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SPENDTHRIFT TRUSTS

IN GENERAL

BY the general rule the beneficiary of a trust may alienate his interest freely. He may transfer this interest in part or in whole, *inter vivos* or by will, for consideration or without. A *cestui que trust* is possessed of the ability to transfer his equitable interest to the same extent that he has the power to transfer a comparable legal interest.¹ Furthermore, the *cestui's* creditors may cause an involuntary alienation of his interest in order to satisfy the debts by him to them.² Therefore, the interest is not only voluntarily transferable, but also involuntarily transferable; that is, it is susceptible to execution to satisfy the claims of the beneficiary's creditors.

A settlor or donor of a trust is often desirous of providing a fund in order to maintain the beneficiary and to protect the fund against a beneficiary's improvidence or incapacity. The settlor thus wishes to create a trust with provisions restricting the alienation of the trust fund by the voluntary act of the beneficiary, or involuntarily, by the beneficiary's creditors. This he may do in most jurisdictions, and such trusts in which the interest of the *cestui* cannot be transferred by him or reached by his creditors, have been dubbed by the somewhat inappropriate name, spendthrift trusts. The name is an anomaly inasmuch as the personal financial habits or the incapacity of the *cestui que trust* are unimportant.³ A trust may be set up for a beneficiary who is a com-

¹ Chase v. York County Savings Bank, 89 Tex. 316, 35 S. W. 406 (1896); McNeill v. Masterson, 79 Tex. 67, 15 S.W. 673 (1891); Woodward v. Snow, 233 Mass. 267, 124 N. E. 35 (1919); Zelley v. Zelley, 101 N. J. Eq. 37, 136 Atl. 738 (1927); Warmesrey v. Tanfield, 1 Ch. Rep. 29 (1628); RESTATEMENT TRUSTS §§ 132, 135, 140 (1935).

² Hoover v. First Nat. Bank, 192 S. W. 1149 (Tex. Comm. App. 1917); Chase v. York County Savings Bank, 89 Tex. 316, 36 S. W. 406 (1896).

³ Adams v. Williams, 112 Tex. 469, 248 S. W. 673 (Tex. Comm. App. 1923); Wagner v. Wagner, 244 Ill. 101, 91 N. E. 66 (1910); RESTATEMENT TRUSTS § 152, Comment (g) (1935).

pletely competent person. In fact, the beneficiary may be a trustee under the terms of the trust instrument.⁴ However, the settlor himself may not be a beneficiary under the trust.⁵ In such a case a restraint on voluntary or involuntary alienation is void.

The question immediately arises as to the validity of a restraint upon the alienation of the beneficiary's interest. Certainly a restraint on the alienation of a legal estate is usually held invalid, and in England this rule has prevailed with respect to the spendthrift trust, as evidenced by the leading case of *Brandon v. Robinson*.⁶ There a father devised and bequeathed real and personal property upon trust to pay the income to his son for life, and after the son's death to pay the principal to his next of kin. A spendthrift clause was inserted to the effect that such income "should not be grantable, transferable, or otherwise assignable, by way of anticipation of any unreceived payment or any part thereof."⁷ After the death of the testator the son became a bankrupt, and the assignee in bankruptcy brought suit to reach the beneficiary's interest under the trust. It was held that the restraint on alienation was ineffective and that the assignee in bankruptcy could reach the interest. However, it was recognized that a forfeiture for alienation would be valid. In other words, there could be inserted in a trust instrument words stating that the beneficiary's interest should be terminated if the beneficiary should attempt to transfer his interest, or his creditors should attempt to reach it, or he should become bankrupt. Such a provision would be upheld, for in such instance there is no attempt to permit the beneficiary to continue to hold and enjoy the interest notwithstanding his

⁴ *Neely v. Brodgen*, 139 S. W. 192 (Tex. Comm. App. 1922) : It is stated at Section 152, comment (m) of the *Restatement of Trusts*, "The rule stated in this section [as to validity of spendthrift trusts] is applicable even though the beneficiary or one of the beneficiaries is one of several trustees, or one of several beneficiaries is the sole trustee. A person, however, cannot be both sole beneficiary and sole trustee of a trust."

