

Take-Away: There is no clear answer if an individual going through a divorce also holds an interest in an irrevocable trust whether the divorce court will take that interest into account when fashioning an equitable distribution of the marital estate, or in making a spousal support award. States have very different laws when it comes to how an irrevocable trust is treated in a divorce. Using a prenuptial agreement to support the beneficial interest in the trust may be useful to protect the beneficiary's interest.

Background: Michigan has a very favorable Trust Code provision that expressly declares that a beneficiary's interest in a *discretionary* trust is not a *property* interest subject to attachment by creditors. [MCL 700.7815(1); MCL 700.7505; *In re Antonia Gualtieri, Living Trust, Michigan Court of Appeals, No 341816 (March 19, 2019).*] The reality, however, is that we live in a highly mobile society, and it is possible that a divorce court in another state will not feel bound by Michigan's declaration that the trust beneficiary does not possess a *property interest* in a discretionary trust, since that might be a position contrary to that other state's public policy.

Separate Property: Some states, like Michigan, follow a distinction between marital property and *separate* property (normally defined as either premarital, or coming to the spouse through gift or inheritance during the marriage.). Normally *separate* property is returned to its owner in a divorce proceeding and is not 'invaded' by the divorce court. However, in extraordinary circumstances (as determined by the divorce judge), e.g., comingling *separate* and marital property, or contribution to the *separate* property's value by the other spouse, or the other spouse's continuing financial need, the divorce court is free to 'invade' one spouse's *separate*

property interest. [MCL 552.23; MCL 552.401.]

Other States: In some other states, the divorce laws permit the equitable distribution of *all* property in which a spouse has an interest; those states do not then distinguish between marital or *separate* property, e.g., Connecticut, Massachusetts, New Hampshire, and Vermont. Some ‘eye opening’ examples follow which clearly communicate that ‘wrapping’ an inheritance in an irrevocable trust is no guarantee that the trust assets will be protected in the trust beneficiary’s future divorce

More than a *Mere Expectancy*: *Levitan v. Rosen*, 95 Mass. App. Ct. 488 (2004) included in the divisible marital estate a spouse’s interest in an irrevocable trust, because the court found that spouse’s interest to be more than a ‘*mere expectancy*.’” That Court went on to explain that analyzing whether a trust may be included in the marital estate for equitable distribution requires a ‘close examination’ of the terms of the trust instrument. In this case the Court found that the trust was includible in the marital estate because the wife’s share had vested on her father’s death, and she had the right to withdraw 5% of the trust principal each year, despite the fact that the same trust instrument gave the independent trustee the right to withhold funds otherwise subject to the wife’s 5% withdrawal right, and her withdrawal right was also subject to a spendthrift limitation. The Court concluded the wife’s interest was more than a ‘mere expectancy’ as compared with trusts in which the class of beneficiaries is left open, or trusts that are generational in nature, or trusts in which distributions are entirely in the ‘uncontrolled’ discretion of the trustees.

***Woven into the Fabric of the Marriage*:** In yet another Massachusetts decision, *Jones v Jones*, 103 Mass. App. Ct. 223 (2023) the Court held that the existence of the trust funds, even if not drawn on during the marriage, may be “*woven into the fabric of the marriage*” in spite of the wife’s argument that the trust assets should be shielded from equitable distribution by the ‘tacit

agreement' of the spouses.

Not so Remote an Interest: In Vermont, the Court in *Chilkott v. Chilkott*, 158 Vt 193 (1992) held that an interest in an irrevocable trust may be marital property that is subject to equitable distribution when the spouse's interest in the trust "*is not so remote*" and "*has a readily ascertainable present value.*" In this case, the husband was one of the beneficiaries of an irrevocable trust that was funded with marketable securities. The husband's 87-year-old mother was entitled to the trust's income during her lifetime, and she was also eligible to receive discretionary distributions of trust principal for her health, maintenance, and welfare. However, the mother had not received any principal distributions from the trust at the time of the divorce. On the mother's death, the husband would be entitled to receive income from the trust and have an unrestricted right to invade trust principal. The Court found that it was appropriate for the trial court to consider the value of the trust when distributing the marital estate, a value that was premised on economic assumptions and the mother's life expectancy.

