Title

Is the property of a trust accessible to the settlor's future creditors?

Text

Introduction. Assume an owner of property gratuitously transfers it in trust to an independent trustee, expressly reserving to himself no powers, whether fiduciary or non-fiduciary. Also assume this is not to be a statutory domestic asset protection trust (DAPT). At time of transfer the settlor is not only solvent but also creditor-free. Sometime post transfer settlor incurs debt that renders him insolvent. May his post-transfer ("future") creditors reach the entrusted property? Had settlor reserved even a contingent interest in the principal, most likely. If not, possibly.

Non-fraudulent entrustment with reserved beneficial interest. Assume terms of this non-DAPT grant independent trustee full discretion to invade/ not invade principal for settlor's benefit. Settlor's equitable property interest is contingent, it being subject to condition precedent of exercise of trustee discretion. The principal is available to the settlor's future creditors, and, quite possibly, to future postmortem creditors as well. Availability is subject neither to entrustment being fraudulent nor trustee ever actually making distributions to the settlor. See §5.3.3.1 of *Loring and Rounds: A Trustee's Handbook* (2023), which section is set forth in appendix below. Handbook available for purchase at https://law-store.wolterskluwer.com/s/product/loring-rounds-trustees-hanbook-2023e/01t4R00000Ojr97QAB.

Entrustment with no reserved beneficial interest. Here fraudulent-conveyance doctrine is implicated. See my 2/14/23 JDSUPRA posting entitled "Intersection of Fraudulent Conveyance Doctrine and the Law of Trusts," accessible below among the links to my previous JDSUPRA postings. Future creditors have two paths to restitution, equitable and statutory. The former via unjust enrichment doctrine, the latter via the Uniform Voidable Transactions Act (2014), or a precursor statute.

Unjust enrichment. Even one unjustly enriched through no fault of his own may be compelled in equity to make restitution. Take someone who disadvantages his current creditors by transferring his property to an innocent trustee for the benefit of innocent third parties. The court may convert the express trustee into a constructive trustee for the benefit of the creditors, thus depriving the innocent but unjustly enriched third parties of their equitable interests. See Restatement of Property §123 (1936). Here, however, it is hard to see how a future creditor could be a victim of unjust enrichment even if the settlor had fraudulently hidden from the creditor the settlor's lack of creditworthiness, the donative transfer in trust having been completed before the settlor began incurring debt. To retroactively deem an innocent trust beneficiary's enrichment "unjust" seems, well, inequitable. So much more so if there has been a reasonable change of position on his part. At best, as between innocent future creditors and innocent third-party trust beneficiaries, the equities are equal. And "when there is equal equity, the law shall prevail." Let's then pull up the prevailing statutory law.

Uniform Voidable Transactions Act (2014) (UVTA). UVTA §4(a)(1) accommodates not only a debtor's current creditors but also his future creditors, whether foreseeable or unforeseeable at time of transfer, provided debtor "actually" had then intended to hinder, delay, or defraud them. The underpinning creditor-friendly policy is traceable to the Statute of 13 Elizabeth (1571). "Numerous state courts have held that a future creditor may seek relief under the fraudulent transfer law, without any requirement that the future creditor be a foreseeable future creditor." David J. Slenn, *The Fraudulent Transfer of Wealth* 88 (ABA 2022). At least one jurisdiction, however, is not in accord. *See* Conn. Gen. Stat. Ann. Section 52-552e.

Appendix

§5.3.3.1 Reaching Settlor's Reserved Beneficial Interest or Even the Entrusted Property Itself [from *Loring and Rounds: A Trustee's Handbook* (2023), available for purchase at https://law-store.wolterskluwer.com/s/product/loring-rounds-trustees-hanbook-2023e/01t4R00000Ojr97QAB].

The settlor-beneficiary's inter vivos creditors. In the United States, for public policy reasons, a settlor[124] cannot place property in trust for the settlor's own benefit and keep it and/or the equitable interest beyond the reach of the settlor's[125] creditors.[126] (It has been likewise in England, at least as far back as the reign of Henry VII, and perhaps as far back as even the reign of Edward III.)[127] In other words, on public policy grounds, a spendthrift provision in a trust established for the settlor's own benefit is unenforceable, at least as against the settlor-beneficiary's creditors, *even if the conveyance in trust had not been fraudulent.*[128] In the United States, however, there are apparently no relevant cases dealing with whether a forfeiture provision in such a trust would violate public policy.[129] In England, "a provision requiring the forfeiture of a settlor's interest upon bankruptcy is invalid as a fraud on the bankruptcy law. But a provision for the forfeiture of the settlor's right to income upon voluntary alienation or if creditors attempt to reach it is valid."[130]

