

1985

Rights of Creditors to Reach Assets of a Revocable Trust after the Death of the Grantor - The Missouri Approach

J. Rodney Johnson

University of Richmond, rjohnson@richmond.edu

Follow this and additional works at: <http://scholarship.richmond.edu/law-faculty-publications>



Part of the [Estates and Trusts Commons](#)

Recommended Citation

Rights of Creditors to Reach Assets of a Revocable Trust after the Death of the Grantor - The Missouri Approach, 20 Real Prop., Prob. and Trust J. 1189 (1985).

This Article is brought to you for free and open access by the School of Law at UR Scholarship Repository. It has been accepted for inclusion in Law Faculty Publications by an authorized administrator of UR Scholarship Repository. For more information, please contact scholarshiprepository@richmond.edu.

RIGHTS OF CREDITORS TO REACH ASSETS OF A REVOCABLE TRUST AFTER THE DEATH OF THE GRANTOR— THE MISSOURI APPROACH*

EDITOR'S SYNOPSIS: *The question whether creditors of a decedent's estate can reach the assets of an inter vivos trust is difficult. This article discusses the answers reached in various situations, and also a recent Missouri statute that allows the trustee to limit the time for creditors' claims.*

I. INTRODUCTION

Revocable inter vivos trusts (herein referred to as "revocable trusts," although the trust normally becomes irrevocable on the death of the grantor) in recent years have been used more frequently as an estate planning vehicle, often replacing the will for making a disposition of assets at death.

There are clearly defined rights of creditors against a probate estate. Most states have a specific period of time during which a probate creditor's claim must be filed or be forever barred; these periods vary from two months to 12 months or more. Assets held in a revocable trust at death do not require probate administration. If there is no probate administration, the creditor procedures applicable to probate generally do not apply. This report will discuss a Missouri statute enacted in 1983 and other statutory and case law relating to the rights of creditors to reach assets of a revocable trust upon the death of the grantor.

II. MISSOURI STATUTE

In 1983, the Missouri Legislature, as part of a new trust law,¹ enacted section 456.610, which provides as follows:

1. Any trustee who has a duty or power to pay the debts of a decedent may publish a notice in some newspaper published in the county once a week for four consecutive weeks in substantially the following form:
2. All persons interested in the estate of _____, decedent. The undersigned _____ is acting as trustee under a trust, the terms of which provide that the debts of the decedent may be paid by the

*Report of Probate and Trust Committee D-2, Formation, Administration and Distribution of Trusts.

¹MO. REV. STAT. § 456.010-456.820.

trustee(s) upon receipt of proper proof thereof. The address of the trustee is _____ . All creditors of the decedent are noticed to present their claims to the undersigned within six (6) months from the date of first publication of this notice or be forever barred.

Trustee

If such publication is duly made by the trustee, any debts not presented to the trustee within six months from the date of the first publication of the aforesaid notice shall be forever barred against the trustee and the trust property.

This is a unique type of statute dealing with a difficult area of law.²

The Missouri statute assumes that creditors of a decedent can reach assets in a revocable trust created by the decedent. Its application is limited to those trusts which provide that the trustee has a duty or power to pay debts of the decedent. The statute's applicability thus depends on the wording of the trust. It presumably relates to a trust of which the decedent was the grantor, but "decedent" is not defined and might include a deceased beneficiary of the trust, who is not the grantor. The statute is not limited to revocable trusts. It might apply to an irrevocable trust where the grantor retained, for example, an income interest. This article will discuss the Missouri statute only in the context of a revocable inter vivos trust on the death of the grantor.

The statute does not require actual notice to known creditors, but merely a published notice. Publication of notice is discretionary with the trustee. Published notice, however, may not satisfy constitutional requirements.³

The statute does give the trustees some protection in making distributions after the period for claims has expired, but it may delay distributions where there are no creditors. Failure to publish the notice to invoke a short statute of limitations might subject the trustee to liability for failure to protect the beneficiaries' interests.

