

Trusts in Divorce Property Divisions

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I. **Introduction.**

With increasing frequency, beneficial interests in third party settled trusts are being included in the pool of assets divisible on divorce. Historically, the law of trusts did not evolve to deal with such divisions because it was unnecessary. At common law, property was divided at divorce strictly in accordance with the title of the property and the courts had no authority to dispose of property in any manner other than by title.¹ Thus, even if a beneficial interest in trust was considered “property” on divorce, the common law title rule would have compelled a court to award the interest to the beneficiary spouse. Although lump sum alimony sometimes mitigated the harshness of the common law title rule, inequitable results occurred.²

A. **Equitable Distribution Statutes.**

By the mid-1980s, as a result of the inequities caused by the common law title rule, almost all of the common law states abandoned the title rule and

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¹ PRINCIPLES OF THE LAW OF FAMILY DISSOLUTION: ANALYSIS AND RECOMMENDATIONS, THE AMERICAN LAW INSTITUTE, (hereinafter “PRINCIPLES OF LAW OF FAMILY DISSOLUTION”) 23 (Lexis 2002).

² In *Fisher v. Worth*, 326 N.Y.S.2d 308 (N.Y. App. Div. 1971), the husband, in a marriage of long duration pursued a “crash savings program” and told the wife that the savings would be “for our latter days” and for “the two of us.” *Id.* at 310. All of the wife’s earnings and some of the husband’s were used for expenses, but most of the husband’s earnings were saved. The savings were titled in the husband’s name and were awarded to him. The court was unwilling to impose a constructive trust on the husband’s property.

enacted some form of equitable distribution, which generally permits a court to divide the property between the spouses equitably.³ Statutes authorizing equitable division are sometimes referred to as “enabling statutes” because they authorize a court to transfer property in a manner not otherwise allowed by law. Generally, the enabling statutes do not alter a state’s property law by creating new classes of property. Instead, they recognize equitable claims on property which arise as a consequence of marriage.

Although the common law title rule has been uniformly abolished, there is no consensus among the enabling statutes as to how equitable distribution is to be accomplished. One general approach, sometimes referred to as the “Alternative A” approach,⁴ or the “all property” approach, allows the divorce court to include in the pool of divisible assets all property owned by the spouses (including property acquired before the marriage, and property acquired by gift, inheritance, devise and descent), and divide that property between the spouses. States adopting this approach constitute a substantial minority.⁵

A second approach, referred to as the “Alternative B” approach,⁶ requires the court to first classify property as either “separate”(sometimes referred to as “nonmarital”) or “marital.” Marital property is typically defined as property acquired subsequent to marriage, except by gift, bequest, devise, and descent.⁷ There are substantial differences in Alternative B jurisdictions as to the treatment of accretion to and income from separate property. Colorado, for example, includes within marital property the

³ See PRINCIPLES OF LAW OF FAMILY DISSOLUTION, §4.02 Reporter’s Note, cmt.a. All non-community property law states have since adopted some form of equitable distribution. *Id.* Community property law systems recognize the contribution of both spouses to acquisitions during marriage, and although the states differ in their approach, all provide for the division of community property at divorce.

⁴ Alternative A is set out as such in the UNIFORM MARRIAGE AND DIVORCE ACT (hereinafter “UMDA”) § 307 (1970).

⁵ See *e.g.*, CONN. GEN. STAT. § 46b-81 (2009), MASS. GEN. LAWS Ch. 208, § 34 (2009), IND. CODE § 31-15-7-4 (2009), and OR. REV. STAT. § 107.105(1)(f) (2009).

⁶ Alternative B is set out as such in UMDA § 307.

⁷ See *e.g.*, COLO. REV. STAT. § 14-10-113 (2009), FLA. STAT. § 61.075(6)(b)(2) (2009), M.R.S. tit. 19 § 953 (2009); and N.Y. DOM. REL. LAW § 236(B)(1)(d)(1) (2009).

increase in and income from separate property.⁸ By comparison, the New York statute includes within the definition of separate property of a spouse the increase in the value of separate property, except to the extent that such appreciation is due to the contributions of the other spouse.⁹

State legislatures have also adopted a variety of hybrid approaches. The Arkansas statute, for example, requires, as a general rule, that the court award separate property to its owner, unless the court makes some other division deemed equitable, taking into consideration facts enumerated in the statute.¹⁰

B. Community Property Jurisdictions.

There is also a lack of uniformity in the property division statutes of the community property law states. California law, as an example of one approach, does not permit the court to award the separate property of one spouse to the other and requires that community property be awarded equally.¹¹ In addition, and as discussed below, rents, issues and profits derived from separate property remain separate property under California law.¹² Washington law on the other hand, has adopted an approach similar

⁸ COLO. REV. STAT. § 14-10-113(4) (2009) and *In Re Marriage of Footitt*, 903 P.2d 1209 (Colo. Ct. App. 1995).

⁹ N.Y. DOM REL. LAW § 236(B)(1)(d)(3) (2009). The New York statute is discussed below. Missouri's statute similarly excludes appreciation of non-marital property (such as property received by gift, bequest, devise or descent) from the pool of divisible assets, unless marital assets, including labor, have contributed to such increases and then only to the extent of such contributions. MO. REV. STAT. § 452.330.2 (5) (2009). However, income received from non-marital property subsequent to marriage is marital property. *Moore v. Moore*, 189 S.W. 3d 627 (Mo. Ct. App. 2006).

¹⁰ ARK. CODE § 9-12-315(a)(2) (2009). Included in a spouse's separate property under the Arkansas statute is the increase in value and the income from separate property. ARK. CODE § 9-12-315(b) (2009). Alaska has adopted a similar approach. *See* ALASKA STAT. § 25.24.160(4) (2009).

¹¹ CA. FAM. CODE § 2550 (2009) and *Fox v. Fox*, 117 P.2d 325 (Ca. 1941). But apportionment between separate and community property may be required when a spouse's separate property is increased by that spouse's skill, expertise or industry. *See* *Pereira v. Pereira*, 103 P. 488 (Ca. 1909).

¹² CA. FAM. CODE § 770 (2009).

to the Alternative A approach under the UMDA by including in the pool of divisible assets all of the parties' property, both community and separate, and allowing the court to make a disposition as "shall appear just and equitable."¹³

C. Expanding Definition of Property and Impact on Trusts.

The property division statutes can apply only to the property of the spouses. Again, there is a lack of uniformity among the states as to what should be included as "property" subject to division. Notwithstanding the lack of uniformity, it is indisputable that the courts are including new types of property and interests in the pool of assets to be divided. Retirement benefits, intellectual ideas, employment perquisites, professional degrees and licenses, celebrity goodwill, and a variety of other assets have been increasingly included in that pool and divided by the courts.¹⁴ "Twenty-plus years ago, many jurisdictions ignored pensions as mere contingencies and not deferred wages. Pensions were typically excluded from property settlements."¹⁵ Today, every state considers equitable division of pensions.¹⁶ As subsequent discussion will demonstrate, interests in trusts have been swept into the expanding pool of divisible assets in many states.

A trust can be a complex package of present and future rights, powers, and interests, which are not necessarily fixed. If a trust is included in the pool of divisible assets on divorce, the trust instrument must be interpreted, its various interests quantified, and the value divided and awarded. Although the process and division may reflect the concept of marriage as a shared enterprise or partnership, this process and division will likely run counter to the intent of the settlor of the trust and may require the participation of third parties, such as family members of a beneficiary spouse, in the

¹³ REV. CODE WASH. § 26.09.080 (2009).

¹⁴ See ROBERT D. FEDER, VALUATION STRATEGIES IN DIVORCE, Ch. 8 (4th ed. 1997 & Supp. 2008). See also, J. Thomas Oldman, *Changes in the Economic Circumstances of Divorces, 1958-2008*, 42 FAMILY L. Q. 419 (2008). "Today's courts construe the concept of what constitutes "property" that is capable of division more broadly than in the past." *Id.* at 430.

¹⁵ GARY A. SHULMAN & DAVID I. KELLEY, DIVIDING PENSIONS IN DIVORCE § 1.1 (2d ed. 1999 & Supp. 2008).

¹⁶ See *Id.*

proceedings. Those family members may view the process as an unjustified appropriation of a family's wealth.

D. Colorado Law: Trend or Anomaly.

The body of law regarding division of trusts on dissolution of marriage is too indistinct to say that the law of any one state represents a general rule. However, Colorado law and practice illustrate the struggle courts and practitioners have had with such divisions and the lack of a stable framework for dealing with such divisions. As a result of recent developments in Colorado law, and the increasing frequency of trust interest divisions in the Colorado trial courts, Colorado seems to be positioned on the forefront in this area of the law. Thus, much of the following discussion will consider Colorado law. Only time will tell if Colorado's experience with these issues constitutes an emerging trend or an anomaly.

E. Impact on Trusts and Estates Practice.

When interests in trusts are subject to a divorce court's dispositional power, the court and the spouses' matrimonial lawyers will require assistance in deciphering trust instruments and valuing temporal interests. Trusts and estates practitioners will be called upon to assist with those tasks as both advisors to the divorcing spouses and as expert witnesses. Trusts and estates practitioners will also be called upon to assist trustees and other trust beneficiaries presented with requests for discovery of information regarding such matters as the nature and value of trust assets, trust distributions, tax returns, and the resources of beneficiaries who are currently eligible to receive trust distributions. Document drafting decisions for trust instruments and advice as to trust administration may also be impacted by the stability of a beneficiary's marriage, the likelihood of a beneficiary having an enduring marriage, and the current or future residency of a beneficiary. Lastly, the urgency of a marital agreement may be affected by this body of law as it exists in a state where a beneficiary resides or might reside in the future.

II. Interests in Trusts as Property.

The law regarding treatment of interests in trusts as divisible property on the dissolution of marriage is diverse and may be determined both statutorily and judicially. The operation of a state's property division statute may preclude or limit the inclusion of beneficial interests in trusts in the pool of assets to be divided. Some courts have held that an interest in trust is not considered property until the interest becomes possessory (the beneficiary has received or has a present

right to withdraw the trust property). Other courts have determined that certain remainder interests constitute property in situations where the trust instrument requires an outright distribution to a beneficiary during the beneficiary's life. Yet other decisions treat interests in trusts as divisible, regardless of whether the interest is fully distributable to a beneficiary at some point in time. Income interests in third party settled trusts have generally not been considered to be property of a spouse for property division purposes, but there is an apparent minority rule to the contrary. Logic would seem to require, and courts have held, that beneficial interests in third party settled revocable trusts should be excluded from the pool of divisible assets, but surprisingly, there are at least two instances where courts have decided otherwise. Assets held in self-settled trusts, as a general rule, are included in the pool of divisible assets, but again, there exists authority to the contrary. Logic would again seem to dictate, and it has been held, that a nongeneral power of appointment is not property for purposes of division, but authority to the contrary exists in this area as well. All of those topics are discussed below.

A. Interests Excluded or Limited by Property Division Statute.

The inclusion of beneficial interests in third party settled trusts in the divisible pool will not arise, or is unlikely to arise, in states that exclude increases in the value of separate property from property divisions.

1. California Statute.

Separate property of a married person is defined by California statute to mean: "all property owned by the person before marriage; all property acquired by the person after marriage by gift, bequest, devise or descent; and the rents, issues and profits from [the above]."¹⁷ All property, real or personal, wherever situated, except separate property, acquired by a married person during the marriage while domiciled in California is community property.¹⁸

On divorce, unless otherwise agreed to in writing or stipulated in court, the community estate is divided equally.¹⁹ The California statutory regime does not permit divorce courts to award the

¹⁷ CAL. FAM. CODE § 770 (2009).

¹⁸ CAL. FAM. CODE § 760 (2009).

¹⁹ CAL. FAM. CODE § 2550 (2009).

separate property of one spouse to the other.²⁰ Thus, the determination in a California divorce proceeding that an interest in a third party settled trust constitutes separate property, or does not constitute property in any respect for purposes of property division, is typically unnecessary because the appreciation of the trust assets, even if separate property, may not be divided by the court.²¹

a. **Washington Law Compared.**

Separate property in Washington, a community property jurisdiction, includes property acquired before marriage, property acquired by gift, bequest, devise or descent and rents, issues and profits thereof.²² In this respect, Washington law is similar to that of California, but unlike California law, all of the property of the parties is subject to division in Washington.²³ Whether an interest in trust is potentially subject to division in Washington would therefore turn on whether the interest in trust constitutes “property” under the property division statute. Property under the Washington statute is defined broadly, “‘embracing everything that has exchangeable value, and every interest or estate which the law regards of sufficient value for judicial recognition.’”²⁴

²⁰ See *Fox v. Fox*, 117 P.2d 325 (Ca. 1941).

²¹ Where, however, a spouse’s separate property has increased in value as a result of that spouse’s marital labor, an apportionment between separate and community property may be required and some portion of the appreciation and profits of the separate property should be allocated to community property. See *Pereira v. Pereira*, 156 Cal. 1, 103 P. 488 (1909).

²² REV. CODE WASH. § 26.16.010 (2009).

²³ REV. CODE WASH. § 26.09.080 (2009).

²⁴ *In re Marriage of Harrington*, 935 P.2d 1357, 1365 (Ct. App. Wa. 1997), quoting *York v Stone*, 34 P.2d 911, 913 (Wa. 1934). In *Harrington*, a one-third interest in an apparent credit shelter trust established by the wife’s deceased father was determined by the trial court to constitute the wife’s separate property. The interest was valued by the court and awarded to the wife. The treatment of the trust by the trial court was not appealed and the terms of the trust were not disclosed.

Washington appellate court authority indicates that such divisions are possible.²⁵

2. New York and Florida Law.

At first glance, New York's equitable division statute would seem to exclude interests in third party settled trusts from a property division. The relevant statutory provisions state that marital property shall be "distributed equitably between the parties, considering the circumstances of the case and of the respective parties"²⁶ and that "separate property shall remain such" (in other words, separate property shall not be divided).²⁷

Marital property is defined in New York as "property acquired by either or both spouses during the marriage... regardless of the form in which title is held."²⁸ Separate property is defined as "property acquired before marriage, or property acquired by bequest, devise, or descent, or gift from a party other than the spouse."²⁹ Also included in the definition of separate property in New York is "property acquired in exchange for, or the increase in value of the separate property, *except to the extent that such appreciation is due in part to the contributions or efforts of the other spouse* (emphasis added)."³⁰

In most instances, it would seem that appreciation of trust assets will not be caused in any part by the contributions or efforts of the non-beneficiary spouse. Where trust assets consist entirely of

²⁵ Harrington, 34 P.2d 911. In *In re Marriage of Irwin*, 822 P.2d 797 (Ct. App. Wa. 1992), an interest in trust was also considered as property, but apparently, litigation was delaying the distribution of the trust that was fully distributable by its terms.

²⁶ N.Y. DOM. REL. LAW § 236(B)(5)(c). (2009)

²⁷ N.Y. DOM. REL. LAW § 236(B)(5)(b) (2009).

²⁸ N.Y. DOM. REL. LAW § 236(B)(1)(c) (2009).

²⁹ N.Y. DOM. REL. LAW § 236(B)(1)(d)(1) (2009).

³⁰ N.Y. DOM. REL. LAW § 236(B)(1)(d)(3) (2009). Income from separate property is also separate property. *Sauer v. Sauer*, 459 N.Y.S.2d 131 (N.Y. App. Div. 4th Dept. 1983).

passive-type, assets, or where the trust and trust assets are administered and managed by neither of the spouses, the New York statute would seem to place the trust beyond the equitable division power of the court.

But not every third party settled trust appears to be beyond the reach of a New York court's equitable division power. In *Hartog v. Hartog*³¹ a portion of the appreciation in the husband's closely held business interests, which constituted his separate property, was transmuted to marital property. The husband claimed his activities in the businesses amounted to "paper participation" only, that his involvement in the businesses was "meager" and had no actual impact on the appreciation in the value of the businesses.³² The husband's brother or others had primary responsibility for the day to day management and operation of the businesses. Although the husband was an officer and director of the corporations, he worked full time in a different business.³³

The court held that transmutation of appreciation of husband's separate property interests occurred and that a non-titled spouse need not prove a definite and direct nexus between the titled spouse's activities and the appreciation. The wife, as the non-titled spouse, was a "traditional homemaker, serving in the roles of spouse, parent, housekeeper and hostess."³⁴ Citing *Price v. Price*³⁵ as precedent, the court determined that the non-titled spouse's indirect contributions in those roles were a sufficient nexus to cause appreciation of the separate property to constitute marital property.

Beneficiaries of trusts frequently serve as trustees and it is not uncommon for trusts to hold assets which require active management and participation. In an effort to document bonafide business purposes, the organizational documents of many closely

³¹ 623 N.Y.S.2d 537 (Ct. App. N.Y. 1995).

³² *Id.* at 542.

³³ *Id.* at 541.

³⁴ *Id.* at 540.

³⁵ 511 N.Y.S.2d 219 (Ct. App. N.Y. 1986).

held entities, such as family limited partnerships, attempt to negate the inference that the entity is passive in nature. Moreover, in response to federal estate tax developments beyond the scope of these materials, it is often preferable for younger family members to serve as the general partners and managers of family limited partnerships and family limited liability companies. Thus, the structure of a closely held entity, interests of which are held in trust, in the most advantageous way for estate tax purposes has the potential of subjecting an interest to the claim of a non-beneficiary spouse in a state with a division statute like New York's. Although research has not revealed New York authority addressing management of trust assets as the reason for inclusion of a trust in the marital estate, the door appears to be open to such an argument in the appropriate circumstances.

Florida's equitable division statute states that "nonmarital assets" include "[a]ssets acquired separately by either party by noninterspousal gift, bequest, devise or descent, . . . assets acquired in exchange for such assets . . . [and] all income derived from nonmarital assets during the marriage unless the income was treated, used or relied upon by the parties as a marital asset."³⁶ However, "marital assets" under the Florida statute include "[the] enhancement in value and appreciation of nonmarital assets resulting either from the efforts of either party during the marriage or from the contribution to or expenditure thereon of marital funds or other forms of marital assets or both."³⁷

In *Chapman v. Chapman*,³⁸ the husband's premarital securities were held in his "retirement fund." The husband was actively trading stocks and bonds and outperformed the majority of professional stock managers. The appellate court affirmed the trial court's holding that a portion of the increase in the retirement fund resulted from marital labor, thereby making it marital property.

³⁶ FLA. STAT. § 61.075(6)(b)(2) and (3) (2009).

³⁷ FLA. STAT. § 61.075(6)(a)(1)b (2009).

³⁸ 866 So.2d 118 (Fla. 4th DCA 2004).

The husband in *Steele v. Steele*³⁹ entered into the marriage with a 401(k) plan that allowed participants to move assets among nineteen different mutual funds. The husband utilized this feature by making three transfers over the six year marriage. Contrary to *Chapman*, the court held that the transfers between mutual funds did not work to convert the pre-marriage portion of the 401(k) plan account into a marital asset because the transfers had only a minimal impact on the value of the account. Thus, in Florida, a de minimis amount of marital labor apparently does not convert appreciation to marital property, but as in the case of a New York divorce, a division of value of an interest in a trust appears to be possible in that state.

In those states where marital labor transmutes otherwise separate property into marital property, an allocation between appreciation attributable to the marital labor and the appreciation attributable to the separate capital itself, which remains separate, is required. There is no uniformity as to the method of allocation, but as an example, one method values the labor by reference to prevailing compensation rates and attributes all remaining gain to separate property.⁴⁰

From a planning perspective, in states where marital labor can result in appreciation constituting marital property, retaining an investment advisor for a trust of which the beneficiary is the trustee would seem to rebut a claim that marital labor was responsible for the appreciation of an investment account held in trust.

3. **Iowa Statute.**

The Iowa property division statute states that the court shall divide the property of the parties, “except inherited property or gifts received by one party, equitably between the parties” after considering several enumerated circumstances.⁴¹ The statute further states that inherited property and property received by gift prior to or during the marriage are not subject to division, “except

³⁹ 945 So.2d 60 (Fla. 4th DCA 2006).

⁴⁰ See PRINCIPLES OF LAW OF FAMILY DISSOLUTION § 4.05 cmt.a.

⁴¹ IOWA CODE § 598.21(5) (2009).

upon a finding that refusal to divide the property is inequitable to the other party or to the children of the marriage.”⁴²

Although divisions of trust interests in Iowa are possible, the effect of the Iowa enabling statute is that such divisions will not occur as frequently as they might in other jurisdictions.⁴³

B. Interest Must be Possessory.

Some courts have held that an interest in trust does not constitute property for purposes of a property division until the interest becomes possessory. In *Solomon v. Solomon*,⁴⁴ the wife’s father created an irrevocable trust for the wife and her three sisters. The wife was entitled to one-fourth of the trust income. The wife could withdraw a small amount of principal before age thirty-five. At age thirty-five, the wife could withdraw one-half of the principal and at age forty, she could withdraw all of the principal. The wife held a power of appointment exercisable by will “over the portion of the trust over which she was entitled to withdraw at the time of her death, with the remainder to pass to her issue, or if none, to the trusts of her three sisters.”⁴⁵ At issue was the increase in the value of the trust and the extent to which the increase constituted marital property subject to the court’s dispositional power.

