Bloomberg Tax

Tax Management Estates, Gifts and Trusts Journal™

Reproduced with permission from Tax Management Estates, Gifts, and Trusts Journal, Vol. 44 No. 5, 09/12/2019. Copyright © 2019 by The Bureau of National Affairs, Inc. (800-372-1033) http://www.bna.com

Is a Prenup Really Necessary for Assets in a Spendthrift Trust?

By Lauren Breitstone and Stephen Breitstone, Esq.[*]

INTRODUCTION

When wealthier clients are considering marriage, the most unpleasant of tasks is to negotiate a prenuptial agreement. Not infrequently, the wealthy client's assets are in trust. Whether the client created the trust, or the trust was created by another for the client, the availability of those assets in divorce must be carefully considered. When the assets are in an irrevocable spendthrift trust there is a temptation to avoid the unpleasantness of asking the future spouse to sign a prenup. The process of negotiating a prenup in anticipation of one of the happiest days of your client's life may really put a damper on things. Before deciding whether the prenup is necessary, especially when the bulk of the client's assets are in trusts, there are a number of factors to consider, not the least of which is whether the trust assets would be available as part of a marital settlement or for alimony or support.

A common misconception in the estate-planning community is that assets held in a spendthrift irrevocable trust are protected against claims in a divorce. Thus, if assets are protected from creditors and transfer taxes (estate, gift, and generation skipping taxes) because they are held in a spendthrift trust, there may be a temptation to avoid the unpleasantness of requiring a spouse-to-be to sign a prenup. It stands to reason that if the assets of the trust cannot be attached by creditors, they should be likewise exempt from the claims of a spouse in a divorce. However, this is not always the case. The law is nuanced.

This article will discuss whether and to what extent an irrevocable spendthrift trust makes a prenup unnecessary. Although the spendthrift trust assets and/or income may not be reachable in a divorce, depending on the jurisdiction, a prenup will usually be necessary to protect those assets/income from being taken into account when dividing the marital estate in a divorce and determining support or maintenance obligations. Even if certain protections are afforded by a spendthrift trust, the prenup can provide an additional level of protection that is essential. For the trust beneficiary, who may not have immediate rights to the trust assets or income, the results can be devastating if the court assumes that access when it is not guaranteed.

BACKGROUND: DISTRIBUTION OF ASSETS IN DIVORCE

Broadly speaking, there are two distinct sets of state law principles that govern the division of property in a divorce: equitable distribution and community property. In addition, the property that is taken into consideration varies from state to state. Most states will exclude assets, usually referred to as "separate property," acquired prior to the marriage or by gift or devise during the marriage so they do not become part of the marital estate. However, there is a substantial minority of states, so-called "all property" states, which do not exclude separately acquired assets. Whether in an all-property state or not, if the married couple has access to assets in trust or an expectancy of such access, then assets held in trust for one of the married persons, or income from those assets, may be taken into consideration in dividing the marital pie.

The best case for excluding assets held in trust from the marital estate is where the trust is established by a third party and where the beneficiary does not have access or control. Note that the desire to keep trust assets out of the divorce calculus may be compromised by common estate planning features such as mandatory distributions of income or mandatory payout upon reaching a specified age. But even absent such distribution rights, common features designed to allow the beneficiary to indirectly maintain control over

---

[*] Lauren Breitstone is a rising second year student at Boston University School of Law and a staff editor on the American Journal of Law and Medicine.

Stephen Breitstone is a partner at the law firm Meltzer, Lippe, Goldstein & Breitstone, LLP, Mineola, N.Y., chairs the Private Wealth and Taxation Group at the firm and is the chair of the Sales, Exchanges and Basis Committee of the ABA Tax Section. Stephen is also a Fellow of the American College of Tax Counsel and a Fellow of the American College of Trusts and Estates Counsel.

© 2019 Tax Management Inc., a subsidiary of The Bureau of National Affairs, Inc.
ISSN 0886-3547

his or her trust could raise an issue that a court may be required to address in a divorce proceeding. Such features may include having ''hire/fire'' powers over trustees, investment advisory powers, and control over the appointment of trust protectors. Another concern would be if the beneficiary is also a trustee. The more control the beneficiary has over the trust the greater the likelihood a court would consider those assets in crafting a divorce settlement. Those concerns may be mitigated by a provision in the trust or under state law that prohibits the trustee from exercising discretion to make distributions to him/herself (or for persons over which the trustee may have a legal obligation of support). Nevertheless, even when distributions are discretionary, a course of conduct of allowing access to the trust assets to maintain the married couple's lifestyle may elevate the exposure of trust assets and/or income. The law varies from state to state. It is difficult to establish a bright line rule for how a court will decide these issues. This uncertainty is the very reason for entering into a carefully crafted prenup that specifically speaks to the treatment of trust assets and/or income in a divorce.