The Missouri statute does not limit its application to transfers into trust which were a fraud on creditors. It is not part of a comprehensive statute dealing with creditors' rights in all nonprobate assets, such as pension benefits, joint tenancy, tenancy by the entirety, life insurance, and Totten trusts. It creates a special statute of limitations, if the trust provides for payment of debts and if the trustee elects to publish the notice to creditors.

²The Committee has surveyed the laws of all other states and the District of Columbia and has not located a similar type statute in any other jurisdiction.

³Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950); Mennonite Bd. of Missions v. Adams, 462 U.S. 791 (1983); Continental Ins. Co. v. Moseley, 463 U.S. 1202 (1983); on remand, 683 P.2d 20 (Nev. 1984) (Moseley requires actual notice to known creditors).

A statute, such as the Missouri statute, would have broader appeal if it applied to all revocable trusts on the death of the grantor, whether or not there was a power or direction to pay debts and whether or not the trust has a spendthrift clause. Ideally the statute should set forth a procedure for acting on claims or rejecting claims. Presumably if a claim is rejected, suit would be brought against the trustee under the applicable statutes of that jurisdiction. Any period for filing of creditors' claims against a revocable trust should correspond to the period provided under the laws of that state for filing creditors' claims against a probate estate. The statute does not provide for priority of payment. Should claims first be satisfied from probate assets and then from trust assets? Should priority among trust creditors be the same as among probate creditors?

There are a number of other will substitutes, such as joint tenancy, Totten trusts, insurance contracts, and pension benefits, each of which raises questions as to the rights of creditors of a decedent to reach assets held in that form.⁴ A comprehensive statutory solution would be of assistance.

III. CREDITORS' RIGHTS GENERALLY ON DEATH OF THE GRANTOR OF A REVOCABLE TRUST

The extent to which the assets of a revocable trust can be reached by the creditors of the grantor on the grantor's death varies from state to state.⁵ Creditors' rights may depend upon a power of revocation, a power of appointment, statutory provisions, fraudulent transfers in trust, or the power of a personal representative to recover assets necessary to pay creditors in a probate estate.

A. Power of Revocation

An early Supreme Court case held that a transfer in trust, where the transferor held a power of revocation and where there was no fraud in the transfer itself, could not be set aside by a creditor. The Court reasoned that the power to revoke was not an interest in the property as such.⁶ In the absence of a statute otherwise providing, the courts have generally taken the view that the mere fact that the settlor or grantor has a power to revoke the trust does not subject him to a duty to his creditors to do so for their benefit, nor does it make him the owner of the property so that creditors can treat it as his property. This view has been reflected in the Restatement of Trusts.⁷ A power of revocation held by the grantor obviously expires on

⁴See Effland, *Rights of Creditors in Nonprobate Assets*, 48 Mo. L. Rev. 431 (1983).

⁵1 CASNER, ESTATE PLANNING § 5.5.9, n. 47 (5th ed. 1984)

⁶Jones v. Clifton, 101 U.S. 225 (1879); also see cases cited in 4 SCOTT, TRUSTS § 330.12 n. 5 (3d ed. 1967).

⁷RESTATEMENT (SECOND) OF TRUSTS § 330, Comment o. The Comment states as follows:

the grantor's death. If the creditors cannot force revocation during lifetime, there is no basis for assuming that creditors have a right to reach property in the revocable trust after the grantor's death, unless a statute confers such a right.

B. Statutory Provisions Favoring Creditors of a Revocable Trust

New York and a number of other jurisdictions have enacted statutes which give creditors specific rights in property transferred to a revocable trust. The New York statute provides as follows:

Where a creator reserves an unqualified power of revocation, he remains the absolute owner of the property disposed of so far as the rights of his creditors or purchasers are concerned.⁸

