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**Testimony of Suzanne Brown Walsh**
**Vice Chair of the Connecticut Bar Association (CBA) Estates and Probate Section**

**In Support of Raised Bill No. 1243**
***AN ACT CONCERNING SPENDTHRIFT AND DISCRETIONARY TRUSTS AND THE CLAIMS OF CREDITORS***

Judiciary Committee
February 26, 2007

Senator McDonald, Representative Lawlor, members of the Judiciary Committee: thank you for the opportunity to appear before the committee to comment on Raised Bill No. 1243, An Act Concerning Spendthrift and Discretionary Trusts and the Claims of Creditors.

My name is Suzanne Brown Walsh. I am a Principal of Cummings & Lockwood in West Hartford, am currently Vice Chair of the Connecticut Bar Association's Estates & Probate Section, a co-chair of its Uniform Laws Subcommittee, and am one of Connecticut's Commissioners on Uniform Laws. I am also past chair of the Connecticut Bar Association's Elder Law Section. On behalf of the Estates and Probate Section of the Connecticut Bar Association, I respectfully request that the Judiciary Committee act **favorably on Raised Bill No. 1243, An Act Concerning Spendthrift and Discretionary Trusts and the Claims of Creditors.**

The bill would enact crucial sections of the Uniform Trust Code (the "UTC"), initially approved by the National Conference of Commissioners on Uniform State Laws in 2000 and amended several times after that, most recently in 2005. The UTC is the first national codification of the law of trusts and has already been enacted in 19 jurisdictions (Kansas, Nebraska, Wyoming, New Mexico, District of Columbia, Utah, Maine, Tennessee, New Hampshire, Missouri, Arkansas, Virginia, South Carolina, Oregon, North Carolina and, recently, Alabama, Florida, Ohio and Pennsylvania). The CUTC is the Connecticut version of the UTC.

While the Estates and Probate Section believes it is vitally important that the entire CUTC be adopted in Connecticut during this session, we ask only that you favorably report this bill, which contains the Connecticut version of UTC Article 5, out of the Judiciary Committee. This bill contains some of the most important provisions of the CUTC governing beneficiary and creditors' rights, modified to serve as an independent statute.

The bill will provide clear statutory law in Connecticut regarding (1) spendthrift protection for trust beneficiaries, (2) the rights of a trust beneficiary's creditors to reach trust assets, (3) the rights of creditors to reach charitable funds, (4) the rights of the settlor's creditors upon the settlor's death, and (5) statutes of limitation applicable to revocable trusts upon the death of the settlor.

Spendthrift provisions, when effective, prohibit a creditor or assignee of a beneficiary from attaching a beneficiary's interest in a trust.[1] Thus, a spendthrift provision provides limited protection for funds retained in the trust, but not for funds actually distributed to the beneficiary. Minor children with enforceable child support orders are recognized as exceptions to the spendthrift bar in the bill, as under Federal Bankruptcy Code § 523(a)(5), ERISA § 206(d)(3) and the Restatement of Trusts,[2] and C.G.S. Section 52-321. The bill thus codifies existing law in this regard.

Since spendthrift protection is limited, most trusts intended to provide creditor protection are designed as discretionary trusts, which allow an independent trustee to withhold or distribute for any reason. If the beneficiary has no enforceable right to a distribution from a trust created by a third party for his or her benefit, as is the case with such fully discretionary trusts, the underlying fund is protected from claims of the beneficiary's creditors.[3] The bill retains and strengthens the protections afforded by such trusts, which can now be further reinforced with spendthrift provisions.[4]

The bill does NOT, in any way, change or limit the State's rights to recover from trusts or trust beneficiaries for public assistance paid. The state is and remains free to provide in its statutes for such recovery. Nor does the bill affect in any way the state's rights to be repaid for assistance from so-called OBRA '93 or payback special needs trusts.

The drafting committee has worked closely with representatives of the Connecticut Attorney General's office to incorporate provisions designed to protect the restricted charitable funds of Connecticut charitable organizations in the event of the organization's bankruptcy, as occurred in Connecticut recently.

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[1] Since C.G.S. Section 52-321 severely limits their use in Connecticut, it will be replaced by the bill.

[2] Restatements are a compilation of policies, existing law and trends, promulgated by the American Law Institute (ALI) on a given area of the law and are often cited by the courts when a state has no statute or other case that applies.

[3] *Corcoran v. Department of Social Services,* SC 16955 (Conn., November 9, 2004); Restatement (Second) of Trusts Section, 155(1).

[4] A discretionary trust interest can actually be attached, but the exercise is pointless because neither the creditor nor the beneficiary can force the trustee to exercise discretion. Adding a valid spendthrift provision in most jurisdictions, and under the bill, prevents such attachments altogether. Restatement (Third) of Trusts, Section 60, cmt. c; Restatement (Second) of Trusts, Sec. 147.

