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CREDITORS' RIGHTS IN PROPERTY SUBJECT TO A BENEFICIARY'S RIGHT OF WITHDRAWAL

S. Alan Medlin[*] & F. Ladson Boyle[**]

Authors' Synopsis: Estate plans often give trust beneficiaries powers of withdrawal for both tax and nontax reasons. For tax reasons, these powers of withdrawal are typically limited, such as a "five or five power" or a so-called Crummey power commonly pegged to the annual gift tax exclusion amount. A central issue with limited powers of withdrawal is the right of a beneficiary's creditor to reach trust property subject to the beneficiary's power to withdraw. Recent uniform statutes, such as the Uniform Trust Code and the Uniform Power of Appointment Act, as well as the Restatement (Third) of Trusts, provide guidance. This Article discusses the typical reasons for creating powers of withdrawal and the historical and recent treatment of the rights of creditors of trust beneficiaries with powers of withdrawal, along with some planning considerations.

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I. INTRODUCTION

Trusts sometimes permit a beneficiary to withdraw a limited portion of property held in the trust. Historically, these trusts typically allow beneficiaries to withdraw, on an annual basis, the greater of $5,000 or 5% of the value of the trust assets. This power of withdrawal is commonly called a "five or five power."[1] In addition to five or five powers, granting a trust beneficiary a right to withdraw some portion or all of the new transfers made to a trust is common when the donor seeks to qualify the gift to the trust for the federal gift tax annual exclusion under Internal Revenue Code (IRC) section 2503.[2] This latter type of withdrawal power is commonly called a "Crummey Power,"[3] from the Ninth Circuit opinion in *Crummey v. Commissioner*,[4] which sustained the annual exclusion based on a limited withdrawal right.[5] Both rights are discussed in greater detail in Parts II.A and II.B.

However, when a beneficiary has a power or right to access the principal of the trust, even a power or right limited by time and amount, the question arises whether creditors of the beneficiary may also reach or attach the trust assets. The treatment of the rights of creditors of a powerholder has been checkered and perhaps occasionally illogical. Most courts determine the rights of creditors depending on the type of power the powerholder holds. Often, the cases deal with claims against the estate of the powerholder, when creditors pursue the appointive assets when the powerholder's probate estate is otherwise insufficient to pay the powerholder's debts. Absent a statute to the contrary, many courts have permitted creditors of the estate of a holder of a general power to attach trust assets if two conditions are satisfied: the powerholder must exercise the power gratuitously and the estate of the powerholder is otherwise insufficient to pay the claim.[6] However, creditors have typically not been

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[1] *See infra* Part II.A; *see also* HOWARD M. ZARITSKY, TAX PLANNING FOR FAMILY WEALTH TRANSFERS DURING LIFE: ANALYSIS WITH FORMS ¶ 4.08(3)(j)(i) (5th ed. 2022).

[2] *See* I.R.C. § 2503(b).

[3] *See infra* Part II.B; For a more complete discussion of Crummey powers of withdrawal, see ZARITSKY, *supra* note 1, ¶ 4.08.

[4] 397 F.2d 82 (9th Cir. 1968).

[5] *See id.*

[6] *See* Slayton v. Fitch Home, 200 N.E. 357 (1936); Ward v. Marie, 68 A. 1084 (N.J. Eq. 1907); Clapp v. Ingra-ham, 126 Mass. 200 (1879); *In re* Bartram's Estate, 42 Pa. 330 (1862); Johnson v. Cushing, 15 N.H. 298 (1844); Roy Lee Steers, Jr., Note, *Creditors' Ability to Reach Assets Under a General Power of Appointment*, 24 VAND. L. REV. 367 (1971) [hereinafter Note, Creditors' Ability to Reach Assets]; *cf. In re* Hagen's Estate, 85 Pa. Super. 123 (1925), aff'd, 32 A. 175 (Pa. Super. Ct. 1926) (discussing how appointive

allowed to seize trust property if the general power of appointment is not exercised.[7] The difference in treatment of an unexercised general power represents a deviation from the usual theory that the powerholder of a general power is essentially the owner, as all the powerholder must do to appropriate the property is appoint to the powerholder.[8]

This general view is summarized in 72 C.J.S. Powers, section 14, which provides:

> Since a power does not of itself give the donee or grantee any interest or estate in the property, it is the general rule that the creditors of the donee may not subject such property to their claims, at least prior to the donee's exercise of the power, except as otherwise provided by statute.[9]

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assets are protected from creditors even if a general power is exercised, unless appointed to donee's estate); Commonwealth v. Duffield, 12 Pa. 277 (1849); *see also* Johnson v. Shriver, 216 P.2d 653 (Colo. 1950).

[7] *See, e.g.*, Arnold v. S. Pine Lumber Co., 123 S.W. 1162 (Tex. Civ. App. 1909); Bentham v. Smith, 15 S.C. Eq. 33 (Chev. Eq. 1840); Alan Newman, *The Rights of Creditors as Beneficiaries Under the Uniform Trust Code: An Examination of the Compromise*, 69 TENN. L. REV. 771, 833 (2002). The Federal Bankruptcy Code, by giving the trustee power to exercise for the benefit of creditors any power of appointment that the debtor could have exercised for the debtor's own benefit at the time of bankruptcy, subjects appointive assets of a general presently exercisable power of appointment to the bankrupt estate. *See* Bankruptcy Code of 1978, 11 U.S.C. § 541(b).

[8] *See* S. Alan Medlin, *A Primer on Powers*, 2 HOFSTRA PROP. L. J. 165, 196–98 (1988).

[9] *See* 72 C.J.S. Powers, § 14 (citations omitted); *see also* 2 Austin W. Scott et al., SCOTT & ASCHER ON TRUSTS, § 14.11.3 (5th ed. 2020 & Supp. 2021). Note that the Restatement (Third) of Trusts section 56 (2003) takes a different view, which also diverges from the treatment by the Uniform Trust Code discussed herein. Restatement (Third) of Trusts section 56 comment b provides:

> Trust property subject to a presently exercisable general power of appointment (a power by which the property may be appointed to the donee, including one in the form of a power of withdrawal), because of the power's equivalence to ownership, is treated as property of the donee of the power. It can therefore be subjected to the satisfaction of the claims of the donee's creditors. (This is and long has been the law under the Federal Bankruptcy Act.) Conversely, the interests of the other trust beneficiaries in that property cannot be reached by their creditors. Thus, the treatment of the assets subject to a presently exercisable general power is like the treatment of revocable trust assets under § 25(2). (That it is immaterial that the terms of a trust creating such a power include a spendthrift restraint, *see* § 58 cmt. b.) Furthermore, assets that were subject to a presently

The possible statutory exception referred to in the C.J.S. quote would include Uniform Trust Code (UTC) section 505, Uniform Powers of Appointment Act (UPAA) sections 502(a)(1) and 503, and similar statutes that may have been adopted in some states.

This Article discusses the rights of creditors of trust beneficiaries with (1) limited withdrawal rights—that is a right limited by either or both time and amount—and (2) withdrawal rights subject to a spendthrift provision, as determined under the UTC and variations of state law.

II. THE TAX ORIGIN OF LIMITED POWERS

A. Five or Five Powers[10]

These withdrawal rights arise out of IRC section 2514(e), which provides that the lapse of such a power of withdrawal does not generally have gift tax consequences, and IRC section 2041(b)(2), which similarly provides that a lapsed five or five power will not have an estate tax consequence to the powerholder.[11] However, if the powerholder dies while the five or five power is currently exercisable, it is a presently exercisable power of appointment resulting in a gross estate tax inclusion under IRC section 2041(a)(2).[12]

While a typical five or five right of withdrawal is commonly limited to the amount that may be withdrawn without tax consequences, it can be something less than $5,000 or 5% if the grantor so wishes. For example, $4,000 or no more than 4%; another example is simply a right to withdraw $3,000.[13] In addition, a time limit is typically imposed on the right of withdrawal, such as the end of the calendar year; one specific calendar month; or even less time, such as one week or even possibly one day in the year. The prototypical five or five power not timely exercised lapses

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> exercisable general power of appointment immediately preceding the donee's death thereafter remain subject to the satisfaction of claims against the donee's estate, including expenses of estate administration.