There are similar statutes in a number of other states.⁹ New York case law has interpreted the New York statute to allow a creditor of a deceased grantor with an insolvent estate to reach assets of a revocable trust.¹⁰ The statutes frequently, however, do not address the issue of whether the creditors have rights to recover property after the death of the grantor. An Ohio statute¹¹ gives the creditors the right to compel revocation of a trust by the holder of that power if necessary to satisfy creditor obligations. However, it has been held that the power to revoke expires at death and therefore creditors after the grantor's death cannot reach the trust assets.¹²

C. Cases Extending a Creditor's Rights to Reach Assets After the Grantor's Death

In *State Street Bank & Trust Co. v. Reiser*, a Massachusetts appellate court made the following observation:

Where a person places property in trust and reserves the right to amend or revoke, or to direct disposition of principal and income, the settlor's creditors may, following the death of the settlor, reach in satisfaction of the settlor's

Unless it is otherwise provided by statute, a power of revocation reserved by the settlor cannot be reached by his creditors. If he revokes the trust and recovers the trust property, the creditors can reach the property; but they cannot compel him to revoke the trust for their benefit.

⁸N.Y. ESTATES, POWERS & TRUST LAW, § 10-10.6

⁹SCOTT, TRUSTS § 330.12, n. 8 (3d ed. 1967). For example, the Minnesota statute provides: When the grantor in a conveyance reserves to himself, for his own benefit, an absolute right of revocation, such grantor is still the absolute owner of the estate conveyed, so far as the rights of creditors and purchasers are concerned.

MINN. STAT. ANN. § 502.76. Kansas has a similar type statute limited to grantors of lands. KAN. STAT. ANN. § 58-2414.

¹⁰*In re Granwell*, 20 N.Y.2d 91, 228 N.E.2d 779, 281 N.Y.S.2d 783 (1967); *Estate of Chaikowsky*, 94 Misc.2d 70, 404 N.Y.S.2d 510, 511 (1978).

¹¹OHIO REV. CODE § 1335.01.

¹²*Schofield v. Cleveland Trust Co.*, 135 Ohio St. 328, 21 N.E.2d 119 (1939).

debts to them, to the extent not satisfied by the settlor's estate, those assets owned by the trust over which the settlor had such control at the time of his death as would have enabled the settlor to use the trust assets for his own benefit.¹³

For a contrary view, see *Greenwich Trust Company v. Tyson*, a Connecticut Supreme Court case.¹⁴

D. Power of Revocation as a General Power of Appointment

Where the grantor of a trust reserves unto himself or herself a general power of appointment there is authority that creditors can reach the property in the trust even after the death of the grantor who held the power, if other assets are insufficient to satisfy creditors' claims.¹⁵

E. Fraudulent Transfers

Some states have applied the concept of fraudulent conveyances to transfers in trust as a basis for allowing creditors to reach assets of a revocable trust. For example, Kansas provides as follows:

Every gift, grant or conveyance of lands, tenements, hereditaments, rents, goods or chattels, and every bond, judgment or execution, made or obtained with intent to hinder, delay or defraud creditors of their just and lawful debts or damages, or to defraud or to deceive the person or persons who shall purchase such lands, tenements, hereditaments, rents, goods or chattels, shall be deemed utterly void and of no effect.¹⁶

This statute has allowed creditors to reach assets of a trust.¹⁷

North Dakota has a statute on fraudulent transfers, which provides as follows:

Every transfer of property or charge made thereon, every obligation incurred, and every judicial proceeding taken, with intent to delay or defraud any creditor or other person of his demands, whether or not the same is valid as between the parties thereto, is void as against all creditors of the debtor and

¹³Mass. App. Ct. 633, 638, 389 N.E.2d 768, 771 (1979). For a similar result see *Johnson v. Comm. Bank*, 284 Ore. 675, 588 P.2d 1096 (1978).

¹⁴129 Conn. 211, 27 A.2d 166 (1942).

¹⁵RESTATEMENT OF PROPERTY § 328. A statute of this type is California Civil Code § 1390.4, which provides:

Property subject to an unexercised general power of appointment created by the donor in favor of himself, whether or not presently exercisable, is subject to the claims of creditors of the donor or of his estate and to the expenses of the administration of his estate. Also, see discussion in 2 SCOTT, TRUSTS § 156 (3d ed. 1967).

