

Trusts: Planning and Drafting for Divorce

Handout materials are available for download or printing on the **HANDOUT TAB** on the **gotowebinar** console. If the tab is not open click on that tab to open it and view the materials.



ChronicIllnessPlanning.org

Trusts: Planning and Drafting for Divorce

By: Susan Reach Winters, Esq.,
Sandra D. Glazier, Esq., Jonathan G.
Blattmachr, Esq., and Martin M.
Shenkman, Esq.

General Disclaimer

- The information and/or the materials provided as part of this program are intended and provided solely for informational and educational purposes. None of the information and/or materials provided as part of this power point or ancillary materials are intended to be, nor should they be, construed to be the basis of any investment, legal, tax or other professional advice. Under no circumstances should the power point or other materials be considered to be, or used as independent legal, tax, investment or other professional advice. The discussions are general in nature and not person specific. Laws vary by state and are subject to constant change. Economic developments could dramatically alter the illustrations or recommendations offered in the program or materials.

Some Webinar Pointers

- The PowerPoint is available for download from the web console during the program.
- A recording of this program and the materials will be posted to www.shenkmanlaw.com/webinars. There is a growing library of 50+ webinar recordings there.
- There is a growing library of 150+ video planning clips on www.laweasy.com.
- There is no CLE or CPE for this program, but you will be sent a certificate of attendance from the webinar system. We cannot control those certificates so if there is an issue we cannot assist.
- If you have questions, please email the panel. All emails are listed on near the end of the slide deck.

Thank you to our sponsors

- InterActive Legal
 - Vanessa Kanaga
 - (321) 252-0100
 - sales@interactivelegal.com



InterActive Legal

Thank you to our sponsors

- Peak Trust Company
 - Nichole King
 - Phone: 702.462.6677
 - Toll Free: 844.391.2789
 - NKing@peaktrust.com



WOUNDED WARRIORS FAMILY SUPPORT



*One of the highest-rated
military charities in the country!*



Clients Can Donate:

- Life Insurance policies
- Stocks
- IRAs
- Bonds
- Land/real estate
- Cash
- Assets

Kevin Sander

(402) 423-5769

Kevin.sander@wwfs.org

wwfs.org

Trusts: Planning and Drafting for Divorce

Introduction

Trust Overview

- Trusts are one of the most powerful tools in planning to minimize the risk to assets and in a future divorce. Careful trust planning can also protect the cash flow/distributions from trust assets. In order to achieve optimum results for clients, trusts may need to be drafted and administered in a manner intended to provide maximum protection.
- Traditional trust drafting can fall short of providing the protections clients may desire. What provisions may be used in drafting trusts to achieve potentially better results? What trust planning techniques can be used in different client situations to plan better?
- Consider: spendthrift clauses; discretionary versus support trusts; long term trusts versus payouts at specified ages; trust ownership of personal use assets; uses and planning implications of trust protectors, investment trustees and directed trusts, floating spouse clauses and more.

The Bottom Line - 1

- In an equitable distribution jurisdiction, the court may fashion a remedy it deems appropriate for the circumstances of the parties. Example: even if you say all the assets of a trust are separate property the court might order an award of all marital property to the other spouse to offset the impact of the separate property trust. In an equitable distribution state, while statutes may govern a court's ability to invade separate property, equitable principles may result in what some argue is the equivalent of "anything goes". The court often tries to fashion what it deems to be fair, but the opinion of "fairness" can vary as can the rules from state to state.
- In a community property jurisdiction, the results may differ.
- Thus, trusts may not always provide sufficient protection.
- Also, prenuptial agreements may not provide sufficient protection.

The Bottom Line - 2

- Caution clients that a layered approach may be advisable. “Layered” may mean a series of different trusts, perhaps in different jurisdictions that own fractional interests in entities owning underlying assets, not in the assets directly.
- There are never any guarantees (consider documenting this to your client).
- So, it is generally advisable to: use a multi-layered approach, corroborate fairness of any arrangement (prenup, post-nup, marital settlement agreement), etc. Example: In a 30-year marriage with a marital net worth of \$15M is one spouse receiving a mere \$2M in a settlement reasonable? This situation can be even more problematic if there is active appreciation during the marriage.

