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Estate Planning Update Winter 2023/2024 - A Trust Could Be a Marital Asset, Says the Massachusetts Appeals Court

Creditor protection remains a substantial concern for many estate planning clients. Among the class of creditors are the typical and anticipated, including a person injured in a car accident caused by a beneficiary or a credit card company to whom a beneficiary owes money. For many, however, a beneficiary's spouse—or ex-spouse—is a greater concern. Families routinely use trusts to protect family money from the claims of beneficiaries' divorcing spouses. State laws vary widely, however, on whether or to what extent trust funds will be implicated in the division of marital assets or the determination of support obligations. The terms of the trust or the extent to which the family used it for support will often play a significant role in such outcomes as well. In a highly mobile society, even a trust created in a more protective jurisdiction may be vulnerable if the beneficiary resides in a less protective jurisdiction at the time a divorce action begins.

Massachusetts courts have seen a high degree of activity in this area. Most recently, the Massachusetts Appeals Court affirmed a lower court decision to, among other things, classify a spouse's beneficial interest in an irrevocable trust as part of the marital estate for the purposes of equitable distribution in a divorce.[1]

Under certain circumstances, assets held in an irrevocable trust for the benefit of a divorcing spouse may not be subject to division among the spouses in a divorce. The effectiveness of a trust for this purpose depends on the terms of the trust, and it is also heavily dependent on the facts and circumstances of the divorce and the law of the state in which the divorce occurs.

In *Jones v. Jones*, the husband and wife who were divorcing were married in Michigan in August 1998 and had two children together. At the time of the divorce, they resided in Massachusetts. During the marriage, the wife's mother made significant gifts that enabled the family to maintain a lifestyle beyond what the couple's own income could support. Among other gifts, the wife's mother created and funded an irrevocable trust of which the wife was the sole beneficiary.

The irrevocable trust at issue was governed by Michigan law, which the Massachusetts court reviewed in determining the nature of the wife's interest in the trust at the time of the divorce. Massachusetts law, including its equitable distribution statute as to marital property, governed the divorce itself. For purposes of equitable distribution in Massachusetts, a party's estate "includes all property to which a party holds title, however acquired," and a court is "not bound by traditional concepts of title or property in considering whether a particular interest is to be included in the marital estate." Because of this particular definition, even assets not within the possession or control of the divorcing spouse could be considered marital assets for purposes of the divorce. In reviewing the trust's terms to determine whether a beneficial interest qualifies as a marital asset, the court will assess whether the interest is fixed and enforceable or too remote and speculative.

The trust at issue in the *Jones* case provided that the wife, as the sole beneficiary, may receive discretionary distributions of income and principal that the trustee, in his sole and absolute discretion, considered necessary for the wife's best interests and welfare. In addition, the trust provided for a mandatory distribution of its remaining assets to the wife on her mother's death, and the wife held a power of appointment to redirect the trust property at her death if she died prior to the trust's termination. The trust authorized the trustee to apply the trust funds for the wife's benefit to avoid the reach of her creditors. The trust also included a "spendthrift" provision prohibiting the assignment of the wife's interest in the trust to creditors, meaning that the trust assets themselves could not be assigned to the husband as part of equitable distribution.

Perhaps most interesting in this case, the trust also included a "postponement of distributions" provision. The postponement provision authorized the trustee to delay any required distribution if the trustee determined that a compelling reason existed

for postponement. The trust itself provided specific examples of a compelling reason, including the possibility of divorce by the beneficiary. Notably, a postponement could be made for the entire lifetime of the beneficiary.

Relying on those provisions, the wife argued that her interest was a mere expectancy and too speculative to be considered a marital asset. The courts held to the contrary, finding the interest to be fixed and vested insofar as the trustee could not divest the wife of her interest. As a result, the court included the wife's trust interest in the overall value of the marital estate, treated the trust assets as part of her share upon divorce, and required her to make equalization payments to the husband over time from other assets.

As noted, the trust's terms can greatly impact a court's decision. Trusts where the divorcing spouse is the sole beneficiary are treated differently from trusts with multiple beneficiaries. Trusts that grant a beneficial interest only if certain conditions are met (such as the beneficiary living to a certain date or surviving the settlor) are also distinguishable from trusts that require distributions. The law of the jurisdiction in which the divorce occurs is also important to the outcome—many states have much less expansive definitions of the marital estate than Massachusetts does. Perhaps most importantly from a planning perspective, the outcome of this case most likely would have been different for the wife if the couple had entered into a prenuptial agreement to address their gifted and inherited assets. In sum, careful planning is required when making gifts to trusts in order to provide appropriate protection for a divorcing beneficiary, and a trust beneficiary should seriously consider entering into a prenuptial agreement in order to provide additional protection.

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[1] *Jones v. Jones*, 103 Mass. App. Ct. 223 (2023). The Supreme Judicial Court of Massachusetts denied appellate review of *Jones* on November 8, 2023.