The Supreme Court of Pennsylvania held that the wife’s interest in the trust “amounted to a mere expectancy as it was contingent upon her attaining age thirty-five” and that “any increase in the value of [the] trust prior to [the wife] acquiring any right to possession and control of the

⁴² IOWA CODE § 598.21(6) (2009).

⁴³ In *In Re Marriage of Rhinehart*, 704 N.W. 2d 677 (Iowa 2005), the Supreme Court of Iowa considered the division of an interest in an irrevocable trust, but excluded the trust from the property division because the beneficiary’s father possessed the right to amend the trust so as to change the beneficiaries. Since the wife could be removed as a beneficiary, and because the Iowa Statute does not automatically include the trust as divisible property, exclusion of the trust from the property division was upheld. Consideration of the trust in making an equitable division of the parties’ property was, however, determined to be proper.

⁴⁴ 611 A.2d 686 (Pa. 1992). See also, *Anzalone v. Anzalone*, 835A.2d 773 (Pa. Super. Ct. 2003).

⁴⁵ *Solomon*, 611 A.2d at 688.

principal cannot be included as marital property.”⁴⁶ The wife did not withdraw the one-half interest in the principal at age thirty-five and the increase in the value of the one-half interest in the principal subsequent to her thirty-fifth birthday was deemed to be marital property.⁴⁷

The Wyoming Supreme Court, in *Storm v. Storm*,⁴⁸ reviewed a testamentary trust that held ranch property. “Income from the ranch [was] to be paid to [the husband] and his sister for a period of ten years from the date of their father’s death. At the end of ten years, ... the ranch was to be set over to [the husband] and his sister ‘or the survivor of them’ in equal undivided interests - or one-half to each.”⁴⁹ The Court noted that the husband’s share would not come into being unless he was living at the end of the ten year period. The Wyoming Supreme Court referred to the interest in the trust as “the inheritance”⁵⁰ and a “prospective expectancy of an estate.”⁵¹ The Court held that the interest was not subject to division.

In another relatively early case, the Supreme Court of Indiana, in *Loeb v. Loeb*,⁵² held that a “vested remainder interest subject to complete defeasance”⁵³ should not have been included in the pool of divisible assets. The husband’s mother created an irrevocable trust and retained the income for her life. At her death, the trust was to be distributed, in part, to the husband if then living. The wife claimed that because the interest was vested it should have included as divisible property. The husband claimed that the interest was contingent and therefore to be excluded from the pool of divisible assets.

⁴⁶ *Id.* at 690.

⁴⁷ *Id.* at 691.

⁴⁸ 470 P.2d 367 (Wy. 1970). *See also*, *Humphrey v. Humphrey*, 157 P. 3d 451, 452 (Wy. 2007).

⁴⁹ *Storm*, 470 P.2d at 368.

⁵⁰ *Id.* at 370.

⁵¹ *Id.*

⁵² 301 N.E.2d 349 (Ind. 1973). *See also*, *Fiste v. Fiste*, 627 N.E.2d 1368 (Ct. App. Ind. 1994).

⁵³ *Loeb*, 301 N.E.2d at 352.

The Court noted the distinction between a vested remainder subject to complete defeasance and a contingent remainder, the difficulty in distinguishing between the two⁵⁴ and concluded that the distinction was not useful in the analysis. According to the court, “[t]he issue is whether the future interest is so remote that it should not have been included in the property settlement award.”⁵⁵ Considering that the husband had “no present interest of possessory value [, that] if he should predecease his mother, he takes nothing under the trust [and that] the trustees have no authority to invade the corpus of the trust during [the mother’s] lifetime,”⁵⁶ the Court held that the remainder interest in the trust should not have been included in the property division.⁵⁷

The Delaware Supreme Court, in *Frank G.W. v. Carol M.W.*⁵⁸ ruled that property was “acquired” by a spouse during marriage, but not before, when a spouse’s beneficial interest in a trust was reduced to possession for the purpose of including the trust within the pool of divisible assets. That same court, however, was unwilling to apply the holding to exclude a future interest in the form of a remainder interest subject to a legal life estate that was acquired prior to marriage.⁵⁹

C. **Remainder Interests Fully Distributable.**

Courts of several states have ruled that a remainder interest that will be fully distributable to a spouse at some point in time is subject to the trial

⁵⁴ Generally, a vested remainder subject to complete defeasance is created as result of a condition subsequent and a contingent remainder is created as a result of a condition precedent. *See* SIMES AND SMITH, THE LAW OF FUTURE INTERESTS, §§ 131-166 (Borron [3rd] ed. 2002).

⁵⁵ Loeb, 301 N.E.2d at 352.

⁵⁶ *Id.* at 353.

⁵⁷ *Loeb* should be considered in conjunction with *In Re Marriage of Moyars*, 717 N.E.2d 976 (Ind. Ct. of App. 1999) where a remainder interest subject only to a legal life estate was not considered too remote to constitute property under the Indiana property division statute.

⁵⁸ 457 A.2d 715 (Del. 1983).

⁵⁹ *Gregg v. Gregg*, 510 A.2d 474, 479-80 (Del. 1986). The Court in *Gregg* limited its holding in *Frank G.W.* to the facts of that case.

court's dispositional power even though the remainder interest may be subject to a survivorship provision or may be reduced or eliminated by a preceding beneficial interest in the trust. Some courts have included such remainder interests in the pool of divisible assets without relying upon a property law rationale, while other courts in an apparent search for a guiding principle, have applied the concept of "vesting" in a property law sense to the analysis.

1. **Vesting Not Necessarily Determinative.**

In the early case of *Trowbridge v. Trowbridge*⁶⁰ a remainder interest in trust was included in the pool of divisible assets and divided between the spouses.

The husband's father created a testamentary trust that required the income of the trust to be distributed to the husband's mother during her life. The mother was also entitled to withdraw up to \$5,000 in any year and the bank co-trustee was authorized to distribute principal to the mother for other unstated purposes. If the husband survived his mother, the trust would be distributed to him at his mother's death. If the husband did not survive his mother, the trust would be distributed to the husband's issue.

The Supreme Court of Wisconsin affirmed a property division that awarded the wife 30% "of whatever interest in said trust accrues to the benefit of the [husband]."⁶¹ The Court's rationale was simply that the "future interest of the type given to [the husband] is part of his 'estate... for the purpose of [the property division statute].'"⁶²

In *Davidson v. Davidson*,⁶³ the husband's remainder interest in a testamentary trust created by his father's will was subject to a property division where the husband was required to survive his

⁶⁰ 114 N.W.2d 129 (Wis. 1962).

⁶¹ *Id.* at 134.

⁶² *Id.* (citation to statute omitted).

⁶³ 474 N.E.2d 1137 (Mass. App. Ct. 1985).

mother and “the trustees were empowered ‘in their uncontrolled discretion’ to invade principal for the benefit of ...[the] mother.”⁶⁴

Acknowledging that the remainder interest “may have been at the outer limits”⁶⁵ as to what constitutes a sufficient property interest, the Court reasoned that the “remainder was fixed at the time of divorce” and “uncertainty of value or inalienability of the interest [as a result of a spendthrift provision, does not] preclude consideration of the interest as subject to division.”⁶⁶

It is important to note that the *Davidson* court specifically rejected the idea that “technical rules of the law of property” should determine the result.⁶⁷ Similarly, although not explicitly stated, the *Trowbridge* court also avoided applying the concept of vesting in a property law sense in arriving at its decision.

2. **Concept of Vesting Applied or Arguably Applied.**

Because a spouse’s interest was “vested” and since he was “an ascertained remainderman,” a remainder interest in trust was subject to the court’s dispositional power in *Flaherty v. Flaherty*.⁶⁸

The irrevocable trust created by the beneficiary’s parents in *Flaherty* provided that the parents were to be paid up to \$1,000 of the trust income monthly and that upon the death of the last surviving parent, the trust would be distributed among their six children. If a child died prior to surviving the last living parent, the trust interest designated for a child would pass to the estate of the child.⁶⁹

⁶⁴ *Id.* at 1144.

⁶⁵ *Id.*

⁶⁶ *Id.* The court further stated that it is not suggested that “a judge must divide such an interest or assign it to the ledger of the holder in making a division of the property.” *Id.* at 1144-1145.

⁶⁷ *Id.* at 1144.

⁶⁸ 638 A.2d 1254, 1256 (N.H. 1994).

⁶⁹ *Id.* at 1256.

In *van Oosting v. van Oosting*,⁷⁰ because the husband had a “vested interest in the trust... [a]lthough contingent in nature,”⁷¹ the remainder in a credit shelter trust created upon the death of the husband’s father was a property interest subject to division even though the trust could be invaded for the benefit of the husband’s living mother.⁷²

Similarly, in *Chilkott v. Chilkott*,⁷³ a spouse’s unrestricted power to invade an apparent credit shelter trust at the death of his 87 year old mother was subject to equitable division where the spouse was required to survive his mother and the trustee had the power to distribute principal for the mother’s health, maintenance and welfare, but had not invaded the trust for such purposes.⁷⁴ The court reasoned that the interest was “fixed and no longer inchoate,”⁷⁵ even though subject to a condition of survivorship.

In *In Re Marriage of Buxbaum*,⁷⁶ the husband’s remainder interest in a testamentary trust was included in the marital estate. The trial court held that the husband’s mother was entitled to the trust’s income and upon her death the trust was to be distributed to the husband and his sisters. The Montana Supreme Court upheld the trial court’s determination noting that both parties agreed that the husband’s interest in the trust was a “vested future interest subject to defeasance.”⁷⁷

⁷⁰ 521 N.W.2d 93 (N.D. 1994).

⁷¹ *Id.* at 97.

⁷² *Id.* at 96. Though not explicitly stated, the husband apparently was required to survive his mother for his interest to become possessory.

⁷³ 607 A.2d 883 (Vt. 1992).

⁷⁴ *Id.* at 884.

⁷⁵ *Id.* at 885.

⁷⁶ 692 P.2d 411 (Mt. 1984).

⁷⁷ *Id.* at 413.

3. ***In Re Marriage of Balanson.***

*In Re Marriage of Balanson*⁷⁸ (referred to as “*Balanson II*”) concerned the determination of whether a wife’s remainder interest in a trust constituted property for purposes of property division in a dissolution of marriage.

The wife’s parents created a joint revocable trust, which at the death of the wife’s mother divided into two irrevocable trusts.⁷⁹ The settlors apparently intended the “A” trust to be a combined trust consisting of the surviving father’s assets and the deceased mother’s assets, which would have qualified the trust for the federal estate tax marital deduction at the mother’s death.⁸⁰ The settlors apparently intended the “B” trust to be a credit shelter trust, that would not be subject to estate tax at the surviving father’s death.⁸¹ Both trusts provided the wife’s father with a mandatory income interest and the power, as the trustee, to distribute principal to himself for his support, care, and maintenance. At the father’s death, the A trust would be distributed in accordance with the father’s general power of appointment exercisable by will and if not exercised, then in accordance with the B trust. The B trust was to be divided at the father’s death into as many equal shares as there were living children of the mother and the father. The wife and her brother were the only living children of the wife’s parents. The wife’s father was the trustee of both trusts and the trust instrument designated the wife’s brother as the successor trustee at the death of the wife’s father.

The issue in *Balanson II* was whether the wife’s remainder interest in the B trust constituted property under Colorado’s equitable

⁷⁸ 25 P.3d 28 (Colo. 2001), *appeal after remand*, 107 P.3d 1037 (Colo. Ct. App. 2004).

⁷⁹ See *In Re Marriage of Balanson*, 107 P.3d 1037 (Colo. Ct. App. 2004), *cert. denied*, 2005 Colo. LEXIS 161, referred to as “*Balanson III*.”

⁸⁰ In *Balanson III*, the court stated that all the assets of both trusts were contributed by the wife’s father. *Id.*

⁸¹ See also, *In Re Marriage of Balanson*, 996 P.2d 213, 220 (Colo. Ct. App. 1999) (“*Balanson I*”), *aff’d in part & rev’d in part*, 25 P.3d 28 (Colo. 2001), *remanded to Balanson III*, 107 P.3d 1037 (Colo. Ct. App. 2004).

division statute. In reversing the Colorado Court of Appeals' holding in *Balanson I* that the wife's interest was an expectancy that did not rise to the level of a property interest,⁸² the Colorado Supreme Court stated that the wife had a "future, vested interest not within the discretion of the trustee to withhold"⁸³ and held that the wife's interest in the B trust constituted property, as opposed to a mere expectancy.⁸⁴ The court reached this conclusion despite the father's income interest and right to invade the principal. According to the court, "[t]hese factors render the value of wife's remainder interest uncertain, but do not convert her interest into a mere expectancy."⁸⁵ The remainder interest constituted the wife's separate property, and the appreciation in the value of her separate property constituted marital property under the Colorado property division statute.⁸⁶

The Colorado Supreme Court in *Balanson II* did not address whether the wife held a property interest in the A trust. The parties

⁸² See *Balanson I*, 996 P.2d at 222.

⁸³ *Balanson II*, 25 P.3d at 41.

⁸⁴ The court in *Balanson II* stated that it previously had reached the same holding with respect to a trust interest similar to the wife's interest in *In Re Question Submitted by the United States Court of Appeals for the Tenth Circuit*, 553 P.2d 382, 384 (Colo. 1976). Although the trusts were similar in some respects, the *Balanson II* opinion ignored the fact that the beneficial interest reviewed in *In Re Question* was not subject to a currently existing income interest and power of invasion of a principal for the benefit of the current trust beneficiary. In *In Re Question*, the surviving spouse of the settlor exercised her right to take an elective share of the estate, which eliminated her beneficial interest in the trust. The remainder beneficiary's interest did not accelerate and the only remaining condition for the beneficiary's interest to become possessory was for the beneficiary to survive the spouse of decedent who had elected against the will. *Id.* at 384.

⁸⁵ *Balanson II*, 25 P.3d at 41.

⁸⁶ *Id.* at 42. COLO. REV. STAT. § 14-10-113 (2009), Colorado's property division statute, generally adopted the Alternative B Approach of the Uniform Marriage and Divorce Act. In Colorado, increases in the value of separate property and income from separate property constitute marital property. Section 14-10-113(4) and *In Re Marriage of Foottit*, 903 P.2d 1209 (Colo. Ct. App. 1995). Marital property in Colorado is divided in a manner that the court determines to be just, which does not necessarily mean an equal division between the spouses. *In Re Marriage of Goldin*, 923 P.2d 376, 381 (Colo. Ct. App. 1996) and *In Re Marriage of Posinoff*, 683 P.2d 377, 378 (Colo. Ct. App. 1984).

apparently did not disagree in any of the appellate proceedings that the wife's interest in the A trust did not constitute property for purposes of the division. The Colorado Court of Appeals, however, observed in *Balanson I* that wife's interest in the A trust was "merely an expectancy."⁸⁷ The Court of Appeals found it significant that "wife's father was given a power of appointment to pass the entire remaining corpus of trust A through his last will, without any limitation as to the beneficiaries who could be designated in such will."⁸⁸

a. **General Power of Appointment.**

At least by way of dicta, there is Colorado authority that a general power of appointment, which may defeat a spouse's remainder interest in a trust, will cause the trust to be excluded as "property." A general power of appointment marital trust, sometimes referred to as a "§ 2056(b)(5) trust,"⁸⁹ will grant a surviving spouse the type of general power held by wife's father over the A trust in *Balanson*, and it would seem that such trusts should not be included in the pool of divisible assets.

In *S.L. v. R.L.*,⁹⁰ the Massachusetts Appeals Court considered whether five trusts would be included in the marital estate for property division purposes.⁹¹ One of the

⁸⁷ *Balanson I*, 996 P.2d at 221.

⁸⁸ *Id.* On remand from *Balanson II*, the trial court reiterated that the "wife had only an expectancy interest" in Trust A. *See* *Balanson III*, 107 P.3d 1037, 1041 (Colo. Ct. App. 2004).

⁸⁹ Such trusts qualify for the estate tax marital deduction pursuant to § 2056(b)(5) of the INTERNAL REVENUE CODE OF 1986, as amended (hereinafter, I.R.C.). A marital trust, such as a qualified terminable interest property ("QTIP") trust, need not provide a surviving spouse with a power of appointment. *See* I.R.C. § 2056(b)(7).

⁹⁰ 774 N.E.2d 1179 (Mass. App. Ct. 2002).

⁹¹ As mentioned, the Massachusetts property division statute empowers the court to make an equitable division of all the spouse's property, whether separate or marital. *See* MASS GEN. LAWS Ch. 208, § 34 (2009).

trusts was a marital trust over which the wife's mother held a general power of appointment exercisable by will.

The court held that the trust should not have been included in the marital estate because the wife's remainder interest was "susceptible of complete divestment upon the wife's mother's exercise of the power."⁹² Under this rationale, whether the power was general or special and whether the trust was a "marital trust" would seem to be irrelevant.

The court reached an opposite conclusion as to the wife's interests in the other trusts, one of which was very similar in design to the *Balanson B* trust. The distinction drawn by the court was that the wife's interest in the nonmarital trusts "[was] subject only to her surviving her [then living] mother, a condition [that Massachusetts precedent] considered not to bar inclusion within the marital estate."⁹³

b. Special Power of Appointment.

Whether a special power of appointment should cause the same result is less certain. For both practical and tax reasons, many settlors grant trust beneficiaries or other persons special powers of appointment. If the wife's father in *Balanson* had held a special power of appointment over the B trust, would the result have been the same?

Assuming the remainder interest in *Balanson II* was a "vested interest,"⁹⁴ if the test in *Balanson II* is that vested remainder interests, even those subject to complete defeasance, constitute property interests, it can be argued

⁹² *S.L.*, 774 N.E.2d at 1182. *See also*, *Hawkins v. Hawkins*, 526 A.2d 872 (App. Ct. Conn. 1987), where a divorcing spouse's interest was also subject to her parent's general power of appointment. The court in *Hawkins* ruled that the trial court did not err in not considering the interest in trust.

⁹³ *S. L.*, 774 N.E.2d at 1182. *See Davidson v. Davidson*, 474 N.E.2d 1137 (Mass. App. Ct. 1985), discussed above.

⁹⁴ Subsequent discussion will establish that a *Balanson B* type trust remainder interest may or may not be "vested" under Colorado law.

that the result would have been the same.⁹⁵ If this position is correct, a trial court would be faced with the choice of completely ignoring the power of appointment in valuing the interest or determining a reduction in the value of the interest attributable to the power of appointment. Such a determination would seem to require a trial court to weigh extremely subjective criteria and calculate a risk factor as to whether and to what extent a power will be exercised.

*In Re Marriage of Beadle*⁹⁶ concerned a trust similar in design to the *Balanson B* trust, except that the husband's living mother held a testamentary special power of appointment over the trust exercisable in favor of descendants.

The trial court in *Beadle* held that the remainder interest, though initially vested, was no longer vested by virtue of the husband's mother's execution of a codicil to her will that would have defeated the husband's interest.⁹⁷ This reasoning is flawed because the power is not exercised until the powerholder's death when her will would become effective. The Montana Supreme Court affirmed, but instead reasoned that husband's remainder could not be vested until the powerholder's death.⁹⁸ In the author's opinion, this logic is also be flawed and a consequence of attempting to reconcile the law of future interests with equitable property divisions.⁹⁹ A more logical rationale is

⁹⁵ "When a vested remainder is so limited that it may be wholly divested by an executory interest, *power of appointment* or power of termination, it is said to be vested subject to complete defeasance." LEWIS M. SIMES, HANDBOOK OF THE LAW OF FUTURE INTERESTS 20 (2d ed. 1966) (emphasis supplied).

⁹⁶ 968 P.2d 698 (Mt. 1998).

⁹⁷ *Id.* at 699.

⁹⁸ According to the Montana Supreme Court, the intent of the testator, evidenced, for example, by a spendthrift provision, can render a vested trust interest contingent. *Id.* at 703-304.

⁹⁹ In *In Re Marriage of Rhinehart*, 704 N.W.2d 677 (Iowa 2005), the Supreme Court of Iowa similarly engaged in faulty logic to obtain the desired result by misinterpreting

that vested or not some interests are simply too uncertain to constitute property for purposes of a property division at divorce.

In *D.L. v. G.L.*,¹⁰⁰ the court held that the marital estate did not include the husband's vested remainder interest in a trust, that was subject to divestment, because the interest "was susceptible of complete divestment upon the [husband's father's] exercise" of a testamentary special power of appointment, and as a consequence, "the equivalent of an expectancy under a will."¹⁰¹ The husband's grandmother created the trust, which would be distributed to the husband and others upon the death of the father in default of the exercise of the power of appointment. Until final distribution, the trustee had the power to spray distributions of income and principal among a broad class of trust beneficiaries.

c. **Vesting as a Bright Line Test.**

If *Balanson II* establishes a bright line test that vested remainders, though subject to divestment, constitute property, unexpected and unusual results will likely follow.¹⁰² However, a different interpretation is possible.

the concept of vesting.

