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Journal of the American Academy of  
**Matrimonial Lawyers**



**TRUSTS**

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Volume 34

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**TRUSTS**

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## About This Issue

This issue of the Journal was scheduled to be on the use of trusts in family law cases and we have three excellent articles related to that topic as well as an extensive annotated bibliography. It soon expanded, however with the addition of excellent submissions on other topics. It now also features articles related to child custody, the tax treatment of S corporations and citizenship for children born abroad through assisted procreation.

Our first article is entitled, *Keeping It in the Family: The Pitfalls of Naming a Family Member as a Trustee* by Richard Ausness. The author first discusses some of the fiduciary duties that trustees must satisfy, including the duty of loyalty, prudence, and impartiality, the duty to inform, and the duty to account. He then highlights special problem areas such as support trusts, discretionary trusts, and the modification of “irrevocable” trusts by decanting. Finally, he describes several precautionary measures that settlors and trustees should take to reduce the chance of future conflicts within the family when a member is named as a trustee. Professor Ausness is currently a member of the College of Law faculty at the University of Kentucky. He received his B.A. degree and J.D. degrees from the University of Florida and received an LL.M. degree from Yale Law School. He currently teaches courses in Property, Trusts & Estates and Products Liability.

Confusion over the interaction between the Uniform Child Custody Jurisdiction and Enforcement Act and the Parental Kidnapping and Prevention Act is the subject of our second article by Andrew Jack Botros entitled, *The UCCJEA, the PKPA, and Preemption: Why the Jurisdictional Provisions of the UCCJEA Cannot Be Waived*. He points to several states that have found that the UCCJEA does not exclusively convey subject matter jurisdiction. He argues that states that have permitted parties to waive the jurisdictional provisions of the UCCJEA believing that they are creating voidable orders are in fact creating void orders that cannot be enforced under the PKPA outside the jurisdiction that rendered the order. He suggests this result follows because the PKPA only requires states to recognize custody and visitation orders that are made consistently with the jurisdictional provisions of the PKPA and because the jurisdictional provisions of the PKPA and UCCJEA are consistent with each other. Mr. Botros is a family law trial and appellate attorney in San Diego, California. He is a Certified Family Law Specialist certified by the State Bar of California’s Board of Legal Specialization and is a Fellow of the American Academy of Matrimonial Lawyers. He was appellate counsel in two published California appellate opinions involving the UCCJEA.

Our next article also relates to child custody issues, specifically modifications of such orders. It is written by Helen R. Davis and is entitled, *Self-Executing Modifications of Custody Orders: Are They Legal?* The article explains what self-executing modification orders are and how they are typically used, it then discusses the legality of the self-executing orders across the country. A very helpful table is included as an appendix that surveys cases state-by-state and notes whether the self-executing orders are permissible, not permissible, or whether legality is unknown or questionable. The article further explores the use of such orders on a pendente lite or temporary basis and the effect of parental agreement on such orders. Ms. Davis has been practicing family law for over twenty years and focuses on complex divorce and custody litigation. She is the President and Chair of the Cavanagh Law firm in Phoenix, Arizona. She is also an adjunct professor at Arizona State University's Sandra Day O'Connor College of Law. She is certified as a family law specialist by the Arizona state Bar and a fellow of the American Academy of Matrimonial Lawyers.

In *The Dynamics of the Enmeshed Family System Ten Years Later: Family Court and Contemporary Understanding of Adulthood, Parentification, and Infantilization*, psychologist Benjamin Garber provides important information for family law attorneys involved in high conflict custody cases. He reports on a ten-year follow up and elaborates upon his seminal discussion of enmeshment in the context of high conflict divorce. More nuanced descriptions of three forms of enmeshment (i.e., adulthood, parentification, and infantilization) are offered, including previously overlooked gender, cultural, religious, and language considerations. He provides case illustrations and discusses how these destructive dynamics can be recognized and remedied. Dr. Garber is a New Hampshire licensed psychologist and consultant to family law matters around the world. He is a prolific writer, educator, and speaker. His forthcoming book, *DYNAMICS, NOT DIAGNOSIS: THE FIELD GUIDE FOR FAMILY LAW PROFESSIONALS* with co-authors Dana Prescott and Chris Mulchay will be available soon.

Our next article details very recent guidance on citizenship for children born abroad through assisted procreation. The author is Bruce Hale and it is entitled, *"Born of" Outside the United States: Acquisition at Birth of U.S. Citizenship by Children Born Through Assisted Procreation*. The article discusses a new interpretation by the Department of State of section 301 of the Immigration and Naturalization Act. The author asserts that this new interpretation is the latest in a series of updates that adjust policy to meet the needs of families today because it focuses on the citizenship status of the married parents of the child without regard to the circumstances of the child's conception and birth. Mr. Hale is a solo practitioner in the Boston, Massachusetts area. His practice, *Modern Family Law*, is focused exclusively on matters related to assisted procreation. He has served as an adjunct professor of law at Suffolk University Law School and Northeastern University School of

Law, teaching the law of assisted reproduction technology at both institutions, and family law at Northeastern. He is the co-author with Maureen McBrien of the third edition of *ASSISTED REPRODUCTIVE TECHNOLOGY: A LAWYER'S GUIDE TO EMERGING LAW AND SCIENCE* (2018), and with Melissa Kucinski and Mike Coffee of the first edition of *FAMILY LAW ACROSS BORDERS* (2021).

Our next article is entitled, *Realizing the Full Value of Hard to Value Assets* by Shari A. Levitan and Kimberly R. Willoughby. It identifies the types of assets that may produce a more optimal outcome if the parties do not value and divide such assets at the time of the divorce. These types of assets are defined and potential issues that may frustrate the ability to divide the asset, even if desired, are discussed. To demonstrate the problems inherent with leaving the valuation, division and allocation to the courts, the applicable law involving such assets is set forth. Additionally, specific tax issues are addressed, and suggestions regarding divorce settlement agreement terms are provided. The identification of assets is extensive and covers stock options, restricted stock units and performance shares, co-operated and co-owned businesses, imminent business sales, private equity interests, venture capital and hedge fund investments, intellectual property, irrevocable trusts, cryptocurrency, co-owned real estate, and pre-embryos. Shari A. Levitan chairs Holland & Knight LLP's New England Private Wealth Services Group. Ms. Levitan's advises high net worth clients pre and post marriage, focusing on strategies that accomplish financial objectives in a tax efficient manner, and structuring trusts and business entities and agreements consistent with the client's goals. Kim Willoughby is the founder and principal of Willoughby & Associates in Golden, Colorado. She has provided boutique, personalized legal services for clients for over twenty-five years, with special emphasis on cases involving intergenerational wealth transfer. A fellow of the American Academy of Matrimonial Lawyers, she lectures to judges and other professionals multiple times each year.

Tax issues are always important to our readers, so we are happy to publish, *The Changing Tax Affecting Landscape in S Corporation Valuations: Time to Say "I Do" in Divorce Cases* by Andrew Z. Soshnick. The article concerns one of the most hotly debated topics in business valuation, the tax treatment of S corporations. The author notes that since 2001, federal courts have embarked on a journey that considers whether to tax affect S corporation earnings in business valuations of those entities. He points out that these opinions may conflict with cases that address the issue in the family law context. The article contains a review of the background of S corporations and their primary purpose. It then considers the premises and standards of value and how those selections can impact tax considerations. It goes on to analyze the progression of federal tax precedent to date, including recent relevant cases and then reviews the most notable divorce precedent addressing this issue and harmonizes that precedent with federal and Delaware tax pre-

cedent. Finally, the author concludes that divorce courts must tax-affect earnings when valuing businesses structured as S corporations to determine value more accurately. Andrew Z. Soshnick is a partner in the Indianapolis office of Faegre Drinker Biddle & Reath LLP where he concentrates his practice in complex matrimonial cases. A Fellow of the American Academy of Matrimonial Lawyers and International Academy of Family Lawyers, Drew writes and speaks extensively on divorce financial and valuation issues.

Our final article is entitled, *Custom of the Country: Trusts and Marriage Planning in High-Wealth Families* by Allison Tait. The article considers the question of asset protection trusts being used as substitutes for prenuptial or post-nuptial contracts, and presses on questions concerning how they work, how trust companies market the new generation of trusts, the judicial treatment of these trusts in court, and how to think about the purported benefits when weighed against harms to spouses, the idea of marital partnership, and equality values. The article begins with a brief history of the use of family trusts in marital planning and, through an examination of recent cases, how these family trusts established by third parties continue to successfully protect family wealth at divorce. It then describes asset protection trusts known as domestic asset protection trusts (DAPTs) and associated case law. Finally, the author takes up the question of what harms these premarital trusts produce by displacing marital norms of economic partnership and entrenching particularly gendered forms of wealth inequality. She concludes that some modes of legally sanctioned wealth preservation come with certain costs because they damage equality values, both within and without of marriage. Allison Tait is a Professor of Law and the Associate Dean for Faculty at the University of Richmond School of Law, where she teaches trusts and estates, family law, estate planning, critical theory, and feminist legal theory. Professor Tait's research addresses questions of family wealth preservation and wealth transfer as well as the role of marriage in the household economy. Recently, she has written about the role of family trusts in creating wealth inequality, the legal framework of high-wealth exceptionalism, and the regulation of high-wealth family assets at both divorce and death.

We have two student comments entitled, *Money Left on the Table: Valuing the Survivor Annuity at Divorce* by Katherine Bourk and *The Changing Landscape of Spousal Support* by Mackenzie Burch. The issue concludes with *Contemporary Issues in the Law of Trusts: An Annotated Bibliography* by Allen Rostron, the William R. Jacques Constitutional Law Scholar and Professor of Law at the University of Missouri-Kansas City School of Law.

Mary Kay Kisthardt  
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## Keeping It in the Family: The Pitfalls of Naming a Family Member as a Trustee

by  
Richard Ausness\*

### I. Introduction

This article is concerned with trusts in which either the settlor, trustee, or beneficiaries are members of the same family. For example, the settlors may be the parents,<sup>1</sup> grandparents,<sup>2</sup> or other relatives<sup>3</sup> of the trust beneficiaries. Trustees may be settlors,<sup>4</sup> parents of the beneficiaries,<sup>5</sup> children of the settlor,<sup>6</sup> and other family members,<sup>7</sup> while beneficiaries may include either the settlor, the settlor's spouse, children, grandchildren, or other

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\* Stites & Harbison Professor of Law, University of Kentucky Rosenberg College of Law, B.A. 1966, J.D. 1968, University of Florida; LL.M. Yale Law School. I would like to thank the University of Kentucky Rosenberg College of Law for supporting this research.

<sup>1</sup> *E.g.*, *Trolan v. Trolan*, 243 Cal. Rptr. 3d 264, 268 (Ct. App. 2019); *Peterson v. Peterson*, 835 S.E.2d 651, 653 (Ga. Ct. App. 2019); *McPherson v. McPherson*, 705 S.E.2d 314, 315 (Ga. Ct. App. 2011); *Rennacker v. Rennacker*, 509 N.E.2d 798, 799 (Ill. App. Ct. 1987); *Hurtig v. Gabrielson*, 525 N.W.2d 612, 612 (Minn. Ct. App. 1995); *In re Estate of Reugh*, 447 P.2d 549 (Wash. Ct. App. 2019).

<sup>2</sup> *E.g.*, *Rollins v. Rollins*, 790 S.E.2d 157, 159 (Ga. Ct. App. 2016); *Cassibry v. Cassibry*, 217 So. 2d 698, 700 (Miss. Ct. App. 2017); *In re McDonald*, 953 N.Y.S.2d 751, 753 (App. Div. 2012).

<sup>3</sup> *In re W.N. Connell & Marjorie T. Connell Living Trust*, 393 P.3d 1090, 1091 (Nev. 2017) (stepfather).

<sup>4</sup> *McCormick v. McCormick*, 455 N.E.2d 103, 106 (Ill. App. Ct. 1983).

<sup>5</sup> *E.g.*, *Rollins*, 790 S.E.2d at 159; *In re Trusts for McDonald*, 953 N.Y.S.2d 751, 752 (N.Y. App. Div. 2012); *Reugh*, 447 P.3d at 550.

<sup>6</sup> *E.g.*, *Peterson*, 835 S.E.2d at 676; *Rennacker*, 509 N.E.2d at 799; *Gillespie v. Seymour*, 823 P.2d 782, 786 (Kan. 1991); *Cassibry v. Cassibry*, 217 So. 3d 298, 700 (Miss. Ct. App. 2017); *In re Estate of Ternansky*, 141 N.E.2d 189, 191 (Ohio Ct. App. 1957); *Fletcher v. Fletcher*, 480 S.E.2d 488, 489 (Va. 1997); *Kerger v. Kerger*, 780 P.2d 923, 926 (Wyo. 1989).

<sup>7</sup> *Peterson*, 835 S.E.2d at 676 (spouse); *Rollins*, 790 S.E.2d at 159; *Laubner v. J.P. Morgan Chase Bank*, 898 N.E.2d 744, 747 (Ill. App. Ct. 2008).

relatives of the settlor.<sup>8</sup> These persons will be referred to as “family members.”

Virtually all family members have disagreements with other family members and sometimes these disagreements can destroy relationships and even lead to bitter, long-term feuds. As the cases discussed below will show, testamentary provisions by a deceased family member can also cause strife within a family, particularly when a long-term trust is involved. More importantly, the chances of this happening are greatly increased when the decedent chooses a family member to serve as trustee. Some settlors are willing to take this risk because they have confidence in the prospective trustee to administer the trust fairly or because they believe that the cost of administering the trust will be less if a family member serves as trustee instead of a bank or other corporate trustee. Nevertheless, a settlor should think twice about appointing a family member as trustee. In particular, a settlor should avoid naming a surviving spouse as sole trustee if some of the beneficiaries are adult children from a prior marriage.

Part II of this Article discusses some of the fiduciary duties that trustees must satisfy, including the duty of loyalty, prudence, and impartiality, the duty to inform, and the duty to account. Part III is concerned with special problem areas such as support trusts, discretionary trusts, and the modification of “irrevocable” trusts by decanting. Finally, Part IV describes a number of precautionary measures that settlors and trustees should take to reduce the chance of future conflicts within the family.

## II. Duties of Trustees

A trust is a fiduciary relationship in which one or more persons (trustees) hold legal title to property for the benefit of equitable owners (beneficiaries).<sup>9</sup> Although trust property at one time usually consisted of real property occupied by a beneficiary, currently it is far more likely to consist of intangible personal property such as stocks and bonds.<sup>10</sup> This means that trustees are

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(stepmother); *Cassibry*, 217 So. 3d 298 (spouse); *Connell Living Trust*, 393 P.3d at 1091 (stepfather); *Rowe v. Rowe*, 347 P. 2d 968, 970 (Or. 1959) (cousin).

<sup>8</sup> *Rollins*, 790 S.E.2d at 159 (brother).

<sup>9</sup> GEORGE T. BOGERT, *TRUSTS* § 1 at 1 (6th ed. 1987).

<sup>10</sup> John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 *YALE L.J.* 625, 637-38 (1995).

no longer mere titleholders of trust property, but instead they must be active managers as well. Furthermore, to carry out these increased managerial responsibilities, trustees are usually given more discretion than was typical in the past.<sup>11</sup>

Trustees are fiduciaries and, thus, are subject to a variety of fiduciary duties for the protection of trust beneficiaries. The most important of these duties are the duties of loyalty, prudence, and impartiality.<sup>12</sup> In addition, trustees who exercise discretion must act in good faith and in the best interests of the trust beneficiaries.<sup>13</sup> Unfortunately, family members who serve as trustees often either are not aware of these fiduciary duties or choose to ignore them. If a serious breach of duty occurs, litigation may ensue causing the trustee to be removed or subjected to a surcharge by the court.

#### A. *The Duty of Loyalty*

One of the most important fiduciary duties is that of loyalty which means that the trustee must avoid self-dealing or conflicts of interest. This is true even when the trustee is also a family member and a beneficiary under the trust.<sup>14</sup>

##### 1. *Self-Dealing*

Self-dealing occurs when a fiduciary engages in a transaction involving individually owned property of the trust or the property of the trustee. This includes the sale or leasing<sup>15</sup> of trust property to the trustee, the borrowing of trust property by the trustee, and the sale of the trustee's property to the trust.<sup>16</sup> Self-dealing may be a problem when both the trust and trustee own shares in a family-run business.

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<sup>11</sup> Richard C. Ausness, *Discretionary Trusts: An Update*, 43 ACTEC L.J. 231, 231 (2018).

<sup>12</sup> Louise Lark Hill, *Fiduciary Duties and Exculpatory Clauses: Clash of the Titans or Cozy Bedfellows?*, 45 U. MICH. J.L. REFORM 832, 832 (2012).

<sup>13</sup> *Sully v. Sully*, 76 N.W.2d 239, 245 (Neb. 1956).

<sup>14</sup> *E.g.*, *Peterson*, 835 S.E.2d at 670; *Rennacker*, 509 N.E.2d at 715; *Cas-sibry*, 217 So. 3d at 709 (Miss. Ct. App. 2017).

<sup>15</sup> *Estate of Stevenson*, 605 N.W.2d 818, 822 (S.D. 2000).

<sup>16</sup> *Stegmier v. Magness*, 728 A.2d 557 (Del. 1999); *Keye v. Gautier*, 684 So. 2d 210, 211 (Fla. Dist. Ct. App. 1996); *Estate of Schulman*, 568 N.Y.S.2d 660, 663 (N.Y. App. Div. 1991).

When self-dealing occurs, the transaction cannot be an arm's length one because the trustee is both the buyer and the seller. Therefore, self-dealing is subject to a "no further inquiry" rule which allows the settlor or the trust's beneficiaries to void the transaction even though the trustee acted reasonably and in good faith.<sup>17</sup> Although, the settlor may waive these requirements either expressly or by implication,<sup>18</sup> the trustee must still act in good faith and in the best interests of the beneficiaries.<sup>19</sup>

*Stegemeier v. Magness*<sup>20</sup> illustrates these principles. In that case, the settlor appointed his brother, Donald, to be the trustee of two testamentary trusts established in his will.<sup>21</sup> The settlor's widow, Anne, was named as the beneficiary of the first trust as well as the income beneficiary of the second or residuary trust.<sup>22</sup> The corpus of the second trust was to be divided among the settlor's six daughters at Anne's death.<sup>23</sup> Three of the daughters were also Anne's children and the other three were daughters of the settlor by a prior marriage.<sup>24</sup> The residuary trust's assets included certain property in a real estate development known as Harmony Crest. The property was subject to a power of sale held by Charles Allmond and Anne Magness who were the co-administrators of the settlor's estate.<sup>25</sup>

In 1982, Donald and Anne formed a corporation, Magness Builders, to obtain construction loans to develop the Harmony Crest property.<sup>26</sup> Donald owned 51% of the new corporation's stock and Anne owned 49%.<sup>27</sup> Over the next few years, Charles

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<sup>17</sup> *Vrendenburgh v. Jones*, 349 A.2d 22, 33 (Del. Ch. 1975); Melanie B. Leslie, *In Defense of the No Further Inquiry Rule: A Response to Professor John Langbein*, 47 WM. & MARY L. REV. 541, 545 (2005); *but see In re Thomas*, 311 A.2d 112, 114 (Del. 1973) (finding no self-dealing when a partnership of which the trustee was a member exercised a pre-existing option to purchase trust-owned land).

<sup>18</sup> *Huntington Nat'l Bank v. Wolfe*, 651 N.E.2d 458, 464 (Ohio Ct. App. 1994).

<sup>19</sup> *Cassibry*, 217 So. 3d at 707.

<sup>20</sup> *Stegmier*, 728 A.2d 557.

<sup>21</sup> *Id.* at 559.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* at 559.

<sup>26</sup> *Id.* at 560.

<sup>27</sup> *Id.*

and Anne exercised their power of sale to transfer all of the Harmony Crest property to Magness Builders who then constructed homes on the property and sold them to third parties.<sup>28</sup> In 1993, two of the residuary trust's remainder beneficiaries, Susane Stegemeier and Diane Mulrooney, brought suit against Charles, Anne, and Donald for breach of their fiduciary duties.<sup>29</sup> The trial court held in favor of the defendants and Susane and Diane appealed.<sup>30</sup>

The principal question before the appeals court was whether the standard applicable to a corporate fiduciary should be applied or whether the higher standard applicable to a trustee was more appropriate.<sup>31</sup> Under the former rule, self-dealing by a corporate director was permitted if a majority of the other directors approved.<sup>32</sup> However, the court held that the corporate fiduciary standard was not applicable to trustees.<sup>33</sup> Instead, it declared that the defendants had engaged in self-dealing by Harmony Crest selling the trust's property to Magness Builders without informing the remainder beneficiaries of the trust and without obtaining their permission.<sup>34</sup> The court remanded the case back to the lower court to determine if the trust had received a fair price from Magness Builders for the property.<sup>35</sup> If the trust did not receive a fair price, the defendants would have to pay the difference between a fair price and the price actually received by the trust.<sup>36</sup>

*Cassibry v. Cassibry* provides a somewhat more complicated example of self-dealing.<sup>37</sup> In that case, Napoleon LePoint Cassibry, Jr. died in 1998, survived by his wife, June, and his three sons, Napoleon, Graham, and John.<sup>38</sup> In his will, Napoleon, Jr. created a Family Trust funded by stock in the Cleveland State

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<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at 562.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 564-65.

<sup>35</sup> *Id.* at 566-67.

<sup>36</sup> *Id.*

<sup>37</sup> 217 So. 3d 698.

<sup>38</sup> *Id.* at 700.

Bank (CSB) and a half-interest in the family home.<sup>39</sup> Napoleon Jr's son, also named Napoleon, was named as trustee.<sup>40</sup> The trust was created primarily for the benefit of June, but Napoleon was also authorized to pay such income to himself and his brothers or their issue that he deemed advisable for their "maintenance, health and education" and at June's death to transfer any remaining trust assets in equal shares to himself and his two brothers.<sup>41</sup>

In 1999, June established the Cassibry Children Irrevocable Trust (Children's Trust), whose beneficiaries were Napoleon, John, and Graham, and appointed Napoleon as trustee.<sup>42</sup> The Children's Trust was created to avoid potential estate taxes and to protect against lawsuits brought by John's ex-wives.<sup>43</sup> The Children's Trust provided that Napoleon as trustee had the discretion to pay any amount of income or principal as he deemed advisable for the health, education, maintenance, support, or comfort of any beneficiary.<sup>44</sup> June subsequently created another trust, know as the June C. Cassibry Irrevocable Trust (JCC Trust) to receive certain life insurance proceeds at her death.<sup>45</sup> Napoleon, John, and Graham were named as beneficiaries and Napoleon was appointed as trustee.<sup>46</sup>

In 2004, Napoleon purchased 20,000 shares of Paragon stock in his own name and he and John formed a partnership, CBP, to purchase another 20,000 shares of Paragon stock.<sup>47</sup> To purchase these shares, Napoleon obtained a \$200,000 personal line of credit at CSB and a \$200,000 line of credit from the Family Trust.<sup>48</sup> These lines of credit were secured by shares of CSB stock held by the Children's Trust and the Family Trust along with other bank stock and the life insurance contract owned by the

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<sup>39</sup> *Id.*

<sup>40</sup> *Id.* To avoid any confusion with the French Emperor of the same name. I will not refer to the son of Napoleon, Jr. as Napoleon III, but instead I will simply call him Napoleon.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *Id.* at 701.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

JCC Trust.<sup>49</sup> Napoleon also withdrew \$190,000 from the Family Trust's checking account and apparently deposited some of it into his personal account.<sup>50</sup>

Unfortunately for Napoleon and John, the value of the Paragon stock fell sharply in 2007 so Napoleon was forced to sell the CSB stock that was used as collateral to purchase the Paragon stock.<sup>51</sup> Since Graham had not participated in the Paragon stock purchase, Napoleon and John had to distribute one-third of the Children's Trust CSB stock to him.<sup>52</sup> Napoleon also sold June's home and purchased a condominium for her with the proceeds.<sup>53</sup> When June died in 2008, Napoleon used the insurance proceeds that were paid into the JCC Trust to pay off the debts associated with the Paragon stock purchase even though the JCC Trust did not authorize this action.<sup>54</sup>

In 2009, Graham sued Napoleon claiming that he had breached his fiduciary duty as trustee of the three trusts and had misappropriated assets from the trusts to borrow money personally to finance the purchase of the Paragon stock.<sup>55</sup> The chancery court ordered an accounting which concluded that Napoleon had withdrawn a total of \$426,373 from his parents' estates.<sup>56</sup> After a bench trial, the court declared that Napoleon's cash withdrawals and loans for his personal benefit were a "blatant example of breach of fiduciary duty" and ordered him to pay Graham 7,757 shares of Paragon stock, \$109,190 from the JCC Trust, and an additional damage award of \$143,665.<sup>57</sup> The lower court also awarded John \$109,190 from the JCC Trust.<sup>58</sup>

On appeal, the appellate court concluded that Napoleon's "loans" to himself from the Children's Trust constituted a breach of the duty of loyalty even though the trust allowed the trustee to make loans to trust beneficiaries.<sup>59</sup> Citing the Restatement of

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<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 701-02.

<sup>52</sup> *Id.* at 702.

<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> *Id.* at 703.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.* at 704-05.

Trusts,<sup>60</sup> the court declared that “[e]ven express authorization to engage in transactions otherwise prohibited under a trustee’s duty of loyalty does not ‘completely dispense with the trustee’s underlying fiduciary responsibility to act in the interests of the beneficiaries and to exercise prudence in administering the trust.’”<sup>61</sup> Accordingly, the appeals court affirmed the lower court’s damage award against Napoleon.<sup>62</sup>

As mentioned earlier, the settlor may allow a trustee to engage in self-dealing. However, courts tend to interpret such waivers strictly. Trustees who are family members should avoid self-dealing at all costs no matter how much they think that their actions are proper and consistent with the settlor’s wishes. Even if the trustee ultimately prevails, the litigation triggered by self-dealing is certain to be costly to the trust and damaging to family relations.

## 2. *Conflicts of Interest*

The duty of loyalty also requires trustees and other fiduciaries to avoid conflicts of interest. Furthermore, it is not necessary to show that the fiduciary’s actions were actually affected by a conflict of interest; rather, it is enough to show that the fiduciary allowed himself to be placed in a position where his interests might conflict with the interests of the trust beneficiaries.<sup>63</sup> The reason for this is obvious. As Professor George Bogert observed many years ago:

It is a well-known quality of human nature that it is extremely difficult, or perhaps impossibly, for an individual to act fairly in the interests of others whom he represents and at the same time to consider his own financial advantage. In most cases, consciously or unconsciously, he will tend to make a choice which is favorable to himself, regardless of its effect on those for whom he is supposed to be acting.<sup>64</sup>

Notwithstanding this pessimistic view of human nature, settlors often create “structural” conflicts of interest by appointing family members as trustee who are either beneficiaries them-

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<sup>60</sup> RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. c (2) (2007).

<sup>61</sup> *Cassibry*, 217 So. 3d at 707.

<sup>62</sup> *Id.* at 709.

<sup>63</sup> *Bloodworth v. Bloodworth*, 579 S.E.2d 858, 862 (Ga. Ct. App. 2003).

<sup>64</sup> BOGERT, *supra* note 9, § 95 at 342.

selves or who have business relationships that may involve conflicts of interest.<sup>65</sup> For example, in *Huntington National Bank v. Wolfe*, the settlor named his brother, John, as co-trustee of a trust the primary asset of which was stock in a closely held corporation that employed him.<sup>66</sup> When the trustees decided to sell some of the company's stock back to the company rather than distributing it in kind to one of the beneficiaries, the court upheld their decision, declaring that "[t]he settlor must have understood that his Co-Trustee [John] would take into consideration the interests of the corporation as well as the interest of the beneficiary in making any decisions concerning the family corporation's stock held by the Trusts."<sup>67</sup> Even though John was eventually vindicated, the impact of this litigation on the family must have been devastating.

*Peterson v. Peterson* provides a more recent example of a structural conflict of interest.<sup>68</sup> Charles Peterson died in 1994, survived by his wife, Mary, and his three sons, Alex, David, and Calhoun.<sup>69</sup> In his will, Charles established a marital trust and a residual "by-pass" trust and named Mary and the children co-trustees of the trusts.<sup>70</sup> The marital trust provided that Mary should receive all of the income from the trust during her lifetime; in addition, she was given a general power of appointment over the trust property.<sup>71</sup> Any property remaining in the marital trust at Mary's death was to be added to the by-pass trust.<sup>72</sup> In addition, the trustees were authorized to invade the corpus of the by-pass trust to provide for Mary's comfortable support and for the proper support and education of the settlor's descendants.<sup>73</sup>

In 2016, Mary demanded that the trustees turn over all of the property in the marital trust to her and also required all of the assets of the by-pass trust to be transferred to Calhoun.<sup>74</sup> When Alex and David refused, Mary sued to terminate the trusts

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<sup>65</sup> Langbein, *supra* note 10, at 665.

<sup>66</sup> 651 N.E.2d 458 (Ohio Ct. App. 1994).

<sup>67</sup> *Id.* at 462.

<sup>68</sup> 835 S.E.2d 651 (Ga. Ct. App. 2019).

<sup>69</sup> *Id.* at 653.

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

<sup>74</sup> *Id.* at 654.

and force them to make the transfers, while Calhoun sued to have them removed as trustees.<sup>75</sup> The trial court granted summary judgment on the plaintiffs' claims and ordered Alex and David to be removed as trustees if they did not agree to transfer the trusts' assets to Mary and Calhoun.<sup>76</sup> However, the appeals court reversed, holding that the exercise of Mary's power of appointment to transfer trust assets was not absolute, but was subject to her fiduciary duties as a trustee.<sup>77</sup> According to the court, allowing Mary to transfer the trusts' assets to herself and Calhoun would conflict with the settlor's intent that the trust property be used to provide support for all of his children.<sup>78</sup> In other words, she put her own interests ahead of those of the trust and the other beneficiaries of the trust.

#### B. *The Duty of Prudence*

The duty of prudence covers the management and investment of trust property. This includes the duty to make such property productive as well as the duty to diversify and otherwise invest trust assets in a prudent manner. Presently, it takes a high degree of expertise to satisfy the duty of prudence when the trust is largely made up of common stocks.

Unless directed otherwise, the trustee should remove unproductive property from the trust. Unproductive property includes property that produces little or no income even though it may be appreciating in value.<sup>79</sup> The same principle also applies to the retention of underproductive property.<sup>80</sup>

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<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> *Id.* at 655.

<sup>78</sup> *Id.*

<sup>79</sup> For example, property such as gold coins or Dutch Masters paintings may increase significantly in value, thereby benefitting remainder beneficiaries, but provide no income for income beneficiaries. One way to avoid this problem is to employ the "unitrust" concept in which the share of income beneficiaries is calculated in terms of a percentage of the trust corpus each year. WILLIAM M. MCGOVERN, SHELDON F. KURTZ & DAVID M. ENGLISH, *WILL, TRUSTS AND ESTATES* § 9.6 at 401 (4th ed. 2010).

<sup>80</sup> *Rutanen v. Ballard*, 678 N.E.2d 133, 138 (Mass. 1997); *but see Champagne v. Champagne*, 734 A.2d 1048, 1050-51 (Conn. App. Ct. 1999).

1. *Retention of Unproductive and Underproductive Property*

Family members who assume the office of trustee sometimes falsely assume that it is safe to retain the settlor's existing portfolio. However, unlike the settlor, the new trustee is required by the duty of prudence to dispose of unproductive or underproductive property as soon as is reasonably possible. For example, failure to make trust property productive resulted in liability in *Witmer v. Blair*, notwithstanding the fact that the settlor's niece received no compensation for serving as trustee and acted in good faith.<sup>81</sup> In that case, the settlor Henry Nussbaum appointed his niece, Jane Ann Blair, as trustee of a testamentary trust to provide for the college education of the children of his daughter, Dorothy Janice Witmer, living at the time of his death.<sup>82</sup> If no child survived (or failed to pursue a college education), the trust was to revert to Henry's daughter, Dorothy Janice Witmer.<sup>83</sup> When Henry died in 1960, his only granddaughter, Marguerite, was seven years old.<sup>84</sup> Later, Marguerite and other trust beneficiaries filed suit against Jane Ann seeking and accounting and her removal as the trustee, as well as an award of actual and punitive damages, claiming that she had breached her fiduciary duties.<sup>85</sup> The lower court ordered an accounting and the removal of Jane Ann as trustee, but refused to award damages for breach of fiduciary duties.<sup>86</sup>

On appeal, the appellate court found that Jane Ann had failed to make the trust property productive.<sup>87</sup> Between 1962 and 1971, Jane Ann had kept all the trust assets in a checking account and a savings account that paid only ½% interest.<sup>88</sup> In light of the fact that Marguerite would not be ready for college for several years, the court concluded that Jane Ann should have invested the trust assets in certificates of deposit or other invest-

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<sup>81</sup> 588 S.W.2d 222, 225 (Mo. Ct. App. 1979).

<sup>82</sup> *Id.* at 223.

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> *Id.* at 222.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.* at 225.

<sup>88</sup> *Id.*

ments that would have provided a better rate of return.<sup>89</sup> Relying on the testimony at trial of an accountant, the court determined that the trust would have earned an additional \$2840 between 1962 and 1971 (when Marguerite might have needed money for college expenses) if Jane Ann had invested most of the trust's assets in one-year certificates of deposit.<sup>90</sup> Therefore, it found that Jane Ann had failed to make the trust property profitable and remanded the case back to the lower court with instructions to award the plaintiffs \$2,840 in damages.

## 2. *Failure to Make Prudent Investments*

For more than one hundred and fifty years, the “prudent man” rule, which first appeared in *Harvard College v. Amory*,<sup>91</sup> was the principal standard governing investment choices by private trustees.<sup>92</sup> The Harvard College case involved the power of the trustee to invest in the stock of companies engaged in manufacturing and insurance.<sup>93</sup> In that case, the court upheld the right of the trustees to do so, declaring that that trustees should “observe how men of prudence, discretion, and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital invested.”<sup>94</sup> This formulation focused on the avoidance of loss rather than on the maximization of return.<sup>95</sup>

This traditional “prudent man” rule was widely criticized during the latter half of the twentieth century<sup>96</sup> and eventually

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<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

<sup>91</sup> 26 Mass. (9 Pick.) 446 (1830).

<sup>92</sup> Jerold I. Horn, *Prudent Investor Rule, Modern Portfolio Theory, and Private Trusts: Drafting and Administration Including the “Give-Me-Five” Unitrust*, 33 REAL PROP. PROB. & TR. 1, 3 (1998).

<sup>93</sup> Paul G. Haskill, *The Prudent Person Rule for Trustee Investment and Modern Portfolio Theory*, 69 N.C. L. REV. 87, 88 (1990). The rule in England at that time limited investment to government bonds and real estate. *Id.*

<sup>94</sup> *Harvard College*, 26 Mass. at 461.

<sup>95</sup> Loren C. Ipsen, *Trends in the Liability of Corporate Fiduciaries*, 24 IDAHO L. REV. 443, 443 (1988).

<sup>96</sup> According to these critics, the prudent man rule, as interpreted by many courts, was deficient because it tended to focus upon the performance of each asset in isolation rather than on the performance of the portfolio as a whole, it focused on the nominal value of the trust corpus and ignored the effect

replaced by such alternatives as the Uniform Prudent Investor Act, Third Restatement of Trusts, and the Uniform Trust Code, which incorporated modern portfolio theory and other financial concepts.<sup>97</sup> According to modern portfolio theory, a particular investment that might seem to involve excessive risk viewed in isolation, may actually reduce overall risk to the portfolio and, therefore, be a more prudent investment.<sup>98</sup> In other words, portfolio theory tries to correlate expected risk and return in order to identify an optimal portfolio that will produce the highest return for a given risk.<sup>99</sup>

*In re Estate of Collins*<sup>100</sup> represents an extreme example of a trustee's failure to exercise prudence with respect to the selection of investments. Although the trustees in *Collins* were business associates rather than family members, the principles set forth by the court in that case are applicable to trustees in general. When the settlor, Ralph Collins, died in 1963, he established a testamentary trust for the benefit of his wife and children and named a business partner, Carl Lamb, and his attorney, C.E. Millikan, as trustees.<sup>101</sup> The trust principal was \$80,000.

Two clients of Millikan, Downing, and Ward, wanted to borrow \$50,000 to develop some property that they owned and Lamb and Millikan agreed to loan them the money on behalf of the trust.<sup>102</sup> The loan was secured by a second mortgage on 9.38 acres of unimproved property in San Bernardino County as well as by 20% of the stock in Downing and Ward's company.<sup>103</sup> Unfortunately, the building boom in the area burst and the company, as well as Downing and Ward, went bankrupt.<sup>104</sup> In

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of inflation on the purchasing power of money. The rule also prohibited certain classes in investments entirely, while providing a safe harbor for other types of investment. In addition, it discouraged trustees from delegating certain management responsibilities and also deterred them from considering new types of investment products. Horn, *supra* note 92, at 7.

<sup>97</sup> Edward C. Hallbach, Jr., *Trust Investment Law in the Third Restatement*, 77 IOWA L. REV. 1151, 1159-63 (1992).

<sup>98</sup> Ipsen, *supra* note 95, at 450.

<sup>99</sup> *Id.*

<sup>100</sup> 139 Cal. Rept. 644 (Ct. App. 1977).

<sup>101</sup> *Id.* at 646.

<sup>102</sup> *Id.* at 647.

<sup>103</sup> *Id.*

<sup>104</sup> *Id.*

addition, the holder of the first mortgage foreclosed, effectively destroying the security of the second mortgage.<sup>105</sup>

In 1973, when Lamb and Millikan sought to be discharged as trustees (having reduced the trust's principal to almost nothing), the beneficiaries sought to have them surcharged for the loss sustained by the trust as the result of their imprudent investments.<sup>106</sup> The trial court discharged the trustees and the beneficiaries appealed.<sup>107</sup> The appellate court reversed, finding that the trustees had failed to follow the prudent person standard by investing two-thirds of the trust principal in one investment and by investing in real property secured by only a second mortgage.<sup>108</sup> The court also determined that the trustees had failed to make an adequate investigation of either the borrowers or the collateral.<sup>109</sup> Specifically, the court found that the trustees failed to discover that at the time the loan was made, there were six notices of default and three lawsuits pending against Downing and Ward.<sup>110</sup> In addition, they did not have the property in question appraised but instead relied on a statement by a real estate broker that property in the area was currently selling for \$18,000 to \$20,000 an acre.<sup>111</sup> Finally, they failed to secure possession of or earmark the company stock that was supposed to provide backup security for the loan.<sup>112</sup> Consequently, the appeals court remanded the case back to the trial court with instructions to surcharge the trustees.<sup>113</sup>

The duty of prudence also requires a trustee to avoid speculative investments,<sup>114</sup> to monitor the performance of trust investments and to reduce industry and firm risk by diversification. As far as choosing investments is concerned, the trustee should invest trust assets with the care, skill, and caution of a prudent in-

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<sup>105</sup> *Id.*

<sup>106</sup> *Id.* at 646.

<sup>107</sup> *Id.*

<sup>108</sup> *Id.* at 648.

<sup>109</sup> *Id.*

<sup>110</sup> *Id.* at 647.

<sup>111</sup> *Id.*

<sup>112</sup> *Id.*

<sup>113</sup> *Id.* at 650.

<sup>114</sup> *But see* RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. e (2007).

vestor.<sup>115</sup> In many cases, this may require the services of a professional financial advisor or investment manager.

### 3. *Failure to Diversify Investments*

According to modern portfolio theory, a prudent investor will try to minimize inherent risks and avoid “uncompensated” risks. Uncompensated risks are those associated with a particular firm or a market sector. Unlike market risk, these risks can be avoided by diversification. Although the duty to diversify may be waived by the settlor, as the *Mueller* case<sup>116</sup> illustrates, this does not relieve the trustee of the duty to act prudently. In *Mueller*, L.J. Mueller, the sole stockholder of the L.J. Mueller Furnace Company, died in 1931. In his will, L.J. Mueller created two trusts funded by shares of Mueller Company stock.<sup>117</sup> The first trust provided that income would go to Mueller’s widow, Jean, for life with a remainder to his children, Robert and Elizabeth.<sup>118</sup> A second trust was created for the benefit of Ruth Mueller and Patricia Maslowski, two children of Mueller’s deceased son.<sup>119</sup> Another son, Harold, received a substantial amount of Mueller Company stock outright.<sup>120</sup> Jean and Harold were named as co-trustees of both trusts.<sup>121</sup>

In 1938, Harold put some of his Mueller Company stock into an *inter vivos* trust and named himself as trustee.<sup>122</sup> Under the terms of the trust, Jean was to receive the income for life and Robert and Elizabeth were named as the remainder beneficiaries.<sup>123</sup> In 1954, the Mueller Company was acquired by the Worthington Corporation and the Mueller Company stock in all three trusts was exchanged for Worthington Company stock.<sup>124</sup>

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<sup>115</sup> Bryon W. Harmon & Laura A. Fisher, *The Prudence of Passivity: An Argument for Default Passive Management in Trust Investing*, 44 ACTEC L.J. 147, 153 (2019).

<sup>116</sup> *In re* Trust Created Under the Last Will and Testament of L.J. Mueller, 135 N.W.2d 854 (Wis. 1965).

<sup>117</sup> *Id.* at 857.

<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

<sup>120</sup> *Id.*

<sup>121</sup> *Id.*

<sup>122</sup> *Id.*

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

In 1958, the county court approved the accounts of the trustees of the two testamentary trusts.<sup>125</sup> However, when the trustees sought court approval in 1962 for their accounts, some of the trust beneficiaries objected, claiming that the trustees should have diversified the trust assets by selling the Worthington Company stock no later than November 1961.<sup>126</sup>

The lower court ruled that the trustees should be surcharged for failing to sell the Worthington stock within a reasonable time and this was affirmed on appeal.<sup>127</sup> The court observed that Harold served as a director of the Worthington company and knew that it, along with a number of other electrical companies, was about to be sued by the United States for antitrust violations.<sup>128</sup> In addition, Harold knew that Worthington was in a profit squeeze.<sup>129</sup> Furthermore, Harold sold much of his own Worthington Company stock during this period when it lost half of its value.<sup>130</sup> On the other hand, Harold in his capacity as trustee failed to sell any of the Worthington Company stock owned by the three trusts until 1963.<sup>131</sup> Consequently, the court concluded that Harold and Jean must reimburse the two testamentary trusts \$147,000 and the *inter vivos* trust \$100,000.<sup>132</sup>

As the *Mueller* case illustrates, trustees often inherit a trust with an unbalanced portfolio.<sup>133</sup> In such cases, the trustee must take steps to diversify the trust portfolio within a reasonable time.<sup>134</sup> Sometimes a settlor will insert a retention clause in the trust that authorizes the trustee to retain the assets in the original portfolio even though the resulting portfolio is seriously unbalanced.<sup>135</sup> However, as *Wood v. U.S. Bank* suggests, courts tend

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<sup>125</sup> *Id.*

<sup>126</sup> *Id.* at 858.

<sup>127</sup> *Id.* at 864.

<sup>128</sup> *Id.* at 862.

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *Id.* at 857-58. The trial court had ruled that Harold would have to indemnify Jean for any damages that she had to pay to the trusts, but the appellate court reversed and held that she was equally responsible. *Id.* at 866-67.

<sup>133</sup> *In re Estate of Janes*, 681 N.E.2d 332 (N.Y. 1997).

<sup>134</sup> *Id.* at 339.

<sup>135</sup> In some cases, the settlor may even mandate that particular assets be retained. Even then, the trustee may be required to request a court to modify

to interpret retention clauses narrowly, particularly when the asset in question is the stock of a corporate trustee.<sup>136</sup> In that case, the settlor created an *inter vivos* trust with himself as trustee for the benefit of his wife, Dana.<sup>137</sup> Firststar Bank became the trustee at the settlor's death.<sup>138</sup> At that time, approximately 80% of the trust principal consisted of Firststar stock.<sup>139</sup> However, a retention clause was added by the settlor which allowed the trust to retain the trustee's corporate stock.<sup>140</sup> Unfortunately, the Firststar stock declined substantially in value and Dana sued the trustee for failure to diversify.<sup>141</sup> On appeal, the court held that the retention clause did not relieve the trustee of its duty to diversify, but merely waived the trustee's conflict of interest in retaining its own stock in the trust.<sup>142</sup> Therefore, the court concluded, the trustee was still required to sell the Firststar stock as soon as it reasonably could.<sup>143</sup>

### C. *The Duty of Impartiality*

The duty of impartiality requires a trustee to treat each beneficiary fairly.<sup>144</sup> Impartiality concerns can arise with respect to investment decisions as well as distribution decisions by a trustee. For example, intergenerational conflicts often occur between the investment goals of income beneficiaries and remainder beneficiaries. In addition, conflicts may arise among beneficiaries of the same generation who may be subject to divergent financial needs and circumstances. Finally, the duty of impartiality may also be a factor where distributions are concerned. For example, disagreements may be present over distribution decisions with respect to sprinkle or spray trusts. Impartiality may also be an issue when the trustee exercises a power to invade the corpus of

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the trust if changed circumstances have made continued retention of the asset inconsistent with the duty of prudence. *In re Pulitzer*, 249 N.Y.S. 87 (Sur. 1931), *aff'd mem.*, 260 N.Y.S. 975 (N.Y. App. Div. 1932).

<sup>136</sup> 828 N.E.2d 1072 (Ohio Ct. App. 2005).

<sup>137</sup> *Id.* at 1074.

<sup>138</sup> *Id.*

<sup>139</sup> *Id.*

<sup>140</sup> *Id.* at 1074-75.

<sup>141</sup> *Id.* at 874.

<sup>142</sup> *Id.* at 1077-78.

<sup>143</sup> *Id.* at 1080.

<sup>144</sup> *Hearst v. Ganzi*, 52 Cal. Rptr. 3d 473, 481 (Ct. App. 2006).

the trust for his own benefit, thereby reducing the assets available for other beneficiaries<sup>145</sup>.

A potential violation of the duty of impartiality arises when the trustee is also a beneficiary. A common example of this is when the surviving spouse is the income beneficiary and children from a prior marriage of the settlor are remainder beneficiaries. For example, in *Carter v. Carter*, the settlor, Luther Carter, created an *inter vivos* trust and named himself as trustee.<sup>146</sup> When Luther died in 2003, the trust was divided into three smaller trusts, including a marital trust for the benefit of Luther's wife, Audrey, and his daughter, Tiffany.<sup>147</sup> Audrey was appointed trustee of the marital trust and was the sole income beneficiary, while Tiffany was the remainder beneficiary.<sup>148</sup> It was undisputed that Audrey, in her capacity as trustee, invested the entire trust corpus in tax-free municipal bonds.<sup>149</sup> Tiffany brought suit against her stepmother, claiming that her investment strategy failed to protect the corpus of the trust from being reduced because of inflation.<sup>150</sup>

The lower court ruled in favor of Audrey.<sup>151</sup> On appeal, Tiffany argued that Audrey had a duty to treat all beneficiaries impartially without favoring her own interests.<sup>152</sup> However, relying on the language of the original trust (which provided for and described the provisions of the marital trust), the appellate court concluded that the settlor intended for the marital trust to generate income during Audrey's lifetime any way that she deemed appropriate.<sup>153</sup> In other words, Luther had waived the duty of impartiality insofar as protecting Tiffany's interest against inflation was concerned.

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<sup>145</sup> See, e.g., *Rachins v. Minassian*, 251 So. 2d 919, 920 (Fla. D.C.A. 2018); see also Joel C. Dobris, *Ethical Problems for Lawyers upon Trust Termination: Conflicts of Interest*, 38 U. MIAMI L. REV. 1, 57 n. 311 (1983).

<sup>146</sup> 965 N.E.2d 1146, 1148 (Ill. App. Ct. 2012).

<sup>147</sup> *Id.* at 1149.

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Id.* at 1149-50.

<sup>152</sup> *Id.* at 1155.

<sup>153</sup> *Id.* at 1155-56.

However, the trustee in *Cooper v. Cooper* was not so lucky.<sup>154</sup> Unfortunately for him, there was no language in the trust authorizing the income beneficiary to maximize income. In that case, De Anne Cooper, who died in 1978, provided in her will that certain property be held in trust during her husband's lifetime.<sup>155</sup> The husband, Fermore (Bert) Cooper, and the Old National Bank (ONB) were named as co-trustees.<sup>156</sup> After Fermore died, the trust corpus was to be divided between the couple's two children, Joyce and Richard.<sup>157</sup> Joyce subsequently petitioned the lower court to remove her father as trustee and to order an accounting.<sup>158</sup> After an accounting was filed, the court found that Fermore had "maintained a policy of investment . . . which maximized the income of the estate . . . to the detriment of the growth of the corpus of the estate."<sup>159</sup> It ordered Fermore to pay \$342,493, which it estimated to be the loss to the remainder interest.<sup>160</sup>

On appeal, the appeals court evaluated Fermore's investment decisions from the perspective of the prudent investor rule rather than as a breach of the duty of impartiality.<sup>161</sup> According to the court, only 13% of the trust's marketable securities were made up of common stocks, while 87% of its assets consisted of bonds and bond equivalents.<sup>162</sup> Furthermore, during the period in question, the purchasing power of the trust's corpus decreased about 4% per year.<sup>163</sup> The court declared that the prudent investor standard requires to trustee to maintain a balance between the rights of the income beneficiary and the remainder beneficiaries.<sup>164</sup> Agreeing with the trial court that Fermore failed to satisfy this standard, the appeals court upheld the lower court's damage award.<sup>165</sup>

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<sup>154</sup> 913 P.2d 393 (Wash. Ct. App. 1996).

<sup>155</sup> *Id.* at 395.

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

<sup>158</sup> *Id.* at 394.

<sup>159</sup> *Id.* at 397.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

<sup>163</sup> *Id.* at 398.

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

Fortunately, there are a number of techniques that can be employed in most states to enable trustees to maximize total return without violating the duty of impartiality. The oldest is the principle of equitable adjustment, which is illustrated by the case of *In re Kuehn*.<sup>166</sup> Max Kuehn died in 1957, leaving a widow, Nell, and two sons, Carter and Max, Jr.<sup>167</sup> According to the terms of Max's will, certain property, including an interest in a farm located near Sioux Fall, South Dakota, was placed in trust. Carter and Max, Jr. were the income beneficiaries of this trust.<sup>168</sup> At the death of Max's two sons and their widows, the trust would terminate and be distributed to the lineal descendants of the sons, and if there were none, to certain charities.<sup>169</sup>

Carter died in 1960 and his interest in the trust went to Max, Jr. When Max, Jr. died in 1971, Nell and Max's daughter became the income beneficiaries of the trust.<sup>170</sup> In 1973, the trustee determined that the farm had become underproductive because of its increase in value and sold it.<sup>171</sup> Shortly thereafter, a dispute arose between the income beneficiaries and the charities over the distribution of the proceeds of the sale.<sup>172</sup> At trial, the court adopted a formula proposed by the Restatement (Second) of Trusts § 241 and allocated a share of the proceeds to the income beneficiaries.<sup>173</sup> This application of equitable adjustment was affirmed on appeal.<sup>174</sup>

A more proactive approach is to employ the unitrust concept. Under this concept, the settlor provides that the income beneficiaries are entitled to a certain percentage of the value of the trust corpus instead of the income generated by the trust.<sup>175</sup> This enables the trustee to invest in assets like land or growth stocks that appreciate in value, even though they do not gener-

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<sup>166</sup> 308 N.W.2d 398 (S.D. 1981).

<sup>167</sup> *Id.* at 399.

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

<sup>170</sup> *Id.*

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> *Id.* at 400.

<sup>174</sup> *Id.* at 401.

<sup>175</sup> Joel C. Dobris, *Why Five? The Strange, Magnetic, and Mesmerizing Affect of the Five Percent Unitrust and Spending Rate on Settlers, their Advisors, and Retirees*, 40 REAL PROP. PROB. & TR. J. 39, 42 (2005).

ate much income without prejudicing the interests of the income beneficiaries.

#### D. Administrative Duties

In the absence of a waiver by the settlor, trustees are subject to a variety of duties associated with trust administration. Family members who serve as trustees are often unaware of these duties and assume that trust beneficiaries will not object if they fail to observe them strictly. However, family members who serve as trustees should be aware of the duty to earmark, the duty not to commingle, the duty not to delegate, the duty to keep accurate records, the duty to inform, and the duty to account.<sup>176</sup> The trustee in *Jimenez v. Lee* managed to violate almost all of these duties.<sup>177</sup> In that case, the plaintiff's grandmother and one of the trustee's clients gave her father a sum of money to be used for his children's education.<sup>178</sup> The father, as "custodian" for his children, subsequently used the money to purchase bank stock.<sup>179</sup> When his daughter found about the bank stock, she sued her father for an accounting.<sup>180</sup> The Oregon Supreme Court concluded that the gifts were made in trust for the benefit of each child's education and further determined that the father held the property in trust.<sup>181</sup> Consequently, he violated various fiduciary duties by failing to earmark the funds as trust property, commingling the funds of the various beneficiaries, failing to keep accurate records, failing to inform his daughter of the existence and value of the trust, and failing to provide a proper accounting. The court imposed a constructive trust on the bank stock and refused to credit the defendant with most of the expenses he claimed because they were not supported by adequate records.<sup>182</sup>

Two of these duties, the duty to account and the duty to inform, can present particular problems for trustees who are also

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<sup>176</sup> Scott Bieber, *Trustee's Duties Extend to Remainder Beneficiaries Too*, 38 EST. PLAN. 23, 23-24 (Nov. 2011).

<sup>177</sup> 547 P.2d 126 (Or. 1976).

<sup>178</sup> *Id.* at 128.

<sup>179</sup> *Id.*

<sup>180</sup> *Id.*

<sup>181</sup> *Id.* at 128-29.

<sup>182</sup> *Id.* at 130-32.

family members.<sup>183</sup> Ordinarily, a trustee is required to keep and render a full and accurate record and accounting to the beneficiary and this duty is strictly enforced by the courts.<sup>184</sup> As *Raak v. Raak*<sup>185</sup> illustrates, a provision in the trust instrument that relieved the trustees from the duty to keep formal accounts did not relieve them of their duty to account for trust assets in court. In 1983, Berdena Raak created a revocable *inter vivos* trust and appointed her children as trustees.<sup>186</sup> At that time, the trust principal was almost \$105,000.<sup>187</sup> In 1984, Berdena revoked the trust and requested the probate court to appoint a conservator.<sup>188</sup> When the trustees returned less than \$33,000 to the conservator, Berdena asked the court to order the trustees to render an accounting to determine the location of the missing assets.<sup>189</sup>

The trustees relied upon language in the trust instrument that purported to relieve them of the duty to keep accounts as long as Berdena was alive.<sup>190</sup> However, affirming the decision of the lower court, the appeals court declared that while this may have relieved the trustees from the need to keep formal accounts, it did not relieve them of their duty to account when required to do so by the probate court.<sup>191</sup>

The Uniform Trust Code provides that “[a] trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests.”<sup>192</sup> The UTC also declares that the trustee should also promptly respond to a request from a beneficiary for information related to the administration of the trust.<sup>193</sup> The duty to inform is illustrated by *Wilson v. Wilson*, decided by a North Carolina intermediate appellate court in 2010.<sup>194</sup> In that case, Lawrence Wilson, Jr. created irrev-

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<sup>183</sup> UNIF. TRUST CODE § 813.

<sup>184</sup> *Raak v. Raak*, 428 N.W.2d 778, 779 (Mich. Ct. App. 1988).

<sup>185</sup> *Id.* at 778.

<sup>186</sup> *Id.* at 778.

<sup>187</sup> *Id.*

<sup>188</sup> *Id.*

<sup>189</sup> *Id.* at 778-79.

<sup>190</sup> *Id.* at 779.

<sup>191</sup> *Id.* at 781.

<sup>192</sup> UNIF. TRUST CODE § 813 (1) (Unif. Law Comm’n 2010).

<sup>193</sup> *Id.*

<sup>194</sup> 690 S.E.2d 710 (N.C. Ct. App. 2010).

ocable *inter vivos* trusts for each of his two children in 1992 and named his father, Lawrence Wilson, Sr., as trustee for both trusts.<sup>195</sup> In 2007, the trust beneficiaries filed suit against Lawrence, Sr., alleging breach of fiduciary duty.<sup>196</sup>

According to the plaintiffs, their grandfather, the trustee, had allowed their father, the settlor, to take control of the trust and enabled him to invest the trust assets in highly speculative personal business ventures.<sup>197</sup> In addition, the plaintiffs claimed that the trustee had failed to distribute income from the trust to them as required by the trust instrument.<sup>198</sup> Accordingly, the plaintiffs requested the court to order the trustee to provide a full and accurate accounting of the trusts from 1992 until the present date.<sup>199</sup> The plaintiffs appealed after the lower court granted summary judgment and issued a protective order in favor of the trustee.<sup>200</sup>

On appeal, the appellate court observed that the settlor had waived the trustee's statutory obligation to provide information to the trust beneficiaries.<sup>201</sup> However, the court also declared that a statutory provision based on the Uniform Trust Code stated that the trustee had a mandatory duty "to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries."<sup>202</sup> Accordingly, it ruled that the trustee was required to disclose the information sought by the plaintiffs because it was reasonably necessary to enable them to enforce their rights under the trust.<sup>203</sup>

### III. Special Issues

There are many circumstances where trustees must be especially careful in their administration and distribution of trust assets. Among these are support trusts, discretionary trusts, and modification of trust provisions by means of decanting.

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<sup>195</sup> *Id.* at 711.

<sup>196</sup> *Id.*

<sup>197</sup> *Id.*

<sup>198</sup> *Id.*

<sup>199</sup> *Id.*

<sup>200</sup> *Id.*

<sup>201</sup> *Id.* at 712.

<sup>202</sup> *Id.* at 714.

<sup>203</sup> *Id.*

### A. Support Trusts

In a support trust, the trustee is directed to disburse funds from trust income or principal that is sufficient to provide for a beneficiary's "comfortable maintenance and support." If the provision is mandatory, the beneficiary's current standard of living usually determines the amount of support to which the beneficiary is entitled. Unfortunately, as *Laubner v. J.P. Morgan Chase Bank*<sup>204</sup> illustrates, the trustee and the beneficiaries may not always agree on what constitutes conformable maintenance and support, particularly if the trustee is given considerable discretion in the matter.

In *Laubner*, William Alley created an irrevocable *inter vivos* trust in 1994 for the benefit of his four daughters.<sup>205</sup> After William died in 1996, the trust was divided into four separate trusts—one for each daughter.<sup>206</sup> William's widow, Deborah, the daughters' stepmother, and J.P. Morgan were named as co-trustees.<sup>207</sup> The 1994 trust directed the trustees to pay so much of the net income as they deemed advisable for the proper care, support, maintenance, or education of each daughter or her issue.<sup>208</sup> After William's death, the trustees adopted a distribution formula that distributed \$11,500 per month to each of the daughters.<sup>209</sup> This amounted to about 3.5% of the trust principal.<sup>210</sup> In 2007, two of William's daughters, Patricia and Pamela, sued to increase distributions from their trusts to \$18,000 per month or 5% of the value of the trust principal from the non-GST trusts.<sup>211</sup> Patricia and Pamela also sought to remove their stepmother as trustee.<sup>212</sup>

The plaintiffs alleged that the trustees had abused their discretion by favoring the remainder beneficiaries instead of focus-

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<sup>204</sup> 898 N.E.2d 744 (Ill. App. Ct. 2008).

<sup>205</sup> *Id.* at 747.

<sup>206</sup> *Id.* Each trust was further divided into two GST Exempt trusts and a GST Nonexempt trust. *Id.*

<sup>207</sup> *Id.*

<sup>208</sup> *Id.* at 748.

<sup>209</sup> *Id.*

<sup>210</sup> *Id.*

<sup>211</sup> *Id.* The idea was to exhaust the non-exempt trusts in order to avoid a 45% GST tax at their deaths. *Id.*

<sup>212</sup> *Id.* at 749.

ing on the support needs of the income beneficiaries.<sup>213</sup> The lower court dismissed the daughters' claim and they appealed.<sup>214</sup> On appeal, the court concluded that the plaintiffs had failed to show that the current level of distributions was not sufficient to maintain their accustomed standard of living.<sup>215</sup> The court reasoned that as long as their needs were being met, the trustees did not abuse their discretion by keeping the trust principal intact for the benefit of the remainder beneficiaries.<sup>216</sup>

### B. *Discretionary Trusts*

Modern trust instruments often authorize trustees to exercise broad discretion over the distribution of trust principal and income.<sup>217</sup> For example, a trustee may be given the power to distribute income from the trust in unequal portions among a group of beneficiaries. This is known as a spray trust. On the other hand, a sprinkle trust allows a trustee to accumulate some of the trust income instead of distributing it to the beneficiaries.<sup>218</sup> In addition, a trustee may be authorized to invade the corpus of the trust and distribute some or all of it to a particular beneficiary.<sup>219</sup> If the trust instrument provides some sort of standard to guide the trustee's exercise of discretion, a court will find that a trustee who has failed to follow the applicable standard is guilty of an abuse of discretion.

However, if no standard is specified, the court will still uphold the validity of the trust as *In re Estate of Ternansky* illustrates.<sup>220</sup> In that case, Rose Ternansky left two-thirds of her estate outright to two of her children, Margaret and Florence.<sup>221</sup> The remaining third was placed in trust for the benefit of her third child, William.<sup>222</sup> Florence was named as trustee for Wil-

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<sup>213</sup> *Id.*

<sup>214</sup> *Id.*

<sup>215</sup> *Id.* at 752.

<sup>216</sup> *Id.* at 751-52.

<sup>217</sup> Richard A. Ausness, *Discretionary Trusts: An Update*, 43 ACTEC L.J. 231, 238 (2018).

<sup>218</sup> *Id.* at 239.