¹⁶KAN. STAT. ANN. § 33-102 (1981).

¹⁷Kansas also has a statute dealing with nonfraudulent transfers of personal property which provides:

All gifts and conveyances of goods and chattels, made in trust to the use of the person or persons making the same shall, to the full extent of both the corpus and income made in trust to such use, be void and of no effect, regardless of motive, as to all past, present or future creditors; but otherwise shall be valid and effective. KAN. STAT. ANN. § 33-101 (1981).

their successors in interest and against all persons upon whom the estate of the debtor devolves in trust for the benefit of others than the debtor.¹⁸

These statutes generally apply to rights of creditors during the grantor's lifetime but, as discussed in the next section, personal representatives are often given the right to recover assets on behalf of estate creditors. These statutes and others are based upon the Uniform Fraudulent Conveyance Act and in particular sections 6 and 7 thereof. Both refer to transfers being fraudulent as to both present and future creditors.¹⁹

F. Rights of Creditors and Personal Representative to Recover Assets After Grantor's Death

A number of states provide for recovery by the personal representative and in some cases by the creditors of assets transferred in fraud of creditors. In Indiana, the real and personal property liable for the payment of debts of a decedent includes all property transferred with intent to defraud creditors. The exclusive right to recover assets transferred in fraud of creditors is given to the personal representative. Fraudulent conveyances may include the rights of subsequent creditors.²⁰

Arkansas authorizes a personal representative of a grantor who has made transfers with intent to delay or defraud his creditors to bring an action to set aside the transfer, recover the assets for the estate and use said assets to pay creditors.²¹

¹⁸N.D. CENT. CODE § 13-01-05.

¹⁹The UNIFORM FRAUDULENT CONVEYANCE ACT has been adopted in at least 26 states, 7A U.L.A. 161.

Section 6 provides:

Every conveyance made and every obligation incurred without fair consideration when the person making the conveyance or entering into the obligation intends or believes that he will incur debts beyond his ability to pay as they mature, is fraudulent as to both present and future creditors.

Section 7 provides:

Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors.

²⁰IND. CODE § 32-2-1-15 provides in part:

All deeds of gift, conveyances, transfers of assignments . . . of goods or things in action, made in trust for the use of the person making the same, shall be void as against creditors, existing or subsequent, of such person.

On the death of a party, creditors' rights are defined in IND. CODE § 29-1-13-4 as follows:

The real and personal property liable for the payments of debts of a decedent shall include all property transferred by him with intent to defraud his creditors or any of them, or transferred by any other means which is in law void as against his creditors or any of them; and the right to recover such property, so far as necessary for the payment of the debts of the decedent, shall be in the personal representative, who shall take such steps as may be necessary to recover the same. Such property shall constitute general assets of the payment of all creditors; but no property so transferred shall be taken from anyone who purchased it for a valuable consideration, in good faith and without knowledge of the fraud.

Wisconsin, in addition to allowing the personal representative to bring suit to recover assets, also allows creditors to bring suit to recover assets that may be liable for debts of the decedent.²²

A California statute authorizes the personal representative to recover assets for estate creditors if there was intent to defraud creditors, avoid obligations or where a gift was made in view of death resulting in a deficiency of assets to pay creditors.²³

G. Augmented Estate

Although not directly applicable, the Uniform Probate Code in section 2-202 provides that assets in a revocable trust will be taken into account in determining the surviving spouse's statutory share of the estate. This is the augmented estate concept. A Massachusetts court has applied this concept of including assets in a revocable trust in determining a surviving spouse's statutory rights in the estate.²⁴

The Uniform Probate Code also gives those interested in a decedent's estate certain rights in multiple party accounts to pay taxes, family allowance and other obligations.²⁵

IV. AN APPROACH

The Missouri statute highlights the problems relating to rights of creditors in assets held in a revocable trust. The Missouri statute is only a statute of limitation. It appears to be optional and is dependent upon the trustee having power to pay debts or expenses. If the trustee does not expect to pay debts from the trust, the publication of notice to creditors would seem inappropriate. The obligation to pay debts is not restricted to debts not paid through probate. It obviously singles out assets in a revocable trust from other nonprobate assets and gives them special protection from creditors. Standing alone, section 456.610 of the Missouri trust statute represents only a first step in dealing with creditors' rights in nonprobate assets.

