Estate Planning to Address Divorce Concerns

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Wealth Planning Insights

Good estate planning includes taking steps to protect your family's wealth from certain risks. A common risk is the possibility that a child or other family member might become entangled in a divorce. Our experiences and observations of those around us demonstrate that the possibility of divorce is very real. And with it comes the potential for assets that we plan to transfer to family members to be at risk.

A recent court case, Ferri v. Powell-Ferri, has drawn much attention for its role in the ongoing development of the law in Massachusetts on a trustee's authority to decant a trust. "Decanting" is a way to essentially amend an irrevocable trust to address unforeseen circumstances. We described decanting under both Massachusetts and New Hampshire law in an earlier article titled "Adaptable Trusts: Changing the Game at Halftime."

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The Ferri case is notable because it strongly suggests that decanting may not be an effective way to protect assets in a trust when a beneficiary divorces. The case reminds us that clients should weigh the possibility of divorce when planning their estates. If it is a concern, they should create trusts for family members instead of transferring assets to them outright. These trusts should be designed in certain ways because stopgap measures such as decanting that might be taken later if a divorce happens may not be effective.

Clients should weigh the possibility of divorce when planning their estates

I. Trust Decanting and Divorce

Paul Ferri was the sole beneficiary of the Paul John Ferri, Jr. Trust, an irrevocable trust that was established in Massachusetts by his father in 1983, when Paul was 18. Under the trust's terms, the trustees had broad discretion to distribute income and principal to Paul or for his benefit. In addition, the trust also gave Paul the right to withdraw trust assets at certain ages. Beginning at age thirty-five he could withdraw up to twenty-five percent of the trust. Beginning at age thirty-nine he could withdraw up to fifty percent of the trust. By age forty-seven he could withdraw the entire trust.

Paul married Nancy Powell-Ferri in 1995. Fifteen years later she filed for divorce in a Connecticut court. Around that time, based on his age Paul had a right to withdraw up to seventy-five percent of the trust's assets. Paul's trustees took steps to protect the trust assets from Nancy's claims in the divorce proceeding. Specifically, they decanted the trust by distributing its assets to a new trust they created for Paul. The trustees did this without informing Paul or obtaining his consent. The new trust had terms similar to the original trust, except that it eliminated Paul's right to withdraw trust assets.

Litigation ensued in Connecticut. Because the trust was administered in Massachusetts, the Connecticut Supreme Court asked the Massachusetts Supreme Judicial Court (the "SJC") to rule on whether, under Massachusetts law, Paul's trustees had the authority to decant the trust.

II. The Court Ruled in the Trustees' Favor, but Warned Massachusetts Trustees

Roughly one-half of the states have enacted decanting statutes, but Massachusetts has not. Instead, the determination of whether the trustee of a trust governed by Massachusetts law has the authority to decant is based upon the legal reasoning of the SJC set forth in the 2013 case of *Morse v. Kraft*. Under this reasoning, a trustee has the power to decant a trust if this power is granted by express language in the trust instrument or if the terms of the trust indicate that the settlor intended to grant this power. It was particularly helpful in the Kraft case that the trust settlor, New England Patriots owner Robert Kraft, was still living and submitted an affidavit stating that decanting was consistent with his intentions

The SJC closely analyzed terms of the trust for Paul Ferri and concluded that his father intended to provide the trustees with the authority to decant the trust if they thought it would be in Paul's interest. As in *Kraft*, the trust had no language authorizing decanting, but the parent who created the trust provided an affidavit outlining his intentions.

Although the court's decision was a victory for the Ferri trustees, a concurring opinion written by the SJC's Chief Justice sounded a warning note for Massachusetts trustees who might try a similar tactic. This concurring opinion emphasized that the SJC did not decide the issue of whether under Massachusetts law a trust could be decanted solely to protect the assets from the claims of a beneficiary's divorcing spouse. It strongly suggested that the SJC would declare such a decanting to be invalid as against "public policy." The concurring opinion also urged the Massachusetts legislature to include in any decanting statute that it might enact a prohibition on decanting to protect trust assets in the case of a beneficiary's divorce.

III. *Ferri* and the Earlier *Phannenstiehl* Case Provide Key Guidance for Estate Planning to Address Divorce Concerns

During the estate planning process, advisors should discuss with clients the risks of family members becoming involved in a divorce down the road. Clients who want to address this possibility in their plans should understand that decanting most likely will not be an effective tool for this purpose. Instead, they should consider various trust design options.

Decanting most likely will not be an effective tool

A. The discretionary nature of divorce law

In divorce matters, the laws of Massachusetts and other states give probate and family courts broad discretion to make an equitable division between the two spouses of the assets that make up their "marital estate." The discretionary nature of these proceedings introduces uncertainty as judges weigh factors such as the length of the marriage and each spouse's conduct, age, health, occupation, income, work skills, employability, net worth, and opportunity to acquire assets and income in the future.