<sup>219</sup> Edward C. Halbach, Jr., *Problems of Discretion in Discretionary Trusts*, 61 COLUM. L. REV. 1425, 1426 (1961).

<sup>220</sup> 141 N.E.2d 189 (Ohio Ct. App. 1957).

<sup>221</sup> *Id.* at 190.

<sup>222</sup> *Id.*

William's trust with uncontrolled discretion to distribute so much of the trust's assets to William as she "may deem advisable."<sup>223</sup> William filed objections to the final and distributive account of his mother's estate, essentially challenging the validity of the discretionary trust.<sup>224</sup> However, William's objections were overruled by the probate court and its decision was affirmed on appeal, which upheld the validity of the trust even though Rose provided no standard to guide Florence in the exercise of her discretion as trustee.<sup>225</sup> Although the court warned that the trustee would not be permitted to exercise his judgment from fraudulent, selfish, or other improper motives. The court also declared that it would not attempt to control the trustee's judgment as long as he acted in good faith to carry out the intention of the settlor.<sup>226</sup>

The settlor may also give a trustee the discretion to terminate the trust prematurely. Thus, in *Sully v. Sully*,<sup>227</sup> Frederick Sully established a testamentary trust for his grandson, Robin, that provided Robin would assume full control of the trust property when he reached the age of 35.<sup>228</sup> However, the trust instrument also authorized the trustee, his uncle Thomas Scully,<sup>229</sup> to terminate the trust and distribute the trust assets to Robin at an earlier age if he determined that Robin possessed sufficient experience, judgment, and prudence to manage the trust assets on his own.<sup>230</sup> When Robin reached the age of thirty, he brought suit when Thomas refused to terminate the trust prematurely.<sup>231</sup>

The county court ruled that Thomas had not abused his discretion when he denied Robin's request.<sup>232</sup> However, the district court reversed and ordered Thomas to terminate the trust and a further appeal was taken.<sup>233</sup> The Nebraska Supreme Court declared that a discretionary power vested in a trustee should not

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<sup>223</sup> *Id.* at 191.

<sup>224</sup> *Id.* at 190.

<sup>225</sup> *Id.* at 191-92.

<sup>226</sup> *Id.*

<sup>227</sup> 76 N.W.2d 239 (Neb. 1956).

<sup>228</sup> *Id.* at 243.

<sup>229</sup> *Id.* at 247.

<sup>230</sup> *Id.* at 243.

<sup>231</sup> *Id.* at 242-43.

<sup>232</sup> *Id.* at 243.

<sup>233</sup> *Id.*

be disturbed by a court unless the trustee acted fraudulently or in bad faith.<sup>234</sup> The trust property consisted of large amounts of real property located in Kansas, Louisiana, and Nebraska.<sup>235</sup> Thomas presented evidence that Robin had done a poor job of managing some of the family's property for his father.<sup>236</sup> Therefore, it concluded that Robin had failed to prove that Thomas had abused his discretion when he refused to terminate the trust prematurely.<sup>237</sup>

### C. Decanting

Decanting occurs when a trustee who is given discretionary power over distributions in the original trust exercises that option to distribute some or all of the trust property to a new trust with updated provisions.<sup>238</sup> The theory that supports trust decanting is that a settlor who gives the trustee the discretionary power to make distributions from trust property implicitly gives the trustee the right to make distributions in further trust. Unlike some other forms of trust modification, decanting does not require court involvement. Decanting was first approved by a court in *Phipps v. Palm Beach Trust Co.* in 1940.<sup>239</sup> At present, about half of the states have adopted statutes that expressly permit decanting but impose procedural and substantive safeguards to protect the interests of beneficiaries. As *Ferri v. Powell-Ferri* illustrates, decanting provides a trustee with the ability to respond quickly to changing conditions.<sup>240</sup>

In that case, John Paul Ferri, Sr. created an irrevocable *inter vivos* trust in 1983 (the 1983 trust) for the benefit of his son, John Paul Ferri, Jr. (John Jr.).<sup>241</sup> John Jr.'s brother, Michael Ferri, and Anthony Medaglia, were named as trustees.<sup>242</sup> The trust provided that once John Jr. reached the age of 35, he could withdraw principal from the trust in increasing amounts depending

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<sup>234</sup> *Id.* at 245.

<sup>235</sup> *Id.* at 246.

<sup>236</sup> *Id.* at 254.

<sup>237</sup> *Id.* at 254-55.

<sup>238</sup> Lydia Lee Lockett & Peter Blumeyer, *Sour Grapes: when Decanting Gives Rise to Litigation*, 33 PROB. & PROP. 26, 27 (Oct. 2019).

<sup>239</sup> 196 So. 299 (Fla. 1940).

<sup>240</sup> 116 A.3d 297 (Conn. 2015).

<sup>241</sup> *Id.* at 300.

<sup>242</sup> *Id.*

on his age.<sup>243</sup> In 2010, John Jr.'s wife, Nancy, filed for divorce.<sup>244</sup> Fearing that Nancy would claim a share of the trust assets as marital property, the trustees transferred a substantial portion of the trust assets to a new trust (the 2011 trust). John Jr. was the only beneficiary of the 2011 trust, but the sole power to withdraw property from the trust was vested in the trustees rather than in John Jr.<sup>245</sup> The trial court found that John Jr. played no role in creating the 2011 trust or in transferring property from the 1983 trust to it.<sup>246</sup>

Shortly after the transfer of assets to the 2011 trust, the trustees sought a declaratory judgment requesting the court to acknowledge that they had validly exercised their power to transfer assets to the new trust and that John Jr. had no interest in the trust that his spouse could reach in a divorce suit.<sup>247</sup> The lower court granted a summary judgment in favor of the trustees and Nancy appealed.<sup>248</sup>

On appeal, Nancy argued that John Jr. had an affirmative duty to protect their marital property by contesting the trustees' action. The Connecticut Supreme Court acknowledged that a spouse had a fiduciary duty not to waste marital property, as well as a duty to disclose the existence of such property.<sup>249</sup> However, the court concluded that John Jr. had not breached any fiduciary duty and that he had no duty to take affirmative steps to recover marital assets from a third party.<sup>250</sup> Consequently, the appellate court affirmed the lower court's judgment for the trustees.<sup>251</sup>

Decanting has also been used to transfer assets from a conventional trust or a support trust to a special needs trust.<sup>252</sup> A New York Surrogate's Court upheld such a transfer in *In re*

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<sup>243</sup> *Id.* Michael testified that the 1983 trust was worth between \$60 and \$70 million. *Id.* at n.2.

<sup>244</sup> *Id.*

<sup>245</sup> *Id.*

<sup>246</sup> *Id.*

<sup>247</sup> *Id.* at 301.

<sup>248</sup> *Id.*

<sup>249</sup> *Id.*

<sup>250</sup> *Id.* at 305.

<sup>251</sup> *Id.* at 307.

<sup>252</sup> Amy J. Fanzlaw, *New Opportunity, to Decant in Florida, Part II: Successful Execution of Trust Decanting*, 93 FLA. B.J. 22, 26 (Dec. 2019).

*Kroll*.<sup>253</sup> The *Kroll* case involved a trust established in 1992 by Moses Ratowsky for the benefit of his grandson, Daniel Schreiber.<sup>254</sup> Daniel's mother, Rachel, and Alan Kroll were named as trustees.<sup>255</sup> According to the trust, Daniel could receive income or principal from the trust at the discretion of the trustees.<sup>256</sup> However, Daniel would be entitled to withdraw all or any of the trust principal once he reached the age of 21.<sup>257</sup>

Prior to Daniel's 21st birthday, the trustees transferred the trust's assets to a new supplemental needs trust for the primary benefit of Daniel.<sup>258</sup> At the time, Daniel was suffering from disabilities and was receiving both Medicaid and SSI benefits.<sup>259</sup> The trustees then sought to have the surrogate court approve the transfer.<sup>260</sup> This request to decant was opposed by the New York Attorney General acting on behalf of the Department of Health which administered the state's Medicaid program.<sup>261</sup>

The Attorney General argued because Daniel was entitled to demand a distribution of principal once he reached the age of 21, the new trust would be considered a self-settled trust which would have required a payback provision to reimburse the state for medical expenses paid on Daniel's behalf.<sup>262</sup> However, the court ruled that the trustees had complied with all of the statutory requirements for the effective exercise of the power of appointment contained in the original trust instrument.<sup>263</sup> Therefore, the court concluded that the new trust was a valid third-party supplemental needs trust and no payback provision was required in the new trust.<sup>264</sup>

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<sup>253</sup> 971 N.Y.S.2d 863 (Surr. Ct. 2013).

<sup>254</sup> *Id.* at 864.

<sup>255</sup> *Id.*

<sup>256</sup> *Id.*

<sup>257</sup> *Id.*

<sup>258</sup> *Id.*

<sup>259</sup> *Id.*

<sup>260</sup> *Id.*

<sup>261</sup> *Id.*

<sup>262</sup> *Id.* at 865.

<sup>263</sup> *Id.* at 866.

<sup>264</sup> *Id.*

#### **IV. Precautionary Measures**

As the foregoing discussion illustrates, appointing family members to serve as trustees creates a risk of sparking ill will and strife within the family. Even worse, disagreements about the trustee's decisions concerning administration of the trust or the distribution of trust assets to particular beneficiaries may lead to expensive and disruptive litigation among family members. It appears that the best strategy for avoiding these situations is for the settlor to appoint someone other than a family member to serve as the trustee. In particular, it is risky to name the surviving spouse as trustee if some of the beneficiaries are not biological children of the spouse. In any event, if the settlor proposes to nominate a family member as trustee who has no legal training, the drafter should take steps to make sure the prospective trustee is aware of the fiduciary duties associated with that office. However, if the settlor insists on appointing a family member to serve as a trustee, there are some additional proactive measures that the settlor and the prospective trustee can take to reduce the risk of family discord in the future.

A better alternative might be to appoint a someone outside the family as the trustee and name a family member as a trust protector with the power to advise the trustee about trust administration and veto certain decisions about investments or the distribution of trust assets. The office of trust protector is a relatively new addition to the law of trusts.<sup>265</sup> Unlike a trustee, a trust protector does not hold legal title to the trust property. However, the trust instrument can give a trust protector power over certain aspects of trust administration or the distribution of trust assets. For example, trust protectors can advise the trustee, oversee certain activities of the trustee such as investment decisions, resolving or mediating disputes between the trustee and one or more beneficiaries, and modifying or terminating the trust.<sup>266</sup>

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<sup>265</sup> Richard C. Ausness, *When Is a Trust Protector a Fiduciary?*, 27 QUINNIPIAC PROB. L.J. 277, 278-83 (2014).

<sup>266</sup> Richard C. Ausness, *The Role of Trust Protectors in American Trust Law*, 45 REAL PROP., TR. & EST. L.J. 319, 329 (2010).

A. *Actions by the Settlor (or the Drafter of the Trust Instrument)*

Regardless of whether the settlor wishes to have a family member administer the trust, he or she should start by hiring a professional estate planner to draft the trust instrument and carefully review the finished product. If the settlor is determined to name a family member as the trustee, the prospect of disputes among family members can be reduced by careful drafting. In particular, the trust instrument should describe in detail the purpose of the trust, its distributive scheme, and the powers and duties of the trustee.

1. *Purpose of the Trust*

The trust instrument should clearly identify the purpose of the trust. For example, the intended purpose may be to provide for the financial security of the surviving spouse (and claim a marital estate tax deduction), to provide for the financial security of the settlor's siblings, children, step-children, or grandchildren, or to enable family members to retain control of a family farm or business. The purpose of the trust can be further fleshed out in a separate letter of intent addressed to the trustee which may be shared with some or all of the beneficiaries.<sup>267</sup>

If the trust is discretionary, the trust instrument should indicate whether the trustee's exercise of discretion is subject to an ascertainable standard or whether it is "sole and unlimited" in nature. Furthermore, if the settlor intends to provide support for certain beneficiaries, the trust instrument should supplement the usual boilerplate language with a more specific description of what is included in the notion of support. For example, a provision for "comfortable maintenance, education, and support" should indicate whether the term "education" includes post-graduate education or non-traditional alternatives such as study at a performing art academy or a trade school. Finally, a support trust should indicate whether the trustee should take a benefi-

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<sup>267</sup> For a discussion on the use of letters of intent, see Alexander A. Bove, Jr., *Commentary on Discretionary Trusts: An Update by Richard C. Ausness*, 43 ACTEC L.J. 441, 445 ((2018); Alexander A. Bove, Jr., *The Letter of Wishes: Can We Influence Discretion in Discretionary Trusts?*, 35 ACTEC J. 38, 39 (2009).

ary's other resources into account when making decisions about payments for support.

## 2. *Powers and Duties of Trustees*

Although trustees have certain inherent powers and duties because of the nature of their office, it is better to identify these powers and duties expressly instead of relying solely on judicial decisions and statutory provisions.<sup>268</sup> As far as powers are concerned, the powers listed in the Uniform Trust Code provide a useful starting point. However, it would be helpful if the trust instrument also spelled out the extent to which the trustee could delegate certain functions to agents, such as financial advisors, accountants, attorneys, and other agents. The trust instrument should also make it clear whether the trustee is to be compensated for time spent administering the trust and also if the trustee will be reimbursed for any money spent on trust business.<sup>269</sup>

In addition, the trust instrument should indicate whether the trustee is to be relieved of the duty of impartiality, the duty of prudence, the duty to avoid self-dealing, or the duty to avoid conflicts of interest. This is especially important if the trustee is also a trust beneficiary or if he or she has the power to make discretionary distributions of trust income or principal. This step is particularly important if the principal asset of the trust is real property or shares in a family business. The settlor might also consider whether to add an *in terrorem* clause or an exculpatory clause to protect the trustee against questionable lawsuits by other family members.

Another issue that the trust instrument should address is how a successor trustee will be chosen if a trustee resigns, dies, or becomes incompetent. Possible options include allowing the remaining trustees to choose a successor if multiple trustees have been appointed, authorizing a corporate trustee to appoint individuals as successor trustees if there is a corporate trustee, and finally the trust instrument could allow a trust protector to select a successor trustee if the trust instrument provides for one.

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<sup>268</sup> The Uniform Trust enumerates a number of trustees' powers and duties. UNIF. TRUST CODE §§ 801-17.

<sup>269</sup> The Uniform Trust Code for the reasonable compensation and reimbursement of trustees. UNIF. TRUST CODE §§ 708-09.

### 3. *Distributive Framework*

Obviously, the trust instrument should identify of all of the potential beneficiaries and their respective rights in the trust. A rigid distributive formula, such as “income in equal shares to *A* and *B*,” has the advantage of reducing the grounds for a challenge to the trustee’s actions, but it could cause problems if unforeseen changes in circumstances affect a beneficiary’s needs. A discretionary power to invade the trust corpus will increase flexibility, but it may encourage a challenge to the exercise of this power from other beneficiaries. One response to this problem would be to require unanimous consent to exercise a power to invade if there are multiple trustees. Another solution might be to require the consent of a trust protector to invade.

#### B. *Actions by the Trustee*

It is highly desirable, if not essential, for the trustee to maintain a good personal relationship with all of the beneficiaries. This is particularly important if the trustee is also a family member. There are various steps that the trustee can take to encourage such relationships. For example, when the trustee assumes office, he or she may convene a family conference to inform family members about the purpose and provisions of the trust. In addition, the trustee should encourage individual beneficiaries to discuss matters of concern with him or her. Furthermore, the trustee should make periodic disclosures about the trust’s performance. Finally, the trustee should inform trust beneficiaries of any issues or events that may affect the trust.

## V. **Conclusion**

A trustee’s life is often not a happy one. As the foregoing discussion has shown, this is particularly true when a family member is chosen to serve as a trustee. Consequently, it is generally a good idea for the settlor to appoint a non-family member, such as a bank or corporate trustee, as trustee or co-trustee. However, if the settlor insists on naming a family member as trustee, there are some common-sense measures that the settlor and the trustee can take to reduce the chances of friction within the family. In particular, the settlor should make sure that the trustee is fully aware of the fiduciary duties that are associated

with the office of trustee. In addition, if possible, both the settlor and the trustee should inform other family members of the general purposes of the trust and the trust provisions that directly affect them. Hopefully, these measures will reduce the chances of conflicts within the family after the settlor's death.

## **The UCCJEA, the PKPA, and Preemption: Why the Jurisdictional Provisions of the UCCJEA Cannot Be Waived**

by  
Andrew Jack Botros\*

The Uniform Child Custody Jurisdiction and Enforcement Act (“UCCJEA”), drafted by its commissioners in 1997, has been adopted by every state, except Massachusetts. The goals of the UCCJEA are set forth in the official comments to the Act. These goals include: (1) avoiding jurisdictional competition and conflict with courts of other states in matters of child custody; (2) promoting cooperation with the courts of other states; (3) discouraging the use of the interstate system for continuing controversies over child custody; (4) deterring abductions of children; (5) avoiding relitigation of custody decisions of multiple states; and (6) facilitating the enforcement of custody decrees of other states.<sup>1</sup>

Toward these ends, the UCCJEA intends to be the “exclusive jurisdictional basis for making a child custody determination” by each state that has adopted it.<sup>2</sup> What the term “exclusive jurisdictional basis” encompasses has been a topic of great controversy and is the focus of this article. Appellate courts in some states have concluded that the UCCJEA is a subject matter jurisdiction scheme.<sup>3</sup> Under this approach, the failure to adhere to

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<sup>1</sup> See UNIF. CHILD CUSTODY JURISDICTION & ENF’T ACT (“UCCJEA”) § 101, comment, 9 U.L.A. 657 (1999).

<sup>2</sup> UCCJEA § 201(b).

<sup>3</sup> “Subject matter jurisdiction” is used throughout this article to mean a court’s jurisdiction over a particular case that cannot be waived, forfeited, or consented to. Although the concept of orders that are void from the outset and always subject to collateral attack is universal throughout the United States, different states have different terms of art to describe the concept. Most states treat subject matter jurisdiction as a binary concept: “Either subject-matter jurisdiction exists or it does not exist.” *Jefferson Cty. Comm’n v. Edwards*, 32 So.

the jurisdictional provisions of the UCCJEA results in a void order. Void orders are not subject to recognition or enforcement under any circumstances, including under the circumstances of waiver, forfeiture, consent, or estoppel. Notably, the official comment to section 201 of the UCCJEA confirms that it was the intent of the drafters of the UCCJEA to make it a subject matter jurisdiction scheme.<sup>4</sup> Many states have found this comment to be compelling, if not dispositive.<sup>5</sup>

Regardless, appellate courts in other states have taken a different approach to this important question of subject matter ju-

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3d 572, 591 (Ala. 2009). In California, however, it is a tertiary concept. In California, there can be 1) no subject matter jurisdiction at all; 2) subject matter jurisdiction that is *non-fundamental*, which is waivable, forfeitable, etc.; and 3) *fundamental* subject matter jurisdiction, which is *not* waivable, forfeitable, etc.

<sup>4</sup> “It should also be noted that since jurisdiction to make a child custody determination is subject matter jurisdiction, an agreement of the parties to confer jurisdiction on a court that would not otherwise have jurisdiction under this Act is ineffective.” Official Comment to Model UCCJEA, § 201.

<sup>5</sup> See *Officer v. Blankenship*, 555 S.W.3d 449, 458 (Ky. Ct. App. 2018) (“The fundamental purpose of the UCCJEA is to avoid jurisdictional competition and conflicts between states in child custody matters. If that objective is to be achieved, the UCCJEA must be interpreted similarly among the various states. The Comments to the Uniform Act itself, make clear that jurisdiction under the Act means subject matter jurisdiction, and that any agreement by the parties with respect to jurisdiction is ‘ineffective.’”); *Friedman v. Eighth Jud. Dist. Ct.*, 264 P.3d 1161, 1167 (Nev. 2011) (“Instead, it accepted Kevyn’s argument that the parties’ agreement to a Nevada forum for future child custody disputes removed her family from the UCCJEA. But this position is unsustainable. NRS 125A.305(2) states that NRS 125A.305(1) ‘is the exclusive jurisdictional basis for making a child custody determination by a court of this State.’ Since the UCCJEA deems this to involve ‘subject matter jurisdiction, an agreement of the parties to confer jurisdiction on a court that would not otherwise have jurisdiction under this Act is ineffective.’”); *Harshberger v. Harshberger*, 724 N.W.2d 148, 153-54 (N.D. 2006) (“Subject matter jurisdiction cannot be conferred by agreement, consent, or waiver, and issues involving subject matter jurisdiction can be raised by the court at any time . . . Uniform Child Custody Jurisdiction and Enforcement Act § 201, Comment, 9 Uniform Laws Annotated 673 (Part IA 1999) (‘since jurisdiction to make a child custody determination is subject matter jurisdiction, an agreement of the parties to confer jurisdiction on a court that would not otherwise have jurisdiction under this Act is ineffective.’”)); *In re Custody of A.C.*, 200 P.3d 689, 693 n.8 (Wash. 2009) (“We also note that to permit waiver of the jurisdictional provisions of the UCCJEA would undermine the goals of avoiding conflicting proceedings. Cf. UCCJEA § 201 cmt., 9 pt. 1A U.L.A. at 673 (an agreement to confer jurisdiction under the UCCJEA statute is not effective).”)

risdiction. The appellate courts in these states have concluded that when the jurisdictional provisions of the UCCJEA are not followed, the result is not a *void* order, but a *voidable* order. Unlike void orders, voidable orders can be waived, forfeited, consented to, etc.<sup>6</sup>

An example will help demonstrate the difference between a void order and a voidable order. Under Section 202 of the Model UCCJEA, a court cannot continue to exercise continuing, exclusive jurisdiction once a child and all the parties move out of a state to reside elsewhere. If State A follows the first approach, an order made pursuant to a modification filed after all the parties have moved out of State A is void because the order was not made consistent with the jurisdictional provisions of the UCCJEA. Since the order is void, it is not entitled to any intra-state or interstate recognition. Accordingly, if a state court made an order under these conditions, either party can come to court at any time and set that order aside. Even until it is set aside, the order does not have any legal force or effect.<sup>7</sup>

If State A, however, follows the second approach, the result may be different. Under this second approach, State A would be required to conclude that, even if State A no longer has jurisdiction under Section 202, a resulting order would be valid and enforceable if the jurisdictional defect was consented to, waived, or forfeited.

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<sup>6</sup> “There is distinction between a judgment that is ‘void’ and one that is ‘voidable.’ . . . A void judgment is so defective that it is deemed never to have had legal force and effect. In contrast, a voidable judgment is a judgment that has been entered based upon some error in procedure that allows a party to have the judgment vacated, but the judgment has legal force and effect unless and until it is vacated . . . . A voidable judgment can be challenged by motion for rehearing or appeal and may be subject to collateral attack under specific circumstances, but it cannot be challenged at any time as void . . . . A trial court’s lack of subject-matter jurisdiction makes its judgment void. *N.W.T. v. L.H.D.*” *Sterling Factors v. U.S. Bank*, 968 So. 2d 658, 665 (Fla. Dist. Ct. App. 2007). In contrast to a void order, a voidable order is “valid until set aside, and parties may be precluded from setting it aside by such things as waiver, estoppel, or the passage of time.” *In re Andres G.*, 75 Cal. Rptr. 2d 285, 288. (Cal. Ct. App. 1998).

<sup>7</sup> See *Sterling Factors*, 968 So. 2d at 665.

A small, but growing group of states have decided to follow this second approach.<sup>8</sup> A May 2020 concurring opinion from Texas Supreme Court Justice Debra Lehrman, agreeing that UCCJEA jurisdiction is waivable, concluded that allowing UCCJEA jurisdiction to be waivable is “consistent with the modern trend . . . away from classifying statutes as jurisdictional in the true subject-matter sense in the absence of clear legislative intent to that effect.”<sup>9</sup> In the same opinion, the court’s majority observed that the jurisdictional nature of the UCCJEA was not a settled question.<sup>10</sup> An August 2020 published opinion from an intermediate appellate court in California, also following this trend, noted that it did not believe that the “model UCCJEA was even intended to regulate the [subject matter] jurisdiction of the courts of states that adopted it.”<sup>11</sup> It noted further, that appellate courts in Washington D.C., Illinois, Indiana, and Missouri had followed this approach.<sup>12</sup>

This article submits the second approach is fundamentally flawed because it fails to consider the implications of federal preemption arising out of the Parental Kidnapping Protection Act (“PKPA”).<sup>13</sup> The result of this preemption is that, first, custody

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<sup>8</sup> See *Officer v. Blankenship*, 555 S.W.3d 449, 455 (Ky. Ct. App. 2018) (“Even though a case for classifying jurisdiction under the UCCJEA as particular case jurisdiction can be made, it is not the approach the majority of states, including our own, have taken.”).

<sup>9</sup> *In the Interest of D.S.*, 602 S.W.3d 504, 521 (Tex. 2020) (Lehrmann, J., concurring).

<sup>10</sup> See *id.* at 517-18.

<sup>11</sup> *In re J.W.*, 53 Cal. App. 5th 347, 362 (2020), *but see* *A.M. v. Superior Court*, D078117, 13-14 (Cal. Ct. App. Apr. 20, 2021) (“The public policy considerations at issue in *J.W.* that formed the basis for its decision to prioritize the dependency scheme over the UCCJEA are not present” because “[t]he potential disruption of the fundamental jurisdiction of the dependency court, whose statutory role is protection of a minor whose well-being is in jeopardy, is far different from the termination of the family court’s jurisdiction in this case.”)

<sup>12</sup> *In re J.W.*, 53 Cal. App. 5th at 364-65.

<sup>13</sup> A distinction should be made between 1) appellate courts that have concluded that the UCCJEA is not intended to be a subject matter jurisdictional scheme; and 2) appellate courts that have concluded that this question is irrelevant because their state constitutions preempt such a result. For instance, in *Hightower v. Myers*, 304 S.W.3d 727 (Mo. 2010), the Supreme Court of Missouri concluded that, regardless of the intent of the UCCJEA, subject matter jurisdiction is conferred in *every civil case* pursuant to the Missouri Constitution. Other states, such as California, look to the legislative intent behind a

and visitation orders that are allowed to stand despite their jurisdictional defects are, at best, only entitled to recognition or enforcement within the territorial borders of a state that makes such an order and, second, a state that issues an order inconsistent with the jurisdictional provisions of the PKPA/UCCJEA must disregard its own orders when that order conflicts with an order made in accordance with the PKPA/UCCJEA. Specifically, this result follows because the PKPA only requires states to recognize custody and visitation orders that are made consistently with the jurisdictional provisions of the PKPA and because the jurisdictional provisions of the PKPA and UCCJEA are consistent with each other. In other words, an order not made consistently with the jurisdictional provisions of the UCCJEA is necessarily not made consistently with the jurisdictional provisions of the PKPA.<sup>14</sup> This dramatically undermines all of the stated goals of the UCCJEA set forth in the introduction to this article.

Part I of this article includes brief histories of the enactments of the Uniform Child Custody Jurisdiction Act (“UCCJA”), the PKPA, and the UCCJEA, inasmuch as they are relevant to the question of subject matter jurisdiction. Part I will demonstrate the importance of the uniformity of the law. Specifically, Part I will establish that the avoidance of conflicting decisions and competing jurisdiction was a primary thrust behind the adoption of the UCCJA in 1967, the PKPA in 1980, the UCCJEA in 1997.

Part II discusses why determining that UCCJEA jurisdiction is waivable is inapposite to the UCCJEA’s primary goal of avoid-

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particular statute in determining whether a statute is a subject matter jurisdictional statute. This is a particularly important distinction because California looks to intent at the statutory level, not the constitutional level, to determine whether subject matter is fundamental. “There is ‘no simple, mechanical test’ for determining whether a specific requirement is jurisdictional . . . or not, but ‘[t]he question is ultimately one of legislative intent.’” *In re J.W.*, 53 Cal. App. 5th at 357. To avoid the problems described below by permitting the UCCJEA to be waived, the states that confer subject matter jurisdiction at the constitutional level would be required to amend their state constitutions.

<sup>14</sup> Since it is not clear whether the PKPA applies to custody and determinations outside of the family law context (e.g., adoption, juvenile dependency), the arguments made in this article only apply, with certainty, to cases within the family law context.

ing conflicting decisions and competing jurisdiction. The PKPA only compels the interstate enforcement of another state's custody or visitation orders when that state makes those orders in compliance with the jurisdictional provisions of the PKPA. The result of this is profound. Not only does this mean that every time a state ignores the jurisdictional defects in a custody and visitation order, such an order is not entitled to recognition in any other state, but it also means any state that issues such an order must disregard its own order whenever it is confronted with a conflicting out-of-state order that is made consistently with the jurisdictional provisions of the PKPA/UCCJEA.

Part III demonstrates the ubiquity of the problem noted in Part II and why this problem cannot be ignored: the UCCJEA only allows one state at a time to exercise jurisdiction over a child. Accordingly, the consideration of waiver is only relevant when a court also concludes that a state incorrectly exercised jurisdiction. If there is a state that incorrectly exercised jurisdiction, there is always a different state that can correctly exercise jurisdiction. That state can ignore the other state's orders and issue conflicting orders *each and every time* the first state issues an order inconsistent with the jurisdictional provisions of the PKPA/UCCJEA.

## **I. A Brief History of the UCCJA, the PKPA, and the UCCJEA**

### *A. The UCCJA*

The UCCJA is the predecessor to the UCCJEA. It was drafted in 1967. Eventually, it was adopted by all fifty states and the District of Columbia. Its stated purpose is very similar to the UCCJEA. It included the avoidance of "jurisdictional competition and conflict with courts of other states in matters of child custody," the promotion of "cooperation with the courts of other states," to "avoid re-litigation of custody decisions other states," and to "make uniform the law of those states which [enacted] it."<sup>15</sup> The Act attempted to create bright line rules for when a

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<sup>15</sup> UNIF. CHILD CUSTODY JURISDICTION ACT ("UCCJA") § 1, 9 U.L.A. 123 (1999).

particular state should exercise jurisdiction over a child.<sup>16</sup> Prior to the enactment of the UCCJA, no uniform act had attempted to tackle these problems.

### B. *The PKPA*

The UCCJA's stated purposes, and the execution of those purposes by the states which enacted the UCCJA, turned out to be very different things. In 1980, the federal government enacted the PKPA, which consists of a single, brief, but enormously impactful statute, 28 U.S.C. § 1738A. The PKPA was enacted specifically "to address the interstate custody jurisdictional problems that continued to exist after the adoption of the UCCJA."<sup>17</sup> It intends to achieve this purpose by mandating "that state authorities give full faith and credit to other states' custody determinations, so long as those determinations were made in conformity with the provisions of the PKPA."<sup>18</sup> As set forth in the following section, many problems remained or were left unaddressed altogether. This would eventually lead to the creation of the UCCJEA.

### C. *The UCCJEA*

Although the jurisdictional provisions of the PKPA and the UCCJEA were similar, there were still significant differences.<sup>19</sup> For instance, while the PKPA directly addressed the concept of continuing, exclusive jurisdiction once a state makes an initial order, the UCCJA did not directly address this. These differences were exacerbated by inconsistent interpretation of the UCCJA and led to a loss of uniformity among the various states.<sup>20</sup> As one commenter put it, the relationship between the UCCJA and the PKPA became "technical enough to delight a medieval property lawyer."<sup>21</sup>

Making the jurisdictional provisions of the UCCJEA consistent with the jurisdictional provisions of the PKPA was the only solution to these problems. This is exactly what the UCCJEA

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<sup>16</sup> See UCCJA § 3.

<sup>17</sup> UCCJEA prefatory note.

<sup>18</sup> *Id.*

<sup>19</sup> See *id.*

<sup>20</sup> See *id.*

<sup>21</sup> HOMER H. CLARK, DOMESTIC RELATIONS § 12.5 at 494 (2d ed. 1988)

accomplishes. The Official Comment to section 303 of the Model UCCJEA states:

Enforcement of custody determinations of issuing States is also required by federal law in the PKPA, 28 U.S.C. § 1738A(a). The changes made [to the jurisdictional provisions] of [the UCCJEA] now make a state's duty to enforce and not modify a child custody determination of another state consistent with the enforcement and non-modification provisions of the PKPA.<sup>22</sup>

As one state legislature put it, “[a]dopting the revised UCCJEA would simply remove the confusion created by the inconsistent provisions of state law [in the UCCJA] and reduce the likelihood of inharmonious decisions.”<sup>23</sup>

In other words, the UCCJEA's jurisdictional provisions in sections 201, 202, 203 and 204 of the model UCCJEA are intended to be consistent with the analogous provisions of the PKPA, 28 U.S.C. sections 1738A(c)-(h).

The UCCJEA's focus on consistency between the PKPA and the UCCJEA, how this relates to enforcement, and how this relates to the jurisdictional provisions is not limited to the comment in section 303. Frequent examples of this focus can be observed throughout the model act and its comments. Notably, virtually every time the jurisdictional provisions of the UCCJEA are mentioned in a section of the UCCJEA, the comment to that section contains a discussion about the importance of the consistency of the UCCJEA and the PKPA along with a reminder that the PKPA requires each state to only enforce orders that are made consistently with the provisions of the PKPA.

Sections 206, 303, and 310 exemplify this connection. Section 206 of the Model UCCJEA states:

(a). . . **[A] court of this State may not exercise its jurisdiction under this [article] if, at the time of the commencement of the proceeding, a proceeding concerning the custody of the child has been commenced in a court of another State having jurisdiction substantially in conformity with this [Act],** unless the proceeding has been terminated or is stayed by the court of the other State because a court of this State is a more convenient forum under Section 207.<sup>24</sup>

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<sup>22</sup> UCCJEA § 303 comment.

<sup>23</sup> California Bill Analysis, S.B. 668 Sen., Apr. 6, 1999, [http://leginfo.ca.gov/pub/99-00/bill/sen/sb\\_0651-0700/sb\\_668\\_cfa\\_19990407\\_142002\\_sen\\_comm.html](http://leginfo.ca.gov/pub/99-00/bill/sen/sb_0651-0700/sb_668_cfa_19990407_142002_sen_comm.html).

<sup>24</sup> UCCJEA § 206 (emphasis added).

The official comment to section 206 states:

The problem of simultaneous proceedings is no longer a significant issue. . . . If there is a State of exclusive, continuing jurisdiction, there cannot be another State with concurrent jurisdiction and, therefore, no simultaneous proceedings. . . [a]lthough the enforcement State is required by the PKPA to enforce according to its terms a custody determination made consistently with the PKPA, that duty is subject to the decree being modified by a State with the power to do so under the PKPA.<sup>25</sup>

Section 206 and its comment make clear that simultaneous proceedings are no longer a problem, not only because of the text of UCCJEA, but because of the clarity and consistency of the UCCJEA and the PKPA. Section 303 of the Model UCCJEA states:

A court of this state shall recognize and enforce a child custody determination of a court of another state **if the latter court exercised jurisdiction in substantial conformity with this part or the determination was made under factual circumstances meeting the jurisdictional standards of this part and the determination has not been modified in accordance with this part.**<sup>26</sup>

As noted above, the official comment to Section 303 reads as follows:

Enforcement of custody determinations of issuing States is also required by federal law in the PKPA, 28 U.S.C. § 1738A(a). The changes made in Article 2 of this Act now make a State's duty to enforce and not modify a child custody determination of another State consistent with the enforcement and nonmodification provisions of the PKPA.<sup>27</sup>

Section 303 and its comment require a state to recognize and enforce child custody determinations of other states only when, essentially, the other state followed the UCCJEA as well as the PKPA, as the jurisdictional provisions in the two acts are consistent.

Section 310 of the Model UCCJEA states:

(a) Unless the court issues a temporary emergency order pursuant to Section 3424, **upon a finding that a petitioner is entitled to immediate physical custody of the child, the court shall order that the petitioner may take immediate physical custody of the child unless the respondent establishes either of the following:**

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<sup>25</sup> UCCJEA § 206 comment.

<sup>26</sup> UCCJEA § 303(a) (emphasis added).

<sup>27</sup> UCCJEA § 303 comment (emphasis added).

**(1) That the child custody determination has not been registered and confirmed under Section 3445 and one of the following is true:**

**(A) The issuing court did not have jurisdiction under Chapter 2 (commencing with Section 3421). . .<sup>28</sup>**

The comment to Model UCCJEA section 310 states the following:

**Federal law requires the court to enforce the custody determination if the issuing state's decree was rendered in compliance with the PKPA. 28 U.S.C. § 1738A(a). This Act requires enforcement of custody determinations that are made in conformity with Article 2's jurisdictional rules.<sup>29</sup>**

This is, again, another important reference to the consistency of the jurisdictional provisions of the UCCJEA and the PKPA, this time in the context of the right to immediate physical custody of a child.

**It is a defense to enforcement that another jurisdiction has issued a custody determination that is required to be enforced under Article 2.<sup>30</sup>**

This portion of the comment makes clear that whenever an order is made inconsistently with the jurisdictional provisions of the UCCJEA, a state may (and, in certain situations explained in Part II below, must) refuse to enforce that order if another state has made a conflicting order with jurisdiction under the UCCJEA.

An example is when one court has based its original custody determination on the UCCJA § 3(a)(2) (significant connections) and another jurisdiction has rendered an original custody determination based on the UCCJA § 3(a)(1) (home State). **When this occurs, Article 2 of this Act, as well as the PKPA, mandate that the home state determination be enforced in all other States, including the State that rendered the significant connections determination.<sup>31</sup>**

This portion of the comment makes clear that whenever an order is made consistently with the jurisdictional provisions of the UCCJEA/PKPA, that order must be enforced in every state, including the very state that made a determination that was in-

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<sup>28</sup> UCCJEA § 310 (emphasis added).

<sup>29</sup> UCCJEA § 310 comment (emphasis added).

<sup>30</sup> *Id.* (emphasis added).

<sup>31</sup> *Id.* (emphasis added).

consistent with the jurisdictional provisions of the UCCJEA/PKPA.

1. *Section 106's Effect on Intrastate and Interstate Enforcement.*

Although not mentioning the PKPA, section 106 of the Model UCCJEA and its predecessor, section 12 of the Model UCCJA, aptly explain how the concepts of subject matter jurisdiction and interstate enforcement are intended to harmonize with each other.

A child-custody determination made by a court of this State that had jurisdiction under this [Act] binds all persons who have been served in accordance with the laws of this State or notified in accordance with Section 108 or who have submitted to the jurisdiction of the court, and who have been given an opportunity to be heard. As to those persons, the determination is conclusive as to all decided issues of law and fact except to the extent the determination is modified.<sup>32</sup>

This section explains under what conditions a child custody is enforceable against those who have participated in the proceedings.

The official comment to Section 106 reads as follows: “No substantive changes have been made to this section which was Section 12 of the UCCJA.”<sup>33</sup> In other words, the intent of Section 106 of the UCCJEA is no different than the intent of Section 12 of the UCCJA.

The official comment to Section 12 of the Model UCCJA reads as follows:

This section deals with the intra-state validity of custody decrees which provides the basis for their interstate recognition and enforcement. The two prerequisites are (1) jurisdiction under section 3 of this Act and (2) strict compliance with due process mandates of notice and opportunity to be heard. . . .<sup>34</sup>

Section 3 of the UCCJA determines when the court has subject matter jurisdiction to act.<sup>35</sup>

Accordingly, not only is an order made outside the bounds of the jurisdictional provisions of the UCCJEA not entitled to

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<sup>32</sup> UCCJEA § 106.

<sup>33</sup> UCCJEA § 106 comment.

<sup>34</sup> Model UCCJA § 12.

<sup>35</sup> *See* UCCJA § 3.

enforcement in other states, it is not even entitled to enforcement in the very state that made it. This conclusion is consistent with the interpretation made by the Supreme Court of Washington.

Finally, the Nagels contend that Cork waived any jurisdictional arguments. The Nagels cite RCW 26.27.061, which states, “A child custody determination made by a court of this state *that had jurisdiction under this chapter* binds all persons . . . who have submitted to the jurisdiction of the court.” Because the superior court did not have jurisdiction to modify Montana’s custody determination under chapter 26.27 RCW, this provision does not apply.<sup>36</sup>

Here, the Washington Supreme Court confirms that having subject matter jurisdiction under the UCCJEA is a necessary pre-condition to a binding order enforceable in any of the fifty states.

Based on the foregoing provisions and their comments, one must not only conclude that the jurisdictional provisions of the PKPA and the UCCJEA are not only consistent, but that this consistency was intended to be the critical foundation of the UCCJEA.

## **II. How Federal Preemption Informs the Interpretation of the PKPA/UCCJEA**

The reason why the PKPA compels the conclusion that UCCJEA jurisdiction is non-waivable comes down to one simple, but important concept: federal preemption.

Article VI, cl. 2, of the Constitution provides that the laws of the United States “shall be the supreme Law of the Land; . . . any Thing in the Constitution or Laws of any state to the Contrary notwithstanding.” Consistent with that command, we have long recognized that state laws that conflict with federal law are “without effect.”<sup>37</sup>

Since the PKPA is a federal law, it supersedes any individual state’s statutory or constitutional law to the contrary.<sup>38</sup> Further, recall the California legislature’s comment that “all states are already required to comply with the requirements of PKPA. . . the federal government has preempted the field in the interstate

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<sup>36</sup> *In re Custody of A.C.*, 200 P.3d 689, 693 (Wa. 2009) (emphasis in original).

<sup>37</sup> *Altria Group, Inc. v. Good*, 555 U.S. 70, 76 (2008).

<sup>38</sup> *See id.*

child custody disputes with PKPA and thus the federal requirements control when there is a conflict with state law.”<sup>39</sup>

The following hypothetical demonstrates the problem that preemption creates for states that allow waiver of the jurisdictional provisions of the PKPA/UCCJEA. It involves Indiana, a state that has concluded that the jurisdictional provisions of the PKPA/UCCJEA *can* be waived, and West Virginia, a state that has concluded that the jurisdictional provisions of the PKPA/UCCJEA *cannot* be waived.

Assume that a child and her parents reside in Indiana. Further assume that Indiana has exercised initial home state jurisdiction in conformity with its version of Model UCCJEA section 201. In other words, the child and her parents have all resided in Indiana for the six months immediately preceding the filing of a first pleading in an action that seeks orders on custody and visitation. Under Indiana’s version of section 202, Indiana maintains continuing and exclusive jurisdiction until it

determines that neither the child, nor the child and one parent, nor the child and a person acting as a parent have a significant connection with [Indiana] and that substantial evidence is no longer available in this [Indiana] concerning the child’s care, protection, training, and personal relationships; or (2) a court of Indiana or a court of another State determines that the child, the child’s parents, and any person acting as a parent do not presently reside in [Indiana].<sup>40</sup>

Further assume that both parents and the child move to the state of West Virginia and, after the move, the mother files a modification motion in Indiana. According to the UCCJEA, an Indiana court would not have jurisdiction under either the UCCJEA or the PKPA to modify the determination because both parents and the child have left the state to move elsewhere.<sup>41</sup> Assume though that the parties consented to Indiana hearing the modification motion and the court accepted the stipulation of the parties to hear the motion. The Indiana court hears the modification motion and awards full custody to the father. The mother appeals and the Indiana appeals court affirms be-

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<sup>39</sup> California Bill Analysis, *supra* note 23.

<sup>40</sup> UCCJEA § 202(a)(1),(2).

<sup>41</sup> *See id.*

cause, under Indiana law, the parties consented to the jurisdiction and that waives the jurisdictional defect.<sup>42</sup>

The mother then decides to file a modification motion in West Virginia. Consistent with the Supreme Court of West Virginia's interpretation of the PKPA and the UCCJEA, the West Virginia court notes that it cannot enforce the modification order because it was not made in accordance with the provisions of the PKPA.<sup>43</sup> It decides, instead, to modify the prior order and gives the mother full custody.

Already, there is a massive problem. The goals of the UCCJEA to avoid conflicting orders and competing jurisdiction, to discourage the use of the interstate system for continuing controversies over child custody, to avoid relitigating custody decisions of other states, and to facilitate the enforcement of custody decrees of other states, has been dramatically undermined. In this hypothetical, two states have simply interpreted the UCCJEA differently. It is not uncommon for two states to interpret parts of the same uniform law differently. As long as a federal question is not involved, both states can be right.

However, in this instance, both states are not right. Only West Virginia is right because only West Virginia made orders consistent with the jurisdictional provisions of the PKPA/UCCJEA. Only West Virginia's orders are entitled to recognition in other states, including Indiana.

Under the PKPA, the "jurisdiction of a court of a State which has made a child custody or visitation determination consistently with the provisions of this section continues as long as

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<sup>42</sup> "The jurisdictional limitations imposed by the [predecessor act to the UCCJEA] are not equivalent to declarations of subject matter jurisdiction, but rather are refinements of the ancillary capacity of a trial court to exercise authority over a particular case. This exercise of authority is waivable." *Williams v. Williams*, 555 N.E.2d 142, 145 (Ind. 1990).

<sup>43</sup> "Pursuant to the Parental Kidnaping Prevention Act [hereinafter "P.K.P.A."], 28 U.S.C.A. § 1738A (2000), we are not required to recognize and enforce custody determinations of sister states that lack jurisdiction under the U.C.C.J.E.A. . . Accordingly, although foreign states' custody decrees should be enforced and recognized by West Virginia courts if they accord with the statutory jurisdictional provisions of the U.C.C.J.E.A. and the P.K.P.A., in child custody matters such as this, where a foreign court lacks jurisdiction under the U.C.C.J.E.A., the full faith and credit doctrine will not be applied." *Rosen v. Rosen*, 222 W. Va. 402, 407-8 (2008).

. . . such State remains the residence of the child or of any contestant.”<sup>44</sup> Similarly, section 202 of the UCCJEA provides that a state court that has rendered “a child-custody determination consistent with Section 201 or 203 has exclusive, continuing jurisdiction over the determination until: . . . a court of this State or a court of another State determines that the child, the child’s parents, and any person acting as a parent do not presently reside in this State.”<sup>45</sup> These jurisdictional provisions are, unsurprisingly, consistent. Put another way, precisely because the jurisdictional provisions of the PKPA and the UCCJEA are consistent, when the PKPA commands all states to “enforce according to its terms . . . any custody determination or visitation determination made consistently with the provisions of [the PKPA] by a court of another state,” this is the equivalent of commanding all states to “enforce according to its terms . . . any custody determination or visitation determination made consistently with” the UCCJEA.<sup>46</sup>

Because of preemption, under federal law, only the order made by West Virginia is entitled to full faith and credit in all other states, including Indiana. Next assume that the mother then registers her West Virginia order for enforcement in Indiana and, simultaneously, the father registers his Indiana order in West Virginia for enforcement. Under the PKPA, Indiana is required to enforce all custody and visitation orders made by West Virginia made in accordance with the PKPA.<sup>47</sup> When the mother attempts to enforce the West Virginia order in Indiana, because of federal preemption, Indiana must disregard its inferior order that was not made consistent with jurisdictional provisions of the PKPA/UCCJEA and must enforce the West Virginia order, just as Indiana must disregard its own statutes to the extent they conflict with federal law.

West Virginia, however, is not compelled by any federal law to enforce the second order from Indiana. The PKPA only requires West Virginia to enforce orders that are made consistently with the provisions of the PKPA/UCCJEA. The Indiana order, however, came after the child and the parties all left the state. In allowing the jurisdictional provisions of the PKPA/UCCJEA to

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<sup>44</sup> 28 U.S.C. § 1738A(d).

<sup>45</sup> UCCJEA § 202(a)(2).

<sup>46</sup> 28 U.S.C. § 1738A(a).

<sup>47</sup> *See* 28 U.S.C. § 1738A(a).

be waived, Indiana has also, inadvertently, allowed its custody and visitation orders made inconsistently with the jurisdictional provisions of the UCCJEA to be meaningless outside the boundaries of its state. This is why to “permit waiver of the jurisdictional provisions of the UCCJEA would undermine the goals of avoiding conflicting proceedings.”<sup>48</sup> This result is contradictory to every stated purpose of the UCCJEA and conclusively demonstrates why permitting waiver is inapposite to the UCCJEA’s purpose of giving “consideration . . . to the need to promote uniformity of the law with respect to its subject matter among States that enact it.”<sup>49</sup>

Importantly, of the cases cited in this article that have held that UCCJEA jurisdiction is waivable, none of them have discussed this result. Further, none except one mentions the PKPA.

### **III. The Ubiquity of the Problem Caused by Ignoring the Jurisdictional Provisions of the UCCJEA**

It is just as important to emphasize not only the severity of the problem noted in Part II, but its ubiquity. One might harken back to the early days of torts in law school and recall the Learned Hand formula. When evaluating the problem noted in Part II, one might not only look at “the gravity of the resulting injury,” but also its “probability.”<sup>50</sup> The gravity of the problem established in Part II is severe to say the least. It is just as important to note, however, the result in Part II is possible every time in every case where a court concludes that jurisdiction is waived. The consideration of waiver is, of course, only relevant when a court also concludes that a state incorrectly exercised jurisdiction. This is because only one state can correctly exercise jurisdiction under the UCCJEA at a time.<sup>51</sup> If there is a state that

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<sup>48</sup> *In re Custody of A.C.*, 200 P.3d 689, 693 n.8 (Wash. 2009).

<sup>49</sup> UCCJEA § 401.

<sup>50</sup> *United States v. Carroll Towing Co.*, 159 F.2d 169, 173 (2d Cir. 1947).

<sup>51</sup> “The UCCJEA ensures that only one state has jurisdiction to make ‘child custody determinations.’” *In re Marriage of Fernandez-Abin & Sanchez*, 191 Cal. App. 4th 1015, 1037 (Cal. Ct. App. 2011); *People ex rel. M.C.*, 94 P.3d 1220, 1223 (Colo. App. 2004) (“[T]he UCCJEA also seeks to eliminate the simultaneous exercise of jurisdiction over custody disputes by more than one state.”); *In re Interests of A.A.-F.*, 444 P.3d 938, 948 (Kan. 2019) (“The

incorrectly exercised jurisdiction, that necessarily means that there is always a different state that can correctly exercise jurisdiction. That state can ignore the other state's orders and issue conflicting orders each time. Every time the state that incorrectly exercised jurisdiction is required to enforce that other state's orders and disregard its own conflicting orders. Such cataclysmic results are only avoidable by concluding that the UCCJEA confers fundamental subject matter jurisdiction.

#### **IV. Conclusion**

Since 1967, at both the state and federal level, the primary thrust behind any of the laws that have sought to address the unique problem of interstate custody jurisdiction and enforcement has been to avoid conflicting orders and competing jurisdiction. After the enactment of the UCCJA, the PKPA was enacted with the express purpose of strengthening the provisions that avoid conflicting orders and competing jurisdiction and the UCCJEA sought to even further remedy these problems.

Interpreting the UCCJEA as a statute that can be waived, as noted above, is a major step back away from not only this goal, but all of the stated goals of the UCCJEA. Although the states that have found the UCCJEA is waivable were well-intentioned, it appears none of them have foreseen the major problems this interpretation causes as a result of the PKPA and preemption. In the future, both courts and state legislatures would be wise to consider the troubling consequences that result from making the UCCJEA waivable.

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UCCJEA's drafters prioritized the jurisdictional grounds to help assure that only one state at a time exercises jurisdiction, thus avoiding conflicting orders."); *Nevares v. Adoptive Couple*, 384 P.3d 213, 217 (Utah 2016) ("[T]he UCCJEA promotes a framework wherein a single state is vested with jurisdiction to make child custody determinations and a uniform set of rules to determine which state is best positioned to adjudicate custody disputes."); *W.H. v. Dep't for Children and Families*, No. 2020-055, 2020 Vt. LEXIS 117, 16-17 (2020) ("Ensuring that one state at a time exercises jurisdiction is a crucial part of the UCCJEA's purpose of avoiding contests between states.").



## Self-Executing Modifications of Custody Orders: Are They Legal?

by  
Helen R. Davis<sup>1</sup>

### I. Introduction

This article will explore the legality of what are interchangeably termed “self-executing” or “automatic” modifications of custody orders. Sometimes these orders are referred to as “step-up” parenting plan orders, as well. That is, they are orders entered by the court that modify the custody of, legal decision-making for, and/or parenting time with minor children upon the pre-determined occurrence of some future event. In some states, the answer to the legality question is clear, but in many jurisdictions the state of the law is silent or unsettled and these orders are utilized by courts and litigants quite frequently.

The first part of this article explains what self-executing modification orders are and how they are typically used. The second part of this article discusses the legality of the self-executing orders across the country. A Table<sup>2</sup> is also provided in Appendix A that surveys cases state-by-state and references whether the self-executing orders are permissible, not permissible, or whether legality is unknown or questionable. The third part of this article considers the legality of self-executing orders on a *pendente lite* or temporary orders basis. Finally, this article in part four addresses the legality of the self-executing orders where stipulated to by the parents.

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<sup>2</sup> Every effort has been made to identify applicable cases across the United States. It is possible, however, that other cases exist that were not discovered because they do not necessarily use the terminology relied on by the author, *i.e.*, “self-executing,” “automatic modification,” or “step-up plans.”

## II. What Is a Self-Executing Modification Order?

Self-executing orders for purposes of this article are orders entered by a court that modify custody, legal decision-making, or parenting time upon the occurrence of a pre-determined future event.<sup>3</sup> For example, one parent seeks to relocate with the child and the other parent objects.<sup>4</sup> The parents proceed to evidentiary hearing, after which the court denies the petition to relocate the child. In rendering its orders, the trial court includes a provision that automatically modifies the child's primary residence or the parenting schedule or decision-making if the move occurs. The order may say that the child will primarily reside with the mother, but if the mother moves from Jersey City to New York City, the child will primarily reside with the father.

Another example might involve a parent with substance abuse issues.<sup>5</sup> One parent may approach the court for a modification due to the potential or real harm to the child resulting from the other parent's alcohol or drug use. In deciding the case, the court may remove the child from the substance using parent until the parent engages in some type of testing protocol, success-

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<sup>3</sup> The Iowa Supreme Court analyzed the meaning of "self-executing orders" for purpose of a supersedeas stay in *Scheffers v. Scheffers*, 44 N.W.2d 676 (Iowa 1950). The issue was whether an ordered transfer of custody of the child in that case from one parent to the other was a self-executing order. *Id.* at 679. In answering the question, the court observed that "A self-executing order has been defined by this court as one which requires 'no act of a ministerial or other officer to put it into effect.'" *Id.* Moreover:

a self-executing order presupposes that no act of the defeated party is required in order to render its fruits available to the successful party. A self-executing order is ordinarily one which is injunctive and prohibitive, or one which fixes the status of a party, as in an action of divorce, or in an action to test the right to office, or one which adjudicates the title to property, and especially where a title is quieted in a party in possession. An order which in its nature and its terms is mandatory upon the defeated party, requiring him to perform an affirmative act, is not a self-executing order, for the simple reason that it is not executed at all while the defeated party refuses to perform. In such a case compulsory process is available to enforce performance. This is just what the contempt proceeding was. If the order had been self-executing, there would have been no need of compulsory process.

*Id.*

<sup>4</sup> See, e.g., *Bojrab v. Bojrab*, 810 N.E.2d 1008 (Ind. 2004).

<sup>5</sup> See, e.g., *Hughes v. Binney*, 285 So. 3d 996 (Fla. Dist. App. Ct. 2019).

fully completes a treatment program, and/or maintains sobriety for some specified period of time. As part of the orders, the court indicates that custody will change upon the achievement of certain milestones automatically and without further hearing. The same type of order can be used in domestic violence cases. For example, a court might impose supervised parenting time until completion of a treatment program, at which point unsupervised parenting time automatically resumes.<sup>6</sup>

Many orders that are self-executing and include step-up parenting time plans are put into place for temporary order purposes or are agreed upon by the parents. Because these orders are temporary and/or stipulated, it is not unusual that appellate decisions discussing the legality of the orders are rare.<sup>7</sup> The step-up parenting time plans are also attractive to parents of very young children because the child's needs and development change so quickly. These plans are also heavily used when an absent parent re-enters the child's life.

### III. The Legality of Self-Executing Orders

It is universal that courts entering orders that impact a child are guided by the best interests of the child standard. In fact, the best interests of the child is said to be the “polestar” and “paramount” consideration when courts are considering parenting orders.<sup>8</sup> When a court enters a self-executing or automatic modification order, the issue of legality focuses on whether the

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<sup>6</sup> See, e.g., *Parks v. Parks*, 214 P.3d 295 (Alaska 2009).

<sup>7</sup> But see *Acre v. Tullis*, 520 S.W.3d 316 (Ark. Ct. App. 2017).

<sup>8</sup> See, e.g., *Ballard v. Ballard*, 289 So.3d 725, 732 ¶ 24 (Miss. 2019) (“In child custody cases, the polestar consideration is the best interest of the child, and this must always be kept paramount.”); *Bastian v. Bastian*, 160 N.E.2d 133, 136 (Ohio Ct. App. 1959) (“The pole star in all custody matters between parents is, what is for the best interests of the child whose custody it is sought to change . . . .”); *Cramer v. Zgela*, 969 A.2d 621, 625 ¶ 6 (Pa. 2009) (“the polestar and paramount concern in evaluating parenting visitation . . . is the best interests and welfare of the children.”); *Bah v. Bah*, 668 S.W.2d 663, 665 (Tenn. Ct. App. 1983) (“We are in agreement that the child's best interest is the paramount consideration. It is the polestar, the *alpha* and *omega*.”) (emphasis in original).

court can determine today what will be in the best interests of a child in the future.<sup>9</sup>

It is interesting to consider this issue because self-executing orders, automatic modifications, and step-up parenting plans are very common; yet, the illegality of the orders is settled in only fifteen states.<sup>10</sup> In five states the illegality can be presumed, but must be qualified because the cases found are not published.<sup>11</sup> In three states, the outcome is unclear because, in two of the three states, the orders existed but were not analyzed in terms of their legality.<sup>12</sup> In two states it appears courts will find the orders legal depending on the terms of the order.<sup>13</sup> Only one state unequivocally finds automatic modifications permissible.<sup>14</sup> Finally, in Minnesota, three cases exist: one is published and two are not published; however, the published case and one of the unpublished cases reversed without analysis. The other unpublished case maintained fairly bizarre orders that sustained a self-executing modification. In twenty-three states, no law was found.<sup>15</sup>

#### *A. Self-Executing Orders Are Illegal in the Majority of Reported Decisions*

Based on the cases found while surveying the fifty states, the majority of states that have actually addressed the issue directly hold that self-executing orders are not legal. The Alabama Court of Appeals considered a case in which the trial court imposed an equal parenting time schedule for the older child, but ordered a more abbreviated schedule for the younger child.<sup>16</sup> When the younger child turned one year old, however, the parenting sched-

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<sup>9</sup> See, e.g., *Koskela v. Koskela*, Nos. 2011-CA-000543-ME, 2011-CA-000544-ME, 2012 WL 601218 (Ky. Ct. App. Feb. 24, 2012).

<sup>10</sup> Alabama, Alaska, Arkansas, California, Colorado, Florida, Illinois, Indiana, Louisiana, New York, North Dakota, Pennsylvania, Vermont, Washington, and Wyoming.

<sup>11</sup> Delaware, Iowa, Kentucky, New Jersey, and Virginia.

<sup>12</sup> Maryland and Utah.

<sup>13</sup> Georgia and Missouri.

<sup>14</sup> Hawaii.

<sup>15</sup> Arizona, Connecticut, Idaho, Kansas, Maine, Massachusetts, Michigan, Mississippi, Montana, Nebraska, Nevada, New Hampshire, North Carolina, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Wisconsin, and West Virginia.

<sup>16</sup> *Cleveland v. Cleveland*, 18 So. 3d 950, 952 (Ala. Civ. App. 2009).

ule automatically changed to place that child on the equal schedule.<sup>17</sup> On appeal, the order was reversed because:

Alabama law forbids automatic modification clauses that change physical custody of a child based on future contingencies. Once a trial court awards physical custody of a child to one parent, the trial court may change that award based only on proof that, due to a material change of circumstances, the change would materially promote the best interests of the child and would more than offset the inherent disruption in the life of the child. A provision automatically changing custody of the child based on some future event improperly relieves the noncustodial parent of his or her burden of satisfying the *McLendon* standard and can only be “premised on a mere speculation of what the best interests of the children may be at a future date.”<sup>18</sup>

Likewise, Alaska considered an automatic future modification from supervised parenting time to unsupervised parenting time after the father completed a domestic violence program.<sup>19</sup> That appellate court decided that the future change was not in the child’s best interest and shifted the burden of proving compliance from the mother to the father.<sup>20</sup>

The California courts rejected a self-executing provision that imposed a step-up parenting plan conditioned on the father’s completion of therapy.<sup>21</sup> The reversal was conditional until the father actually rebutted the presumption against joint custody with evidence, which had not been received by the court.<sup>22</sup> The trial court could not enter those orders, even where delayed, without proof the condition had been met.<sup>23</sup> In the second case, the court of appeals considered the enforcement of a statute that automatically reinstated parenting time to deployed military parents.<sup>24</sup> Notably, the statute “establishes a presumption that a servicemember returning from military service should regain his or her predeployment custody of a child, unless the court determines it is not in the child’s best interest.”<sup>25</sup> The father argued

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<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> Parks, 214 P.3d at 295 .

<sup>20</sup> *Id.*

<sup>21</sup> Jason P. v. Danielle S., 215 Cal. Rptr. 3d 542 (Cal. Ct. App. 2017).

<sup>22</sup> *Id.* at 570.

<sup>23</sup> *Id.*

<sup>24</sup> *In re Marriage of E.U. & J.E.*, 152 Cal. Rptr. 3d 58 (Cal. Ct. App. 2012).