RESTATEMENT (THIRD) OF TRUSTS § 56 cmt. b (AM. L. INST. 2003).

[10] Historically, five or five powers were sometimes called five and five powers, although this slang for the power is not statutorily correct because the IRC statutes upon which the power is structured consistently provides for a power that is the greater of $5,000 or 5% of the property subject to the power. *See* I.R.C. §§ 2041(a)(2), 2514(e) (1954); s*ee also* Roy M. Adams & Scott Bieber, *Making "5 and 5" Equal 20: Crummey Powers after ERTA*, TR. & EST. 22 (1983) (providing an example of the misdescription of five or five powers); UNIF. TR. CODE § 505(b) cmt. (UNIF. L. COMM'N 2000).

[11] *See* I.R.C. §§ 2041(b)(2), 2514(e) (1954).

[12] *See* I.R.C. § 2041(a)(2) (1954).

[13] *See* Irwin Union Bank & Tr. Co. v. Long, 312 N.E.2d 908, 910 (Ind. Ct. App. 1974).

so that it is not considered when determining what withdrawal rights a beneficiary might have in a subsequent year.[14]

B. Crummey Powers - Annual Exclusion Gifts[15]

In the years since the *Crummey* decision, limited withdrawal rights have become the mainstay for gifts in trust when the gift tax annual exclusion is a key goal of the grantor.[16] The standard irrevocable life insurance trust (ILIT) uses limited withdrawal rights to make annual payments of life insurance premiums without using any (or using less) of the donor's basic estate and gift exclusion amount under IRC sections 2010 and 2505.[17]

This right of withdrawal is commonly limited by both time and amount. The time limit routinely is thirty days[18] but may be as long as the current tax year,[19] and the Internal Revenue Service (Service) in private letter rulings has approved shorter withdrawal windows.[20] The amount that

[14] *See id.*

[15] For a more complete discussion of Crummey powers of withdrawal, see ZARITSKY, *supra* note 1, ¶ 4.08.

[16] The gift tax annual exclusion is found in IRC section 2503(b), which provides that present interest gifts by a donor are excluded from the section 2502(a) definitions of "taxable gifts" to the extent of the first $10,000 given to each donee. *See* I.R.C. §§ 2503(b), 2502(a). The $10,000 amount is indexed for inflation and is $16,000 in 2022. *See, e.g.*, Rev. Proc. 2021-45.43, 2021-48 I.R.B 764. For a full discussion of present interest gifts in trust that qualify for the gift tax annual exclusion, see F. Ladson Boyle, *Present Interest Gifts in Trust: Donor and Donee Problems*, 29 GONZ. L. REV. 453 (1994).

[17] *See* I.R.C. §§ 2010, 2505. Donors often create trusts to own life insurance to achieve significant tax and nontax benefits, such as control over policy proceeds at the insured's death and gifts of premium amounts that qualify for the federal gift tax annual exclusion. Such trusts are commonly called "ILITs," an abbreviation for Irrevocable Life Insurance Trusts. A life insurance policy owned by an ILIT can remove the policy proceeds from the federal gross estate of the insured and the estate of the insured's spouse. Nevertheless, the policy proceeds can benefit the spouse and children of the insured and possibly be available to address liquidity problems in the estate of the insured or the estate of the insured's spouse. For a more complete discussion of Crummey powers of withdrawal, see ZARITSKY, *supra* note 1, ¶ 4.08.

[18] *See id.*

[19] The right of withdrawal in Crummey was for the calendar year of the gift. *See id.*

[20] *See, e.g.*, I.R.S. Priv. Ltr. Rul. 200130030 (Jul. 27, 2001); I.R.S. Priv. Ltr. Rul. 200011058 (Mar. 17, 2001); I.R.S. Priv. Ltr. Rul. 200011054-200011056 (Mar. 17, 2000); I.R.S. Priv. Ltr. Rul. 199912016 (Mar. 26, 1999); I.R.S. Priv. Ltr. Rul. 9812006 (Mar. 20, 1998); I.R.S. Priv. Ltr. Rul. 9810006 (Mar. 6, 1998); I.R.S. Priv. Ltr. Rul. 9809006 (Feb. 27, 1998), I.R.S. Priv. Ltr. Rul. 9809004 (Feb. 27, 1998); *see also* Est. of Cristofani v. Comm'r, 97 T.C. 74 (1991), *acq. in result* 1992-1 C.B. 4, 1996-1 C.B. 1, in which the withdrawal right was limited to fifteen days.

may be withdrawn may be limited to the current year's annual exclusion ($16,000 in 2022) or twice that amount ($32,000) if the donor is married, but sometimes the entire amount of the gift to the trust may be withdrawn regardless of the size of the transfer to the trust.[21]

Some Crummey powers provide that the right of withdrawal expires annually within the parameters of IRC section 2514(e),[22] although the right of withdrawal is over a larger sum. This variation, known as a "hanging power," is used when the donor wishes to give a large sum to the trust, but wants to reduce or eliminate long-term tax consequences for the trust beneficiary.[23]

III. CREDITORS RIGHTS - STATE LAW

A. Common Law

As discussed above,[24] without a statutory override, a creditor may generally not reach property subject to a debtor's unexercised withdrawal rights in a trust, even assuming the withdrawal rights are considered a general power of appointment.[25] A seminal case is *Irwin Union Bank & Trust Co. v. Long*.[26] In *Irwin*, the creditor was an ex-wife seeking to collect a divorce judgment from her ex-husband's interest in a trust created by his mother.[27] The trust authorized the ex-husband as beneficiary to withdraw 4% of the trust principal each year.[28]

> Philip W. Long shall have the right to withdraw from principal once in any calendar year upon thirty (30) days written notice to the Trustee up to four percent (4%) of the market value of the entire trust principal on the date of such notice, which right shall not be cumulative . . . .[29]

The creditor argued that the debtor had a general power of appointment over 4% of the trust corpus each year, which was subject to the claims of his creditors.[30] The debtor countered that the creditor could

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[21] For a more complete discussion of Crummey powers of withdrawal, see ZARITSKY, *supra* note 1, ¶ 4.08.

[22] *See* 26 U.S.C. § 2514(e)(1)-(3) (detailing the choice of $5,000 or 5%).

[23] *See* Roy M. Adams & Scott Bieber, *supra* note 10, at 22–23.

[24] *See supra* note 8 and accompanying text; *supra* note 9 and accompanying text.

[25] As discussed above, the Restatement (Third) of Trusts section 56 takes a contrary position. *See* RESTATEMENT (THIRD) OF TRUSTS § 56 (AM. L. INST. 2003).

[26] 312 N.E.2d 908 (Ind. Ct. App. 1974).

[27] *See id.* at 909.

[28] *See id.* at 910.

[29] *See id.*

[30] *See id.*

not attach his interest unless he actually exercised the power of appointment.[31] In a case of first impression for the state court, it explained the difference between general and special powers:

> Powers are either general or special. They are general when they are capable of being exercised by the donee in favor of any person, including himself, and are not restricted as to the estate or interest over which he may exercise the power, while the power is special if its exercise is restricted to particular persons, or a particular class of persons, or if it can by exercised only for certain named purposes or under certain conditions.[32]

Although the trial court ruled in favor of the creditor, the appellate court instead viewed the debtor's unexercised power over the trust principal to be merely an offer or invitation from the donor—his mother as settlor of the trust—that did not vest until he might choose to exercise the power.[33] Only when he exercised the power would the property be subject to the claims of creditors, to the extent of the exercise.[34]

Other appellate decisions exist in jurisdictions without a statutory rule as referenced in C.J.S. A more recent example of an appellate decision in a jurisdiction without a statutory rule is *University National Bank v. Rhoadarmer*,[35] in which the debtor was the beneficiary of a trust that gave her an annual five or five withdrawal power.[36] Although the debtor did not exercise the power in the years in question, the creditor asserted that it could garnish the property subject to the beneficiary's power over trust assets.[37] The appellate court determined, however, that the unexercised five or five power was not an interest in the trust; rather, the power was a power of appointment.[38] As such, until the power was exercised, the title

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[31] *See id.*

[32] *See id.* at 911.

[33] *See id.* at 911–12.