¹⁰⁰ 811 N.E.2d 1013 (Mass. App. Ct. 2004).

¹⁰¹ *Id.* at 1028.

¹⁰² The court stated in *Balanson II* that "[w]e have previously held that a trust interest similar to that of Wife's in this case constitutes a *vested interest*." *Balanson II*, 25 P.3d at 41 (emphasis added). That *Balanson II* has been interpreted as equating a vested interest to a property interest subject to division is easy to see. The Court of Appeals in *In Re Marriage of Gorman*, 36 P.3d 211 (Colo. Ct. App. 2001), *superseded by statute as stated in In Re Marriage of Guinn*, 93 P.3d 568, 571 (Colo. Ct. App. 2004), discussed below, adopted this interpretation when it held that a spouse's remainder interest in a living parent's revocable trust constituted property for purposes of property division. Non-beneficiary litigants in Colorado divorces have contended that "vesting," in a property law sense, continues to constitute a bright line rule and that the rationale in *Gorman* was correct, even though the result was legislatively overruled. At least one recent Colorado trial court has adopted the *Gorman* bright line rule rationale in holding that a spouse's remainder interest in trust, subject to a broad testamentary non-general power of appointment exercisable by the

Balanson II may, and in this author's opinion should be, interpreted as a more limited holding. The remainder interest in the B trust, which was subject only to conditions of survivorship and the invasion of trust principal for the care and maintenance of the beneficiary with the then current interest, constituted property under the facts and circumstances of that case. Under this interpretation, the type, number, and extent of the contingencies, both under the instrument, and under the facts and circumstances of each case could result in a determination that the interest, even though "vested" (at least under the common law), is too susceptible to complete divestment to constitute property (whether by reason of a power of appointment, trustee power, or the needs of the current beneficiaries). If this more limited interpretation is correct, the corollary is that not every trust that provides for a fully distributable remainder interest to a spouse-beneficiary is property for purposes of Colorado's property division statute.

Such a facts and circumstances approach may require the trial court to consider the contingencies to which interests in trusts are subject and the facts and circumstances surrounding the trust and its beneficiaries. At some point, a court may appropriately say the contingencies render the interest too uncertain, remote, or speculative to constitute property. The court could then avoid the issues and difficulties that otherwise would ensue when quantifying those contingencies and predicting the likelihood of an exercise of powers. *Balanson II* would then be viewed as a marker on one end of the spectrum. "Vesting," in its common law sense, would not serve as a talisman. More than one court has said that "the concept of vesting should probably find no significant place in the developing law of equitable distribution."¹⁰³

spouse's parent which could completely eliminate the spouse's interest in the trust, constituted a "vested" interest and therefore "property." As discussed below, under current Colorado law, the remainder trust interest in a *Balanson* B type trust executed, republished or affirmed after July 1, 1995 would be "unvested."

¹⁰³ See *Stern v. Stern*, 331 A.2d 257, 262 (N.J. 1975); *Davidson*, 474 N.E.2d at 1137. The *Davidson* court noted the rejection in Massachusetts "of the notion that the content of the estates of divorcing parties ought to be determined by the wooden application

Moreover, utilizing vesting as a definitive test is at odds with the concept of equitable distribution. A vested remainder subject to complete defeasance has been defined as a remainder interest “subject to an executory interest, a contingent remainder, or a power the exercise of which may terminate the remainder.”¹⁰⁴ Where a remainder is to an ascertained person on a condition precedent, the remainder is considered a contingent remainder.¹⁰⁵ There can be little practical difference between a vested remainder subject to complete defeasance and a contingent remainder. With state legislatures having moved away from the formalistic title theory of dividing assets in favor of equitable divisions, it is difficult to understand why divorce courts would adopt a mechanical and formalistic approach in dividing one type of asset. That the outcome should turn on whether the trust instrument utilized a condition precedent or a condition subsequent seems arbitrary and would require, in many instances, a complex future interests analysis to distinguish vested and contingent remainders.¹⁰⁶

of technical rules of the law of property.” *Id.* at 1144. *See also*, D.L. v. G.L., 811 N.E.2d at 1020 (“[T]he judge is not bound by traditional concepts of title or property.”). The Colorado Court of Appeals in *Balanson III* has apparently criticized the notion that vesting should drive the result, and this seems to indicate a change of direction for that court. 107 P.3d 1037, 1043 (Colo. Ct. App. 2004). Less than one year before, another division of that court stated: “*In Re Marriage of Balanson* . . . holds that the appreciation in a vested remainder interest in an irrevocable trust during the course of the marriage constitutes marital property under § 14-10-113(4).” *In Re Marriage of Dale*, 87 P.3d 219, 225 (Colo. Ct. App. 2003).

¹⁰⁴ SIMES AND SMITH, *THE LAW OF FUTURE INTERESTS* § 110 (Borron [3rd] ed. 2002).

¹⁰⁵ *Id.* at § 111.

¹⁰⁶ A substantial amount of case law and commentary exists in distinguishing between the two types of remainders. *See* SIMES AND SMITH, at § § 131-166. “It is believed that no single satisfactory test can be stated which will, by itself, serve to distinguish the vested and contingent remainder.” *Id.* at § 141.

d. **Vesting as a Bright Line Rule: A Possible Contradiction.**

As mentioned, the *Balanson II* opinion states that “we have previously held that a trust interest similar to that of Wife’s in this case constitutes a vested interest” and that “Wife has a future, vested interest not within the discretion of the trustee to withhold.”¹⁰⁷ As also mentioned, this language has sometimes been viewed as imposing a bright line rule that a vested remainder interest for purposes of property law necessarily constitutes “property” for purposes of an equitable division. Underpinning such a bright line rule is the assumption that a remainder interest in trust, such as the remainder interest considered in *Balanson II*, constitutes a “vested” interest. In other words, if a *Balanson B* type trust remainder interest is not “vested,” a bright line vesting rule would be self-contradictory.

At common law, a transfer from “T to A for life then to B” did not require B to survive A to take the interest. B possessed a vested remainder, and in this instance an indefeasibly vested remainder, because of the common law rule of construction referred to as the “no-implied-condition-of-survivorship rule” or “NICS Rule.”¹⁰⁸ Uniform Probate Code (“UPC”) § 2-707(b) reverses the NICS Rule as to trusts by stating: “A future interest under the terms of a trust is contingent on the beneficiary’s

¹⁰⁷ Balanson II, 25 P.3d at 41. The previous holding referred to is *In Re Question Submitted by the United States Court of Appeals for the Tenth Circuit*, 553 P.2d 382 (Colo. 1976), decided prior to the enactment of COLO. REV. STAT. § 15-11-707(2) (effective July 1, 1995), discussed below. The remainder interest considered in *In Re Question* was a vested interest under Colorado law at that time. See *Burden v. Colorado Nat’l. Bank*, 179 P.2d 267 (Colo. 1947).

¹⁰⁸ See UNIFORM PROBATE CODE § 2-707 cmt. See also, F. Philip Manns Jr., *New Reasons to Remember the Estate Taxation of Reversions*, 44 REAL PROP. TRUST & ESTATE JOURNAL ____ (Fall 2009), advance copy on file with the author. The NICS Rule furthered the common law “rule of early vesting,” which was designed to promote the earliest indefeasible vesting of future interests.

surviving the distribution date.”¹⁰⁹ The rationale in reversing the common law NICS Rule “is to prevent cumbersome and costly distributions to and through the estates of deceased beneficiaries of future interests, who may have died long before the distribution date.”¹¹⁰ If a future interest in trust fails, UPC § 2-707(b) creates a substitute gift in the deceased beneficiary’s surviving descendants, unless the gift is in the form of a class gift.¹¹¹

According to the drafters of UPC § 2-707, “subsection (b) renders a future interest [in trust] ‘contingent’ on the beneficiary’s survival of the distribution date. **As a result, future interests [in trust] are ‘non-vested’** and subject to the Rule Against Perpetuities (emphasis added).”¹¹²

Thus, the wife’s remainder interest in the *Balanson B* trust, although “vested” under the common law, would be a non-vested contingent remainder under the UPC and current Colorado law by virtue of UPC § 2-707(b) and its Colorado counterpart.¹¹³

¹⁰⁹ Colorado’s version of the UPC provision, COLO. REV. STAT. § 15-11-707(2) (2009), contains the identical language, except that COLO. REV. STAT. § 15-11-701(2)(2009) makes the rule applicable only to instruments “executed or republished or reaffirmed on or after July 1, 1995 and only ‘in the absence of a finding of a contrary intention.’”

¹¹⁰ UPC § 2-707 cmt. The principal drafter’s explanation of the UPC rule is set forth in Lawrence W. Waggoner, *The Uniform Probate Code Extends Antilapse - Type Protection to Poorly Drafted Trusts*, 94 MICH. L. REV. 2309 (1996).

¹¹¹ UPC § 2-707(b)(1).

¹¹² UPC § 2-707 cmt.

¹¹³ As mentioned, COLO. REV. STAT. § 15-11-701(2)(2009) makes the new rule applicable to instruments “executed or republished or reaffirmed on or after July 1, 1995.” The *Balanson* master trust was created in 1976 and *Balanson B* trust became irrevocable in 1990. See *Balanson III*, 107 P.3rd at 1040. However, it is possible to interpret § 15-11-701(2) as applying the new rule to pre-July 1, 1995 trusts which were not republished or reaffirmed if the intention is found that current law applies to the construction of the instrument.

At least with respect to post-July 1, 1995 instruments (or those “republished” or “reaffirmed” after that date), if the holding in *Balanson II* is that a vested remainder in trust constitutes property under the property division statute, then the holding would contradict the result because the remainder interest in a *Balanson* type trust would be “non-vested.” The only means of eliminating the contradiction is to read into the *Balanson II* opinion an implied requirement that in making a determination of whether an interest is vested, otherwise applicable law is to be ignored and the common law NICS Rule is to be applied for this purpose. This interpretation seems unlikely at best. There is no policy justification for a mechanical vesting rule to drive an equitable distribution determination to begin with and reading into this mechanical rule a strained and unlikely constituent rule which would be necessary to validate it seems even more misguided.¹¹⁴

Moreover, if the result for purposes of equitable distribution turns on a property law determination, there remains the question of which state’s property law is to be applied in that determination. The issue may require a complex conflict of laws analysis and it would seem that in determining the rights of beneficiaries in trusts and classifying their interests, sound argument could be made that the law governing the trust instrument should control rather than the law of the dissolution proceeding.¹¹⁵

Adding support to the conclusion that *Balanson* does not impose a bright line vesting rule is the following language from the opinion:

¹¹⁴ As to pre-July 1, 1995 instruments, the result would turn on whether the instrument was republished or reaffirmed, acts which seem difficult to define at best, or perhaps whether there is an intention to have current law apply. It seems unlikely to this author that an equitable distribution result should turn on complex and technical probate code construction.

¹¹⁵ At least one court has held that the construction and interpretation of the provisions of a trust instrument are determined under the instrument’s governing law, but the ultimate question of whether the value of the trust is property is determined under the law of tribunal. *See* *Tremaine v. Tremaine*, 663 A.2d 387 (Conn. 1995).

“In the present case, Wife has a future, vested interest not within the discretion of the trustee to withhold...Such interests are distinguishable from interests in discretionary trusts because although the value of such interest may be uncertain at the time of the dissolution of marriage, they nonetheless constitute property because they are certain, fixed interests **subject only to the condition of survivorship.**”¹¹⁶

Implied here is that if other conditions may defeat the remainder interest, the interest might not constitute property.

The alternative to a bright line vesting rule (a facts and circumstances approach), will no doubt complicate property divisions. While it is true that trial courts have been charged before with the task of identifying, valuing and dividing other complex assets, interests in trusts pose their own special issues, problems and expense. Dividing interests in trusts may have furthered the policy objective of treating marriage as a partnership, but the complexity and expense of doing so must also be acknowledged.

D. **Remainder Interests Not Fully Distributable: *In Re Marriage of Jones*.**

In arriving at its decision in *Balanson II*, the Colorado Supreme Court distinguished its prior decision in *In Re Marriage of Jones*.¹¹⁷

In *Jones*, the wife became a beneficiary of a trust created by her mother’s will during the marriage. A bank and the wife’s father as trustees “had [the] uncontrolled discretion to distribute income and principal from the trust to [the father], the wife, or to the wife’s descendants for expenses that the trustees determined to be necessary for their ‘health, welfare, comfort, support, maintenance and education.’”¹¹⁸ The trust was to terminate upon the death of both the wife’s father and the wife, at which time the trust

¹¹⁶ Balanson II, 25 P.3d at 41 (emphasis added).

¹¹⁷ 812 P.2d 1152 (Colo. 1991).

¹¹⁸ *Id.*

assets were to be distributed to the wife's descendants and if there were no descendants, to the mother's heirs.

The husband argued that the trust was the separate property of the wife and that the increase in the value of the trust principal was marital property. The court held that the wife's rights in the trusts were "merely an expectancy and [did] not rise to the level of property."¹¹⁹ The court provided three distinct rationales for its holding.

First, the trust was "completely discretionary."¹²⁰ In other words, the trustee was given "extended discretion" in making distributions.¹²¹ According to the court, the wife "could not force the trustee to pay income or principal unless she could establish fraud or abuse."¹²² This rationale raises the question of whether the result would have been different if the trustees were granted only ordinary discretion or if the trustees were required to distribute the trust property for wife's reasonable needs. Would the result in *Jones* have been the same if the wife had the legal right to compel the trustee to make distributions to her?¹²³ At this time, the question cannot be answered with certainty.

Second, the court stated that the interest in the trust was "not assignable and [could not] be reached by [the beneficiary's] creditors."¹²⁴ Spendthrift provisions typically are included in trust instruments, and the existence of

¹¹⁹ *Id.* at 1155.

¹²⁰ *Id.* at 1156.

¹²¹ Generally, when a trustee has extended discretion, the court will not interfere unless the trustee acts dishonestly, in bad faith or with improper motive. *See* RESTATEMENT (THIRD) TRUSTS § 50 cmt. c. (2001).

¹²² *Id.*

¹²³ In many circumstances, beneficiaries possess the ability to enforce their rights to distributions under state law. "Absent language of extended (*e.g.*, 'absolute' or 'uncontrolled') discretion . . . , a court will . . . intervene if it finds the payments made, or not made, to be unreasonable as a means of carrying out the trust provisions. For example, a beneficiary may be entitled to amounts sufficient to provide support, or to meet some other standard, and the amounts being paid by the trustee may be clearly excessive or inadequate for the purpose." RESTATEMENT (THIRD) TRUSTS § 50, cmt b. (2001).

¹²⁴ *Jones*, 812 P.2d at 1156.

those provisions has been irrelevant in the analysis of whether beneficial interests in trusts constitute property.¹²⁵ If the result turns on whether a trust instrument contains a spendthrift clause, few trusts would be included in the pool of divisible assets.

Third, the court distinguished “a discretionary trust from those trusts that grant the beneficiary some future, vested benefit not within the discretion of the trustee to withhold, but whose value may be uncertain at the dissolution of the marriage.”¹²⁶ This rationale may be the most compelling and suggests a framework for analysis of trust interests. By distinguishing a fully distributable remainder interest in trust from the wife’s trust interest in *Jones*, the court may have indicated that it might consider a fully distributable remainder interest “property.” Ten years after *Jones*, the court in *Balanson II* did consider a fully distributable remainder interest and held that it was property.

Jones and *Balanson* can be viewed as cases on two ends of a spectrum. If the trust terms and the facts and circumstances more closely resemble *Jones*, the trust should be excluded as property. On the other hand, if the resemblance is closer to *Balanson*, the trust interest constitutes property. Such an approach is obviously subjective, but it would avoid a determination based upon mechanical rules which have no relevance to an equitable distribution of property. Under such a spectrum analysis, whether the trust instrument does or does not include the words “uncontrolled,” or “absolute” (in defining trustee discretion), or whether a trust remainder interest would have been “vested” under the common law would not determine the outcome.

1. ***In Re Marriage of Rosenblum.***

The *Jones* court cited with approval the Colorado Court of Appeals’ decision in *In Re Marriage of Rosenblum*.¹²⁷ In *Rosenblum*, the husband’s mother created an irrevocable trust and designated husband and his sister as the co-trustees with authority

¹²⁵ Spendthrift clauses have not barred the inclusion of trusts in the pool of divisible assets. See *Lauricella v. Lauricella*, 565 N.E.2d 436, 439 (Mass. 1991).

¹²⁶ *Jones*, 812 P.2d at 1157. The *Jones* court specifically declined to address whether vested interests subject to divestment constitute property.

¹²⁷ *Jones*, 812 P.2d at 1154-56, 1158. *Rosenblum*, 602 P.2d 892 (Colo. Ct. App. 1979).

“in their absolute discretion to distribute ‘all, none or any part’ of the net income and principal to any of the beneficiaries [the husband and his descendants], to make unequal distributions, or to withhold all income from ‘one or more or all.’”¹²⁸ The trust instrument stated that “no beneficiary shall have any right or power to enforce the payment of principal or income to himself or any other person.”¹²⁹ At the husband’s death, the trust assets were to be divided and held in trust for the benefit of the husband’s children (or descendants of a deceased child).¹³⁰

The trial court found “that the husband used the assets of [the] trust on occasions as if he were the sole owner thereof” and that he had borrowed from the trust, sometimes without interest and often without the formality of promissory notes. There was also evidence that the husband handled all transactions of the trust and that the co-trustee acceded to his decisions.¹³¹ The trial court determined that the increase in value of the trust assets was marital property and awarded the wife a share of the increase.¹³² The Colorado Court of Appeals reversed and determined that the trust interest was not “property” for purposes of a division.

2. ***Kasser v. Kasser.***

The Vermont Supreme Court excluded a “Jones type” trust from the marital estate in *Kasser v. Kasser*.¹³³ Although all of the relevant terms of the trust are unknown, this much can be

¹²⁸ Rosenblum, 602 P.2d at 893. While the husband was a trustee, distributions to him could not be made “in excess of that necessary for his ‘health, education, support or maintenance.’” *Id.*

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ *Id.* But the trial court also stated that this behavior “did not have the effect of setting aside the trust and causing its assets to be [the husband’s] sole property.” *Id.*

¹³² *Id.*

¹³³ 895 A.2d 134 (Vt. 2006). In the case of a similar trust and holding *see* the trial court decision of *Dryfoos v. Dryfoos* (Unpub. Conn. Super. opinion), 2000 WL 119 6339.

determined. The husband's father created an irrevocable trust which "pays income to husband for life. When the husband dies, the parties' children receive the income and, eventually, the principal."¹³⁴ The husband "had a limited right to invade the principal of the trust for his benefit during his lifetime, but [the trial court found that] a prudent fiduciary would not exercise that right absent dire need, which appeared unlikely given husband's financial situation."¹³⁵ The husband was apparently the sole current beneficiary of the trust.¹³⁶ The dissenting opinion adds that one trust provision "allows husband to use as much of the trust as the trustee deems appropriate for husband's 'welfare, comfort and support' as long as husband's physician certifies him to be 'disabled in any manner' [and that] husband has the power, if he so chooses, to replace the trustee and invade the principal of the trust."¹³⁷

Despite the wife's claim that the "husband's behavior [was that] that he [treated] the trust as his personal savings account,"¹³⁸ the Vermont Supreme Court upheld the trial court and ruled that the trust was not includible in the marital estate.¹³⁹ Two rationales were provided by the court. First, the parties apparently stipulated that the trust should not be invaded. This rationale is questionable. With few exceptions, when a third party settled trust is found to constitute divisible property, the validity of spendthrift provisions have not been successfully challenged. Rather, it is the "value" of the trust interest that is divided and an offset of other divisible property is made or some other means of award is utilized that does not call for an invasion of trust assets. Thus, the parties'

¹³⁴ Kasser, 895 A.2d at 136.

¹³⁵ *Id.* The trial court did not consider the power of invasion to constitute "an unlimited right to the principal" and considered the trust as a source of income only. *Id.*

¹³⁶ *Id.* at 141.

¹³⁷ *Id.* at 150 - 151, Johnson & Skoaglund, JJ.,dissenting.

¹³⁸ *Id.* at 141.

¹³⁹ The dissent to this holding is noted. *See* Kasser, 895 A.2d at 147, Johnson & Skoaglund, JJ., dissenting. "[H]usband [had] control over the trust, and there is no reason to exclude it from the marital estate." *Id.* at 150.

stipulation seems to have no bearing on whether the value of the trust constituted divisible property.

The court's second and better rationale was that "the husband [did] not and will never have, an unrestricted right to invade the principal of the trust."¹⁴⁰ The court distinguished its prior decision in *Chilcott v. Chilcott*¹⁴¹ where the beneficiary spouse had an unrestricted right to invade the trust at the death of his 87 year old mother and the trust interest was held to constitute property for purposes of a division.

