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PARTIAL SPENDTHRIFT TRUSTS

by

William G. Williams

A spendthrift trust is a trust in which both voluntary and involuntary alienation are restricted, i.e., the beneficiary cannot assign his interest (voluntary alienation) and the beneficiary's creditors cannot attach his interest for his debts and liabilities (involuntary alienation). Or, as stated in *In re Keeler's Estate*, 3A. (2d) 413 (Pa.), a spendthrift trust "exists where there is an express provision forbidding anticipatory alienation and attachments by creditors." In case of a legal life estate it is the general rule that a direct restraint upon alienation, voluntary or involuntary, is invalid; but in most jurisdictions, the settlor of a trust may impose both of these restraints upon the equitable estate and they will be given effect, at least where there is provision, express or implied, against both. The purpose of this article is to discuss the situation when there is a restriction against only one.

Pennsylvania recognizes a complete spendthrift trust. Of this there is no doubt. Spendthrift trusts had had their origin in the Pennsylvania case of *Fisher v. Taylor*, 2 Rawle (Pa.) 33. The theory upon which spendthrift trusts are upheld, has often been stated in Pennsylvania cases. In *In re Morgan's Estate*, 223 Pa. 228, it was said that spendthrift trusts are sustained because the law protects the *donor's* right of property, not because it (the law) is concerned with keeping the donee from wasting it, and in *Patrick v. Smith*, 2 Pa. Super. 113, it was said, "A spendthrift trust is in no sense a conveyance in fraud of the beneficiary's creditors, since it is not his property but that of the settlor, which is conveyed. It becomes the property of the beneficiary only so far as it is made such by the deed of settlement, and with only such control, incidents of ownership and liability to creditors as are therein given."

A partial spendthrift trust, if there is any such thing, is a trust in which only one of the two restrictions essential to a complete spendthrift trust is present. The subject divides itself quite nicely into three distinct problems, each of which contains two sub-problems.

1. The first problem arises where only one of the two restraints is expressed by the settlor and the question is whether that restraint will be enforced.

(1). Suppose the settlor provides that the beneficiary's creditors shall not be able to attach the beneficiary's interest, but says nothing concerning the beneficiary's right to assign, and the question is whether an attachment by the creditors is valid. The only problem here is whether the restraint expressed is valid and effective. Here the case is stronger in favor of the persons attacking the validity of the restraint than in the converse situation, discussed below, since the rights of third persons to the transaction are involved. However, the creditor is no worse off than before the conveyance in trust was made and the settlor's power to impose both restraints should include the power to impose one of the restraints.

It seems that in Pennsylvania such provision would be held to be effective to protect the beneficiary's interest against the claims of his creditors.

In *Beck's Estate*, 133 Pa. 51, there was a bequest to Elizabeth Beck "upon condition that they shall not be attached or seized for any debts or money which said Elizabeth Beck shall owe at the time of my decease, but that the whole amount of her share shall be paid directly to said Elizabeth Beck by my executor, without discrimination for the payment of her said indebtedness." In this case the court held that the provision was valid and effective to protect the property while it was in the hands of the executor.

In *Goe's Estate*, 146 Pa. 431, the testatrix provided: "It is my distinct will and desire that none of the effects, real, personal, or mixed, as above devised and bequeathed to my children, or to either of them,

can be seized upon or levied upon for any debt or claim whatsoever against any one of my said children." The court again held that the provision was effective to protect the property bequeathed until it came to the hands of the children.

It will be noted that neither of these cases deals directly with trusts and possibly restraints on property in the hands of an executor will be treated differently than restraints on property held in trust. This, of course, detracts from the authority of these cases.

In *Holmesburg Building Association v. Badger et ux.*, 144 Pa. Super. 65, the testator imposed a restraint upon involuntary alienation and said nothing about voluntary alienation. The court held that the provision was effective against creditors of the beneficiary, saying, "The property of testator becomes the property of devisee or legatee only so far as it is made such by the will and then with such control, incidents of ownership, and liability to creditors as are therein given to it." (repeating the language used in *Patrick v. Smith*, *Supra.*).

(2.) Suppose the beneficiary's power to assign his interest is expressly withheld, but nothing is said about the rights of the beneficiary's creditors to attach his interest and the question arises as to whether he has the power to assign. Whether such provision manifests an intent to create a complete spendthrift trust does not arise here since the only issue is whether or not the express provision will be enforced. In such a case, it is submitted, that it follows, a fortiori from the first situation, that this restriction will be given effect, since here the rights of third persons are not involved, and we have a much weaker case against the validity of the restraint than in the first situation. If the settlor has the power to effectively impose restrictions on both types of alienation, he should have the power to restrain voluntary alienation; as was said in discussing the first situation, the greater should include the lesser.

