How to Draft Distribution Standards for Discretionary Dynasty Trusts

By reversing common law regarding the asset protection behind a discretionary trust, the Restatement Third has made drafting discretionary dynasty trusts unclear. But estate planners have several options, as the second part of this three-part article explains.

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In 2005, *The Wall Street Journal* reported that U.S. personal trust assets grew to $1.19 trillion, nearly doubling from $658.71 billion in 1998 based on a study from VIP Forum, a research group.[2] In early 2008, some speculated that the personal trust assets held by public trust companies may well be close to $1.3 trillion. As a side note, *The Wall Street Journal* reports that $100 billion in trust business has left states that failed to be competitive with the top trust jurisdictions (e.g., Alaska, Delaware, Nevada, South Dakota—listed in alphabetical order).[3] Part of this increase in trust business may well be attributed to the public learning about the advantage of leaving a child's inheritance in trust. This second part of a three-part article discusses the asset protection benefits behind a discretionary trust. (Part 1 of this article, which analyzed the nine keys to drafting a discretionary dynasty trust and introduced the three common methods of drafting these trusts, appeared in the last issue of ESTATE PLANNING.[4])

Two main types of asset protection under common law

There are primarily two types of asset protection under American common law: (1) discretionary trust protection and (2) spendthrift protection.[5] Discretionary trust protection originated under English common law and has nothing to do with spendthrift protection. Rather, it is based on the fact that a beneficiary does not have an enforceable right to a distribution,[6] and therefore, no creditor may stand in the shoes of a beneficiary. In this respect, the beneficiary's interest is not a property interest[7] and is nothing more than an expectancy that cannot be attached by any creditor.[8]

Conversely, spendthrift protection began in America approximately 125 years ago. It has never been accepted by the English courts. Under American law, except for certain debts such as for child support, alimony, governmental claims, and necessary expenses of a beneficiary (i.e., exception creditors), a spendthrift clause protects against creditors of the beneficiary attaching the assets at the trust level and forcing a distribution in satisfaction of the creditor's claim.

While almost all discretionary trusts contain (and should contain[9])

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a spendthrift clause, when one reads the cases, the case analysis never gets that far. Rather, the beneficiary did not have either an enforceable right to a distribution or a property interest, and because the beneficiary held nothing, no creditor (not even an exception creditor) could stand in the beneficiary's shoes. Hence, no creditor could reach the beneficiary's interest by forcing a distribution or attaching the beneficiary's interest.[10]

Law is now in a state of flux

English common law, the Restatement of Trusts ("Restatement First"), the Restatement (Second) of Trusts ("Restatement Second"), as well as almost all case law on point were relatively consistent, and estate planners could draft a discretionary distribution standard with relative certainty so that a beneficiary did not have an enforceable right to a distribution and the beneficiary did not hold a property interest.

Unfortunately, with almost no case law to support its position, the Restatement (Third) of Trusts ("Restatement Third") *reverses* how a court should interpret a distribution standard so that it will almost always create an enforceable right in a discretionary trust. Many estate planners believe that the Uniform Trust Code ("UTC") follows the Restatement Third's position regarding this issue.

In response to this problem created by the Restatement Third, states are beginning to enact statutes codifying the Restatement Second in this area. Unless your state is one of the states that, by statute, has addressed the issues created by the Restatement Third, the result is a great degree of uncertainty regarding how one should draft the discretionary distribution language.

This second part of a three-part article analyzes the law and distribution language for a common law discretionary trust as developed under (1) the Restatements (First and Second) of Trusts, (2) the Restatement (Third) of Trusts, (3) the Uniform Trust Code, and (4) some state statutes in lead trust jurisdictions. This article then suggests some drafting options for practitioners not so fortunate as to be in a state that has provided a Restatement Second solution by statute. However, before we begin this discussion, it is imperative to understand why it is so critical not to create an enforceable right with a discretionary trust.

Enforceable right issues in divorce

There are three divorce issues when a beneficiary has an enforceable right to a distribution. The first issue applies to almost all discretionary dynasty trusts, and the second issue will most likely in the future be applied to trusts where the beneficiary has an enforceable right. The third of these issues will be discussed in Part 3 (the final installment) of this article (which will appear in the next issue of ESTATE PLANNING), and applies *only* if inheritance or the appreciation on one's inheritance is classified as marital property.

Estranged spouse suing through a grandchild beneficiary. A discretionary dynasty trust is frequently recommended by estate planners when lurking in the background is an estranged spouse who would attempt to extract part of a former spouse's inheritance. For this reason, many estate planners advise clients to create a discretionary dynasty trust under common law to protect a child's inheritance from an estranged spouse. Under common law, a discretionary beneficiary does *not* have a right to force a distribution. (See note 33 for very limited circumstances when a court could review a trustee's discretion.) Conversely, under the Restatement Third, most—if not all—discretionary beneficiaries *have* a right to force a distribution pursuant to the undefined continuum of discretionary trusts. Consequently, an estranged spouse standing in the shoes of a minor beneficiary (i.e., grandchild) can demand a distribution from the trust.

Imagine the predicament this places the estate planner in. Prior to the Restatement Third, the minor grandchild had no right to force a distribution, and the estate planner had told his or her clients this. Now, even though the estranged spouse of the child is not an exception creditor,[11] the estranged spouse now has a right to stand in the shoes of the minor grandchild, and demand a distribution on behalf of the minor grandchild. It is suggested that should a child's

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1 "The Modular Approach to Estate Planning" is trademarked by Mark Merric.

2 Silverman, "Demystifying Trust Funds," Wall St. J., p. B1 (12/24/05).

3 Silverman, "Looser Trust Laws Lure $100 Billion," Wall St. J., p. D1 (2/16/05).

4 See Merric, "How to Draft Discretionary Dynasty Trusts — Part 1," 36 ETPL 3 (Feb. 2009).

5 There is actually a third type of asset protection under common law where a trustee may make distributions based only on the purpose of the trust. For example, if a trust is only for educational or support purposes, a creditor may not reach the beneficiary's interest, unless the creditor's claim is for education or support. Restatement (Second) of Trusts, section 154 ("Restatement Second"). The fourth type of asset protection is based on inseparable interests. Restatement Second, section 161.

6 Restatement Second, section 155(1) and comment (1)b.

7 See *infra* note 42.

8 See *infra* note 43.

9 Absent a spendthrift provision, Uniform Trust Code ("UTC") section 501 allows any creditor to attach present and future distributions of any trust, including a discretionary trust. The Restatement (Third) of Trusts ("Restatement Third") also takes this position. This is a change from the majority rule as discussed in note 43, *infra*. Conversely, four UTC states have kept the common law rule. See *infra* note 53.

10 See *infra* note 43.

11 In these circumstances, the estranged spouse is not bringing an alimony claim or a child support claim. Rather, the estranged spouse is bringing a claim based on the child's rights to a distribution from the trust.

estranged spouse ever bring such an action, let alone be successful with such an action, the estate planner would most likely have a very angry settlor/client if he or she did not lose the client forever.

