Marquette Law Review

Volume 36
Issue 2 *Fall 1952*

Article 5

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Lawrence J. Binder, *Spendthrift Trusts in Wisconsin*, 36 Marq. L. Rev. 167 (1952).
Available at: http://scholarship.law.marquette.edu/mulr/vol36/iss2/5

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SPENDTHRIFT TRUSTS IN WISCONSIN

A recent decision by the Iowa Supreme Court, which settles the validity of a spendthrift trust in our neighboring state,[1] makes appropriate a re-examination of the Wisconsin position on this question. A spendthrift trust may be defined as one in which the beneficiary has the right to the income of the trust property for life, or a term of years, and which provides that his interest shall not be transferable by him, and shall not be subject to the claims of his creditors.[2] Or it may be more succintly stated as a trust wherein the beneficiary's right to the income is not subject to voluntary or involuntary alienation. In the spendthrift trust the beneficiary has the right to receive a certain income. This distinguishes it from the discretionary trust where whether the beneficiary shall receive any income or not is within the sole discretion of the trustees. Therefore, the beneficiary in such a trust cannot be said to have an ascertainable interest which could be the subject matter of a voluntary or involuntary transfer.[3]

A spendthrift trust is also to be distinguished from those trusts which provide that the beneficiary's right to income is subject to a condition precedent (for example, solvency or "after bankruptcy") and from those which provide that the beneficiary's interest is subject to a limitation over (condition subsequent) (for example, in the event of bankruptcy).[4]

And finally, a spendthrift trust is to be distinguished from what are called "support trusts." In these it is provided in the instrument that the trustee shall pay or apply only so much of the income or principal[5] as is necessary for the support and education of the beneficiary. Therefore, the beneficiary has no right to a fixed amount but only to the amount necessary for his support. The purpose is restricted and the beneficiary's interest is not subject to voluntary or involuntary alienation.[6]

In the majority of American jurisdictions today the spendthrift trust is recognized as valid.[7] However, some jurisdictions refuse to recognize their validity and while the trust as such is valid the restraints against voluntary and involuntary alienation of the beneficiary's interest

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[1] In re Bucklin's Estate, . . . Iowa . . ., 51 N.W. 2d 412 (1952).

[2] See RESTATEMENT OF TRUSTS §152.

[3] 1A Bogert on Trusts §226 (1951); 1 SCOTT ON TRUSTS §155 (1939); GRISWOLD ON SPENDTHRIFT TRUSTS §422 (2nd ed., 1947).

[4] 1A BOGERT ON TRUSTS §220 (1951).

[5] The validity of provisions in any type of trust which attempt to make the beneficiary's interest in the principal of a trust fund inalienable is a distinct problem not treated herein. In this regard see note in 119 A.L.R. 19 (1939), supplemented in 138 A.L.R. 1325 (1942).

[6] 1A BOGERT ON TRUSTS §1226; (1951); 1 SCOTT ON TRUSTS §154 (1939); GRISWOLD ON SPENDTHRIFT TRUSTS §430 (2nd ed., 1947).

[7] The cases are collected in 119 A.L.R. 19 (1939), supplemented in 138 A.L.R. 1325 (1942).

are void.[8] All, however, are agreed on certain basic premises. The trustee has legal title to both the principal and the income. The interest of the beneficiary is not a legal one but is rather an equitable right to demand and receive the income from the trustee as it becomes payable.

Perhaps the leading cases in support of spendthrift trusts are the Massachusetts case of *Broadway Nat. Bank v. Adams,*[9] decided in 1881, and the United States Supreme Court case of *Nichols v. Eaton,* [10] decided in 1875. *Brahmey v. Rollins,*[11] a New Hampshire case decided in 1935, is the leading American case holding spendthrift provisions invalid. In the very recent Iowa decision, referred to above,[12] the Iowa Supreme Court, after a full discussion of the above cases and the considerations involved on this question followed *Broadway Nat. Bank v. Adams* and ruled in favor of validity.