B. Application of divorce law to trust interests

The 2016 SJC case of *Pfannenstiehl v. Pfannenstiehl* indicates how a beneficiary's interest in a trust will be treated in a divorce proceeding under Massachusetts law. Curt and Diane Pfannenstiehl were married in 2000 and had two children, one of whom had special needs. They lived an upper middle class lifestyle funded mostly by: 1) Curt's generous income from working as an assistant bookstore manager in his family's education business, 2) support from Curt's father, and 3) distributions from a family trust his father created in 2004. At the urging of Curt and his family, Diane retired from the Army Reserves after the birth of their second child and two years short of the twenty years of service that would have qualified her for a military pension. She earned a modest amount working part-time as an ultrasound technician. She also contributed to the marriage as the family's homemaker and caretaker for the children. Curt filed for divorce in 2010.

Curt's father created the 2004 family trust for a class of beneficiaries that included all of his descendants. He gave the trustees the discretion to distribute income and principal in equal or unequal shares for each beneficiary's "comfortable support, health, maintenance, welfare and education." At the time of Curt's divorce, the trust had eleven beneficiaries and was worth $24.9 million. From 2008 until late 2010, Curt and his siblings received regular trust distributions. Curt's distributions totaled $800,000. The trustees stopped making distributions to Curt when he filed for divorce out of concern that the court might require him to share the distributed funds with Diane.

The probate and family court judge treated Curt as having a one-eleventh interest in the family trust, included it in the marital estate, and awarded Diane sixty percent of this interest. As a result, the judge ordered Curt to make twenty-four monthly payments to Diane totaling $1,168,794.41.

This outcome surprised most estate planning advisors, and the SJC overturned it. The court viewed Curt's interest in the family trust as too speculative and indefinite to be a property interest that could be included

in the marital estate. Thus, it should not have been a part of the equitable division of assets in the divorce proceeding. The SJC remanded the case back to the probate and family court for further proceedings. It instructed the lower court that, although the trust interest should not be included in the marital estate, it could consider it as an opportunity for Curt to acquire assets and income in the future. Thus, Curt's trust interest could still have an impact on the division of the marital estate assets between him and Diane.

C. Trust design features to consider

Pfannenstiehl indicates that a client may reduce the risk of a court including a trust interest in a beneficiary's marital estate if the trust includes one or more of the following design features:

- Multiple current beneficiaries – The trust in *Pfannenstiehl* had many current beneficiaries. The trust in *Ferri* had just one beneficiary—Paul. A beneficiary's trust interest is less likely to be included in his or her marital estate if there are other beneficiaries who may currently receive distributions of income and/or principal.
- An "open" class of beneficiaries – A class of beneficiaries is "open" when it may be expanded by the birth of additional family members after the trust is established. An example would be a trust for the benefit of one's adult child, that child's son and daughter, and any children, grandchildren, etc. who might be born in that child's branch of the family tree in the future. The class of beneficiaries in *Pfannensthiehl* was an open class of all descendants of Curt's father. A beneficiary's trust interest is more speculative and indefinite when it may be diluted by the birth of additional beneficiaries.
- Broad trustee discretion to make distributions – If the trust gives the trustee broad discretion to make distributions, a beneficiary's interest is generally viewed as being too uncertain to be a property interest includable in a marital estate. A narrower right to receive distributions for a beneficiary's health, education, maintenance, or support, is more likely to be viewed as a property interest.
- No withdrawal rights at "benchmark" ages – Many trusts, like the trust in Ferri, give a beneficiary the right to withdraw portions and then all of the trust when they attain certain ages. People who include these rights in their trusts have relatively little interest in controlling their wealth throughout the beneficiary's lifetime. They also presume that at certain ages the beneficiary will be sufficiently responsible to handle the assets. Clients who are concerned about the risk of divorce should consider not including such withdrawal rights in their trusts.
- No powers of appointment – Many clients enhance the long-term flexibility of their estate plans by giving beneficiaries the power to appoint trust assets. These powers usually are exercisable at death by the inclusion of language in the beneficiary's will. In at least one case, a Massachusetts court cited a power of appointment as a contributing factor in including a trust interest in a divorcing beneficiary's marital estate.

A beneficiary's trust interest is less likely to be included in his or her marital estate if there are other beneficiaries

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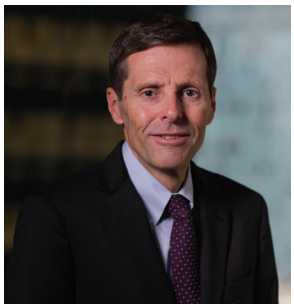

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IV. Conclusion

During the estate planning process, steps can be taken to reduce the impact of a beneficiary's divorce on your family's wealth. It is possible to avoid the direct transfer trust assets to a beneficiary's ex-spouse as part of the equitable division of a marital estate. Instead, the role of the trust in the divorce proceeding can be limited to affecting that division by being factored in by the judge as an opportunity for the beneficiary to acquire assets and income in the future.

This article provides a general discussion based on Massachusetts law. It should not be interpreted as advice for any specific client situation. Such advice would require the involvement of an experienced lawyer, with whom we would be happy to collaborate. For those clients who live outside Massachusetts, this article provides useful background information, but the involvement of a local lawyer familiar with the laws of their state would be necessary. ■

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