[34] *See id.* 914–15; *see also supra* Part II.A. Federal estate and gift tax law differs in the treatment of an unexercised general power of appointment beyond a five or five power by considering the excess subject to tax. *See* 26 U.S.C. § 2041(b)(1) (defining a general power of appointment as one that "is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.").

[35] 827 P.2d 561 (Colo. App. 1991). Colorado now has a version of UTC section 505(a), but not section 505(b). *See* COLO. REV. STAT. § 15-5-505. All state statutory citations in this Article refer to the current statute unless otherwise indicated.

[36] *See University Nat'l Bank*, 827 P.2d at 562.

[37] *See id.*

[38] *See id.*

to the property remained with the trust and could not be seized.[39] The court distinguished a state estate tax decision that taxed the estate of a power-holder who died while the power was currently exercisable as a general power of appointment, rather than an attempt to garnish property held in trust.[40]

In reaching its decision, the court stated:

> we rely upon the more fundamental common law principle that property subject to a donee's general power of appointment is available to his creditors only if the power is exercised. G. Bogert, Trusts & Trustees § 233 (rev. 2d ed. 1977); Annot., 18 A.L.R. 1470 (1922). Further, the donee of such a power may not be compelled to exercise it, nor may his creditors acquire the power. IIA A. Scott, Trusts § 147.3 (4th ed. 1987).[41]

B. UTC Section 505 and Creditors of Settlors

1. Revocable Trusts

The Uniform Trust Code (UTC) addresses the creditors' rights issue when a settlor creates a trust for his or her own benefit. UTC section 505(a) provides that the property of a revocable trust is subject to claims of the settlor's creditors during the settlor's lifetime whether the trust contains a spendthrift restriction or not.[42] After the settlor's death, the property of a former revocable trust is subject to claims of the settlor's creditors.[43]

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[39] *See id.* at 563.

[40] *See id.*

[41] *See id.* at 564.

[42] *See* COLO. REV. STAT. § 15-5-505(a)(1). This treatment is logical based on the premise of a revocable trust, giving the settlor the power to revoke and return the trust property to the settlor's absolute ownership. Consistent with this notion is UTC section 603, which effectively provides that the trustee owes duties only to the settlor while the trust is revocable and subjugates the rights of other beneficiaries to those of the settlor while the trust is revocable. *See* UNIF. TR. CODE § 603 (UNIF. L. COMM'N 2000).

[43] *See* UNIF. TR. CODE § 505(a)(3) cmt. (UNIF. L. COMM'N 2000). The comment observes that, because a revocable trust usually serves as a will substitute, the trust assets are subject to postmortem creditors' claims, assuming the probate estate is otherwise insufficient. *See id.* This latter qualification is similar to the UPC treatment of multiple party bank accounts and postmortem creditors. *See* former UNIF. PR. CODE § 6-107 (UNIF. L. COMM'N 2010) (dealing with multiple party bank accounts); UNIF. PR. CODE § 6-102 (UNIF. L. COMM'N 2010) (expanding that treatment to general non-probate transfers). For an interesting consideration of postmortem claims and multiple party accounts, see TD Bank, N.A. v. Miller, No. 20-3255-CV, 2022 WL 500447 (2d Cir. Feb. 18, 2022).

For example, in *Dale Exploration, LLC v. Hiepler*,[44] while grappling with an issue involving the ability to convey title by mineral deed, the court cited the commonly-recognized view that a creditor's claim against the settlor of a revocable trust can be asserted against the trust property.[45]

> North Dakota has adopted the Uniform Trust Code, which implements the "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 Section 25 cmt. e (Tentative Draft No. 1, approved 1996)." UNIF. TRUST CODE § 505 cmt. to (a)(1) (2010). "Subsection (a)(2), which is based on Restatement (Third) of Trusts Section 58(2) and cmt. e (Tentative Draft No. 2, approved 1999), and Restatement (Second) of Trusts Section 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." UNIF. TRUST CODE § 505 cmt. to (a)(2) (2010). Under the Uniform Trust Code, if a settlor has unlimited power to withdraw property or revoke the trust, "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." UNIF. TRUST CODE § 505 cmt. to (b)(1). Adoption of the Uniform Trust Code shows North Dakota's intent for a revocable trust to be treated as the grantor's property, not as a means for settlors to hide from creditors.[46]

2. Irrevocable Trusts

For an irrevocable trust, a creditor of a settlor may reach the maximum amount that can be distributed to or for the settlor's benefit.[47] As the comment to UTC section 505(a)(3) notes,[48] this provision is based on the "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."[49]

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[44] 920 N.W.2d 750, 758 (N.D. 2018).

[45] *See id.* at 758.

[46] *See id.*

[47] *See* UNIF. TR. CODE § 505(a)(2) (UNIF. L. COMM'N 2010). A creditor can reach the trust property based on what the trustee is empowered to distribute to the settlor-beneficiary, not merely on what the trustee actually decides to distribute.

[48] *See* UNIF. TR. CODE § 505(a)(3) cmt. (UNIF. L. COMM'N 2010).

[49] *See id.* Those states enacting asset-protection trust statutes, such as Alaska and Delaware, obviously take a different policy view.

C. UTC Beneficiary Withdrawal Rights

The five or five and the Crummey rights situations are governed by the general UTC policy that a settlor's creditors may reach the trust property of a revocable trust and may reach the trust property of an irrevocable trust to the extent the trustee is empowered to make distributions to the settlor-beneficiary.[50]

UTC section 103(11) defines a power of withdrawal as

> a presently exercisable general power of appointment other than a power: (A) exercisable by a trustee and limited by an ascertainable standard;[51] or (B) exercisable by another person only upon consent of the trustee or a person holding an adverse interest.[52]

UTC section 505(b)(1) provides that the holder of a withdrawal power is treated the same as the settlor of a revocable trust while the power may be exercised, to the extent of the property subject to the power.[53] The Reporter's Comment to UTC section 505(b) provides:

> 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 Section 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

[50] *See id.* Of course, a creditor or an assignee can acquire no greater rights in the trust property than a debtor-beneficiary had.

[51] Ascertainable standard is a tax term defined in Treas. Reg. § 20.2041-1(c)(2), but has been generally adopted for state law purposes, such as in UTC section 103(11).

[52] *See* UNIF. TR. CODE § 103(11) (UNIF. L. COMM'N 2010).

[53] *See* UNIF. TR. CODE § 505(b)(1) (UNIF. L. COMM'N 2010). Because the UTC section 103(11) excludes from its definition of power of withdrawal any power of appointment with an ascertainable standard, UTC section 505(b)(1) does not apply to a power of appointment subject an ascertainable standard.

> the creditor to the $10,000 contribution and require the creditor to take action prior to the expiration of the 30-day period.[54]

Therefore, in states where adopted, UTC section 505(b)(1) reverses the rule in *Irwin Union National Bank* and *University National Bank*, at least while a power of withdrawal is currently exercisable.

The failure to timely exercise a power of withdrawal effectively constitutes a lapse, release, or waiver of that power. UTC section 505(b)(2) provides that

> 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.[55]

Thus, UTC section 505(b)(2) limits what a creditor can attach after the lapse, release, or waiver of the power of withdrawal to the amount that exceeds the greater of the five or five annual lapse amount or the federal gift tax annual exclusion.

The Reporter's Comment to UTC section 505(b) provides:

> 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 [505](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 Section 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

[54] *See* UNIF. TR. CODE § 505 cmt. (UNIF. L. COMM'N 2010).
[55] *See* UNIF. TR. CODE § 505(b)(2) (UNIF. L. COMM'N 2010).

