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To protect assets from a potential future divorce, a multi-pronged strategy is often the most powerful approach. A well-crafted plan often includes the following key components:

- A comprehensive prenuptial agreement
- Careful trust planning to insulate trust assets in divorce
- A domestic asset protection trust
- Proactive updates in the event of divorce or separation
- Consideration of techniques like decanting to strengthen existing trusts

## PRENUPTIAL AGREEMENTS

There is no substitute for a comprehensive prenuptial agreement.

Clients who have either created trusts themselves before marriage or are beneficiaries of preexisting trust structures created by third parties might believe those trust structures will insulate the trust assets in divorce. However, rarely will prior trust planning prevent a matrimonial lawyer from attacking trust structures in an attempt to poke holes in the planning to illustrate why the trust assets should be included in the marital balance sheet. The trust protection becomes much less clear if the married couple has relied on trust distributions to support

their lifestyle, if trust assets have become commingled with marital assets, or if the trust assets have appreciated during the course of the marriage, in which case the appreciation may be subject to division in the event of divorce.

A prenuptial agreement can shield trust assets in the event of divorce. The requirements for enforceable prenuptial agreements can vary with state law, but generally, prenuptial agreements should be signed as far in advance of the marriage as possible and should meet the following requirements:

- the agreement is fair and equitable when signed, and potentially at the time of enforcement as well
- there has been full and adequate disclosure
- each party has been represented by competent counsel

## CAREFUL TRUST PLANNING

To determine whether trust assets are considered marital property, the driving inquiry is generally whether the beneficiary spouse's interest is a property interest that can be considered an asset under the relevant state's law. Even if excluded from the marital estate for division purposes, the trust may be considered in determining alimony and child support obligations. If a beneficiary spouse was receiving trust distributions on which the family relied for support, the issue is whether those distributions can be factored into the court's analysis.

From separate property states (where a spouse's assets acquired via gift or bequest are generally protected from division in divorce) to all-property states (where a court can divide all assets of the spouses, irrespective of how received) to equitable distribution or community property regimes within those states, the law across the country is highly state-specific. While much will depend on state law with regard to whether a beneficiary's interest can be considered in a divorce proceeding, determining the nature of the trust interest is the starting point.

Ultimately, the less certain that a beneficiary will receive trust distributions and the less control the beneficiary can exert over trust assets, the less likely that a court will find that the trust assets are reachable in divorce. Whether a beneficiary spouse can access the trust is dependent on a number of factors:

### Who created the trust?

Courts are less likely to consider a trust created by a third party (as opposed to one of the spouses) to be part of the marital estate. Even so, although the trust principal itself may not be subject to division if the beneficiary is not able to access the trust assets, a claim for alimony or child support can potentially succeed if there has been a pattern of reliance on trust distributions to support the marital lifestyle.

### Who are the beneficiaries?

If the trust includes a class of beneficiaries—including multiple people over current and future generations—as opposed to the spouse beneficiary being the sole beneficiary, it will be less likely that the spouse will receive trust distributions. Since the timing and amount of any potential distribution is difficult to ascertain, particularly if the class of beneficiaries is left open (i.e., the class includes beneficiaries not yet born, such as future issue, leaving the number of potential beneficiaries undeterminable), it is less likely that the trust interest will be reachable in divorce.

### On what basis can trustees make distributions?

The more likely a trustee is to make distributions to a beneficiary spouse, the more likely the trust assets will be considered in a divorce proceeding.

If a trustee is given broad authority to make distributions within its sole discretion, the timing and amount of distributions is uncertain. It is less likely that a court will find such a discretionary interest reachable in divorce than it would if the trustee's ability to pay out to a beneficiary was linked to a so-called ascertainable standard. A common ascertainable standard is health, education, maintenance, and support. That standard is often used to avoid an adverse tax consequence. An ascertainable standard bestows upon a beneficiary the right to compel a trustee to make distributions in accordance with that standard, which might make those assets accessible in divorce to that extent.

### Is there a spendthrift provision?

A spendthrift clause is commonly inserted in trust documents as a form of creditor protection. It prevents a beneficiary's creditors, which can include an ex-spouse, from accessing trust assets while they remain in trust. It provides that a beneficiary's interest will not be subject to their debts or liabilities. In essence, creditors must wait until a distribution is made to a beneficiary to assert any claims against those assets.