The reservation of a general inter vivos power of appointment exposes the entrusted property itself to creditor attack. If the settlor retains the right during his or her lifetime[131] to revoke the trust, or retains an

[124]The beneficiary need not have made the actual transfer of the property to the trustee. *See generally* §8.43 of this handbook (determining the trust's true settlor). A beneficiary who had paid consideration in return for which someone else made the transfer would be deemed the settlor with the result that the beneficiary's creditors would have access to the constructively retained interest. Restatement (Third) of Trusts §58 cmt. f. Also, "[a] life beneficiary of a spendthrift trust created by another who pays off encumbrances on the trust property becomes to that extent settlor of the trust." Restatement (Third) of Trusts §58 cmt. f.

[125]*See* Restatement (Third) of Trusts §58 cmt. e (confirming that the policy would not necessarily negate a spendthrift restraint with respect to the interests of persons other than the settlor).

[126]"Such interest will pass to the settlor's trustee in bankruptcy as 'a beneficial interest … in a trust that' is not subject to a restriction on transfer 'that is enforceable under applicable nonbankruptcy law' under the terms of Bankruptcy Code §541(c)(2)." Restatement (Third) of Trusts §58 cmt. e.

[127]73 Hen. VII, c. 4 (1487); 50 Edw. III, c. 6 (1376). *See generally* Erwin N. Griswold, *Spendthrift Trusts Created in Whole or in Part for the Benefit of the Settlor*, 44 Harv. L. Rev. 203 (1930). *See also* 1 Scott & Ascher §1.1 (noting that "for six hundred years, people have resorted to trusts to evade creditors' claims, but, until very recently, it has always been recognized that permitting them to do so was contrary to sound policy"); 3 Scott & Ascher §15.4 (noting that these English statutes were also interpreted as "enabling the settlor's creditors to reach the settlor's beneficial interest by a proceeding at common law, without the expense of a creditor's suit in Chancery").

[128]*See* 3 Scott & Ascher §15.4. *See generally* The Fraudulent Conveyances Act 1571 (13 Eliz. 1, c5), otherwise known as the Statute of 13 Elizabeth (regulating fraudulent conveyances generally) [England].

[129]*See* 3 Scott & Ascher §15.1.1. By forfeiture provision, we mean a provision that terminates the interest of a beneficiary "upon an attempt by the beneficiary to alienate the interest or an attempt by the beneficiary's creditors to reach it." 3 Scott & Ascher §15.1.1.

[130]3 Scott & Ascher §15.1.1.

[131]*Cf.* Restatement (Third) of Trusts §58 cmt. e (providing that if the settlor reserves not only a right to receive the income of a trust for life but also a general power to appoint the entrusted property by will, neither the life interest nor the property subject to the right to appoint can be protected from the creditors of the settlor by a spendthrift restraint). "The settlor's creditors can reach the principal of the trust,

unrestricted right to amend it, the subject property will be reachable by the settlor's creditors, and later by the creditors of the settlor's estate, to the extent the property would be reachable were the settlor to own the property outright and free of trust.[132]

What if the settlor reserves no beneficial interest, only a naked right of revocation? Until relatively recently, the common law has held that an unexercised,[133] naked reserved right of revocation will not expose the principal, *i.e.*, the underlying trust property, to attack by the settlor's creditors.[134] It was reasonable to expect, however, that form would give way to substance sooner rather than later.[135] That process is well under way,[136] and probably was inevitable after *In re Totten*.[137] More and more, courts and legislatures are hard pressed to justify why, as a matter of public policy, the settlor's creditors should be thwarted by naked reserved rights of revocation under which settlors retain rights of consumption over the subject properties—rights that are the functional equivalent of ownership—but should not be thwarted by reserved beneficial interests in discretionary trusts where control is transferred to independent trustees. After all, a naked retained right of revocation enables a competent settlor to destroy the contingent equitable interests of all ostensible beneficiaries.[138] While in form the settlor may have only a personal right of disposition, in substance he is a beneficiary—in fact the primary beneficiary.[139] This is because the interests of the ostensible beneficiaries are subordinate to the settlor's right to get back the entrusted property.[140] It should be noted that the UTC would afford the creditors of the holder of a naked right of revocation access to the trust principal.[141] The Restatement (Third) of Trusts is in accord.[142] On the other hand, the reservation of a general testamentary power of appointment in and of itself will not subject the underlying trust property to the claims of the settlor's creditors during the settlor's lifetime.[143]

The self-settled discretionary trust and the vulnerability of the entrusted property itself. Assume that the settlor is both the sole trustee and the sole permissible beneficiary of a discretionary trust that terminates in favor of the settlor's probate estate. The subject property is reachable by the settlor's creditors because the property is owned outright and free of trust due to merger. Merger is taken up generally in §8.7 of this

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provided there are no interests in others who can receive benefits during the settlor's lifetime." Restatement (Third) of Trusts §58 cmt. e.