Planning prior to marriage

- In equitable distribution states, courts are generally tasked with determining which property is marital and which is separate. Different rules may apply when invasion of separate property is sought (e.g., because of contribution, need, insufficient marital estate, or active appreciation during the marriage).
- In some states gifts and inheritances received by one party during the marriage are considered marital property, not separate property.
- Property held in properly drafted trusts may or may not be considered for equitable distribution but may be considered for maintenance award. This varies based upon state law.

Yes, You Still Need A Prenuptial (or Post-) Agreement

- Clients often don't want (or don't think they will need) a prenup but when a divorce occurs every client wishes that they had one.
- Consider advising clients about the potential benefits of obtaining a prenup before marriage.
- For those clients without prenups a post-nup may be helpful, but the rules as to enforceability vary by state.
- Prenups can also be helpful from an asset protection perspective. Example – consider not requiring the parties to file joint income tax returns, have the couple's CPA prepare married filing separate income tax returns and from that data generate any joint return that the parties might decide to file.

Importance of pre-nup agreements

- May determine provisions for:
 - Equitable distribution.
 - Maintenance.
 - Post-death rights of election.
 - Retirement plan benefits (if separate plan documents are executed after the marriage and delivered to the plan administrator).

Importance of pre-nup agreements - DSUE

- DSUE (deceased spouse unused exclusion) elections.
 - This could be used as a negotiating point in the pre-nup. The monied spouse will get the non-monied spouse's exclusion, and what will be provided in return (consideration).
 - What happens if the exemption is reduced by the Biden administration from \$11.7 million to \$3.5 million? What if a Van Hollen capital gains on death is enacted? How will prior negotiated provision be interpreted with new laws? What if consideration was provided based on a \$10 million inflation adjusted exemption amount that is reduced to \$3.5 million? Should that prenuptial agreement be modified?

Importance of pre-nup agreements – DSUE Sample Clause - 2

- If Wife and Husband are married at the time of her death, Wife agrees that she shall cause the Executor of her estate to transfer all of her unused transfer tax exemption, if any (the so-called “DSUE”) to Husband. In exchange, Husband agrees that if, as and when he thereafter utilizes part or all of Wife’s DSUE during his lifetime, he shall pay to Wife’s children, in equal shares, a total amount equal to fifteen percent (15%) of the amount of Wife’s DSUE so used by Husband. For example, if he uses \$1,000,000 of Wife’s exemption, he shall owe a payment equal to \$150,000. Except in the event of divorce, Husband shall have the option to effect such payments, either in whole or in part, a) during his lifetime, or b) to the extent not paid by him during his lifetime, by devise in his will. **Note: If a dollar amount not a percentage is used it could be problematic if the exemption is reduced.**
- The Parties agree that promptly after they marry, Wife will execute a new Last Will and Testament (or codicil thereto) which expressly directs her Executor to timely file a U.S. Estate Tax Return (Form 706) and elect thereon to transfer Wife’s “Deceased Spousal Unused Exclusion Amount”, if any, as defined in Code Section 2010(c)(4) of the Internal Revenue Code, to Husband.

Importance of pre-nup agreements – DSUE Sample Clause - 2

- If, notwithstanding the provisions of section 2010(c)(4) of the Code, and this paragraph of this Agreement, a U.S. Estate Tax Return on behalf of Wife's estate would not otherwise be required to be filed other than to make the portability election, then it is agreed that Husband shall reimburse Wife's estate for all costs incurred to effect the portability election (including accounting, appraisal and attorneys' fees paid in connection therewith). Reimbursement by Husband shall be made promptly upon his receipt of a written request for reimbursement by Wife's Executor.
- Wife's Executor shall provide to Husband as applicable a true and accurate copy of the U.S. Estate Tax Return at the time it is filed for Wife's estate, together with copies of all supporting documentation used in connection with its preparation.
- The parties, however, each understand that they are free to prepare and execute an appropriate Last Will and Testament that provides the other party with benefits in excess of those provided for in this Agreement and that those provisions for additional benefits shall be enforceable.

Risks of Prenuptial Agreements - 1

- Need to be fair and equitable when entered into, and when you seek to enforce.
 - State laws differ.
 - Were these factors tested and documented?
- Full and adequate disclosure.
- May require separate and independent advice of counsel.
- Duress.
 - Someone seeking to overturn the prenuptial agreement can claim they signed under duress.
 - Example – signed 2 days before the wedding.
 - Should you video tape a prenuptial execution?
- May wish to consider choice of law and jurisdictional issues when drafting.

