

**UNIFORM TRUST CODE COMMITTEE**  
**ARTICLE 5**  
**CREDITOR CLAIMS; SPENDTHRIFT; AND DISCRETIONARY TRUSTS**

1. UTC SECTION	501
2. SUBJECT	RIGHTS OF BENEFICIARY'S CREDITOR OR ASSIGNEE
3. UTC STATUTE	<p>To the extent a beneficiary's interest is not subject to a spendthrift provision, the court may authorize a creditor or assignee of the beneficiary to reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means. The court may limit the award to such relief as is appropriate under the circumstances.</p>
<p>4. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS COMMENTS</p>	<p>This section applies only if the trust does not contain a spendthrift provision or the spendthrift provision does not apply to a particular beneficiary's interest. A settlor may subject to spendthrift protection the interests of certain beneficiaries but not others. A settlor may also subject only a portion of the trust to spendthrift protection such as an interest in the income but not principal. For the effect of a spendthrift provision on creditor claims, see Section 503.</p> <p>Absent a valid spendthrift provision, a creditor may ordinarily reach the interest of a beneficiary the same as any other of the beneficiary's assets. This does not necessarily mean that the creditor can collect all distributions made to the beneficiary. The interest may be too indefinite or contingent for the creditor to reach or the interest may qualify for an exemption under the state's general creditor exemption statutes. See [Restatement] (Third) of Trusts Section 56 (2003); Restatement (Second) of Trusts Sections 147-149, 162 (1959). Other creditor law of the State may limit the creditor to a specified percentage of a distribution. See, e.g., Cal. Prob. Code § 15306.5. This section does not prescribe the procedures ("other means") for reaching a beneficiary's interest or of priority among claimants, leaving those issues to the enacting State's laws on creditor rights. The section does clarify, however, that an order obtained against the trustee, whatever state procedure may have been used, may extend to future distributions whether made directly to the beneficiary or to others for the beneficiary's benefit. By allowing an order to extend to future payments, the need for the creditor periodically to return to court will be reduced.</p> <p>Because proceedings to satisfy a claim are equitable in nature, the second sentence of this section ratifies the court's discretion to limit the award as appropriate under the circumstances. In exercising its discretion to limit relief, the court may appropriately consider the circumstances of a beneficiary and the beneficiary's family. See Restatement (Third) of Trusts § 56 cmt. e (Tentative Draft No. 2, approved 1999).</p>

	<p><b>2005 Amendment.</b> A 2005 amendment changes “protected by” to “subject to” in the first sentence of the section. No substantive change is intended. The amendment was made to negate an implication that this section allowed an exception creditor to reach a beneficiary’s interest even though the trust contained a spendthrift provision. The list of exception creditors and their remedies are contained in Section 503. Clarifying changes are also made in the comments and unnecessary language on creditor remedies omitted.</p>
<p><b>5. COLORADO COMMITTEE COMMENTS</b></p>	<p>Absent an applicable, valid spendthrift provision, the interest of a beneficiary in a trust may be attached.</p> <p>This section does not prescribe the procedures that a creditor must follow to attach the interest. Such procedures are left to other state law.</p> <p>The creditor must go to court first and cannot proceed directly against the trust. Typical judicial proceedings result in an attachment, garnishment or similar remedy.</p> <p>Use of the words "attachment of present or future distributions to or for the beneficiary" make it clear that the attachment or garnishment may reach current and future distributions that the trustee is required to make or that the trustee decides to make. Thus, the creditor intercepts such distributions.</p> <p>Use of the words "beneficiary's interest" suggest that the creditor's remedy is limited to reaching the interest the beneficiary has in the trust. Thus, if the beneficiary has only an income interest, the creditor cannot reach or attach the principal that generates the income.</p> <p>2005 Amendment. The intent of the drafters is that 501 apply only when the trust does not contain a spendthrift provision or when a spendthrift provision does not apply to a particular beneficial interest. As originally written, 501 was susceptible of another meaning, to wit:</p> <p>501 might apply when there is no spendthrift protection (e.g. in the case of an exception creditor under 503.) This change and a corresponding clarification in the 2005 official comments are intended to make the drafters' intent regarding 501 clear.</p>
<p><b>6. COLORADO LAW</b></p>	<p>No Colorado law directly on point.</p>
<p><b>7. RECOMMENDATIONS</b></p>	<p>This section should be enacted.</p>

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1. UTC SECTION	502
2. SUBJECT	SPENDTHRIFT PROVISION
3. UTC STATUTE	<p>(a) A spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest.</p> <p>(b) A term of a trust providing that the interest of a beneficiary is held subject to a "spendthrift trust," or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest.</p> <p>(c) A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this [article], a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary.</p>
4. NATIONAL CONFERENCE OF COMMISSIONER ON UNIFORM STATE LAWS COMMENTS	<p>Under this section, a settlor has the power to restrain the transfer of a beneficiary's interest, regardless of whether the beneficiary has an interest in income, in principal, or in both. Unless one of the exceptions under this article applies, a creditor of the beneficiary is prohibited from attaching a protected interest and may only attempt to collect directly from the beneficiary after payment is made. This section is similar to Restatement (Third) of Trusts § 58 (Tentative Draft No. 2, approved 1999), and Restatement (Second) of Trusts §§ 152-153 (1959). For the definition of spendthrift provision, see Section 103(15).</p> <p>For a spendthrift provision to be effective under this Code, it must prohibit both the voluntary and involuntary transfer of the beneficiary's interest, that is, a settlor may not allow a beneficiary to assign while prohibiting a beneficiary's creditor from collecting, and vice versa. <i>See</i> Restatement (Third) of Trusts § 58 cmt. b (Tentative Draft No. 2, approved 1999). <i>See also</i> Restatement (Second) of Trusts § 152(2) (1959). A spendthrift provision valid under this Subsection (b), which is derived from Texas Property Code will also be recognized as valid in a federal bankruptcy proceeding. <i>See</i> 11 U.S.C. § 541(c)(2). § 112.035(b), allows a settlor to provide maximum spendthrift protection simply by stating in the instrument that all interests are held subject to a "spendthrift trust" or words of similar effect.</p> <p>A disclaimer, because it is a refusal to accept ownership of an interest and not a transfer of an interest already owned, is not affected by the presence or absence of a spendthrift provision. Most disclaimer statutes expressly provide that the validity of a disclaimer is not affected by a spendthrift protection. <i>See, e.g.,</i> Uniform Probate Code § 2-801(a). Releases and</p>

exercises of powers of appointment are also not affected because they are not transfers of property. *See* Restatement (Third) of Trusts § 58 cmt. c (Tentative Draft No. 2, approved 1999).

A spendthrift provision is ineffective against a beneficial interest retained by the settlor. *See* Restatement (Third) of Trusts §58(2), approved 1999. This is a necessary corollary to Section 505(a)(2), which allows a creditor or assignee of the settlor to reach the maximum amount that can be distributed to or for the settlor's benefit. This right to reach the trust applies whether or not the trust contains a spendthrift provision.