<sup>25</sup> *Id.* at 60.

the “reinstatement directive is self-executing.”<sup>26</sup> The court agreed the directive was “unconditional,” but stated it was “loath to consider a previously issued court order to be wholly self-executing as to future custody changes. In our view, when a court is asked to enforce such an order, it should conduct a *limited* inquiry into the child’s best interests.”<sup>27</sup>

In Colorado, a case addressed the issue in a footnote that says a “[c]hange of custody may only be ordered based on circumstances existing at the time the change is being contemplated. An automatic order of modification in the future is thus inappropriate. A court cannot determine what will be in the child’s best interests in the future.”<sup>28</sup>

Florida also reversed a trial court’s imposition of an automatic reversion to equal parenting time if the father achieved certain milestones related to opioid addiction recovery.<sup>29</sup> In doing so, the court of appeals held that parenting time:

may not be modified without a showing of a substantial, material, and unanticipated change in circumstances and a determination that the modification is in the best interests of the child. Determining what

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<sup>26</sup> *Id.* at 70.

<sup>27</sup> *Id.* (emphasis in original). The author did not research the statutes of every state for purposes of this article. The military reinstatement statute is, however, not novel to California. *See, e.g.*, Arizona statute ARIZ. REV. STAT. § 25-411. That said, none of the cases found while conducting the research for this article referenced any statute other than the California case, *E.U. & J.E.*, 152 Cal. Rptr. 3d 58, referenced herein. The unreported Kentucky case, *Koskela*, refers to a parental agreement to modify on the father’s return from deployment. The Uniform Law Commission (ULC), in 2012, adopted the Uniform Deployed Parents Custody and Visitation Act, which has been adopted by 10 states. Mark Sullivan, *The Uniform Deployed Parents Custody and Visitation Act*, FAM. LAW. MAG., Mar. 17, 2020, <https://familylawyermagazine.com/articles/uniform-deployed-parent-custody-visitation-act/>. According to Mr. Sullivan, ten states had adopted the Act as of March 2020. Neither the referenced Arizona statute, nor the California statute, are based on adoption of the Act, but some states have passed legislation similar to the Act, which bundles what the Uniform Law Commission deemed to be the best provisions from various state laws to uniformly address issues such as jurisdiction. *Id.* As seen in California, however, even a provision that provides for automatic presumptions is subject to review at the time of the event.

<sup>28</sup> *In re Marriage of Francis*, 919 P.2d 776, 786 n.13 (Colo. 1996), *citing* Missouri case *Koenig v. Koenig*, 782 S.W.2d 86, 90 (Mo. Ct. App. 1989).

<sup>29</sup> *Hughes*, 285 So. 3d at 998, *citing* *Arthur v. Arthur*, 54 So. 3d 454 (Fla. 2010).

course of action is in the best interests of the child requires a court to evaluate “all of the factors affecting the welfare and interests of the particular minor child and the circumstances of” the family. Trial courts may not engage in a “prospective-based analysis” when modifying a time-sharing schedule that attempts to anticipate what the future best interests of a child will be.<sup>30</sup>

The Illinois Court of Appeals reversed a trial court’s order that made the award of custody to the mother contingent on her residence in one of two counties.<sup>31</sup> The court specifically rejected the order because it automatically modified custody rather than assessing the child’s best interests when the situation came to pass.<sup>32</sup> The court of appeals considered such an order arbitrary.<sup>33</sup>

Indiana agrees that an automatic modification on a parent’s relocation is not appropriate.<sup>34</sup> In reversing the trial court, the appellate court confirmed “that a trial court may not prospectively order an automatic change of custody in the event of any significant future relocation by the wife.”<sup>35</sup> However, the court interpreted the subject order as providing the father with the basis to seek modification if the “custody order is undermined” by a relocation by the mother.<sup>36</sup>

The Louisiana Court of Appeals considered a case with somewhat different facts relied on to render an automatic change of custody.<sup>37</sup> In that case, the original custody orders contained a provision prohibiting a particular woman from associating with the minor children.<sup>38</sup> In a subsequent modification proceeding the father asserted that the mother had violated that provision.<sup>39</sup> When the trial court entered its orders, it maintained custody with the mother, but imposed an automatic reversal of custody should the mother again violate the no-contact prohibition.<sup>40</sup>

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<sup>30</sup> *Id.*

<sup>31</sup> *In re Marriage of Seitzinger*, 775 N.E.2d 282, 289 (Ill. App. Ct. 2002).

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 288.

<sup>34</sup> *Bojrab*, 810 N.E.2d at 1012.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Cook v. Cook*, 902 So. 2d 981 (La. Ct. App. 2006).

<sup>38</sup> *Id.* at 982.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.* at 983.

The court of appeals, however, reversed, instructing that the trial courts maintain continuing jurisdiction and are not bound by orders over time where they are not in the children's best interest.<sup>41</sup> An "automatic non-judicial change" to a custody order is not permissible.<sup>42</sup>

North Dakota reversed an automatic modification based on relocation that occurred "without analysis under the best-interest factors at the time of (the parent's) possible relocation. The court's provisions essentially seek to control a future determination on primary residential responsibility, regardless of when (the parent's) 'imminent' relocation to Grand Forks would occur."<sup>43</sup>

Pennsylvania reversed an order that provided for automatic change of custody on further denial of visitation to the other parent.<sup>44</sup> The court indicated it was not clear that the provision was intended to be self-effectuating without a hearing, but "the threat implicit therein should be removed from the order. In this way, the regularity of future proceedings will best be preserved."<sup>45</sup>

Vermont's Supreme Court reversed a trial court order that automatically shifted custody at a date in the future when the child started kindergarten.<sup>46</sup> In doing so, the court held that such provisions are contrary to Vermont law and the public policy on which custody statutes are based.<sup>47</sup> The court went on to instruct that a modification of custody must be based on the best interest of the child assessed at the time of the change.<sup>48</sup> Moreover, the court expressed concern that an automatic modification could create instability for the child, whether the change event is anticipated or not.<sup>49</sup>

Washington and Wyoming also disapprove of automatic modification orders. Washington held that an automatic modification triggered by a parent's move was impermissible without the filing of a modification petition.<sup>50</sup> The Wyoming Supreme

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<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Woelfel v. Gifford*, 948 N.W.2d 814, 817 ¶ 15 (N.D. 2020).

<sup>44</sup> *Rosenberg v. Rosenberg*, 504 A.2d 350 (Pa. Super. Ct. 1986).

<sup>45</sup> *Id.* at 353.

<sup>46</sup> *Knutsen v. Cegalis*, 989 A.2d 1010, 1013 (Vt. 2008).

<sup>47</sup> *Id.* at 1013 ¶ 7.

<sup>48</sup> *Id.* at ¶ 8.

<sup>49</sup> *Id.* at 101 ¶ 12.

<sup>50</sup> *In re Marriage of Christel*, 1 P.3d 600 (Wash. Ct. App. 2000).

Court invalidated what it referred to as an “anticipatory conclusion” that a parent’s relocation would be harmful to the child’s best interests.<sup>51</sup>

Based on the referenced reported decisions, courts fairly uniformly decide that a trial court cannot anticipate what the child’s best interests will be at some future time resulting from even an anticipated event. Most of the cases dealt with relocation provisions in which the trial courts appeared to be imposing a harsh consequence to influence a parent not to leave the state or locale. None of these reasons, however, were thought adequate to supplant the court’s duty to examine the facts at the time of the event to ensure the child’s best interests were adequately evaluated.

#### B. *Illegality May Be Presumed in Many States*

It is possible to presume that self-executing orders are illegal in a number of states, but that conclusion is not definitive because the cases are not published. In Iowa, Kentucky, and New Jersey, the courts reached similar results relying on the same basic reasoning: the events that triggered the automatic modification (relocation in two cases and military deployment in the third), replace the court’s analysis of the child’s best interests at the time of modification, which essentially results in creating a dispositive result.<sup>52</sup> As the New Jersey court pointed out, a hearing is necessary.<sup>53</sup>

In Delaware, an unpublished disposition exists that very briefly discusses a trial court order that conditioned placement of primary residence with the mother on her residence remaining in Delaware.<sup>54</sup> The higher court affirmed placement of the child with the mother, but rejected the condition that was outside the current circumstances.<sup>55</sup>

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<sup>51</sup> Bruegman v. Bruegman, 417 P.3d 157, 168 (Wyo. 2018).

<sup>52</sup> Hoffman v. Muff, 791 N.W.2d 430 (Iowa Ct. App. 2010); Koskela v. Koskela, Nos. 2011–CA–000543–ME, 2011–CA–000544–ME, 2012 WL 601218 (Ky. Ct. App. Feb. 24, 2012); K.F. v. N.V., No. A-1742-19, 2021 WL 772880 (N.J. Super. Ct. App. Mar. 1, 2021).

<sup>53</sup> K.F., 2021 WL 772880, at 12.

<sup>54</sup> Anderson v. Anderson, No. 513, 1998 WL 309848 (Del. May 28, 1998).

<sup>55</sup> *Id.* at 1.

While these decisions do not create precedent, they are similar in factual circumstances and legal reasoning to the majority of states that hold automatic modifications are illegal. It is reasonable to assume, therefore, that self-executing modifications are, likewise, not enforceable in these states.

*C. Georgia, Missouri and Minnesota May Allow Self-Executing Orders*

Georgia is probably the most prolific state in terms of the published law on this issue. In what is likely the seminal case in that state, the Georgia Supreme Court struck down an automatic change of custody provision based on a parent's relocation.<sup>56</sup> In that case, the court reflected that "children are not immutable objects but living beings who mature and develop in unforeseeable directions" and, thus, the award of custody at one point is not necessarily in the best interests of the child at another point in time.<sup>57</sup> Importantly, the child's best interests control modifications of custody.<sup>58</sup>

The court referenced automatic changes of custody provisions as "draconian" and reflected that the provisions apply automatically to uproot the children despite their current circumstances.<sup>59</sup> The court stated that the purpose of such provisions "is to provide a speedy and convenient short-cut for the non-custodial parent to obtain custody of a child by bypassing the objective judicial scrutiny into the child's best interests that a modification action . . . requires."<sup>60</sup> However, if that were allowed, it would be accomplished to the detriment of the child.<sup>61</sup> Importantly, "[n]either the convenience of the parents nor the clogged calendars of the courts can justify automatically uprooting a child from his or her home absent evidence that the change is in the child's best interests. The paramount concern in any change of custody must be the best interests of the minor child."<sup>62</sup>

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<sup>56</sup> *Scott v. Scott*, 578 S.E.2d 876 (Ga. 2003).

<sup>57</sup> *Id.* at 878.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.* at 879.

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.* at 880 (emphasis in original).

A later Georgia Supreme Court decision considered a self-executing visitation provision that set out two parenting plans: one that contemplated equal time and one that automatically went into effect if the mother moved more than thirty-five miles away from the existing county.<sup>63</sup> That court cited favorably to *Scott* and held that self-executing material changes in visitation violate this State's public policy founded on the best interests of a child unless there is evidence before the court that one or both parties have committed to a given course of action that will be implemented at a given time; the court has heard evidence how that course of action will impact upon the best interests of the child or children involved; and the provision is carefully crafted to address the effects on the offspring of that given course of action. Such provisions should be the exception, not the rule, and should be narrowly drafted to ensure that they will not impact adversely upon any child's best interests.<sup>64</sup> The court went on to invalidate the provision at issue in that case.<sup>65</sup>

A more recent Georgia Court of Appeals case affirmed an automatic modification provision despite the existence of *Scott* and *Dellinger*.<sup>66</sup> That said, an even later and almost contemporaneous decision followed the holding in *Scott*.<sup>67</sup> Both cases bear further discussion to understand Georgia's perspective on the subject issue.

*Durden* concerned an admittedly "self-executing automatic future modification" provision.<sup>68</sup> Specifically, the order implemented an automatic modification that *reduced* the father's parenting time when the child entered school.<sup>69</sup> The *Durden* court held that such a provision "may be permissible if the provision gives paramount importance to the child's best interests," citing *Scott*.<sup>70</sup> The court then found that this provision was acceptable because "it is not an open-ended provision conditioned upon the occurrence of some future event that may never take

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<sup>63</sup> *Dellinger v. Dellinger*, 609 S.E.2d 331, 332 (Ga. 2004).

<sup>64</sup> *Id.* at 333.

<sup>65</sup> *Id.*

<sup>66</sup> *Durden v. Anderson*, 790 S.E.2d 818 (Ga. Ct. App. 2016).

<sup>67</sup> *Hardin v. Hardin*, 790 S.E.2d 546 (Ga. Ct. App. 2016).

<sup>68</sup> *Durden*, 790 S.E.2d at 819.

<sup>69</sup> *Id.* at 820.

<sup>70</sup> *Id.* at 820-21.

place; rather, it is a custody change coinciding with a planned event that will occur at a readily identifiable time.”<sup>71</sup>

The court in *Hardin* addressed a trial court order that permitted the mother to restart visitation at a therapist’s office.<sup>72</sup> In that case the court considered the report of a custody evaluator who identified concerns about the mother’s mental health.<sup>73</sup> After hearing, and despite no evidence in the record of the mother’s improved condition, the trial court entered an order allowing the mother to automatically begin visitation at the therapist’s office if she first completed eight sessions with her own therapist over two months.<sup>74</sup> The trial court’s order gave detailed instructions to the therapist, who also was tasked by the court with making further treatment recommendations, and continued until the child reached the age of majority.<sup>75</sup> The trial court based its orders on its belief that the therapeutic involvement would repair the relationship, and that doing so was best for the child.<sup>76</sup> The Georgia Court of Appeals disagreed and determined that the order was “impermissibly self-executing.”<sup>77</sup> The *Hardin* court noted that Georgia does not forbid all self-executing orders; however, a trial court holds the authority to determine if evidence exists that supports a modification or termination of visitation, which responsibility cannot be allocated to a third party, no matter how knowledgeable that person may be.<sup>78</sup> The court also observed that impermissible orders contain two flaws – the order relies on a third party’s expertise or direction, thereby delegating the court’s authority; and the timing at which the provision goes into place is not certain.<sup>79</sup> Importantly, the court stated:

This is troubling for precisely the reason the father argues in his appeal – the mother may not actually have made ‘progress’ in her therapy in the sense that the trial court intended, or she may not be complying with the counselor’s additional treatment recommendations

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<sup>71</sup> *Id.* at 821.

<sup>72</sup> *Hardin*, 790 S.E.2d at 547.

<sup>73</sup> *Id.*

<sup>74</sup> *Id.* at 548.

<sup>75</sup> *Id.* (quotations omitted).

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> *Id.* at 549.

<sup>79</sup> *Id.*

or the rest of the court's order. . . . This makes the event triggering the automatic change in visitation arbitrary, with 'only a tangential connection' to the child's best interests. Thus, the order lacks 'the flexibility needed to adapt to the unique variables that must be assessed in order to determine what serves the best interests and welfare of a child.'<sup>80</sup>

In Missouri, self-executing orders are referred to as "conditional judgments" that depend "upon the performance of future acts by a litigant"; and are void.<sup>81</sup> Two cases decided in 1991 and 1983 refused to enforce automatic changes of custody on relocation.<sup>82</sup> However, a more recent 2009 case affirmed an order that changed parenting time when the child started kindergarten, reasoning that "the enforcement of the trial court's judgment is not dependent upon future acts by the parties, but is, instead, based upon the known need of the child to have a predictable and stable custody arrangement, particularly when school begins."<sup>83</sup> The court said the order was not speculative and "it makes little sense to force the parties back into court thirteen months later under these circumstances."<sup>84</sup>

The state of the law in Minnesota is unclear. In a reported Minnesota appellate court decision, the court considered an order that shifted custody between the parents every six months, which arrangement was reversed without analysis related to automatic or self-effectuating modifications.<sup>85</sup> That said, it would seem rational to categorize such an order as imposing successive automatic modifications and, indeed, in a later unpublished case a father made that argument.<sup>86</sup> Notably, in *In re Marriage of Henderson*, the trial court ordered that parenting time to the mother would resume if she was released from prison while the children were minors.<sup>87</sup> The father argued this was an impermissible automatic modification prohibited by *In re Marriage of*

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<sup>80</sup> *Id.* at 549-50 (emphasis in original).

<sup>81</sup> *Burch v. Burch*, 805 S.W.2d 341, 343 (Mo. Ct. App. 1991).

<sup>82</sup> *Id.*; *In re Marriage of Dusing*, 654 S.W.2d 938 (Mo. Ct. App. 1983).

<sup>83</sup> *Pijanowski v. Pijanowski*, 272 S.W.3d 321, 327 (Mo. Ct. App. 2009).

<sup>84</sup> *Id.*

<sup>85</sup> *Wopata v. Wopata*, 498 N.W.2d 478 (Minn. Ct. App. 1993).

<sup>86</sup> *In re Marriage of Henderson*, No. A05-1696, 2006 WL 1891182 at 1 (Minn. Ct. App. July 11, 2006).

<sup>87</sup> *Id.*

*Wopata*.<sup>88</sup> The court of appeals disagreed with the father, distinguished *Wopata*, and affirmed the trial court.<sup>89</sup> The court rationalized its decision by reflecting that the mother was unlikely to be released from prison during the children's minority.<sup>90</sup> In another questionable twist, the court also affirmed a time sharing arrangement that placed the children in the care of the incarcerated mother's husband despite no procedural request from the step-parent seeking that order.<sup>91</sup>

Finally, a third Minnesota case decided after *Henderson* reversed an automatic modification order based on an evaluator's recommendation that the parenting schedule increase in three steps at certain ages.<sup>92</sup> The court of appeals reversed the automatic modification, but did so based on the lack of findings and without analysis of the legality of self-executing modifications.<sup>93</sup>

It appears that both Georgia and Missouri have moved toward approval of a self-executing order where the modification is based on a known event and date. That said, these cases do not resolve how a trial court can know what will be in the best interest of a child at a future date despite that a modification event is predictable (e.g., entering school at a certain date). As for Minnesota, the facts of *Henderson* are so unusual that it is not possible to rely on that unpublished case as giving any assurances for purposes of precedential value, especially where the other two cases, one of which was reported, disallow the automatic modifications.

#### D. *Hawaii Is the Only State that Unequivocally Allows Self-Executing Orders*

Only one case was found that unequivocally holds that an automatic modification provision is legal and where no other cases potentially dilute or make the decision conditional or questionable. The subject case, *Maeda v. Maeda*, was decided by the

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<sup>88</sup> *Id.* at 2.

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

<sup>91</sup> *Id.* at 3.

<sup>92</sup> *Wilson v. Wilson*, No. A09-1386, 2010 WL 2362749 (Minn. Ct. App. June 15, 2010).

<sup>93</sup> *Id.* at 2.

Hawaii Court of Appeals.<sup>94</sup> In *Maeda*, the parents were litigating custody of their children in tandem with the mother's potential desire to relocate away from Hilo, Hawaii to the mainland.<sup>95</sup> The trial court awarded the mother sole legal and physical custody and afforded visitation rights to the father.<sup>96</sup> That said, the trial court made the award to the mother conditional on remaining in Hawaii.<sup>97</sup> If the mother relocated to the mainland, the custody and visitation orders essentially reversed in favor of the father.<sup>98</sup> The court of appeals affirmed this result in a way that is interesting. The court said that the trial court's order was based on the child's best interests, but no evidence existed as to whether *a move in the future* would be in the child's best interests.<sup>99</sup> The court, thus, looked at the issue in the exact way other courts look at the issue, but came to the opposite result. That is, the automatic modification was in the child's best interests because it did not have evidence of the future best interests as opposed to the reasoning that no automatic modification can be had because no evidence of best interests existed at the time the ruling was made.

#### E. *Should States Allow Self-Executing Orders?*

No cases were located in twenty-three states that in any way address self-executing orders. In at least one state, Arizona, the courts are imposing such orders routinely. The question, thus, is whether those states, once presented with the issue, should allow self-executing orders. The answer should be a resounding "no." The vast majority of states that have actually analyzed the issue hold that self-executing orders are not legal. The major reason for that result is founded on the perceived inability of the trial court to predict with any reliability what will be in the best interest of a child in the future. Two courts (Georgia and Missouri) have departed from the mainstream to distinguish a future modification based on a knowable event as allowable despite other decisions, even of higher courts in the case of Georgia, which

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<sup>94</sup> 794 P.2d 268 (Hawaii Ct. App. 1990).

<sup>95</sup> *Id.* at 269.

<sup>96</sup> *Id.*

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* at 270.

overturned such orders. Those cases are in the distinct minority, however.

Judicial officers probably do not want to be told that self-executing orders are illegal. Many reasons for this attitude might exist, including that the orders are convenient and can reduce the need for future hearings and litigation. That reality was candidly addressed by the Georgia Supreme Court as discussed above; however, it is simply not permissible to sacrifice the child's best interests for the convenience of the parents or the courts

#### **IV. Are Stipulated Self-Executing Orders Legal?**

It is likely that many litigants enter into self-executing modification orders frequently, but the very nature of these stipulated orders defies locating a reported decision. When folks agree, they tend not to appeal. That said, reaching agreements at one point does not mean that litigation will not take place in the future. Five cases did not address the entry of self-executing orders in the first instance, but, indeed, were at issue in later litigation. In *Acre v. Tullis*, the parents entered into an agreed order that alternated the primary residential parent status between the parents in the school year and summer when the child entered kindergarten.<sup>100</sup> When the mother then wanted to relocate from Arkansas to Mississippi, the court declined to enforce the parties' agreement, and allowed the relocation.<sup>101</sup> The father appealed. The court of appeals affirmed the trial court because "the parties cannot enter into a contract with regard to custody that seeks to avoid the provisions of (Arkansas case law) which created the presumption in favor of relocation by a custodial parent."<sup>102</sup>

Another case, *Finnerty v. Finnerty*, is similar in result to the Arkansas case, albeit unpublished.<sup>103</sup> In that case, the court rejected the parents' agreement to an automatic loss of custody if that parent later raised the children observant to a religion other than Roman Catholicism.<sup>104</sup> The court held that such a contractual provision cannot be embodied as a nearly self-executing,

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<sup>100</sup> *Acre v. Tullis*, 520 S.W.3d 316, 318 (Ark. Ct. App. 2017).

<sup>101</sup> *Id.* at 320.

<sup>102</sup> *Id.*

<sup>103</sup> *Finnerty v. Finnerty*, 22 Va. Cir. 523 (Va. Cir. 1982).

<sup>104</sup> *Id.* at 528-29.

custody-terminating decree provision. To do so would create not only an auto-da-fe against the non-complying parent but also a means of immolation of the court's own necessary continuing control over child custody and an instrument to destroy basic civil tenets on that subject.<sup>105</sup>

While the Arkansas court did not expressly comment on the legality of the automatic modification orders themselves, the reference to the parents' inability to enter into a binding contract around custody issues is illustrative. Likewise, the Virginia court focused on the inability to usurp the court's control over custody decisions, but also disapproved of the self-executing nature of the provision. Of course, in many if not most states, decisions about the best interests of a child are within the sole purview of the court and that authority cannot be delegated to others.<sup>106</sup> Parents do, of course, settle their custody matters, but the settlement is subject to adoption by the court. In the Arkansas case, the parents had an agreement that was part of earlier orders, but, as seen in this case, the prior adoption of that order by the court did not guarantee enforcement later. Thus, if parents agree to step-up plans or automatic modification provisions, they do so at their own risk.

In a third case, the parents agreed to orders that imposed a "penalty for any violation by the mother would be the transfer of physical custody to the father."<sup>107</sup> After violation by the mother, the court entered a temporary order transferring custody to the father and then held a final hearing after which the father was granted sole legal and physical custody.<sup>108</sup> The court of appeals affirmed, but did so only after recognizing that "a best interests analysis is required even where, as here, the parties agreed to automatic change in custody 'upon one's failure to satisfy a condition or the happening of a specified event.'"<sup>109</sup> Thus, while the end result was consistent with the parents' agreement, the court

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<sup>105</sup> *Id.* at 529.

<sup>106</sup> *Id.*; *see, e.g.*, *Nold v. Nold*, 304 P.3d 1093, 1097 ¶ 14 (Ariz. Ct. App. 2019); *Kyle S. v. Jayne K.*, 190 A.3d 68, 81 (Conn. App. Ct. 2018); *Meyr v. Meyr*, 7 A.3d 125 (Md. Ct. Spec. App. 2011); *Matter of Acosta v. Melendez*, 118 N.Y.S.3d 730, 733 (N.Y. Ct. App. 2020).

<sup>107</sup> *Zwack v. Kosier*, 61 A.D.3d 1020, 1021 (N.Y. Ct. App. 2009).

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

was nonetheless required to assess whether the orders were in the child's best interests.

Finally, an Ohio trial court enforced the automatic change of custody from the father to the mother based on an agreement by the parents that was incorporated into a prior court order.<sup>110</sup> The court of appeals reversed, not based on an analysis of the automatic modification provision, but because it held that the trial court was not bound by the parties' agreements.<sup>111</sup>

## V. Are Self-Executing *Pendente Lite* Orders Legal?

Not surprisingly, appellate decisions addressing the legality of self-executing orders entered for temporary or *pendente lite* orders purposes are not numerous. Only two cases, *Zwack v. Kosier* and *Acre v. Tullis*, mentioned temporary orders.<sup>112</sup> In *Zwack*, as discussed above, the parents had agreed to an automatic modification penalty, which the trial court enforced as a temporary order before the trial court later maintained the result after a full evidentiary hearing.<sup>113</sup> The result in that case was affirmed, but the appellate decision included a reminder that a full best interests analysis is required despite agreements.<sup>114</sup> The appellate court did not address or criticize the temporary order.<sup>115</sup> In *Acre*, the parents agreed to an alternating custody schedule, which the court enforced on a temporary orders basis.<sup>116</sup> Two years later, the court kept that order in place while allowing the mother to relocate.<sup>117</sup> Again, however, the appellate court did not analyze the temporary order.<sup>118</sup>

As might be inferred from *Zwack* and *Acre*, it is very possible that self-executing orders entered while a divorce case or post-decree modification case is pending before final decree, judgment, or order, are legal. This is because those orders, by

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<sup>110</sup> *Bastian v. Bastian*, 160 N.E.2d 133, 136 (Ohio Ct. App. 1959).

<sup>111</sup> *Id.* at 136-37.

<sup>112</sup> *Zwack*, 61 A.D.3d 1020, 1021; *Acre*, 520 S.W.3d at 316.

<sup>113</sup> *Zwack*, 61 A.D.3d at 1021.

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Acre*, 520 S.W.3d at 318-19.

<sup>117</sup> *Id.* at 319.

<sup>118</sup> *Id.*

their very nature, remain under review by the court. Because the case is not resolved and will be subject to a full analysis by the court at the entry of the final decree, judgment, or order, the court can consider the best interests of the child as the step-up plan, for instance, rolls out. That said, if those orders are adopted wholesale in the final decree, judgment, or order, enforceability and legality is questionable.

## **VI. Conclusion: Self-Executing Orders Should Be Illegal**

Based on a review of the cases, self-executing orders are not a good idea other than, perhaps, on a temporary or *pendente lite* basis. Even if the court accepts a stipulated self-executing order in the first instance, the risk remains that such an order will not be enforced in later litigation. While the orders can reduce ongoing litigation, at least conceptually, they are fundamentally improper where the best interests of the child at the time of the modification is secondary to convenience.

What do litigants or courts do, then, to address issues for which step-up plans or other changes make sense given the facts? For example, a parent may or may not relocate; a parent may or may not stay sober; a parent may or may not control their violent outbursts. These situations are, admittedly, perfect for such orders, which is why the orders likely exist. The best way to ensure legality of the orders is for the court to schedule review processes over time as the modification occurs. While this will, of course, require more court involvement, it also ensures that the child's best interests are paramount.

### Appendix A

#### 50 State Survey of Self-Executing Custody Orders

State	Permissible or No	Rules or Qualifications	Citation
Alabama	No	<p>The court imposed a parenting schedule for an infant that automatically changed to equal visitation on the child's first birthday.</p> <p>“Alabama law forbids automatic modification clauses that change physical custody of a child based on future contingencies. Once a trial court awards physical custody of a child to one parent, the trial court may change that award based only on proof that, due to a material change of circumstances, the change would materially promote the best interests of the child and would more than offset the inherent disruption in the life of the child. A provision automatically changing custody of the child based on some future event improperly relieves</p>	<p><i>Cleveland v. Cleveland</i>, 18 So.3d 950, 952 (Ala. Civ. App. 2009)</p>

State	Permissible or No	Rules or Qualifications	Citation
		the noncustodial parent of his or her burden of satisfying the <i>McLendon</i> standard and can only be “premised on a mere speculation of what the best interests of the children may be at a future date.”	
Alaska	No	“Automatic future change from supervised to unsupervised visitation when husband completed domestic violence program was not in daughter’s best interest.” The court also opined that the trial court’s order shifted the burden of proof from the father to the mother because the father was not required to prove his completion of court-ordered steps. It was, therefore, the mother’s obligation to monitor the father’s compliance.	<i>Parks v. Parks</i> , 214 P.3d 295 (Alaska 2009)
Arizona	Unknown		None found
Arkansas	No	The parents entered into an agreed order that provided that when	<i>Acre v. Tullis</i> , 520 S.W.3d 316 (Ark. Ct. App. 2017)

State	Permissible or No	Rules or Qualifications	Citation
		<p>the child entered kindergarten, the mother would be the primary residential parent and the father would be the same during summer. They also provided for parenting time during weekends. When the mother wanted to relocate to Mississippi, the court declined to enforce the parties' agreement and allowed the relocation. The father appealed. The court of appeals affirmed, because "the parties cannot enter into a contract with regard to custody that seeks to avoid the provisions of (Arkansas case law) which created the presumption in favor of relocation by a custodial parent."</p>	
California	No	<p>In <i>Jason P.</i>, the trial court put a self-executing provision into place that awarded joint legal custody and a step-up parenting plan after the father completed six</p>	<p><i>Jason P. v. Danielle S.</i>, 215 Cal. Rptr. 3d 542 (Cal. Ct. App. 2017)</p> <p><i>In re Marriage of E.U. &amp; J.E.</i>, 152 Cal. Rptr. 3d 58 (Cal. Ct. App. 2012).</p>

State	Permissible or No	Rules or Qualifications	Citation
		<p>months of therapy. The court of appeals conditionally reversed finding that the presumption against joint custody had to be rebutted by evidence and the trial court did not receive evidence that the father had participated in the counseling and, thus, it could not award joint custody to the father, even delayed joint custody. However, because two years had passed, the reversal was conditional so the court could look at whether the counseling had since been completed. If so, the trial court could reinstate the original order. The same argument applied to the step-up parenting plan and the error would be harmless if the father would now have the ability to rebut the presumption.</p> <p>The <i>E.U.</i> case addressed the rein-</p>	

State	Permissible or No	Rules or Qualifications	Citation
		<p>statement statute as applied to deployed military parents. Notably, the statute “establishes a presumption that a service member returning from military service should regain his or her predeployment custody of a child, unless the court determines it is not in the child’s best interest.” The father argued the “reinstatement directive is self-executing.” While the court agreed the directive was “unconditional,” the court stated it was “loath to consider a previously issued court order to be wholly self-executing as to future custody changes. In our view, when a court is asked to enforce such an order, it should conduct a <i>limited</i> inquiry into the child’s best interests.” (Emphasis in original.)</p>	
Colorado	No	This case, in a footnote, says that “Change of custody	<i>In re Marriage of Francis</i> , 919 P.2d 776, 786 n.13 (Co-

State	Permissible or No	Rules or Qualifications	Citation
		may only be ordered based on circumstances existing at the time the change is being contemplated. An automatic modification in the future is thus inappropriate. A court cannot determine what will be in the child's best interests in the future."	lo. 1996), <i>citing</i> Missouri case <i>Koenig v. Koenig</i> , 782 S.W.2d 86, 90 (Mo. Ct. App. 2989)
Connecticut	Unknown		None found
Delaware	Unclear because case unpublished	Reversed conditional award of custody to the mother based on remaining in Delaware.	<i>Anderson v. Anderson</i> , No. 513, 1998 WL 309848 (Del. May 28, 1998).
Florida	No	Reversing the trial court's imposition of an automatic reversion to 50/50 time if the father achieved certain milestones related to addiction recovery.  Parenting time "may not be modified without a showing of a substantial, material, and unanticipated change in circumstances and a determination that the modification is in the best interests	<i>Hughes v. Binney</i> , 285 So. 3d 996, 998 (Fla. Dist. Ct. App. 2019), <i>citing</i> <i>Arthur v. Arthur</i> , 54 So.3d 454 (Fla. 2010).

State	Permissible or No	Rules or Qualifications	Citation
		of the child. Determining what course of action is in the best interests of the child requires a court to evaluate all of the factors affecting the welfare and interests of the particular minor child and the circumstances of the family. Trial courts may not engage in a prospective-based analysis when modifying a time-sharing schedule that attempts to anticipate what the future best interests of a child will be.”	
Georgia	It depends	<p>Scott struck down an automatic modification where best interests could not be determined as to the future.</p> <p><i>Dellinger</i> held that self-executing modification provisions (here upon relocation) were contrary to public policy, citing <i>Scott</i>.</p> <p><i>Durden</i>, however, affirmed an automatic modification provision that re-</p>	<p><i>Scott v. Scott</i>, 576 S.E.2d 876 (Ga. 2003); <i>Dellinger v. Dellinger</i>, 609 S.E.2d 331 (Ga. Ct. 2004); <i>Durden v. Anderson</i>, 790 S.E.2d 818 (Ga. App. 2016); <i>Hardin v. Hardin</i>, 790 S.E.2d 546 (Ga. Ct. App. 2016)</p>

State	Permissible or No	Rules or Qualifications	Citation
		<p>duced a father's parenting time when the child started school. Durden said such a provision can be enforceable of it "gives paramount importance to the child's best interests." The provision here was acceptable because "it is not an open-ended provision conditioned upon the occurrence of some future event that may never take place; rather it is a custody change coinciding with a planned event that will occur at a readily identifiable time."</p> <p><i>Hardin</i>, which was decided almost contemporaneously with <i>Durden</i>, addressed a situation where a motion was allowed to resume parenting time through weekly therapy sessions after she completed a certain number of sessions of therapy herself. <i>Hardin</i> determined that</p>	

State	Permissible or No	Rules or Qualifications	Citation
		<p>this was an impermissible order, but also said that Georgia does not forbid all self-executing orders. “[I]t is the trial court’s responsibility to determine whether the evidence is such that a modification or suspension of custody/visitation privileges is warranted, and the responsibility for making that decision cannot be delegated to another.” The <i>Hardin</i> order contained two flaws: the court delegated its authority to another and the timing of the change was uncertain.</p>	
Hawaii	Yes	<p>The trial court order awarded the mother sole legal and physical custody with visitation rights to the father; however, that was award automatically shifted to the father if the mother decided to move to the mainland.</p> <p>The appellate court affirmed that order</p>	<p><i>Maeda v. Maeda</i>, 794 P.2d 268 (Hawaii Ct. App. 1990)</p>

State	Permissible or No	Rules or Qualifications	Citation
		on the basis that the trial court made its decision in the child's best interests and no evidence existed to know if moving would be in the child's best interests.	
Idaho	Unknown	Trial court entered an order that automatically transferred custody of the children to father if mother relocated. The mother challenged the order on the basis that the court's decision was erroneous, but not because of the automatic modification. The court of appeals affirmed, finding that the court's decision was not a change of custody, but a decision about the city in which the children would reside. Custody was secondary. There was discussion of whether the automatic modification provision was had by the court.	<i>Roberts v. Roberts</i> , 64 P.3d 327, 330 (Id. 2003).

State	Permissible or No	Rules or Qualifications	Citation
Illinois	No	The court's conditioning retention of sole custody on the mother's remaining in a certain county was impermissible.	<i>In re Marriage of Seitzinger</i> , 775 N.E.2d 282 (Ill. Ct. App. 2002)
Indiana	No	Reversing the court imposed automatic modification if a parent relocated.  The court confirmed "that a trial court may not prospectively order an automatic change of custody in the event of any significant future relocation by the wife." But then the court interpreted the subject order as providing the father with the basis to seek modification if the "custody order is undermined" by a relocation by the mother.	<i>Bojrab v. Bojrab</i> , 810 N.E.2d 1008, 1012 (Ind. 2004)
Iowa	Qualified No (Qualified because the case is unpublished.)	Striking from the decree automatic modification if a parent relocates.  Self-executing provisions "abrogate a contextualized analysis of facts pertinent to the physical care determination and	<i>Hoffman v. Muff</i> , 791 N.W.2d 430 (Iowa Ct. App. 2010) -- <b>UN-PUBLISHED</b>

State	Permissible or No	Rules or Qualifications	Citation
		impermissibly elevated the parties' locations on a future date to the sole dispositive factor."	
Kansas	Unknown		None found
Kentucky	Qualified No (Qualified because the case is not published.)	Reversing an automatic modification on the deployment of a parent.  Automatic modification of parenting time "upon the occurrence of a single event . . . , at an indeterminate future date, without considering (because it is impossible to do so) the best interest of the children <i>at that time</i> " is impermissible.	<i>Koskela v. Koskela</i> , Nos. 2011-CA-000543-ME, 2011-CA-000544-ME, 2012 WL 601218 (Ky. Ct. App. Feb. 24, 2012) -- <b>UN-PUBLISHED</b>
Louisiana	No	A trial court order automatically reversing custody if the mother allowed the child to visit with a particular person was impermissible.	<i>Cook v. Cook</i> , 920 So.2d 981 (La. Ct. App. 2006)
Maine	Unknown		None found
Maryland	Unclear (Unclear because the court does not address	The trial court awarded supervised visitation to the mother and sole legal custody to father, but also or-	<i>Sviatyi v. Sviatyi</i> , No. 781, 2018 WL 3619391 (Md. Ct. Spec. App. July 30, 2018) – <b>UN-PUBLISHED</b>

State	Permissible or No	Rules or Qualifications	Citation
	<p>the legality of the self executing order and, despite that the court entered a self executing order, the court also set a review hearing. The mother seemed to argue it could not do so, but the appellate court disagreed.)</p>	<p>dered “it would allow (the mother) to have unsupervised visitation once she gets a mental health evaluation and complies with any treatment recommendations.”</p> <p>The mother appealed because, among other reasons, the court “erred in scheduling a review hearing disregarded the self executing authentication of the custody order that required her to obtain a mental health evaluation.” (Sic.)</p> <p>The court of appeals affirmed, holding that the mother’s “argument misses the mark because the circuit court’s order was not entered until May 3, 2018. Until that time there was no ‘self executing order’ in place. Further, as we have explained, there was ‘significant evidence’ to support the court’s</p>	

State	Permissible or No	Rules or Qualifications	Citation
		finding that appellant suffered from a mental health issue. As such, the court was within its discretion to schedule a review hearing to ensure that (the mother) followed through with the evaluation and any treatment recommendations.” (Sic.)	
Massachusetts	Unknown		None found
Michigan	Unknown		None found
Minnesota	Unclear	<p><i>Wopata</i>, the only reported decision, involved an order that shifted physical and legal custody between the parents every six months, which arrangement was reversed without analysis related to automatic or self-effectuating modifications.</p> <p>In <i>Henderson</i>, the court ordered parenting time to the mother would resume if she was released from incarceration while the children were minors. The father argued this was an impermissible au-</p>	<p><i>In re Marriage of Wopata</i>, 498 N.W.2d 478 (Minn. Ct. App. 1993)</p> <p><b>UNPUBLISHED:</b></p> <p><i>In re Marriage of Henderson</i>, No. A05-1696, 2006 WL 1891182 (Minn. Ct. App. July 11, 2006)</p> <p><i>Wilson v. Wilson</i>, No. A09-1386, 2010 WL 2362749 (Minn. Ct. App. June 15, 2010)</p>

State	Permissible or No	Rules or Qualifications	Citation
		<p>automatic modification per <i>Wopata</i>. The court of appeals disagreed, distinguished <i>Wopata</i>, and affirmed while stating that it was not likely the mother would be released during the children's minority. (This case also, however, affirmed a time sharing arrangement that put the children at the mother's husband's home despite no procedural request establishing that possible outcome.)</p> <p>In <i>Wilson</i>, the court adopted an evaluator's recommendation that imposed a parenting schedule that increased in three tiers at certain ages. The court reversed this automatic modification, but in doing so relied on the lack of findings supporting such a schedule.</p>	
Mississippi	Unknown		None found
Missouri	It depends	"A conditional judgment, that is one whose en-	<i>Pijanowski v. Pijanowski</i> , 272 S.W.3d 321, 327

State	Permissible or No	Rules or Qualifications	Citation
		<p>forcement is dependent upon the performance of future acts by a litigant and which is to be annulled if default occurs, is void.”</p> <p><i>Burch</i> “found that a provision ordering a change of custody if the mother stopped residing with her parents was unenforceable.”</p> <p><i>Dusing</i> and <i>Rice</i> “refused to enforce provisions that provided for automatic transfers of custody if one of the parents relocated.”</p> <p><i>Pijanowski</i>, however, affirmed an order that changed parenting time when the child started kindergarten, stating “the enforcement of the trial court’s judgment is not dependent upon future acts by the parties, but is, instead, based upon the known need of the child to have a predictable and</p>	<p>(Mo. Ct. App. 2009)</p> <p><i>Burch v. Burch</i>, 805 S.W.2d 341 (Mo. Ct. App. 1991); <i>In re Marriage of Dusing</i>, 654 S.W.2d 938 (Mo. Ct. App. 1983); <i>Rice v. Shepard</i>, 877 S.W.2d 229 (Mo. Ct. App. 1994)</p>

State	Permissible or No	Rules or Qualifications	Citation
		stable custody arrangement, particularly when school begins.” The court said the order was not speculative and “it makes little sense to force the parties back into court thirteen months later under these circumstances.”	
Montana	Unknown		None found
Nebraska	Unknown		None found
Nevada	Unknown		None found
New Hampshire	Unknown		None found
New Jersey	Qualified No (Qualified because case is not published)	<p>The court reversed an automatic modification of custody if the mother relocated from New Jersey to Pennsylvania.</p> <p>The court held that the order was “improvidently entered. It contained no end date and was not premised upon an assessment of the parties’ and the child’s circumstances at the time such a move might occur.” The court went on to cite authority holding that “absent exigent</p>	<p><i>K.F. v. N.V.</i>, No. A-1742-19, 2021 WL 772880 (N.J. Super. Ct. App. Div. Mar. 1, 2021) – <b>UN-PUBLISHED</b></p>

State	Permissible or No	Rules or Qualifications	Citation
		<p>circumstances, changes in custody should not be ordered absent a full plenary hearing.” The court cited to <i>Faucett v. Vasquez</i>, 411 N.J. Super. 108, 199 (N.J. Super. Ct. App. Div. 2009), for the last concept. That case, however, does not address automatic modifications.</p>	
New York	No	<p>Parents agreed to orders that included a “penalty for any violation by the mother would be the transfer of physical custody to the father.” After a violation by the mother, the court entered a temporary order transferring custody to the father and then held a final hearing after which the father was granted sole legal and physical custody.</p> <p>The court of appeals affirmed, but did so recognizing that “A best interests analysis is required even where, as here, the parties</p>	<p><i>Zwack v. Kosier</i>, 61 A.D.3d 1020, 1021 (N.Y. App. Div. 2009)</p>

State	Permissible or No	Rules or Qualifications	Citation
		agreed to automatic change in custody ‘upon one’s failure to satisfy a condition or the happening of a specified event.’”	
North Carolina	Unknown		None found
North Dakota	No	The court reversed an automatic modification on relocation of a parent made “without analysis under the best-interest factor at the time of (the parent’s) possible relocation. The court’s provisions essentially seek to control a future determination on primary residential responsibility, regardless of when (the parent’s) ‘imminent’ relocation to Grand Forks would occur.”	<i>Woelfel v. Gifford</i> , 948 N.W.2d 814, 817 (N.D. 2020)
Ohio	Unknown	In <i>Bastian</i> , the parties agreed that the child would be in the care of the father until the mother acquired adequate living arrangements. When that occurred, the mother moved to modify	<i>Bastian v. Bastian</i> , 160 N.E.2d 133 (Ohio Ct. App. 1959)  <i>Cavanagh v. Sealy</i> , No. 69907, 69908, 69909, 1997 WL 25521 (Ohio Ct. App. Jan. 23, 1997) – <u>UN-</u>

State	Permissible or No	Rules or Qualifications	Citation
		<p>and the court shifted the child to the mother because it believed it was required to observe the prior agreement and order. The court of appeals reversed, not based on an analysis of the automatic modification provision, but because the court was not bound by the prior order.</p> <p>The <i>Cavanaugh</i> case discusses an order in which the father's parenting time would be automatically suspended if he engaged in domestic violence directed toward the mother, which occurred. The mother filed a restraining order, which was granted. The court never addresses the legality of the suspension because the pro per father did not raise a timely or appealable issue.</p>	<p><b><u>PUBLISHED</u></b></p>
Oklahoma	Unknown		None found

State	Permissible or No	Rules or Qualifications	Citation
Oregon	Unknown	The issue is mentioned, but not decided.	<i>Sakraida v. Sakraida</i> , 217 P.2d 242 (Or. 1950).
Pennsylvania	No	The court reversed a provision that provided for automatic change of custody on further denial of visitation to the other parent.  The court indicated it was not clear that the provision was intended to be self-effectuating without a hearing, but “that the threat implicit therein should be removed from the order. In this way, the regularity of future proceedings will best be preserved.”	<i>Rosenberg v. Rosenberg</i> , 504 A.2d 350 (Pa. Super. Ct. 1986)
Rhode Island	Unknown		None found
South Carolina	Unknown		None found
South Dakota	Unknown		None found
Tennessee	Unknown		None found
Texas	Unknown		None found
Utah	Unclear, but likely no	The litigant argued that the court’s order reverting to prior stipulated parenting terms was an automatic modification forbidden by Utah law. The court did	<i>Day v. Barnes</i> , 427 P.3d 1272 (Utah Ct. App. 2018)

State	Permissible or No	Rules or Qualifications	Citation
		not address the viability of those provisions directly, but did not disagree either. Rather, the court held that the provision did not operate as the litigant claimed. An inference can, therefore, be made that automatic modifications are not sustainable in Utah.	
Vermont	No	<p>The court reversed a trial court order automatically shifting custody at a date in the future when the child starts kindergarten.</p> <p>“[A]utomatic changes in parental rights and responsibilities are contrary to precedent and contravene policies behind the child custody statutes.”</p> <p>“Any change of custody, ... , must be based on an independent assessment of the best interests of the children at the time of the contemplated change.”</p> <p>“Automatic change</p>	<i>Knutsen v. Cegalis</i> , 989 A.2d 1010 (Vt. 2008)

State	Permissible or No	Rules or Qualifications	Citation
		provisions like the one at issue in this case build instability into a child's life, and this is so whether the automatic change is premised on an anticipated or unanticipated event."	
Virginia	Qualified No (Qualified because case is not published)	Qualified because the decision is not reported. The case, however, rejects parents' agreement to automatic loss of custody if a parent raises the children observant to a religion other than Roman Catholicism. The court held that such a contractual provision "cannot be embodied as a nearly self-executing, custody-terminating decree provision. To do so would create not only an auto-da-fe against the non-complying parent but also a means of immolation of the Court's own necessary continuing control over child custody and	<i>Finnerty v. Finnerty</i> , 22 Va. Cir. 523 (Va. Cir. 1982) -- <b>UNPUBLISHED</b>

State	Permissible or No	Rules or Qualifications	Citation
		an instrument to destroy basic civil tenets on that subject.”	
Washington	No	Automatic modification triggered by move was impermissible absent a modification petition.	<i>In re Marriage of Christel</i> , 1 P.3d 600 (Wash. App. 2000)
Wisconsin	Unknown		None found
West Virginia	Unknown		None found
Wyoming	No	Automatic modification on relocation was an impermissible “anticipatory conclusion.”	<i>Bruegman v. Bruegman</i> , 417 P.3d 157 (Wyo. 2018)



# **The Dynamics of the Enmeshed Family System Ten Years Later: Family Court and Contemporary Understanding of Adulthood, Parentification, and Infantilization**

by  
Benjamin D. Garber\*

## **Abstract**

Time, experience, experimentation, and case law have together moved family law practice forward from a primitive and inflammatory binary view of high conflict family dynamics to a much more nuanced, ecological perspective. The field has invested enormous resources struggling to understand alienation in its larger relationship ecology, while largely failing to invest in understanding concurrent family system dynamics including enmeshment. This is a ten-year follow up and elaboration upon a seminal discussion of enmeshment in the context of high conflict divorce. Far more nuanced descriptions of three forms of enmeshment (i.e., adulthood, parentification, and infantilization) are offered, including previously overlooked gender, cultural, religious, and language considerations. Case illustrations are provided. Discussion includes consideration of how these destructive dynamics can be recognized and remedied. These distinctions are described as among the necessary components of every family law professional's field guide to understanding and responding to the dynamics of the conflicted family system.<sup>1</sup>

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<sup>1</sup> The use of names or gender are intended to be neutral and for purposes of illustration only.

## I. Introduction

The field of family law is still in its infancy. Born of the awkward union between the legal system and mental health practice, its professionals have only just begun to recognize the blessings and burdens associated with its lineage. In fact, neither the adversarial courts nor the medical model of individual diagnosis and treatment fit the needs of the conflicted family system or the best interests of the child standard.

The struggles of this early identity crisis have been nowhere more obvious or painful than with regard to the concept of parental alienation. Fortunately, this highly divisive issue among the legal and mental health systems has achieved some small degree of equilibrium in recent years with the rejection of the syndrome argument and a reconceptualization of the larger dynamics that eschew inferred motives in favor of behavioral descriptions.<sup>2</sup> Thus, binary alienation-versus-estrangement arguments are increasingly recognized as fallacious and dangerous.<sup>3</sup> Instead, the phrase “resist/refuse dynamics” has achieved something of a consensual foothold.<sup>4</sup>

A multi-factorial model emphasizing the combined influence of many simultaneous and interwoven relationship dynamics and pressures has provided a more research-based framework for considering family dynamics and conflict.<sup>5</sup> Known as a hybrid

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<sup>2</sup> Janet R. Johnston & Matthew J. Sullivan, *Parental Alienation: In Search of Common Ground for a More Differentiated Theory*, 58 FAM. CT. REV. 270, 271 (2020).

<sup>3</sup> *Id.* at 273; Madelyn S. Milchman, Robert Geffner & Joan S. Meier, *Ideology and Rhetoric Replace Science and Reason in Some Parental Alienation Literature and Advocacy: A Critique*, 58 FAM. CT. REV. 340, 346 (2020).

<sup>4</sup> Marjorie Gans Walters & Steven Friedlander, *When a Child Rejects a Parent: Working with the Intractable Resist/Refuse Dynamic*, 54 FAM. CT. REV. 424, 424 (2016).

<sup>5</sup> See Jean Mercer, *Are Intensive Parental Alienation Treatments Effective and Safe for Children and Adolescents?*, 16 J. CHILD CUSTODY 67, 96 (2019) (“This position is implausible in light of studies of child development and of family dynamics that emphasize the effects of multiple factors and of interactions among those factors. This multifactor emphasis has increased with the growing influence of dynamic systems theory, an approach concerned with the ability of any system to organize and re-organize itself along unique lines. DST posits the existence of dynamic equilibria in systems or groups, resulting in individual variations within an expectable range even when the environment (e.g., the behavior or attitudes of a parent) does not change.”).

model<sup>6</sup> or, more broadly, as an ecological model<sup>7</sup> the multifactorial approach requires that many mutually compatible and commonly co-occurring variables all be assessed in the effort to unravel any particular child's resist/refuse behaviors. Chief among these variables are alienation, estrangement, and enmeshment.

Unfortunately, while theory and research have flourished around questions related to alienation and, less so, estrangement, little has been added to the family law literature on the subject of enmeshment in the last ten years.<sup>8</sup> The present article seeks to elaborate upon and update that literature in support of the field's urgent need to establish a common vocabulary for family dynamics and conflict for purposes of forensic and expert opinions, guardian ad litem investigations, and judicial decision making.

## II. The Dynamics of Enmeshment

### A. *Enmeshment in Developmental Context*

If a healthy parent's job is to gradually launch his or her child toward autonomy, then development is about building and always adapting psychological boundaries.<sup>9</sup> Boundaries distinguish what is in from what is out. Psychological boundaries recur at every level of inquiry across fields as seemingly diverse as cosmology and sociology and virology. For the present purposes, boundaries distinguish one individual from another within the family system, and the family system itself from its surrounding

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<sup>6</sup> Walters & Friedlander, *supra* note 4, at 429.

<sup>7</sup> Shely Polak & Michael Saini, *The Complexity of Families Involved in High-conflict Disputes: A Postseparation Ecological Transactional Framework*, 60 J. DIVORCE & REMARRIAGE 117 (2019).

<sup>8</sup> See generally Benjamin D. Garber, *Parental Alienation and the Dynamics of the Enmeshed Parent-Child Dyad: Adultification, Parentification, and Infantilization*, 49 FAM. CT. REV. 322 (2011); Johnston & Sullivan, *supra* note 3; Daniel G. Saunders, *Research Based Recommendations for Child Custody Evaluation Practices and Policies in Cases of Intimate Partner Violence*, 12 J. CHILD CUSTODY 71 (2015); Daniel G. Saunders, Kathleen C. Faller & Richard M. Tolman, *Beliefs and Recommendations Regarding Child Custody and Visitation in Cases Involving Domestic Violence: A Comparison of Professionals in Different Roles*, 22 VIOLENCE AGAINST WOMEN 722 (2016).

<sup>9</sup> See BENJAMIN D. GARBER, DANA E. PRESCOTT & CHRISTOPHER MULCHAY, *A PRACTICAL FIELD GUIDE FOR FAMILY LAW PROFESSIONALS: DYNAMICS, NOT DIAGNOSES* (2021).

community.<sup>10</sup> Of course, boundaries must adapt to life circumstances as when a baby is born, a child grows up, and when parents separate and divorce.

In the healthy course of development, the child's sense of a bounded and separate identity grows from the infant's oceanic sense of self<sup>11</sup> toward adolescent rebellion and peer group affiliations into the faux autonomy of young adulthood, only then to be blurred again by love and marriage and parenting. The process emerges in an ANOVA-like friction between the variance within and variance without.<sup>12</sup> Within the family, boundaries are created, constantly tested, and redefined in the lifelong tension between hold-me-tight and let-me-go.<sup>13</sup> The child's limit testing and the parents' gradually eroding rules and restrictions create psychological and physical boundaries which are breached and then

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<sup>10</sup> See Tara S. Peris & Robert E. Emery, *Redefining the Parent-Child Relationship Following Divorce: Examining the Risk for Boundary Dissolution*, 5 J. EMOTIONAL ABUSE 169, 171-72 (2005) ("Boundaries are defined as the implicit or explicit rules of relationships in general, and they are central in establishing the structure of family relationships in particular. Boundaries delineate each member's unique psychological domain, as well as his or her role within the broader family system.").

<sup>11</sup> SIGMUND FREUD, *CIVILIZATION AND ITS DISCONTENTS* 9 (David McLintock trans., Penguin 2002) (1930).

<sup>12</sup> An analysis of variance (ANOVA) is a statistical method that determines whether a subset is coherent. It asks whether there is more variation within the identified subset than between that proposed subset and those that surround it (in which case the subset is not coherent), or more variation between the proposed subset and its neighbors (in which case the subset is coherent). Note, of course, that metaphors relying on statistical measures carry a risk. One of the challenges for lawyers and judges (and some mental health professional) is the misuse of statistics and the accompanying potential for misleading the court by suggesting correlations which are not or using variables which are not really that. See, e.g., *Doe v. Sex Offender Registry Bd.*, 4 N.E.3d 1264, 1270 (Mass. App. Ct. 2014) ("Our own review of the scientific and statistical studies in the record reveals that they are technical and complex."); *Id.* at 1271 n.9; see also David G. Herr, *On the History of ANOVA in Unbalanced, Factorial Designs: The First 30 Years*, 40 AM. STAT. 265, 265 (1986) ("During the past decade and a half there has been a flurry of work on the problem of fixed-effects analysis of variance (ANOVA) for unbalanced, factorial designs. Yet there remains considerable confusion as to how one should analyze such designs.").

<sup>13</sup> BENJAMIN D. GARBER, *HOLDING TIGHT/LETTING GO: RAISING HEALTHY KIDS IN ANXIOUS TIMES* (2016).

recreated a million times over in every child's life and into adulthood.

The same pressures that can encourage the child's healthy movement toward autonomy can also impede it. This is most often the case when a parent turns to a child for need fulfillment. This breach of boundaries can be born of necessity and/or pathology, it may feel good to the parent and/or to the child, but it is ultimately destructive of both. This is *enmeshment*.

This author first imported and applied the developmental and family systems theory and research concerned with enmeshment into the family law literature a decade ago.<sup>14</sup> This included cataloguing diverse relationship ecologies in which enmeshment has been commonly reported, e.g., in the context of poverty,<sup>15</sup> immigrant families,<sup>16</sup> among chronically physically or mentally ill, addicted and/or, incarcerated parents, in the context of intimate partner violence,<sup>17</sup> and high conflict divorce. These distorted systemic pressures yield what have often been called *role reversals*, thereby suggesting an exchange of roles between parent and child or "when a distressed parent looks to the child to meet unmet needs for comfort, intimacy, or companionship. A parent in marital conflict may be particularly prone to role reversal, which in turn adversely affects child development."<sup>18</sup>

Recognizing the variety of dynamics that these pressures can yield, the term *role corruption* proves to be more descriptive. Parent-child role corruption can be seen within the dysfunctional family system in at least three distinct but mutually compatible

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<sup>14</sup> Garber, *supra* note 8, at 322.

<sup>15</sup> Linda Burton, *Childhood Adultification in Economically Disadvantaged Families: A Conceptual Model*, 56 *FAM. RELATIONS* 329, 330 (2007).

<sup>16</sup> Maria Elena Puig, *The Adultification of Refugee Children: Implications for Cross-cultural Social Work Practice*, 5.3-4 *J. HUM. BEHAV. SOC. ENV'T.* 85 (2002); Sophie Walsh et al., *The Role of Parentification and Family Climate in Adaptation Among Immigrant Adolescents in Israel*, 16 *J. RES. ADOLESCENCE* 321 (2006).

<sup>17</sup> Debra Lynn Stephens, *Battered Women's Views of Their Children*, 14 *J. INTERPERSONAL VIOLENCE* 731 (1999).

<sup>18</sup> Janet R. Johnston, Marjorie G. Walters & Nancy W. Olesen, *Is It Alienating Parenting, Role Reversal or Child Abuse? A Study of Children's Rejection of a Parent in Child Custody Disputes*, 5.4 *J. EMOTIONAL ABUSE* 191 (2005); Jenny Macfie et al., *Pathways from Infant Exposure to Marital Conflict to Parent-Toddler Role Reversal*, 29 *INFANT MENTAL HEALTH J.* 297 (2008).

forms: adultification, parentification, and infantilization. Much as these terms capture role corruptions within particular parent-child dyads, a genuinely ecological understanding of family systems has taught us that these dynamics are systemic. That is, enmeshment in each of its several distinct forms can only be recognized, communicated, and remedied in the context of and with the active involvement of all members of the family system. This is nowhere more obvious and practically relevant than when one is concerned with “reunification” therapies, those interventions intended to respond to resist/refuse dynamics.<sup>19</sup>

### III. Adultification in the Developmental Context

Like many terms in family law, “adultification” comes with a lot of irrelevant baggage. It has been used to refer to the treatment of minors as adults under the law,<sup>20</sup> to communicate racist attributions about immigrant youths,<sup>21</sup> to describe children’s premature responsibilities to care for younger siblings,<sup>22</sup> to demean the adult-like characteristics of transgendered minors,<sup>23</sup> and as a political platform for children’s rights,<sup>24</sup> among other

<sup>19</sup> BARBARA J. FIDLER ET AL., CHILDREN WHO RESIST POSTSEPARATION PARENTAL CONTACT: A DIFFERENTIAL APPROACH FOR LEGAL AND MENTAL HEALTH PROFESSIONALS (2013); Barbara J. Fidler & Peggie Ward, *Clinical Decision-Making in Parent-Child Contact Problem Cases: Tailoring the Intervention to the Family’s Needs*, in OVERCOMING PARENT-CHILD CONTACT PROBLEMS: FAMILY-BASED INTERVENTIONS FOR RESISTANCE, REJECTION, AND ALIENATION 13 (Abigail M. Judge & Robin M. Deutsch eds. 2016).

<sup>20</sup> Riane M. Bolin & Brandon K. Applegate, *Adultification in Juvenile Corrections: Examining the Orientations of Juvenile and Adult Probation and Parole Officers*, 41 AM. J. CRIM. JUST. 321, 333 (2016); Mae C. Quinn & Grace R. McLaughlin, *Article III Adultification of Kids: History, Mystery, and Troubling Implications of Federal Youth Transfers*, 26 WASH. & LEE J. CIV. RTS. & SOC. JUST. 523, 555 (2019).

<sup>21</sup> Laila Hlass, *The Adultification of Immigrant Children*, 34 GEO. IMMIGR. L.J. 199, 202 (2019).

<sup>22</sup> Rachel M. Schmitz & Kimberly A. Tyler, *Growing Up Before Their Time: The Early Adultification Experiences of Homeless Young People*, 64 CHILDREN & YOUTH SERVS. REV. 15, 16 (2016).

<sup>23</sup> Amy L. Stone, *Gender Panics About Transgender Children in Religious Right Discourse*, 15 J. LGBT YOUTH 1 (2018).

