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Estate Planning Update July 2017 - Trusts Can Protect Family Wealth from Divorce

We often think of trusts primarily as vehicles for saving taxes or for preserving the assets of minors or adults who are unable to manage their own assets. Parents may hesitate to "tie up" assets with a trustee for the lives of their children and grandchildren. Trust beneficiaries often see a trust as an obstacle, preventing them from gaining full control of the trust assets.

Donors, trustees and trust beneficiaries should be aware that trusts can protect inherited and gifted assets should a beneficiary go through a divorce. In many states, without the protection of a trust, the divorcing spouse can be entitled to a significant portion of the inherited or gifted assets.

To illustrate, suppose that Parents plan on making significant gifts to their children, who are teenagers. Parents believe that the gifted assets should be protected while their children are minors and while they are young adults, but they do not want the assets to be tied up forever. They consequently decide to give the assets to trusts for the benefit of their children rather than to them outright. However, the trusts give each child the unilateral right to withdraw assets as they reach particular ages, with the ability to withdraw the full trust principal at age 47. Thirty years after the gifts take place, Son's wife files for divorce. At this point, Son is in his mid-40s and is entitled to withdraw 75 percent of the trust assets. As the divorce proceedings drag on, he reaches age 47 and becomes entitled to withdraw 100 percent of the trust assets. Son's wife argues that the trust effectively has terminated and she should receive half of the trust assets in the divorce.

The previous paragraph is based on a recent case, *Ferri v. Powell-Ferri*, 476 Mass. 651 (2017). In that case, some quick thinking by the trustee seems to have saved the day for Son, but only after extensive litigation that went up to the highest courts in two states (Connecticut and Massachusetts). For a summary of the case and the extraordinary lengths the trustee went to in order to preserve the trust assets, see "Do Trustees Have a Duty to Consider Decanting?"

Donors should consider the benefits of ongoing, flexible trusts for their children, grandchildren and other beneficiaries. In addition to insulating trust assets from divorcing spouses, they can provide protection from other creditors, as well as from possible mismanagement by the beneficiaries.

Beneficiaries who have grown impatient with their trustees may wish to consider these advantages before asking that the trust be terminated or before exercising withdrawal rights they may already have.

Trustees should give consideration to creditor protection in making trust distributions. On the other side of the equation, they should consider being flexible and responsive to the needs of the trust beneficiaries so the trust can be a blessing rather than a burden for the beneficiaries. Finally, in the event a beneficiary faces divorce or creditor issues, trustees should take note of the powers they may have under the trust instrument or, as in the *Ferri* case, under state law that may allow them to protect the trust assets for the intended beneficiaries.