Also of interest in *Kasser* is the court's treatment of a trust created for the parties' children, discussed below, and the treatment of husband's 50% interest in "hotel properties." With respect to the latter, the Supreme Court of Vermont held that the trial court "acted within its discretion in reducing the value of husband's interests by 25% to 33% to account for the 50% ownership."¹⁴²

3. *United States v. Delano.*

In one instance, a bundle of rights and powers in a discretionary trust was so substantial that the court determined it constituted an interest in property under Colorado law for another purpose. In *United States v. Delano*,¹⁴³ the United States commenced a civil action against the trustees of a trust to foreclose a tax lien on a beneficiary's interest in a trust created under the will of the beneficiary's mother.¹⁴⁴ The court distinguished *Jones* and *Rosenblum* and held that, under Colorado law, the beneficiary's interest in trust constituted a property right to which the tax lien attached.¹⁴⁵ The beneficiary was the current sole beneficiary of the

¹⁴⁰ Kasser, 895 A.2d at 141.

¹⁴¹ 607 A.2d 883 (Vt. 1992).

¹⁴² Kasser, 895 A.2d at 143. The actual discount applied to the 50% interest appears to be approximately 31.46%.

¹⁴³ 182 F. Supp. 2d 1020 (D. Colo. 2001).

¹⁴⁴ *Id.* at 1021.

¹⁴⁵ *Id.* at 1022, 1024.

trust and had the discretion to terminate the trust and retain the assets, although the court did not elaborate on the terms and conditions of the power of termination.¹⁴⁶ In addition, the trust instrument provided that the “trustee shall pay to or apply for the benefit of [the beneficiary] . . . income or principal, or both, as [the] trustee in its sole and absolute discretion shall deem necessary or advisable for [the beneficiary’s] maintenance, health, education, comfort and welfare.”¹⁴⁷ According to the court, had a “pure discretionary trust” been intended, the settlor would have used the word “may” instead of “shall.”¹⁴⁸ The beneficiary and another individual were the initial co-trustees. The beneficiary exercised his power to remove the other co-trustee and replaced the co-trustee with the beneficiary’s son.¹⁴⁹

E. Rights in Multi-Generational Trusts Divisible in Some States.

Some courts have determined that a bundle of rights in a trust, though discretionary or usufructuary in nature can constitute a property interest subject to division.

In *Comins v. Comins*,¹⁵⁰ the marital estate included the wife’s interest in a trust settled by her father. A bank, in its discretion as trustee, was to pay to wife income and principal for wife’s “comfort, welfare, support, travel and happiness.”¹⁵¹ Wife held a power to appoint the trust principal at her death and if the power was not exercised, the remainder was to be distributed by representation to her heirs.¹⁵² The opinion does not state whether the power of appointment was a general or non-general. The court determined that the wife had a present, enforceable, equitable right to use the trust property of the trust and included the trust in the marital estate.

¹⁴⁶ *Id.* at 1023.

¹⁴⁷ *Id.* at 1022.

¹⁴⁸ *Id.* at 1023.

¹⁴⁹ *Id.* at 1021.

¹⁵⁰ 595 N.E.2d 804 (Mass. App. Ct. 1992)

¹⁵¹ *Id.* at 806.

¹⁵² *Id.* at 806 n.4.

In *D.L. v. G.L.*,¹⁵³ the same court stated that a judge is not necessarily precluded from including a discretionary trust in the marital estate, rather, “the trust instrument and other relevant evidence must be examined closely to determine whether that party’s interest is too remote.”¹⁵⁴

The Appeals Court of Massachusetts more recently affirmed a trial court’s inclusion in the marital estate of an apparent multi-generational trust valued at approximately \$5,000,000 in *Caruso v. Caruso*.¹⁵⁵ The trust was created by the husband’s father and named the husband and his issue as beneficiaries. Other dispositive provisions of the trust are not disclosed. The husband and his family’s long-time accountant were the trustees. Distributions could not be made to the husband without the accountant-co-trustee’s consent. The trust held stock of a family business which the husband managed. The trial court held that the husband’s beneficial interest was not too remote because the accountant “was in reality little more than the husband’s ‘yes man,’ who would go along with anything the husband wanted.”¹⁵⁶ The trial court found that the beneficial interest, “far from being remote or ‘speculative,’ was ‘real and equitable.’ ”¹⁵⁷ The beneficial interest was, according to the court, “in practical effect complete and immediate” and it was not error to include the trust in the marital estate.¹⁵⁸ In dividing the marital estate, the trust was awarded to the husband.

Oregon law also permits a usufructuary-type interest in trust to be divided in a property division. In *In Re Marriage of Taylor*,¹⁵⁹ the husband was

¹⁵³ 811 N.E.2d 1013 (Mass. App. Ct. 2004).

¹⁵⁴ *Id.* at 1023.

¹⁵⁵ 2008 WL 200301 (Mass. App. Ct. 2008). *Caruso* constitutes an unpublished decision and as such, Massachusetts law allows its citation for its persuasive value, but not as binding precedent in that state. *See Chase v. Curran*, 881 N.E.2d 792 (Mass. App. Ct. 2008).

¹⁵⁶ *Id.* The accountant “apparently was unaware until so informed at trial that he was a trustee under the trust or had any duties with respect thereto.” *Caruso*, 2008 WL 200301 (Mass. App. Ct. 2005).

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ 856 P.2d 325 (Or. Ct. App. 1993).

entitled to income and discretionary distributions from a trust, and apparently, no required distribution of trust principal was to be made to him during his life.¹⁶⁰ The court held that the interests were subject to division.¹⁶¹

In *Moore v. Moore*,¹⁶² the wife was a beneficiary and the sole trustee of two trusts referred to as the “Descendant’s Trust” and the “Exempt Trust.” All of the trust income was required to be distributed to the wife and the wife was entitled to distributions of principal for her maintenance, support, health or education.¹⁶³ The dispositive provisions of the trust applicable upon the wife’s death were not disclosed. Apparently, the trust interests were characterized by the court as the wife’s non-marital property and as a consequence, the income from the trusts was marital property under Missouri law.¹⁶⁴ Compelling to the court was that the wife was both “the sole trustee and sole beneficiary of each trust” and thereby held “both equitable and legal title.”¹⁶⁵ The court equated the wife’s rights in the trust to a right to withdraw all of the trust property and held that the distributions of trust income to the wife were thereby marital property.¹⁶⁶

Arguably, *Moore* may be cited for the proposition that multi-generational trusts of which a spouse is the sole trustee and sole current beneficiary constitute property for purposes of a divorce. But undermining that proposition and the *Moore* court’s logic is that the wife’s fiduciary duties

¹⁶⁰ *Id.* at 326.

¹⁶¹ *Id.* See also, *Bentson v. Bentson*, 656 P.2d 395 (Or. Ct. App. 1983).

¹⁶² 189 S.W.3d 627 (Mo. Ct. App. 2006).

¹⁶³ *Id.* at 636.

¹⁶⁴ *Id.* at 637. Increases in the value of non-marital property remain non-marital property under the Missouri statute, unless marital assets, including, labor, have contributed to the increases. MO. REV. STAT. § 452.330.2 (2009). However, as discussed in *Moore*, income from a spouse’s non-marital property constitutes marital property.

¹⁶⁵ *Moore*, 189 S.W.3d at 637.

¹⁶⁶ *Id.* at 636-637. Subsequent to *Moore*, and as discussed below, MO. REV. STAT. § 456.5.504-1 (2009), was revised to exclude an interest in a discretionary trust as property, even if the discretion is expressed in the form of a standard of distribution or if the beneficiary is serving as a trustee.

to successive trust beneficiaries were no different than those of a third party trustee.

In the author's opinion, it is too early to predict whether these cases represent a growing trend in matrimonial law or are simply anomalies.

F. **Income Interests.**

1. **Income Interests Not Considered Property.**

Courts have held that a beneficiary's mandatory income interest in a trust should not be included as property subject to the court's dispositional power.

In *In Re Marriage of Guinn*,¹⁶⁷ the Colorado Court of Appeals held that property for purposes of the Colorado property division statute should not include a spouse's mandatory income interest in an irrevocable trust.

In *Guinn*, the husband's parents created an irrevocable generation-skipping trust.¹⁶⁸ The husband was entitled to the net income from the trust, which was to be distributed at least annually. Discretionary distributions of trust principal to the husband were permitted if such payments were reasonably necessary for the husband's health, maintenance, support, and education. Upon the husband's death, the principal was to remain in trust for the benefit of the husband's descendants. The husband had no power of appointment with respect to the trust. The husband's parents were the trustees of the trust. Specifically, the trust instrument allowed the trustee to determine, in the trustee's reasonable discretion, what was principal and what was income of the trust. The trust instrument allowed the trustee to allocate capital gains to income. Testimony established that capital gains had been allocated to the principal, and interest and dividend income had been allocated to the income interest during the entire term of the trust.¹⁶⁹

¹⁶⁷ 93 P.3d 568 (Colo. Ct. App. 2004).

¹⁶⁸ *Id.* at 570.

¹⁶⁹ *Id.*

The wife contended that the husband's income interest in the trust constituted property under Colorado property division statute.¹⁷⁰ The Court of Appeals decided otherwise and held that the husband's income interest in the trust was not property under the statute.¹⁷¹ The court stated that "when the beneficiary has no interest in the corpus, and no right to control how the corpus is invested, . . . the income is a mere gratuity deriving from the beneficence of the settlors."¹⁷²

Reaching the same result with respect to a mandatory income interest, but utilizing a different rationale, the Delaware Supreme Court in *Sayer v. Sayer*¹⁷³ reasoned that the income interest was not subject to a property division because it could not be reduced to actual or constructive possession.¹⁷⁴

*In re Marriage of Harris*¹⁷⁵ involved a trust of which the husband's living mother was apparently the sole current beneficiary. Upon the mother's death, the husband and his two brothers "will each receive one-third of the annual interest income from the trust."¹⁷⁶ The opinion described the trust as a "generation-skipping trust," and further stated that the husband will not be entitled to any of the trust principal, "except if needed for health care purposes."¹⁷⁷ The trial court found that "the couple had made no retirement plans, based in large part on the assumption that [the husband's] ultimate

¹⁷⁰ The court noted the trial court's finding (and that the wife did not dispute such finding) that the husband had no property interest in the trust principal for purposes of COLO. REV. STAT. § 14-10-113 as a consequence of the trustee's power to distribute principal to him for his health, maintenance, support, and education. Solely at issue on appeal was whether the income interest constituted property. *Id.* at 570-71.

¹⁷¹ *Id.* at 572.

¹⁷² *Id.*

¹⁷³ 492 A.2d 238 (Del. 1985).

¹⁷⁴ *Id.* at 240.

¹⁷⁵ 132 P.2d 502 (Mt. 2006).

¹⁷⁶ *Id.* at 504.

¹⁷⁷ *Id.*

inheritance would allow them to continue their lifestyle into retirement.”¹⁷⁸ The trial court valued the husband’s “one-third life interest income” in the trust at \$3,000,000 and placed it on the husband’s side of the ledger, apparently offsetting that value with other divisible property in the wife’s favor. The Montana Supreme Court reversed the trial court and held that the trust should not have been included in the marital estate, but that the husband’s trust interest could be considered when distributing the existing marital estate.¹⁷⁹

It would seem that the logic for excluding an income interest from the pool of divisible assets would also apply to annuity and unitrust interests and at least one decision has so extended that logic to an annuity interest.¹⁸⁰

2. **Income Interests Considered Property.**

Contrary to the decisions discussed above, North Dakota law permits an income interest to be considered as property for purposes of its enabling statute.

In *Fox v. Fox*,¹⁸¹ the North Dakota Supreme Court held that an income interest in a “self sustaining” irrevocable life insurance trust created by the husband, of which the wife was the trustee,

¹⁷⁸ *Id.* at 505.

¹⁷⁹ *Id.* at 508.

¹⁸⁰ *See Kroha v. Kroha*, 578 S.W.2d 10 (Ark. 1979), which was decided under a predecessor of the Arkansas property division statute. In *Kroha*, an annuity of \$200 per month and discretionary distributions for “any emergency” were payable to the husband for his lifetime. *Id.* at 11. There is also analogous support for treating an annuity interest the same as mandatory income interest. RESTATEMENT (THIRD) OF PROPERTY (WILLS AND DONATIVE TRANSFERS) § 15.1 cmt p., Tentative Draft No. 4, 2004, treats periodic annuity payments the same as income payments for the purpose of determining when a class gift is closed.

¹⁸¹ *Fox v. Fox*, 592 N.W.2d 541 (N.D. 2001), referred to as “Fox I,” was later reviewed by the North Dakota Supreme Court in *Fox v. Fox*, 626 N.W.2d 660 (N.D. 2001), which is discussed below.

should be included in the marital estate.¹⁸² The trust held policies on the husband's life with death benefits of \$814,969 and cash values of \$290,000.¹⁸³ The wife was given the income from the trust for her life and held the right to withdraw the greater of \$5,000 or 5% of the principal of the trust each calendar year. Even though the trust produced no income in the past, and the wife stated at trial that she had no intent (as trustee) of surrendering the policies, the Court required the value of the income interest and the withdrawal right to be included in the marital estate.

The value of a beneficiary's lifetime income interest in a trust is also subject to the court's dispositional power in Oregon. In *Becker v. Becker*,¹⁸⁴ the Court of Appeals of Oregon determined that the wife's income interests, in addition to her beneficial interests in other trusts, were subject to the trial court's authority to divide property. The court awarded the non-beneficiary spouse his share of the trust interests by means of a judgement payable in installments, with a balloon payment due when the property of one trust became distributable at the death of an elderly aunt.¹⁸⁵

The New Hampshire Supreme Court held that the right to receive "interest" from an unusual "charitable trust" constituted "marital property subject to distribution" in a property division in *Chamberlin v. Chamberlin*.¹⁸⁶

¹⁸² Fox I, 592 N.W.2d at 544. N.D. CENT. CODE § 14-05-24 includes all of the property of the parties in the marital estate and the court must equitably divide the property based upon the circumstances of the particular case. *Id.* citing Galrupp v. Galrupp, 510 N.W.2d 620, 621 (N.D. 1994) and Nelson v. Nelson, 584 N.W.2d 527 (N.D. 1998).

¹⁸³ Fox I, 592 N.W.2d at 545-546.

¹⁸⁴ 858 P.2d 480 (Ore. Ct. App. 1993).

¹⁸⁵ *Id.* at 481-482. In support of the disposition of the parties' assets, the court noted that "[d]uring the marriage, wife's entitlement to her trust interests was never in doubt. They used husband's salary and did not save for retirement in anticipation that wife's trust receipts and husband's pension would keep them financially secure during retirement. The judgement partially compensates husband for his reliance on wife's assets for retirement." *Id.* at 483.

¹⁸⁶ 915 A.2d 1 (N.H. 2007).

3. **Income Interests in Texas.**¹⁸⁷

Before discussing Texas income interests, a brief discussion of Texas property divisions deserves mention.

Community property in Texas consists of the property other than separate property acquired by either spouse during marriage.¹⁸⁸ Upon divorce, a “just and right” division of community property is made by the court.¹⁸⁹ Separate property consists of property owned or claimed by a spouse before marriage, property acquired by a spouse during marriage by gift, devise or descent, and recovery for personal injuries sustained by a spouse during marriage, except for recovery for loss of earning capacity during marriage.¹⁹⁰ The Court is prohibited from awarding separate property or its increase of one spouse to the other,¹⁹¹ but the community estate is entitled to reimbursement from the separate estate for the reasonable value of the time, toil, and effort expended by one or both spouses to enhance the separate estate, less the remuneration received for that time and effort.¹⁹² Income generated during marriage from separate property is community property.¹⁹³

Income distributed from a trust of which a beneficiary possesses a mandatory income interest has been held to be community property.¹⁹⁴ Corpus distributions remain separate property.¹⁹⁵ Where the trustee had the right to withhold the distribution of trust

¹⁸⁷ See also, W. Michael Wiist, *Comment, Trust Income: Separate or Community Property?* 51 BAYLOR L.REV. 1149 (1999).

¹⁸⁸ TEX. FAM. CODE § 3.002 (2009).

¹⁸⁹ TEX. FAM. CODE § 7.001. (2009)

¹⁹⁰ TEX. FAM. CODE § 3.001 (2009).

¹⁹¹ *Cameron v. Cameron*, 641 S.W.2d 210 (Tex. 1982).

¹⁹² *Jensen v. Jensen*, 665 S.W.2d 107 (Tex. 1984).

¹⁹³ *Arnold v. Leonard*, 273 S.W. 799 (Tex. 1925).

¹⁹⁴ *Ridgell v. Ridgell*, 960 S.W.2d 144 (Tex. Civ. App. 1997).

¹⁹⁵ *Id.* at 149.

income from a beneficiary spouse of a discretionary trust and the beneficiary spouse was not the trustee, the undistributed income was not deemed community property in *In Re Marriage of Burns*.¹⁹⁶ Where a beneficiary spouse had the right to withdraw one-half of the corpus at age twenty-five and attained that age during the marriage, but did not withdraw the trust property, the court held that the accumulated income after age twenty-five from his one-half share was community property, which was subject to division.¹⁹⁷

If created by gift, devise or descent, it appears that the principal of a trust will not be subject to a property division in Texas, but it also seems possible that accumulated income of a trust may in some circumstances, constitute community property subject to equitable division by the Texas courts. A Texas non-beneficiary spouse might argue that income of a discretionary trust of which the beneficiary spouse served as the trustee should be treated in the same manner as a mandatory income interest, since the beneficiary could freely distribute income to himself or herself. Similarly, where a trust holds an asset created by the time, talent and industry of a spouse, an equitable division of some portion of the trust also seems possible in Texas.

G. **Interests in Third Party Revocable Trusts.**

It is logical and courts have held that a beneficiary's interest in a third party settled revocable trust of a living settlor is not includible in the pool of divisible assets in the remainder beneficiary's divorce.¹⁹⁸ Courts have

¹⁹⁶ 573 S.W.2d 555 (Tex. Civ. App. 1978). *See also*, *Lemke v. Lemke*, 929 S.W.2d 662 (Tex. Civ. App. 1996).

¹⁹⁷ *In Re Marriage of Long*, 542 S.W.2d 712 (Tex. Civ. App. 1976). *But see*, *Cleaver v. Cleaver*, 935 S.W.2d 491 (Tex. Civ. App. 1995), where a beneficiary had only a mandatory income interest in the trust and the court determined that the undistributed income was separate property, but "interest" earned on the undistributed trust income was community property.

¹⁹⁸ *See e.g.*, *Rubin v. Rubin*, 527 A.2d 1184 (Conn. 1987); *Dorn v. Heritage Trust Co.*, 24 P.3d 886 (Ct. App. Okla. 2001); *Estate of Knickerbocker*, 912 P.2d 969 (Utah 1996); *Centioli v. Centioli*, 781 N.E.2d 611 (App. Ct. Ill. 2002); *Davis v. Davis*, 2008 Vt. Unpub. Lexis 63; and *In Re Marriage of Githens and Moffet*, 204 P.3d 835 (Or. Ct. App. 2009).

acknowledged that the interest of a remainder beneficiary of a revocable trust is indistinguishable from an expectancy under a will.¹⁹⁹

Running counter-logic are decisions that a remainder beneficiary's interest in a third party created revocable trust of a living settlor constitutes a property interest of a spouse.

In *Tatham v. Tatham*,²⁰⁰ the husband's father transferred all of his assets, which included a farm, to a trust that was revocable by the father. If the husband survived his father by thirty (30) days, the trust instrument provided that the husband was to receive the farm. The father died and title to the farm was then conveyed to the husband. The Appellate Court of Illinois determined that the husband obtained a "beneficial interest and therefore a property right" in the farm at the date of the creation of the revocable trust.²⁰¹ According to the court, the designation of the husband as a beneficiary of his father's revocable trust "was equivalent to a 'gift' as that term appears in the statute so that the beneficial interest was [the husband's] nonmarital property."²⁰²

1. ***In Re Marriage of Gorman and the Anti-Gorman Statute.***

In *In Re Marriage of Gorman*,²⁰³ the husband's living mother created a typical revocable trust in which she retained all the income from the trust, the right to receive distributions of principal for her benefit, and the power to revoke or amend the trust. Upon the mother's death, the trust was to be distributed to the husband and his siblings.

The trial court held that husband did not possess a property interest in the trust, but only a mere expectancy.²⁰⁴ The Colorado Court of

¹⁹⁹ See for example, Centioli, 781 N.E.2d at 616.

²⁰⁰ 527 N.E.2d 1351 (App. Ct. Ill. 1988).

²⁰¹ *Id.* at 1355.

²⁰² *Id.* Consequently, the husband's uncompensated services on the farm constituted a contribution of the marital estate to the nonmarital estate. *Id.*

²⁰³ 36 P.3d 211 (Colo. Ct. App.2001).