An approach to creditors reaching revocable trust assets is to provide by statute, as do a number of states, that assets in a revocable trust are subject to creditors' claims, if probate assets are insufficient to satisfy all claims. The personal representative of a decedent's probate estate, to the

²²WIS. PROB. CODE § 859.40; N.Y. Surr. Ct. Proc. Act § 1810 apparently gives the creditor the choice of proceeding on a creditor's claim against both probate and trust assets.

²³CALIF. PROB. CODE § 579. This section provides:

If the decedent, in his lifetime, conveyed any real or personal property, or any right or interest therein, with intent to defraud his creditors, or to avoid any obligation due another, or made a conveyance that by law is void as against creditors, or made a gift of property in view of death, and there is a deficiency of assets in the hands of the executor or administrator, the latter, on application of any creditor, must commence and prosecute to final judgment an action for the recovery of the same for the benefit of the creditors.

²⁴Sullivan v. Burkin, 390 Mass. 864, 460 N.E.2d 572 (1984).

extent the decedent's probate assets are insufficient to satisfy creditors' claims, should be authorized to recover on behalf of probate estate creditors assets in a revocable trust created by the decedent, as well as other nonprobate assets. In the event there is no probate proceeding, then a statute, such as the Missouri statute, allowing publication of a notice of death by the trustee and requiring claims to be filed against the trust within a short period of time, such as six months, would be an appropriate alternate procedure, if, but only if, creditors in that jurisdiction can otherwise reach assets of a revocable trust to satisfy claims. In the majority of jurisdictions which protect assets in a revocable trust from creditors, assuming no fraudulent conveyance, then the Missouri statute would be inappropriate.

The laws of a particular jurisdiction as to creditors' rights in probate assets, in revocable trust assets, and in other nonprobate assets should be carefully coordinated to clearly define rights and procedures in all assets at death. The Missouri statute touches an aspect of creditors' rights in a revocable trust, but those rights require further clarification in most jurisdictions. Enactment of the Missouri statute of limitation would seem advisable only in those jurisdictions which give creditors a direct cause of action against revocable trust assets on a decedent's death.

The creditor aspects of nonprobate assets, including those assets held in a revocable trust, require greater study than has been done by this Committee. A study by the American Law Institute or a uniform law on creditors' rights in nonprobate assets would seem appropriate.

Respectfully submitted,

CHARLES A. COLLIER, JR., *Chairman*
Los Angeles, CA

ESTELLE M. DEPPER, *Vice-Chairman*
San Francisco, CA

GEORGE E. STEPHENS, JR., *Vice-Chairman*
Los Angeles, CA

KATHRYN ANN BALLSUN
Los Angeles, CA

BONNIE ANN BARBER
Chicago, IL

GEORGE W. BUTTERWORTH, III
Boston, MA

JOSEPH P. CUMMINGS
Scottsdale, AZ

THOMAS W. DIETRICH
Gainesville, FL

ROBERT W. ELZER
Indianapolis, IN

JOHN H. HILL
Corinth, MS

J. RODNEY JOHNSON
Richmond, VA

ROBERT LOPILATO
Dorchester, MA

D. KARL MANGUM
Salt Lake City, UT

ROBERT S. MAXWELL
Topeka, KS

F. J. MUEGENBURG, JR.
Ventura, CA

JAMES I. RIDLEY
Plantation, FL

GERARD T. SHEVLIN
New York, NY

JOSEPH A. TRICARICO
New York, N.Y.

VIRGIL N. WOOLFOLK, JR.
New York, NY