

# THE RISELING REPORT . . . . .

## EXCLUSIVELY FOR THE ESTATE PLANNING PROFESSIONAL

### OKLAHOMA DISCRETIONARY AND SPECIAL NEEDS TRUST ACT

*The Oklahoma Discretionary and Special Needs Trust Act* (the “**Act**”) was signed by Governor Henry on May 26, 2010 at 6:27 P.M. The stated effective date of the Act was November 1, 2010. The codification of the Act (the “**Law**”) is found at 60 O.S. §§175.81 – 175.92. Go to [WWW.OSCN.NET](http://WWW.OSCN.NET)  
All references to “§” means 60 O.S. §.

#### EFFECTIVE DATE(S):

- ❖ §175.83 provides that its particular provisions apply “**to all trusts created or modified from and after November 1, 2010**”.
- ❖ §175.84 provides that its provisions apply “**to all Trusts created pursuant to the Oklahoma Discretionary and Special Needs Trust Act**”.
- ❖ §175.87 apparently applies only to Trusts “**created on or after November 1, 2010**”.
- ❖ §175.89 apparently applies “**only to Trusts with one or more beneficiaries holding discretionary interests**” – no mention of when the Trust was created.

## OVERVIEW

The Act appears to:

1. Establish the right of a beneficiary to bring an action against the Trustee,
2. Limit the rights of creditors to attach a beneficiary's interest in a Trust, and
3. Define a special needs trust and provide protection for its beneficiary.

## DETAILED OUTLINE

1. §175.82 contains definitions.
  - A “**beneficial interest**” in a Trust means a distribution interest or a remainder interest. It specifically excludes a power of appointment or any power reserved by the Settlor of the Trust.
  - “**Beneficiary**” means a person who has a present or future beneficial interest in a trust, vested or contingent. It does not include the holder of a *power of appointment*.
  - “**Current Distribution Interest**” means a distribution interest if a beneficiary on the date of qualification is either an eligible distributee or a permissible distributee of trust income or principal.
  - “**Discretionary Interest**” means any interest for which a Trustee has discretion to make or withhold a distribution. The statute specifically provides that the discretionary interest language may include the term “may make distributions” or it may include mandatory language such as the Trustee shall make distributions in its sole and absolute discretion. In other words, this provision appears to be an

attempt to eliminate the difference between the terms “may” and “shall”.

- **“Distribution Interest”** means a beneficiary’s equitable interest to enforce the distribution terms of the Trust. A distribution interest can be a mandatory interest, a support interest, a discretionary interest or a combination of those interests. In addition, a distribution interest includes both current distribution interests and future distribution interests.
- **“Exception Creditor”** means a child of a beneficiary who has a judgment or court order against the beneficiary for support.
- **“Mandatory Interest”** means a distribution interest for which the Trustee has no discretion in determining whether a distribution shall be made, or the amount or timing of the distribution.
- **“Remainder Interest”** means an interest for which a Trust beneficiary will receive the property **outright** in the future. I believe this would apply to the general concept of a typical “per stirpes” distribution provision. On the other hand, the statute specifically indicates that a remainder interest means an interest for which the beneficiary will receive the property outright in the future, not future retained Trust distributions. In other words, this statutory definition may mean that the interest of successor beneficiaries of generation skipping trusts will not be considered remainder beneficiaries since the distribution would not be outright.

- **“Power of Appointment”** means an inter vivos or testamentary power to direct the disposition of Trust property – other than a distribution decision by a Trustee relative to a beneficiary’s distributions. Powers of Appointment are held by donees, not the Settlor. (I assume this means that a reserved power by a Settlor is not a power of appointment). Power of Appointment also includes any right or power granted by statute to any person other than the Settlor.
- **"Special Needs Trust"** means a trust created for the partial or exclusive benefit of a disabled or incapacitated person, in order to allow the disabled or incapacitated beneficiary to avoid loss of eligibility for government benefit programs, including, but not limited to, Medicaid, Supplemental Security Income, Social Security Disability Income or other state or federal benefit programs

2. §175.83 contains provisions which affect creditors. The provisions of §175.83 apply to all Trusts ***created or modified from and after November 1, 2010***. Included in these creditor provisions are the following:

- A distribution interest shall not be judicially sold.
- A remainder interest, power of appointment, or a reserved power in a trust shall not be judicially sold.
- Except as to a Settlor who is also a Trustee of a Revocable Trust, trust property is not subject to personal obligations of the Trustee.
- The sole and exclusive remedies available to a creditor or other non-beneficiary claiming an interest in the trust are in the Act or the Uniform Fraudulent Transfer Act.

3. §175.84 specifies that its provisions apply to all Trusts created pursuant to the Oklahoma Discretionary and Special Needs Trust Act.

- §175.84 specifically provides that **“a creditor shall not attach . . . or otherwise reach an interest of a beneficiary or any other person who holds the unconditional or conditional removal or replacement power over a Trustee”**.
- §175.84 also specifies that this power is personal to the beneficiary, may not be exercised by the creditors of the beneficiary and no Court may direct any person to exercise this power.
- §175.84 further provides that a creditor shall not reach an interest of a beneficiary or compel a distribution (from the Trust) because the beneficiary is serving as a Trustee or Co-Trustee.
- §175.84 also contains several provisions concerning what is or is not “considered to mean in control over a Trust”. Factors (alone or in combination) which are not considered the exercise of dominion and control over a Trust include:
  - A. A beneficiary serving as Trustee or Co-Trustee
  - B. The Settlor or beneficiary holds an unrestricted power to remove or replace a Trustee.
  - C. The Settlor or a beneficiary is named in the applicable Trust instrument as a Trust Administrator, Trust Protector, Special Trustee or is a General Partner of a Partnership, a Manager of Limited Liability Company, an officer of a corporation or any other manager or function of any other type of entity.
  - D. A person related by blood or adoption to a Settlor or a beneficiary is appointed Trustee or

- E. An accountant, attorney, financial advisor, business associate or a friend of a Settlor or beneficiary is appointed as Trustee.