The bill also provides a helpful and clear procedure (virtually identical to the procedure available to the Executor of a decedent's probate estate) for trustees to settle creditors' claims after the settlor of a revocable trust dies. It recognizes that a revocable trust is usually employed as a will substitute. As such, the trust assets, following the death of the settlor, should be subject to the settlor's debts and other charges, except to the extent they are protected by C.G.S. Section 45a-472 (life insurance and retirement plan benefits). However, in accordance with traditional doctrine, the assets of the settlor's probate estate must normally first be exhausted before the assets of the revocable trust can be reached.[5]

Presently, there is no statutory procedure trustees can use to bar claims after the settlor of a revocable trust dies, nor is there a directly applicable statute of limitations on creditors' claims against trusts after the settlor's death. Thus, if the trust is to be distributed, either the trustee must somehow use the probate claims law that applies to decedents' estates, or distribute the trust assets at his peril.

Take, for example, the estate of a 36 year old mother who died after a long battle with cancer. Her entire estate, save for a $200 bank account, consisted of assets owned by the decedent's revocable trust and other non-probate assets. Her husband is aware of a disputed, two year old hospital bill for $25,000 and does not know if it was paid by insurance, or simply not pursued because of alleged medical malpractice by the hospital. In any case, her trustee cannot distribute all of her trust assets without risk of later liability for the claim and has no easy method for foreclosing it. After this bill is enacted, the trustee can follow the claims procedure currently available to probate estates and the claim can be barred or otherwise resolved within clear statutory time periods, and the trust assets distributed without a reserve for the unresolved claim.

The bill creates a simple, clear procedure for presenting and barring claims, similar to the probate one, thus facilitating the use of revocable trusts as will substitutes. It does not, however, affect spousal elective rights against revocable trusts or overrule the forty one year old *Cherniack* decision.[6]

The bill further clarifies Connecticut law by protecting trust assets subject to certain protected powers, defined in Section 9 of the bill. These are essentially withdrawal rights that are limited for tax purposes, but which are actually general powers of appointment under property law.

For example, under existing Connecticut law, it has been common for settlors to give their spouse or children limited rights to withdraw from trusts they create for them,

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[5] See Restatement (Third) of Trusts Section 25(2) cmt. e (Tentative Draft No.2, approved 1999.

[6] *Cherniack v. National Bank & Trust*, 151 Conn. 367 (1964), which holds that spousal rights to elect against a deceased spouse's will do not apply to revocable trusts. Effective, the case allows the disinheritance of one spouse by the other by means of a will substitute, funded revocable trust.

while the spouse or children are acting as trustees, because this arrangement gives the spouse or child some control over the fund while still protecting the underlying fund from estate taxes, the child's improvidence, a divorcing spouse or some other creditor. The most common example would be a beneficiary/trustee's right to distribute to himself or herself, subject to an "ascertainable standard" which is one relating to the beneficiary's health, education, maintenance or support. Without this bill, this protection may now be unavailable, because of a change made in the new Restatement of Trusts.[7] Most existing trusts are threatened by that change, which this bill corrects.

Similarly, under existing law, it is clear that trust assets subject to withdrawal powers which lapse after a specified time period are not thereafter subject to claims of the powerholder's creditors, nor do they cause the trust assets to be includible in the beneficiary-power holder's estate for tax purposes.[8] Once again the Restatement (Third) of Trusts would undermine or eliminate this result. Such powers exist in many trusts and their protected status has been codified in the bill. A very common example of this is the inter vivos irrevocable life insurance trust. These trusts typically give very limited lapsing withdrawal rights to trust beneficiaries in order to qualify the annual premium gifts to the trust for the $12,000 gift tax annual exclusion. Without the enactment of this bill these trusts may now be subject to the claims of the beneficiary's creditors and includible in the beneficiary's taxable estate for federal estate tax purposes.

In addition, the bill mirrors New York and Florida laws which clarify that a trustee's power to reimburse a settlor for income taxes on trust income does not subject the entire trust to the claims of the settlor's creditors (see Rev. Rul. 2004-64). Until this provision (Section 6(a)(4)) is enacted, Connecticut practitioners are likely to continue to counsel clients to establish certain irrevocable trusts in those states, instead of in Connecticut.

The bill is designed to maintain our current state property laws, the present tax rules and benefits of certain withdrawal rights used in irrevocable trusts, and does not modify or alter our existing common law.

Thank you again for this opportunity to comment on Raised Bill No 1243. On behalf of the Estates and Probate Section of the Connecticut Bar Association, I respectfully request that the Judiciary Committee act favorably on Raised Bill No.1243, An Act Concerning Spendthrift and Discretionary Trusts and the Claims of Creditors.

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[7] See Restatement (Third) of Trusts, § 60, Comment g.

[8] Restatement, Property 2d (Donative Transfers) Section 13.1.