Second divorce issue. Making an analogy to special needs trusts, if a beneficiary has an enforceable right, the income and trust assets are imputed to the beneficiary, regardless of whether the beneficiary has received any distribution. Why wouldn't the same logic apply for alimony and child support?

Whether this unbridled expansion of judicial power is overstated can be seen in the case of *Dwight v. Dwight*.[12] The facts of the case are as follows: Upon dad's death, 60% of the estate went to his two daughters outright, and the other 40% of the estate went to the son in a trust. The trust was discretionary, and provided that the trustee make distributions of income and principal as the trustee deemed necessary or desirable for the support, comfort, maintenance, or education of the beneficiaries. It appears the court interpreted this to be a discretionary standard. The beneficiaries were the husband (the son) and the husband's issue. During the nine years prior to the Massachusetts Appellate Court decision, the trust made one discretionary distribution in the amount of $7,000 to the husband. Also, during this period, the trust corpus grew from $435,000 to $984,000.

Based on this finding, the trial judge stated that it was highly likely that the main reason the husband received his inheritance in trust, rather than outright like his two siblings, was to defeat a claim for alimony. The trial court further found the husband had access to additional funds at any time he desired based on two facts:

1. The broad purposes for which the trustee may make payments to the husband.[13]
2. A statement the husband made to the trustee that he did not need any additional money.

The trial court found that the husband's earnings from the discretionary trust should be imputed for the purpose of alimony. The Massachusetts Court of Appeals agreed with the trial court. Without any discussion, the appeals court decision dismissed the husband's contentions that the trust was a discretionary trust and could not be reached by an exception creditor (i.e., for alimony). Rather, the opinion cites the Restatement Third section 59 (Ten. Draft No. 2, 1999) as authority that a spouse can reach the assets of a discretionary trust for alimony.

As discussed below, the strong majority rule was that no creditor, not even an exception creditor, was allowed to attach a discretionary trust until the Restatement Third and Uniform Trust Code reversed this common law principle.[14] Because neither the common law nor the Restatement Second

[12] 756 N.E.2d 17 (Mass. Ct. of App., 2001).

[13] The trust provided that the trustee could make distributions to both the husband and his issue of "so much of the annual net income and principal of the trust property as the trustee may deem to be necessary or desirable for the support, comfort, maintenance, education or benefit of such beneficiary or beneficiaries." The trial court and the appellate court thought the word "benefit" was overly broad. The author disagrees with this apparent result-oriented decision. Almost all discretionary trusts use broad distribution standards. In fact, in New York, the asset protection benefits of a discretionary trust may be lost if the distribution standard is limited to an ascertainable standard. See *infra* note 38.

[14] See *infra* note 43.

would support the result desired by the Massachusetts court, the court cited the Restatement Third. Once the court found exception creditor status, it used a "dominion and control" argument to impute alimony of $2,600 a month, which is $31,200 a year on a trust where the fair market value of the assets was only $984,000 and there were multiple beneficiaries. The author is aware of no other case where a court has held that (1) telling the trustee that you do not need a distribution, and (2) a broad discretionary distribution standard would even begin to justify a holding of dominion and control.

Conversely, as discussed below under Restatement Third, there is a much stronger argument supporting the imputation of trust income for alimony or child support. Does a beneficiary of a trust have an enforceable right to demand a distribution? If so, and the beneficiary does not make the request, why wouldn't a court impute income for child support or alimony? This is the same conclusion regarding an available resource that is applied to trusts when someone qualifies for Medicaid or other governmental benefits. If a beneficiary has an ability to force a distribution, must he or she do so? Under common law, a beneficiary of a discretionary trust has no such right so there was no income imputation issue. However, this is not the case under the Restatement Third, as discussed below.

Settlor estate inclusion issues resulting from enforceable rights

In addition to the divorce issues created when a beneficiary holds an enforceable right, there is an estate inclusion issue for spousal lifetime access trusts ("SLATs") as well as self-settled estate planning trusts. First, if a spouse who is listed as a beneficiary has no ability to force a distribution (i.e., no enforceable right to a distribution), the settlor has not created an inter vivos trust for the purpose of satisfying a support obligation. This is the common law rule for a discretionary trust, and the reason there is no estate inclusion issue for this type of SLAT.[15]

On the other hand, if the spouse does have the ability to force a distribution for support or maintenance, the settlor also has the ability to force the trustee to use the trust property for the settlor's support obligation, and there is an estate inclusion issue.[16] This estate inclusion issue may be mitigated by including distribution language that provides that the trustee must look to the beneficiary's resources, including the settlor's obligation of support.[17] Unfortunately, looking to a beneficiary's resources may well defeat the purpose of creating a SLAT in the first place (so distributions could be made through the spouse), because the amount that may be distributed would be severely limited.[18] For this reason, discretionary dynasty trusts are generally drafted with distribution language which states that a beneficiary, including the settlor's spouse, does not have an enforceable right to a distribution.

A self-settled estate planning trust also has estate inclusion issues if the settlor/beneficiary may force a distribution. A self-settled estate planning trust is a trust in which the settlor is one of the beneficiaries; the trust is sited in a domestic or offshore asset protection jurisdiction, and the settlor hopes the transfer will be treated as a completed gift and excluded from the settlor's estate. If the settlor may force a distribution from the trust, he or she has a retained interest under Section 2036. Therefore, these trusts must be drafted as common law discretionary trusts, in which the settlor/beneficiary does not have an enforceable right to a distribution.[19]

Common law discretionary trust-support trust distinction

For creditor purposes, common law divided trusts into two main categories: (1) a support trust, where the asset protection depends primarily on spendthrift protection; and (2) a discretionary trust where the nature of the beneficiary's interest provides the asset protection.[20]

Support trust. A support trust under common law was created by the settlor to support one or more beneficiaries. A support trust directs the trustee to apply the trust's income and/or principal as is necessary for the support, maintenance, education, and welfare of a beneficiary.[21]

15 Estate of Chrysler, 44 TC 55 (1965); Estate of Douglass, 143 F.2d 961, 32 AFTR 1108 (CA-3, 1944). Also see Lettice, 237 F. Supp. 123, 15 AFTR2d 1286 (DC Cal., 1964), as applied to minor dependent children.

16 First Nat'l Bank of Montgomery, 211 F. Supp. 403, 11 AFTR2d 1751 (DC Ala., 1962). Estate of Lee, 33 TC 1064 (1960); Estate of Dwight, 205 F.2d. 298, 44 AFTR 48 (CA-2, 1953); Estate of Richards, TCM 1965-263. Also see Estate of Gokey, 72 TC 721 (1980). *Gokey* is not a spousal access trust case. However, a settlor also has an estate inclusion issue if he or she creates a trust that satisfies an obligation to support minor children. The case is used in this article as an analogy of the same issue to illustrate the distribution language of a support trust.

17 Ltr. Rul. 8504011 and Colonial-American Nat'l Bank, 243 F.2d 312, 51 AFTR 80 (CA-4, 1957). There is further tangential authority supporting the position that looking to the beneficiary's resources solves the estate inclusion issue under Ltr. Rul. 8113079.

