SPENDTHRIFT TRUST AND CREDITORS' CLAIMS:
"Out of the frying pan and into the fire"

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Nature and History of Spendthrift Trusts

- Historical rule: interests in trust transferable, attachable.
- Modern U.S. rule dates from 1875: *Nichols v. Eaton*, 91 U.S. 716 (freedom of disposition).
- "Spendthrift" provision: prohibits voluntary or involuntary alienation of beneficiary's interest in the trust.
- Statutory or case law permitting establishment of *third-party* spendthrift trusts now exists generally in U.S. jurisdictions.

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Uniform Trust Code (2005 revision):

SECTION 502. SPENDTHRIFT PROVISION.

(a) A spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest.

(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.

(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.

Exceptions to Spendthrift Protection: General and Georgia-Specific

Uniform Trust Code (2005 revision):

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) A spendthrift provision is unenforceable against:

(1) a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance;

(2) a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust; and

(3) a claim of this State or the United States to the extent a statute of this State or federal law so provides.

(c) A claimant against which a spendthrift provision cannot be enforced may 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.

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Georgia Trust Code:

§ 53-12-80. Spendthrift provisions

(a) A spendthrift provision shall only be valid if it prohibits both voluntary and involuntary transfers.

(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, shall be sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest in the manner set forth in this article.

(c) A beneficiary shall not transfer an interest in a trust in violation of a valid spendthrift provision, and, except as otherwise provided in this Code section, a creditor or assignee of the beneficiary shall not reach the interest or a distribution by the trustee before its receipt by the beneficiary.

(d) A spendthrift provision shall not be valid as to the following claims against a beneficiary's right to a current distribution to the extent the distribution would be subject to garnishment under Article 2 of Chapter 4 of Title 18 if the distribution were disposable earnings:

(1) Alimony or child support;

(2) Taxes or other governmental claims;

(3) Tort judgments;

(4) Judgments or orders for restitution as a result of a criminal conviction of the beneficiary; or

(5) Judgments for necessaries.

The ability of a creditor or assignee to reach a beneficiary's interest under this subsection shall not apply to the extent that it would disqualify the trust as a special needs trust established pursuant to 42 U.S.C. Sections 1396p(d)(4)(A) or 1396p(d)(4)(C).

Self-Settled Trusts

- Majority rule: settlor cannot protect his or her interest in trust from his or her own creditors (compare with “third-party” spendthrift trust).
- Some states now purport to offer self-settled creditor protection trusts, typically referred to as “domestic asset protection trusts” (DAPTs).
- These are largely untested in the courts of “non-DAPT” states, and are subject to express exceptions in the federal bankruptcy code.
- Better/more reliable results can be achieved with other structures.

Discretionary vs. Mandatory Trusts

§ 53-12-81. Limitations on creditors' rights to discretionary distributions

A transferee or creditor of a beneficiary shall not compel the trustee to pay any amount that is payable **only in the trustee's discretion** regardless of whether the trustee is also a beneficiary. This Code section shall not apply to the extent of the proportion of trust property attributable to the beneficiary's contribution.

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Fraudulent Transfers

- Transfers can be undone (1) if made with actual intent to hinder, delay or defraud a creditor or (2) under certain conditions, without receiving a reasonably equivalent value in exchange.
- Transfers in trust for the benefit of third parties can be undone even if the settlor has no interest in the trust. Spendthrift protection is irrelevant.
- Statute of limitation in most cases: four years in Georgia.
- Query whether a contribution to another form of entity would be subject if transferor receives interests in the entity in exchange.

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