by enacting a statute such as, "[t]he Federal Bankruptcy Trustee is an exception creditor pursuant to Section 503(c) of any State that has adopted this provision of the Uniform Trust Code?"

All a creditor need do is file an involuntary bankruptcy against the debtor, assuming the requirements for such a filing are met, and the creditor would have easy access to the trust assets. In essence, this would mean all judgment creditors - not just alimony, child support, necessary expenses of the creditor, federal claims, state claims and tort creditors - but anyone who had a debt greater than $11,625.[134] Should federal bankruptcy law ever allow recovery against a trust in a UTC state, *there is virtually **no** asset protection provided by a spendthrift provision.* In other words, all credit card

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companies as well as any other creditors could easily recover from any spendthrift trust through this possible bankruptcy end run approach.

Many asset protection attorneys have indicated that, with a spendthrift trust, all the trustee need do to avoid attachment and still support the beneficiary is to pay the debtor/beneficiary's expenses directly rather than making a distribution to the beneficiary.[135] Both the UTC and Restatement Third end this possibility. Section 501 of the UTC provides that a creditor may attach "present or future distributions to *or for the benefit of the beneficiary.*" Section 60, comment c and Illustration 4 of the Restatement Third provide that, "[i]f the trustee has been served with process…, the trustee is personally liable to the creditor for any amount paid to or applied for the benefit of the beneficiary in disregard of the rights of the creditor.

The inability of the trustee to pay the expenses of a beneficiary is much more expansive that one might think. This is how most special needs trusts pay beneficiaries' expenses so that a distribution is not considered an available resource. Also, the interpretation of UTC §501 may lead to the unfortunate conclusion that all creditors may attach present or future distributions. This is because UTC §501 provides that "[t]o the extent a beneficiary's interest is not protected by spendthrift provisions, 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 . . ." Pursuant to the Restatement Second,[136] any distributions received by a beneficiary are not protected by spendthrift provisions.[137] The result is that spendthrift provisions only protect assets while held in trust. Therefore, if spendthrift provisions only protect assets that are held in trust, does UTC §501 allow attachment by <u>any</u> creditor? If UTC §501 is interpreted this way, **it for the most part almost completely defeats the asset protection benefits of using a trust** since any creditor could attach and merely wait for satisfaction of his or her claim.

The UTC does not limit the courts from adding judicially created exception creditors. Further, the Restatement Third encourages the expansion of exception creditors. Comment a(2) specifically provides that "[s]pecial circumstances or evolving policy may justify recognition of other exceptions, allowing the beneficiary's interest to be reached by certain creditors in appropriate proceedings….[p]ossible exceptions in this case require case-by-case weighing of the relevant considerations and evolving policies."

In essence this part of the Restatement Third gives the courts a blank check to create an exception at the court's whim. So while the UTC exception list is incredibly troublesome from an asset protection perspective, interpretation of the UTC by the Restatement Third is much worse. Furthermore, this portion of the Restatement Third continues, "[i]n some circumstances, to permit attachment despite the spendthrift restraint may not undermine, <u>and may even support, the protective purposes of the trust</u> [emphasis added] or some policy of law." Since it is inconceivable that a client would ever ask the trust scrivener to draft the trust so that creditors of the beneficiaries can recover from the trust, it is unlikely that this could ever be a "purpose" of the trust.

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Under the Restatement Second, it appeared that when attorneys sued the trust for fees to protect a beneficial interest, the courts seldom adopted the exception. The UTC takes the opposite position of common law by codifying this exception for attorney's fees.[138] The comment under Section 503 provides that "[t]his exception allows a beneficiary a 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." However, almost all discretionary trusts are created with the purpose that the beneficiaries have virtually no right to challenge the trust. Hence, the terms "sole," "absolute," "unfettered" and "uncontrolled" discretion were used to mean exactly what they say.

Under the UTC and the Restatement Third, a reasonableness standard (or good faith standard) is now imposed on the trustee. Does the attorney fee exception under the UTC now mean that the trust is obligated to pay for a challenge by the beneficiary where most likely such challenge is against the settlor's wishes? Further, does this mean that an exception creditor may challenge a discretionary trust when suing under the distribution standard, and that the trust is obligated to pay for it? Unfortunately, with the first situation this may easily be the case, and, with the second situation, neither the statutory language of the UTC nor its Comments clearly establish whether this is in fact the case.

C. Restatement (Third) of Trusts

The Restatement Third adopts a substantially similar approach to that of the UTC by imposing a reasonableness standard of review. In this respect, the Restatement Third is in no sense a restatement of the current law of trusts at all. As related to the common law of almost all states, the Restatement Third is a complete rewrite of history in this area.

At first blush, the Restatement Third appears to have narrowed the exception creditors to three:

(a) Support of a child, spouse, or former spouse;
(b) Services or supplies provided for the necessities; or
(c) For the protection of the beneficiary's interest in the trust.[139]

However, comment a(1) specifically provides that governmental claimants, and other claimants as well, may reach the interest of a beneficiary of a spendthrift trust to the extent provided by federal law or an applicable state statute.

Special Needs Trusts

With respect to Medicaid or special needs trusts, the UTC and Restatement Third create two big concerns. First, will a federal or state government be able to attach the beneficial interest? Second, will the Medicaid or special needs trust be considered an available resource of the beneficiary?

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For states that pass the UTC, it may only be a short period of time before third party[140] Medicaid or special needs type planning will be greatly curtailed and eventually eliminated. If the discretionary trust and support trust distinction no longer exists, then the federal government or state legislature can pierce any trust by enacting a statute saying that the government may attach the beneficiary's interest and reach some or all of the trust assets.

