DIVORCE AND TRUST INTERESTS: DEMYSTIFYING THE LEGAL LANDSCAPE FOR THE PRACTICTIONER

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The interplay between divorce and trust interests may be one of the most vexing for practitioners and mediators. This primer attempts to synthesize the legal landscape in this area and to demystify the issue so that we may better serve our clients.

I. INTERPRETATION OF TRUST

In interpreting a trust, a court must "ascertain the …. [donor's] intention from the whole instrument… and to give effect to that intent unless [the law forbids]." *Upham v. Siskind*, 16 Mass.App.Ct. 588, 594 (1983) *citing Putnam v. Putnam*, 366 Mass. 261, 266-67 (1974). Where the donor's intent is ambiguous, one must now consult, in addition to case law, the newly enacted *Massachusetts Uniform Trust Code*, G.L. c.203E generally ("MUTC").

II. TRUST ASSETS AS PART OF MARITAL ESTATE

Where a trust asset is an issue in a divorce, G.L. c.208, § 34 comes into play. Our equitable distribution statute, as the practitioner knows, is quite expansive -- the estate of a party includes all property to which he or she holds title, however acquired, *Rice v. Rice*, 372 Mass. 398, 401 (1977) and the trial judge has broad discretion to assign assets in the pursuit of equity, *Bianco v. Bianco,* 371 Mass. 420 (1976).

Moreover, "[i]n making the determination of what to include in the estate, the judge is not bound by traditional concepts of title or property." *S.L. v. R.L.,* 55 Mass. App. Ct. 880, 882 (2002).

Interests do not have to be vested in order to be included in a § 34 estate, *see Baccanti v. Morton*, 434 Mass. 787 (2001) (unvested stock options are part of estate).

III. IS THE TRUST REVOCABLE?

The first question to consider when dealing with a trust in a divorce case is whether it is revocable or irrevocable[1]. Where a trust established by a party

[1] In most cases, this will be apparent from the instrument. If not, it is presumed to be revocable as to instruments drafted after July 9, 2011. (*MUTC* at § 602(a)(3))

can be revoked at will, courts across the United States have "generally refused to treat the trust as a distinct entity …[because they consider]… the power to revoke … as tantamount to … ownership." 2 Brett R. Turner, *Equitable Distribution of Property* § 6:93 (3rd Ed. 2005).

In a divorce, since the assets in a revocable trust would be viewed as owned by the settlor-spouse, they are subject to division under § 34. *See*, *e.g. Wolfe v. Wolfe*, 21 Mass. App. Ct. 254 (1985):

> Where a settlor of a revocable trust had the absolute right and power to withdraw up to five-sixths of the trust corpus for his own use and benefit, the corpus could be invaded to that extent in order to meet payments due from the settlor to his former wife pursuant to a probate judge's order under G. L. c. 208, Section 34.

Note that an asset "subject to division" is not necessarily one that will be divided – it simply means that the court may consider the asset for division.

Similarly, where a non-spouse third party sets up a revocable trust for the benefit of a spouse, the courts generally treat the trust as an asset of that non-spouse. *Id.* While the court cannot consider this revocable trust an asset subject to division, the court can consider this as an expectancy interest in rendering a division of assets. G.L. c.208 § 34.

IV. INTERESTS SUBJECT TO POWERS OF APPOINTMENT

A power of appointment is "a power created in a written instrument, usually a trust or will, which allows" the "holder" to designate recipients of the property subject to the power. 1 John H. Clymer, Katherine L. Babson, Jr., Robert G. Bannish, *Massachusetts Estate Planning, Will Drafting and Estate Administration: Forms* § 3.07.

Courts have consistently held that a spouse with a beneficial interest subject to a power of appointment has only an expectancy that should not be included in the marital estate. For example, one case involved a trust in which the husband's father had a testamentary power of appointment over the principal – specifically, he could devise the principal to any beneficiary of his choosing. The Appeals Court agreed with the trial court that the interest was like an expectancy interest under a will and that it was properly excluded from the marital estate. *D.L. v. G.L.,* 61 Mass.App.Ct 488 (2004).

In another case, a trust was properly excluded because the wife's mother, a lifetime income beneficiary under her father's trust, had a power of appointment over any remaining corpus. Furthermore, the wife's mother had the ability, upon request, to withdraw all of the trust assets. *S.L. v. R.L.,* 55 Mass. App. Ct. 880, 882 (2002).

Where the settlor-spouse holds a power of appointment, as in *Ruml v. Ruml*, 50 Mass.App.Ct. 500 (2000), the assets in the trust are subject to equitable distribution. In other words, if the spouse owns it, it is in the estate.