A valid spendthrift provision makes it impossible for a beneficiary to make a legally binding transfer, but the trustee may choose to honor the beneficiary's purported assignment. The trustee may recommence distributions to the beneficiary at anytime. The beneficiary, not having made a binding transfer, can withdraw the beneficiary's direction but only as to future payments. *See* Restatement (Third) of Trusts § 58 cmt. d (Tentative Draft No. 2, approved 1999); Restatement (Second) of Trusts § 152 cmt. i (1959).

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UTC §103 (15) defines a spendthrift provision as "...a term of a trust which restrains the voluntary and involuntary transfer of a beneficiary's interest."

This is a fairly traditional definition of a spendthrift provision.

A restriction on a voluntary transfer means that the beneficiary cannot sell, pledge, assign, transfer or otherwise deal with the beneficiary's interest during the term of the trust.

A restriction on an involuntary transfer means that a creditor of a beneficiary cannot attach the beneficiary's interest during the term of the trust.

For a spendthrift provision to be effective under the UTC, it must prohibit both a voluntary and involuntary transfer.

The UTC recognizes the validity of spendthrift provisions in this section. Thus, a beneficiary's interest in a "spendthrift trust" is protected until a distribution has been made and received by the beneficiary.

There are some exceptions to spendthrift as shall be seen in subsequent UTC sections.

UTC §502 follows *Restatement (Second) of Trusts*, §§ 152 and 153 (1959) and *Restatement (Third) of Trusts*, §58 (preliminary draft no. 4, 1998).

For comparison, the *Restatement (Second)* sections read verbatim as follows:

§152. *Restraint on Alienation of Income*

(1) *Except as stated in §§ 156 and 157, if by the terms of a trust the*

	<p><i>beneficiary is entitled to the income from the trust property for life or for a term of years and it is provided that his interest shall not be transferable by him and shall not be subject to the claims of his creditors, the restraint on the voluntary and involuntary transfer of his right to the income accruing during his life is valid.</i></p> <p>(2) <i>A trust in which by the terms of the trust or by statute a valid restraint on the voluntary and involuntary transfer of the interest of the beneficiary is imposed is a spendthrift trust.</i></p> <p>§153. <i>Restraint on Alienation of Principal</i></p> <p>(1) <i>Except as stated in §§ 156 and 157, if by the terms of a trust the beneficiary is entitled to have the principal conveyed to him at a future time, a restraint on the voluntary or involuntary transfer of his interest in the principal is valid.</i></p> <p>(2) <i>If the beneficiary is entitled to have the principal conveyed to him immediately, a restraint on the voluntary or involuntary transfer of his interest in the principal is invalid.</i></p> <p>(3) <i>If the principal is not to be conveyed to the beneficiary during his lifetime, a restraint on the voluntary or involuntary transfer of his interest in the principal is invalid.</i></p>
<p><b>6. COLORADO LAW</b></p>	<p>Spendthrift provisions in trusts are valid in Colorado. See <u>Snyder vs. O'Conner</u>, 81 P.2d 773(1938); <u>Newell vs. Tubbs</u>, 84 P.2d 820 (1938) (spendthrift provisions are enforceable generally, but language used in this case not sufficient to create spendthrift protection); <u>In re Nicholson's Estate. People, et al. vs. City and County of Denver, et al.</u>, 93 P.2d 880, 883-884 (Colo. 1939). See also, <i>Wade/Parks Colorado Law of Wills, Trusts &amp; Fiduciary Administration</i>, section 32-39, 1998 edition.</p> <p>Many statutory benefit programs have similar spendthrift protection. See for example the spendthrift protection afforded PERA retirement plan benefits under §24-54.5-107 C.R.S. The spendthrift protection is absolute for PERA benefits except in the case of child support obligations. Colorado has embraced a public policy exception to PERA spendthrift provisions when it comes to child support.</p>
<p><b>7. RECOMMENDATIONS</b></p>	<p>Settlers have for years included spendthrift provisions in the terms of their trusts. The validity of spendthrift provisions has been recognized in the <i>Restatement (Second)</i> position which Colorado apparently follows. UTC §502 codifies the <i>Restatement (Second)</i> position. This section should be enacted.</p>

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1. UTC SECTION	503
2. SUBJECT	EXCEPTIONS TO SPENDTHRIFT PROVISION
3. UTC STATUTE	<p>(a) In this section, "child" includes any person for whom an order or judgment for child support has been entered in this or another State.</p> <p>(b) <u>To the extent provided in subsection (c), a</u> <del>A</del> spendthrift provision is unenforceable against:</p> <ul style="list-style-type: none"> <li>(1) a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance;</li> <li>(2) a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust; and</li> <li>(3) a claim of this State or the United States to the extent a statute of this State or federal law so provides.</li> </ul> <p>(c) <u>The only remedy of a</u> <del>A</del> claimant against whom a spendthrift provision cannot be enforced <u>may is to</u> obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary. The court may limit the award to such relief as is appropriate under the circumstances.</p>
4. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS COMMENTS	<p>This section exempts the claims of certain categories of creditors from the effects of a spendthrift restriction and specifies the remedies such exemption creditors may take to satisfy their claims.</p> <p>The exception in subsection (b)(1) for judgments or orders to support a beneficiary's child or current or former spouse is in accord with Restatement (Third) of Trusts § 59(a) (Tentative Draft No. 2, approved 1999), Restatement (Second) of Trusts § 157(a) (1959), and numerous state statutes. It is also consistent with federal bankruptcy law, which exempts such support orders from discharge. The effect of this exception is to permit the claimant for unpaid support to attach present or future distributions that would otherwise be made to the beneficiary. Distributions subject to attachment include distributions required by the express terms of the trust, such as mandatory payments of income, and distributions the trustee has otherwise decided to make, such as through the exercise of discretion. Subsection (b)(1), unlike Section 504, does not authorize the spousal or child claimant to compel a distribution from the trust. Section 504 authorizes a spouse or child claimant to compel a distribution to the extent the trustee has abused a discretion or failed to comply with a standard for distribution.</p> <p>Subsection (b)(1) refers both to "support" and "maintenance" in order to accommodate differences among the States in terminology employed. No difference in meaning between the two terms is intended.</p>

The definition of "child" in subsection (a) accommodates the differing approaches States take to defining the class of individuals eligible for child support, including such issues as whether support can be awarded to stepchildren. However the State making the award chooses to define "child" will be recognized under this Code, whether the order sought to be enforced was entered in the same or different State. For the definition of "state," which includes Puerto Rico and other American possessions, see Section 103(17).

The definition of "child" in subsection (a) is not exclusive. The definition clarifies that a "child" includes an individual awarded child support in any state. The definition does not expressly include but neither does it exclude persons awarded child support in some other country or political subdivision, such as a Canadian province.

The exception in subsection (b)(2) for a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust is in accord with Restatement (Third) of Trusts § 59(b) (Tentative Draft No. 2, approved 1999), and Restatement (Second) of Trusts § 157(c) (1959). This exception allows a beneficiary of modest means to overcome an obstacle preventing the beneficiary's obtaining services essential to the protection or enforcement of the beneficiary's rights under the trust. *See* Restatement (Third) of Trusts § 59 cmt. d (Tentative Draft No. 2, approved 1999).