⁵ *Brown v. MacGill*, 87 Md. 161, 39 Atl. 613 (1898) ; SCOTT ON TRUSTS, § 156 (1939) ; RESTATEMENT TRUSTS § 156 (1935).

⁶ 34 Eng. Rep. 379 (1811).

⁷ *Ibid.*

transfer or his failure to pay his creditors. A spendthrift provision inserted in a trust for a married woman was also distinguished, and it was stated that such a restraint would be valid, for a married woman was not *sui juris*. Since equity made her the owner of the interest and permitted her to alien, equity might also limit her power over the interest by permitting a restriction.

Thus, the English rule denies the validity of restraints upon alienation and declares them to be void in the absence of a gift over in case of transfer of the interest by the *cestui* or insolvency of the beneficiary. However, most American courts, including the courts of Texas,⁸ have taken a contrary view recognizing the validity of a provision in a trust restraining the alienation of the interest of the *cestui*, thus preventing his interest from being reached by creditors and preventing voluntary alienation. The Massachusetts court, in *Broadway National Bank v. Adams*⁹ expresses the American view. In this case the plaintiff instituted a bill in equity to reach the income of a trust, created for the defendant during his life free from the interference or control of his creditors. The settlor further stated his intention that the use of the income should not be anticipated by assignment. The court in upholding the spendthrift provision recognized but rejected the common law rule to the effect that there may not be attached to a transfer of property a condition that it shall not be alienated. The common law view was that "by such a condition the grantor undertakes to deprive the property in the hands of the grantee of one of its legal incidents and attributes, namely its alienability, which is deemed to be against public policy."¹⁰

The court in refuting the common law rule reasoned as follows:

"By the creation of a trust like the one before us, the trust property passes to the trustee with all its incidents and attributes unimpaired.

⁸ *Estes v. Estes*, 255 S. W. 649 (Tex. Civ. App. 1923); *aff'd*, 267 S. W. 709 (Tex. Comm. App. 1924); *Gamble v. Dabney*, 20 Tex. 69 (1875).

⁹ 133 Mass. 170 (1882).

¹⁰ *Id.* at 171.

He takes the whole legal title to the property, with the power of alienation; the *cestui que trust* takes the whole legal title to the accrued income at the moment it is paid over to him. Neither the principal nor the income is at any time inalienable."¹¹

The court held that the settlor could give the beneficiary a restricted estate by providing that such beneficiary could not alienate it by anticipation and that his creditors could not reach it through any process of law or equity. The court was of the belief that since the donor was the absolute owner of the property, that he could dispose of it as he desired with any limitations thereon not repugnant to law. Restrictions providing against the improvidence or ill-fortune of the beneficiary were not contrary to the general welfare even in the face of the rule of public policy which subjects a debtor's property to the payment of his debts. It was further believed that there was no element of fraud on the creditors of the beneficiary because as stated:

"... creditors have no right to reply on property thus held and to give him [the beneficiary] credit upon the basis of an estate which, by the instrument creating it, is declared to be inalienable by him, and not liable for his debts. By the exercise of proper diligence they can ascertain the nature and extent of his estate, especially in the Commonwealth where all wills and most deeds are spread upon the public records"¹²

CREATION OF SPENDTHRIFT TRUSTS

In order to bring about the creation of a spendthrift trust, it is not necessary that the settlor use any specific or particular form of words. However, it is said that the language or wording of the trust instrument itself must show an intent to restrain alienation of the beneficiary's interest.¹³ It is not difficult to determine the creation of such a trust when express words are used. For example, it might be stated in the trust instrument that the income

¹¹ *Id.* at 172.

¹² *Id.* at 173.

