UTC May Reduce the Asset Protection of Non-Self-Settled Trusts

The new Uniform Trust Code will reduce substantially the asset protection of non-self-settled trusts. This second part of a three-part article examines the traditional asset protection rules relating to interests in trusts, spendthrift provisions, and divorce actions.

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Distribution standard and the current beneficial interest

For creditor purposes, 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, there is a problem when a scrivener mixes the elements of a discretionary trust with those of a support trust.

Mandatory distribution trust. 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 clearly 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*,[1] the Tenth Circuit held that a beneficiary's future right to receive $1,000 per month was a property interest.

With respect to a mandatory distribution right, the creditor is not attaching the trusts assets. Rather, the creditor is attempting to attach the mandatory distribution stream.[2] Because this interest is a property right, the only question is whether a spendthrift provision provides some type of creditor protection for a mandatory distribution received from a trust.

Support trust. The common law purpose of this trust is to provide support for a beneficiary based on a "standard." The most common standard used is "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 that 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 cause a trust not to be classified as a support trust.

If a trust is classified as a support trust, a beneficiary of such a 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,[3] 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.[4] If this is the case, does the creditor stand in the beneficiary's shoes and have the power

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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 (*infra*).

Discretionary interest. Under the Restatement (Second) of Trusts ("Restatement Second") and almost all the case law to date, a discretionary beneficiary has no contractual or enforceable right to any income or principal from the trust, and hence the beneficiary cannot force any action by the trustee.[5] The reason is that a court may review a discretionary trust only for bad faith.[6] There is no reasonableness standard of review by a court with respect to a discretionary trust. Further, the discretionary interest is not assignable.[7] 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.[8] 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 a non-Uniform Trust Code ("UTC") state, whether the assets of a discretionary trust are protected from creditors does not depend on spendthrift provisions with respect to the current beneficial interest. The asset protection features of a discretionary trust under common law are much stronger than those of a support trust or a mandatory distribution trust that must rely on spendthrift protection.

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 has the right to sue the trustee only for a minimal distribution.[9] As a result, the hybrid trust does not provide the same degree of creditor protection as a discretionary trust. Rather, a hybrid trust is more similar to a support trust than to 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 requires a slightly different analysis than does a current beneficial interest. While divorce cases tend to use the word "property" in determining a remainder interest,[10] the rule under section 160 of the Restatement Second requires a determination as to whether there are "inseparable interests." In essence, the "inseparable interest" rule functions quite similarly to the property analysis used for a current beneficial interest. Further, the Restatement Second adds 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. This analysis is shown in Exhibit 1.

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."[11] 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?

Indefinite and contingent interests. A vested interest is not a contingent interest. A vested interest is one that the debtor/beneficiary or the debtor/beneficiary's estate will take at some point 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.[12] These cases

1 191 Colo. 406, 411, 553 P.2d 382, 386 (1976).

2 Restatement (Third) of Trusts ("Restatement Third"), section 56, comment a; Uniform Trust Code ("UTC"), section 501.

3 Chenot v. Bordeleau, 561 A.2d 891 (R.I., 1989); Eckes v. Richland County Social Services, 621 N.W.2d 851 (N.D., 2001); Restatement (Second) of Trusts ("Restatement Second"), section 128, comments d and e.

4 Each state's 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.

5 In re Marriage of Jones, 812 P.2d 1152 (Colo., 1991); Bogert, *Trusts and Trustees*, section 228 (2nd ed. 1979).

6 Bad faith or abuse under common law has been defined as the trustee (1) acting dishonestly, (2) with an improper purpose, or (3) failing to act. 3 Scott and Fratcher, *The Law of Trusts*, section 187, at 15 (4th ed. 1988).