18 For a detailed discussion of this issue, see Merric and Goodwin, "Spousal Access Trusts—The Good, the Bad, and the Ugly—Parts I through III," Steve Leimberg's LISI Estate Planning Newsletter #1334, #1352, and #1379 (8/20/08, 10/14/08, 12/2/08, respectively), www.leimbergservices.com.

19 For a detailed discussion of this issue, see Merric, "Estate Inclusion Issues of Reciprocal Trusts and Self-Settled Estate Planning Trusts, The Doctrine of Reciprocal Trusts Part V," Steve Leimberg's LISI Estate Planning Newsletter #1339 (9/5/08); Merric, "Estate Inclusion Issues of Self-Settled Estate Planning Trusts, Parts I through II," Steve Leimberg's LISI Estate Planning Newsletter (11/13/08 and 1/6/09).

20 See *supra* note 6.

21 First Nat'l Bank of Maryland v. Dept. of Health and Mental Hygiene, 399 A.2d 891 (Md., 1979); Restatement Second, section 154.

The beneficiary of a support trust can compel the trustee to make a distribution of trust income or principal merely by demonstrating that the money is necessary for his or her support, maintenance, education, or welfare.[22] The magical language for a support trust is something similar to:

> The Trustee *shall* make distributions of income or principal for the beneficiary's *health, education, maintenance,* and *support.*

Implicit in this support language are two components: (1) a command that the trustee "shall" make distributions;[23] and (2) under what standard or circumstances (i.e., health, education, maintenance, and welfare) distributions are to be made. In addition to the mandatory language of distribution, the trustee is given a standard for making distributions, which may be reviewed by a court for reasonableness. Typically, the standard contains words such as "health, education, maintenance, and support." However, such standard may also include terms such as "comfort and welfare."[24] Furthermore, a support trust gives the trustee discretion *only* with regard to the time, manner, or size of distributions needed to achieve a certain purpose, such as support of the beneficiary.[25]

Courts have determined that the following language created a support trust:

- "[T]he trustee *shall* pay...[to the settlor's] daughters such reasonable sums as shall be needed for their *care, support, maintenance, and education*" [emphasis added].[26]
- "[T]he Trustee *shall* use a sufficient amount of the income to provide for the grandchild's *support, maintenance and education*" [emphasis added].[27]
- "[T]he trustee shall administer the trust estate for the benefit of my wife and my said daughter, or the survivor of either, and the trustee *shall* apply the income in such proportion together with such amounts of principal as the trustee, it its discretion, deems advisable for the *maintenance, care, support and education* of both my wife and my said daughter" [emphasis added].[28]

Asset protection behind a support trust. The asset protection behind a support trust is, for the most part, limited to spendthrift protection.[29] A spendthrift clause provides that a beneficiary may not alienate his or her interest, and a creditor may not attach such interest. The Restatement Second provided for the following four exception creditors to a support trust that could attach the trust assets and force a distribution:

1. Child support and alimony.
2. Necessary expenses of a beneficiary.
3. Attorney's fees.
4. Governmental claims.[30]

While the Restatement Second and Restatement Third listed all four exception creditors, for the most part, the only exception creditor that obtained approximately 50% adoption by the states was the child support exception creditor.[31] The other exception creditors, such as necessary expenses of a beneficiary and governmental claims, were accepted by states on a less frequent basis, and attorney's fees were adopted by courts in only two or three states. While a spendthrift clause prevents all but exception creditors from attaching a trust, a beneficiary still has an enforceable right to a distribution, and the "enforceable right" issues previously discussed in this article remain unprotected by spendthrift provisions.

22 Chenot v. Bordeleau, 561 A.2d 891 (R.I., 1989); Eckes v. Richland County Social Services, 621 N.W. 2d 851 (N.D., 2001); Restatement Second, section 128 and comments d and e; *id.*

23 Lineback by Hutchens v. Stout, 339 S.E.2d 103 (N.C. App., 1986).

24 For estate tax purposes, the "welfare" standard would result in the trust failing the definition of an ascertainable standard. However, for the definition of a support trust, it is included within the ascertainable standard. Further, in some cases, language such as "comfort and general welfare" will also take the trust language outside that of a general support trust. Lang v. Com., Dept. of Public Welfare, 528 A.2d 1335 (Pa., 1987); Restatement Second, section 154 and comments thereto. But see, Bohac v. Graham, 424 N.W.2d 144 (N.D., 1988).

25 Eckes v. Richland County Social Services, *supra* note 22.

26 In re Carlson's Trust, 152 N.W.2d 434 (S.D., 1967).

27 McElrath v. Citizens and Southern Nat'l Bank, 189 S.E.2d 49 (Ga., 1972).

28 McNiff v. Olmsted County Welfare Dept., 176 N.W.2d 888 (Minn., 1970).

29 But see, *supra* note 5.

30 Restatement Second, section 157; Restatement Third, section 59.

31 Begleiter, "In the Code We Trust," 49 Drake L. Rev. 165 (2001), at footnote 276.

Discretionary trust. In determining whether a distribution standard resulted in the classification of the trust as a discretionary trust, courts have used some of the following four factors in order of importance:

1. Words of uncontrolled discretion.
2. Permissive language.
3. No requirement of equality.
4. Standard of distribution was not ascertainable.

Words of uncontrolled discretion. The use of the words "sole," "absolute," "unfettered," or other words of uncontrolled discretion were the most important factor resulting in the classification of a discretionary trust.[32] The Restatement Second referred to using any of these words in the distribution standard as a grant of "extended discretion." These words meant that the settlor wished the court to review the trustee's discretion *only* if the trustee acted dishonestly or with an improper motive, or failed to use his or her judgment.[33]

Permissive language. Generally, a discretionary trust uses permissive language—for example, the word "may" instead of the word "shall."[34] Some courts have placed greater emphasis on the discretionary nature of a trust with words such as "may" v. "shall."[35]

No requirement of equality. Other courts have noted that when the uncontrolled discretion is combined with the ability to discriminate among beneficiaries, there is little, if any question, that the settlor intended to create a discretionary trust.[36]

Standard is not ascertainable. Some courts have noted that words such as "comfort and general welfare" may not be capable of judicial determination, and that this language may remove a trust from being classified as a support trust.[37] In general, New York[38] requires that the distribution standard cannot be ascertainable for a discretionary trust.

Under common law, except for the three to four "hybrid states" (Ohio, Connecticut, possibly Pennsylvania, and formerly Iowa),[39] the following language would create a "purely or wholly" discretionary trust:

> My Trustee may pay to or apply for the benefit of any one or more of the beneficiaries listed in Section 1.07 as much of the net income and principal as the trustee determines in his sole and absolute discretion for his or her health, education, maintenance, support, comfort, general welfare, an emergency, or happiness. The Trustees, in their sole and absolute discretion, at any time or times, may exclude any of the beneficiaries or may make unequal distributions among them.

