Break 'Em Open: Accessing Trust Funds

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Sharon is President of Family Wealth, Eastern U.S. Region, for Wilmington Trust, N.A. She is responsible for overseeing the delivery of all Wealth Management services by teams of professionals, including planning, trust, investment management, family governance and education, family office, and private banking services. Sharon also heads Wilmington Trust's National Divorce Advisory Practice.

Sharon has over 25 years of experience in the wealth advisory arena and is a nationally recognized speaker and author. Global media company *Forbes* features Sharon as a Top Advisor in multiple categories since 2020. In 2023 she was selected as one of the Top 50 Women Wealth Advisors in America, one of the Top 10 in New York and one of the Top 5 in New York City. Leading business publication *Crain's* named Sharon to its 2020 inaugural list of the Most Notable Women in Financial Advice. In 2023, Sharon was chosen as a Leading High Net Worth Wealth Manager by *Chambers.* In 2018, she was honored by the UJA-Federation of New York Lawyers Division for her contributions to the trusts & estates community and the community at large. Sharon is a Fellow of the American College of Trust and Estate Counsel, a highly selective professional organization of preeminent estate planning attorneys in the U.S. and internationally. Sharon was inducted into the Estate Planning Hall of Fame in 2021. This award is considered the pinnacle of accomplishment in this field. Only 125 people across the U.S. have received this award since its inception in 2004.

Sharon is a member of The Rockefeller University Committee on Trust and Estate Gift Plans, the New York Bankers Association Trust & Investment Division Executive Committee, the Estates, Gifts and Trusts Advisory Board for The Bureau of National Affairs and the Thomson Reuters Trusts & Estates Advisory Board. She chairs the Domestic Relations Committee of *Trusts & Estates* magazine, where she sits on the Board, and is on the Advisory Board of *Family Lawyer Magazine*. Sharon is a past chair of the New York City Bar Association's Trusts, Estates and Surrogate's Court Committee, and a past chair of the New York State Bar Association's Trusts and Estates Law Section Taxation Committee. She served on the Board of the American Brain Foundation and was a member of its Finance Committee.

Prior to joining Wilmington Trust, Sharon was Managing Director at Lazard, the internationally renowned global investment banking and management company. In her role as Head of Wealth Advisory of Lazard Wealth Management, she led the delivery of all wealth advisory services. Before that, she headed the Estate department at Fiduciary Trust Company International. Sharon began her career as a trusts & estates attorney at Rosenman & Colin (now Katten Muchin Rosenman LLP).

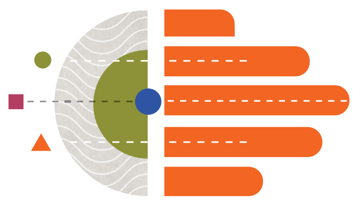
Sharon, who holds U.S., British and Australian citizenships, earned a master of laws from the Boalt Hall School of Law at the University of California, Berkeley, and received a bachelor of arts and a bachelor of laws from the University of New South Wales, Australia and is a Certified Divorce Financial Analyst.

WILMINGTON TRUST

MEMBER OF THE M&T FAMILY

CORPORATE FACT SHEET

The Wilmington Trust Advantage



With roots dating back to the founding of Wilmington Trust Company by T. Coleman duPont in 1903, Wilmington Trust has been serving successful individual and institutional clients for more than a century. Wilmington Trust is internationally recognized and has a team of experienced and skilled professionals focused on delivering a high caliber of service to every client relationship.

A powerful combination of strength and experience

We are proud to be part of the M&T corporate family, one of the 15-largest U.S.-owned commercial bank holding companies.[1]

M&T Bank Corporation data (as of 3/31/23)

— $203 billion in assets

— $176 billion in assets under management[2]

— $25 billion in shareholders' equity

— $132 billion in loans and leases

— $159 billion in deposits

— Tier 1 capital ratio: 10.15%

— Profitable for 187 consecutive quarters as of 3/31/23

The markets we serve

Global Capital Markets

— Clients in more than 90 countries

— Specialized trust services for capital markets financing structures

— Domestic and global institutional custody services

— Customized institutional investment capabilities

Wealth Management

— Wealth planning, investment management, trust and estate services, financial solutions, and private banking[3]

— Industry-recognized leaders in trusts, planning, and investments

— Dedicated to finding innovative solutions to complex situations

Retirement & Institutional Custody Services

— Directed trustee and custody services for institutional retirement and benefit programs

— 401(k) advisory services providing plan design, benchmarking, and governance

All investments involve risks, including the possible loss of principal. There is no assurance that any investment strategy will be successful.

1 S&P Global Market Intelligence as of March 31, 2023. Methodology excludes subsidiaries of foreign bank parents, investment banks, credit card companies, insurance company subsidiaries, brokers, and asset managers.

2 Wilmington Trust is a registered service mark, used for investment and other financial services offered to trust, individual, and institutional clients by certain subsidiaries and affiliates of M&T Bank Corporation, including, but not limited to, Manufacturers & Traders Trust Company (M&T Bank), Wilmington Trust Company (WTC), Wilmington Trust, N.A. (WTNA), Wilmington Trust Investment Advisors, Inc. (WTIA), Wilmington Funds Management Corporation (WFMC), Wilmington Trust Asset Management, LLC (WTAM), and Wilmington Trust Investment Management, LLC (WTIM). As of 3/31/2023. Assets under management data are calculated in the aggregate, and include assets managed by various Wilmington Trust entities -- including M&T Bank, WTC, WTNA, WTIA, WFMC, WTIM, and People's United Advisors, Inc. On 4/29/2023, Wilmington Trust sold its Collective Investment Trust business, which managed $97,717,974,705 in assets as of 3/31/23. The AUM reported as of 3/31/2023 includes the Collective Investment Trust AUM. WTC, operating in Delaware only, Wilmington Trust, N.A., M&T Bank, and certain other affiliates, provide various fiduciary and non-fiduciary services, including trustee, custodial, agency, investment management, and other services. International corporate and institutional services are offered through M&T Bank Corporation's international affiliates. Loans, credit cards, retail and business deposits, and other business and personal banking services and products are offered by M&T Bank, Member FDIC.

3 Private Banking is the marketing name for an offering of M&T Bank deposit and loan products and services.

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WILMINGTON TRUST

MEMBER OF THE M&T FAMILY

TRUST AND ESTATE SERVICES

The Delaware Dynasty Trust

Trusts may be effective estate planning tools as part of your overall plan. Wilmington Trust has managed trusts for families that span multiple generations, providing trusted fiduciary oversight and skilled administration.

Why might I need a Delaware dynasty trust?

If your goals include achieving multigenerational tax savings, creditor protection, and flexibility, you may want to explore establishing a Delaware dynasty trust. This type of trust is an irrevocable trust with the ability to stay in effect for multiple generations. Because future growth of the trust's assets may not be subject to estate, gift, or generation-skipping transfer (GST) taxes, the trust may in effect become a "family endowment fund" for future generations.

As the grantor, you would work with your attorney to establish the dynasty trust using appropriate GST tax and/or gift tax exemptions. The trust may be established as a sprinkle trust, which means that the funds held in the trust may be distributed or sprinkled to the beneficiaries as needed. The undistributed funds then typically grow free of wealth transfer taxes for the next generation and beyond.

If the dynasty trust is properly structured as a grantor trust for federal income tax purposes, you pay the trust's federal income taxes, allowing the trust to grow federal income-tax-free as well.*

The provisions of the dynasty trust may be drafted to help provide for your beneficiaries, while discouraging them from becoming too dependent on the trust for support, and it may also be drafted flexibly to permit the trustee to make distribution decisions.

Features of the Delaware dynasty trust when properly structured:

- Allows for the accumulation of wealth potentially without incurring additional transfer taxes
- Can protect the trust's assets from a beneficiary's creditors, including in a divorce settlement
- Permits income-tax-free growth of assets if the trust is a grantor trust for which you, as the grantor, pay the trust's federal income tax during your lifetime
- There is no Delaware state income tax on income or capital gains accumulated for beneficiaries who are not current Delaware residents
- Can be perpetual if funded with personal property; real estate can remain in trust for 110 years
- Long-term dynasty trusts are possible in a number of states; however, not all states offer the same benefits that may be available in Delaware, so it's important to consult with your advisors

* State income tax may apply in some cases, as not all states follow federal tax rules.

Continued

Key terms

Grantor: The person who creates a trust and who determines what property to include and who the beneficiaries will be.

Dynasty trust: A long-term trust created to pass wealth from generation to generation without incurring transfer taxes—such as the gift tax, estate tax, and GST tax (GSTT)—as long as assets remain in the trust.

Trust protector: The person named in the trust instrument with certain duties that may include the ability to appoint and remove trustees.

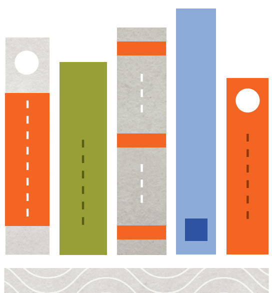
Important information to know

Under Delaware law you may appoint advisors to direct the trustee on a variety of matters. A distribution advisor, for example, can direct, consent to, or veto distributions from the trust, while a trust protector can remove or replace a trustee and assist with carrying out the grantor's goals in establishing the trust. Similarly, an investment advisor may direct the trustee on the investment of the trust's assets. This is particularly helpful for unique assets, such as a family business. This is not simple delegation of the investment duties with oversight by the trustee, but is a true separation of the duties, generally resulting in lower trustee fees.

The Wilmington Trust difference

We have extensive knowledge of Delaware's favorable laws for personal trusts and business entities, and have played a role in helping to shape the First State's trust and estate planning legislation.

Please contact us if you would like to learn more about the features of a Delaware dynasty trust.



Trusts may be effective estate planning tools as part of your overall plan. We've managed trusts for families that span multiple generations, providing fiduciary oversight and skilled administration.

TRUST AND ESTATE SERVICES

The Delaware Asset Protection Trust

Why might I need a Delaware asset protection trust?

If you are a doctor or dentist, corporate executive, business owner, or other professional who may have an increased chance of becoming subject to costly lawsuits due to the nature of your occupation, you may want to consider a Delaware asset protection trust (APT).

You can help preserve your financial security by placing some of your personal assets in an asset protection trust. Provided you remain solvent after the trust is funded, the trust assets should be protected from the claims of most creditors, while you retain certain benefits from the assets. It may also be beneficial if you are interested in prenuptial planning, or wish to maintain an "emergency" or "rainy day" fund.

Features of the Delaware asset protection trust:

- In certain instances, income tax on undistributed ordinary income and capital gains imposed by your state of residence may be mitigated
- Once you have created an irrevocable Delaware spendthrift trust, payments of income and principal may be made to the beneficiaries (including yourself) under certain circumstances as outlined in the trust agreement
- Possible estate tax savings can be achieved if the trust is considered a completed gift for federal gift tax purposes and its assets appreciate in value
- Helps protect assets from your own creditors
- Because Delaware APTs are immune from most claims by future spouses, your children can use them to shield assets from those claims without providing the financial disclosure that is required to implement effective prenuptial agreements
- Caveat: Keep in mind that asset protection trusts are irrevocable, meaning that once you have transferred assets to the trust, you cannot change your mind and pull them back out again

Important information to know

Delaware's distinctive trust law allows someone living anywhere in the United States, or the world, to create a Delaware APT. Even if you don't live in the state of Delaware, we can help you explore the reasons why you might consider establishing a new trust in Delaware or moving an existing trust to the First State.

Continued

Key terms

Grantor: The person who creates a trust and who determines what property to include and who the beneficiaries will be.

Asset protection trust: A trust created to hold an individual's assets to shield them from creditors.

The Wilmington Trust difference

Throughout our history, we have helped to shape trust, tax, and estate planning legislation in Delaware, gaining extensive knowledge of the state's favorable laws for personal trusts and business entities.

Please contact us if you would like to learn more about the advantages of a Delaware asset protection trust.

TRUST AND ESTATE SERVICES

The Spousal Lifetime Access Trust

Trusts may be effective estate planning tools as part of your overall plan. We've managed trusts for families that span multiple generations, providing trusted fiduciary oversight and skilled administration.

Why might I need a spousal lifetime access trust?

There are many types of trusts that can be used for estate planning and gifting purposes depending on your family's unique situation. One solution that can be effective for families is a spousal lifetime access trust (SLAT), which is an irrevocable trust created by one spouse (the grantor) that names the other spouse as a permitted beneficiary. The grantor spouse has indirect access to the trust assets through the beneficiary spouse. A SLAT permits a grantor to take advantage of some or all of the lifetime gift exemption from the federal estate tax while still making provisions for a spouse.

How does the SLAT work?

In general, the process involves the grantor spouse using a portion of his or her lifetime gift tax exemption to make an irrevocable gift to the SLAT. (The grantor retains his or her own attorney to properly create the SLAT.) The other spouse is named as a current beneficiary. Children and grandchildren may also be named as current beneficiaries, or they may only benefit after the beneficiary spouse passes away. The beneficiary spouse may receive income and principal without causing the trust to be included in either the grantor's or spouse's estates. If the grantor spouse allocated his or her generation-skipping transfer (GST) tax exemption to the trust, a SLAT may last for multiple generations—possibly free not only from the estate tax, but from the GST tax as well. Note, unlike a marital trust for the benefit of a spouse, a properly created SLAT will not be treated as part of the beneficiary spouse's estate on his or her death.

In planning a SLAT, there are certain circumstances when the grantor spouse no longer has access to indirect distributions from the trust, primarily divorce and death of the spousal beneficiary. In the event of divorce, it is unlikely the estranged beneficiary spouse would allow the former spouse indirect access to the trust. If not drafted correctly, the grantor spouse could potentially find the trust continues to support the beneficiary spouse even after the divorce. A second issue is when the beneficiary spouse dies. The grantor spouse no longer has indirect access. It is possible, however, in some jurisdictions for the decedent beneficiary spouse to appoint the trust assets back to a class of beneficiaries that may include the grantor spouse using a limited testamentary power of appointment to solve the access issue.

