

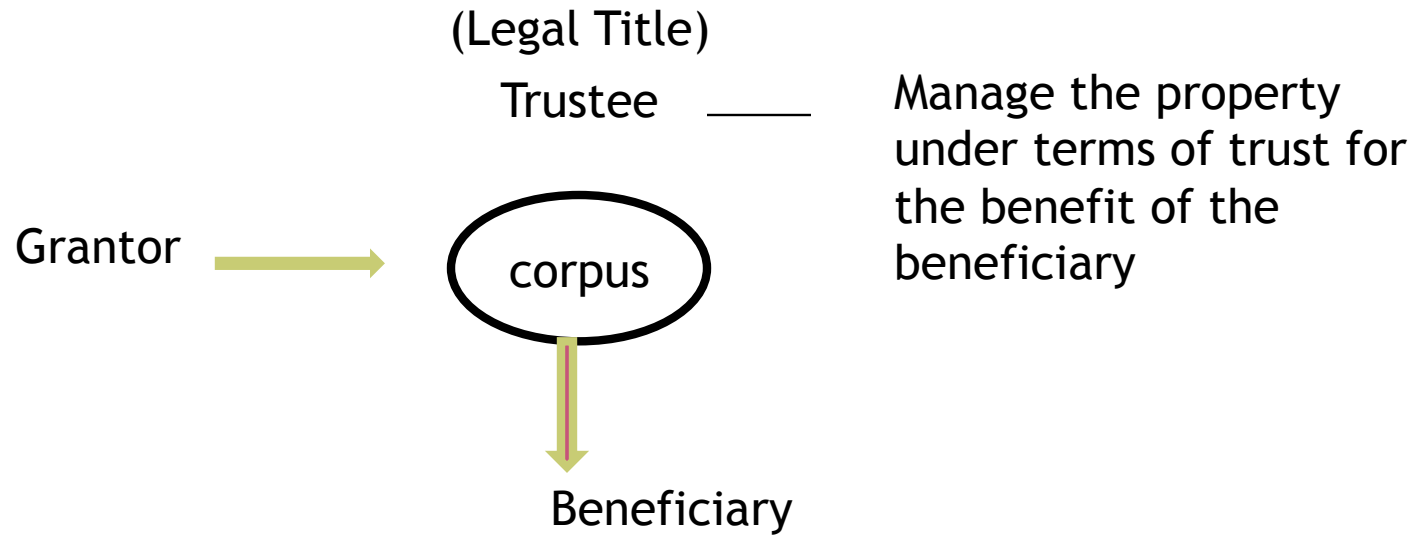
# Irrevocable Trusts in Divorce (Berger Schatz)

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# What is a Trust



- ◎ Revocable - can modify or amend or revoke until death
  - This is a “grantor” trust and the grantor - the person who set up the trust - pays the income taxes and retains the power to amend/restate the trust
  - Grantor is usually trustee (if the Grantor has capacity)
  - Because revocable generally treated as owned by settlor, and therefore not available in divorce.

But a vested remainder interest may be property.

A remainder interest is a right to receive the trust corpus after a trust terminates.

Ex: Wife's father gives property to an irrevocable trust with income to wife's mother for life then to wife and her brother at mother's death and settlor is dead at the time of the divorce. (Vested) But if determined at wife's death, not vested.

In re Marriage of Tatham 173 Ill. App. 3d 1072 527 N.E. 2d 1351 (1988)

## © IRREVOCAABLE TRUST:

Grantor makes an irrevocable transfer of property to Trustee subject to trust terms:

- Self-settled-created by the Grantor or Grantor and Grantor's spouse. Grantor(s) is/are also beneficiaries of the trust.
- Third Party Trusts - Is NOT created by the Grantor but are created and funded by someone like parent, aunt or uncle to benefit child, niece, nephew etc., third party is not a beneficiary.

## ■ SELF-SETTLED IRREVOCABLE TRUSTS

- Insurance Trust - Self-settled created by divorcing couple (or one of them)
- Asset protection trust created by one or both spouses as a self-settled asset protection trust - DAPT at least eighteen states have adopted DAPT legislation
- Illinois is not a DAPT state.
- Case law varies among states when established after marriage

# Marital Trusts

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- Qualified Terminable Interest Property (QTIP) Trusts.
- Client may create a new QTIP trust for each spouse they marry.
- Note, Inter Vivos QTIP is *not* terminated by divorce:
  - Former spouse will retain his/her income interest for the remainder of their life, even if remarried
  - Trust can be drafted so a trustee's discretionary right to invade principal for the benefit of the spouse is contingent upon being married to grantor

## ■ THIRD PARTY TRUSTS

Trusts created by third parties (parents, grandparents, uncles or aunts, etc.) are generally NOT marital property. 750 ILCS 5/503(a)(1).