In states that do not follow the UTC or Restatement Third, an interest in a discretionary trust is not a property interest (i.e., and enforceable right). Both Medicaid trust and special needs trust planning depend on the dichotomy between discretionary and support trusts related to this property issue. In fact, the federal or state government need not necessarily attach a beneficiary's interest. The federal or state government may merely consider the trust as an "available resource" and deny benefits.[141]

Beneficiary as Sole Trustee

Attorneys often draft trusts in which one of the beneficiaries is the sole trustee. For estate tax purposes, such a trust, if drafted correctly with an ascertainable standard, is not included in the trustee/beneficiary's taxable estate.[142] Unfortunately, under the Restatement Third, Section 60, when a trustee/beneficiary is the sole trustee, any creditor, not just an exception creditor, may reach the maximum amount that the trustee may properly take.[143] The Restatement Third departs from common law. Originally, the UTC was silent on this issue. However, after opponents to the UTC expressed their concern over this issue, the UTC was amended in August of 2004 so that a sole trustee/beneficiary's interest would not be subject to creditor attachment if such interest was limited by an ascertainable standard.

Domestic Relations Case and Imputed Income

In *Dwight v. Dwight,*[144] upon dad's death, sixty percent of the estate went to his two daughters outright, and the other forty percent of the estate went to the son in a discretionary trust.[145] The trust was created approximately two years after this second son was divorced. The trust was discretionary, and the distribution provisions provided that the trustee may make distributions of income and principal as the trustee deems to be necessary or desirable for the support, comfort, maintenance or education of the beneficiaries. The court concluded that this was a discretionary standard. The beneficiaries were the son and the son's issue. During the nine years prior to the Massachusetts Appellate Court decision, the trust made one discretionary distribution of $7,000 to the son. During this period of time, the trust corpus grew from $435,000 to a value of $984,000.

The trial court judge stated that it was highly likely that the principal reason the son received his inheritance in trust rather than outright was in order to defeat a claim for alimony. The trial court further found that the son had access to additional funds at anytime he desired based on two facts:

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(1) The broad purposes for which the trustee may make payments to the son; and

(2) A statement the son made to the trustee that he did not need any additional money.

The trial court found that the son's earnings should be imputed from the discretionary trust for purposes of alimony. The Massachusetts Court of Appeals agreed with the trial court.

Without any discussion, the Appellate Court dismissed the son's contention that the trust was a discretionary trust. Rather, the opinion cites the Restatement of Trusts (Third), Section 59 (Ten. Draft No. 2, 1999) as authority for dismissing the son's claim. As noted above, under the Restatement Third as well as the UTC[146] a spouse can reach the assets of a discretionary trust for alimony and child support. Further, a judge may determine what amount the trustee should "reasonably" distribute or what amount should distributed in "good faith."[147] The broad standards for the purpose of the distributions must be analyzed to determine whether distributions should have been made (and therefore be part of the alimony computation). Here, the court determined that defeating an alimony claim was not an acceptable purpose. Therefore, under both the UTC and the Restatement Third, the court was within its authority to impute income to the husband for the basis of alimony, even though he only received a token of what was imputed to him.

Although *Dwight v. Dwight* relied on the Restatement Third in reaching its conclusion, the case was decided before the Restatement Third was even finalized. Further, Massachusetts has not yet adopted the UTC. However, if Massachusetts had adopted the UTC, to add insult to injury, it appears that the former spouse would also be able to recover legal fees from the trust.

End Round to Force A Distribution For All Creditors

All creditors may attach an "overdue" or "mandatory" distribution under UTC §506. Unfortunately, the terms "overdue" and "mandatory" are both undefined. Further problems are created when one refers to the Third Restatement for interpretation of a mandatory distribution under the newly created theory of a "continuum of discretionary trusts."[148] This is because a judge must now interpret the distribution language of the trust to determine where the trust should be classified on this new undefined continuum of discretionary trusts.

Once this determination has been made, the judge would then determine when and how much should be periodically distributed to the beneficiary. This is the amount that would become an overdue distribution in the event it was not timely paid. For example, distribution language such as "the trustee may make distributions, in the trustee's sole and absolute discretion, for health, education, maintenance, and support" may create a scenario in which the judge concludes that the trustee should periodically

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make distributions to the beneficiary. If this is the result, then these deemed distributions would be subject to attachment by any creditor.

Planning Around the Restatement Third and UTC

As noted above, both the UTC and the Restatement Third seem to have gone to great lengths to greatly reduce the asset protection provided by creating a reasonableness or good faith standard, even if the terms of the trust provide for the opposite. Therefore, the trust scrivener should consider providing absolutely no standard whatsoever when drafting a discretionary trust. For example, the trust could be drafted such that "the trustee may make distributions in his sole and absolute discretion to any beneficiary."

While this will provide some help to mitigate the asset protection problems posed by the Restatement Third, it may not solve the problem. This is because, under Section 50, comment d, when no standard is provided, the Restatement of Trusts Third provides that "even then a general standard of reasonableness, or at least a 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." Regardless, not including a standard of distribution will make it more difficult for a judge to conclude that the intent of the settlor was to create an enforceable right in the beneficiary for a distribution.

While all exception creditors may generally attach a remainder interest, it appears that a remainder interest in a dynasty interest would not be able to be attached because it is an interest that does not vest with anyone. In this respect, drafting trusts with dynasty interests should still avoid many creditor issues and should be a matter of course for most clients, not just a technique for the ultra-wealthy.