So it seems that either a restraint on voluntary alienation or a restraint on involuntary alienation of the beneficiary's interest standing alone will be enforced. Mr. Bogert in his work on *Trusts*, page 719, is in accord with this conclusion. In the cases discussed under 1 (1) the court refused to consider the question of the validity of a possible assignment by the beneficiary and this brings us to the second main division.

2. Where one type of alienation is expressly forbidden and nothing is said about the other, will the prohibition of the one not mentioned be implied from the presence of the other?

(1.) Suppose the settlor of the trust provides that the beneficiary's interest shall not be assignable by the beneficiary and says nothing about attachment for debts, and the beneficiary's creditors attempt to attach his

interest to satisfy their claim, will the court allow the attachment or will the court say that a restriction against involuntary alienation will be implied from the restriction against voluntary alienation?

The Restatement of Trusts in section 152(d) says merely "Words in terms restraining voluntary alienation *may* manifest an intention also to restrain involuntary alienation." This statement adds absolutely nothing since the Restatement in section 152 (c) had already stated that a spendthrift trust could be created by any terms manifesting an intent to create such trust. It is a recognized fact that no particular form of words is necessary to create a spendthrift trust. Pennsylvania courts have often said that to create a spendthrift trust it is not essential that there be a specific provision that the income should not be subject to the debts or liabilities of the beneficiary if the terms of the creating instrument would be frustrated by the claims of the creditors. If the intention to create a spendthrift trust appears that is all that is required.¹

The Pennsylvania case most often cited as an authority for the proposition that a restriction upon involuntary alienation will be implied from an express restraint upon voluntary alienation is *Winthrop Company v. Clinton*, 196 Pa. 472. In that case A created a trust with his wife as life-beneficiary, upon her death, the son was to become beneficiary, with no power of anticipation. The wife died and thereafter the son's creditor tried to get at the son's interest to satisfy his claim. The court said, "It is not essential that a spendthrift trust should contain words providing specifically that the income shall not be subject to debts or liabilities of the cestui que trust." The court went on to say that *on all the facts* in the case they felt that testator intended to create a complete spendthrift trust.

It will be readily seen that this case is not an authority for the proposition that whenever there is an express restriction upon voluntary alienation, the restriction upon involuntary alienation will be implied. The cases seem to require that something more than the restriction upon voluntary alienation be present, though just what is required is not clear. From this it appears that the language of the Restatement of Trusts seems to give an erroneous impression at least so far as Pennsylvania law is concerned. The impression gathered from the statement above cited is that the intent to restrain involuntary alienation may be implied from the restriction against voluntary alienation. This is not so, the restriction upon involuntary alienation is implied from all the facts, of which a restraint upon voluntary alienation may or may not be one. Mr. Scott's statement in section 152.4

¹Appeal of Grothe (1890) 135 Pa. 585, 19A. 1058; *Winthrop Company v. Clinton* (1900) 196 Ua. 472, 46A. 435; *In re Showers Estate*, 31 Pa. Super. 162; *Benefactor Building & Loan Association v. Latter* 106 Pa. Super. 156, 161A. 757.

of his work on Trusts seems to be better. Mr. Scott says "Although in express language the settlor has imposed only one of the two restraints, the intent to restrain the other may also be manifested." The Restaters presumably meant to say the same thing, but were not so clear.

The net result seems to be that if from the language used by the testator in the trust instrument and all the surrounding circumstances, the intent to restrain involuntary alienation is manifested, the court will enforce a complete spendthrift trust, though the instrument expresses only the restraint upon voluntary alienation. Considering this along with our conclusions in the discussion of the first problem, it appears that it is possible to create a valid partial spendthrift trust; if only the restraint upon voluntary alienation is expressed we have seen that it should be enforced and if the intent to impose a restraint upon involuntary alienation is not manifested, it will not be imposed, the result being a trust in which the beneficiary cannot assign his interests but his creditors may seize his interest to satisfy their claims.

(2.) Now, the converse situation. Suppose the settlor expresses a restraint upon involuntary alienation, but says nothing about restraining voluntary alienation and the question arises as to whether the beneficiary may assign his interest. Here the Restatement of Trusts in section 152(e) says in effect, that the intent to restrain voluntary alienation may be manifested from the words restraining involuntary alienation. It seems that the courts in Pennsylvania will imply a restraint upon voluntary alienation from the expressed restraint upon involuntary alienation.

