

How Powers of Appointment Affect Irrevocable Trust Remainder Interests in Dissolution of Marriage Proceedings

Four Approaches

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In dissolution of marriage proceedings, a remainder interest in an irrevocable trust may be characterized as property or an economic circumstance for purposes of dividing marital property. A power of appointment in an irrevocable trust may factor into the classification, but the specifics are murky. This article considers four prevailing approaches under Colorado's existing authority regarding this issue.

Powers of appointment are used to accomplish different practical and tax purposes in estate planning by creating flexibility in the face of unanticipated circumstances. Variations in the design of trusts through the use of powers of appointment potentially affect the treatment of a remainder interest in an irrevocable trust as property or an economic circumstance when marital property is divided in dissolution of marriage proceedings. However, existing Colorado statutory and appellate case law provides little, if any, guidance on how a power of appointment in an irrevocable trust affects the classification of a trust remainder interest as property or an economic circumstance in a dissolution of marriage proceeding.

In a broader context, the *In re Marriage of Balanson* line of cases¹ and the Colorado legislature's enactment of CRS § 14-10-113(7)(b) in 2002 in response to *In re Marriage of Gorman*² have led to much uncertainty and differing opinions among experts on issues such as:

- whether a remainder interest in an irrevocable qualified personal residence trust or an irrevocable grantor retained annuity trust should be treated as property or an economic circumstance;
- how to analyze a remainder interest as property when an irrevocable trust is decanted;³
- the proper characterization of a trust interest when a spouse is both the sole trustee and the sole current beneficiary of an irrevocable trust that gives the trustee discretion to make distributions of income and/or principal to the divorcing spouse as a beneficiary, and the impact of substantial distributions that have been

made to the spouse, either by the spouse as trustee or by another trustee who is being controlled by the spouse, even if the trust is a generation-skipping trust;

- the weight and treatment of a trust interest that is an economic circumstance when dividing the marital property; and
- how various types of powers of appointment affect the treatment of a remainder interest in an irrevocable trust as property or an economic circumstance.

This article focuses on the last issue, arguably the most complex issue in this area, by exploring different approaches on its resolution.

Dividing Marital Property in Colorado

In a Colorado dissolution of marriage proceeding, the court must set apart to each spouse his or her separate property and divide the marital property after considering all relevant factors.⁴ The relevant factors concerning the division of marital property include “the value of the property set apart to each spouse,” “any increases or decreases in the value of the separate property of the spouse during the marriage,” and “the economic circumstances of each spouse at the time the division of property is to become effective.”⁵ Colorado courts have broadly interpreted the meaning of economic circumstances.⁶

Colorado courts generally consider a remainder interest in an irrevocable trust to be property in a Colorado dissolution of marriage proceeding.⁷ Typically, courts treat the initial value of such a remainder interest (i.e., the value at the later of the placing of assets into the trust or the date of the marriage of the divorcing parties) as separate property, but the increase in the value of that separate property (i.e., appreciation) is considered to have a marital

property component.⁸ If the court treats the remainder interest as separate property and the increase in value as having a marital property component, this could significantly impact the court's division of marital property.

If a spouse has an interest in an irrevocable trust that is characterized as an economic circumstance under CRS § 14-10-113(1)(c) rather than as property, the court may give less monetary weight to that trust interest when dividing the marital property. If CRS § 14-10-113(7)(b) (discussed below) is deemed applicable, a spouse's interest in a trust would be neither property nor an economic circumstance, and the court should not give any weight to such an interest in a trust when the court divides the marital property.

Powers of Appointment

A power of appointment is “a personal power of disposition” over the assets in trust.⁹ There are two categories of powers of appointment, general and limited (sometimes referred to as non-general or special).¹⁰ The powerholder of a general power of appointment may exercise it for the powerholder's own benefit. In contrast, the powerholder of a limited power of appointment may exercise it only for the benefit of other persons or charities, but not for the benefit of any members of a class consisting of the powerholder, creditors of the powerholder, the powerholder's estate, or creditors of the powerholder's estate.

