

How Parents Can Divorce-Proof Their Children's Inheritance

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Agenda

- Hypothetical
- Division of Marital Estate in Divorce
- Marital Estate
- When are trusts interests included in the Marital Estate?
- Present Interests vs. Mere Expectancies
- Discussion of Relevant Case Law
- Drafting Recommendations

Hypothetical

- Mr. and Mrs. Smith come into your office for an initial estate planning consultation. They have assets of approximately \$15 million.
- They have two children, one of whom was recently married without a prenuptial agreement. They want to set up an estate plan, including an inter vivos irrevocable trust for the benefit of their children and future generations.
- Protecting their assets from a divorcing daughter-in-law or son-in-law is of significant importance to them.
- What do you advise them?

Division of Marital Estate in Divorce

- Probate Court Judge has broad authority to divide marital property in divorce under M.G.L. c. 208, § 34
 - Many factors that the Court can consider
 - Concept of “equitable” vs. “equal” division
 - Based upon a partnership theory of marriage

What is the Marital Estate?

- M.G.L. c. 208, § 34 defines marital estate
 - Includes “all vested and non vested benefits, rights and funds accrued during the marriage” including but not limited to “retirement benefits...pension, profit-sharing, annuity, deferred compensation and insurance”
 - Includes “all property to which a party holds title, however acquired”¹

¹ *Williams v. Massa*, 431. Mass. 619, 625 (2000)

Inclusion of Trusts Interests in Marital Estate

- Includes any trust interest that is a “fixed and enforceable property right”²
 - Vested interests treated differently from speculative/contingent interests

² *Lauricella v. Lauricella*, 409 Mass. 211, 213 (1991); *D.L. v. G.L.*, 61 Mass. App. Ct. 488, 499 (2004)

Expectancies

- Marital estate does not include “mere expectancy under an inheritance or will”³
 - But Court may consider expectancy in dividing marital estate
 - ❑ E.g. potential inheritance from parents or grandparents
 - ❑ Discussion of *Vaughan* affidavits⁴

³ *Davidson v. Davidson*, 19 Mass. App. Ct. 374, 488 (2004); *Williams v. Massa*, 431 Mass. 619, 629 (2000)

⁴ *Vaughan v. Vaughan*, SJC Single Justice, No. 91-485 (1991) (unpublished)

When is a trust interest “fixed and enforceable”?

- Trust with ascertainable standard:
 - Beneficiary has a present, enforceable interest
 - Right to compel a trustee to make a distribution
 - Trustee obligated to make distributions to maintain beneficiary’s standard of living⁵

⁵ *Comins v. Comins*, 33 Mass. App. Ct. 28, 30-31 (1992)

When is a trust interest “remote and speculative”?

- Trust with wholly discretionary standard:
 - Beneficiary has no present right to the trust property ⁶
 - Can't compel a distribution
 - Contingent remainder interest in trust or interest subject to divestment upon exercise of testamentary power of appointment – less likely to be included in marital estate⁷

⁶ *D.L. v. G.L.*, 61 Mass. App. Court 488, 496-497 (2004)

⁷ *S.L. v. R.L.*, 55 Mass. App. Ct. 880 (2002)

*Pfannenstiehl v. Pfannenstiehl*⁸

- Divorcing husband was the beneficiary of an irrevocable spendthrift trust established by his father in 2004 for the benefit of father's issue
 - Trustees were husband's brother and a family attorney
 - ❑ stopped making distributions to Husband before divorce
 - ❑ continued making distributions to his siblings

⁸ *Pfannenstiehl v. Pfannenstiehl*, 475 Mass. 105 (2016)

Pfannenstiehl v. Pfannenstiehl: Continued

- Mixed distribution standard
- Wife argued that Husband had a present, enforceable right to trust property
 - Argued trust had ascertainable standard
- Husband argued he had no interest in the trust
 - Argued trust was wholly discretionary
 - Open class of beneficiaries
 - Asked the Court to consider Settlor's intent

Pfannenstiehl v. Pfannenstiehl: Continued

- SJC held that husband's interest in the trust was too remote and speculative to include in marital estate
- SJC noted that the trust may be considered an expectancy in division

Drafting the Smith's Estate Plan

- Same considerations for irrevocable inter vivos trusts and trusts distributed at survivor's death
- Avoid creating any “fixed and enforceable” property right
 - Lifetime trusts for children
 - No automatic distributions
 - No withdrawal rights
 - Not easy to value any beneficiary's interest with open class of beneficiaries