7 See note 5, *supra*.

8 O'Shaughnessy, 517 N.W.2d 574 (Minn., 1994); In re Marriage of Jones, *supra* note 5.

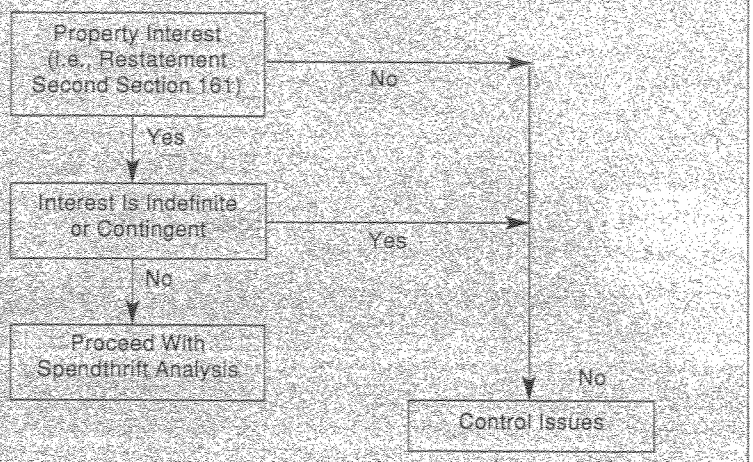
9 Strojek by Mills v. Hardin County Bd. of Supervisors, 602 N.W.2d 566 (Iowa App., 1999); In re Sullivan's Will, 12 N.W.2d 148 (Neb., 1943); Abravanel, "Discretionary Support Trusts," 68 Iowa L. Rev. 273, 290 (1983); 3 Scott and Fratcher, *The Law of Trusts* section 187, at 15 (4th ed. 1988).

10 In re 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).

11 Restatement Second, section 161.

12 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).

EXHIBIT 1
Analysis of Remainder Interest



follow the general property rule that a remainder interest in property may be sold even though it is a future interest.[13]

Many estate planners consider a remainder interest to be a contingent interest if 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. Nevertheless, the Restatement Second, section 162, Illustration 1 indicates that the mere fact that a child must survive a parent to take the trust property is *not* too contingent, and, therefore, unless the remainder interest cannot 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.[14]

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 in which anyone other than a former spouse attaches the remainder interest.[15] 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.[16]

Spendthrift provisions

A spendthrift provision in a trust agreement 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 protect a beneficiary other than the trust settlor 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. Accordingly, 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.[17] 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.[18]

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

[13] Mid American Corp. v. Geisman, 380 P.2d 85 (Okla., 1963). (A debtor received a remainder interest under a will. Upon the testator's death, 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.)

[14] In re Neuton, 922 F.2d 1379 (CA-9, 1990) (the fact that the debtor would need to outlive his mother to take the trust property was not so contingent as to prevent the judicial foreclosure sale of 25% of the debtor's interest by a bankruptcy trustee); In re Balanson, *supra* note 10; Davidson v. Davidson, *supra* note 10; Benston v. Benston, *supra* note 12; Trowbridge v. Trowbridge, *supra* note 10; but see Loeb v. Loeb, 301 N.E.2d 349 (Ind., 1973).

[15] Mid America Corp. v. Geisman, *supra* note 13. (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.)

[16] Restatement Third, section 56, comment e.

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

[18] Even though almost all drafters 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 (DC Pa., 1996); Chandler v. Hale, 377 A.2d 318 (Conn., 1977).

common law. Consequently, in a non-UTC state, neither the beneficiary nor his creditors have any right to force a distribution from the trust. Nevertheless, scriveners should nearly always include spendthrift provisions,[19] especially if the UTC becomes law.

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 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 assets from attachment.[20] The Restatement Second, section 157 carves out the following four key exceptions 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.[21] If a trust is classified as a support trust, an estranged spouse may almost always reach the trust assets to satisfy a maintenance or child support claim. This exception, though, 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 attempts to attach a beneficiary's interest for medical services rendered on behalf of the beneficiary.[22] Further, in almost all 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 either to sue the trust or to 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. Attorneys are frequently not allowed to recover their fees from the trust.

4. A claim by the U.S. or a state to satisfy a claim against a beneficiary. Generally, these are tax liens. The IRS may often reach a beneficiary's interest in a support trust for payment of a tax lien.[23] In *First Northern Trust Co. v. IRS*,[24] 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 despite any state laws or recognized exemptions to the contrary.[25]

In summary, there are four exception creditors that can reach support trusts' 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 the trust were drafted as a discretionary dynasty trust.

