



“THESE BOOTS WERE MADE  
FOR WALKING”  
IS YOUR TRUST WALKING  
TOO?  
EVALUATING THE IMPACT OF  
DIVORCE ON  
IRREVOCABLE TRUSTS

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## PUBLIC POLICIES AT ISSUE: POWER OF DISPOSITION VS. PROTECTION OF THE FAMILY

- General concept/public policy that the earner/owner should be able to decide who to give property and under what conditions.
- General concept/public policy to protect the beneficiary from his or her own improvident behavior.
- General public policy of paying one's debts
- General public policy of providing protection/support for the family



# ITS NOT A COLLISION; BUT RATHER AN INTERMINGLING OF PRACTICE AREAS



- \*Estate and Trust Counsel

- \*Family Law Counsel

Strong practitioners understanding that these two practice areas are not isolated and competition areas of practice; but rather are intermingled.



# CHALLENGES COME IN MANNER FORMS:

- **Category #1** - Beneficiary of a 3<sup>rd</sup> Party Spendthrift Trust Gets Divorced
  - Challenges by non-beneficiary spouse
  - Challenges by a beneficiary spouse (who often loses beneficial status on divorce)
- **Category #2** - Trustor of a 3<sup>rd</sup> Party Spendthrift Trust Gets Divorced
  - Challenges by a beneficiary spouse of the Trustor (SLAT/Hybrid)
  - Challenges by spouse of Trustor to the formation of the trust
- **Category #3** – Trustor/Beneficiary of a Self Settled DAPT Gets Divorced
  - Challenges by a beneficiary spouse of the Trustor/Beneficiary
  - Challenges by a spouse of Trustor/Beneficiary to the formation of the trust
  - Challenges by a spouse of Trustor/Beneficiary to obtain spousal support

# Understanding Types of Irrevocable Trusts

## Discretionary vs. Spendthrift

- **Discretionary Trust** - The trustee has some type of discretion over distributions to the beneficiaries. NRS 163.4185
  - Purely Discretion – “absolute”, “unfettered”, “sole & absolute”, in conjunction with “may”, and never “must” or “shall”
  - Limited Discretion – discretion over some but not all (i.e, a QTIP (mandatory income) with a discretionary authority to invade principal.
- **Support Trust** – generally directed toward providing support to one or more beneficiaries. NRS 163.417(3)
  - mandatory requirement to support the beneficiary
- **Hybrid Discretionary Support Trust**
  - As much distribution as the trustee determines is necessary for HEMS
  - “shall” vs. “may”
- **Spendthrift Trust** - Prohibition against beneficiary’s voluntary and involuntary alienation of beneficial interests- NRS Chapter 166
  - *Nichols v. Eaton*, 133 Mass 170 (1882) – established the foundational support for spendthrift trusts; very controversial at time.
  - *Scanlan v. Eisenberg*, 669 F.3d 838 (7<sup>th</sup> Cir. 2012)
- **Third Party Spendthrift Trust** - Established by someone for the benefit of another (i.e., grandparent fbo grandchild; parent fbo child; husband fbo wife)
- **Asset Protection Trust (APT)** - General term for a trust that has asset protection features. APT was traditionally used to referred to offshore trusts but now is a more general term.
- **Domestic Asset Protection Trust (DAPT)** - Self settled spendthrift trust established by one for the benefit of self (but may also benefit others).

Q: DOES “DISCRETION” REALLY MEAN DISCRETION?

A: “It depends on the jurisdiction and the judge”.

\* DOES DISCRETION (“SOLE AND ABSOLUTE”) FIT WITH CONCEPTS OF A TRUSTEE’S DUTIES OF GOOD FAITH AND FAIR DEALING; OR  
DUTY OF LOYALTY? IS A FAILURE TO EXERCISE DISCRETION “REASONABLY” EVIDENCE OF BAD FAITH?