> subject to the power at the time of the lapse, release, or waiver exceeded the greater of the amounts specified in IRC Sections 2041(b)(2) or 2514(e) [greater of 5% or $5,000], or IRC § 2503(b) [$10,000 in 2001].[56]

Therefore, a beneficiary with power of withdrawal is treated as the settlor of a revocable trust or the settlor of an irrevocable trust, to the extent that a beneficiary can require the trustee to make distributions to the beneficiary. In other words, a creditor of a beneficiary with a right to withdraw can reach the trust property to the extent that the right to withdraw currently covers trust property and, upon the lapse, release, or waiver of the power of withdrawal, to the extent the power of withdrawal exceeds the amounts provided in IRC sections 2041(b)(2) or 2514(e)—the greater of 5% or $5,000—and the amount provided in IRC section 2503(b)—the annual gift tax exclusion, which is $16,000 in 2022.[57]

A 2016 case illustrates the issue. In *Hannah v. Washington County Assessor*,[58] the court considered whether a property tax deferral based on a homestead qualification should be discontinued.[59] The applicable state statute provided that the deferral terminated when the property was sold or when "some person other than the taxpayer who claimed the deferral, including a transferee, becomes the owner of the property."[60] A husband and wife had created an inter vivos trust.[61] Upon the husband's death, the trust provided for the creation and administration of a marital trust for the benefit of the wife as surviving spouse.[62] The wife was one of three trustees.[63] The trust provided for monthly distributions of income and, in addition, distributions of principal as the wife may request.[64] The trust expressly placed no limitation on the amount of or the reason for the wife's request for principal distribution.[65]

The Oregon Department of Revenue (DOR) contended that, upon the husband's death, the trust became irrevocable and legal title vested in the

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[56] *See* UNIF. TR. CODE § 505(b)(2) cmt. (UNIF. L. COMM'N 2010).

[57] *See id.* If the beneficiary exercises the power of withdrawal, that property is subject to the claims of creditors.

[58] No. TC-MD 150449N, 2016 WL 6988865 (Or. T.C. Nov. 29, 2016).

[59] *See id.* at *2 ("The legislature's guiding principle was to keep senior and disabled taxpayers in their long-term homes and only to demand payment of deferred property taxes when the property was sold or transferred.").

[60] *See* OR. REV. STAT. ANN. § 311.684.

[61] *See Hannah*, 2016 WL 3097991, at *1.

[62] *See id.*

[63] *See id.*

[64] *See id.*

[65] *See id.*

trustees.[66] According to the DOR, the wife "could no longer have removed the subject property from the trust."[67] Consequently, the DOR contended that a conveyance of the property occurred at that point, which disqualified the property from the property tax deferral.[68]

The court rejected the DOR's argument.[69] It reasoned that the legal title had been held by the trust, through the trustees, since the trust was funded with the property.[70] Moreover, the court determined that the wife was both a trustee, holding legal title to the property, and the sole present beneficiary, with "an unqualified right to withdraw all of the income and principal of the trust at any time, for any reason."[71] Citing a law review article discussing Oregon's version of the UTC, the court determined that a person with power of withdrawal is deemed to be the "owner" of the property subject to that power.[72] The court also referred to the Restatement (Third) of Trusts, section 56, comment b, for the proposition that the powerholder of a general power of appointment is deemed to be the effective owner of the property.[73]

Because the wife held "all of the rights associated with ownership," including an absolute right to demand property from the trust, she was an owner of the property, preventing a finding that a transfer of ownership occurred that would trigger disqualification of the property tax deferral.[74]

IV. EFFECT OF A SPENDTHRIFT PROVISION

A spendthrift provision in a trust generally provides protection from a beneficiary's creditors by prohibiting the voluntary and involuntary alienation of the beneficiary's interests.[75] However, in those states that provide that a beneficiary is "deemed" to be the settlor such that a settlor's creditors may reach trust assets, the spendthrift provision likely provides no protection while the power is exercisable and provides protection after

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[66] *See id.* at *3.

[67] *See id.* at *2.

[68] Before the husband's death, while the trust was revocable, the property qualified under the applicable requirements for property tax deferral.

[69] *See Hannah*, 2016 WL 6988865, at *4.

[70] *See id.*

[71] *See id.* at *3.

[72] *See id.*; *see also* Valerie J. Vollmar, *The Oregon Uniform Trust Code and Comments*, 42 WILLAMETTE L. REV. 187, 212 (2006) ("The holder of a power of withdrawal has the rights of a settlor of a revocable trust.").

[73] *See Hannah*, 2016 WL 6988865, at *4.

[74] *See id.*

[75] *See* UNIF. TR. CODE §§ 502, 503 (UNIF. L. COMM'N 2010) (discussing spendthrift provisions). Because settlors presumably care about their beneficiaries, spendthrift provisions —protecting the beneficiaries' interests—are commonplace in modern estate planning.

the power lapses only to the extent that the powerholder is not deemed a settlor.[76]

Recent cases illustrate the issue. For example, in *In re Skubitz*,[77] a bankruptcy court considered whether a surviving spouse's beneficial interest in a trust involved a power of withdrawal that would include the trust property in the bankruptcy estate.[78] The debtor's husband executed his will in 1994 and died in 2003.[79] The will created two trusts: a marital trust and a family bypass trust.[80] The marital trust benefited the debtor as surviving spouse.[81] The family bypass trust terminated in 2005.[82] The marital trust authorized the trustee to pay net income and principal to the wife-debtor in the trustee's absolute discretion in accordance with an ascertainable standard—the debtor's reasonable support, maintenance, and health.[83] Upon the debtor's death, the trust was to be divided into separate trusts for the decedent's children per stirpes.[84] The trust contained a spendthrift provision that precluded the voluntary assignment and involuntary attachment of the debtor's interest in the trust property.[85] Under bankruptcy law, a valid spendthrift provision generally excludes a debtor's beneficial interest in trust property from the bankruptcy estate.[86] However, the bankruptcy trustee argued that the debtor's interest in the trust property was not excluded from the bankruptcy estate because she had a power of withdrawal under state law, as she had the discretionary power as trustee to make distributions of trust property to herself.[87] According to the bankruptcy trustee, the power of withdrawal overrode the

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[76] *See* UNIF. TR. CODE § 505(b)(2) (UNIF. L. COMM'N 2010). UTC section 505 applies regardless of whether the trust contains a spendthrift provision.

[77] No. 12-11544-7, 2014 WL 222103 (Bankr. D. Kan. Jan. 21, 2014).

[78] *See generally id.*

[79] *See id.* at *1.

[80] The marital trust was funded with the amount of assets qualifying for the marital deduction less the decedent's available federal estate tax unified credit amount, which passed to the family bypass trust. In 2003, the federal estate tax unified credit amount exempted $1 million of assets from tax. *See id.*

[81] *See id.*

[82] *See id.*

[83] The factors in the trust's ascertainable standard are commonly found in wills and trusts because the IRC provides that, if the trustee's discretion is limited by similar language, the trustee does not have a general power of appointment. *See* I.R.C. § 2041. To the extent a trustee has a general power of appointment, any transfer from the trust constitutes a taxable transfer from the trustee personally.

[84] *See Skubitz*, 2014 WL 222103, at *1.

[85] *See id.* at *2.

[86] *See* 11 U.S.C. 541(c)(2).

[87] *See Skubitz*, 2014 WL 222103, at *2.

state law protection for a beneficial interest subject to a spendthrift provision and allowed her creditors to reach the maximum amount the trustee could distribute to her, and therefore, the court should determine that maximum amount.[88]

The court noted that the bankruptcy trustee conceded that the spendthrift language in the trust qualified as a spendthrift provision under the state's version of the UTC.[89] However, the bankruptcy trustee cited a different state statute, which he contended superseded the protective language of the spendthrift statute: the state's version of UTC section 505 allowed creditors to reach trust property of either a trust's settlor or the holder of a power of withdrawal under the trust.[90] The court concluded that the debtor did not have a power of withdrawal pursuant to the applicable state statute.[91] Moreover, the court reasoned that the bankruptcy trustee's theory failed even if the trust did not contain a spendthrift provision.[92]

Under the state's version of UTC section 502(d), a creditor of a beneficiary cannot compel a trustee with discretion to make a distribution, regardless of whether the trust contains a spendthrift provision.[93] In *Skubitz*, the debtor was the trustee and the beneficiary, but the court effectively recognized that the debtor was wearing two separate hats.[94] The policy underlying UTC section 502(d) is that a beneficiary whose distributions are subject to the discretion of a trustee does not have a transmissible interest in the trust property unless and until the trustee decides to make a distribution, at which point the beneficiary has an interest in the trust property to the extent of the amount of the trustee's

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[88] *See id.* at *6.

[89] *See id.* at *2; *see also* KAN. STAT. ANN. § 58a-502.

[90] *See* KAN. STAT. ANN. § 58a-505 (providing that "whether or not the terms of a trust contain a spendthrift provision, the following rules apply . . . 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 . . . [and] [f]or purposes of this section: 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.").

[91] *See Skubitz*, 2014 WL 222103, at *6.