<sup>24</sup> Nancy E. Dowd, *Children’s Equality: Perspectives on Rights and Realities for Children of Color: Response: Strategizing a New Deal for Children*, 47 FORDHAM URB. L.J. 379 (2019).

variations. In the present context, adultification describes one among three common forms of intergenerational role corruption. Adultification, like parentification, deprives a child of the opportunity to remain a child, undermining his security, and burdening him with practical and/or emotional responsibilities he is not likely prepared to bear.<sup>25</sup>

Adultification occurs when a parent prematurely enlists a child as an ally, peer, friend, or “emotional partner.”<sup>26</sup> Adultification can occur out of practical necessity, as when a military parent is deployed and the parent who remains home turns to her son for support. It can occur as a result of social, ethnic, and/or religious isolation. And adultification can occur as a by-product of a psychologically disturbed adult’s inappropriate emotional investment in her child.<sup>27</sup>

Among the many lessons learned in the last ten years is the extent to which adultification is common and can even be healthy in certain relationship ecologies. Context matters tremendously. For example, one must be very careful not to overgeneralize from a child’s discrete tasks and adult-like “practice” responsibilities within the family system to infer role corruption and pathogenic dynamics: “Temporary parentification is considered normative at times and may even be associated with responsibil-

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<sup>25</sup> See, e.g., *Palazzolo v. Mire*, 10 So. 3d 748, 758 (La. Ct. App. 2009) (“Dr. Jordan translated the statement in his initial report that I.P. is a product of early adultification to mean that the parents had given her too much independence to make decisions beyond her age level. Dr. Jordan explained that he omitted this statement from his final report because he did not believe it was a significant issue given the many changes in I.P. between December 2005 and August 2006.”); *In re A.M.L.M.*, No. 13-18-00527-CV, 2019 WL 1187154, at \*12 (Tex. App. Mar. 14, 2019) (“As for Mother, Holder [LPC] did not recommend reunification for two reasons. First, Holder opined that “the family role scale is elevated.” This elevation resulted from Mother “dumping” on the children by using them for comfort and emotional support. Such a dynamic leads to “adultification” of the children and limits their social engagement outside the home.”).

<sup>26</sup> Anita Chandra et al., *Children on the Homefront: The Experience of Children from Military Families*, 125 *PEDIATRICS* 16 (2010).

<sup>27</sup> GREGORY K. JURKOVIC, *DESTRUCTIVE PARENTIFICATION IN FAMILIES: CAUSES AND CONSEQUENCES* (1998); Patricia Lester & Brenda Bursch, *The Long War Comes Home: Mitigating Risk and Promoting Resilience in Military Children and Families*, 28.7 *PSYCHIATRIC TIMES* 26 (2011).

ity, competence, and autonomy in children who are given adequate support and acknowledged for their helpfulness.”<sup>28</sup>

The contextual framework necessary for investigating whether a particular child has been adultified must account for factors such as age of onset, such that a longer history of healthy family relationships may act to insulate a child against the deleterious effects otherwise associated with adultification. Birth order and, whether the child has siblings, and how the sibling groups function within the larger family system are also relevant, such that later-born children with the benefit of sibling support may be less vulnerable to the deleterious effects of adultification.<sup>29</sup> The history and nature of co-parental conflict and the child’s exposure to that conflict may also be related to the risk of role corruption, such that those children exposed younger, longer, and to more severe conflict are at greater risk.<sup>30</sup> Only-children may be at higher risk than children with siblings.<sup>31</sup>

Much as the adultified child may bask in the enmeshed parent’s special attention and may even develop precocious social skills due, in part, to his special relationship with one parent, the developmental costs incurred can be tremendous. Role corrup-

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<sup>28</sup> Genie Burnett et al., *Family Unpredictability, Parental Alcoholism, and the Development of Parentification*, 24.3 AM. J. FAM. THERAPY 181, 181 (2006).

<sup>29</sup> For a review of case law and policy arguments concerning the rights of siblings, see James G. Dwyer, *A Taxonomy of Children’s Existing Rights in State Decision Making About Their Relationships*, 11 WM. & MARY BILL RTS. J. 845 (2002); Dana E. Prescott, *Biological Altruism, Splitting Siblings and the Judicial Process: A Child’s Right to Constitutional Protection in Family Dislocation*, 71 UMKC L. REV. 623 (2003).

<sup>30</sup> Patricia Noller et al., *Conflict in Divorcing and Continuously Married Families: A Study of Marital, Parent–Child and Sibling Relationships*, 49 J. DIVORCE & REMARRIAGE 1, 20-21 (2008) (“We found that the sibling relationships in the divorcing families tended to be “affect-intense,” or high in both nurturance and hostility. The Noller et al. comments made by the adolescents in the interviews helped us to interpret these data; younger siblings, in particular, tended not to appreciate what they saw as overprotection on the part of their older sibling, who sought to nurture them in the face of parental separation and divorce.); Katia E. Roth, Debra A. Harkins & Lauren A. Eng, *Parental Conflict During Divorce as an Indicator of Adjustment and Future Relationships: A Retrospective Sibling Study*, 55.2 J. DIVORCE & REMARRIAGE 117, 119 (2014).

<sup>31</sup> Esti Iturralde et al., *Positive and Negative Interactions Observed Between Siblings: Moderating Effects for Children Exposed to Parents’ Conflict*, 23.4 J. RES. ADOLESCENCE (2013), <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3828047/pdf/nihms425519.pdf>.

tion in general, and adultification in particular are associated with increased risks of social and emotional dysfunction later in life, including difficulties with autonomy and anxiety. They are furthermore associated with higher risks of drug and alcohol abuse and addiction.<sup>32</sup> As an illustration:

Twelve-year-old Sam lived at least half of his life exposed to his parents' incessant conflicts. When his father moved out of the family home, his mother explicitly alerted him that he was now "the man of the house." Sam was proud of his role as his mother's confidant and helper in part because it made him feel special and in part because he could lord it over his younger sister. Although Sam often didn't understand the court orders that his mother shared with him, he liked to think that he helped her cope with her stress just by listening. When Father complained that Sam's grades had begun to decline and that Sam had quit the swim team, Sam simply stopped spending weekends with him. His mother said all the right things about "visiting with your father" but honestly felt validated by the child's rejection of the man whom she now hated.<sup>33</sup>

#### IV. Parentification in the Developmental Context

Although this term has taken on a number of meanings, it is far easier to disambiguate than some. The terms *adultification* and *parentification* are often confused and interchanged, confounding identification and the implementation of dynamic-specific remedies.<sup>34</sup> "Parentification" is sometimes used to describe a child's premature promotion to serve as his or her siblings' caregiver, a role that is looked upon differently across race and culture.<sup>35</sup> In the present context, we reserve the term to describe

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<sup>32</sup> Julia Margarita Bernard, *Exploring the Predictors and Outcomes of the Adultification of Adolescents* (2010), <https://docs.lib.purdue.edu/dissertations/AAI3444478/>.

<sup>33</sup> Case illustrations are anonymized accounts of the author's direct experience conducting child custody evaluations and/or serving as an expert witness in high conflict family law matters.

<sup>34</sup> Judyta Borchet et al., *We Are in This Together: Retrospective Parentification, Sibling Relationships, and Self-Esteem*, 29.10 J. CHILD & FAM. STUD. 2982, 2982 (2020); Lisa M. Hooper, Heather M. Moore & Annie K. Smith, *Parentification in Military Families: Overlapping Constructs and Theoretical Explorations in Family, Clinical, and Military Psychology*, 39 CHILD. YOUTH SERVS. REV. 123 (2014).

<sup>35</sup> Karissa DiMarzio et al., *Parent-Child Role Confusion: Exploring the Role of Family Processes in the Context of Parental Depression*, J. CLINICAL

a genuine role reversal, that is, those family system dynamics that prematurely promote a child to serve as his or her parent's caregiver. One particularly astute court described parentification as follows:

. . . parentification results in “pseudo-maturity,” characterized by children acting very responsible and trying very hard to be good caretakers. The problem. . . is [that] parentified children minimize their own need to be nurtured because they are placed in the role of the caretaker, rather than the child. As a result, parentified children may develop significant relationship problems as adults. The parentification manifests itself in adulthood in one of two extreme ways. The first is codependency, which results when parentified children try to compensate for the lack of nurturing they received as children. The second is continuing the self-sacrificing role of the caretaker at the expense of their own emotional needs. . . . parentification is “one facet of role reversal.” He testified[that] the anxiety resulting from parentification causes sleep loss, obsessive thoughts, perfectionism, over-extension, and depression.<sup>36</sup>

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CHILD & ADOLESCENT PSYCHOL. (2021) <https://cdn.vanderbilt.edu/vu-my/wp-content/uploads/sites/2804/2018/04/10214808/Parent-child-role-confusion-exploring-the-role-of-family-processes-in-the-context-of-parental-depression.pdf>; *Parentification*, in MODELS OF PSYCHOPATHOLOGY 37 (Lisa M. Hooper et al. 2014); Lisa M. Hooper et al., *Parentification, Ethnic Identity, and Psychological Health in Black and White American College Students: Implications of Family-of-Origin and Cultural Factors*, 43 J. COMPARATIVE FAM. STUD. 811, 811 (2012).

<sup>36</sup> *Mayo v. Mayo*, 619 N.W.2d 631, 636 (N.D. 2000). The dissent is important to read both as to policy and analysis. *Id.* at 641 (Maring, J., dissenting) (“Despite the questionable basis of Dr. Ascano’s opinions regarding ‘parentification’ of the oldest child, the trial court chooses to find the testimony of Dr. Will, Banjac’s expert, not credible because the ‘basis for his opinions are not reliable, valid tests due to the fact they are highly subjective and lack generally recognized scientific validity and reliability as predictive tests.’ The testing the trial court refers to includes the Rorschach test, which has been administered and interpreted by professionals to form diagnoses in psychiatric and psychological examinations.”); *See, e.g., Grace L. v. State*, 329 P.3d 980, 985 n.12 (Alaska 2014) (“[P]arentification in the family entails a functional and/or emotional role reversal in which the child sacrifices his or her own needs for attention, comfort, and guidance in order to accommodate and care for logistical or emotional needs of the parent.” Nancy D. Chase, *Parentification: An Overview of Theory, Research, and Societal Issues*, in BURDENED CHILDREN: THEORY, RESEARCH AND TREATMENT OF PARENTIFICATION 3, 5 (Nancy D. Chase ed., 1999).”); *In re Marriage of McKean*, 254 Cal. Rptr. 3d 726, 734, 41 Cal. App. 5th 1083, 1092-93 (Cal. Ct. App. 2019) (“Testimony demonstrated the siblings had mutual bonds and Si.’s cognitive state was akin to that of a one-year-old to 18-

Parentification is observed among immigrant families,<sup>37</sup> impoverished families,<sup>38</sup> working parents,<sup>39</sup> parents with diagnosed character pathology,<sup>40</sup> and substance dependent parents,<sup>41</sup> and children who are homeless.<sup>42</sup> In homes with substance abuse, for example, researchers have found that, “When parents drink and

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month-old child. Children of that age indeed have relationships with their families, and dismissing the impact of separating the siblings based purely on Si.’s disability was error. Furthermore, there was insufficient evidence of the supposed “parentification” of Sa. and W.”).

<sup>37</sup> Olga Oznobishin & Jenny Kurman, *Parent–Child Role Reversal and Psychological Adjustment Among Immigrant Youth in Israel*, 23 J. FAM. PSYCHOL. 405 (2009).

<sup>38</sup> Thomas I. McMahon & Suniya S. Luthar, *Defining Characteristics and Potential Consequences of Caretaking Burden Among Children Living in Urban Poverty*, 77 AM. J. ORTHOPSYCHIATRY 267 (2007).

<sup>39</sup> EARL A. GROLLMAN & GERRI L. SWEDER, *THE WORKING PARENT DILEMMA: HOW TO BALANCE THE RESPONSIBILITIES OF CHILDREN AND CAREERS* (1988).

<sup>40</sup> Monica M. Fitzgerald et al., *Child Sexual Abuse, Early Family Risk, and Childhood Parentification: Pathways to Current Psychosocial Adjustment*, 22 J. FAM. PSYCHOL. 320, 320 (2008).

<sup>41</sup> Marolyn Wells, Cheryl Glickauf-Hughes & Rebecca Jones, *Codependency: A Grass Roots Construct’s Relationship to Shame-Proneness, Low Self-Esteem, and Childhood Parentification*, 27 AM. J. FAM. THERAPY 63 (1999).

<sup>42</sup> Schmitz & Tyler, *supra* note 22 (“Adopting early adult roles, or early adultification/parentification, consists of a child or adolescent assuming adult-like traits and responsibilities, such as providing extensive caregiving to parents or younger siblings.”); Amy K. Nuttall & Kristin Valentino, *An Ecological-Transactional Model of Generational Boundary Dissolution Across Development*, 53.2 MARRIAGE & FAM. REV. 105, 108 (2017). Adultification is often characterized using the term “triangulation” in reference to the child’s involvement in the parental subsystem as a decision maker or emotional support. (See, e.g., Patricia K. Kerig, *Triangles in the Family Circle: Effects of Family Structure on Marriage, Parenting, and Child Adjustment*, 9 J. FAM. PSYCH. 28 (1995)); Patricia K. Kerig & Julie A. Swanson, *Ties that Bind: Triangulation, Boundary Dissolution, and the Effects of Interparental Conflict on Child Development*, in *STRENGTHENING COUPLE RELATIONSHIPS FOR OPTIMAL CHILD DEVELOPMENT: LESSONS FROM RESEARCH AND INTERVENTION* 59–76 (Marc Schulz, Marcia K. Pruett, Patricia K. Kerig & Ross Parke eds., 2010). The impact of adultification is likely not as severe as that of parentification. *Id.* However, portrayed competence may actually mask the child’s burden and later negatively influence development, which Hetherington described as “competence at a cost.” *COPING WITH DIVORCE, SINGLE PARENTING, AND REMARRIAGE: A RISK AND RESILIENCY PERSPECTIVE* (Mavis Hetherington, ed., 1999).

children feel frightened and helpless. They may care for their parents [in order] to bring some sense of control to an otherwise uncontrollable situation.”<sup>43</sup> Of particular interest in the context of family law is the observation that “emotionally deprived parents may unconsciously regard their children as parental figures.”<sup>44</sup>

Parentification is most commonly observed and reported about mothers concerning their daughters,<sup>45</sup> and when the parentifying adult is chronically ill,<sup>46</sup> single, or out of work.<sup>47</sup> The experience of parentification has been linked to the child’s distress and dysfunction beginning in the adolescent years and well into adulthood.<sup>48</sup> Parentification has been associated with many forms of diagnosable psychopathology, particularly depression and character pathology. The experience is so common and deleterious that one author advised that, “It is important for clinical psychologists and other mental health care providers to assess for level and duration of the parentification roles and responsibilities carried out in the family of origin.”<sup>49</sup>

The literature of the last ten years has broadened professional understanding of parentification as it might be applied to family law. This includes the critical distinction between *instrumental parentification* and *emotional parentification*. The former describes the more benign dynamic at work when a child serves

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<sup>43</sup> Burnett et al., *supra* note 28, at 186.

<sup>44</sup> JURKOVIC, *supra* note 27, at 240.

<sup>45</sup> GROLLMAN & SWEDER, *supra* note 39; Deborah Jacobvitz, Shelly Riggs & Elizabeth Johnson, *Cross-Sex and Same-Sex Family Alliances: Immediate and Long-Term Effects on Sons and Daughters*, in BURDENED CHILDREN: THEORY, RESEARCH, AND TREATMENT OF PARENTIFICATION (N.D. Chase ed., 1999).

<sup>46</sup> Marie M. Duryea, *Mothers with Chronic Physical Illness and the Parentification of Their Children* (2008), <https://core.ac.uk/download/pdf/151575158.pdf>; Tanya L. Tompkins, *Parentification and Maternal HIV Infection: Beneficial Role or Pathological Burden?*, 16.1 J. CHILD & FAM. STUD. 108, 113 (2007).

<sup>47</sup> Jo Aldridge, *Experiences of Children Living with and Caring for Parents with Mental Illness*, 15.2 CHILD ABUSE REV. 79 (2006).

<sup>48</sup> Cliff Yung-Chi Chen & Andrea Panebianco, *Physical and Psychological Conditions of Parental Chronic Illness, Parentification and Adolescent Psychological Adjustment*, 35 PSYCHOL. & HEALTH 1075 (2020).

<sup>49</sup> Lisa M. Hooper et al., *Characterizing the Magnitude of the Relation Between Self-reported Childhood Parentification and Adult Psychopathology: A Meta-Analysis*, 67 J. CLINICAL PSYCHOL. 1028, 1039 (2011).

the practical or mechanical needs of the parent as when, for example, a disabled parent needs help with dressing or meal preparation. The latter is applied when a parent relies on a child for emotional nurturance, succor, and support. Of course, the two are not incompatible. In terms of the child's well-being, instrumental and emotional parentification differ to the extent that the former does not compromise the child's experience of the adult as an emotional anchor.<sup>50</sup> As long as the child feels emotionally secure, instrumental parentification can actually build resilience,<sup>51</sup> enhance problem solving abilities, and diminish the risk of substance abuse.<sup>52</sup> It is the child's loss of security associated with emotional parentification implicit in the parent's need to be cared for that seems to do the damage. By way of illustration,

Rachel's father had been in and out of her life for years, detoxing, participating in serial rehabs, and twice hospitalized due to opioid overdoses. When her mother finally left the family home, the eight-year-old refused to spend overnights with her insisting, instead, to stay with her father. Mother accused the father of alienation. Lawyers were enlisted. Experts were hired. The court ordered a child custody evaluation. The evaluator found little evidence that the father had been undermining the little girl's relationship with the mother. Instead, Rachel was terrified that her daddy would use drugs and die if she was away overnight. She had taken on the role of her father's caregiver, making certain that he took his medications and checking on him throughout the night in case he needed her.

One particular form of instrumental parentification deserves special attention. In many immigrant families, parents come to rely on their children as *culture brokers*.<sup>53</sup> Although educational and healthcare professionals often express concern about the

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<sup>50</sup> Borchet et al., *supra* note 34, at 2983.

<sup>51</sup> Antonietta DiCaccavo, *Working with Parentification: Implications for Clients and Counselling Psychologists*, 79.3 *PSYCHOL. & PSYCHOTHERAPY: THEORY, RES. & PRACTICE* 469 (2006).

<sup>52</sup> Lisa M. Hooper et al., *Patterns of Self-reported Alcohol Use, Depressive Symptoms, and Body Mass Index in a Family Sample: The Buffering Effects of Parentification*, 20.2 *FAM. J.* 164, 166 (2012).

<sup>53</sup> Vanja Lazarevic, *Effects of Cultural Brokering on Individual Wellbeing and Family Dynamics Among Immigrant Youth*, 55 *J. ADOLESCENCE* 77, 77 (2017); Edison J. Trickett & Curtis J. Jones, *Adolescent Culture Brokering and Family Functioning: A Study of Families from Vietnam*, 13.2 *CULTURAL DIVERSITY & ETHNIC MINORITY PSYCHOL.* 143 (2007). This raises fascinating questions about the current generation of children serving as "technology brokers" for their parents and grandparents. These children facilitate others' access to

well-being of children cast into this role,<sup>54</sup> empirical studies are mixed. For example, teens who serve as their parents' translators tend toward stronger academic achievement than others.<sup>55</sup>

## V. Infantilization in the Developmental Context

By contrast with adultification and parentification, infantilization only carries two meanings in the professional and popular literatures. The term is sometimes used in a pejorative sense to describe minorities, women, the elderly, and the disabled who are subjugated to the will of others.<sup>56</sup> In the present context, infantilization describes the family system dynamic in force when a parent acts to inhibit a child's otherwise age- and culture-appropriate movement toward autonomy. In this sense, infantilization is often associated with the idea of the "helicopter parent"<sup>57</sup> or, as others identify this practice, "overparenting."<sup>58</sup> In a forthcoming book, the authors suggest that, "The infantilized child never learns how to tolerate frustration, delay gratification, or manage adversity. He is the ruler of his own private kingdom at home within the enmeshed and infantilizing relationship, but out of

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software, cloud-based technologies, and video platforms at unknown costs and with unknown benefits.

<sup>54</sup> Tony Cline, Sarah Crafter & Evangelia Prokopiou, *Child Language Brokering in Schools: A Discussion of Selected Findings from a Survey of Teachers and Ex-students*, 31.2 EDUC. & CHILD PSYCHOL. 34 (2014).

<sup>55</sup> Raymond Buriel et al., *The Relationship of Language Brokering to Academic Performance, Biculturalism, and Self-efficacy Among Latino Adolescents*, 20.3 HISPANIC J. BEHAV. SCI. 283, 283 (1998).

<sup>56</sup> Joan C. Chrisler, Angela Barney & Brigida Palatino, *Ageism Can Be Hazardous to Women's Health: Ageism, Sexism, and Stereotypes of Older Women in the Healthcare System*, 72 J. SOC. ISSUES 86, 93 (2016); Rachel D. Godsil et al., *The Effects of Gender Roles, Implicit Bias, and Stereotype Threat on the Lives of Women and Girls*, 2.1 SCI. EQUALITY 14, 32 (2016); Rhoda Olkin et al., *The Experiences of Microaggressions Against Women with Visible and Invisible Disabilities*, 75 J. SOC. ISSUES 757, 775 (2019).

<sup>57</sup> Jill C. Bradley-Geist & Julie B. Olson-Buchanan, *Helicopter Parents: An Examination of the Correlates of Over-parenting of College Students*, 56 EDUC. + TRAINING 314, 314 (2014); Wendy M. Rote et al., *Helicopter Parenting and Perceived Overcontrol by Emerging Adults: A Family-Level Profile Analysis*, 29 J. CHILD & FAM. STUD. 3153 (2020).

<sup>58</sup> Nathan A. Winner & Bonnie C. Nicholson, *Overparenting and Narcissism in Young Adults: The Mediating Role of Psychological Control*, 27 J. CHILD & FAM. STUD. 3650, 3650 (2018).

place, rejected, and bullied in any environment that expects age-appropriate prosocial behavior.”<sup>59</sup>

Infantilization has been observed across cultures, languages, religions, socio-economic classes, and in parents of both genders.<sup>60</sup> Infantilizing parents are often described as inclined to anxiety and perfectionism.<sup>61</sup> Mothers may be more likely to infantilize than fathers and the developmental impact of their corrupted roles may differ by gender such that the children of infantilizing fathers have greater difficulty with emotional functioning by young adulthood while the children of infantilizing mothers tend to have more difficulty with social functioning.<sup>62</sup> The social and emotional impact of infantilization may be greater for daughters than for sons, at least into the college years.<sup>63</sup>

Regardless of parent or child gender, children who have been infantilized are routinely described as academic and occupational underachievers,<sup>64</sup> anxious and/or depressed,<sup>65</sup> entitled,<sup>66</sup>

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<sup>59</sup> GARBER, PRESCOTT & MULCHAY, *supra* note 9.

<sup>60</sup> Guillermo Bernal, María I. Jiménez-Chafey & Melanie M. Domenech Rodríguez, *Cultural Adaptation of Treatments: A Resource for Considering Culture in Evidence-Based Practice*, 40.4 PROF. PSYCHOL.: RES. & PRAC. 361 (2009); Ryan J. Gagnon, *Examining Overparenting, Socioeconomic Status, and Parental Out-of-School- Time Experience: Does Socioeconomic Status and Out-of-School-Time Experience Matter?*, 101 CHILDREN & YOUTH SERVS. REV. 181, 187 (2019).

<sup>61</sup> Chris Segrin, Tricia J. Burke & Trevor Kauer, *Overparenting Is Associated with Perfectionism in Parents of Young Adults*, 9.3 COUPLE & FAM. PSYCHOL.: RES. & PRAC. 181 (2020).

<sup>62</sup> Sofie Rousseau & Miri Scharf, “I Will Guide You” *The Indirect Link Between Overparenting and Young Adults’ Adjustment*, 228 PSYCHIATRY RES. 826, 826 (2015).

<sup>63</sup> Chrystyna D. Kouros et al., *Helicopter Parenting, Autonomy Support, and College Students’ Mental Health and Well-being: The Moderating Role of Sex and Ethnicity*, 26 J. CHILD & FAM. STUD. 939, 946 (2016).

<sup>64</sup> Bradley-Geist & Olson-Buchanan, *supra* note 57, at 323.

<sup>65</sup> Jaerim Lee & and Sieun Kang, *Perceived Helicopter Parenting and Korean Emerging Adults’ Psychological Adjustment: The Mediation Role of Parent-Child Affection and Pressure from Parental Career Expectations*, 27 J. CHILD & FAM. STUD. 3672 (2018).

<sup>66</sup> Holly H. Schiffrin & Miriam Liss, *The Effects of Helicopter Parenting on Academic Motivation*, 26 J. CHILD & FAM. STUD. 1472 (2017).

with weaker empathy,<sup>67</sup> lower perceived self-efficacy in young adulthood,<sup>68</sup> and a higher risk of substance abuse.<sup>69</sup> Of course, here and in every instance in which research is cited, one must keep in mind the biases and limitations of empirical design, sampling, sample size, culture and era before generalizing to any single family system.<sup>70</sup>

As is the case with both adultification and parentification, the last ten years have generated research, theory, and case law<sup>71</sup>

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<sup>67</sup> Meredith McGinley, *Can Hovering Hinder Helping? Examining the Joint Effects of Helicopter Parenting and Attachment on Prosocial Behaviors and Empathy in Emerging Adults*, 179.2 J. GENETIC PSYCHOL. 102 (2018).

<sup>68</sup> Veronica Darlow, Jill M. Norvilitis & Pamela Schuetze, *The Relationship Between Helicopter Parenting and Adjustment to College*, 26 J. CHILD & FAM. STUD. 2291 (2017).

<sup>69</sup> Ming Cui et al., *Indulgent Parenting, Helicopter Parenting, and Well-being of Parents and Emerging Adults*, 28 J CHILD & FAM. STUD. 860, 861-62 (2019); Jie Xu & Xiaoxia Cao, *Young Adults' (Mis)use of Prescription Opioid Drugs: An Exploratory Study*, 35 HEALTH COMM. 1407 (2020).

<sup>70</sup> For a discussion on these limitations, see Jonathan Anthony Michaels, *Potential for Epistemic Injustice in Evidence-Based Healthcare Policy and Guidance*, 47.6 J. MED. ETHICS 417 (2021); Karen Newbigging & Julie Ridley, *Epistemic Struggles: The Role of Advocacy in Promoting Epistemic Justice and Rights in Mental Health*, 219 SOC. SCI. & MED. 36 (2018); Dana E. Prescott, *Bending the Light of Social Science in Family Court: Epistemic Injustice and Epistemic Exceptionalism Matter*, 33 J. AM. ACAD. MATRIM. LAW. 99 (2020).

<sup>71</sup> See e.g. *Palazzolo v. Mire*, 10 So. 3d 748, 758 (La. Ct. App. 2009) (“Dr. Jordan translated the statement in his initial report that I.P. is a product of early adultification to mean that the parents had given her too much independence to make decisions beyond her age level. Dr. Jordan explained that he omitted this statement from his final report because he did not believe it was a significant issue given the many changes in I.P. between December 2005 and August 2006.”); *In re Collin Q.*, 114 N.Y.S.3d 142, 147, 178 A.D.3d 1208, 1212 (N.Y. Sup. Ct. 2019) (“The foster parents’ adult daughter - the child’s primary caretaker - disputed some of the infantilization claims during her testimony. The parent educators confirmed, however, that the child would be carried to supervised visits by the foster parents’ adult daughter, that she encouraged the child to use the pacifier during the visits and that she discouraged the child from helping pick up prior to the conclusion of visits.”); *In re A.M.L.M.*, 2019 WL 1187154, at \*11-12 (“As for Mother, Holder [LPC] did not recommend reunification for two reasons. First, Holder opined that “the family role scale is elevated.” This elevation resulted from Mother “dumping” on the children by using them for comfort and emotional support. Such a dynamic leads to “adultification” of the children and limits their social engagement outside the home.”).

which together suggest the value of distinguishing at least four mutually compatible types of infantilization.

*Adaptive infantilization* is a transitory, chameleon-like state.<sup>72</sup> A child who may otherwise appear to be developmentally appropriate falls back into a regressed and needy state in the care of a parent who needs to be needed and recovers his or her more appropriate functioning in other caregiving environments.

*Permissive infantilization* is associated with a parent who cannot or will not set behavioral limits and follow through with associated consequences. As a result, this child has little or no opportunity to learn to tolerate frustration or delay gratification. This parent may fear the child's anger and rejection, may be physically or emotionally absent, and/or may be engaged in a bidding war with another parent for the child's time, affection, and attention.

*Opportunistic infantilization* arises when a parent tacitly enjoys the social, emotional, and practical benefits accrued as a result of her child's genuine illness, injury, and/or developmental difference.<sup>73</sup>

*Infantilization as Factitious Disorder Imposed on Another (FDIA)*. FDIA (formerly known as Munchausen Syndrome by Proxy and Factitious Disorder by Proxy) is a diagnosable condition in which a parent induces an illness, injury, or developmental difference in a child so as to benefit from the resulting professional attention.<sup>74</sup>

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<sup>72</sup> Benjamin D. Garber, *The Chameleon Child: Children as Actors in the High Conflict Divorce Drama*, 11.1 J. CHILD CUSTODY 25 (2014).

<sup>73</sup> If the adult's only goal is external (e.g., financial) then the DSM would identify this as malingering. The term "malingering" is often misused even in forensics. For a helpful summary of the policy and literature, see David T.R. Berry & Nathaniel W. Nelson, *DSM-5 and Malingering: A Modest Proposal*, 3.4 PSYCHOL. INJURY & L. 295 (2010).

<sup>74</sup> Noemi Faedda et al., *Don't Judge a Book by Its Cover: Factitious Disorder Imposed on Children—Report on 2 Cases*, 6 FRONTIERS IN PEDIATRICS 110 (2018); Melanie Kean, *Fabricated or Induced Illness: The Importance of Health Chronologies in Recognising This Form of Abuse*, 1.6 BRIT. J. CHILD HEALTH 275 (2020).

## V. Recognition, Rigor, and Remedies

To date, the mental health and legal professions have few reliable and validated means of consistently assessing these and similar family system dynamics in the high conflict population that fills the family courts. Researchers have been more precisely defining terms and conceptual frameworks for treatment and forensics, and that research gives reason for optimism. This matters because evidence-based planning for mental health professionals and the family justice system requires evidence-informed and effective interventions grounded in the precise use of language. At the present time, evaluators are left to rely upon interview and observation, emphasizing the importance of culturally relevant developmental and family system norms, the value of structured and semi-structured interview methods, and adherence to the law's best interest of the children's standards.<sup>75</sup>

One such structured method is the process-oriented observational protocol.<sup>76</sup> Whereas child custody evaluations [CCEs] typically schedule interviews and observations across the calendar on the basis of participant and evaluator availability, the process-oriented method schedules these data-rich elements back-to-back across the course of one or more consecutive days, thereby allowing the evaluator to observe how family members use one another to manage the stresses of transition.<sup>77</sup> More than collect-

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<sup>75</sup> Milfred D. Dale & Desiree Smith, *Making the Case for Videoconferencing and Remote Child Custody Evaluations (RCCEs): The Empirical, Ethical, and Evidentiary Arguments for Accepting New Technology*, 27.1 PSYCHOL., PUB. POL'Y, & L. 30 (2021) ("If offering an opinion on the ultimate issues of custody and parenting time, evaluators are also expected to consider these factors, and when possible and appropriate, evaluators may use social science research to support their choice of methods, inferences, and opinions."); Michele J. McIntosh & Janice M. Morse, *Situating and Constructing Diversity in Semi-Structured Interviews*, 2 GLOBAL QUALITATIVE NURSING RES. 233339361559 7674 (2015) ("The SSI is designed to ascertain subjective responses from persons regarding a particular situation or phenomenon they have experienced. It employs a relatively detailed interview guide or schedule, and may be used when there is sufficient objective knowledge about an experience or phenomenon, but the subjective knowledge is lacking.").

<sup>76</sup> Benjamin D. Garber, *Exploring a Process-Oriented Forensic Family Observation Protocol*, 54 FAM. CT. REV. 261, 262 (2016).

<sup>77</sup> Scheduling back-to-back interviews and observations is also more time- and cost-efficient. A parent who travels one hour each way for three one-hour interviews must invest nine hours. When that parent is interviewed for three

ing only the data available within a particular interview or observation, observing how participants manage the transitions between these elements is an incredibly valuable and often overlooked window into the system's dynamics.

A process-oriented approach can yield invaluable insights into the quality of parent-child and parent-parent relationships, including and especially questions about enmeshment. Whereas observing ten-year-old Sally in the conventional paradigm with her father on Tuesday and with her mother on Friday will likely provide valuable data about the quality of the child's relationship with each parent, a process approach calls for observing Sally with her father at 10 AM on Tuesday with the foreknowledge that mother will knock on the evaluator's office door and Father will leave at 11 AM. How do the father and daughter cope with separation? How do the adults behave toward one another? How does Sally greet Mother upon her arrival? How do all three manage the fleeting but emotionally supercharged transition as the father leaves and the mother arrives?

Clues that can generate hypotheses about enmeshment<sup>78</sup> are woven throughout these episodes. Does Sally's preoccupation

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consecutive hours, she must only invest five hours. The fatigue associated with such a rigorous protocol becomes one of the variables being studied: How do the participants anticipate, plan for, and manage their own and their children's needs during such a long day?

<sup>78</sup> The phrase "pathological enmeshment" has entered the lexicon of family courts through the testimony of mental health professionals. *See, e.g.,* Wagner v. Gordon, No. 1-19-1886, 2020 WL 4196841, at \*12 (Ill. App. Ct. July 21, 2020) ("And then the evaluator herself, Dr. Wilner, goes on to opine that, since the time of the couple's physical separation, it is this evaluator's opinion that Mark has developed and fostered a pathological enmeshment with Matthew such that Matthew has been encouraged to emotionally align with Mark around saving the family and encouraging Nancy to reconcile her marriage. \* \* \* This symbiotic reliance of Matthew has deepened Matthew's perception that he can only be happy in Franklin Grove with his father in wide open spaces and does not feel comfortable with his mom in Evanston."); Kirk v. Kirk, 770 N.E.2d 304, 306 (Ind. 2002) ("Mrs. Kirk has her own issues. She was diagnosed as "severely narcissistically disordered" and unknowingly "involved in manipulative, deceitful and exploitative behaviors in an effort to preserve her pathological enmeshment with her daughter."). This phrase should be used very carefully, if at all, as it has powerful connotations when misused in court (the word "pathological") and is not a recognized diagnosis. *See* Xavier F. Jimenez et al., *Clinical, Demographic, Psychological, and Behavioral Features of Factitious Disorder: A Retrospective Analysis*, 62 GEN. HOSP. PSYCHIATRY 93, 95 (2020) ("Ongoing dynamic

with the father's well-being while they are apart suggest parentification? Does the mother's not-so-subtle reminder that Sally needs to tell the evaluator important new information suggest adultification? Does Sally's abrupt decompensation when her parents are together at transition suggest adaptive infantilization?

Once these dynamics are recognized, there is some direction about the steps necessary (if not sufficient) to (re-) establish the child's opportunity to enjoy a healthy relationship with both (all) caregivers. In short:

- 1 Even though the problem may appear to be dyadic (e.g., one parent and child is enmeshed), the remedy must be systemic. All members of the family system must be invested in and prepared to support the process or, if not, then the explanation for why not must consider factors and consequences.<sup>79</sup>
- 2 Understanding that the enmeshed parent has inappropriately turned to the child for his or her need fulfillment, part of the solution must include that parent's establishment of alternate, healthier resources so as to free the child of his or her instrumental and/or emotional burden. This refers, for example, to systemically informed individual psychotherapies and a breadth of other resilience-building resources such as affiliation with preferred religious, community, and/or professional groups.<sup>80</sup>

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conflicts were also present in every case examined, though our methodology revealed a variety of issues ranging from grief discord, abuse, and pathological enmeshment.”).

<sup>79</sup> Polak & Saini, *supra* note 7.

<sup>80</sup> This and many of the issues inherent in these dynamics can be easily communicated using the metaphor of gassing up a car. People, like vehicles, need to be refueled. A parent's job is to keep his or her tank full so as to be available to refuel the child. The child has a tiny tank and is therefore unable to refuel the parent. Where else can the parent get refueled? Church? Gym? Book club? Intimate partner? *See, e.g.,* John Byng-Hall, *The Significance of Children Fulfilling Parental Roles: Implications for Family Therapy*, 30.2 J. FAM. THERAPY 147 (2008); Vanessa F. Schiller, Diana S. Dorstyn & Amanda M. Taylor, *The Protective Role of Social Support Sources and Types Against Depression in Caregivers: A Meta-Analysis*, 51 J. AUTISM & DEVELOPMENTAL DISORDERS 1304 (2021).

- 3 Divesting the adultified or parentified child of her role is likely to feel like a loss or a failure to the child and to spark anxiety for the enmeshed parent. Family therapists have often approached this step as a graduation of sorts, creating a ceremony for the child complete with gratitude for her hard work and reassurance that the formerly enmeshed parent now has alternate resources.<sup>81</sup> The child's anxiety can be further quelled when she can be given developmentally-appropriate exposure to the enmeshed parent's new supports, e.g., meeting the father's new AA sponsor or attending his new church together.
- 4 Identification of adaptive infantilization suggests that the child already has more mature skills evident in other relationships. This child needs to experience the formerly infantilizing parent's support for exercising those skills in his or her care.<sup>82</sup> This remedial process often requires coaching and scripting with the parent who may not know how to praise the child's movement toward autonomy.
- 5 Identification of permissive infantilization calls for an assessment of the adult's parenting capacity.<sup>83</sup> Those who have the skills and the maturity to establish and maintain healthy caregiving structures will need case management, education, and therapy to help them do so. Adults without these basic resources and those whose caregiving has taken a backseat to other priorities (e.g., addictions) may additionally require services such as psychotherapy, medication evaluation, and detoxification/rehabilitation. Co-parenting interventions are often a further necessary step in support of increased consistency of parenting practices.
- 6 Identification of opportunistic and/or FDIA infantilization likely calls for prompt and continuing intervention

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<sup>81</sup> Chase, *supra* note 36; Helen W. Coale, *Therapeutic Use of Rituals with Stepfamilies*, 2.1 FAM. J. 2 (1994).

<sup>82</sup> Hermioni N. Lokko & Theodore A. Stern, *Regression: Diagnosis, Evaluation, and Management*, 17.3 PRIMARY CARE COMPANION FOR CNS DISORDERS (2015).

<sup>83</sup> Terry Donald & Jon Jureidini, *Parenting Capacity*, 13.1 CHILD ABUSE REV. 5, 6 (2004).

from Child Protective Service (CPS), medical, mental health, and child development specialists, if not also law enforcement. These infantilization dynamics can pose imminent risks of harm and even death.<sup>84</sup>

- 7 The non-enmeshed parent will simultaneously need education and support. This adult's parenting skills may be weak and/or rigid, and he or she may have acted to or around the child in a manner that adds estrangement to the resist/refuse recipe.<sup>85</sup>
- 8 Both parents and their allies (e.g., extended family, intimate partners, surrogate caregivers) are also likely to need education, if not close supervision and the threat of court sanctions intended to minimize the child's exposure to words, actions, and expressed emotions that denigrate any caregiver.
- 9 The characteristics and behaviors of the enmeshed child's full-, half- and stepsiblings must be understood to the extent that they play a role in and are affected by the dysfunctional family system. Concerned professionals must take care, for example, that an enmeshing parent does not shift her needs from one child to another, that siblings aren't serving as one or another parent's agents, and that the resist/refuse polarization isn't reversed.
- 10 The child's anxiety adjusting to the new balance of family relationships must be respected and treated with great care. In some cases, security and reassurance can be buttressed through the use of transitional objects.<sup>86</sup>
- 11 Finally, it is critical that a uniform narrative be established that explains the shifting family dynamics and avoids shame and blame. "The parentified child's future development and the possible outcomes may depend on

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<sup>84</sup> Lauren B. Day et al., *Personality Profiles of Factitious Disorder Imposed by Mothers: A Comparative Analysis*, 14.2 J. CHILD CUSTODY 191 (2017).

<sup>85</sup> Richard A. Warshak, *Reclaiming Parent-Child Relationships: Outcomes of Family Bridges with Alienated Children*, 60 J. DIVORCE & REMARRIAGE 645 (2019).

<sup>86</sup> Benjamin D. Garber & Dana E. Prescott, *On the Value of Teddy Bears and Barbie Dolls: The Place of Children's Transitional Objects in Family Law*, 49 SW. L. REV. 189, 196 (2020).

how the child feels about, and makes meaning of, the parentification experience.”<sup>87</sup>

## VI. Conclusion: Dynamics not Diagnoses

If the goal of the family law process is to serve the best interests of the child, then family law professionals have a responsibility to understand and be prepared to recommend those conditions most likely to facilitate healthy development. This means eschewing individual diagnoses and the individual adult psychometric instruments that generate them in favor of developing the means of recognizing, communicating, and recommending as necessary the means to remedy family system dynamics. As much as simple, black-and-white answers may be appealing, in the context of family law they tend to be misleading and may even do harm. If our own personal experiences as children and parents are not sufficient to teach us about the incredibly complex nature of relationship dynamics, then the accumulating body of research and case law will have to suffice.

The polarized child’s alliance with Parent A and resistance/refusal of Parent B is seldom or never the result of a single bad act or caused by a single bad actor. Family law professionals must learn not to ask *which* dynamic is at work, but instead to ask *how* each of many concurrent and interwoven dynamics are at work in any single family. This includes a thorough understanding of healthy child and family development and how the boundaries within the dysfunctional system can be corrupted. This article has endeavored to update the means of recognizing, communicating about, and responding to evidence of developmentally inappropriate enmeshment as one among the numerous factors that can contribute to resist/refuse behaviors.

Unfortunately, the process of developing a vocabulary of high conflict family system dynamics is hindered by psychology’s historical indebtedness to the medical model of individual diagnosis and treatment. Systems are exponentially more complex than individuals at every level of inquiry from the subatomic to the super-cosmic. Families are chaotic and non-linear systems that consume and are infinitely greater than the sum of their parts.

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<sup>87</sup> Borchet et al., *supra* note 34, at 2982.

Two cautions are offered in conclusion. Both fall under the general understanding that this is necessarily a work in progress. First, it should be self-evident that many of the distinctions and attributions offered here are often built on small, individual, and often qualitative reports. There is an urgent need for replication, expansion, and rigorous analysis of these studies across cultures and languages and ages and genders. A 2031 ten-year update of this article may well make different distinctions, but hopefully will add at least as much depth to this discussion as this article added to that of its predecessor.

The second caution is less obvious but arguably more important: As family law professionals, we have the hubris to intervene in, evaluate, opine about, and adjudicate other people's lives. This comes with the very high risk of being drawn into pathological and pathogenic relationship dynamics in ways that harm not only those whom we intend to serve, but ourselves, as well.<sup>88</sup> Building this science serves the additional benefit of providing an anchor outside of the fray, an *etic* as opposed to an *emic* perspective on the people who look and act and feel so much like the person in the mirror.<sup>89</sup> The goal is to reinforce professional objectivity and help to minimize individual bias to the benefit of all.

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<sup>88</sup> Lisa Morgillo, *Do Not Make Their Trauma Your Trauma: Coping with Burnout as a Family Law Attorney*, 53 *FAM. CT. REV.* 456, 459 (2015); Alexis Resnick, Karen A. Myatt & Priscilla V. Marotta, *Surviving Bench Stress*, 49 *FAM. CT. REV.* 610 (2011); Richard A. Warshak, *Risks to Professionals Who Work with Troubled and Alienated Parent-Child Relationships*, 44.3 *AM. J. FAM. THERAPY* 111 (2016).

<sup>89</sup> Nina Hansen & Luzia Heu, *All Human, Yet Different: An Emic-Etic Approach to Cross-Cultural Replication in Social Psychology*, 51 *SOC. PSYCHOL.* 361 (2020); Andrew Lindridge, *Etic-Emic Dilemma*, in *WILEY ENCYCLOPEDIA OF MANAGEMENT* 9 (Carey Cooper et al. eds., 2015) ("The emic looks at the system from within, embedded in the experience and immersed in its reality. The emic validates personal experience but has no baseline that might allow analysis. Where the etic are objective, the emic are subjective. Where the etic are scientific, the emic are phenomenological. Where the etic foster emotional distance, the emic foster rapport. And where the etic categorize and quantify, the emic empathize."); GARBER, PRESCOTT & MULCHAY, *supra* note 9.

## **“Born of” Outside the United States: Acquisition at Birth of U.S. Citizenship by Children Born Through Assisted Procreation**

by  
Bruce Hale\*

Section 301 of the Immigration and Naturalization Act (INA) describes how children born abroad may acquire U.S. citizenship from a U.S. citizen parent, so long as the U.S. citizen parent is married to the child’s other parent.<sup>1</sup> Section 309 of the INA specifies the requirements for acquisition of citizenship when the parents are not married (the child is born “out of wedlock”).<sup>2</sup> This article focuses on the acquisition of U.S. citizenship of children born through assisted procreation<sup>3</sup> to married parents, and whose situations thus are evaluated under section 301. The important distinction between the two sections for the purposes of this article is that section 309, for children born out of wedlock, contains stricter criteria for the transmission of U.S. citizenship between the U.S. citizen parent and the child than does section 301. Thus, children whose citizenship claim is evaluated under INA section 309 face a higher burden and a less certain outcome than those whose claim is evaluated under section 301.

The INA entered into effect in 1952, long before medical advances in reproductive medicine, such as *in vitro fertilization* (IVF), existed. Thus, the language of the 1952 law did not take into account the current realities of gamete donation and surro-

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<sup>1</sup> 8 U.S.C. § 1401 (2018).

<sup>2</sup> 8 U.S.C. § 1409 (2018).

<sup>3</sup> The Uniform Parentage Act defines “assisted reproduction” as “a method of causing pregnancy other than sexual intercourse. The term includes: (A) intrauterine or intracervical insemination; (B) donation of gametes; (C) donation of embryos; (D) in-vitro fertilization and transfer of embryos; and (E) intracytoplasmic sperm injection.” This article uses the term “assisted procreation” as a more accurate and inclusive alternative to “assisted reproduction.” UNIF. PARENTAGE ACT § 102 (2017).

gacy, among other medically-assisted procreative techniques. Also not even on the horizon in 1952 was the U.S. Supreme Court's 2014 decision in *United States v. Windsor* which struck down section three of the Defense of Marriage Act that prevented the federal government from recognizing same-sex marriages,<sup>4</sup> and the 2015 *Obergefell v. Hodges* decision which found that the Fourteenth Amendment to the U.S. Constitution required all states to perform and recognize marriages between two people of the same sex.<sup>5</sup> The Truman-era INA has therefore become inadequate to serve the more varied needs of families today.

In May of 2021, the Department of State released new guidance on its updated interpretation of section 301 of the INA as applied to children born abroad through assisted procreation.<sup>6</sup> This new interpretation focuses on the citizenship status of the married parents of the child without regard to the circumstances of the child's conception and birth, and is the latest in a series of updates that adjust policy to meet the needs of families today.

This article asserts that the latest update to the Department of State's interpretation of Section 301 of the INA is based on a more modern view of the family structure into which a child is born. Part I of this article examines the text of the INA that is subject to interpretation in modern families. Part II discusses prior interpretations of Section 301 of the INA, and why those interpretations are inadequate today. Part III explains the new interpretation of Section 301, and Part IV concludes with additional considerations on the subject.

## I. The Law

The pertinent provisions of the INA read:

§ 1401. Nationals and citizens of United States at birth

The following shall be nationals and citizens of the United States at birth:

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<sup>4</sup> *United States v. Windsor*, 133 S. Ct. 2675 (2013).

<sup>5</sup> *Obergefell v. Hodges*, 135 S. Ct. 2584 (2015).

<sup>6</sup> See Press Statement, *U.S. Citizenship Transmission and Assisted Reproductive Technology*, U.S. DEP'T OF STATE (May 18, 2021), <https://www.state.gov/u-s-citizenship-transmission-and-assisted-reproductive-technology/>.

(c) a person BORN outside of the United States and its outlying possessions OF PARENTS both of whom are citizens of the United States and one of whom has had a residence in the United States or one of its outlying possessions, prior to the birth of such person;

(d) a person BORN outside of the United States and its outlying possessions OF PARENTS one of whom is a citizen of the United States who has been physically present in the United States or one of its outlying possessions for a continuous period of one year prior to the birth of such person, and the other of whom is a national, but not a citizen of the United States.<sup>7</sup>

At issue is the meaning of the phrase “born . . . of parents” found in in the text. In 1952, a child “born of” married parents was almost certainly conceived by sexual intercourse between a husband and wife and carried to term by the wife of the couple.<sup>8</sup> Today, the situation is not so clear.

Medical advances have added a layer of complexity to the meaning of “born of.” The first person to be conceived through in vitro fertilization (IVF) was born in 1978.<sup>9</sup> The medical process of IVF, where eggs are retrieved from a woman’s body and combined with sperm outside the womb gave rise to the possibility of a woman carrying a child that is not genetically her own genetic child. As this possibility became a reality, egg donation as a method of fertility treatment – as sperm donation had decades prior – shattered the truism that the child a woman delivered was necessarily her own. An infertile women could now conceive and bear a child using eggs donated by another woman. Likewise, a gestational carrier (or gestational surrogate) could gestate and deliver a child on behalf of others who intended to parent the child.<sup>10</sup>

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<sup>7</sup> 8 U.S.C. § 1401 (emphasis added).

<sup>8</sup> Human conception via artificial insemination was in its infancy in 1952. See Willem Ombelet & Johan Van Robays, *Artificial Insemination History: Hurdles and Milestones*, 7(2) FACTS, VIEWS & VISION OBGYN, 137 (2015), <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4498171>.

<sup>9</sup> Louise Brown, born on July 25, 1978 in a hospital outside of London was the first IVF – or “test tube” – baby. Dr. Robert Edwards of Cambridge University, one of the doctors involved in the development of IVF, was awarded the Nobel Prize in Medicine in 2010 for his contribution to IVF.

<sup>10</sup> One definition of gestational carrier is : “A woman who carries a child who is not genetically related to her and who intends to give birth to a child for other persons who are the intended parents.” MAUREEN MCBRIEN & BRUCE

Apart from the medical advances, the legal recognition of who the “parents” were also shifted in the years since 1952. Notably, in 2004, Massachusetts became the first state in the nation to issue marriage licenses to same-sex couples.<sup>11</sup> A decade later, same-sex marriages performed by states were recognized by the federal government.<sup>12</sup> And then one year later, all states in the nation would be required to perform same-sex marriages.<sup>13</sup> These legal advances in family law for same-sex couples opened the door to the establishment of parentage of children by same-sex couples by operation of law as children “of the marriage” of the couple.

For both same-sex and different-sex couples, “of the marriage” for parentage purposes has not been considered the same as “born of” for citizenship purposes. A child who is born while her mother is married may have the spouse of the mother recognized as her other legal parent, whether or not this designation is based on biological reality.<sup>14</sup> However, the Department of State has up to now required a legal connection (legal parentage) and a genetic connection between the U.S. citizen parent and the child in order for the child to be considered “born of” her parents and thus acquire U.S. citizenship through the U.S. citizen parent.

With the medical and legal advances for family-building, modern families would sometimes find that the text of the 1952 INA posed a difficult barrier for the acquisition of U.S. citizenship by the children. Absent a clear definition of the meaning of “born of” – and absent any congressional action to update the INA – it has been up to the Department of State to interpret the phrase for the purposes of citizenship acquisition by children born abroad.

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HALE, ASSISTED REPRODUCTIVE TECHNOLOGY, A LAWYER’S GUIDE TO EMERGING LAW AND SCIENCE 385 (3d ed. 2018).

<sup>11</sup> *Goodridge v. Dept. of Pub. Health*, 798 N.E.2d 941 (Mass. 2003).

<sup>12</sup> *Windsor*, 133 S. Ct. 2675.

<sup>13</sup> *Obergefell*, 135 S. Ct. 2584.

<sup>14</sup> See, e.g., *Michael H. v. Gerald D.*, 491 US 110 (1989) (genetic father of a child was unable to rebut the presumption of parentage of the husband of the child’s mother due to passage of time); *Pavan v. Smith*, 582 U.S. 137 (2017) (presumption of parentage applies equally to a same-sex spouse).

## II. Pre-2021 Interpretations of the INA<sup>2</sup>

Prior to May 2021, when evaluating the citizenship status of a child born abroad through assisted procreation, the Department of State required a genetic or gestational link to a U.S. citizen and a legal link between the child and her parents in order for the child to acquire U.S. citizenship from the U.S. citizen parent. Specifically, the parents needed to be married to one another, and the child needed to be the genetic child of the U.S.-citizen parent or gestated by the U.S. citizen parent to receive U.S. citizenship through that parent. For example, if a U.S. citizen husband living in France with his French-citizen wife conceived a child with donor sperm, technically the child would not acquire U.S. citizenship from her father under INA Section 301 because the U.S. citizen in this married couple neither gestated nor provided genetic material to the child.

Specific guidance is provided in the Department of State Foreign Affairs Manual (FAM). At the time this article is authored, it has not yet been updated to reflect the 2021 interpretation. It reads as follows.

a. A child born abroad to a U.S. citizen gestational mother who is also the legal parent of the child at the time of birth in the location of birth, whose genetic parents are an anonymous egg donor and the U.S. citizen husband of the gestational legal mother, is considered for citizenship purposes to be a person born in wedlock of two U.S. citizens, with a citizenship claim adjudicated under the Immigration and Nationality Act (INA) 301(c).

b. A child born abroad to a U.S. citizen gestational mother who is the legal parent of the child at the time of birth in the location of birth, whose genetic parents are an anonymous sperm donor and the U.S. citizen wife of the gestational legal mother, is considered for citizenship purposes to be a person born in wedlock of two U.S. citizens, with a citizenship claim adjudicated under INA 301(c).

c. A child born abroad to a U.S. citizen gestational mother who is the legal parent of the child at the time of birth in the location of birth, whose genetic parents are an anonymous egg donor and the non-U.S. citizen husband of the gestational legal mother, is considered for citizenship purposes to be a person born in wedlock of a U.S. citizen mother and alien father, with a citizenship claim adjudicated under INA 301(g).

d. A child born abroad to a U.S. citizen gestational mother who is the legal parent of the child at the time of birth in the location of birth, and who is not married to the genetic mother or father of the child at the time of the child's birth, is considered for citizenship purposes to be a person born out of wedlock of a U.S. citizen mother, with a citizenship claim adjudicated under INA 309(c).<sup>15</sup>

This interpretation of a “biological” connection by the U.S. citizen mother evaluated as gestation or genetics dates back to 2014, but clearly applies only to the U.S. citizen mother.<sup>16</sup> Here, as long as she is, first, married and, second, the legal mother at the time and in the location of the birth, she can pass U.S. citizenship to her child. When the biological link with the U.S. citizen mother is absent, however, an issue arises with the pre-2021 interpretation of section 301 of the INA.

a. For purposes of this section, the term “surrogate” refers to a woman who gives birth to a child, who is not the legal parent of the child at the time of the child's birth in the location of the birth. In such a case, the surrogate's citizenship is irrelevant to the child's citizenship analysis.

b. A child born abroad to a surrogate, whose genetic parents are a U.S. citizen mother and her U.S. citizen spouse, is considered for citizenship purposes to be a person born in wedlock of two U.S. citizen parents, with a citizenship claim adjudicated under INA 301(c).

c. A child born abroad to a surrogate, whose genetic parents are a U.S. citizen mother and anonymous sperm donor, is considered for citizenship purposes to be a person born out of wedlock to a U.S. citizen mother, with a citizenship claim adjudicated under INA 309(c). This is the case regardless of whether the woman is married and regardless of whether her spouse is the legal parent of the child at the time of birth.

d. A child born abroad to a surrogate, whose genetic parents are a U.S. citizen mother and her non-U.S. citizen spouse, is considered for citizenship purposes to be a person born in wedlock of a U.S. citizen

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<sup>15</sup> *Acquisition of U.S. Citizenship at Birth – Assisted Reproductive Technology, Birth Abroad to a U.S. Citizen Gestational Mother Who Is Also the Legal Mother at the Time She Gives Birth (Birth Mother, but Not Genetic Mother)*, 8 FAM 304.3-1 (Mar. 3, 2020), <https://fam.state.gov/FAM/08FAM/08FAM030403.html>.

<sup>16</sup> See AILA Doc. No. 14020740, *DOS Policy Changes Related to Children Born Abroad Through ART Applies Retroactively* (Jan. 14, 2014), <https://www.aila.org/infonet/dos-policy-changes-related-to-children-born-abroad>.

mother and alien spouse, with a citizenship claim adjudicated under INA 301(g).

e. A child born abroad to a surrogate, whose genetic parents are a U.S. citizen father and his non-U.S. citizen spouse, is considered for citizenship purposes to be a person born in wedlock of a U.S. citizen father and alien spouse, with a citizenship claim adjudicated under INA 301(g).

f. A child born abroad to a surrogate, whose genetic parents are a U.S. citizen father and anonymous egg donor, is considered for citizenship purposes to be a person born out of wedlock of a U.S. citizen father, with a citizenship claim adjudicated under INA 309(a). This is the case regardless of whether the man is married and regardless of whether his spouse is the legal parent of the child at the time of birth.

g. A child born abroad to a surrogate, whose genetic parents are a U.S. citizen father and the surrogate (mother) who is not married to the U.S. citizen father is considered for citizenship purposes to be a person born out of wedlock of a U.S. citizen father, with a citizenship claim adjudicated under INA 309(a). Note that in such a case, despite the genetic and gestational connection, the surrogate mother is not the legal parent of the child at the time of birth, usually pursuant to a surrogacy agreement.<sup>17</sup>

Here, subparagraphs c and f provide that when the child is conceived with donated gametes and gestated by a surrogate, the child is considered born out of wedlock. Compare 8 FAM 304.3-2 (f) to 8 FAM 304-3-1 (c). In 8 FAM 304-3-1 (c), the child acquires U.S. citizenship through INA section 301 even though there is no genetic connection to a U.S. citizen. The gestation of the child by the U.S. citizen wife is sufficient for INA 301 to apply. However, if the U.S. citizen wife does not gestate the child, and even if her spouse is a U.S. citizen and provides gametes for the conception of the child, acquisition of citizenship by the child must be evaluated under INA section 309. This is an inconsistency based solely on the gender of the parents and the method by which the child was conceived and born.

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<sup>17</sup> *Acquisition of U.S. Citizenship at Birth – Assisted Reproductive Technology, Birth Abroad to a Surrogate of a Child Who Is the Genetic Issue of a U.S. Citizen Mother and/or U.S. Citizen Father*, 8 FAM 304.3-2 (June 27, 2018), <https://fam.state.gov/FAM/08FAM/08FAM030403.html>.

Note that when a child is conceived with donated gametes from a U.S. citizen, the child does not automatically acquire U.S. citizenship from that genetic connection.

U.S. citizenship cannot be transmitted by an anonymous sperm or egg donor, even if a clinic, sperm bank, or intended parent(s) purport to certify that the sperm or egg was donated by a U.S. citizen. The applicant (or his or her parent, applying on behalf of a minor applicant) bears the burden of demonstrating the donor transmitting parent's U.S. citizenship and fulfillment of each other statutory requirement, and the evidence in support must be verified by the consular officer. This will require cooperation from the donor(s) to establish the possible claim to U.S. citizenship.<sup>18</sup>

Prior to 2014, the interpretation of citizenship acquisition by a child born through assisted procreation was far more strict, because the child needed to be the genetic child of *both* of her married parents in order to benefit from the provisions of INA 301 (child born in wedlock) and to acquire citizenship through her U.S. citizen parent.

a. The laws on acquisition of U.S. citizenship through a parent have always contemplated the existence of a blood relationship between the child and the parent(s) through whom citizenship is claimed. It is not enough that the child is presumed to be the issue of the parents' marriage by the laws of the jurisdiction where the child was born. Absent a blood relationship between the child and the parent on whose citizenship the child's own claim is based, U.S. citizenship is not acquired. The burden of proving a claim to U.S. citizenship, including blood relationship and legal relationship, where applicable, is on the person making such claim.

b. Applicants must meet different standards of proof of blood relationship depending on the circumstances of their birth:

(1) The statutes do not specify a standard of proof for persons claiming birth in wedlock to a U.S. citizen parent or out of wedlock to an American mother. The Department's regulations also do not explicitly establish a standard of proof. The Department applies the general standard of a preponderance of the evidence. This standard means that the evidence of blood relationship is of greater weight than the evidence to the contrary. It is credible and convincing and best accords with reason and probability. It does not depend on the volume of evidence presented. . .

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<sup>18</sup> *Acquisition of U.S. Citizenship at Birth – Assisted Reproductive Technology, Anonymous Sperm/Egg Donors Cannot Transmit U.S. Citizenship to a Child*, 8 FAM 304.3-3 (June 27, 2018), <https://fam.state.gov/FAM/08FAM/08FAM030403.html>.

c. Children born in wedlock are generally presumed to be the issue of that marriage. This presumption is not determinative in citizenship cases, however, because an actual blood relationship to a U.S. citizen parent is required. If doubt arises that the citizen “parent” is related by blood to the child, the consular officer is expected to investigate carefully. Circumstances that might give rise to such a doubt include:

- (1) Conception or birth of a child when either of the alleged biological parents was married to another;
- (2) Naming on the birth certificate, as father and/or mother, person(s) other than the alleged biological parents; and
- (3) Evidence or indications that the child was conceived at a time when the alleged father had no physical access to the mother. . . .<sup>19</sup>

This interpretation from 2010 with the requirement that the child be the genetic child of the married parents led to absurd conclusions as applied to children born through assisted procreation. If the married couple used donated gametes in their attempt to conceive, the child would automatically be considered “out of wedlock” (and thus subject to the citizenship provisions of INA Section 309) simply because the source of the sperm and the source of the egg were not married *to each other*.

For married same-sex couples abroad, this interpretation from 2010 meant that any child born to them would necessarily be considered “out of wedlock” since the two genetic progenitors were not married to each other. The result would be that the citizenship of the child would have to be evaluated under Section 309 of the INA, the provisions for children born out of wedlock abroad. The 2014 interpretation of INA section 301 allowed a child born to a married same-sex female couple to be evaluated under INA section 301 if the gestating spouse was a U.S. citizen, reducing somewhat the problem for families.