Powers of appointment may be either presently exercisable (inter vivos) or testamentary (effective at death).¹¹ A presently exercisable power of appointment is effective during the powerholder's lifetime. A testamentary power of appointment is effective at the powerholder's death. A power of appointment (whether gen-

eral or limited) may be presently exercisable, testamentary, or both.

The *Balanson* Line of Cases

The *Balanson* line of cases comprises three Colorado appellate court opinions issued between 1999 and 2004 concerning, as relevant here, whether a remainder interest in an irrevocable trust constituted the wife's property. The wife's father and mother were the grantors of a trust.¹² Upon the death of the wife's mother, the trust became irrevocable and was divided into two sub-trusts, Trust A and Trust B.¹³ The wife's father, as trustee, was directed to pay the entire net income from Trust A and Trust B to himself during his lifetime;¹⁴ he was permitted to make principal distributions from Trust A for his own support, care, and maintenance until the principal was exhausted, and thereafter he could make discretionary principal distributions to himself from Trust B during his lifetime.¹⁵ The wife had a remainder interest in Trust B as she was to receive a portion of Trust B outright at the death of her father.¹⁶ In *Balanson I*, the Court of Appeals held that the wife did not have a property interest in Trust A or Trust B, noting that her father, as trustee, had discretion to distribute the trust assets in Trust A and Trust B to himself and had a testamentary general power of appointment over Trust A (any portion not designated by this power of appointment would pass to Trust B).¹⁷

In *Balanson II*, the Colorado Supreme Court instead concluded that the wife's remainder interest in Trust B constituted property because at the termination of Trust B, the wife "ha[d] a future, vested interest [in the trust] not within the discretion of the trustee to withhold."¹⁸ The Court acknowledged the difficulties in valuing the wife's interest because of her father's rights in the trust as its trustee, but nevertheless determined that the wife possessed a property interest in the trust.¹⁹ The Court did not specifically address the issue of the father's testamentary general power of appointment over Trust A.

Balanson III involved the issue of when the wife acquired her property interest in Trust B.²⁰ The Court of Appeals held that the wife acquired her property interest in Trust B when her mother died, and the trust became irrevocable.²¹ The

Court of Appeals acknowledged the trial court's findings, subsequent to *Balanson II*, that the wife had a "mere expectancy" interest in Trust A but her interest in Trust B was property.²² However, like the Supreme Court in *Balanson II*, the Court of Appeals did not specifically address the impact of the father's testamentary general power of appointment over Trust A on the nature of the wife's interest in Trust A for the purpose of the division of marital property.

CRS § 14-10-113(7)(b)

Meanwhile, in 2001 the Court of Appeals held in *Gorman* that a remainder interest in a conventional revocable trust was property for dissolution of marriage purposes.²³ Subsequently, in 2002 the Colorado legislature enacted CRS § 14-10-113(7)(b), which excludes from the definition of both "property" and "economic circumstance" 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. . . ." In 2003, in *In re Marriage of Dale*, the Court of Appeals concluded that CRS § 14-10-113(7)(b) was enacted in response to *Gorman*, did not overturn the holding in *Balanson II*, and was not intended to alter the treatment of remainder interests in irrevocable trusts as property.²⁴

Different Approaches on a Power of Appointment's Effect

The above described state of the law in Colorado does not specifically address the effect of various types of powers of appointment on the characterization of a remainder interest in an irrevocable trust as property or an economic circumstance in a dissolution of marriage proceeding. As a result, four different approaches have arisen regarding how various powers of appointment affect the characterization of a remainder interest in an irrevocable trust as property or an economic circumstance.²⁵

First Approach

The first approach concludes that a presently exercisable general power of appointment, whether retained by the settlor or granted to a third party who is not the spouse, usually

negates the characterization of a remainder interest in an irrevocable trust held by a spouse as property or an economic circumstance because a presently exercisable general power of appointment is effectively a power to amend or revoke under CRS § 14-10-113(7)(b).²⁶ Other types of powers of appointment do not negate the characterization of a remainder interest in an irrevocable trust as property or an economic circumstance but may affect the valuation of the trust interest.

