

Creditors' Rights and Spendthrift Trusts

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More litigation is being generated, it seems, due to the many personal bankruptcy filings occurring in this time of economic crisis. In previous Partridge Snow & Hahn LLP Take Note e-alerts we shared with you developing law. (Links to those alerts can be found at the bottom of this page.)

A recent case in Alabama dealt with a Qualified Personal Residual Trust (QPRT) which was established by a mother for her four children. When the mother died, the QPRT was divided into separate shares, one for each of her children, according to the terms of the trust. Some time thereafter, one child for whom a trust share was administered filed for personal bankruptcy (as a co-debtor.)

As might be expected, the bankruptcy trustee began the effort to bring in to the child's bankruptcy estate her share of the QPRT.

This effort of the bankruptcy trustee failed. The child's share of the QPRT remained protected from her creditors and her bankruptcy estate because the trust was determined to be a spendthrift trust under state law. Because the spendthrift clause included in the QPRT complied with Alabama's statutory requirements, the bankruptcy trustee could not attach the child's share of the QPRT.

In reaching this conclusion, the court rejected the argument of the bankruptcy trustee that the trust terminated at the mother's death and should have been distributed to the child because the trustee's decision whether to terminate the trust or not was discretionary, and not mandatory.

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