Subsection (b)(3), which is similar to Restatement (Third) of Trusts § 59 cmt. a (Tentative Draft No. 2, approved 1999), exempts certain governmental claims from a spendthrift restriction. Federal preemption guarantees that certain federal claims, such as claims by the Internal Revenue Service, may bypass a spendthrift provision no matter what this Code might say. The case law and relevant Internal Revenue Code provisions on the exception for federal tax claims are collected in George G. Bogert & George T. Bogert, *The Law of Trusts and Trustees* § 224 (Rev. 2d ed. 1992); and 2A Austin W. Scott & William F. Fratcher, *The Law of Trusts* § 157.4 (4th ed. 1987). Regarding claims by state governments, this subsection recognizes that States take a variety of approaches with respect to collection, depending on whether the claim is for unpaid taxes, for care provided at an institution, or for other charges. Acknowledging this diversity, subsection (c) does not prescribe a rule, but refers to other statutes of the State on whether particular claims are subject to or exempted from spendthrift provisions.

Unlike Restatement (Third) of Trusts § 59(2) (Tentative Draft No. 2, approved 1999), and Restatement (Second) of Trusts § 157(b) (1959), this Code does not create an exception to the spendthrift restriction for creditors who have furnished necessary services or supplies to the beneficiary. Most of these cases involve claims by governmental entities, which the drafters concluded are better handled by the enactment of special legislation as authorized by subsection (b)(3). The drafters also declined to create an exception for tort claimants. For a discussion of the exception for tort claims, which has not generally been recognized, see Restatement (Third) of Trusts § 59 Reporter's Notes to cmt. a (Tentative Draft No. 2, approved 1999). For a discussion of other exceptions to a spendthrift restriction, recognized in some States, see George G. Bogert & George T. Bogert, *The Law of Trusts and*

Trustees § 224 (Rev. 2d ed. 1992); and 2A Austin W. Scott & William F. Fratcher, *The Law of Trusts* §§ 157-157.5 (4th ed. 1987).

Subsection (c) provides that the only remedy available to an exception creditor is attachment of present or future distributions. Depending on other creditor law of the state, additional remedies may be available should a beneficiary's interest not be subject to a spendthrift provision. Section 501, which applies in such situations, provides that the creditor may reach the beneficiary's interest under that section by attachment or "other means." Subsection (c) similar to Section 501, clarifies that the court has the authority to limit the creditor's relief as appropriate under the circumstances.

**2005 Amendment.** The amendment rewrote this section. The section previously provided:

**SECTION 503. EXCEPTIONS TO SPENDTHRIFT PROVISION.**

- (a) In this section, "child" includes any person for whom an order or judgment for child support has been entered in this or another State.
- (b) Even if a trust contains a spendthrift provision, a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance, or a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust, may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary.
- (c) A spendthrift provision is unenforceable against a claim of this State or the United States to the extent a statute of this State or federal law so provides.

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*Restatement (Second) of Trusts* §157 (1959) recognizes preferred status for some creditors of a beneficiary of a trust. The *Restatement* position is expressed as follows:

*§157. Particular Classes of Claimants*

*Although a trust is a spendthrift trust or a trust for support, the interest of the beneficiary can be reached in satisfaction of an enforceable claim against the beneficiary,*

*(a) by the wife or child of the beneficiary for support, or by the wife for alimony;*

*(b) for necessary services rendered to the beneficiary or necessary supplies furnished to him;*

*(c) for services rendered and materials furnished which preserve or benefit the interest of the beneficiary;*

*(d) by the United States or a State to satisfy a claim against the*

*beneficiary.*

Thus, per *Restatement (Second)*, these preferred creditors may attach a beneficiary's interest in a trust even though the trust contains a valid spendthrift provision. The *Restatements (Second)* and *(Third)* recognize that an owner of property does not have an unqualified power of disposition. There are common law and statutory restrictions based on public policy. Thus, spendthrift restraint is not unqualified. For public policy reasons, some creditors are not bared by spendthrift provisions.

The UTC codifies some, but not all, of the common law preferred creditor classes. Under the UTC, there are only three preferred creditor classes, to wit: (i) a beneficiary's child, spouse or former spouse who has a judgment or court order against the beneficiary for support or maintenance; (ii) a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust; and (iii) a claim of a state or the United States to the extent a statute of this state or federal law so provides.

*Restatement (Third) of Trusts* section 59 provides:

*Section 59. Spendthrift Trusts: Exceptions for Particular Types of Claims:*

*The interest of a beneficiary in a spendthrift trust can be reached in satisfaction of an enforceable claim against the beneficiary for:*

- a) Support of a child, spouse or former spouse; or*
- b) Services or supplies provided for necessities or for protection of the beneficiary's interest in the trust.*

*Restatement (Third) of Trusts* section 59 cmt. a(1) provides that "It is implicit in the rule of this section, as a statement of the common law, that governmental claimants, and other claimants as well, may reach the interest of a beneficiary of a spendthrift trust to the extent provided by federal law or an applicable state statute."

*Restatement (Third) of Trusts* section 59 cmt. a(2) provides that "The exceptions to spendthrift immunity stated in this section are not exclusive. Special circumstances, or evolving policy may justify recognition of other exceptions, ...."

While the *Restatement (Third) of Trusts* section 59 leaves open the possibility that courts may recognize other exceptions to spendthrift protection, such as for a tort creditor, enactment of the UTC will prevent courts from doing so. The UTC provides that creditors may not reach a beneficial interest in a spendthrift trust "except as otherwise provided" in the Code. See UTC section 502(c) supra. Thus, enactment of the UTC will limit the classes of exception creditors to only those recognized by the legislature.

**2005 Amendment** 503 has been restructured for three reasons.

(i) In connection with the amendment of 501, remedies for government exception creditors are being addressed in 503. As originally drafted, 503(c) did not address government exception creditor remedies on the assumption that state and federal laws piercing spendthrift would provided the remedies (e.g. tax liens.) Some have argued that because 503(c) did not contain remedies, the drafters intended that 501 (as originally drafted) did; and that as a consequence, a government creditor could force a spendthrift interest to "judicial sale." The drafters did not intend this result. Remedies for such exception creditors are now to be addressed in 503(c).

ii) Under 503(b) as originally drafted, child, spouse, former spouse and "protection provider" exception creditors were limited to attaching only present or future distributions. There is a belief that this same restriction should apply to government exception creditors unless state or federal law applies otherwise. Accordingly, the remedy restriction has been moved to new subsection 503(c); and 503(b) has been rewritten to simply identify the three classes of exception creditors (although section 503(b)(3) continues to recognize state and federal law remedies engrafted into spendthrift piercing statutes/laws.)

iii) There is an interest in bringing the benefit of the last sentence of 501 to bear on relief granted to all exception creditors under 503. Accordingly, new subsection (c) duplicates the last sentence in 501.