A SLAT can be funded with investment assets, business assets, life insurance, or even real estate, such as rental property or a vacation home. Typically, real estate is held in a limited liability company (LLC), with the trust holding some or all of the LLC membership units. If closely held business assets will be gifted to a trust, it can often make sense to restructure the business prior to making the gift, so that voting control can remain with the grantor and nonvoting stock (or units for an LLC) can be used to fund the trust.

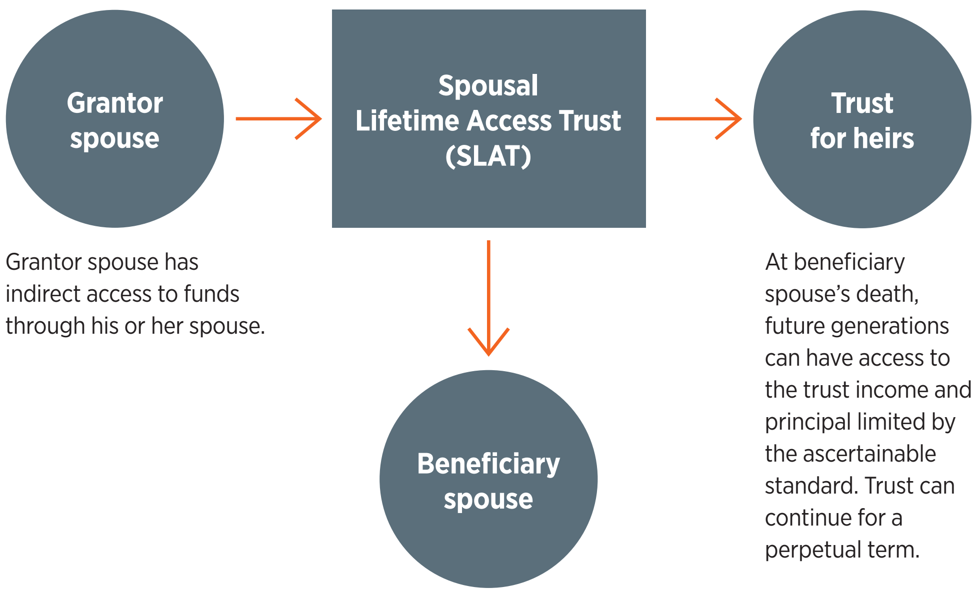
Continued

Structuring a SLAT

A SLAT may be structured as either a grantor or nongrantor trust for federal income tax purposes. The benefit of structuring it as a grantor trust is that the income and gains (deductions and credits) generated by the trust will be reported on the grantor spouse's federal income tax return, allowing the trust to grow without being reduced by federal income taxes. The payment of taxes is not considered a gift for gift tax purposes. An added value of making the SLAT a grantor trust is that it will allow the grantor to substitute assets inside the trust with assets outside the trust as a way to add in flexibility to manage income tax basis.

The grantor spouse may want to provide the beneficiary spouse with a testamentary limited power of appointment. This power would give the beneficiary spouse the option to allocate remaining trust assets to a limited class of recipients, usually children and grandchildren, and in certain jurisdictions it may be possible to add the grantor spouse. This provides additional flexibility to adjust the trust once the needs of future generations are better understood.

The trust income is included on grantor spouse's federal income tax return.



Grantor spouse has indirect access to funds through his or her spouse.

At beneficiary spouse's death, future generations can have access to the trust income and principal limited by the ascertainable standard. Trust can continue for a perpetual term.

For beneficiary spouse's lifetime, he or she may receive trust income and principal restricted to ascertainable standard of health, education, maintenance, and support if the spouse is the trustee. Other family members may also receive trust income and principal limited by the same ascertainable standard.

A properly drafted SLAT will enable the trust assets to not be included in beneficiary spouse's estate at his or her death and no further GST exemption will have to be allocated.

Continued

Key terms

Grantor: The person who creates a trust and who determines what property to include and who the beneficiaries will be.

Spousal lifetime access trust: An irrevocable trust created by one spouse (the grantor) that names the other spouse as a permitted beneficiary, along with children and/or grandchildren.

Lifetime gift exemption: The amount of money or assets you may give away over the course of your lifetime without having to pay the federal gift tax.

In deciding what to give to a trust, families need to consider:

- How much income is currently derived from the assets?
- Which assets are likely to appreciate most in value for the long-term benefit of the family?
- Which assets would be preferable to keep in the grantor's estate so that his or her heirs will inherit a full fair market value basis at death (by contrast, assets given during life keep the grantor's basis so that the recipient may have income tax from a future sale of the gifted asset)?
- How much income and assets need to be retained to continue the current lifestyle?

Important information to know: Beware reciprocal trusts

In some circumstances, each spouse may wish to create a SLAT benefiting the other spouse. Such trusts need very careful drafting, by the grantor's own attorney, and must be sufficiently different from each other to avoid treatment as "reciprocal trusts," which result in the assets being taxed to the grantor's estate after all.

The Wilmington Trust difference

As skilled fiduciaries, we have considerable experience administering many types of trusts. We work closely with you, as the grantor of the trust, and with your beneficiaries to provide personal and attentive service.

Please contact us if you would like to learn more about the features and benefits of a spousal lifetime access trust.

Trusts may be effective estate planning tools as part of your overall plan. We've managed trusts for families that span multiple generations, providing fiduciary oversight and skilled administration.

TRUST AND ESTATE SERVICES

The Qualified Personal Residence Trust

Why might I need a qualified personal residence trust (QPRT)?

If you have a beloved family home that you would like to leave to your heirs while also mitigating taxes, a QPRT is a commonly used strategy to facilitate the generational transfer of family residences in a tax-efficient manner.

How does a QPRT work?

As the grantor, you transfer a primary or vacation residence to the trust and retain the legal right to live in the residence for a specified period of time.

- Because the transfer is irrevocable, a gift is deemed to be made to the remainder beneficiaries of the trust at the time of transfer
- The value of the gift, however, can be substantially reduced by the value of your right to live in the house for the term
- You are responsible for paying property taxes and may receive any relevant tax deductions that accompany ownership of the property
- At the end of the specified term, the residence is transferred to your beneficiaries free of any other taxes
- Your beneficiaries may rent the house back to you, but you cannot have any prearrangement with them to this effect
- A QPRT can be a good way to transfer a second residence, such as a vacation home, as many people are not comfortable with giving up their primary home

Important information to know

The term of the trust should be set short enough so that you, the grantor, are likely to live longer than the trust term. Of course, the shorter the trust's term, the smaller the potential tax benefits. However, if you do not outlive the term, the house would just revert back to you as though the strategy had never been put in place. When a QPRT is used as part of a comprehensive wealth transfer plan, it can help to mitigate estate taxes by transferring a residence to trust beneficiaries at a reduced value. However, there are also disadvantages to using a QPRT. For one, if you survive the term, you will have to pay rent on the property you no longer own. You will also lose certain property tax benefits, as the home may be reassessed for its current market value.

Continued

Key terms

Grantor: The person who creates a trust and determines what property it will include and who its beneficiaries will be.

QPRT: Formally called a qualified personal residence trust, this type of trust allows its creator, or grantor, to remove a personal home from his or her estate for the purpose of reducing the amount of gift tax that is incurred when transferring assets to a beneficiary.

Fiduciary: A person to whom property or power is entrusted for the benefit of another; one often in a position of authority who obligates himself or herself to act on behalf of another (as in managing money or property) and assumes a duty to act in good faith and with care, candor, and loyalty in fulfilling the obligation.

The Wilmington Trust difference

As seasoned fiduciaries, we have experience administering many types of trusts. We can work closely with you, as the grantor of the trust, as well as with your beneficiaries to provide personal and attentive service.

Please contact us if you would like to learn more about the features and benefits of a qualified personal residence trust.

WILMINGTON TRUST

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TRUST AND ESTATE SERVICES

The Grantor Retained Annuity Trust

Trusts may be effective estate planning tools as part of your overall plan. Wilmington Trust has managed trusts for families that span multiple generations, providing trusted fiduciary oversight and skilled administration.

Is a grantor retained annuity trust right for me?

If you are looking for a way to transfer wealth to your heirs in a tax-efficient way, a grantor retained annuity trust (GRAT) may be a strategy to consider. This trust can be particularly useful if you wish to retain an income stream during your lifetime while still achieving tax benefits on the ultimate transfer of the trust's assets.

How does a GRAT work?

- The GRAT is established as an irrevocable trust into which you can transfer assets that are expected to appreciate
- It provides you, the grantor, with an income—in the form of annuity payments—throughout the trust's term, usually a specified number of years
- At the trust's creation, the Internal Revenue Service (IRS) allows you a gift tax deduction for the actuarial value of the income interest that is retained, thus reducing the gift tax cost of transferring the assets
- The present value of the retained interest is based on the annuity payout for the term of the trust and is calculated using the interest rate specified in Internal Revenue Code Section 7520, which changes monthly
- This estate planning technique actually freezes the current value of the assets transferred into the trust; if the assets appreciate at a rate greater than the stated IRS rate, your beneficiaries will receive the excess appreciation amount free of gift or estate tax obligations
- At the end of the trust term, the assets pass to family members outright or in further trust

Important information to know

Setting the length of the GRAT term is material: you should consider your age and health as you must survive the GRAT term for an effective transfer. A substantial part, and possibly all of the GRAT assets, may be included in your estate if you pass away before the end of the GRAT's term—as though the GRAT never existed. You could help mitigate that risk by purchasing life insurance to cover the estimated amount of any federal and state estate tax that would be due if you did not survive the term of the GRAT.

Continued

Key terms

Grantor: The person who creates a trust and determines what property it will include and who its beneficiaries will be.

Grantor Retained Annuity Trust: A financial instrument used in estate planning to minimize taxes on large financial gifts to family members. Under these plans, an irrevocable trust is created for a certain term or period of time.

IRC Section 7520 Rate: The rate to be used for valuing annuities, life interests, or interests for terms of years and remainder or reversionary interests. This is the rate used in GRAT planning.

The Wilmington Trust difference

As skilled fiduciaries, we have considerable experience administering many types of trusts. We can work closely with you, as the grantor of the trust, as well as with your beneficiaries to provide personal and attentive service. We've helped many families and business owners take advantage of the benefits available through GRATs.

Please contact us if you would like to learn more about the features and benefits of a grantor retained annuity trust.

Break 'Em Open: Accessing Trust Funds

By: Sharon L. Klein
Executive Vice President
Head of National Divorce Advisory Practice
Wilmington Trust, N.A.

When a married couple's trust planning is done and a marriage dissolves, who can access assets in trusts created by spouses or other family members?

A key question for advisors is the extent to which trust assets can be considered in a divorce proceeding. Whether included in determining how marital assets are divided or factored into the calculation for alimony or child support, the driving inquiry is whether trust assets are reachable.

I. Can Trust Assets be Accessed in Divorce?

To determine whether trust assets are considered marital property, the key question is generally whether the interest of the beneficiary spouse is a property interest that can be considered an asset under the relevant state's law. If so, the methodology used to value the trust interest will be situation-specific, and can also depend on state law. Note that trust interests are routinely valued for transfer tax purposes based on actuarial calculations, and that may be one approach to consider.

Even if excluded from the marital estate for division purposes, the trust may be considered in determining alimony and child support obligations. If a beneficiary spouse was receiving trust distributions on which the family relied for support, the issue is whether those distributions can be factored into the court's analysis.

From separate property states (where a spouse's assets acquired via gift or bequest are generally protected from division in divorce) to all-property states (where a court can divide all assets of the spouses, irrespective of how received), to equitable distribution or community property regimes within those states, the law across the country is highly state-specific. While much will depend on state law in terms of whether a beneficiary's interest can be considered in a divorce proceeding, the starting point will be to determine the nature of the trust interest. Trusts created by third parties (that is, not created by a spouse) in which the beneficiary does not have access or control will afford the strongest protection. It will be foundational to review the trust terms.

A. Start with the Trust Terms

The less certain it is that a beneficiary spouse will receive trust distributions, the less likely a court will find that the trust assets are reachable in divorce. Whether a beneficiary spouse can access the trust is dependent on a number of factors:

1. Who created the trust?

Courts are less likely to consider an irrevocable trust created by a third party as part of the marital estate. The trust principal will not typically be subject to division if the spouse beneficiary is not able to access the trust assets, but a claim for alimony or child support can potentially succeed if there has been a pattern of reliance on trust distributions to support the martial lifestyle. Third party trusts that are revocable are generally treated as mere expectancies since a beneficiary's interest is extinguishable. ***In re Marriage of Githens***, the Oregon Court of Appeals held that a husband's beneficial interest in his mother's revocable trust, which was revocable at his mother's whim, was too speculative to be considered "property" that could be divided in a dissolution case.[1] While a revocable trust created by a party to the marriage should not have any impact on the division of the marital estate since the grantor spouse can modify or revoke the trust at any time, it can be useful to create a revocable trust before marriage to help clearly distinguish separate property from marital assets, and can minimize the risk of commingling or transmutation.

2. Who are the beneficiaries?

If the trust includes a class of beneficiaries, including multiple people over current and future generations, as opposed to the beneficiary spouse being the sole beneficiary, it will be less likely that the beneficiary spouse will receive trust distributions. Since the timing and amount of any potential distribution is difficult to ascertain, particularly if the class of beneficiaries is left "open" (i.e., the class includes beneficiaries not yet born, such as future issue, leaving the number of potential beneficiaries undeterminable), it is less likely the trust interest will be reachable in divorce.

3. On what basis can trustees make distributions?

The more likely a trustee is to make distributions to a beneficiary spouse, the more likely the trust assets will be considered in a divorce proceeding.

a. Check the trust language:

Trust distribution language that *requires* the trustee to make distributions (the trustee "shall," "must" or "will" pay) causes trust assets to be more vulnerable to attack in divorce than trust distribution language that gives the trustee discretion about whether to make distributions (the trustee "may," or "can"). Mixing distribution standards can lead to confusion: For example, providing that a trustee "shall" make distributions in its sole discretion.