Passive Appreciation of Trust Property: The Pennsylvania Supreme Court in *Solomon v. Solomon*, 531 Pa. 113 (1992) held that although the principal of a trust may be a gift and therefore non-marital property by its statute, the increase (appreciation) in value of that principal during the marriage can be classified as marital property that is subject to distribution in the beneficiary's divorce.

These cases are just a representative sample of the reality that 'wrapping' an inheritance in an irrevocable trust will not necessarily provide absolute protection for that inheritance if the beneficiary is in a future divorce in another state.

Additionally, other states, by statute, expressly authorize the distribution of assets classified as *separate* property in a divorce, e.g., Indiana, Wisconsin, Hawaii, Kansas, Iowa.

Spousal Support: Even if the use of an irrevocable trust will protect the trust assets from distribution in the beneficiary's divorce, a divorce court may still take the trust's income into consideration in making a spousal support award. Consider the following two examples:

Primary Source of Income: In *Marriage of Harter*, 837 N.W.2d 680 (Iowa Ct of App. 2013) the Court affirmed the decision of the trial court that ordered the husband to pay \$3,500 a month in spousal support for 10 years. The Court observed that the husband had received distributions of \$6,000 from the trust established by his parents during the marriage, and that later the husband then received \$10,000 per month, which the Court found to be was “*the couple's primary source of income.*” The Court also observed that the trust could not be divided in the divorce proceeding because there was a spendthrift limitation, but once the husband received a distribution from the trust “*the money in his hands is subject to his obligation to pay spousal support.*”

Virtually Unrestricted Control: In the New York case, *Correa v. Alvaes-Correa*, 726 N.Y.S.2d 668 (2001) the divorce court found that the husband and his brothers had “*virtually unrestricted control over, and complete and unfettered access to*” \$37 million held in trust established by their grandmother. The Supreme Court held that it was appropriate to take such funds into account when determining the husband's spousal support obligation.

Elective Rights: It is even possible for a beneficiary's interest in an irrevocable trust to be considered upon the beneficiary's death for his/her surviving spouse's elective rights. Take, for example, an irrevocable trust established for a child that gives that child a testamentary power of appointment to appoint trust assets. That power of appointment over the trust assets could expand the surviving spouse's elective share (taking against the deceased child's will.) MCL 556.116 (1)(c) provides that the exercise of a general power of appointment by the trust beneficiary will be

part of the decedent's estate for inclusion in determining the right of election by the beneficiary's surviving spouse (though this statute only refers to a '*widow's*' right of election.)

Practical Solution: This sampling of divorce court decisions should strongly suggest that a beneficiary's interest in an irrevocable trust may not provide a high level of protection in the event of the trust beneficiary's future divorce. This is when the use of a prenuptial agreement, along with the irrevocable trust, might provide a better level of protection that is lacking with the trust instrument alone. A prenuptial agreement might contain provisions that address many of the situations where divorce courts have seized upon to include the beneficiary's interest in the distribution of the marital estate. Example provisions that a prenuptial agreement might include:

- Expressly state and agree that all appreciation of *separate property* interests, either held outside the irrevocable trust or inside as a beneficial interest in the trust, whether passive or active appreciation, is the beneficiary's *separate* property that is not subject to equitable distribution in a divorce.
- Agree that distributions of assets from an irrevocable trust which are used to acquire marital property or jointly owned property, e.g., the marital residence, retains its *separate* property character, despite its subsequent commingling with marital property interests thus preventing the 'transmutation' of the asset to marital property.
- Provide for a 'dollar-for-dollar' credit off the top of the marital estate for any *separate* property, including trust distributions, that may have contributed to the acquisition of a marital residence held in the spouses' names, or which is the source of any capital improvements or mortgage principal payments.
- Exclude any general powers of appointment held in the irrevocable trust by the spouse-beneficiary from the beneficiary's surviving

spouse's elective share.

Conclusion: A beneficiary's interest in an irrevocable trust may be vulnerable to attack in the event of a future divorce. While Michigan provides some protection to the trust beneficiary of a discretionary trust, that is only with a *discretionary* trust. Nor is there much assurance the trust will be ignored if the trust beneficiary moves to another estate which does not respect a *separate* property distinction. Thus, encouraging the trust beneficiary to also have a prenuptial, or postnuptial, agreement with their spouse may go along way to protect the trust's assets in the event of a future divorce.