A court should consider exercising its equitable powers under the last sentence of section 503(c) where it seems appropriate in light of a beneficiary's particular circumstances. Consider for example the case of a beneficiary who is disabled for medical reasons with a reduction in employment and wages. Although the beneficiary had been ordered to pay maintenance to a former spouse, maintenance has fallen into arrears because of disability. The former spouse obtains a judgment for the maintenance arrearage. In these circumstances, the court should limit the former spouse's award.

**6. COLORADO LAW**

There is no comparable Colorado law on point. However, Colorado has already embraced the public policy position placing the interest of a beneficiary's child for support ahead of the beneficiary's interest in such statutory benefits as PERA retirement, etc. See discussion re: section 502, supra.

**7. RECOMMENDATIONS**

This section should be enacted. There is no Colorado law on the matter and there is benefit to be derived from a clear statutory rule that will add certainty to the classes of exception creditors recognized in Colorado.

**UNIFORM TRUST CODE COMMITTEE**  
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1. UTC SECTION	504
2. SUBJECT	DISCRETIONARY TRUSTS; EFFECT OF STANDARD
3. UTC STATUTE	<p>(a) In this section, "child" includes any person for whom an order or judgment for child support has been entered in this or another State.</p> <p>(b) Except as otherwise provided in subsection (c), whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if:</p> <p style="padding-left: 20px;">(1) the discretion is expressed in the form of a standard of distribution;  or  (2) the trustee has abused the discretion.</p> <p>(c) To the extent a trustee has not complied with a standard of distribution or has abused a discretion:</p> <p style="padding-left: 20px;">(1) a distribution may be ordered by the court to satisfy a judgment or court order against the beneficiary for support or maintenance of the beneficiary's child, spouse, or former spouse; and  (2) the court shall direct the trustee to pay to the child, spouse, or former spouse such amount as is equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for the benefit of the beneficiary had the trustee complied with the standard or not abused the discretion.</p> <p>(d) This section does not limit the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for <u>of</u> distribution.</p> <p>(e) If the trustee's or cotrustee's discretion to make distributions for the trustee's or cotrustee's own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as trustee or cotrustee.</p>
4. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS COMMENTS	<p>This section addresses the ability of a beneficiary's creditor to reach the beneficiary's discretionary trust interest, whether or not the exercise of the trustee's discretion is subject to a standard. This section, similar to the Restatement, eliminates the distinction between discretionary and support trusts, unifying the rules for all trusts fitting within either of the former categories. <i>See</i> Restatement (Third) of Trusts § 60 Reporter's Notes to cmt. a (Tentative Draft No. 2, approved 1999). By eliminating this distinction, the rights of a creditor are the same whether the distribution standard is discretionary, subject to a standard, or both. Other than for a claim by a</p>

child, spouse or former spouse, a beneficiary's creditor may not reach the beneficiary's interest. Eliminating this distinction affects only the rights of creditors. The affect of this change is limited to the rights of creditors. It does not affect the rights of a beneficiary to compel a distribution. Whether the trustee has a duty in a given situation to make a distribution depends on factors such as the breadth of the discretion granted and whether the terms of the trust include a support or other standard. *See* Section 814 comment.

For a discussion of the definition of "child" in subsection (a), see Section 503 Comment.

Subsection (b), which establishes the general rule, forbids a creditor from compelling a distribution from the trust, even if the trustee has failed to comply with the standard of distribution or has abused a discretion. Under subsection (d), the power to force a distribution due to an abuse of discretion or failure to comply with a standard belongs solely to the beneficiary. Under Section 814(a), a trustee must always exercise a discretionary power in good faith and with regard to the purposes of the trust and the interests of the beneficiaries.

Subsection (c) creates an exception for support claims of a child, spouse, or former spouse who has a judgment or order against a beneficiary for support or maintenance. While a creditor of a beneficiary generally may not assert that a trustee has abused a discretion or failed to comply with a standard of distribution, such a claim may be asserted by the beneficiary's child, spouse, or former spouse enforcing a judgment or court order against the beneficiary for unpaid support or maintenance. The court must direct the trustee to pay the child, spouse or former spouse such amount as is equitable under the circumstances but not in excess of the amount the trustee was otherwise required to distribute to or for the benefit of the beneficiary. Before fixing this amount, the court having jurisdiction over the trust should consider that in setting the respective support award, the family court has already considered the respective needs and assets of the family. The Uniform Trust Code does not prescribe a particular procedural method for enforcing a judgment or order against the trust, leaving that matter to local collection law.

Subsection (e), which was added by a 2004 amendment, is discussed below.

#### **2004 Amendment**

##### **Section 504(e), 103(11)**

Trusts are frequently drafted in which a trustee is also a beneficiary. A common example is what is often referred to as a bypass trust, under which the settlor's spouse will frequently be named as both trustee and beneficiary. An amount equal to the exemption from federal estate tax will be placed in the bypass trust, and the trustee, who will often be the settlor's spouse, will be given discretion to make distributions to the beneficiaries, a class which will usually include the spouse/trustee. To prevent the inclusion of the trust in the spouse-trustee's gross estate, the spouse's discretion to make distributions for

the spouse's own benefit will be limited by an ascertainable standard relating to health, education, maintenance, or support.

The UTC, as previously drafted, did not specifically address the issue of whether a creditor of a beneficiary may reach the beneficial interest of a beneficiary who is also a trustee. However, *Restatement (Third) of Trusts* §60, comment g, which was approved by the American law Institute in 1999, provides that the beneficial interest of a beneficiary/trustee may be reached by the beneficiary/trustee's creditors. Because the UTC is supplemented by the common law (see UTC Section 106), this *Restatement* rule might also apply in states enacting the UTC. The drafting committee has concluded that adoption of the *Restatement* rule would unduly disrupt standard estate planning and should be limited. Consequently, Section 504 is amended to provide that the provisions of this section, which generally prohibit a creditor of a beneficiary from reaching a beneficiary's discretionary interest, apply even if the beneficiary is also a trustee or cotrustee. The beneficiary-trustee is protected from creditor claims to the extent the beneficiary-trustee's discretion is protected by an ascertainable standard as defined in the relevant Internal Revenue Code sections. The result is that the beneficiary's trustee's interest is protected to the extent it is also exempt from federal estate tax. The amendment thereby achieves its main purpose, which is to protect the trustee-beneficiary of a bypass trust from creditor claims.

The protection conferred by this subsection, however, is no greater than if the beneficiary had not been named trustee. If an exception creditor can reach the beneficiary's interest under some other provision, the interest is not insulated from creditor claims by the fact the beneficiary is or becomes a trustee.

In addition, the definition of "power of withdrawal" in Section 103 is amended to clarify that a power of withdrawal does not include a power exercisable by the trustee that is limited by an ascertainable standard. The purpose of this amendment is to preclude a claim that the power of a trustee-beneficiary to make discretionary distributions for the trustee-beneficiary's own benefit results in an enforceable claim of the trustee-beneficiary's creditors to reach the trustee-beneficiary's interest as provided in Section 505(b). Similar to the amendment to Section 504, the amendment to "power of withdrawal" is being made because of concerns that *Restatement (Third) of Trusts* Section 60 comment g, otherwise might allow a beneficiary-trustee's creditors to reach the trustee's beneficial interest.

