TO: **The Honorable Lance Kinzer**
And Members of the House Judiciary Committee

FROM: **Tim O'Sullivan**
On Behalf of the Kansas Bar Association

RE: **SB 404, spendthrift and discretionary trusts**

DATE: **March 15, 2012**

Chairman Kinzer and Members of the House Judiciary Committee:

I am Tim O'Sullivan. I am an attorney in Wichita specializing in probate and trust matters. I am appearing on behalf of the Kansas Bar Association (KBA) in support of SB 404, which amends K.S.A. 58a-502(d). The Bill was proposed by the KBA Real Property, Probate and Trust Section, approved by the KBA Legislative Committee and then subsequently approved by the KBA Board of Governors.

Amendment to Kansas Uniform Trust Code (KUTC)

K.S.A. 58a-502(d), a provision in the Kansas version of the Uniform Trust Code (UTC), provides that even in the absence of a spendthrift clause, "a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion even if: (1) The discretion is expressed in the form of a standard for distribution; or (2) the trustee has abused the discretion."

Recommendation of Uniform Commissioners to Modify UTC

The Commissioners on Uniform State Laws (the "Uniform Commissioners") have expressed a concern that as such provision does not specifically address the situation in which a beneficiary is serving as sole trustee, it might be construed not to apply to a situation in which the beneficiary is serving as a sole trustee even in the circumstance where the distribution standard under the instrument is what is termed under the estate tax provisions of the Internal Revenue Code an "ascertainable standard" relating to the beneficiary's health, education, support and maintenance." Such "ascertainable standard" imposes the same substantial judicially enforceable responsibilities and restrictions on a trustee/beneficiary, particularly as to the making of trust distributions, as it does on third party trustees. If so, a creditor of such beneficiary would be able to compel a distribution the trustee/beneficiary could make to him or her under the provisions of the instrument, or even worse, ignore a spendthrift clause and directly attach the beneficiary's beneficial interest in the trust estate.

This concern is due to the possible acceptance in the courts of a 1997 "out of the mainstream" common law position of the Third Restatement of Trusts which has to date been adopted by only a very

small minority of courts, not including Kansas. Such position, which departs from all prior Restatements, would not only permit creditors to attach the beneficial interest of a beneficiary in the situation in which a beneficiary was serving as sole trustee and ignore a spendthrift clause in the instrument in the process. In determining such beneficiary's beneficial interest, it would also ignore any language in the trust instrument which would require the trustee to consider the beneficiary's outside resources before making a distribution to the beneficiary.

Thus, the Uniform Commissioners have amended the UTC to specifically provide that the trust estate would remain protected against creditors of the beneficiary in such situation and accordingly recommended that states such as Kansas, which enacted the UTC prior to inclusion of such change in the UTC by the Uniform Commissioners, should similarly amend their statutes. This Bill is in response to their call to do so.

Rationale for Amendment

Although it does not appear likely that a Kansas appellate court would adopt the extreme position of the Third Restatement, the Kansas Bar Association and its Real Property, Probate and Trust Section, as do the Uniform Commissioners, believe that the foregoing statute should be amended to ensure that such adverse construction of the statute could not possibly ensue. Indeed, at least fourteen of the approximately twenty-three states which have adopted the UTC, including our sister state of Missouri, have already made similar amendments to their statutes.

The reasons to make this amendment are several. First, public policy considerations dictate that the grantor should not be compelled to benefit creditors of the beneficiary simply because a beneficiary is serving as trustee in such situation, having the same fiduciary responsibilities and subject to the same judicial restraints as would a third party trustee. Moreover, creditors of a beneficiary should not be able to subvert the intent of the grantor or testator who created the trust instrument by diverting the trust estate in their favor, let alone unjustly expand their "taking" under the Restatement position by being able to ignore language in the trust instrument that requires the trustee to consider the beneficiary's other resources prior to making a distribution in the process of determining such beneficiary's beneficial interest in the trust estate. Creditors of the trustee would not only be taking property away from the intended beneficiary/trustee's needs, but also from other current and remainder beneficiaries of the trust as well.

Further, such potential judicial position would place the beneficiary and creditor in the factual and quite costly abyss of litigating, on an on-going situational basis, the economic value of the trustee's discretionary authority in the beneficiary's favor. Given the plethora of variations in the wording of trusts having "ascertainable standards," along with the complexities imposed by "blended trusts" which have multiple beneficiaries, it would often be a factual and legal quagmire in determining the nature or degree of a beneficiary's beneficial interest in the trust.

In addition, such adverse consequences would also extend to the possible inclusion of the trust estate in the trustee/beneficiary's taxable estate for federal estate tax purposes, despite the trust distribution provisions having an ascertainable standard which would be expected to preclude its inclusion under Section 2041 of the Internal Revenue Code. For if the trust estate was indeed exposed to the claims of the trustee/beneficiary's creditors under the Restatement position, as noted in the Uniform

Commissioner's Comments, this could well be viewed as an impermissible general power of appointment in favor of the beneficiary's creditors, exposing the trust estate to estate taxation and turning decades of estate tax planning "on its head."

Finally, the Kansas legislature, being the first state to enact the UTC, has shown a decided interest in preferring the intent of the testator or grantor first, and interests of the beneficiary second, over interests of the beneficiary's creditors, having deleted all creditor exceptions to the validity of spendthrift provisions which had been included in the "pure UTC." This Bill would ensure that such goals are not judicially compromised.

We respectfully ask that you give it your support.

On behalf of the Kansas Bar Association, I thank you for your today and would be available to respond to questions.

About the Kansas Bar Association:
The Kansas Bar Association (KBA) was founded in 1882 as a voluntary association for dedicated legal professionals and has more than 7,200 members, including lawyers, judges, law students, and paralegals. www.ksbar.org