Depending on the state, however, alimony and child support may be treated differently, and trust funds may be factored into the analysis despite the presence of a spendthrift clause. Indeed, a spendthrift clause does not necessarily prevent a court from considering a trust interest as part of the marital estate and equalizing it with assets outside the trust although that interest itself may not be reachable.[1]

### Does a beneficiary have control powers?

The greater the powers of a beneficiary to exert control over a trust, the greater the likelihood that a court will consider the beneficiary's interest in a divorce proceeding. Common features frequently inserted in trust agreements to give a beneficiary some measure of control without triggering adverse tax consequences include the beneficiary acting as trustee (while not being permitted to make discretionary distributions to themselves or having other powers that have negative tax implications), having the power to remove and replace trustees or other advisors, or having a power of appointment. A power of appointment allows a beneficiary to direct the disposition of trust assets. A testamentary power of appointment can be exercised only at death, whereas a lifetime power of appointment could allow the appointee of the power to redirect trust assets at any time, potentially making those assets more vulnerable in divorce.

### Who is the trustee?

If an independent, neutral trustee is acting, particularly a corporate trustee, this usually removes even the appearance of impropriety and can circumvent the suspicion that a family member or friend acting as trustee is manipulating trust distributions for the benefit of a trust beneficiary.

### How is spouse defined?

If a trust includes a beneficiary's or a grantor's spouse as a potential beneficiary, the trust agreement's definition of the term spouse, wife, or husband will be key. Some documents make it clear that a divorced spouse will cease to be a beneficiary, either by using a floating spouse concept (the spouse to whom the trust creator is married from time to time is the beneficial spouse, which is a flexible definition that can adjust and readjust after divorce and remarriage) or by naming a particular spouse, provided that the spouse and the trust creator remain married. In the absence of guidance in the document addressing divorce or requiring that the parties remain married, courts search for the creator's intent by examining the trust provisions.

The lesson learned from considering these seven questions is that trust terms are critical, both when counseling clients in the process of divorce and when advisors are in the

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1 Levitan v. Rosen, 124 N.E.3d 148 (Mass. App. Ct. 2019), *app. rev. denied*, 127 N.E.3d 266 (Mass. 2019).

drafting phase. The following features have helped insulate a trust from attack:

- A distribution standard with broad, unfettered discretion
- An open class of beneficiaries (instead of one beneficiary)
- A detailed spendthrift provision
- A definition of spouse that accords with intent
- An independent corporate trustee

## ASSET PROTECTION TRUSTS

A trust specifically designed for asset protection can present additional formidable obstacles for creditors, including an ex-spouse. In most jurisdictions, it is not possible for a person to create a trust for themselves and protect the assets from their creditors. Under the laws of an increasing number of jurisdictions, however, including Delaware, an asset protection trust (APT) generally limits the ability of an individual's creditors to reach the trust assets while allowing the creator of the trust to remain a trust beneficiary. Creating an APT in a different jurisdiction forces a creditor to initiate an action outside the settlor's home state where the creditor is also likely situated, creating additional hurdles to bringing suit. Delaware is often the jurisdiction of choice because of its attractive laws and the fact that it was the first jurisdiction in the country to enact domestic asset protection laws over two decades ago. The creator of an APT need not live in the state whose laws govern the trust but does need to appoint a resident trustee.

A very limited number of creditors can pursue claims against a Delaware APT (DAPT). In the family context, a spouse, former spouse, or minor child who has a claim resulting from an agreement or court order for alimony, child support, or property division incident to a judicial proceeding with respect to a separation or divorce may potentially reach the assets of a DAPT,[2] but a spouse whom the client marries after creating the trust may not take advantage of this exception. Accordingly, an APT is a technique that works very well in conjunction with a prenuptial agreement. An APT can be created before marriage and then disclosed in a prenuptial agreement to ensure that it is walled off in the event of divorce.