[132]Restatement (Third) of Trusts §25 cmt. e; UTC §505(a)(1); 3 Scott & Ascher §§14.11.3, 15.4.1.

[133]*See generally* 3 Scott & Ascher §14.11.3 (noting that "[t]here is authority for the proposition that if the donee of a general power exercises it, and if the donee's other assets are insufficient to pay the donee's debts, the donee's creditors can reach the appointed property, but … [that] … there is also … [some]… authority to the contrary").

[134]*See* Restatement (Second) of Trusts §330 cmt. o; Jones v. Clifton, 101 U.S. 225, 230–231 (1879). For statutes providing otherwise, *see* 4 Scott on Trusts §330.12. *See also* UTC §505(a)(1) (during the lifetime of the settlor, the property of a revocable trust is subject to the claims of the settlor's creditors).

[135]*See generally* Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 Real Prop. Prob. & Tr. J. 567, 591–592 (Fall 2005).

[136]3 Scott & Ascher §§14.11.3, 15.4.2.

[137]179 N.Y. 112, 71 N.E. 748 (1904). *See generally* §9.8.5 of this handbook (the Totten or tentative trust).

[138]*See generally* 3 Scott & Ascher §§15.4.1, 15.4.2.

[139]*See generally* 3 Scott & Ascher §§15.4.1, 15.4.2.

[140]*See* UTC §505(a)(1) (providing that the settlor's possession of a naked reserved right of revocation alone will subject the trust property to the claims of the settlor's creditors). *See also* UTC §603(b) (providing that to the extent a trust is revocable and the settlor has capacity to revoke the trust, the rights of the beneficiaries are subject to the control of, and the duties of the trustee are owed exclusively to, the settlor).

[141]UTC §505(a)(1).

[142]Restatement (Third) of Trusts §25 cmt. e.

[143]*See generally* 3 Scott & Ascher §15.4.1.

handbook.

But what if there is no merger, if, say, persons other than the settlor are designated remaindermen? The subject property of a trust under which the trustee has full discretion to use income and/or *principal* to or for the benefit of the settlor is still reachable by the settlor's creditors, even though the reserved equitable interest is a contingent property interest (the condition precedent being the trustee's exercise of discretion). Even if the trust instrument contains a spendthrift clause, even if the remaindermen and the settlor-beneficiary are strangers, and even if the inception transfer had not been procured by fraud,[144] the settlor's creditors will still be afforded access.[145] It is the trustee's mere possession of a fiduciary power of appointment exercisable for the benefit of the settlor-beneficiary that is critical. The principal is vulnerable even if the trustee is truly independent and whether or not the trustee ever actually exercises his discretion to make distributions. The Restatement (Third) of Trusts is in accord,[146] as is the UTC.[147] The trail, however, had already been well-blazed by §156(2) of the Restatement (Second) of Trusts.[148] It provided that "where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit."[149]

It is safe to say that the spirit of §156(2) is now settled equity doctrine, doctrine that now can be abrogated, at least in the near term, only by statute.[150] "First, the rule grants to creditors greater rights than those retained by the settlor himself or herself: the settlor cannot … [directly]… compel trust distributions, but the settlor's creditors can. Second, the rule applies notwithstanding that allowing the settlor's creditors to reach the assets of the trust may defeat not just the settlor's interests, but also the interests of other beneficiaries."[151]

What about the mere reservation of a contingent equitable remainder? Would that render the entrusted property reachable by the settlor's creditors? At least one court has held that it would not.[152]

Would a retained income interest plus a general testamentary power of appointment render the entrusted property, i.e., the principal, vulnerable to the settlor's creditors? The Restatement (Third) of

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[144]*See generally* 3 Scott & Ascher §15.4. *See* Hickory Point Bank & Tr., FSB v. Natural Concepts, Inc., 2017 IL App (3d) 160260-U (Ill. App. Ct. 2017) (unpublished) ("The Illinois Supreme Court found that the common law rule was still valid, noting that 'it is not a fraudulent transfer of funds that renders the trust void as to creditors under the common law, but rather it is the spendthrift provision in the self-settled trust and the settlor's retention of the benefits that renders the trust void as to creditors.'"). The UTC does not address possible rights against a settlor who was insolvent at the time of the trust's creation or was rendered insolvent by the transfer of property to the trust, the subject instead being left to state fraudulent transfer law. UTC §505 cmt.

