Are Beneficial Interests in Irrevocable, Spendthrift Trusts a Divisible Asset in Divorce?

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The Massachusetts Appeals Court recently determined that an irrevocable spendthrift trust, created by the husband's father in 2004 and funded from his family's operation of various corporations for the benefit of the husband and his siblings, was properly included in the marital estate and subject to division in the husband's divorce.[1]

BACKGROUND

The parties were married in 2000 and lived together as husband and wife until 2010. The parties are the parents of two children, both of whom have significant special needs. At the time of the divorce, the husband was employed as an assistant bookstore manager at one of the family's for-profit educational universities, earning approximately $170,000 per year for a position that the trial court determined generally pays between $50,000 and $60,000 annually. The wife left the United States military in 2004, just two years prior to the 20 years of service required to receive a military pension. The decision to retire was made after the birth of the parties' daughter in 2004 and was a result of pressure from the husband and his parents. At the time of the divorce, the wife worked one day per week as an ultrasound technician and earned less than $23,000 per year. The trial court found that throughout the marriage, the wife had been the primary homemaker and caretaker of the parties' two children.

Between 2008 and 2010, the husband received tax-free distributions from the 2004 irrevocable trust in the amount of $800,000. In the eight months prior to the filing of the divorce action, the husband received monthly distributions of $20,000. However, one month prior to the husband filing the divorce complaint, the distributions to the husband ceased while distributions to the husband's siblings, also beneficiaries, continued. The trial court found that the family's expansive lifestyle was connected to the distributions from the 2004 trust. The trial court also found that cutoff of distributions from the 2004 trust on the eve of the divorce "was a deliberate manipulation to erase a major component of the husband's annual income and to silence his interest in the trust – for a convenient time while the divorce was ongoing."

THE 2004 TRUST

The 2004 trust at issue in the *Pfannenstiehl* case is an irrevocable, spendthrift trust that was established by the husband's father. The 2004 trust holds shares of stock in the family-controlled private corporations which, in turn, own and operate private, for-profit colleges. The trust was valued at almost $25,000,000 at the time of the divorce. The beneficiaries of the trust are the husband, his brother and sister, and their children (at the time of the divorce there were 11 beneficiaries, but the trust remained open to expansion).

There are two trustees of the 2004 trust. The husband's brother is one trustee. The court found the husband's brother – as an officer and director of the corporations held in the trust, along with his father – is able to manipulate what dividends are to be paid to the trust, thereby influencing the 2004 trust principal and income available for distributions.

The second trustee, a lawyer, while allegedly an outside, independent trustee, was found to be inextricably connected and aligned with the husband's family. This trustee and his law firm have represented the husband's father and his businesses since 1972, and his law firm represents the trustees of the 2004 trust. Based on this trustee's testimony at trial, the court found that he appeared unaware of the timing or level of the distributions and had not scrutinized the distributions from the 2004 trust as he should have. The court concluded the 2004 trust had not been administered impartially by the two trustees, and upon the filing of the divorce, the "proverbial family wagons circled the family money."

The 2004 trust contains a standard spendthrift clause. Specifically, it states, "neither the principal nor income of any trust created hereunder shall be subject to alienation, pledge, assignment or other anticipation by the person for whom the same is intended, nor attachment, execution, garnishment or other seizure under any legal, equitable or other process."

The 2004 trust also contains an ascertainable standard for distributions that reads as follows:

(U)ntil the division of the Trust into separate shares pursuant to Paragraph B below, the Trustee shall pay to, or apply for the benefit of, a class comprised of any one or more of the Donor's then living issue such amounts of income and principal as the Trustee, in its sole discretion, may deem advisable from time

[1] *Pfannenstiehl v. Pfannenstiehl*, 88, Mass. App. Ct. 121

to time, whether in equal or unequal shares, to provide for the comfortable support, health, maintenance, welfare and education of each or all members of such class. In the exercise of such discretion, the Trustee may take into account funds available from other sources for such needs of each beneficiary. At the end of each taxable year, any net income which is not disposed of by the terms of this paragraph shall be added to the principal of the trust estate.