### III. The Updated Interpretation of the INA

The 2021 interpretation has improved the situation further. A recent case involved the birth of twins to a gestational carrier in Canada, where the parents of the twins were a married male

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<sup>19</sup> *Blood Relationship Essential - Establishing Blood Relationship*, 7 FAM 1134.1 (December 13, 2010), <https://www.scribd.com/document/82784532/U-S-Department-of-State-Foreign-Affairs-Manual-Volume-7-Consular-Affairs>.

couple.<sup>20</sup> One of the men was a U.S. citizen, the other was not. The twins were conceived with eggs from a donor, and sperm from both of the men. Thus, one twin was the genetic child of the U.S. citizen, and the other was the genetic child of the non-citizen. According to the pre-2021 interpretation of Section 301 of the INA, only the genetic child of the U.S. citizen was able to acquire U.S. citizenship, leaving the family with an unusual citizenship status: one twin was a U.S. citizen, the other was not.

On May 18, 2021, the Department of State released a statement that reads in part:

Children born abroad to parents, at least one of whom is a U.S. citizen and who are married to each other at the time of the birth, will be U.S. citizens from birth if they have a genetic or gestational tie to at least one of their parents and meet the INA's other requirements. . . .

This change will allow increased numbers of married couples to transmit U.S. citizenship to their children born overseas, while continuing to follow the citizenship transmission requirements established in the INA. Requirements for children born to unmarried parents remain unchanged.<sup>21</sup>

This new interpretation focuses on the marital and citizenship status of the child's parents without regard to the circumstances of the child's conception and birth. Under this new interpretation, when a child is conceived through assisted procreation and born outside the United States, she can acquire U.S. citizenship at birth so long as her legal parents (as recognized by the jurisdiction where she is born) are married to each other, and at least one of them is a U.S. citizen.

#### **IV. Practical Implications**

It is important to note that the requirement for a blood relationship between a child and a U.S. citizen parent is still an important component in the interpretation of the INA as applied to children conceived and born outside the United States without

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<sup>20</sup> *Dvash-Banks, et al. v. Pompeo, et al.*, Case No. CV 18-523-JFW(JCx), 2019 WL 911799 (C.D. Cal. Feb. 21, 2019).

<sup>21</sup> Press Statement, *U.S. Citizenship Transmission and Assisted Reproductive Technology*, U.S. DEP'T OF STATE (May 18, 2021), <https://www.state.gov/u-s-citizenship-transmission-and-assisted-reproductive-technology/>.

the use of assisted procreative methods.<sup>22</sup> The United States maintains an interest in confirming that the child acquiring U.S. citizenship is, in fact, the child of a U.S. citizen – particularly to address issues of paternity fraud.

a. Issues of false or fraudulent paternity claims: Paternity fraud is an intentionally-filed claim to citizenship filed on behalf of a child said to have been born to a U.S. citizen father who is not, in fact, the biological father of the child. Paternity fraud is most commonly found in cases where the claimed biological mother is an alien. In some cases, the alleged father believes that he is the biological father in which case the claim is properly considered false rather than fraudulent. In other cases, he knows that he is not the father, and intentional fraud is involved.<sup>23</sup>

Maternity fraud is a lesser, but documented, concern.

a. Indications of fraudulent maternity claims: Cases in which a U.S. citizen woman intentionally and falsely claims a child as her biological child for citizenship purposes are relatively rare but can occur. The U.S. citizen woman, alone or in collaboration with her spouse, claims that a foreign-born child is her biological child, when instead she has adopted the child or otherwise obtained physical custody of the child. The false claim that the child is hers is made to avoid full legal adoption and/or visa procedures and to instead fraudulently document the child as a U.S. citizen.<sup>24</sup>

However, the pre-2021 (and pre-2014) interpretations of the INA as applied to children conceived through assisted procreation and born outside the United States necessarily placed some families in the same position as those who may attempt paternity or maternity fraud. Specifically, it was obvious that the paternity of a child born to a married same-sex female couple would be in question, and that the maternity of a child born via a surrogate to a married same-sex male couple would be in question. For a married, different-sex couple, the lack of genetic connection be-

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<sup>22</sup> See, e.g., *A Biological Relationship, or Blood Relationship, Is Required for a U.S. Citizen Parent of a Child Born Abroad to Transmit U.S. Citizenship to the Child – Establishing Blood Relationship*, 8 FAM 301.4-1(D)(1) (June 27, 2018), <https://fam.state.gov/FAM/08FAM/08FAM030104.html>.

<sup>23</sup> *Suspected False or Fraudulent Citizenship Claim of Minor Child – Paternity Issues*, 8 FAM 301.4-1(E)(2) (June 27, 2018), <https://fam.state.gov/FAM/08FAM/08FAM030104.html>.

<sup>24</sup> *Suspected False or Fraudulent Citizenship Claim of Minor Child – Maternity Issues*, 8 FAM 301.4-1(E)(3) (June 27, 2018), <https://fam.state.gov/FAM/08FAM/08FAM030104.html>.

tween their child and a U.S. citizen may not be so readily apparent. The Department of State rightfully understands that “Questions of possible parentage fraud must be handled sensitively. Necessary efforts to enforce the citizenship laws may result in the Department being accused of threatening the family unit and of jeopardizing the welfare of the child.”<sup>25</sup> The pre-2021 interpretations of section 301 of the INA automatically placed many children in categories (i.e. “out of wedlock”) that burdened the families, simply because of the method of conception and birth of the child, without the sensitive treatment due to their counterparts who were conceived without assisted procreation methods.

There are still children who will not benefit from the 2021 interpretation of INA section 301. Children of unmarried parents will continue to have their citizenship evaluated by INA section 309, regardless of whether they are conceived “naturally” or through assisted procreation. Here, at least, children born as a result of assisted procreation will be similarly situated to children conceived through intercourse.

We may see over time continued improvements to the acquisition of U.S. citizenship of children conceived through assisted procreation and born abroad to U.S. citizens. In the meantime, in the words of the Department of State: “This change will allow increased numbers of married couples to transmit U.S. citizenship to their children born overseas, while continuing to follow the citizenship transmission requirements established in the INA.”<sup>26</sup>

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<sup>25</sup> *Suspected False or Fraudulent Citizenship Claim of Minor Child – General Guidance*, 8 FAM 301.4-1(E)(1) (2018) (June 27, 2018), <https://fam.state.gov/FAM/08FAM/08FAM030104.html>.

<sup>26</sup> Press Statement, *supra* note 21.

## Realizing the Full Value of Hard to Value Assets

by

Shari A. Levitan and Kimberly R. Willoughby\* (with special credit to Tyler J. Allain\*\* and Patrick Marzolino\*\*\*)

### I. Introduction

Matrimonial attorneys spend a significant amount of time and client resources valuing assets in a dissolution of marriage matter. Some assets, however, are almost impossible to value accurately. Every good matrimonial attorney knows valuing even slightly unique assets involves a heavy quotient of “artfulness,” “subjectivity,” or even “educated guessing.”

Further, valuing some assets, even though not particularly unique, can carry significant risks of inaccuracy simply due to ordinary circumstances, including valuation timing.<sup>1</sup> For the spouse who owns the property, valuation poses the risk of being too high, and for the spouse who does not own the property, the risk is that the valuation is too low. More importantly, there are situations in which valuing property carries a built-in risk of a substantially inequitable property allocation result that cannot be fairly addressed with a mere discount rate that factors in the risk.

Whenever a valuation is difficult or speculative, the attorney and valuation expert also have exposure to claims of malpractice.<sup>2</sup> No one wants to receive the call two years after the divorce

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<sup>1</sup> See Lynn Weddle Judkins, Comment, *The Road to Splitsville: How the Timing of Valuation During Marital Dissolution Leads to Costly Detours*, 15 J. AM. ACAD. MATRIM. LAW. 465 (1998).

<sup>2</sup> See e.g., *Spolar v. Datsopoulos*, 66 P.3d 284 (Mont. 2003).

that the asset valued in the divorce at \$500,000 just sold for \$10,000,000.

Compounding the problem of difficult valuations is the judicial position regarding the value and appropriate allocation of unique or speculative value assets. The case law is inconsistent in the treatment of such assets, making professionals wary that the asset will not be treated appropriately.<sup>3</sup> Courts may deem the asset's value so speculative that it is not even an asset worthy of consideration. Courts have wide discretion in determining how an asset is valued, from choosing the standard of value to deciding or altering the inputs used in the valuation, or even the timing of valuation and allocation. Courts can choose to value and divide assets at the time of divorce, defer a specific division until a stated triggering event, or simply rule that upon the occurrence of a stated triggering event the parties must return to court. Submitting the valuation and division issues to the trial court always carries its own quotient of risk.

There are times in a divorce when neither party wants to sell or divest themselves of an asset. Other times, an asset cannot be divided and allocated between both spouses due to prohibitions on transfer and assignment or other practical issues. Sometimes the parties both wish, or need, to retain an asset for some period of time to achieve full value. In other circumstances, a family's long term wealth plan can only play out by maintaining the status quo, and an early exit, sale, or termination of interests will significantly diminish the efficacy of the plan.

For example, a couple may have jointly owned and operated a business that they believe they will transfer someday to their children. A couple's investment strategy may include private equity investments held by one spouse and locked up for the next eight years; there may ultimately be little value in such assets, or substantial value. One spouse may have recently received a patent on an invention years in the making. A spouse may have ownership in a company that is likely to go public or be acquired by a special purpose acquisition company. A fund manager spouse may be four years away from the completion of the investment horizon for a fund.

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<sup>3</sup> Laurence J. Cutler & Samuel V. Schoonmaker, IV, *Division and Valuation of Speculative Assets: Reasons Adjudication or Courthouse Confusion?*, 15 J. AM. ACAD. MATRIM. LAW. 257 (1998).

This article is written for a special segment of clients - clients who are more interested in preserving their overall wealth than spending their resources on disputes about imperfect valuations. In our experience, these are clients who have a history of working closely together with wealth management professionals and estate planners. Most of the time, they have been in long term marriages, and their only children are children of their marriage. In many cases, these are clients who have had businesses that they have owned and operated together. In divorce actions, it is standard to take all steps possible to financially separate a couple as soon as possible in order to avoid ongoing conflict. This article is written for clients whose negotiations and divorce settlement agreements are not driven primarily by a need to eliminate all ties, but rather, who are attuned to the concept that continuing to cooperate in some respects can allow them to both fully realize the value of an asset. Thus, the suggested divorce settlement agreement terms discussed below do not assume the other spouse is a bad actor who should never be trusted. In fact, they assume the opposite, and that there are ways of maintaining the alignment of interests even with divorced spouses.

Maintaining ongoing relationships with the parties' joint estate planners, financial advisors and accounting professionals is a key component to the success of this ongoing joint financial relationship, for consistency in recordkeeping and reporting. To the extent the spouses wish to have separate advisors as additional resources, that can be a good adjunct to the joint planning, as a way to assure compliance, but if the spouses wish to have separate advisors at the outset, that may signal caution in pursuing what may be a long term, ongoing economic partnership.

In those circumstances where a divorcing couple believe it would serve their interests best to not simply sell or value and divide an asset, they will construct an in-kind division of some sort. There are a number of ways to do this. For instance, one party may hold the asset in a constructive trust for the other. Other times, the parties will continue to simply co-own an asset and enter into a detailed joint ownership agreement. One solution for an asset that cannot be transferred is to use a trust with a trusted independent trustee, who uses the trust as a liquidating trust to collect, account for, and distribute the income and proceeds of an asset to the parties as determined in the divorce set-

tlement agreement. This can work if the asset is transferable, if the parties are able to agree on a third party, and if there is a third party willing to accept the fiduciary responsibility for caretaking the assets until final distribution. Sometimes, the asset is transferable, but the party spouse who owned the asset must remain the owner, as trustee. Another solution involves the creation of a limited liability company (“LLC”) which contains appropriate management, distribution, investment, and tax provisions and can provide more appropriate fiduciary standards and details. This is often most appropriate where the original owner of the asset must remain as the titular owner of the asset, but a new entity and taxpayer identification number is acceptable. The LLC can streamline the income tax contributions and reporting for the parties often better than a trust.

Matrimonial lawyers should identify the possibility of these kinds of property resolutions early, and they should strongly consider engaging a trust and estates attorney, accountant and potentially a wealth manager at the beginning of a representation. This helps to ensure that all issues related to the asset’s eventual disposition are addressed early and can continue to be actively monitored until finally liquidated.

This article identifies many of the types of assets that may produce a more optimal outcome if the parties do not value and divide such assets at the time of the divorce. The type of asset is defined, potential issues that may frustrate the ability to divide the asset even if desired are discussed, and the applicable law involving such assets is set forth to discuss how courts have addressed the type of asset, to demonstrate the problems inherent with leaving the valuation, division, and allocation to the courts. Additionally, specific tax issues are addressed, and suggestions regarding divorce settlement agreement terms are provided. Part II of this Article examines stock options, restricted stock units, and performance shares. Part III addresses co-operated and co-owned businesses. Part IV offers suggestions around imminent business sales. Private equity interests, venture capital and hedge fund investments are discussed in Part V, intellectual property is explored in Part VI, and irrevocable trusts are considered in Part VII. We analyze cryptocurrency in Part VIII, outline considerations for co-owned real estate in Part IX, and make suggestions for agreements around pre-embryos in Part X.

Finally, in Part XI, we provide further suggestions for issues that should be considered in most all divorce settlement agreements and ongoing business agreements that are applicable to many of these assets.

## **II. Stock Options, Restricted Stock Units, and Performance Shares**

Stock options are an asset that divorcing couples have been dividing in-kind for decades. Trial courts have recognized that with respect to these assets, because valuation and allocation at the time of a divorce may be very unfair to one party, a type of in-kind division is most equitable.

### *A. Defining the Asset*

Employee stock options are a type of compensation granted by a company to employees. Stock options are either incentive stock options (ISOs), which the Internal Revenue Service considers qualified for special income tax treatment or nonqualified stock options (NQSOs), which the IRS does not deem qualified for such treatment.<sup>4</sup> NQSOs may be granted to members of boards of directors and advisors, but ISOs only may be granted to employees.<sup>5</sup>

Options are received via a written grant plan established by the company. The grant gives an employee a conditional right to buy company stock at a specified price for a finite period of time.<sup>6</sup> Typically, the options will “vest” over a period of time, and only vested options may be exercised by the employee. Stock options commonly vest over a period of three to five years, because vesting schedules are intended to reward employees who remain with the company for an extended period of time. Stock option plans typically contain vesting acceleration clauses for events outside the employee’s control, such as acquisition of the company or death of the option holder but ceasing employment for other reasons will result in forfeiture of unvested options.

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<sup>4</sup> See BORIS BITTKER & LAWRENCE LOKKEN, *Statutory Stock*, FEDERAL TAX OF INCOME, ESTATES AND GIFTS 60.7 (2020).

<sup>5</sup> 26 U.S.C.S. § 423(b) (2018); see also BITTKER & LOKKEN, *infra* note 4, at 60.7.1.

<sup>6</sup> See, e.g., *Bornemann v. Bornemann*, 752 A.2d 978 (Conn. 1998).

Stock option plans are applicable to both public and private companies. Part of an executive compensation package may be annual grants, each of which is a grant of a certain number of options every year for a certain number of years. If at the time the employee may exercise the option to purchase the stock, the stock price is greater than the exercise price (also called the “strike price”), the employee may wish to purchase the stock at the exercise price. At that point, the employee may sell the stock at a gain or may choose to hold it.

Stock options have been treated in a variety of ways in the divorce context. Some states have held that options that are not vested at the time of a divorce are not property because they are too speculative or because they may be forfeited.<sup>7</sup> In most states, though, employee stock options are, at least in part, marital property.<sup>8</sup> In those states, the granted options are marital property if they were awarded as compensation for past employment performance or service, and not marital if they are granted for future services, as an incentive.<sup>9</sup> California, a community property state, has employed a number of coverture formulas to cal-

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<sup>7</sup> See *Hann v. Hann*, 655 N.E.2d 566, 571 (Ind. Ct. App. 1995); *Hall v. Hall*, 363 S.E.2d 189, 196 (N.C. Ct. App. 1987).

<sup>8</sup> See *Richardson v. Richardson*, 659 S.W.2d 510, 511 (Ark. 1983); *In re Marriage of Hug*, 154 Cal. App. 3d 780, 794 (1984); *In re Marriage of Miller*, 915 P.2d 1314, 1319 (Colo. 1996); *Bornemann*, 752 A.2d at 984; *Otley v. Otley*, 810 A.2d 1, 8 (Md. Ct. Spec. App. 2002) (holding that “in line with the majority of other states, and consistent with federal tax treatment . . . unexercised and unvested stock options can constitute marital property.”); *Baccanti v. Morton*, 752 N.E.2d 718, 794-796 (Mass. 2001)(concluding that if “unvested stock options could not be considered marital assets, we would be denying one spouse the right to share in what may be the most valuable asset between the spouses, and one to which both may have contributed.”); *Davidson v. Davidson*, 578 N.W.2d 848, 851-52 (Neb. 1998); *Pascale v. Pascale*, 660 A.2d 485, 499 (N.J. 1995); *Hall*, 363 S.E.2d at 196; *Fisher v. Fisher*, 769 A.2d 1165, 1169 (Penn. 2001) (treating unvested stock options identically with unvested pensions and concluding that the stock options acquired during marriage were marital assets); *Golden v. Cooper-Ellis*, 924 A.2d 19, 25 (Ver. 2007); *In re Marriage of Short*, 890 P.2d 12, 17 (Wash. 1995).

<sup>9</sup> See *Miller*, 915 P.2d at 1318; *Salstrom v. Salstrom*, 404 N.W.2d 848, 851 (Minn. Ct. App. 1987); *DeJesus v. DeJesus*, 687 N.E.2d 1319, 1324 (N.Y. 1997); *Hall*, 363 S.E.2d at 196.

culate what portion of stock options should be distributed to the non-employee spouse.<sup>10</sup>

Restricted Stock Units (“RSUs”) are grants of actual shares at the date of grant, subject to vesting and other requirements, instead of the grant of the right to acquire shares at a later date. Grants of RSUs are the promise by an employer to deliver the shares to the employee at a time in the future once the vesting conditions have been met.<sup>11</sup> Performance Shares are also actual shares of stock; they are promised via a grant, and are issued only upon reaching certain milestones, such as the company reaching certain sales or revenue projections and/or the employee’s continued employment through a particular date. The employer grants the RSUs and Performance Shares to the employee via a grant document. Like stock options, if the employee’s employment is severed before the RSUs or Performance Shares vest, the employee’s right to the stock terminates. If a private company goes public, typically the vesting schedule is uninterrupted, but if the company is acquired, the acquirer may accelerate vesting, issue RSUs to the acquirer, or even convert them to options or buy them out.

### B. *Valuation Difficulties*

For a number of reasons, employee stock options are difficult to value. While one way to value options is simply to subtract the exercise price from the current stock price, there are other, less simplistic (and arguably more accurate) ways of valuing options.<sup>12</sup>

First, the present value of stock options depends on the value of the stock at several points in time in the future. For instance, if the employee stock options were granted on a five-

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<sup>10</sup> In re Marriage of Walker, 216 Cal. App. 3d 644 (1989); In re Marriage of Harrison, 179 Cal. App. 3d 1216 (1986); In re Marriage of Nelson, 177 Cal. App. 3d 150 (1986); *Hug*, 154 Cal. App. 3d 780 (1984).

<sup>11</sup> Michael B. Snyder, *What Is Restricted Stock*, HRS-CB § 10:76 (2021).

<sup>12</sup> See Deborah A. Gregor, Laura Montgomery Lee, & Paige Pritchett Yarbrough, *Stock Options*, 1 CRITTENDEN AND KINDREGAN, ALA. FAM. L. § 17:10 (2020) (discussing stock option valuation methods employed by Alabama Courts in divorce proceedings); Frank Kiepura, *Valuing Securities Using the Option Pricing Method* (2020), <https://www.cpajournal.com/2020/09/09/valuing-securities-using-the-option-pricing-method/>; Will Kenton, *Black Scholes Model* (2020), <https://www.investopedia.com/terms/b/blackscholes.asp>.

year vesting schedule and the divorce occurs during the first year of the vesting schedule, the value of the stock options at the time of the divorce will depend on the value of the stock in each year for the next four years. Second, if the employee leaves the company, the employee forfeits the unvested options, and there may be a curtailed period for exercise of vested options. As a result, the risk of a loss of the full potential value of the options must be factored into the value. Various methodologies have been employed to value employee stock options, such as the Black-Scholes Model, the Internal Revenue Service methodology, and reference to the options market.<sup>13</sup>

Employee stock options are often granted by startup companies to attract talent and provide value where ordinary compensation would not adequately compensate the employee. For an early-stage company, the company's determination of the fair market value of the stock itself is at best an educated guess, particularly in a highly regulated industry. For example, a biotech company may have a promising new drug, but if late-stage tests do not result in FDA approval, the value of the company's stock likely will plummet. In addition, there are times when the exercise price of the stock options is greater than the stock price at the time of a divorce, but the non-employee spouse has a strong feeling that the stock price will eventually exceed the exercise price significantly. Because the non-employee spouse may have sacrificed significantly to enable the employee spouse to work at the startup company during the marriage, the non-employee spouse may not want to forego the possibility of high future value. Additionally, it is not always clear whether, as a legal matter, a grant of employee stock options creates property at all, creates marital property, or creates separate property.<sup>14</sup>

RSUs and Performance Shares, as conditional equities whose value is determined at a future time, share the same valuation difficulties.

Given the valuation uncertainties and the uncertainty of how a court will characterize certain employee stock options, RSUs and Performance Shares, the most cost-efficient way of dealing with them can be an in-kind division. Because most NQ-

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<sup>13</sup> *See Id.*

<sup>14</sup> Eric Hollowell, *Divorce and Separation: Treatment of Stock Options for Purposes of Dividing Marital Property*, 46 A.L.R. 4TH 640 (1986).

SOs, RSUs and Performance Shares are not transferable, it is important to address transferability, how the economics of the asset will be shared when realized, and tax consequences. For Non-Qualified Stock Options, the income tax treatment for future tax reporting by the company, discussed below, is not necessarily reflective of the value of dividing assets.

### C. *Income Tax Considerations*

The inability to make an in-kind division of stock options means that income related to the stock options must be reported as income of the employee spouse. Some NQSOs are transferable by the terms of the stock option plan, but the transfer terms under the plan will require the income tax obligation to remain with the employee spouse. NQSOs are not transferable if the plan does not so provide, with the result that the employer cannot permit a one-off transfer. By contrast, ISOs are never transferable. In most cases, neither type of option is taxed at the time of grant, nor at the time of vesting.<sup>15</sup> When exercised, the excess value over the strike price for NQSOs is not taxable for regular income tax or employment tax purposes, but may be taxable for alternative minimum tax (“AMT”) purposes.<sup>16</sup> When the shares are later sold, the value in excess of basis is taxed as long term capital gain so long as the shares are held for at least one year after exercise of the option; otherwise, the excess value will be taxed as ordinary income.<sup>17</sup> The excess value is treated as additional compensation, and will be reported by the company on Form W-2 or 1099.<sup>18</sup> The taxation of proceeds from the sale of shares acquired by exercise of ISOs will depend on whether the sale occurs more than two years from the date of grant and whether the shares have been held for more than one year, in which case capital gains tax rates apply; otherwise ordinary in-

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<sup>15</sup> See 26 U.S.C. § 83 (2018); 26 U.S.C. § 421(a) (2018); 26 C.F.R. §§ 1.83-1-1.83-8 (2020); 26 C.F.R. §§ 1.421-1, 1.421-2 (2020); BITTKER & LOKKEN, *supra* note 4, at ¶ 60.1, 60.7.

<sup>16</sup> See 26 U.S.C. § 55-59 (2018); 26 C.F.R. § 1.55-1 (2018); 26 U.S.C. § 83; 26 C.F.R. §§ 1.83-1-1.83-8; BITTKER & LOKKEN, *supra* note 4.

<sup>17</sup> See 26 U.S.C. § 83; 26 C.F.R. §§ 1.83-1-1.83-8; 26 U.S.C. § 421(a); 26 C.F.R. §§ 1.421-1, 1.421-2; BITTKER & LOKKEN, *supra* note 4.

<sup>18</sup> See 26 C.F.R. § 1.6041-2(a)(1) (2020); Notice 2001-72, 2001-49 IRB 548; BITTKER & LOKKEN, *supra* note 4.

come tax rates apply.<sup>19</sup> For stock that was acquired from the exercise of ISOs, any disposition of the shares before satisfying the ISO holding period is treated as a sale, whether or not the transfer is actually a sale.<sup>20</sup> This can complicate a division of assets, although the divorce settlement agreement can contain a promise to transfer the shares once the holding period has been satisfied.

RSUs and performance shares are taxed as employment income at the time of vesting, based on the fair market value of the shares at that date.<sup>21</sup> When shares are later sold, the usual rules of whether the gain is taxed as short term or long term capital gain apply. Note that care should be taken to identify which shares are being sold if there are multiple grants since the income tax basis will be different for each tranche. In addition, transfer of stock from one spouse to the other must take place no later than six years post-divorce to be a nontaxable event.<sup>22</sup> Special considerations to keep in mind apply if the receiving spouse is not a U.S. citizen. The nontaxable treatment for transfers incident to divorce under Section 1041 of the Internal Revenue Code do not apply to transfers to non-citizen spouses. For resident non-citizen spouses, transfers will be subject to gift tax<sup>23</sup>; allocation of assets to a non-citizen non-U.S. resident spouse are deemed sales by the transferring spouse.<sup>24</sup>

#### *D. Language for the Division of Employee Stock Options, RSUs, and Performance Shares*

Divorce settlement agreements dividing stock options between the spouses typically provide that the owner of stock options holds some portion of them for the other spouse on a constructive trust theory. But, because there is no actual trust instrument, the responsibilities of the option holder are not spelled out, creating a significant potential for disagreement where the expectations of the parties about decision making are

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<sup>19</sup> See 26 U.S.C. § 421(a); 26 C.F.R. §§ 1.421-1, 1.421-2.

<sup>20</sup> *Id.*

<sup>21</sup> 26 U.S.C. § 83(a).

<sup>22</sup> See 26 U.S.C. § 1041 (2018); 26 C.F.R. § 1.1041-1T (2020).

<sup>23</sup> 26 U.S.C. § 1041(b).

<sup>24</sup> 26 U.S.C. § 1041(d). In such cases, the disposition is treated as a deemed sale to the recipient spouse, who obtains a new basis in the asset for U.S. tax purposes.

at odds. An agreement to divide employee stock options should include the following: First, there should be a very clear identification of what grants are subject to the divorce settlement agreement. Employees generally hold their options in brokerage accounts that hold all options, including options that are granted after the divorce. One way to clearly identify the grants subject to the agreement is to attach to the agreement the grant schedule that describes the options to be shared. The divorce settlement agreement should include a notice provision that requires the employee spouse to notify the non-employee spouse at least ten days before any grants vest. Additionally, if the employer requires that cash be tendered to the employer to exercise options, that notice period should be significantly increased to allow the other spouse to identify funds to use for the purchase. There should also be an agreement that the employee spouse notify the non-employee spouse of the value of the options at the vesting date, notify the non-employee spouse of the receipt of any correspondence regarding the options, and finally, notify the non-employee spouse of all employer withholdings when stocks are sold.

The divorce settlement agreement should identify how options are exercised. For instance, will the employee spouse be required to exercise options that are “in the money” (meaning, the strike price is lower than current share price) when the options vest? Or will both parties make a decision at that time? Will the employee spouse have sole discretion as to whether to exercise? Will each party be able to direct the exercise on “their” portion of the options? If one party does not wish to exercise the options, will the other party have the option to do so and retain the upside?<sup>25</sup> Will the potential income tax consequences, and the potential that one spouse’s exercise of options put them into another tax bracket or subject them to additional Medicare tax or AMT, be a factor in the decision-making process?

If the exercise of stock options is not a cashless exercise, when must the other spouse be required to tender cash to the employee spouse? The divorce settlement agreement should cover what happens if either spouse does not have cash on hand needed for a cash exercise when the options vest. If the exercise

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<sup>25</sup> If payment is made to the non-exercising party, such party will recognize gain; if the non-exercising party permits the other party to exercise and retain the shares, the usual rules for transfer will apply.

is a cashless exercise, the agreement should set forth whether all the options when exercised should be immediately sold (although the company may require this), whether all that can be held should be held, or whether the parties need to come to that agreement when the options vest.

What happens after the exercise of the options is the next issue to memorialize in the divorce settlement agreement. If the company is a public company, most agreements will state that the non-employee spouse's shares should be distributed to such party. If it is a private company, the non-employee spouse should be given the opportunity to sell shares to the employee spouse or to the company. If the private company shares cannot be sold to the employee spouse, the company, or a third party, and cannot be assigned to the non-employee spouse, the divorce settlement agreement should cover the terms of continued retention of shares in a constructive trust.

Because RSUs and Performance Shares are the promise of actual shares when granted, and when they vest the shares are delivered to the employee, they are generally easier to address in divorce settlement agreements. If the stock is transferable, the stock can be assigned to the non-employee spouse when the right to the stock vests.

The divorce settlement agreement should cover the possibility that the company will be acquired before all of the options vest, are exercised, and the shares sold. In particular, the employee spouse should commit to receiving the full value of the options and shares in cash, as opposed to other employee compensation or benefits from the acquiring company that would not redound to the non-employee spouse. This should also be included in agreements about RSUs and Performance Shares.

Until the non-employee spouse can own shares in his or her own name, all income related to the shares will be reported only to the employee-spouse. Thus, the divorce settlement agreement must provide that the non-employee spouse is responsible for the income tax on such party's portion of the options or shares. In general, the parties should agree that income tax returns for the employee-spouse be prepared with and without the non-employee spouse's share of income related to options, and the non-employee spouse will be responsible for the difference. Income taxes are withheld from options related events, and thus there

will need to be a true-up of income taxes over-withheld or under-withheld. Agreements should include calendar deadlines for these determinations and true-ups, as well as who will determine the amount of true-up, and whether such determination will be binding on the parties.

The divorce settlement agreement should address whether the income that is related to the options, RSUs, or performance shares will be income for support purposes for either party.<sup>26</sup>

Finally, the divorce settlement agreement should provide that if the employee spouse dies before the non-employee spouse receives the employee spouse's portion of the options, RSUs, or performance shares, the non-employee spouse will have a creditor's claim against the employee spouse's estate for the value as determined under the agreement. If a plan permits designation of a beneficiary, which would be unlikely, the divorce settlement agreement may require that the non-employee spouse be named irrevocably as beneficiary to secure the benefit. Finally, the agreement must address what should occur with respect to any shared decision-making if the non-employee spouse predeceases the employee spouse.

### **III. Co-Operated and Co-Owned Businesses**

#### *A. Defining the Asset*

An operating business is a business which provides a product or service to the marketplace and the primary source of revenue for an operating business is the providing of that product or service. One or both of the spouses may have an ownership stake in the business and/or may apply their time, effort, and skills to the management of the business. For example, a non-owner spouse may devote unpaid services to the business and/or tangential benefits by hosting social events for marketing purposes, taking charge of social media feeds, and assuming other responsibilities inside and outside the home to permit the business owner to devote time and attention to the business. The business may take the form of a sole proprietorship, a partnership, a limited

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<sup>26</sup> For a discussion regarding the issue of treating options as assets or income for support purposes, see Robert J. Durst, II, *Stock Options: A Significant but Unsettled Issue in the Distribution of Marital Assets*, 17 J. AM. ACAD. MATRIM. LAW. 275, 299-302 (2001).

liability company, or a corporation. Generally, interests in a business acquired after marriage are marital property and subject to division in equitable division jurisdictions, even if the business interest is owned in the name of only one spouse,<sup>27</sup> although efforts of the non-owner spouse during the marriage to support the business enterprise may convert some portion of the business interests acquired before the marriage into marital property.<sup>28</sup>

In some cases, parties co-own or co-manage a business that neither wishes to relinquish after a divorce. In these situations, the attorney will often hear that the parties may not have a good intimate partner relationship, but they have a very good working relationship. These are parties who acknowledge that a marital business is enhanced by the skills or attributes of each party, and the business value would be diminished if one of the parties were no longer involved. Additionally, adult children may be involved in the business and the parties' long term estate plan may involve the gradual transfer of business interests over time to the children. In some cases, both parties may be needed to develop the adult children as owner/operators of the business. The business interests of each party may already be held by irrevocable trusts as part of the parties' estate planning, making divestment of one party's interest at divorce impossible, or even if possible, complicated and not optimal in light of the larger family estate planning picture, potentially pitting the senior generation against later generations.

This is not to suggest that matrimonial attorneys should generally advise clients to continue to own and operate a business together. In the majority of circumstances, divorcing spouses will be unable to continue operating a business together as co-owners without being locked into continuing conflict. For the right clients though, matrimonial attorneys who are knowledgeable and creative can facilitate the wishes of parties who really are able to

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<sup>27</sup> Barbara J. Van Arsdale, Kristina E. Music Biro, George L. Blum, Noah J. Gordon, Lonnie E. Griffith, Janice Holben, Mary Babb Morris, Karl Oakes, Jeffrey J. Shampo, Eric C. Surette, & Mary Ellen Tomazic, *Business Interests as Subject to Division in Divorce* (updated Feb. 2021), 24 AM. JUR. 2D DIVORCE AND SEPARATION § 491 (Westlaw, 2021).

<sup>28</sup> George L. Bluml, *Divorce and Separation: Appreciation in Value of Separate Property During Marriage with Contribution by Either Spouse as Separate or Community Property (Doctrine of "Active Appreciation")*, 39 A.L.R. 6TH 205 (2008).

continue to co-own and operate a business together even post-divorce with a detailed course of conduct they will follow for transparency and to minimize conflict, rather than just assuming that the parties cannot and should not continue to co-own a business, or that it is a terrible experiment doomed to fail.

### *B. Valuation Difficulties*

When the parties have co-operated a business, they will have their own thoughts about the value of a business, and those valuations are not likely to be the same as that of a valuation by an expert. Their own views, industry experience, and risk tolerance will color the factual information. The ownership of a business, and the parties' respective titles and roles in it, likely provide a number of tangible and intangible values to each of them. The business may be an integral part of the parties' overall lifestyle, identity, and, sometimes, social life. The business likely provides valuable, tangible benefits, such as the ability to expense items that have become "personal" to the operator while still being legitimate business expenses. The business may be the best employment opportunity for one or both spouses in terms of compensation, and no job available in the marketplace will be able to replace either or both spouses' share of business profits and autonomy. Consider the example of a jointly owned, jointly operated inn, equestrian center, and wedding venue in a rural area, located partially on a civil war battlefield. Consider further that the wife does not have a college degree but is a remarkable wedding planner. Because the area is rural, the parties live in the area and their friends and family are also local. Both parties are equestrians. The parties see the property as a legacy property. The parties may determine that the value of the property to them is much higher than any expert will ever determine, and the advantages to both of them retaining the business outweigh the negatives of possible conflict later.

Valuing an operating business is an art, and not a science. The value will depend in part on factors within the control of the principals, and in part on factors outside their control, including among other things, changes in taxation, regulatory changes, and unique events, such as the COVID pandemic, which has decreased demand for some products and services, and increased demand for others. Value may depend on the dedication and ef-

fort of the parties who actively work in the business, and whether that dedication and effort will continue unabated following divorce.

*C. Language for Co-Ownning and Co-Operating a Business*

When parties agree to co-own a business after divorce, they must shift their expectations, and agree to be legal business partners, with arm's-length terms. If they do not already have a sophisticated corporate attorney, they should retain one to review current corporate documents such as articles of incorporation, bylaws, operating agreements, partnership agreements, buy-sell agreements, and director agreements. It is very common for spouses to not have all or even many of the necessary corporate documents in place and up to date. Even the most basic decisions, such as who will serve as officers and directors should be examined, as well as whether having outside board members will facilitate the ongoing co-ownership of the business in a successful manner.

A certified public accountant ("CPA") with expertise in advising the type of business also should be consulted. Spouses very often pay personal expenses from the business without accurately reporting those expenses as income. The CPA should help establish the rules regarding what expenses are and are not deductible business expenses, and what expenses the parties will continue to pay from the business.

The parties should have detailed agreements about compensation. Not only must compensation in the form of regular wages be discussed, but there are other forms of compensation that should be considered as well, including retirement plan allocations, individual plan life insurance and disability premium payments, auto leases, memberships, credit cards, and similar benefits. A procedure and structure for regular review of these items is important. In the case of limited liability companies and certain corporations, there may be distributions made annually for the payment of personal income taxes, as well as distributions that are a return on capital, in excess of routine compensation. In many family businesses, actual compensation has been minimized in favor of leaving funds in the company to enhance growth potential, with the business treated as the family "piggy bank" for distributions as needed. Post-divorce, incentives and

financial needs naturally change. In some cases, spouses working in the operating business feel entitled to take a market wage (or more), sometimes attempting to disguise the distributions, or to take less in order to leave more in the company for expansion plans. An independent consultant can confirm reasonable compensation, and approval levels can be agreed upon for distributions that would exceed customary reasonable compensation, similar to what a corporate acquirer would require in a corporate deal.

The newly established business agreements should address a wider variety of issues than might otherwise be dealt with in the context of unrelated co-owners, such as what each party's responsibilities in the business will be (e.g., human resources, marketing, business development, operations), the compensation for each party, whether profits will be retained by the business for investment and development, how net profits will be distributed, and how financing will be acquired. Agreements should include identification of each party's role in the company (e.g., CEO, CFO, CIO, full-time employee, or part-time employee) and obligations to the company (i.e., restrictions on competition and dissemination of company information).

There are other key business decisions that should only be implemented following agreement of the parties after full discussion. Those decisions include, but are not limited to, relocating the business, transitioning the business from a brick-and-mortar business to an on-line business (whether partially or completely), hiring certain high-level employees, purchasing software for use in the business, acquiring another business or its assets, and borrowing money or entering a new lending relationship. Keep in mind that the business may lease space or equipment from one or both of the parties. During the marriage under market rent may have been paid; it is not uncommon to charge the business only enough to cover the operating costs for the real estate.

The parties may also wish to come to an agreement regarding the time and attention that either or both of the parties will be required to dedicate to the business. Similarly, the agreement should address retirement, decisions about business management succession, and decisions about any potential future sale of the business or its assets. The parties should agree how to address the incapacity or death of the other party, and whether incapacity or

death should trigger an optional or mandatory buy-out of the incapacitated or deceased party's interest in the business by the other party or require sale of the business.

Finally, the parties must determine what constitutes a breach of their business agreements, and the mechanism for how the breaching party will exit the business if needed or desired.

If, ultimately, the parties do not wish to continue to co-own the business, or if the agreement provides that the disability or death of a spouse will require a buy-out, how the value of the exiting party's interest will be determined is critically important. The discussion about fair value is applicable here, since the selling party expects to be paid fair value, which ignores discounts. In fact, the selling party may even claim that fair value should include a premium for the ability of the purchasing party to have control over the entire business. Note that the use of fair value without discount will impact the value used for transfer tax purposes for gifts during life, and sales during life to related parties and at death because the IRS will assume that the valuation methodology used in an agreement between former spouses is reflective of an arm's-length valuation.

Many of the same issues discussed above apply to a sale to a third party in close proximity to the purchase of one party's interest by the other party. If, however, the buyout of one party was at a discounted value due to breach, it would not be reasonable to have any sort of claw back for future upside, unless the ouster were contrived.

#### D. *Income Tax Considerations*

When married, or incident to divorce, one spouse's purchase of interests in a business from the other spouse is not treated as a sale for income tax purposes, meaning the selling spouse does not realize a taxable gain on the sale of interests, and the purchasing spouse receives carry-over basis from the selling spouse.<sup>29</sup> A later sale of the business may result in gain, making it important to consider unrealized gains.<sup>30</sup> However, the spouses

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<sup>29</sup> 26 U.S.C. § 1041(a)-(b).

<sup>30</sup> Michael A. Paschall, *Discounting for Built-In Capital Gains in LLCs, Partnerships, and S Corporations*, Fair Value (2003), <https://www.businessvaluation.com/resources/Valuation-Articles/Built-in-Gains-LLCs-FLPs-S-Corps.pdf>; Robert P. Schweih, *Valuation Adjustment for Built-in Capital Gains in a C*

may wish to continue to co-own the business, or may need to in order to fairly divide their marital property if a buyout cannot be achieved, and only after the period has passed for nontaxable treatment for a sale between them has occurred, determine that the arrangement is no longer desirable.<sup>31</sup> If the business has non-U.S. operations, care should be taken to understand any foreign tax issues.

*E. Liability Considerations, Including Those Incorporated in the Purchase and Sale Contract*

The same liability considerations apply in a sale between the parties but are often not given sufficient attention as compared to a sale to a third party since the parties will assume they are knowledgeable. In fact, one of the parties may have been more involved in certain aspects of the business and have a greater appreciation for the liabilities of the business.

Again, the parties' new relationship will simply be as business partners, but as former spouses, it is advisable for the business documentation to cover a wider range of issues and do so with more precision than might otherwise be the case. This ensures the expectations of both parties are known to one another; otherwise, a party may simply assume that conduct during the marriage will or should continue, or, conversely, will change, post-divorce. Unrelated parties assume the other party will behave in a businesslike manner; sometimes former spouses unreasonably assume that their former personal relationship will make the business relationship less rigorous.

The divorce settlement agreement need only reflect that the parties will each be allocated a share of the business and that income will be derived from a co-owned business. Divorce courts should not have responsibility for interpreting or enforcing business agreements. The business agreements should be completed and signed before the divorce is fully settled and may be referenced in the divorce settlement agreement. Business operating documents and the divorce settlement agreement each should contain a dispute resolution clause, including venue.

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*Corporation*, GIFT AND ESTATE TAX VALUATION INSIGHTS (2012), [http://www.willamette.com/insights\\_journal/12/summer\\_2012\\_4.pdf](http://www.willamette.com/insights_journal/12/summer_2012_4.pdf).

<sup>31</sup> 26 U.S.C. § 83(a); 26 U.S.C. § 1041; 26 C.F.R. § 1.1041-1T.

F. *Change of Corporate Structure or Business Focus Should Not Negatively Impact Agreement*

The spouse working in the business should not be able to relinquish or delegate decision-making over the business or change the corporate structure of the business without the consent of the other spouse. This includes changes in structure that would change the flow of funds from the business or alter the manner in which business decisions are made, especially if doing so would in any way be contrary to the divorce settlement agreement. This would include, for example, a change in corporate tax structure from a C corporation to an S corporation. While that may be advisable for overall income tax planning, an S corporation must allocate its profits to the shareholders for tax purposes, but is not required to actually distribute those profits to the shareholders.<sup>32</sup> Depending on the terms of the agreement, this phantom income can create significant imbalance in the parties' respective financial positions and upset the parties' expectations as outlined in the divorce settlement agreement. Because changes to corporate tax structure may impact other portions of the divorce settlement agreement, such as spousal support, an amendment to the divorce settlement agreement may be required in addition to requiring the other party's consent in the ordinary business sense.

## **IV. Imminent Business Sales**

A. *Valuation Difficulties*

The best means of determining the value of an asset is by selling it on the open market. One of the hardest assets to value is a closely held private company.<sup>33</sup> At divorce, the owner-spouse will generally claim it is worth much less than what the non-owner spouse has heard about the value during the marriage. There is no shortage of attorney war stories about the businesses sold shortly after a divorce for much higher than the divorce valuation.

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<sup>32</sup> 26 U.S.C. § 1366(a)(1) (2018).

<sup>33</sup> Gunnar J. Gitlin, *Business Valuation in Divorce Cases - 101 - What a Family Lawyer Needs to Know to Competently Represent Your Client* (2013), <http://gitlinlawfirm.com/wp-content/uploads/2016/07/Article-3a-Business-Valuation-101-outline.pdf>.

What is very difficult to incorporate into a determination of fair value (and fair market value as well) are potential future corporate events. That includes a public offering, or an acquisition for cash and/or an interest in the acquiring entity. The owner-spouse will be concerned that a valuation will fail to take into account certain liabilities imposed on the seller, including corporate taxes, the value of contractual obligations, rent, and similar matters. While those known at the time of divorce should be considered by the appraiser, there also may be extraordinary liabilities, including a tax audit, an employment claim, an environmental claim, or a patent infringement claim. Of course, an appraisal can only make reasonable assumptions based on facts certain or very likely to occur.

While a sale may provide a potentially exponential upside, a portion of the upside may be held in escrow or subject to an earn-out schedule for benchmarks met post-closing over a period of time, as well as reduced liabilities for unknown events that the acquirer will not assume. Most sales are structured as a sale of the assets of the business, rather than a sale of shares because the buyer will not agree to acquire the liabilities of the business, but if they are limited in nature, a buyer may purchase the shares, but the purchase agreement may impose a reserve for liabilities the buyer does not intend to assume.

## *B. Considerations for the Imminent Sale of a Business*

### *1. Claw Back*

To protect against a sale in close proximity to the divorce producing a substantially different value than determined by appraisal or agreement, a claw back provision can be included in the divorce settlement agreement. The claw back provision would provide that if the business is sold shortly post-divorce at a markedly different value, the non-owner spouse would be entitled to an additional settlement amount based on the increased value of the business over what was assumed at the time of divorce. A claw back provision should be limited in time, most commonly between twelve and eighteen months; otherwise, it may be argued that the increased value is due to the services of the owner, changed market conditions, or other, new factors than existed at the time of divorce.

What is rarely considered is the situation where the business sells for less than the appraised or agreed upon value, and whether there should be a claw back for the owner spouse. If it is contemplated that a business will be sold soon after the divorce, the more equitable approach for both parties may be to have a non-owner spouse's share of the asset allocated when value is realized. In a sense, this makes the non-owner spouse a silent partner until the sale occurs, and may suggest that in the divorce settlement agreement, certain rights typically held by co-owners apply, such as decisions about sale price and terms. Because third parties cannot be bound by a divorce settlement agreement between the parties, the divorce settlement agreement might contain indemnification provisions between the spouses to address potential unknown liabilities that might be retained by the seller in a sale to a third party.

In the case of division at the time of divorce with a claw back provision, it would be unusual to have the other party need to consent to a sale, but disclosure provisions are essential.

## *2. Deferred Division*

If the division of assets is deferred, pending a sale to a third party, the divorce settlement agreement should specify who makes decisions about timing and terms of a sale, what disclosures are required to be made to the other spouse, and what value adjustments will be made. There is a balance between disclosure and having a silent partner with veto power over a sale.

The party who is the sole owner of the business naturally will want to have sole control over decisions about whether to sell the business, and all of the details for a sale. However, that may disadvantage the other party. For example, the owner may be perfectly happy receiving shares of the acquirer, or payment in part with a promissory note, both of which effectively make the acquirer the "bank." The owner may want to sell the business to key employees on more favorable terms than the market might achieve, out of a sense of loyalty to longtime employees, or may wish to hold out for a strategic buyer, even if none is on the horizon. What disclosures and consents must be obtained from the other spouse should be clear in the business agreement, and it may be agreed that the decision about what is the "best" sale may be subject to the business judgment rule, as distinct from a

fiduciary standard of care.<sup>34</sup> The parties' expectations about the timing of a sale and how the price will be established should be agreed upon, as well as how much of the detail the non-owner spouse must approve before a sale is consummated. An important issue to consider is the need for confidentiality so as not to chill the market.

The non-owner spouse will be concerned that the owner spouse may not adequately protect the value that will be delivered to the non-owner spouse. Even though their interests would seem to be aligned to maximize value, there are matters that may be more appropriately determined jointly to assure that the economic result achieved is what the parties intend.

The purchase agreement may also contain so-called "golden handcuffs," to assure that the owner of the business remains actively engaged in the business for some period of time following the sale, assuring continuity for the purchaser. It is rare for a business owner accustomed to running a business without oversight to remain employed for the entire duration of a golden-handcuffs term. Should the future compensation paid by the acquirer be treated as part of the value of the business to be divided, or simply compensation to the selling spouse in the ordinary course, separate from the value of the business? The buyer may sweeten the deal by including options or warrants in the acquiring company. Other less obvious personal benefits to the selling party may include the ability to retain assets of the corporation, including receivables, tangible assets (equipment, vehicles, and the like), and agreement for a new consulting business established by the seller to provide certain services to the buyer, or an unusual non-compete provision.

### C. *Income Tax Considerations*

The sale of a business or the assets of a business is generally classified as capital gain for tax purposes.<sup>35</sup> A stock sale is taxed

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<sup>34</sup> See *The Delaware Way: Deference to the Business Judgment of Director Who Act Loyal and Carefully* (Apr. 2021), <https://corplaw.delaware.gov/delaware-way-business-judgment/> (discussing differences between the business judgment rule and the duty of loyalty).

<sup>35</sup> See 26 U.S.C. § 1221 (2018); 26 C.F.R. § 1.1221-1 (2020); 26 U.S.C. § 64 (2018); 26 U.S.C. § 1 (2018); 26 C.F.R. § 1.1-1 (2020); 26 U.S.C. § 61 (2018).

once, at the shareholder level.<sup>36</sup> An asset sale, often preferred by buyers, will be taxed differently, depending on the corporate structure. C corporations are subject to potential double taxation, once at the corporate level, and then again by the shareholder as ordinary dividend income when the net proceeds are distributed.<sup>37</sup> If, on the other hand, the entity is taxed as an S corporation for tax purposes, while there is no double tax, some of the gain may be taxed as ordinary income due to depreciation recapture, and it is possible that if the corporation had previously been taxed as a C corporation, there may be some portion of the proceeds that are not taxed at all.<sup>38</sup> For partnerships, including LLCs, an asset sale requires careful consideration of the particulars to confirm whether any portion will be taxed as ordinary income.

Ideally the parties will do their tax reporting in a consistent manner, and while the divorce settlement agreement and business agreements might obligate them to consult with one another, they should not obligate themselves to take a tax reporting position that may be incorrect if one party has a higher risk tolerance for gray areas than the other.

## **V. Private Equity, Venture Capital and Hedge Fund Investments – Investor and Principal**

### *A. Defining the Asset*

A person holding an interest in a private equity, venture capital, or hedge fund may be simply an investor without management responsibilities or that person may be a principal who actively participates in management in order to generate returns for the fund.

Private equity funds obtain capital contributions from wealthy investors in exchange for a limited (non-managing) ownership interest in the fund. An investor typically makes a commitment at the outset to make contributions of capital to the

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<sup>36</sup> *Id.*

<sup>37</sup> See 26 U.S.C. § 11 (2018); 26 C.F.R. § 1.11-1 (2020); see 26 U.S.C. § 1; 26 U.S.C. § 61.

<sup>38</sup> Timothy C. Smith, *Impact of Tax Reform on Choice of Entity*, NAT'L L. REV. (2018), <https://www.natlawreview.com/article/impact-tax-reform-choice-entity>.

fund at certain points in time to facilitate investment by the fund. The fund will use raised capital to purchase interests in existing businesses, often controlling interests, with the goal of increasing the value of the acquired business over time and eventually selling those interests off for a profit. Because increasing the value of an operating business takes time, funds often have long investment horizons, with investor capital unable to be withdrawn for several years after the initial investment.

Venture capital funds can be thought of as a type of private equity fund, typically investing in newer, less mature businesses. Venture capital funds typically spread investments across a large number of start-ups, acquiring minority positions in each. The expectation is that a majority of the businesses invested in will fail, but if the fund “hits” on the next Facebook, for example, returns could be exceptional. Private equity funds typically look to create value by acquiring a controlling stake in an existing business and actively working to increase the value of the business, whereas venture capital funds simply try to identify early-stage companies with great growth potential and try to ride that growth to strong investor returns.

Hedge funds are pooled investment vehicles that, like private equity funds, obtain capital contributions from investors. Unlike private equity funds, hedge funds invest in securities and other assets, taking long and/or short positions, with the goal of outperforming the returns of the broader market in such assets by taking an aggressive position about the strength or weakness of the particular investment sector, or minimizing downside risk. Hedge fund managers do not typically seek to acquire a controlling stake in a business. The fund typically will focus on a particular industry segment, or strategy for investment (long or short term, for example). Hedge fund investments typically are more liquid in nature than private equity investments, but the fund still depends on maintaining the contributed capital, with the result that withdrawals will be subject to calendar windows and capital requirements for transfer or redemption. Redemption timing limitations can cause the interests to be subject to valuation discount for the lock up periods and future volatility. For example, a fund may have one annual notice for withdrawal by, say October 1, with payment to be made the following January 15. If an investor fails to provide capital to the fund following a call on

commitments by fund management, the investor may forfeit the interest in the fund.

For all three, an investor must be an accredited investor and qualified purchaser, as defined in regulations established by the Securities and Exchange Commission (“SEC”).<sup>39</sup> The ability of an investor to transfer the interest in the fund may be severely restricted. The partnership agreement governing the relationship between the general and limited partners often restricts transfer of an investor’s interest such that it may only be transferred to another limited partner in the fund. Even if an investor’s interest may be transferred, the transferee must qualify as an accredited investor and qualified purchaser under SEC regulations, and the investor’s spouse may not qualify as an accredited investor or qualified purchaser even after a division of other marital assets.<sup>40</sup> Because of the limited transferability of the investor’s interest in the fund, and speculative future value, the fund interests likely will be subject to steep discounts for valuation purposes.

Fund principals have additional potential economic upside in the form of “carried interest,” which is typically structured as a percentage return once the limited partners have either received back their initial investments, or their initial investment plus a stated return. Economic interests in the management entities likely will be subject to a vesting schedule and may not be easily transferred for the obvious reason that fund principals want to work with specific persons who are knowledgeable in the particular business and limited partners want management to be in the hands of competent, knowledgeable individuals recognized as having industry experience and talent.

#### B. *Valuation Difficulties*

Most private equity and venture capital funds provide periodic statements that project future value, since there is no ready value until the fund has completed its investment commitment, completes the exit strategies for the investments by selling or liquidating the investments, and winds up. As a result, it may be impossible to obtain from the fund current fair market value information. Even where information may be available, there is

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<sup>39</sup> 17 C.F.R. § 230.501 (2020).

<sup>40</sup> *See Id.*

often a substantial lag time for information to be disseminated to investors.

Hedge funds do provide periodic statements to investors, but the value reflected on the statements does not take into account the lock up period. In addition to the timing issues, market forces can severely impact the value of the asset. Current examples include the impact of day traders running up the value of GameStop and AMC,<sup>41</sup> and the impact of volatile oil prices.<sup>42</sup>

In addition to a lack of good information about current market values, when these interests are valued for divorce purposes, they are subject to very high discounts for lack of marketability and lack of control. Thus, for example, an owner spouse can invest \$500,000 on January 2, receive a statement that shows a value of \$520,000 and a projected value of \$700,000, but the divorce valuation on January 3 will be \$275,000. That often seems extremely inequitable to the non-owner spouse.

### C. *Language for the Division of Private Equity, Venture Capital, and Hedge Fund Investments*

When dividing these assets in kind, look first to the subscription agreements and operating agreements to determine restrictions on transferability of the interests. Look also for provisions specific to transfers by operation of law, including the divorce of an interest holder. If partial interests are transferable to the spouse, be sure all transfer rules are followed, such as obtaining consent from the manager, agreeing to and signing all necessary agreements that the owner of the interests agreed to, meeting investor requirements, and during transferring an open window for transfer (usually at the end or beginning of a calendar year). The parties may agree that the economics before a permitted transfer date will be shared by them.

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<sup>41</sup> Bloomberg, *Hedge Fund Titans Steve Cohen and Dan Sundheim Lose Big in GameStop Short Squeeze Frenzy*, FORTUNE (Jan. 2021), <https://fortune.com/2021/01/28/gamestop-hedge-fund-losses-steven-cohen-dan-sundheim>; Pippa Steves, *AMC Share Price Quadruples as Retail Traders Raid Hedge-Fund Short Targets*, CNBC (Jan. 27, 2021), <https://www.cnbc.com/2021/01/27/amc-shares-triple-as-retail-investor-raid-of-hedge-fund-short-targets-spreads-from-gamestop.html>.

<sup>42</sup> ZeroHedge, *This Hedge Fund Made a Killing on Oil Volatility in 2020*, OIL PRICE (Jan. 27, 2021), <https://oilprice.com/Energy/Energy-General/This-Hedge-Fund-Made-A-Killing-On-Oil-Volatility-In-2020.html>.

If an outright partial transfer is not allowed, determine if a transfer of all interests can be made to an LLC. If so, the spouse who owns the interests may create an LLC to hold the interests, with the spouses as members in whatever percentage membership interests they determine. Note that not all funds will permit a transfer to an LLC, and it may be that the parties will need to agree that the fund interests will be held as though they had been transferred to such an LLC. Even where the fund permits a transfer to an LLC, it is likely the fund will require a single manager to serve as the point of contact between the LLC and the fund. The fund will likely require that the manager be the spouse who is the initial investor or principal of the fund, as opposed to the spouse who may receive an interest in the fund incident to the divorce proceeding.

In addition to management considerations, the LLC operating agreement should address the following issues: timing of distributions to the spouses, including specifying reserve requirements; LLC distribution triggers, including for tax payments owed by the members; transferability of LLC membership interests; management of the LLC and management succession in the event of the manager's death or disability; anticipated duration of the LLC and whether further investments can or should be made; and how retained cash for reserves should be invested. Because of the complex nature of the assets, it will be important to carefully consider a reserve for claw back liabilities to the fund, and, if the spouse is a principal in the fund, for other liabilities, as well as indemnification if the reserve is insufficient. Some principals wish to make charitable transfers of stock to be received and how that will be treated for LLC distribution purposes should be spelled out in detail in the operating agreement. For example, will a charitable contribution from the LLC be treated as a charitable contribution pro rata by the members, or a distribution to one of the members, who in turn is deemed to have made a charitable contribution.

Finally, for fund principals, there may be multiple fund interests transferred to the LLC, with future vesting and reinvestment opportunities. The spouses may determine that interests vested as of a date certain will be shared via the LLC structure, but interests that vest after a certain date will not be shared in the same proportion. However, if fund management cannot or

will not bifurcate the marital portion to be shared via the LLC, then the entire interest can be transferred to the LLC, and the operating agreement can address how distributions will be made between the parties.

As with co-owned and managed businesses, rather than stating all of the above details in the divorce settlement agreement, the operating agreement should control and will be governed by state corporate law. The parties will be members of an LLC, not spouses or ex-spouses. However, the operating agreement can be an exhibit to the divorce settlement agreement that should certainly be completed and signed before the divorce settlement is complete.

#### *D. Income Tax Considerations*

For interests that cannot be transferred, but will be shared by the parties, the value shared should be the net after tax value. The utility of the LLC arrangement is that income taxes can be paid by the LLC and net value can be distributed to the parties. It is very common to include in the operating agreement that the tax impact of the distributions will be certified by an accounting firm and the parties will rely on that certification.

For fund principals, recent changes to the Internal Revenue Code alter the income tax treatment of carried interest from capital gains to ordinary income under certain circumstances and can accelerate gain recognition on transfers of carried interests to “related parties.”<sup>43</sup> Fortunately, the Final Treasury Regulations issued on January 7, 2021 clarify that the gain acceleration on the transfer of a carried interest applies only where gain would otherwise be recognized.<sup>44</sup> As a result, acceleration of gain is not triggered on gifts or transactions that would otherwise be tax-free.<sup>45</sup> Assuming assets are distributed between spouses incident to the divorce and are otherwise exempt from current income tax recognition, the final regulations clarify that gain is not accelerated on the transfer of carried interest.<sup>46</sup>

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<sup>43</sup> 26 U.S.C. § 1061 (2018); *see* T.D. 9445.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

### E. *Monitoring/Management*

Reporting for these interests are often subject to substantial time lags in reporting from the fund itself. Both spouses and their advisors should review the reporting and the resulting value shared and tax reporting on an agreed upon schedule. There is often little or no transparency from the fund itself, unless the fund is very small and wholly owned for management purposes by one or both of the parties. The ability to obtain different reporting from the fund itself, therefore, may be non-existent. If the flow of funds is transparent from the reporting, that will allow each party to trust and verify the distributions.

## VI. Intellectual Property

### A. *Defining the Asset*<sup>47</sup>

Intellectual property is defined as intangible rights protecting the commercially valuable products of the human intellect.<sup>48</sup> It is also “the set of legal rights to an expressed idea—it is property that results from the fruits of mental labor.”<sup>49</sup>

In the divorce context, courts have divided intellectual property that includes rights granted via patents,<sup>50</sup> trademarks and trade secrets,<sup>51</sup> and copyrights.<sup>52</sup> Underlying those rights are the creations themselves, such as software developed, technology or

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<sup>47</sup> The authors have intentionally omitted personal goodwill such as celebrity goodwill.

<sup>48</sup> *Intellectual Property*, BLACK’S LAW DICTIONARY (11th ed. 2019).

<sup>49</sup> *Alsens v. Alsens*, 101 S.W.3d 648, 653 (Tex. App. 2003) (citing Richard R. Orsinger & David G. Henry, *Intellectual Property*, NEW FRONTIERS IN MARITAL PROPERTY LAW, A1-1 (1999)).

<sup>50</sup> See *Lorraine v. Lorraine*, 48 P.2d 48, 701-702 (Cal. Ct. App. 1935); see *Teller v. Teller*, 53 P.3d 240, 249 (Haw. 2002) (holding that the family court did not abuse its discretion when it determined that the patent and trade secrets constituted marital income subject to equitable distribution); see *Matter of Marriage of Monslow*, 912 P.2d 735 (Kan. 1996); see *Howes v. Howes*, 436 So. 2d 689 (La. App. 1983); see *McDougal v. McDougal*, 545 N.W.2d 357, 359 (Mich. 1996).

<sup>51</sup> See *Teller*, 53 P.3d at 247.