[145]*See* Restatement (Second) of Trusts §156. *See, e.g.*, Spenlinhauer v. Spencer Press, Inc., 195 B.R. 543 (Bankr. D. Me. 1996), *aff'd*, 103 F.3d 106 (1st Cir. 1996). *See generally* Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 Real Prop. Prob. & Tr. J. 567, 590 (Fall 2005).

[146]Restatement (Third) of Trusts §58 cmt. e & §60 cmt. f.

[147]UTC §505(a)(2).

[148]*See, e.g.,* Ware v. Gulda, 331 Mass. 68, 117 N.E.2d 137 (1954) ("The rule we apply is found in Restatement: Trusts, §156(2)….").

[149]*See* Restatement (Second) of Trusts §156 appendix. *See also* UTC §505(a)(2).

[150]*See* 2A Scott on Trusts §156 n.1; 3 Scott & Ascher §15.4.3 (Discretionary Trust for the Settlor).

[151]Robert T. Danforth, *Rethinking the Law of Creditors' Rights in Trusts*, 53 Hastings L.J. 287, 294, 301 (2002).

[152]*See* Hickory Point Bank & Tr., FSB v. Natural Concepts, Inc., 2017 IL App (3d) 160260-U (Ill. App. Ct. 2017) (unpublished) (asserting that for the assets of a self-settled trust to be reachable by the settlor's creditors, the settlor must be the "primary beneficiary").

Trusts would allow the settlor's creditors during his lifetime to reach the entire principal of a purported spendthrift trust in which the settlor has reserved a life interest and a general power to appoint the entrusted property at death.[153] Georgia equity doctrine is in accord.[154]

Vulnerability of a retained income or unitrust interest without more. While the entrusted property itself may not be vulnerable to the settlor creditors, a retained vested equitable property interest would be. A retained equitable or beneficial interest, such as a right to all net trust accounting income or a right to periodic unitrust distributions,[155] for example, would be accessible to the settlor's creditors.

Is principal safe from attack by the settlor's creditors when the settlor creates an income-only spendthrift trust for the settlor's own benefit, notwithstanding the fact that the spendthrift clause cannot protect the income stream itself from the reach of the settlor's creditors?[156] Probably yes—at least for the foreseeable future.[157] There is a counterargument, however: The principal—the engine that generates the income—is employed for the benefit of the settlor. Thus, because the entire principal is dedicated to the benefit of the settlor, the spirit and letter of §156(2) dictates that the principal itself should be vulnerable to creditor attack.[158] While the engine argument is essentially Congress' rationale for including property subject to a reserved life estate in the Federal Gross Estate for estate tax purposes,[159] it has so far proven of little utility to the settlor's creditors.[160] Note, however, that a self-settled income-only trust containing a reserved general power of appointment, be it inter vivos or testamentary, may well be creditor-vulnerable.[161] *The reservation of a nongeneral power without more will not expose the entrusted property to attack by the settlor's creditors.* The reservation of a special/limited/nongeneral inter vivos power of appointment, in and of itself, will *not* subject the underlying trust property to the claims of the settlor's creditors, as the power may be exercised neither in favor of the settlor nor in favor of the settlor's creditors.[162] This is the case even though an exercise of the power could bring about the trust's termination.

The tax implications of creditor accessibility in the self-settled-trust context. Creditor accessibility can

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[153]*See* Restatement (Third) of Trusts §58 cmt. e.

[154]*See* Phillips v. Moore, 286 Ga. 619, 690 S.E.2d 620 (2010) (a reserved income interest coupled with a reserved testamentary power of appointment renders the entrusted property accessible to the settlor's inter vivos creditors even in the face of a spendthrift clause, even though there are designated takers in default of the power's exercise, and even though the settlor himself lacks access to the entrusted principal during his lifetime).

[155]*See* 3 Scott & Ascher §15.4.

[156]*See generally* 3 Scott & Ascher §15.4.

[157]*See generally* 2A Scott on Trusts §156 n.2 and accompanying text.

[158]*See generally* Charles E. Rounds, Jr., *The Vulnerability of Trust Assets to Attack by the Deceased Settlors Creditors, by the Commonwealth Should It Seek Reimbursement for Medicaid Payments, and by the Spouse*, 73 Mass. L. Rev. 67, 70 (1988).