ARGUMENTS PRO AND CON

It is argued against validity that the common law rule of property invalidating direct restraints upon alienation applies with equal force to equitable interests.[13] On the other hand, it is said that the beneficiary's interest is a creature of equity, existing in spite of the rules of property and that equity can determine its nature.[14] With respect to the English view that the rule against restraints of alienation applies to equitable interests also, the United States Supreme Court said in *Nichols v. Eaton,* "This doctrine is one which the English Chancery Court has ingrafted upon the common law for the benefit of creditors, and is comparatively of modern origin."

In support of validity it is argued that the owner of property can use and dispose of property as he chooses. This is a fundamental right not to be curtailed unless the public interest demands.[15] In answer it is said that it is unconscionable that one should have property not subject to his debts.[16] But the proponents of validity reply that the creditors are not actually injured because in the donors hands they had no right to it and they simply remain in that status, and that further, they have no more right to rely on the trust income for payment as a basis for extending credit than they have to rely upon property exempt from creditors under state law.[17] To which the opponents say the creditors

[9] 133 Mass. 170, 43 Am. Rep. 504 (1881).
[10] 91 U.S. 716, 23 L. Ed. 254 (1875).
[11] 87 N.H. 290, 179 A. 186, 119 A.L.R. 8 (1935).
[12] *Supra* note 1.
[13] Brahmey v. Rollins, *supra* note 11.
[14] Broadway Nat. Bank v. Adams, *supra* note 9; *supra* note 1.
[15] "Why a parent, or one who loves another, and wishes to use his own property in securing the object of his affection, as far as property can do it, from the ills of life, the vicissitudes of fortune, and even his own improvidence, or incapacity for self-protection, should not be permitted to do so, is not readily perceived." Nichols v. Eaton, *supra* note 10.
[16] Brahmey v. Rollins, *supra* note 11.
[17] Broadway Nat. Bank v. Adams, *supra* note 9.
[8] *Ibid.*

are in fact deceived by the beneficiary's appearance of wealth and that it is in reliance thereone that they extend the credit.[18] In reply it is pointed out that all wills and most deeds are a matter of public record so that a diligent creditor can readily determine the beneficiary's interest.[19]

Again it is argued on the one hand that spendthrift trusts prevent a rapid dissipation and waste of wealth by the beneficiary whereas on the other hand it is said that the tying up of wealth in the hands of naturally conservative trustees does not make for a progressive economy and that the sepndthrift trust in particular by taking away all responsibility from the beneficiary tends to dampen initiative and create an indolent class.[20]

The proponents advance as a final argument that the effect of holding spendthrift trusts invalid is not a benefit to the creditor but is rather only a restriction upon the settlor. Admittedly, even in jurisdictions that do not recognize spendthrift trusts, the discretionary trust and the trust with a limitation over are valid.[21] Thus, the settlor can accomplish his purpose of keeping the right to income out of the control of the beneficiary and out of the hands of creditors quite as effectively as with the spendthrift trust. But it is more awkward. The settlor cannot fix the amount and other terms of his gift as his own discretion demands, but he must rely upon the discretion of a third party trustee. In short, as long as the settlor can accomplish his purpose by indirection, the refusal to allow him to accomplish it directly is rather a restriction upon him than a protection for third parties.

Although the spendthrift trust may be found valid it would seem to be well within the power of the Court of Equity which upholds them to circumscribe their effect as against those with what may be called a superior equity. Thus, although the contract creditor was free to extend credit or not, and it does not seem unfair to place upon him the burden of checking the credit risk or, upon his failing to do so, to place the risk of loss upon him, yet there is a class of claimants who did not voluntarily take the beneficiary as their debtor and as to whom it appears grossly unjust to allow the beneficiary to perhaps live in luxury and splendor while their just claims go unheeded. In this class are the claims of the wife and children for support and the divorced wife for alimony.[22] Perhaps also there should be included in this class the claims against the beneficiary by the victims of torts committed by him. Pos-

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[22] 1 Scott on Trusts §157 (1939).
[18] Brahmey v. Rollins, *supra* note 11.
[19] Broadway Nat. Bank v. Adams, *supra* note 9.
[20] The arguments as to the general social and economic effect are treated more fully in Griswold on Spendthrift Trusts, Sec. 555, and the conclusion is reached that a valuation of the relative weight of these arguments is impossible.
[21] Brahmey v. Rollins, *supra* note 11.

sibly the court should limit the spendthrift provisions as applicable only against voluntary alienation and the claims of contract creditors.