<sup>52</sup> See *Berry v. Berry*, 277 P.3d 968, 969 (Haw. 2012); see *Rodrigue v. Rodrigue*, 218 F.3d 432, 443 (5th Cir. 2000).

devices invented,<sup>53</sup> plant varieties invented, paintings painted,<sup>54</sup> books written,<sup>55</sup> movies made,<sup>56</sup> and music composed.<sup>57</sup> Finally, courts can divide the income that is derived from the intellectual property by allocating royalties, income from licensing agreements, income from franchise agreements, and proceeds from sales of the property.

Often the work behind the creation of intellectual property represents an enormous effort and sacrifice during a marriage. In fact, it can be the reason for a divorce. Take the example of the spouse who quit a lucrative job as the CIO of a large company to start developing her own software as a service (SAS). The spouse has used all of the family's savings to develop the SAS and keep the family afloat during the time there was no income. The spouse dedicated all working time during the marriage toward development efforts for the intellectual property. The other spouse undertook more of the family responsibilities and perhaps took a less interesting job solely to provide economic support, rather than intellectual stimulation, all to support the family and the efforts of the spouse developing the intellectual property. If the divorce occurs before the SAS has produced anything tangible or is capable of being valued, the supporting spouse will want recompense if the SAS ultimately sells for millions, as the parties always assumed it would.

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<sup>53</sup> See *In re Perkel*, 963 S.W.2d 445, 451 (Mo. Ct. App.1998) (noting that the software written by the husband during the marriage was marital property); see *Hazard v. Hazard*, 833 S.W.2d 911, 916 (Tenn. Ct. App. 1991).

<sup>54</sup> See *Rodrigue*, 218 F.3d at 443.

<sup>55</sup> See *In re Worth*, 195 Cal. App.3d 768, 773 (Cal. App. 1987) (noting that "there seems little doubt than any artistic work created during marriage is community property"); see *Gallo v. Gallo*, 440 A.2d 782, 788 (Conn. 1981); see *In re Marriage of Heinze*, 631 N.E.2d 728, 731 (Ill. App. 1994) (reasoning that where contract rights to future book royalties were acquired during marriage, those royalties are fruits of the shared enterprise of marriage subject to equitable distribution); see *In re Marriage of White*, 537 N.W.2d 744, 747 (Iowa 1995).

<sup>56</sup> See *Canisius v. Morgenstern*, 35 N.E.3d 385 (Mass. App. Ct. 2015); see *C.G. v. R.G.*, 9 N.Y.S.3d 592 (N.Y. Sup. Ct. 2015) (holding that proceeds from selling the husband's film will be divided between the parties 70% to the husband and 30% to the wife).

<sup>57</sup> See generally *Zander v. Zander*, No. FA 970074587S, Aug. 30, 1999 WL 711503 (Conn. Super. Ct. 1999) (holding that a husband was not entitled to royalties from the sale of his wife's song recordings, because of the future efforts that would be required of the wife to retain the royalty stream).

In divorce cases, intellectual property is often analogized to and treated similarly to pensions.<sup>58</sup> Like a pension,<sup>59</sup> intellectual property is property, as opposed to a mere expectancy, but whether and how much value a person may actually receive from the asset is uncertain. Like a pension, intellectual property may have components of its value that accrued before the marriage, during the marriage, and after the marriage. Value accrued during the marriage is marital property,<sup>60</sup> but value accrued before and after the marriage is separate property.

Like the history of the treatment of pensions in divorce matters, intellectual property is not universally deemed “property.” One federal district court held that a copyright is the separate property of the creator due to the federal preemption by copyright law, but the proceeds from the copyright are subject to division between spouses.<sup>61</sup> On appeal, in a threading of a proverbial needle, the federal appellate court determined instead that the creator “maintains exclusive managerial control” of the copyright, but the economic benefits thereof can be divided at divorce.<sup>62</sup> Another court held it was not error to fail to place a value on patents when the future of the income was too specula-

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<sup>58</sup> See e.g., *Heinze*, 631 N.E.2d at 731 (reasoning that similar to pension rights, future book royalties are the fruit of the shared enterprise of marriage and should be divided as marital property). However, “[u]nlike pensions and other professional goodwill, rights in intellectual property are highly transferable, and title may thereafter be placed in the name of one who not originally produce them.” *In re Monslow*, 912 P.2d 735, 743 (Kan. 1996).

<sup>59</sup> See Susan J. Prather, Comment, *Characterization, Valuation, and Distribution of Pensions at Divorce*, 15 J. AM. ACAD. MATRIM. LAW. 443, 449 (1998); Brett R. Turner, *Intellectual Property—Treatment as Property*, 2 EQUIT. DISTRIBUT. PROP., 4th § 6:79; *Monslow*, 912 P.2d at 744 (citing RUTKIN, VALUATION AND DISTRIBUTION OF MARITAL PROPERTY § 23.07[1], p. 23–133 (1995)).

<sup>60</sup> See *Worth*, 195 Cal. App. 3d at 776; see also *Curtis v. Curtis*, 208 Cal. App. 3d 387 (Cal. Ct. App. 2d. Dist. 1989); *Monslow*, 912 P.2d at 743; *Perkel*, 963 S.W.2d at 45 (“All property acquired by either spouse subsequent to the marriage and prior to a decree of legal separation or dissolution of marriage is presumed to be marital property.”); *Hazard v. Hazard*, 833 S.W.2d 911, 916 (Tenn. Ct. App. 1991); *Alsenz v. Alsenz*, 101 S.W.3d 648, 655 (Tex. App. 2003); *Rodrigue v. Rodrigue*, 218 F.3d 432, 443 (5th Cir. 2000).

<sup>61</sup> *Rodrigue*, 55 F. Supp.2d 534 (E.D. La. 1999), *rev’d*, 218 F.3d 432 (5th Cir. 2000).

<sup>62</sup> *Rodrigue*, 218 F.3d at 436.

tive to consider.<sup>63</sup> Still another queried whether proceeds from pre-marital intellectual property should be considered the return of that property (like an annuity) or income, such as the income from a pre-marital investment.<sup>64</sup> Finally, some courts have determined that if a future income stream from property is too speculative, it does not need to award interests in the intellectual property as part of the property division.<sup>65</sup>

The moment when an idea, concept, code, or scribble becomes property is more difficult to identify than when a pension becomes property; however, there are different times that the property right can be said to have accrued or vested: when the property right can be said to have accrued or vested: when the concept is sufficiently developed to generate a plan to create the intellectual property; when the intellectual property can be said to have been made or created; or the when the intellectual property is actually linked to something that can generate income, like a patent, a production transaction, or a contract.<sup>66</sup> Thus, separating premarital from marital intellectual property can be challenging, and the question may arise as to when the idea was sufficiently formed to be something that has the nature of property and when it had value. One court has noted that a property right vests when the right in a trade secret vests, and there can be a second vesting date for the same intellectual property when a patent is received.<sup>67</sup>

It can also be difficult to separate marital property value from post-marital property value added to intellectual property. One of the most famous examples of this is the dispute between actor Michael Douglas and his ex-wife regarding the movie “Wall Street.” The Douglases divided royalties and sales from Mr. Douglas’ movies that were made during the marriage. One of those movies was “Wall Street.” Ms. Douglas claimed an interest in the sequel, “Wall Street: Money Never Sleeps.” She argued it

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<sup>63</sup> *Yannas v. Frondistou-Yannas*, 481 N.E.2d 1153, 1160 (Mass. 1985) (holding that a patent on artificial skin was too speculative for division).

<sup>64</sup> *Alsenz*, 101 S.W.3d at 653 (holding that the husband’s inventions patented before marriage were revenue and the fruit of his separate property and thus community property).

<sup>65</sup> *Woodward v. Woodward*, 363 S.E.2d 413, 417 (S.C. Ct. App. 1987) (awarding the husband an interest in the wife’s profits from an unspecified speculative patent would violate public policy favoring finality of judgments).

<sup>66</sup> See *Teller v. Teller*, 53 P.3d 240, 249 (Hawai’i 2002).

<sup>67</sup> *Id.* at 254.

was a spinoff derived from marital intellectual property. Mr. Douglas claimed the movie was a distinct work and only post-marital efforts were in play.<sup>68</sup> Ms. Douglas' bid for an additional award was denied on the grounds of improper venue.<sup>69</sup> A more pedestrian example is *In re Marriage of Heinze*, where the co-author of speech therapy books successfully argued to the Third District Appellate Court of Illinois that she should be awarded a greater percentage of post-marriage royalties from her books because her post-marriage marketing efforts would help generate the royalties.<sup>70</sup> Courts tend to take a rather blunt force instrument to the issue, however. Often, the court simply awards the non-owner spouse a lower than equal percent of future income from the property when the owner spouse will be exerting efforts to produce the income after marriage.<sup>71</sup>

Just as the intellectual property can be divided in a divorce, so can the debt related to the development of intellectual property when it was incurred during the marriage.<sup>72</sup> Similarly, courts have held that the parties should share income taxes on the funds received from the property in an appropriate manner.<sup>73</sup>

#### B. *Valuation Difficulties*

Intellectual property can be very difficult to value, especially if it has not yet started to produce income. When valuing intellectual property, the valuation must take into account the highest and best usage in light of the most reasonable and legal use of

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<sup>68</sup> David P. Schwartz, *Judge Returns Diandra Douglas' Settlement Case to California Courts*, ORANGE COUNTY DIVORCE LAWYER BLOG (June 2011), <https://www.orangecountydivorcelawyerblog.com/judge-returns-diandra-douglas/>.

<sup>69</sup> Aaron Couch, *Michael Douglas' Ex-wife Diandra Loses Bid for 'Wall Street 2' Earnings*, HOLLYWOOD REPORTER, (June 18, 2011), <https://www.hollywoodreporter.com/news/michael-douglas-wife-diandra-loses-203073>.

<sup>70</sup> *In re Marriage of Heinze*, 631 N.E.2d 728, 732 (Ill. App. Ct. 1994).

<sup>71</sup> See *Heinze*, 631 N.E.2d at 732; see *In re Monslow*, 912 P.2d 735, 747 (Kan. 1996); see generally *Dunn v. Dunn*, 802 P.2d 1314, 1319 (Utah Ct. App. 1990).

<sup>72</sup> See, e.g., Frank J. Wozniak, *Copyright, Patent, or Other Intellectual Property as Marital Property for Purposes of Alimony, Support, or Divorce Settlement*, 80 A.L.R. 5TH 487 (2000); see also *Allen v. Allen*, 601 P.2d 760, 762 (Okla. Ct. App. 1979).

<sup>73</sup> See *Wozniak*, *supra* note 72, at § 6[a]; See *Heinze*, 631 N.E.2d at 733; *In re Marriage of White*, 537 N.W.2d 744 (Iowa 1995).

the intellectual property, that is physically possible, appropriately supported, and financially feasible, and that results in the highest value.<sup>74</sup>

The usual valuation methodologies are not easily applied to intellectual property. For instance, the cost approach may be problematic because the cost to develop intellectual property may include failed or inefficient “first tries.” The market approach is not likely to yield a supportable valuation because there are not often comparable sales for unique intellectual property. Some courts use an investment value approach, asking what an investor would pay for the foreseen return, but this is just a fair market value approach and therefore has the same weaknesses.<sup>75</sup> The income approach is too speculative if the intellectual property is not already receiving an income stream. In addition, a competing intellectual property may be introduced to the marketplace and reduce the income stream. Finally, there may be unforeseen costs in the future that will need to be expended to protect the income stream, such as patent infringement suits.<sup>76</sup> In short, each valuation methodology is susceptible to significant inaccuracy due to the lack of information regarding the net value of intellectual property both during development and at all stages of the property’s useful lifetime.

Due to valuation difficulties, some courts have determined that to equitably divide the property, the court should award the non-owner spouse a percentage of future net profits.<sup>77</sup>

Case law on the valuation of intellectual property can be found more readily in federal cases involving copyright law,<sup>78</sup>

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<sup>74</sup> Lee G. Meyer, et al, *Intellectual Property in Today’s Financing Market*, 19 AM. BANKR. INST. J. 20 (Mar. 2000).

<sup>75</sup> See *Precision Plating & Metal Finishing, Inc. v. Martin-Marietta Corp.*, 435 F.2d 1262, 1263 (5th Cir. 1970); *Teller*, 53 P.3d at 254.

<sup>76</sup> See, e.g., *Matter of Marriage of Monslow*, 912 P.2d 735, 747 (Kan. 1996).

<sup>77</sup> See *Monslow*, 912 P.2d at 737(reasoning that it was proper for the trial court to divide the property so that the patent was awarded to the husband and the wife for all future profits from the patent); *Heinze*, 631 N.E.2d at 787 (concluding that future book royalties should have been classified as marital property and allocated between the parties).

<sup>78</sup> See *CCC Info. Servs., Inc. v. Maclean Hunter Mkt. Reports, Inc.*, 44 F.3d 61 (2d Cir. 1994).

patent law,<sup>79</sup> tax law,<sup>80</sup> and criminal law<sup>81</sup> than domestic relations cases.

### C. *Income Tax Considerations*

Intellectual property is taxed as an intangible asset. A taxpayer's basis in intellectual property will either be what the taxpayer paid to acquire it from a seller, or, if self-created, what the taxpayer put into it, so long as those costs were not deducted. For a profitable, on-going business, some research and development or research and experimentation expenses can be deducted from that year's income.<sup>82</sup> Other costs must be capitalized,<sup>83</sup> and some, like research and experimental costs, may be capitalized.<sup>84</sup> Capitalization of these costs can be helpful for companies that have not yet started earning an income. Also helpful for startups is the provision of the Internal Revenue Code that allows for the deferral of deducting certain expenses until the business is active.<sup>85</sup>

Copyrights and patents can be amortized because they are deemed to have a limited useful life. Since trademarks are typically renewable indefinitely, they are not amortizable because they do not have a limited useful life. The transfer of all rights to intellectual property is the sale of a capital asset,<sup>86</sup> and thus proceeds from the transfer will be taxed as capital gains or losses, subject to recapture rules.<sup>87</sup> Royalties, income derived from a license to use intellectual property, are taxed as ordinary income.<sup>88</sup> Whether the transfer of intellectual property is deemed

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<sup>79</sup> See *In re Villena*, 745 F. App'x 374 (Fed. Cir. 2018).

<sup>80</sup> See *Amazon.com, Inc. v. Comm'r*, 934 F.3d 976 (9th Cir. 2019).

<sup>81</sup> See *Hall v. Nettles*, No. 1:08-cv-2437-TCB, 2010 WL 11493784 (N.D. Ga. Jan. 7, 2010).

<sup>82</sup> I.R.C. §§ 162, 174.

<sup>83</sup> I.R.C. §§ 263, 263A.

<sup>84</sup> I.R.C. § 174 (Starting in 2022, however, these research and experimental costs cannot be deducted, and must be capitalized.)

<sup>85</sup> I.R.C. § 195.

<sup>86</sup> I.R.C. § 1235.

<sup>87</sup> I.R.C. § 1245.

<sup>88</sup> *Bell Intercontinental Corp. v. United States*, 381 F. 2d 1004, 1016 (Ct. Cl. 1967).

a sale or a license depends upon whether all rights to the property have been transferred.<sup>89</sup>

There can be some actions that impact taxes when intellectual property is involved. For instance, manipulating when and what costs are deducted from income can reduce income and reduce income taxes, or reduce or increase basis. If an agreement is reached whereby the non-owner spouse's interest in income or the asset reduces over time, and the non-owner spouse does not participate in sale proceeds after a certain amount of time, there should be some non-spouse consent required for certain tax elections.

#### *D. Language for the Division*

A divorce settlement agreement that divides intellectual property in-kind should start with a clear definition of the property to be divided, to include whether the asset is, for instance, merely income from licensing of a patent, or the patent itself. If the intellectual property is still in development, the agreement should identify the phase it is in, and the steps to be taken for full development. The agreement should also include the date on which the property is being divided. If there will be a sunset provision, i.e., a date at which the property's marital property component is depleted or expired, that date should also be clearly in the agreement.

The agreement should include provisions similar to those concerning the division of unvested stock options. The owner spouse should be deemed to hold the non-owner spouse's interest in a constructive trust.

The duties arising out of the owner holding the property in a constructive trust should be included in the divorce settlement agreement and should be specific and limited in nature. The agreement should include a provision that no fiduciary duty is owed to the non-owner spouse. Duties would usually include a quarterly accounting of cash flows; providing notice of all communications from any source regarding the intellectual property within a certain number of days; providing notice of all offers to purchase; creating an affirmative duty to take actions required to preserve the intellectual property insofar as possible and reason-

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<sup>89</sup> I.R.C. §§ 1221, 1231.

able; and providing annual income tax analysis prior to filing deadlines.

As should be clear from the discussion about taxes and intellectual property above, tax issues are complex. The agreement must include a commitment to use a joint CPA, who has full access to all information requested, and who is directed to ensure that parties are treated equally as to divided interests in the property, and fairly as to divided interests versus non-marital interests of the owner, if any.

The agreement should address who has authority to initiate, conduct, and settle lawsuits involving the intellectual property. The agreement should address how decisions to sell an asset outright shall be determined. Will only the owner spouse have authority to decide to sell? Who will have authority over terms of sale decisions? The agreement must state how net sale proceeds will be divided. A definition of "sale proceeds" should be written into the agreement. The non-owner spouse's obligations should be spelled out in the agreement. For instance, the non-owner spouse should be required to contribute to all fees and costs associated with preserving the asset.

If there will be out of pocket costs for the owner spouse that are required to monetize the asset to the greatest extent, such as attendance at trade shows or travel for book signings, identification of reimbursable expenses should be included in the agreement, and methods of reimbursement identified. Consideration should be given to the owner spouse being entitled a salary from proceeds if that is the most appropriate or easiest means of compensating the owner spouse for post marital efforts.

The agreement should clearly state how the parties will share net income over time. Will the sharing be based upon a formula where the non-owner spouses' share decreases over time? Will the non-owner spouse's share decrease over time if the owner spouse contributes additional property to the intellectual property?

## **VII. Irrevocable Life Insurance Trusts and Spousal Lifetime Access Trusts**

### *A. Defining the Asset*

Wealthy spouses often use irrevocable trusts in their estate and gift planning to accomplish various objectives, including, but not limited to, minimizing the impact of transfer taxes on assets and protecting their assets from creditors. Irrevocable trusts can be structured in different ways to accomplish these objectives. While the parties are married, the tax planning can work exceedingly well from the perspective of transferring wealth. Estate planners have come up with descriptors for trusts having certain characteristics as a way of communicating about those trusts. For example, there are irrevocable life insurance trusts, spousal lifetime access trusts, grantor retained annuity trusts, intentionally defective grantor trusts, and charitable remainder trusts. Each of these types of trusts is defined by a set of characteristics and objectives. This is not an exhaustive list of the different types of trusts estate planners use to accomplish their clients' goals and there is much overlap among and between those trusts in terms of their characteristics. The many different varieties of trusts as well as the characteristics of those trusts and why they are used is beyond the scope of this article. Below is a discussion of two common types of trusts that a wealthy donor may establish for the benefit of the other spouse and descendants, either contemporaneously or sequentially, and issues to consider at the time of divorce.

### *B. Irrevocable Life Insurance Trusts (“ILITs”)*

Irrevocable life insurance trusts (“ILITs”) are a widely used estate planning tool that provides an insured's estate with liquidity at the death without increasing the insured's estate tax liability. By having an ILIT own an insurance policy on the insured's life and having the policy payable to the ILIT at the insured's death, no part of the policy will be included in the insured's taxable estate.<sup>90</sup> As a result, no estate tax will be assessed on the value of the policy.

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<sup>90</sup> See 26 U.S.C. § 2042 (2018); 26 C.F.R. § 20.2042-1 (2020) (This assumes the policy was purchased by the ILIT directly and that ownership was not trans-

ILITs may hold life insurance policies on one spouse's life or policies on both spouses' lives (i.e., joint and survivor or second-to-die policies). Often the life insurance policies are whole life or universal life policies, meaning they may have cash value and they are intended to be held by the ILIT until the death of the insured.<sup>91</sup> Additionally, it is almost always the case that life insurance policies become more valuable as time goes on, because increased age and changes in the health of the insured may make equivalent coverage too expensive or impossible to obtain, even if the type of policy has diminishing surrender (cash out) value. An ILIT may be funded, meaning the trust holds liquid assets or loaned funds from which life insurance premiums may be paid, or unfunded, meaning the trust's ability to pay life insurance premiums is dependent on ongoing annual contributions to the trust by the donor(s), but otherwise holds no assets other than the insurance policy.

ILITs that include the spouse as a beneficiary may name the spouse by name as a beneficiary (e.g., my wife, Wilma), may name a spouse generically as a beneficiary (e.g., my spouse as existing from time to time, sometimes called the "floating spouse"), or may have an automatic forfeiture of beneficial interest upon divorce (e.g., my spouse shall be treated as though she had then died if we are no longer married). ILITs often name the non-insured spouse as a trustee, may give the beneficiary-spouse the power to remove and replace trustees, and may grant the beneficiary-spouse the ability to alter the identity of the beneficiaries at the beneficiary-spouse's death through a power of appointment. While the assets of the ILIT may or may not be determined to be marital property subject to division, there are times when one or both spouses wish to keep the insurance in place because it is valuable as part of an overall estate plan for liquidity purposes, and/or because insurance benefits their descendants. However, they may not wish for the non-insured

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ferred by the donor-insured to the ILIT within three years of the donor-insured's death); *See* 26 U.S.C. § 2035 (2018).

<sup>91</sup> In contrast, term insurance policies expire at the end of a fixed term. A term insurance policy may contain a rider to permit conversion to a cash value policy, but typically the premium is expensive as no current medical evidence is required, and, as a result, a conversion is most valuable for an insured whose health has undergone adverse changes.

spouse to remain as beneficiary, trustee, or other fiduciary (e.g., an investment advisor) of the ILIT. They may also wish to limit the definition of descendants to exclude potential future descendants of the insured spouse.

C. *Options for Dealing with an ILIT Post-Divorce*

1. *Removing the Non-Insured Spouse as a Beneficiary of the Irrevocable Trust*

If a spouse is a beneficiary of the ILIT and the parties agree that should not continue post-divorce, it may be possible to decant the assets of the ILIT into another trust with substantially similar provisions for the beneficiaries other than the spouse. Decanting is essentially a distribution from the existing trust to a new or other existing trust by the trustee of the ILIT. Decanting requires a willing trustee and trust provisions or local law permitting transfer of assets to another trust.<sup>92</sup> When decanting, care should be taken not to trigger the “transfer for value” rules under Section 101 of the Code, which would cause the death proceeds to become income taxable to the recipient (whereas ordinarily death proceeds are income-tax free).<sup>93</sup> “Value” for the transfer for value rules does not have to be consideration paid in cash or in kind; it can consist of other bargained-for consideration, including provisions in a divorce settlement agreement.<sup>94</sup> An exception to the transfer for value rule is a sale from one grantor trust to another so long as the grantors are the same.<sup>95</sup> If decanting is not possible, and if the trust is treated as a grantor trust such that all income of the trust is taxable to the insured spouse for federal income tax purposes, it may be possible for a new grantor trust created by the insured spouse to purchase the policy from the old trust, because a transfer from one grantor trust to another grantor trust established by the same donor is

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<sup>92</sup> *But see* Hodges v. Johnson, 177 A.3d 86 (N.H. 2017) (holding that a trustee must give “due regard for the diverse beneficial interests created by the terms of the trust” in decanting). While a trustee selected by a donor-spouse may be inclined to do as the donor-spouse wishes, the trustee should approach a decanting with appropriate caution.

<sup>93</sup> See 26 U.S.C. § 101 (2018).

<sup>94</sup> *Id.*

<sup>95</sup> See 26 U.S.C. § 671 (2018); 26 C.F.R. § 1.671-3(a) (2020); Rev. Rul. 85-13, 1985-1 C.B. 184.

not a transfer for value which would cause the death benefit to be income-taxable to the recipient.<sup>96</sup> Of course, the trustee could surrender the policy if the insured spouse remains insurable and life insurance premiums on a policy to be purchased by a new trust are affordable. While it may be tempting to simply have the beneficiary-spouse renounce any further interest in the trust, that may cause unintended gift tax consequences for the beneficiary-spouse.<sup>97</sup>

### *2. Leaving Insurance in Place but Cease Funding Premium Contributions*

If the spouse cannot be removed as a beneficiary, or there is no desire to maintain the policy, that leaves the trustee to determine what should be done with the insurance policy. It may be possible to maintain a policy that has value for some time without further contributions at the same or a lesser death benefit.

### *3. Surrendering the Life Insurance Policy*

The insurance policy held by the ILIT could be surrendered for its cash value, if any. To the extent the value received from surrender exceeds the basis in the contract, the excess gain will be taxed at ordinary income rates.<sup>98</sup> Because the ILIT holds the policy, it will be the responsibility of the trustee to surrender the policy and the proceeds will become an asset of the ILIT. Because the ILIT is a grantor trust as to the insured spouse, any gain on surrender will be taxable to the insured spouse, rather than the ILIT.<sup>99</sup>

### *4. Selling the Life Insurance Policy*

Finally, it may be possible to sell the policy to a state-licensed third party in what is called a viatical settlement.<sup>100</sup> If the insured is chronically or acutely ill, a third-party purchaser may be willing to purchase the policy for an amount greater than the

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<sup>96</sup> *See id.*

<sup>97</sup> *See* 26 U.S.C. §§ 2501(a), 2511, 2512 (2018); 26 C.F.R. §§ 25.2511-1-25.2512-1 (2020).

<sup>98</sup> 26 U.S.C. § 64.

<sup>99</sup> 26 U.S.C. § 677(a)(3) (2018).

<sup>100</sup> Julia Kagan, *Viatical Settlement* (2021), <https://www.investopedia.com/terms/v/viaticalsettlement.asp>.

current cash value in exchange for a lump sum payment up front. Even a term insurance policy may have some value for this purpose, beyond any premium refund. The purchaser becomes the owner of the policy, becoming responsible for payment of future premiums. In 1996, the Health Insurance Portability and Accountability Act (HIPAA) made viatical settlements and accelerated death benefits income-tax free for chronically ill and terminally ill insureds,<sup>101</sup> settling a concern that such proceeds in excess of basis would be income taxable in the same manner as a policy surrendered.

#### *5. The Second-to-Die Life Insurance Policy*

ILITs can also own joint and survivor or so-called second-to-die policies. Neither insured spouse is a beneficiary of the trust, and the insurance was most likely acquired to provide liquidity for estate taxes and the surviving spouse's death under a conventional "postpone estate taxes until the surviving spouse's death" estate plan. Post-divorce, that sort of insurance is not needed; in fact, each party will likely need to address estate taxes at death independent of the survival of the other party. But determining what to do with the policy may depend on the cooperation of the parties. Some policies can be split into two separate, single life policies. While the single life policy premiums will likely be higher than the second-to-die policy premium, splitting the policy may allow a trustee for each party to deal with a separate policy through the techniques described above, taking care not to run afoul of the transfer for value rules in the case of any purchases. In other situations, the parties wish to maintain the second-to-die policy for their descendants and will need to address the payment of ongoing premiums. Any binding promises to pay premiums in a divorce settlement agreement may constitute a taxable gift,<sup>102</sup> so it will be important to consult with tax professionals.

#### *D. Spousal Lifetime Access Trusts ("SLATs")*

Another popular estate planning technique is to transfer wealth in the name of one spouse to an irrevocable trust for the

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<sup>101</sup> 26 U.S.C. § 101(g)(2)(a).

<sup>102</sup> See 26 U.S.C. §§ 2501(a), 2511, 2512 (2018); 26 C.F.R. §§ 25.2511-1-25.2512-1 (2020).

benefit of the other spouse, either as sole current beneficiary or as a beneficiary with descendants, using all or part of the donor-spouse's transfer tax exemption amount. This type of trust is commonly referred to as a spousal lifetime access trust or a "SLAT." An ILIT that has the non-insured spouse as a beneficiary is a SLAT, but typically a SLAT refers to a trust that owns assets other than a life insurance policy and annual contributions to fund it.

Establishing and funding a SLAT is a popular estate planning technique designed to remove assets transferred to the SLAT from the donor's taxable estate, while still permitting the non-donor spouse to benefit from the trust assets. SLATs are particularly popular at the time of the writing of this article in no small part due to the historically high unified exemption from the estate and gift tax.<sup>103</sup> Whether or not legislation reducing the available unified gift and estate tax exemption is passed during the tenure of President Biden, the Tax Cuts and Jobs Act provision increasing the exemption to its current level will sunset at the end of 2025.<sup>104</sup> SLATs are grantor trusts, so that the spouse who funded the irrevocable trust remains responsible for paying income tax on trust income.<sup>105</sup> The use of the word "access" in the name "spousal lifetime access trust" actually is a misnomer, since it suggests that the spouse may have unilateral authority to access trust funds for that spouse's own benefit; that is not the case. The trust may contain ascertainable standards for distributions (i.e., may authorize distributions for the health, maintenance, support, and education of the beneficiary-spouse), or provide for broad discretion for an independent trustee to make distributions in the best interests of the beneficiary-spouse. Sometimes, a spouse will have a limited withdrawal power over a certain amount of the trust without trustee approval.

Valuing the spouse's beneficial interest in a SLAT may be impractical notwithstanding the fact that the assets of the trust may be easily valued. Other than a limited withdrawal right if

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<sup>103</sup> In 2021, the unified gift and estate tax exemption is \$11,700,000 per individual. Rev. Proc. 2020-45.

<sup>104</sup> 26 U.S.C. § 2010(c)(3)(C) (2018).

<sup>105</sup> See Scott Grenier & Megan Dunham, *Planning For The Prospect That TCJA Provisions Sunset*, 46 EST. PLAN. 41, 44, 2019 WL 1255061, 5 (2019).

there are so-called Crummey withdrawal powers,<sup>106</sup> the grantor spouse cannot compel a distribution, nor can the beneficiary-spouse. Thus, in many states, the interest would not be considered property. However, actual distributions can be required to be shared. If the beneficiary-spouse relinquishes the beneficial interest in the trust, a taxable gift will have been made to the other beneficiaries of the trust,<sup>107</sup> but whether the value of the gift is susceptible to being valued is a separate matter. The trust may be able to be decanted as described with respect to ILITs.

#### E. *ILITs, SLATs, and Important Tax Considerations*

An intentionally defective grantor trust allows the grantor to irrevocably transfer at current value for estate tax purposes, while remaining the owner of the assets for income tax purposes. If a trust qualifies as a grantor trust under the Internal Revenue Code, income realized by the trust will be taxable to the donor of the trust and will be reported on the donor's own income tax return.<sup>108</sup> The hoped-for benefit with a grantor trust is that the grantor's continued payment of income taxes on trust realized income will allow trust assets to grow unencumbered by income tax, allowing for larger non-taxable gifts to the trust beneficiaries. Grantor trusts are especially useful where the trust donor has exhausted his or her gift tax exemption limits and wishes to transfer additional value to descendants or other family members without application of the gift tax.

If the donor's spouse is a beneficiary of the trust,<sup>109</sup> if the trust pays premiums for life insurance,<sup>110</sup> if a donor to a trust retains certain administrative powers,<sup>111</sup> or if certain persons who are "related or subordinate" to the donor as defined in the Internal Revenue Code serve as trustee,<sup>112</sup> the trust will be treated as a grantor trust for income tax purposes.

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<sup>106</sup> See *Crummey v. Comm'r*, 397 F.2d 82 (9th Cir. 1968); 26 C.F.R. § 25.2503-3(b).

<sup>107</sup> See 26 U.S.C. §§ 2501(a), 2511, 2512 (2018); 26 C.F.R. §§ 25.2511-1-25.2512-1 (2020).

<sup>108</sup> 26 U.S.C. § 671; 26 C.F.R. §§ 1.671-1-1.671-5 (2020).

<sup>109</sup> 26 U.S.C. § 677(a)(1)-(2).

<sup>110</sup> *Id.* at (a)(3).

<sup>111</sup> 26 U.S.C. § 675 (2018).

<sup>112</sup> 26 U.S.C. § 672(c) (2018).

While grantor trusts have been employed successfully to transfer wealth undiminished by taxes to a donor's family members, future taxation can cause economic hardship when a married couple divorces if grantor trust status continues. If the spouse was a beneficiary of a trust prior to the repeal of Section 682, unless and until Congress addresses other grantor trust rules, the trust will continue as a grantor trust.<sup>113</sup> While the trust may contain a discretionary power in the trustee to make income tax reimbursement payments to the donor, the donor cannot retain or compel such distributions.<sup>114</sup> As a result, grantor trust status of a trust must be considered and addressed in the divorce settlement agreement. If the spouse will remain a trust beneficiary, the divorce settlement agreement may contain a tax sharing provision.

More complex issues may exist in grantor trusts, and the following discussion is a brief overview; consultation with an expert is essential. If the trust donor makes a gift into a grantor trust with the donor's spouse consenting to splitting the gift for purposes of gift tax reporting, the donor will nonetheless be treated as the grantor as to the entire gift.<sup>115</sup> The reason for this is that grantor trust status is dependent on actual transfer of assets to the trust.<sup>116</sup> While the donor's spouse will be deemed transferor as to half of the value of the gift for gift tax purposes, the spouse will not be treated as the "grantor" for income tax purposes.<sup>117</sup> However, it may be the case that the spouses each actually contributed assets to the trust at various times. The name of the donor on the trust instrument is not determinative for grantor trust purposes; the identity of the person having transferred the

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<sup>113</sup> Charles D. Fox IV, *Comments re Repeal of I.R.C. Section 682*, ACTEC (July 5, 2018), [https://www.actec.org/assets/1/6/ACTEC\\_Comments\\_on\\_Transition\\_Rule\\_to\\_Repeal\\_of\\_682.pdf](https://www.actec.org/assets/1/6/ACTEC_Comments_on_Transition_Rule_to_Repeal_of_682.pdf). (Discussion of the taxation of trusts in which the about to be ex-spouse is a beneficiary is beyond the scope of this article, but a good summary of the concerns about potential ongoing grantor trust income tax treatment unless further correction of the tax code occurs can be found in The American College of Trust and Estate Counsel's comments on guidance in connection with the repeal of Section 682 of the Internal Revenue Code.)

<sup>114</sup> See 26 U.S.C. §§ 2036, 2041 (2018). Possession of such a power by the donor could cause inclusion of the trust's assets in the donor's taxable estate.

<sup>115</sup> 26 U.S.C. § 671; 26 C.F.R. §§ 1.671-2(e)(1) (2020).

<sup>116</sup> See *id.*

<sup>117</sup> See *id.*

assets is what matters. While the couple is married and filing a joint income tax return, the status of the trust as being a part grantor trust as to each spouse is not an issue. Once the couple divorces and no longer files jointly, it may come as a surprise to the spouses that each of them is responsible for such spouse's pro rata share of the taxes. In some cases, the less wealthy spouse asks the wealthier spouse to indemnify him or her by assuming all of the grantor trust tax obligations. However, that ongoing property settlement is difficult to quantify, and does not address what happens if the spouse assuming the obligation dies as the trust would continue to be treated as a grantor trust with respect to the surviving spouse, and a non-grantor trust as to the portion contributed by the now-deceased spouse. The obligation to continue to indemnify for such taxes beyond death is not practical. As a result, it may be necessary to consider whether grantor trust status can be "turned off" for the spouse who no longer wishes to be responsible for taxes. Whether that is possible depends on what causes grantor trust status. If, for example, grantor trust status is achieved by reason of the donor having the power to substitute assets of equivalent value to the trust, the donor can irrevocably relinquish that power.<sup>118</sup> If grantor trust status is achieved because the trustee may add beneficiaries to the class of permissible distributees, or make loans to the donor without adequate security, the trustee may be willing to irrevocably relinquish such powers.<sup>119</sup> Powers that require relinquishment by the trustee to alter tax treatment for the trust may put the trustee in a position of conflict because relinquishing the power will result in the trust being required to pay its own taxes as to the portion that was formerly reportable by such donor, thereby reducing assets available for the beneficiaries. The trustee may request indemnification from such donor before relinquishing any powers, in order to limit exposure to a claim by beneficiaries for breach of fiduciary duty. In other cases, it is the nature of the assets of the trust that causes grantor trust status, as is the case for a trust that holds life insurance.<sup>120</sup>

Even if other powers are relinquished, the trust nevertheless may remain a grantor trust for tax purposes. In such cases, it

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<sup>118</sup> See 26 U.S.C. § 675.

<sup>119</sup> See *id.*

<sup>120</sup> 26 U.S.C § 677(a)(3).

may be that with trustee cooperation, the insurance could be distributed or acquired by another trust to eliminate the issue. Because the trustee is not a party to the divorce, and because the parties themselves cannot compel the trustee to act, care should be taken in how to memorialize what is intended and agreed to. Note, however, that decanting some or all of the trust to another trust, or having a different trust purchase assets from the old trust, must be done carefully to avoid transfer for value issues, in the case of life insurance, and may not solve the grantor trust issue at all, depending on the reason. Distributing assets to a new trust which is a grantor trust as to one of the spouses does not result in the assets received from the old trust being treated for grantor trust purposes as having been transferred by the donor of the new trust; the identity of the donor will follow the assets from the old trust to the new trust.<sup>121</sup>

One significant further point is that many grantor trusts are funded with gifts, whereas others are created in part with gifts and in part by a sale of assets in exchange for a promissory note. Where there is a single donor, the payments on the note during the donor's life and so long as the trust is a grantor trust is a non-taxable event, the theory being that the seller and buyer are one and the same for income tax purposes.<sup>122</sup> But, in dividing assets, if the note is allocated to the other spouse, the non-taxable treatment will cease as to the note payments. A final caution concerns life insurance subject to a split dollar funding arrangement because changes to ownership of the policy or termination of the split dollar agreement may have substantial tax consequences.

#### F. *Divorce Settlement Agreement Language for ILITs and SLATs*

If the irrevocable trust will be decanted to a new trust of which the spouse is not a beneficiary or fiduciary, and has no powers or duties, the divorce settlement agreement may contain a provision that the spouse will not object, and, if requested by the trustee, will consent to the decanting. Because the trustee is not a party to the divorce settlement agreement, the parties can-

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<sup>121</sup> See 26 U.S.C. § 671; 26 C.F.R. § 1.671-3(a); Rev. Rul. 85-13, 1985-1 C.B. 184.

<sup>122</sup> See *id.*

not bind the trustee to take or refrain from taking certain actions. However, if the trustee is on board and is preparing to take certain actions, those actions can be referenced in the agreement. The trustee can also be joined as a party, either voluntarily or involuntarily, pursuant to the applicable state joinder rules.<sup>123</sup>

Similarly, if the definition of “issue” or “descendants” in the trust is not limited to the issue of the parties’ marriage, decanting can address that point. Estate planning and other tax advisors should be consulted regarding the precise wording so that the spouse whose interest is being reduced is not deemed to have made a taxable gift, as might occur if the spouse renounced future beneficial interests in the trust.<sup>124</sup> The agreement can, however, address the spouse’s resignation as a trustee and/or other fiduciary, as well as the renunciation of any other powers retained by the trust donor or granted to the spouse beneficiary. The relinquishment of certain powers may affect the trust’s treatment in the future as a grantor trust for income tax purposes, and, if that is the intent, it should be clearly stated.

If the spouse will remain a beneficiary of the irrevocable trust, the trust can remain a grantor trust as to the donor-spouse. The trust may or may not contain the discretionary power for the trustee to make a distribution to the donor-spouse to cover such taxes; the trust cannot contain a mandatory tax reimbursement provision without causing inclusion in the donor’s taxable estate.<sup>125</sup> Of course, whether a trustee will exercise a discretionary power is uncertain and cannot be agreed to by the spouses as part of their agreement. However, the spouses can provide in their agreement an affirmative obligation to do what they are able to do, to the extent possible, to terminate grantor trust status, and failing that, the agreement can contain a right of contribution for grantor trust taxes. A spouse beneficiary can agree to refrain from requesting discretionary distributions unless necessary, but the trustee will always have a fiduciary obligation to consider the needs of beneficiaries, and if there are children of the couple’s marriage, a future discretionary distribution to the

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<sup>123</sup> *E.g.*, Colo. R. Civ. P. 20, 19.

<sup>124</sup> *See* 26 U.S.C. §§ 2501(a), 2511, 2512 (2018); 26 C.F.R. §§ 25.2511-1-25.2512-1 (2020).

<sup>125</sup> *See* Fox, *supra* note 113.

spouse might be advisable for tax planning purposes, so flexibility may be important.

Depending on what the parties agree should occur and what the trustee is willing to do, the parties should agree on what reporting needs to occur, what monitoring may be required, and what provisions should be contained in a separate side agreement and not in their divorce settlement agreement.

## **VIII. Cryptocurrency**

### *A. Defining the Asset*

Cryptocurrency is a peer-to-peer electronic cash system that is not backed by any government or financial institution, is not backed by any physical commodity or precious metal, and is not tangible. It is sometimes referred to as “virtual currency.” It is, however, limited in supply.

The Internal Revenue Service has defined it as

digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. In some environments, it operates like “real” currency (i.e., the coin and paper money of the United States or of any other country that is designated as legal tender, circulates, and is customarily used and accepted as a medium of exchange in the country of issuance), but it does not have legal tender status in any jurisdiction. Cryptocurrency is a type of virtual currency that utilizes cryptography to validate and secure transactions that are digitally recorded on a distributed ledger, such as a blockchain.<sup>126</sup>

Transactions using cryptocurrency are verified and recorded by “miners” in a public ledger called the “blockchain.” Cryptocurrency is stored by an owner in a digital wallet and is accessed by the owner with a private key. The owner participates in transactions by using a public key, which is something like an email address, to send or receive cryptocurrency. Transactions in cryptocurrency are permanently recorded, are transparent, and can be viewed online at any time using a blockchain explorer. Each unit of cryptocurrency is traceable from the time it came into being. The transactions are recorded by transaction amount, date, and address/public key of the owner. While this sounds

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<sup>126</sup> *Virtual Currencies*, I.R.S. (2021), <https://www.irs.gov/businesses/small-businesses-self-employed/virtual-currencies>.

very secure, there have been a number of high-profile cases of cryptocurrency thefts.<sup>127</sup>

To obtain cryptocurrency, usually one goes to an exchange, such as Coinbase or Kraken. The exchanges also provide the ability to pay for goods and services via an app. There are also hedge funds and publicly traded companies that hold cryptocurrency.

The Internal Revenue Code classifies cryptocurrency as both a currency and an asset.<sup>128</sup>

### B. Valuation Difficulties

Cryptocurrency value is extremely volatile. On February 15, 2021, a Bitcoin's value was about \$49,184.63. On January 12, 2021, it was \$33,447. On January 12, 2020, it was \$8,033.26.<sup>129</sup> However, cryptocurrency is not like publicly traded stock, since there is not one place to go to look at the daily value of, for instance, Bitcoin. There is no closing price on any given day. There are a couple of exchanges where one can buy and sell Bitcoin, but one can also buy and sell it in a parking lot.

A number of factors affect the value of a given cryptocurrency, such as the supply of the currency and the market for it, the cost of producing the currency through the mining process, the rewards to the miners who verify transactions, the number of competing cryptocurrencies, governmental regulations of cryptocurrencies,<sup>130</sup> the financial stability of governments,<sup>131</sup> the

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<sup>127</sup> Danny Nelson, *Crypto Criminals Have Already Stolen \$1.4B in 2020, Says Cipher Trace*, COIN DESK (2020), <https://www.coindesk.com/crypto-criminals-have-already-stolen-1-4b-in-2020-says-ciphertrace>.

<sup>128</sup> IRS Notice 2014-21.

<sup>129</sup> Coindesk, *Bitcoin Price Index and Live Chart*, COIN DESK, [www.coindesk.com/price/bitcoin](http://www.coindesk.com/price/bitcoin) (last visited Feb. 15, 2021).

<sup>130</sup> See, Thomas Yeung, *Three Important Factors Driving the Price of Bitcoin* (Oct. 9, 2020), <https://www.nasdaq.com/articles/3-important-factors-driving-the-price-of-bitcoin-2020-10-09>; See also Harry Robertson, *Janet Yellen Suggests 'Curtailing' Cryptocurrencies Such as Bitcoin, Saying They Are Mainly Used for Illegal Financing*" (2021), <https://markets.businessinsider.com/currencies/news/bitcoin-price-cryptocurrency-should-be-curtailed-terrorism-concerns-yellen-2021-1-1029985692#:~:text=JAnet%20Yellen%20on%20Tuesday%20suggested,tough%20on%20Bitcoin%20and%20Ethereum> (On January 19, 2021, the value of Bitcoin was \$35,501.38. On January 20, 2021, Janet Yellen in her confirmation hearing as Treasury Secretary to the Biden Administration

internal governance of the cryptocurrency, the stability of the computers of the exchange on which the currency is bought and sold, and social media.<sup>132</sup>

### C. *Income Tax Considerations*

Cryptocurrency is subject to U.S. income tax when it is traded for cash, traded for other cryptocurrencies, or used to purchase goods or services.<sup>133</sup> It can be taxed as currency, meaning, as income received if the cryptocurrency is received as payment for services. In addition, because cryptocurrency is an asset, gain or loss may be realized upon disposition of the asset.

When cryptocurrency is received as payment for services, it is taxed as regular income at the fair market value of the cryptocurrency on the date received. The basis of that cryptocurrency received as payment for goods or services is the fair market value of the cryptocurrency on the date it was received.<sup>134</sup> If cryptocurrency is used to purchase property, if the fair market value of the property purchased is greater than the fair market value of the cryptocurrency, there is a taxable gain. If it is less, there is a loss.<sup>135</sup>

If there is inaccurate reporting of cryptocurrency taxable events, the taxpayer is subject to accuracy related penalties and information reporting penalties.<sup>136</sup>

### D. *Language for the Division of Cryptocurrency*

Cryptocurrency is divided in kind by having the owner transfer 50% of each tranche he or she purchased to the spouse. Be-

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said cryptocurrency should be regulated by the U.S. government and on January 21, 2021, Bitcoin's value dropped to \$29,880.26).

<sup>131</sup> Colin Kwan, *How the Greece Debt Crisis Showed the World That Bitcoin Is a Store of Value*, COIN TELEGRAPH (July 14, 2015), <https://cointelegraph.com/news/how-the-greece-debt-crisis-showed-the-world-that-bitcoin-is-a-store-of-value>.

<sup>132</sup> Ben Winck, *Dogecoin Rockets 59% Higher After Elon Musk Backs the Cryptocurrency in Return to Twitter*, BUS. INSIDER (Feb. 4, 2021), <https://markets.businessinsider.com/currencies/news/dogecoin-price-elon-musk-twitter-cryptocurrency-market-trading-reddit-doge-2021-2-1030043774>.

<sup>133</sup> *Virtual Currencies*, *supra* note 126.

<sup>134</sup> IRS Notice 2014-21.

<sup>135</sup> *Id.*

<sup>136</sup> 26 U.S.C. § 6662 (2018).

cause cryptocurrency is linked to a part of the blockchain, and because it is deemed an asset by the IRS, it should be divided like stock is divided when divided in kind.

When cryptocurrency is being divided in kind, the divorce settlement agreement should include a recitation of the fair market value when all cryptocurrencies were first received so that each party can correctly report to the IRS.

The cryptocurrency can be transferred from one spouse to the other from the exchange that is being used via an app. The transaction works rather like a Venmo transaction.

The separation agreement should include a clause regarding how audits of joint income tax returns will be handled. The U.S. government has increased its interest in tax reporting for cryptocurrency.<sup>137</sup>

## **IX. Co-Owned Real Estate**

A marital estate may include valuable personal use real estate that has value to the parties outside of just the market value. It may have sentimental value, it may have legacy value, and its continued co-use and ownership may promote harmony with children if both spouses can continue to own and use the property. For instance, consider the ski area vacation home that has been in the family since the children were very young, as is needed by both parents for the children's competitive ski team participation.

Carefully drafting a use agreement will avoid unhappiness and unpleasant tax surprises. A use agreement may address the following questions and others: What is the expectation for use during high season and off season? What arrangements will be made for stocking supplies and cleaning in between uses? Will

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<sup>137</sup> See FinCEN Notice 2020-2. This notes that "the Report of Foreign Bank and Financial Accounts (FBAR) regulations do not define a foreign account holding virtual currency as a type of reportable account. (See 31 C.F.R. 1010.350(c)). For that reason, at this time, a foreign account holding virtual currency is not reportable on the FBAR (unless it is a reportable account under 31 C.F.R. 1010.350 because it holds reportable assets besides virtual currency). However, FinCEN intends to propose to amend the regulations implementing the Bank Secrecy Act (BSA) regarding reports of foreign financial accounts (FBAR) to include virtual currency as a type of reportable account." 31 C.F.R. § 1010.350.

friends and others be able to use the property? Are pets permitted? Is smoking permitted? How will routine carrying charges, repairs, and improvements be made? Will there be a right of first refusal or purchase option in the other spouse and/or children? If one spouse pays more than that spouse's share of the carrying charges, a taxable gift will have been made to the other spouse.<sup>138</sup> For those reasons, it is essential to have an annual budget, a designated account established for the property, and a cash reserve amount held in the account. Neither spouse should have the ability to pledge an interest in the home without written consent from the other.

Parties may also wish to continue to co-own commercial real estate. These properties are usually titled to an LLC or corporation. Both spouses can co-own by being members of the LLC or shareholders of the corporation. There are some things that should be considered, though, before the non-owner spouse agrees to, or even can, receive an ownership interest. For instance, there may be outstanding mortgages, with full or partial personal guarantees, that may require lender consent before a transfer of even a partial interest occurs. Certain real estate may have regulatory oversight mandating that management be approved, as in the case of HUD developments. There may be environmental concerns which would make co-ownership undesirable from a liability shifting perspective if the former non-owner spouse is now considered an owner or operator of the real estate.

If the real estate is leased to an operating business owned by one or both of the spouses, the lease may need to be revised, since rent may have been previously set at below market when the income was "all in the family." Once addressed and resolved, the non-owner spouse can co-own by receiving a portion of the owner-spouse's interests, and the entity operating agreements will control.

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<sup>138</sup> 26 U.S.C. § 2501, 2511 (2018); 26 C.F.R. § 25.2511-1 (2020).

## X. Pre-embryos

### A. Defining the Asset

Many couples have used assisted reproductive technology (ART). One form of ART is in vitro fertilization. When a couple uses in vitro fertilization, pre-embryos<sup>139</sup> are created outside of the womb and then transferred to the womb, or cryopreserved.<sup>140</sup> Most of the time, more pre-embryos are created than will be transplanted at a time, and the excess pre-embryos are cryopreserved and stored. Pre-embryos can be implanted, cryopreserved indefinitely, donated to another potential parent, donated for research, or destroyed. The National Embryo Donation Center states that “[a]n estimated 1,000,000 human embryos are stored in the U.S. right now.”<sup>141</sup>

There is very little legislation in the United States regarding the disposition of pre-embryos. Fertility clinics are not regulated as to how they store or dispose of pre-embryos. The contracts that fertility clinics enter into with patients with respect to the handling of pre-embryos are not regulated at all in most states and only lightly regulated in others.<sup>142</sup> There are no laws governing the agreements that two or more intended parents might

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<sup>139</sup> A pre-embryo is a fertilized ovum up to fourteen days old, before it becomes implanted in the uterus.

<sup>140</sup> American Society for Reproductive Medicine, *In Vitro Fertilization (IVF)*, <https://www.asrm.org/topics/topics-index/in-vitro-fertilization-ivf/> (last visited July 30, 2021).

<sup>141</sup> National Embryo Donation Center, *About Us* (2021), <https://www.embryodonation.org/about/>.

<sup>142</sup> The following state statutes require fertility clinics to provide patients with a form regarding disposition of pre-embryo choices: Arizona, California, Connecticut, Florida, Massachusetts, New Jersey, and New York. ARIZ. REV. STAT. ANN. § 25-318.03 (2018), CAL. HEALTH & SAFETY CODE § 125315 (2004), CONN. GEN. STAT. ANN. § 19a-32d(c) (2) (2015), FLA. STAT. ANN. § 742.17 (2016), MASS. GEN. L. ANN. CH. 111L, § 4 (2005), N.J. STAT. ANN. § 26:2Z-2 (2004), & N.Y. FAM. CT. L. § 581-306 (eff. 2/15/21). Some statutes even prohibit the destruction of embryos. See LA. STAT. ANN. § 9:129 (1986) (“[a] viable in vitro fertilized human ovum is a juridical person which shall not be intentionally destroyed by any natural or other juridical person or through the actions of any other such person”); LA. STAT. ANN. § 9:131 (“In disputes arising between any parties regarding the in vitro fertilized ovum, the judicial standard for resolving such disputes is to be in the best interest of the in vitro fertilized ovum.”).

enter into with respect to the disposition of pre-embryos. A committee of the Uniform Law Commission has recommended that there be a study to explore a uniform law governing the disposition of pre-embryos.<sup>143</sup>

In most states, the case law considers pre-embryos a type of property, albeit a special type.<sup>144</sup> When a couple uses a fertility clinic to achieve pregnancy, they sign a contract with the clinic regarding the disposition of pre-embryos before treatment begins. Thus, these contracts are a starting point for a couple's resolution of how to deal with them after a divorce, and they are documents that may need to be amended after a divorce. However, these contracts should be understood as contracts between the couple and the clinic as opposed to between the couple, and should not be understood as marital agreements between the couple regarding the allocation of this property at divorce.<sup>145</sup>

Disputes between divorcing couples regarding the disposition of cryopreserved pre-embryos is one of the most interesting areas of matrimonial law.<sup>146</sup> Sometimes, though, parties are in

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<sup>143</sup> Barbara Atwood & Linda Elrod, *Recommendation for Study Committee*, <https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=324180e7-0408-9fdf-28a6-bdec13bb7fbb> (Nov. 30, 2018).

<sup>144</sup> See *Jeter v. Mayo Clinic Arizona*, 121 P.3d 1256, 1271 (Ariz. Ct. App. 2005); *In re Marriage of Rooks*, 429 P.3d 579 (Colo. 2018); *McQueen v. Gadberr*, 507 S.W.3d 127, 132 (Mo. Ct. App. 2016); *Davis v. Davis*, 842 S.W.2d 588, 597 (Tenn. 1992).

<sup>145</sup> Deborah L. Forman, *Embryo Disposition and Divorce: Why Clinic Consent Forms Are Not the Answer*, 24 J. AM. ACAD. MATRIM. LAW. 57 (2011).

<sup>146</sup> See *In re Marriage of Fabos & Olsen*, 451 P.3d 1218 (Colo. App. 2019) (holding that the party's interest in donating pre-embryos should not turn on their personal views of the morality of donation and that the trial court abused its discretion in favoring the ex-wife's interest in donating more heavily than the ex-husband's interest in avoiding procreation); *Szafranski v. Dunston*, 34 N.E.3d 1132, 1162 (Ill. App. Ct. 2015) (concluding that the ex-girlfriends' interest in the use of pre-embryos when she had ovarian failure as a result from chemotherapy outweighed the ex-boyfriend's interest in the effect that having a child through IVF would have on his existing and future relationships); *In re Marriage of Witten*, 672 N.W.2d 768 (Iowa 2003) (noting that because the parties' were unable to reach a new agreement that was mutually satisfactory, there could be no use or disposition of the embryos unless an agreement was reached between the parties); *A.Z. v. B.Z.*, 725 N.E.2d 1051, 1059 (Mass. 2000) (concluding that, as a matter of public policy, the court "would not enforce an agreement that would compel one donor to become a parent against his or her will");

agreement that pre-embryos should continue to be cryopreserved even after a divorce. Some couples cannot, for religious reasons, abide the destruction of the pre-embryos, but on the other hand, they do not wish to donate them to research or another person to create a child. In fact, the burgeoning dilemma of abandoned pre-embryos demonstrates that couples find it extremely difficult to make a final dispositional decision.<sup>147</sup> Other times, there is a recognition that a time may come when a party may wish to use the pre-embryos, and the other party would not disagree. Such may be the case upon the death of one of the parties,<sup>148</sup> or the continued childlessness of a party. Moreover, a party who originally wanted to preserve the pre-em-

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J.B. v. M.B., 783 A.2d 707, 717 (N.J. 2001) (noting that it could not force the former wife to become a biological parent against her will); Kass v. Kass, 696 N.E.2d 174, 182 (N.Y. 1998) (affirming that “when parties to an IVF procedure have themselves predetermined the disposition of any unused fertilized eggs” the law will honor their agreement); Finkelstein v. Finkelstein, 162 A.d.3d 401, 404 (N.Y. App. Div. 2018) (concluding that because one party withdrew consent, the remaining cryopreserved embryos should be awarded to the husband only for the purpose of disposing them pursuant to the parties’ consent agreement); *In re Marriage of Dahl*, 194 P.3d 834 (Or. Ct. App. 2008) (reasoning that because the party’s disposition agreement designated the wife to be the decision maker regarding the embryos, the trial court’s order to destroy them would not be disturbed); *Reber v. Reiss*, 42 A.3d 1131, 1137 (Pa. 2012) (concluding that the wife, under a balancing approach, should be awarded the pre-embryos since she did not have an ability to procreate biologically); *Davis*, 842 S.W.2d at 603-04 (concluding that the ex-husband’s interest in avoiding becoming a genetic parent outweighed the wife’s interest in donating the pre-embryos to another couple); *Roman v. Roman*, 193 S.W.3d 40, 55 (Tex. 2006) (noting that by awarding the frozen embryos to one of the parties the trial court improperly rewrote the disposition agreement); *Litowitz v. Litowitz*, 48 P.3d 261 (Wash. 2002) (concluding that under the cryopreservation contract, the husband and wife had to petition the court for instructions when they were unable to reach a mutual decision regarding the disposition of the pre-embryos upon divorce); 2A MASS. PRAC., FAMILY LAW AND PRACTICE § 56:26 (4th ed. 2020).

<sup>147</sup> Mary Pflum, *Nation’s Fertility Clinics Struggle with a Growing Number of Abandoned Embryos*, NBC NEWS (Aug. 12, 2019), <https://www.nbcnews.com/health/features/nation-s-fertility-clinics-struggle-growing-number-abandoned-embryos-n1040806>.

<sup>148</sup> The recognition that people may wish to use genetic material post-mortem led to a substantial revision to the Uniform Probate Code in 2008. See *Probate Code Amendments* (2008), <https://www.uniformlaws.org/committees/community-home?CommunityKey=10eab220-e81c-477f-8874-910c3ef9c546>; Lawrence W. Waggoner & Sheldon F. Kurtz, *The UPC Addresses the Class-Gift*

bryos for later use may no longer wish to do so, perhaps due to a natural pregnancy and birth, or merely due to the passage of time and increased age. As pre-embryos can be cryopreserved nearly indefinitely and successfully implanted as many as twenty-four years after freezing,<sup>149</sup> couples may wish to spell out in their divorce settlement agreement a plan that allows time to elapse and more of life's circumstances to play out before a final disposition of the pre-embryos is made.<sup>150</sup> Of course, if one of the parties becomes incapacitated or dies, the question for a deferred disposition is who will make the decision for the incapacitated or deceased party.

#### B. *Language for Genetic Material*

Agreements about the disposition of cryopreserved pre-embryos should address the following issues: current handling of the pre-embryos (i.e., continue to cryopreserve irrespective of the consent form on file with the clinic); length of time to cryopreserve; responsibility for payment of the clinic fees; what happens if a party with responsibility for payment does not pay clinic fees; who is responsible for communications with the clinic; the effect of the death of a party; the effect of the incapacity of a party; whether an heir, beneficiary, or agent can stand in the shoes of a party with respect to dispositional agreements; what happens if the clinic can no longer store and preserve the pre-embryos; whether a party can unilaterally bring suit against a clinic; how proceeds are allocated if suit is brought against a clinic and there is a settlement or award; whether a party can implant the pre-embryos; whether a third party can implant the pre-embryos; other limitations, if any, on implantation; parentage of any child that results from implantation; whether implantation may take place after the death of a party; if a child results from postmortem implantation, whether that child will be an heir of the decedent; whether the pre-embryos can be donated for re-

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*and Intestacy Rights of Children of Assisted Reproduction Technologies*, 35: 1 ACTEC J. 30 (2009).

<sup>149</sup> Richard Vaughn *Uniform Laws Needed to Regulate Abandoned Embryos*, INT'L FERTILITY L. GROUP (2019), <https://www.iflg.net/laws-needed-abandoned-embryos/>.

<sup>150</sup> See Forman, *supra* note 145, at 70-75 (decisions about disposition of pre-embryos are unstable over time).

search, and, if so, upon what conditions; if pre-embryos can be donated to another person, and, if so, under what conditions; and, under what conditions pre-embryos can be destroyed. If the parties can only agree that the pre-embryos should remain cryopreserved until further agreement, that agreement should include a trigger for one person or that person's estate to make a final dispositional decision. Triggers might be a certain number of years, or the death of a party.

Agreements about the disposition of cryopreserved pre-embryos should be submitted to the fertility clinic and preservation facility and should expressly supplement and supplant any provisions to the contrary in the original agreement with the fertility clinic and preservation facility. Agreements about the disposition of cryopreserved pre-embryos are particularly well suited to include clauses regarding the review of the agreement every couple of years.

## **XI. General Terms for All Divorce Settlement Agreements**

It bears repeating that this article is designed to help matrimonial and estate planning attorneys work together when divorcing parties are able to cooperate in maximizing the value of their assets by continuing to have co-interests in assets after divorce. The authors are not presenting agreement terms for situations when there is a real or perceived reason to not to have at least some level of trust in the other party. Nevertheless, future events can introduce uncertainty, and human instinct is to take expedient action to protect one's own interests. Moreover, one or both of the parties in the future may be represented by someone else in the form of an agent under a durable power of attorney, executor, or trustee who is less familiar with what the parties intended.

### *1. Rules of Engagement*

In general, agreements should reflect terms consistent with an arm's length transaction. Agreements should be drafted to require transparency and full, timely communication of necessary information. Agreements should be as detailed as possible and

should assume as little as possible concerning the parties' former agreements and "ways of doing things."