[159]I.R.C. §2036(a)(1) (1978), *rev'g* May v. Heiner, 281 U.S. 238 (1930). *See also* Omnibus Budget Reconciliation Act of 1993 §13611 (1993) (making the principal of self-settled income-only trusts countable for Medicaid eligibility purposes).

[160]*See, e.g.*, Restatement (Third) of Trusts §58 cmt. e, illus. 8.

[161]Restatement (Third) of Trusts §58 cmt. e; Restatement (Second) of Trusts §156 cmt., illus. 1.c. *See, e.g.*, Phillips v. Moore, 286 Ga. 619, 690 S.E.2d 620 (2010) (holding that a reserved income interest under a trust, coupled with a reserved general *testamentary* power of appointment, will subject trust principal to the reach of the settlor's *inter vivos* creditors).

[162]3 Scott & Ascher §14.11.3. *See generally* §8.1 of this handbook (powers of appointment). Likewise, the reservation of a special/limited/nongeneral testamentary power of appointment, in and of itself, will not subject the underlying trust property to the claims of the settlor's creditors, as the power, by its terms, may not be exercised in favor of the settlor, the settlor's creditors, the settlor's probate estate, or the creditors of the settlor's probate estate.

have gift and estate tax consequences as well. The settlor-beneficiary of a fully discretionary trust,[163] for example, may have failed to relinquish dominion and control over the trust property sufficient to have made a completed gift for gift tax purposes.[164] On the other hand, the "settlor's ability to secure the economic benefit of the trust assets by borrowing and relegating creditors to those assets for repayment may well trigger inclusion of the property in the settlor's gross estate under secs. 2036(a)(1) or 2038(a)(1)… [of the Internal Revenue Code]…."[165]

When there are multiple settlors. Under the UTC, if a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.[166] In one case, a husband and his wife owning property as tenants by the entireties transferred the property into an irrevocable self-settled spendthrift trust.[167] A judgment creditor of the husband tried unsuccessfully to reach the trust assets. The court reasoned that had the judgment been against the husband and wife jointly and severally, the creditor's claim would have been valid. The judgment, however, was against the husband only. Just as the creditor would have had no legal right to levy against the real estate before they conveyed it to the trustee, the legal title to the real estate having been held by them as tenants by the entireties, so it "stands to reason" that the creditor could not have access to it after the conveyance.

Crummey trusts. The UTC provides that a lapse, release, or waiver of a power of withdrawal, whether the power was reserved by or granted to the holder, will cause the holder to be treated as the settlor of the trust for creditor accessibility purposes only to the extent the value of the property affected by the lapse, release, or waiver exceeds the *Crummey* or "5 and 5" power.[168] For a discussion of the "5 and 5" power, see §9.18 of this handbook.

The Special Power of Appointment Trust (SPAT): An asset-protection scheme problematic as to form as well as substance. A settlor-beneficiary's creditors may reach the maximum amount that the trustee could have paid to the settlor-beneficiary. The UTC, specifically §505(a)(2), is in accord, and then some. According to the UTC, the creditors may capture all distributions, not just distributions made by the trustee. In any case, it has been suggested that a settlor's creditors can be kept at bay if the settlor bestows on a third party a nonfiduciary special power of appointment under which the settlor is a permissible appointee, expressly reserving no equitable interest and no powers. Arguably SPAT distributions would not be coming *from the trustee*. But that cannot be. Legal title is in the trustee. Any distribution triggered by a power exercise would entail the passage of legal title *from the trustee* to the settlor-appointee. So much for form. Now to substance. In equity's world, substance trumps form.[169] Thus, there is the real risk that equity would consider the powerholder the settlor's common-law agent, deeming any distributions as coming not from the trustee and not from the powerholder but from settlor himself. There would go the SPAT's asset-protection feature

The settlor-beneficiary's postmortem creditors. It is self-evident that the legitimate postmortem creditors of the settlor of a testamentary trust will have access to that portion of the settlor's probate estate that is destined to fund the trust, *i.e.*, to the extent their lawful claims have not been or cannot be satisfied from other estate assets. Whether by statute or decision, the probate estate is generally where postmortem

[163]That is a trust under which the trustee alone has full discretion to use income and/or principal to or for the benefit of the settlor.

[164]Outwin v. Comm'r, 76 T.C. 153, 164–165 (1981). *See generally* §4.1.3 of this handbook (creditor accessibility as a general inter vivos power of appointment).

[165]Outwin v. Comm'r, 76 T.C. 153, n.5 (1981).

[166]UTC §505(a)(2).

[167]Bolton Roofing Co. v. Hedrick, 701 S.W.2d 183 (Mo. Ct. App. 1985).