In *Shankland's Estate*, 47 Pa. 113, the trustee was to hold the estate, both real and personal, of the testatrix in trust for and to collect and receive rents, etc., and pay them over to the beneficiary, without being subject to his debts or liabilities. The court said, "The legal estate was vested in the trustee, and no act of the cestui que trust could deprive him of it, or allow him to interfere with the collection of the income, and no creditor could touch the income or any interest which the cestui que trust had in it. . . . Shankland can give no such estate as he contracted to sell." It will be seen that as a result of the decision a complete spendthrift trust was here created.

If this case is correct it is clear that it is impossible to create a partial spendthrift trust in which the creditors of the beneficiary cannot attach his interest but in which the beneficiary can assign, since any attempt to do so will result in a complete spendthrift trust, as the restraint upon voluntary alienation will be implied from the restraint upon involuntary alienation. Whether it would be possible to expressly restrain involuntary alienation and expressly permit voluntary alienation or vice versa will be discussed below.

One situation in which this problem is of interest is in the cases arising under the Federal Bankruptcy Act. This is, of course, not strictly Pennsylvania

law but is of interest and deserves mention here. The Act vests in the trustee in bankruptcy all "property which prior to the filing of the petition he (the bankrupt) could by any means have transferred (11 U.S.C.A. section 110).

In *Boston Safe Deposit and Trust Company, Trustee v. Luke*, 220 Mass. 484, 108 N.E. 64, a trust was set up, income to be paid to the beneficiary; "said income to be free from the interference or control of her creditors;" nothing was said about the beneficiary's power to assign. The state court held that the beneficiary's interest could not be taken by the trustee in bankruptcy under the Bankruptcy Act, even though the court also said "there is nothing in the will which forbids the life tenant's assigning her equitable life interest. It follows that it is assignable" (this statement is to be doubted in Pennsylvania). The above case was then appealed to the United States Supreme Court where the holding was affirmed in *Eaton v. Boston Trust Company*, 240 U.S. 427, 36 S. Ct. 391, 60 L.Ed. 723. The Supreme Court did not flatly say whether the beneficiary could have assigned her interest or not, but the court implied that it could not have been assigned, saying, "If it be true. . . . that the bankrupt could have assigned her interest and by so doing could have freed from the trust both the fund and any proceeds received by her, the argument would be very strong that the statute intended the fund to pass. . . . There would be difficulty in admitting that a person could have property over which he could exercise all the powers of ownership except to make it liable for his debts. The conclusion (of the state court) that the fund was assignable was based on two cases, and we presume was meant to go further than their authority required." But the court then went on to say that even if the beneficiary did have the power to assign her interest "we feel warranted in assuming that the power of (voluntary) alienation will not be pressed to a point inconsistent with the dominant intent of the will. Whether if that power were absolute the restriction (upon involuntary alienation) still should be upheld. . . . it is not necessary to decide."

So it is clear that, whether or not the federal courts will imply a restraint upon voluntary alienation from the express restraint upon involuntary alienation (though very probably they will), the beneficiary's interest in such a trust does not vest in the trustee in bankruptcy.

So as to whether a restraint upon one type of alienation will be implied from the express restraint upon the other type, it seems that if there is an express restraint upon involuntary alienation, a restraint upon voluntary alienation will be implied; if there is an express restraint upon voluntary alienation, a restraint upon involuntary alienation will not be implied unless the intent of the settlor to restrain involuntary alienation is otherwise manifested.

3. We come now to the case in which the settlor has left nothing to implication but has expressly restrained the one and expressly permitted the other. This is the true partial spendthrift trust, there can be no implication or mani-

festation indulged in by the court, the question is presented unequivocally, "Will we sustain a partial spendthrift trust?" This question the Restatement of Trusts leaves open by caveat. Here again the topic must be divided into the two converse situations.

(1.) Suppose the settlor expressly provides that the beneficiary's interest shall not be seized to satisfy the claims of his creditors and also expressly provides that the beneficiary shall have the power to assign his interest. It is very doubtful whether this may be done in Pennsylvania, though one early case seems to permit it.

In *Vaux v. Parke*, 7 W. & S. 19 (1844), a father left property in the hands of trustees for the benefit of his son and providing that the income should be paid to the son or to such person as the son might appoint and that if he became "relieved from embarrassment" to transfer the property to him in fee simple. It was held that there was no interest in the property which could be attached by the son's creditors.