²⁰⁴ *Id.*

Appeals reversed and held that husband’s “vested remainder interest” had to be treated in the same manner as the vested remainder interest considered in *Balanson II*,²⁰⁵ discussed above.²⁰⁶ The court acknowledged the difficulty in valuing such an interest, but suggested that the property division could be delayed until husband came into actual possession of the interest.²⁰⁷

In response to *Gorman*, the Colorado legislature revised Colorado’s property division statute, effective July 1, 2002.²⁰⁸ The revised statute states, in pertinent part:

‘[P]roperty’ and ‘an asset of a spouse’ shall not include any interest a party may have as an heir at law of a living person or any interest under any donative third party instrument which is amendable or revocable, including but not limited to third-party wills, revocable trusts, life insurance, and retirement benefit instruments, nor shall any such interests be considered as an economic circumstance or other factor.²⁰⁹

²⁰⁵ *Id.* at 212-13.

²⁰⁶ Perplexing is the fact that only seven months before, a different division of the same appellate court ignored the interests of remainder beneficiaries of a revocable trust in determining the separate property of the settlor and the marital property of the settlor and the settlor’s spouse. *See In Re Marriage of Seewald*, 22 P.3d 580 (Colo. Ct. App. 2001).

²⁰⁷ *Id.* at 213.

²⁰⁸ COLO. REV. STAT. § 14-10-113(7)(c) states that the new provision applies to all causes of action filed on or after July 1, 2002, and causes of action filed before such date in which a “final property disposition order” was not entered prior to July 1, 2002. In March of 2003, the trial court, on remand from *Balanson II*, did not consider COLO. REV. STAT. § 14-10-113(7)(b) and included in the wife’s remainder interest in the B trust that portion of the appreciation attributable to the period of time when the trust was revocable by the joint settlors. The court of appeals in *Balanson III* found that a final order had not been entered in the matter and that the trial court erred by failing to consider COLO. REV. STAT. § 14-10-113(7)(b) and (c).

²⁰⁹ COLO. REV. STAT. § 14-10-113(7)(b).

The statute does not define the terms “amendable” and “revocable,” and the meaning of those terms will be fertile ground for controversy. A trust instrument may, of course, grant powers of appointment, both inter vivos and testamentary, to persons who are typically, but not necessarily, beneficiaries of the trust. The practical effect of the exercise of a power of appointment on the beneficial interest of a divorcing spouse is no different than if a settlor of a revocable trust amended or revoked the terms of the trust altering or eliminating the beneficial interest. Similarly, a trustee’s or third person’s power also might be considered substantial enough to render the beneficial interest amendable or revocable.²¹⁰

Even if a court determined that a power of appointment or other power rendered the interest in trust too remote to constitute property, a remaining issue is whether the beneficial interest may be considered as an “economic circumstance or other factor.” *In Re Marriage of Jones* held that the trust interest in that case, although a mere expectancy and not property, should be considered as an economic circumstance under the Colorado property division statute.²¹¹ The extent to which § 14-10-113(7)(b) overrules that holding is unknown at this time.

*In Re Marriage of Dale*²¹² held that the wife’s remainder interest in an irrevocable trust created by her grandfather constituted property within the meaning of C.R.S.A. § 14-10-113. The court determined that the wife’s interest was indistinguishable from the remainder interest in *Balanson*.²¹³

The wife contended that since the trust would be distributed to her father’s heirs at law at his death, she held the remainder interest by

²¹⁰ For example, intentionally defective grantor trusts often are drafted to allow a non-adverse party to add beneficiaries of the trust, which creates grantor trust status under I.R.C. § 674(5) without causing the trust to be included in the grantor’s gross estate for federal estate tax purposes.

²¹¹ Jones, 812 P.2d at 1157.

²¹² 87 P.3d 219, 224 (Colo. Ct. App. 2003).

²¹³ *Id.* at 225.

virtue of being an “heir at law” of her living father.²¹⁴ Because § 14-10-113(7)(b) excludes “any interest a party may have as an heir at law of a living person,”²¹⁵ the remainder interest, according to wife, was not property.

The court noted that the definition of an “heir” is “a person who, under the laws of intestacy, is entitled to receive an intestate decedent’s property.”²¹⁶ The court reasoned that the wife held her remainder interest in the trust not as an heir at law under the laws of intestacy, but as a vested beneficiary of an irrevocable trust.²¹⁷

Although the court stated that it need not consider any other interpretive aids, the opinion then added:

The legislative history shows that § 14-10-113(7)(b) was adopted to overturn the holding in *In Re Marriage of Gorman, supra*, that a vested remainder interest in a revocable or modifiable trust is a property interest subject to division. Speakers on behalf of the bill specifically referenced the *Gorman* decision and explained that subsection (7)(b) was drafted as a noncompromise measure to accomplish a complete reversal of that holding. The speakers also clearly advised that the statutory change did not address the holding in *In Re Marriage of Balanson, supra*, and was not intended to change the classification of remainder interests in irrevocable trusts as property subject to division. . . . Hearings on S.B. 02-160 before the Senate Judiciary Committee and the House Judiciary Committee, 63rd General Assembly, Second Regular Session (Jan. 9, 2002).²¹⁸

²¹⁴ *Id.* at 223.

²¹⁵ *Id.* at 222-23 (quoting COLO. REV. STAT. § 14-10-113(7)(b)).

²¹⁶ *Id.* at 223 (quoting BLACK’S LAW DICTIONARY 727 (7th ed. 1999)).

²¹⁷ *See Id.*

²¹⁸ Dale, 87 P.3d at 224.

Perhaps § 14-10-113(7)(b) could have been more explicit, but in this author's opinion, criticism of the statutory revision is undeserved. The amendment succeeded in its primary objective, and any uncertainty created by the statute is minor relative to the problem that it cured.

H. Self-Settled Trusts.

In *In Re Marriage of Pooley*,²¹⁹ proceeds from a personal injury settlement received by the wife were transferred to an irrevocable trust with the wife as beneficiary and the wife's parents as trustees. Distributions of income and principal by the trustees to the wife were within the "sole and absolute discretion" of the trustees.²²⁰ The husband argued that the trust was funded with marital property.

Although the trial court and the Colorado Court of Appeals acknowledged that the assets from a personal injury settlement are generally marital property subject to equitable division, both courts disagreed with the husband's contention that the trust property was marital property subject to division.²²¹ The Court of Appeals stated that it did not read the holding in *In Re Marriage of Jones* as "in any way dependent on the fact that the trust at issue [in *Jones*] was created with funds that would otherwise have been the beneficiary's separate property."²²² The Court further stated:

under *Jones*, it is the extent of the beneficiary's right to or interest in the trust rather than the source of funding for the trust that determines whether the trust and the income from it are property. While the trust at issue here was funded with settlement proceeds that would otherwise have been marital property, wife's interest in these funds after they

²¹⁹ 996 P.2d 230 (Colo. Ct. App. 1999).

²²⁰ *Id.* at 231.

²²¹ Unliquidated personal injury claims arising during marriage are marital property under Colorado law. *See In Re Marriage of Fields*, 779 P.2d 1371 (Colo. Ct. App. 1989).

²²² *Pooley*, 996 P.2d at 231-232.

were placed in a discretionary trust was no different from the interest of the wife/beneficiary in *Jones*.²²³

The wife in *In Re Marriage of Kaladic*²²⁴ transferred property to an “irrevocable discretionary spendthrift trust”²²⁵ of which the wife was the beneficiary and her lawyer the trustee. The wife transferred the property in trust without the husband’s knowledge because of what the wife viewed as the husband’s excessive drinking and financial irresponsibility. The transfer in trust was made by the wife eleven months before filing the dissolution of marriage action.

The trial court awarded the husband approximately 26% of the trust and ordered the trustee to make such payment to the husband. The Colorado Court of Appeals affirmed and held that the wife’s conveyance of the marital assets into trust was “illusory and fraudulent” against the husband.²²⁶

If it is possible to reconcile *Pooley* and *Kaladic*, the distinction would turn on whether the spouse who conveyed the property in trust acted fraudulently as to the other spouse. Thus, it is at least arguable that a self-settled discretionary trust with a third party trustee, funded without fraudulent intent as to non-beneficiary spouse, should not be considered property for purposes of the enabling statute even though the trust property would have been subject to equitable division if the transfer in trust had not been made.

Alternatively, *Pooley* may be viewed as simply wrong and its holding result driven. As a general rule, if a settlor creates a trust with spendthrift provisions for his or her own benefit, it is void as to existing and future creditors.²²⁷ To extend *Pooley* beyond the facts of that case would likely

²²³ *Id.* at 232.

²²⁴ 589 P.2d 502 (Colo. Ct. App. 1978).

²²⁵ *Id.* at 503.

²²⁶ *Id.* at 505. *See also*, *Breitenstine v. Breitenstine*, 62 P.3d 587 (Wyo. 2003), where the husband’s transfer of assets to an offshore asset protection trust did not avoid a fair division of marital property.

²²⁷ GEORGE GLEASON BOGERT, GEORGE TAYLOR BOGERT AND AMY MORRIS HESS, *THE LAW OF TRUSTS AND TRUSTEES*, § 223, citing *RESTATEMENT (SECOND) TRUSTS*,

result in the odd and unusual circumstance of placing a spouse in an inferior position as to the divisible property relative to an ordinary creditor of the spouse who created the self-settled trust.

In a decision with facts similar to *Pooley*, the Supreme Court of Georgia, in *Speed v. Speed*,²²⁸ reviewed a discretionary irrevocable trust created by the husband with a portion of his personal injury settlement. The husband was the sole beneficiary of the trust.²²⁹ The wife argued that the spendthrift provision of the trust prohibiting involuntary transfer of the trust property was unenforceable because the husband was both the settlor and sole beneficiary of the trust. The Supreme Court of Georgia agreed with the wife and held that the trust could not shield those assets from claims for both alimony and a property division. According to the Court, since a creditor of a beneficiary of a self-settled trust could reach the assets of the trust, the wife could do likewise with respect to a property division.

Where a third party trustee of a self-settled trust is alleged to be in possession of marital property, joinder of the trustee in the divorce action appears to be permissible.²³⁰

I. **Power of Appointment as Property: *Cooley and Ruml*.**

1. ***Cooley v. Cooley*.**

A limited of power of appointment exercisable by the husband during his lifetime or by will in favor of the wife or the husband's brothers was held not to be a part of the marital estate and therefore

§ 156 and other authority. *See also*, RESTATEMENT (THIRD) TRUSTS, § 58(2) (2003), which states that a restraint on the voluntary or involuntary alienation of a beneficial interest retained by the settlor of a trust is invalid.

²²⁸ 430 S.E.2d 348 (Ga. 1993).

²²⁹ The trust instrument instructed the trustees to “distribute principal and interest (sic) as necessary, in the trustee’s discretion for the husband’s maintenance and support.” *Id.*

²³⁰ *See for example*, *Schnabel v. Superior Court of Orange County*, 36 Cal. Rptr.2d 677 (Ca. Ct. App. 1994) and *In the Matter of the Marriage of Holemar*, 557 P.2d 38 (Or. Ct. App. 1976).

not subject to the court's dispositional power in a divorce in *Cooley v. Cooley*.²³¹

The Connecticut Court of Appeals in *Cooley* ruled that the trial court properly refused to order the husband to exercise his limited power of appointment.²³² The court distinguished a limited power of appointment from a general power of appointment, noting that “[w]here...a general power has been created, the donee is substantially in the position of an owner,”²³³ [but in a case of a limited power, the powerholder] has no interest, beneficial or otherwise.”²³⁴

The result in *Cooley* seems correct and obvious. The court's distinction between general and limited powers of appointment also seems appropriate and implies that trust property subject to a spouse's inter vivos general power of appointment can be subject to the court's dispositional power if the trust property can be reduced to the possession of the powerholder by reason of the exercise of the power.²³⁵

²³¹ 628 A.2d 608 (Conn. Ct. App. 1993).

²³² *Id.* at 614.

²³³ *Id.*, quoting RESTATEMENT (SECOND) PROPERTY § 13.1 cmt. a. (1996).

²³⁴ *Cooley*, 628 A.2d at 614.

²³⁵ Trust assets over which a spouse has a general power of appointment at divorce have been specifically included in the marital estate in Massachusetts. *See Sullivan v. Burkin*, 460 N.E.2d 572, 577 n.6 (Mass. 1984).

2. *Ruml v. Ruml*.

In a case involving egregious facts, the Appeals Court of Massachusetts, in *Ruml v. Ruml*²³⁶ upheld a decision that awarded the wife all of the trust property of a trust created by the husband for the benefit of his “spouse and children” over which the husband held a nongeneral power of appointment exercisable in favor of a broad class of appointees, which included the spouse of the settlor.²³⁷ The third party trustee was not a party to the divorce action. The husband was ordered “to assign to the wife all of the [trust property],”²³⁸ but apparently did not. The trial court simply awarded the trust property to the wife and the appellate court affirmed that decision.

Generally, it is the “value” of a trust interest that is awarded by the divorce court. Even when there exists egregious circumstances, there is no basis for a court to award the property of a trust without having jurisdiction over the trustee.²³⁹

Ruml stands for the disturbing proposition that a court may order a spouse to exercise a nongeneral power of appointment over a trust

²³⁶ 738 N.E.2d 1131 (Mass. App. Ct. 2000). The husband possessed substantial resources. He abandoned his wife and minor children, made transfers of otherwise divisible property to third persons, resided with a woman whom he had a romantic relationship, failed to pay child support, failed to provide health insurance for his children, as ordered, and refused to participate in the divorce proceedings, despite contempt citations. Both the trial court’s and appellate court’s displeasure with the husband were obvious. The appellate court ruled that the trial court did not commit error by failing to award the husband his clothes, shoes and diplomas. *Id.* at 1143.

²³⁷ *Id.* at 1138, 1142.

²³⁸ *Id.* at 1140.

²³⁹ See for example, *Riechers v. Riechers*, 679 N.Y.S.2d 233 (N.Y. Sup. Ct. 1998), where the court awarded the wife “one-half of the value of the marital assets placed in [a] Cooks Island trust” by the husband, leaving “the ultimate determination of entitlement to the corpus of the trust with the high court of Cook Islands.” *Id.* at 236. See also, *Breitenstine v. Breitenstine*, 62 P.3d 587 (Wyo. 2003), where the existence of an offshore asset protection trust was not ignored even though the transfer of marital property to the trust by the husband was found to be fraudulent as to the wife.

in favor of the other spouse even though the husband held no beneficial interest in the trust.

The Appeals Court of Massachusetts affirmed the trial court's award of the trust property to the wife, even though the husband failed to exercise the power of appointment in compliance with the court's order and the absence of the trustee in the divorce proceedings. This aspect of the *Ruml* opinion is perhaps even more disturbing. *Ruml* may be best explained by the axiom that bad facts make bad law.²⁴⁰

J. **Dissipation Claims and Trusts.**

The dissipation of assets by a spouse prior to divorce proceedings which would have otherwise have been available for a property division may be taken into account in dividing the property.²⁴¹ The justification is that a party dissipating assets for a purpose unrelated to the marriage should not benefit by such action.²⁴² If dissipation of divisible property is found, the

²⁴⁰ There are instances where public policy does require that spendthrift provisions be ignored and a creditor be treated as a "spendthrift exception creditor." For example, a trust beneficiary's child support obligations and alimony obligations may be paid from a trust notwithstanding spendthrift provisions to the contrary. See RESTATEMENT (SECOND) TRUSTS § 157 (1959) and UNIFORM TRUST CODE § 503 (2003). The better view is that the UNIFORM TRUST CODE does not extend spendthrift exception status to a divorcing spouse in connection with a property division of a third party settled trust. See Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 REAL PROP. PROB. & TR. J. 567,627 (2005).

²⁴¹ See e.g., *In re Marriage of Hagshenas*, 600 N.E. 2d 437 (Ill. Ct. App. 1992); *Turner v. Turner*, 809 A. 2d 18 (Md. Spec. App. Ct. 2002); *In re Marriage of Martinez*, 77 P. 3d 827 (Colo. Ct. App. 2003).

²⁴² See generally, J. Thomas Oldham, "Romance Without Finance Ain't Got No Chance": *Development of the Doctrine of Dissipation in Equitable Distribution States*, 21 J. AM. ACAD. MATRIMONIAL LAW. 201 (2008); Brett R. Turner, *Division of Third-Party Property in Divorce Cases*, 18 J. AM. ACAD. MATRIMONIAL LAW. 375, 419 (2003).

spouse who did not commit the dissipation may be entitled to a “setoff”²⁴³ or perhaps compensated otherwise.

When a spouse transfers assets in trust for the benefit of third parties prior to the commencement of divorce proceedings, a dissipation claim is possible. In *In re Marriage of Lee*,²⁴⁴ the spouses were undergoing marital difficulties. On or about the day the parties separated the husband transferred \$100,000 to an irrevocable trust for the benefit of the parties’ children, naming the husband’s niece and nephew as contingent beneficiaries.

The court held that the transfer may be regarded as a dissipation of marital assets and affirmed the trial court’s finding of dissipation of the transfer in trust, as well as other assets transferred to or for the benefit of the children.²⁴⁵ Whether a dissipation occurred, according to the court, depends on the facts of a particular case and “excessive expenditures, even if for a permissible purpose, may cause a dissipation.”²⁴⁶ The amounts transferred by the husband in the months prior to separation were not comparable to his previous transfers to the children. The wife had no knowledge of the transfers and therefore did not acquiesce to them. The husband was a physician whose income was substantially greater than the wife’s and the expense of the childrens’ education most likely would, according to the court, have been borne by the husband. By transferring the dissipated marital property, which the court assumed would have been divided equally, the husband shifted a portion of the childrens’ education from himself to the wife.²⁴⁷ To have held otherwise, according to the court, “invites vindictive spouses to make such transfers for the primary

²⁴³ See e.g., *In re Marriage of Paulsen*, 677 P. 2d 1389 (Colo. Ct. App. 1984). If marital assets have been dissipated, some courts have held that those assets must be valued as of the last date they existed as marital property. See e.g., *In re Marriage of Feiner*, 920 P. 2d 325, 331 (Colo. Ct. App. 1996).

²⁴⁴ 615 N.E.2d 1314 (Ill. App. Ct. 1993).

²⁴⁵ *Id.* at 1319 - 1320.

²⁴⁶ *Id.* at 1319.

²⁴⁷ *Id.* at 1320.

purpose of depriving the other spouse of the use of his or her fair share of the marital estate.”²⁴⁸

The court also found an improper dissipation of assets in *Schneider v. Schneider*,²⁴⁹ where the husband transferred an interest in a life insurance policy subject to a split dollar agreement to an irrevocable trust he created for his children. The trust was treated as one of the husband’s assets for purposes of equitable division because the value of the trust came from the sale of the husband’s medical practice, which he built during the marriage, and also because the wife was unaware that the husband had created the trust. The court noted that the husband established the trust at a time when he was having an extramarital affair, while anticipating a dissolution proceeding.²⁵⁰

By contrast, husband’s transfers of closely held stock at apparently substantially discounted values to irrevocable trusts for his children one month before he filed for divorce was not considered a dissipation of the marital estate in *Kasser v. Kasser*.²⁵¹ The dissenting opinion in *Kasser* states that the wife was not informed of the transfers and the gifts were substantially greater than the husband’s prior gifts to the trusts.²⁵² Notwithstanding these circumstances, the majority upheld the trial court and found that the contributions to the trusts were not done with any purpose to deplete the marital estate.

In *Loomis v. Loomis*,²⁵³ the wife created an irrevocable life insurance trust and transferred a life insurance policy to it almost 6 years before the

²⁴⁸ *Id.*

²⁴⁹ 864 So.2d 1193 (Fla. 4th DCA 2004).

²⁵⁰ *Id.* at 1195-1196. *See also*, FLA. STAT. § 61.075(1)(i) (2009), which states that a relevant factor in a Florida property division is “the intentional dissipation . . . of marital assets within 2 years prior to filing the petition.”

²⁵¹ 895 A.2d 134 (Vt. 2006).

²⁵² *Id.* Johnson & Skoaglund, JJ. dissenting at 149. According to the dissent, the husband characterized the pre-divorce transfers “as a ‘brilliant piece of estate planning’ [and] the trial court accepted this explanation, focusing exclusively on whether the transfers represented good estate planning.” *Id.*

²⁵³ 158 S.W.3d 787 (Mo. Ct. App. 2005).

parties separated. The wife was neither a trustee or beneficiary of the trust, but the trial court held that the policy constituted marital property and the wife's award of marital property included the cash value of the policy. There was no evidence that the wife secreted or squandered the insurance policy in anticipation of divorce by placing the policy in the trust almost 6 years prior to the parties' separation and the trial courts' holding was therefore reversed.

It has been stated that "the initial burden of production in showing dissipation is on the party making the allegation . . . [and] [t]hat party retains throughout the burden of persuading the court that funds have been dissipated, but after that party establishes a prima facie case that monies have been dissipated . . . , the burden shifts to the party who spent the money to produce evidence sufficient to show that expenditures were appropriate."²⁵⁴

The testimony of a document drafter would seem to be relevant in establishing the purposes of a trust and circumstances of a transfer in a dissipation claim. Thus, discovery directed to a document drafter who represented only one of the spouses when substantial gifts and transfers in trust are made for the benefit of third persons shortly before the commencement of divorce proceedings should not come as a surprise.