[168]UTC §505(b)(2). *See generally* Kevin D. Millard, *Rights of a Trust Beneficiary's Creditors under the Uniform Trust Code*, 34 ACTEC L.J. 58, 65–66 (2008).

[169]*See generally* §8.12 of this handbook (equity's maxims).

creditors are expected to look to first. Under certain circumstances, however, the postmortem creditors also may have access to the underlying property of a trust that the decedent had established during his or her lifetime. This is likely to be the case if the settlor had reserved a general inter vivos power of appointment, such as a right of revocation, or possibly even a general testamentary power of appointment. Finally, the proceeds of any insurance on the life of a settlor of a revocable inter vivos trust that are paid to the trustee also might be vulnerable to the claims of the settlor's postmortem creditors, unless there is a statute that provides otherwise.

The postmortem implications for creditor access if the deceased settlor-beneficiary had held a general inter vivos power of appointment. Although the "traditional thinking" was otherwise,[170] the current trend of the law favors allowing the settlor's postmortem creditors, as well as the surviving spouse, access to the principal of an inter vivos trust if the settlor reserved a personal power to consume[171] the underlying property *at the time of the settlor's death.*[172] By power to consume, we mean an express or constructive general inter vivos power of appointment. This should be contrasted with the lot of the inter vivos creditor where the focus traditionally was on the retention of a beneficial interest, rather than a power to consume.[173] Thus, we traditionally had such anomalies as the naked reserved right of revocation exposing trust assets to the reach of the settlor's postmortem creditors, but not the inter vivos ones;[174] or the property of a self-settled "irrevocable" discretionary trust being subject to the reach of the settlor's inter vivos creditors, but

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[170]*See* 3 Scott & Ascher §14.11.3.

[171]*See generally* Unif. Nonprobate Transfers on Death Act §102(a) (defining a nonprobate transfer to include "a valid transfer effective at death by a transferor … to the extent that the transferor immediately before death had power, acting alone, to prevent the transfer by … withdrawal and instead to use the property for the benefit of the transferor or apply it to discharge claims against the transferor's probate estate." The Act provides that retention alone of a general testamentary power of appointment would not expose the subject property to attack by the settlor's postmortem creditors. Unif. Nonprobate Transfers on Death Act §102(a).

[172]Restatement (Third) of Trusts §25(2) cmt. e. *See, e.g.*, *In re* Est. of Nagel, 580 N.W.2d 810 (Iowa 1998); State St. Bank & Tr. Co. v. Reiser, 7 Mass. App. Ct. 633, 389 N.E.2d 768 (1979) (creditor access because of power of consumption at time of debtor's death); Sullivan v. Burkin, 390 Mass. 864, 460 N.E.2d 572 (1984) (spousal access because of power of consumption during marriage). *See* Clifton B. Kruse, Jr. (compiler), *Summary of Case Law: Rights of Creditors Following Death of Settlor-Beneficiaries of Revocable Trusts*, 23 ACTEC Notes 155 (1997). *See also* UTC §505(a)(3) (providing that "[a]fter the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and statutory allowances to a surviving spouse and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses, and allowances"); Restatement (Second) of Property (Wills and Other Donative Transfers) §34.3 (rejecting the principle of Jones v. Clifton, 101 U.S. 225 (1879), that a trust settlor's reserved power to revoke is not an asset subject to creditors' claims and instead providing that a settlor's creditors may reach the assets of a revocable trust even when the trust transfer to the trustee was not fraudulent); UPC §6-102(b) (Revised 1998) (establishing liability of nonprobate transferees for creditor claims and statutory allowances). *See generally* Wellman & Brucken, *NCCUSL To Your Rescue: New UPC Sec. 6-102*, 26 ACTEC Notes 361 (2001).

[173]*See* 4 Scott on Trusts §330.12; Restatement (Second) of Trusts §330 cmt. o.