Forum Shopping

From an asset protection perspective, the defects in both the UTC and Restatement Third may be so great that clients domiciled in a UTC state should strongly consider forum shopping and using the laws of another state for their high-net-worth clients. From a domestic perspective, an estate planner will have two options: (1) a non-UTC state, or (2) a domestic asset protection trust ("APT") state. A domestic APT state may prove to be a better choice. First, in the event a conflict of law issue arises between a non-UTC state and a domestic APT state, many judges in non-UTC states may not be as concerned with upholding their own state law as would a judge in a domestic APT jurisdiction. Second, it appears much more likely that a domestic APT state would have a strong public policy reason to see the conflict of law issue through to the U.S. Supreme Court. For domestic asset protection trust states, estate planners should consider Alaska, Delaware, Nevada, and Rhode Island.

Unfortunately, the conflict of law clause in both the UTC and the Restatement Third allow a judge to use the "most significant relationship" test if the law chosen under the trust violates a strong public policy of the forum state.[149] It is questionable whether

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the U.S. Supreme Court would uphold this conflict of law provision. However, a factor test, including the factors of the residence of the trustee, the location of assets, where the trust was originally formed, the residence of the settlor, and the residence of the beneficiaries, may be more determinative. In this respect, the more factors in favor of the non-UTC jurisdiction, the more likely the choice of law clause in the trust will be upheld. Furthermore, two of the factors - the residence of the trustee, as well as the location of the assets - may be weighed to a greater extent than the other factors. For this reason, in the event the estate planner has decided that forum shopping is the best alternative, it may be wise to move all liquid assets out of UTC states to non-UTC jurisdictions.

Conclusion

While the Uniform Trust Code has not yet been adopted by many states, nor are the authors aware of a reported case interpreting the asset protection results decided under the Restatement Third (with the exception of *Dwight v. Dwight),* both of these promulgations would change over one hundred and twenty-five years of common law regarding the distinction between support trusts and discretionary trusts. Unfortunately, the changes would operate to significantly reduce the asset protection of discretionary trusts and special needs trusts from all exception creditors, including an estranged spouse.

Furthermore, the possible expansion of exception creditors in this area of spendthrift trusts is quite troublesome, particularly in the bankrupt context. The possible classification of current as well as remainder interests as marital property, a factor to be used to determine the equitable division of marital property, and the imputation of income from the trust for the purpose of child support and alimony, also create problems.

The ability for all creditors to force a distribution based on the undefined distribution terms "mandatory" and "overdue" adds further complications. Finally, in the event a court determines that all creditors may attach an interest in a trust and wait for any future distributions, then asset protection through spendthrift protection may be substantially impaired, if not virtually eliminated. The same is also true if the bankruptcy trustee is allowed to stand in the shoes of the debtor and force a distribution based on the standard included in the spendthrift trust. In this respect, in order to retain the traditional asset protection afforded by discretionary trusts and spendthrift trusts, many estate planners may want to forum shop by moving both the trust and the underlying assets out of a UTC state.

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[1] Howard D. Rosen, 810 T.M., Asset Protection Planning, BNA Tax Management Portfolio at A-1.

[2] *Restatement (Second) of Trusts*, Section 157.

[3] Id.

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[4] As discussed later in this article, in a non-UTC state or non-hybrid trust state, exception creditors may only recover against a trust that is classified as a support trust, not against a trust that is classified as a discretionary trust.

[5] Rather than using a property analysis, some courts will find that the beneficiary's interest has no ascertainable value. *Miller v. Department of Mental Health*, 442 N.W.2d 617 (Mich. 1989); *Henderson v. Collins,* 267 S.E.2d 202 (Ga. 1980); *In re Dias*, 37 BR 584 (D. Idaho 1984). In essence, the analysis is the same - there is no interest or enforceable right that a creditor may attach because under this analysis the beneficial interest has no value.

[6] *Restatement (Second) of Trusts*, Section 155, comment b.

[7] *Miller v. Department of Mental Health*, 442 N.W.2d 617 (Mich. 1989); *Restatement (Second) of Trusts*, Section 157; *Henderson v. Collins,* 267 S.E.2d 202 (Ga. 1980); *In re Dias*, 37 BR 584 (D. Idaho 1984).

[8] *In re Bottom,* 176 B.R. 950 (N.D. Fla. 1994).

[9] *Restatement (Second) of Trusts*, Section 161.

[10] *Restatement (Second) of Trusts*, Section 162.

[11] *First National Bank of Maryland v. Dept. of Health and Mental Hygiene,* 399 A.2d 891 (Md. 1979); *Restatement (Second) of Trusts*, Section 154.

[12] *Chenot v. Bordeleau*, 561 A.2d 891 (R.I. 1989); *Eckes v. Richland County Social Services,* 621 N.W. 2d 851 (ND 2001); Restatement (Second) Trusts, Section 128, comments d and e.

[13] *Lineback by Hutchens v. Stout*, 339 S.E.2d 103 (NC App. 1986).

[14] For estate tax purposes, under IRC §2041, the "welfare" standard would result in the trust failing the definition of an ascertainable standard and thereby being deemed a general power of appointment. However, for the definition of a support trust, it is included within the ascertainable standard. Further, in some cases, language such as "comfort and general welfare" will also take the trust language outside that of a general support trust. *Lang v. Com., Dept of Public* Welfare, 528 A.2d 1335 (PA 1987); *Restatement (Second) of Trusts, Section 154* and comments thereto. But see *Bohac v. Graham*, 424 N.W.2d 144 (ND 1988).