[92] *See id.*

[93] The initial version of the state statute was effective on January 1, 2003. In 2004, the state legislature added the following provision at the end of the section: "even if: (1) The discretion is expressed in the form of a standard for distribution; or (2) the trustee has abused the discretion." *See* KAN. STAT. ANN. § 58a-502(d). According to the court, a trustee with discretion cannot be compelled by creditors to make a distribution to a beneficiary. *See Skubitz*, 2014 WL 222103, at *3.

[94] *See id.*

decision to distribute.[95] Citing the effective date provisions of the state version of the UTC, the court concluded that the state's initial version and the amended version of UTC section 502(d) applied to the trust.[96]

In any event, the *Skubitz* court held that the debtor did not have a power of withdrawal.[97] The court noted that, when the decedent's will was filed, "'power of withdrawal'" was used in the UTC to mean '"a presently exercisable general power of appointment other than a power exercisable . . . only upon consent of the trustee or a person holding an adverse interest."'[98] The court ruled that the debtor, as trustee, did not have a power of appointment because she was subject to fiduciary duties; whereas, a powerholder of a naked power of appointment does not have any fiduciary obligation, but only a power.[99] The court also noted that the state amended its version of UTC section 103(10) in 2006 to exclude from the definition of power of withdrawal any power of appointment held by a trustee, who was also a beneficiary, that is subject to an ascertainable standard for Internal Revenue Code purposes.[100] If a power of appointment is limited by an appropriate ascertainable standard, it is not a general power of

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[95] *See* UNIF. TR. CODE § 502(d) (UNIF. L. COMM'N 2010). That section deals with the rights of creditors of beneficiaries of discretionary trusts and is, with respect to creditors' rights, more specific than UTC section 814, which provides inter alia that a trustee with even absolute discretion is subject to court oversight to ensure that the trustee acts in good faith. However, UTC section 814 also governs certain situations when a non-settlor beneficiary and trustee may exercise the power—only when subject to an ascertainable standard—and does not apply to a surviving spouse serving as a trustee for a trust that qualified for the federal estate tax marital deduction. These situations are in part tax-related, with the former provision guarding against the creation of a general power of appointment and the latter guarding against the inadvertent loss of qualification for the marital deduction. In any event, UTC section 502(d) appears to override any argument that section 814 allows a creditor to stand in a debtor's shoes and attempt to compel a distribution because the trustee is not acting in good faith.

[96] *See* KAN. STAT. ANN. § 58a-1106(a).

[97] *See Skubitz*, 2014 WL 222103, at *6.

[98] *Skubitz*, 2014 WL 222103, at *4 (quoting KAN. STAT. ANN. § 58a-103(10)). The court observed that the statute was subsequently amended, but its definition remained limited to a "power of appointment." *See id.* (quoting KAN. STAT. ANN. 2012 Supp. § 58a-103(10)).

[99] *See Skubitz*, 2014 WL 222103, at *4. The court cited to comment a of the Restatement (Third) of Trusts section 50, which distinguishes between a trustee's power of discretion, which is subject to fiduciary responsibility, and a power of appointment, which is not. However, the issue may be more nuanced than stated by the Restatement. *See* Medlin, *supra* note 8, at 165.

[100] *See Skubitz*, 2014 WL 222103, at *5. The state and UTC versions reference I.R.C. sections 2041(b)(1)(A) (regarding federal estate tax powers of appointment) and 2514(c)(1) (regarding federal gift tax powers of appointment).

appointment for federal estate and gift tax purposes and is not a power of withdrawal for UTC purposes.[101] For the foregoing reasons, the *Skubitz* court rejected the bankruptcy trustee's contentions.

Another recent case dealing with the spendthrift issue is *DePrins v. Michaeles.*[102] In *DePrins* a couple moved from Massachusetts to Arizona in 2000.[103] While there, they argued with their neighbors over water rights and eventually lost in court.[104] The couple then moved to California, where the wife committed suicide in 2008.[105] The husband moved back to Arizona to live with his daughter and, while there, executed an irrevocable trust.[106] He was both the settlor and the beneficiary, and he transferred substantially all of his assets into the trust.[107] His son served as trustee.[108] In 2009, the husband killed his former neighbors in Arizona and committed suicide the next day.[109]

The victims' son brought a probate action and eventually agreed to a stipulation with the personal representative of the husband's estate; the stipulation provided that the victims' wrongful death action against the husband's estate would be settled for $750,000 and that the judgment would be enforced against the husband's trust.[110] The victims' son made a demand against the husband's trust but was not paid.[111] Consequently, the son brought an action in federal court to collect the debt from the trust assets[112]—a reach and apply[113] action. The trust moved for summary judgment and argued that the trust's spendthrift provision precluded the reach and apply action.[114]

The court examined the basic rules governing spendthrift provisions, which were recognized in Massachusetts when created by a third party for

[101] *See Skubitz*, 2014 WL 222103, at *5.
[102] 342 F. Supp. 3d 199 (D. Mass. 2018).
[103] *Id.* at 202.
[104] *See id.*
[105] *See id.*
[106] *See id.*
[107] *See id.*
[108] *See id.*
[109] *See id.*
[110] *See id.* at 202–03.
[111] *See id.* at 203.
[112] *See id.* at 206 ("Self-settled trusts, where the beneficiary is also the settlor, cannot be used to protect one's assets from creditors.").
[113] The state's reach and apply action allows a claimant to collect money damages by reaching property of the debtor that it could not otherwise secure by legal attachment, and subsequently applying that property to pay a debt. *See id.* at 204 (citing MASS. GEN. L. 214 § 3(6)).
[114] *See id.* at 203.

beneficiaries other than the settlor.[115] However, a self-settled trust could not contain a valid spendthrift trust because allowing the settlor to benefit from the settlor's own property while protecting it from the settlor's creditors violated public policy.[116] Thus, the court granted summary judgment for the victims' son to reach and apply the interest of the husband in the trust in the amount of $750,000.[117]

Fahey Banking Co. v. Carpenter[118] considered the impact of a spendthrift provision on a power to withdraw under UTC-style statutes. In *Fahey Banking Co.*, the creditor obtained a judgment for over $1.25 million and sought to recover against the debtor's beneficial interest in an irrevocable trust because the debtor apparently did not own sufficient assets to satisfy the claim.[119] Based on a spendthrift provision in the trust, the trial court granted the trust's motion to dismiss, and the creditor appealed.[120] The creditor argued that the trial court failed to recognize that the spendthrift provision did not apply to the beneficiary's "present right of withdrawal."[121]

On appeal, the parties agreed that the irrevocable trust contained a valid spendthrift provision.[122] The trust contended that the applicable state statutes, based on UTC sections 501 and 505,[123] precluded a creditor from attaching a beneficiary's interest in the trust.[124] The creditor countered that the spendthrift provision was ineffective because the debtor as beneficiary had the annual right to withdraw $5,000 or 5% of the trust principal.[125] The creditor cited the state's version of UTC section 505,[126] which provided that a creditor may reach a debtor's interest in an irrevocable trust if the debtor is a settlor of that trust, regardless of a spendthrift provision. According to the creditor, the applicable state statute treated a beneficiary

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[115] *See id.* at 205–06.
[116] *See id.* at 206.
[117] *See id.*
[118] No. 17AP-842, 2019 WL 951188 (Ohio 2019).
[119] *See Fahey Banking Co.*, 2019 WL 951188, at *1.
[120] *See id.* at *2.
[121] *See id.*
[122] *See id.*
[123] *See* OHIO REV. CODE ANN. §§ 5805.01–.05(A).
[124] *See Fahey Banking Co.*, 2019 WL 951188, at *3–4.
[125] *See id.* at *4.
[126] *See* OHIO REV. CODE ANN. § 5805.06. As discussed above, this rule is based on the generally-held public policy that a person should not be able to create a trust for that settlor's benefit yet protect those assets from the claims of the settlor's creditors. Of course, a number of states by statute have rejected that policy by allowing asset protection trusts. *See, e.g.*, DEL. CODE ANN. tit. 12, § 3570(11); MICH. COMP. LAWS ANN. § 700.1042(aa); NEV. REV. STAT. § 166.040.