This approach is based on the unique nature of presently exercisable general powers of appointment (as compared to other types of powers of appointment), an interpretation of the *Balanson* line of cases, and a limited application of CRS § 14-10-113(7)(b).

The nature of presently exercisable powers of appointment. Because a presently exercisable general power of appointment is the functional equivalent of ownership of the underlying trust property, it follows that a presently exercisable general power of appointment is fundamentally different than powers of appointment that are testamentary and/or limited.²⁷ Consistent with this distinction, various Colorado statutes similarly distinguish general powers of appointment that are presently exercisable from powers of appointment that are testamentary and/or limited.²⁸

The interpretation of the *Balanson* cases.

Proponents of this approach argue that *Balanson II* overturned the ruling in *Balanson I* that the wife did not have a property interest in Trust A, because in *Balanson II*, the Supreme Court identified the wife's father's testamentary general power of appointment over Trust A, but otherwise did not distinguish between Trust A and Trust B.²⁹ It could be argued that the Supreme Court's holding that the wife's interest in the family trust was property would logically apply to both Trust A and Trust B. But in *Balanson III* the Court of Appeals acknowledged the trial court's findings that the wife had a "mere expectancy" interest in Trust A, while her interest in Trust B was property, which seems contrary to this argument.³⁰

In *Balanson II*, the Supreme Court noted that a number of factors could affect a remainder interest in an irrevocable trust, which makes the

value of the remainder interest uncertain, but does not convert the remainder interest into a “mere expectancy” or cause it to not be property for dissolution of marriage purposes.³¹ While *Balanson II* did not specifically address powers of appointment, the effect of the possible exercise of a power of appointment could be viewed as just another contingency, such as the death of a beneficiary who has a remainder interest before termination of a trust. Under such an analysis, the power of appointment should only affect the valuation of that beneficiary’s remainder interest in an irrevocable trust, not negate its characterization as property.

The limited application of CRS § 14-10-113(7)(b). Proponents of this approach take the position that CRS § 14-10-113(7)(b) only extends to interests in irrevocable trusts that are subject to powers of appointment that are presently exercisable and general. Because applying this statute denies a trust interest status as either property or an economic circumstance, a narrow interpretation that allows a court to consider more information when dividing the marital property seems more appropriate from a public policy perspective. Further, the legislative history of CRS § 14-10-113(7)(b) supports its limited application. The committee drafting the statute compromised, agreeing to address only the *Gorman* decision, which dealt with a conventional revocable trust, rather than extending its application to all remainder interests in irrevocable trusts.³²

Because only a presently exercisable general power of appointment is deemed to be a form of a power of amendment or revocation, CRS § 14-10-113(7)(b) should apply only in cases involving irrevocable trusts that have a presently exercisable general power of appointment.³³ Accordingly, a power of appointment’s impact on a remainder interest in an irrevocable trust, other than a presently exercisable general power of appointment, should be limited to the valuation of the interest; the impact should not extend to that interest’s characterization as property or an economic circumstance.

Second Approach

A second approach agrees with the conclusion that a presently exercisable general power of ap-

pointment usually negates the characterization of a remainder interest in an irrevocable trust as both property and an economic circumstance. In addition, proponents of the second approach

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conclude that a testamentary general power of appointment also negates the characterization of a remainder interest in an irrevocable trust as property, but not as an economic circumstance. On the other hand, limited powers of

appointment, whether presently exercisable or testamentary, do not negate the characterization of a remainder interest in an irrevocable trust as property, but may impact the valuation of the trust interest. This approach is based on a different interpretation of the *Balanson* line of cases and a limited application of CRS § 14-10-113(7)(b).

The interpretation of the *Balanson* cases.

Proponents of this approach contend that *Balanson I* stands for the proposition that an interest in an irrevocable trust subject to a testamentary general power of appointment constitutes a “mere expectancy,” not property.³⁴ In *Balanson I*, 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.”³⁵ Thus, the Supreme Court’s decision in *Balanson II* did not alter the *Balanson I* holding with regard to Trust A because *Balanson II* addressed only Trust B.