Conflicting distribution language

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, 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

[19] This is particularly true should the governing state law of the trust ever adopt the UTC or the Restatement Third.

[20] In re Graham, 726 F.2d 1268 (CA-8, 1984); In re Stephens, 47 B.R. 85 (Bkrtcy. D. Vt., 1985).

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

[22] Dept. of Mental Health and Developmental Disabilities v. First Nat'l Bank of Chicago, 432 N.E.2d 1086 (Ill. App. 1 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).

[23] Bank One Ohio Trust Co., 80 F.3d 173, 77 AFTR2d 96-1579 (CA-6, 1996).

[24] 622 F.2d 387 (CA-8, 1980).

[25] But see Riggs Nat'l Bank, 636 F. Supp 172 (DC D.C., 1986).

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 without an estate tax inclusion issue.[26] On the other hand, if the spouse or child is the sole trustee as well as a beneficiary of a discretionary trust, the spouse or child will be considered to hold a general power of appointment, thereby resulting in inclusion in the trustee/beneficiary's estate for estate tax purposes.[27]

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

The Service would argue that this language creates a discretionary trust because the distribution trustee would have a general power of appointment at death and therefore the trust assets would be included in the trustee's estate under IRC Section 2041.[28] Conversely, the taxpayer would argue that distributions are pursuant to an ascertainable standard in order to avoid the estate tax inclusion issue.

Moreover, if a governmental agency 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.

Almost all non-UTC courts will decide one way or the other, but not both ways.[29] By attempting to accomplish the best of both worlds, the estate planner typically does more damage than good. The planner either creates a possible estate inclusion issue or allows a

[26] 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 estate inclusion under IRC Section 2041.

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

[28] Estate of Carpenter, 45 AFTR2d 80-1784 (DC Wis., 1980); Independence Bk. Waukesha (N.A.), 761 F.2d 442, 55 AFTR2d 85-1593 (CA-7, 1985)—tangential reference to "without court approval"; analogy—Ltr. Rul. 9118017; but see Best, 902 F. Supp. 1023, 79 AFTR2d 97-1092 (DC Neb., 1995), where "sole and absolute" language was not argued by the Service.

[29] 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."

creditor to recover from the trust assets. For this reason, the drafter should avoid conflicting trust language and should draft either a purely discretionary trust or a support trust.[30]

Hybrid trust. In the few states that recognize a hybrid trust,[31] this trust is by definition a conflicting language trust. The problem is that most of these states require the trustee to make a minimal distribution for the beneficiaries' needs. As a result, a creditor for necessary expenses of the beneficiary most likely becomes an exception creditor.[32] 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 creditor protection than a support trust does.

Remainder interest

Absent spendthrift provisions, a beneficiary may transfer the remainder interest, and absent the indefinite and contingent issues under the Restatement Second, a creditor may attach such interest.[33] Creditors would include an estranged spouse as well as any other creditor.[34]

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.[35] For example, in *In Re Neuton*,[36] a California state statute provided that spendthrift provisions protected 75% of the remainder interest. The debtor's ordinary creditor could not recover against the amount protected by state law. However, if the creditor is an exception creditor and the "sold with fairness" rule does not apply, the creditor may attach and/or judicially foreclose and sell the remainder interest.[37]

Control and dominion issues

If a creditor cannot attach the trust assets under one of the above theories of recovery, the 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*,[38] the spendthrift provision protection was not upheld because the sole beneficiary was the sole trustee, and the creditor was able to reach the trust assets. In contrast, 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.[39]

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

In *In re Schwen*,[40] the court mentioned that if one of the beneficiaries was the sole trustee, the trustee/beneficiary's control

30 One would hope that various judges throughout the states would agree whether similar conflicting language gives rise to a discretionary trust or one based on an ascertainable standard, but this is generally not the case. Even if in one state the judges were consistent on what similar conflicting language meant, what if the trust jurisdiction is changed to another state or nation? Will the new jurisdiction agree with the old jurisdiction's interpretation of the conflicting language? The following decisions noted that the trust used both discretionary and support language, but held that the trust was a discretionary trust: Myers v. Kansas Dept. 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 (N.C. App., 1986); Chenot v. Bordeleau, *supra* note 3. The following decisions noted that the trust used both discretionary and support language, but held that the trust was a support trust: Bohac v. Graham, 424 N.W.2d 144 (N.D., 1988); Button by Curio v. Elmhurst Nat'l Bank, 522 N.E.2d 1368 (Ill. App., 1988); 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).