If a trustee is required to pay income or principal to a beneficiary, that beneficiary will likely have the right to compel trust distributions in accordance with the trust terms, and the assets to which that beneficiary is entitled may be factored into the divorce balance sheet. Often, a trust can combine mandatory and discretionary provisions (for example, a trustee may be required to pay all income to a beneficiary while principal distributions remain discretionary with the trustee). In that case, the mandated distributions might be considered a resource in a divorce proceeding while the uncertain discretionary expectancy might not.

b. What is the standard pursuant to which trustees can make distributions?

If a trustee is given broad authority to make distributions within its sole discretion, the timing and amount of distributions is uncertain; no beneficiary is *entitled* to distributions. It is less likely a court will find such a discretionary interest reachable in divorce than if the trustee's ability to pay out to a beneficiary was linked to a so-called "ascertainable standard." A common ascertainable standard is health, education, maintenance and support. That standard tracks language in the Internal Revenue Code (IRC) and is often used to avoid an adverse tax consequence. An ascertainable standard bestows upon a beneficiary the right to compel a trustee to make distributions in accordance with that standard, which might make those distributions accessible in divorce. In contrast, if the trust contains a broad discretionary standard, a beneficiary ordinarily will only have a claim against the trustee if that beneficiary can demonstrate the trustee has abused its discretion – a formidable standard.[2]

A seminal case on the significance of a broad discretionary standard is the Massachusetts case of ***Pfannensteihl v. Pfannenstiehl***.[3] A trust created by husband's father after husband's marriage named an open class of beneficiaries, composed of father's living issue, which at the time of trial totaled 11 people. The independent trustees could make income and principal distributions, equally or unequally among all beneficiaries, in their sole discretion, to provide for the beneficiaries' comfortable support, health, maintenance, welfare and education. The trustees had made irregular and unequal distributions, including not making any distributions in some years. Specifically, from 2004-2007 the trustees did not make any distributions. From 2008-2010, the trustees made regular distributions to the husband and his siblings. The trustees did not make any further distributions to the husband after the divorce complaint was filed, although they continued to make distributions to the husband's siblings. The lower court initially held that the husband had a one-eleventh interest in the trust, and awarded the wife a portion of it. The decision was reversed on appeal, with the appellate court finding that the husband's interest was too speculative: the interest in a completely discretionary trust was nothing more than an expectancy, and was not assignable to the marital estate. Fundamental to the courts determination were the facts that the class of beneficiaries was open and generational in nature (rendering the husband's one-eleventh interest susceptible to further reduction), the trustees' distribution discretion was broad, it could be exercised unequally among beneficiaries, it was in fact exercised unequally in the past, and the trust contained a specific provision that the settlor's "overarching intent" was that the trust assets would not be treated as marital property or counted as assets available to a beneficiary in a divorce action.

Importantly, in ***Pfannensteihl***, the court noted that because the trial judge determined to divide the husband's trust interest, the judge did not use any future stream of income from distributions in assessing alimony, and did not award alimony. The appellate court noted that, since it concluded that the trust should not have been included in the divisible marital estate, it may be appropriate on remand for the judge and the parties to revisit whether alimony was now appropriate.

Notably, if a trust provides for principal to be distributed at certain ages, once the money is paid out of the trust (unless a technique for preventing that, such as decanting, is successfully implemented), the trust protection will be lost completely, and those assets will be treated as owned by the beneficiary.

4. Is there a "spendthrift" provision?

A spendthrift clause is commonly inserted in trust documents as a form of creditor protection. It circumvents a beneficiary's creditors, which can include an ex-spouse, from accessing trust assets while they remain in trust. It prohibits a beneficiary from pledging, assigning, selling or transferring their interest in the trust and provides that a beneficiary's interest will not be subject to that person's debts or liabilities. In essence, creditors must wait until a distribution is made to a beneficiary to assert any claims against those assets.

This is an example of a spendthrift clause:

> *No individual interested in the income from and/or principal of any Trust shall pledge, assign, transfer, sell, or otherwise dispose of any portion or all of such income and/or principal, or have the power to anticipate, charge or encumber any portion or all of such income and/or principal, and no interest in such income and/or principal shall be subject to the debts, liabilities or obligations of such individual.*

Some states preclude any beneficial interest in a trust that is subject to a spendthrift provision from being classified as marital property.[4] Depending on the state, however, alimony and child support may be treated differently, and trust funds may be factored into the analysis despite the presence of a spendthrift clause. Indeed, a spendthrift clause does not necessarily prevent a court considering a trust interest as part of the marital estate and, although that interest itself may not be reachable, equalizing with assets outside the trust.

In ***Levitan v. Rosen***,[5] a decision that has been found troublesome by many practitioners, the issue before the Massachusetts Court of Appeals was whether the wife's beneficial interest in an irrevocable discretionary trust governed by Florida law, which contained a spendthrift provision, was includable in the marital estate for equitable distribution purposes. The wife also had the right to withdraw five percent of the trust principal annually, which she exercised consecutively for three years. The wife was the sole beneficiary of the trust, clearly showing the settlor's intent to benefit her exclusively, and she had received trust distributions in the past. The court was not persuaded by the fact that an absolute discretion standard governed, so that the wife did not have a *right* to future distributions. The court included the wife's entire interest in the trust as part of the marital estate subject to equitable distribution, despite finding that the wife's interest was protected by the spendthrift clause, including her five percent withdrawal right since that right was expressly subject to the spendthrift provision. The court circumvented the spendthrift clause by assigning the wife's trust interest to her exclusively, leaving it to the trial judge to distribute the remaining marital property, in his discretion.

In ***Smith v. Smith***,[6] the Supreme Court of Minnesota held that a beneficiary of a spendthrift trust who had an unqualified present right to withdraw certain amounts of trust principal at specified ages (one-third at age 35, two-thirds at age 40 and all at age 45) could, by a stipulated property settlement in a divorce proceeding, make a binding and enforceable agreement to transfer to the other party at a future date such portion of the principal of the trust assets as he, at the time of the agreement, had the unqualified right to presently possess and own. According to the court, the enforcement by court order of a provision of a divorce decree embodying this stipulation does not violate the settlor's intent with respect to the spendthrift provisions of such trust.

Some courts have omitted discretionary interests in spendthrift trusts from the marital estate for division purposes, but have taken those interests into account for alimony purposes.[7]

It may also be possible to move a trust to different jurisdiction to circumvent a spendthrift provision, as was successfully accomplished in the ***Matter of Cleopatra Cameron Gift Trust, Dated May 26, 1998***.[8] Under California law, a spendthrift clause does not a prevent a claim for child support against trust assets, but under South Dakota law a creditor cannot compel child support payments from spendthrift trusts. In the ***Cleopatra*** case, trusts that contained spendthrift provisions were moved from California to South Dakota to circumvent an order of a California family court directing the trustees to pay child support from trust funds.

Cleopatra Cameron's father created trusts for her benefit that were governed by California law. Cleopatra subsequently married in 2005, living in California with her husband and two minor children until her husband filed for divorce in 2009. In 2012, in her capacity as trustee, Cleopatra moved the trusts from California to South Dakota, a corporate trustee was ultimately appointed and stopped making child support payments to husband. The Supreme Court of South Dakota confirmed that, while the obligation to pay child support was determined under California law and very much intact, it was South Dakota law that determined whether the order could be enforced. According to the Supreme Court, full faith and credit considerations are not implicated in the means of enforcing judgements, and the South Dakota court was not required to submit to a California order compelling trust payments that were expressly prohibited under South Dakota law.

5. Does a beneficiary have control powers?

The greater the powers of a beneficiary to exert control over a trust, the greater the likelihood that a court will consider the beneficiary's interest in a divorce proceeding. Common features frequently inserted in trust agreements to give a beneficiary some measure of control without triggering adverse tax consequences include the beneficiary's acting as trustee (while not being permitted to make discretionary distributions to himself or having other powers that trigger negative tax implications), having the power to remove and replace trustees or other advisors or having a so-called power of appointment. A power of appointment allows a beneficiary to direct the disposition of trust assets. A testamentary power of appointment can be exercised only at death, whereas a lifetime power of appointment could allow the appointee of the power to redirect trust assets at any time. Depending on the terms of the power, a spouse who has a lifetime power of appointment might be able to exercise substantial control over the trust assets, potentially making those assets more vulnerable in divorce. Even a testamentary power has been used to argue that a beneficiary had a level of control over trust assets.

In ***Matter of Nerbonne***,[9] the parties to the marriage funded a Family Trust with marital assets, including liquidated investments and funds from a buy-out package the husband received from his employer during the parties' marriage. The Supreme Court of New Hampshire determined that the trust was a marital asset because the parties retained extensive rights and powers to control the trust and trust funds since the wife was trustee and a beneficiary of the trust and the husband as grantor had the power to remove the wife as trustee at any time and for any reason. Furthermore, the wife as trustee had the ability to distribute funds to herself for her health, maintenance, support and education, appoint a special trustee who could, without limitation, distribute some or all of the trust funds to the wife as beneficiary, and amend or terminate the trust for any reason. Since the trust was a marital asset, the court remanded the case for the trial court to determine an equitable division of the trust.

6. Is the settlor's intent clear?

Under common law principles and the Uniform Trust Code (UTC), it is axiomatic that the settlor's intent is paramount. In ***Pfannensteihl***, the court noted that the settlor's "overarching intent" was that the trust assets would not be treated as marital property or counted as assets available to a beneficiary in a divorce action. In ***Tannen*** (discussed below) the settlor's stated intent in the trust document was that the beneficiary should not be permitted, under any circumstances, to compel distributions of income and/or principal prior to the time of final distribution.

7. Who is the trustee?

If an independent, neutral trustee is acting, particularly a corporate trustee, this usually removes even the appearance of impropriety and can circumvent the suspicion that a family member/friend acting as trustee is manipulating trust distributions for the benefit of a trust beneficiary.

B. Consider the History of Trust Distributions

A court can consider the history of trust distributions to identify any patterns and consider whether couples have used trust funds to support their lifestyle. In other words, have trust distributions "become part of the fabric of the marriage?"[10]

In the leading New Jersey case ***Tannen v. Tannen***,[11] wife's parents established an irrevocable trust for their daughter's sole benefit, with an ascertainable distribution standard. The trustees, in their sole discretion, could make distributions for the wife's health, support, maintenance, education and general welfare as they determined would be in her best interest, after taking into account her other financial resources, which the court found could include alimony and child support. The trust had paid for certain marital expenses during the marriage, including real estate taxes on the marital home, home improvements and private school for the children. The lower court, which ordered the joinder of the trustees (the wife and her parents), imputed a $4,000 monthly trust distribution to wife, ordered the trust to make that payment (which would have reduced the husband's spousal support obligations), and to continue making the other marital trust payments. The Appellate Division reversed.

The appellate court's driving inquiry was whether the wife's interest was an "asset held by" her or whether she had "control" over the trust's income generation or "the ability to tap the income source." The court noted there was no history of distributions to the wife, and pointed to the settlor's stated intent in the trust document that the wife should not be permitted, under any circumstances, to compel distributions of income and/or principal prior to the time of final distribution. The trust also contained a spendthrift provision. The court interpreted the fact that the wife had yet to receive a direct distribution from the trust, which had been in existence for seven years, as evidence that the wife did not have control over the trust or access to trust income. While acknowledging that decisions in other jurisdictions do not reflect unanimity (different courts making distinctions between whether the beneficial interest in a trust is an asset or whether it is reachable by a spouse seeking the payment of child support or alimony already awarded), the Superior Court of New Jersey, Appellate Division, concluded that the trust assets would not be included in the marital estate or used to reduce the wife' claim to alimony or child support. The appellate court also held that the trial court had no power to order the trustees to make a distribution and that the trustees were not proper parties to the litigation. The Supreme Court of New Jersey affirmed the decision.[12]

C. Courts can Consider the Value of a Trust Interest

Even if a spouse's assets in a trust are not included as marital property, the court may still consider the value of trust assets as an economic circumstance in determining the equitable division of the marital estate. In ***In re Marriage of Holman***,[13] the Illinois court noted that, in apportioning the marital property, the court is directed specifically to consider the "value of the property set apart to each spouse."[14] The court held that factor especially important in this case, noting that the wife received a significant amount of nonmarital trust property from her predeceased first husband. According to the court, the wife's significant amount of nonmarital property justified an award of most of the marital property to the husband.

D. Trust Assets May Impact Alimony and Child Support Payments

The settlor's intent, conditions placed on trust distributions, the frequency of distributions, and the beneficiary's ability to access trust funds will also impact whether a nonbeneficiary spouse can access trust assets for alimony and child support payments. As seen in ***Tannen***, one way a settlor can give guidance to the trustee regarding distributions is by making a distribution conditional on the trustee considering the other financial resources available to the beneficiary. If history reveals that no distributions have been made to a beneficiary, that strengthens the position that trust assets should not be considered as a resource available to the beneficiary spouse.

On the other hand, if a divorcing spouse can access trust funds and receives distributions, a court may consider those distributions, and the expectancy that they will continue, when calculating alimony and child support, particularly if the distributions have funded a couple's lifestyle. In the New York case of ***Alvares-Correa v. Alvares-Correa***,[15] the court explicitly stated: "A party's interests in trusts can be taken into account when making maintenance and child support awards." The court considered husband's trust interests in determining whether he would be able to afford maintenance and child support, although his interest in the trust property was not evaluated for equitable distribution purposes. Indeed, the burden was on the husband to show that the extensive trust assets were not available to him. The trial court found that the husband had not met that burden, and the appellate court found no reason to disturb that finding. Not only was the husband a vested beneficiary of the four trusts at issue, he also had a power of appointment, which allowed him to direct the distribution of the trust assets. The court found that the husband had control and management over the trust assets and, pursuant to the trust documents, had "complete and unfettered access to those funds."

In ***In re Marriage of de Guigne***,[16] a husband was ordered to pay child and spousal support that exceeded his total monthly income. Husband was born into wealth and social prominence and he and his wife lived an opulent lifestyle, although neither was employed. The court found it more consistent with the statutory principles of child support in California to consider all of husband's assets in determining his earning capacity, including income from securities holdings and family trusts.

In ***Guagenti v. Guagenti***,[17] the Court of Appeals of Ohio determined that, even though the corpus of an irrevocable trust established by husband's father was not an asset belonging to either spouse, the court could take into consideration income the husband received for the purposes of calculating child and spousal support.