There may also be an issue as to whether assets will be included that have been transferred during the marriage to trusts. The trusts may be pursuant to normal estate planning or even for asset protection. Domestic asset protection trusts (DAPTs) have come into widespread use in this context. DAPTs are formed in jurisdictions that have enacted legislation that overrides the ''self-settled trust'' doctrine. Under the self-settled trust doctrine if someone sets up a trust but retains access to the income of the trust (or other beneficial enjoyment), the trust will not be protected from the claims of the settlor's creditors. If relying on a DAPT, carefully review the law of the state where it maintains its situs. The exceptions to creditor protection varies from state to state. Depending upon the state where the trust has its situs, the DAPT may in fact provide limited or no protection against claims of a spouse or child support in the event of a divorce.

Yet, while the law is uncertain and nuanced, there are also many cases that exclude assets (and sometimes the income from those assets) from the marital estate. Nevertheless, it is usually prudent and necessary to establish the rights in the marriage to trust assets in a clearly worded, carefully crafted prenup to avoid a protracted legal battle should the marriage not work out. When a marriage is failing the parties are often emotionally charged and make poor decisions. While a prenup may not completely eliminate areas of conflict, it may minimize them. Especially where the family holds dynastic wealth, the prenup is important to establish that the trust assets are off the table.

SEPARATE PROPERTY STATES vs. ALL PROPERTY STATES

In determining assets subject to division (whether under equitable distribution or community property) a further consideration is whether the state is a ''separate property state'' or an ''all property state.'' All property states allow separate property to be divided upon divorce. A significant minority of states follow the all property concept of property division in a divorce, including Connecticut, Indiana, Kansas, Massachusetts, Michigan, Mississippi, Montana, New Hampshire, North Dakota, South Dakota, Oregon, Vermont, Washington, and Wyoming. The all-property system allows the court to divide all property of the spouses at divorce, no matter its source. However, even in all property states, the courts will generally not attempt to divide property that is owned by a third party—for example, a trust established by a third party where the spouse may be a discretionary beneficiary.

In separate property states, a spouse's assets received through gift, bequest, devise, or descent are generally exempt from distribution in divorce.[1] However, separate property can be considered marital property if it has been co-mingled with marital assets or if it has appreciated in value during the marriage due to the efforts of the spouses. The efforts of a spouse may take many forms, including being a homemaker. There is a presumption based on legislative intent that the definition of marital property be read broadly, while separate property be construed narrowly.[2]

Equitable Distribution States

In general, under equitable distribution, the court divides property at the time of divorce, taking into account the relative means and needs of the spouses. Most states follow some form of equitable distribution. The equitable division of property does not necessarily mean that the property will be divided equally, but rather a judge will divide the property between the spouses in a way that the court deems fair. The trial court has great flexibility in creating an equitable distribution of marital assets. A court may consider factors such as employment prospects, homemaker status, age, or health of either party. Less clear is whether the court may consider continued access to income and other periodic distributions from a trust. In general, assets that constitute separate property are exempt from equitable distribution.[3]

The absence of hard-line rules coupled with equitable principles makes it difficult to predict how a court will, or will not, factor a trust into determining equitable distribution. For example, a married couple may depend on a steady source of income or distributions from a spendthrift trust where one spouse is a discretionary beneficiary to maintain their lifestyle.

---

[1] *See, e.g.*, N.Y. Domestic Relations Law §236[B][1][d][1].

[2] *Price v. Price*, 511 N.Y.S.2d 219, 222, N.E.2d 684 (1986) (*citing Majauskas v. Majauskas*, 474 N.Y.S.2d 699, 463 N.E.2d 15 (1984)). Some courts have required a spouse attempting to prove that property is actually separate property to do so by clear and convincing evidence. *Fields v. Fields*, 905 N.Y.S.2d 783, 785, N.E.2d 1039 (2010) (*citing DeJesus v. DeJesus*, 665 N.Y.S.2d 36, N.E.2d 1319 (1997)).

[3] *Motta v. Motta*, 43 N.Y.S.3d 336 (App Div, 1st Dept 2016).

© 2019 Tax Management Inc., a subsidiary of The Bureau of National Affairs, Inc.
ISSN 0886-3547

Yet, the spouse beneficiary may have no actual rights to receive these funds. The receipt of these funds may be wholly within the discretion of independent trustees. Absent a prenup that resolves the issue, a court may divide assets under equitable distribution in a fashion that assumes continued access to the trust assets or distributions. This could potentially bankrupt a spouse beneficiary who may be required to pay an equitable distribution award taking into account trust assets he or she may not be able to access.

Community Property States

Community property states include Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Under community property law, all assets of the married couple are deemed owned 50% by each spouse. There is less qualitative judgment by the courts than in equitable distribution jurisdictions. If the assets are considered to be part of the marital estate, they will be split equally in a divorce. Trust assets will be either in or out of the marital estate depending upon access and the laws of the state of formation. There is little or no concern that trust assets that are not ''owned'' by the married beneficiary will be taken into account as they would or could be in an equitable distribution state. Similar principles apply to the treatment of separate property in community property states.[4]

How trusts are treated in community property jurisdictions turns on the court's view of the beneficiary's access to trust income or principal and a determination of whether the trust is considered separate property. Like in equitable distribution states, co-mingling can convert separate property into community property. Note that where the community interest is inconsequential in the property with which it has been intermingled, the community aspect will not draw in the separate estate.[5]

