

NON-PROBATE TRANSFERS AND RIGHTS OF CREDITORS

By Bob Ciancola

Traditionally, when a person died, his or her property was transferred by a will. The process of admitting a will and carrying out its provisions in settlement of the decedent's estate is called probate. In current times, many other means of transferring property at death exist which do not involve probate. The Arizona law on non-probate transfers contains important rules on asset protection and creditors rights which should not be overlooked.

A non-probate transfer is a valid transfer effective at death by a decedent who, prior to death and acting alone, had the power to revoke or withdraw the transfer and who could have used the property for his own benefit or to satisfy creditors. Under A.R.S. § 14-6102(l), a transfer of real estate by right of survivorship is specifically excluded from the definition. This definition is broad enough to cover most common forms of property transferred by beneficiary designation, such as insurance proceeds, retirement accounts, pay-on-death designated bank accounts and securities with transfer-on-death designations. It appears it would not cover stock or accounts held as joint tenancies because the decedent would not ordinarily have the power to terminate the joint tenant's interest unilaterally. The definition clearly includes transfers at a person's death by common revocable trusts.

Under Arizona law, the recipients of non-probate transfers are liable to the decedent's probate estate for claims of creditors and statutory allowances to the decedent's spouse and children to the extent the probate estate is insufficient. This includes trust beneficiaries. If the trustee of the decedent's trust has already distributed assets to beneficiaries, those beneficiaries are liable to creditors of the decedent to the extent of their inheritance. If a creditor desires to initiate a proceeding to enforce the liability, a demand must be made upon the personal representative of the estate to present a claim to the trustee. If the personal representative refuses to do so, the creditors may, at their own expense, initiate a proceeding to require abatement. The action must commence within two years of the date of death, unless a claim has been submitted and disputed, in which case the limit is 60 days after final allowance. The personal representative may give notice to transferors of non-probate transfers, including insurance companies and trustees, that there is a deficiency in the probate estate. Upon such notice, the transferor may become liable if distribution is made without satisfaction of the claims of creditors.

Creditors Rights Under the Uniform Trust Code

Under the now-postponed UTC, the ability of creditors to obtain assets held in trust for a debtor is addressed. Although the UTC is under attack in Arizona and may not be allowed to take effect, it is arguable that they are already the law in Arizona, absent a statutory provision to the contrary, because they are to be found in the common law.

Under the UTC, The effectiveness of a trust against creditors depends on the inclusion of an effective spendthrift clause. Absent such a clause, creditors of a beneficiary can reach the beneficiary's interest by attachment. A spendthrift provision is valid only if it restrains both voluntary (e.g., pledging or assigning) and involuntary (e.g., bankruptcy)

transfers. There are exceptions to the protection from creditors that a spendthrift trust provides. It is not effective against:

- A judgment or court order for support in favor of a spouse, child or former spouse;
- A judgment creditor who has provided services for the protection of a beneficiary's interest in the trust (e.g., attorney or trustee);
- A claim of the state or federal government (including tax claims) where a statute so provides.

When the spendthrift clause is effective, it will prevent a creditor from attaching a beneficiary's interest or distributions (before receipt by the beneficiary), except when the beneficiary is entitled to mandatory distributions and the trustee has failed to make such distributions. Whether or not a trust has a spendthrift provision, a creditor (other than a spouse or child having a support order) may not compel a distribution where the distribution is discretionary with the trustee, even if a refusal of the trustee to make a distribution is an abuse of discretion or contrary to a standard expressed in the trust.

These protections against creditors do not apply to the settlor (the creator of the trust). During the settlor's lifetime and after his death, a creditor may attach property of a trust which was revocable during the settlor's life. In the case of an irrevocable trust, the creditor may reach the maximum amount which could be distributed to the settlor. Anyone who has the ability to withdraw money from the trust is treated as a settlor to the extent of the power to withdraw. In no event is the property of a trust subject to the claims of a creditor of a trustee who is not also a beneficiary.

Bob Ciancola is an attorney in Scottsdale practicing in business transactions, tax law and estate planning. He may be reached at 480 346-1080 or on his website at www.ciancolaw.com.