Many times in this literature, authors use the term "purely or wholly" discretionary trust to mean a trust where the trustee has been granted extended discretion under the Restatement Second and/or the beneficiary has neither an enforceable right to a distribution nor a property interest. Except in the three or four hybrid states, a "purely or wholly" discretionary trust would almost always have a standard for making distributions.

Asset protection behind a common law discretionary trust. The typical or purely discretionary trust allows the trustee complete and uncontrolled discretion to make allocations of trust funds if and when it deems appropriate.[40] If the beneficiary cannot force a distribution[41] and does not have a property interest,[42] no creditor can stand in the shoes of the beneficiary and

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32 Restatement Second, section 187, comment j.

33 Restatement Second, section 187 comment j and section 122. While this is not the judicial standard of review adopted by all courts, it is by far the most common judicial review standard for discretionary trusts, with courts from 14 states and two countries using it. Colorado—In re Marriage of Jones, 812 P.2d 1152 (Colo., 1991); In re Guinn, 93 P.2d 568 (Colo. App., 2004). Connecticut—Auchincloss v. City Bank Farmers Trust Co., 70 A.2d 105 (Conn., 1946). Iowa—In re Estate of Tone, 39 N.W.2d 401 (Iowa 1949); Wright v. Wright, 2002 WL 1071934 (Iowa App., 2002) (not cited for publication). Illinois—Croslow v. Croslow, 347 N.E.2d 800 (Ill. App., 1976). Kansas—Simpson v. State, Dept. of Social and Rehabilitation Services, 906 P.2d 174 (Kan. App., 1995); Kansas Dept. of Social and Rehabilitation Services, 866 P.2d 1052 (Kan., 1994). Maryland—First Nat'l Bank of Maryland v. Dept. of Health & Mental Hygiene, *supra* note 21. Massachusetts—Town of Randolph v. Roberts, 195 N.E.2d 72 (Mass., 1964). New York—Vanderbilt Credit Corp. v. Chase Manhattan Bank, N.A., 473 N.Y.S.2d 242 (1984). Ohio—In re Ternansky's Estate, 141 N.E.2d 189 (Ohio, 1957); Culver v. Culver, 169 N.E. 486 (Ohio, 1960); Thomas v. Harrison, 191 N.E.2d 862 (Ohio, 1962). Oregon—Barnard v. U.S. Nat'l Bank, 495 P.2d 766 (Or. App., 1972). Pennsylvania—Lang v. Com., Dept. of Public Welfare, *supra* note 24. Rhode Island—Chenot v. Bordeleau, *supra* note 22. South Dakota—SDCL § 55-1-43(3). Texas—Ridgell v. Ridgell, 960 S.W.2d 144 (Tex. App., 1997). England—Re Trafford's Settlement: Moore v. Inland Revenue Commissioners, 1 All E.R. 1108 (Ch. D.) 1984. Canada—Minister of Community & Social Services v. Henson, C.C.L. 3069 (Ont. C.A.) (because trustees have unfettered discretion as to whether to pay income or principal to handicapped beneficiary, beneficiary cannot compel payment, so beneficiary has no "liquid assets" that disqualify him for an allowance as a disabled); In re Maw, 1 D.L.R. 365 (Man.) 1953.

34 State ex. rel. Secretary of SRS v. Jackson, 822 P.2d 1033 (Kan., 1991).

35 Tidrow v. Director, Division of Family Services, 668 S.W.2d 912 (Mo. Ct. App., 1985); Matter of Henry's Estate, 565 P.2d 1166 (Wash., 1977); Lineback by Hutchens v. Stout, *supra* note 23; LaSalle Nat'l Bank, 636 F.Supp. 874, 58 AFTR2d 86-5298 (DC Ill., 1986); Delano, 182 F. Supp. 2d 1020, 88 AFTR2d 2001-7071 (DC Colo., 2001).

36 Dryfoos v. Dryfoos, 2000 WL 1196339 (Conn. Super., 2000) (unreported case); McNiff v. Olmstead County Welfare Dept., *supra* note 28; First Northwestern Trust Company of South Dakota, 622 F.2d 387 (CA-8, 1980); Matter of Brooks' Estate, 596 P.2d 1220 (Colo. App., 1979); Hamilton v. Drogo, 150 N.E. 496 (Ct. App. N.Y., 1926).

37 Bohac v. Graham, *supra* note 24.

38 Estate of Escher, 420 N.E. 91 (Ct. App. N.Y., 1981).

39 In Ohio, Connecticut, and in certain circumstances Pennsylvania, any standard creates an enforceable right in a beneficiary. Iowa's status as a hybrid trust state was reversed by § 633A.4702 of the Iowa Trust Code.

40 First Nat'l Bank of Maryland v. Dept. of Health and Mental Hygiene, *supra* note 21.

41 In re Horton, 668 N.W.2d 208 (Minn. App., 2003) (noting no property interest or enforceable right); Carlisle v. Carlisle, 1994 WL 592243 (Super. Ct. Conn., 1994); Lauricella v. Lauricella, 565 N.E.2d 436 (Mass., 1991); Baltrusis v. Baltrusis, 2002 WL 31058635 (Wash. App., 2002) (unreported case); In re Marriage of Jones, *supra* note 33; State v. Rubion, 308 S.W.2d 4 (Tex., 1957).

has no right of recovery. No creditor, not even an exception creditor, may attach a discretionary trust interest.[43] A beneficiary has nothing more than a mere expectancy.[44] An "expectancy is the bare hope of succession to the property of another, such as may be entertained by an heir apparent. Such a hope is inchoate. It has no attribute of property, and the interest to which it relates is at the time nonexistent and may never exist."[45]

Third Restatement's rewrite of common law

The Restatement Second focuses on the grant of extended discretion to determine whether a beneficiary has an enforceable right. Absent the settlor's clear intent to the contrary, the use of the words "sole," "absolute," or "unfettered" discretion will almost always result in the classification of the trust as a discretionary trust. In this respect, regardless of whether a trust contained a standard capable of judicial interpretation or incapable of judicial interpretation, the trust would be classified as a discretionary trust, and a beneficiary would not have an enforceable right.

Restatement Third abolishes the discretionary-support distinction. Even with hundreds of cases supporting the discretionary-support distinction under common law, the Restatement Third—with virtually no authority to support its position—abolished the discretionary-support trust distinction.[46] The comments to the Restatement Third give the following reason for ignoring virtually almost all common law on point.