¹³ *Jones v. Ready*, 27 U. S. 642 (1926); *Nunn v. Titché-Goettinger Co.*, 245 S. W. 421 (Tex. Comm. App. 1922).

to the beneficiary during his life is to be free from the interference or control of creditors and is not to be paid out by way of anticipation or assignment. The settlor may express that the income shall be paid to the beneficiary for life without his having the power to sell, assign, pledge, mortgage or otherwise dispose of such income previous to its payment to him, and that such income shall not be subject to liability for his debts. Again, the trust instrument may provide simply that the income shall be paid to the beneficiary and to no one else whether claiming by his authority or otherwise. In each instance a spendthrift trust is created.

If the settlor manifests an intent in express terms that the beneficiary should be restrained from a voluntary alienation, those words may also show an intention that the interest should not be subject to the demands of his creditors. Conversely, the settlor may impose in express language a restraint only upon involuntary alienation of the beneficiary's interest, and at the same time evince an intent to restrain a voluntary alienation.¹⁴

A question arises as to the validity of a provision in the trust which restrains involuntary alienation, but permits voluntary alienation of the *cestui's* interest. Such a provision has been held effective to preclude resort by the trustee in bankruptcy to the interest of the beneficiary where there was no restraint on voluntary alienation, but the trust instrument declared that the interest of a life beneficiary should be free from the interference or control of the beneficiary's creditors.¹⁵ The Supreme Court seemed to indicate in its opinion, however, that there was an implied restraint on voluntary alienation also. It would seem that to permit voluntary alienation and to protect the interest from the claims of creditors would be contrary to sound public policy, but it has been permitted by some courts.¹⁶

¹⁴ *Berry v. Dunham*, 202 Mass. 133, 88 N. E. 904 (1909); *Nickerson v. Van Horn*, 181 Mass. 562, 64 N. E. 204 (1902).

¹⁵ *Boston Safe Deposit & Trust Co. v. Luke*, 220 Mass. 494, 108 N. E. 64 (1915); *aff'd. sub. nom. Eaton v. Boston Safe Deposit & Trust Co.*, 240 U. S. 427 (1916).

¹⁶ *Scott*, *op. cit. supra* note 5, at § 152.3.

If the interest may be so protected from involuntary alienation, it would certainly seem that the converse of the situation would be permitted. That is, an instance wherein the trust makes no provision to exempt the equity from the claims of creditors, but does restrict voluntary alienation would seem permissible. It is apparent that there would be less objection to permitting restraint upon voluntary transfer than in a provision preventing his creditors from subjecting it to claims. A rather peculiar situation might arise where there is a provision against voluntary transfer and none against involuntary alienation and the beneficiary assigns his interest for value. In such a case, since the assignee may not actually reach the interest under the assignment, he is still entitled to recover the amount thus paid as a creditor of the beneficiary, since under the trust there is no restraint on the subjecting of the beneficiary's interest to the claims of creditors.¹⁷

As has been stated, there is no rigid formula by which to evidence the creation of a spendthrift trust. The settlor must manifest the desire to restrain the transfer of the *cestui's* interest, and such intent must appear from the terms of the trust. The general rule is that extrinsic evidence is not admissible to show the settlor's intention to create such a trust. If there is no intention manifested in the trust instrument the *cestui* cannot offer evidence that the donor actually intended to create a spendthrift trust, since he, the *cestui*, was improvident or wasteful.¹⁸ Courts have, however, found an intention to impose restraint where there was very little to indicate such an intent in the the trust instrument. The Texas courts seem to have gone further still, permitting extrinsic evidence to show such intent where there was nothing in the trust instrument manifesting it. For example, where there was no intimation in the instrument that a spendthrift trust was to be created, the courts have taken into consideration the fact that the beneficiary was improvident or that a father (settlor) was obsessed

¹⁷ *Ibid.*

¹⁸ RESTATEMENT TRUSTS § 152, Comment (f) (1935).