[15] *Eckes v. Richland County Social Services*, 621 N.W.2d 851 (ND 2001).

[16] *McElrath v. Citizens and Southern Nat. Bank*, 189 S.E.2d 49 (GA. 1972).

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[17] *In re Carlson's Trust*, 152 N.W.2d 434 (SD 1967).

[18] *McNiff v. Olmsted County Welfare Dept.*, 176 N.W. 2d 888 (Minn. 1970).

[19] *First National Bank of Maryland v. Dept. of Health and Mental Hygiene,* 399 A.2d 891 (Md. 1979).

[20] *Town of Randolph v. Roberts*, 195 N.E.2d 72 (Mass. 1964); *Lineback*, 339 S.E. 2d at 106 (NC App. 1986); *Ridgell v. Ridgell,* 960 S. W. 2d 144 (Tex. App. 1997); *Restatement (Second) of Trusts,* Section 187, comment e.

[21] *State ex. rel. Secretary of SRS v. Jackson,* 822 P2d 1033 (KS 1991).

[22] *Myers v. Kansas Dept. of Social and Rehabilitation Services*, 866 P.2d 1052 (Kan. 1994).

[23] *McNiff v. Olmstead County Welfare Dept.*, 176 N.W.2d 888 (Minn. 1970).

[24] *In re Matter of Leona Carlisle Trust*, 498 N.W.2d 260 (Minn. App. 1993).

[25] Id.

[26] *Zeoli v. Commissioner of Social Services*, 425 A.2d 553 (Conn. 1979).

[27] *Simpson v. State Dept. of Social and Rehabilitation Services*, 906 P.2d 174 (Kan. App. 1995).

[28] *Eckes v. Richland County Social Services*, 621 N.W.2d 851 (ND 2001).

[29] *Elvelyn Ginsberg Abravanel*, Discretionary Support Trusts, 68 Iowa L. Rev. 273, 279, n. 26 (1983).

[30] *Bohac v. Graham*, 424 N.W.2d at 144 (ND 1988).

[31] 424 N.W. 2d at 146.

[32] 607 N.W.2d 237 (ND 2000).

[33] 528 A.2d 1335 (PA 1987).

[34] 517 N.W.2d 394 (Neb 1994).

[35] In *Strojek ex re. Mills v. Hardin County Bd. of Supervisors*, 602 N.W. 2d 566 (Iowa App. 1999); *In re Sullivan's Will*, 12 N.W.2d 148 (Neb. 1943); Elvelyn Ginsberg Abravanel, *Discretionary Support Trusts*, 68 Iowa L. Rev. 273, 290

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(1983); 3 Austin Wakeman Scott & William Franklin Fratcher, *The Law of Trusts* §187 at Page 15 (4th ed. 1988).

[36] In *Strojek ex re. Mills v. Hardin County Bd. of Supervisors*, 602 N.W. 2d 566 (Iowa App. 1999); Elvelyn Ginsberg Abravanel, *Discretionary Support Trusts*, 68 Iowa L. Rev. 273, 290 (1983); Lawrence A Forlik, *Discretionary Trusts for a Disabled Beneficiary: A Solution or a Trap For the Unwary?*, 46 U. Pitt L. Rev. 335, 342 (1985).

[37] *Bureau of Support in Dep't of Mental Hygiene & Correction v. Kreitzer,* 243 N.E. 2d 83 (Ohio 1968).

[38] *Martin v. Martin*, 374 N.E. 2d 1384 (Ohio 1978).

[39] Different courts define the term "bad faith" slightly differently. As used in this article, the term bad faith means the trustee (1) acts dishonestly, (2) acts with an improper motive, or (3) fails to use his or her judgment. *In Re Jones*, 812 P.2d 1152 (Colo. 1991) (citing *Scott on Trusts,* Section 130 at Page 409 (4th ed. 1989). Also see the detailed analysis of *Scott on Trusts*, Section 187 at Page 15 where it is noted that if the distribution standard includes enlarged or qualifying adjectives such as "sole and absolute discretion" combined with "no fixed standard by which the trustee can be determined is abusing his discretion…the trustee's discretion would generally be deemed final." Furthermore, Section 187.2 provides, "[e]ven though there is no standard by which it can be judged whether the trustee is acting reasonably or not, or though by the terms of the trust he is not required to act reasonably, the court will interfere where he acts dishonestly or in bad faith, or where he acts from an improper motive." This analysis by *Scott on Trusts* remains consistent through the 2003 supplemental volume.

George Taylor Bogert also seems to hold relatively the same definitional analysis as *Scott* in *The Law of Trusts and Trustees*, 2nd Edition 1980, Supplement through 2003. Section 560 of the Supplement at Page 183 provides that if a settlor has given a discretionary power (without qualification), the court is reluctant to interfere with the trustee's use of the power…Hence, in the absence of one or more of the special circumstances mentioned hereinafter, the court will not upset the decision of the trustee. These special circumstances (at Page 196) are (1) a trustee fails to use his judgment; (2) an abuse of discretion; (3) bad faith; (4) dishonesty; (5) an arbitrary action. Regarding the issue of "arbitrary action," *Bogert* provides, "[i]f the trustee has gone through the formality of using his discretion, but has not deliberately considered the arguments pro and con, and thus has made a decision for no reason at all, his conduct may be characterized as arbitrary and capricious, as amounting to a failure to use his discretion. In this respect, *Bogert* suggests that the "arbitrary" action is a subset of a trustee failing to act.