*Bildner V. Bildner*, 2023 WL 6162011, No. 160493/2019 (N.Y. Sup. Ct Sept. 21, 2023)

*In Re Matter Of William J. Raggio Family Tr.*, 136 Nev. 172 460 P.3d 969 (2020)

*In The Matter Of The Linda Lee Ward Revocable Tr. Agreement Dated July 7, 2004*, 137 Nev. 926 499 P.3d 1217 (2022)

*Ventura Cty Dept. Of Child Serv. Vs. Brown*, 117 Cal App 4<sup>th</sup> 144 (Cal. Ct. App. 2004)

NRS 163.419(2) - *trustee given discretion in a trust instrument that is described as sole, absolute, uncontrolled, unrestricted or unfettered discretion, or with similar words, “has no duty to act reasonably in the exercise of that discretion” evidencing that failure to act reasonably does not evidence bad faith or willful neglect.*





# SPENDTHRIFT TRUSTS - PROHIBITION AGAINST ALIENATION DOES NOT MEAN TRUSTEE CANNOT BE COMPELLED TO ACT.

*Scanlan v. Eisenberg*, 669 F.3d 838 (7th Cir. 2012) - The fact that a creditor could not reach into the trust did not negate the ability of the beneficiary to sue a trustee for breach and seek to compel a distribution based on special fiduciary relationship.

*Berlinger vs. Casselberry*, Fla ed DCA Case No. 2D12-6470, (Nov. 27, 2013) – The fact that a creditor could not reach into the trust to compel a distribution did not mean court could not compel trustee to pay the creditor first when a distribution ultimately is made in priority to interest of the beneficiary.

Restatement (Second) of Trusts Section 157 – recognizing exceptions to spendthrift trusts for spouse or child for support/alimony.

# UNDERSTANDING THE BENEFICIARY'S INTEREST IN THE IRREVOCABLE TRUST.

- \*VESTED

- \*CONTINGENT

- \*VESTED SUBJECT TO BEING DIVESTED

- \*PRESENT INTEREST VS. FUTURE INTEREST

# CONNECTING MARITAL RIGHTS TO INTERESTS IN TRUSTS

## COMMUNITY PROPERTY JURISDICTIONS:

- Presumptions of community property
- Separate property status of pre-marriage assets; gifts; inheritance
  - Maintain records for tracing
  - Keep separate property separate
- “Creeping community interests” in separate property
- Prohibitions on Unilateral Transfers of Community Property
- Availability of all property for support
- COMMON LAW STATES/EQUITABLE DIVISION
  - Concept of the “marital property” available for division
  - Concept of the “marital property” for support







## MARITAL AGREEMENTS – ALTERING THE DEFAULT

- Pre-marriage Transfers; DAPTS; Gifts – Removal of Assets from becoming part of the marital estate before marriage.
- Prenuptial Agreement.
- Postnuptial Agreement.
- Transmutation Agreements.

