INSIDE THE LAW

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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."

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

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 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 husband has asked the Massachusetts Supreme Judicial Court to grant his application for further appellate review. If that court accepts the case, it will be interesting to see how it 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. **FT**

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

LEGAL ISSUES AT THE INTERSECTION OF ESTATE PLANNING AND ELDER LAW

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Clients in the retirement age bracket are sometimes referred to as the "Sandwich Generation" by the mainstream media. That is, they are caught between caring for their own children and, at the same time, providing care to their aging parents. This group of individuals has specific legal needs that should be addressed by an attorney versed in the practice areas of both elder law and traditional estate planning. The following is a checklist of some legal considerations for those individuals approaching retirement age.

I. INCAPACITY PLANNING

Clients approaching their retirement years should be sure to have, at the very minimum, their health care proxies and durable powers of attorney in place and up to date. A health care proxy will appoint an agent to make medical decisions on your behalf if you are unable to do so yourself. Even if you have a spouse, marriage does not grant an individual the right to make medical decisions on a spouse's behalf in the event of a sudden incapacity. Having a proper health care proxy in place will avoid the need to pursue a guardianship in the event of an unforeseen illness or accident. A power of attorney appoints an attorney-in-fact to represent you with regard to financial planning. Typically, this appointment will take effect as soon as the document is signed. Similar to a health care proxy, this document will avoid the need for your spouse or other trusted individual to have to seek a conservatorship to handle your financial affairs in the event of your unforeseen incapacity.

II. BEQUESTS AND LIFETIME GIFTS TO CHILDREN

Clients with grown children often prefer to leave assets to those children directly in their estate plans. However, for a variety of reasons, an outright bequest to a child may not always be the appropriate choice. For example, if a child has creditor issues, is still enrolled in college or graduate school, owns a business, has a shaky marriage, or is not financially astute, it may be more appropriate to leave assets in a discretionary trust for that child. Assets held in a discretionary trust will be managed by a trustee, and distributions will be made only in the event that the trustee deems it an appropriate expenditure of the trust funds.

Clients in the retirement age bracket are sometimes referred to as the "Sandwich Generation" by the mainstream media. That is, they are caught between caring for their own children and, at the same time, providing care to their aging parents.

Clients should be aware that in a recent Massachusetts case, *Pfannenstiehl v. Pfannenstiehl*, the court awarded to the wife in a divorce action assets held in a long-standing trust created by the husband's family and of which he was a beneficiary. I note that the trust at issue in this case provided an ascertainable and not purely discretionary standard for distribution, and this, among other factors, contributed to the court's decision to include the trust assets in the marital estate during the divorce. A further appeal of this case to the Massachusetts Supreme Judicial Court is expected. However, in the meantime, clients should consider a discretionary trust as a vehicle to leave assets to their children rather than to a trust with an ascertainable standard.

Clients should also be aware that any significant lifetime gifts made to children could render the client ineligible for MassHealth long-term care benefits if, for some reason, nursing home care is needed before the five-year ineligibility period created by the gifting has passed. A common misconception is that a gift to a child made pursuant to the IRS annual gift tax exclusion is also allowable for purposes of MassHealth planning. However, any gift made under the IRS-imposed guidelines would still create an ineligibility period from MassHealth long-term care benefits were the client to apply for benefits within five years of making the gift.

III. PLANNING TO PROTECT THE PRIMARY RESIDENCE

Typically, clients wishing to protect their primary residence from a lien imposed by the state in the event of their nursing home admission and subsequent need for MassHealth long-term care benefits would transfer the residence into an irrevocable trust. Following a period of five years from the date of transfer, the residence would presumably be protected from any future attachment by the state in the event of a nursing home admission. However, recent litigation surrounding irrevocable trusts has left this MassHealth planning strategy, for the time being,

in a state of upheaval. Our firm is currently handling the litigation matter of *Roche v. Thorn*, which is an irrevocable trust appeal case now pending in the Massachusetts Appeals Court. When decided, the Roche matter should bring some clarity to the use of irrevocable trusts in the MassHealth planning context.

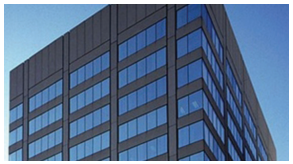
For the time being, clients should take some comfort in the fact that if one spouse were to become ill unexpectedly, the residence can always be protected for the spouse remaining at home through a basic title transfer. However, for those clients who are widowed or otherwise single, it remains an uncertain and difficult time to plan to protect the primary residence from potential long-term care costs. We have been advising clients who are in the appropriate financial position to consider consulting with their financial advisor about the possibility of purchasing long-term care insurance to safeguard their residence and other assets from the possibility of a nursing home spend down.

IV. PROVIDING FOR AN ELDERLY PARENT

Occasionally, a client will want to provide for an elderly parent in the event of the client's premature demise. It is always recommend that assets left for elderly parents be segregated in either a discretionary trust or third-party supplemental needs trust created for the benefit of the elderly parent. If the elderly parent were to inherit assets outright when the child died and then were to need long-term nursing home care, inherited assets would be subject to a MassHealth spend-down process. By leaving assets to parents in a separate trust, a client can ensure that those funds will not be jeopardized in the event of the parents' nursing home admission.