[174]*See* State St. Bank & Tr. Co. v. Reiser, 7 Mass. App. Ct. 633, 638, 389 N.E.2d 768, 771 (1979) (in the postmortem context, a reserved general inter vivos power may be enough to expose trust property to creditor attack); Restatement (Second) of Trusts §330 cmt. o (in inter vivos context a naked reserved general inter vivos power may not be enough to expose property to creditor attack).

not the postmortem ones.[175] (In the latter case, surely it can be said that the trust, as a practical matter, was actually not irrevocable at the time of the settlor's death, a topic we take up in §4.1.3 of this handbook.) In any case, the law is now quickly evolving to the point where the settlor-beneficiary's inter vivos and postmortem creditors have coextensive access to the property of an inter vivos trust.[176] The Restatement (Third) of Property is fully there, in letter and in spirit.[177] Until this process is complete, however, such subtle divergences in the law will continue to complicate the already complicated life of the trustee.[178]

The UTC would provide that the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and statutory allowances to a surviving spouse and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses, and allowances.[179] The UTC defines "revocable" as meaning "revocable" by the settlor "without the consent of the trustee or a person holding an adverse interest."[180] The settlor, of course, would retain the right to direct in his or her estate planning documents the source from which postmortem liabilities will be paid.[181] On the other hand, the UPC (specifically §6-102(a)) and the Uniform Nonprobate Transfers on Death Act (specifically §102(a)) are somewhat less creditor-friendly. They provide by implication that if the settlor at the time of death possessed a right of revocation jointly *with a nonadverse party*, his or her postmortem creditors will not have access to the subject property. One "puzzled" commentator explains how easily "Section 102" can be "manipulated to avoid creditors":

> To avoid the reach of Section 102, the trustor simply could require that to revoke the trust the nonadverse party must join the trustor in making the revocation. The trust could then give the trustor the power to replace at will the joint powerholder with another powerholder of the trustor's own choosing. As a result, the trustor could remove and replace the joint powerholder until the trustor found one willing to agree with trustor that the trust should be revoked. Such a provision would be no more than a minor inconvenience in light of the greater benefit bestowed by the possibility of avoiding creditor claims following death.[182]

Because procedures for affording a decedent's postmortem creditors access to nonprobate assets, such

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[175]*See generally* Elaine H. Gagliardi, *Remembering the Creditor at Death: Aligning Probate and Nonprobate Transfers*, 41 Real Prop. Prob. & Tr. J. 819, 858–859 (2007).

[176]*See, e.g.*, De Prins v. Michaeles, 486 Mass. 41, 154 N.E.3d 921 (2020) (In which Massachusetts' version of the Uniform Trust Code having failed to "address the situation at issue," its Supreme Judicial Court articulates an equitable principle of Massachusetts equity, namely that the assets of a self-settled, discretionary, spendthrift, ostensibly "irrevocable," inter vivos trust are nonetheless accessible to the deceased settlor's creditors via equitable reach and apply action). *See generally* Elaine H. Gagliardi, *Remembering the Creditor at Death: Aligning Probate and Nonprobate Transfers*, 41 Real Prop. Prob. & Tr. J. 819 (2007).

[177]*See* Restatement (Third) of Property (Wills and Other Donative Transfers) §22.2, cmt. f.

[178]*See, e.g.*, UTC §505(a)(1) (providing that during the lifetime of the settlor, the property of a revocable trust is subject to the claims of the settlor's creditors).

[179]UTC §505(a)(3).

[180]UTC §103(14).

[181]UTC §505(a)(3).

[182]Elaine H. Gagliardi, *Remembering the Creditor at Death: Aligning Probate and Nonprobate Transfers*, 41 Real Prop. Prob. & Tr. J. 819, 856 (2007). "The comments to Section 102 … [of the Uniform Nonprobate Transfers on Death Act]… indicate, however, that liability under Section 102 might attach regardless of whether the decedent holds the sole power to revoke 'if the trust is named as beneficiary of a nonprobate transfer, such as of securities registered in [transfer-on-death] form.'" *Id*. at 855–856 (citing to Uniform Nonprobate Transfers on Death Act §102 cmt. 7).

as those in the hands of trustee transferees, are state specific, one is loath to generalize. With that caveat, it is probably safe to say that in most U.S. jurisdictions, the current state of the default procedural law is that the postmortem creditors of a decedent must (1) "pursue probate administration, even in the absence of probate assets, prior to pursuing the nonprobate transferee[s] directly" and (2) "pursue probate assets before pursuing nonprobate transferees."[183] The UPC is in accord.[184] This two-step process can pose a real problem for the postmortem creditor: "At times, the creditor's search for a decedent's assets resembles a game of hide-the-ball, with the trustee distributing assets before being notified of any judgment on the creditor's claim, as was the case in *Dobler v. Arluk Center Industrial Group*. In that case, the trustee of decedent's revocable trust was able to evade creditors by transferring assets to beneficiaries prior to a judgment being issued in the probate court."[185]