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Also, both *Scott and Bogert* note that a few states have statutes where unless the trust agreement contains language such as the "sole and absolute discretion" of the trustee, the trustee may not act arbitrarily. *Bogert* 2003 Suppl. at 199, footnote 85; *Scott*, Section 187.2, Page 39, footnote 12; *California Probate Code §1608,* enacted 1986 c.820; *Montana Code §72-23-306* (1983); *North Dakota Cent. Code §59-02-12; South Dakota Codified Laws §55-3-9* (1967).

[40] *Carlisle v. Carlisle,* 194 WL 592243 (Superior Ct. Connecticut 1994); *Lauricella v. Lauricella*, 565 N.E. 2d 436 (Mass. 1991).

[41] *Miller v. Department of Mental Health*, 442 N.W.2d 617 (Mich. 1989); *Henderson v. Collins,* 267 S.E.2d 202 (Ga. 1980); *In re Dias*, 37 BR 584 (D. Idaho 1984).

[42] A creditor cannot recover against a beneficial interest that is not a property interest. *Magavern v. U.S.*, 550 F.2d 797 (2nd Cir. 1977) (reversing the state court, but still discussing the property interest issue). However, due to some state domestic relations statutes, a value may be assigned to a discretionary interest in a trust to determine what the other spouse should receive upon the divorce.

[43] *Graham v. Graham*, 194 Colo. 429; 574 P.2d 75, 76 (Colo. 1978) (citing Black's Law Dictionary, 1382 [4th ed.]).

[44] *Senior v. Braden,* 295 U.S. 422 (1935); *Brown v. Fletcher*, 235 U.S. 589 (1915); *II W. Fratcher Scott on Trusts*, Section 130 at 406 (1987).

[45] *In re Question Submitted by the United States Court of Appeals for the Tenth Circuit*, 191 Colo. 406, 411; 553 P.2d 382, 386 (1976).

[46] *Restatement (Third) of Trusts,* Section 56, comment a; *Uniform Trust Code*, Section 501.

[47] *Chenot v. Bordeleau*, 561 A.2d 891 (R.I. 1989); *Eckes v. Richland County Social Services,* 621 N.W. 2d 851 (ND 2001); *Restatement (Second) of Trusts*, Section 128, comments d and e.

[48] Each state law must be analyzed in this respect. However, the authors are unaware of a case where state law held that a beneficiary of a support trust did not have a property right (i.e., an enforceable right) to force the trust to make a distribution pursuant to the support standard.

[49] *In re Marriage of Jones*, 812 P.2d 1152 (Colo. 1991); G. Bogert, *Trusts and Trustees,* Section 228 (2nd ed. 1979).

[50] Id.

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[51] *U.S. v. O'Shaughnessy*, 517 N.W. 2d 574 (Minn. 1994); *In re Marriage of Jones*, 812 P.2d 1152 (Colo. 1991).

[52] In *Strojek ex re. Mills v. Hardin County Bd. of Supervisors*, 602 N.W. 2d 566 (Iowa App. 1999); *In re Sullivan's Will*, 12 N.W.2d 148 (Neb. 1943); Elvelyn Ginsberg Abravanel, *Discretionary Support Trusts*, 68 Iowa L. Rev. 273, 290 (1983); 3 Austin Wakeman Scott & William Franklin Fratcher, *The Law of Trusts* Section 187, at 15 (4th ed. 1988).

[53] *Balanson v. Balanson,* 25 P.3d 28 (Colo. 2001); *Davidson v. Davidson*, 474 N.E. 2d 1137 (Mass. App. Ct. 1985); *Trowbridge v. Trowbridge*, 114 N.W.2d 129, 134 (Wis. 1962).

[54] *Restatement (Second) of Trusts,* Section 161.

[55] *Henderson v. Collins*, 267 S.E.2d 202 (Ga. 1980) [vested remainder interest in a discretionary trust may be sold at judicial foreclosure sale]; *Burrell v. Burrell*, 537 P.2d 1 (Alaska 1975); *Moyars v. Moyars,* 717 N.E. 2d 976 (Ct. App. Ind. 1999); *Benston v. Benston*, 656 P.2d 395 (Or. App. 1983); *Lauricella v. Lauricella*, 565 N.E. 2d 436 (Mass. 1991) [under all of these cases, a vested remainder interest was considered marital property for division purposes].

[56] *Mid American Corp. v. Geisman*, 380 P.2d 85 (Okla. 1963) [A debtor received a remainder interest under a will. Once the death of the will maker had occurred, the remainder interest was vested. It was not in trust, and a simple future property analysis provided for the property to be received under the will to be sold at a judicial foreclosure sale.].

[57] *In Re Neuton,* 922 F.2d 1379 (9th Cir. 1990) [where the fact that the debtor would need to outlive his mother in order to take the trust property was not so contingent as to prevent the judicial foreclosure sale of a 25% of the debtor's interest by a bankruptcy trustee]; *Balanson v. Balanson,* 25 P.3d 28 (Colo. 2001); *Davidson v. Davidson*, 474 N.E. 2d 1137 (Mass. 1985); *Benston v. Benston*, 656 P.2d 359 (Or. App. 1983); *Trowbridge v. Trowbridge*, 114 N.W. 2d 129 (Wis. 1962) [Under all of these cases, vested remainder interests were not too indefinite to be classified as marital property for purposes of division.]; but see *Loeb v. Loeb*, 301 N.E. 2d 349 (Ind. 1973) where the contingency of outliving the debtor's mother was considered too indefinite for purposes of equitable division in a divorce.

[58] *Mid America Corp. v. Geisman*, 380 P.2d 85 (Okla. 1963) [In a one paragraph holding, the Supreme Court of Oklahoma reversed the appellate court decision to sell the remainder interest, noting the proper remedy was a lien. The Supreme Court thought the remedy was too drastic a measure as related to the beneficiary.].