Similarly, in ***D.L. v. G.L.***,[18] a Massachusetts Appeals Court found a husband's interests in certain trusts too remote or speculative to be included within the marital estate, while considering fixed and recurring distributions of income for purposes of determining alimony and child support. According to the trial judge, other than for income payments, that trusts had "never been part of the fabric of [the] marriage."

In ***Sullivan v. Sullivan***,[19] husband was a beneficiary of a trust that provided that no interest of any beneficiary shall be subject to claims for alimony or support. The trust distributions husband received were deposited into a joint bank account held by him and his wife, which was the same account from which the family's bills were paid. The trust distributions were used to purchase cars for the wife and the parties' children, to pay for the children's private school and college tuitions, to renovate the marital residence, and to rent a second house where the family resided for a period. Since the trust distributions were deposited into a joint account and used for family expenses, the court concluded that the evidence was sufficient to prove that the trust distributions had been "used regularly for the common benefit of the parties during their marriage." The Civil Appeals Court of Alabama affirmed the trial court's divorce judgment that the wife was entitled to 25% of any distribution that the husband actually received from the trust.

E. Trusts Created by the Parties to the Marriage

Trusts created by the spouses themselves, instead of third parties (parents, grandparents, etc.) are also common. The parties might not realize the consequences of transferring marital assets into an irrevocable trust during the marriage - until they are going through a divorce. If a marital asset is transferred into an irrevocable trust, it can lose its character as marital property. If the asset is no longer considered marital property, it may not be considered for equitable distribution purposes, even if the asset was a marital asset prior to the transfer. Where an irrevocable trust is set up for the benefit of third parties and neither spouse is a trustee or has a beneficial interest, it has been held that a court may not dispose of it, even if one or both of the spouses created or funded it.[20] The relevant question is whether a spouse has an interest in the trust's assets or control over them, not the source of the trust assets.[21]

In the Missouri case of ***Loomis v. Loomis***,[22] the wife transferred her life insurance policy to an irrevocable trust that was created during the marriage. The Missouri Court of Appeals, Eastern District, agreed with the wife that the life insurance policy could not be classified as marital property. Since the wife was only the settlor of the trust, not a trustee or beneficiary, the wife had no ownership interest in the life insurance policy. Pursuant to the terms of the trust, upon divorce, husband lost his status as beneficiary, highlighting the pivotal importance of the specific trust terms. The appellate court held that the trust was not a marital asset subject to division because neither the husband nor the wife was a trustees or beneficiary, and neither of them had any ownership interest in the trust assets.

Similarly, in the New York case of ***Markowitz v. Markowitz***,[23] the Appellate Division, Second Department, found that the Supreme Court erred in awarding the cash surrender value of a life insurance policy to the wife. According to the appellate court, although marital assets placed in a trust may be subject to equitable distribution, here the trust was irrevocable, and neither spouse was trustee with the power to transfer control of the trust assets. Accordingly, the trust assets were unavailable to either party.

In ***Vanderlugt v. Vanderlugt***,[24] the New Mexico Court of Appeals found no community lien interest in the corpus of an insurance trust where neither party had a property interest in the Trust, even though policy premiums came from community funds before the policy became self-funding.

However, where the facts point to unfair behavior, courts have come to a different conclusion.

In ***Kim v. Kim***[25] an Ohio Court of Appeals affirmed a trial court's decision that the cash value of the life insurance policies within a trust were marital property because (1) the premiums were paid for with martial monies and (2) despite the fact the policies were held in trust, husband retained control over the policies and had taken loans again the cash value during the marriage. Husband, a self-identified estate and trust attorney, stated that he personally drafted and executed the trust and named his brother as the trustee. He further testified that although wife was the current primary beneficiary of the trust, once their divorce was finalized, she would be deemed to have predeceased him and their three children will become the primary beneficiaries.

In ***Yerushalmi v. Yerushalmi***[26] the Appellate Division of the New York Supreme Court found that a residence that had been transferred to a trust was still marital property. The parties purchased a marital residence in 1983. In 1995, wife transferred the title to a qualified personal residence trust (QPRT) and the couple continued to reside there. The QPRT had a 23-year term.

If wife died before the term ended, the home would be disposed of as part of her estate. If the QPRT terminated after 23 years, the property passed into a further trust. In 2013 husband listed the marital residence for sale. Wife moved to enjoin husband from selling or transferring the residence.

The Supreme Court, upon determining that the marital residence was not a marital asset because it was owned by the QPRT, and not by the parties, denied those branches of the motion. However, the Appellate Division reversed, holding that, since the marital residence was purchased by the parties during their marriage, using marital funds, it was presumed to be marital property. According to the court: "The fact that title had been transferred to the QPRT, *allegedly for estate planning purposes*, while the parties continued to reside at the marital residence, was, under the circumstances here, insufficient to rebut the presumption…" (Italics added). As authority for that proposition, the court cited to ***Riechers v. Riechers,***[27] where the husband established an off-shore trust in the Cook Islands, naming himself, the couple's children and "Spouse of the Settlor" as beneficiaries (wife would cease to be a beneficiary after divorce since she was not designated by name). Although the ***Riechers*** court did not find explicitly that the transaction was a subterfuge to deliberately secret marital assets out of reach of wife, the court held that the value of the irrevocable trust asset was subject to equitable distribution. According to the court:

> "…a cause of action would not lie to set aside the trust since the trust was established for the legitimate purpose of protecting family assets for the benefit of the Riechers family members. Nevertheless, it is clear and unequivocal, that the … Trust [was] funded with marital assets…the question remains, therefore, whether… the value of marital assets placed in an irrevocable trust is subject to equitable distribution? The answer is in the affirmative…this Court awards to the plaintiff one-half of the value of the marital assets placed in the Cook Islands Trust by the defendant…to wit: $2,000,000."

Certainly, if a trust is created by a spouse into which assets are transferred with the intent to fraudulently defeat the rights of the other spouse, the trust will be set aside.[28]

The court in ***Villi v. O'Caining-Villi***[29] distinguished ***Riechers*** in a case similarly involving a similar QPRT that was created by spouses to hold their marital home. The home was purchased by the husband after the marriage with a loan from his parents and was initially transferred into a family partnership where husband and wife each held a 49.5% partnership share and the wife's son from a prior marriage held the remaining 1%. The home was later transferred by the spouses to a Family Trust. The expenses and carrying charges were paid using marital funds. The ***Villi*** court found ***Reichers*** was factually distinguishable in two central aspects. First, in ***Reichers***, the parties were the beneficiaries of the trust established by the husband. Thus, there was some expectation that in consideration of the transfer of marital assets to the trust, the wife would receive some distributions in the future. In ***Villi***, the only benefit received by either party under the trust agreement was the right to reside in the home during their lifetimes. Secondly, by virtue of the manner in which the wife's capacity under the ***Reichers*** trust was defined, upon the divorce of the parties she was no longer the "Spouse of the Settlor," and thus was no longer a beneficiary, although the husband remained a beneficiary who was entitled to receive distributions from the trust. The ***Villi*** court found the ***Reichers*** situation clearly different from the one before them, where the trust agreement explicitly denied either party any right to receive a distribution under any circumstances. Ultimately, the ***Villi*** court found that what the parties accomplished by their transfer of the home to the Family Trust was akin to the making of a gift of the home to wife's son, subject only to the condition that both parties may continue to reside in the home during their respective lifetimes: "Thus viewed, the Home no longer constitutes marital property."

In ***Oppenheim v. Oppenheim***,[30] the court refused to equitably distribute the value of a family trust despite the wife's accusations that her husband "commandeered" the family trust, the funding of which came from assets in her name. The wife pointed out that, although the family trust was ostensibly intended to benefit the parties' children, the husband had the power to discharge the independent trustee, was himself a permissible beneficiary and also had a testamentary power of appointment exercisable in favor of any beneficiary, not just the children. Notably, the wife never challenged the validity of the family trust, nor sought to set it aside. Rather, she sought equitable distribution, not of the actual funds held by the family trust, but of funds of equivalent value from her husband's other assets. The appellate court gave deference to the trial court's credibility assessments and agreed that the creation of the family trust and the terms of the trust itself did not support the wife's contentions that the husband acted inequitably in regard to the trust's formation. Although the trial court found it "troubling" that the attorney who created the trust communicated "for the most part" only with the husband, it ultimately found that the husband kept the wife informed during the process and that the wife was fully aware of the source of funding and the trust's anticipated tax implications. The wife reportedly later sued the attorney for malpractice. This case serves as an important reminder that it may be prudent to include in engagement letters that, when an attorney is planning for spouses, the advice is rooted in optimizing planning for the spouses as a married couple, which does not necessarily mean that the planning will be equally fair to both in the event of divorce.

F. Definition of "Spouse" is Key

Note the importance played by a trust agreement's definition of the term "spouse/wife/husband." Some documents make it clear that a divorced spouse will cease to be a beneficiary, either by using a "floating spouse" concept (the spouse to whom the trust creator is married from time to time is the beneficial spouse, a flexible definition that can adjust and readjust after divorce and remarriage), or by naming a particular spouse, provided the spouse and the trust creator remain married. In the absence of guidance in the document addressing divorce or requiring that the parties remain married, courts can search for the creator's intent by examining the trust provisions.[31]

In ***Ochse v. Ochse***,[32] the court had to interpret the word "spouse" in a trust instrument. The grantor named her son's "spouse" as a beneficiary. At the time of the trust's creation, the son was married to his first wife, but they later divorced after thirty years of marriage, and he subsequently remarried. The issue was whether the settlor intended the term “spouse” to mean her son’s spouse at the time she created the trust or if the term “spouse” was intended to describe a status, not an individual, since the first spouse was not specifically named as a beneficiary.

After much litigation, the Texas Court of Appeals finally affirmed that the term “spouse” referred to the son’s first spouse at the time of execution, and not a class of persons that would include the second spouse. The court was not persuaded to view “spouse” as a status or class gift, finding that interpretation failed to harmonize the trust’s provisions and was inconsistent with Texas precedent regarding the use of class gifts. This prolonged litigation could have been avoided by carefully defining “spouse” to prevent ambiguity.

G. Marital Trusts can Impact Premarital Planning

In ***Crawford v. Crawford***,[33] the Indiana Court of Appeals held that a joint revocable trust amended a couple’s premarital agreement. A day before their wedding, the husband instructed wife to go to his lawyer’s office to sign the premarital agreement, which set forth their individual assets and provided that neither had interest in the property of the other as a consequence of their marriage, divorce, or death. When the parties were married, wife was seven months pregnant and working at husband's dental practice. Wife sold her house and the proceeds were deposited into husband's dental practice checking account. Wife's other assets were lost in a fire. Twelve years after they wed, the parties jointly executed a trust, naming husband and wife co-trustees and lifetime beneficiaries and funding the trust with all their property. The trust did not acknowledge the premarital agreement. At the time the trust was executed, husband had retained most of his premarital assets.

The trial court found, and the appellate court agreed, that the trust trumped the premarital agreement, being later in time and totally contrary in philosophy and intent to the premarital agreement. In particular, according to the appellate court, the trust pulled the parties’ separate premarital estates into the trust, providing the parties with joint and equal control over all the assets transferred into the trust.

This case is another important reminder of how important it is for trusts & estates and family lawyers to collaborate and insure marital trust planning dovetails with premarital planning.

H. Asset Protection Trusts

A trust specifically designed for asset protection can present additional formidable obstacles for creditors, including an ex-spouse. A Delaware Asset Protection Trust (DAPT) is an irrevocable trust created under Delaware law, with a Delaware trustee. Neither the trust creator nor any of the beneficiaries need to live in Delaware to create a Delaware trust. In most jurisdictions, it is not possible for a person to create a trust for themselves and protect the assets from their creditors. Under Delaware law, however, the DAPT generally limits the ability of an individual’s creditors to reach the trust assets, while allowing the creator of the trust to remain a trust beneficiary. The creator can retain the right to receive current income distributions, the right to receive a 5% annual unitrust payout and the ability to receive income or principal in the discretion of an independent trustee. While Ohio[34] is one of 20 jurisdictions that has enacted some form of asset protection legislation, it is very common for clients to look outside their home states in setting up these trusts: A driving reason to create an asset protection trust is to build obstacles creditors must overcome. Having to initiate an action in a different jurisdiction, rather than the settlor's home state where the creditor is likely situated, creates additional hurdles to bringing suit. When selecting a trust jurisdiction, Delaware is often the jurisdiction of choice because of its attractive laws. Additionally, while legislation in some states is very new, Delaware has the distinction of being one of the first jurisdictions in the country to enact domestic asset protection laws over two decades ago.

Delaware requires a creditor to bring an action against a DAPT in the Delaware Court of Chancery. For claims arising after an individual creates a DAPT, there is a four-year statute of limitations.[35] For claims arising before an individual creates a DAPT, a creditor must bring suit within four years after creation of the trust or, if later, within one year after the creditor discovered (or should have discovered) the trust.[36] For all claims, the creditor must prove by clear and convincing evidence that creation of the trust was a fraudulent transfer as to that creditor.[37] A very limited number of creditors can pursue claims against a DAPT. In the family context, a spouse, former spouse, or minor child who has a claim resulting from an agreement or court order for alimony, child support, or property division incident to a judicial proceeding with respect to a separation or divorce may potentially reach the assets of a DAPT,[38] but a spouse whom the client marries *after* creating the trust may not take advantage of this exception. Accordingly, since future spouses cannot generally assert claims against a DAPT, clients or their children can establish these trusts to protect assets from claims of future spouses, without providing the financial disclosure that ordinarily is required for enforceable prenuptial agreements.[39]

Giving an independent corporate trustee broad discretion to make distributions to a class of beneficiaries, instead of predicating distributions on an ascertainable standard, is also recommended since a court would be less likely to find such a discretionary interest reachable in divorce.[40] Some practitioners are also recommending inserting provisions in the documents that require a beneficiary's spouse to waive marital rights to trust assets each time the beneficiary is eligible to receive a principal distribution, before the distribution can be made. Others prohibit the trustee from making distributions to any married beneficiary who does not have a prenuptial agreement.

