

Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #217

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From: Steve Leimberg's Asset Protection Planning Newsletter

Subject: [Steve Oshins & Bob Keebler on the 40th Anniversary of Garretson v. Garretson: Spendthrift Trusts and Divorce Protection](#)

“The year 2013 marks the 40th anniversary of Garretson v. Garretson, a landmark court decision in which the Supreme Court of Delaware ruled that Delaware public policy is such that the rights of a divorcing spouse to access the assets of a spendthrift trust override the rights of a settlor to establish a third-party spendthrift trust for the benefit of the settlor’s intended beneficiaries and protect those trust assets from the divorcing spouses of the trust beneficiaries.”

However, Delaware is not the only jurisdiction where a divorcing spouse can pierce a third-party spendthrift trust. Some jurisdictions, like Delaware, allow divorcing spouses to pierce through the trusts pursuant to an exception created by case law. Other jurisdictions do so through so-called “exception creditor” statutes. Estate planners should be aware of which jurisdictions have such exceptions so they can plan accordingly for their clients.”

Now, **Steve Oshins** and **Bob Keebler** remind **LISI** members of the importance of designing third-party trusts so that the underlying assets are protected from the divorcing spouses of the beneficiaries.

Steven J. Oshins, Esq., AEP (Distinguished) is a member of the Law Offices of **Oshins & Associates, LLC** in Las Vegas, Nevada. Steve is a nationally known attorney who is listed in The Best Lawyers in America® and has been named one of the Top 100 Attorneys in Worth magazine. He was inducted into the NAEPC Estate Planning Hall of Fame® in 2011. He has written some of Nevada's most important estate planning and creditor protection laws, including the law making the charging order the exclusive remedy of a judgment creditor of a Nevada LLC and LP (in 2001, 2003 and 2011), the law changing the Nevada rule against perpetuities to 365 years (in 2005) and the law making Nevada the first and only state to allow a Restricted LLC and a Restricted LP, creating larger valuation discounts than any other state allows (in 2009). He is also the author of the Annual Domestic Asset Protection Trust State Rankings Chart at http://www.oshins.com/images/DAPT_Rankings.pdf and the Annual Dynasty Trust State Rankings Chart at http://www.oshins.com/images/Dynasty_Trust_Rankings.pdf. Steve can be reached at 702-341-6000, x2 or at soshins@oshins.com. His law firm's web

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Robert S. Keebler, CPA, MST, AEP (Distinguished) is a partner with **Keebler & Associates, LLP** and is a 2007 recipient of the prestigious Accredited Estate Planners (Distinguished) award from the National Association of Estate Planning Councils. He has been named by CPA Magazine as one of the Top 100 Most Influential Practitioners in the United States and one of the Top 40 Tax Advisors to Know During a Recession. His practice includes family wealth transfer and preservation planning, charitable giving, retirement distribution planning, and estate administration. Mr. Keebler frequently represents clients before the National Office of the Internal Revenue Service (IRS) in the private letter ruling process and in estate, gift and income tax examinations and appeals, and he has received more than 150 favorable private letter rulings including several key rulings of “first impression”. He is the author of over 100 articles and columns and is the editor, author or co-author of many books and treatises on wealth transfer and taxation.

Now, here is Steve and Bob’s commentary.

EXECUTIVE SUMMARY:

It is well-established that a court will generally not interfere with the intent of a settlor in establishing a trust for the settlor’s intended beneficiaries under the terms desired by the settlor. However, over the years, courts in some jurisdictions have made exceptions to this general rule. When doing so, these courts have balanced the public policy interest in protecting the intent of the settlor with the public policy interest in protecting the rights of others who would be adversely affected by an inability to access the trust assets.

The year 2013 marks the 40th anniversary of *Garretson v. Garretson* (306 A.2d 737 (1973)), a landmark court decision in which the Supreme Court of Delaware ruled that Delaware public policy is such that the rights of a divorcing spouse to access the assets of a spendthrift trust override the rights of a settlor to establish a third-party spendthrift trust for the benefit of the settlor’s intended beneficiaries and protect those trust assets from the divorcing spouses of the trust beneficiaries.

However, Delaware is not the only jurisdiction where a divorcing spouse can pierce a third-party spendthrift trust. Some jurisdictions, like Delaware, allow

divorcing spouses to pierce through the trusts pursuant to an exception created by case law. Other jurisdictions do so through so-called “exception creditor” statutes. Estate planners should be aware of which jurisdictions have such exceptions so they can plan accordingly for their clients.

Garretson v. Garretson

Mr. and Mrs. Garretson were married in 1943 and lived together until December 19, 1967 when Mr. Garretson left Mrs. Garretson. Ultimately, the parties negotiated a settlement which was cast in the form of a separation agreement and incorporated in a final order dated September 9, 1969 by the Delaware Court of Chancery. Under the terms of the settlement, Mr. Garretson was required to pay Mrs. Garretson \$400 a month.

