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Steve Leimberg Asset Protection Newsletter

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CHALLENGING THE JUDGE

THE MASSACHUSETTS APPEALS COURT CONTINUES TO MAKE ITS OWN RULES OF TRUST LAW

Introduction

When we as advisors set out to develop an estate plan with asset protection components , we take a careful look at the applicable statutes and established case law, and, if we are careful to remain within the settled law, we can be pretty sure the plan will work – unless a court decides to ignore or disregard the settled law. That's exactly what happened in a recent Massachusetts Appeals Court decision. And this is the second time this court has done so, the first, fortunately, having been reversed by the Massachusetts Supreme Judicial Court as noted below. Will this one be reversed?

Summary

The Massachusetts Appeals Court has done it again. It has disregarded and casually cast aside one of the most important well-settled and commonly used principals of trust law – the spendthrift trust – in order to justify its decision in a divorce case involving a 'third party" trust (one settled by someone other than the beneficiary). Four years ago, the same court gained national attention when it held that a husband's fractional share of assets in an irrevocable spendthrift trust established by his father for the husband and ten other beneficiaries should be treated as part of the marital estate for purposes of equitable division.[1] On appeal to the Supreme Judicial Court, the highly criticized ruling was reversed.[2] In the subject case[3], the Appeals

Court again felt it could justify its similarly aggressive holding on the basis that this time there was only one (lifetime) beneficiary of the irrevocable spendthrift trust in question rather than eleven. Thus, the beneficiary's interest in the trust was more than an "expectancy", and despite decades of law upholding the spendthrift provision, that would justify disregarding the spendthrift provision and treating the entire trust fund as a "marital asset subject to equitable division".[4]

Facts

Amy Levitan was the sole lifetime beneficiary of an irrevocable trust established by her father decades ago under Florida law. On Amy's death, the trust remainder would be held for her five children. Amy had the right to withdraw 5% of the corpus annually. The trust included a spendthrift provision, and the independent trustee was given authority to distribute to Amy "as much of the income and principal" as he "deems advisable". On Amy's death, the remainder was to be held for her children, with outright distribution when there is no living child under age twenty-five. There was no ascertainable standard for distributions; distributions were at the sole discretion of the trust. The trust contained just under $1.7 million in assets; while the husband's main asset (a retirement plan) was just under $130,000). At trial, the lower court found that the 5% withdrawal right was not subject to the spendthrift provision of the trust, and was a marital asset since it was more than a mere expectancy. The judge awarded the 5% to the wife, and the husband kept his retirement account. The spendthrift trust itself was excluded from the marital estate.

On appeal, the Appeals Court noted that "[t]he central issue at trial was whether the wife's trust share was includable in the marital estate for purposes of equitable distribution under Mass

G.L.c. 208, §34."[5] The trust was a Florida trust, but the trial court stated in a footnote that "Florida law appears to be consistent with Massachusetts law in all marital respects on the question of the enforceability of the spendthrift provision".[6]

Massachusetts law is quite clear on the spendthrift doctrine, that doctrine having been established over a hundred years ago in the case of *Broadway National Bank v. Adams*,[7] following the U.S. Supreme Court decision in *Nichols v. Eaton*[8]. In the *Broadway National Bank* case, the court stated:

> The rule of public policy which subjects a debtor's property to the payment of his debts, does not subject the property of a donor to the debts of his beneficiary, and does not give the creditor a right to complain that, in the exercise of his absolute right of disposition, the donor has not seen fir to give the property to the creditor, but has left it out of his reach.[9]

And this doctrine has been repeated countless times in cases across the United States. *In re Morgan's Estate*[10], for example the court said:

> When a trust of this kind has been created, the law holds that the donor has an individual right of property in the execution of the trust; and to deprive him of it would be fraud on his generosity. For the law to appropriate a gift to a person not intended would be an invasion of the donor's private dominion. It is always to be remembered that consideration for the beneficiary does not even in the remotest way enter into the policy of the law. It has regard solely to the rights of the donor. Spendthrift trusts can have no other justification than is to be found in considerations affecting the donor alone. They allow the donor to so control his bounty, through the creation of the trust that it may be exempt from liability for the donee's debts, not because the law is concerned to keep the donee wasting it, but because it is concerned to protect the donor's right of property.[11]