with a power of withdrawal as a settlor of a trust, thereby subjecting the powerholder's interest to the same exception to a spendthrift provision as a settlor, to the extent of the power of withdrawal.[127] The appellate court focused on the following language of the state's version of UTC section 505(a):

> To the extent that a trust that gives a beneficiary the right to receive one or more mandatory distributions does not contain a spendthrift provision, the court may authorize a creditor or assignee of the beneficiary to attach present or future mandatory distributions to or for the benefit of the beneficiary or to reach the beneficiary's interest by other means.[128]

The appellate court read the "to the extent" language in that section to apply to a spendthrift provision and not to a beneficiary's right to receive mandatory distributions.[129] The appellate court referred to the language in the state's version of UTC section 505, which, for purposes of creditors' claims, equated the holder of a power of withdrawal with the settlor of a trust for such purposes.[130] That statute expressly applies to lapses, releases, or waivers of a power of withdrawal, to the extent the property subject to the power of withdrawal exceeds the applicable amount exempted by the Internal Revenue Code:

> (2) Upon the lapse, release, or waiver of the power of withdrawal, 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 greatest of the following amounts:
>
> (a) The amount specified in section 2041(b)(2) or 2514(e) of the Internal Revenue Code;
>
> (b) If the donor of the property subject to the holder's power of withdrawal is not married at the time of the transfer of the property to the trust, the amount specified in section 2503(b) of the Internal Revenue Code;
>
> (c) If the donor of the property subject to the holder's power of withdrawal is married at the time of the transfer

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[127] *See Fahey Banking Co.*, 2019 WL 951188, at *4.
[128] *Id.* at *5 (quoting OHIO REV. CODE ANN. § 5805.05(A)).
[129] *See id.* at *5.
[130] *See id.* (citing OHIO REV. CODE ANN. § 5805.06).

> of the property to the trust, twice the amount specified in section 2503(b) of the Internal Revenue Code.[131]

The appellate court also cited *Great American Insurance Co. v. Thompson Trust*,[132] which referred to the Restatement (Third) of Trusts section 58 for the proposition that a spendthrift provision does not apply to a general power of appointment.[133] Although the trustee argued that *Great American Insurance* was decided before the applicable state statute became effective in 2007, the appellate court found that the statutory language was consistent with the holding in that case because the state's version of UTC section 502, recognizing the effect of a spendthrift provision, specifically excepted the state's version of UTC section 505 from protection by a spendthrift provision.[134]

Consequently, the appellate court reversed and remanded the case to the trial court to consider whether, pursuant to the state's version of UTC section 505, the creditor could attach mandatory distributions to the debtor as beneficiary of the trust.[135]

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[131] *See id.* at *3.

[132] No. C-040127, 2006 WL 199751 (Ohio Ct. App. Jan. 27, 2006).

[133] *See Fahey Banking Co.*, 2019 WL 951188, at *4.

[134] *See id.* at *5.

[135] *See id.* at *6. A number of recent scholarly articles addressing estate planning, powers of appointment, or asset protection issues discuss UTC section 505 in the context of those topics. *See, e.g.*, Jessica A. Cohen & Blake N. Melton, *Using Powers of Appointment to Increase the Period Assets Are Held in Trust*, 54 REAL PROP. TR. & EST. L.J. 1 (2019) (discussing powers of appointment and creditor protection issues per UTC section 505); *see also* Ira Mark Bloom, *Powers of Appointment Under the Restatement (Third) of Property*, 33 OHIO N.U. L. REV. 755 (2007) (similar); Alexander A. Bove, Jr., *Using the Power of Appointment to Protect Assets – More Power Than You Ever Imagined*, 36 ACTEC L.J. 333 (2010) (similar); Griffin H. Bridgers, *Basis Step-Up Planning: A Double-Edged Sword*, 32 PROB & PROP. 24 (July/Aug. 2018) (similar); Wendy C. Gerzog, *The New Super-Charged PAT (Power of Appointment Trust)*, 48 HOUS. L. REV. 507 (2011) (similar); Nancy G. Henderson, *Gather Useful Crumbs of Knowledge About Crummey Powers*, 40 EST. PLAN. 3 (2013) (similar); Jennifer A. Maas, *The New Minnesota Trust Code: Out With (Most of) the Old and In With (Most of) the UTC*, 42 MITCHELL HAMLINE L. REV. 940 (2016) (similar); Kevin D. Millard, *Rights of a Trust Beneficiary's Creditors Under the Uniform Trust Code*, 34 ACTEC L.J. 58 (2008) (similar); Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 REAL PROP. TR. & EST. L.J. 567 (2005) (similar); Alan Newman, *The Rights of Creditors of Beneficiaries Under the Uniform Trust Code: An Examination of the Compromise*, 69 TENN. L. REV. 771 (2002) (similar); John V. Orth, *The Paradoxes of Joint Tenancies*, 46 REAL PROP. TR. & EST. L.J. 483 (2012) (similar); Peter B. Tiernan, *Personal Power Stops Second-Guessing of Trustee Decisions*, 38 EST. PLAN. 37 (2011) (similar).

V. WHICH STATES HAVE ADOPTED UTC SECTION 505(B)

As with most uniform laws promulgated by the Uniform Laws Commission, not all states have adopted all of UTC section 505(b), and those that have adopted a version may not have always adopted section 505(b) verbatim.[136]

States that have adopted UTC section 505(b), or some variation thereof, include:

- Alabama[137]
- District of Columbia[138]
- Hawaii[139]
- Kansas[140]
- Maine[141]
- Missouri[142]
- Montana[143]
- Nebraska[144]
- New Jersey[145]
- New Mexico[146]
- North Dakota[147]
- Utah[148]
- Vermont[149]

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[136] This compilation is based on a Westlaw word search of the various jurisdictions using the terms "trust," "creditor," and "power." It is possible that the search did not locate all of the potentially applicable state laws. Others have compiled similar state law surveys. For example, see generally Steve Gorin, *Structuring Ownership of Privately-Owned Businesses: Tax and Estate Planning Implications* (printed 4/18/2022), available by emailing the author at sgorin@thompsoncoburn.com; Edwin P. Morrow, *IRC Section 678 and the Beneficiary Deemed Owner Trust (BDOT)*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3165 592.

[137] *See* ALA. CODE § 19-3B-505(c).

[138] *See* D.C. CODE § 19-1305.05(b).

[139] *See* HAW. REV. STAT. § 554D-505(b).

[140] *See* KAN. STAT. ANN. § 58a-505(b).

[141] *See* ME. REV. STAT. tit. 18-B, § 505(1).

[142] *See* MO. REV. STAT. § 456.5-505(6).

[143] *See* MONT. CODE ANN. § 72-38-505(2).

[144] *See* NEB. REV. STAT. § 30-3850.

[145] *See* N.J. STAT. ANN. § 3B:31-39(b).

[146] *See* N.M. STAT. ANN. § 46A-5-505(B).

[147] *See* N.D. CENT. CODE § 59-13-05(2).

[148] *See* UTAH CODE ANN. § 75-10-503(2).

[149] *See* VT. STAT. ANN. tit. 14A, § 505(b).

- West Virginia[150]
- Wisconsin[151]

A few states have adopted UTC section 505(b) but have increased the IRC section 2503(b) annual exclusion amount to include a possible split gift by the donor's spouse under IRC section 2513 for transfers to third parties. These states include:

- Florida[152]
- Oregon[153]
- Virginia[154]

Illinois has adopted UTC section 505(b) as originally proposed but does not include the IRC section 2503(b) annual exclusion so that is it limited to lapses within the parameters of IRC sections 2514(e) and 2041(b)(2).

- Illinois[155]

Another variation is found in states that have adopted UTC section 505(b)(1), but specifically reject (b)(2). This group includes:

- Arizona[156]
- Arkansas[157]
- Georgia[158]
- Kentucky[159]
- Louisiana (not based on UTC but appears to be of that effect)[160]
- New Hampshire[161]
- North Carolina[162]

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[150] *See* W.VA. CODE ANN. § 44D-5-505(b).
[151] *See* WISC. STAT. § 701.0505.
[152] *See* FLA. STAT. ANN. § 736.0505(b).
[153] *See* OR. REV. STAT. § 130.315(2)-(3).
[154] *See* VA. CODE ANN.§ 64.2-747(B).
[155] *See* 760 ILL. COMP. STAT. ANN. 3/505(b).
[156] *See* ARIZ. REV. STAT. ANN. § 14-10505(B).
[157] *See* ARK. CODE ANN. § 28-73-505(b).
[158] *See* GA. CODE ANN. § 53-12-83.
[159] *See* KY. REV. STAT. ANN. § 386B.5-040(2).
[160] *See* LA. STAT. ANN. § 9:2004.
[161] *See* N.H. REV. STAT. ANN. § 564-B:5-505(e).
[162] *See* N.C. GEN. STAT. § 36C-5-505(b).