> Not only is the supposed distinction between support and discretionary trusts arbitrary and artificial, but the lines are also difficult—and costly—to attempt to draw. Attempting to do so produces dubious categorizations and almost inevitably different results (based on fortuitous differences in wording or maybe a "fireside" sense of equity) from case to case for beneficiaries who appear, realistically, to be similarly situated as objects of similar settlor intentions.[47]

This author must simply disagree with the Reporter's conclusions. First, while there are a couple of hundred cases under the discretionary-support distinction, most of these cases are trusts seeking to qualify for governmental benefits, usually Medicaid. They did not include any special needs or luxury language commonly found in today's Medicaid or special needs trusts. Furthermore, the settlor may well have originally intended to provide the beneficiary with an enforceable right to a distribution. However, now the beneficiary wishes to qualify for governmental benefits, and now argues that it was

[42] A couple of UTC proponents take the position that all trust interests, including a discretionary interest, are property interests. The great majority of common law discretionary trust cases disagree and hold that a discretionary interest is not a property interest. This nonproperty interest distinction is important, because if a discretionary beneficiary does not hold a property interest, no creditor may attach such interest. See *infra* note 43. Colorado—In re Marriage of Jones, supra note 33; Ramey v. Rizzuto, 72 F. Supp. 2d. 1202 (DC Colo., 1999), Delano, *supra* note 35. Connecticut—Dryfoos v. Dryfoos, *supra* note 36; In re Britton, 300 B.R. 155 (Bankr. D. Conn., 2003). Florida—Florida UTC § 736.0504, recognizing that a beneficiary's interest may not be a property interest with the words "if any" and "might have" added by the 2007 amendment. Illinois—In re Pritzker, 2004 WL 414313 (Ill. Cir. 2004) (not reported). Indiana—Grimm, 865 F. Supp. 1303, 74 AFTR2d 94-7011 (DC Ind., 1994). Kansas—In re Pechanec, 59 B.R. 899 (Bkrtcy. D. Kan., 1986). Massachusetts—D.L. v. G.L., 811 N.E.2d 1013 (Mass. App., 2004). Minnesota—O'Shaughnessy, 517 N.W.2d 574 (Minn., 1994). Missouri—M.S. 456.5-504. New Jersey—Pulizzoto, 1990 WL 120670, 71A AFTR2d 93-3829 (DC N.J., 1990) (not reported). New York—In re Duncan's Will, 362 N.Y.S.2d 788 (N.Y. Surr., 1974). Ohio—In re Eley, 331 B.R. 353 (Bkrtcy S.D. Ohio, 2005), Bankruptcy § 541(c)(2). Pennsylvania—Lang v. Com., Dept. of Public Welfare, *supra* note 24. South Dakota—First Northwestern Trust Co. of South Dakota, *supra* note 36, and SDCL § 55-1-43. Texas—Bass v. Denney, 171 F.3d 1016 (CA-5, 1999); In re Watson, 325 B.R. 380 (Bkrtcy. S.D. Tex., 2005); In re Shurley, 171 B.R. 769 (Bkrtcy. W.D. Tex., 1994). Tennessee—In re Cassada, 86 B.R. 541 (Bkrtcy. E.D. Tenn., 1988); Bankruptcy § 541(c)(2). In addition to the areas of special needs trusts, marital dissolution, federal tax liens, and the above cases, a discretionary interest is not a property interest under bankruptcy law. See Kansas, Ohio, and Tennessee cited above. With the adoption of the UTC in Kansas, Pennsylvania, and Tennessee, these states may have created a property interest in all discretionary trusts. See discussion under the "Uniform Trust Code" in the text and notes 43 and 53. Even though the majority opinion holds that a common law discretionary interest is not a property interest, a discretionary beneficiary still has an equitable interest to enforce the terms of the trust. Farmers State Bank of Fosston v. Sigellingson & Co., 16 N.W.2d 319 (Minn., 1944). Restatement Second, section 199.

[43] Again, certain UTC proponents incorrectly state that a creditor may attach a discretionary trust interest under common law. These UTC authors miscite section 157.4 of 2A *Scott & Fratcher on Trusts* for authority. Section 157.4 is about spendthrift trusts and support trusts. It does not apply to discretionary trusts, which are covered in section 155. The majority opinion, as illustrated by the following cases, again disagrees with these UTC proponents. *Majority Rule Prior to the UTC*—Bass v. Denney, *supra* note 42 ("A universal canon of Anglo-American trust law proclaims that when the trustee's powers of distribution are wholly discretionary, the beneficiary has no ownership interest in the trust assets." The court further held that a creditor could not attach a discretionary interest, nor could a trustee be required to give 72 hours' notice before a distribution is made.). California—In re Canfield's Estate, 181 P.2d 732 (Cal. App., 1947). Colorado—Delano, *supra* note 35 ("However, such a lien cannot attach to property in which the taxpayer has no 'property' interest. *Aquilino v. United States*, 363 U.S. 509, 512, 80 S.Ct. 1277, 4 L.Ed.2d 1365 (1960); *Carlson*, 580 F.2d at 1369."). In re Marriage of Jones, *supra* note 33 (In a discretionary trust, "neither the corpus nor the income may be reached by his [a beneficiary's] creditors until a distribution occurs." Further, the court states, "the interest in a discretionary trust is not assignable and cannot be reached by his or her creditors." Citing Bogert, *Trusts*, § 41 (6th ed. 1987)). Connecticut—Spencer v. Spencer, 802 A.2d 215 (Conn. App., 2002); also see Foley v. Hastings, 139 A. 305 (Conn., 1927). District of Columbia—Morrow v. Apple, 26 F.2d 543 (CA-D.C., 1928). Iowa—In re Estate of Tone, *supra* note 33; Kifner v. Kifner, 171 N.W. 590 (Iowa, 1919); Roorda v. Roorda, 300 N.W. 294 (Iowa, 1941). It is uncertain whether Iowa's Trust Code now allows attachment of a discretionary trust. ICA § 633A.2302 provides for certain exception creditors, but ICA § 633A.2305 provides that these exception creditors may not force a distribution. The Iowa Trust Code is silent on whether they may attach a discretionary interest. Illinois—First of America Trust Co., 1993 WL 327684, 72 AFTR2d 93-5296 (DC Ill., 1993) (not reported). Kansas—Watts v. McKay, 162 P.2d 82 (Kan., 1945). The Kansas UTC has reversed this case holding. K.S.A. § 58a-501. Kentucky—Calloway v. Smith, 186 S.W.2d 642 (Ky., 1945); Davidson's Ex'rs v. Kemper, 79 Ky. 5, 1880 WL 7269 (1880); Todd's Ex'rs v. Todd, 86 S.W.2d 168 (Ky. App., 1935). Maryland—First Nat'l Bank of Maryland v. Dept. of Health & Hygiene, *supra* note 21. Massachusetts—Brown v. Lumbert, 108 N.E. 1079 (Mass., 1915); Iasigi v. Shaw, 45 N.E. 627 (Mass., 1897); Morel v. Cornell, 125 N.E. 575 (Mass., 1920).

the settlor's intent to create a discretionary interest.

Second, as previously noted, there were only three to four hybrid states. These states took the position that any standard created an enforceable right to a distribution, regardless of the presence of the other three discretionary factors. All other states with discretionary trust cases followed a Restatement Second analysis as modified by the three common law factors discussed above. These factors were not arbitrary or artificial; rather, they were guidelines for estate planners to accomplish the settlor's intent when drafting a common law discretionary trust.