WISCONSIN STATUTES AND DECISIONS

In Wisconsin a number of statutes have some bearing upon the subject of spendthrift trusts. Section 273.02 was enacted in 1860 and repealed in 1935.[23] This statute provided in general for discovery of property of the debtor and, so far as here concerned, provided for discovery of any

> "property, money or thing in action due or held in trust for him . . . except where such trusts has been created by, or the fund so held in trust has proceeded from, some person other than the defendant himself."

Under this section, although every trust set up by someone other than the beneficiary might have been made a spendthrift trust, at least as to involuntary alienation,[24] in *Arzbacher v. Mayer*[25] the court held the exception inapplicable where the beneficiary "has the absolute power of transferring, conveying or assigning his interest in property so held in trust." This was on the grounds that New York had so decided before the adoption of the statute in Wisconsin and that to make such an absolute interest free from the claims of creditors is against public policy and the legislature could not have intended such an effect. This case was followed in *Meyer v. Reif*.[26]

Two more directly applicable statutes are:[27]

> 231.13 Profits of land liable to creditors. When a trust is created to receive the rents and profits of lands, and no valid direction for accumulation is given, the surplus of such rents and profits, beyond the sum that may be necessary for the education and support of the person for whose benefit the trust is created, shall be liable in equity to the claims of the creditors of such person in the same manner as other personal property which cannot be reached by an execution at law.
>
> 231.19 Alienation Restrained. No person benefically interested in a trust for the receipt of the rents and profits of lands can assign or in any manner dispose of such interest, but the rights and interests of every person for whose benefit a trust for the payment of a sum in gross is created are assignable.

Although actually the construction of these statutes was not in question in the *Arzbacher* case the court there gives with approval the New York construction. They must be construed together and the income of a beneficiary of a trust cannot be alienated by him, whereas any amount

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[23] WIS. STATS. (1933), sec. 273.02—repealed by Laws of 1935, Ch. 541, Sec. 267—1 WISCONSIN ANNOTATION TO THE RESTATEMENT OF TRUSTS §152 says the revisor noted that this section was unnecessary.
[24] See 119 A.L.R. 41 for cases from jurisdictions so holding.
[25] 53 Wis. 380, 10 N.W. 440 (1881).
[26] 217 Wis. 11, 258 N.W. 391 (1935).
[27] WIS. STATS. (1951), sec. 231.13 and sec. 231.19.

in excess of what is required for his education and support is subject to the claims of his creditors. But in *Lamberton v. Pereles*[28] the Wisconsin Court rejected the New York view that these statutes were applicable to personalty, as well as realty, saying the New York application of these statutes to personalty was based upon certain other provisions in their statutes which Wisconsin did not have.[29]

However, in *Meyer v. Reif,*[30] where the corpus of the trust was a cash fund, and the income over that necessary for support was to be accumulated until age twenty-five, the court quoted the provision of 231.19 as to a "sum in gross" as a reason why the creditor can get at the amount due at the age of twenty-five. Although the court did not rely for support solely upon this statute, yet it would seem that 231.19 may be severable, the first part referring to "the rents and profits of" realty only, whereas the second part refers to a "sum in gross" whether the corpus is land or personalty.

It seems certain in Wisconsin then that where the corpus of the trust is realty, we have a spendthrift trust by statute[31] up to the amount necessary for education and support in that the interest of the income beneficiary is not subject to either voluntary or involuntary alienation. However as to the excess of such income above that necessary for education and support, although it cannot be voluntarily alienated either,[32] under 231.13 it is subject to involuntary alienation. It should also be noted that often, although the corpus of the trust is land under the

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[28] 87 Wis. 449, 58 N.W. 776 (1894).