K. **Statutory Amendments.**

1. **Alaska Statutory Amendment.**

In Alaska, the court's dispositional power extends to all of the parties' property.²⁵⁵

²⁵⁴ Turner v. Turner, 809 A.2d 18, 52 (Md. Ct. Spec. App. 2002).

²⁵⁵ ALASKA STAT. § 25.24.160(a)(4) (2009), which provides, in part, that "the court may provide . . . for the division between the parties of their property . . . whether joint or separate, acquired only during marriage, in a just manner . . . ; however, the court in making the division may invade the property . . . of either spouse acquired before marriage when the balancing of the equities between the parties requires it . . ."

A 2006 statutory revision imposed a limitation on the courts' dispositional power over both third party and self-settled trusts.²⁵⁶ ALASKA STAT. § 34.40.110(1)(2009) states, in part, as follows:

If a trust has a transfer restriction allowed under (a) of this section,²⁵⁷ in the event of the divorce or dissolution of the marriage of a beneficiary of the trust, the beneficiary's interest in the trust is not considered property subject to division under . . . [the Alaska property division statutes] or a part of a property division . . . Unless otherwise agreed to in writing by the parties to the marriage, this subsection does not apply to a settlor's interest in a self-settled trust with respect to assets transferred to the trust

(1) after the settlor's marriage; or

(2) within 30 days before the settlor's marriage unless the settlor gives written notice to the other party to the marriage of the transfer.

Thus, under the Alaska statute, the court is prohibited from awarding the property or the "value" of the property of a third party settled trust (as well as a self-settled trust if the conditions of the statute are met) to the non-beneficiary spouse. The statute does not address whether a third party or self-settled trust is a "factor" for consideration by the court in the division of divisible property and apparently, consideration of a trust in Alaska remains a factor for consideration in an award of maintenance.²⁵⁸

²⁵⁶ See David G. Shaftel and Jonathan G. Blattmachr, *Alaska's 2006 Amendments to Its Trust and Estate Statutes*, 34 ESTATE PLANNING J. 10 (January 2007).

²⁵⁷ Subsection (a) of the statute states, in part, that "[a] person who in writing transfers property in trust may provide that the interest of a beneficiary of the trust, including a beneficiary who is the settlor of the trust, may not be either voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee."

²⁵⁸ See ALASKA STAT. § 25.24.160(a)(2) (2009).

2. **Missouri Statutory Amendment.**

Missouri amended its version of the Uniform Trust Code effective August, 2006, by revising MO. REV. STAT. § 456.5-504 (2009) to state, in part, as follows:

A beneficiary's interest in a trust that is subject to the trustee's discretion does not constitute an interest in property or an enforceable right even if the discretion is expressed in the form of a standard of distribution or the beneficiary is then serving as a trustee or co-trustee. A creditor or other claimant may not attach present or future distributions from such an interest or right, obtain an order from a court forcing the judicial sale of the interest or compelling the trustee to make distributions, or reach the interest or right by any other means, even if the trustee has abused the trustee's discretion. . . . This section applies whether or not an interest is subject to a spendthrift provision. . . . [A] beneficiary's interest in a trust is subject to the trustee's discretion if that interest does not constitute a mandatory distribution.²⁵⁹

The Missouri comment to § 4.56-5-504 states that the section was altered to clearly restate Missouri law that discretionary interests in trusts are not property for any purpose, including dissolution of marriage.

²⁵⁹ A mandatory distribution is defined in MO. REV. STAT. § 456.5-506 (2009).

Trusts providing for “mandatory distributions” may still result in divisible property in Missouri, depending upon the circumstances and the law in effect prior to the 2006 statutory amendment.²⁶⁰

L. Applicable Law.

If the governing law of a trust instrument is of a jurisdiction that does not treat a trust interest as property until the interest is possessory (such as Wyoming), will the court of a different jurisdiction whose property division law is dissimilar (such as Colorado or Massachusetts) apply the law governing the trust instrument or its own law for property division purposes? The Supreme Court of Connecticut answered this question by holding that although the construction of the trust instrument is to be governed by the law stated to be applicable in the trust instrument, the ultimate question of whether the value of the trust is included in the pool of divisible assets is determined under the law of the tribunal determining the property division.²⁶¹

When spouses move from one jurisdiction to another, a related issue is whether the law of the of jurisdiction where the spouses reside at the time the property was “acquired” applies or whether the law of the jurisdiction where the divorce is granted is applicable. For example, if a spouse becomes a beneficiary of a trust at a time when the spouses are living in Wyoming, but the spouses later move to Colorado, is it Wyoming or Colorado law that is applied in determining if the trust interest constitutes property? If applicable law is that of the state where the particular property was acquired, then the approach has been referred to as “partial mutability.” The term, “total mutability,” has been used to refer to the application of the law of the divorce court in determining the parties’ rights in a property division, regardless of where or when the property was acquired.²⁶² “[A] minority of U.S. states apply the law of the place of acquisition to determine the parties rights in such property at divorce. This approach was developed by some states as a strategy to deal with the situation when spouses move from a non-community property state to a

²⁶⁰ See Keith A. Herman, *How to Protect Trust Assets from a Beneficiary’s Divorce*, 63 J. MO. BAR 228 (September/October, 2007).

²⁶¹ *Tremaine v. Tremaine*, 663 A.2d 387 (Conn. 1995).

²⁶² See J. Thomas Oldham, *What if the Beckhams Move to L.A. and Divorce? Marital Property Rights of Mobile Spouses When They Divorce in the U.S.*, 42 FAM. L.Q. 263 (2008).

community property state. It is now accepted in Idaho, Nevada and Washington.”²⁶³ “The trend, however, is to apply forum law to divide all of the parties’ property.”²⁶⁴

If the partial mutability approach is applied to interests in trusts, courts of one jurisdiction would likely encounter substantial difficulty in determining and applying the law of another jurisdiction. An analogous “property interest” might be a professional degree. A professional degree constitutes divisible property in New York and New York divorce courts have developed significant expertise in making calculations as to how the degree will increase lifetime earnings.²⁶⁵ Courts of other states would have difficulty in applying this aspect of New York law. Determining the law of another jurisdiction as to treatment of interests in trusts and their valuation would seem to be no less difficult.

III. The Pension Analogy and Distribution.

To view the development of the law regarding pensions and interests in trusts as parallel and analogous is tempting and in some respects, the analogy may be appropriate. For example, pensions and interests in trusts may be vested or unvested and the enjoyment of the benefits may be defeated by the death of the participant or beneficiary.²⁶⁶ However, pensions and interests in trusts are incongruous in many other respects. Unlike pensions, some interests in trusts, though vested, may be decreased or eliminated by powers of appointment, distributions to other beneficiaries, and payment of transfer taxes due upon the death of a beneficiary who is not one of the divorcing spouses. Also, pension distribution requirements are fairly standardized, whereas variations of trust dispositive schemes are virtually unlimited.

²⁶³ *Id.* at 279. Citations omitted.

²⁶⁴ *Id.* at 280.

²⁶⁵ *See Id.* at 281.

²⁶⁶ In recent years, courts have been willing to divide unvested pension rights. *See Bender v. Bender*, 785 A.2d 197 (Conn. 2001) and *Hansen v. Hansen*, 836 A.2d 1288 (Conn. App. Ct. 2003) which state that the court is not precluded from awarding a spouse a portion of retirement benefits earned by the former spouse subsequent to the date of dissolution. In Colorado, unvested military pensions have been divided by the court. *See In Re Marriage of Hunt*, 909 P.2d 525 (Co. 1995). Military pensions do not partially vest, and if twenty years of service is not attained, the entire pension is forfeited. *Id.* at 530.

Despite the differences between pensions and trusts, courts have suggested that division and distribution of interests in trusts may be guided by those principles developed in dealing with divisions of pensions.²⁶⁷ For this reason, a basic discussion of those principles is relevant. Colorado law regarding pension division and distribution is representative of the law in many states.

A. Net Present Value Method.

Colorado and many other jurisdictions recognize three methods of pension division and distribution upon dissolution: the “net present value” method; the “deferred distribution” method; and the “reserve jurisdiction” method.²⁶⁸

The net present value method, also referred to as the “immediate offset” method, results in immediate distribution to the non-employee spouse. The court in *In Re Marriage of Hunt* noted: “if using this method, the trial court, guided by actuarial data, values the future benefit, considers a number of different factors, including certain risks . . . , and accords a present value to the future benefit.”²⁶⁹ The lump sum that represents the present value is offset by the value of other marital property.

Applying the net present value method to trusts may be difficult. A frequent uncertainty in the valuation of an interest in a trust arises as a consequence of a right of one or more current trust beneficiaries to receive discretionary distributions from the trust. Many trusts create (and the tax law encourages) discretionary interests in trusts for the benefit of an older generation because it allows flexible access to trust property without subjecting the trust property to estate tax at the older generation. A preceding invasionary right can produce a range of outcomes, depending on the facts and circumstances. At one end of the spectrum, the invasionary right might be ignored, but at the other end, the invasionary right might render a divorcing spouse’s interest in the trust too uncertain and speculative to be quantified.

²⁶⁷ See e.g., *Davidson*, 474 N.E.2d at 1145 n.12, where the court stated “guidance in crafting creative judgments may be found in cases dealing with pension interests.”

²⁶⁸ See *Hunt*, 909 P.2d at 525. See also, Elizabeth Barker Brandt, *Valuation, Allocation, and Distribution of Retirement Plans at Divorce: Where are We?*, 35 FAM. L.Q. 469 (2001); Marvin Snyder, *Challenges in Valuing Pension Plans*, 35 FAM. L.Q. 235 (2001).

²⁶⁹ 909 P.2d at 531.

Present value calculations involving pensions have been the source of substantial litigation. They require expert testimony, and the resulting calculations can vary significantly.²⁷⁰ The potential for experts to disagree is even greater in valuing interests in trusts. The terms of trust instruments will vary much more than those of retirement plans, and trusts will involve more subjective valuation factors and perhaps multiple measuring lives. In addition, actuaries and accountants may be ill-equipped to decipher trust instruments and their estate, gift, and generation-skipping transfer tax consequences. As with pension assets, the offsetting assets may not be sufficient to equal the share awarded to the non-beneficiary spouse.

B. Deferred Distribution Method and Reserve Jurisdiction Method.

Under the deferred distribution and reserve jurisdiction methods, the latter of which is sometimes referred to as the “wait and see” method, the non-employee spouse does not receive any benefits until the benefits are actually paid to the employee spouse or the employee spouse becomes eligible to receive the benefits.

The deferred distribution method requires the court to predetermine the non-employee spouse’s percentage of the pension stream that the non-employee spouse will be eligible to receive, once the pension is both vested and matured. The same principle has been applied to trusts in instances where a beneficiary’s interest is to become possessory upon the death of a current beneficiary or a future event.

If a divorce court reserves jurisdiction, the non-employee spouse’s percentage share is calculated later, at the time when the pension has vested and matured.²⁷¹ In the case of a trust, the event triggering the court’s reserved jurisdiction could be the death of a preceding lifetime beneficiary or other event causing the trust interest to be possessory.²⁷²

²⁷⁰ In *In Re Marriage of James*, 950 P.2d 624 (Colo. Ct. App. 1997), the parties’ respective experts valued the marital component of a pension at \$50,000 and \$190,000. *See also*, Brandt, 35 FAM. L.Q. at 483.

²⁷¹ *In Re Marriage of Hunt*, 909 P.2d at 531.

²⁷² In one instance a Colorado trial court reserved jurisdiction by requiring the beneficiary spouse to notify the non-beneficiary spouse within 10 days of the date the beneficiary obtained control or possession of trust assets (which was to occur at the death of the beneficiary’s parent), at which time a determination of the marital portion of the distributed property was to be made.

At least one appellate court has held that a trial court cannot use the reserve jurisdiction method or retain jurisdiction to enforce a deferred distribution order with respect to a trust. In *Smith v. Smith*,²⁷³ the Connecticut Supreme Court reviewed a trial court's order that it would retain jurisdiction to divide the trust if a subsequent determination was made that the husband had an interest in the trust. The husband simply disclosed that he was a remainder beneficiary of a family trust, but provided no other information regarding the interest. The Connecticut Supreme Court held that the Connecticut enabling statute did not permit the trial court to retain continuing jurisdiction to divide interests in trusts that were "expected or unvested interests, or to interests that the court has not quantified."²⁷⁴

IV. Valuation and Division of Interests in Trusts.

Once a court has determined that an interest in trust constitutes property for purposes of property division, another and perhaps equally complex analysis will be involved in determining the value of the interest. Trusts are designed to accomplish a variety of purposes, and the design of dispositive trust provisions are virtually unlimited. Courts will be required to analyze not only the interests of the trust beneficiaries, but also the powers, duties, discretions, and guidelines of the trustee. In addition, valuation of interests in trusts may require a trial court to consider matters extrinsic to the trust instrument and the marriage that typically are not considered in a property division proceeding.

Divorce courts and family law lawyers often lack experience in the valuation of temporal interests in property. If the value of an intervening beneficial interest in a trust is to be quantified on a subjective basis, for the purpose of determining a reduction in the value of the interest subject to division, it would seem that any trier of fact would struggle with such a determination. In many divorces, valuation of assets are entrusted to a single expert, such as an accountant, who may lack the background necessary for trust interpretation and valuation. With these factors in mind, it is easy to see why the law regarding valuation of interests in trusts lacks uniformity and precision.

²⁷³ 752 A.2d 1023 (Conn. 1999).

²⁷⁴ *Id.* at 1030.

A. **Colorado Law.**

Emerging valuation principles have evolved in Colorado. Even though much uncertainty remains, the Colorado courts have established a rudimentary framework in the valuation and division of interests in trusts.

1. ***Jones and Balanson.***

As previously discussed, *In Re Marriage of Jones*²⁷⁵ held that a beneficiary's interest in the principal of the trust did not constitute the separate property of a spouse for purposes of division under Colorado's equitable division statute. The dissenting opinion in *Jones*, states that the increase in the value of the trust assets during the marriage as marital property should have been treated as marital property.²⁷⁶ Acknowledging that apportioning the increase in the value of a trust may be difficult, the dissenting opinion states that trial courts are faced with valuation difficulties every day and goes on to say:

As in the case of valuing prospective pension payments, a court can employ any of several alternatives. One alternative might [be] to place a value on [the beneficiary's] interest in the increased value of the trust corpus by utilizing a table similar to that for valuing a remainder interest for purposes of estate taxes. Another alternative might consist of ordering a percentage of future funds received by the beneficiary to be paid over to the other spouse. Other alternative methods can be employed, based upon a trial court's "experience, insight and knowledge."²⁷⁷

Balanson II provided trial courts with similar, but less specific guidance in valuing interests:

Other courts that have addressed the valuation of similar interests have suggested an approach similar

²⁷⁵ 812 P.2d 1152 (Colo. 1991).

²⁷⁶ *Id.* at 1159 (Quinn, J., dissenting).

²⁷⁷ *Id.* at 1160 (citations omitted).

to that taken when valuing pensions. Under this approach, we conclude that the trial court may consider a variety of circumstances when determining the present value of the trust, including actuarial information concerning the life expectancy of [the beneficiary holding the current possessory interest in the trust] and information concerning the probability and extent to which [the beneficiary holding the current possessory interest] will need to invade principal for [the beneficiary's] maintenance.²⁷⁸

Balanson II and the dissent in *Jones* provide trial courts with the following guidance in valuation:

- a. A trial court may value beneficial interests in trusts in the same actuarial manner utilized for federal estate and gift tax purposes.²⁷⁹
- b. A trial court may order that a percentage of trust distributions received by the beneficiary's spouse subsequent to a legal separation or dissolution of the marriage be paid to the non-beneficiary spouse.²⁸⁰
- c. A trial court may utilize other unspecified valuation methods based upon the court's "experience, insight and knowledge."²⁸¹
- d. A trial court may consider a variety of circumstances, including actuarial information concerning the life expectancy of other beneficiaries of the trust and the extent to which other beneficiaries of the trust eligible for

²⁷⁸ *Balanson II*, 25 P.3d at 43 n.6 (citations omitted).

²⁷⁹ The *Jones* dissent suggested the application of estate tax principles. *See Jones*, 812 P.2d at 1160 (Quinn, J., dissenting). Presumably, federal gift tax principles also would apply.

²⁸⁰ *See Balanson II*, 25 P.3d at 42.

²⁸¹ *Jones*, 812 P.2d at 1160 (Quinn, J., dissenting).

distributions may require principal distributions.²⁸² Impliedly, an invasion power exercisable in favor of a non-spouse beneficiary may be quantified in the calculation of the beneficiary spouse's interest.

2. ***In Re Marriage of Mohrlang.***

*In Re Marriage of Mohrlang*²⁸³ concerned the husband's interest in an irrevocable trust that was "not modifiable."²⁸⁴ The trust principal consisted of stock in a closely-held corporation, which had appreciated since the date of the marriage.²⁸⁵ Income of the trust was required to be distributed to the husband at least quarterly, and principal distributions to the husband could be made to him for his health, maintenance, support, and education, within the discretion of the trustee. The husband's interest would terminate if he predeceased his parents, in which case his share would be divided among his children and the descendants of any of his deceased children. Apparently, the trust principal would be distributed to the husband upon his parents' deaths. No other person held an interest in the trust that preceded or existed concurrently with the husband's interest in the trust.²⁸⁶

The trial court did not discount to present value the husband's interest in the trust. At issue on appeal was whether the trial court erred in failing to discount the interest to its present value.²⁸⁷ The

²⁸² Balanson II, 25 P.3d at 43 n.6.

²⁸³ 85 P.3d 561 (Colo. Ct. App. 2003), *cert. denied*, No. 03SC701, 2004 WL 423111 (Colo. Mar. 8, 2004).

²⁸⁴ *Id.* at 562.

²⁸⁵ The husband's expert valued the trust assets (the stock) on an income approach using a capitalization rate of 33% and a present value discount rate of 4% (for an unspecified number of years) because the husband's interest in the trust would not become possessory until his parents died. The wife's expert valued the stock, and the trial court agreed, on the basis of the corporation's net assets. *See Id.*

²⁸⁶ *Id.*

²⁸⁷ *Id.* at 563. Because the husband had a mandatory income interest, a right to distributions of principal within the trustee's discretion, and the children of the marriage

Colorado Court of Appeals held that the trial court “should have considered actuarial information concerning the life expectancy of the husband’s parents and . . . the likelihood that the trustee would invade the trust corpus in the future.”²⁸⁸ The trial court was reversed and the case was remanded to “reconsider whether the value of husband’s trust interest . . . should be discounted by an appropriate rate because of the delay in husband’s receiving his interest, the possibility of forfeiture, and other contingencies.”²⁸⁹

Mohrlang raises the following questions:

- a. How is an appropriate discount rate determined?²⁹⁰
- b. What tables are to be used in determining life expectancy of a measuring life?
- c. Should the analysis be limited to actuarial tables or should other factors such as the actual health of a measuring life (e.g., the parents of the husband) be considered?
- d. Does the possibility of the husband’s death prior to his parents’ death reduce the value of the interest in the trust?²⁹¹

would receive the assets if husband died, the trial court determined that present value discounting was not warranted. The Colorado Court of Appeals determined that the trial court erred by rejecting any discount because the husband’s interest would go to his children if he predeceased them. *Id.*

²⁸⁸ *Id.*

²⁸⁹ *Id.*

²⁹⁰ The court noted *In Re Marriage of Grubb*, 745 P.2d 661 (Colo. 1987), which applied a 7% discount rate in connection with valuation of a pension. *Mohrlang*, 85 P.3d at 563.

²⁹¹ For example, the additional life expectancy of a 70 year old under mortality table 2000CM, the most recent mortality table for determining the gift and estate tax values of various component interests in property, is approximately 14 years. The probability of a 40 year old dying within 14 years is 4.8%. It would seem that the calculation suggested by *Mohrlang* could reduce the present value of the trust assets by 4.8% to account for the risk that the beneficiary might not survive until the projected distribution date.

- e. Assuming the trust instrument allows for discretionary distributions, how might a history of discretionary distributions of principal affect valuation?
- f. What “other contingencies,” referred to in *Mohrlang*, should a trial court to consider?

Although the *Mohrlang* opinion raises a number of questions, it does establish one important rule. Regardless of whether the beneficiary is entitled to mandatory income distributions and discretionary distributions of principal, the trial court at least must consider if the interest in the trust should be discounted to its present value for the period of time until the interest becomes possessory.

3. ***In Re Marriage of Dale.***

In *In Re Marriage of Dale*,²⁹² the Colorado Court of Appeals affirmed the trial court’s valuation of a remainder interest that was, according to the court, similar to the remainder interest of the B trust in *Balanson II*. The trial court valued the marital appreciation in the wife’s interest at \$313,962 and awarded the husband \$120,867.50 of that amount. One-half of the amount was to be paid within sixty days after the death of the wife’s father (the current trust beneficiary), and the other half was to be paid after the death of the wife’s mother.²⁹³ The trial court discounted the interest to present value by applying a six percent discount rate.²⁹⁴

²⁹² 87 P.3d 219 (Colo. Ct. App. 2003).