31 Iowa, Nebraska, North Dakota, and possibly Pennsylvania. Also, 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."

32 Strojek by Mills v. Hardin County Bd. of Supervisors, *supra* note 9; Abravanel, *supra* note 9, at 290; Frolik, "Discretionary Trusts for a Disabled Beneficiary: A Solution or a Trap for the Unwary?," 46 U. Pitt L. Rev. 335, 342 (1985).

33 Restatement Second, section 161; Henderson v. Collins, *supra* note 12.

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

35 However, in the highly controversial case, 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.

36 922 F.2d 1379 (CA-9, 1990).

37 Miller v. Dept. of Mental Health, *supra* note 34.

38 176 B.R. 950 (DC Fla., 1994).

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

40 43 Collier Bankr. Cas. 2d 255 (DC Minn., 1999).

regarding making distributions was still limited by a fiduciary duty to other beneficiaries. Therefore, the trustee/beneficiary would not have too much control.[41] In *Schwen,* there were actually two trustees, and the court mentioned the sole trustee situation purely as dicta. Fortunately, in *In re Coumbe,*[42] in a review of a bankruptcy case, the court provided further guidance when it held that a sole beneficiary could serve as the sole trustee so long as there were different remainder beneficiaries.

Nuances under state domestic relations law

Until recently, almost all asset protection planners thought that a remainder interest was free from division of marital property in divorce. Most Colorado estate planners were shocked when the Colorado Supreme Court handed down the decision in *In re Balanson.*[43] There, the court 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, but any appreciation on inherited property is considered marital property. Prior to this, Colorado had held that remainder interests in trusts were indivisible.[44]

The disturbing facts of *Balanson* began when the daughter married. A few years later, Mom and Dad executed a standard estate plan that created a marital trust and credit shelter trust upon the death of the first spouse. Mom subsequently died, and the trusts were funded. Dad was the sole trustee of both trusts. Dad also 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 the trust property to his son. Several years after Mom died, Daughter filed for divorce. Son-in-law claimed that Daughter's vested remainder interest was marital property eligible for division in the divorce.

Daughter's remainder interest might be considered contingent since she must outlive her father. Daughter's interest was also subject to complete divestment because her dad could exercise his special power of appointment solely in favor of his son. Nevertheless, 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 court cited two other cases—*Davidson v. Davidson*[45] (a Massachusetts case) and *Trowbridge v. Trowbridge*[46] (a Wisconsin case)—and

41 Young, "The Pro Tanto Invalidity of Protective Trusts: Partial Self-Settlement and Beneficiary Control," 78 Marq. L. Rev. 807, 855 (1955).

42 304 B.R. 378 (CA-9, 2003).

43 25 P.3d 28 (Colo., 2001).

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

45 474 N.E.2d 1137 (Mass. App. Ct., 1985).

46 114 N.W.2d 129, 134 (Wis., 1962).

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 some isolated occurrences in a few states. The authors believe that this issue may be similar to what has happened with retirement plans. Approximately 40 years ago, most courts held that retirement plans were not divisible and thus were not subject to division in the domestic relations context. Now, though, 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.*[47] In 1975, the Alaska Supreme Court found a vested remainder interest subject to division.

2. Colorado—*In re Balanson.* 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.*[48] 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.

4. Indiana—*Moyars v. Moyars.*[49] In 1999, the Indiana Court of Appeals distinguished *Loeb v. Loeb,*[50] which had held that a contingent remainder interest was too remote to be 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 which was not contingent on him outliving his mother's life estate. Instead, the remainder interest would pass to his estate if he predeceased his mother. Accordingly, the court held that a vested remainder interest was marital property.