Sometime thereafter, Mr. Garretson stopped making payments to Mrs. Garretson. As a result, Mrs. Garretson brought a second action in the Delaware Court of Chancery seeking a judgment against Mr. Garretson for the amount of the arrearages and an order upon the Bank of Delaware, as trustee of a testamentary spendthrift trust of which Mr. Garretson was a beneficiary.

In the Supreme Court of Delaware, Mr. Garretson and the Bank of Delaware, as trustee, then argued that the trust in question was a spendthrift trust, and under the terms of the trust instrument his divorcing spouse may not seek redress by the seizure of trust assets.

The argument was based upon ITEM II of the will creating the testamentary trust which provided as follows:

"The interest of a beneficiary in the trust property or in the income therefrom shall not be subject to the rights of the creditors of such beneficiary and shall be exempt from execution, attachment, distress for rent, and all other legal or equitable process instituted by or on behalf of such creditors, and the interest of such beneficiary in the trust property or in the income therefrom shall be unassignable."

The question thus presented to the Supreme Court of Delaware was whether or not a wife, seeking support from her husband, is a creditor within the meaning of the word as it is used in § 3536 and in ITEM II of the will. If the wife is a creditor, then seizure of any of the trust assets on her behalf is prohibited by the terms of § 3536 and of ITEM II of the will.

An action brought by a wife seeking separate maintenance from her husband who has deserted her is an attempt on her part to compel the performance of a duty imposed by law upon the husband to support his wife and dependents. The Supreme Court of Delaware concluded that the weight of authority is to the effect that a wife seeking such relief is not a creditor and is not bound by the spendthrift provisions of a trust from reaching the trust assets.

Bank of Delaware, as trustee, argued that Mr. Garretson was a creditor seeking specific performance of a contract, the separation agreement, which was made a part of the final decree in the separate maintenance action. The Supreme Court of Delaware ruled to the contrary and concluded that a divorcing spouse is not a creditor in the standard debtor/creditor relationship and thus created an exception allowing a divorcing spouse to pierce a third-party Delaware spendthrift trust.

The Leading Dynasty Trust States

In the current Annual Dynasty Trust State Rankings Chart at http://www.oshins.com/images/Dynasty_Trust_Rankings.pdf, the following Top 10 Dynasty Trust States, in the order of ranking, are either protected or not protected as follows:

1. South Dakota – Protected
2. Alaska – Protected
3. Nevada – Protected
4. Tennessee - Protected
- 5(tie) Delaware – **Not Protected** (*Garretson v. Garretson (1973)*)
- 5(tie) Wyoming – Protected
7. New Hampshire – **Not Protected** (N.H. Rev. Stat. Ann. §564-B:5-503(b)(1)-(2))
8. Ohio – Protected
9. Illinois – Protected
10. Florida – **Not Protected** (Fla. Stat. Ann. §736.0503(2)(a) codifying *Bacardi v. White (1985)*)

Drafting around the Problem

Even if you domicile the trust in a jurisdiction that, either by case law or by statute, allows a divorcing spouse to pierce through a third-party spendthrift trust, you can still draft around the problem by designing the trust as a

discretionary trust rather than a support trust.

Support Trusts - The very large majority of trusts are drafted as support trusts, usually using “health, education, maintenance and support” as the distribution standard. The reason for this language is to avoid estate inclusion as a general power of appointment when the trustee is also a beneficiary of the trust. As long as a support trust includes a spendthrift provision, its assets are protected from most classes of creditors, the exception being where by case law or by statute the applicable jurisdiction has carved out an exception. Divorcing spouses have been carved out as an exception by numerous jurisdictions since many jurisdictions’ public policies are such that the interests of a divorcing spouse outweigh the interests of a settlor to transfer property as the settlor wishes.

Discretionary Trusts - Since most of our clients want to protect their assets from the reach of divorcing spouses of their intended beneficiaries, one way to do that is to domicile the trust in a jurisdiction that does not carve out an exception for divorcing spouses. Note, however, that there is no guarantee that the jurisdiction won’t one day carve out an exception, such as Delaware did in *Garretson v. Garretson*, allowing divorcing spouses to pierce through the trust.

A discretionary trust gives a trustee (who is not a beneficiary) sole and absolute discretion over distributions of income and principal and often includes language such as “unreviewable by a court of law” in order to make it absolutely clear that the trust is fully discretionary. Although a discretionary trust should also include a spendthrift clause, because it is already protected by virtue of the fact that there is no required distribution standard, a discretionary trust does not need the spendthrift clause to give the beneficiaries protection from EVERY class of creditors. In order to give the primary beneficiary control, yet also provide this level of protection, many discretionary trusts will bifurcate the trustee powers by giving the primary beneficiary the investment powers and an independent trustee the distribution powers. The independent trustee can be a close friend of the primary beneficiary.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Steve Oshins

Bob Keebler

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