## ALL PLANNING DOCUMENTS REQUIRE REVIEW

In the event of divorce, clients should review important planning documents and beneficiary designations to confirm that the chosen heirs and designees for healthcare and power of attorney documents are still appropriate. During the pendency of a divorce, in order to maintain the status quo and preserve marital property until final determination, parties may be prohibited from transacting financial affairs except in the usual course of business for customary and usual household expenses. Accordingly, clients should change the documents they are entitled to change immediately and be poised to change the balance as soon as they are permitted.

The following documents should be considered:

### Powers of attorney and healthcare directives

It is important to carefully review powers of attorney, which allow a designated person to conduct financial transactions, and healthcare directives, which allow a designated person to make important healthcare and potentially end-of-life decisions, to ensure that an estranged spouse is removed from those roles.

In some states (for example, Alabama, Connecticut, and Hawaii),[3] an agent's authority under a power of attorney terminates when an action is filed for the dissolution or annulment of the agent's marriage to the principal or their legal separation, unless the power of attorney provides otherwise. Best practice, however, would be to not rely on state default statutes but rather to proactively change documents to ensure that they reflect intent.

### Wills and trusts

These documents must be reviewed immediately. In most jurisdictions, a will can and should be changed as soon as possible, subject to state laws and prior agreement. Typically, unless a spouse has waived marital rights in an agreement, an individual cannot disinherit a spouse. However, in most states, it should be possible to modify a will to leave a soon-to-be ex-spouse the minimum amount required under state law or a marital agreement.

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2 Del. Code Ann. tit. 12, § 3573(1) (West, Westlaw through ch. 257 of 151st Gen. Assembly (2021-2022)).

3 Ala. Code § 26-1A-110 (West, Westlaw through end of 2021 Reg. Sess., end of 2021 1st Spec. Sess., and 2021 2d Spec. Sess.); Conn. Gen. Stat. Ann. § 1-350i (West, Westlaw through all enactments of 2021 Reg. Sess. and 2021 June Spec. Sess.); Haw. Rev. Stat. § 551E-6 (West, Westlaw through end of 2021 Spec. Sess.).

If an individual has been divorced and dies having failed to update their estate planning documents to reflect the divorce, some states revoke bequests to former spouses in wills or other estate planning documents. Many do not. Even if a so-called revocation-on-divorce statute does apply, those laws will be inapplicable during the pendency of the divorce, up until the time a final divorce decree is entered.

Additionally, some states (like New Jersey[4]) revoke any revocable dispositions or appointments of property to, and executor or trustee nominations of, a former spouse, as well as relatives of a former spouse. Other states (like New York[5] and California[6]) revoke all dispositions or appointments of property from the divorced spouse to the former spouse and all nominations of the former spouse as executor and trustee but do not extend the revocatory effect of divorce to the relatives of an ex-spouse. That distinction played a pivotal role in *In re Estate of Lewis*,[7] where the New York statute disqualified the decedent's ex-husband from inheriting under her will or acting as executor. However, the ex-husband's father (the decedent's ex-father-in-law) was the successor beneficiary and executor, and he was not disqualified under the terms of the statute. Presumably, the ex-husband would just inherit or obtain the property from his father, causing an end-run around the statute. While the court acknowledged this, it opined that the statute was clear and unambiguous in omitting the relatives of ex-spouses from disinheritance.

The lesson to be learned: the most prudent course of action is to not rely on state default law. Divorced spouses, spouses in the process of getting a divorce, and unmarried couples who are separated should give immediate attention to their planning documents to ensure that they reflect their intent (subject to elective share statutes and other legal restrictions).

### Retirement accounts and other beneficiary designations, such as life insurance

State laws that do provide for revocation on divorce may not apply to retirement plan beneficiary designations, which should be reviewed promptly. Spousal rights in retirement plans governed by the Employee Retirement Income Security Act of 1974 (ERISA) are subject to special rules. It is also important to reconsider designated beneficiaries of life insurance policies.

## TRUST DECANTING CAN BE A POWERFUL TOOL: REVISING AN OTHERWISE IRREVOCABLE TRUST

When irrevocable trusts are drafted in happier times and then times change, is it possible to reduce or even eliminate the interest of an ex-spouse or soon to be ex-spouse? Trustees potentially have access to powerful tools that might change beneficial interests.