with the idea that a son (beneficiary) would waste the property.¹⁹ However, it has also been held in Texas that there must be words in the instrument to the effect that the settlor intended to create a spendthrift trust.²⁰ Therefore, there would seem to be conflict upon this point, but it is obvious that the Texas courts have been very liberal and are apt to find the intention to impose restraint on alienation. Even in the absence of language making the interest of the beneficiary inalienable, the courts find an intent to restrain alienation if the trust property is to be used for the support of the beneficiary or if the trust instrument gives to the trustee uncontrolled discretion as to the amounts to be paid to the *cestui*.²¹

RESTRAINT ON ALIENATION OF INCOME AND RESTRAINT ON ALIENATION OF PRINCIPAL

The ordinary spendthrift trust provides for restraint on the alienation of the income. It is usually stated that the beneficiary is entitled to the income from the trust property for life, or for a term of years, that he may not dispose of his right to future income may not be subjected to the claims of his creditors. In such instance the income which is to accrue in the future is not subject to voluntary or involuntary alienation. If the beneficiary assigns or makes a contract to assign this restricted interest, the assignment is ineffective and the contract is not specifically enforceable, although the beneficiary will be personally liable for breach of contract. Nevertheless, income which has accrued and has actually been paid to the beneficiary by the trustee may be freely transferred or reached by his creditors.²² On the other hand, in-

¹⁹ *Linsey v. Rose*, 175 S. W. 829 (Tex. Civ. App. 1915); *Patten v. Herring*, 9 Civ. App. 640, 29 S. W. 388 (1895).

²⁰ *Nunn v. Titcher-Goettinger*, 245 S. W. 421 (Tex. Comm. App. 1922).

²¹ However such trust would either be a trust for support or a discretionary trust and is to be distinguished from a spendthrift trust since in the former "it is the nature of the beneficiary's interest rather than a provision forbidding alienation which prevents the transfer of the beneficiary's interest." *RESTATEMENT TRUSTS* § 154 (1935).

²² *SCOTT, op. cit. supra* note 5, at § 152.5; *GRISWOLD, SPENDTHRIFT TRUSTS* § 370 (1936); *RESTATEMENT TRUSTS* § 152 comment (j) (1935).

come accrued and received by the trustee, which has not yet been paid to the *cestui*, is still subject to the restraint. It may not be reached by creditors until paid over to the *cestui* and until that time he may not assign.²³ However, if the *cestui* assigns his right to this income received by the trustee but not yet paid, such assignment has been held effective as a revocable authorization to the trustee. If the trustee pays the income as it accrues to the assignee before revocation of the assignment, the beneficiary is unable to force the trustee to pay again and cannot recover the amount from the assignee.²⁴ It has been determined by some authority that the assignment is valid, not only as to income accrued at the time of the assignment, but also as to future income which accrued before the assignment was revoked by the beneficiary.²⁵

The contention has been made that the spendthrift trust can preserve the beneficiary's right to future income only and that protection cannot be extended to his right to future principal. In other words, may alienation of the beneficiary's right to future principal be restrained? There has been conflict on this question in jurisdictions recognizing the validity of restraint as to future income. The reluctance of courts to extend the spendthrift doctrine to the right to receive principal has been based upon the idea that there should be no restraint on alienation of the actual corpus of the trust, the ownership itself.²⁶ The situation is analogous to an attempted restraint on the alienation of a fee simple in land law, which is prevented by a strong rule of public policy.

The issue presents itself in the following types of cases:

1. Under the terms of the trust the beneficiary is entitled to have the trust property paid or conveyed to him immediately, or

²³ *Boston Safe Deposit & Trust Co. v. Luke*, 220 Mass. 484, 108 N. E. 64 (1915), *aff'd sub nom. Eaton v. Boston Safe Deposit & Trust Co.*, 240 U. S. 427 (1916).

²⁴ *Matter of Perlmutter*, 156 Misc. 571, 282 N. Y. Supp. 282 (1935); *Keelers' Estate*, 334 Pa. 225, 3 A. (2d) 413 (1939).