V. WITHDRAWAL RIGHTS IN AN IRREVOCABLE LIFE INSURANCE TRUST

Another general power of appointment that surfaces in our practices is the beneficiary's right of withdrawal in an irrevocable life insurance trust. 3 Phyllis E. Federico, Peter F. Zupcofska, et al., *Massachusetts Divorce Law Practice Manual* § 29.10.4 (3rd Ed. 2014).

Some background for those less familiar with estate planning might be useful.

When the life insurance policy is owned by the trust rather than the insured, the proceeds of the policy are not included in the insured's gross estate for estate tax purposes. See generally I.R.C. § 2042. How does the trustee, then, pay the premiums without gift tax consequences? Usually, the trustee utilizes the annual gift tax exclusion under I.R.C. § 2503 (currently $14,000 for 2014).

Unfortunately, the gift tax exclusion only covers gifts of a "present interest" – which does not include gifts to a trust unless the beneficiary has an immediate right to the gift. Therefore, the trust will typically provide that when funds are added to the trust (or in the case of a whole life policy, when income is earned), the beneficiaries have a right to withdraw all or part of the gift within thirty days, after which it lapses. The idea, of course, is that the beneficiaries will not exercise the withdrawal right because the ultimate benefit of the trust is the life insurance proceeds.

Since, as noted earlier, the withdrawal right is a general power of appointment, the gift property is reachable by creditors and, arguably, included in the marital estate and subject to division. *See, e.g., State Street Bank & Trust v.*

Reiser, 7 Mass. App. Ct. 633 (1979) and *Lipsitt v. Sweeney,* 317 Mass. 706 (1945) (creditor's right to attach gifted property prior to lapsing). Again: since the spouse owns it, it is in the estate.

As to whether the spouse's share of the death benefit would be a § 34 asset, the court would apply the "fairly certain" test, Section VII *infra.*

ILIT's are the most common of the irrevocable gifting trusts. But there are other types that might arise in our practices. For example, a case might involve trusts that "hold stock in a closely held company as part of a gifting strategy to shift the stock to a younger generation without putting the stock directly in their hands." Federico and Zupcofska, *supra* at § 29.10.4.

VI. NOMINEE TRUSTS

As with the withdrawal right in an ILIT, a beneficiary's ownership interest in a nominee trust is similarly unencumbered.

Briefly, a nominee trust is often used to conceal the identity of the true owner of property, typically real estate; this is accomplished because the beneficiaries are not set forth in the trust instrument but in a separate unrecorded schedule of beneficiaries. Further, the nominee trustee holds legal title to the property and acts only at the discretion of the beneficiaries, *see, e.g. Roberts v. Roberts*, 419 Mass. 685, 687 (1995), who have fully vested transferable interests in the property, Charles E. Rounds, Jr. et al., *Loring and Rounds: A Trustee's Handbook* § 9.6 (2014).

These factors have led most commentators to conclude that the nominee trust is in most cases "not really a trust at all" but "an agency agreement." Robert L. Marzelli and Elizabeth S. Marzelli, *Massachusetts Real Estate* § 7.4 (2003).

Considering the nature of the beneficiary's interest in the nominee trust, it is certainly subject to equitable distribution. Once more: if the spouse owns it, it is in the estate.

VII. THE "FAIRLY CERTAIN" STANDARD

In and of itself, the characterization of an interest in an irrevocable trust -- whether it is a contingent or remainder interest, for example -- does not

dictate whether it is included in the marital estate. These categories, central to trust law, are less important in cases involving the division of a marital estate. In the latter context, equity predominates over bright-line trust concepts -- the core issue for the Court is to determine what to include in the marital estate and to render an "equitable" division of property.

That is where the "fairly certain" requirement comes in.

Consider, for example, two hypothetical cases in which a spouse has a contingent interest in a trust. In one case, the interest of a healthy 25-year-old beneficiary is contingent on surviving his 95-year-old mother. One might consider that interest "fairly certain" as opposed to "highly speculative" or "remote." In another case, the spouse-beneficiary is a 25-year-old cancer patient whose interest is contingent on surviving her 50-year-old father. Most of us would agree that this case stands on a different footing. Although they are both contingent interests, one can see how inequitable it would be to include both interests in the marital estate.

Massachusetts law recognizes that equity demands a flexible approach to trusts in the context of a divorce. The SJC has made clear that so long as "the future acquisition of assets is fairly certain, and current valuation possible, the assets may be considered for assignment under § 34." *Williams v. Massa*, 431 Mass. 619, 628 (2000). Interests considered "too remote or speculative" for inclusion within the estate are instead weighed under the § 34 criterion of "opportunity of each [spouse] for future acquisition of capital assets and income" in dividing the marital property. *Williams v. Massa*, *supra* at 629.