MAINTENANCE, SUPPORT, AND ALIMONY: HOW IT WORKS

Courts may find that a party's interest in trusts can be taken into account when making maintenance and child support awards, especially where the party has access or control over the trust assets.[6] In *Alvares-Correa v. Alvares-Correa*,[7] a New York lower court held that the defendant's property interest in four offshore trust funds was properly taken into account when determining whether he would be able to afford maintenance and child support, where he was a vested beneficiary of all four trusts and had power of appointment for three of those trusts, allowing him to direct distribution of all or any part of trust assets valued at $37 million. Likewise, in *Payer v. Orgill*,[8] an Ohio court held that a former wife, who secured a judgment for alimony and support, and the wife's mother, who secured a judgment for supplying necessaries to her daughter, could reach the interest of the former husband-beneficiary in a spendthrift trust to the extent of an income limitation specified in the trust, notwithstanding the fact that the trust contained spendthrift features and provided that the income interest of the beneficiary was exempt from his creditors' claims.

The history and pattern of distributions from the trust during the marriage is a significant factor a court may consider in deciding whether, and to what extent, assets held in trust should be taken into account. For example, in determining spousal support, the New Jersey high court in *Tannen v. Tannen*,[9] decided that the wife's current beneficial interest in a discretionary trust subject to an ascertainable standard should not be considered when resolving the amount of spousal support her husband would owe her. The court considered the fact that although the wife was the sole beneficiary of the trust, she had yet to receive a direct monetary distribution. The court said the ''[wife's] beneficial interest in the [trust] was not an 'asset[] held by' her. It was, therefore, improper to impute income from the [trust] to [wife] in determining [husband's] alimony obligation.'' In arriving at this holding, the court took into account the intent of the settlor. The trust instrument provided that ''it was the express intention of the Grantors . . . that [wife] shall not be permitted, under any circumstances, to compel distributions of income and/or principal prior to the time of final distribution.''

Community Property States and Alimony

Many community property states do not permit permanent or temporary alimony. Community property laws provide that all assets and debts acquired during the marriage are owned equally by both spouses. The reasoning behind community property states' lack of alimony originates from the notion that after the divorce, both spouses are in the same financial situation, and neither has more nor less assets to support the other. It's important to note that the types of qualita-

[4] *See Fisher v. Fisher*, 86 Idaho 131, 383 P.2d 840 (1963).

[5] *In re Estate of Cudworth*, 133 Cal. 462, 65 P. 1041 (1901).

[6] *See, e.g.*, *Morton v Morton*, 394 Pa. 402, 147 A.2d 150 (1959) (holding that where a husband creates a trust out of his own property, reserving the income for his life, his wife may reach the income to satisfy a claim for alimony, maintenance, or child support); *Matthews v. Matthews*, 5 Ohio App. 3d 140, 450 N.E.2d 278 (App. 10th Dist. 1981) (Income from trust that is neither purely discretionary nor strict support trust and that contains no express exclusion therefrom of beneficiary's children may be attached for purpose of paying judgment against beneficiary for child support); The Restatement, Trusts 2d §157 provides: ''Although a trust is a spendthrift trust or a trust for support, the interest of the beneficiary can be reached in satisfaction of an enforceable claim against the beneficiary, (a) by the wife or child of the beneficiary for support, or by the wife for alimony.''

[7] 726 N.Y.S.2d 668 (App Div, 1st Dept 2001).

[8] 191 N.E.2d 373 (Ohio Com. Pl. 1963).

[9] 416 N.J. Super. 248 (2010), *aff'd* 208 N.J. 409 (2011).

© 2019 Tax Management Inc., a subsidiary of The Bureau of National Affairs, Inc.
ISSN 0886-3547

tive considerations in an equitable distribution jurisdiction generally do not come into play when the exercise constitutes dividing the community property equally.

DOMESTIC ASSET PROTECTION TRUSTS

A discussion of the impact of trusts in divorce would not be complete without some mention of the self-settled trust doctrine and DAPTs. As mentioned above, under the self-settled trust doctrine if the person setting up the trust retains access to the income of the trust (or other beneficial enjoyment), the trust will not be protected from the claims of the settlor's creditors. However, a number of jurisdictions have adopted legislation that allows self-settled trusts to be exempt from the claims of some or all of the settlor's creditors. The question is whether, and in what circumstances, will a trust created by a spouse, for his or her own benefit, be sheltered from claims of the other spouse (and for child support) in a divorce. The answer is, unquestionably, it depends.

Self-settled spendthrift trusts have become increasingly popular for those who wish to protect their assets from future creditors. A self-settled trust is a type of irrevocable trust in which the grantor is also the primary or beneficiary. Traditionally, self-settled asset protection trusts were not permitted in a majority of states because of the concern that people would create trusts to wrongfully defeat the claims of future creditors. Thus, the common law rule, followed by the vast majority of American jurisdictions, is that a self-settled trust is ineffective against the claims of creditors. In *Vanderbilt Credit Corp. v. Chase Manhattan Bank,*[10] a New York lower court noted that when a person designs a trust that serves his or her own benefit, the creditors can reach the maximum amount that the trustee could have paid to the beneficiary. Further, the court noted that it is against public policy to permit someone ''to tie up her own property in such a way that she can still enjoy it but can prevent her creditors from reaching it.''