Third, the Reporter's proposed solution is much worse than the Reporter's perceived problem under almost all common law. As noted above, the Reporter does not believe in categorizations based on the distribution language. What guidance does the Restatement Third offer for drafting a discretionary trust that does not create an enforceable right to a distribution or a property interest? Unfortunately, the answer is, "virtually none."

Instead, the Restatement Third creates a "continuum of discretionary trusts," where a trial court judge who has much less knowledge about the subject than almost any drafting estate planning attorney will decide how much of an enforceable right each beneficiary possesses.

The following quotations from the Restatement Third detail the new interpretation of discretionary trusts articulated by the Restatement Third.

- "A transferee or creditor of a trust beneficiary cannot compel the trustee to make discretionary distributions if the beneficiary personally could not do so."[48] At first glance, it appears that the Restatement Third is following common law. Nevertheless, the sentence immediately following the above sentence, for almost all purposes negates the above sentence. It states, "It is rare, however, that the beneficiary's circumstances, the terms of the discretionary power, and the purposes of the trust leave the beneficiary so powerless."[49]
- "Reasonably definite or objective standards serve to assure a beneficiary some minimum level of benefits, even when other standards are included to grant broad latitude with respect to additional benefits."[50] In other words, similar to the hybrid line of discretionary-support trust cases in Ohio, Connecticut, and to a lesser extent Pennsylvania, the Restatement Third adopts this distinct minority position.
- Even if a trust does not include a standard, under the Restatement Third the beneficiary is *not* safe. "It is not necessary, however, that the terms of the trust provide specific standards in order for the trustee's good-faith decision to be found unreasonable and thus constitute an abuse of discretion."[51] The Restatement Third goes further to the most likely imputation of a distribution standard if there is no standard or guideline when it states, "Sometimes trust terms express no standards or other clear guidance concerning the purpose of a discretionary power, or about the relative priority intended among the various beneficiaries. Even then a general standard of reasonableness or at least good-faith judgment will apply to the trustee (comment b), based on the extent of the trustee's discretion, the various beneficial interests created, the beneficiaries' circumstances and relationships to the setttlor, and the general purposes of the trust."[52]
- Reporter comment under section 60(a) states, "The fact of the

Michigan—Miller v. Dept. of Mental Health, 442 N.W.2d 617 (Mich., 1989). Minnesota—O'Shaughnessy, *supra* note 42 ("Under Minnesota law, the beneficiary of a discretionary trust . . . does not have property or any right to property in the nondistributed principal or income before the trustees have exercised their discretionary power." Later, the opinion states, "Creditors who stand in the shoes of the beneficiary, have no remedy against the trustee until the trustee distributes the property." Therefore, a federal tax lien could not attach to the discretionary trust.). New Hampshire—Anthorne v. Anthorne, 128 A.2d 910 (N.H., 1957). The New Hampshire UTC has reversed this case holding. N.H. Rev. Stat. §§ 564-B:5-501 and 504). Ohio—Domo v. McCarthy, 612 N.E.2d 706 (Ohio, 1993) ("the discretionary nature of the substituted trust prevents creditors, including Domo, from attaching James Stouffer, Jr.'s interest in the James Stouffer, Sr. trust."). Also, see In re Eley, *supra* note 42 (noting a discretionary trust is equally effective against creditors as a spendthrift provision is). Morris v. Daiker, 172 N.E. 540 (Ohio App., 1929). Pennsylvania—Keyser v. Mitchell, 67 Pa. 473 (1871) "Where the amount results from the discretion of the trustee, and that discretion is personal, no sum, economic benefit, exists to be attached." This case has been reversed by the Pennsylvania UTC. 20 Pa. Code § § 7741 and 7744. Rhode Island—Petition of Smyth, 139 A. 657 (R.I., 1927) ("If the trustees have discretion to withhold income from the beneficiary, he has no vested interest and the income can neither pass by assignment nor be reached by the creditors . . ."). South Carolina—Collins v. Collins, 122 S.E.2d 1 (S.C., 1961). This case has been reversed by the South Carolina UTC. S.C. Code 1976 § § 62-7-501 and 504. Tennessee—In re Elsea, 47 B.R. 142 (Bkrtcy. Tenn., 1985) ("A debtor's interest in a discretionary trust is free from the claims of his creditors because the trustee's discretion as to whether to make payments deprives the beneficiary of any interest that can be anticipated. Restatement (Second) Trusts § § 154 and 155 (1959)." This case has been reversed by the Tennessee UTC. Tenn. Code § § 35-15-501 and 504. Texas—Bass v. Denney, cited above as the majority rule. Other cases are In re Watson, supra note 42; Texas Commerce Bank Nat. Assn., 908 F. Supp. 453, 76 AFTR2d 95-7292 (DC Tex., 1993). Although the UTC in Kansas, New Hampshire, Pennsylvania, South Carolina, and Tennessee has reversed these states' case law that prevented a creditor from attaching a discretionary interest in trust, the following UTC states have modified the national UTC so that a creditor could not attach a discretionary interest: Florida—Fla. Stat. § 736.0501 and § 736.0504; Missouri—M.S. 456.5-504; Ohio—Ohio R.C. 5805.03 for its definition of a very limited wholly discretionary trust; Wyoming—Wyo. Stat. § 4-10-504. In addition to the above four UTC states, lead trust jurisdictions also preventing the attachment of a discretionary interest by statute are: Delaware—12 Del. Code § 3536; South Dakota—SDCL § 55-1-26(2).

44 O'Shaughnessy, *supra* note 42; In re Marriage of Jones, *supra* note 33; Medical Park Hosp.

matter is that there is a continuum of discretionary trusts, with the terms of the distributive powers ranging from the most objective (or 'ascertainable,' IRC 2041) of standards (pure 'support') to the most open ended (e.g., 'happiness') or vague ('benefit') of standards, or even with no standards manifested at all (*for which a court will probably apply 'a general standard of reasonableness'*)." [Emphasis added.] In other words, it is the Third Restatement's view that a "reasonableness standard" of review should be applied to most discretionary trusts, regardless of whether or not the trustee is granted "sole," "absolute," or "unfettered" discretion.

After reviewing the above quotations as well as reading sections 50 and 60 (including comments and Reporter comments), it becomes quite apparent that "it is rare, however, that the beneficiary's circumstances, the terms of the discretionary power, and the purposes of the trust leave the beneficiary so powerless" that such beneficiary cannot force a minimal distribution. In other words, the Restatement Third adopts the hybrid state law regarding the creation of an enforceable right and a property interest in almost all discretionary trusts that contain a standard.

Worse yet, even if there is no standard, the Restatement Third suggests that a standard should be imputed based on a standard of reasonableness or possibly good faith. The Restatement Third provides no guidance for how an estate planner should draft a discretionary trust in which a beneficiary has neither an enforceable right to a distribution nor a property interest.