A threshold question in determining whether a trust interest is included in the § 34 estate is whether the beneficiary has a "present, enforceable, equitable right to use the trust property for his benefit." *Lauricella v. Lauricella*, 409 Mass 211 (1991). Note, however, that the lack of such an interest does not necessarily guarantee its exclusion. *Child v. Child*, 58 Mass. App. Ct. 76, 84 (2002).

VIII. THE EXTENT OF TRUSTEE DISCRETION

The right of a beneficiary to income or principal where the trustee has discretion to invade principal or distribute income is frequently controversial. In determining those rights, it is critical to examine the specific language of the trust. Many of the cases turn on the extent of trustee discretion.

In *Woodberry v. Bunker*, 359 Mass. 239 (1971), a trustee had the discretion

to invade principal "as in the opinion of [the] trustees shall be needed for his or her comfortable support, medical or nursing care, or other purposes which seem wise to [the] trustees."

While the standard on its face may seem amorphous and unenforceable, this, like most other "broadly expressed fiduciary standards," is a "judicially enforceable, external, and ascertainable standard." Specifically, the court went on, the beneficiary in this case has a right to be maintained "in accordance with the standard of living which was normal for him before he became a beneficiary of the trust." Moreover, the phrase "which seem wise to [the] trustees" does not affect the judicial enforceability of the standard.

At issue in *Marsman v. Nasca*, 30 Mass.App.Ct. 789 (1991), was the trustee's discretion to pay the beneficiaries such amounts "as they deem advisable for his comfort, support, and maintenance." As with *Woodberry*, the Court interpreted a judicially enforceable standard – "to maintain the … beneficiary in accordance with the standard of living which was normal for him before he became a beneficiary of the trust."

In *Child*, *supra,* the trustee had "sole discretion" to distribute principal and income to the husband, the beneficiary spouse, without any judicially enforceable standard. Because the husband, however, conceded at trial that the trust was a marital asset, the Appeals Court did not disturb the trial court's finding that it was a marital asset. However, were the issue properly before them, the Appeals Court opined, the "sole discretion" standard appeared to suggest that the husband's interests were "too remote and speculative" and that he probably did not have a present enforceable right to trust assets.

In *Comins v. Comins*, 33 Mass. App. Ct. 28 (1992), the trustee was empowered to distribute income and principal as "in its discretion it deems advisable to provide for the comfort, welfare, support, travel and happiness of [the wife]." Since the trustee standard here was judicially enforceable, *see Woodberry, supra*, the Court found that the wife had a "present, enforceable, equitable right to use the trust property for her benefit." Her beneficial interest was properly included in the marital estate.

In one of the several trusts at issue in *D.L. v. G.L.,* 61 Mass.App.Ct 488 (2004), the trustees had the authority to distribute income and principal to the husband in their "uncontrolled discretion" as they deemed "advisable." Upon the termination of the trust, the remaining corpus is distributed to the husband's children.

The trial court found that, over the past 38 years, all of the income was distributed to the husband and none of the principal. The Appeals Court affirmed the trial court's finding that the husband did not have a present and enforceable right to the principal and, therefore, it was proper to conclude that the trust was not a part of the § 34 estate. The trial court correctly considered the trust under the § 34 factor "opportunity of each spouse for future acquisition of capital assets and income." The Court also correctly considered income from the trust for support and alimony purposes.

IX. INTERESTS CONTINGENT ON SURVIVAL OF ANOTHER

Often, a spouse-beneficiary will have a vested remainder interest in trust property -- the right to receive trust property when the trust terminates. In that case, the only uncertainty may be if the spouse is not alive to take possession. This, in most instances, would be considered property subject to division in a § 34 case. *See*, *e.g. S.L. v. R.L, supra.*

The husband in *Lauricella, supra* had a vested remainder interest in the trust corpus, a two-family house in West Newton. He was 26 years old at the time of divorce and would receive a share of the trust principal when the trust terminated in seventeen years. Additionally, he was a current equitable beneficiary in that he had the right to use the property and to rent the property. In fact, he was living in the house. Here, the interest was properly included in the marital estate.

From the relative certainty of vested remainder interests, we move to a common set of slightly less certain interests – specifically, interests contingent on a spouse surviving his/her parent. In and of itself, considering the equitable nature of the landscape, this condition does not guarantee exclusion or inclusion in the § 34 estate. The cases, instead, reveal "no clear consensus," and the "decisions turn more on the particular attributes of the respective disputed interests than on principles of general application." *S.L. v. R.L at 883, citing Lauricella* at 215-216.