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[59] *Restatement (Third) of Trusts*, Section 56, comment e.

[60] The U.S. Supreme Court followed the common law view of spendthrift protection in *Nichols v. Eaton*, 91 U.S. 716 (1875).

[61] Even though almost all scriveners include a spendthrift provision in a trust, the trust instrument must still be examined to make sure that this is indeed the case. If a spendthrift clause is not included, a creditor stands in the shoes of the beneficiary and may enforce any right that he has - mandatory distribution, ascertainable standard distribution or a remainder interest. *In re Katz*, 203 B.R. 227 (E.D. Pa. 1996); *Chandler v. Hale*, 377 A.2d 318 (Conn. 1977).

[62] This is particularly true should the governing state law of the trust ever adopt the UTC or the *Restatement (Third) of Trusts*.

[63] *In Re Graham* 726 F.2d 1268 (C.A.8. Iowa 1984); *In re Stephens*, 47 B.R. 85 (Bkrtcy. D. Vt. 1985).

[64] *Restatement (Second) of Trusts*, Section 157.

[65] *In re Threewitt*, 20.B.R. 434 (Bkrtcy. D. Kan. 1982); *Payer v. Orgill,* 191 N.E.2d 373 (Ohio 1963).

[66] *Department of Mental Health and Development Disabilities v. First Nat. Bank of Chicago*, 432 N.E. 2d 1086 (Ill. App. 1 Dist., 1982); *Department of Mental Health and Developmental Disabilities v. First Nat. Bank of Chicago*, 432 N.E. 2d 1086 (Ill. App. Dist. 1982); *State v. Rubion*, 308 S.W. 2d 4 (Tex. 1957); *Lang v. Com., Dept of Public Welfare,* 528 A.2d 1335 (Pa. 1987); *Sisters of Mercy Health Corp. v. First Bank of Whiting,* 624 N.E. 2d 520 (Ind. App. 3 Dist. 1993).

[67] *Bank One Ohio Trust & Co.,* 80 F.3d 173 (6th Cir. 1996).

[68] 622 F.2d 387 (8th Cir. 1980).

[69] But see *U.S. v. Riggs Nat. Bank*, 636 F. Supp 172 (D.D.C. 1986).

[70] For example, if the beneficiary children are adults (i.e., the spouse has no support obligation) and the distribution is pursuant to an ascertainable standard, the spouse may be the sole trustee without IRC §2041 estate inclusion.

[71] As a trustee, the spouse or child would have unlimited power to distribute any amount of the trust assets to himself as a beneficiary of the trust.

[72] *Estate of Carpenter*, 45 AFTR 2d 80-1784, 80-1 USTC 13,339 (D. Wis. 1980); *Independence Bk. Waukesha (N.A.) v. U.S.,* 761 F.2d 442 (7th Cir. 1985) –

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tangential reference to “without court approval”; analogy – PLR 9118017; *but see Best v. U.S.*, 902 F. Supp. 1023 (D. Neb. 1995) where “sole and absolute” language was not argued by the Service.

73 The only exceptions are Iowa, Nebraska, North Dakota, and possibly Pennsylvania, each of which has taken the position that there is a third type of trust – a “discretionary support trust.”

74 One would hope that various judges throughout the states would agree whether similar conflicting language constituted a discretionary trust or one based on an ascertainable standard. Unfortunately, this is generally not the case. The judges appear to be equally confused on the issue. Further, even if in one state the judges would be consistent on what similar conflicting language meant, what if the trust jurisdiction changes to another state or nation? Will the new jurisdiction agree with the old jurisdiction’s interpretation of the conflicting language?

Support Trust Conflicting Language - The following court decisions noted that the language of the trust used both discretionary and support language, but held that the trust was a discretionary trust:

**Myers v. Kansas Depts of SRS,* 866 P.2d 1052 (Kan. 1994).
**Roorda v. Roorda*, 300 N.W. 294 (1941).
**Lineback by Hutchens v. Stout*, 339 S.E.2d 103 (NC App. 1986).
**Chenot v. Bordeleau*, 561 A.2d 891 (RI 1989).

Discretionary Trust Conflicting Language - The following court decisions noted that the language of the trust used both discretionary and support language, but held that the trust was a support trust:

**Bohac v. Graham*, 424 NW 2d. 144 (ND 1988).
**Button by Curio v. Elmhurst Nat. Bank*, 522 N.E.2d 1368 (Ill. App. 1988).
**Kryzsko v. Ramsey County Social Services.*
**Bureau of Support in Dept. of Mental Hygiene and Correction v. Kreitzer*, 243 N.E. 2d 83 (Ohio 1968).
**McNiff v. Olmsted County Welfare Dept.*, 176 N.W.2d 888 (Minn. 1970).

75 Iowa, Nebraska, North Dakota, and possibly Pennsylvania. Also, as previously discussed, Ohio imposes a reasonableness standard as to whether the trustee must make distributions to a beneficiary, but Ohio does not use the term “hybrid trust.”

76 In *Strojek ex re. Mills v. Hardin County Bd. of Supervisors*, 602 N.W. 2d 566 (Iowa App. 1999); Elvelyn Ginsberg Abravanel, *Discretionary Support Trusts*, 68 Iowa L. Rev. 273, 290 (1983); Lawrence A Forlik, *Discretionary Trusts for a*

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Disabled Beneficiary: A Solution or a Trap For the Unwary?, 46 U. Pitt L. Rev. 335, 342 (1985).