Risks of Prenuptial Agreements - 2

- Michigan Allard Case.
 - Legislation may change result but no certainty. Might other states follow suit?
 - You cannot waive court's statutory right to invade separate property which could undermine prenuptial agreement.
 - This may enhance the importance of considering a DAPT before marriage.
 - After marriage, a DAPT to address inherited property, with consent of spouse can also be important.

Trusts: Planning and Drafting for Divorce

Trusts and Divorce
Protection -
Fundamentals

Trust Benefits

- State Income Tax Minimization.
 - Non-grantor trusts.
- Estate Tax Minimization.
 - But this may be limited by new legislation.
- GST Tax Minimization.
 - But this may be limited by new legislation.
- Protection from Creditors/Divorce.
- Protection from Beneficiary Improvidence.

682 Repeal - 1

- Prior to 2017 Tax Act there was a tie between Section 71 and 215 (alimony) and Section 682. Section 682 was an income shifting mechanism that resulted in the spouse who was receiving payments under a trust being treated as the income recipient for income tax purposes.
- In 2017 Tax Act Section 682 was repealed. The income shifting provisions were eliminated or modified. Section 71 remains applicable for pre-Act judgments (payor spouse got an alimony deduction and the payee spouse reported income).
- But if you have an irrevocable trust that was in existence prior to the 2017 Tax Act, and divorce occurred after the Act, the settlor spouse will continue to be taxed on the income of the trust even if it is all paid to the now ex-spouse.

682 Repeal - 2

- Now, for those that already have grantor trusts or create a grantor trust to address support for a spouse in the event of a divorce, or create a SLAT for a spouse, if the spouse is a beneficiary post-divorce, the income will continue to be taxed to the settlor-spouse post-divorce.
- When planning a prenuptial or postnuptial agreement, drafting settlement agreements and when drafting a trust consider addressing the implications of the repeal of Section 682.
 - Should spouse waive right to be treated as a beneficiary post-divorce or be required to disclaim the interest?
 - Do you wish to empower a trust protector to terminate an ex-spouse's interest in a trust or provide them with the power to terminate the trust?
 - Consider a floating spouse clause.

Trusts: Planning and Drafting for Divorce

Pfannenstiehl Case –
Lessons on Trust
Accessibility in
Divorce

Pfannenstiehl Case – Lessons on Trust Accessibility in Divorce - 1

- Is trust to be considered as part of the marital estate?
- Mass. – Pfannenstiehl v. Pfannenstiehl considered trusts as part of marital estate if more than an expectancy and then subject to division.
- Court decided when divorce took place 11 beneficiaries, Husband, 2 siblings and grandchildren are not a closed class because other descendants would be added as born.

Pfannenstiehl Case – Lessons on Trust Accessibility in Divorce - 2

- Ascertainable standard of sorts was included: support, etc.
- Lower court said it was part of the marital estate and said value was $1/11$ x full value since husband was one of 11 beneficiaries and gave wife 60% in value.
- Appealed. Court noted that it was manipulative of trustees to stop making payments on eve of divorce.

Pfannenstiehl Case – Lessons on Trust Accessibility in Divorce - 3

- SJC decision. Found that it was a mere expectancy, so it is not subject to division. Note that does not mean it cannot impact how marital assets are divided.
- Remanded to trial court to determine spouse's rights – i.e., spousal maintenance consideration.

Trusts: Planning and Drafting for Divorce

**Self Settled Trust -
Pre-Marriage**

Self-Settled Trusts and Divorce

- Domestic asset protection trust (“DAPT”) statutes enacted in 19 states.
- Generally protected if funded at least 30 days prior to marriage – but may only apply if divorce jurisdiction recognizes DAPTs.
- Foreign APTs may provide greater protection – but depending on funding date may be included in marital asset valuation – See, *Riechers v. Riechers*, 178 Misc. 2d 170 (1998).
- Consider self-settled trusts to hold and segregate pre-marriage or inherited separate property.
- A Nevada DAPT was upheld as protecting assets from spousal support and child support claims. Wife was seeking an \$800,000 lump sum alimony award. *Klabacka v. Nelson*, 133 Nev. Advance Opinion 24 (5/25/2017).
- A reduced exemption, or inclusion of grantor trusts in the settlor’s estate, as proposed in the Sanders bill or the Van Hollen bill could change how DAPTs will be structured.