[29] This view, that these statutes do not apply to personalty, is followed in Williams v. Smith, 117 Wis. 142, 93 N.W. 464 (1903); Mangan v. Shea, 158 Wis. 619, 149 N.W. 378 (1914); Rust v. Evenson, 161 Wis. 627, 155 N.W. 145 (1915). An article in 35 Ill. L. Rev. 99 (1940) states Wisconsin has since adopted the New York statutory provisions (namely Chap. 287 of the Laws of 1925 amending Sec. 230.14, which relates to the suspension of the power of alienation, the amendment so far as herein pertinent reading, "Limitations of future or contingent interests in personal property are subject to the rules prescribed in relation to future estates in real propety,") upon which the distinction in *Lamberton v. Pereles* (*supra* note 28) is based and suggests that these statutes (231.13 and 231.19) would now be held to apply to personalty also. However, in *Will of Schilling,* 205 Wis. 259, 237 N.W. 122 (1931), the scope of this 1925 amendment was under consideration. It was contended that 230.37 (relating to the accumulation of rents and profits from real estate) was changed by this amendment to include personalty. The court, however, says that the purpose of the amendment was only to make the rule against the suspension of the power of alienation also applicable to personalty and that if the legislature had intended to amend 230.37 in addition it would have been a simple matter to do so. This holding would seem applicable as well to the contention that the application of 231.13 and 231.19 was changed by this amendment.

[30] *Supra* note 26.

[31] "The statute in question (namely 231.19) is often referred to as a spendthrift statute and was intended to protect beneficiaries against their own improvident acts whereby the purpose of the trust might be defeated." Baker v. Stern, 194 Wis. 233, 216 N.W. 147, 58 A.L.R. 462 (1927).

[32] Webber v. Webber, 108 Wis. 626, 84 N.W. 896 (1901); Patton v. Patrick, 123 Wis. 218, 101 N.W. 408 (1904).

doctrine of equitable conversion it may nevertheless be treated as personalty.[33]

The validity of a spendthrift trust where the statutes are inapplicable has not been settled. A number of Wisconsin cases have emphasized the right of the testator to control his property and the sanctity a court should place upon his wishes.[34] In two early cases there appear dicta expressly recognizing the right of the testator to restrain alienation.[35] In *Estate of Wakefield*[36] and *Mangan v. Shea*[37] it is specifically pointed out that there was no provision in the trust to shield the beneficiary from creditors or prevent him from alienating his income. In 1940 the Seventh Circuit Court of Appeals decided *Schwager v. Schwager*.[38] This case involved the right of the wife to claim alimony and the children to claim support from the beneficiary of a spendthrift trust which specifically expressed the intention that neither the first wife nor his children by her should receive any of the income. The court found the case was governed by Wisconsin law.

In attempting to decide what Wisconsin law is or should be the court laid down this proposition, "that a testator has the right to dispose of his property as his judgment may dictate—a doctrine firmly established in every jurisdiction so far as we are aware." In support of this proposition the court cited the United States Supreme Court case of *Nichols v. Eaton*[39] and a number of Wisconsin cases.[40] Both the majority and dissent assume the validity of the spendthrift trust in Wisconsin and only split as to the claims of the divorced wife and children, the majority holding that they cannot recover.

[33] An equitable conversion will be worked where the trustee is under mandatory direction, express or implied, to convert the property to personalty, and this is so even in the case where the time when he is to convert is left completely within his discretion. Will of Shilling, *supra* note 29.

[34] "The rights of an owner of property to control its use and management during his life and after his death within certain limitations imposed by law, are among the most sacred, and entitled to the most careful protection at the hands of the courts, without scrutiny as to the quality of his reasons in making such choice." Patton v. Patrick, *supra* note 32; and cases cited *infra* note 40.

[35] "The bounty of a grantor or testator may, however, be secured to another by means of a trust, a "spendthrifts," as it is sometimes called; so that the periodical income of the estate cannot be anticipated by the cestui que trust, but may be paid to him from time to time, beyond the power of creditors to intercept or reach it." Van Osdell v. Champion, 89 Wis. 661, 62 N.W. 539 (1895).

"It would seem that the founder of a trust fund may secure the benefits of the same to the object of his bounty by providing that the income thereof shall not be alienable by anticipation nor subject to be taken for his debts." Lamberton v. Pereles, *supra* note 28.

[36] 182 Wis. 208, 196 N.W. 541 (1923).

[37] *Supra* note 29.

[38] 109 F. 2d 754 (7th Cir., 1940).

[39] *Supra* note 10.

[40] Estate of Wilkins, 192 Wis. 111, 211 N.W. 652, 51 A.L.R. 1106 (1927); Graaf v. Kanouse, 205 Wis. 597, 238 N.W. 377 (1931); In re Boyles Estate 232 Wis. 631, 288 N.W. 257 (1939).