In recent years, however, a number of states have enacted laws allowing self-settled trusts to be sheltered from the settlor's creditors, but there are limitations on the protection afforded. Only 17 states currently permit DAPTs: Alaska, Delaware, Hawaii, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming. Because most states still do not permit DAPTs, the trusts must be created in one of these states using a trustee in that state. Nevada is often an attractive option because Nevada only requires a two-year waiting period before self-settled trusts are protected from creditors. In addition, in Nevada the trust creator can also serve as trustee of his or her own self-settled trust, but will be subject to further restrictions on self-distributions from the funds. Note that creating such a trust does not require the creator to be a resident of the state where it is being established. Thus, people who do not live in a jurisdiction that permits DAPTs may still benefit from this type of asset protection.

It's unclear whether a resident in a state that follows the self-settled trust doctrine can gain protection in a jurisdiction that allows DAPTs in cases where the assets in question are not located in the DAPT state. In DAPT cases courts are often faced with a choice of law issue and must decide whether to enforce the law where the trust was formed or to enforce the law of the state where the lawsuit is filed and the assets and/or the settlor are located. For example, applying Washington law, the Bankruptcy Court for the Western District of Washington in *In re Huber*[11] held that pre-petition transfers of the debtor's assets to a self-settled trust created under Alaska law were void under Washington law. This case involved a Washington real estate developer who formed an Alaskan DAPT in anticipation of potential personal liability on a business loan. The trust was funded with interests in an Alaskan limited liability company established for that purpose, to which the debtor transferred substantially all of his assets, most of which were real property situated in Washington. The only other asset transferred to the trust was a $10,000 certificate of deposit situated in Alaska.

The primary issue that the Washington bankruptcy court faced was whether to apply the law of Alaska—a state that permits domestic asset protection law—or the law of Washington, which did not have a statute allowing DAPTs. The court said in accordance with Restatement 2d of Conflict of Laws, §270, ''this Court will disregard the settlor's choice of Alaska law, which is obviously more favorable to him, and will apply Washington law in determining the Trustee's claim regarding validity of the Trust.'' The outcome of *Huber* suggests that a debtor will likely only be able to successfully shield his or her assets in a self-settled trust if the jurisdiction where the assets have their situs permits self-settled trusts. The court pointed to Washington's public policy against enforcing self-settled asset protection trusts in reaching its decision, referencing *In re Portnoy,*[12] a similar decision where an offshore asset protection trust was involved. Analogizing to *Portnoy*, the *Huber* court said, ''[a]s with New York, Washington has a policy that a debtor should not be able to escape the claims of his creditors by utilizing a spendthrift trust.'' The court also noted that statutory disapproval of self-settled trusts has been in place for over a century. However, the *Huber* court failed to emphasize an important distinction between the facts of *Huber* and *Portnoy*: *Huber* involved a dispute between two domestic laws, while *Portnoy* involved a dispute between domestic law and

[10] 473 N.Y.S.2d 242 (App Div, 2d Dept 1984).

[11] *Waldron v. Huber (In re Huber)*, 493 B.R. 798 (Bankr. W.D. Wash. 2013).

[12] *Marine Midland Bank v. Portnoy (In re Portnoy)*, 201 B.R. 685 (Bankr. S.D.N.Y. 1996).

© 2019 Tax Management Inc., a subsidiary of The Bureau of National Affairs, Inc.
ISSN 0886-3547

foreign law. Similarly, the Supreme Court of Illinois held in *Rush Univ. Med. Ctr. v. Sessions,*[13] that self-settled trusts formed in a jurisdiction that permits DAPTs, in which the assets were located in Illinois, no matter under what jurisdiction they were created, to be void as to creditors under Illinois law.

An important consideration among states that have passed DAPT legislation is how each respective state treats child support claims. Some legislators were concerned that settlors could utilize DAPTs to avoid alimony or child support payments. Accordingly, most states, including Delaware, Missouri, New Hampshire, Oklahoma, Rhode Island, South Dakota, Tennessee, Ohio, Virginia, and Wyoming, provided some sort of exception for child support. In including this exception, these states followed the general principle that spendthrift clauses do not prevent child support ''creditors'' from being able to reach the beneficiary's interest in the trust. However, not all DAPT states have adopted such exceptions. For instance, the high court of Nevada held in *Klabacka v. Nelson*[14] that the assets in a husband's DAPT could not be reached for satisfaction of future child support and spousal support claims. The Nevada court relied heavily on the legislative history of Nevada's DAPT statute. Nevada's law is frequently cited as providing the strongest protections. Similarly, Utah, being a very protective DAPT state, provides protection of the DAPT assets against spousal and child support claims.

WHY USE A PRENUP FOR ASSETS HELD IN TRUST?

A prenup is a contract entered into between a married couple in contemplation, and in consideration, of their future marriage. The property rights and economic interests of either the prospective wife or husband, or both, are determined and set forth, with the agreements often including provisions concerning the distribution of property upon divorce. In general, prenups are designed to define what property or financial assets each spouse is entitled to in the event of divorce.