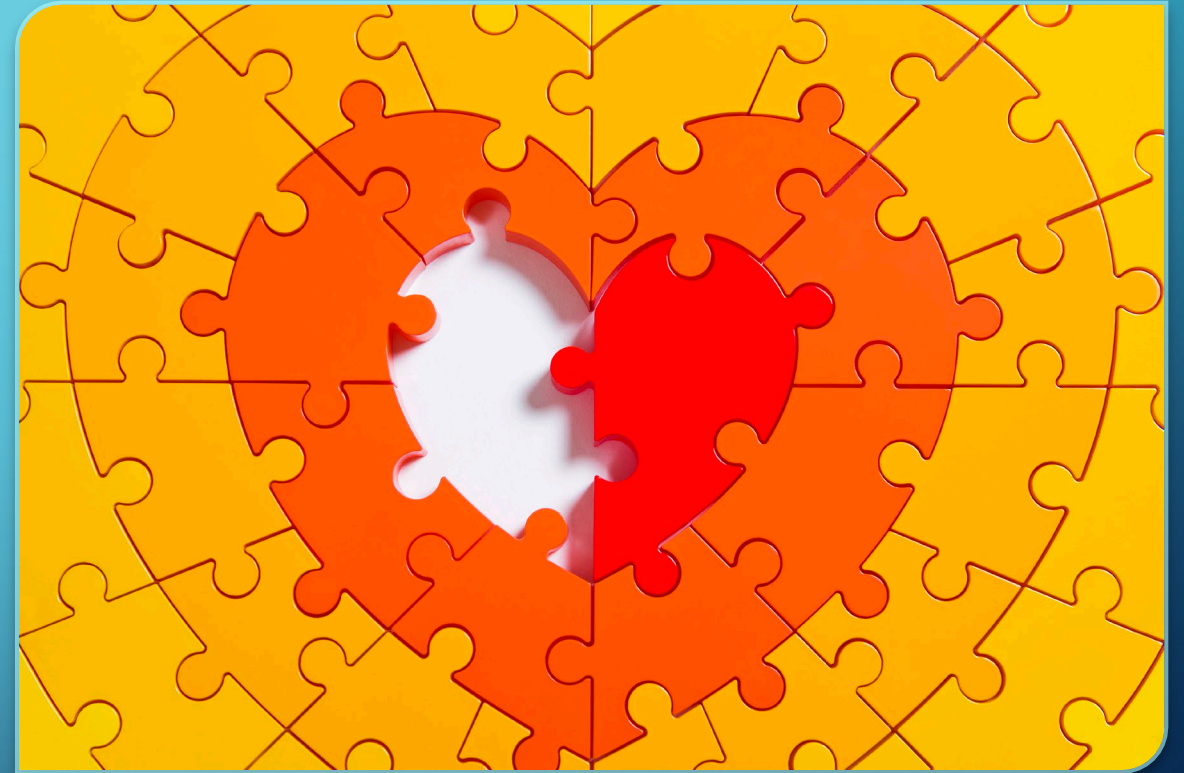
But what about those assets that are not and never were “property” of the beneficiary... (i.e., gifts in trust from another that beneficiary has no authority to contract around).

# TREATMENT OF INTERESTS IN DISCRETIONARY TRUSTS AND SPENDTHRIFT TRUSTS IN DIVORCE



# SPOUSAL ATTACKS ON TRUSTS IN DIVORCE

- Challenges to Ownership & Character of Property
- Challenges to Identifying Assets Subject to Divorce (including nullification of lifetime gifts)
- Challenges to Applicable Law and Jurisdiction of Court
- Challenges to Contractual Obligations of Spouses
- Challenges (And Recurring Challenged) to Alimony
- Other Challenges





## **#1 - When the Beneficiary Gets Divorced #1:**

- \*What is the beneficiary's interest? (support interest, HEMS, discretionary interest)
- \*Is it a mandatory or discretionary support? "shall" vs. "may"
- \*Is the "beneficiary's interest" a vested "property" right subject to division in divorce or subject to consideration from equitable position as an "available" resource for support
- \*Is there any way that the community has paid toward any trust assets?
- \*Can the beneficiary's interest be valued in the divorce? (Consistent payments?)
- \*Are there other beneficiaries who will be impacted (i.e. pot/sprinkle trusts vs. single beneficiary)
- \*Is there a course of action/did the married couple rely on trust funds sprinkle trusts

# BUT WHAT IS THE CLAIM BY BENEFICIARY'S SPOUSE

- Its available to pay alimony/support
- It should be considered in calculation of above
- An adjustment should be made of the non-trust property taking into consideration this property
- I am a beneficiary as the “spouse” of a beneficiary - is the spouse a beneficiary and does divorce change that status? See *Ochese v. Ochese*, N0-04-20-00035-CV BL 446966 (Tex. Ct. App Nov. 18, 2020) where the ex was the “spouse” for purpose of the specific trust.

See *Levitan v. Rosen*, 95 Mass App Ct 248 (2019) – although the trust was discretionary and beneficiary had a minor 5/5 power, she really was the sole beneficiary of this trust, and whole thing should be considered.