The Code does not specifically address the extent to which a creditor of a trustee/beneficiary may reach a beneficial interest of a beneficiary/trustee that is not limited by an ascertainable standard.

For the definition of "ascertainable standard," see Section 103(2).

**5. COLORADO  
COMMITTEE  
COMMENTS**

While trusts with valid spendthrift provisions directly prevent beneficiaries from assigning their interests and creditors of such beneficiaries from attaching their interests (with certain exceptions as we have seen), the very

nature of beneficial interests in discretionary trusts and trusts subject to a standard indirectly bar the reach of creditors of a beneficiary.

A creditor who has attached a discretionary interest (because of the absence of a spendthrift provision or because a spendthrift exception applies) can't, as a general rule, force exercise of discretion. Thus, the indirect protection against creditor claims.

*Restatement (Second) of Trusts*, sections 154 and 155 provide:

*§154. Trusts for Support*

*Except as stated in §§ 156 and 157, if by the terms of a trust it is provided that the trustee shall pay or apply only so much of the income and principal or either as is necessary for the education or support of the beneficiary, the beneficiary cannot transfer his interest and his creditors cannot reach it.*

*§155. Discretionary Trusts*

*(1) Except as stated in § 156, if by the terms of a trust it is provided that the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his uncontrolled discretion shall see fit to pay or apply, a transferee or creditor of the beneficiary cannot compel the trustee to pay any part of the income or principal.*

*(2) Unless a valid restraint on alienation has been imposed in accordance with the rules stated in §§ 152 and 153, if the trustee pays to or applies for the beneficiary any part of the income or principal with knowledge of the transfer or after he has been served with process in a proceeding by a creditor to reach it, he is liable to such transferee or creditor.*

*Restatement (Third) of Trusts* section 60 provides:

*Transfer or Attachment of Discretionary Interests*

*Subject to the rules stated in sections 58 and 59 (on spendthrift trusts), if the terms of a trust provide for a beneficiary to receive distributions in the trustee's discretion, a transferee or creditor of the beneficiary is entitled to receive or attach any distributions the trustee makes or is required to make in the exercise of that discretion after the trustee has knowledge of the transfer or attachment. The amounts a creditor can reach may be limited to provide for the beneficiary's needs (Comment c), or the amounts may be increased where the beneficiary is either the settlor (Comment f) or holds the discretionary power to determine his or her own distributions (Comment g).*

*Restatement (Third) of Trusts* recognizes the common law right of a beneficiary's creditor to attach his or her discretionary interest unless a valid spendthrift provision applies to the interest. *Restatement (Third) of Trusts* section 60 cmt. a.

In a departure from the *Restatement (Second) of Trusts*, with respect to creditor rights, *Restatement (Third)* applies to discretionary interests whether expressed in the form of a standard or not. *Restatement (Third) of Trusts* section 60 cmt. a and Rptr's Notes on cmt. a.

Under *Restatement (Third)*, self-settled discretionary interests are not protected against creditor claims whether or not there is a spendthrift provision. *Restatement (Third) of Trusts* section 60 cmt. f.

Under the *Third Restatement* where a discretionary beneficiary is also trustee, his or her creditors are able to reach the maximum amount that the trustee/beneficiary can properly take. *Restatement (Third) of Trusts* section 60 cmt. g.

As a general rule, a creditor of a beneficiary cannot compel the trustee to make discretionary distributions if the beneficiary cannot do so. However, the *Restatement (Third) of Trusts* points out that it is rare that a beneficiary is so powerless taking into account the beneficiary's circumstances, the terms of the discretionary power and the purposes of the trust. Thus, the exercise or non-exercise of discretion is always subject to judicial review to prevent abuse. *Restatement (Third) of Trusts* section 60 cmt. e.

Compared with the *Restatement* position, the rule codified in the Uniform Trust Code is much more protective of discretionary interests with respect to creditor claims. The UTC makes it clear that, whether or not there is a spendthrift provision in the terms of the trust, no creditor of a beneficiary can compel a distribution that is subject to the trustee's discretion whether such discretion is expressed in the form of a standard or not, even if the trustee has abused discretion or failed to comply with the standard. Thus, under the UTC, even a creditor who has provided support to the beneficiary of a support trust is unable to force exercise of discretion.

Section 504(c) of the Uniform Trust Code makes a public policy exception with respect to a discretionary beneficiary's child, spouse or former spouse who has a judgment for support. Such a creditor can force exercise of discretion but only if the trustee has abused discretion or failed to comply with the standard. However, this UTC provision only authorizes the court to force exercise of discretion in satisfaction of the judgment. It does not require it. If a court does act, the UTC requires the court to direct the trustee to distribute to the creditor only an amount that is equitable taking into account the discretionary beneficiary's circumstances.

#### **2005 Amendment.**

*Restatement (Third) of Trusts* section 60, cmt. g. provides that the beneficial interest of a beneficiary/trustee may be reached by his or her creditors. This *Restatement* position would apply in the case of the surviving spouse serving as trustee and beneficiary of a family (exemption) trust. This 2004 NCCUSL amendment is intended to eliminate such a result and thereby protect estate plans employing a traditional family trust arrangement, provided the trustee's power to make discretionary distributions to self is

<p><b>6. COLORADO LAW</b></p>	<p>limited by an ascertainable standard.</p> <p>Colorado courts have recognized the <i>Restatement (Second)</i> position with respect to discretionary trusts in the context of determining whether a discretionary interest is "property" for purposes of division of property in divorce. <u>Absent an abuse of discretion</u> a beneficiary cannot compel exercise of discretion and therefore, the discretionary interest is not "property" for this purpose. See for example <u>In Re Marriage of Rosenblum</u>; 602 P.2d 892 (Colo. App. 1979); <u>In Re Marriage of Jones</u>, 812 P.2d 1152 (Colo. 1991); and in <u>Re McCart</u>, 847 P2d 184 (Colo. App. 1992.)</p> <p>These Colorado decisions do not address whether and under what circumstances a beneficiary's creditor can force exercise of discretion.</p> <p>The <i>Restatement (Third)</i> position recognizes the common law right of a creditor to force exercise of discretion. If the trustee has abused discretion it is possible, but not likely, that the beneficiary's creditor could obtain a court order forcing exercise of discretion. <i>Restatement (Third) of Trusts, Section 60 cmt. e.</i></p> <p>UTC section 504 is more protective than the <i>Restatement</i> position. Under this section, no creditor is permitted to force a trustee's exercise of discretion, even if the trustee has abused discretion (e.g. acted dishonestly with an improper motive or failed to exercise judgment or act at all). However, a beneficiary's child, spouse or former spouse, who has a judgment against the beneficiary for support or maintenance, may obtain a court ordered distribution from the trust if the child, spouse or former spouse can demonstrate that the trustee has abused discretion. Any such court ordered distribution must be equitable taking into account the beneficiary's interest. Moreover, such court ordered distribution cannot exceed the amount that the trustee would have distributed if the trustee had not abused discretion.</p>
<p><b>7. RECOMMENDATIONS</b></p>	<p>This section should be enacted.</p>

