

Spendthrift Clauses

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Take-Away: A *spendthrift* clause protects a beneficiary's interest in a trust. Such a clause can also frustrate future efforts to modify the trust's terms or the trust beneficiary's effort to plan their own estate. We now learn that an attempt by the beneficiary to assign his/her beneficial interest in the trust is void.

Background: The Michigan Trust Code (MTC) defines a *spendthrift* provision as 'a term of a trust that restrains either the voluntary or involuntary transfer of a trust beneficiary's interest.' [MCL 700.7103(j).] This limitation is valid and enforceable by courts. [MCL 700.7502(1) and(2).] Subject to a couple of statutory exceptions, with a spendthrift provision the trust beneficiary's interest in the trust cannot be transferred in violation of the valid spendthrift provision, and trust property is not subject to enforcement of a creditor's judgment until the property is distributed directly to the trust beneficiary. [MCL 700.7502(3).]

Exceptions: The interests of a trust beneficiary can be reached in satisfaction of an enforceable claim by a trust beneficiary's child or former spouse who has a judgment or court order against the trust beneficiary for support or maintenance [MCL 700.7504(a)], or a judgment creditor who has provided services that enhance, preserve, or protect a beneficiary's interest in a trust [MCL 700.7504(b),] or the State of Michigan or the United States. [MCL 700.7504(c).] However, in these limited situations the court can only order the trustee to satisfy part or all of a judgment or court order only out of part or all of a distribution of income or principal "*as they become due.*" [MCL 700.7504(3).]

Prior Missives: We've covered the topic of *spendthrift* clauses in the past, such as whether the presence of a *spendthrift* clause in a trust is a limiting *material* purpose of the trust (it is, unless the settlor says otherwise in the trust instrument, see *In re Estate of Larry E. Hutchinson Living Trust*, 2016 Mich App LEXIS 1311 (July 7, 2016)), and how sometimes the presence of a *spendthrift* clause in the trust can impede other planning steps, e.g., the income beneficiary

of a QTIP trust cannot assign his/her income interest in the QTIP to effectively use his/her then available applicable exemption amount by a deemed distribution of the QTIP trust's principal. [IRC 2019.] Or, how a *spendthrift* clause might prevent the trustee from loaning trust principal to the trust beneficiary since the trustee has no collateral or security interest in the trust assets.

MTC: As a reminder, the Uniform Trust Code [UTC Section 411(c)] created an optional provision that provided that a *spendthrift* clause was not presumed to be a *material purpose* of the Trust. The MTC drafters felt that the settlors of most trusts consider a *spendthrift provision* to be *material*. Thus, since it is a challenge to modify an irrevocable trust contrary to its material purpose, the presence of a spendthrift clause in a trust could preclude a judicial modification. [MCL 700.7411.]

Spendthrift Clause- Void or Voidable? A recent case from West Virginia raises yet another question about the implications of *spendthrift* clause in a trust- is an assignment or transfer of the beneficiary's interest in the *spendthrift* trust void, or only voidable? Does it really matter which it is?

Haymond Case: In *Haymond v. Haymond*, 22-621, West Virginia Supreme Court, 2024), the Court addressed these specific questions. Apparently two beneficiaries of the trust with a *spendthrift* clause transferred their interests to one of the trustees

(how did that even happen? Well, it is West Virginia, need I say more?). Twenty years later, those two same trust beneficiaries sought a declaration from a court that the transfer of their beneficial interests were void, not voidable.

Statute of Limitations: Why this is important is because a void transfer or assignment is invalid from its inception, so no statute of limitations will normally apply. A voidable transaction is one that *could* be invalidated, but only if a timely lawsuit is brought that alleges the reasons why the beneficiary's transfer should be treated as void. In short, a voidable transaction is usually subject to a statute of limitations based on when the transfer took place. In *Haymond*, the statute of limitations had long

expired if the beneficiaries' assignment was merely voidable. If their assignment 20 years earlier could be declared void by the court, that would benefit the original trust beneficiaries.

Void, not Voidable: The West Virginia Supreme Court held that the transfer of a beneficial interest that is subject to a *spendthrift* clause is void, not voidable. The Court, emphasizing the settlor's intent, went on to say:

"It is contrary to the intent of the settlor in including such a provision to render an attempted sale as merely voidable. Consistent with the logic we apply here, commentators recognize that 'a beneficiary's attempted transfer of her interest under a spendthrift trust is generally treated as void.'... As the property does not belong to the donee prior to the creation of the trust, and after the creation of the trust the donee's interest is subject to the conditions attached by the donor, creditors or transferees of the donee have no right to rely upon it for the satisfaction of their claims. Attempts to alienate interests in violation of a spendthrift provision are thus void ab initio."

Transfer to Trustee: little was said by the Court on the assignment of the beneficiaries' interests in the trust to one of their trustees, which I thought was surprising.

Conclusion: As more and more trusts are created to exist for long durations, in order to avoid the federal estate and generation skipping transfer taxes, more thought needs to go into the insertion of a *spendthrift* provision. Perhaps a better approach might be to not initially include a *spendthrift* provision in the trust instrument, but give a trust director the authority to add, or later take away, the *spendthrift* limitation. Or, simply use a *discretionary* trust, where the beneficiary is treated as not possessing any property interest in the trust.