In four of the other trusts in *D.L. v. G.L*, *supra,* the husband's contingent remainder interests were properly excluded from the marital estate. All of these trusts terminated at a date that was seven years from the divorce judgment – at which point husband would receive a share of the trust principal provided that he survived his father. His father, at the time of trial, was 67 years old and no

evidence was presented regarding his health. Therefore, since it cannot be "fairly certain" that those contingencies would be met, the trust interests were properly excluded from the marital estate.

In four of the trusts at issue in *S.L. v. G.L., supra*, the only contingency was the wife, 55 years old at trial, surviving her mother, 77 years old at trial. The court found that the wife was healthy and there was no evidence as to her mother's health. All four of the trusts were properly included in the marital estate, according to the Appeals Court.

In one *S.L. v. G.L.* trust, the wife's mother was a lifetime income beneficiary. The trustees had the discretion to distribute principal to the mother "taking into consideration other income and assets available to her, to allow her to maintain the standard of living enjoyed during [her father's] life." Upon the mother's death, the trust assets would be distributed in equal shares to the wife and her siblings. This trust was properly included in the marital estate, according to the Appeals Court.

In another *S.L. v. G.L.* trust, the wife's mother was also a lifetime income beneficiary and, upon her death, the trust income was to be paid to wife and her siblings until each of the siblings reached 21 years of age – at which point, the principal would be distributed in equal shares. The wife's mother had no right to principal. This trust was properly included in the marital estate, according to the Appeals Court.

The wife's mother was a lifetime income beneficiary in two of the other trusts in *S.L. v. G.L., supra*. In both trusts, during the wife's mother's life, the trustee had discretion to distribute principal subject to specific objective financial condition of the trust and certain other trusts. Upon the wife's mother's death, both trusts would be divided into separate equal portions for the wife and her siblings who would be lifetime income beneficiaries. Upon wife's death, the wife's children would receive distribution of the wife's portion of the trust principal. These trusts were properly included in the marital estate, according to the Appeals Court.

Davidson v. Davidson, 19 Mass. App. Ct. 364 (1985) involved a remainder interest contingent on survivorship. Here, the interest was subject to the husband surviving his mother. But the remainder interest at issue was a vulnerable one. Despite the fact that the trustees had the right to invade principal for the mother in their "uncontrolled discretion," the trial court included the trust in the marital estate. The Appeals Court upheld it warily,

noting that this was on the "outer limits" of what might be properly included in the marital estate. As *Davidson* predates the *Williams v. Massa*, *supra*., "fairly certain" requirement, it remains an open question whether a similar trust could be included in a § 34 estate today.

X. SPENDTHRIFT CLAUSES

By itself, a spendthrift clause, *i.e.* a clause that seeks to prevent attachment of trust property by creditors, is generally not a bar to including the interest in the marital estate. *See Davidson, supra* (that the remainder interest was subject to a spendthrift provision did not prevent its inclusion in the marital estate), *S.L. v. R.L., supra* (three of the trusts properly included in the marital estate contained valid spendthrift clauses) and *Ruml v. Ruml*, 50 Mass. App. Ct. 500, 512, n. 19 ("We also note that the spendthrift clause in the trust agreement does not preclude the distribution of trust assets to the wife.")

However, although a spendthrift interest may be properly included in the marital estate, courts generally do not order a spendthrift trustee to make payments from a trust in order to satisfy obligations related to the divorce. This becomes relevant for the spouse or ex-spouse who is a creditor.

> [T]he path of the wife seeking recovery from her husband's trust interest for alimony or support of children is more difficult in Massachusetts. . . It has been held that she can recover neither as a judgment creditor . . . nor in a suit to require the trustee to pay reasonable sums from the trust income for the support of legal dependents of the beneficiary.

Pemberton v. Pemberton, 9 Mass. App. Ct. 9 (1980) summarizing the holdings of *Bucknam v. Bucknam,* 294 Mass. 214 (1936) and *Burrage v. Bucknam*, 301 Mass. 235 (1938) (holding that where the trust does not mention the ex-husband's family, it would "do violence to the plain words" of the settlor to read their names into the instrument and direct the trustee to pay anything to them.)

The recently enacted MUTC did not change the law. Notably, our state's version of the uniform law does not include Section 503 which would have created "spendthrift exceptions for certain preferred creditors, including children, spouses and former spouses with court orders against the beneficiary for support." *Report of the Ad Hoc Massachusetts Uniform Trust Code Committee*, p. 26, § 503 (2012).