Decanting is a technique that allows the trustee of an otherwise irrevocable trust to transfer the trust assets into a new trust with different terms. The rationale behind decanting is that a greater power should include a lesser power: if a trustee can make outright discretionary distributions to a beneficiary, then the trustee should also be permitted to do something less than an outright distribution and instead distribute trust assets into another trust for that beneficiary. Decanting can be a tremendous tool for dealing with changed circumstances, correcting mistakes, or optimizing a trust's administration. In the divorce context, a trustee might be able to use decanting to limit a beneficiary's interest or even eliminate a beneficiary.

*Ferri v. Powell-Ferri*[8] is a recent example of the power of decanting in the divorce context. Trust assets were successfully moved out of reach of a divorcing wife, although they were considered for alimony purposes. The husband was the beneficiary of a trust (the 1983 Trust) created by his father

4 N.J. Stat. Ann. § 3B:3-14 (West, Westlaw through L.2021, c. 253, and J.R. No. 3.).
5 N.Y. Est. Powers & Trusts Law § 5-1.4 (West, Westlaw through L.2021).
6 Cal. Prob. Code § 6122 (West, Westlaw through Ch. 770 of 2021 Reg. Sess.).
7 34 N.E.3d 833 (N.Y. 2015).
8 72 N.E.3d 541 (Mass. 2017).

under which he had the right to receive the trust assets at certain ages. The trust was valued between $69 million and $98 million. The trustees, who were concerned the divorcing wife would reach the trust assets, transferred the assets to a new trust (the 2011 Trust) without the husband's knowledge or consent. At the time the 2011 Trust was created, the husband had a right to request outright 75 percent of the 1983 Trust assets, and during the course of the legal proceedings, his right matured to 100 percent. The new 2011 Trust extinguished the husband's power to request trust assets at stated ages, making distributions solely discretionary with the trustees. The wife had filed to dissolve the marriage in Connecticut. The trusts were settled in Massachusetts. The Connecticut Supreme Court asked the Supreme Judicial Court of Massachusetts to determine whether the trustees, one of whom was the husband's brother, had validly exercised their powers under the 1983 Trust to distribute the trust property to the 2011 Trust. The Massachusetts court determined that since the father, who created the 1983 Trust, intended to convey to the trustees almost unlimited discretion to act, the decanting was authorized.

The Connecticut Supreme Court adopted the opinion of the Massachusetts Supreme Judicial Court.[9] Because the 2011 Trust was a spendthrift trust (protected from creditors), it was not considered an asset of the marital estate that the court could divide under Connecticut law. The wife's status was that of a creditor, and the court held that although the court could divide the assets while they were held in the 1983 Trust, it could not reach them after they were moved into the 2011 Trust. Thus, the decanting was successful in removing the assets from division.

## SOME FURTHER THOUGHTS ABOUT DECANTING

Note that about half the states in the United States provide statutory authority to decant. Most states require that notice be given to beneficiaries. It was important in the *Ferri* case that the decanting occurred without the husband's permission, knowledge, or consent. Query if the same result would follow if a beneficiary were given notice of the decanting, or whether notice alone would not detract from the Connecticut Supreme Court's holding that the husband took "no active role in planning, funding or creating the 2011 Trust."[10]

Including decanting provisions in trust instruments may maximize flexibility without resort to state default law. Indeed, in a recent New York case, *Davidovich v. Hoppenstein*,[11] the trustees successfully relied on their powers under a trust document to distribute a life insurance policy on the settlor's life to a new trust that excluded an estranged daughter of the settlor and her issue. Dismissing an objection that the transfer did not satisfy the requirements of the New York decanting statute, the court held that the statute had no bearing on the case since the trustees relied on their powers under the document to effectuate the transfer.

## HAVING THE RIGHT MULTIDISCIPLINARY TEAM IS KEY

Issues surrounding asset protection in divorce are complex and nuanced. Having the right multidisciplinary team of experts, including an investment advisor, trusts and estates attorney, and matrimonial attorney, is key to optimizing asset protection planning before, during, and after marriage.

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9 Ferri v. Powell-Ferri, 165 A.3d 1137 (Conn. 2017).
10 *Id.* at 1148 (emphasis added).
11 79 N.Y.S.3d 133 (N.Y. App. Div. 2018).