The agreement should address how decisions regarding the asset will be made, and who will make them. If any decisions are to be made jointly, there should be appropriate notice provisions and timing requirements. For example, notice and timing provisions must be included in agreements regarding the exercise of stock options, the sale of some or all of a business or its assets, the changing the form of business for tax purposes or relocating the situs of a business that may have tax implications. There should be a time certain for responses and agreed upon next steps if the parties fail to reach resolution or one party becomes unresponsive. For some matters, it may be appropriate to have a negative consent provision, so that if no disagreement is sent by a certain date, action may be taken consistent with the notice.

### *2. Notice Requirements*

Agreements should require each party to immediately provide the other party with any and all types of communications regarding the assets, or any issue in any way related to the asset. The form of notice, and obligation to update mail, email, and phone details should be included, as well as whether the expiration of any notice period is triggered from the date notice is sent or the date notice is received.

### *3. Standards of Care and Loyalties*

Agreements should be clear about what standards of care each party is being held to with respect to the asset, and what duties they owe to each other. Is the standard a fiduciary standard? Prudent investor? Reasonable person? Or simply no liability in the absence of negligence or bad faith? In particular, if the phrase "constructive trust" is used to describe how an asset is being held, be sure the agreement discusses whether a fiduciary duty is owed to the non-title holder. Note that the fiduciary standard of care for a trust may be higher than the usual business standard of care for a manager of an LLC,<sup>151</sup> although that may be modified in the operating agreement. In the case of businesses and intellectual property in particular, address the expect-

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<sup>151</sup> See *supra* note 34.

tations of the parties regarding time and attention to be devoted to the asset, if appropriate, versus the ability of a party to devote time and attention to a new or different endeavor.

#### *4. Liabilities*

If there are liabilities associated with a particular asset, what indemnifications will be included to facilitate payment of what may be a joint and several liability, or the sole liability of the current or former asset owner? Liabilities may be tax liabilities, general litigation associated with the asset (as in the case of a claim by an employee), or, for example, an environmental claim. Further, if the asset must remain in the titular name of only one of the parties, that asset will be subject to the claims of creditors of the asset owner unrelated to the asset. The non-owner party will be an unsecured creditor, with no superior claim to the asset value. The agreement should discuss how the non-titular owner will be made whole in such a circumstance.

For liabilities in the nature of debt, the agreement should address whether the estate of a deceased owner will be released from lending agreements, as well as any personal guarantees on business assets, as appropriate.

#### *5. Lawsuits to Defend the Asset*

Agreements should outline who shall be responsible for determining whether to hire attorneys and whether to file suit to protect an asset, and how far to take litigation if the initial suit is unsuccessful. Agreements should further define who has the authority to reach settlement agreements. Of course, how lawsuits are funded will be a critical part of this portion of the agreement. Finally, the allocation of any recovery should be set forth, particularly if one party is funding the litigation.

#### *6. Taxes*

An important threshold question in structuring agreements is whether the transfer will be treated as incident to the divorce. The transfer must occur either: (a) within one year from the date the marriage ceases; or (b) occur no later than six years from the cessation of the marriage pursuant to a written divorce settle-

ment agreement.<sup>152</sup> The transfer of an asset from an entity to a spouse is not a transfer from spouse-to-spouse incident to divorce, unless the entity is treated as a disregarded entity, as in the case of a single member LLC.

If income taxes must be reported by only one party as the titular owner of the asset or right, as in the case of stock options, what reporting will be given to the other party, and how will any disputes about tax reporting and treatment be addressed? IRS and state tax revenue departments are not bound by the private agreement of the parties and will look to the party who must report the income. That party will in turn have a generic contract enforcement claim against the other party. The agreement can provide that the defaulting party waives claims, defenses, claims for presentment, and the like. Note that if the defaulting party dies, the period for making a claim against the estate may be subject to a shortened statute of limitations. If a 1099 will be issued to the other party to shift tax reporting to the other spouse, the agreement should clearly state that and obligate the parties to report in a consistent manner. The parties should consider designating a professional who will make the decision about tax reporting if they do not agree.

### *7. Exit Plan*

One of the most important terms of the agreement will be the terms concerning how a party exits the agreement if the in-kind division or co-ownership regime is unworkable. Each plan will be tailored to the parties and the circumstances but should include notice provisions regarding a desire to exit the situation, a time and method for the parties to see if an alternative to exit is available, and then a process for the exit. Parties should not be given an incentive to exit, so the exiting party's entitlement should be significantly less than if the agreement were carried out. Once a party has notified the other that he or she wishes to exit, the notice may trigger limitations on use of funds, distributions, reinvestment of funds, and the like to protect asset value. A voluntary unwinding should be done in an agreed upon manner that will not damage the value of the asset to the other party who may acquire the asset in a buyout, or the sale to a third

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<sup>152</sup> 26 C.F.R. § 1.1041-1T (2020).

party. Parties may agree to a set amount to be distributed to one party if there is an exit, to a valuation methodology, or to a complete forfeiture of rights and interests. If any payout is given to the exiting party, a time and means for payout should be established, such as a payment via a promissory note over a certain amount of time at a certain amount of interest, or at the time of a triggering event, such as sale of the asset or death of a party. Actions that need to be taken by both parties if there is an exit (i.e., amendment to operating agreements, notice to third parties, retitling) should be identified and each party should agree to cooperate.

#### *8. Subsequent Spouses*

Parties who will co-own assets after a divorce should be cognizant of the fact that a subsequent spouse of a party may have rights in co-owned assets as a result of the marriage. These rights may be community property rights, rights on divorce, or rights on death. Parties should try to mitigate this extra complexity with spousal waivers regarding co-owned assets, spousal consents to operating agreements, prenuptial agreements, or adequate life insurance paid to the estate to reduce friction.

#### *9. Transfers During Life and at Death*

The agreement should address what transfers of interests may be permitted during life and at death. For example, can an interest in a business be transferred to a third party? If one party wishes to transfer interests, should the other have a right of first refusal? To a limited class of third parties, such as blood relatives? Descendants only? Must an interest in a co-owned asset be transferred to the surviving other party? Will the survivor have an obligation to the decedent's estate? Should there be life insurance in place to secure that obligation? Should there be a valuation, or a valuation methodology built into the agreement?

#### *10. Incapacity and Death*

The agreement should address what happens in the case of a party's incapacity as it affects management and decision making involving co-owned assets. With respect to these complex assets, do the parties wish to agree on who the designated agent will be for each of them in the event of incapacity? The designated agent

may be different than the designated agent for the parties' other assets. Whether the other party can or should serve as agent will depend on the level of trust and consideration of conflicts of interest. Naming the other party should not be assumed without due consideration for obvious reasons.

The divorce settlement agreement also should address whether disability or death should trigger a purchase right or obligation to sell the business to a third party if continued ownership of an asset, such as an operating business, is not feasible or optimal for conserving value. There may also be an opportunity for hiring a third-party manager or key employee to manage the asset if that would be preferable, for the short term or indefinitely. Should the operating agreement contain a mandatory or optional buyout provision? If so, how will the interest be appraised, and will the value be discounted for lack of marketability and control?

Similar to the question concerning the identity of the agent in the context of incapacity, do the parties wish to identify who will serve as special trustee or special executor for co-owned assets? Whether the other spouse can serve in this role is dependent on the trust that conflicts of interest will not negatively impact the deceased party's estate.

Because complex assets likely mean that the estate will be of a size that results in estate tax, will the parties commit to having sufficient liquid assets and/or life insurance so as not to force a sale of the asset simply to raise liquidity for taxes? Even with a mandatory buyout provision, there may be insufficient liquidity to pay estate taxes, which are due nine months from the date of death, as it is likely that a divorce settlement agreement may contain provision for payment in part by a promissory note. Importantly, a buyout that does not discount for lack of marketability or a non-controlling interest in an asset will fix the value for estate tax purposes at the undiscounted value.

Once the terms have been settled, it is important to consider who will be responsible for carrying out the active decisions in the event the party who has the designated responsibility becomes incapacitated or dies. Even where the assets have been transferred, if there are decisions that remain with the transferor spouse, who will succeed to the management responsibilities is important. In situations where the asset cannot be transferred

the issues become more acute since the receiving spouse may have little or no ability to take charge of the asset or management succession. A general estate planning document, such as a durable power of attorney or will does not necessarily give the power holder the right to manage certain assets. For example, an agent under a durable power of attorney does not have the right to assume management responsibilities as trustee or as manager of an LLC but does have capacity to vote shares of a business and LLC interests. Care should be taken to address management succession for particular responsibilities and, in the case of incapacity, how incapacity will be determined, so that there is no prolonged vacancy when exigent decisions must be made. At death, obligations to a former spouse are typically unsecured, and will be subordinate to estate taxes, expenses of administration, and secured debt. As a result, it is critically important to include representations and warranties that the obligor spouse will not intentionally encumber any asset managed for the benefit of the other spouse, including promises that the assets will not be shown on a balance sheet for lending purposes, nor pledged without the consent of the former spouse. An often overlooked but critical issue is the estate tax obligation at death.<sup>153</sup> Without a marital deduction for asset value passing to a spouse, there may be estate tax due. The estimated tax is due nine months from the date of death. If there is insufficient liquidity, and assuming no mandatory buyout from the surviving owner, the other option for payment of estate taxes may involve obtaining loans, either from a third party or, in some cases, from the IRS under a Section 6166 election<sup>154</sup> or other deferred payment arrangement. The risks attendant in co-ownership of an ongoing enterprise without a date certain or at least a time frame for exit should not be underestimated.

#### *11. Alternative Dispute Resolution and Reserved Jurisdiction*

Agreements should have a robust section regarding alternative dispute resolution (“ADR”). Events or impasses that trigger a requirement to participate in ADR should be clearly defined.

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<sup>153</sup> 26 U.S.C. § 2001 (2020). Note that some states still impose a state estate tax as well.

<sup>154</sup> See 26 U.S.C. § 6166 (2018).

Deadlines for participating in ADR should be put into the divorce settlement agreement. A default provider should be identified. The agreement should further state that if the default provider is not used, the alternative shall be agreed to, and shall meet certain criteria for expertise and experience. Parties may wish to include other requirements, such as a geographical location. Thought should be given as to whether the provider should have domestic relations experience or experience in the subject of the agreement, such as patents. Failure to timely and in good faith participate in ADR should come with a defined consequence, such as a weekly fine or an automatic attorney fee award. The agreement should include a provision that each party pays one-half of the ADR costs, together with such party's own legal, accounting, and expert fees. Finally, most ADR provisions will start with a mediation clause. Parties should also agree on the minimum number of mediations to participate in, and if there is no full resolution, that parties will be required to arbitrate. If the parties can, it is a good idea to further agree upon arbitration rules, such as applying the Uniform Arbitration Act as well as venue.

## **XII. CONCLUSION**

A matrimonial attorney's job with respect to property is to disassemble a marital estate and create two separate estates. It is difficult, as a result, to conceptualize the idea that not everything has to be taken apart or taken apart immediately. Because the segment of people that matrimonial attorneys work for tend to be those with more rather than less conflict, it can be hard to realize that the agreements like those set forth in this Article are entered into by people all the time. Just because people used to be married does not automatically preclude them from successful arm's-length property agreements. Trusts and estates attorneys are well versed in putting together plans regarding property that are followed through the years, and even through the generations. Collaboration between matrimonial attorneys and trusts and estates attorneys can afford clients a means of dealing with their assets in a way that gives each, and perhaps their children and grandchildren, an ability to realize the full value of the assets created and developed during the marriage.

## **The Changing Tax Affecting Landscape in S Corporation Valuations: Time to Say “I Do” in Divorce Cases?**

by  
Andrew Z. Soshnick

### **I. Introduction**

One of the most hotly debated topics in business valuation is the tax treatment of S corporations. Since 2001, federal courts have embarked on a journey that considers whether to tax affect S corporation earnings in business valuations of those entities. That circuitous path, mostly in the context of gift tax disputes, sometimes conflicts with the two seminal divorce opinions of *Bernier v. Bernier* that address this issue in the family law setting. Recent trends send mixed messages as to tax-affecting S corporation earnings in business valuations of those entities regarding reaching more accurate conclusions of value. Part II of this article reviews the background of S corporations and their primary purpose. Part III of this article discusses premises and standards of value and how those selections can impact tax considerations. Part IV of this article analyzes the progression of federal tax precedent to current date, including the recent Michael Jackson estate litigation, and the impact of the important *Delaware Open MRI Associates v. Kessler* Delaware Court of Chancery opinion. Part V of this article reviews the most notable divorce precedent addressing this issue and harmonizes that precedent with federal and Delaware tax precedent. Finally, Part VI of this article evaluates this background and precedent and concludes that divorce courts must tax-affect earnings when valuing businesses structured as S corporations in order to most accurately determine value.

## II. S Corporation Background

To evaluate whether to tax affect S corporation earnings, an understanding of the genesis S corporations is essential. Prior to the establishment of S corporations by the U.S. Congress, businesses could elect either C corporation, partnership, or sole proprietorship status.<sup>1</sup> C corporations had tax impact at both the corporate income and shareholder dividend levels with limited liability.<sup>2</sup> Partnerships and sole proprietorships had tax impact at only the personal tax level but left individuals with unlimited liability.<sup>3</sup> Neither of these choices were optimal. In particular, small businesses were forced to choose between structures that had two levels of taxation with limited liability or one level of taxation with unlimited liability. This choice placed smaller entities at a competitive disadvantage relative to larger enterprises. As early as 1946, the U.S. Department of Treasury proposed a business structure that melded together one level of federal taxation and limited liability. That initial suggestion led to Congress in 1958 creating subchapter S of the Internal Revenue Code.<sup>4</sup> The election of S corporation status had the following limits. First, S corporations must be domestic corporations.<sup>5</sup> Second, the only allowable shareholders of S corporations are individuals and certain trusts and estates, and not partnerships, corporations, or nonresident alien shareholders.<sup>6</sup> Third, S corporations must have no more than 100 shareholders.<sup>7</sup> Fourth, S corporations must have only one class of stock.<sup>8</sup> Finally, S corporations cannot be ineligible corporations (e.g., certain financial institutions, insurance companies, and domestic international sales corporations).<sup>9</sup>

Essentially, S corporation status emerged as an attempt to benefit small businesses by creating a single level of taxes and

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<sup>1</sup> Zach Oehlman, *Valuing S, Corporations in Family Law Engagements*, WILLAMETTE VALUATION ASSOCIATES INSIGHTS, Spring 2013, at 50.

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at 51.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

limited liability that would eliminate the tax disadvantages that might dissuade small businesses from adopting the corporate form.<sup>10</sup> This goal is accomplished by establishing a pass-through system under which corporate income, losses, deductions, and credits are attributed to shareholders in a manner akin to the tax treatment of partnerships.<sup>11</sup> As a result, S corporations pay no state or federal income tax, instead passing their income through to shareholders who report their *pro rata* shares of income on individual tax returns.<sup>12</sup> This favorable tax treatment led to increasing popularity for S corporation election. From this new form of entity emerged a new controversy in business valuation: Should S corporations be valued the same as C corporations by tax affecting income streams using C corporation tax rates? Is that a fairer result in removing the valuation distinction based on entity structure? If not removed, does using C corporation tax rates created a price premium for S corporations? Further, should the answer differ in the case of tax disputes, shareholder controversies, and divorce cases? This background laid the foundation for the evolution of S corporation business valuation approaches and precedent.

### III. Premises and Standards of Value

To further evaluate this question and the progression of S corporation valuation, an understanding of both premise of value and standard of value is critical. Premise of value assists in defining the standard of value falls into two categories: value in exchange and value to the holder.<sup>13</sup> Value in exchange is the value derived from an interest changing hands in a real or hypothetical transaction.<sup>14</sup> Value to the holder is the value of an interest being maintained in its present form by its present owner and is sometimes called “going concern” or “intrinsic” value.<sup>15</sup> Value to the holder does not have to be marketable to have value.<sup>16</sup>

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<sup>10</sup> Gross v. Comm’r, 272 F.3d 333, 335 (6th Cir. 2001).

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> JAY E. FISHMAN, SHANNON P. PRATT & WILLIAM J. MORRISON, STANDARDS OF VALUE – THEORY AND APPLICATION 20-21 (2d ed. 2013).

<sup>14</sup> *Id.* at 20.

<sup>15</sup> *Id.* at 21.

<sup>16</sup> *Id.*

Premises of value help define standards of value that are applied. With a value in exchange premise of value, the fair market value standard typically is applied.<sup>17</sup> With a value to the holder premise of value, a fair value or investment standard of value may apply.<sup>18</sup> Unfortunately, most states do not specify a standard of value. Only Arkansas and Louisiana provide statutory guidance as to the standard of value.<sup>19</sup> Case law provides guidance in twenty-four additional states.<sup>20</sup> The standard of value in the remaining twenty-four states and the District of Columbia must be inferred from valuation concepts that are used and applied.<sup>21</sup> From this review, it can be inferred thirty-five states and the District of Columbia use a fair market value standard, three states use a fair value standard, five states use an investment value standard, and seven states use a hybrid standard.<sup>22</sup> Yet none of these standards distinguish between the subject matter of cases such as tax controversies, shareholder disputes, and divorce actions. This scattered landscape foreshadows why S corporation valuations have proven to be so problematic to both valuation professionals and the courts and offers insight as to the uneven history beginning with federal, primarily Tax Court, analysis.

#### **IV. Federal Tax Precedent and the Delaware Court of Chancery Detour**

The odyssey of S corporation valuations begins with *Gross v. Commissioner*.<sup>23</sup> Taxpayers Walter L. Gross, Jr. and Patricia G. Linnemann, and their spouses by virtue of consent, gifted shares of stock of Pepsi-Cola Bottlers, Inc. (“G & J”) to their children.<sup>24</sup> By written agreement dated November 1, 1982, G & J shareholders elected to be taxed as an S corporation.<sup>25</sup> On July 31, 1992, Gross gifted each of his three children 124.5 shares of G & J

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<sup>17</sup> *Id.* at 20-21.

<sup>18</sup> *Id.* at 20.

<sup>19</sup> *Id.* at 265.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 268-72.

<sup>23</sup> See generally *Gross v. Comm’r*, 272 F.3d 333.

<sup>24</sup> *Id.* at 335.

<sup>25</sup> *Id.*

stock.<sup>26</sup> That same day, Linnemann gifted each of her two her children 187.5 shares of G & J stock.<sup>27</sup> After hearing conflicting expert testimony, the U.S. Tax Court determined that the G & J stock should not be tax affected (or, as it put it, the stock should be discounted using a tax affect of 0%).<sup>28</sup> The lead opinion by Judge Clay concluded that the use of a 0% tax affect was clearly erroneous but, in an unusual procedural posture, the other two judges (Judge Daughtrey and Senior Judge Cohn) disagreed, so that the majority holding was that the Tax Court's use of the 0% tax affect was proper.<sup>29</sup> The Commissioner argued that tax affecting was not a generally accepted business practice at the time, but the Service's expert admitted on cross-examination that there was a growing controversy in 1992 as to the propriety of tax affecting.<sup>30</sup> The lead opinion noted that there were two internal IRS documents that endorsed the policy of tax affecting when valuing the stock of S corporations: The IRS Valuation Guide of Income, Estate, and Gift Taxes: Valuation Training for Appeals Officers *and* the IRS Examination Technique Handbook.<sup>31</sup> Further, the IRS had previously approved 1988 taxes paid by the taxpayers based on a tax affected discounted cash flow method under the income approach.<sup>32</sup> Judge Clay found the Service's internal directives and prior approval of tax affecting for the taxpayers made the Tax Court's decision to use a 0% tax affect implausible.<sup>33</sup> Judge Daughtrey and Senior Judge Cohn rejected this assertion and found the lead opinion's sole focus on perceived unfairness to the taxpayers to be improper under the willing buyer and willing seller fair market value concept.<sup>34</sup> They added that the entire valuation process is a fiction and that a court is not required to presume hypothetical, unlikely, or unreasonable facts in determining fair market value.<sup>35</sup> *Gross* sent

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<sup>26</sup> *Id.* at 336.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 338; *see also* *Gross v. Comm'r*, 78 T.C.M. (CCH) 201, T.C.M. (RIA) 1999-254.

<sup>29</sup> *Gross v. Comm'r*, 272 F.3d 333, 342.

<sup>30</sup> *Id.* at 345.

<sup>31</sup> *Id.* at 347.

<sup>32</sup> *Id.* at 348.

<sup>33</sup> *Id.* at 348-49.

<sup>34</sup> *Id.* at 354.

<sup>35</sup> *Id.* at 356.

shockwaves through the business valuation community and served as the standard for the next two decades as its vitality became increasingly called into question.

Less than one year later, the U.S. Tax Court in *Adams v. Commissioner*<sup>36</sup> followed the majority holding in *Gross* and concluded that a valuation expert's estimate of an S corporation's prospective net cashflows under the income approach to valuation was not pre-tax because it is appropriate to use a 0% corporate tax rate to estimate S corporation net cashflow. Interestingly, the Tax Court took issue with aspects of both valuation experts' reports and testimony and determined a business valuation (\$1,161,705.00) much closer to that contended by the estate (\$920,800.00) than by the Service (\$1,746,000.00).<sup>37</sup> The focus on other factors and concessions benefitting the taxpayer made the outcome less precedentially impactful but demonstrated that the *Gross* methodology had a toehold on S corporation valuations.

Four years later, the Delaware Court of Chancery offered a detour from *Gross*. *Delaware Open MRI Associates v. Kessler*<sup>38</sup> involved the issue of whether shareholders of a radiology professional association received fair value in a freeze-out merger. Among the myriad issues was whether to tax affect the earnings of the radiology concern in determining fair value.<sup>39</sup> The chancery court considered the fact that the entity was an S corporation and found both experts' conclusions to be lacking.<sup>40</sup> The purchasers' expert, in treating the S corporation as a C corporation, understated the fair value of the merger price.<sup>41</sup> Conversely, the sellers' expert overstated the S corporation premium attributable to a potential sale.<sup>42</sup> The chancery court embraced the reasoning of prior decisions that an S corporation structure can produce a material increase in economic value for a shareholder and should be given proper weight in a valuation, and found this reasoning to be consonant with *Gross* and its prog-

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<sup>36</sup> *Adams v. Comm'r*, 83 T.C.M. (CCH) 1421, T.C.M. (RIA) 2002-080.

<sup>37</sup> *Id.*

<sup>38</sup> 898 A.2d 290, 299 (Del. Ch. 2006).

<sup>39</sup> *Id.* at 326.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* at 327.

<sup>42</sup> *Id.*

eny.<sup>43</sup> The chancery court undertook a detailed analysis in estimating an equivalent, hypothetical “pre-dividend” S corporation tax rate of 29.4% to the earnings of the radiology corporation in order to treat the S corporation shareholder as receiving the full benefit of untaxed dividends by equating its after-tax return to a C corporation shareholder.<sup>44</sup> *Kessler* effectively adopted a hybrid position of tax affecting S corporation earnings at a lower rate than the shareholders requested but well beyond a 0% tax affect contemplated by *Gross*. However, the reach of this decision at the time was dubious. Did traditional limitations of chancery court authorities apply? Did the precedent apply only to freeze-out merger situations? Did statutory fair value standards yield different outcomes from market-based fair value standards? The U.S. Tax Court’s initial reaction was soon to follow.

Five months later, *Dallas v. Commissioner*<sup>45</sup> answered these questions. At issue was the value of 55% of non-voting stock of Dallas Group of America, Inc. (“Dallas”) for gift tax purposes.<sup>46</sup> Dallas’s expert witnesses reduced Dallas projected income by 40% and 35%, respectively based on tax affecting, assuming that Dallas’s S corporation status could be lost after a sale.<sup>47</sup> The U.S. Tax Court found that assumption to be lacking in basis and damaged the experts’ credibility.<sup>48</sup> The Tax Court considered and rejected evidence of tax affecting an employee stock ownership plan valuation because there was no evidence that the U.S. Department of Labor’s definition of value was similar to the applicable definition of fair market value.<sup>49</sup> More significantly, the Tax Court rejected the *Kessler* rationale and noted that fair value in minority stock appraisal cases is not equivalent to fair market value.<sup>50</sup> Put another way, the Delaware chancery court did not decide the price that a hypothetical willing buyer would pay a hypothetical willing seller, both having reasonable knowledge of all relevant facts and neither being under compulsion to buy or

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<sup>43</sup> *Id.*

<sup>44</sup> *Id.* at 330.

<sup>45</sup> *See generally* Dallas v. Comm’r, 92 T.C.M. (CCH) 313, T.C.M. (RIA) 2006-212.

<sup>46</sup> *See* T.C.M. (RIA) 2006-212 at \*1.

<sup>47</sup> *See id.* at \*2.

<sup>48</sup> *Id.* at \*6.

<sup>49</sup> *Id.* at \*7.

<sup>50</sup> *Id.* at \*7.

sell.<sup>51</sup> The Tax Court concluded that there was insufficient evidence to conclude that a hypothetical buyer and seller would tax affect Dallas's earnings and that tax affecting was not appropriate.<sup>52</sup> From the Tax Court's perspective, an initial review of *Kessler* did not lead to immediate changes in the *Gross* approach to gift tax valuations.

Five years later, *Estate of Gallagher v. Commissioner*<sup>53</sup> revisited tax affecting. *Gallagher* involved the fair market value of 3,970 membership units in Paxton Media Group, LLC ("PMG"), a privately-held and family-owned newspaper publishing company, for gift tax purposes.<sup>54</sup> On December 26, 1996, PMG elected S corporation status and by agreement preserved that continued election upon its conversion to an LLC in 2001.<sup>55</sup> Among the many valuation issues was an assessment of the estate's valuation and the expert's tax affecting of PMG's earnings under the income approach discounted cash flow method.<sup>56</sup> The estate argued that *Gross* supported that adjustment in its commentary that a reduction in total tax burden should not be ignored in valuing an S corporation.<sup>57</sup> The Tax Court disagreed with the estate's analysis of *Gross*, noting that, as to S corporation tax affecting, the imposition of a 0% corporate tax rate properly reflected the tax savings and that the estate's experts tax adjustment should be disregarded.<sup>58</sup> The Tax Court found for the Service in part and the estate in part, and made an adjustment to the deficiency on other grounds.<sup>59</sup> *Kessler* a half decade later had no material impact on Tax Court S corporation income approach valuations, or so it seemed. That was about to change.

Also in 2011, the U.S. Tax Court considered *Estate of Giustina v. Commissioner* and rejected the estate's expert's reduction

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<sup>51</sup> See *id.* at \*7; see also Rev. Rul. 59-60 at \*19-20.

<sup>52</sup> T.C.M. (RIA) 2006-212 at \*27.

<sup>53</sup> See generally *Estate of Gallagher v. Comm'r*, 101 T.C.M. (CCH) 1702, T.C.M. (RIA) 2011-148.

<sup>54</sup> See T.C.M. (RIA) 2011-148 at \*1.

<sup>55</sup> *Id.* at \*2.

<sup>56</sup> *Id.* at \*9-20.

<sup>57</sup> *Id.* at \*17.

<sup>58</sup> *Id.*

<sup>59</sup> See *id.* at \*20; see also *Estate of Gallagher v. Comm'r*, 102 T.C.M. (CCH) 388, T.C.M. (RIA) 2011-244 (supplemental opinion correcting an error in the discounted cash flow analysis).

of predicted cashflow by 25% to account for the income taxes that would be owed by the owner of the partnership interest on that owner's share of the partnership income.<sup>60</sup> The Tax Court opined that a business valuation expert should not reduce cashflows by income tax while simultaneously using a pre-tax rate of return to discount the cashflows to present value.<sup>61</sup> On remand, the Tax Court noted that the U.S. Court of Appeals for the Ninth Circuit held that the Tax Court's valuation was flawed because it should have valued the partnership as a going concern, and not considered the value of the partnership's assets, and not reduced the company specific risk premium.<sup>62</sup> On remand, the Tax Court adjusted normalized pre-tax income by a 25% reduction to determine normalized net income.<sup>63</sup> *Giustina* demonstrates federal appellate court limits to Tax Court tax-affecting autonomy and serves as a precursor to a monumental change in view toward S corporation tax affecting that was in the offing.

The year 2019 saw a seismic shift in the approach to tax affecting in the landmark case of *Kress v. United States*.<sup>64</sup> The plaintiffs were shareholders in Green Bay Packaging, Inc. ("GBP"), an S corporation that was a vertically integrated manufacturer of corrugated packaging, folding cartons, coated labels, and related products.<sup>65</sup> The Kress family owned approximated 90% of GBP common stock.<sup>66</sup> The Kress family could only gift, bequest, or sell their shares to other members of the Kress family.<sup>67</sup> The plaintiffs gifted minority shares of GBP stock to their children and grandchildren in 2006, 2007, and 2008 and valued the shares on gift tax returns at \$28.00 for tax year 2007, \$25.90 for tax year 2008, and \$21.60 for tax years 2009 on gift tax returns.<sup>68</sup> The Service challenged the values, finding that the fair

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<sup>60</sup> See *Estate of Giustina v. Comm'r*, 101 T.C.M. (CCH) 1676, \*6, T.C.M. (RIA) 2011-141, *rev'd and remanded by* 586 Fed. Appx. 417 (9th Cir. 2014).

<sup>61</sup> *Id.*

<sup>62</sup> See *Estate of Gisutina v. Comm'r*, 111 T.C.M. (CCH) 1551, \*1, T.C.M. (RIA) 2016-114.

<sup>63</sup> T.C.M. (RIA) 2016-114 at \*6.

<sup>64</sup> See *generally* *Kress v. United States*, 382 F. Supp. 3d 820 (E.D. Wis. 2019).

<sup>65</sup> *Id.* at 825.

<sup>66</sup> *Id.* at 825-26.

<sup>67</sup> *Id.* at 826.

<sup>68</sup> *Id.*

market value of the stock was that used for actual share transactions between GBP and its employees: \$45.97 on December 31, 2006, \$47.63 on December 31, 2007, and \$50.85 on December 31, 2008.<sup>69</sup> The plaintiffs paid gift tax deficiencies and accrued interest of \$2,218,465.80 in December 2014 and initiated a lawsuit to recover those amounts on June 24, 2016.<sup>70</sup> The U.S. Court of Appeals for the Eastern District of Wisconsin considered competing expert testimony. The Service's expert, Francis Burns, weighted the market approach 60% and the income approach 40% to determine final fair market value.<sup>71</sup> The district court found that Burns's valuation overstated the value of a minority interest in GBP stock because his market approach analysis was inflated by not adequately accounting for the 2008 recession and relying on an outlier as a comparable company.<sup>72</sup> The district court found that Burns applied a too low discount for lack of marketability: 10.8% for 2007, 11.0% for 2008, and 11.2% for 2009.<sup>73</sup> More significant was the fact that Burns, like plaintiffs' experts, applied C corporation-level taxes to GBP's earnings to effectively compare GBP to C corporations.<sup>74</sup> Burns then assessed a premium to account for the tax advantages associated with subchapter S status, such as the elimination of a corporate level of taxes.<sup>75</sup> Burns calculated the fair market value of a share of GBP stock to be \$38.40 for tax year 2007, \$27.81 for tax year 2008, and \$40.05 for tax year 2009.<sup>76</sup> The district court reiterated its conclusion that Burns overvalued a minority interest in GBP for tax years 2007, 2008, and 2009, and gave less weight to his conclusions.<sup>77</sup> The plaintiffs had two experts, John Emory and Nancy Czaplinski.<sup>78</sup> Emory employed the market approach and, although he did not explicitly complete an income approach assessment, applied income approach concepts in his overall analy-

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<sup>69</sup> *Id.* at 826-27.

<sup>70</sup> *Id.* at 827.

<sup>71</sup> *Id.* at 833.

<sup>72</sup> *Id.* at 833-34.

<sup>73</sup> *Id.* at 835.

<sup>74</sup> *Id.*

<sup>75</sup> *Id.* at 835-36.

<sup>76</sup> *Id.* at 832.

<sup>77</sup> *Id.* at 836.

<sup>78</sup> *Id.*

sis.<sup>79</sup> Emory's marketability discounts of 30.0% for 2007 and 2008 and 28.0% for 2009 were the highest of the three experts but lower than he had applied in the past.<sup>80</sup> Emory calculated the fair market value of a share of GBP stock to be \$28.00 for tax year 2007, \$25.90 for tax year 2008, and \$21.60 for tax year 2009.<sup>81</sup> In response to Service criticism that Emory did not employ a separate income approach, the plaintiffs retained Czaplinski to prepare a report using a combination of the market approach and the income approach.<sup>82</sup> She weighted the market approach 14% and the income approach 86% and calculated the fair market value of a share of GBP stock to be \$30.87 for tax year 2007, \$25.92 for tax year 2008, and \$25.92 for tax year 2009.<sup>83</sup> After reviewing the reports and testimony of all three witnesses, the district court found the valuation methodology of Emory to be the most sound.<sup>84</sup> However, the district court reduced Emory's discounts for lack of marketability to 27.0% for tax years 2007 and 2008 and 25.0% for tax year 2009, resulting in a GBP share value of \$29.20 for tax year 2007, \$27.01 for tax year 2008, and \$22.50 for tax year 2009.<sup>85</sup> *Kress* is notable in that all three experts tax-affected GBP's earnings and the district court accepted that approach. While the district court's opinion might not carry the same gravitas as an opinion from the U.S. Tax Court, the facts illustrate flexibility in the Service's position and portended a similar re-evaluation by the Tax Court just five months later.

*Estate of Jones v. Commissioner*<sup>86</sup> directly tackled the tax-affecting issue left in limbo since *Gross* attempted to explicate the landscape. In 1954, the decedent established Seneca Sawmill Co. ("SSC"), a lumber manufacturing company incorporated in Oregon.<sup>87</sup> From its founding through the 1980s, SSC was largely

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<sup>79</sup> *Id.*

<sup>80</sup> *Id.* at 837.

<sup>81</sup> *Id.* at 836.

<sup>82</sup> *Id.* at 837.

<sup>83</sup> *Id.*

<sup>84</sup> *Id.* at 838.

<sup>85</sup> *Id.* at 841.

<sup>86</sup> See generally *Estate of Jones v. Comm'r*, 118 T.C.M. (CCH) 143, T.C.M. (RIA) 2019-101.

<sup>87</sup> T.C.M. (RIA) 2019-101 at \*1.

dependent on timber from federal lands.<sup>88</sup> In 1989 and 1992, the decedent purchased additional timberland from private owners.<sup>89</sup> On August 25, 1992, the decedent formed Seneca Jones Timber Co. ("SJTC"), an Oregon limited partnership, to invest in, acquire, hold, and manage timberlands, beginning with the timberlands he purchased in 1989 and 1992.<sup>90</sup> As of the valuation date, SSC's largest supplier of logs was SJTC.<sup>91</sup> SSC and SJTC operated in tandem in furtherance of SSC's sawmill business.<sup>92</sup> In 1996, the decedent began to create a succession plan that included forming family and generation-skipping trusts on May 28, 2009.<sup>93</sup> Gifts to the various trusts included Class A and Class B shares of SSC to the trusts and gifts of limited partnership units to each of his two daughters.<sup>94</sup> The estate submitted an expert report valuing the blocks of gifted SSC Class A and Class B shares and the Service submitted a report critiquing that valuation.<sup>95</sup> Both the estate and the Service submitted expert reports valuing the SJTC limited partnership units.<sup>96</sup> The estate valued the SSC Class A shares and Class B shares, and the SJTC units, at \$325.00, \$207.00, and \$230.00, respectively, on the gift tax return but conceded the amounts to \$390.00, \$380.00, and \$380.00, respectively.<sup>97</sup> The Service increased its value of an SJTC limited partnership unit from \$2,511.00 to \$2,530.00, placing that valuation in issue.<sup>98</sup> The estate's expert, Richard Reilly, valued SJTC and SSC as going concerns and relied on the discounted cash flow method under the income approach.<sup>99</sup> The Service's expert, Philip Schwab, valued SJTC as a going concern and relied on the asset approach.<sup>100</sup> The Service's rebuttal expert contested Reilly's use of certain projections, his treatment of SSC's general

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<sup>88</sup> *Id.*

<sup>89</sup> *See id.*

<sup>90</sup> *Id.*

<sup>91</sup> *Id.* at \*2.

<sup>92</sup> *Id.* at \*4.

<sup>93</sup> *Id.* at \*7.

<sup>94</sup> *See id.*

<sup>95</sup> *Id.* at \*8.

<sup>96</sup> *Id.*

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* at \*9.

<sup>100</sup> *Id.*

interest in SJTC, and the intercompany receivable it held in valuing SSC.<sup>101</sup> In a detailed analysis, the U.S. Tax Court concluded that an income approach like Reilly applied was the more appropriate approach to value SJTC.<sup>102</sup> Of most relevance, the Tax Court determined that Reilly's tax-affecting SJTC's earnings by a 38% proxy for combined federal and state C corporation tax burdens was appropriate.<sup>103</sup> Noting *Gross*, *Gallagher*, and *Giustina* each declined to tax affect earnings, the Tax Court noted the deficiencies in the experts' methods in those cases and elucidated that the question in those cases and this case was not whether to take into account the tax benefits inuring to a pass-through entity but rather how.<sup>104</sup> The rationale in *Gross* considered that an S corporation election is a reduction in total tax burden for the owners and the owners' tax savings should not be ignored in valuing S corporations.<sup>105</sup> The Tax Court also considered the different outcomes in *Kessler* and *Bernier v. Bernier*,<sup>106</sup> and noted the fact-sensitivity of the *Gross* decision based on the record before it.<sup>107</sup> The Tax Court concluded that Reilly had more accurately taken into account the tax consequences of SJTC's pass-through status and that his tax-affecting was more complete and convincing than the Service's 0% tax rate.<sup>108</sup> For the same reasons, the Tax Court accepted Reilly's tax-affecting in his valuation of SSC.<sup>109</sup> *Jones* stands as a hallmark deviation from *Gross*. A more accurate reading is that *Jones* explicates the reasoning in *Gross*, illuminates that different facts can produce different outcomes (especially when both side's experts tax affect cash flows), recognizes the relevance of non-tax opinions to tax controversies, and impresses the importance of cogent and effective expert advocacy. The *Jones* chapter remains open, as an appeal of the Tax Court decision remains pending.

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<sup>101</sup> *See id.*

<sup>102</sup> *Id.* at \*12.

<sup>103</sup> *Id.*

<sup>104</sup> *See id.* at \*12-14.

<sup>105</sup> *Id.* at \*13.

<sup>106</sup> 873 N.E.2d 216 (Mass. 2007), discussed in detail in Part VI, *infra*.

<sup>107</sup> Estate of Jones v. Comm'r, 118 T.C.M. (CCH) 143, T.C.M. (RIA) 2019-101, \*13

<sup>108</sup> T.C.M. (RIA) 2019-101 at \*14.

<sup>109</sup> *See id.*

What does not remain pending is the longstanding saga of the Michael Jackson estate, with the recent U.S. Tax Court decision offering another turn in the tax affecting odyssey. In *Jackson v. Commissioner*,<sup>110</sup> the estate and Commissioner disputed the values of three intangible assets: (1) Jackson's image and likeness, (2) Jackson's interest in New Horizon Trust II, through which he held an interest in Sony/ATV Music Publishing, LLC, and (3) Jackson's interest in New Horizon Trust III, which contained Mijac Music, a music publishing catalog that owned copyrights to compositions Jackson wrote or co-wrote and compositions by other songwriters.<sup>111</sup> Jackson died on June 25, 2009.<sup>112</sup> On its 2009 Form 706, the estate valued Jackson's image and likeness at \$2,105.00, New Horizon Trust II at \$0.00, and New Horizon Trust III at \$22,207,351.00.<sup>113</sup> The Commissioner audited the estate's tax return and in May 2013 issued a notice of deficiency in which it valued Jackson's image and likeness at \$434,261,895.00, New Horizon Trust II at \$469,005.086.00, and New Horizon Trust III at \$58,478.593.00.<sup>114</sup> The adjusted valuation of these and other assets led the Commissioner to assert that the estate had underpaid estate tax by more than \$500,000,000.00.<sup>115</sup>

The estate retained four experts for trial.<sup>116</sup> Mark Roesler, the founder and CEO of CMG Worldwide, Inc., and Jay Fishman, a managing director of Financial Research Associates, valued Jackson's image and likeness.<sup>117</sup> CMG Worldwide was an international licensing and rights-management company that specialized in representing living and deceased celebrities such as Marilyn Monroe, James Dean, Buddy Holly, Chuck Berry, Princess Diana, and Jackie Robinson.<sup>118</sup> Roesler projected ten years of revenues from the exploitation of Jackson's image and likeness under California law and from some associated trademarks.<sup>119</sup>

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<sup>110</sup> See Estate of Jackson v. Comm'r, T.C.M. 2021-48.

<sup>111</sup> *Id.* at \*2.

<sup>112</sup> *Id.* at \*12.

<sup>113</sup> *Id.* at \*18.

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.* at \*19.

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> *Id.* at \*19.

Fishman then used these projections under the income approach and discounted cash flow method to value Jackson's image and likeness at about \$3,000,000.00.<sup>120</sup> Alan Wallis, the leader of the media and entertainment team in Ernst & Young's UK valuation practice applied the market and income approach and concluded that New Horizon's Trust II was worth \$0.00 after consideration of debt.<sup>121</sup> Owen Dahl, the president and founder of Dahl consulting Group and a principal at Moss Adams, applied the income approach to value New Horizon Trust III at about \$2,700,000.00.<sup>122</sup> Each of these experts tax affected the cashflows produced by the assets to reflect the tax implications to a hypothetical buyer.<sup>123</sup> Additionally, valuation expert Nancy Fannon testified for the estate as to the current state of academic research and empirical evidence that proved that the prospect of taxes would affect the price a prospective buyer would be willing to pay for assets.<sup>124</sup>

The Commissioner's sole expert was Weston Anson, the Chairman of CONSOR Intellectual Asset Management that had valued intangible assets of Dr. Seuss, Andy Warhol, Tupac Shakur, Audrey Hepburn, Marlon Brando, and Woody Allen.<sup>125</sup> Anson valued Jackson's image and likeness by considering five "opportunities" that he believed a hypothetical buyer could reasonably foresee at Jackson's death: themed attractions and products, branded merchandise, a Cirque du Soleil show, a film, and a Broadway musical, and reached a conclusion of value of \$161,000,000.00.<sup>126</sup> He valued New Horizon Trust II applying the income and market approaches and reached a conclusion of value of \$206,000,000.00.<sup>127</sup> Finally, Anson valued New Horizon Trust using only the income approach and reached a conclusion of value of \$114,000,000.00.<sup>128</sup> Anson's credibility at trial was seriously damaged when he inaccurately contended that he had never previously worked for the Internal Revenue Service before

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120 *Id.*

121 *See id.* at \*60-65.

122 *Id.* at \*20.

123 *Id.*

124 *Id.*

125 *Id.*

126 *See id.*

127 *Id.*

128 *Id.*

and that he and his firm had never advertised to promote business.<sup>129</sup> While Anson's testimony was not stricken, his credibility was undermined.<sup>130</sup>

The Tax Court noted that tax affecting was a consideration that impacted its valuation of all three disputed assets.<sup>131</sup> Each asset in dispute was held by a pass-through entity, which means that the Internal Revenue Code imposes no tax on the income that these assets produced.<sup>132</sup> All other things being equal, an income-producing asset would be worth more to a pass-through entity than to a C corporation.<sup>133</sup>

Each of the estate's experts in his respective discounted cash flow analyses concluded that the hypothetical buyer for each asset would be a C corporation and reduced cashflows by the income tax liability that would be paid by a hypothetical C corporation buyer, but each used a different tax rate.<sup>134</sup> The Tax Court noted that in the past it shied away from tax affecting because of difficult practical problems.<sup>135</sup> However, it noted that *Jones* allowed tax affecting in valuation.<sup>136</sup> Nevertheless, the Tax Court found, as it had consistently in the past apart from *Jones*, that by a preponderance of the evidence tax affecting was not appropriate in this case since the estate had failed to persuade that a C corporation would be the only or even likely buyer for these assets.<sup>137</sup> Further, the estate's experts used inconsistent tax rates and were met with opposing expert testimony that was persuasive in light of Tax Court precedent.<sup>138</sup> The Tax Court distinguished *Jones* since all the experts in that case tax affected cashflows but emphasized that it was not wholesale rejecting tax affecting in all instances.<sup>139</sup> What followed was an extensive analysis and critique of all the experts that led the Tax Court to conclude the following values: (1) Jackson's image and likeness

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<sup>129</sup> *See id.* at \*21.

<sup>130</sup> *See id.*

<sup>131</sup> *See id.*

<sup>132</sup> *Id.* at \*26.

<sup>133</sup> *Id.* at \*27.

<sup>134</sup> *Id.*

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> *Id.* at \*28.

<sup>138</sup> *Id.*

<sup>139</sup> *Id.*

at \$4,153,912.00, (2) New Horizons Trust II at \$0.00, and (3) New Horizons Trust III at \$107,313.561.00.<sup>140</sup>

*Jackson* seemingly reverts to the majority of Tax Court decisions that reject tax affecting, takes great pains to rebut certain assumptions when tax affecting is applied, and distinguishes *Jones*. Is *Jackson* a step back from *Kress* and *Jones* or simply a demonstration of the fact sensitivity of each case? More significantly, what do these decisions mean for tax affecting in divorce cases? To project the future, it is instructive to look to the past.

### V. *Bernier v. Bernier*

The intersection of Tax Court and state divorce court views regarding tax affecting is best exemplified by two Massachusetts appellate court opinions in *Bernier v. Bernier*. *Bernier I* involved the valuation of supermarkets: Bernier's Market, Inc. doing business as Cronig's State Road Market (and Bernier's Up Island Market (doing business as Cronig's Up Island Market)).<sup>141</sup> The wife's expert, Mark Leicester, valued the supermarkets at \$16,391,000.00.<sup>142</sup> The husband's expert, Joel Horvitz, valued the supermarkets at \$7,850,000.00.<sup>143</sup> The experts were largely in agreement, and each applied the income approach to valuation.<sup>144</sup> One of the major points of disagreement was tax affecting. Horvitz tax affected as if the S corporation were a C corporation at a 35% "average corporate rate," reasoning that a potential buyer of an S corporation would factor into the probable rate of return the tax consequences of the purchase.<sup>145</sup> Leicester did not tax affect the supermarkets' income because an S corporation, unlike a C corporation, does not pay taxes at the entity level and no sale of the business was contemplated.<sup>146</sup> The trial court adopted Horvitz's method of tax affecting and \$7,850,000.00 value, citing *Gross*.<sup>147</sup> The Supreme Judicial Court of Massachusetts recognized that C corporation earnings are

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<sup>140</sup> *Id.* at \*85.

<sup>141</sup> *See Bernier v. Bernier*, 873 N.E.2d 216, 222 (Mass. 2007).

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> *See id.*

<sup>145</sup> *Id.* at 223.

<sup>146</sup> *Id.*

<sup>147</sup> *See id.* at 223-24.

taxed at both the corporate level and then at the individual level on shareholder dividends, while S corporations are taxed only at the individual level and avoid double taxation.<sup>148</sup> Noting that the valuation of an S corporation is an inexact science, the supreme court cited *Gross* and observed that both case law and professional scholarship cast serious doubt on the efficacy of tax affecting.<sup>149</sup> The supreme court further observed that the trial court incorrectly cited *Gross* as supporting tax affecting when the *Gross* court applied a zero percent tax affect rather than the 35% championed by Horvitz.<sup>150</sup> The trial court erred in applying the 35% tax adjustment, as it would produce an arbitrary result and a significant undervaluation of the supermarkets.<sup>151</sup> Turning next to an assessment of *Kessler* and the alternate approach applied in that case, the supreme court again recognized that application of a 35% tax adjustment understated the value of the supermarkets while failing to adequately account for the loss of S corporation benefits to the wife.<sup>152</sup> On remand, the supreme court instructed the trial court to reject the all-or-nothing approach and adopted the *Kessler* metric when tax affecting.<sup>153</sup>

*Bernier I* looked to federal and Delaware authorities, recognized marketplace realities as to tax considerations, and urged the trial court to evaluate the real tax implications of the supermarkets continuing to operate as S corporations post-divorce. In doing so, it followed the *Kessler* abstract framework but did not direct a specific tax adjustment on remand. Would this perspective make tax affecting easier for divorce courts? At least in Massachusetts, the answer would take five years to mature.

*Bernier II*<sup>154</sup> made clear that tax affecting in divorce cases, even with the apparent guidance of *Bernier I*, was complicated. On remand, the Appeals Court of Massachusetts explained that the *Kessler* approach attempted to capture the tax benefit to the buyer of S corporation shares of receiving cash dividends not

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<sup>148</sup> *See id.* at 225.

<sup>149</sup> *See id.* at 225-26.

<sup>150</sup> *See id.* at 227-28.

<sup>151</sup> *Id.* at 228.

<sup>152</sup> *Id.* at 229-30.

<sup>153</sup> *Id.* at 231.

<sup>154</sup> *See generally* *Bernier v. Bernier*, 970 N.E.2d 363 (Mass. App. Ct. 2012).

subject to dividend taxes at the entity level.<sup>155</sup> *Kessler* asked what the effective pre-dividend corporate tax rate would be for the S corporation shareholder even though the entity paid no corporate taxes.<sup>156</sup> This theoretical tax adjustment was designed to leave the shareholder of an S corporation with the same amount of money in his or her pocket as the shareholder of a C corporation.<sup>157</sup> On remand, the trial court had applied the same 29.4% tax affecting rate as in *Kessler* in valuing the supermarkets at \$11,366,129.00.<sup>158</sup> The wife contended that the trial court's adoption of the *Kessler* court's percentage adjustment was error while the husband contended that, while the strict application of the *Kessler* metric yielded a zero percent tax adjustment, S corporation earnings must be tax affected to avoid an inequitable result in the valuation process.<sup>159</sup> The court of appeals rejected both the trial court's analysis and the husband's contentions, and opined that a zero percent tax affecting rate did not necessarily lead to an inequitable result.<sup>160</sup> Accordingly, applying the *Kessler* approach on remand, because the dividend tax rate in effect in 2000 was 40% a zero percent tax affecting rate was necessary to put an S corporation shareholder in the same position as a C corporation shareholder.<sup>161</sup>

*Bernier II* strictly follows the *Kessler* approach rather than mechanically applying the *Kessler* percentage, evaluates particular facts, circumstances, and tax rates, and results in no tax adjustment. That methodology, however, offers a ringing endorsement of tax affecting in divorce cases when applicable tax rates warrant. Both *Bernier* opinions attempt to harmonize existing federal and Delaware authorities with the realities of the distribution of marital property between spouses and the going concern, non-salable nature of businesses in that context.

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<sup>155</sup> *Id.* at 371.

<sup>156</sup> *Id.* at 368.

<sup>157</sup> *Id.*

<sup>158</sup> *Id.* at 370.

<sup>159</sup> *See id.* at 370-71.

<sup>160</sup> *Id.* at 371.

<sup>161</sup> *See id.*

## **VI. Conclusion**

As is evident, the U.S. Tax Court has struggled with tax affecting S corporations – mostly in the context of estate disputes. Even with that backdrop, the Tax Court has reasoned that there is a potential penalty to S corporation valuations if the double taxation impacting S corporations is not taken into consideration in business valuations. That impact is even more profound in divorce cases where there is potentially no sale, change of ownership, business interruption, business termination, or other structural alteration to a going concern. In, *Kessler*, the Delaware Court of Chancery confronted the realities of tax impact on businesses and their salability and applied a model for approximating tax consequences. That model, although imperfect, balances competing considerations and keeps irregular economic disincentives from becoming more pronounced. In turn, application of the *Kessler* approach allows businesses to be valued as if real-world transactions were occurring even though notional tax rates are employed. The Tax Court and divorce courts would do well to study, reflect upon, and apply the *Kessler* formula in some incarnation in order to equitably apportion the competing interests of private citizens and governmental authorities – particularly in the division of marital property.

## Custom of the Country: Trusts and Marriage Planning in High-Wealth Families

by  
Allison Tait\*

“Even now, however, [Undine] was not always happy. She had everything she wanted, but she still felt, at times, that there were other things she might want if she knew about them.”

—Edith Wharton, *The Custom of the Country* (1913)

### Introduction

That marriage has always been a property arrangement in some form or another – particularly for those families and couples with property to arrange – is a truism. It is a truism because marriage has significant property implications for the intended spouses, with the result that financial planning around marriage is both a historical and continuing reality, despite changes in the social and economic norms governing marriage. Moreover, the wealth management industry has, past and present, trained its eye and its expertise on marriage planning as part of a family’s larger wealth planning, offering services and products to help mitigate the economic risk of marriage to family wealth preservation. In particular, wealth managers and lawyers have long recommended that families pay close attention to the effects of divorce because “the divorce of a family member . . . can paralyse a [wealth] structure and produce major problems and uncertainty for the family members who have a stake in the family wealth structures.”<sup>1</sup> Divorce, these advisors warn, presents a particularly grave danger because it redistributes fam-

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<sup>1</sup> TAYLOR WESSING LLP, THE FAMILY CONSTITUTION GUIDE 9 (2014), [https://img.borsen.dk/img/cms/tuksi4/uploads/img\\_server\\_adm.files/4738\\_file\\_name\\_4008.pdf](https://img.borsen.dk/img/cms/tuksi4/uploads/img_server_adm.files/4738_file_name_4008.pdf) (“Matrimonial breakdown is a major problem for family wealth structures.”).

ily wealth in ways that the advisors characterize as not only undesirable but unjust: “[L]aws designed to protect a spouse can be abused to provide a spouse with rights to family businesses and wealth that by no stretch of the imagination should they have access to.”<sup>2</sup>

In recent decades, prenuptial agreements – contracts entered into before marriage that detail how property will be divided in the case of divorce – have caught the attention of legal commentators and planners as well as the popular press.<sup>3</sup> Prenuptial agreements, or prenups, are likely the most well-known mechanism available to help couples prepare for and contract around the deep financial entwinement of marriage. Articles appear regularly in various media forms discussing the benefits and detriments of prenups,<sup>4</sup> how different age groups use prenups,<sup>5</sup>

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<sup>2</sup> PHILIP MARCOVICI, *THE DESTRUCTIVE POWER OF FAMILY WEALTH: A GUIDE TO SUCCESSION PLANNING, ASSET PROTECTION, TAXATION, AND WEALTH MANAGEMENT* 107, 112 (2016).

<sup>3</sup> For a small sample of the legal commentary, see SHARON THOMPSON, *PRENUPTIAL AGREEMENTS AND THE PRESUMPTION OF FREE CHOICE* (2017); Jonathan Fields, *Forbidden Provisions in Prenuptial Agreements: Legal and Practical Consideration for the Matrimonial Lawyer*, 21 J. AM. ACAD. MATRIM. LAW. 413 (2008). See also Brian Bix, *Bargaining in the Shadow of Law: The Enforcement of Premarital Agreements and How We Think About Marriage*, 40 WM. & MARY L. REV. 145 (1998), Elizabeth Carter, *Rethinking Premarital Agreements: A Collaborative Approach* 46 N.M. L. REV. 354 (2016). In popular media, see, e.g., *10 Things You Need to Know about Prenups*, <https://www.forbes.com/sites/christinefletcher/2018/09/18/10-things-you-need-to-know-about-prenups/?sh=2d05165962ba>; *What Is a Prenuptial Agreement*, <https://www.townandcountrymag.com/society/money-and-power/a30707086/what-is-a-prenup/>.

<sup>4</sup> See, for example, *Considering a Prenup? Here's Everything You Need to Know* (<https://www.thespruce.com/prenuptial-marriage-agreements-2300430>); *The Pros and Cons of Prenups* (<https://money.usnews.com/money/personal-finance/family-finance/articles/2018-08-03/the-pros-and-cons-of-prenups>).

<sup>5</sup> Cheryl Winokur Munk, *Millennials Embrace Prenups—but Through a Very Different Lens Than in the Past*, WALL ST. J. (Jan. 21, 2021 1:00 PM ET), <https://www.wsj.com/articles/millennials-embrace-prenupsbut-through-a-very-different-lens-than-in-the-past-11611252036>; see also *Prenups Aren't Just for the Rich or Famous — More millennials are signing them before getting married, and you probably should Too* <https://www.businessinsider.com/why-sign-a-prenup-marriage-divorce-2018-9>, and *The Rise of the Millennial Prenup* [https://www.nytimes.com/2018/07/06/smarter-living/millennial-prenup-weddings-money.html?mc=aud\\_dev&ad-keywords=auddevgate&gclid=CJ0KCCQjwktKFBhCkARIsAJeDT0i4\\_QkcLEUCsz5EqZmow\\_6nkmdIPmderWwc9mz1eC8xlgjC1G9Z0IaAhMQEALw\\_wcB&gclsrc=aw.ds](https://www.nytimes.com/2018/07/06/smarter-living/millennial-prenup-weddings-money.html?mc=aud_dev&ad-keywords=auddevgate&gclid=CJ0KCCQjwktKFBhCkARIsAJeDT0i4_QkcLEUCsz5EqZmow_6nkmdIPmderWwc9mz1eC8xlgjC1G9Z0IaAhMQEALw_wcB&gclsrc=aw.ds).

and what kinds of new content are appearing in prenups.<sup>6</sup> Prenups, however, have had a surprisingly short history of use, and it was not until 1983, when the National Conference of Commissioners on Uniform State Laws approved the Uniform Premarital Agreement Act (UPAA), that they gained widespread acceptance with courts and subsequently legal advisors.<sup>7</sup> Before that time, courts routinely considered prenups to be per se invalid and refused to enforce them, claiming that “[t]hey undermined the institution of marriage by encouraging divorce and abrogating the state-established obligations of matrimony.”<sup>8</sup> Even now, while the actual number of couples who sign prenuptial agreements is unknown, that number is relatively small<sup>9</sup> and objections to prenups remain plentiful, focusing on the idea that executing a prenup is a form of “planning for failure.” As one matrimonial lawyer remarks: “[L]ike a self-fulfilling prophecy, the prenup might itself plant the seed for exactly that outcome that the parties fear the most—a divorce!”<sup>10</sup>

What gets forgotten in these discussions about prenuptial agreements and marriage planning is the trust. While prenups have most recently been the focus of attention, they have never been the sole or even the preferred mechanism for protecting

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<sup>6</sup> New content in prenups includes pet custody terms *see* C.E.L. & Associates, *Pet Pre-Nups, Visitation Rights, and Alimony: The Realities Of Pet Ownership and Divorce*, <https://celandassociates.com/pet-pre-nups-visitation-rights-and-alimony-the-realities-of-pet-ownership-and-divorce/> (January 30, 2020) and social media use terms Hekmat, Law & Mediation, *Millennials Are Redefining Prenups—Here’s Why It Matters*, <https://hekmatfamilylaw.com/prenups/millennials-are-redefining-prenups-heres-why-it-matters/> (February 19, 2021).

<sup>7</sup> Peter T. Leeson & Joshua Pierson, *Prenup*, 45 J. LEGAL STUD. 367, 371 (2016).

<sup>8</sup> *Id.* at 371. *See also* Bix, *supra* note 3, at 145.

<sup>9</sup> Because prenuptial agreements are private, it is almost impossible to know how many couples have them. Recent estimates suggest that between 3-5% of marrying couples have these kinds of contracts. *Interesting Prenuptial Agreement Statistics* (May 20, 2017), <http://brandongaille.com/18-interesting-prenuptial-agreement-statistics> [perma.cc/2HZR3YMR] (“Only 3% of people who have a spouse or are planning on getting married in the near future have a prenuptial agreement.”). For a discussion of the reasons why so few people use prenuptial agreements, *see* [http://140.247.200.140/programs/olin\\_center/papers/pdf/436.pdf](http://140.247.200.140/programs/olin_center/papers/pdf/436.pdf).

<sup>10</sup> Chaim Steinberger, *The Perils of Prenup*, 263 N.Y.L.J. 1 (2020), <https://www.manhattan-law.com/wp-content/uploads/2020/04/The-Perils-of-Prenups.pdf>.

family money from the perceived perils of divorce. In fact, the conventional mechanism for protecting family money in high-wealth families has, over time, been relatively constant: the family trust. Trust-based marriage settlements flourished historically both in England and the United States and family trusts are still widely used in high-wealth circles to mitigate spousal claims to family wealth. What is more, if there was any doubt of the trust's utility in this respect, a new generation of asset protection trusts – designed to compete with offshore asset protection trusts – has revitalized the use of asset protection trusts in premarital planning by offering enhanced protections.<sup>11</sup> Asset protection trusts are, accordingly, specifically marketed as an alternative to prenuptial contracts and trust companies are explicitly promoting their products as a superior form of asset management for those on the brink of marriage.

This article takes up the question of asset protection trusts being used as substitutes for prenuptial – or, in some cases, postnuptial – contracts, and presses on questions concerning how they work, how trust companies market the new generation of trusts, the judicial treatment of these trusts in court, and how to think about the purported benefits when weighed against harms to spouses, the idea of marital partnership, and equality values. The article begins in Part I with a brief history of the usage of family trusts in marital planning, both in England and the United States, and details, through an examination of recent cases, how these family trusts established by third parties continue to successfully protect family wealth at divorce. Part II examines the arrival of new asset protection trusts in American states – domestic asset protection trusts (DAPTs) – and explains how they work and what various state rules governing these trusts look like. This Part also analyzes cases dealing with these trusts that are beginning to show up on divorce court dockets. Finally, Part III takes up the question of what harms these premarital trusts produce by displacing marital norms of economic partnership and entrenching particularly gendered forms of wealth inequality. Ultimately, trusts used as mechanisms for marriage planning are a time-honored tradition in high-wealth families and have, both historically and currently, worked to further family wealth pres-

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<sup>11</sup> See *infra* Part II. A.

ervation. What is important to recognize is that this legally sanctioned mode of wealth preservation comes with certain costs since it damages equality values, both within and without of marriage.

