REVOKING THE IRREVOCABLE TRUST IN A DIVORCE OR NEVER SAY CAN'T, SAY DECANT

By: Atty. Jonathan Fields

Even with Pfannenstiehl behind us, the complex interplay of the irrevocable trust and divorce continues to vex practitioners. The topic du jour is decanting and divorce -- and the SJC just dove right in with the Ferri case. Before we go further, a quick primer. Decanting is the process of pouring assets from an irrevocable trust into a newly created trust.

The big question at the heart of decanting and divorce: what if, during (or anticipating) a divorce, the trustee decanted the assets into a newly created trust that was, say, more divorce-proof than the original trust?

But, before we dive into that issue, a bit more about decanting. When can a trustee decant the assets in an irrevocable Massachusetts trust to another trust?

Since Massachusetts, unlike other states, has no decanting statute, we look to case law and, in particular, *Morse v. Kraft*, 466 Mass. 92 (2013). Essentially, the case involved an irrevocable trust created by Robert Kraft which contained four sub-trusts, one for each of the donor's sons who were very young when the trust was created in 1982. The sub-trusts were administered by a trustee, Morse, and, under the trust terms, the sons could not participate in any distribution decisions. Now that the children were all in their forties and financially sophisticated, Morse wanted to delegate his trustee powers to them.

Since the trust gave Morse no explicit right to decant and Massachusetts has no decanting statute, Morse filed a petition asking the court to interpret the trust's language as authorizing decanting without court approval.1

The SJC agreed with Morse's position – that the trust authorized him to decant.

In its analysis, the SJC reminds practitioners that, in interpreting a trust, the donor's intent is the paramount consideration. Here, because the trust gave Morse broad discretion to make outright distributions to or for the benefit of the beneficiaries, the SJC concluded that the discretion, therefore, encompassed a distribution to a new trust if doing so would serve the beneficiaries' best interests. In addition to considering the language of the trust, the Court also relied on affidavits from the donor, the drafter, and Morse to the effect that each intended the trustee to have the right to decant.

Notably, the *Morse* court put on notice drafters of future, post-Morse, trusts: if you want a trustee to have a right to decant, you would be best served by articulating that power in the trust.

With that brief background, let us return to the main issue -- decanting the assets during a divorce to a more divorce-proof trust.
So, let's dispose of the easy case first: with a post-Morse Massachusetts irrevocable trust without an explicit power to decant, it is likely that decanting would not be permissible.

With a pre-*Morse* Massachusetts irrevocable trust without an explicit power to decant, we look to *Morse v. Kraft*. That is, a trustee may well be permitted to decant if the trustee's discretion is sufficiently broad to make outright distributions to or for the benefit of the beneficiaries, if it is in line with the donor's intent, and it is in the beneficiaries' best interests.

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A recent SJC case, Powell Ferri, involved a Connecticut divorce and an 1983 pre-Morse irrevocable Massachusetts trust that did not articulate an explicit decanting power for the trustee. The trustee decanted to another trust in the context of a divorce. The Connecticut Supreme Court certified three questions to the SJC -- the essence of the inquiry for our purposes was that they sought a ruling on whether the trustee had the power to decant per the terms of the 1983 trust.

Reviewing the trust language in detail, which is beyond our scope here, the SJC found that the trustee's powers were broad enough to encompass the authority to decant. Notable, too, was the SJC's reliance on the affidavit of the settlor who stated his intention that the trustee have the authority to decant, particularly in light of the pending divorce and the need to protect the trust assets from the wife as a potential creditor. The Connecticut Supreme Court found that because the husband was unaware of the decanting, it did not violate that state's public policy.

That does not mean this would work in Massachusetts, the concurrence made clear to point out. Whether such a decanting would violate state public policy remains an open question not reached by the Court because it was outside the scope of the certification.

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What if the decanting occurs in the context of a divorce?

Consider a 2005 Massachusetts irrevocable trust set up by Richard and Cindy Smith for the benefit of their daughter, Wendy Smith, who is now anticipating a divorce from her husband Dana Jones. The 2005 Trust contains an ascertainable distribution standard (i.e. “Trustee must consider Wendy’s health, education, and welfare in making distributions.”) Assume that this provision, among others, bring the trust within the marital estate for purpose of equitable distribution under G.L. c.208 s.34. The trustee, Gabe Johnson, wants to decant the assets of the irrevocable trust to another irrevocable trust. The terms are virtually identical except that the distribution standard in the new trust gives the trustee “absolute discretion” in making distributions to Wendy. This “absolute discretion” standard, let us assume, takes the trust out of the marital estate.

If Gabe Johnson, the trustee, petitions the SJC, as Morse did, how does he make the case? On the one hand, the distribution standard is more restrictive to Wendy. On the other hand, it arguably protects her from the vagaries of divorce. Assume, similar to Morse, that Wendy’s

parents, the donors, submit an affidavit that they intended the trustee to have the power to decant. Gabe Johnson, the trustee, further argued, similar to the trustee's argument in Morse, that Wendy was not married at the time the trust was created, and that since she is now married, they want to protect her in the event of a divorce. Is that analogous to the Kraft boys not being financially mature enough to handle money when they were minors but, in their forties, they are? Might the SJC grant the petition? Let's imagine the trustee succeeds and the SJC grants the petition.