## OTHER INTERESTING CASES

- *Ventura Cty Dept. Of Child Serv. Vs. Brown*, 117 Cal App 4<sup>th</sup> 144 (Cal. Ct. App. 2004) – available resource to pay child support
- *Harrison v. Harrison*, 88 N.E.3d 232 (Ind. 2017)
- *Bock v. Bock*, 116 N.E.3d 1124 (2018).
- *Pratt v. Ferguson* , 3 Cal App 5<sup>th</sup> 102 (Cal App 2016) - grantor intent interpreted to broadly benefit grandchildren
- *Pfannenstiehl v. Pfannenstiehl*, 475 Mass 105 (2016) – “more than a mere expectancy?”
- *Comins v. Comins*, 33 Mass App Ct. 28 (1992) – HEMS standard made distributions sufficiently certain



# UNCLEAN HANDS: DID THE BENEFICIARY SPOUSE DO THINGS TO THWART THE OTHER SPOUSE'S RIGHTS?

NO – *IN FERRI V POWELL* – 476 MASS 651 (2017) – TRUSTEES DECANTED THE TRUST IN LIGHT OF DIVORCE TO REMOVE THE BENEFICIARY'S WITHDRAWAL RIGHT. IT WORKED AS COURT FOUND THAT THE SON PLAYED NO ROLE IN THIS ACT.

BUT- CONSIDER WHETHER IT WOULD BE DIFFERENT IF HE HAD ACTED?

## #2. WHEN THE SETTLOR OF A THIRD PARTY GETS DIVORCED



## Challenges To Settlor's Transfer In Trust For The Benefit Of Third Parties:

(1) THE TIMING OF THE GIFT OR GIFTS IN TRUST – PRE MARRIAGE VS. POST MARRIAGE.

(2) THE CHARACTER OF THE PROPERTY TRANSFERRED  
(*BROOKS V. BROOKS, INFRA*)

(3) PURPOSE OF THE TRANSFER – FRAUDULENT TRANSFERS. *ANDERSON V. ANDERSON*

(4) CONSENT/NOTICE (OR ABSENCE) TO OTHER SPOUSE. (*BROOKS V. BROOKS, INFRA*)

(5) JURISDICTIONAL DIFFERENCES IN POLICIES



# INTERESTING CASES

*Brooks v. Brooks*, 733 P.2d 1044 (Alaska 1987) – Husbands gifts to 4 sons deemed “voidable”

*Anderson v. Anderson*, 583 S.W. 2d 504 (Ky. 1979) – Impermissible to gift during life to thwart a marital right on death.

*Windsor v. Leonard*, 475 F.2d 932 (D.C. Cir. 1973) – Intervivos trust that gave away benefits on death to others deemed permissible.

*VanderLugt v. VanderLugt*, 429 P.3d 1269 (NM Ct. App 2018) – wife had no lien in the ILIT despite husband using community property to pay premiums. She knew it was happening, and he’d set it up before marriage.

*Pezza v. Pezza*, 690 A.2d 345 (1997) – wife had no interest in 3 parcels that husband transferred to trust for kids was not a sham, illusory or fraud on spouse.

### **#3 WHEN THE SETTLOR-BENEFICIARY GET'S DIVORCED**

# Challenging Settlor's Transfer to a DAPT for own Benefit

Concepts of protecting disposition intention of a settlor's hard-earned (or inherited) wealth is respected, but does that concept change when the settlor is the beneficiary being protected?

- (1) Timing of the gift or gifts in trust – Pre marriage vs. post marriage
- (2) Character of the property transferred
- (3) Purpose of the transfer – Fraudulent transfers. Sham Trusts, Illusory Trusts
- (4) Consent/Notice to other spouse
- (5) Jurisdictional differences