Prenups are typically initiated by a wealthy spouse to protect his or her assets. However, these prenups must be carefully negotiated. During the negotiation, the less wealthy spouse may insist upon a certain level of financial security in the event the marriage does not work out. Determining what financial protections are to be afforded in the prenup can be a daunting task. This is particularly sensitive when someone marries the heir of a wealthy family. The heir may or may not have access or entitlement to share in the family wealth. It is not unusual for the bulk of the family wealth to be held in irrevocable and even generation skipping trusts. There are both tax and nontax reasons for these types of trusts.

If the assets of the wealthy spouse-to-be are held in an irrevocable spendthrift trust, is the prenup necessary?

[13] 980 N.E.2d 45 (Ill. 2012).

[14] 394 P.3d 940 (2017).

The answer is only partially no. As will be discussed below, the trust may provide protections for the family wealth against distribution in divorce whether the law of equitable distribution or community property applies. However, if the married couple bases their lifestyle upon income or other distributions from the trusts, the expectancy that those distributions will continue may be taken into account by a court during a divorce in determining maintenance or support obligations and child support.

As already discussed, there are limitations on spendthrift protections of trusts—especially in the divorce context. There are numerous examples of cases where courts have deemed assets in trust to be available as part of the marital estate. Even if not available, trust assets may be a factor in determining a division of assets in equitable distribution. A carefully crafted prenup may go a long way toward and perhaps totally protect trust assets in a divorce. Even where the trust assets should be protected under general legal principles the prenup can play a major role in avoiding litigation over the inclusion of trust assets and income. The prenup can also eliminate any doubt as to whether family legacy assets (whether in trust or not) will be considered to be marital assets or will be taken into account in fashioning equitable distribution.

Both parties must fully and accurately disclose their income and assets in order for a prenup to be deemed valid by a court.[15] A few states allow a spouse to waive a full disclosure of assets, but the waiver must be made knowingly and voluntarily. If a full and accurate disclosure was not made, and disclosure was not waived, a court may refuse to enforce the agreement. Further, some states require that each party have separate and independent counsel.

There is scant authority as to what constitutes full and adequate disclosure of assets of a trust in which the party to the prenup is a wholly discretionary beneficiary. Arguably, disclosure should not be required because the beneficiary does not have vested ownership in the trust assets and may have no control over the assets or distributions. Nevertheless, the rights of a trust beneficiary are extensive, including the right to an accounting. This makes it difficult for the beneficiary to claim he or she has no rights to the underlying trust assets. Moreover, if those trust assets provide the means to support the married couple, it will be an uphill battle to assert in a divorce proceeding that those assets should not be taken into account.

Where assets are held in irrevocable spendthrift trusts established by a senior generation, the disclo-

[15] When evaluating the validity of a prenup, the court looks to ''fair disclosure'' requirements, in which a judge considers whether (1) the agreement contains a fair and reasonable provision as measured at the time of its execution for the party contesting the agreement; (2) the contesting party was adequately informed of the other party's net value prior to the execution of the agreement or acquired, or should have acquired, independent knowledge of the other party's net value; and (3) a waiver by the contesting party is set forth. *Eyster v. Pechenik*, 71 Mass. App. Ct. 773, 887 N.E.2d 272 (App. Ct. 2008).

© 2019 Tax Management Inc., a subsidiary of The Bureau of National Affairs, Inc.
ISSN 0886-3547

sure of those assets may be particularly sensitive and/or troubling. The beneficiary of the trust may or may not have access to the level of detailed information about assets held in trust to provide full disclosure in the context of negotiating a prenup. It is one thing to require a party to a prenup to disclose assets he or she owns. But what if that party is a mere sprinklee of a dynasty trust where distributions to that person are wholly discretionary and out of the control of the beneficiary? Although the beneficiary may have certain rights as a beneficiary to an accounting of trust assets, that is far different than having the right to current and immediate disclosure of trust assets. The trustees and other family members may have strong objections to disclosing the trust assets. Indeed, the beneficiary may not even know of the existence of the trust or of its assets in jurisdictions that allow ''quiet trusts.'' Will the failure or inability to disclose trust assets provide a wedge to invalidate the prenup? It is difficult to predict how a court will view such nondisclosure.[16] All sensitivities aside, it is prudent to err on the side of providing some level of disclosure of the nature and extent of the trust.

EFFICACY OF TRUSTS IN DIVORCE

Whether and to what extent a trust will be respected as keeping its assets out of the calculation of marital assets in a divorce depends upon (1) who settled the trust; (2) the court's perception of the party's access; and (3) the laws of the state with jurisdiction over the trust and the divorce. In other words, it is not safe to assume any particular outcome without a careful legal and factual analysis.

Trust Settled by Another Person for the Benefit of the Spouse Beneficiary

In general, a trust set up by a third party (e.g., a parent for a child, etc.) is more likely to be excluded from the marital estate. The corpus of the trust will generally be excluded provided the party to the divorce does not have access to the underlying assets. But if there is a pattern of distributions from the trust that fund the marital lifestyle, that income interest may be taking into consideration in equitable distribution jurisdictions.