Uniform Trust Code

At their 7/18/06 estate planning teleconference, Roy Adams and Charles Redd both agreed that the UTC substantially broadened the rights of creditors over common law. A couple of Roy Adams statements are as follows:

> Trusts are used so often on a spendthrift reason alone Clary; at least I see in my practice the children receive certain property outright at a certain point in time, but something is held back that others can't reach—third parties, and those rules have been substantially weakened. A discretionary trust is not treated like under common law where discretion does not give them any property right, but under statutory law of the UTC where it is a property right.
>
> Everyone in our state [Missouri] believed that before we enacted the UTC in our state, which became effective January 1, 2005, that there was a huge distinction with regard to creditor's rights between discretionary and support trusts.

Roy Adams did not elaborate on why the UTC created a property right in a discretionary trust. However, this author is aware of two possible reasons why the UTC would create a property interest: (1) reversing common law, the UTC allows for the attachment of a discretionary trust by exception creditors; and/or (2) similar to the Restatement Third, the UTC creates an enforceable right to a distribution. In order for a creditor to attach a discretionary interest, the creditor would need some type of property interest to attach. The national version that was adopted by 17 UTC states[53] allows attachment, and this should create a property interest in these states. Conversely, four UTC states specifically preclude attachment of a discretionary interest.[54]

The second issue of whether, similar to the Restatement Third, the UTC created an enforceable right to a distribution in almost all discretionary trusts, has been hotly debated. Prior to the 2005 amendments, this author would have concluded that this was the case. After the 2005 amendments where the National Conference of Commissioners on Uniform State Laws withdrew partially from their original position, this author would agree with Mark Worthington's analysis of the Uniform Trust Code presented at the 2006 NAELA annual conference[55] that a court could do one of the following:

v. Bancorpsouth, 2004 WL 965927 (Ark., 2004); In re Horton, *supra* note 41; Estate of Johnson, 198 Cal. App. 2d 503 (Cal. App., 1961); In re Canfield's Estate, *supra* note 43; 12 Del. Code § 3536(f); SDCL § 55-1-43. Rather than using a property analysis, some courts will find that the beneficiary's interest has no ascertainable value. Miller v. Dept. of Mental Health, *supra* note 43; Henderson v. Collins, 267 S.E.2d 202 (Ga., 1980); In re Dias, 37 B.R. 584 (DC Idaho, 1984); First Northwestern Trust Company of South Dakota, *supra* note 36.

45 Dryfoos v. Dryfoos, *supra* note 36.

46 Many estate planners have voiced the concern that a Restatement is supposed to be exactly that, "a restatement of the law," not the creation that a small group of people would like the law to become.

47 Restatement Third, section 60, Reporter's Note to comment a.

48 Restatement Third, section 60, comment e.

49 *Id.*

50 Restatement Third, section 50, comment on subsection (2): d., first paragraph.

51 Restatement Third, section 50, comment on subsection (1): b., third paragraph last line.

52 Restatement Third, section 50, comment on subsection (2): d., second paragraph.

53 The following UTC states allow attachment of a discretionary interest: Alabama—Ala. Code 1975 § § 19-3B-501 and 504; Arkansas—Ark. Stat. § § 28-73-501 and 504; Arizona—Ariz. Rev. Stat. § § 14-10503 and 10504; District of Columbia—D.C. Code § 19-1305.01; Kansas—K.S.A. § 58a-501; Maine—18-B M.R.S. § 501; Nebraska—Neb. Rev. Stat. § § 30-3847 and 3849; New Hampshire—N.H. Rev. Stat. § § 564-B:5-501 and 504; New Mexico—N.M.S. 1978 § § 46A-5-501 and 504; North Carolina—N.C. G.S. § § 36c-5-501 and 504; North Dakota—NDCC § § 59-13-01 and -04; Oregon—O.R.S. § 130.300; Pennsylvania—20 Pa. Code § § 7741 and 7744; South Carolina—S.C. Code 1976 § § 62-7-501 and 504; Tennessee—Tenn. Code § § 35-15-501 and 504; Utah—Utah Code 1953 § § 75-7 501 and 504; Virginia—Va. Code § § 55-545.01 and 504. While the District of Columbia, Kansas, and Oregon have all eliminated UTC section 504, section 501 allows any creditor to attach a trust that does not contain a spendthrift clause. Conversely, Florida, Missouri, Ohio, and Wyoming prevent the attachment of a discretionary interest. See *supra* note 43.

54 See *supra* note 43 and note 53.

1. Follow the Restatement Third, which creates an enforceable right in almost all discretionary trusts;
2. Follow the comments to section 814 of the UTC, which also most likely will result in creating an enforceable right in a discretionary trust;
3. Completely miss discussing the issues presented under Article 5, section 814(a) and the comments thereunder; or
4. Follow the common law of the state.[56]

Rather than rehashing these previous discussions, the author notes that many UTC states have attempted to and continue to make changes in their statutes to address these asset protection issues.[57] Regarding the enforceable right issue, the Missouri and proposed Michigan Uniform Trust Codes provide that the beneficiary of a discretionary trust has neither an enforceable right nor a property interest.[58]

The Florida, Missouri, Ohio, and Wyoming UTCs do not allow any creditor to attach a discretionary interest.[59] While not directly mentioned in the Florida statute, the Legislative Position Request Form notes the reason for the 2007 modification to section 504 of the Florida Trust Code was to recognize that a beneficiary's discretionary interest may not be a property interest.[60] Finally, the Arizona UTC provides that a court will look to the Restatement Second for interpretation, not the Restatement Third when interpreting that state's trust code. As far as statutes addressing the enforceable right issues, the author finds the proposed Michigan UTC Article 5 and section 814 provide the best UTC solution. The Missouri UTC provides the second best solution.[61]

'Clear as mud'

The problems created by the Restatement Third's rewrite of trust law were best summarized in the title of a discretionary distribution standard seminar at the Texas Bar Association's 32nd Annual Estate Planning and Probate Seminar titled "Clear as Mud." As noted by Al Golden, "Where under virtually all common law and under the First and Second Restatement there was reasonable guidance on how to draft a discretionary trust so that the beneficiary did not have an enforceable right or a property interest, the same is not true under the continuum of discretionary trusts proposed by the Restatement (Third) of Trusts. Rather, the Restatement (Third) of Trusts attempts to create an enforceable right in almost all trusts, and drafting out of this problem is as clear as mud."

Whether the UTC creates the same issues that the Restatement Third does is hotly debated. Conversely, neither those expressing concerns about the UTC nor proponents of the UTC disagree that a judge could apply the Restatement Third position regarding enforceable rights in interpreting the UTC. So how does an estate planner draft a discretionary trust so that there is not an enforceable right or a property interest? One solution would be to forum shop to a state that, by statute, has codified discretionary trust law under the Restatement Second.

Statutory responses by lead trust jurisdictions. South Dakota was the first state to adopt a comprehensive discretionary-support trust statute modeled after the Restatement Second.[62] This statute (1) defines a discretionary distribution interest, (2) provides that a discretionary interest is neither an enforceable right nor a property interest, and (3) follows the Restatement Second's judicial review standard for a discretionary trust. Similar to the Arizona UTC, South Dakota's Discretionary-Support Trust Act states

55 Worthington, "The Impact of the Uniform Trust Code on Third Party Special Needs Trusts," 2006 NAELA Annual Conference.