DECISION

The Massachusetts Appeals Court, in a 3-2 decision, affirmed the trial court's decision as follows: (1) the husband's beneficial interest in the 2004 trust is a marital asset to be divided in the divorce; (2) the husband's interest in the 2004 trust is worth 1/11 (number of beneficiaries) of the corpus of the trust; (3) the wife is entitled to receive 60% of the husband's interest in the 2004 trust; and (4) the husband shall pay to the wife her 60% interest in the 2004 trust, in addition to 60% of non-trust assets, in cash, monthly over a two-year period. The appeals court vacated the trial court's finding that the husband was guilty of contempt for subsequently failing to make the required payments to the wife.

The Massachusetts Appeals Court held that a spendthrift clause in a trust does not automatically shield it from equitable distribution in the event of a divorce. In this case, the court concluded that the cessation of trust distributions immediately prior to the divorce after a lengthy period of substantial and consistent distributions belies the invocation of the spendthrift clause. In so concluding, the court cites a 1979 case: "The law does not require that an obligor be allowed to enjoy an asset – such as a valuable home or the beneficial interest in a spendthrift trust – while he neglects to provide for those persons whom he is legally required to support."[2]

The appeals court then looked at the ascertainable standard in the 2004 trust to support the inclusion of the trust in the marital estate and found that the husband has a present, enforceable right to distributions from the trust, in which the trustees were obligated to, and did, in fact, make distribution from the trust to the husband and other beneficiaries for such things as their comfortable support, health, maintenance, welfare, and education. It noted that the ascertainable standard in the 2004 trust, and the requirement that distributions be made, differs from wholly discretionary trusts, with no ascertainable distribution standard, i.e., "distributions may be made to the beneficiaries in the trustee's sole discretion." Previous case law has excluded a purely discretionary trust where no distributions had been made to the divorcing spouse from the marital estate. Presumably, the trustees are also required to observe the spendthrift clause in the trust for the benefit of the beneficiaries but it is not apparent from the decision that this point was considered.

In concluding that the 2004 trust is a marital asset subject to division in the divorce, the court found that the substantial distributions were woven into the fabric of the marriage. To that end, "the 2004 trust distributions were integral to the family unit, and the family depended upon the trust distributions monies to meet their routine expenses and to maintain their standard of living."

Interestingly, and in apparent contradiction to its finding that the husband has a present, enforceable right to distributions from the trust, the appeals court vacated the trial court's judgment of contempt against the husband for failing to make the required payments to the wife for her interest in the 2004 trust. The husband's defense to the contempt action, which the appeals court accepted, was that he did not have the ability to pay the wife. He had requested the trustees to distribute trust assets to him to pay the wife. Not surprisingly, the trustees refused to make such distributions. Because the court found that the husband "tried, or at least ostensibly tried, to do what he was supposed to do," he could not be found in contempt. Since the trustees were not parties to the divorce case, the court could not compel them to make distributions.

DISSENT

Two appellate court justices dissented. The dissent argues that the 2004 trust is too remote and speculative for inclusion in the marital estate because the ascertainable standard must be read in context of the discretion of the trustees. The dissent further argues that the valuation of the husband's interest in the 2004 trust is erroneous because the number of beneficiaries may change and distributions may be made in equal or unequal shares in the trustees' discretion. The dissent concludes that "the fractional share methodology employed by the judge has produced an arbitrary result." In essence, the 2004 trust is too elusive of valuation to be included in the marital estate for purposes of equitable distribution.

The dissent rejected the majority's focus on the machinations on the part of the trustees to cease distributions to the husband on the eve of the divorce filing. The dissent states that "the primary focus of the instant inquiry should be the terms of the trust instrument itself, not how those terms may be or have been manipulated."

CONCLUSION

The Supreme Judicial Court granted the husband's application for further appellate review and both sides delivered compelling arguments for their positions at the oral argument on April 5, 2016. It will be interesting to see how the Supreme Judicial Court tackles the intersection of divorce and trust law. While the implications of the *Pfannenstiehl* case may not yet be clear, it is safe to say that, for now, irrevocable, spendthrift trusts with ascertainable distribution standards may not provide complete protection in the event of a divorce.

[2] *Krokyn v. Krokyn*, 378 Mass. 206, 213-14 (1979)

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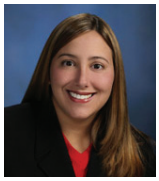

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