Many states look to whether a beneficiary spouse has a present and absolute right to receive the trust assets. For example, in *Mey v. Mey,*[17] the New Jersey high court held that a beneficiary spouse's interest in a trust does not constitute property that is legally and beneficially acquired, unless the beneficiary has acquired ''unimpaired control and totally free use and enjoyment'' of the trust assets.

Trust Settled by Divorcing Parent for Children

Do assets transferred to trusts to accomplish normal estate planning objectives of the marital unit take the transferred assets out of the marital estate? The answer is resoundingly ''perhaps.'' In at least one New York case such transfer was upheld. In *Villi v. O'Caining-Villi,*[18] the husband had transferred the matrimonial residence into a family partnership. He and his wife each held a 49.5% partnership share and his sons held the remaining 1%. Subsequently, the partnership transferred the house into a New York trust for the benefit of the family. Neither husband nor wife was a beneficiary but they each had the right to lifetime use and enjoyment. One of the spouses sought to have the court determine that the residence was not part of the marital estate for purposes of equitable distribution. The court held, in large part based on lack of evidence to the contrary, that the transfer of the trust was not designed to benefit one spouse over the other so that the house was not marital. The court also based its decision on the fact that neither of the parties had retained control over the trust and had granted all decision making power to the trustees. The court said ''Here, what the parties have accomplished by their transfer of the Home to the Villi Family Trust is akin to the making of a gift of the Home to defendant's son ...'' It is important to note that the court distinguished cases where there is evidence that the trust was fraudulently created in order to defeat a defendant's equitable distribution rights. However, in *Surasi v. Surasi*[19] the court invalidated a sham trust finding it was created to defeat the marital claims of the spouse.

Trust decanting is a method by which the trustee of an irrevocable trust distributes trust assets into a new trust with revised terms. In *Ferri v. Powell-Ferri,*[20] the Massachusetts high court held that trust property in a Massachusetts irrevocable trust may be decanted (i.e. transferred) into a new trust even if doing so

---

[16] When evaluating the validity of a prenup, the court looks to ''fair disclosure'' requirements, in which a judge considers whether (1) the agreement contains a fair and reasonable provision as measured at the time of its execution for the party contesting the agreement; (2) the contesting party was adequately informed of the other party's net value prior to the execution of the agreement or acquired, or should have acquired, independent knowledge of the other party's net value; and (3) a waiver by the contesting party is set forth. *Eyster v. Pechenik*, 887 N.E.2d at 272.

In *Mamot v. Mamot*, 283 Neb. 659, 813 N.W.2d (2012) the Nebraska high court held that in order for the wife to prove that the premarital agreement was unconscionable, she had to show that prior to the execution of the agreement: (1) she was not supplied a fair and reasonable disclosure of her spouse's property or financial obligations; (2) she did not expressly waive disclosure of such information; and (3) she did not have, or reasonably could not have had, an adequate knowledge of such information.

[17] 79 N.J. 121 (1979). *See also Friebel v. Friebel*, 181 Wis. 2d 285, 510 N.W.2d 767 (Ct. App. 1993), *Lipsey v. Lipsey*, 983 S.W.2d 345, 351 (Tex. Ct. App. 1998).

[18] 809 N.Y.S.2d 484 (Sup. Ct. 2005).

[19] 2001 NY Slip Op 40408, 2001 BL 8289 (Sup Ct. Nov. 20, 2001).

[20] 476 Mass. 651 (2017).

© 2019 Tax Management Inc., a subsidiary of The Bureau of National Affairs, Inc.
ISSN 0886-3547

would remove the trust assets from the beneficiary's marital estate during his divorce. The court ruled that the trustees of an irrevocable trust that was created in 1983 could decant the trust's assets into a new trust, even though at the time of the decanting the beneficiary, who was going through a divorce, had the right to withdraw 75% of the trust property. The court noted that the husband played no role and had no knowledge of the decanting. The case involved Connecticut and Massachusetts law, both ''all property'' states, with the effect that if the property was distributed from the trust it would have immediately become part of the marital estate and thus subject to equitable distribution. The trustees decanted the assets to a trust that would not pay out to avoid this outcome. It was unclear if the result would have differed had the husband played a role in the planning for the decanting. Note that had the case involved a separate property state, the decanting might have been unnecessary because the trust assets distributed would likely have constituted ''separate'' property.

In states that do not recognize separately acquired assets, a party's estate for purposes of equitable division may include ''all property to which a party holds title, however acquired.''[21] Thus, assets held in trust may become part of the marital estate if the spouse beneficiary has access to these assets. Where interests are properly characterized as mere expectancies, they should not be included in the divisible estate of the divorcing parties.[22] For these types of trusts, whether the trust has a spendthrift clause, or is spendthrift under governing state law, may be dispositive. The courts may examine whether the spouse beneficiary's rights are a ''fixed and enforceable'' property right or alternatively ''whether the party's interest is too remote or speculative'' to be included.[23]