²⁹³ The wife’s grandparents created and funded the trust, and the wife’s 83 year old father was the current trust beneficiary. The value of the trust at the time of hearing was \$6,647,781. The trust income was distributed to the wife’s father, but the father had not taken any distributions of principal since 1963. One-half of the trust principal was to be distributed at the father’s death to the wife and her three siblings, and the balance was to be similarly distributed upon the death of the wife’s mother who might hold a “life estate” in the trust as a result of the father’s exercise of a testamentary power of appointment. *Id.* at 223, 225.

²⁹⁴ *Id.* at 225. The husband submitted the discount rate, but the court did not mention a rationale for the selection of the rate.

The court based the term of the present value calculation on the mortality table set forth in a Colorado statute.²⁹⁵

The wife argued that the valuation was defective because it was not based on expert testimony, no rationale for the discount rate was provided, and the discount rate did not account sufficiently for the mother's usufructuary interest, trustee fees, tax liabilities, market changes in the value of trust principal, or capital gains tax due on trust distribution. The court rejected those arguments and held that the trial court's calculations were reasonable based on the limited information from which the trial court could determine value.²⁹⁶

B. Other Jurisdictions.

Other states have addressed valuation and division of interests in trusts. The methods have been diverse, and in some instances not well reasoned. The following discussion provides a sample of methods employed in various jurisdictions.

In *McCain v. McCain*,²⁹⁷ the husband possessed remainder interests in two tracts of farmland subject to life estates of one aunt for one tract and another aunt for the second tract. The court valued the husband's remainder interest as it would have been valued for federal estate tax purposes.²⁹⁸

²⁹⁵ COLO. REV. STAT. § 13-25-102 (2009) provides, in part, that “[i]n . . . civil actions . . . when it is necessary to establish the expectancy of continued life of any person . . . the table [of] § 13-25-103 shall be received as evidence, together with other evidence as to health, constitution, habits, and occupation of such person of such expectancy.”

²⁹⁶ Dale, 87 P.3d at 225-26. Also unsuccessful was the wife's argument that her remainder interest is not acquired until it ripens into an actual possessory interest. *Id.* at 224-225.

²⁹⁷ 549 P.2d 896 (Kan. 1976).

²⁹⁸ The court used the table set forth in Treasury Regulation § 20.2031-10(f), which applied to transfers prior to May 1989. For transfers after April 1989, the method required by I.R.C. § 7520 will apply.

In *In re Marriage of Von Ofenheim*,²⁹⁹ the husband was a beneficiary of three trusts. His remainder interest in one trust was to become possessory if he survived his 74 year old mother who held a mandatory income interest and a right to withdraw 5% of the trust principal per year. The two other trusts were to be distributed to the husband at a date certain. The trial court valued the trust interests using the current value of the trust assets and the appellate court affirmed. No reduction in value was attributed to the fact that the husband's interests would not become possessory until events and dates in the future. The wife's award of her share of the trust interests was determined to be a sum secured by the husband's interest in the trusts.³⁰⁰ The award was in the form of a judgment against the husband to be paid on the date one of the trusts was to terminate, with interest to accrue until payment.³⁰¹

In *In re Marriage of Van Riesen and Cross*,³⁰² also decided by the Oregon Court of Appeals, the wife was a remainder beneficiary of a trust created by her deceased father. The wife's living stepmother was apparently entitled to distributions for support during her lifetime, with the balance of the trust remaining at the death of the stepmother to be distributed to the wife and her siblings. The husband was awarded twenty percent of the wife's share of the trust, to be paid within thirty days of the wife receiving her share.³⁰³

²⁹⁹ 596 P.2d 1007 (Or. Ct. App. 1979).

³⁰⁰ *Id.* at 1009. The court directed the husband to execute an assignment of his interests as security for payment of the judgment. *Id.* at 1010. The opinion does not indicate if the trust instrument contained a spendthrift provision, but does indicate that the husband's interest in one trust was pledged to the repayment of a loan he obtained.

³⁰¹ *Id.* at 1010.

³⁰² 177 P.3d 34, (Or. Ct. of App. 2008).

³⁰³ In *Ofenheim*, the husband claimed that the only fair method was to defer the wife's share until his interest became possessory. *Ofenheim*, 596 P.2d at 1009. The wife countered by saying the husband and his family could easily employ methods to divest the wife of her interest and the court agreed. In *Van Riesen*, a deferred distribution method apparently did not raise the same concern. In *Dryfoos v. Dryfoos*, 2000 WL 1196339, a Connecticut trial court awarded the non-beneficiary spouse 20% of the amount the beneficiary spouse receives in cash, shares of stock or any other form, in a trust with a 10 year term that was to distribute to the beneficiary spouse.

The Montana Supreme Court in *Buxbaum v. Buxbaum*³⁰⁴ reviewed the valuation of a trust beneficiary's "vested" remainder interest subject to defeasance by a power of invasion for the benefit of the beneficiary's living mother. After first concluding that the remainder interest should be included in the marital estate, the court affirmed the trial court's valuation of the remainder using the undiscounted appraised value of the trust assets. Rejecting the beneficiary spouse's contention that the discounted present value of the interest should be used, the court reasoned that the current value of the remainder interest was used as collateral by a corporation of which the trust was a thirty-five percent shareholder.³⁰⁵

In *Fox v. Fox*,³⁰⁶ the Supreme Court of North Dakota considered the value of the wife's interest in an irrevocable life insurance trust that held life insurance policies insuring husband's life. The policies had combined cash values of \$290,000, and the wife was the trustee of the trust. The wife was entitled to all the trust income from its inception and after the husband's death. The wife, during any calendar year, also could withdraw the greater of \$5,000 or five percent of the trust principal. In determining the value of the wife's interest in the trust, the trial court agreed with the approach propounded by the wife's expert, who provided several different scenarios.³⁰⁷

The wife's expert calculated the value of the wife's interest in the following manner:

1. The cash values of the life insurance policies were determined.
2. A payment stream of the income until husband's projected date of death was calculated using an assumed interest rate.

³⁰⁴ 692 P.2d 411 (Mont. 1984).

³⁰⁵ *Id.* at 413-14.

³⁰⁶ 626 N.W.2d 660 (N.D. 2001). *See also*, *Fox v. Fox*, 592 N.W.2d 541 (N.D. 1999) discussed above.

³⁰⁷ *Fox*, 626 N.W.2d at 662-63. The different scenarios altered the projected dates of death of the husband and the wife. In contrast, the husband's expert determined the wife's interest in the trust to have a much higher value, based in part on the death benefit of the policies and no reduction of the interest to its present value. *Id.* at 662.

3. The trust income for wife's remaining life expectancy after the husband's projected date of death was calculated in addition to the greater of \$5,000 or five percent of the trust principal per year.
4. The sum of the income and withdrawn principal was discounted to its present value.³⁰⁸

The North Dakota Supreme Court upheld the trial court's determination as being within the range of its discretion.³⁰⁹

In *Fox*, the income beneficiary's interest was valued for purposes of a property division.³¹⁰ It appears that the analysis would also have been applicable for the valuation of the remainder interest in the trust. If the North Dakota court was instead valuing the remainder interest, it would seem that the remainder interest would have been the current value of the trust assets reduced by the present value of the income beneficiary's interest.

As mentioned, the trust reviewed in *Fox* was an irrevocable life insurance trust.³¹¹ Irrevocable life insurance trusts are common estate planning devices, which are typically used to make life insurance policy proceeds available to an insured's family, without subjecting the proceeds to estate tax at the deaths of the insured or the insured's spouse. Because irrevocable life insurance trusts are frequently utilized, courts likely will encounter them in identifying and valuing interests in trusts.

In *Trowbridge v. Trowbridge*,³¹² the husband was entitled to a future distribution of a remainder interest that was subject to the husband's mother's income interest, her right to withdraw \$5,000 of trust principal in any year,

³⁰⁸ Fox, 626 N.W.2d at 661.

³⁰⁹ According to the North Dakota Supreme Court, the trial court's valuation was dependent upon the evidence presented by the parties and "judges, whether trial or appellate, are not ferrets, obligated to engage in unassisted searches of the record for evidence to support a litigant's position." *Id.* at 665.

³¹⁰ *Id.* at 663. As discussed in Part II F, *supra*, the income interest would not have been considered "property" in other states.

³¹¹ *Id.* at 661.

³¹² 114 N.W.2d 129 (Wis. 1962).

and her right to receive additional amounts of principal as the bank trustee “deem[ed] necessary or advisable for certain purposes.”³¹³

The Wisconsin Supreme Court approved the trial court’s decision to award wife thirty percent of whatever accrued to husband.³¹⁴ The court further stated that the trial court could properly order the husband to transfer to the wife or her heirs, legatees, or assigns, thirty percent of any funds received by the husband from the trust and that such order could contain other provisions to make that one effective, such as retaining jurisdiction for the purpose of enforcement, enjoining the husband from attempting to transfer or surrender his interest, or otherwise act to prejudice the wife’s rights, and imposing a lien upon the assets now assigned to the husband as security for the transfer of thirty per cent of the trust proceeds.³¹⁵

In *Zuger v. Zuger*,³¹⁶ the husband’s deceased father created a testamentary trust that was valued at \$936,000 at the time of trial. The surviving spouse (the husband’s mother) possessed a mandatory income interest during her life and a right to withdraw the greater of \$5,000 or five percent of the trust principal each calendar year on a noncumulative basis. At the mother’s death, the principal was to be distributed equally between the husband and his three siblings.

Because the principal could be invaded, the trial court concluded that an award to the wife of a specific dollar amount would be speculative, and instead ordered that the wife receive one-half of the husband’s share when it became available to him. The North Dakota Supreme Court upheld the percentage and the method of distribution.³¹⁷

The husband’s interest in the trust in *Zuger* could have been quantified without difficulty by making a present value calculation.³¹⁸ Although the

³¹³ *Id.* at 134.

³¹⁴ *Id.*

³¹⁵ *Id.* at 136.

³¹⁶ 563 N.W.2d 804 (N.D. 1997).

³¹⁷ *Id.* at 807.

³¹⁸ Using Tiger Tables Software and estate and gift tax principles, assuming the husband’s mother’s age was 75 at the time of trial, the § 7520 rate was 5%, the husband was

approach in *Zuger* eased the burden of the trial court by eliminating an actuarial calculation, it would seem that quantification of the value of the interest and finality of the divorce proceedings is preferable. Otherwise, the risk is high that divorced spouses, trustees, and other trust beneficiaries will become involved in controversies regarding the administration of trusts and the exercise of powers and discretions. There may be instances where a court has little choice but to use a method that avoids a current valuation of an interest in a trust, such as when little or no evidence is provided to establish a value. But the failure to quantify an award is likely to result in the continuing financial and emotional entanglement of ex-spouses and their families. In those instances, it may be necessary for the courts to later explore the uncharted waters of trust and matrimonial law as to whether a former spouse has standing with respect to a trust in connection with a claim arising from a property division.

V. Estate and Gift Tax Valuation of Temporal Interests.

A. Section 7520 and Application to Property Divisions.

Determining the value of a future interest in a trust on the basis of relevant facts and circumstances may require consideration of a number of subjective factors, such as the health of beneficiaries, the specific assets held in trust, the past performance of trust assets, the projections for future performance, prior trust distributions, and the identity of the trustees. To avoid a facts and circumstances analysis, Congress mandated the use of actuarial valuation tables for certain tax purposes.³¹⁹

a one-third remainder beneficiary, and the value of the trust was \$936,000, the husband's interest in the trust was \$125,273. The above calculation reduces the remainder interest by the mother's income interest and her "5 and 5" withdrawal right. If the husband was required to survive to take the interest, a reduction in the value of his remainder interest could be made to account for the risk of the husband's death within 11 years (the mother's remaining life expectancy). For example, the probability of a 40 year old individual dying within eleven years is 3.4% (applying the same mortality tables).

³¹⁹ I.R.C. § 7520(a) (requiring the application of actuarial tables to value "any annuity, any interest for life or a term of years, or any remainder or reversionary interest"). The tables prescribed under § 7520 apply for valuation purposes to income tax charitable contributions, charitable remainder trusts, estate tax valuation, estate tax charitable deductions, gift tax valuation, gift tax charitable deductions, and generation-skipping transfer tax valuation. *See* Treas. Reg. §§ 1.7520-1(a), 20.7520-1(a), 25.7520-1(a). The § 7520 tables do not apply to qualified retirement plans and certain other tax valuations. *See* I.R.C. § 7520(b); Treas. Reg. § 1.7520-3(a).

Valuation under I.R.C. § 7520 is a present value calculation that applies mortality and interest rate factors mandated by the Internal Revenue Code.³²⁰ In other present value calculations, the selection of discount rates may vary depending upon market conditions and the specific assets being valued. Similarly, other mortality tables exist that produce values different from that required by I.R.C. § 7520.

For interests in trusts to which I.R.C. § 7520 would apply, a divorce court could use those principles (assuming applicable state law permits the court to do so within the exercise of its discretion) and eliminate considerable uncertainty in valuing future interests in trusts in a property division.³²¹ In valuing a remainder interest under I.R.C. § 7520 for gift tax purposes, the calculation does not take into account the risk that a remainder beneficiary's death may occur prior to trust distribution. In the context of a property division, reducing the value of a beneficiary's interest by a factor attributable to the risk that the beneficiary might not survive until

³²⁰ I.R.C. § 7520(a). The discount rate “is the rate of return, rounded to the nearest two-tenths of one percent, that is equal to 120 percent of the applicable Federal mid-term rate, compounded annually, for purposes of § 1274(d)(i), for the month in which the valuation date falls.” Treas. Reg. § 1.7520-1(b)(1)(I). “The mortality component reflects the mortality date most recently available from the United States Census.” Treas. Reg. § 1.7520-1(b)(2). The pertinent factors are published in I.R.S. Publications 1457 & 1458 (July 1999). The calculation of such values is typically made using computer software programs.

³²¹ At least one court has ignored the application of § 7520 valuation when application was clearly applicable for tax purposes. In *Skokos v. Skokos*, 40 S.W.3d 768, 775-76 (Ark. 2001), the trial court valued the husband grantor's reversionary interests (and not the grantor's term interests, which were not at issue) in qualified personal residence trusts at more than nine times their values for gift tax purposes. The grantor of a qualified personal residence trust retains the right to live in the residence for a term of years and also may retain a reversion if the grantor dies during the term. The remainder interest constitutes the gift, which is valued in accordance with I.R.C. § 7520. *See* Treas. Reg. § 25.2702-5(c). The expert who propounded the higher value was a real estate appraiser. *Skokos*, 40 S.W.2d at 775-76. The expert who propounded the gift tax value for the reversion was a tax lawyer using a computer software program to determine the value. *Id.* Instead of requiring the distribution of the trust to the grantor on the sale of the residence, which the *Skokos* trusts required, a qualified personal residence trust may be drafted to provide that the trust assets must be converted to a qualified annuity interest upon the sale of the residence. *See* Treas. Reg. § 25.2702-5(c)(8). If the trust instrument did not require distribution of the trust assets to the grantor upon sale, the argument for gift tax valuation would have been more compelling.

the projected date of distribution (e.g., the death of the current trust beneficiary) may be appropriate. The same mortality tables could be used to determine a reduction in the value of a remainder interest attributable to the possible death of the remainder beneficiary prior to the distribution of the remainder interest.

Some interests in trusts cannot be valued actuarially for tax purposes because of a contingency, power, or other restriction,³²² and if the tables are not applicable, the value for tax purposes is based on all the facts and circumstances.³²³ Diversions of income and corpus may also prevent the application of the I.R.C. § 7520 tables for tax valuations,³²⁴ as will a terminal illness for a measuring life.³²⁵ If valuation under the tables is not allowed for tax purposes in these situations, logic dictates that valuation by exclusive reliance on the tables for the purposes of a property division at divorce is also inappropriate.

Some interests in trusts, though subject to contingencies and diversions, will be certain enough to constitute property for purposes of property division. This category of interests will present the greatest challenge to a trial court. A number of factors may be relevant in valuing these interests, including a review of prior diversions of trust property and the resources of current trust beneficiaries. In those instances, qualitative analysis and creative solutions by trial courts will be required. Complex discovery and the participation of trustees and family members in the proceedings also will be required.

Even in those situations in which contingencies and diversions require a facts and circumstances analysis, tax valuation principles still may be useful to a trial court. For example, if a court determined that a power of invasion in a trust for the support of a divorcing spouse's parent might reduce the value of the trust corpus by as much as one-half, it would seem

³²² Treas. Reg. §§ 20.7520-3(b)(1)(ii), 25.7520-3(b)(1)(ii). *See also*, Deal v. Commissioner, 29 T.C. 730 (1958).

³²³ Treas. Reg. §§ 20.7520-3(b)(iii), 25.7520-3(b)(iii).

³²⁴ Treas. Reg. §§ 20.7520-3(b)(2)(B), 25.7520-3(b)(2)(B).

³²⁵ Treas. Reg. §§ 20.7520-3(b)(3), 25.7520-3(b)(3). For this purpose, "an individual who is known to have an incurable illness or other deteriorating physical condition is considered terminally ill if there is at least a 50 percent probability that the individual will die within 1 year." Treas. Reg. §§ 20.7520-3(b)(3), 25.7520-3(b)(3).

than an I.R.C. § 7520 valuation of a spouse's remainder interest utilizing one-half of the value of the trust corpus would be within the bounds of a trial court's exercise of discretion.

B. Ignoring Contingencies and Diversions.

The tax law also may be useful, at least by analogy, in instances in which a trial court exercises discretion in quantifying contingencies and diversions. A power of invasion or a contingency over trust principal does not, under the tax law, necessarily render actuarial valuation inapplicable. If the possibility of the diversion of principal is negligible or remote, the diversionary right may be ignored. For example, if a gift to charity is dependent upon a condition or power, no estate tax charitable deduction is allowed, unless the possibility that the charitable interest would not become effective is so remote as to be negligible.³²⁶

In *Estate of Jack v. Commissioner*,³²⁷ a widow's right to discretionary distributions of trust principal for comfort and support had no value because the widow's property and the income from the trust substantially exceeded her needs, the widow was of advanced age, no distributions of principal were made to the widow, and distributions were allowed only to maintain the widow's standard of living and only if the income of the trust was insufficient. Accordingly, the remainder's passing to charity qualified for the estate tax charitable deduction.³²⁸

In *Estate of De Foucaucourt v. Commissioner*,³²⁹ the ability of an elderly and disabled individual to have or adopt children also was considered so remote as to be negligible and did not disqualify the deduction for the remainder interest's passing to charity.³³⁰ In the context of dividing interests in a trust in a property division, this principle would seem to be

³²⁶ See Treas. Reg. § 20.2055-2(b).

³²⁷ 6 T.C. 241 (1946).

³²⁸ *Id.*

³²⁹ 62 T.C. 485 (1974).

³³⁰ Prior to the Tax Reform Act of 1969, but not after, an interest in a split interest trust, such as those in *Estate of Jack* and *Estate of De Foucaucourt*, could qualify for the estate tax charitable deduction. I.R.C. § 2055(e)(2) now requires that one of three qualifying methods be used.

equally applicable, and the remainder interest of a spouse should be undiminished by the diversionary rights of current trust beneficiaries in some circumstances.

C. *Estate of Gokey.*

In *Estate of Gokey v. Commissioner*,³³¹ the Tax Court valued two remainder interests passing to the decedent's children on the basis of the actuarial tables for estate tax purposes.³³² The remainder interests were subject to the corporate trustee's power to invade income or principal for the benefit of the settlor's spouse if the trustee determined such use necessary for the spouse's care, comfort, support, or welfare.³³³ The trust instrument did not require the trustee to consider any of the spouse's other assets. The taxpayer argued that the remainder interests had no value because no one would buy a remainder interest subject to a spendthrift provision and power of invasion.³³⁴

The Seventh Circuit reversed the Tax Court³³⁵ holding that the tables did not apply and that the value must be determined under the willing buyer and willing seller test because of the power of invasion.³³⁶ The Seventh Circuit also determined that the value of the remainder interest was not reduced by the spendthrift provision because the inability to sell the remainder interests was offset by the inability of creditors to reach the assets.³³⁷ On remand, the Tax Court considered the needs of the spouse for the rest of her life by reviewing her recent expenditures and the value of her other assets.³³⁸ Noting the "inherent uncertainty in any valuation

³³¹ 72 T.C. 721 (1979), *rev'd in part*, 735 F.2d 1367 (7th Cir. 1984), (Table, No. 83-1492, 83-1430), *remanded to T.C.* Memo 1984-665, 49 T.C.M. (CCH) 367 (1984).

³³² *Id.* at 728.

³³³ *Id.* at 724.

³³⁴ *Id.* at 728.

³³⁵ *Gokey*, 735 F.2d at 1367.

³³⁶ *See Gokey*, 49 T.C.M. (CCH) at 368; *See also*, Treas. Reg. § 20.2031-9.

³³⁷ *See Gokey*, 49 T.C.M. (CCH) at 368-69.