The foregoing provisions are relative if someone alleges that a Settlor is exercising dominion and control over a Trust because of a power held by a Settlor or because the Trustee is related to the Settlor.

- Section 4 of §175.84 specifically states that the Settlor or any beneficiary shall not be deemed to be the alter ego of a Trustee. The statute lists four factors which are not sufficient evidence for a Court to conclude that the Settlor controls a Trustee or is the alter ego of a Trustee. These factors are:
  - A. Any combination of factors described in paragraph 3 of this statute (previous page).
  - B. “Occasional Occurrences” in which the Settlor or beneficiary may have signed checks or made disbursements.
  - C. Making requests for distributions on behalf of a beneficiary.
  - D. Requesting the Trustee to hold, purchase or sell Trust property.

4. §175.85 contains specific provisions relating to Spendthrift provisions of a Trust. Generally speaking, spendthrift provisions are valid against all creditors except for an exception creditor of a support interest (child support). This provision clearly states that a creditor or assignee of the beneficiary cannot reach an interest in a Trust or distribution by the Trustee until the distribution is actually received by the beneficiary. The creditor must wait until a distribution is received before attachment, except that an exception creditor may attach current and future distributions at the Trust level.

- This provision applies to current distributions, future distributions, and remainder interests.
- A power of appointment is not a property interest and cannot be attached or forced to be exercised by a creditor or a Court – even if a spendthrift provision is not present in the Trust.
- Even though reserved powers are not protected by a spendthrift provision, if the reserved power does not constitute a power for the Settlor to withdraw income or principal, the holder of a reserved power may exercise the power in his or her sole and absolute discretion, “unencumbered by any Court”.

5. §175.86 relates to distribution interests and how they are classified. Specifically, a distribution interest shall be classified as a mandatory interest, a support interest or a discretionary interest. It also provides for pro-rating Trust property depending upon the type of distribution interest applicable.

6. §175.87 applies to a Trust created on or after November 1, 2010. This section provides that if the Trust contains a spendthrift provision, a creditor shall not attach present and future distributions from the Trust. A creditor must wait until a distribution is received by a beneficiary, except an exception creditor may attach present and future mandatory distributions for child support.

- If a Trust does not contain a spendthrift provision, a creditor may attach present and future mandatory distributions from the Trust at the Trust level. §175.87B Query: Since this section applies only to Trusts created on or after November 1, 2010, should all Trusts be re-created (not just amended or restated) to obtain spendthrift protection?
- §175.85 contains a provision concerning spendthrift trusts which may conflict with §175.87. 60 O.S. §175.85 D. states that “a creditor shall wait until a distribution is received by a beneficiary before attachment”. There is an exception for an exception creditor. No mention is made of whether or not the Trust needs to contain a spendthrift clause for this Section to apply. 60 O.S. §175.85 does not have a specific effective date other than November 1, 2010.
- §175.87 C. contains an interesting provision which allows a Court to review the distribution discretion of a Trustee “if the Trustee acts beyond the bounds of reasonableness”.

7. §175.88 allows a Court to review the distribution discretion of a Trustee if the Trustee acts “beyond the bounds of reasonableness”. This section also states that the “only exception creditor” under the Act is a child of a beneficiary who has a judgment or court order against the beneficiary for support (same definition as in §175.82(7)). In addition, this section states that the sole and exclusive remedy of an exception creditor is the attachment of the beneficiary’s support interest at the Trust level. The court may limit the amount subject to attachment as “appropriate under the circumstances” to provide for the need of the beneficiary and the family of the beneficiary”.

8. §175.89 applies to trusts with one or more beneficiaries holding discretionary interests.

- A discretionary interest is not a property interest or an enforceable distribution right. It is a “mere expectancy”, but a beneficiary can bring an action against the Trustee!
- A Trustee may totally exhaust a trust for a discretionary beneficiary without liability. Trustee can directly or indirectly pay expenses for a beneficiary, without liability to the beneficiary’s creditors.
- A court may review a Trustee’s discretionary authority only if it is proved by clear and convincing evidence that the Trustee:
  - A. Acts dishonestly.
  - B. Acts with an “improper motive”.
  - C. Fails to act.
- There is no standard of “reasonableness” under the above review standard.
- The sole “factor” not to make a distribution does not constitute a failure to act. What does that mean?

9. §175.90 contains provisions which can limit an exception creditor. You can limit Trust distributions by prohibiting distributions which might result in a beneficiary’s loss of eligibility for State or Federal assistance. Even an exception creditor cannot attach present or future distributions, subject to this restriction.

10. §175.91 validates “springing” Trust provisions.
  - A provision that provides a remainder interest shall terminate or change upon attachment by any creditor (including an exception creditor) is valid.
  - A provision that provides a remainder interest shall terminate or change into a “dynasty interest” is valid. I could not find a definition of “dynasty interest” in the Act.

11. §175.92 provides that assets held in a revocable trust are subject to the claims of the Settlor’s creditors, during the lifetime of the Settlor and also subject to the provisions of the Family Wealth Preservation Trust Act.

#### **OTHER THOUGHTS**

1. Are the “old” spendthrift provisions at §175.25 repealed?
2. If the “old” spendthrift provisions are not repealed, which takes precedence? Is there an “automatic” application of the new statute?
3. What constitutes “modified” in §175.83 which would allow the new Act to apply?