56 While states will fall into the four alternatives, the author would most likely find the first two alternatives as the most likely outcome in a UTC state. Conversely, in the only special needs trust case decided under the UTC, In re Pohlman, 710 N.W.2d 639 (Neb., 2006), at first blush one might conclude that the Nebraska Supreme Court followed option four. However, Doug Stein, who spoke with Mark Worthington at the 2006 NAELA conference on the UTC, confirmed with the defendant's counsel that neither the state nor counsel were aware of the changes made by the Restatement Third or the UTC, and none of these issues were presented to the court. Further, the Nebraska Supreme Court miscited the Restatement Third, stating that it provided for discretionary and support trusts. Actually, the Nebraska Supreme Court erred; the Third Restatement abolished this distinction. In this respect, it appears that the Nebraska Supreme Court, the appellate court, and the trial court missed all of the issues (option 3) and then followed their own state law.

57 An abbreviated discussion of some of these changes follows. The Maine UTC deleted two sections from section 504, and the Maine comment says "because, among other things, of a desire to preserve the common law distinction between discretionary and support trusts." 18-B M.R.S. § 504. Wyoming defines a discretionary and support trust, and then abolished the good faith judicial review standard under section 814. North Carolina and South Carolina define a discretionary trust under section 501. Alabama, Tennessee, and Virginia carve out exceptions attempting to protect special needs trusts. Ohio created a very limited "wholly discretionary trust." Kansas eliminated UTC sections 503 and 504. Arkansas eliminated section 503. Both Oregon and the District of Columbia eliminated UTC section 504.

58 M.S. 456.5-504; Proposed Michigan UTC § 504.

59 See *supra* note 43.

60 The Legislative Fact sheet states, "These changes are intended to clarify that the protection given to discretionary trusts trumps the rights given to exception creditors in § 736.0503(2) and that it includes not only the inability to compel distributions but the right to attach a beneficiary's interest or expectancy in a trust. Reference to 'if any' and 'might have' in (2)(b) is intended to avoid any implication that the beneficiary of a purely discretionary trust has an interest more than a mere expectancy."

61 As noted under the "Lead trust jurisdictions" portion of this article, there are three parts to codifying the discretionary asset protection provided by the Restatement Second: (1) defining a discretionary trust interest, (2) stating the legal effect of a discretionary interest (i.e., the beneficiary does not have an enforceable right or a property interest), and (3) providing a judicial review standard that does not create an enforceable right. The proposed Michigan UTC does all of this. The Missouri UTC covers only the second issue, which is the most important of the three issues.

62 SDCL § 55-1-23 through § 55-1-43.

"the Legislature does not intend the courts to consult the Restatement (Third) of the Law of Trusts Articles § 50, § 56, § 58, § 59, or § 60...."[63] Also, when addressing the judicial standard of review, Delaware Code § 3315(a) provides that a court shall apply section 187 of the Restatement Second, not sections 50 and 60 of the Restatement Third.

Drafting language

Absent a statute that (1) defines a discretionary distribution interest, (2) states that a discretionary interest is not an enforceable right or a property interest, and (3) has a judicial review standard consistent with the Restatement Second for a discretionary trust,[64] estate planners must draft under the possibility that a court may apply the Restatement Third, regardless if there is very little case law to support many of its creditor positions. In this respect, the conservative approach would be to use a very discretionary distribution standard. The author suggests the following language as some of the most discretionary distribution language that he has used.

> My Trustee may distribute as much of the net income and principal as my Trustee, in its sole, absolute, and unfettered discretion, determines to any beneficiary listed in Section 1.07. My Trustee, in its sole, absolute, and unfettered discretion, at any time or times, may exclude any of the beneficiaries or may make unequal distributions among them. Also, my Trustee, in its sole discretion may distribute all of the income and principal of this Trust to one of the beneficiaries and exclude all other beneficiaries from any of the Trust Property. When making distributions, my Trustee may, in its sole, absolute, and unfettered discretion may, but need not, consider a beneficiary's income or other resources that are available to the beneficiary outside of the trust and are known to the Trustee. The power to make a distribution in my Trustee's sole, absolute, and unfettered discretion includes the power to withhold making a distribution to any beneficiary in my Trustee's sole, absolute, and unfettered discretion.
>
> In keeping with the wholly discretionary nature of this trust and all separate trusts created hereunder, no beneficiary, except as regards to any irrevocable vesting in the beneficiary's favor, shall have any ascertainable, proportionate, actuarial or otherwise fixed or definable right to or interest in all or any portion of any trust or its property. It is my intent that the Trustee have all of the discretion of a natural person, and that a distribution beneficiary holds nothing more than a mere expectancy. It is also my intention that the above language be interpreted as to provide my Trustee with the greatest discretion allowed under law.
>
> Distributions made to a beneficiary under this Article shall not be considered advances and shall not be charged against the share of such beneficiary that may be distributable under other provisions of this agreement. Any undistributed net income shall be accumulated and added to the principal of the trust.

Some corporate trustees may be reluctant to accept a trust with such discretionary language. They may correctly note that the above language gives them absolutely no guidance on how to make distributions. Conversely, some corporate trustees may have the reverse reaction and gladly accept the trust. These corporate trustees will note that there is very little likelihood of a beneficiary ever challenging the trustee's distribution discretion. For the type of discretionary dynasty trusts discussed in this series of articles, the settlor, the settlor's spouse, or a beneficiary holds a removal-replacement power over the trustee. Therefore, settlors or beneficiaries seldom, if ever, have any concerns with the great amount of discretion that is granted to the trustee.

Conclusion

More and more, parents are leaving their children's inheritance in trust. The trend toward drafting discretionary dynasty trusts continues to grow as many estate planners realize the benefits of these trusts. Part 1 of this article discussed the nine keys to drafting a discretionary dynasty trust. One of the more important keys is that a discretionary distribution standard does not create an enforceable right or a property interest. Estranged spouses are not able to use grandchildren as a method of reaching a beneficiary's inheritance.

By reversing common law regarding the asset protection behind a discretionary trust, the Restatement Third has made drafting discretionary dynasty trusts as "clear as mud." States are beginning to solve these Restatement Third problems by adopting statutes that codify the Restatement Second. However, most of us cannot wait to draft trusts until our state adopts a statute that fixes the problems created by the Restatement Third. In this respect, an estate planner is left with the option of (1) forum shopping to one of the lead trust jurisdictions or (2) using the most discretionary distribution standard language possible.

Part 3 of this three-part article (which will appear in the next issue of ESTATE PLANNING) will discuss another key aspect regarding the asset protection provided by dynasty provisions, but not by spendthrift protection. Part 3 will also cover the dominion and control issues that, if violated, allow any creditor to pierce a trust, regardless of whether it is discretionary or whether there are any spendthrift provisions. ■

63 SDCL § 55-1-25.

64 See *supra* note 33.