Trusts: Planning and Drafting for Divorce

Using Revocable
Trusts Post Marriage

Might a Revocable Separate Property Trust Help?

- Commingling issues in a divorce create a tracing (forensic accounting) nightmare.
- Many clients enter prenuptial agreements delineating assets that are separate. Others do not enter prenuptial agreements but assume pre-marital assets are separate.
- It may be helpful to create a special revocable trust to hold only separate property to serve as an accounting entity to endeavor to reduce the risks of commingling and keep assets intended to be separate, distinct from marital assets.

Trusts: Planning and Drafting for Divorce

**Trust Planning
Post-Divorce**



How May Court View Transfers/Restructures Near Time of Filing?

- Downside is the court viewing the actions as “divorce planning.” If so, the court may put the asset back into the marital estate.
- Might actions that are viewed by the court as overreaching, aggressive or inappropriate color the court’s view of the client?
- Can the trust protector or trustee take the action so that the client does not?
- How might the court view that?

In Re Cleopatra Cameron Gift Trust

- In this case the trust was moved from CA to SD because SD law provided greater protection for trust assets than CA. Some states protect trust assets from all creditors while other states provide for different levels of “exception creditors” which often include exceptions for an ex-spouse and children.
- The move from CA to SD was intended to take advantage of that.
- SD courts upheld the jurisdiction of the SD courts.
- CA courts did not have jurisdiction over the trustees so that the CA courts could not force the trustees to make distributions to satisfy the obligations.

Decanting Existing Trusts

- Where desired to increase protection in existing trusts consider decanting, non-judicial settlements, trust division.
- Massachusetts' highest court has held that the trustees of an irrevocable trust could decant trust property to a new trust even though, at the time of the decanting, the beneficiary, who was going through a divorce, had the current right to withdraw 75 percent of the trust property. The trustees, apparently on their own initiative, may have protected the trust property from the beneficiary's divorcing spouse. *Ferri v. Powell-Ferri*, 476 Mass. 651 (2017).

Trusts: Planning and Drafting for Divorce

Improving Existing Irrevocable Trusts



Modification Using Terms of Existing Trust

- Beneficiary trustee appoints a co-trustee who is independent.
 - The independent trustee may have authority under the governing instrument to suspend distributions or take actions the beneficiary/trustee cannot take.
- Beneficiary trustee resigning.
- Relinquishing powers/rights.
- Change in situs.
 - This might be accomplished by trustee or trust protection action.
 - May require change in trustees from a family member to an institutional trustee in a trust friendly jurisdiction.
- Trust Protector actions.
 - This may be preferable to the beneficiary taking actions.
 - Many old trusts don't have trust protector provisions.
 - An independent trustee may be able to decant, change situs and jurisdiction and modify administrative provisions of the trust.
- Decanting (see above).

Non-Judicial Modification

- Example- DE law provides under 12 Del.C.Sec. 3342(a): “Notwithstanding any provision of law or a trust's governing instrument limiting or prohibiting amendment of the trust, an irrevocable trust may be modified to include any provision that could have been included in the governing instrument of a trust created upon the date of the modification upon written consent or written nonobjection of the trustor, all then serving fiduciaries and all beneficiaries even if the modification violates a material purpose of the trust.”
- If the beneficiary/soon-to-be-divorced spouse consents, will that affect how a court views the modification that makes the trust more difficult to reach in a divorce? Might a decanting undertaken by the trustee be preferable?
- Be careful of having the beneficiary/divorcing party signing a consent to the Non-Judicial Modification (“NJMA”)? Might the court view a consent as pre-divorce planning?
- If that party can “non-object” is that assuredly safe? Might the court view a non-objection as less likely to constitute pre-divorce planning?
- Would a decanting by the trustee avoid the issues of NJMA?

Trusts: Planning and Drafting for Divorce

**Trust Drafting -
Clauses**



Naming Trustee to Provide Protection

- When naming a trustee, the preferable approach may be to name an independent trustee, i.e., not the beneficiary or someone the beneficiary can control (e.g., an employee of a company owned by the beneficiary), and to vest distribution decision making in that independent trustee.