I. Uniform Trust Code Creates Exception Creditors

For those states that have adopted the Uniform Trust Code (UTC), including Ohio, §504 (b) establishes the general rule, which forbids a creditor from compelling a distribution from a discretionary trust, whether or not the trust contains a spendthrift provision, even if the trustee has failed to comply with the standard of distribution or has abused a discretion. Under UTC §504 (d), the power to force a distribution due to an abuse of discretion or failure to comply with a standard belongs solely to the beneficiary.

UTC §504 (c) creates an exception for support claims of a child, spouse, or former spouse who has a judgment or order against a beneficiary for support or maintenance. While a creditor of a beneficiary generally may not assert that a trustee has abused a discretion or failed to comply with a standard of distribution, such a claim may be asserted by the beneficiary's child, spouse, or former spouse enforcing a judgment or court order against the beneficiary for unpaid support or maintenance. The court must direct the trustee to pay the child, spouse or former spouse such amount as is equitable under the circumstances but not in excess of the amount the trustee was otherwise required to distribute to or for the benefit of the beneficiary.

Note that the UTC creates an exception to a spendthrift clause for creditors who have a judgment for support that they are trying to enforce against the beneficiary's trust interest. That is different from the question as to whether a court will consider a beneficiary's interest in a trust for the purposes of determining spousal support. Note also that some states, like California, have adopted the UTC provision, which explicitly excepts children, spouses, or former spouses with support orders. Other states, like North Carolina[41] and Texas,[42] limit the exception from creditor protection to a beneficiary's child who has a judgment or court order, omitting the exception for a spouse or former spouse. In Ohio, exception creditors are limited to children and the current spouse only; a spendthrift provision is enforceable against the beneficiary's former spouse.[43]

Other states, including Delaware, provide significantly greater protection for discretionary trust beneficiaries. When determining trust situs for clients, practitioners should give careful attention to the protections afforded by different state's laws.

<u>Lessons learned for analyzing if a trust is vulnerable to attack in divorce:</u>

The following factors have shown to provide the greatest protection against a future ex-spouse:

- Being prepared before marriage with a prenuptial agreement can shield trust assets in the event of divorce. The requirements for enforceable prenuptial agreements can vary with state law, but they should be signed as far in advance of the marriage as possible and generally require that:
    - The agreement is fair and equitable when signed, and potentially at the time of enforcement as well;
    - There has been full and adequate disclosure;
    - Each party has been represented by competent counsel.
- Shielding separate property in a revocable trust before marriage can help clearly distinguish separate property from marital assets, and can minimize the risk of commingling or transmutation.
- Trust terms are critical, and these features have helped insulate a trust from attack:
    - A trust standard with broad, unfettered discretion;
    - An open class of beneficiaries (instead of one beneficiary);
    - A specific waiver of the trustee's duty of impartiality with the respect to distributions to sanction irregular and uneven distributions among beneficiaries and avoid a possible claim by an ex-spouse that the trustee is breaching fiduciary responsibilities by omitting a spouse beneficiary from receiving distributions;
    - A detailed spendthrift provision;

- An independent corporate trustee;
- Requiring a beneficiary's spouse to waive marital rights to trust assets each time the beneficiary is eligible to receive a principal distribution, before the distribution can be made;
- Prohibiting the trustee from making distributions to any beneficiary who is married without a prenuptial agreement;
- If a trust is created during the marriage by one of the parties, subject to not jeopardizing a marital deduction for tax purposes:
  - defining spouse as the spouse to whom the trust creator is married at the time a distribution is made, so the definition self-adjusts with a new marriage;
  - requiring that the parties be married for the trust creator's spouse to be a potential trust beneficiary.

II. <u>Trust Decanting Can be a Powerful Tool: Revising an Otherwise Irrevocable Trust</u>

When irrevocable trusts are drafted in happier times, and then times change, is it possible to reduce or even eliminate the interest of an ex-spouse or soon to be ex-spouse? Trustees potentially have access to powerful tools that might change beneficial interests. Indeed, it might be said that there is no such thing as an "irrevocable" trust. In any event, advisors should counsel clients to investigate the options.

"Decanting" is a technique that allows the trustee of an otherwise irrevocable trust to transfer the trust assets into a new trust with different terms. The rationale behind decanting is that a greater power should include a lesser power: If a trustee can make outright discretionary distributions to a beneficiary, then the trustee should also be permitted to do something less than an outright distribution and instead distribute trust assets into another trust for that beneficiary. Decanting can be a tremendous tool for dealing with changed circumstances, making trustee changes, correcting mistakes, facilitating tax benefits or optimizing a trust's administration. In the divorce context, a trustee might be able to use the decanting technique to limit a beneficiary's interest, or even eliminate a beneficiary.

Ferri v. Powell-Ferri,[44] is a recent example of the power of decanting in the divorce context. Trust assets were successfully moved out of reach of a divorcing wife, although they were considered for alimony purposes**.** Husband was the beneficiary of a trust (the 1983 Trust) created by his father under which he had the right to receive the trust assets at certain ages. The trust was valued between $69 – $98 million. The trustees, who were concerned divorcing wife would reach trust assets, transferred the assets to a new trust (the 2011 Trust) without the knowledge or consent of husband. At the time of the creation of the 2011 Trust, husband had a right to request outright 75% of the 1983 Trust assets, and during the course of the legal proceedings, his right matured to 100%. The new 2011 Trust extinguished husband's power to request trust assets at stated ages, making distributions solely discretionary with the trustees. Wife had filed to dissolve the marriage in Connecticut. The trusts were settled in Massachusetts. The Connecticut Supreme Court asked the Supreme Judicial Court of

Massachusetts to determine whether the trustees, one of whom was husband's brother, validly exercised their powers under the 1983 Trust to distribute the trust property to the 2011 Trust. The Massachusetts Court determined that since husband's father, who created the 1983 Trust, intended to convey to the trustees almost unlimited discretion to act, the decanting was authorized. The Massachusetts Court did not rule on whether the trust assets must be considered in the divorce, including for alimony purposes.

The Connecticut Supreme Court issued two opinions in the ***Ferri*** matters, one related to the decanting, the other related to the divorce action.

Action for Declaratory Judgment: Decanting was Authorized[45]
The trustees sought a judgment declaring that they were authorized to decant assets to the new trust, and that wife had no right or interest in those assets. The Connecticut Supreme Court adopted the opinion of the Massachusetts Supreme Judicial Court, and held that the decanting was proper.

The Connecticut Supreme Court did affirm the determination of the Connecticut trial court that wife had standing to challenge the trustees' actions because their actions regarding the original trust directly affected the dissolution court's ability to make equitable financial orders in the underlying dissolution action. Under Connecticut law, the 1983 Trust was a marital asset because husband had an absolute right to withdraw up to 75%, and later 100% of the principal.

Action for Dissolution of Marriage: 2011 Trust not Marital Asset, but Could be Considered in Alimony Determination[46]
The court noted that the Massachusetts Supreme Judicial Court determined that the decanting was appropriate: "Consequently, the assets from the 1983 Trust cannot be considered as part of the dissolution judgment..." With regard to the 2011 trust, because that was a so-called "spendthrift trust" (protected from creditors), it was not considered an asset of the marital estate that the court could divide under Connecticut law. Wife's status was that of a creditor and the court held that, although the court could divide the assets while they were held in the 1983 Trust (Connecticut and Massachusetts, so called "kitchen sink" states, can consider gifts and inheritances received during marriage to be martial property subject to division), it could not reach them once they were moved into the 2011 Trust. The decanting was successful in removing the assets from division.

However, the court noted that, although the trial court could not consider the assets decanted to the 2011 trust for equitable distribution purposes, it could and did consider husband's ability to earn additional income when crafting its alimony orders. The trial court found that the trust funds had routinely supported husband's investments. Notably, the trial court ordered husband to pay wife $300,000 in alimony annually, despite the fact that, when the action was commenced, he had been earning only $200,000 annually.

Some Further Thoughts About Decanting

Note that about half the states, including New York[47] and Ohio,[48] provide statutory authority to decant.[49] Most states require that notice be given to beneficiaries. Ohio requires at least 30 days written notice of the intended exercise of the decanting power to recipients, including qualified beneficiaries.[50] It was important in the ***Ferri*** case that the decanting occurred without husband's permission, knowledge or consent. Query if the same result would follow if a beneficiary was given notice of the decanting, or whether notice alone would not detract from the Connecticut Supreme Court's holding that husband took "no *active* role in planning, funding or creating the 2011 Trust" (emphasis added).

Including decanting provisions in trust instruments may maximize flexibility without resort to state default law. Indeed, in a New York case, ***Davidovich v. Hoppenstein***,[51] the trustees successfully relied on their powers under a trust document to distribute a life insurance policy on the settlor's life to a new trust that excluded an estranged daughter of the settlor and her issue. Dismissing an objection that the transfer did not satisfy the requirements of the New York decanting statute, the court held that the New York decanting statute had no bearing on the case since the trustees relied on their powers under the document to effectuate the transfer.

In ***Hodges v. Johnson***,[52] however, a New Hampshire court found that trustees had violated their duty of impartiality because they did not consider the interests of beneficiaries who were removed in decantings. The court found that the decantings were void and ordered the removal of the trustees. Although the court's decision rested on broader grounds, the facts of the case may have influenced the holding: The trial judge found that the trustees decanted the trusts to remove beneficiaries in three separate decantings at the request of the settlor and commented on the "deeply personal and harsh nature of the decantings." The beneficiaries who were removed were the grantor's second spouse, his stepchildren and one biological child, leaving his other two children as beneficiaries. In each of the three decantings, one of the two individual co-trustees resigned; the settlor's estate attorney was appointed as trustee to replace the trustee who resigned; the co-trustee who remained as trustee delegated his decanting power to the attorney/trustee; and the attorney/trustee executed the decanting documents. Once the decanting documents were executed, the attorney/trustee resigned as co-trustee, and the individual trustee who had resigned was re-appointed. This occurred on three successive occasions.

Perhaps this is just a reminder that trustees must be vigilant about performing their fiduciary obligations, and cannot act at the behest of the settlor or any other individual. Including specific guidance in trust agreements as to why the settlor may wish the trustee to exercise discretion unevenly may be helpful.

III. Other Potential Ways to Modify Trust Distributions: Power to Adjust & Unitrust Regimes

A trustee must invest assets pursuant to the so-called Prudent Investor Rule. Under that rule, a trustee is required to invest for "total return." That is, a trustee must invest in a way that benefits both income and principal beneficiaries. However, when beneficial interests clash - as they typically do in a divorce scenario - the source of return becomes critical, and the tension between investing for income and investing for growth can become more pronounced. Specifically, how does a trustee invest without considering whether return is produced from income or from capital appreciation when the income beneficiary (perhaps a second spouse) is pressuring the trustee for more income and the remainder persons (perhaps children from a prior marriage) are pressuring the trustee for more growth?

Fortunately, there are two regimes that provide trustees with the means to implement the mandate of total return investing - the power to adjust and unitrust regimes. Under a power to adjust regime,[53] the trustee is permitted to make adjustments between income and principal to be fair and reasonable to all beneficiaries. In other words, even if a principal distribution is not permitted under a trust document, or is permissible pursuant only to a very limited standard (like health or education), the trustee can "redefine" a portion of the principal as income, and pay that to the income beneficiary. Under the unitrust regime, the trustee can convert an income beneficiary's interest into a unitrust payout of a fixed percentage of the trust's principal. Most states allow a trustee to determine the appropriate unitrust payout within a band of 3-5%. In a few states, the unitrust payment is fixed. In New York, for example, the unitrust payment is fixed at 4%.[54]

These two regimes are intended to ease the tension between competing income and remainder beneficiaries and align interests, so all beneficiaries benefit from the trust's growth, wherever that growth may emanate. Every state in the country has enacted one or both regimes, and every trustee or advisor should be aware of these powerful tools. In the matrimonial context, a trustee might consider whether to evaluate existing trust terms in the event of divorce to potentially adjust beneficial interests.

Shifting Beneficial Interests by Opting into a Unitrust Regime

In ***Matter of Jacob Heller***,[55] the trustees defended a challenge to their determination to opt into the unitrust regime. Jacob Heller created a trust under his will for the benefit of his second wife, who was to receive income for her life. Decedent's children from a prior marriage were named as remainder beneficiaries, and two of those stepchildren, the decedent's sons, became trustees.

When Mrs. Heller's two stepsons became trustees of the trust, Mrs. Heller's annual trust payment was $190,000, far above a 4% payout. In 2003, the co-trustees opted into the unitrust regime pursuant to New York law to reduce the payment to their stepmother to 4% *and* opted to make their election retroactive to January 1, 2002 (the date the unitrust regime became effective in New York). As a result of the unitrust election, Mrs. Heller's annual income from the trust was reduced from $190,000 to $70,000. As result of making the election retroactive, Mrs. Heller would have owed the trust $360,000 ($120,000 a year from the date of the 2005 decision, back to each of the three preceding years).

Mrs. Heller commenced a proceeding seeking to annul the unitrust election on the grounds that the co-trustees were also remainder beneficiaries of the trust and conflicted from making that decision, and a determination that the unitrust election could not be made retroactive to January 1, 2002. The court reasoned that the co-trustees owed fiduciary duties to Mrs. Heller as an income beneficiary, but also to all remainder beneficiaries, including the trustees' siblings. The fact that the remainder beneficiaries' interests aligned with the interests of the co-trustees did not disqualify them from opting into the unitrust regime.[56] As such, a question of fact remained as to whether the co-trustees acted reasonably, precluding summary judgment on that issue.

Additionally, since the New York statute allowed a trustee to specify the effective date of a unitrust election, the Court of Appeals held that the co-trustees' retroactive application of the unitrust election was proper. (Note that in some jurisdictions the unitrust election can only be made prospectively). Since the decision in the ***Heller*** case, New York law has been revised; a retroactive unitrust election is still possible, but only with court approval.[57] In other states, including California, it appears that the unitrust can be exercised only prospectively.[58] A state-by-state analysis is required to determine whether a power to adjust or unitrust election can be made retroactively.