Drafting the Smith's Estate Plan

- Choice of Trustee
- Spendthrift Clause
- Statement of Settlor's intent
 - Intends assets to be protected from a divorcing spouse

Drafting the Smith's Estate Plan

- Create flexibility for the future
- Limited Power of Appointment
 - only give child testamentary power of appointment in favor of issue
 - If including spouses consider limiting to income interest
- Include decanting power
 - May be questions about extent decanting power removes assets from marital estate⁹

⁹ *Ferri v. Powell-Ferri*, 476 Mass. 651, 665 (2017) (Gantz, C. J., concurring)

The Known Unknown: *Ferri v. Powell-Ferri*

- A Connecticut Divorce case involving a Massachusetts irrevocable trust.
- Trustees decanted after beneficiary's spouse filed for divorce.
 - Trustees claimed the trust was “under attack” and decanted to shield the trust assets.
- **SJC of Massachusetts held:**
 - The Trustees had the power to decant;
 - The Court may consider the settlor's affidavit to determine intent.

Ferri v. Powell-Ferri Continued

- What does this mean?
 - Does this case create a duty to decant?
 - Should public policy prevent a Trustee from decanting for the express purpose of protecting those assets in a divorce proceeding?
 - What, if any, are the unintended tax consequences of such a power?
 - ☐ To be continued...

What can the Smith's do to protect their assets?

“The pessimist complains about the wind; the optimist expects it to change; the realist adjusts the sails.” Arthur Ward

- What are their planning goals?
- Is a post-nuptial agreement a possibility?
- The laws are constantly changing, the plans need to incorporate flexibility.
- Limit “fixed and enforceable” property rights.
- Consider the different powers given to beneficiaries and trustees.
- Choose your trustee wisely.

Bios

Josh Miller is a managing director and senior wealth strategist in CIBC Atlantic Trust Private Wealth Management's Boston office.

Josh has more than 14 years of industry experience, counseling high net worth individuals, corporate executives, closely held business owners and multinationals on sophisticated estate plan designs and strategies. He works directly with clients and their advisors to develop and implement charitable, estate and wealth transfer and management planning as part of CIBC Atlantic Trust's integrated wealth management process.

Prior to joining the firm, Josh was a senior relationship manager and wealth strategist for BNY Mellon Wealth Management, where he worked with business owners and high net worth individuals throughout the country advising them and their families on investment management and various areas of wealth planning. Previously, he practiced at the law firm of Holland & Knight.

Josh received his Juris Doctor degree from Suffolk University Law School and graduated cum laude with a Bachelor of Arts from the State University of New York at Oswego. He also holds the CERTIFIED FINANCIAL PLANNER™ certification and is a Registered Trust and Estate Practitioner with STEP, the Society of Trust and Estate Practitioners.

Josh serves on several boards including the Boston Estate Planning Council, the Arts & Business Council of Boston and Boston Chapter of STEP. In addition, Josh has contributed numerous articles to publications including Massachusetts Family Business magazine, Mass. Lawyers Weekly, Private Wealth magazine and Family Wealth Report.

Bios

Caroline Spillane Sacks is an associate in the private client group at Ropes & Gray in Boston, Massachusetts.

Caroline's practice consists of representing high net worth individuals and multi-generational families in complex wealth transfer planning matters. As an associate in the private client group, Caroline assists clients with the preparation of comprehensive estate plans, including drafting core revocable estate planning documents and sophisticated gifting documents, such as GRATs, QPRTs and GST Gifting Trusts. Caroline also helps clients achieve their philanthropic goals by developing and implementing customized charitable planning strategies.

Building on prior experience as a domestic relations attorney, Caroline works with clients on complex estate planning and tax issues related to divorce.

Caroline received her juris doctor from Boston College Law School and graduated magna cum laude with a Bachelor of Arts from the University of Pennsylvania. Caroline serves on the Trust & Estates New Development Committee for the Boston Bar Association and is a member of the Boston Estate Planning Council and Trusts & Estates Consortium.

Caroline is a board member of Invest in Girls, a non-profit organization which teaches high school girls financial concepts, exposes them to professional women role models, and introduces them to career paths in finance to empower them to become tomorrow's leaders.