

OUTSIDE COUNSEL

Trust Considerations in Prenuptial Agreements

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Ofentimes, when the beneficiary of a trust is getting married, their family wonders whether the beneficiary needs a prenuptial agreement (a “prenup”) to protect family money held in a trust.

Perhaps the beneficiary does not have significant assets of their own, but the family wants to ensure that the trust will be protected in the event of a divorce. Is the trust alone enough protection? This is a commonly debated issue amongst matrimonial and trust and estates practitioners.

In New York, a beneficial interest in trust is generally not considered “property” in a divorce proceeding. If a trust is not funded with marital property, is irrevocable, and neither party is a trustee, the trust assets are typically deemed “unavailable to either party,” and not subject to distribution in a divorce (*Markowitz v. Markowitz*, 146 A.D.3d 872, 873–74 (2017)). The premise is that where a beneficiary has no control or right to access the trust assets, the beneficiary’s interest in the trust is neither marital nor separate property.

While a beneficiary’s interest in an irrevocable trust will generally be well-protected by the trust alone, prenups provide an extra layer of security and



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mitigate risk. There are several reasons why a prenup is a smart decision, including hedging against changes to the law and closing loopholes that otherwise might be a minefield. In thoughtfully crafted prenups, all parties walk away with peace of mind and protection for the future.

The Law Can Change

New York generally offers strong protections for trusts in a divorce action, but vulnerabilities exist in other states. The law that governs a couple’s divorce is the law of the state where they reside when a divorce action is commenced. Even if a couple married in New York and spent most of their married life there, should they move to Massachusetts and file for divorce after residing there long enough for jurisdiction to be proper, the divorce would be subject to Massachusetts law.

Trust assets that would be protected in most jurisdictions may be vulnerable in Massachusetts. Under

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the divorce statute, courts in Massachusetts may assign to either party all or any part of the estate of the other. *Mass. Gen. Laws ch. 208, §34*.

If a Massachusetts court finds a trust interest sufficiently similar to a property interest (i.e., there is “a present, enforceable, equitable right” to use trust property or compel trust distributions, *Lauricella v. Lauricella*, 409 Mass. 211 (1991)), a court may include trusts in the marital estate for purposes of equitable distribution.

In the infamous *Pfannenstiehl* case (475 Mass. 105), a probate and family court judge ruled that the husband’s interest in a family trust constituted part of the marital estate for purposes of the division of marital property and awarded a sizeable portion of the husband’s remainder interest in the trust to his wife.

The lower court’s holding was reversed on appeal, but the case was cited subsequently (*Levitan v. Rosen*, 95 Mass. App. Ct. 248 (2019)), when an appeals court held that a wife’s entire beneficial interest in a discretionary family trust was includable in the marital estate for purposes of equitable distribution, because she had a “fixed and enforceable” property right in the trust.

The law in this area is ever changing, and what matters is the law in place at the time of divorce. Though New York is friendly to trusts today, the law can change.

Several other states, including Colorado and Oregon, have similar case law that makes trusts vulnerable in a divorce proceeding. Though a beneficiary’s interest in an irrevocable trust will most likely be protected if a divorce occurs in New York or another trust-friendly state, families should consider how much they’re willing to risk, especially if they have engaged in significant trust-planning.

A corollary to this point is that the law in this area is ever changing, and what matters is the law in

place at the time of divorce. Though New York is friendly to trusts today, the law can change. Prenups can hedge against these jurisdictional risks and changes to the law by stating, prior to the marriage, that trust assets are off the table in all instances and regardless of a change in jurisdiction or change in the law.

Closing Loopholes

In every state, including New York, there are certain loopholes and ambiguities that are better addressed in a prenup than in a divorce. For families where there are likely to be significant distributions from a trust to a beneficiary, a prenup is essential, even if the beneficiary stays in New York. Trust distributions will almost certainly be considered “income” to the beneficiary for purposes of determining maintenance and child support.

Upon a distribution, once assets are held in the beneficiary’s name, the appreciation of those assets will be considered marital property if they are actively managed. The distribution itself would remain separate property provided it remains in the beneficiary’s sole name and is not commingled with marital property, but the appreciation is vulnerable. A prenup can provide that all appreciation on separate property, even if it is due to the active efforts of one spouse, will remain separate property.

Even more concerning, at least one case in New York has indicated it is possible that appreciation on trust assets could be considered marital property. In *DeNiro v. DeNiro*, 185 A.D.3d (2020), the wife’s father purchased a vacation home in both his and his daughter’s names, then transferred it to an irrevocable family trust.

The court determined the vacation home was the wife’s separate property (and therefore, a property interest subject to the court’s discretion in a divorce), noting that the wife was “not only the primary beneficiary of the trust, but she also had the power to remove and replace the trustee, who in turn had the ‘absolute discretion’ to terminate the trust.”

Though the home was determined to be the wife's separate property, making it possible that the appreciation would be considered marital property, on appeal the court found that the husband was not entitled to a percentage of the home's appreciation, as he failed to demonstrate the nexus between his contributions (paying for occasional expenses) and the increase in the value of the property.

The holding in *DeNiro* has not yet been extended to other cases, and in New York, the issue of whether active appreciation on assets held in trust could be considered marital property remains an open issue. If this precedent were extended, it would be devastating for a beneficiary who, for example, is actively managing a family office.

Similarly, if a beneficiary is working for a family business owned in trust, and that business appreciates during the marriage, a divorce action could require valuation of that business and the non-beneficiary spouse could be entitled to a piece of the appreciation.

Prenups can simultaneously protect a trust for the family's peace of mind and allow a beneficiary and their spouse to avail themselves of the trust's benefits to enhance their quality of life.

A prenup can close this loophole and clarify that the appreciation of assets held in trust will always be protected. A prenup can also shield distributions from a trust from consideration in a maintenance analysis.

Protection for All Parties

One of the goals of a trust is often to ensure that funds are available to improve the life of the beneficiary and his or her descendants, whether that means making below market loans so that beneficiary can

purchase his or her first home, providing funding for a beneficiary's business venture, or simply making an annual distribution to supplement a beneficiary's lifestyle.

If a trustee is worried about taking defensive measures to protect against a potential divorce, the beneficiary cannot enjoy the support that the trust has been established to provide, and family relationships can become strained as a consequence.

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Though the goal of a prenup is typically to protect the wealthier party (and any trusts for his or her benefit), a well-crafted prenup should also provide a benefit to the less monied spouse. In exchange for assuring the family and trustee(s) that a beneficiary's interest in trust is airtight, a family normally offers the less-monied spouse a benefit he or she would not otherwise be entitled to under the law. Typically, this takes the form of housing security, a distributive award, guaranteed maintenance, or allowing the less monied spouse to keep as separate property some of their assets, which would otherwise be deemed marital property under the law. Doing so proactively is often a wise negotiating posture as it streamlines the process and leaves both sides feeling protected and respected.

In sum, beneficiaries of trusts and their families should educate themselves about the risks inherent in the law if they choose to marry without a prenup. A prenup offers security by protecting trusts and other family wealth regardless of where a couple lives, changes in the law, and the relationship between the beneficiary and the trust during the marriage. By offering protections to the beneficiary's prospective spouse as well, a prenup can set a solid foundation for a financially responsible lifelong partnership.