²⁵ *Matter of Lynch*, 151 Misc. 549, 272 N. Y. Supp. 79 (1934); *Matter of Bechtoldt*, 148 Misc. 8, 266 N. Y. Supp. 408 (1933).

²⁶ *Scott, op. cit. supra* note 5, at § 153.

at any time he may request. An attempted restraint on alienation of the principal in this case is invalid.²⁷

2. Under the terms of the trust a beneficiary is entitled to the principal after a certain period but is not entitled to the income during the period. For example, X conveys to A in trust, income to be paid to C for life, and at C's death the principal to be conveyed to D. A restraint on alienation is placed on D's interest so that a voluntary transfer cannot be made and creditors may not reach it in legal or equitable proceedings. The conclusion has been reached that public policy forbids a restraint on D's right to receive the principal,²⁸ but some jurisdictions, including Texas, have reached a differing view.²⁹

3. Under the terms of the trust the beneficiary is entitled to the income for a certain period and at the expiration of that period the principal is to be paid to him or his estate. A restraint is imposed on the alienation of the beneficiary's interest in both income and principal. Generally, the restraint on the income is held to be effective, but the restraint on the beneficiary's interest in the principal is held to be ineffective.³⁰ A minority of states, again including Texas, have determined that the restraint upon both principal and income is valid.³¹

SPENDTHRIFT TRUST INVALID AS TO CERTAIN CLAIMANTS

Although a spendthrift provision in a trust instrument protects the beneficiary's interest as to claims of creditors, particular

²⁷ Morgan's Estate (No. 1), 223 Pa. 228, 72 Atl. 498 (1909); RESTATEMENT TRUSTS § 151, comment (b) (1935); *but see contra* Darling v. Dodge, 200 Iowa 1303, 306 N. W. 266 (1925).

²⁸ RESTATEMENT TRUSTS § 151, comment (c) (1935).

²⁹ Caples v. Buell, 243 S. W. 1066 (Tex. Comm. App. 1922); Haskell v. Haskell, 234 Mass. 442, 125 N. E. 601 (1920); see SCOTT *op. cit. supra* note 5, at § 153.2 for discussion on this point.

³⁰ Vellacott v. Murphy, 16 F. (2d) 700 (C. C. A. 5th 1927) *cert denied*, 273 U. S. 767 (1927); Clark v. Clark, 121 Tex. 165, 46 S. W. (2d) 658 (1932); Caples v. Ward, 107 Tex. 341, 179 S. W. 856 (1915); RESTATEMENT TRUSTS § 153 (1935)

³¹ Caples v. Buell, 243 S. W. 1066 (Tex. Comm. App. 1922); Erickson v. Erickson, 197 Minn. 71, 266 N. W. 161, 267 N. W. 426 (1936); Beck's Estate, 133 Pa. 51, 19 Atl. 842 (1890); see SCOTT *op. cit. supra* note 5, at § 153.3 for discussion on this point.

classes of claimants have been permitted to reach the interest of the *cestui*. It would seem that the wife and children of the beneficiary should be able to subject his interest to claims for support, on the ground that it was not the intention of the settlor to exempt the interest from their claims.³² Even when the settlor did intend to exclude them, it has been held that the wife and children could enforce their claims for support, inasmuch as public policy demands that the beneficiary should not be enabled to enjoy the income and refuse to support his dependents.³³ Some cases, however, have reached a contrary view by construing the trust instrument in such a way as to make no exception to the spendthrift provisions.³⁴ Claims for necessary services rendered to the beneficiary or supplies furnished to him are excluded, however, since the purpose of a spendthrift trust is to protect the beneficiary against his own improvidence, and a claim for necessaries does not derogate from such purpose but furthers it.³⁵ Claims for services rendered the beneficiary in the protection of his interest in the trust estate itself may be enforced, even though the interest is subject to a spendthrift provision.³⁶ Certainly claims of the government, such as claims for unpaid taxes, may be enforced against the beneficiary's interest.³⁷ Moreover, it would seem that a tort creditor would be able to reach the interest.³⁸

In an instance where the income is payable to a beneficiary

³² *Keller v. Keller*, 284 Ill. App. 198, 1 N. E. (2d) 773 (1936); *Thomas v. Thomas*, 112 Pa. Super. 578, 172 Atl. 36 (1934).

