

Iowa Court Says Distributions Held by Spendthrift Trust are Protected from Creditors

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The case is [*A.Y. McDonald Industries, Inc. v. McDonald*, No. 21-1365 \(Iowa Ct. App. Aug. 31, 2022\)](#).

On August 31, 2022, the Iowa Court of Appeals held that a creditor cannot collect distributions from a spendthrift trust until the funds are in the beneficiary's control. A creditor attempted to garnish funds of two spendthrift trusts which were being held by a trustee for the debtor's benefit. The district court denied the debtor's motion to quash the garnishment. Because the debtor had not yet received the distributions, the Court of Appeals reversed the district court's order.



Background

A CEO of a manufacturing company agreed to pay restitution after misappropriating company funds. The CEO signed a limited power of attorney (LPOA) which allowed a third-party to collect the distributions the CEO received as a beneficiary of two spendthrift trusts and then transfer those payments to the company. The CEO attempted to revoke the LPOA and the company sued.

The [Court of Appeals](#) determined that “creditors can only collect after the trust has paid or distributed property to the beneficiary.” Therefore, a beneficiary of a spendthrift trust cannot make an irrevocable transfer of his right to future distributions. However, the court held that the CEO had breached the parties' agreement and was still liable for the funds.

The company resumed its collection efforts and the CEO, in a new lawsuit, petitioned to quash the garnishment. The district court denied the motion and authorized the collection of funds held by the trust. The CEO appealed.

Spendthrift Protections: Iowa Code 633A.2302

A spendthrift trust protects the beneficiary's interest from creditors as long as the interest is held by the trust. Restatement (Third) of Trusts § 58 cmt. d(2) (Am. Law. Inst. May 2022 Update); *see also* Iowa Code § 633A.2301. The CEO was a beneficiary of two spendthrift trusts, the J. Bruce McDonald Trust and the Delos L. McDonald Trust.

A bank, as the third-party garnishee, transferred the CEO's quarterly distributions from the J. Bruce McDonald Trust into a "subaccount." This allowed the other beneficiaries to receive their quarterly distributions. In the original lawsuit, the district court determined that the funds held in the subaccount were not entitled to spendthrift protections. The CEO did not appeal that ruling. Therefore, the court held that the doctrine of *res judicata* precluded the CEO from raising the issue on appeal.

The Delos L. McDonald Trust had also been allocating funds to the CEO; however, these funds remained within the trust account for the benefit of the CEO as the parties resolved their issues. The company argued that these allocations constituted "distributions." It also pointed out the fact that the bank had issued K-1 statements to the CEO to report the distributions as income on his tax return.

A beneficiary shall not transfer, assign, or encumber an interest in a trust in violation of a valid spendthrift provision, and a creditor or assignee of the beneficiary of a spendthrift trust shall not reach the interest of the beneficiary or a distribution by the trustee before its *receipt by the beneficiary*.

Iowa Code § 633A.2302(2) (emphasis added). At trial, bank employees testified that the distributions were discretionary. Unlike mandatory distributions, the courts cannot order payments of discretionary distributions from a trust. Iowa Code § 633A.2306(1).

Here, the CEO had accrued funds held in trust. The court concluded that the term "receipt" meant that the funds would be protected in the spendthrift trust until the CEO had control over them. Therefore, once the funds are distributed, they would be treated the same as any other property and the spendthrift protections would not apply. *Kiffner v. Kiffner*, 171 N.W. 590, 591 (1919).