UNIFORM TRUST CODE COMMITTEE  
 ARTICLE 5  
 CREDITOR CLAIMS; SPENDTHRIFT; AND DISCRETIONARY TRUSTS

1. UTC SECTION	505
2. SUBJECT	CREDITOR'S CLAIM AGAINST SETTLOR
3. UTC STATUTE	<p>(a) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:</p> <p>(1) During the lifetime of the settlor, the property of a revocable trust is subject to the claims of the settlor's creditors. <u>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.</u></p> <p>(2) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. 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.</p> <p>(3) After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, <u>and, except as otherwise provided by §13-54-102 C.R.S. or other applicable statutes,</u> 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 <del>[statutory allowances]</del> <u>statutory allowances</u> to a surviving spouse and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, <del>expenses, and allowances.</del> <u>expenses and allowances.</u></p> <p>(b) For purposes of this section:</p> <p>(1) during the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power; and</p> <p>(2) upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greater of the amount specified in Section 2041(b)(2) or 2514(e) of the Internal Revenue Code of 1986, or Section 2503(b) of the Internal Revenue Code of 1986, in <del>each</del> <u>either</u> case as in effect on <del>[the effective date of this [Code]]</del>, or as later amended].</p>
4. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE	Subsection (a)(1) states what is now a well accepted conclusion, that a revocable trust is subject to the claims of the settlor's creditors while the settlor is living. See Restatement (Third) of Trusts § 25 cmt. e (Tentative Draft No. 1, approved 1996). Such claims were not allowed at common law,

however. *See* Restatement (Second) of Trusts § 330 cmt. o (1959). Because a settlor usually also retains a beneficial interest that a creditor may reach under subsection (a)(2), the common law rule, were it retained in this Code, would be of little significance. *See* Restatement (Second) of Trusts § 156(2) (1959).

Subsection (a)(2), which is based on Restatement (Third) of Trusts § 58(2) and cmt. e (Tentative Draft No. 2, approved 1999), and Restatement (Second) of Trusts § 156 (1959), follows traditional doctrine in providing that a settlor who is also a beneficiary may not use the trust as a shield against the settlor's creditors. The drafters of the Uniform Trust Code concluded that traditional doctrine reflects sound policy. Consequently, the drafters rejected the approach taken in States like Alaska and Delaware, both of which allow a settlor to retain a beneficial interest immune from creditor claims. *See* Henry J. Lischer, Jr., *Domestic Asset Protection Trusts: Pallbearers to Liability*, 35 Real Prop. Prob. & Tr. J. 479 (2000); John E. Sullivan, III, *Gutting the Rule Against Self-Settled Trusts: How the Delaware Trust Law Competes with Offshore Trusts*, 23 Del. J. Corp. L. 423 (1998). Under the Code, whether the trust contains a spendthrift provision or not, a creditor of the settlor may reach the maximum amount that the trustee could have paid to the settlor-beneficiary. If the trustee has discretion to distribute the entire income and principal to the settlor, the effect of this subsection is to place the settlor's creditors in the same position as if the trust had not been created. For the definition of "settlor," see Section 103(15).

This section 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. This subject is instead left to the State's law on fraudulent transfers. A transfer to the trust by an insolvent settlor might also constitute a voidable preference under federal bankruptcy law.

Subsection (a)(3) recognizes that a revocable trust is usually employed as a will substitute. As such, the trust assets, following the death of the settlor, should be subject to the settlor's debts and other charges. However, in accordance with traditional doctrine, the assets of the settlor's probate estate must normally first be exhausted before the assets of the revocable trust can be reached. This section does not attempt to address the procedural issues raised by the need first to exhaust the decedent's probate estate before reaching the assets of the revocable trust. Nor does this section address the priority of creditor claims or liability of the decedent's other nonprobate assets for the decedent's debts and other charges. Subsection (a)(3), however, does ratify the typical pourover will, revocable trust plan. As long as the rights of the creditor or family member claiming a statutory allowance are not impaired, the settlor is free to shift liability from the probate estate to the revocable trust. Regarding other issues associated with potential liability of nonprobate assets for unpaid claims, see Section 6-102 of the Uniform Probate Code, which was added to that Code in 1998.

Subsection (b)(1) treats a power of withdrawal as the equivalent of a power of revocation because the two powers are functionally identical. This is also the approach taken in Restatement (Third) of Trusts § 56 cmt. b (Tentative

Draft No. 2, approved 1999). If the power is unlimited, the property subject to the power will be fully subject to the claims of the power holder's creditors, the same as the power holder's other assets. If the power holder retains the power until death, the property subject to the power may be liable for claims and statutory allowances to the extent the power holder's probate estate is insufficient to satisfy those claims and allowances. For powers limited either in time or amount, such as a right to withdraw a \$10,000 annual exclusion contribution within 30 days, this subsection would limit the creditor to the \$10,000 contribution and require the creditor to take action prior to the expiration of the 30-day period.

Upon the lapse, release, or waiver of a power of withdrawal, the property formerly subject to the power will normally be subject to the claims of the power holder's creditors and assignees the same as if the power holder were the settlor of a now irrevocable trust. Pursuant to subsection (a)(2), a creditor or assignee of the power holder generally may reach the power holder's entire beneficial interest in the trust, whether or not distribution is subject to the trustee's discretion. However, following the lead of Arizona Revised Statutes § 14-7705(g) and Texas Property Code § 112.035(e), subsection (b)(2) creates an exception for trust property which was subject to a Crummey or five and five power. Upon the lapse, release, or waiver of a power of withdrawal, the holder is treated as the settlor of the trust only to the extent the value of the property subject to the power at the time of the lapse, release, or waiver exceeded the greater of the amounts specified in IRC §§ 2041(b)(2) or 2514(e) [greater of 5% or \$5,000], or IRC § 2503(b) [\$10,000 in 2001].

The Uniform Trust Code does not address creditor issues with respect to property subject to a special power of appointment or a testamentary general power of appointment. For creditor rights against such interests, see Restatement (Property) Second: Donative Transfers §§ 13.1-13.7 (1986).

5. COLORADO  
COMMITTEE  
COMMENTS

This UTC section follows *Restatement (Second) of Trusts* §156 (1959) which provides:

*§156. WHERE THE SETTLOR IS A BENEFICIARY*

(1) *Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest.*

(2) *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.*

UTC Subsection (a) (1)

This subsection recognizes the modern view holding that a settlor's revocable trust is subject to the claims of such settlor's creditors while the settlor is living. See *Restatement (Second) of Trusts* §156 (2) (1959). At

common law this was not so if the settlor reserved only a "naked" power to revoke. See *Restatement (Second) of Trusts* §330, comment o (1959). The Uniform Trust Code overrules this narrow common law position. The Official Comments to the UTC suggests that the common law rule has little significance today since settlors of revocable trusts typically retain a beneficial interest as well as a power to revoke.