Distribution Standards – Support vs. Discretionary

- A support trust is one which provides that the trustee pay to the beneficiary as much of the trust income as is necessary for the beneficiary's health, education, maintenance and support.
- A discretionary trust leaves it to the trustees' discretion to determine what, if anything, to distribute.
- Many trusts are combinations of these standards.
- Traditional trust drafting more often would incorporate a standard for distributions, such as pay income (even when not required such as to qualify for an estate tax marital deduction), or to provide for the beneficiary's health, education, maintenance and support ("HEMS").
- Modern trust drafting tends to more often favor giving an independent trustee the discretion as to what distributions to make. A purely discretionary distribution standard entrusted to an independent trustee is more protective against a future ex-spouse than any other type of standard.

Distribution Standards - Restatement

- The Restatement Second of Trusts provides that 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. In a jurisdiction whose laws follows this, a discretionary trust may not be accessible in divorce.
- The Restatement Third of Trusts states that a discretionary trust can be enforced as a support trust (based on the notion that the trustee must act in the best interests of the beneficiary). In jurisdictions that follow the newer Restatement, even a discretionary trust may not be as protective as desired.
- The answer for clients in those jurisdictions is to apply the law of another jurisdiction and preferably structure the trust to have situs in a better jurisdiction.

Distribution Standards – Income/Sprinkling

- Pay all Income standard: A traditional trust often gave the beneficiary a mandatory income right. For example, the trust might mandate that income must be distributed quarterly. This income right might expose the actual income, or an estimated income stream, to the reach of an ex-spouse. Certainly, a mandatory income stream might be viewed as a resource in determining maintenance or child support.
- Sprinkling Provision: Ideally, the trust (excluding marital trusts which are required for tax purposes to distribute all income to the spousal beneficiary) should give the trustee the power to "sprinkle" trust income and corpus among a class of beneficiaries, not merely the spouse. Including multiple beneficiaries, each of whom has the right to receive distributions in the discretion of a trustee, makes the rights of any one beneficiary indeterminate. This could enhance the protection the trust affords in a later matrimonial action.

Distribution Standards – Use of Property

- Traditional trusts may not have addressed holding personal use assets. Modern trust drafting, in contrast, generally provides for and encourages the trust holding personal use assets.
- This could include a residence, vacation home, artwork, even jewelry.
- If the spouse is a beneficiary of such a trust, he can use the assets held by the trust, but he would not own them. While a court might consider the use an available resource in its analysis, the court may not be able to compel distribution of property held in an irrevocable trust.
- Example: If a client/beneficiary wishes to buy a house (or other assets) the traditional approach was to distribute cash to the beneficiary to buy a house. Instead, the trust itself should purchase the house and permit the beneficiary to live in it. This would generally keep the economic value involved in the protective envelope of the trust.

Distribution Standards – Use of Property

- Practitioners should be aware of a common twist on this planning. If the trust was created in a jurisdiction with more protective trust laws than the client's home state, it may be advisable for the trust not to own real property in the home state. To do so could taint the trust as subject to the jurisdiction of home state courts which might negate the sought-after benefits of creating the trust in a better jurisdiction. In these instances, the house (or other tangible property) can be held in a single member limited liability company formed by the trustee and owned by the trust.

No Distributions for Spouse of Beneficiary

- The trust instrument could expressly state that it is the settlor's intent not to allow distributions to a beneficiary's spouse or limit rights of the beneficiary in the event divorce or separate maintenance proceedings are initiated.
- Limit distributions to a married beneficiary solely for immediate and direct personal needs of that descendant/beneficiary (even pursuant to a HEMS standard). Clarify that a broader reading of a HEMS distribution standard is not intended to include the spouse.
- Caveat – this may unduly limit distributions while the beneficiary is happily married. Most irrevocable trusts are created for general asset protection benefits, not only for divorce protection benefits. Example: Mom creates a trust for son and names son's spouse as a beneficiary too. With the spouse may be a discretionary beneficiary of the trust, if the child/beneficiary is sued, distributions can be made to the spouse instead of the child to avoid the child's creditors from reaching the funds.

Distribution Standard - Waiver

- Avoid 5 x 5 powers and rights of withdrawal at stated ages or periods. Such withdrawal rights might be considered vested property rights in a divorce which a Court might insist on the beneficiary spouse exercising. If such rights are included, consider suspending or terminating such powers in the event of divorce.
- Consider including requirement for spousal waiver prior to any distribution.