77 *Restatement (Second) of Trusts*, Section 161; *Henderson v. Collins,* 267 S.E.2d 202 (Ga. 1980) [noting that in this case a remainder interest was a future property interest].

78 *Martin v. Martin*, 374 N.E.2d 1384 (Ohio 1978); *Miller v. Department of Mental Health,* 442 N.W. 2d 617 (Mich. 1989).

79 However, in the highly controversial case *U.S. v. Craft,* 122 S. Ct. 1414 (2002) the Supreme Court overturned 50 years of well-established property law when it stated that federal common law determined property rights.

80 *In Re Neuton,* 922 F.2d 1379 (9th Cir. 1990).

81 *Miller v. Department of Mental Health,* 442 N.W. 2d 617 (Mich. 1989).

82 *In re Bottom,* 176 B.R. 950 (N.D. Fla. 1994).

83 *In re Hersloff*, 147 B.R. 262 (M.D. Fla. 1992); *In re Schwen*, 43 Collier Bankr. Cas. 2d 255 (D. Minn. 1999).

84 David B. Young, *The Pro Tanto Invalidity of Protective Trusts: Partial Self-Settlement and Beneficiary Control,* 78 MARG.L.REV, 807, 855 (1955).

85 *In re Coumbe*, 304 B.R. 378 (9th Cir. 2003).

86 *In re Balanson*, 25 P.3d 28 (Colo. 2001).

87 *In re Marriage of Rosenblum*, 602 P.2d 892 (1979).

88 *Davidson v. Davidson*, 474 N.E. 2d 1137 (Mass. App. Ct. 1985); *Trowbridge v. Trowbridge*, 114 N.W.2d 129, 134 (Wis. 1962).

89 537 P.2d 1 (Alaska 1975).

90 25 P.3d 28 (Colo. 2001).

91 194 WL 592243 (Superior Ct. of Conn. 1994).

92 717 N.E.2d 976 (Ct. App. Ind. 1999).

93 301 N.E. 2d 349 (Ind. 1973).

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[94] 474 N.E. 2d 1137 (Mass. 1985). See also *Lauricella v. Lauricella,* 565 N.E. 2d 436 (Mass. 1991) where a vested remainder interest in an irrevocable trust subject to a term of years was subject to division as marital property.

[95] 692 P.2d 411 (Mont. 1984).

[96] 638 A.2d 1254 (N.H. 1994).

[97] ND Sup Ct., No 940003 (1994).

[98] 374 N.E. 2d 1384 (Ohio 1978).

[99] 656 P.2d 395 (Or. App. 1983).

[100] 607 A.2d 883 (Vt. 1992).

[101] 114 N.W. 2d 129 (Wis. 1962).

[102] *Restatement (Second) of Trusts,* Section 162; *Henderson v. Collins*, 267 S.E. 2d 202 (Ga. 1980) [noting that a remainder interest was future property].

[103] Some state statutes on domestic relations issues do not separate alimony and property settlements. Rather, these states view the two as integrated in a divorce settlement. In these states, the spouse would be an exception creditor.

[104] *Loeb v. Loeb,* 301 N.E. 2d 349 (Ind. 1973) [where a wife's interest under a trust in which she is not a beneficiary can never be greater than her beneficiary-husband's interest]; *Buckman v. Buckman,* 200 N.E. 918 (Mass. 1936) [where a former spouse attempting to enforce alimony stood "no better than any other creditor"]. Note that *Buckman* appears to have been reversed by the holding in *Davidson v. Davidson,* 474 N.E. 2d 1137 (Mass. 1985). However, while the *Davidson* court cited *Buckman*, it did not specifically state that such holding was reversed.

[105] *Davidson v. Davidson,* 474 N.E.2d 1137 (Mass. 1985).

[106] *Restatement (Second) of Trusts,* Section 161; *Henderson v. Collins*, 267 S.E. 2d 202 (Ga. 1980) [noting that a remainder interest was future property].

[107] *Dwight v. Dwight,* 756 N.E.2d 17 (Mass. Ct. of App. 2001).

[108] *Restatement (Third) of Trusts*.

[109] See Endnote 39.

[110] *Restatement (Second) of Trusts*, Section 155, comment b.

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[111] *McDonald v. Evatt*, 62 N.E. 2d 164 (Ohio 1945).

[112] *Caswell v. Lenihan*, 126 N.E.2d 902 (Ohio 1955); *Huntington Natl. Bank v. Aladdin Crippled Children's Hosp. Assn.,* 157 N.E.2d 138 (Ohio App. 1959).

[113] *Culver v. Culver*, 169 N.E.2d 486 (Ohio App. 1960).

[114] It is uncertain how the Court is using the term "bad faith" in this case.

[115] *Bureau of Support in the Department of Mental Hygiene and Correction v. Kreitzer*, 243 N.E.2d 83 (Ohio 1968).

[116] The following are unreported appellate cases that follow the *Kreitzer* analysis: *Matter of Gantz*, 1986 WL 12960; *Samson v. Bertok*, 1986 WL 14819 (however, the creditor did not recover because it was not a governmental claim); *Matter of Trust of Stum*, 1987 WL 26246; *Schierer v. Ostafin*, 1999 WL 493940 (however, the creditor did not recover because it was not a governmental claim).

[117] No. L-96-073 (Ohio App. 6 Dist. 1997).

[118] 2001 WL 1123960 (Ohio App. 7 Dist).

[119] *Metz v. Ohio Dept. of Human Services*, 762 N.E. 2d 1032 (OH App. 2001).