UTC Subsection (a)(2)

A. Whether or not there is a spendthrift provision, in the case of a beneficiary who is also a settlor of an irrevocable trust, the creditor of such beneficiary can reach the maximum amount that the trustee can distribute for the beneficiary. The creditor "stands in the beneficiary's shoes" with respect to the beneficial interest in such a trust. If there are more than one settlor/beneficiary, the creditor of one of them can reach only the interest attributable to that settlor/beneficiary.

This codification is in accord with *Restatement (Third) of Trusts* section 58(2) which provides that: "A restraint on the voluntary and involuntary alienation of a beneficial interest retained by the settlor of a trust is invalid."

There does not have to be a fraudulent conveyance for this subsection to apply.

UTC Subsection (a) (3)

B. Following one of the principal policies underpinning *Restatement (Third) of Trusts* this subsection recognizes that revocable trusts are truly will substitutes, and that disposition of property under revocable trusts should be treated the same as disposition under wills. Therefore, this subsection provides that creditors of decedents who die with property devolving under revocable trusts should be treated the same as creditors of decedents who die with property devolving under wills. See *Restatement (Third) of Trusts* §25, comments d and e (tentative draft no. 1)

Thus, this subsection codifies the well established modern trend in case law holding that: (i) assets of a deceased settlor's revocable trust do not escape liability for the claims of such settlor's creditors to the extent (ii) the settlor's probate estate is insufficient to satisfy such claims.<sup>1</sup>

State Street Bank and Trust Co. v. Raiser, 389 N.E.2d 768 (1979) where citing the rule in *Restatement (Second) of Trusts* §156 the court said that "it is excessive obeisance to the form in which property is held to prevent creditors from reaching property placed in trust [following the creditor's death.];" and Johnson v. Commercial Bank, 588 P.2d 1096 (1978). See also *Restatement of Property* §328 comment a (1940).

This section is an "enabling" section making clear that revocable trust assets do not escape liability for creditor claims. The UTC drafters have left to other state law the procedure to follow in reaching such assets postmortem.

Colorado is now considering new UPC §6- 102 which, if enacted, will establish such procedures in Colorado.

If Colorado enacts UPC §6-102 it is important that UTC §505(a)(3) coordinate with such enactment. Subsection (a)(3) has been drafted accordingly.

UTC Subsection (b)(1)

According to the official comments, this subsection "...treats a presently exercisable general power of appointment as the functional equivalent of a power of revocation." Thus, the policy of UTC §505 and *Restatement (Third) of Trusts* is brought to bear on the property subject to such a power. The power holder is treated as the settlor of a revocable trust to the extent of property subject to the power.

UTC Subsection (b)(2)

This subsection provides that the holder of a power of withdrawal continues to be treated as a settlor of a trust with respect to property that had been subject to the withdrawal power even after lapse, release or waiver of the power, but only to the extent that the value of the property subject to the withdrawal power exceeds the 5 x 5 limit or the annual gift tax exclusion amount. Thus, for example, after lapse of a Crummey withdrawal power, property which had been subject to the power will no longer be subject to the power holder's creditors' claims to the extent the value of the property subject to the lapsed power is less than the 5 x 5 limit or the annual gift tax exclusion amount.

6. COLORADO LAW

Self Settled Trusts.

Some have suggested that section 38-10-111 C.R.S. applies only to creditors existing at the time a self settled trust is created and, therefore, that creditors arising after creation of such a trust can't reach the settlor/beneficiary's interest. This position has been refuted by the Colorado Supreme Court in dicta in In re: Cohen, 8 P. 3d 429, 432 (Colo. 1999) citing *Restatement (Second) of Trusts* section 156 (1959).

Powers of Appointment/Withdrawal.

The Court of Appeals has taken a position with respect to creditors' rights in property subject to a currently exercisable general power of appointment. In University National Bank v. Rhoadarmer, 827 P.2d 561 (Colo. App. 1991), a trust beneficiary held a currently exercisable power to withdraw trust principal up to \$5,000.00 or 5% of the current market value of the trust principal. The beneficiary's creditor attempted garnishment of this interest. The Court of Appeals held: (i) that a currently exercisable power of appointment is not "property" of the power holder and is therefore not subject to garnishment; (ii) that absent exercise of the power, the

	<p>beneficiary has no "property" held by the trust susceptible to garnishment; and (iii) the existence of a spendthrift provision in the trust terms prevents invasion of trust property for benefit of the power holder's creditors.</p> <p>Enactment of UTC §505 (b) (1) and (2) will overrule the holding in <u>Rhoadarmer</u>.</p>
<p><b>7. RECOMMENDATIONS</b></p>	<p>Under existing Colorado law, death benefits payable to designated beneficiaries under life insurance policies and benefits payable to designated beneficiaries pursuant to pension and retirement plans are exempt from the claims of the insureds'/participants' creditors after death. Section 13-54-102 C.R.S. Reference to §13-54-102 C.R.S. in the UTC section should be added to apply this policy in the case of such benefits payable to an insured's revocable trust after the insured's death.</p> <p>The overruling of the holding in <u>Rhoadarmer</u>, supra, by subsections (b)(1) and (2) is a policy matter that should be brought to the attention of the legislature.</p> <p>Otherwise, UTC Section 505, as modified by specific reference to §13-54-102 C.R.S., should be approved.</p>

UNIFORM TRUST CODE COMMITTEE  
 ARTICLE 5  
 CREDITOR CLAIMS; SPENDTHRIFT; AND DISCRETIONARY TRUSTS

1. UTC SECTION	506
2. SUBJECT	OVERDUE DISTRIBUTION
3. UTC STATUTE	<p>(a) In this section, "mandatory distribution" means a distribution of income or principal which the trustee is required to make to a beneficiary under the terms of the trust, including a distribution upon termination of the trust. The term does not include a distribution subject to the exercise of the trustee's discretion even if (1) the discretion is expressed in the form of a standard of distribution, or (2) the terms of the trust authorizing a distribution couple language of discretion with language of direction.</p> <p>(b) Whether or not a trust contains a spendthrift provision, a creditor or assignee of a beneficiary may reach a mandatory distribution of income or principal, including a distribution upon termination of the trust, if the trustee has not made the distribution to the beneficiary within a reasonable time after the designated distribution date.</p>
4. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS COMMENTS	<p>The effect of a spendthrift provision is generally to insulate totally a beneficiary's interest until a distribution is made and received by the beneficiary. <i>See</i> Section 502. But this section, along with several other sections in this article, recognizes exceptions to this general rule. Whether a trust contains a spendthrift provision or not, a trustee should not be able to avoid creditor claims against a beneficiary by refusing to make a distribution required to be made by the express terms of the trust. On the other hand, a spendthrift provision would become largely a nullity were a beneficiary's creditors able to attach all required payments as soon as they became due. This section reflects a compromise between these two competing principles. A creditor can reach a mandatory distribution, including a distribution upon termination, if the trustee has failed to make the payment within a reasonable time after the designated distribution date. Following this reasonable period, payments mandated by the express terms of the trust are in effect being held by the trustee as agent for the beneficiary and should be treated as part of the beneficiary's personal assets.</p> <p>This section is similar to Restatement (Third) of Trusts § 58 cmt. d (Tentative Draft No. 2, approved 1999).</p> <p><b>2001 Amendment.</b> By amendment in 2001, "designated distribution date" was substituted for "required distribution date" in subsection (b). The amendment conforms the language of this section to terminology used elsewhere in the Code.</p>