Trusts: Planning and Drafting for Divorce

Crummey Powers



Crummey Powers

- Many irrevocable trusts include an annual demand or “Crummey” power to assure that gifts to the trust qualify for the annual gift tax exclusion.
- Crummey powers may provide another mechanism of attack. A Crummey power permits the beneficiary to demand a distribution of the amount given in a particular year to the trust, typically the annual gift exclusion (\$15,000 in 2021). There may even be “hanging powers” outstanding.
- During any period when an ex-spouse has the power to withdraw that amount may be exposed. New trusts might consider whether to even include such powers. With the transfer tax exemption now at \$11,700,000 (2021) most estates are not subject to an estate tax. This may be reduced by new legislation to a substantially lower number.
- Consider how proposed legislation may restrict Crummey powers.

Trusts: Planning and Drafting for Divorce

Term of Trust



Trust Termination

- Trusts were traditionally structured to end with distributions of trust principal at specified ages, for example, principal may have been directed to be distributed to the beneficiary in approximately one-third increments as follows: one-third at age 25, one-half at age 30 and the balance at age 35.
- Once assets are distributed out of a trust, any protection the trust had previously afforded terminates as to the portion of the trust distributed.
- Modern trust drafting tends to favor very long term or perpetual trusts. This coordinates with the holding of personal use assets above. If the trust, for example, can hold a house and other assets there is less need to distribute significant trust assets outright to the beneficiary at any age.

Trust Termination (cont'd)

- Consider decanting existing trusts into new trusts that retain assets long term. While the new trust may be limited by the rule against perpetuities of the old trust incremental protection may be achieved.
- This should preferably be done well in advance of a divorce to lessen the challenges that it was “pre-divorce planning.”
- New trusts should be structured to last as long as state law permits (but legislative proposals may require a balancing of capital gains tax consequences every 21 years against the risk of divorce or creditor claims if the STEP Act, or a similar proposal, is enacted).

Trusts: Planning and Drafting for Divorce

How to Define Spouse



Floating Spouse Clause - Generally

- Traditional trust drafting would either include or exclude the client's spouse. Modern trust drafting sometimes uses a more flexible variant by naming a spouse as beneficiary but then defining that spouse to be whomsoever the client happens to be married to at an applicable point in time.
- The divorce may terminate the ex-spouse's interests in a trust if the trust can only distribute to the person then married to a named beneficiary. This might provide an opportunity to use trust assets to benefit the spouse prior to but not after the divorce.
- Practitioners might consider the ability to use this technique to make a trust safer from future divorce. Consideration might be given to the existence of potential floating spouse rights in pre- and post-nuptial agreements.
- If the practitioner is preparing a joint estate plan, you'll need a conflict waiver. If you are using a floating spouse, you need to explain the implications of such a clause/definition to both spouses.

Floating Spouse Clause – How Define “Spouse?”

- Ochse vs. Ochse – is a cautionary tale of defining who qualifies as a spouse. One might read the language used to provide that only the spouse to whom the person is married at the time of a proposed distribution is a permissible distributee, but the court held no. It found the intention was the spouse to whom he was married at the time the mother created “the trust for the benefit of the son was the permissible distributee, not his spouse at the time of the proposed distribution”.
- In litigation against the son as successor trustee for breach of fiduciary duty, his ex-wife and current wife joined the litigation. The court held that the ex-spouse was still a beneficiary as she was the spouse at the time the trust was created and became irrevocable and was therefore the intended beneficiary despite now being his ex-spouse.
- It is important to define clearly who the “spouse” is.
- This issue may apply not only to a floating spouse clause but to any estate plan.

Trusts: Planning and Drafting for Divorce

**Spendthrift
Provision**



Spendthrift Provision

- Both traditional and modern trust drafting tend to include spendthrift provisions in many (not all) irrevocable trusts. This type of provision prevents a beneficiary from assigning his interests in a trust to creditors, which could include an ex-spouse.
- Practitioners should encourage clients planning for future matrimonial issues to incorporate spendthrift protections in new trusts.
- Spendthrift Trust – UTC § 502:
 - Public Policy Exceptions in some states– Child support/spousal maintenance/tort creditors/ tax obligations/creditors providing services for protection of beneficiary.