## BUT SOMETIMES ...

...the third party trust assets may still be considered: this will turn often on whether the trust is a “fully discretionary” trust or a support trust.

In a third-party trust the trustee's discretion can be broad or it may be limited to a defined standard like: **“health, education maintenance, and support” (“HEMS”)**. The broader the trustee's discretion, the less likely the trust will be considered as property in a divorce. This is because in a fully discretionary trust such as **“best interests”** no one but the trustee can determine whether a distribution is to be made. This is referred to as a subjective standard.

HEMS is known as an “objective” standard: a court can enforce.

If the beneficiary needs to make a mortgage payment or undergo surgery the trustee has a fiduciary duty.

- Whether the 3<sup>rd</sup> party trust corpus will be considered is determined in Illinois by looking at whether the beneficiary spouse has a property interest, or merely the expectancy of a future discretionary distribution.

- If there is a property right, may be taken into consideration for division. A “HEMS” standard is an enforceable property right and may be considered a resource available for maintenance and subject to division, or available for college expenses, child support, or attorney fees.
- Therefore, even if trust is not reachable
  - i. Value of the trust; and
  - ii. History of trust distributions are pertinent to the fact finder

Property Right

Mere Expectancy



Best Interests

- Right to Income
- HEMS
- Right of Withdrawal
- Right to Receive at Stated Age

# CONFIDENTIAL RELATIONSHIP

- One spouse cannot settle property in trust without the other spouse's informed consent.

The property can be brought back into the marriage. (Papson v Papson N. 10065-1997, 1998 WL 1177948) (N.Y. Sup. Ct. 1998)

(Ct. held transfer violated public policy and ordered husband to terminate trust and return funds.)

Note: This may also be a fraudulent transfer

## Dahl v. Dahl

The Supreme Court of Utah ruling that the trust was a revocable trust not a DAPT.

“Settlor reserve any power whatsoever to alter or amend any of the terms or provisions hereof.”

Charles Dahl set up what was wholly intended to be a Nevada DAPT - spouse and issue as bennies; transferred securities, business interest and residence.

Wife Kim claimed marital property, the Court said Utah has a strong public policy interest in equitable division of marital assets and applied Utah law.



## See also:

- ◉ Westrate v. Westrate - involved a husband's transfer of the bulk of the marital assets to a Cook Island trust after consulting a divorce attorney. The case settled after the court found sufficient facts to invoke the crime-fraud exception to attorney-client privilege and ordered the lawyer to answer interrogatories.

(Case discussed in ABA Journal; Debra Baker, Island Castaway, A.B.A.J., Oct. 1998 @ 55)

## Kloiber v. Kloiber

In this Delaware case Dan Kloiber's father set up a third party support trust stating that the Trustee "shall pay to or apply for Dan's benefit such amounts as shall be necessary or advisable from time to time for Dan's health, education support and maintenance." (Classic support trust.)

Beth Kloiber was able to take \$30 million plus from the trust.

## In Re Marriage of Eddy (210 Ill.App. 3d 450, 569 N.E.2d 174 1991)

Wife was a beneficiary of trust created by grandparents holding approximately \$2 million. Her parents were primary beneficiaries. Her parents could have exercised a limited power of appointment to eliminate her, but if they did not she would receive a share. There were “spray” provisions allowing distributions to her for her “best interests” if needed, but would have to make same distribution to all bennies. Previously, she had received \$5,000 per year.

TC found a property interest based on her ability to increase her distributions, or change investments to increase her income.

AC found a “mere expectancy”

## Court said:

“Potential inheritances, just as expected degrees or licenses, are not property which can be valued and awarded to a spouse, although they can be given some consideration in determining property distributions”

“In order to be property ... the res must be in the nature of a present property interest, rather than a mere expectancy interest”

The Eddy Court did approve the trial court’s consideration of the \$5,000 per year in income previously received.”

# Indirect Trust Interest

- 1) Giving an Independent Trustee or Trust Protector the power to add an individual later
- 2) Power of Appointment - A person may have exercised a power of appointment in favor of the spouse
- 3) Power to Decant Creating a new trust

So, what if divorcing spouse James's father, “Dad”, creates a trust for James with funds transferred from James, and through a “power of appointment” Dad can appoint the property back to James.

While James may object that he is not a beneficiary these assets may be overlooked unless inquiry is made as to transfers, rather than just whether spouse is a trust beneficiary.