	<p><b>2005 Amendment.</b> The amendment adds a clarifying definition of "mandatory distribution" in subsection (a), which is based on an Ohio proposal. The amendment:</p> <ul style="list-style-type: none"> <li>• tracks the traditional understanding that a mandatory distribution includes a provision requiring that a beneficiary be paid the income of a trust or receive principal upon termination;</li> <li>• correlates the definition of "mandatory distribution" in this section to the broad definition of discretionary trust used in Section 504. Under both Sections 504 and 506, a trust is discretionary even if the discretion is expressed in the form of a standard, such as a provision directing a trustee to pay for a beneficiary's support;</li> <li>• addresses the situation where the terms of the trust couple language of discretion with language of direction. An example of such a provision is "my trustees shall, in their absolute discretion, distribute such amounts as are necessary for the beneficiary's support." Despite the presence of the imperative "shall," the provision is discretionary, not mandatory. For a more elaborate example of such a discretionary "shall" provision, see Marsman, Nasca, 573 N.E. 2d 1025 (Mass. Ct. App. 1991).</li> <li>• is clarifying. No change of substance is intended by this amendment. This amendment merely clarifies that a mandatory distribution is to be understood in its traditional sense such as a provision requiring that the beneficiary receive an income or receive principal upon termination of the trust.</li> </ul>
<p><b>5. COLORADO COMMITTEE COMMENTS</b></p>	<p>If a trustee fails to make a distribution to a beneficiary within a "reasonable time" after the express terms of the trust require the distribution to be made, the trustee has become an agent for the beneficiary and the creditors of such beneficiary may attach the distribution held back by the trustee. Such a distribution has already become an asset of the beneficiary.</p> <p>It had been argued that some discretionary trust terms might be construed as creating "mandatory" interests (e.g. "trustee shall distribute principal and income for the beneficiary's support") and that 506 "creates" a right in the beneficiary to compel them. Therefore, it had been argued, a creditor could "stand in the shoes" of the beneficiary and compel the distribution. The drafters did not intend this result. A mandatory distribution is one that the trustee does not have discretion to withhold. Moreover, the intent of article 5 is to treat all discretionary trusts, whether expressed in the form of a standard or not, as discretionary for purposes of defining creditor's rights. New subsection (a) is being added to make the intent of 506 clear.</p> <p>In some contexts, the word "shall" has been construed to mean "may" and vice versa. For discussion of the misuse of the word "shall" in legal documents see Brian A. Garner, <i>A Dictionary of Modern Legal Usage</i>, p. 939-942 (2nd. ed., Oxford University Press).</p>

<b>6. COLORADO LAW</b>	There is none.
<b>7. RECOMMENDATIONS</b>	This section should be enacted.

UNIFORM TRUST CODE COMMITTEE  
 ARTICLE 5  
 CREDITOR CLAIMS; SPENDTHRIFT; AND DISCRETIONARY TRUSTS

1. UTC SECTION	507
2. SUBJECT	PERSONAL OBLIGATIONS OF TRUSTEE
3. UTC STATUTE	Trust property is not subject to personal obligations of the trustee, even if the trustee becomes insolvent or bankrupt.
4. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS COMMENTS	<p>Because the beneficiaries of the trust hold the beneficial interest in the trust property and the trustee holds only legal title without the benefits of ownership, the creditors of the trustee have only a personal claim against the trustee. <i>See</i> Restatement (Third) § 5 cmt. k (Tentative Draft No.1, approved 1996); Restatement (Second) of Trusts § 12 cmt. a (1959). Similarly, a personal creditor of the trustee who attaches trust property to satisfy the debt does not acquire title as a bona fide purchaser even if the creditor is unaware of the trust. <i>See</i> Restatement (Second) of Trusts § 308 (1959). The protection afforded by this section is consistent with that provided by the Bankruptcy Code. Property in which the trustee holds legal title as trustee is not part of the trustee's bankruptcy estate. 11 U.S.C. § 541(d).</p> <p>The exemption of the trust property from the personal obligations of the trustee is the most significant feature of Anglo-American trust law by comparison with the devices available in civil law countries. A principal objective of the Hague Convention on the Law Applicable to Trusts and on their Recognition is to protect the Anglo-American trust with respect to transactions in civil law countries. <i>See</i> Hague Convention art. 11. <i>See also</i> Henry Hansmann &amp; Ugo Mattei, <i>The Functions of Trust Law: A Comparative Legal and Economic Analysis</i>, 73 N.Y.U. L. Rev. 434 (1998); John H. Langbein, <i>The Secret Life of the Trust: The Trust as an Instrument of Commerce</i>, 107 Yale L.J. 165, 179-80 (1997).</p>
5. COLORADO COMMITTEE COMMENTS	<p>The intent of this section is to make clear that the personal creditors of a trustee may not attach property interests titled to the trustee for benefit of third party beneficiaries.</p> <p>This position follows <i>Restatement (Second) of Trusts</i>, section 12, cmt. (a) and <i>Restatement (Third) of Trusts</i>, section 5, cmt. (k) (tentative draft no. 1, 1996).</p> <p><i>Restatement (Third) of Trusts</i>, section 5, cmt. (k) explains that when a trust is created there is a fiduciary relationship between the trustee and the beneficiaries. The beneficiaries have equitable interests in trust property. On the other hand, a debtor does not stand in a fiduciary relationship to his creditors.</p>

	<p>When one person transfers funds to another, it depends on the manifest intention of the parties whether the relationship created is that of trust or debt. If the intention is that the money shall be kept or used as a separate fund for the benefit of the payor or one or more third persons, a trust is created. If it is intended, however, that the person receiving the money shall have the unrestricted use of it, being liable to pay a similar amount to the payor or a third person, whether with or without interest, a debt is created. <i>Restatement (Third) of Trusts</i>, section 5, cmt. (k). Thus, if a trustee becomes insolvent, beneficiaries retain their equitable interests in trust property. On the other hand, if a loan has been made and the borrower becomes insolvent, the lender has a personal claim against the borrower and may reach the borrower's property but not property held by the borrower as trustee for others.</p>
<p><b>6. COLORADO LAW</b></p>	<p>This section is a codification of part of the policy underpinning the holding in <u>Lagae v. Lackner</u>, 996 P.2d 1281 (Colo. 2000).</p>
<p><b>7. RECOMMENDATIONS</b></p>	<p>This section should be enacted.</p>