A sampling of state statues is set forth below:

State	Power to Adjust	Power to Adjust Guidelines	Unitrust Regime	Unitrust Regime Guidelines
Delaware	Yes Del. Code Ann. Tit. 12, §61-104	No guidelines	Yes Del. Code Ann. Tit. 12, §61-106	3%-5% Unitrust
Florida	Yes Fla. Stat. Ann. §738.104	No guidelines	Yes Fla. Stat. Ann. §738.1041	3%-5% Unitrust or 50% of AFR
Indiana	Yes Ind. Code §30-2-14-15	Trustee must first consider power to invade principal or income	Yes Ind. Code §§ 30-2-15-1-30-2-15-26	4% if trustee proposes and no objection; 3%-5% by agreement
Kentucky	Yes Ky. Rev. Stat. Ann. §386.454(1)	No guidelines	Yes Ky. Rev. Stat. Ann. §386.454(2)	3-5%; 4% if fiduciary makes no determination
Michigan	Yes Mich. Comp. Laws § 555.504	No guidelines	No	
New York	Yes EPTL §11-2.3(b)(5)	No guidelines	Yes EPTL §11-2.4	4% Unitrust
Ohio	Yes Ohio Rev. Code Ann. §5812.03	Safe harbor for adjustments up to and including 4%	No	
Pennsylvania	Yes 20 Pa C.S. §8104	No guidelines	Yes 20 Pa C.S. §8105	4% Unitrust
West Virginia	Yes W. Va. Code §44B-1-104	Trustee must first consider power to invade principal or income	Yes W. Va. Code §44B-1-104a	3%-5% Unitrust

Note that even if a divorce action is taking place in one state, a spouse may be a beneficiary of a trust governed by the laws of another jurisdiction, so familiarity with the operation of that other state's power to adjust or unitrust laws may be important. Typically, state statutes provide a number of factors for a trustee to consider in determining whether or not to make an adjustment or opt into the unitrust regime.[59]

IV. New Considerations in Light of Tax Act

On December 22, 2017, the Tax Cuts and Jobs Act (the Tax Act) was signed into law. The Tax Act has created significant ramifications in the divorce context, particularly on the income tax front.

A. Alimony Payments Have Lost their Taxable/Tax Deductible Status: Courts Begin to Deal with Impact

Until 2019, alimony payments were characterized as taxable income to the recipient and deductible by the payer.[60] With the spouse paying alimony likely to be in a higher income tax bracket than the recipient spouse, the recipient spouse potentially was able to pay taxes on the alimony at a lower rate. The paying spouse received the benefit of a deduction at a higher tax bracket. This bracket play often resulted in overall tax savings between the parties.

Under the Tax Act, alimony payments made pursuant to a divorce or separation agreement signed after December 31, 2018 are no longer treated as taxable income to the recipient, and alimony payments cannot be deductible by the payer. Divorce or separation agreements signed before January 1, 2019 will be grandfathered. However, since a prenuptial agreement is likely not included in the definition of "divorce or separation agreement," a prenuptial agreement signed before January 1, 2019 likely will not be grandfathered if the divorce decree that incorporated its terms is issued after December 31, 2018.

All prenuptial agreements signed before January 1, 2019 must be reviewed in light of these changes. A report prepared by the Family Law Section of the American Bar Association describes the unfairness to a couple who entered into a prenuptial agreement with alimony provisions based on the assumption that the alimony deduction would be available:"…the parties who agreed to pay alimony on the assumption that it would be tax deductible will now be required to pay the amount agreed upon without that benefit and the party receiving the alimony will receive a windfall." Reopening a prenuptial agreement to revisit the issue may be possible but could be undesirable for fear other items may also be revisited.

In ***Wisseman v. Wisseman***,[61] the New York Supreme Court, Duchess County, considered the impact of the new tax law on a maintenance award, where the divorce was not finalized before December 31, 2018. Since the maintenance was no longer deductible to the husband, he argued that the award should be reduced by his tax rate, 22%. The wife argued the award should be reduced by her tax rate, 12%, which is what she would have paid in taxes under prior law, had the maintenance been taxable to her. The court determined to reduce the award by 12%: "the net result of which is application of the guidelines as intended by the New York State Legislature prior to the federal change in the relevant tax law, impacted only by a reduction concomitant with the wife's tax bracket and what she would have been obligated to include as taxable income."

In ***Montemurro v. Montemurro***,[62] the husband complained that a divorce decree, which was entered in November 2018, incorrectly incorporated the new law regarding the taxation of alimony, which only became effective for divorce decrees entered after December 31, 2018. The Arizona Court of Appeals, Division 1, noted that, regardless of what the decree said about the tax effects of spousal maintenance payments, and even assuming the decree incorrectly stated the applicable federal law, federal law, not the decree, governs the tax treatment of those payments: "…ultimately it is the Internal Revenue Code and not State court orders that determines one's eligibility to claim a deduction for Federal income purposes…"

For state purposes, some states have decoupled from the federal treatment of alimony payments. Accordingly, alimony can be subtracted from federal adjusted gross income in computing state taxable income. This is the case, for example, in California,[63] New York[64] and New Jersey.[65] Ohio has not decoupled.

The Tax Act changes regarding the taxation of alimony payments are permanent, and do not sunset.

B. Taxation of Trust Income Under the New Tax Laws Has Dramatically Changed

The Tax Act repeals IRC § 682, which deals with the taxation of trust income following divorce.

For estate planning purposes, individuals can create irrevocable trusts for the benefit of family members. Using the federal gift tax exemption, which at $12.92 million per person for 2023 is an all-time high, they can move assets up to that amount into those irrevocable trusts without a federal gift tax consequence. Property transferred to the trusts (and the appreciation on that property) is removed from the individuals' taxable estates when they die because they will no longer own those assets at death. With the current top federal estate tax bracket at 40% and with many states imposing their own estate taxes, which can be as high as 20%, significant estate tax savings can be garnered through the use of these irrevocable trusts. Although the trust creator – known as the grantor – does not own the assets after they are transferred to the trust, the grantor can remain responsible for paying the trusts' income and capital gains taxes (a so-called "grantor trust"). Having a grantor assume the tax liability that otherwise would be payable by the trust or trust beneficiaries is a popular planning tool; essentially allowing these trusts to grow tax-free for the trust beneficiaries because someone else is paying the taxes. Although the tax payments are in effect gifts to the trust by the grantor, they are not treated as gifts by the Internal Revenue Service (IRS). Accordingly, practitioners often purposely include provisions in trusts that will trigger grantor trust status.

Additionally, under IRC § 677(a)(1), a grantor is treated as the owner of any portion of a trust if the income from the trust may be distributed to the grantor or the grantor's spouse. Under IRC § 672(e)(1) (the so-called spousal unity rule), a grantor is treated as holding any power or interest held by an individual who was the grantor's spouse at the time the power or interest was *created*. Accordingly, the trust remains a grantor trust even if the grantor and the grantor's spouse subsequently divorce. If, after a divorce, trust income was payable to a grantor's spouse, in the absence of relief, the grantor would continue to be taxed on the income and the ex-spouse would receive the income tax-free. IRC § 682 prevented that result by providing that the income distributed to a spouse after a divorce is taxable to the recipient. The Tax Act repeals § 682 with regard to divorce or separation agreements signed in 2019 or thereafter. Note that the repeal is keyed to the date of the divorce or separation agreement, not the date of the trust agreement. Accordingly, the grantor spouse will be liable to pay the income tax on trust income from grantor trusts potentially created years before a divorce, even though the ex-spouse will be receiving that income.

If the trust agreement is clear that a divorced spouse will cease to be a beneficiary, the trust would remain a grantor trust, but income will not be payable to the former spouse. If the trust document is not clear, collaboration between estate and matrimonial attorneys can be key in investigating any possible techniques to potentially change grantor trust status, being mindful of potential adverse tax consequences, for example, in jeopardizing a trust that qualified for the marital deduction. With that caveat, possibilities might include:

- If the trust allows for discretionary distributions, paying out all the assets to the beneficiary spouse and equalizing the grantor with other assets. This strategy is not an ideal solution from a planning perspective because dissolving the trust will defeat the original transfer tax saving goals;
- Decanting or otherwise modifying a trust to remove the spouse in favor of other beneficiaries, and equalizing with other assets;
- Terminating grantor trust status by decanting or otherwise modifying the trust to require the consent of adverse parties (non-spousal beneficiaries, typically children) before any distribution can be made to the spouse.[66] However, requiring children to consent before every distribution is made to a parent is a very difficult position in which to place the children.
- Including a reimbursement provision or other equalization mechanism in a separation agreement for the taxes payable by the grantor spouse. This also might not be an ideal solution because typically the goal is to extricate former spouses from each other, not bind them together with on-going obligations.

The tax impact of every trust created during the marriage should be carefully considered when negotiating a divorce settlement or presenting evidence to a court.

The Department of the Treasury and the IRS issued a Notice[67] announcing they will issue regulations clarifying that §682 will continue to apply with regard to trust income payable to a former spouse who was divorced or legally separated under a divorce or separation instrument executed on or before December 31, 2018, unless that instrument is modified after that date and the modification provides that the changes made by the Tax Act apply to the modification. They requested comments regarding the application of certain grantor trust rules to the taxation of trusts for the benefit of a spouse following a divorce or separation, in light of the repeal of §682. Written comments were to be submitted by July 11, 2018.

The American College of Trusts and Estates Counsel (ACTEC) submitted two sets of comments. In a comment letter submitted on July 2, 2018, ACTEC suggests terminating the application of the spousal unity rule in §672(e) once the spousal relationship has been terminated by decree of divorce or legal separation or by the execution of a separation agreement. According to the letter, the spousal unity rule is presumably based on a belief that spouses form a single economic unit. When the end of the marriage separates the unit there is no longer a reason for the rule to apply. According to the comment letter submitted on July 5, 2018, ACTEC believes that tying the effective date provision to the date the divorce or separation agreement is signed, not the date a trust was executed, unfairly applies the repeal to trusts that were irrevocable on the date the Tax Act was enacted. As explained in the letter, a grantor who created a trust for the benefit of their spouse before the repeal of §682 likely would not have done so had the grantor expected to continue to be taxed on trust income after divorce. Accordingly, ACTEC recommends that §682 continue to apply to the income of trusts that were irrevocable on December 22, 2017. Whether either of the ACTEC comment letter suggestions will be adopted is yet to be seen since we are still awaiting IRS guidance.

The Tax Act changes regarding the repeal of IRC § 682 are permanent, and do not sunset.

V. Tax-Free Transfer Opportunities

Pursuant to IRC §1041(a)(2), no gain or loss is recognized on a transfer of property from an individual to (or in trust for the benefit of) a spouse, or a former spouse, but only if the transfer is "incident to the divorce." A transfer of property is incident to the divorce if the transfer:

1. Occurs within one year after the date on which the marriage ceases, **or**
2. Is related to the cessation of the marriage (IRC §1041(a)(2)).

Thus, a transfer of property occurring not more than one year after the date on which the marriage ceases need not be related to the cessation of the marriage to qualify for §1041 treatment.

A transfer of property is treated as related to the cessation of the marriage if the transfer:

1. Is pursuant to a divorce or separation instrument, **and**
2. Occurs not more than 6 years after the date on which the marriage ceases (Temp. Reg. §1.1041-1T(b).

Any transfer not made pursuant to a divorce or separation instrument and any transfer occurring more than 6 years after the cessation of the marriage is presumed to be not related to the cessation of the marriage. This presumption may be rebutted only by showing that the transfer was made to effect the division of property owned by the former spouses at the time of the cessation of the marriage (for example, if there were legal or business impediments to the transfer or disputes concerning the value of the property owned at the time of the cessation of the marriage, and the transfer was effected promptly after the impediment was removed).

Pursuant to IRC §2516 there are no gift tax consequences associated with a written marital settlement agreement if divorce occurs within the three-year period beginning on the date one year before the agreement is entered into (whether or not the agreement is approved by the divorce decree).

Of course, if a trust is created incident to a divorce *after* a couple is divorced, the problem created by the repeal of §682 should never arise.

Transfers to which §1041(a) applies are treated as gifts; the basis of the transferee in the property is the adjusted basis of the transferor immediately before the transfer (with a couple of exceptions, including no further basis adjustment for gift taxes paid by the transferor).

Note that §1041 does not eliminate gain; it defers an immediate gain on transfer, postponing gain recognition until the gain actually is realized. Accordingly, it is critical to factor in the impact of potential future imbedded gains when negotiating settlement agreements.

VI. The Role of Life Insurance and Irrevocable Life Insurance Trusts in Divorce

In many divorce proceedings, life insurance plays an integral role as part of the ultimate resolution/settlement, whether it is an asset to be allocated between the parties or is required to be maintained for some period to secure settlement obligations.

Periodic Policy Reviews Can be Critical

It is important to review life insurance policies periodically to ensure they are performing as intended at the best cost, and that the premiums are being paid by the responsible party.

A policy review may uncover some or all of the following factors:

- The interest rate environment could have affected the policy performance, particularly if initial illustrations were run in a different interest rate environment
- Market returns may have underachieved expectations
- Policies may have been based on outdated mortality tables. Life expectancies have increased over time which may generate lower premium rates in newer policies
- Newer policies have guaranteed and/or extended Death Benefit Guarantees that may not have been available with the original policy
- There may have been a change in market conditions, the health of the insured or the original intention in purchasing the insurance (for example, to fund education), which may make other insurance options more attractive to consider

Irrevocable Life Insurance Trusts

Utilizing an Irrevocable Life Insurance Trust (ILIT) can be an advantageous way to purchase and maintain life insurance in divorce and other contexts. An ILIT is an irrevocable trust designed to hold ownership of an insurance policy. To create an ILIT, an individual establishes a trust and transfers funds to the trust. The trustee then purchases a life insurance policy payable to the trust upon the insured's death. The primary benefit of using an ILIT is that, upon the death of the insured, policy proceeds pass to heirs free of estate taxes. An ILIT can also hold existing policies transferred to it by an insured. Provided the insured lives for three years following the transfer of the policy, the policy proceeds can avoid taxation in the insured's estate.