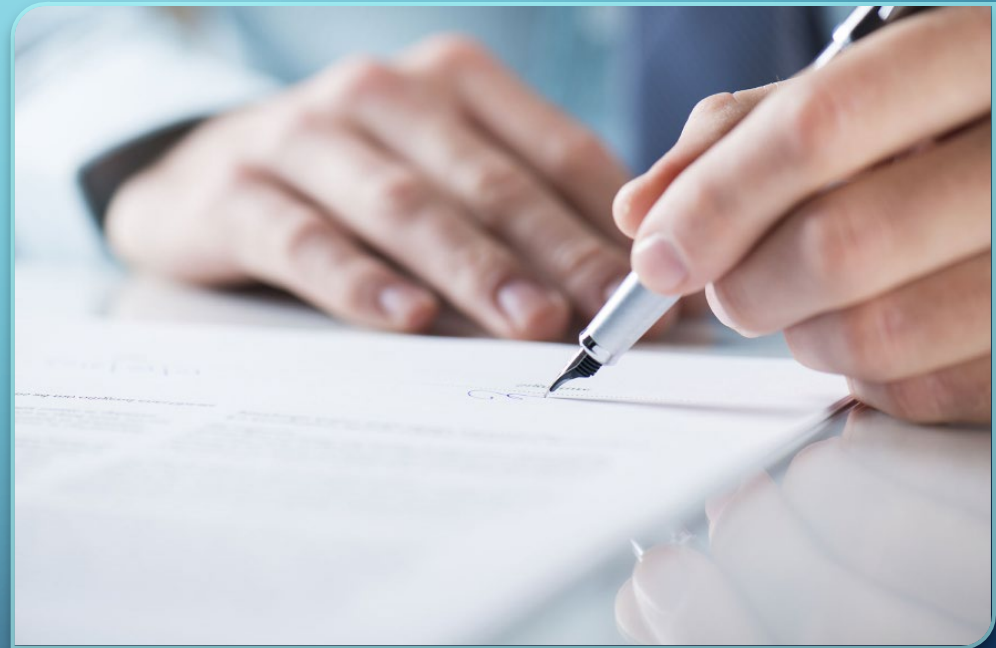
# INTERESTING CASES

- *Klabacka v. Nelson*, 133 Nev. 164, 394 P.3d 940 (2017).
- *Dahl v. Dahl*, 459 P.3d 276 (2015).
- *Berlinger vs. Casselberry*, Fla ed. DCA Case No. 2D12-6470, (Nov. 27, 2013).
- *Waldren vs. Huber*, 493 B.R. 798 (Bankr. W.D. Wash. Nov. 25, 2013).

#4.

DIVORCE CHALLENGES TO BENEFICIARY'S TRANSACTION WITH SPENDTHRIFT TRUST.

- *IMO Daniel Kloiber Dynasty Trust, 98 A.3d 924 (Ky. 2014)*
- *\*Support Interests*
- *\*Discretionary Interests*
- *\*Is the beneficial interest “property” subject to division in divorce*



# FORMALITIES MATTER AT TIME OF FORMATION.

Valid Trust

Fund the Trust  
Carefully and  
Correctly.

The Trust must be  
irrevocable.

Limitation on  
Distributions to the  
Settlor/Beneficiary.

Discretionary Pot Trust  
Features May be  
More Protective in  
Third Party  
Spendthrift Trusts.

Trustee Other Than the  
Settlor/Beneficiary.