There is an important distinction between the determination of whether assets in a spendthrift trust constitute marital property, on the one hand, and whether they may be taken into account in determining equitable distribution. Courts have held that assets held in a spendthrift trust where the spouse beneficiary's rights are solely discretionary, while not part of the marital estate, may still be taken into account in determining equitable distribution.[24] That makes sense because the spouse beneficiary may have no immediate right to those assets. The court deciding the equitable distribution claims may not have direct jurisdiction over the trust. However, the potential for the spouse beneficiary to receive assets from the trust may be a factor in determining equitable distribution. Consequently, the bulk of the spouse beneficiary's personal assets may be awarded to the other spouse under equitable distribution on the assumption that the trust will eventually step in to bail out the spouse beneficiary. This conclusion strongly suggests not to place too much reliance on the protection afforded by a spendthrift trust where distributions to the beneficiary are discretionary. While the trust assets may not be directly subject to equitable distribution, at least to the extent of the personal assets of the spouse beneficiary, the trust assets could be said to be ''indirectly'' subject to equitable distribution.

In *Pfannenstiehl v. Pfannenstiehlt*[25] the Massachusetts high court reversed the trial court for including the present value of a husband's beneficial interest in a discretionary spendthrift trust in the parties' divisible marital estate under Mass. Gen. Laws ch. 208, §34 because his expectancy of future income from the trust was so speculative as to constitute nothing more than an expectancy. His right to receive anything was subject to the trustee's having first exercised his discretion in determining the needs of an unknown number of beneficiaries, and the possibility that the trust would be terminated and the principal distributed to the remainder beneficiaries was remote. The court found that because it was within the sole discretion of the trustees to distribute funds to the husband, it was speculative as to whether he would receive anything further in the future. That speculative nature did not mean, notably, that the court could not consider the trust interest in the equitable distribution—only that the court could not distribute that interest as part of the marital estate. The court also notably found that, although it had dispensed with an award of alimony, the court could reconsider that issue and potentially award alimony, considering that the trust interest would not be distributed as part of the marital estate.

One Massachusetts case went even further finding that the principal assets in the trust were subject to equitable division. In *Lauricella v. Lauricella,*[26] the Massachusetts high court held that a husband's beneficial interest in a trust comprised of real estate, which was ''present, enforceable, and valuable,'' was subject to equitable division. In holding that the husband's beneficial interest was in fact a marital asset subject to distribution, the court held that ''estate'' meant all property to which a spouse holds title whenever and however acquired. Because the husband had a present, enforceable, equitable right to use the trust property for his benefit, his interest was a marital asset and was subject to property distribution as a part of the divorce proceedings. Note that this decision was no doubt influenced by the fact that Massachusetts is an all property state. It would be more difficult (but not impossible) for a court to reach a similar conclusion in a state that recognizes separate property.

In an all property state such as Massachusetts, inherited assets, including an interest in trust property established by one spouse's parents, may comprise part of a marital estate for purposes of possible divi-

---

[21] *Williams v. Massa*, 431 Mass. 619, 625, 728 N.E.2d 932 (2000).

[22] *Hanify v. Hanify*, 403 Mass. 184, 526 N.E.2d 1056 (1988).

[23] *D.L. v. G.L.*, 611 Mass. App. Ct. 488, 499, 811 N.E.2d 1013 (2004).

[24] *Riechers v. Riechers*, 679 N.Y.S.2d 233 (Sup. Ct. 1998); *Yerushalmi v Yerushalmi*, 26 N.Y.S.3d 114 (App Div, 2d Dept 2016).

[25] 475 Mass. 105, 55 N.E.3d 933 (2016).

[26] 565 N.E.2d 436 (1991).

© 2019 Tax Management Inc., a subsidiary of The Bureau of National Affairs, Inc.
ISSN 0886-3547

sion under G. L. c. 208, §34.[27] The mere fact that a trustee's discretion is ''uncontrolled'' (i.e., not governed by an ascertainable standard) does not necessarily preclude a trust's inclusion in the marital estate.[28] In *Levitan*, the central issue at trial was whether the wife's trust share was includable in the marital estate for purposes of equitable distribution under G. L. c. 208, §34. The wife argued that her share was not includable because the spendthrift provision barred distributions to third parties, including the husband. The lower Massachusetts court distinguished the facts of the case from *Pfannenstiehl*, finding that because the wife's share of the trust was not susceptible to reduction (as she was the sole beneficiary of her share held in trust), the beneficiary class was closed, and the ''primary intent'' of the trust was to provide for the wife rather than for subsequent generations.

Discretionary Trusts under the UTC

The Uniform Trust Code (UTC) made a radical departure from common law in Article 5, §504, which deals with who is entitled to compel a distribution from discretionary and support trusts. Under traditional common law, a beneficiary has no enforceable property right in the trust. Further, trust assets or distributions are not necessarily considered in alimony, child support, or equitable distribution. However, UTC §504(c) allows spouses and children to compel distributions from a discretionary trust if the trustee has abused his or her discretion. With respect to alimony and child support claims, a former spouse and minor children are exception creditors, and the former spouse may attach a current beneficial interest of a support trust on behalf of minor children. Absent facts indicating the spouse has access (in practice or in fact) to the trust in states that have not adopted the UTC or Restatement Third, a spouse generally does not have any claim against a discretionary trust.