The post mortem implications for creditor access if the deceased settlor-beneficiary had held a general testamentary power of appointment. If a settlor establishes an inter vivos trust, reserving only a naked general testamentary power of appointment over the underlying trust property, then would the settlor's postmortem creditors have access to the property were the settlor to die not having exercised the power? The traditional answer was no. Only to the extent that the power was actually exercised by the terms of the settlor's will would the subject property become vulnerable to the claims of the settlor's postmortem creditors.[186] Thus, if the deceased settlor by the terms of a valid will were to actually exercise the power over, say, 50 percent of the subject property, then the settlor's postmortem creditors would have access to that 50 percent, and only that 50 percent. What was left over from that 50 percent would then pass to the appointees. It should be borne in mind that the postmortem creditors would have had no need to turn to the assets of the inter vivos trust had there been sufficient assets in the settlor's probate estate to satisfy their claims in the first place. It should also be noted that the law may be trending in the direction of affording the settlor's postmortem creditors access to *all* property subject to the reserved general testamentary power of appointment, *whether or not there had been an actual exercise*.[187] The Restatement (Third) of Property (Wills and Other Donative Transfers) is already there.[188] Section 22.2 provides that "[p]roperty subject to a general power of appointment that was created by the donee is subject to the payment of the claims of the donee's creditors to the same extent that it would be subject to those claims if the property were owned by the donee."

The Restatement (Third), however, muddles its explanation of the mechanics of reaching entrusted appointive property. It suggests in an illustration supporting §22.2 that on the donor-donee's death, the claims against the donor-donee's estate "can be satisfied *out of the remainder*… to the same extent as if the Donor-Donee owned the remainder interest at Donor-Donee's death."[189] Because the *full legal title* to entrusted appointive property is in the trustee, it is the entire legal interest in the hands of the trustee *at the time of the donor-donee's death*, not just the equitable quasi-remainder, that is vulnerable to the claims of

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[183]Elaine H. Gagliardi, *Remembering the Creditor at Death: Aligning Probate and Nonprobate Transfers*, 41 Real Prop. Prob. & Tr. J. 819, 822–823 (2007). *See, e.g.*, State St. Bank & Tr. Co. v. Reiser, 7 Mass. App. Ct. 633, 389 N.E.2d 768 (1979) (the court requiring an exhaustion of the probate estate before affording creditors access to the assets of a trust over which the decedent held a general inter vivos power of appointment at the time of death).

[184]*See* UPC §6-102(b) and cmt. 1.

[185]Elaine H. Gagliardi, *Remembering the Creditor at Death: Aligning Probate and Nonprobate Transfers*, 41 Real Prop. Prob. & Tr. J. 819, 881 (2007) (citing to Dobler v. Arluk Med. Ctr. Indus. Grp., 107 Cal. Rptr. 2d 478 (Ct. App. 2001), *aff'd*, 11 Cal. Rptr. 3d 194 (Ct. App. 2004)).

[186]*Cf.* State St. Tr. Co. v. Kissel, 302 Mass. 328, 19 N.E.2d 25 (1939) (involving the actual exercise of a general testamentary power of appointment under a trust established by someone other than the deceased powerholder).

[187]*See generally* 3 Scott & Ascher §15.4.1.

[188]*See* Restatement (Third) of Property (Wills and Other Donative Transfers) §22.1, cmt. a.

[189]*See* Restatement (Third) of Property (Wills and Other Donative Transfers) §22.2, illus. 4.

the donor-donee's postmortem creditors. That the underlying trust property itself is vulnerable to the claims of the donor-donee's creditors is buttressed by the wording of §22.2: It is the property that is "subject to a general power of appointment" that is vulnerable to external claims. There is nothing about going after the equitable property interests. Nor can there be a legal remainder in the traditional sense, full legal title to the entrusted appointive property, as we said before, being in the trustee.[190] The bottom line: The Restatement (Third) appears to have conflated and confused reaching entrusted property subject to an equitable power of appointment and attaching the equitable property interests that are thrown off incident to the trust relationship itself.

Life insurance proceeds. Life insurance proceeds paid to the insured's revocable inter vivos trust upon the death of the insured may, by statute, be beyond the reach of the settlor's postmortem creditors.[191] Prior to paying the settlor's postmortem creditors from life insurance proceeds payable to the trustee by reason of the settlor's death, the trustee should consult counsel.

Domestic asset protection havens. *The Domestic Asset Protection Trust (DAPT) is taken up in §9.28 of this handbook.*

[190]*See generally* §8.27 of this handbook (comparing and contrasting legal and equitable property interests).

[191]*See generally* 5 Scott on Trusts §508.4; Bogert §243. *Cf. In re* Est. of Clotworthy, 742 N.Y.S.2d 168 (App. Div. 2002) (involving a commercial structured settlement annuity).