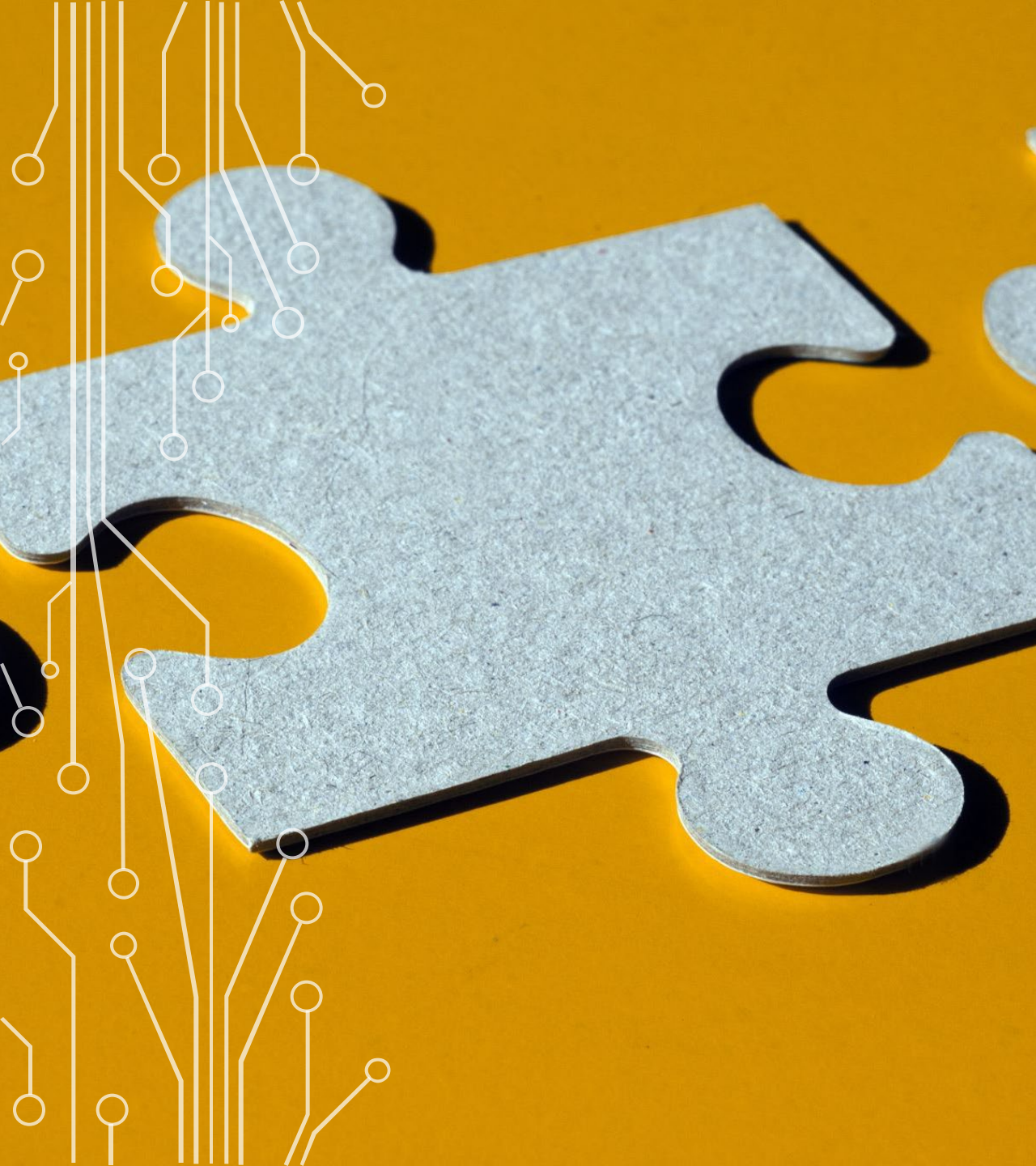
Proper Purpose – No  
intent to hinder, delay  
or defraud at time of  
formation.

Bad fact cause bad  
results.

Find a Nexus to the  
State of Formation.

Affidavits of Solvency.





- **Other consideration in avoiding divorce disputes**
- **1. Notice of Formation**
- **2. Review timing, and form of funding.**
- **3. Evaluate if transmutations are needed and requirements.**
- **4. Evaluate Jurisdiction Issues – What states ?**
- **5. Tracing Assets Transferred to a DAPT to Characterize Property.**
- **6. Admitting Trust to Court Jurisdiction.**
- **7. Is “Spouse” defined?**

# OTHER TRUSTS THAT MAY CAUSE ISSUES IN DIVORCE

- SLATS - who is the “spouse” and can it change? (i.e. floating spouse)
- QPRTS – use of property as residence and impact of divorce
- QTIPS - Create regular mandatory income streams.
- IDGT - Create tax obligations that can continue after divorce
- ILTS - is spouse a trustee/beneficiary after divorce?
- Grantor Trust Status – Does it change on divorce? Can it change?
- Rev Trust - See *Crawford v Crawford*, No 19A-DC-2152 (Id. Ct. App 2020) where joint rev trust was deemed sufficient to revoke premarital agreement.





## CONCLUSION –

AS WITH ANYTHING  
WORTHWHILE, MOST OF  
OBSTACLES TO IRREVOCABLE  
TRUSTS CAN BE OVERCOME  
WITH PLANNING AND  
WORK...

BUT ONE CAN NEVER  
UNDERESTIMATE THE POWER  
OF A BROKEN HEART ON  
EVEN THE BEST PLANNED  
TRUST.