[120] 582 N.E.2d 1047 (Ohio 1989).

[121] For more information about the beneficiary controlled trust concept, see Richard A. Oshins and Steven J. Oshins, "Protecting & Preserving Wealth into the Next Millenium," *Trusts & Estates* (Sept. and Oct. 1998).

[122] *Restatement (Third) of Trusts,* Section 50, comment c., last paragraph.

[123] *Restatement (Third) of Trusts,* Section 60, comment a.

[124] For purposes of this article and under case law, the term "bad faith" is not defined as the antithesis of a good faith standard. Rather, bad faith means the trustee is acting dishonestly, acting with an improper motive, or failing to use his or her judgment.

[125] *Restatement (Third) of Trusts*, Section 50, comment d.

[126] *Restatement (Third) of Trusts*, Section 60, comment a.

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[127] However, it should be noted that due to the incredibly confusing language in Article 5 of the UTC, some estate planners claim that the discretionary analysis may have only been abolished for the exception creditor for child support or alimony. First, Section 503 provides that all exception creditors may pierce a spendthrift provision. No distinction is made between a discretionary trust and a support trust. The second paragraph of the comments under Section 503 of the UTC references Section 59(a) of the *Restatement (Third) of Trusts*. The fifth paragraph of the comments under Section 503 of the UTC references Section 59(b) of the *Restatement (Third) of Trusts*. General comment (a) of the Restatement Third specifically states that "certain categories of creditors [i.e., the exception creditors] can reach beneficial interests in spendthrift trusts…, including discretionary interests in those trusts."

Second, Section 60 provides as to discretionary trusts that a spouse, former spouse, or a spouse acting on behalf of a child may reach the trust assets for child support or alimony. So at first blush, it appears that the UTC may be eliminating the discretionary/support distinction for only this purpose. However, the first paragraph of the comments under Section 60 provides that "[t]his section, similar to the Restatement Third, eliminates the distinction between discretionary and support trusts, unifying the rules for all trusts fitting within either of the former categories." If the rules have been unified (i.e., the discretionary property analysis has been eliminated), then the argument that alimony and spousal support is the only exception to a discretionary trust has little merit.

Third, adding more confusion to an already confusing Article 5, Section 503(c) provides no limit to any state or federal claim to the extent the statute provides. By the literal terms of this Section, this means that all of these types of federal claimants may directly access the trust assets, regardless of whether it is a federal or state claim. Therefore, this also appears to support the argument that the discretionary/support distinction has been completely eliminated.

Fourth, again adding more confusion to Article 5, there is no definition of a discretionary trust or a support trust provided by the UTC. Both Section 504 of the UTC and Section 60 of the Restatement (Third) of Trusts say that they apply to discretionary interests. But unlike the Restatement (Second) of Trusts, there is no definition.

[128] *Restatement (Third) of Trusts*, Section 60, comment a goes to some length to explain a continuum of discretion under a reasonableness standard. Unfortunately, when courts are given a factor test, a balancing test, or a continuum to choose from, it is usually nothing more than a blank check for a court to decide the case almost any way it chooses. For an example of such, in the divorce case apparently using a *Restatement (Third) of Trusts* analysis with a discretionary trust, see *Dwight v. Dwight,* 756 N.E.2d 17 (Mass. Ct. of App. 2001).

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[129] A beneficiary could only bring an action if the trustee acted dishonestly, with an improper motive, or failed to act.

[130] *Uniform Trust Code*, Section 503.

[131] 11 U.S.C. §541.

[132] *Sligh v. First National Bank of Holmes County*, 704 So 2d 1020 (Miss. 1997).

[133] Miss. Code Ann. Section 91-9-503 (Family Trust Preservation Act 1998).

[134] If there are twelve or less creditors, any one creditor with a claim greater than $11,625 may file an involuntary bankruptcy. If there are more than twelve creditors, then any three with claims aggregating greater than $11,625 may file an involuntary bankruptcy. 11 U.S.C. §303(b).

[135] *Duncan v. Elkins*, 45 A.2d 297 (NH 1946).

[136] *Restatement (Second) of Trusts,* Section 152, comment j.

[137] See also *Lundgren v. Hoglund*, 711 P.2d. 809 (Mont. 1985); *Guidry v. Sheet Metal Workers, Int'l Ass'n*, 10 F.3d 700 (10th Cir. 1993).

[138] *Uniform Trust Code,* Section 503.

[139] *Restatement (Third) of Trusts*, Section 59.

[140] A third party Medicaid or special needs trust is a trust where the parents or grandparents have created the trust for the benefit of a child. It is <u>not</u> the self-settled trust under 42 U.S.C. §1396p(d)(4)(A) (many times commonly referred to as a "d4A Trust").

[141] *Metz v. Ohio Dept. of Human Services*, 762 N.E. 2d 1032 (Ohio App. 2001).

[142] IRC §2041.

[143] *Restatement (Third) of Trusts*, Section 60, comment g.

[144] 756 N.E. 2d 17 (Mass. Ct. of App. 2001).

[145] For an excellent analysis of *Dwight v Dwight*, see *Another Look at "Dwight" and Spendthrift Trusts*, Alexander A. Bove Jr. and Melissa Langa, Massachusetts Lawyers Weekly, December 10, 2001.

[146] *Uniform Trust Code*, Section 504.

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[147] *Restatement (Third) of Trusts*, Section 50, comment b.; *Uniform Trust Code* Section 814(a).

[148] *Restatement of Trusts (Third),* Section 60 comment e and e(1).

[149] *Uniform Trust Code*, Section 107.

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