However, later cases have taken a contrary view.

In *Keyser's Appeal*, 57 Pa. 236, the court held that there was an attempt to give the beneficiary an equitable estate in fee with full power to alien, but not subject to the claims of his creditors and said that "the mere interposition of a dry trust will not enable a testator to give a beneficial estate in fee simple with all the incidents of ownership, except that of liability for debts."

This case loses much of its authority in view of the fact that very probably any restraint upon an estate in fee would be held to be void.

In *Morgan's Estate* (No. 1), 223 Pa. 228 (1909), a wife left property to a trustee for the benefit of her husband, providing that it should be delivered to any one to whom the husband should appoint. If he did not appoint, he should continue to enjoy the benefits, but none of the estate should be liable for his debts. The court said that the obvious intent of the donor was to vest her husband with absolute title to the land and still to protect it from his creditors, since he was given an absolute power of assignment. "The very fact that power is given which may be used by the cestui to apply the fund in whole or in part to the payment of his debts (the court is here referring to the power of the beneficiary to make an assignment in favor of his creditors), is an investiture pro tanto of ownership." Since the law's purpose in sustaining spendthrift trusts "is to give effect to the will of the donor as he has expressed it. When a donor substitutes for his own absolute right of disposition, the pleasure of the donee, the gift is absolute."

It therefore appears that the settlor may not expressly permit voluntary alienation and expressly restrain involuntary alienation. If he attempts to do so, the result is an ordinary trust which is subject to either type of alienation. This conclusion is in line with Mr. Scott's statement in section 152.3

of his work on Trusts ". . . it would seem that the creator of the trust should not be permitted to make the interest of the beneficiary exempt from the claims of his creditors if the beneficiary is permitted to make a voluntary transfer of his interest." Mr. Scott feels this is against public policy.

(2.) Suppose the settlor expressly imposes a restraint upon voluntary alienation but expressly permits involuntary alienation. The situation here is a bit different from the first. There are apparently no cases in Pennsylvania in point, but it seems that this should be permissible. Mr. Scott in his work on Trusts in section 152.3 says, "It would seem clear that the creator of a trust may effectively restrain the beneficiary from transferring his interest, even though by the terms of the trust his creditors are permitted to reach it."

Mr. Scott's conclusion seems sound. The beneficiary is better off than he was before the trust was created and the donee should not be heard to complain that the donor gave him only half a loaf when he could have given a whole loaf. Then, too, the policy of protecting the property right of the donor and giving effect to his wishes supports this view more strongly than in the last situation, since there the policy against giving the donee all rights of ownership and at the same time depriving his creditors of their rights overbalanced the policy favoring the donor's wishes.

CONCLUSIONS

1. A complete spendthrift trust is recognized and enforced in Pennsylvania.
2. If a restraint is imposed upon voluntary alienation and nothing is said about involuntary alienation, the restraint expressed will be enforced.
3. If a restraint is imposed upon involuntary alienation and nothing is said about voluntary alienation, the restraint expressed will be enforced.
4. If the settlor imposes a restraint upon voluntary alienation, and makes no mention of involuntary alienation, a restraint will be implied upon involuntary alienation only if the intention to so restrain is manifested by the terms of the trust instrument and all the circumstances.
5. If the settlor imposes a restraint upon involuntary alienation, saying nothing about voluntary alienation, the restraint upon voluntary alienation will be implied from the express restraint upon involuntary; the result being a complete spendthrift trust.
6. If the settlor expressly permits voluntary alienation and expressly prohibits involuntary alienation, the restraint is invalid and the result is an ordinary trust.
7. If the settlor expressly permits involuntary alienation and prohibits voluntary alienation, it is submitted that the trust should be enforced as expressed.

8. A valid partial spendthrift trust is possible in only two situations:
- (a) Where the settlor expresses only a restraint upon voluntary alienation and there is no manifestation of an intention to restrain involuntary. and
 - (b) Where the settlor expressly permits involuntary alienation and expressly prohibits voluntary alienation.

REMARKS

It seems that it is foolish for the settlor of a trust to create a partial spendthrift trust, for his object of protecting the property from the beneficiary's waste is achieved only if both restraints are imposed. So long as the beneficiary's creditors may satisfy their claims from his interest, he may run up debts for which the creditors will attach his interest and there will be an assignment, in effect, if not in name.