Nevertheless, Massachusetts courts presiding over divorce cases seem to be repeatedly seeking to disregard the underlying concept of the spendthrift doctrine by making aggressive, if not unsupported attempts to distinguish spendthrift trusts in one way or another and rule that the spendthrift trust assets are "a marital asset subject to division". Granted, depending on the provisions of the trust, it may be that assets are "available" to a spouse and therefore should be

considered. This was one of the reasons for the lower court's ruling in the *Pfannenstiehl* case.[12] The trust contained an "ascertainable standard" (health, education, maintenance) and therefore, the non-beneficiary spouse argued, could be enforced by a beneficiary. In that case, the Appeals Court's decision was reversed, because the "standard" was not held enforceable, rather it simply operated as a restriction on the trustee. Also, there were eleven discretionary beneficiaries, and it was impossible to calculate at any point what would be available to the divorcing spouse/beneficiary. Further, as benefits were paid out to others, any "share" of the spouse would be thereby reduced. The Appeals Court's *Pfannenstiehl* case was the subject of widespread criticism for the court's disregard of basic, well-settled trust law.[13]

In the present case, we see a similar disregard in order to reach a desired result. The court argued, for one thing, that "the mere fact a trustee's discretion is 'uncontrolled' (i.e. not governed by an ascertainable standard) does not necessarily preclude a trust's inclusion in the marital estate".[14] To support this position the Appeals Court cites *Davidson v. Davidson*. [15] In the *Davidson* case[16], while there was no ascertainable standard, in fact, the subject property interest was vested in the spouse who also had the sole remainder interest in the trust property. Famously, the *Davidson* court stated " …. Implicit in our appellate decisions is the rejection of the notion that the content of the estates of divorcing parties ought to be determined by the wooden application of technical rules of the law of property."[17] In this case, Amy's children are the remainder beneficiaries, and despite the broad discretion given to the trustee (even to the extent of "complete exclusion of the remaindermen"), no reasonable trustee would exhaust the principal to the exclusion of the remaindermen. Thus, Amy had no right (other than her limited right of withdrawal) to demand principal; she and her creditors (which the trust specifically stated would include her spouse), were precluded from recovery by the trust's spendthrift

provision. An attack or claim by any creditor other than a spouse would have been rejected out of hand by the Massachusetts courts. Nevertheless, the Appeals Court held that Amy's interest was not speculative, was not "subject to reduction", and was more than a mere expectancy. Thus, it was property "considered as an asset subject to equitable distribution under § 34".[18]

But, then a surprise! The Appeals Court concluded that the spendthrift provision in this trust, especially because of the power of the trustee to withhold a distribution, required the entire trust to be "awarded" to Amy. No equitable division at all, including Amy's withdrawal right. The case was remanded to the trial court to decide upon the equitable division of the remaining marital assets (basically the husband's retirement account).

Interestingly, this ruling itself may provide a planning opportunity (but not for trusts in Massachusetts where a divorce is involved). That is to say, the trustee's power to withhold an otherwise permissible withdrawal by a beneficiary could be regarded, as the court did here, as a power of appointment (held by the beneficiary) subject to the consent of the trustee (the power to withhold). Such an arrangement could prevent a creditor from reaching the share that is subject to a beneficiary's withdrawal right.

Here, however, that treatment did not change the court's decision that the entire trust was a part of the marital estate. The court's reasoning was that the spouse is a form of "super-creditor", and although the spendthrift provision would (we hope) prevent any <u>other</u> creditor from reaching the trust assets, the reach of §34 extends beyond certain principals of trust and property law (see quote above from the *Davidson* case) to allow a creation of marital asset based on what the court determines is equitable.

For planning purposes, then, one thing is clear, at least in Massachusetts, or until this decision is reversed, settlors of third party trusts should consider adding one or more discretionary beneficiaries, and perhaps crafting the trust as generational, and perhaps also adding a special power of appointment. (And maybe even a trust protector) The addition of beneficiaries would require the court to follow the *Pfannenstiehl* rule, and the presence of a power of appointment would allow the quick emptying of the trust to another trust, which could remove the assets from an order that the third party spendthrift trust is a marital asset subject to equitable division. So, too, should the drafter consider the addition within the spendthrift clause of the power in an independent trustee to withhold an otherwise mandatory distribution.

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[1] Pfannenstiehl v Pfannenstiehl, 88 Mass App. Ct. 121 (2015)
[2] Pfannenstiehl v Pfannenstiehl, 475 Mass. 105, 55 N.E.3d 933 (2016)
[3] Levitan v Rosen, Mass. Appeals Court No 18-P-847, May 6, 2019
[4] Id. at 13
[5] Id. at 5
[6] Id. at 7, footnote 8
[7] 133 Mass. 170 (1882)
[8] 91 U.S. 716 (1875)
[9] Supra note 7 at 173
[10] 233 PA 228 (1909)
[11] Id. at 230
[12] Supra note 1
[13] See e.g. Leimberg Asset Protection Newsletter – Archive Message #315, Mark Chorney, and Newsletter #307, Gideon Rothschild and Daniel Rubin
[14] Supra note 3 at 11
[15] Supra note 3 at 11
[16] 19 Mass. App. Ct. 364 (1985)
[17] Id. at 371
[18] Supra note 3 at 13