Trusts: Planning and Drafting for Divorce

Trust Protectors



Trust Protector

- A trust protector (or trust director) is a position that is being used more frequently in trust drafting but may still be rather uncommon.
- The roles which a trust protector can play can differ based on state law and the provisions of the governing instrument.
- A protector can have certain specified powers, typically including the right to remove a trustee, replace a trustee, change the situs and governing law of the trust, and in some instances other powers.

Trust Protector (cont'd)

- **Example:** Mom sets up a trust for daughter and names daughter as trustee. Daughter's powers to distribute to herself must be limited to an ascertainable standard to avoid having trust assets reachable by daughter's creditors and to avoid having trust assets included in daughter's estate.
- Depending on state law this distribution standard might expose trust assets to daughter's later divorce. Daughter perceives her marriage as becoming uncertain. She resigns as trustee and her brother who is named successor, takes over. If this was done one month prior to the divorce how might the court view the resignation?
- What if instead of daughter resigning, an independent trust protector removed her? It would no longer be daughter's action which might be viewed as pre-divorce planning?

Trust Protector (cont'd)

- **Power to Change Trust Situs**: Traditionally trusts were created in, and governed by the law of, the client's home state. But there is no reason to restrict trust administration to the settlor's home state. While more practitioners are considering state income tax impact of trust situs, the matrimonial implications could be significant.
- **Example**: The protector's actions in the preceding example might be taken further. Perhaps the protector might opt to name a trustee based in Nevada and use the authority as protector to change governing law and situs from an east coast state to Nevada and name a trust company in Nevada. How might that raise the cost and difficulty of the ex-husband pursuing the trust? If the home state law where the mother/settlor created the trust makes the trust accessible in divorce as a support trust, could moving the trust to a state whose laws do not make a support trust reachable suffice to mitigate that risk?

Trusts: Planning and Drafting for Divorce

Swap Power



Swap Power - 1

- Another common power that has been used to cause trusts to be characterized as grantor trusts for tax purposes and to provide planning flexibility is the swap or substitution power. This gives the settlor the right to swap assets of equivalent value for assets in the trust.
- **Example**: Wife started a widget manufacturing company and gifted 20% of the stock to an irrevocable trust for the children. Husband was named trustee. The business grew substantially. In the maelstrom of the divorce the status of the trust was overlooked. Post-divorce, wife wanted to reclaim her stock, since a 20% minority interest in the business out of her control would be an impediment to her selling the company. So, she attempted to swap a personal note to the trust in exchange for the stock. The now ex-husband, who remained the trustee, refused to honor the transaction. So, while a swap power could have been an important tool for flexibility had the issues been addressed during the pendency of the divorce it may prove elusive.
- Swap powers can be a challenge to implement as to the determination of the equivalent value of hard to value assets. See the Tom Benson case.

Swap Power - 2

- A similar fact pattern arose in a recent case. The couple divorced. The ex-husband tried to exercise swap power and now ex-wife trustee refused. He tried to swap in a note and the ex-wife/trustee objected saying it was not of equivalent value as required by the trust instrument. *Schinazi v. Eden* 2016 WL 5867215. In the divorce the issue of trustee and trust actions could have been addressed. It may have been preferable for all involved to have had the wife/ex-wife resign as trustee in favor of an independent, and ideally an institutional, trustee.
- Consider providing for the elimination of the spouse's beneficial and fiduciary interest upon filing of divorce rather than on entry of a judgment.
- If a swap power is added to a trust, consider naming an independent trustee to make the swap. If a spouse is trustee for a trust with a swap power, as part of the divorce consider naming an independent trustee to prevent the ex-spouses from feuding over the exercise of a swap or other powers.
- Even better, provide that upon a divorce any interest a spouse has should be terminated (i.e., Spouse deemed to be predeceased).

Trusts: Planning and Drafting for Divorce

Conclusion



Conclusion

- Practitioners should exercise care in tailoring trusts and other estate planning of their clients. The increased flexibility and complexity of modern trusts will require special care and provisions in marital agreements.
- Both matrimonial and estate practitioners may need to address the new flexibility in trust drafting and planning to obtain optimal results for clients.
- A “team approach” which includes a knowledgeable planner with a matrimonial lawyer may provide more informed results.

Additional information

- Susan Reach Winters
swinters@csglaw.com
- Sandra D. Glazier
sglazier@lipsonneilson.com
- Martin M. Shenkman
shenkman@shenkmanlaw.com
- Jonathan G. Blattmachr
jblattmachr@hotmail.com