V. IF YOUR SPOUSE IS ALREADY ILL

For those with a spouse who already has a diagnosis of Alzheimer's or dementia or is otherwise in ill health, there are special estate planning techniques to consider. Clients with an ill spouse should consider leaving assets into a testamentary trust created under their will for the benefit of their spouse, rather than providing an outright distribution. Assets held in a testamentary trust for a surviving ill spouse will not need to be spent down on that spouse's long-term care needs. In addition, a client should consider revising beneficiary designations to leave assets to the testamentary trust directly, rather than the ill spouse outright. Designations made under a power of attorney or health care proxy may also need to be revised. **FT**



FIRM NEWS

ONCE AGAIN, FLETCHER TILTON HAS RECEIVED A TIER 1 RANKING IN THE 2016 EDITION OF U.S. NEWS - BEST LAWYERS, BEST LAW FIRMS.

This Tier 1 ranking was determined through the firm's overall evaluation, which was derived from a combination of our client's impressive feedback, the high regard that lawyers in other firms in the same practice area have for our firm, and the information that was provided in response to the law firm survey.

Firms included in the 2016 "Best Law Firms" list are recognized for professional excellence with persistently impressive ratings from clients and peers. Achieving a tiered ranking signals a unique combination of quality law practice and breadth of legal expertise.

FLETCHER TILTON WELCOMES ATTORNEY SARAH TRICOT

Sarah focuses her practice on real estate law. She represents buyers, sellers and local lending institutions in both commercial and residential real estate transactions. Sarah's experience ranges from complex commercial lending to residential purchase transactions. She also has negotiated and reviewed commercial leases representing both landlord and tenant. With her work in real estate law she is also versed in business and corporate transactions and formation and estate planning.

Attorney Tricot is based out of the firm's Framingham office and can be reached at *508.532.3519* or *stricot@fletchertilton.com*.

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CONGRATULATIONS TO THE FLETCHER TILTON ATTORNEYS ON THE 2015 SUPER LAWYERS LIST

Super Lawyers selects attorneys using peer nominations and evaluations, combined with independent research. Each candidate is evaluated on 12 indicators of peer recognition and professional achievement. Selections are made on an annual, state-by-state basis.

The selection process for the Rising Stars list is the same as the Super Lawyers selection process, with one exception: to be eligible for inclusion in Rising Stars, a candidate must be either 40 years old or younger or in practice for 10 years or less. While up to five percent of the lawyers in the state are named to Super Lawyers, no more than 2.5 percent are named to the Rising Stars list.

JENNIFER VARNET TAKES THIRD PLACE IN PHOTO CONTEST

Created last year by The Massachusetts Developmental Disabilities Council, this contest is to showcase the contributions individuals with disabilities make in their workplaces and communities, those individuals are asked to submit photos of themselves at their workplaces. Thirty-one entries were received this year, and contest winners were chosen through online voting. When Jennifer was asked what the favorite part of her job at Fletcher Tilton was, she replied "I like closing files and I like copying and scanning." Jennifer is eligible to receive up to $100 each for conference registration fees to attend any disability related conference or training event. Congratulations, Jenny!

GOVERNOR APPOINTS PETER BARBIERI TO SPECIAL COMMISSION

Attorney Peter R. Barbieri has recently been appointed by Governor Charlie Baker to a special commission, 495/MetroWest Suburban Edge Community Commission. This commission shall make an investigation and study relative to development challenges being experienced by edge communities, such as needs to address transportation, water, cellular and energy infrastructure, transit services, residential development, reuse of former industrial facilities, brownfields reclamation, downtown redevelopment and other constraints.

Attorney Barbieri, a Holliston resident, was one of 5 municipal officials appointed by the governor. He was nominated by the Town of Holliston with recommendations from State Senator Karen Spilka and State Representative Carolyn Dykema. Attorney Barbieri will be representing the town of Holliston. To find out more on the ***495/MetroWest Suburban Edge Community Commission***, go to the Mass.gov website: *http://www.mass.gov/bb/gaa/fy2015/os_15/h233.htm*.

SAMANTHA MCDONALD AND PATRICK TINSLEY NAMED OFFICERS OF FLETCHER TILTON PC

Samantha P. McDonald, has been with Fletcher Tilton since 2009. She concentrates her practice in business and real property law including representing buyers and sellers of businesses, landlord-tenant, land use and development, and surrounding property issues.

Attorney McDonald works in the firm's Worcester office and can be reached at *smcdonald@fletchertilton.com*.

Patrick C. Tinsley, has been with Fletcher Tilton since 2012. His practice includes fiduciary litigation, business torts, contract disputes, and employment law, with a focus on public and private sector whistleblower claims. Mr. Tinsley's experience includes matters in state and federal courts and administrative forums, as well as arbitration and mediation.

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