Five key questions an advisor should consider when dealing with life insurance

1. **Are premium notices being sent to the correct address and are premiums being paid on time?**

It is critical to ensure that premiums are being paid in a timely fashion. Failure to maintain a policy can leave the obligor's estate liable to pay the entire amount of the insurance proceeds – but full recovery might not be possible if the estate has insufficient assets. In ***Woytas v. Greenwood Tree Experts, Inc.***,[68] a Marital Settlement Agreement (MSA) required an ex-husband to maintain life insurance policies to secure his child support and alimony obligations. The MSA provided that, if either party failed to maintain the life insurance policy requirements, that party's estate would be liable for any outstanding obligations owned under the agreement. The policy included a "suicide exclusion" barring recovery of benefits if the insured were to commit suicide within two years of purchase, which he did. The New Jersey Supreme Court affirmed that the ex-husband failed to "maintain" life insurance, and therefore breached the MSA, entitling the beneficiaries to payment from the ex-husband's estate for the amount of the unrecoverable proceeds. Since the estate was less than the value of the claim, the court ordered that the entire balance of the estate be paid to the ex-wife.

Similarly, if no one is confirming that the premium notices are being sent to the right address, the result can be disastrous. In ***Orchin v. Great-West Life & Annuity Insurance Company***,[69] the insured's friend and fellow dentist Orchin served as trustee of a trust holding a life insurance policy. He did not miss a single premium payment from 1993 (when the policy was assigned to the trust) through January 2009. In April 2009, Orchin moved his residence. Though he claimed to have told the post office his forwarding address, the insurance company was never notified of this change. It continued to send payment notifications to Orchin's old address, and as a result, Orchin never received them, nor the notices that the policy was in default nor the notice that the policy eventually lapsed.

On January 15, 2010, the insured died suddenly. At this point, Orchin realized he failed to pay the previous premium payments. Omitting to mention that the insured had died, Orchin convinced a supervisor to exercise her authority to make a one-time exception and reinstate the policy.

When Great-West Insurance discovered that the insured had died before the insurance was reinstated, they denied the claim. The insured's wife and Orchin brought suit against Great-West for improper termination of the policy and breach of contract, and the insured's wife also brought suit against Orchin for breach of fiduciary duty.

The court held that Great-West's decision to reinstate the coverage was unenforceable. Although "a close question," the court denied Orchin's summary judgment motion because issues of fact remained. Specifically, there were questions regarding whether it was reasonable for Orchin to expect the insurance notices to reach his new address and whether he exercised ordinary diligence.

As noted, if an insurance policy required pursuant to a settlement agreement or court order lapses for failure to pay the premium, there may be a claim against the insured (or his or her estate, if deceased). However, there may not be sufficient assets to satisfy the value of the claim. Accordingly, practitioners might recommend that duplicate premium notices and/or confirmations of payment are sent to the other spouse or another party, or that some other arrangements are made to confirm that the policy is maintained.

As well as emphasizing the importance of having a reliable policy review mechanism in place to prevent a policy lapse, the ***Orchin*** case also highlights the issue that, when friends or family members are appointed as trustees, oftentimes they are ill-equipped to discharge the myriad duties to which they are subject. Professional trustees have expertise in fulfilling those responsibilities.

2. <u>Is the Policy Properly Titled from an Ownership Perspective?</u>

If insurance is held in a properly designed insurance trust, the proceeds should pass free of estate taxes to heirs. If, however, a policy is owned by the insured, the proceeds will be includible in the estate, and will be potentially subject to estate tax (in 2023 the top federal estate tax rate is 40% and the top state estate tax rate is 20%).

Attorneys may be subject to a malpractice action if insurance is not appropriately titled, and attorneys have been sued for failing to correctly advise clients as to how insurance should be owned. Whether a third-party beneficiary can maintain a malpractice action against an estate planning attorney depends on state law, and most states permit those actions to be brought under the appropriate circumstances. Very few states follow the concept of strict privity, which provides that only the client who suffered the malpractice can maintain an action against the attorney.

A Sampling of How Different States Approach the Issue of Privity

<u>California</u>

In ***Biakanja v. Irving***,[70] the California Supreme Court rejected the strict privity test for professional liability. That court held that the determination whether in a specific case the defendant will be held liable to a third person not in privity is a matter of policy and involves the balancing of various factors, among which are (1) the extent to which transaction was intended to affect the plaintiff, (2) the foreseeability of harm to him, (3) the degree of certainty that the plaintiff suffered injury, (4) the closeness of the connection between the defendant's conduct and the injury suffered, (5) the moral blame attached to the defendant's conduct, and (6) the policy of preventing future harm.

<u>Connecticut</u>

In ***Krawczyk v. Stingle***,[71] the Connecticut Supreme Court noted that determining when attorneys should be held liable to parties with whom they are not in privity is a question of public policy. In addressing this issue, the Supreme Court observed that courts have looked principally to whether the primary or direct purpose of the transaction was to benefit the third party. Additional factors considered include: (1) the foreseeability of harm; (2) the proximity of the injury to the conduct complained of; (3) the policy of preventing future harm; and (4) the burden on the legal profession that would result from the imposition of liability.

Delaware

In Delaware, a beneficiary may sue a testator's attorney where a testator's intent is apparent on the face of a testamentary instrument and the bequest fails solely due to the scrivener's drafting. Where the drafting is correct, yet the bequest fails for other reasons, the disappointed heir must allege facts that irrefutably lay the bequest's failure at the scrivener's door.[72]

Florida

In Florida, generally, a legal malpractice claim may be brought only by one who is in privity with the attorney. However, an exception exists that permits an intended third-party beneficiary of the legal services to bring suit where "testamentary intent as expressed in the will … [was] frustrated by the attorney's negligence and as a direct result of such negligence the beneficiaries' legacy [wa]s lost or diminished."[73]

Hawaii

In Hawaii, a beneficiary may sue a testator's attorney for failing to draft an instrument that carries out the testator's intentions.[74]

Michigan

In Michigan, a beneficiary may sue a testator's attorney for failing to draft an instrument that carries out the testator's intentions. However, Michigan courts have declined to allow plaintiffs to introduce extrinsic evidence to prove the testator's intent when the trust terms are clear and unambiguous.[75]

New Jersey

In New Jersey, courts have simplified the test for surmounting the privity requirement through reliance, considering the following factors in determining whether the duty undertaken by an attorney extends to a third party not in privity with the attorney: (1) the extent to which [the attorney/client relationship] was intended to affect the plaintiff; (2) the foreseeability of reliance by the plaintiff and the harm it could thereby suffer; (3) the degree of certainty that plaintiff has been harmed; and (4) the need from a public policy standpoint of preventing future harm without unduly burdening the profession.[76]

New York

Until recently in New York, absent fraud, strict privity was required to maintain a legal malpractice claim against an estate planning attorney. Since negligence in the estate planning context is usually not discovered until after a client's death, the strict privity requirement often resulted in the cause of action dying with the client.

In ***Estate of Saul Schneider v. Finmann***,[77] the decedent's estate commenced a malpractice action against the decedent's estate planning attorney, alleging that the attorney negligently advised the decedent to transfer, or failed to advise decedent not to transfer, an insurance policy into his own name. The result was that the insurance proceeds were includable in the decedent's estate and subject to estate tax. With proper planning, the policy should not have been in the decedent's name, and the proceeds should have passed to heirs free of estate tax.

The New York Court of Appeals held that sufficient privity existed between the personal representative of the estate and the estate planning attorney for the personal representative to maintain a malpractice claim against the attorney on the estate's behalf. According to the court, the strict privity rule leaves the estate with no recourse against an attorney who planned the estate negligently, and the estate essentially "stands in the shoes of a decedent," giving the estate capacity to maintain the malpractice action.

Ohio

In Ohio, because the personal representative assumes the right to prosecute any surviving cause of action after the decedent's death, the personal representative's right to sue succeeds the decedent's right to sue. The personal representative, therefore, is in privity with the decedent. Consequently, a personal representative may bring a cause of action for legal malpractice on behalf of the estate for negligent estate planning that occurred during the decedent's lifetime.[78]

South Carolina

In ***Fabian v. Lindsay***,[79] the South Carolina Supreme Court held that beneficiaries of an existing will or estate planning document may recover as third-party beneficiaries against an attorney whose drafting error defeats or diminishes the client's intent under legal malpractice or breach of contract theories. Recovery is limited to persons who are named in the estate planning document or otherwise identified by their status. The burden of proof for such claims is the clear and convincing standard.

West Virginia

In West Virginia, a direct, intended, and specifically identifiable beneficiary may sue a testator's attorney who prepared the will where the testator's intent expressed in the will has been frustrated by negligence on the part of the attorney so that the beneficiaries' interest(s) under the will is either lost or diminished.[80]

Perhaps the most important lesson is not to rely on a privity doctrine to avoid liability, but to carefully consider ownership of insurance policies.

3. Does the Policy Have the Correct Beneficiary Designation?

Divorced individuals and those in the process of getting divorced should update all their important planning documents, account titles and beneficiary designations to be certain chosen heirs are still appropriate. Of course, during the pendency of a divorce, parties may be prohibited from transacting financial affairs except in the usual course of business for customary and usual household expenses. This prohibition is designed to maintain the status quo and preserve marital property until final determination. Accordingly, clients should change the documents they are entitled to change immediately (in most jurisdictions a will can and should be changed as soon as possible, subject to state rights and prior agreement), and be poised to change the balance as soon as they are permitted.

In ***Randle v. Farmers New World Life Ins. Co***.,[81] the California Court of Appeal, Second District, held that a life insurance policy's requirements for changing ownership do not control over the provisions of a contract of which the insurer has notice, such as a divorce decree between the insured and insured's spouse addressing rights of the parties under the policy.

What if estate planning documents are not updated following divorce, and an ex-spouse remains the beneficiary at death? About half the states in the U.S.[82] have so-called revocation on divorce statutes. In Ohio, a divorce, dissolution of marriage, or annulment of marriage revokes a spouse's designation as a beneficiary of a life insurance policy, an annuity, a payable on death account, an individual retirement plan, or an employer death benefit plan as if the ex-spouse predeceased.[83] Upon a trust grantor divorcing, obtaining a dissolution of marriage, annulment or separation, any provision in the trust conferring any beneficial interest or a general or special power of appointment on the ex-spouse or nominating the spouse or former spouse as trustee or trust advisor is revoked.[84] Divorce, dissolution or annulment of marriage, or execution of a separation agreement revokes the designation of a spouse as an attorney in fact in a power of attorney .[85] These statutes can revoke bequests to ex-spouses in wills or other estate planning documents if those documents have not been updated to reflect the divorce at the time of an individual's death.

However, half the states in the U.S. do not have these statutes, and even among those that do, not all revoke life insurance designations. ***In re Irrevocable Trust Agreement of Klein***,[86] the court held that, under plain language of an irrevocable trust, which contained no requirement that the parties remain married, the decedent's former spouse was a co-trustee and beneficiary of irrevocable trust. Accordingly, the ex-spouse had standing to file objections to co-trustee's accounting.

Moreover, even if a revocation on divorce statue does apply, the statute will be inapplicable during the pendency of the divorce, until the final divorce decree is entered.

In ***Sveen v. Melin,***[87] decided by the Supreme Court determined that the retroactive application of a Minnesota statute does not violate the Contracts Clause of the U.S. Constitution.

The statute under consideration provided that "the dissolution or annulment of a marriage revokes any revocable . . . beneficiary designation . . . made by an individual to the individual's former spouse." Under the statute, if one spouse has made the other the beneficiary of a life insurance policy or similar asset, their divorce automatically revokes that designation so that the insurance proceeds will instead pass to the contingent beneficiary or the policyholder's estate upon death. The decedent's children argued that under Minnesota's revocation-on-divorce law, their father's divorce canceled his ex-spouse's beneficiary designation, leaving them as the rightful beneficiaries. The ex-spouse claimed that, because the law did not exist when the policy was purchased and she was named as the primary beneficiary, applying the later-enacted law to the policy violated the Constitution's Contracts Clause.

The court found that the law does not substantially impair pre-existing contractual arrangements. First, the law is designed to reflect a policyholder's intent—and so to support, rather than impair, the contractual scheme. It applies a prevalent legislative presumption that a divorcee would not want his former partner to benefit from his life insurance policy and other will substitutes. Second, the law is unlikely to disturb any policyholder's expectations at the time of contracting because an insured cannot reasonably rely on a beneficiary designation staying in place after a divorce. Lastly, the law supplies a mere default rule, which the policyholder can undo in a moment. If the law's presumption about what an insured wants after divorcing is wrong, the insured may overthrow it simply by sending a change-of-beneficiary form to his insurer.

The key lesson to be learned from cases like this is not to rely on state default law and to update all estate planning documents and beneficiary designations as soon as possible.

4. Are Taxes Apportioned as Intended?

A case decided in Georgia underscores the importance of having both the correct beneficiary designation and the tax apportionment result that was intended. In ***Smoot v. Smoot***,[88] decedent's ex-wife, Dianne Smoot, was the named beneficiary of life insurance and retirement assets that were included in the taxable estate. The decedent and Dianne had divorced in 2006, but the decedent had not changed any of his beneficiary designations. Having lost a previous action in which the decedent's son from a prior marriage claimed that Dianne was not entitled to the decedent's retirement benefits, the son argued in this action that Dianne was responsible for paying her pro-rata share of the federal estate taxes. The tax apportionment clause in the decedent's will provided for taxes to be pro-rated against those who received property included in his taxable estate.

The court held that federal law governed the tax apportionment concerning the life insurance proceeds. However, regarding the retirement benefits, the court noted that, under Georgia law, "[a]ll provisions of a will made prior to a testator's final divorce…in which no provision is made in contemplation of such event shall take effect as if the former spouse had predeceased the testator..." According to the court, because the will made no provision in contemplation of divorce, the tax apportionment clause had to be construed as if Dianne had predeceased the decedent. Accordingly, the tax apportionment clause did not apply to her, with the harsh result that not only did the ex-wife receive the retirement benefits, but she received them tax-free because her stepson was saddled with the tax liability.

Although some states may have default laws that would have prevented this result (because designations are revoked in the event of divorce or because of default pro-rata tax apportionment provisions), this case is another stark reminder not to rely on state law but to carefully update beneficiary designations.