In the ensuing divorce, Wendy argues that the trust is outside the marital estate because, among other reasons, she has no ability to reach the monies – after all, she argues, the trustee has absolute discretion. Dana, her husband, encourages the court to consider the equities of the case; since the decanting occurred on the eve of the divorce, he argues, the trust should be included in the estate. Dana cites *Pfannenstiehl* where the court was impressed, in part, by the trustee shenanigans in continuing to distribute to all the other siblings except the divorcing spouse.

Dana argues, alternatively, that assuming the trust is out of the estate, the Court should give him more of the available assets. Or, failing that, Dana could argue that he receive a portion from the trust on an "if, as, and when" basis. Or, he could take an even more aggressive position and seek a present division, as in *Pfannenstiehl*.

Whatever the outcome, and considering the uncertainty, it is a lot of trouble to go through in order to decant the assets from a pre-Morse trust that has no explicit decanting provision.

Many of our cases involve parents setting up trusts in their home states for their adult children who live in Massachusetts. Consider, then, the same Massachusetts couple, Wendy and Dana, except that the trust involved is one from State X – a state with a decanting statute.

What do the decanting provisions from other states look like? And how might that impact a decanting in anticipation of a divorce – or, even mid-divorce?

In most states, it is common to restrict the beneficiary class to those identified in the original trust. Indeed, Morse supported this principle.

See Wareh & Dorsch, *Decanting: A Statutory Cornucopia*, Trusts & Estates, March 2012, 24 ("no state permits the direct addition of a new beneficiary").2

Most decanting statutes are silent on whether a distribution standard may be changed through decanting. See Wareh & Dorsch, supra, at 26. Alaska, Delaware, New York, North Carolina and Ohio do not permit the trustee to change distribution standards.
In the 22 states with decanting statutes, what authority must the trustee have in order to decant?

Some states are very restrictive. Florida, Ohio, Indiana, and Rhode Island, require a trustee to have “absolute” power to invade principal in order to decant.
Other states are less restrictive. Alaska, Delaware, Illinois, Michigan, New York, North Carolina, South Carolina, South Dakota, Texas, and Virginia, permit a trustee to decant provided the trustee has discretion to distribute income or principal. In all of these states (except South Dakota), however, the distribution standard in the new trust must be the same as in the old trust.

In South Dakota, a trustee can decant from a trust with an ascertainable standard into a wholly discretionary trust – arguably taking the trust out of Wendy’s and Dana’s marital estate and wreaking more than a bit of havoc in their Massachusetts divorce.
Some states are quite permissive. In Arizona, Kentucky, Missouri, Nevada, New Hampshire, Tennessee, Wisconsin, and Wyoming the trustee’s distribution standard is irrelevant. A trustee with any power to distribute principal may decant those assets in further trust for the beneficiary.

In a recent unpublished Connecticut case, interpreting Massachusetts trust law, the parties (let’s call them Wendy and Dana) were involved in a divorce and the trustee decanted a substantial portion of the assets from a Massachusetts trust that permitted Wendy to withdraw principal to a Connecticut trust that prohibited such withdrawals without the trustee’s approval. *Ferri v. Powell-Ferri*, 2103 Conn.Super. LEXIS 1938, 2013 WL 5289955 (Conn.Super. 2013). Presumably, this would

advantage Wendy in her divorce by removing the asset from the marital estate. The Superior Court judge found that the elimination of Wendy's withdrawal rights was a radical deviation from the original trust and, therefore, the second trust could not stand.

No matter the trust situs, Dana should pay careful attention to whether the interest decanted is a vested one. For example, an irrevocable gifting trust might grant withdrawal rights to a beneficiary which vest over time. Indeed, in *Ferri*, the beneficiary had a vested withdrawal right in 75% of the trust assets at the time the action was commenced. The Court noted, therefore, that these assets were unquestionably divisible marital property under Connecticut's equitable distribution statute. The same analysis would apply to our own G.L. c.208 s.34.

As decanting becomes more widespread nationwide, the issue is likely to surface in more of our cases that involve local or out-of-state trusts. The recent *Morse* case was welcome guidance to practitioners and, perhaps, the legislature will step in to clarify further. In any event, in this evolving area, as family law practitioners and mediators, we should be reasonably versed so that we are able to identify the issues for our clients

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1 Further, although it is beyond the scope of this article, this approval was necessary in order to qualify the new trust as grandfathered under the Generation Skipping Tax rules.

2 Query whether in Massachusetts a trustee could decant the assets to a second trust with additional beneficiaries if the trust language, donor intent and/or credible testimony indicated that a material purpose of the trust was that it was intended to be "divorce-proof." Although in that case, where Wendy's interest was diluted, it is difficult to see how that would be in her best interest simply because it devalues a potential marital asset that may be shared with her husband Dana.