However, even though the wife’s interest in Trust A was characterized as a “mere expectancy” in *Balanson I*, the Court of Appeals still held that such interest was an economic circumstance.³⁶ In *Balanson II* and *Balanson III* the Courts did not exclude a trust interest that is a “mere expectancy” from being an economic circumstance. Further, the Supreme Court has held that a “mere expectancy” can be considered an economic circumstance in a dissolution of marriage proceeding.³⁷

The limited application of CRS § 14-10-113(7)(b). Proponents of this approach view the application of CRS § 14-10-113(7)(b) to interests in irrevocable trusts narrowly, because its legislative history indicates that the statute’s drafters focused solely on addressing the *Gorman* decision and its impact on revocable trusts.³⁸ Thus, only a presently exercisable general power of appointment would be a form of a power of amendment or revocation. Because it is not presently exercisable, a testamentary general power of appointment would not constitute a power of amendment or revocation, so CRS § 14-10-113(7)(b) should not apply when a testamentary general power of appointment is at issue.

Third Approach

A third approach concludes that a power of appointment of any variety would negate the characterization of a remainder interest in an irrevocable trust as property, but not as an economic circumstance. This approach is based on a different interpretation of the *Balanson* cases and the legislative history of CRS § 14-10-113(7)(b).

The interpretation of the *Balanson* cases.

Adherents to this approach contend that *Balanson I* supports the proposition that an interest in a trust subject to a power of appointment of any variety becomes a “mere expectancy” because the Supreme Court’s decision in *Balanson II* did not alter the holding in *Balanson I* concerning Trust A; *Balanson II* addressed only Trust B, which was not subject to a power of appointment.³⁹ Arguably, such a conclusion is supported by *Balanson III*, where the Court of Appeals acknowledged the trial court’s findings that the wife had a “mere expectancy” interest in Trust A, which was the only trust subject to a power of appointment.⁴⁰

While the *Balanson* line of cases involved a testamentary general power of appointment over Trust A, neither the Supreme Court nor the Court of Appeals addressed whether the outcome would have been different if a different type of power of appointment had been involved. Further, the Supreme Court has held that a “mere expectancy” interest can be considered an economic circumstance in a dissolution of marriage proceeding.⁴¹

The limited application of CRS § 14-10-113(7)(b). Proponents of this approach interpret CRS § 14-10-113(7)(b) as not intended to extend to interests in irrevocable trusts based on its (1) lack of specific reference to powers of appointment in the statute, and (2) legislative history as explained in *Dale*.⁴²

Fourth Approach

A final approach concludes that any type of power of appointment would negate the characterization of a remainder interest in an irrevocable trust as both property and an economic circumstance. This approach is based on a broad application of CRS § 14-10-113(7)(b).

Proponents of this approach interpret CRS § 14-10-113(7)(b) as denying all trust interests

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subject to any type of power of appointment treatment as both property and an economic circumstance, because the practical effect of the exercise of a power of appointment of any kind by a grantor or a third party is the functional equivalent of a grantor reserving the right to amend or revoke a trust.

Marc Chorney in his publication on trust interests in divorce notes:

The statute [CRS § 14-10-113(7)(b)] does not define the terms “amendable” and “revocable,” and the meaning of those terms has and will continue to 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.⁴³

However, the approach that an interest in an irrevocable trust subject to any type of power of appointment cannot be considered to be even an economic circumstance appears contrary to both the statute’s legislative history and the trend in Colorado courts to consider a remainder interest in an irrevocable trust in the division of marital property between divorcing parties. Practically, the possibility of a power of appointment being exercised may be so unlikely that relying on the statute to negate its characterization as either property or an economic circumstance would be to place form over substance.