5. What is the Value of Life Insurance Policies for Divorce Settlement Purposes?

Oftentimes, parties have existing life insurance policies, the value of which may be factored into the division of property between them. Survivorship insurance, often taken out to provide liquidity for estate tax obligations on the death of the surviving spouse, may no longer be appropriate post-divorce. Some couples may wish to maintain an insurance policy to benefit their family. If not, under appropriate circumstances, practitioners can consider a life settlement: the sale of a life insurance policy to a third-party investor, to raise cash for the divorce settlement. The policy holder can receive cash for the life insurance policy in exchange for the investor taking over the premium payments and receiving the death benefit upon the death of the insured. A life settlement could potentially yield a greater return for the policy holder than surrendering the policy to the insurance carrier for the cash value. The amount of the life settlement depends upon the policy's death benefit and the insured's life expectancy. If the death benefit is substantial and the insured is in poor health, the value of the life settlement will be greater. In comparison, if the death benefit is not very large and the insured is healthy, the value of the life settlement might not be cost effective.

When calculating the expected proceeds from a life settlement, practitioners should be mindful of the tax consequences. The methodology for calculating the basis of life insurance contracts was revised under the 2017 Tax Act. The new favorable law provides that no adjustment to basis is made for mortality, expense or other reasonable charges incurred under a life insurance contract.

The tax treatment of life settlement proceeds is generally determined in three tiers:

1. Proceeds received up to the cost basis of the policy are not taxed;
2. Proceeds representing the difference between the cost basis and the policy's cash value are taxed as ordinary income; and
3. Proceeds received in excess of the policy's cash value are taxed as capital gains.[89]

It will be important to value the proceeds from a life settlement after taxes to make sure the transaction is financially sound.

VII. The Bottom Line: Collaboration is Key

Clients benefit when matrimonial, trusts & estates, accounting and investment professionals partner to integrate considerations that cross disciplines. Advisors will be well-served in taking a collaborative approach to ensure they effectively represent clients by considering the many nuanced factors in this arena.

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[1] *In re Marriage of Githens*, 227 Or. App. 73, 204 P.3d 835 (2009)
[2] Restatement (Third) of Trusts, §50 (2) provides that "the benefits to which a beneficiary of a discretionary interest is entitled, and what may constitute an abuse of discretion by the trustee, depend on the terms of the discretion, including the proper construction of any accompanying standards, and on the settlor's purposes in granting the discretionary power and in creating the trust." Section 50 comment b provides guidance and standards for reviewing discretion. Delaware, for example, has an even more restrictive standard of review, rejecting Restatement (Third) of Trusts, Section 50 and explicitly referencing Restatement (Second) of Trusts §187, which provides that "where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion." Delaware Code, Title 12, §3315(a).
[3] *Pfannensteihl v. Pfannenstiehl,* 475 Mass. 105, 55 N.E.3d 993 (2016)
[4] In New Hampshire, for example, see *Matter of Earley*, 174 N.H. 2020, 261 A.3d 964 (2021), distinguishing *Flaherty v. Flaherty,* 138 N.H. 337 (1994), where a New Hampshire court construed a trust governed by Massachusetts law.
[5] *Levitan v. Rosen*, 95 Mass. App. Ct. 248, 124 N.E.3d 148, *reviewed denied*, 482 Mass. 1105, 127 N.E.3d 266 (2019)
[6] *Smith v. Smith*, 253 N.W.2d 143, 312 Minn. 541 (1977)
[7] See discussion beginning on page 7 of this article
[8] *Matter of Cleopatra Cameron Gift Trust, Dated May 26, 1998*, 2019 S.D. 35, 931 N.W.2d 244
[9] *In Matter of Nerbonne*, No. 2013-0281, 2014 WL 11643701 (N.H. Oct. 24, 2014)
[10] *D.L. v. G.L.*, 61 Mass App Ct 488 (2004)
[11] *Tannen v. Tannen*, 416 N.J. Super. 248, 3 A.3d 1229 (App. Div. 2010), *aff'd*, 208 N.J. 409, 31 A.3d 621 (2011)
[12] *Tannen v. Tannen*, 208 N.J. 409, 31 A.3d 621 (2011)
[13] *In re Marriage of Holman*, 122 Ill. App. 3d 1001, 462 N.E.2d 30 (1984)
[14] Ill.Rev.Stat., 1982 Supp., ch. 40, par. 503(d)(2), now 750 Ill. Comp. Stat. Ann. 5/503(d)(3), which provides: value of property "assigned" (instead of "set apart") to each spouse
[15] *Alvares-Correa v. Alvares-Correa*, 285 A.D.2d 123, 726 N.Y.S.2d 668 (2001)
[16] *In re Marriage of de Guigne*, 97 Cal. App. 4th 1353, 119 Cal. Rptr. 2d 430 (2002)
[17] *Guaenti v. Gugenti*, 2017-Ohio-2706, 90 N.E.3d 297
[18] *D.L. v. G.L.*, 61 Mass. App. Ct. 488, 811 N.E.2d 1013 (2004)
[19] *Sullivan v. Sullivan*, 211 So. 3d 836 (Ala. Civ. App. 2016)
[20] *Vanderlugt v. Vanderlugt*, 429 P.3d 1269 (2018). If neither spouse is a trustee or beneficiary of an irrevocable trust, a court's equitable powers may nevertheless reach the trust's assets if the trust was set up for a fraudulent purpose (such as depriving a spouse of an equitable division of assets) or there was a fraudulent transfer of assets to the trust in anticipation of divorce.
[21] *Vanderlugt v. Vanderlugt*, *supra*
[22] *Loomis v. Loomis*, 158 S.W.3d 787 (Mo. Ct. App. 2005)
[23] *Markowitz v. Markowitz*, 146 A.D.3d 872, 45 N.Y.S.3d 203 (N.Y. App. Div. 2017)
[24] *Vanderlugt v. Vanderlugt, supra.* The New Mexico Court of Appeals held that the district court correctly noted that it did not have jurisdiction over the trust itself because it was not owned or controlled by either spouse.
[25] *Kim v. Kim*, 2020-Ohio-22, 150 N.E.3d 1229. Husband had argued that the trial court lacked jurisdiction to direct the trustee of the Trust to take any action pursuant to the trust because neither he nor the trust were joined as parties. However, the Court of Appeals noted that the trial court did not order the trustee nor the trust itself to

take any action. Rather, the trial court credited the cash value of all the life insurance policies within the trust to husband when the court sought to equalize the distribution of marital property. Accordingly, husband's contention was without merit.
[26] *Yerushalmi v. Yerushalmi*, 26 N.Y.S.3d 114136 A.D.3d 812 (2016)
[27] *Riechers v. Riechers,* 267 A.D.2d at 446, 701 N.Y.S.2d 113
[28] *Surasi v. Surasi*, No. 5057/92, 2001 WL 1607927 (N.Y. Sup. Ct. Nov. 20, 2001)
[29] *Villi v. O'Caining-Villi, 10 Misc. 3d 1060(A)*
[30] *Oppenheim v. Oppenheim*, 168 A.D.3d 1085, 93 N.Y.S.3d 92 (2019)
[31] *In re Erny's Tr.*, 415 Pa. 8, 202 A.2d 30 (1964)*; Wells Fargo Bank v. Marshall*, 20 Cal. App. 4th 447, 24 Cal. Rptr. 2d 507 (1993)
[32] *Ochse v. Ochse*, No. 04-20-00035-CV, 2020 WL 6749044 (Tex. App. Nov. 18, 2020)
[33] *Crawford v. Crawford*, 147 N.E.3d 1047, 2020 WL 2485249 (Ind. Ct. App.)
[34] Ohio Rev. Code Ann. §5816.03
[35] 12 Del. C. §3572
[36] Id.
[37] Id.
[38] 12 Del. C. §3573(1)
[39] There is a risk that a court in the state where the divorce is proceeding might decide that its law, not Delaware law, applies. However, at the least, a properly designed DAPT will raise formidable obstacles for creditors.
[40] *Pfannenstiehl v. Pfannenstiehl* (Massachusetts Supreme Judicial Court) 475 Mass 105, 55 N.E. 3d 933
[41] N.C. Gen. Stat. Ann. §36C-5-503
[42] Tex. Fam. Code Ann. §154.005
[43] Ohio Rev. Code Ann. §5805.02
[44] *Ferri v. Powell-Ferri*, 476 Mass. 651, 72 N.E.3d 541 (2017)
[45] *Ferri v. Powell-Ferri*, 326 Conn. 438, 165 A.3d 1137 (2017)
[46] *Powell-Ferri v. Ferri*, 326 Conn. 457, 165 A.3d 1124 (2017)
[47] N.Y. EPTL §10-6.6
[48] Ohio Rev. Code Ann. §5808.18
[49] *See* Susan T. Bart, *Summaries of State Decanting Statutes* (updated Dec. 1, 2021), https://www.actec.org/assets/1/6/Bart-State-Decanting-Statutes.pdf
[50] Ohio Rev. Code Ann. §5808.18(F)
[51] *Davidovich v. Hoppenstein*, 162 A.D.3d 512, 79 N.Y.S.3d 133 (2018)
[52] *Hodges v. Johnson*, 170 N.H. 470, 177 A.3d 86 (2017)
[53] New York's power to adjust regime is found in EPTL §11-2.3
[54] N.Y. EPTL §11-2.4
[55] *Matter of Jacob Heller*, 800 N.Y.S. 2d 207 (App. Div. 2005), aff'd, 849 N.E.2d 262 (Ct. App. 2006)
[56] State statutes in many other jurisdictions do explicitly prohibit an interested trustee from opting into a unitrust election; an analysis of applicable state law is required.
[57] See, for example, *In re Will of Kruszewski*, 116 A.D.3d 1288, 984 N.Y.S. 2d 232 (2014)
[58] Cal. Prob. Code § 16336.4
[59] For example, when opting into the unitrust regime in New York, a trustee is required to consider the following factors:
(i) the nature, purpose, and expected duration of the trust;
(ii) the intent of the creator of the trust;
(iii) the identity and circumstances of the beneficiaries;
(iv) the needs for liquidity, regularity of payment, and preservation and appreciation of capital;
(v) the assets held in the trust; the extent to which they consist of financial assets, interests in closely held enterprises, tangible and intangible personal property, or real property; the extent to which an asset is used by a beneficiary; and whether an asset was purchased by the trustee or received from the creator of the trust.
(N.Y. Estates, Powers and Trust Law §11-2.4 (e)(5))
[60] IRC §§71(a) and 215(a)
[61] *Wisseman v. Wisseman*, 63 Misc. 3d 819, 97 N.Y.S.3d 823 (N.Y. Sup. Ct. 2019)

[62] *Montemurro v. Montemurro*, No. 1 CA-CV 19-0228 FC, 2020 WL 632612 (Ariz. Ct. App. Feb. 11, 2020)
[63] Cal. Rev. & Tax. Code §§17071, 17081, 17201, 17302, 17731, 17737
[64] N.Y. Tax Law §612(w)
[65] N.J.S.A. §54A:3-2
[66] IRC §677(a)
[67] Notice 2018-37
[68] *Woytas v. Greenwood Tree Experts, Inc.*, 237 N.J. 501, 206 A.3d 386 (2019)
[69] *Orchin v. Great-West Life & Annuity Insurance Company*, 2015 WL 5726334, 133 F.Supp.3d 138 (2015)
[70] *Biakanja v. Irving*, 49 Cal. 2d 647, 320 P.2d 16 (1958)
[71] *Krawczyk v. Stingle*, 208 Conn. 239, 543 A.2d 733 (1988)
[72] *Pinckney v. Tigani*, No. CIV.A. 02C-08-129FSS, 2004 WL 2827896 (Del. Super. Ct. Nov. 30, 2004)
[73] *Gallo v. Brady*, 925 So. 2d 363 (Fla. Dist. Ct. App. 2006)
[74] *Blair v. Ing*, 95 Haw. 247, 21 P.3d 452 (2001)
[75] *Mieras v. DeBona*, 452 Mich. 278, 550 N.W.2d 202, at 209 (1996); *In re Solomon Gaston Miller Trust*, No. 341502, 2018 WL 6252061, at 7 (Mich. Ct. App. Nov. 29, 2018)
[76] *Rathblott v. Levin*, 697 F. Supp. 817 (D.N.J. 1988); *Varelli v. White*, No. A-4675-16T3, 2019 WL 3229679, (N.J. Super. Ct. App. Div. July 18, 2019), *cert. denied*, 240 N.J. 130, 220 A.3d 986 (2019), and *cert. denied*, 240 N.J. 139, 220 A.3d 991 (2019)
[77] *Estate of Schneider v. Finmann*, 15 N.Y. 3d 306, 933 N.E.2d 718 (2010)
[78] *White v. Sheridan*, 2022-Ohio-2418
[79] *Fabian v. Lindsay*, 410 S.C. 475, 765 S.E.2d 132 (2014)
[80] *Calvert v. Scharf*, 217 W. Va. 684, 619 S.E.2d 197 (2005)
[81] *Randle v. Farmers New World Life Ins. Co.*, 85 Cal. App. 5th 53, 301 Cal. Rptr. 3d 83 (2022), *review denied* (Feb. 1, 2023)
[82] For example, the Uniform Probate Code, in effect in Alaska, Arizona, Colorado, Idaho, Massachusetts, Michigan, Montana, New Jersey, New Mexico, North Dakota, South Dakota and Utah, revokes dispositions to and fiduciary nominations of the former spouse, as well relatives of the former spouse.
[83] Ohio Rev. Code Ann. §5815.33(B)(1)
[84] Ohio Rev. Code Ann. §5815.31
[85] Ohio Rev. Code Ann. §5815.32
[86] *In re Irrevocable Trust Agreement of Klein*, PICS Case No. 16-0355 (C.P. Monroe Jan. 7, 2016)
[87] *Sveen v. Melin*, 138 S. Ct. 1815, 201 L. Ed 2d 180 (2018)
[88] *Smoot v. Smoot,* 2015 TNT 69-13, No. 2:13-cv00040 (U.S.D.C. S.D. Ga. March 31, 2015)
[89] 26 U.S.C.A. §1016. *See* Rev. Rul. 2020-05