UTC §504(b) provides substantial protection against creditors being able to ''stand in the shoes'' of a beneficiary and compel distributions from discretionary trusts subject to a distribution standard. UTC §504(b) provides that whether or not a trust contains a spendthrift clause, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if the discretion is expressed in the form of an ascertainable standard of distribution or the trustee has abused the discretion.

The UTC and Restatement Third permit the argument to be made that all beneficial trust interests, current beneficial interests as well as future interests, are property or a sufficient enforceable right. Most states are trending toward rejecting Restatement Third. For example, in *Tannen v. Tannen,*[29] the New Jersey high court held that a spendthrift trust is not included in the equitable distribution of the marital estate. The *Tannen* decision affirmed that in New Jersey, ''a purely discretionary trust will be honored as giving the trustee unfettered discretion to distribute or not distribute, regardless of the support needs of the beneficiary.''

Sham Trusts

Courts have not looked kindly upon spouses who place their assets in a trust in anticipation of divorce in order to defeat the claims of the other spouse. The dissipation or secreting of marital assets constitutes a form of ''economic fault,'' which should be considered in making an equitable distribution.[30] In *Surasi v. Surasi*,[31] the court held that the trust in question was revocable because it was a sham trust created in an effort to defeat the plaintiff's rights regarding arrears and equitable distribution. Further, in *Riechers v. Riechers*,[32] the husband had established an irrevocable trust in the Cook Islands, funded with assets of a limited partnership formed under the laws of Colorado. The trust beneficiaries were the wife, husband, and their children. However, the wife was not personally designated as a beneficiary—the trust designated the wife in a separate category as ''Spouse of the Settlor'' so the wife would lose the benefits on entry of a judgment of divorce. 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. Although the court did not find with any degree of certainty that the formation of the trust was necessarily an attempt by the husband to avoid the consequences of equitable distribution of marital assets in contemplation of divorce by secreting marital assets or by deliberate dissipation of marital assets, the court did find that the value of the marital assets placed in the irrevocable trust was subject to equitable distribution.

In *Aronson v. Aronson*,[33] the Massachusetts appellate court held that there was ample evidence that a transfer of real property to an irrevocable trust for the benefit of the parties' children was fraudulent. The trial court had set aside the conveyance finding that it was ''made in fraud of the Plaintiff's rights'' in violation of G.L. c. §109A. Specifically, the trial court found that the ''husband had transferred the land to deprive the wife of her right to claim it as part of the marital estate.''

Excluded Claims in DAPT States

DAPT assets can be used in calculations for child support or spousal maintenance when a trust is determined to be created through a fraudulent transfer or

---

[27] *Ruml v. Ruml*, 50 Mass. App. Ct. 500, 738 N.E.2d 1131 (App. Ct. 2000).

[28] *Levitan v. Rosen*, 95 Mass. App. Ct. 248, 124 N.E.3d 148 (App. Ct. 2019).

[29] 416 N.J. Super. 248 (App. Div. 2010), *aff'd*, 208 N.J. 409 (2011).

[30] *Goldberg v. Goldberg*, 568 N.Y.S.2d 394 (App Div, 1st Dept 1991).

[31] 2001 NY Slip Op 40408.

[32] *Riechers v. Riechers*, 679 N.Y.S.2d 233 (Sup. Ct. 1998).

[33] 25 Mass. App. Ct. 164, 516 N.E.2d 184 (App. Ct. 1987).

© 2019 Tax Management Inc., a subsidiary of The Bureau of National Affairs, Inc.
ISSN 0886-3547

when it is invalidated for other reasons. A course of conduct, such as the receipt of regular distributions to pay taxes of the settlor, may be considered by a court to be evidence that the settlor has sufficient access to the trust even if the language of the trust suggests otherwise. This would leave those assets open for the court to distribute in a divorce action. Distributions may also be considered by a court in determining child support and/or spousal maintenance because once they are distributed to the settlor the assets are considered to have left the protection of the trust account and are then in the possession of the settlor again. The assets are only shielded from creditors when they are within the trust account, and therefore any discretionary distribution from the trust account could be considered by the court in a marital dissolution.

CONCLUSION

Some practitioners believe that assets held in an irrevocable spendthrift trust are protected, so a prenup is unnecessary. Because the process of negotiating a prenup may be perceived as antithetical to the spirit in which the parties are planning to marry, there is a temptation to avoid the process. In some cases, there may be considerable pushback by someone marrying into a family with dynastic wealth who is being asked to sign a prenup. The prenup may go too far by depriving the spouse-to-be the possibility of future accretion to wealth that a married couple may attain. It is important to strike a balance. When the entirety of the beneficiary's wealth is in trust, allowing a new spouse to attain ownership of trust assets may be anathema to the other family members who are also beneficiaries. This often requires the wisdom of Solomon to avert a real conflict that could derail the marriage. Nevertheless, clarity is an important goal that can be achieved only by entering into a prenup. The mere fact that assets are in a dynastic trust does not put them out of harm's way should the marriage not work out. Only through an enforceable prenup can there be virtual certainty that the trust assets will be ''off the table.''

© 2019 Tax Management Inc., a subsidiary of The Bureau of National Affairs, Inc.
ISSN 0886-3547