5. Massachusetts—*Davidson v. Davidson.* 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 was sufficient to preclude division.

6. Montana—*Buxbaum v. Buxbaum.*[51] In 1984, the Montana Supreme Court ruled that a husband who had benefited from his vested future 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.*[52] 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 Oosting v. van Oosting.*[53] In 1994, the North Dakota Supreme Court concluded that when the present value of the husband's vested interest in a 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.*[54] In 1978, the Ohio Supreme Court found that a future interest, whether contingent or executory, is alienable.

10. Oregon—*Benston v. Benston.*[55] In 1983, the Oregon Appeals Court found that a vested, as well as a contingent, remainder interest is subject to division.

11. Vermont—*Chilkott v. Chilkott.*[56] In 1992, the Vermont Supreme Court held that techniques of actuarial valuation of pension interests were applicable in determining the present value of the husband's vested, defeasible trust interest for the purposes of property division at dissolution.

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

To date, 12 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 contingent remainder interest to be property eligible for division. First, a hand-

47 537 P.2d 1 (Alaska, 1975).
48 1994 WL 592243 (Conn. Super. Ct., 1994).
49 717 N.E.2d 976 (Ct. App. Ind., 1999).
50 301 N.E.2d 349 (Ind., 1973).
51 692 P.2d 411 (Mont., 1984).
52 638 A.2d 1254 (N.H., 1994).
53 521 N.W.2d 93 (N.D., 1994).
54 374 N.E.2d 1384 (Ohio, 1978).
55 656 P.2d 395 (Or. App., 1983).
56 607 A.2d 883 (Vt., 1992).

ful of states still follow the theory that a vested or contingent remainder interest is not divisible, or that it is a mere expectancy, or that it is too remote to be classified as marital property. But the primary reason more states have not found that a remainder interest is marital property is that 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 are based generally on one of the following types:

- An inheritance is classified as a marital asset.
- An inheritance is separate property, but the appreciation on an inheritance is a marital asset.
- 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 upon divorce, an estranged spouse has greater rights than an ordinary creditor. Under the Restatement Second, an ordinary creditor cannot generally attach a remainder interest until it is distributed because the interest is either indefinite, contingent or subject to a spendthrift provision.[57] However, a spouse is an exception creditor for purposes of child support and alimony, not with respect to the division of marital property.[58]

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.[59] Unfortunately, in all but one of the cases cited above, the courts did not discuss the spendthrift issue. In one case, *Davidson v. Davidson,* though, 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 wooden application of the technical rules of the law of property. We [the court] think an expansive approach, within the marital partnership concept, is appropriate."[60] Therefore, a former spouse in many states has greater rights to a remainder interest than those of an ordinary creditor.

In light of these issues, it is surprising that more estate planners do not create discretionary multigenerational dynasty trusts[61] as a matter of course. 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 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 in *Dwight v. Dwight*[62] held that the amount of alimony could be based on imputing income from a discretionary trust. A discretionary trust is not even a property interest or an enforceable right, 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.[63] Consequently, how could it be possible that income would be imputed to a beneficiary who could not even sue for a distribution? This case begins to make sense only in light of the radical changes to common law that are adopted by both the UTC and the Restatement Third when they are compared to current trust law.

Part 3 of this article, which will appear in the next issue, analyzes the UTC. ■

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57 Restatement Second, section 162; Henderson v. Collins, *supra* note 12.

58 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.

59 Loeb v. Loeb, *supra* note 14 (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"). Buckman appears to have been reversed by Davidson v. Davidson, *supra* note 10. However, while the Davidson court cited Buckman, it did not specifically state that such holding was reversed.

60 Davidson v. Davidson, *supra* note 10.

61 Restatement Second, section 161; Henderson v. Collins, *supra* note 12.

62 756 N.E.2d 17 (Mass. Ct. of App., 2001).

63 See note 6 *supra*.