A few states have adopted UTC section 505(b)(1), but the adopting statute makes no mention of UTC section 505(b)(2):

- Iowa[163]
- Ohio[164]
- South Carolina[165]

Some states do not permit a creditor to reach a presently exercisable power of appointment, unless it exceeds IRC sections 2514(e), 2041(b), and 2503(b), and in the case of Mississippi twice the annual exclusion amount:

- Connecticut[166]
- Mississippi[167]
- Tennessee[168]
- Texas[169]

A few states affirmatively reject a power of withdrawal being subject to creditors' claims:

- Delaware[170]
- Maryland[171]
- Oklahoma[172]
- South Dakota[173]

Pennsylvania permits a power of withdrawal to be attached while in existence and after the lapse, release, and waiver.[174] New York permits a currently exercisable power to be attached.[175]

A few states provide that a power of withdrawal is not subject to creditors' claims unless (1) it is a power to appoint to the donee's creditors, the donee's estate, or the creditors of the donee's estate, and (2) it is exercised in favor of the donee's creditors, the donee's estate, or the creditors of the donee's estate. These include:

[163] *See* IOWA CODE § 663A.3105.
[164] *See* OHIO REV. CODE ANN. § 5805.06.
[165] *See* S.C. CODE ANN. § 62-7-505.
[166] *See* CONN. GEN. STAT. § 45a-499nn(a).
[167] *See* MISS. CODE ANN. § 91-8-504(b).
[168] *See* TENN. CODE ANN. § 35-15-505(b).
[169] *See* TEX. PROP. CODE 112.035.
[170] *See* DEL. CODE ANN. tit. 12, § 3536(a).
[171] *See* MD. CODE ANN., EST. & TRUSTS § 14.5-507.
[172] *See* OKLA. STAT. tit. 60, § 175.85(F).
[173] *See* S.D. CODIFIED LAWS § 55-1-26.
[174] *See* 20 PA. STAT AND CONS. STAT. § 7748.
[175] *See* N.Y. EST., POWERS & TRUSTS LAW § 10-7.2.

- Alaska[176]
- Rhode Island[177]
- Wyoming[178]

Some other states have statutes that vary greatly from UTC section 505 or do not have any statutory equivalent.

A. Uniform Powers of Appointment Act

The UPAA also addresses creditors' rights in property subject to a power of appointment. As with UTC section 505(b)(2), UPAA section 503 treats a power to withdraw trust property, to the extent that property is subject to the power to withdraw, as a general presently exercisable power of appointment; if the power to withdraw lapses or is released or waived, this rule applies only to the excess of the property subject to the power over the federal estate and gift tax five or five powers and the federal gift tax annual exclusion amount.[179] However, the UPAA offers more protection from creditors than the UTC in one instance: UPAA section 502(a)(1) provides that

> (a) Except as otherwise provided in subsection (b), appointive property subject to a general power of appointment *created by a person other than the powerholder* is subject to a claim of a creditor of: (1) the powerholder, to the extent the powerholder's property is insufficient, if the power is presently exercisable . . . .[180]

This potential right of creditors to reach property of a debtor is less than what is provided in UTC section 505(b) because UPAA section 502(a)(1) applies only when the powerholder's other resources are insufficient to satisfy creditor claims, whether the claim is premortem or post-

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[176] *See* ALASKA STAT. § 34.40.115.

[177] *See* 34 R.I. GEN. LAWS. ANN § 34-22-13.

[178] *See* WYO. STAT. ANN. § 4-10-505.1.

[179] *See* UNIF. POWERS OF APPOINTMENT ACT § 503; UNIF. TR. CODE § 505(b)(2) (UNIF. L. COMM'N 2010).

[180] *See* UNIF. POWERS OF APPOINTMENT ACT § 502(a)(1) (emphasis added). UPAA section 501 governs creditors' claims against the creator of a general power of appointment who is also the powerholder. To the extent an irrevocable exercise of the power to someone other than the powerholder has not yet occurred, creditors of the powerholder may reach the appointive property, regardless of any spendthrift provision. *See id.* The comment to section 501 observes that the section "states a well-settled rule: a donor of a power of appointment cannot use a fraudulent transfer to avoid creditors."

mortem.[181] Nonetheless, it is meaningful in states that have not adopted UTC section 505 or some version thereof but have adopted the UPAA.[182] This distinction also might be meaningful when the beneficiary's assets are illiquid, while the assets subject to the power are cash or marketable securities—it may be more desirable for a powerholder's creditor to reach and seize liquid assets in trust subject to the power to withdraw rather than the powerholder's own illiquid assets, even if otherwise sufficient to satisfy the claim, but that is not a creditor's choice.

VI. THE TAX DIFFERENCE

It should be noted that the rule of UTC section 505(b)(2) applies to releases and waivers of powers of withdrawal as well as lapses. The gift and estate tax exclusion provided for by IRC sections 2514 and 2041 applies only to lapses. Thus, the UTC is broader than the IRC. This means that a powerholder who has creditor problems may be able to release or waive the power of withdrawal before a creditor might attach it. The full extent to which a release or waiver may thwart a creditor is not certain. In particular, it is not likely to apply to claims of the federal government as in *Drye v. United States*,[183] the Supreme Court ruled that a federal tax lien attached to inherited property notwithstanding a timely disclaimer under IRC section 2518. In *Drye*, the decedent's son owed the federal government approximately $325,000 when the decedent died intestate.[184] The Service had valid tax liens on all of his "property and rights to property," pursuant to IRC section 6321.[185] The son disclaimed his inheritance, which then passed to his daughter.[186] Justice Ginsberg, writing for a unanimous court, distinguished the ability of state law to create rights and federal courts to determine their impact on federal law.[187] The Court

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[181] By comparison, the UTC limits creditors' claims against trust property subject to a power of withdrawal to postmortem claims when the powerholder's probate assets are otherwise insufficient, but it does not limit premortem claims based on the powerholder's other assets. *See* UNIF. TR. CODE § 505(a)(3) (UNIF. L. COMM'N 2010).

[182] Based on the Uniform Laws Commission website, it appears that only Nevada and Washington have adopted the UPAA but not the UTC. *See Powers of Appointment Act*, UNIF. L. COMM'N, https://www.uniformlaws.org/committees/community-home?CommunityKey=70faefab-5c3d-4146-a51b-9b0a5b1f490d (displaying that Nevada and Washington have adopted the UPAA); *Trust Code*, UNIF. L. COMM'N, https://www.uniformlaws.org/committees/community-home?CommunityKey=193ff839-7955-4846-8f3c-ce74ac23938d (displaying that Nevada and Washington have not adopted the UTC).

[183] 528 U.S. 49 (1999).

[184] *See id.* at 52.

[185] *See id.* at 53.

[186] *See id.*

[187] *See id.* at 58.

reasoned that, even though state law treated a disclaimant as predeceasing the transfer, the state law right to disclaim gave the son "a right of considerable value,"[188] which thus could not avoid the federal tax lien over his property and rights. "That right simply cannot be written off as a mere personal right to accept or reject a gift."[189] The Court contrasted a donee who declines a gift—which leaves the property with the donor—with a disclaimant, who does not restore the status quo by disclaiming.[190] According to the Court, a disclaimant thus exercises dominion over the property.[191] Of course, if the Court's analysis that the right to disclaim is a property right itself is applied more broadly than to the federal tax lien situation in *Drye*, the very foundation of a disclaimer is destroyed. Under such an analysis, no disclaimer could avoid creditors, at least those with existing liens.[192] To date, there does not appear to be an outpouring by courts to dramatically expand the reach of *Drye*.