XI. WHAT HAPPENS ONCE THE TRUST ASSET IS IN THE MARITAL ESTATE

Once it is determined that a spouse's trust interest is divisible, the question becomes whether that interest will be divided with the other spouse. And, to that question, courts, of course, look to G.L. c.208, § 34 generally – length of marriage, age, health, station, conduct, relative contributions, *etc.* Of particular relevance in the trust context are many of the principles that attach generally to the division of inherited assets. Two factors surface in the case law about trusts -- the extent to which parties relied upon the asset and the history of the distributions.

The reliance factors were central in *Lauricella* and *Comins*.

In *Lauricella*, *supra*., the husband's father created a trust which held title to the marital home which had been occupied by the family for the whole marriage. Thus, the trust principal, the only asset available for distribution upon divorce, was fully incorporated into the marriage.

The family in *Comins*, similarly, relied upon the wife's trust assets during the marriage. This factor, among others, was significant in the court's decision to include the asset in the marital estate.

The history of principal and income distributions can also be important in a case.

In one case, the trustees had the authority to distribute income and principal to the husband-beneficiary in their "uncontrolled discretion" as they deemed "advisable." Upon the termination of the trust, the remaining corpus is distributed to the husband's children. *D.L. v. G.L.*, 61 Mass.App.Ct 488 (2004). In finding that the husband did not have a present and enforceable right to the principal, the trial court and Appeals Court were influenced both by the pure discretionary nature of the trust as well as the fact that over the past 38 years, the trustee did not distribute any of the principal to the husband.

On the contrary, in the same case, over the past 10 years, all of the income was distributed to the husband. The Appeals Court affirmed the judge's decision not to include the husband's income interest in the trust as part of the marital estate for purposes of property division but, rather, as a stream of income for child support and alimony – at least, as here, "where income

from the trust has historically been distributed to the husband on a consistent basis." *Id.* at 498.

XII. TIMING OF DIVISION OF TRUST ASSETS

If the trust interest is not possessory, it may be appropriate to divide it on an "if as and when received" basis. The court noted that, although such a disposition is "generally disfavored," it can be appropriate in certain instances. *S.L. v. R.L* at 885, *citing Dewan v. Dewan*, 399 Mass. 754, 757 (1987) and *Williams v. Massa* at 628.

One rationale for a deferred division is "where there are insufficient assets available at the time of divorce to divide the present value of the future interest without causing undue hardship to either spouse." *Id.*

An "if as and when received" approach also makes sense, according to the *S.L. v. G.L.* court, "where present valuation [of the future trust interest] is uncertain or impractical," such as an employee-spouse's contingent interest in unvested stock options; if he/she does not remain employed with the company until vesting he may never realize any value. *Baccanti v. Morton*, *supra*. *See also Davidson* at 373, n. 12 (suggesting that where an interest has not vested in possession at the time of trial, the court may consider an "if, as, and when received" division).

A court may also use an "if as and when received" approach when it is unable to compel a trustee to disburse trust assets. *See Bucknam* and *Burrage supra*.

Conversely, courts may reject a request for an "if, as, and when received" distribution in favor of an offset, for example. Where valuation is uncontested and the parties have sufficient assets to permit a present division, the SJC upheld the trial court's assignment to the husband of "a particular investment vehicle" and crediting the wife with a sum equal to one-half the value. *Zaleski v. Zaleski*, 469 Mass. 230 (2014).

XIII. CONCLUSION

A few parting thoughts are in order.

The first is that trust assets are commonly misunderstood by clients going through divorce and that, before we can opine how a court might view such an interest, the documents must be closely reviewed. Further, emotional issues around trusts and inheritances are common. As such, we might remind

the beneficiary resisting disclosure or claiming non- access that they often have the right to information about the trust -- depending on the remoteness of their interest. *See MUTC* at §§ 103, 813 (trustee's duty to inform a "qualified beneficiary"). And, moreover, they might be reminded that the Probate and Family Court having personal jurisdiction over them would have the right to compel them to demand information from the trustee if necessary.

The second point is that, putting aside the arcane terminology, the way to think about how a trust asset intersects with divorce is straightforward. Compare it first to a simple asset. If a spouse owns an asset (a bank account, for example), it is in the marital estate. Put that on one end of the continuum. On the other end, put an expectancy interest – for example, the hope that your mother will remember you in her will. So, when you look at a trust, ask yourself – is it reasonable that this interest should be counted as an asset? How far across the continuum is the trust interest from, say, your everyday checking account?

The "fairly certain" test properly recognizes that rigid rules have no place in equity and, instead, attempts to locate that interest on an ownership continuum, as set forth above. When contextualized in this way, the soundness of the Massachusetts approach to trust interests in a divorce context is apparent.