³³ *Ibid*; RESTATEMENT TRUSTS § 157 (1935). In Texas it has been held that when the *cestui* of a spendthrift trust is a married person, the income, when received, is community property and not subject to federal income tax as the separate property of the *cestui*. *Commissioner of Internal Revenue v. Porter*, 148 F. (2d) 566 (C. C. A. 5th 1945).

³⁴ *Canfield v. Security Trust Nat. Bank*, 8 Cal. App. (2d) 277, 48 P. (2d) 733 (1935); *Erickson v. Erickson*, 197 Minn. 71, 266 N. W. 161, 267 N. W. 426 (1936).

³⁵ *Pole v. Pietsch*, 61 Md. 570 (1884); *Matter of Berrien*, 147 Misc. 788, 264 N. Y. Supp. 593 (1933); RESTATEMENT TRUSTS § 157 clause (b) (1935).

³⁶ *Matter of Williams*, 187 N. Y. 286, 79 N. E. 1019 (1907); RESTATEMENT TRUSTS § 157 clause (c) (1935).

³⁷ *United States v. Dallas Nat. Bank*, 152 F. (2d) 582 (C. C. A. 5th 1945); *Matter of Rosenberg*, 269 N. Y. 247, 199 N. E. 206 (1935).

³⁸ *Scott, op. cit. supra* note 5, at § 157.5.

and subject to restraint on alienation, if the beneficiary is an infant or under a disability, the appointed guardian of his property can compel the trustee to pay the income to him even though the beneficiary's interest is not otherwise transferable by the terms of the trust.³⁹ Upon the death of the beneficiary his personal representative is entitled to accrued income which has not yet been paid to the beneficiary.⁴⁰

CONCLUSION

The desirability of upholding a spendthrift trust has been strongly debated. Those opposing spendthrift trusts do so in part on technical legal grounds. It is said that such trusts do restrain alienation and since legal life estates or estates in fee may not be subjected to such restraints, there is no reason that equitable interests should be permitted to be encumbered. On grounds of public policy it is contended that spendthrift provisions show a trend toward paternalism and socialism and that they protect and encourage incompetency and weakness. Moreover, it is said that such trusts are misleading to the creditors of the beneficiary.

On the other hand, it is argued with equal vigor that there is really no restraint in the case of such a trust because the trustee may alienate the legal title and the beneficiary may alienate his interest once it becomes due and is paid to him. Furthermore, it is thought not to be against public policy with respect to the misleading of creditors since the creditors by diligence may ascertain the restriction. It is also stated that a donor should be permitted to do with his property as he wishes and that it is not desirable for a beneficiary of a trust to waste or squander his inheritance, especially where he is a person of improvident habits and weak in intellect.⁴¹

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³⁹ *Brookshire v. Wambough*, 9 S. W. 2d 269 (Tex. Civ. App. 1928); *Bradshaw v. Lucas*, 214 Ill. App. 218 (1919); *Gosquet v. Pollock*, 1 App. Div. 512, 37 N. Y. Supp. 357 (1896); *aff'd. mem.* 158 N. Y. 734, 53 N. E. 1125 (1899); RESTATEMENT TRUSTS § 158 clause (1) (1935).

⁴⁰ *Welsh v. Apthorp*, 203 Mass. 249, 89 N. E. 432 (1909); RESTATEMENT TRUSTS § 158 clause (2) (1935).

⁴¹ For arguments pro and con with respect to spendthrift trust see: BOCERT ON TRUSTS 163-165 (2d ed. 1942) and SCOTT, *op. cit. supra* note 5, at § 152.