Second, withdrawal powers that are designed to qualify a gift for the gift tax annual exclusion (Crummey powers) are sometimes drafted to provide that the amount that may be withdrawn is twice the annual exclusion if the donor is married.[193] Thus, in some adopting states, UTC section 505(b)(2) may still apply to a portion of a gift to a trust that qualifies for a couple's joint annual exclusions ($32,000 in 2022) as the UTC appears to limit the exclusion to a single annual exclusion ($16,000 in 2022). Nevertheless, some states have increased the post-lapse exclusion to double the annual exclusion if the donor is married.[194]

If the donor uses a "hanging power"[195] to minimize the tax impact to the donee, the amount subject to a right of withdrawal may remain open for a longer period of time and thus permit a creditor to reach trust assets in jurisdictions that have adopted UTC section 505(b)(1), or an equivalent statute. This extended creditor exposure is a potential downside to hanging powers that is in addition to the risk that a beneficiary, with more time to think about it, might exercise the right until it ultimately lapses, or the

[188] *Id.* at 60.

[189] *Id.*

[190] *See id.* at 60–61.

[191] *See id.* at 61.

[192] Although not focused on by the Court, the optics of the daughter's actions post-disclaimer probably did not help. She created a trust, which included her father as beneficiary, with a spendthrift provision. Perhaps a better theory for the Court would have been that the disclaimer was not valid because the disclaimant actually directed the disposition of the property.

[193] *See* ZARITSKY, *supra* note 1, ¶ 4.08.

[194] *See id.*

[195] *See id.* ¶ 4.08(3)(j)(iii); KOREN, EST., TAX AND PERS. FIN. PLAN., § 8.19 (2022).

powerholder might die while the power is open, resulting in a federal estate tax inclusion under IRC section 2041.

VII. PLANNING THAT MIGHT ADDRESS THE CREDITOR ISSUE

As indicated above, state law varies, which offers a planning opportunity when a grantor considers creating a trust. If a beneficiary's creditors are a potential problem and are known to the grantor, the grantor might choose a trustee in a state with a favorable state law and adopt that state's law as the governing law. Moreover, a number of states, exemplified by Alaska[196] and Delaware,[197] offer a settlor the opportunity to create self-settled asset-protection trusts, contrary to the public policy espoused by the comment to UTC section 505.[198]

For existing trusts with a beneficiary with creditor issues, it may be possible to relocate the trust to a more favorable jurisdiction. For example, in the 2019 decision, *In re Cleopatra Cameron Gift Trust, Dated May 26, 1998*,[199] the trustees of several trusts created in California for the same discretionary beneficiary were directed by a California court order to make child support payments to the custodial parent of the beneficiary's children, although the trusts contained spendthrift limitations.[200] California law permits a court to order such direct payments.[201] Eventually, however, the trusts were moved to South Dakota by the beneficiary pursuant to a power granted in the trust documents.[202] Once in South Dakota, a successor trustee refused to make the direct payments for child support.[203] The custodial parent sued, alleging that the Full Faith Credit Clause of the United States Constitution required the trustee to continue the payments.[204] The South Dakota Supreme Court ruled, however, that the Full Faith and Credit Clause[205] required South Dakota to accept the validity of the debt, but ordering direct payments was a method of enforcement of the debt and South Dakota was not required to give the

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[196] *See* ALASKA STAT. § 34.40.115.

[197] *See* DEL. CODE ANN. tit. 12, §§ 3570-76.

[198] *See* UNIF. TR. CODE § 505 cmt. (UNIF. L. COMM'N 2003); *see also* Richard W. Nenno, *Planning with Domestic Asset Protection Trusts: Part I*, 40 REAL PROP. PROB. & TR. J. 263, 271–73 (2005).

[199] 931 N.W.2d 244 (S.D. 2019).

[200] *See id.*; *see also* UNIF. TR. CODE § 503 (UNIF. L. COMM'N 2000) (for similar provisions).

[201] *See In re Cleopatra Cameron Gift Tr.*, 931 N.W.2d at 247.

[202] *See id.* at 248.

[203] *See id.*

[204] *See id.* at 249.

[205] *See* U.S. CONST. art. IV, § 1.

collection order Full Faith and Credit.[206] Thus, the spendthrift provision of the trusts, which are valid under South Dakota law, prohibited direct payments.[207]

Whether a particular state would allow such a change of jurisdiction for the purposes of avoiding creditors' claims requires an examination of state policy. For example, UTC section 107 provides:

> The meaning and effect of the terms of a trust are determined by:
>
> (1) the law of the jurisdiction designated in the terms unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue; or
>
> (2) in the absence of a controlling designation in the terms of the trust, the law of the jurisdiction having the most significant relationship to the matter at issue.[208]

UTC section 108 defines a trust's principal place of administration and empowers a trustee in certain circumstances to move the principal place of administration.[209] As the comment notes, "Locating a trust's principal place of administration will ordinarily determine which court has primary if not exclusive jurisdiction over the trust" and "[d]esignating the principal place of administration should be distinguished from designating the law to determine the meaning and effect of the trust's terms, as authorized by section 107."[210] The comment to UTC section 108 also states that "[w]hile transfer of the principal place of administration will normally change the governing law with respect to administrative matters, a transfer does not normally alter the controlling law with respect to the validity of the trust and the construction of its dispositive provisions."[211] UTC section 108 provides that

> (a) Without precluding other means for establishing a sufficient connection with the designated jurisdiction, terms of a trust designating the principal place of administration are valid and controlling if:

[206] *See In re Cleopatra Cameron Gift Tr.*, 931 N.W.2d at 250–51.
[207] *See id.*
[208] UNIF. TR. CODE § 107 (UNIF. L. COMM'N 2000).
[209] *See* UNIF. TR. CODE § 108 (UNIF. L. COMM'N 2000).
[210] UNIF. TR. CODE § 108 cmt. (UNIF. L. COMM'N 2000).
[211] *Id*.

> (1) a trustee's principal place of business is located in or a trustee is a resident of the designated jurisdiction; or
>
> (2) all or part of the administration occurs in the designated jurisdiction.[212]

Thus, the UTC affords an opportunity to choose applicable law either at the time of the trust's creation or subsequently. Whether a court considering creditors' claims is determining administrative matters or construction matters may be debated on a case-by-case basis, and the answer to that issue may determine the extent to which UTC section 107 section 108 is applicable. Caveat that, regardless of the opportunity to choose the trust's jurisdiction, choosing the law of a state less favorable to creditors might not be an option if the chosen state's law would violate the public policy of the settlor's state as noted in UTC section 107 as well as UTC section 105, requiring a trust to not violate public policy.[213]

VIII. CONCLUSION[214]

Estate plans often include powers of withdrawal, both for tax reasons and nontax reasons. For example, a settlor may give a beneficiary who is entitled to income distributions the power to invade principal from time to time to provide some level of financial independence for that beneficiary. To avoid estate or gift tax consequences for the powerholder, the settlor may limit the beneficiary's right to withdraw principal to the greater of $5,000 or 5% of the principal value. Of course, a settlor may set the amount of the power to withdraw at a limit higher than these tax-protected safe harbors. Moreover, a settlor commonly wants to protect the beneficiary's interest from the claims of creditors to the extent reasonable and possible. The problem for the settlor is whether giving the beneficiary a power to withdraw opens the door to the beneficiary's creditors.

Generally, a power to withdraw has been seen as a general power of appointment. Historically, the commonly-held view was that a creditor of a powerholder with a general power of appointment could reach the assets subject to the power of appointment only if, and to the extent that, the powerholder exercised the power; however, if the powerholder did not exercise the power, the creditor could not reach the assets subject to the power. More recently, that general rule has eroded through such

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[212] UNIF. TR. CODE § 108(a) (UNIF. L. COMM'N 2000).

[213] *See, e.g.*, Dahl v. Dahl, 459 P.3d 276 (Utah 2015).

[214] This Article surveys the laws of fifty states and the District of Columbia. Of necessity, we have made generalizations and conclusions that may not be applicable in a specific state. Readers are encouraged to use the materials contained in Part V to identify applicable state law and then identify any specific nuances that may exist.

authorities as the Restatement (Third) of Trusts, the Uniform Trust Code, and the Uniform Power of Appointment Act. Settlors today may still protect their beneficiaries from creditors' claims, but that protection is usually limited and requires careful consideration of the applicable state statutory and case law, along with the appropriate tax law.