In 1943 the same question was presented to the Wisconsin Supreme Court in *Dillon v. Dillon*[41] with the distinction that here there was no express intent to exclude the wife and children. Although it was on just this distinction that the Schwager case was decided, Justice Fritz, writing the opinion, seems to disapprove of that decision and from his extensive quotations from the *Moorehead* case[42] in Pennsylvania he seems to indicate that regardless of the testator's intention he cannot cut off the rights of the wife and children. There is some question in the case whether it is being decided under Wisconsin or Pennsylvania law. As the appellants expressly raised the contention that Wisconsin law was applicable and yet the opinion does not consider the question, it would seem that the court considers the law of Wisconsin to be the same as that of Pennsylvania. Further, the court stated that the conclusions in the *Moorehead* case in Pennsylvania "as thus stated are sound." It would seem implicit in the court's consideration of whether the wife and children have a special right that the spendthrift trust as such is recognized as valid, although neither side raised this question in their briefs.

In 1944 in *Will of Razall*[43] a somewhat analogous situation came up. However, this case involved a support trust with a specific prohibition against the use of the trust income or principal for alimony or support of the beneficiary's divorced wife.[44] Justice Fritz did not sit and the court split three to three upon whether the divorced wife could subject any surplus over the amount necessary for the beneficiary's support to her claims for alimony, the result being an affirmance of the lower court's decision that she could not.

Wisconsin recognizes restrictions upon the power of alienation as valid in certain other situations. Under a Wisconsin statute the insured under a life insurance policy can provide that the beneficiary's interest in the proceeds cannot be alienated while they are in the hands of the company. Such a policy is not restricted in amount and provides a way to set up what is for all purposes a spendthrift trust through the medium of an insurance company.[45] Another situation is that the right of the wife to alimony is not subject to either voluntary or involuntary alienation.[46]

It is the conclusion of the writer that as a general proposition Wisconsin will recognize the spendthrift trust. However, as to certain favored claimants the prohibition against involuntary alienation may be

[41] 244 Wis. 122, 11 N.W. 2d 764 (1944).
[42] In re Moorhead's Estate, 289 Pa. 542, 137 Atl. 802, 52 A.L.R. 1251 (1927).
[43] 245 Wis. 416, 14 N.W. 2d 764 (1944).
[44] See Will of Razall, 243 Wis. 152, 9 N.W. 2d 639 (1943), where the provisions of this same trust were also before the court.
[45] WIS. STATS. (1951), sec. 206.39.
[46] Estate of Wakefield, *supra* note 36.

void. Where the corpus of the trust is realty, under 231.13 and 231.19, the income up to the amount necessary for education and support is inalienable and the surplus over this amount by 231.19 is not subject to voluntary alienation, but under 231.13 is subject to involuntary alienation so that the only question unsettled is whether 231.13 was intended to apply and allow involuntary alienation where the settlor specifically provides to the contrary. Under an identical statute a recent California case[47] held that the statute governs and the settlor cannot effectively prohibit involuntary alienation.

As the actual validity of spendthrift trusts has not been squarely settled in Wisconsin it is suggested that the attorney wishing to draw up such a trust should cover the possibility of such trusts being held invalid and the consequent frustration of the settlor's purpose. One way of doing this is to create a spendthrift trust with a limitation over, if the interest of the beneficiary is alienated, to a discretionary trust. Thus, if Wisconsin upholds the spendthrift trust the limitation over is completely ineffective and superflous, but, if they should be found invalid, then upon attempted alienation a discretionary trust by which the testator's purpose can also be fulfilled exists. An example of an instrument with such provisions is given in Griswold on Spendthrift Trusts.[48] The trusts instruments in *Schwager v. Schwager,*[49] and in *In Buchlin's Estate,*[50] and in *Canfield v. Security-First Nat. Bank*[51] appear to be of such a nature.

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[47] Canfield v. Security—First Nat. Bank 13 Cal. 2d 1, 87 P. 2d 830 (1939).
[48] Sec. 574.
[49] *Supra* note 38.
[50] *Supra* note 1.
[51] *Supra* note 47.