

Trust Beneficial Interest Included in Marital Estate

Take-Away: Another state's public policy concerns might override Michigan public policy implications reflected in the Michigan Trust Code. Such was the case in a Massachusetts' divorce decision from last year finding a wife's beneficiary interest in a Michigan discretionary trust to nonetheless be a property interest for a divorce property settlement.

Background: In the past we have covered Michigan's favorable treatment of a beneficiary's interest in a discretionary trust where the statute clearly states that the beneficiary's interest in that discretionary trust is not a *property* interest for purposes of a divorce. [MCL 700.7815(1).] However, a recent appellate court case from Massachusetts suggests that while that might be the law in Michigan, it may not be followed by other states when the trust beneficiary resides in another jurisdiction.

Jones v Jones, Massachusetts Court of Appeals, No. 21-P-655 (September 6, 2023)

Facts: Juliana and her husband Dylan were married in Michigan 1998. They had two children. Both were employed outside of the home. Juliana and Dylan were living in Massachusetts at the time of Dylan filed for divorce. During the marriage Juliana's mother funded an irrevocable trust for Juliana's benefit. Her mother also made substantial financial gifts to Juliana including deposits in CDs and a 99% limited liability company interest which held title to Juliana's home and a one-third interest in Michigan real estate.

Lifestyle Based on Parental Gifts: In its finding of facts, the divorce court noted: *"The wife's mother played a significant role in shaping the marital lifestyle and financial expectations. The wife's mother showered the family with gifts, whether monetary or experiential. She created an LLC which purchased the marital home and paid for its associated real estate taxes and major repairs or renovations. The parties did not have to budget to meet those expenses and instead put those funds towards frequent travel, summer camp and a lifestyle they would not have otherwise been able to afford. The wife always knew that there was*

additional money available to meet the family's needs and whims, which she used to supplement their lifestyle. But for the wife's mother's generosity and this money, the parties would not have been able to maintain the lifestyle that they did on their income and from their employment alone."

Trust: The important terms of the wife's interest in the trust her mother established for her in 2015, when the Michigan Trust Code was in effect, was a remainder interest in a short-term GRAT. After the mother's annuity term ended, the assets would remain in a continuing trust for Juliana and her brother (separate shares were created for each child.) The continuing trust was governed by Michigan law and managed by an independent Michigan trustee. Key trust provisions were that the trustee had sole discretion to make distributions of income or principal to Juliana until her mother's death. After her mother's death, Juliana would then have a right to withdraw her interest from the trust. However, there was yet another provision that gave the trustee the discretion to withhold a mandatory distribution right for 'compelling reasons', e.g., Juliana's right to withdraw principal could be delayed by the trustee in its sole discretion, for presumably an unlimited period. The trust instrument also gave Juliana a testamentary power of appointment to her estate. Additionally, there was a conventional spendthrift limitation in the trust.

Dispute: Juliana argued that her interest in the trust was a *mere expectancy*, meaning that her interest in the continuing trust was not a property interest for inclusion in the marital estate subject to the divorce judge's equitable division of the marital estate. Her husband argued that the trust should be included in the divisible marital estate. Juliana premised her arguments on the Michigan Trust Code, MCL 700.7815(1), in that, with a discretionary trust she possessed no *property* interest.

Divorce Court: The trial judge found that the value of Juliana’s interest in the trust was \$1,285,263. The trial judge found that although the trust was a discretionary trust with a spendthrift provision, *“the wife’s interest in [the trust] is a fixed and enforceable property right that is includable in the marital estate because the wife is entitled to the whole trust property, and her share is not susceptible to reduction, and the primary intent of the trust is to benefit the wife.”*

Court of Appeals: The Massachusetts Court of Appeals sustained the decision of the trial judge to include the value of Juliana’s interest in the trust in the marital estate. In doing so the Court relied on several Michigan appellate decisions, but did not seem to get hung up on the clear language of MCL 700.7815(1) that there is no *property* interest in the trust under Michigan law.

Quasi-Discretionary Trust: Even if a trustee’s discretion is uncontrolled, that fact does not necessarily preclude a trust’s inclusion in the marital estate. *“Here, moreover, while the trust clearly contains discretionary components, the wife largely ignores the mandatory distribution language and the limits on the trustee’s discretion to postpone such a distribution.”*

Shall Pay: The Court found the trust to not be a ‘pure discretionary trust’ because it also provided for a mandatory distribution of the entire trust corpus that the trustee ‘shall pay’ to the wife on her mother’s death.

Limits to Trustee’s Power to Postpone Distributions: Additionally, the Court found that while the trustee had the power to postpone the wife’s enjoyment and possession of her mandatory distribution right, pursuant to the postponement provision, the trustee does not have the power to divest the wife of her interest in the trust corpus. More to this point, the Court noted that Juliana always retained the power to appoint the trust corpus to the beneficiaries of her estate, even if she dies before the mandatory distribution is made. And the Court concluded that the

trustee's power to postpone a distribution right was only for a "compelling reason" under the trust. Thus, Juliana's rights in the trust were vested and could be enforced

Summary: *"In summary, the wife is the sole beneficiary (in a closed beneficiary class) of an irrevocable trust; her interest in the trust is not susceptible to reduction or divestment; she is eligible to receive discretionary distributions of income and principal that the trustee deems in her 'best interests and welfare', and she may also have payments made on her behalf by the trustee (in lieu of outright distributions; her right to receive a mandatory distribution of the entire corpus upon her mother's death is vested and fixed; and she has the power to appoint trust assets to the beneficiaries of her estate if she dies before receiving the mandatory distribution. To the extent that the trustee has the discretion to 'postpone' distributions for a 'compelling reason,' that discretion is subject to judicially enforceable limits.... We therefore conclude that the wife's interest in [the trust] is sufficiently 'fixed and enforceable' to constitute a property interest (rather than 'too remote or speculative.'"*

Comment: It is unclear how the Massachusetts court would have ruled had the trust for Juliana remained a solely discretionary trust where she did not have any right of withdrawal after her mother's death. The court seemed to emphasize the withdrawal right, albeit far into the future as the mother was still alive and it equated the testamentary power of appointment over the trust assets as conferring on Juliana a vested property interest in the trust that while she might never enjoy the trust assets, the beneficiaries of her estate might. This gets back to the recurring question of how does one go about valuing a beneficiary's interest in a discretionary trust, where the trustee can suspend a future right of withdrawal, it is subject to a spendthrift limitation, and where the value of assets subject to a *testamentary* power of appointment are included, currently, in the powerholder's marital estate when that power might not be exercised until decades into the future. My 'two cents' concerning this decision is: (i) the Court continued to emphasize in its

decision that Juliana will expect to receive a large inheritance in the future, so she would not arguably be harmed by including the perceived value of her interest in the trust in the marital estate; and (ii) unlike Michigan, Massachusetts is very, very liberal in including all assets in the marital estate, even those assets that come to a spouse through lifetime gift or inheritance, and as such, really it does not distinguish between marital property and separate property as does Michigan.

Conclusion: While Michigan may have a favorable provision in its Trust Code with respect to a beneficiary's interest in a discretionary trust, i.e., that it is not a *property* interest subject to the claims of creditors, other states are apparently free to ignore that Trust Code classification when it better suits that state's public policy.

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