³³⁸ *Id.* at 369. According to the court, "the proper method of analysis is to determine whether the power of invasion is subject to an ascertainable standard, and if so,

case,”³³⁹ the Tax Court then valued the remainder interests at approximately twenty-four percent of the value of the interests under the tables. The opinion did not disclose how the Tax Court arrived at the values.

VI. Valuation Under Elective Share Statutes.

Courts and legislatures have also struggled with valuation of interests in trusts and the calculation of the amount to properly credit a spouse for a trust interest under elective share statutes.³⁴⁰ The surviving spouse’s interests in trusts under many elective share statutes are taken into account in determining what has passed to the surviving spouse. The analogy of elective share valuations to equitable division valuations is imperfect, but perhaps still useful.³⁴¹

Some elective share statutes provide no specific guidance as to how the interest in trust is to be valued while other statutory regimes provide a specific valuation method of a trust interest.³⁴²

Under elective share statutes that do not provide for a specific method of evaluation, courts have utilized estate and gift tax valuation principles to value the

to determine the remoteness of invasion, or the extent of possible invasion under the standard.” *Id.*

³³⁹ *Id.*

³⁴⁰ See Donna Litman, *The Interrelationship Between the Elective Share and the Marital Deduction*, 40 REAL PROP. PROB. & TR. J. 539 (2005); Ronald L. Volkmer, *The Complicated World of the Electing Spouse: In Re Estate of Myers and Recent Statutory Developments*, 33 CREIGHTON L.REV. 121 (1999); and Ira Mark Bloom, *The Treatment of Trust and Other Partial Interests of the Surviving Spouse Under the Redesigned Elective-Share System; Some Concerns and Suggestions*, 55 ALBANY L.REV. 941 (1992).

³⁴¹ Elective share statutes are said to be designed to reflect the partnership theory of marriage. Bloom at 944-945. At the same time, the analogy is imperfect because if a surviving spouse is a beneficiary of a trust, he or she need not exercise the right of election.

³⁴² See Litman, *supra*, for a discussion of various statutory schemes.

surviving spouse's interest in trust.³⁴³ At least one commentary has criticized this approach as too mechanical.³⁴⁴

Specific valuation methods of interests in trusts under elective share statutes vary. The Maine statute, for example, states that "the electing spouse's beneficial interest in any trust shall be computed as if worth ½ of the total value of the... trust estate, unless higher or lower values for these interests are established by proof."³⁴⁵

In an elective share valuation, the interest valued will likely be the preceding interest in a trust to the interest being valued in a property division at divorce. If the value of the interest not subject to division can be ascertained, it would seem that subtracting the valued interest from the whole would yield a value of the interest subject to the equitable division.

For example, Florida's elective share statute requires that a QTIP trust with no authorization to distribute principal would result in a valuation of 50% of the trust for elective share purposes.³⁴⁶ If the QTIP trust allows the trustee to invade trust principal for the health, maintenance and support of the spouse, regardless of whether other resources of the spouse are to be taken into account, 80% of the

³⁴³ See for example, *Myers v. Myers*, 594 N.W.2d 563 (Neb. 1999) and *Estate of Fisher*, 545 A.2d 1266 (Me. 1988).

³⁴⁴ See Bloom, *supra*, at 962-963. For valuations for tax purposes, that author acknowledges that such a method is necessary for tax administration. *Id.* at 963. A valuation for a different purpose suggests a hybrid type tax valuation approach that would allow more flexibility than a pure estate and gift tax valuation. *Beach v. Beach*, 56 P.3d 1125 (Colo. Ct. App. 2002), involved a partition of real property, and the court considered the valuation of the life estate in the property. The court held that the estate and gift tax method of valuing a life estate should be used, subject to certain equitable adjustments, such as adjustments for the parties' specific circumstances. *Id.* at 1130-1131.

³⁴⁵ M.R.S. tit. 18-A sec. 2-207(a)(2009). The Alabama statute also provides for a 50% valuation of the trust estate, unless higher or lower values are established by proof, except if the surviving spouse's interest is coupled with a general power of appointment, in which case the interest is valued at 2/3rds of the trust property. ALA. CODE sec. 43-8-75 (2009).

³⁴⁶ FLA. STAT. § § 732.2025(2) and 732.2095(2) (2009).

trust is to be credited to the surviving spouse.³⁴⁷ Particularly in a situation where extrinsic evidence concerning the trust beneficiaries and their resources is not available to a court, perhaps it would be within the reasonable exercise of a divorce court's discretion to apply such a rule by analogy and value the remainder interest in the latter case as 20% of the trust principal.³⁴⁸ The appeal of the Florida statute and others like it is the avoidance of complex discovery and fact finding. If property division statutes are to be revised in an effort to simplify equitable divisions of trust interests, perhaps review of those elective share statutes would be useful.

VII. Tax Consequences as a Factor in Valuation.

There is no certainty as to whether the tax treatment of the trust and the beneficiaries is to be considered in the valuation of an interest in trust.³⁴⁹

Consider a trust for which a QTIP election has been made.³⁵⁰ Assume that a deceased father's will established a trust that provides the mother with income for her life to be paid at least annually. At the mother's death, the trust is to be distributed to the wife. If a QTIP election was made with respect to the trust and the trust qualifies for QTIP treatment, the trust will be included in mother's gross estate for estate tax purposes.³⁵¹ Unless the mother provides otherwise in her will, the QTIP trust property will be subject to estate tax at the highest marginal rate for

³⁴⁷ If the surviving spouse has a general power of appointment and the trust may be invaded for the spouse's health, support and maintenance, 100% of the trust is taken into account. *Id.*

³⁴⁸ The likelihood of a Florida divorce court dividing an interest in trust is discussed at Part II A 2, *supra*. It would seem that the analogy might be applicable to a divorce proceeding outside of Florida regarding a trust with a Florida situs.

³⁴⁹ In *In re Marriage of Finer*, 920 P. 2d 325, 332 (Colo. St. App. 1996), the court stated that "[i]n valuing property, the trial court may, in its discretion, consider tax consequences . . . [h]owever, central to this decision is a determination whether the property will actually be sold." In *Dale*, 87 P.3d at 226, the court stated that "a trial court is not obligated to consider hypothetical tax implications."

³⁵⁰ If a QTIP election is made pursuant to Code § 2056(b)(7) or Code § 2523(f), the property will qualify for the estate tax marital deduction and gift tax marital deduction, respectively.

³⁵¹ See I.R.C. § 2044.

mother's estate.³⁵² For decedents who die in 2009, the estate tax on the QTIP property could be as much as forty-five percent of the property's value.³⁵³ Thus, valuing the wife's remainder interest in the QTIP trust for property division purposes without taking into account its estate tax treatment at the mother's death could result in a gross overstatement of value.

Income tax treatment of the trust and its beneficiaries may be another factor to consider. As a general rule, distributions from trusts are excluded from the beneficiary's gross income,³⁵⁴ but distributions that constitute the income from trust property are not.³⁵⁵ In-kind distributions will not result in gain or loss or constitute income to a beneficiary, unless the trustee uses appreciated property in satisfaction of a right to receive a specific dollar amount, the distribution is in satisfaction of a right to receive property other than that distributed, or the in-kind distribution is in satisfaction of the right to receive income.³⁵⁶

Assuming that an in-kind distribution is excluded from the beneficiary's income, the income tax basis of the assets acquired by the beneficiary will be determined under I.R.C. § 1015. Generally, for gain purposes, the beneficiary's basis will be the grantor's basis,³⁵⁷ unless the rules of I.R.C. § 1014 apply (property is acquired from a decedent).

If the non-beneficiary spouse is awarded offsetting marital property, a trial court might not determine income tax consequences of a trust distribution or sale of distributed property projected to occur in the future to be a significant factor. Yet, if an obligation is due to the non-beneficiary spouse at trust distribution or if the division is deferred, and a compulsory sale of the assets by the beneficiary is

³⁵² See I.R.C. § 2207A.

³⁵³ See I.R.C. § 2001(c)(2)(B).

³⁵⁴ See I.R.C. § 102(a).

³⁵⁵ See I.R.C. § 102(b). The distribution will carry out its proportionate share of distributable net income under the rules of I.R.C. § 662, unless the amount is paid as a specific sum of money or of specific property and is paid all at once or in not more than three installments. See I.R.C. § 663(a). If the income is used to satisfy a beneficiary's legal obligation, the income is taxable to the beneficiary. See Treas. Reg. § 1.661(a)-2(d).

³⁵⁶ See Treas. Reg. § 1.661(a)-2(f).

³⁵⁷ See *Id.* § 1.1015-2(a)(1). The beneficiary's holding period for the property will include the trust's holding period. I.R.C. § 1223(2).

anticipated several years after the dissolution of marriage, the income tax payable by the beneficiary spouse may alter the intended economics of the property division. If the property settlement allows the beneficiary spouse to distribute assets in kind to the non-beneficiary spouse, a transfer occurring more than six years after the divorce is not guaranteed to qualify for non-recognition treatment under I.R.C. § 1041.³⁵⁸

VIII. Trustee Involvement in Proceedings.

A. Joinder in Divorce Proceedings.

*Cooley v. Cooley*³⁵⁹ raises the issue of trustee and beneficiary involvement in the divorce proceedings. Although the Connecticut Court of Appeals found it unnecessary to resolve the issue, the court noted “with concern” that the trial court did not appoint counsel for the spouses’ minor daughter and that the husband’s sons were unrepresented throughout the action even though they were beneficiaries of the trust.³⁶⁰ Also “troubling” to the

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I.R.C. § 1041(a), (c) provides:

No gain or loss shall be recognized on a transfer of property from an individual to (or in trust for the benefit of) . . . a spouse, or . . . former spouse, but only if the transfer is “incident to the divorce” [A] transfer of property is incident to the divorce if such transfer . . . occurs within 1 year after the date on which the marriage ceases, or . . . is related to the cessation of the marriage.

Temporary regulations provide that a transfer is related to cessation of the marriage if the transfer is both pursuant to a divorce or separation instrument and occurs not more than six years after the date on which marriage ceased. *See* Temp. Treas. Reg. § 1.1041-1T(a), Q & A-7. Transfers that fail the test are presumed to be non-divorce related, but the presumption is rebuttable by showing that the transfer was made to effect the division of property owned by the parties at the time of the divorce. The Treasury Regulations further state that the presumption may be rebutted by showing factors that hampered an earlier transfer of the property, such as legal or business impediments. *See e.g.*, PLR 9235026 (May 29, 1992). Nonetheless, in the absence of a private letter ruling, there can be no certainty as to the outcome of a transaction occurring more than six years after the decree and questions regarding the temporary regulations remain open. *See* CINDY LYNN WOFFORD, TAX MANAGEMENT PORTFOLIO, DIVORCE AND SEPARATION, No. 515-2nd T.M., § IV.E.3.b (2009).

³⁵⁹

628 A.2d 608 (Conn. Ct. App. 1993).

³⁶⁰

Cooley, 628 A.2d at 611 n.2.

Court was the absence of the bank trustee in the divorce proceedings. The Court stated that the trustee “owes a fiduciary duty to all of the persons whose interests may be affected by the financial orders in the dissolution action.”³⁶¹

At least in Connecticut, the appellate court’s admonition of the trial court and the trustee opens the door to a substantial expansion of the parties to property division proceedings involving trusts with, of course, a corresponding increase in expense and complexity. More importantly, from the trustee’s perspective, is the specter of trustee liability for the failure to appear and defend the trust against attack.³⁶²

Where a property division does not affect a trust interest until after a spouse’s interest becomes possessory or the property division does not affect trust property and requires only a set-off of a spouse’s other property, it would seem unlikely that trustee liability would attach for the failure to participate in the divorce proceedings. In the absence of a trustee’s participation in the dissolution proceedings it would also seem that the divorce court would have no jurisdiction over the trustee or the trust property.³⁶³

³⁶¹ *Id.*

³⁶² “The trustee has a duty to defend the trust...[and] the trustee would be liable to the beneficiaries occasioned by an unwarranted capitulation.” CHARLES E. ROUNDS, JR., LORING, A TRUSTEE’S HANDBOOK § 6.2.6 (2009 ed.). “Equity imposes upon the trustee the duty of defending the integrity of the trust, if he has reasonable grounds for believing the attack is unjustified or if he is reasonably in doubt on that subject.” GEORGE GLEASON BOGERT, GEORGE TAYLOR BOGERT AND AMY MORRIS HESS, THE LAW OF TRUSTS AND TRUSTEES § 581 (2nd ed. 1980 & Supp. 2008).

³⁶³ *See for example*, In Re Marriage of Kaladic, 589 P.2d 502 (Colo. Ct. App. 1978), Morgan v. Morgan, 340 P.2d 1060 (Colo. 1959) and In Re Marriage of McKean, 38 P.3d 1053 (Wa. App. Ct. 2002). In *McKean*, husband and wife and third parties were co-trustees. *See also*, Enrody v. Enrody, 914 P.2d 1166, 1169 (Ct. App. Utah 1996) (“equitable powers of the trial court in divorce proceedings do not permit the court to distribute assets held in a trust created by non-parties to the divorce or in a manner which is inimical to the terms of the trust agreement.”) *But see*, Ruml v. Ruml, 738 N.E.2d 1131 (App. Ct. Mass. 2000), discussed above.

At the same time, this author can envision circumstances where a trustee may rightfully decide to intervene in a property division proceeding.³⁶⁴ A particularly cautious trustee might also consider obtaining releases and waivers from beneficiaries in conjunction with a decision not to participate in marital dissolution proceedings or, at the inception of the trust, require that the trust instrument waive any obligation to participate in the divorce proceedings of a trust beneficiary unless properly joined.

Joinder of a third party by the court in a family law proceeding is possible, but in the words of one court, “is compelled only in the rarest of circumstances.”³⁶⁵ Joinder of third parties, has occurred where, for example, a spouse has transferred property to a third person and such property is subject to a property division.³⁶⁶

B. **Discovery.**

The rules of discovery in divorce proceedings vary from state to state, but some generalizations are possible. Although discovery upon a spouse beneficiary may request information or documents regarding a trust, many beneficiaries will be unable to comply with such requests because they lack information regarding the trust and its administration. In such instances it is therefore likely that discovery will be directed to the trustee.

Depending upon applicable state rules, discovery may take one of several forms, such as deposition upon oral examination, deposition by telephone or deposition by written questions.³⁶⁷ One treatise states that “persons who should be deposed are those with knowledge about the parties’ assets [and]... if the individual has relevant and important financial information

³⁶⁴ Third parties may intervene in divorce actions to protect their interests, but divorce courts may not allow intervention when neither spouse sought to join the person or when the applicant did not make a *prima facie* showing that intervention was proper. See JOHN C. MAYOUE, BALANCING COMPETING INTERESTS IN FAMILY LAW, 104, A.B.A. (2nd ed. 2003).

³⁶⁵ Schnabel v. Superior Court of Orange County, 36 Cal. Rptr.2d 677 (Ct. App. Ca. 1994). “A third party should not be forced, absent dire necessity, to participate in what is often a bitter, time consuming and expensive conflict.” *Id.* at 680.

³⁶⁶ See MAYOUE, 108.

³⁶⁷ See for example, COLO. RULE CIV. PROC. 16.2, 30 and 31 (2009).

that is not in possession of the spouses themselves, the deposition is warranted.”³⁶⁸

Notwithstanding the reluctance of a trustee in complying with a discovery request in a divorce proceeding, compliance with lawful discovery requests is required and sanctions are appropriate for a trustee’s failure to comply.³⁶⁹ If a trustee resides outside the jurisdiction of the divorce proceedings, a commission or letters rogatory proceeding may be necessary in order to compel the discovery.³⁷⁰ Such a procedure requires the involvement of a court in the trustee’s jurisdiction and is therefore cumbersome and expensive. In addition to applicable rules of discovery, institutional trustees may be subject to other law regarding disclosure of information.³⁷¹

IX. Interests in Trusts and Marital Agreements.

Perhaps the best means of avoiding a property division of an interest in a trust is a well crafted and enforceable marital agreement. A marital agreement can be comprehensive and address all rights and obligations of the spouses or more limited and address only specific matters or property, such as the exclusion of one or more trusts from the pool of divisible assets upon divorce. Depending upon applicable law, a marital agreement may be determined to be unenforceable if the party seeking to uphold the marital agreement did not make a fair and reasonable disclosure of his or her property.³⁷²

The Uniform Premarital Agreement Act defines “property” broadly to mean “an interest, present or future, legal or equitable, vested or contingent, in real or

³⁶⁸ ROBERT D. FEDER, VALUATION STRATEGIES IN DIVORCE, § 10.10, (4th ed. 1997 & Supp. 2008).

³⁶⁹ *See for example*, COLO. RULE CIV. PROC. 37(b) (2009).

³⁷⁰ *See for example*, COLO. RULE CIV. PROC. 28 (c) (2009).

³⁷¹ *See for example*, ALA. CODE sec. 5-5A-43 (2009) (which states, in part, that a bank shall disclose financial records of its customers pursuant to a lawful subpoena, summons, warrant or court order... served upon the bank), M.R.S. tit. 9-B sec. 162 (2009); OR. REV. STAT. sec. 192.565 (2009). A number of other states have also codified provisions regarding disclosure of information by financial institutions.

³⁷² *See James O. Pearson, Failure to Disclose Extent of or Value of Property Owned as Ground for Avoiding Premarital Contract*, 3 A.L.R. 5th 394 (1992).

personal property, including income and earnings.”³⁷³ The definition of property is expansive and a trust beneficiary should therefore disclose the beneficial interest and the nature and value of the trust assets.

Providing a copy of the trust instrument and current trust values would seem to satisfy disclosure requirements. Although many families and trustees may prefer that such information not be provided to the spouse of a beneficiary (and perhaps the beneficiary as well), there appears to be no alternative to disclosure to ensure the enforceability of the marital agreement and the exclusion of trust assets from a property division proceeding in the event of divorce.

In one instance, the prospective spouses made complete and mutual waivers as to the other’s property in a premarital agreement. The husband failed to disclose “a life interest in a trust giving him a yearly \$15,000 tax-free income.”³⁷⁴ The wife elected against the husband’s will claiming the marital agreement was invalid. The Supreme Court of Pennsylvania upheld the agreement. The relevant test, according to the court, was not whether the trust interest was important in the husband’s general economic picture, but whether it affected the size of the husband’s testamentary estate.³⁷⁵ Since the husband disclosed all assets which had a bearing on the wife’s right of election, non-disclosure of the trust interest did not invalidate the marital agreement.

The Court’s logic may be applicable to non-disclosure of trust interests when a marital agreement is challenged at the time of divorce. If the trust interest would not have constituted “property” under the relevant statute of equitable distribution, it would seem that the non-disclosure of the trust interest by the beneficiary spouse had no bearing on what the non-beneficiary spouse would receive on divorce, and consequently, the non-disclosure should not invalidate the agreement. If a court did utilize such a test, it would be necessary to determine whether the trust interest constituted “property” at the date of the marriage.

³⁷³ The Uniform Premarital Agreement Act has been adopted in 26 states. Colorado, though not adopting the act, has incorporated much of the act (including the definition of “property”) in its legislation. *See* COLO. REV. STAT. § 14-2-301 to 14-2-310.

³⁷⁴ *In Re Estate of Perelman*, 263 A.2d 375, 376 (Pa. 1970).

³⁷⁵ *Id.* at 376.

X. Conclusion.

Including interests in trusts in the pool of divisible assets may have furthered the policy objective of treating marriage as a partnership or a shared enterprise, but it has also frustrated the intent of settlors of trusts by denying them the ability to dispose of the value of property to the individuals they wish to benefit. An easy resolution to this conflict is doubtful and it is likely that courts will continue to differ in their resolution of the conflict.

State legislatures might also be compelled to resolve this conflict. Equitable division is a creature of the legislature and if a legislature determines that an appellate court has gone too far in the expansion of the definition of property, the remedy is statutory revision. In this respect, *In Re Marriage of Gorman*,³⁷⁶ and the subsequent amendment of the Colorado enabling statute in response to *Gorman*,³⁷⁷ are illustrative. The consequence of the *Gorman* decision was that a divorce court was required to consider the assets of funded revocable trusts of living settlors in which a divorcing spouse was a remainder beneficiary. The need to reverse the result was compelling and the statutory revision was therefore narrowly focused and quickly accomplished. Broader legislation affecting beneficial interests in trusts is possible if a state legislature is so inclined. The 2006 Alaska statutory amendment is such an example.³⁷⁸

When an interest in trust is subject to a divorce court's dispositional power, many complex and uncertain issues can arise. However, one certainty is that trusts and estates practitioners cannot ignore the developments in this area of the law, regardless of where those developments occur. Since it is likely to be the law of the state of the divorce court that controls, a practitioner may be advising a trustee or a family in connection with a divorce and the law of equitable divisions in a distant jurisdiction.

³⁷⁶ 36 P.3d 211 (Colo. Ct. App. 2001), discussed above.

³⁷⁷ COLO. REV. STAT. § 14-10-113(7)(b) (2009).

³⁷⁸ ALASKA STAT. § 34.40.110(l) (2009), discussed above.