Conclusion

Given the lack of specific Colorado authority addressing the issue, different conclusions can be reached as to how a power of appointment affects the characterization of a remainder interest in an irrevocable trust in a dissolution of marriage proceeding. Pending further clarification, practitioners must be aware of the various arguments on this issue and how they may affect property divisions in divorce cases. CL



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NOTES

1. *In re Marriage of Balanson*, 996 P.2d 213 (Colo.App. 1999) (*Balanson I*); *In re Marriage of Balanson*, 25 P.3d 28 (Colo. 2001) (*Balanson II*); and *In re Marriage of Balanson*, 107 P.3d 1037 (Colo.App. 2004) (*Balanson III*).
2. *In re Marriage of Gorman*, 36 P.3d 211, 213 (Colo.App. 2001).
3. See Haskell and Chorney, “Decanting in Connection with Divorce: A Case Study,” 48 *Colo. Law.* 62 (Oct. 2019).
4. CRS § 14-10-113(1).
5. CRS § 14-10-113(1)(b), (c), and (d).
6. See *In re Marriage of Jones*, 812 P.2d 1152, 1157–58 (Colo. 1991).
7. *Balanson II*, 25 P.3d at 41; *In re Marriage of Dale*, 87 P.3d 219, 224 (Colo.App. 2003).
8. CRS § 14-10-113(1)(d).
9. Rounds, Jr. and Rounds III, *Loring and Rounds: A Trustee’s Handbook* at § 8.1.1, 839 (citing *Restatement (Second) of Property (Wills and Other Donative Transfers)* § 11.1) (Wolters Kluwer 2019 ed.).
10. See *generally id.* at § 8.1.1, 839–56; Scott et al., *Scott and Ascher on Trusts* § 3.1 (5th ed. Wolters Kluwer Law and Business 2006).
11. See *generally* Rounds, Jr. and Rounds III, *supra* note 9 at § 8.1.1, 839–56; Scott et al., *supra* note 10 at § 3.1, 137–47.
12. *Balanson I*, 996 P.2d at 220–21.
13. *Id.*
14. *Id.*
15. *Id.* at 221–22.
16. *Id.* at 220–21.
17. See *id.* at 221–22.
18. *Balanson II*, 25 P.3d at 41.
19. See *id.*
20. *Balanson III*, 107 P.3d at 1047.
21. *Id.*
22. See *id.* at 1041.
23. *Gorman*, 36 P.3d at 213.
24. See *Dale*, 87 P.3d at 224 (citing the hearings on S.B. 02-160 before the Senate Judiciary Committee and the House Judiciary Committee, 63rd Gen. Ass., Second Reg. Sess. (Jan. 9, 2002)).
25. Legal scholar Marc Chorney, a leading commentator in the area of trust interests in dissolution of marriage proceedings, has analyzed some of the approaches relevant to this matter. Chorney, *Trusts in Divorce Property Divisions* at § 2.3.3 (2d ed. CLE in Colo. Inc. 2014).
26. See Rounds, Jr. and Rounds III, *supra* note 9 at § 8.1.1, 849–50.
27. See *id.*
28. See, e.g., CRS §§ 15-10-403(3)(a) and -108.
29. See *Balanson II*, 25 P.3d at 33, 40–42.
30. See *id.* at 41. See also *Balanson III*, 107 P.3d at 1041.
31. See *Balanson II*, 25 P.3d at 41.
32. See *Dale*, 87 P.3d at 224.
33. See Rounds, Jr. and Rounds III, *supra* note 9 at § 8.1.1, 849–50.
34. See Chorney, *supra* note 25 at § 2.3.3 (citing *Balanson I* at 221).
35. *Balanson I*, 996 P.2d at 221.
36. See *id.* at 222–23.
37. See *Jones*, 812 P.2d at 1157–58 (prior to the enactment of CRS § 14-10-113(7)(b)).
38. See *Dale*, 87 P.3d at 224.
39. See *Balanson I*, 996 P.2d at 221.
40. See *Balanson III*, 107 P.3d at 1041.
41. See *Jones*, 812 P.2d at 1157–58.
42. See *Dale*, 87 P.3d at 224.
43. Chorney, *supra* note 25 at § 2.7.1.

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