## **I. Trusts, Marriage Settlements, and Family Wealth Preservation**

The connection between trusts and premarital planning, in England and America, is long-standing and discretionary spend-thrift trusts have regularly served the needs of high-wealth families seeking to protect family fortunes from creditors, including spouses who marry into (and divorce out) of the family. These trusts accommodate the wealth preservation desires of elite families by taking ownership and control out of the hands of family-member beneficiaries and vesting it instead in a trustee, who controls not only the investment but also the distribution of the trust assets. This Part explores the historical use of premarital trusts in England and how, subsequently, the usage of these trusts was both imported and embraced by American families pursuing the same goal of family wealth preservation.

### *A. A Brief History of Trusts and Marriage*

As enthusiasts of English history and novels know, elite and aristocratic families have historically exploited property forms including the entail and intricate trusts to keep family land and wealth from erosion or fractionation. In early modern England, trusts were the building blocks of complex marriage settlements and a marriage was an important moment not only for negotiating terms with an intended spouse's family but also to revise terms in the family trust in order to reflect the formation of a new family generation.<sup>12</sup> The trust was central to this type of estate planning because the trust accommodated the desire of families to limit access to trust principal, restrict the sale of estate assets, and make assets available for the benefit of one spouse but not the other.<sup>13</sup> Exploiting these trust features, each family

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<sup>12</sup> H.J. Habakkuk, *Marriage Settlements in the Eighteenth Century*, 32 *TRANSACTIONS ROYAL HIST. SOC'Y* 15, 20–21 (1950).

<sup>13</sup> On the use of trusts in these settlements, see generally LLOYD BONFIELD, *MARRIAGE SETTLEMENTS, 1601-1740* (1883).

sought to protect – and, if possible, enhance – their family patrimony. This was especially important for the bride’s family since the wife’s property rights were subsumed into the husband’s right upon marriage through coverture rules. Accordingly, these agreements stipulated the bride’s dowry, what assets the couple could access during the marriage, and what assets would return to the spouse’s family of origin at death if there were no heirs to carry on the family line.<sup>14</sup> Moreover, families marrying off their daughters routinely took precautions to protect the family wealth during the marriage in case the spouse turned out to be an unabashed spendthrift or otherwise likely to dissipate the wife’s fortune. Samuel Johnson blithely summarized this instinct, stating: “It is mighty foolish to let a stranger have [your estate] because he marrie[d] your daughter.”<sup>15</sup>

In the United States, colonies imported the traditional trust forms from England and retained them after gaining independence and statehood, thereby allowing high-wealth families with assets to use the trust in marriage planning, just as their aristocratic counterparts in England did. And at the end of the nineteenth century as states increasingly began to allow for absolute divorce, the asset protection features of the trust became even more useful. Two trust features in particular were key to protecting family money at divorce: spendthrift provisions and discretionary trust terms. Spendthrift provisions<sup>16</sup> in trusts were a useful tool because they prohibited alienation of trust assets and effectively barred divorcing spouses from making a claim on

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<sup>14</sup> For discussion of early-modern marriage settlements, see AMY LOUISE ERICKSON, *WOMEN AND PROPERTY IN EARLY MODERN ENGLAND* 79–114 (1993); EILEEN SPRING, *LAW, LAND, AND FAMILY: ARISTOCRATIC INHERITANCE IN ENGLAND 1300 TO 1800*, 123–48 (1993); SUSAN STAVES, *MARRIED WOMEN’S SEPARATE PROPERTY IN ENGLAND, 1660-1833*, ch. 6 (1990); Christopher Clay, *Marriage, Inheritance, and the Rise of Large Estates in England, 1660-1815*, 21 *ECON. HIST. REV.* 503, 507, 510 (1968); Habakkuk, *supra* note 12, at 22.

<sup>15</sup> JAMES BOSWELL, *BOSWELL’S LIFE OF JOHNSON* 520 (1904).

<sup>16</sup> A spendthrift trust, in its most basic form, is a trust containing a provision stating that the beneficiary cannot voluntarily alienate her interest in the trust. Because of this restriction, creditors cannot attach the beneficiary’s interest nor can they obtain a court order to attach a future distribution. This holds true even if the beneficiary is entitled to mandatory distributions and has funds available to satisfy creditors. See JESSE DUKEMINIER & ROBERT H. SITKOFF, *WILLS, TRUSTS, AND ESTATES* 695–96 (9th ed. 2013).

funds that had been put in trust for the other spouse. Spendthrift trusts subsequently became a useful tool that helped families shelter assets from creditors, including spouses.<sup>17</sup> In 1896, for example, a Texas appellate court upheld the use of a spendthrift trust to keep assets held in trust for the benefit of the husband from being counted as community property.<sup>18</sup> In *McClelland v. McClelland*, Dora McClelland sued her ex-husband seeking rental income from property that had been left to her ex-husband by his father. The court concluded that if “the income arising from the estate was not available” to the husband, then it was not available to the wife as community property upon divorce. To allow the wife an interest in the trust income, the court reasoned, would be to diminish and harm “the right of the testator.”<sup>19</sup> The spendthrift provision did exactly what it was supposed to do and protected the husband’s family money when divorce claims threatened.

The second feature that families depended upon to protect family assets, during marriage and at divorce, was use of discretionary terms to safeguard assets and bar creditors (including a divorcing spouse). Highly discretionary distribution terms, terms that vested discretion over distributions to the trustee, accomplished (and still accomplish) this goal of wealth protection by stripping the beneficiary of guaranteed income. When income from these trusts was not guaranteed to the beneficiary and was distributable only at the trustee’s discretion, the money in trust was not available to creditors unless and until the beneficiary actually received a distribution. The validity of these trusts, like spendthrift trusts, was affirmed by American courts at the end of the nineteenth century and early into the twentieth century again on the basis of donor freedom. In the famous 1926 case of *Hamilton v. Drogo*, a New York court protected the assets put in trust for William Drogo, Duke of Manchester, by his mother, disallow-

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<sup>17</sup> *Bradley v. Palmer*, 61 N.E. 856, 881–82 (Ill. 1901) (explaining that the mother created a spendthrift trust for her son, who was an extravagant spender and an alcoholic, and stated specifically that “in no case shall any of such income be applied to the support or maintenance of my said son’s wife; and the same shall never be amenable to any order or judgment of a court which his said wife might obtain for alimony, support, or for any other cause”).

<sup>18</sup> *McClelland v. McClelland*, 37 S.W. 350, 358 (Tex. Civ. App. 1896), *writ refused*.

<sup>19</sup> *Id.*

ing creditor interference until a distribution was made. The court stated: “In the present case no income may ever become due to the judgment debtor. We may not interfere with the discretion which the testatrix has vested in the trustee any more than her son may do so.”<sup>20</sup> Both of these asset protection features made the trust a highly valuable tool for families engaging in wealth transfer and wealth preservation. Moreover, the features could be used together to provide a maximal level of protection, all but ensuring that spouses would not have a claim to family wealth if and when conflict arose.

### *B. The Continuing Advantages of Family Trusts*

Discretionary spendthrift trusts – tested and refined by these previous generations of wealthy families – still play a large role in protecting family assets from irresponsible spending, bad investments, and the claims of a divorcing spouse.<sup>21</sup> The modern rule, in fact, looks very much like the early-modern rule: courts generally do not include trust interests in the marital estate at divorce nor do they include trust interest as income when calculating spousal or child support unless the beneficiary has a present interest in the trust. Fully discretionary trusts take away that present interest and beneficiaries of a discretionary spendthrift trust are considered to possess nothing more than a speculative interest in the trust assets—a “mere expectancy”—because they do not have a guaranteed right to distributions from the trust. Following this rule, Missouri, New Jersey, Pennsylvania, Texas, and Wisconsin include trust interests in the marital estate at divorce only when the beneficiary has a present possessory interest or the right to withdraw trust assets.<sup>22</sup> Massachusetts courts have similarly concluded that any interest in a discretionary trust is not

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<sup>20</sup> *Hamilton v. Drogo*, 150 N.E. 496, 497 (N.Y. 1926).

<sup>21</sup> See Jonathan W. Wolfe, *How a Trust May Impact Your Divorce Case*, FAM. ADVOC., Fall 2015, at 14-15 (noting that while some states have “a breadth of precedent” governing this issue, other states have few, if any, reported decisions).

<sup>22</sup> *Id.* at 17. New Jersey courts have routinely held that a beneficiary spouse’s trust interest does not constitute marital property unless the beneficiary has acquired “unimpaired control and totally free use and enjoyment” of the trust assets. See *Mey v. Mey*, 398 A.2d 88, 92 (N.J. 1979); see also *Paulson v. Paulson*, 783 N.W.2d 262, 271 (N.D. 2010); *Friebel v. Friebel*, 510 N.W.2d 767, 769 (Wis. Ct. App. 1993).

includable in the marital estate: “[A] party’s beneficial interest in a discretionary trust . . . because of the peculiar nature of such a trust . . . is too remote or speculative to be so included.”<sup>23</sup> The Colorado Supreme Court, in agreement, concluded in *In re Marriage of Jones* that, “unlike a vested retirement plan, the beneficiary of a discretionary trust has no contractual or enforceable right to income or principal from the trust, and cannot force any action by the trustee unless the trustee performs dishonestly or does not act at all.”<sup>24</sup>

One example of the successful use of a discretionary spendthrift trust in shielding assets from a spouse’s claim at divorce came to light in the 1985 case, *duPont v. Southern National Bank of Houston, Texas*.<sup>25</sup> The court noted at the beginning of the opinion: “This case illustrates once again the unfortunate verity that the family, although ideally a nurturer of love and affection, often succumbs to the corrosive influence of avarice and financial calculation.”<sup>26</sup> The case, broadly speaking, was about the efforts of Eugene duPont III, the “patriarch of the family,” to rescind an irrevocable discretionary trust that he had created in 1972 with his child and his spouse as the primary beneficiaries. The lower court noted that duPont had “established the Trust largely to prevent his then-wife, Joanne A. duPont, from obtaining his property in the event of a divorce. Having since divorced Joanne duPont and remarried, duPont III now wishes to return the Trust property to his own control.”<sup>27</sup> That is to say, the trust was created during the marriage to mitigate potential damaging effects of divorce on the duPont fortune – and the trust did just that. When duPont and his wife divorced in 1978, duPont claimed that the assets in the trust – which included several family homes as well as family heirlooms, such as “a soup tureen and plates” – could not be included as part of the marital estate. And the court agreed. Moreover, excluding the trust properties and their in-

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<sup>23</sup> See *D.L. v. G.L.*, 811 N.E.2d 1013, 1023 (Mass. App. Ct. 2004).

<sup>24</sup> *In re Marriage of Jones*, 812 P.2d 1152, 1156–. (Colo. 1991) (concluding “[t]o the extent that it has already not done so, the trial court on remand should consider the wife’s interest in the trust as an economic circumstance” and a discretionary factor when allocating property and awarding support). *Id.* at 1158.

<sup>25</sup> *duPont v. S. Nat’l Bank of Hous.*, 771 F.2d 874 (5th Cir. 1985).

<sup>26</sup> *Id.* at 877.

<sup>27</sup> *Id.*

come, duPont's liabilities exceeded his assets, with the result that the divorce settlement for duPont's spouse was small in comparison to the scope of the family assets. The spouse, Joanne duPont, "received \$70,000 in alimony and \$10,000 in child-support per year, as compared to duPont III's average Trust income of \$1.1 million."<sup>28</sup> Ultimately, duPont failed in his quest to rescind the trust – nevertheless the trust had done its work on behalf of the duPont family money at the moment of divorce.<sup>29</sup>

More recently, the 2016 Massachusetts case of *Pfannenstiehl v. Pfannenstiehl* provided an exemplary instance of how discretionary trusts work by design to preserve family wealth. In *Pfannenstiehl*, the couple married in 2000 and during the twelve-year marriage, the husband worked as an assistant bookstore manager at one of his father's subsidiary corporations, earning approximately \$170,000 annually.<sup>30</sup> In 2004, the husband's father established a discretionary spendthrift trust meant to "to provide for the comfortable support, health, maintenance, welfare and education of each or all members of such class"<sup>31</sup> for the benefit of the father's "issue" as an open class.<sup>32</sup> From the time of the trust's creation in 2004 until the divorce, only Curt and his two siblings had received any distributions and Curt's distributions over that period totaled approximately \$800,000. The court noted that these distributions, as well as gifts from Curt's family, enabled the couple to enjoy "an upper middle-class lifestyle. They owned a home valued at in excess of \$700,000, as well as other real estate, took several vacations each year, and belonged to a country club." Curt's wife, who had been in the Army Reserves, retired from that job in 2004 at the behest of her husband, to stay at home with their special needs daughter and dedicate more time to being a "homemaker and caretaker." The wife did work part time as an ultrasound technician and earned approximately \$22,672 annually.<sup>33</sup>

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<sup>28</sup> *Id.* at 878.

<sup>29</sup> *Id.* at 888. "Having made one disposition of his property to shield it from his former wife, he now seeks a different result. We agree with the district court that duPont III has not justified revoking or reforming the Trust, which by its terms is irrevocable." *Id.* at 888.

<sup>30</sup> *Pfannenstiehl v. Pfannenstiehl*, 55 N.E.3d 933, 935–36 (Mass. 2016).

<sup>31</sup> *Id.* at 937.

<sup>32</sup> *Id.* at 936

<sup>33</sup> *Id.* She earned another \$7,428 in rental income. *Id.*

During the divorce proceedings, the issue arose whether the present value of the husband's interest in the trust – which was then valued at approximately \$25 million – could be considered part of the marital estate.<sup>34</sup> The trial court judge valued the husband's interest to be approximately \$2 million and included it in the marital estate, a decision that the appellate court affirmed.<sup>35</sup> The trial court judge “found that the distributions to Curt ceased when he filed the complaint for divorce because the trustees deemed it too risky to distribute funds to Curt at a time when he might be required to share the funds with Diane, a nonbeneficiary.”<sup>36</sup> And in affirming the decision, the appellate court specifically reiterated this point, noting that the husband's monthly distributions from the trust, made relatively regularly since 2007, stopped “precisely on the eve of the husband's divorce filing.”<sup>37</sup> The appellate court then remarked: “[T]he spendthrift provision is being invoked as a subterfuge to mask the husband's income stream and thwart the division of the marital estate in the divorce.”<sup>38</sup> What had happened, the appellate court concluded, was that “as the divorce began, ‘the proverbial family wagons circled the family money.’”<sup>39</sup>

Once the case reached the Massachusetts Supreme Court, however, the tide turned. That court disagreed with the lower court rulings and returned to the conventional analytic framework for assessing the availability of a trust interest. Keeping in line with conventional doctrine, the court concluded that the husband's trust interest was “so speculative as to constitute nothing more than [an] expectanc[y],” and consequently was not includable in the marital estate.<sup>40</sup> The court observed:

Interests in discretionary trusts generally are . . . too remote for inclusion in a marital estate, because the interest is not “present [and] enforceable”; the beneficiary must rely on the trustee's exercise of

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<sup>34</sup> *Id.* at 937–38.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.* at 937.

<sup>37</sup> *Pfannenstiehl v. Pfannenstiehl*, 37 N.E.3d 15, 17 (Mass. App. Ct. 2015), review granted, 47 N.E.3d 684 (Mass. 2015), and vacated and remanded, 55 N.E.3d 933, 934 (Mass. 2016).

<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at 21.

<sup>40</sup> *Pfannenstiehl*, 55 N.E.3d at 935 (quoting *Adams v. Adams*, 945 N.E.2d 844, 859 (Mass. 2011)).

discretion, does not have a present right to use the trust principal, and cannot compel distributions.<sup>41</sup>

The wife lost and the trust assets remained safe—protected by the “family wagons.” The very best result for the wife, within this framework of analysis, was to have the husband’s assets considered as one among many factors at the distribution phase and in the determination of spousal support.<sup>42</sup>

Many trust lawyers hailed the outcome, relieved that the court did not undo the trust’s asset protection features.<sup>43</sup> The husband’s lawyer expressed his satisfaction with the ruling, invoking the traditional justification of donor intent: “[The husband’s father] did not intend . . . for an ex-spouse to get part of his estate, and that’s what the court is upholding.”<sup>44</sup> Another commentator wrote: “This is a relief to those who draft trusts for the purpose of ‘asset protection.’”<sup>45</sup> Other commentators, how-

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<sup>41</sup> *Id.* at 940.

<sup>42</sup> The other right that an ex-spouse has to trust assets is as an exception creditor in states that have adopted the Uniform Trust Code (UTC). This right does not help divorcing spouses reach trust assets during a divorce but allows ex-spouses to potentially reach trust assets to satisfy obligations already written into a divorce judgment. In these states, an ex-spouse with a divorce judgment can try to pierce a trust and make the income available for spousal or child support payments if they are in arrears. With discretionary trusts, the UTC states that a court may order a distribution to satisfy a court order for either spousal or child support, but only to “[t]he extent a trustee has not complied with a standard of distribution or has abused a discretion.” UNIF. TRUST CODE § 504(c) (UNIF. LAW COMM’N 2000). This is a high bar to reach for and, moreover, a court cannot direct a trustee to distribute more than the trustee should have distributed absent the abuse of discretion.

<sup>43</sup> See, e.g., Robert J. O’Regan, Pfannenstiehl: *Out of a Mistake Comes Clarity*, WEALTHMANAGEMENT.COM (Aug. 9, 2016), <https://www.wealthmanagement.com/estate-planning/pfannenstiehl-out-mistake-comes-clarity> [perma.cc/QDY8-D7L4].

<sup>44</sup> Michael Levenson, *SJC Rules Heir Can Refuse to Pay \$1.4M to Ex-wife*, BOSTON GLOBE (Aug. 05, 2016), <https://www.bostonglobe.com/metro/2016/08/05/high-court-rules-scion-wealthy-family-doesn-have-pay-wife/cLDKzM7oTGbkvVNM5O3dK/story.html> [perma.cc/FJ7K-VDGF].

<sup>45</sup> Matthew Solomon, *Words Matter: Pfannenstiehl Overruled by Supreme Judicial Court*, ISRAEL, VAN KOOY & DAYS, LLC, <http://www.yourfamilyattorneyslawblog.com/words-matter-pfannenstiehl-overruled-by-supreme-judicial-court/> [perma.cc/DYQ7-PH7P] (last visited July 15, 2017). Practitioners have relied on the asset protection features of the trust and continue to recommend them as safeguards against the negative results of a divorce.

ever, have been less enthusiastic about the outcome, mentioning that “[t]he equities of this case appear to favor Diane.”<sup>46</sup> Whatever analytic tension might surround the outcome, however, what the Massachusetts court made abundantly clear in *Pfannenstiehl* is that third-party discretionary spendthrift trusts continue to be an unmistakably effective mechanism for keeping assets from a divorcing spouse, even when created during the marriage.<sup>47</sup>

## II. Self-Made Money and “Selfie”<sup>48</sup> Premarital Trusts

In the twenty-first century, family trusts that protect the beneficiary-spouses still retain their utility and their power to help families preserve their wealth. In the last several decades,

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Third party trusts are . . . effective in protecting the income and principal of the trust from the beneficiary’s divorcing spouse. In its simplest terms, for example, the parents or grandparents create a trust for the benefit of their child/grandchild who is about to marry . . . [and] if one of the goals of the trust is to avoid a beneficiary’s spouse from claiming any income or principal from the trust, one might consider giving the trustee . . . absolute discretion in distributing the income and assets of the trust. With this “absolute discretion” provision the funds can protected from being used for marital purposes or included as an asset or stream of income if a beneficiary’s marriage ends in divorce.

Cindy S. Vova, *Prenuptial Agreements and Trusts — “Keeping It All in the Family”*, LAWYERS.COM (July 24, 2020), <https://blogs.lawyers.com/attorney/premarital-agreements/prenuptial-agreements-and-trusts-keeping-it-all-in-the-family-63920/>.

<sup>46</sup> Harry S. Margolis, *Does Pfannenstiehl Case Undermine Asset Protection in Massachusetts?*, MARGOLIS & BLOOM, LLP, (Sept. 22, 2015), [http://www.margolis.com/our-blog/does-recent-divorce-undermine-centuries-of-spendthrift-trust-law\[perma.cc/6HYP-LWRD\]](http://www.margolis.com/our-blog/does-recent-divorce-undermine-centuries-of-spendthrift-trust-law[perma.cc/6HYP-LWRD]). In addition, questions about the independence of the trustee, the decanting of the trust, and the ability of the court to encompass separate property into the marital estate using Massachusetts’s hotchpot approach have continued to cast doubt on the result.

<sup>47</sup> See also *Loomis v. Loomis*, 158 S.W.3d 787 (Mo. Ct. App. 2005); *Avent v. Avent*, 849 N.E.2d 98 (Ohio Ct. App. 2006); *Robinson v. Robinson* 621 S.E.2d 147 (Va. Ct. App. 2005).

<sup>48</sup> Ashlea Ebeling, *Onshore Asset Protection with the Selfie Trust*, FORBES (July 6, 2016, 7:48AM) <https://www.forbes.com/sites/ashleaebeling/2016/07/06/onshore-asset-protection-with-the-selfie-trust/?sh=55d45d361be5>

however, a new breed of asset protection trusts has proliferated and increased the use of trusts in marital planning by making asset protection trusts available to an expanded class of users – individuals who want to create trusts with their own money while retaining a modicum of control over the assets. This Part explores the phenomenon of this new generation of asset protection trusts becoming available across the United States, the strategies of trust companies and practitioners for marketing these trusts as an alternative to prenups, and how these new “prenup trusts” are faring in court.

#### A. *The New Generation of Asset Protection Trusts*

In the last several decades, prodigious changes to trust law in a number of states have created new opportunities for wealth preservation, providing asset protection far beyond what already exists while also reshaping conventional trust rules. The largest change in trust law over the past decades has been the introduction and adoption of Domestic Asset Protection Trusts (DAPTs). What is new about these asset protection trusts is that they allow the settlor to be a beneficiary and even a trustee of an irrevocable trust and still obtain the asset protection features long associated with discretionary spendthrift trusts. This development is in contravention of the traditional rules for asset protection which hold that, for a beneficiary’s interest to be protected, the trust must be created by a third party:

To hold otherwise would be to give unexampled opportunity to unscrupulous persons to shelter their property before engaging in speculative business enterprises, to mislead creditors into thinking that the settlor still owned the property since he appeared to be receiving its income, and thereby work a gross fraud on creditors who might place reliance on the former prosperity and financial stability of the debtor.<sup>49</sup>

The Uniform Trust Code reiterated this rule, stating that individuals cannot shield assets from creditors, including spouses, by placing them in a trust for their own benefit,<sup>50</sup> and “even if the trust is discretionary, spendthrift, or both, the settlor’s creditors

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<sup>49</sup> GEORGE T. BOGERT, TRUSTS § 40, at 155–56 (6th ed. 1987); *see also* Henry J. Lischer, *Domestic Asset Protection Trusts: Pallbearers to Liability?*, 35 REAL PROP. PROB. & TR. J. 479 (2000).

<sup>50</sup> UNIF. TRUST CODE § 505 (UNIF. LAW COMM’N 2000).

can reach the maximum amount that the trustee could under any circumstances pay to the settlor or apply for the settlor's benefit."<sup>51</sup> Accordingly, family wealth planning has historically been anchored by the use of these third-party trusts, as discussed in Part II, and these family trusts have done exactly what they were designed to do: protect assets based on the theory of donor intent.

This longstanding rule first came under attack in the 1980s when the Cook Islands amended that jurisdiction's governing law to allow for self-settled asset protection trusts in an attempt, which would prove immensely successful, to attract foreign capital.<sup>52</sup> Other offshore jurisdictions soon followed suit in allowing these "Foreign Asset Protection Trusts" (FAPTs),<sup>53</sup> "and the great Offshore Boom of the 1990s came like a tidal wave."<sup>54</sup> Eager to compete for a part of this lucrative trust business, American states fought back. Alaska became the first state to enact legislation allowing Domestic Asset Protection Trusts in 1997. Several months after Alaska took this step, Delaware did the same, hoping "to maintain Delaware's role as the most favored domestic jurisdiction for the establishment of trusts."<sup>55</sup> Since

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<sup>51</sup> DUKEMINIER & SITKOFF, *supra* note 16, at 703. The reporter for the Restatement on Trusts wrote, "it is well settled that where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditor can reach his interest." Ritchie W. Taylor, *Domestic Asset Protection Trusts: The "Estate Planning Tool of the Decade" or a Charlatan?*, 13 BYU J. PUB. L. 163, 167 (2013) (quoting RESTATEMENT (SECOND) OF TRUSTS § 156 reporter's notes (AM. LAW INST. 1957)).

<sup>52</sup> Stewart Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom*, 85 CORNELL L. REV. 1035, 1048 (2000). "To that end, the statute include[d] numerous measures that made the Cook Islands a favorite trust situs for settlors seeking to avoid creditor claims." *Id.*

<sup>53</sup> See FOREIGN ASSET PROTECTION TRUSTS, <https://www.lodmell.com/asset-protection/foreign-trusts> [perma.cc/5CVM-L9HZ] (last visited July 23, 2017).

<sup>54</sup> Jay Adkisson, *A Short History of Asset Protection Trust Law*, FORBES, (Jan. 26, 2015), <https://www.forbes.com/sites/jayadkisson/2015/01/26/a-short-history-of-asset-protection-trust-law/#605ecd2f3fb4> [https://perma.cc/LD83-ND5Z].

<sup>55</sup> DUKEMINIER & SITKOFF, *supra* note 16, at 705. Alaska and Delaware have not been shy in expressing their respective desire to become the leading trust jurisdictions—not only domestically but also as an alternative to the offshore jurisdictions which have garnered so much world-wide business in the last several years. John K. Eason, *Home from the Islands: Domestic Asset Protection*

Alaska and Delaware paved the way for DAPTs, seventeen other states have passed legislation authorizing these trusts.<sup>56</sup>

Playing to the presumed desire of clients to build and preserve their family legacies, trust companies continually invent new names for their trust products, offering Dynasty Trusts,<sup>57</sup> Legacy Trusts,<sup>58</sup> and Millennium Trusts.<sup>59</sup> One trust company offers a “Bloodline Trust”<sup>60</sup> and one even boldly markets a “Have Your Cake and Eat It Too” Trust (HYCET Trust®).<sup>61</sup> What these trusts all offer is new possibilities and opportunities for individuals without generational family money to establish their own financial “legacies” and protect their own fortunes from spousal claims at divorce. That is to say, DAPTs allow newly rich trust settlors to hide their own money away in trust, while still

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*Trust Alternatives Impact Traditional Estate and Gift Tax Planning Considerations*, 52 FLA. L. REV. 41, 53 (2000).

<sup>56</sup> Connecticut, Hawaii, Indiana, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, Wyoming, and West Virginia have also enacted legislation validating DAPTs. Following the 1986 creation of the GST exemption, states have similarly raced to change or abolish the rule against perpetuities and compete for dynasty trust business. Roughly \$100 billion in trust assets has migrated into states that have provided for dynasty trusts.

<sup>57</sup> *The Dynasty Trust*, WILMINGTON TR. CORP., <https://www.wilmingtontrust.com/wtcom/index.jsp?fileid=3000303> [perma.cc/Z383-7CEV] (last visited July 16, 2017) (explaining that “a dynasty trust is an irrevocable trust designed so that it may stay in effect for multiple generations, creating a powerful estate planning tool for high-net-worth families”).

<sup>58</sup> Christopher Cline, *Why Use Legacy Trusts*, ABBOT DOWNING, <https://www.abbotdowning.com/asset/ggckc8/LegacyTrusts.pdf> [perma.cc/MCZ3 - NCWL] (last visited July 16, 2017) (explaining that legacy trust is a term for any trust that lasts perpetually).

<sup>59</sup> *Trusts to Consider*, PEAK TR. CO., <https://www.peaktrust.com/trustee/trusts-to-consider/> [perma.cc/3TPQ-JA84] (last visited July 16, 2017) (explaining that “perpetual trust[s] (Millennium Trust) provide for a long-term trust that saves estate and gift taxes while increasing the family wealth, using Alaska jurisdiction”).

<sup>60</sup> *The Benefits of Bloodline Trusts Special Report*, BEGLEY L. GROUP, <http://www.begleylawyer.com/2012/02/the-benefits-of-bloodline-trusts-special-report/> [perma.cc/UC2R-H9AY] (last visited July 16, 2017) (explaining that a bloodline trust is designed to keep money in the family protecting the inheritance of your children and their descendants).

<sup>61</sup> *Have Your Cake and Eat It Too: The HYCET Trust*, JEFFERY M. VERDON L. GROUP, LLP, [hereinafter *HYCET*] <http://jmvlaw.com/hycet-trust/> [perma.cc/ABH4-AD4D] (last visited July 16, 2017).

potentially benefitting from the assets, and receive the asset protection of a conventional trust.

### B. *Marketing Romance and Providing Asset Protection*

While the marketing of DAPTs takes many forms and targets a number of users – from doctors potentially subject to large malpractice claims to entrepreneurs and financial speculators in high-risk industries – trust companies quickly discovered the connection between trusts and divorce. And because of the enhanced protections that DAPTs offer against creditors in general, trust companies, wealth managers, and financial planners began heavily marketing DAPTs as a new and improved alternative to prenuptial agreements. The new narrative – put forth by both the trust companies as well as wealth managers – is this: prenups are fine, but premarital trusts are even better. No wealth manager, of course, will advise against a prenuptial agreement, if a prenup is the only form of protection that a couple is considering. Nevertheless, most wealth managers will tell clients that prenuptial agreements are not sufficient, especially when significant assets are at stake. One lawyer remarks: “Prenuptial agreements are good, but there are numerous personal and legal issues that deter couples from actually executing a prenuptial agreement.”<sup>62</sup> Another lawyer is more specific about what can go wrong with a prenup:

Spouses attempt many strategies to circumvent a prenuptial agreement with success. A spouse can attempt to prove they had been tricked, coerced or were the victim of bad intent when they agreed. A spouse can also try to prove that the document was never signed, that their attorney was ineffective or the prenuptial agreement is outrageous (maybe it wasn't when signed, but it is now). Spouses also attempt to prove that the agreement was signed without adequate knowledge of the other spouse's assets. Any of these can nullify a prenuptial agreement and at the very least pull the other spouse into a

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<sup>62</sup> Richard Shapiro et al., *Domestic Asset Protection Trusts v. Prenuptial Agreements*, BLUSTEIN, SHAPIRO, RICH & BARONE, LLP (Oct. 14, 2016), <https://www.mid-hudsonlaw.com/blog/domestic-asset-protection-trusts-v-prenuptial-agreements/> [perma.cc/B89F-UK3J].

prolonged divorce proceeding, and possibly push you into a settlement.<sup>63</sup>

Wealth managers also warn that many jurisdictions “take a robust approach to family wealth structures,”<sup>64</sup> meaning that the courts are willing to break up family wealth at divorce, and wealth managers routinely stress the significant discretion that family court judges have, emphasizing the uneven and unpredictable results that follow if a prenup is challenged in court.<sup>65</sup>

One option that advisors sometimes recommend is to do both – execute a prenup and use a DAPT, the “belt and suspenders”<sup>66</sup> approach. Trust companies and lawyers generally ad-

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<sup>63</sup> *Irrevocable Trust vs. a Prenuptial Agreement*, ESTATE STREET PARTNERS LLC, <https://irrevocable-trust.ultratrust.com/irrevocable-trust-vs-prenuptial-agreement.html> (last visited Mar. 16, 2021).

<sup>64</sup> TAYLOR WESSING LLP, *supra* note 1, at 33.

<sup>65</sup> Wealth managers also warn that even placing family assets in a discretionary asset-protection trust might not suffice to protect them at divorce. High-profile divorces such as the 2014 Poon case in which the wife of Otto Poon received a payout of over HK\$700 million after trust assets were determined to be marital property have reinforced this message. Jennifer Hughes, *Hong Kong Divorce Case Rattles Family Trust Industry*, FIN. TIMES, July 17, 2014, <https://www.ft.com/content/f953e8e4-0d92-11e4-815f-00144feabdc>; see also Abby Schultz, *Prenuptial Agreements Gain Traction in Asia*, BARRON'S (Dec. 18, 2015), <https://www.barrons.com/articles/prenuptial-agreements-gain-traction-in-asia-1450409202>.

<sup>66</sup> See Rachel Emma Silverman, *Beyond the Prenup: Families Increasingly Turn to Trust to Protect Assets, Inheritances from Ex Spouses*, WALL ST. J. (Sept. 22, 2005), <https://www.wsj.com/articles/SB112735445722148247> (explaining that “[p]rotecting wealth from the financial ravages of divorce has long been a key concern of families”).

Because of the possibility of a court rewriting the intent of the parties based on equitable principles, a better way to ensure protection of separate property prior to a marriage includes the use of irrevocable trusts, including a DAPT, which can be used by either party to provide enhanced asset protection for separate assets. I would argue that while a prenuptial agreement and DAPT are similar tools, a DAPT is superior and more powerful tool. Why? Prenuptial agreements are contracts and like any contract, can be misconstrued or equitably rewritten by a judge. Of course, you can have both as well, as a sort of belt and suspender approach, to provide a prenuptial contract for your understanding with your spouse and a DAPT to protect the assets that the spouse agrees not to pursue.

Randall A. Denha, *For Better or for Worse—Prenuptial Agreement or Domestic Asset Protection Trust*, DENHA & ASSOCS. PLLC BLOG, <http://denhalaw.com/>

vise, however, that the DAPT alone is sufficient and that the DAPT-only approach even has additional benefits. Specifically, trust companies and wealth managers highlight that – unlike prenuptial agreements – DAPTs can be created by one fiancé unilaterally. Accordingly, DAPTs are characterized as a good alternative to pre-marital contracts because they help fiancés avoid “awkward” conversations about money during wedding planning. One lawyer explains the problem with prenuptial agreements: “The bottom line is that while many couples are delighted to share their lives together when entering into a marriage, they may feel uncomfortable sharing information about their net worth.”<sup>67</sup> A Delaware trust company, responsive to this concern, states that DAPTs act as a substitute for prenuptial agreements but with the added advantage that they help individuals avoid negotiations.<sup>68</sup> An article in the American Bar Association newsletter describes the utility of the DAPT by similarly underscoring the “low-stress” angle these trusts provide and remarking that this approach is well-suited to any individuals who are contemplating asset protection upon marriage but “would like to do so quietly and without any hassle.”<sup>69</sup> One website offering asset protection advice even offers this advice:

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for-better-or-for-worse-prenuptial-agreement-or-domestic-asset-protection-trust/ (last visited Mar. 16, 2021).

Consequently, when a prenuptial agreement is impractical, undesirable, or potentially unenforceable, a DAPT is an effective alternative, provided that it is created and funded prior to the wedding (with the additional benefit of protecting the DAPT’s assets from an elective share claim by a surviving spouse). There is no requirement to disclose the creation of the trust, to ask the future spouse to sign it, or to disclose financial assets. Alternatively, a DAPT used in combination with a prenuptial agreement can also be an effective strategy.

*Twenty Questions About Using Delaware Trusts*, THE FREE LIBRARY, Sept. 1, 2013, <https://www.thefreelibrary.com/Twenty+questions+about+using+Delaware+trusts-a0344842326>

<sup>67</sup> Shapiro et al., *supra* note 62.

<sup>68</sup> Northern Trust, *Delaware Trusts: Safeguarding Personal Assets* (2019), [https://www.northerntrust.com/documents/white-papers/wealth-management/research/delaware-trusts-safeguarding-personal-wealth.pdf?bc=25683840\[perma.cc/5SJ5-XE3H\]](https://www.northerntrust.com/documents/white-papers/wealth-management/research/delaware-trusts-safeguarding-personal-wealth.pdf?bc=25683840[perma.cc/5SJ5-XE3H]).

<sup>69</sup> Kalimah Z. White, *Domestic Asset Protection Trusts: An Alternative to Prenuptial Agreements 2* (Feb. 2006), <http://www.americanbar.org/newsletter/>

So, asset protection plans do not even have to be disclosed to the future spouse; or if you want to be really tricky, you can show the future spouse that she is a beneficiary. You can say, honey, I've made you rich. You are now the beneficiary of my asset protection plan. This thing has some money in it and you're going to be fine. Well, a week later you can change the beneficiary designation at any time. You don't have to tell her. You're not obligated to tell her. You don't even need her consent to do the trust.<sup>70</sup>

Based on this idea of avoiding awkward conversations and the ability of the intended spouse to act unilaterally, trust companies and wealth planners subsequently market DAPTs as the “romantic” option, while prenups are characterized as “unromantic” and tied to communication challenges.<sup>71</sup> Wealth managers make the comparison very directly: “Due to the unromantic pitfalls of negotiating a family property settlement the week of the wedding, some proactive individuals are avoiding the prenup altogether.”<sup>72</sup> Another lawyer observes: “Many wealthy individuals choose to forgo a prenup altogether, for fear that it will dim the ardor of romance—and for them a premarital trust is a good alternative.”<sup>73</sup>

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publications/law\_trends\_news\_practice\_area\_e\_newsletter\_home/domestic\_trust.html [perma.cc/W9B7-4657].

<sup>70</sup> *Why Trusts Are a Better Alternative to Prenup*, ASSETPROTECTION-TRAINING.COM, <https://www.assetprotectiontraining.com/asset-protection-trusts-prenuptial-agreements/> (last visited Mar. 16, 2021).

<sup>71</sup> As one lawyer remarks: “As a practical matter, asking a future spouse to enter into a prenuptial agreement often causes discomfort to blossoming love relationships.” Shapiro, *supra* note 62.

<sup>72</sup> *Divorce Asset Protection*, ASSET PROTECTION PLANNERS, [http://asset-protectionplanners.com/articles/divorce/\[perma.cc/GR2R-DVWF\]](http://asset-protectionplanners.com/articles/divorce/[perma.cc/GR2R-DVWF]) (last visited July 16, 2017).

One benefit of utilizing a trust rather than a prenuptial agreement is that the creation of a trust does not require the signature of the other party to the marriage. One party can make the unilateral decision to put his or her assets in a trust prior to the marriage. Also, the settlor does not need to inform the other party of the existence of the trust. This can eliminate the potential of offending or insulting the other party, which could have potentially put a strain on the relationship.

*Using Trusts as an Alternative to Prenuptial Agreements*, MILVIDSKIY LAW GROUP P.C., <https://www.milvidlaw.com/estate-planning/using-trusts-as-an-alternative-to-prenuptial-agreements/>.

<sup>73</sup> Rachel Winokur Munk, *Beyond the Prenup*, WALL ST. J. (Sept. 22, 2005 12:01 AM ET), <https://www.wsj.com/articles/SB112735445722148247>.

11th Annual Domestic Asset Protection Trust State Rankings Chart											
Rank	State	Statute (50% weight)	Uniform Voidable Transactions Act (12.5% weight)	Statute of Limitations (Future Creditor) (2.5% weight)	Statute of Limitations (Preexisting Creditor) (2.5% weight)	Spouse/ Child Support Exception Creditors (Spouse 3%, Alimony 1%, Child Support 1% weight)	Preexisting Torts Exception Creditors/Other Exception Creditors (5% weight)	Ease of Use – New Affidavit of Solvency required for every new transfer? (7.5% weight)	Fraudulent Transfer Standard (10% weight)	Decanting State Ranking (5% weight)	Total Score
1	NV	<a href="#">§§166.010 to 166.170</a>	No	2 Yrs.	2 Yrs. or 0.5 Yr. Discovery	No	No	No Affidavit Required	Clear and convincing	Ranked #2	99
2	SD	<a href="#">§§35-16-1 to 16</a>	No	2 Yrs.	2 Yrs. or 0.5 Yr. Discovery	Divorcing Spouse; Alimony; Child Support (only if indebted at time of transfer)	No	No Affidavit Required	Clear and convincing	Ranked #1	98
3	OH	<a href="#">Ch. 5816</a>	No	1.5 Yrs.	1.5 Yrs. or 0.5 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	No	Affidavit Required (with exceptions)	Clear and convincing	Ranked #6	85
4	MO	<a href="#">§456.5-505</a>	No	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Alimony; Child Support	State/U.S. to extent state/federal law provides	No Affidavit Required	Clear and convincing	Ranked #7	84.5
5	CT	<a href="#">Public Act No. 19-137</a>	No	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Divorcing Spouse; Alimony; Child Support (only if indebted at time of transfer)	Preexisting Torts	No Affidavit Required	Clear and convincing	None	84
6 (tie)	DE	<a href="#">Tit. 12 §§3670-3576</a>	No	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	Preexisting Torts	No Affidavit Required	Clear and convincing	Ranked #3	83.5
6 (tie)	TN	<a href="#">§§35-16-101 to 112</a>	No	2 Yrs.	2 Yrs. or 0.5 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	No	Affidavit Required	Clear and convincing	Ranked #4	83.5
8	AK	<a href="#">§34.40.110-§13.36.310</a>	No	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Divorcing Spouse	No	Affidavit Required	Clear and convincing	Ranked #8 (tie)	82.5
9	RI	<a href="#">§18-9.2</a>	No	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	Preexisting Torts	No Affidavit Required	Clear and convincing	Ranked #14	82
10	IN	<a href="#">§30-4-8</a>	No	2 Yrs.	2 Yrs. or 0.5 Yr. Discovery	Divorcing Spouse; Child Support	Properly listed on app. to obtain credit – but only as to that lender	Affidavit Required	Clear and convincing	Ranked #10 (tie)	80.5
11	NH	<a href="#">§564-B:5-505A</a>	No	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	No	No Affidavit Required	Limited clear and convincing standard	Ranked #5	79
12	WY	<a href="#">§§4-10-500, 504, 506(c), §10-523</a>	No	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Child Support	Properly listed on app. to obtain credit – but only as to that lender	Affidavit Required	Clear and convincing	Ranked #13	78
13	MI	<a href="#">§§700.1041 to 700.10502</a>	Yes	2 Yrs.	2 Yrs. or 1 Yr. Discovery	Divorcing Spouse	No	Affidavit Required (with exceptions)	Clear and convincing	Ranked #25 (tie)	75
14	MS	<a href="#">§§91-9-701 to 91-9-723</a>	No	2 Yrs.	2 Yrs. or 0.5 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	Preexisting Torts, State Criminal Restitution/ Up to \$1.5MM if no \$1MM Umbrella Policy	Affidavit Required	Clear and convincing	None	72.5
15	HI	<a href="#">§554G</a>	No	2 Yrs.	2 Yrs. Pers. Injury, 6 Yrs. Contract	Divorcing Spouse; Alimony; Child Support	Preexisting Torts/ Certain Lenders/ Hawaii Tax	No Affidavit Required	Limited clear and convincing standard	None	72
16	UT	<a href="#">§25-6-502</a>	Yes	None	2 Yrs. or 1 Yr. Discovery (with 100-day mailing publication option)	No	No	Affidavit Required	Missing clear and convincing standard	None	60
NR	OK	<a href="#">Tit. 31, §§10 to 18</a>	No	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Child Support	Must be majority Oklahoma assets	No Affidavit Required	Clear and convincing	None	NR
NR	VA	<a href="#">§§4-2-745-1, §64-2-745.2</a>	No	None	5 Yrs.	Child Support	Creditor who has provided services to protect trust/ U.S.fch, etc.	No Affidavit Required	Clear and convincing	Ranked #16 (tie)	NR
NR	WV	<a href="#">§44D-5-503A, §44D-5-503B</a>	No	None	4 Yrs.	No	No	Affidavit Required	Missing clear and convincing standard	None	NR

\*11th Annual Domestic Asset Protection Trust State Rankings Chart created in April 2020. Original State Rankings Chart created in April 2010. Copyright © 2010-2020 by Steve Oshins (soshins@osohins.com / www.osohins.com / (702) 341-6000, ext. 2). All rights reserved. \*The Decanting State Ranking column is based on the 7th Annual Trust Decanting State Rankings Chart (Jan. 2020) at <http://www.osohins.com/state-rankings-charts>.

Perhaps the most significant benefit of DAPTs, however, is the amount of asset protection that these trusts provide at divorce – a benefit that is discussed in depth by practitioners and certainly alluded to by the trust companies. Delaware trust companies advertise “extra breaks, including stronger protection from creditors and exclusion of assets in divorce proceedings.”<sup>74</sup>

<sup>74</sup> *Dynasty Trusts Let U.S. Wealthy Duck Estate, Gift Taxes Forever*, BLOOMBERG NEWS (July 28, 2011), <http://www.fa-mag.com/news/dynasty-trusts-let-us-wealthy-duck-estate-gift-taxes-forever—7913.html> [perma.cc/VQR4-R5Q4]. In states that have not adopted the UTC, local rules do not generally dictate any exceptions for spouse creditors.

Another lawyer suggests DAPTs because “utilizing Domestic Asset Protection Trusts in the pre-marital planning process greatly reduces the chances of a successful attack resulting in the equitable distribution of property brought to the marriage.”<sup>75</sup> Marketing for Nevada trust companies is straight-to-the-point: “Nevada is one of two states that have no exception creditors. This includes divorcing spouses.”<sup>76</sup> That asset protection at divorce is a highly desirable feature and one that is sought after by clients, as the Annual Domestic Asset Protection Trust State Rankings Chart makes clear (see image).<sup>77</sup> This rankings chart demonstrates that states clearly compete in offering trust settlors varied opportunities to shield assets from marital property and spousal support claims. Nevada, for example “has apparently chosen to be even more competitive by providing for no statutory creditor exceptions [including spouses] to the self-settled spendthrift trust features of its legislation.”<sup>78</sup> Oklahoma law, likewise, bars spouses from access to trust assets at divorce, as does Wyoming.<sup>79</sup> Wyoming DAPT law, moreover, shields trust assets from spousal and child support claims when the settlor is thirty days or more in default.<sup>80</sup> Other states give more weight to spousal claims, but doing so lowers their ranking and may make their jurisdiction less attractive to clients for trust formation purposes.

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<sup>75</sup> *Use of Asset Protection Trusts in the Pre-Marital Planning Process*, MCKONLY & ASBURY, <http://www.macpas.com/use-of-asset-protection-trusts-in-the-pre-marital-planning-process/> [perma.cc/S2JX-SWHB?type=image] (last visited July 16, 2017).

<sup>76</sup> *The 4 Things You Need to Know About a Nevada Asset Protection Trust*, PREMIER TRUST, <https://premiertrust.com/2016/12/30/the-4-things-you-need-to-know-about-a-nevada-asset-protection-trust/> [perma.cc/M68T-C9QZ] (last visited July 17, 2017).

<sup>77</sup> STATE RANKINGS CHARTS, <https://www.oshins.com/state-rankings-charts> [perma.cc/4HC3-CQP7] (last visited July 16, 2017); Ashlea Ebeling, *Comparing Domestic Asset Protection Trust States*, FORBES (July 6, 2016), <http://www.forbes.com/sites/ashleaebeling/2016/07/06/comparing-domestic-asset-protection-trust-states/#7caed6a765fe> [perma.cc/4VXK-E7HY].

<sup>78</sup> See Edward D. Brown & Hudson Mead, *Divorce and the Self-Settled Trust: Insights into How-and Where-Clients Might Protect Their Trust Assets from Financial Risk of a Future Divorce*, 2 FEATURE: EST. PLAN. & TAX’N (Feb. 2014), <http://www.barryengel.com/pdf/divorce-self-settled-trust.pdf> [perma.cc/7BLV-6YHD].

<sup>79</sup> STATE RANKINGS CHARTS, *supra* note 77.

<sup>80</sup> *Id.*

This is not to say that there are no limits whatsoever on the use of DAPTs as premarital trusts in the states that have adopted them. Some states require a certain amount of time before the marriage before granting asset protection. For example, assets in an Alaskan or Hawaiian DAPT are not protected at divorce unless the DAPT was created more than thirty days before the marriage or written notice was provided to the to-be spouse.<sup>81</sup> These constraints are not, however, burdensome, and neither are they a large part of the marketing message circulated by the trust industry and practitioners. These constraints are also, certainly, of a different order from the requirements that accompany the drafting and execution of a prenuptial agreement.

In this new landscape of DAPTs, then, prenups are characterized as difficult to execute, subject to challenge, the source of difficult conversations, and “unromantic.” DAPTs, on the other hand, are described as the better option because they allow for unilateral action and flexible timing while avoiding awkward exchanges about wealth and property.

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<sup>81</sup> Amy J. Amundsen, *Domestic Asset Protection Trusts in Divorce Litigation*, 29 J. AM. ACAD. MATRIM. LAW. 1, 11-12 (2016), [https://cdn.ymaws.com/aaml.org/resource/collection/385FDCDA-028C-494C-8530-7641053BD254/MAT106\\_9.pdf](https://cdn.ymaws.com/aaml.org/resource/collection/385FDCDA-028C-494C-8530-7641053BD254/MAT106_9.pdf) A greater number of states (Delaware, Mississippi, New Hampshire, Ohio, Rhode Island, South Dakota, and Tennessee) require notice if the DAPT is created during the marriage. *Id.* at 12. In South Dakota, marital property transferred into the DAPT is protected at divorce, but only if the spouse received notice in the form provided by the statute or provided written consent after having received substantially similar notice. *Id.* The statute directs that any letter of notice containing the following language, in capital letters and at the top of the letter:

“YOUR SPOUSE IS CREATING A PERMANENT TRUST INTO WHICH PROPERTY IS BEING TRANSFERRED. YOUR RIGHTS TO THIS PROPERTY MAY BE AFFECTED DURING YOUR MARRIAGE, UPON DIVORCE (INCLUDING THE PAYMENT OF CHILD SUPPORT OR ALIMONY OR A DIVISION OR DISTRIBUTION OF PROPERTY IN A DIVORCE), OR AT THE DEATH OF YOUR SPOUSE.”

*Id.* The notice must also describe the property being transferred. *Id.* at 13. The spouse may request a copy of the trust document and is advised to seek independent legal counsel. Failure to object after notice is construed as consent. S.D. CODIFIED LAWS § 5516-15(3)(a); *Codified Laws*, S.D. LEGISLATURE, [https://sdlegislature.gov/Statutes/Codified\\_Laws/2073006](https://sdlegislature.gov/Statutes/Codified_Laws/2073006).

*C. New Asset Protection Trusts in the Courtroom*

Despite all the work and planning that wealth managers put into safeguarding assets, there is a critical question that remains: how do DAPTs fare in the courtroom? The answer so far is ambiguous, as DAPT divorce cases have produced mixed results, often turning at this preliminary stage on conflict of law questions.<sup>82</sup> *Dahl v. Dahl* illustrates the types of DAPT divorce issues that are currently showing up in court. Charles and Kim Dahl were married and lived in Utah for almost eighteen years before the husband filed for divorce in 2006, beginning proceedings that the district court called a “train wreck.”<sup>83</sup> Charles was a cardiologist and Kim had worked as an interior designer and school counselor for a short time before the marriage. During the marriage, she was primarily a stay-at-home parent and the primary caretaker of two children.<sup>84</sup> One of the main issues in this “contentious” divorce were the assets that Charles had placed in a trust that he created in Nevada in 2002, the Dahl Family Irrevocable Trust, naming himself as beneficiary and his brother C. Robert Dahl and the Nevada State Bank as co-trustees. Charles initially funded the trust with 97% of the shares in Marlette Enterprises, a Utah real estate investment company (LLC) that he owned and that was valued at approximately \$1 million. The following year, the couple jointly transferred the deed to their primary residence to the trust. Despite the fact that the couple lived in Utah, Nevada was listed as place of domicile in the trust’s choice of law provision.

When divorce proceedings began, Kim sought a share of assets in trust on the grounds that they were marital property. The Utah district court concluded that Kim had no interest in trust assets both because of the choice-of-law provision and because

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<sup>82</sup> Courts have found against granting jurisdiction to the state of trust settlement in other creditor contexts—notably in *In re Huber*, 493 B.R. 798, 807–09 (Bankr. W.D. Wash. 2013), a case about a real estate developer trying to shield his assets through the use of a DAPT. At least one commentator has argued that these types of trusts should be protected as a matter of supporting trustor intent. See Brendan Duffy, *In States We “Trust”: Self-Settled Trusts, Public Policy, and Interstate Federalism*, 111 Nw. U. L. REV. 205 (2016).

<sup>83</sup> *Dahl v. Dahl*, 345 P.3d 566, 575 (Utah 2015).

<sup>84</sup> *Id.* at 575.

the trust was irrevocable,<sup>85</sup> but the Utah Supreme Court disagreed on appeal. Charles admitted that at least some part of the trust assets were marital property and, consequently, the court stated: “Thus, to the extent that the Trust corpus contains marital property, Utah has a strong interest in ensuring that such property is equitably divided in the parties’ divorce action.”<sup>86</sup> Ultimately, the court concluded that Kim’s interest in the marital home was undeniably marital property and there was an open question as to what, if any, percentage of the real estate company was marital property.<sup>87</sup> The larger message that the court sent in its conclusion was that the trust’s choice-of-law provision was invalid and Nevada’s highly protectionist trust law did not save Charles from claims to marital assets in the trust.

The twist in the case—and the resolution—depended, however, on what was likely a mistake in trust drafting. The main reason that the court concluded some portion of the trust assets were reachable by Kim at divorce was because the court determined that the trust was revocable—not irrevocable as Charles claimed. The trust agreement stated: “The Trust hereby established is irrevocable. Settlor reserves *any power whatsoever* to alter or amend *any* of the terms or provisions hereof.”<sup>88</sup> As commentators have pointed out: “[T]his provision may contain a typographical error—if one substitutes ‘no’ for ‘any,’ the phrase not only reads as more natural but makes sense as a provision in an irrevocable trust.”<sup>89</sup> Had the trust been correctly drafted as an irrevocable trust, it is highly possible that the outcome for Kim would have been quite different and that the DAPT would have done its intended work.

*IMO Daniel Kloiber Dynasty Trust*, another DAPT divorce case turning on the inclusion of trust assets, likewise involved a family business and claims by the wife to a portion of the assets

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<sup>85</sup> *Id.* at 577.

<sup>86</sup> *Id.* at 579.

<sup>87</sup> *Id.* In addition, Ms. Dahl claims to have conveyed to the Trust her interest in Marlette Enterprises and other marital property with a value of at least \$2 million. *Id.*

<sup>88</sup> *Id.* at 580.

<sup>89</sup> See *Utah Supreme Court Decides Conflict-of-Laws Issue in Revoking Dahl*, FORBES (Feb. 16, 2015) <https://www.forbes.com/sites/jayadkisson/2015/02/16/utah-supreme-court-decides-conflict-of-laws-issue-in-revoking-dahl/?sh=E1f986f652eb>.

in trust.<sup>90</sup> The trust in *Kloiber* was a dynasty trust, a particular form of a DAPT,<sup>91</sup> that Glenn Kloiber created in 2002 with PNC bank for the benefit of his son, Daniel Kloiber. Although Glenn was the initial trust creator, Daniel was not only the primary beneficiary, with a right to withdraw up to 5% of the net fair market value of the trust estate annually,<sup>92</sup> Daniel was also quickly given special powers of appointment<sup>93</sup> and was named as a “special trustee,” with sole authority to direct the trustee regarding investment decisions, distributions, and trustee selection.<sup>94</sup> Moreover, the assets in the trust were primarily Daniel’s. Glenn initially funded the trust with approximately \$15,000. The real wealth, however, was placed in trust by Daniel less than a year later, when Daniel sold 99.45% of his shares in Exstream Software (a company that he had founded and still co-owned) to the trust for “an unsecured promissory note with a face amount of \$6 million.”<sup>95</sup> By 2008, the trust had sold all of this stock for approximately \$310 million.<sup>96</sup> The trust, therefore, offered maximum asset protection and tax benefits while still giving Daniel signifi-

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<sup>90</sup> For more on the divorce, see Jay Adkisson, *Delaware Anti-Suit Injunction Nixed as to Dynasty Trust in Kloiber*, FORBES (Aug. 18, 2014), <http://www.forbes.com/sites/jayadkisson/2014/08/18/delaware-anti-suit-injunction-nixed-as-to-dynasty-trust-in-kloiber/6/#6bb14c77328b> [perma.cc/94WX-WC5J].

<sup>91</sup> Dynasty trusts are created in jurisdictions that offer enhanced asset protection and exemption from the rule against perpetuities, thereby allowing for “dynastic” wealth to accrue without termination. *Id.*

<sup>92</sup> “In addition, 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.’ *Id.* § 1.1.3. The Trustee also may use funds from the trust estate to provide and maintain a personal residence for Dan. *Id.* § 1.1.7.” *In re Kloiber*, 98 A.3d 924, 929 (Del. Ch. 2014).

<sup>93</sup> That permitted him to appoint the principal of the trust estate to the “wife of the Grantor’s son,” to his blood relations, or to a charitable organization. *Id.*

<sup>94</sup> The Special Trustee possessed powers including the following: “Sole authority to direct the Trustee with respect to investment of the trust estate, *id.* § 9.1; Sole authority to direct the Trustee with respect to Special Holdings, *id.* § 9.2; Sole authority to direct the Trustee with respect to discretionary distributions, *id.* § 9.3; and Sole authority to remove and replace the Trustee, *id.* § 9.4.” *Id.* at 931–32.

<sup>95</sup> *Id.* at 932.

<sup>96</sup> *Id.*

cant control over the trust wealth, which derived primarily from the sale of his company.<sup>97</sup>

When Daniel filed for divorce in 2010, his wife, Beth, argued that the trust assets were marital property. The Kentucky court, presiding over the divorce because of the couple's domicile in Kentucky, froze all the couple's asset including the assets in trust,<sup>98</sup> after which Daniel resigned as special trustee—transferring the power to his son. As a result of the freeze, the Delaware trust company (PNC) sought a declaration that Delaware's Court of Chancery had exclusive jurisdiction over all matters pertaining to the trust, excluding all other courts including the Kentucky Family Court.<sup>99</sup> Unpersuaded, the Delaware court concluded that the Delaware Court of Chancery possessed exclusive jurisdiction with respect to other Delaware courts.<sup>100</sup> Moreover, the court remarked: "This case differs from a situation where parties have agreed voluntarily by contract to an exclusive forum. Beth did not execute the Trust Agreement, nor is there any indication that she chose explicitly or implicitly to become bound by its terms."<sup>101</sup> In other words, the use of the trust as a mechanism for apportioning property rights was not, the court concluded, the same as a prenuptial contract that had been reviewed and consented to by both parties. Ultimately, the parties settled and some (undisclosed) portion of the dynasty DAPT assets were severed from the original trust and placed in a new trust for Beth. The question of what portion of the trust assets were marital, if any, was circumvented by private settlement and left unanswered. The takeaways for wealth managers were that exclusive jurisdiction was not necessarily exclusive and that safeguarding

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<sup>97</sup> Jocelyn Margolin Borowsky & Richard W. Nenno, *Myths and Facts About Kloiber*, MARTINDALE.COM (Apr. 12, 2017), [https://www.martindale.com/family-law/article\\_Duane-Morris-LLP\\_2242706.htm](https://www.martindale.com/family-law/article_Duane-Morris-LLP_2242706.htm) [perma.cc/8DD3-MLJV].

<sup>98</sup> *Kloiber*, 98 A.3d at 933. A subsequent order additionally prohibited Daniel from "taking action to facilitate, request or procure any change in any of the liquid, cash or cash equivalent investments within the [dynasty trust], or within the entities within the [dynasty trust]." *Id.* at 934.

<sup>99</sup> *Id.* at 938 (citing 12 DEL. CODE § 3572(a)).

<sup>100</sup> *Id.* at 939 (concluding not only that Delaware did not have exclusive jurisdiction, but also that Delaware did not have primary jurisdiction).

<sup>101</sup> *Id.* at 940 (citing *Garretson v. Garretson*, 306 A.2d 737, 740 (Del. 1973)).

assets from distribution by a divorce court was a trickier proposition than originally imagined.<sup>102</sup>

Other cases, such as the high-profile *Bosarge* case, similarly have settled before courts can rule on the efficacy of DAPTs in keeping assets out of reach of divorcing spouses. The *Bosarge* divorce has been covered extensively in the popular press because of the enormous wealth involved and the intricate complex of trusts that Ed Bosarge created to shield assets from all creditors, including the wife he was divorcing. Ed and Marie Bosarge married in 1989, before Ed Bosarge made billions through the company he co-founded, Quantlab, a high-frequency trading company. Their marriage lasted over thirty years – during which time Ed developed and profited from Quantlab – until 2017 when Ed served Marie with divorce papers just as she was “putting the finishing touches on their newest pad, a \$45 million Georgian mansion in billionaire haven Belgrave Square.”<sup>103</sup> when her husband served her with the divorce papers. Marie was surprised, one article recounts, because “she assumed Ed would see it as too expensive to divorce her since the couple didn’t have a prenuptial property agreement and Texas is a community property state—meaning everything earned during their marriage, including those Quantlab profits, would be jointly owned.”<sup>104</sup>

What Marie failed to realize or consider was the fact that their communal assets had been almost entirely poured into South Dakota DAPTs. Accordingly, when Ed filed for divorce, he claimed that

the couple’s community property assets total just \$25 million since an array of trusts own not only his Quantlab stock, but also their homes in Houston, Aspen, London and Maine and the 72-acre island in the Bahamas where they docked their three (trust-owned) yachts, includ-

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<sup>102</sup> Steven J. Oshins, *Beware of Rights of Beneficiary’s Divorcing Spouse in Delaware*, *INFORMA* (Nov. 1, 2016), <http://www.wealthmanagement.com/estate-planning/beware-rights-beneficiary-s-divorcing-spouse-delaware> [perma.cc/AAW9-HFUV].

<sup>103</sup> Christopher Helman, *How to Hide a Billion Dollars: Three Techniques the Ultrarich Use to Dodge Ex-Spouses, the Taxman and Disgruntled Business Partners*, *FORBES*, Sept. 4, 2020, <https://www.forbes.com/sites/christopherhelman/2020/09/04/how-to-hide-a-billion-dollars-three-techniques-the-ultra-rich-use-to-dodge-ex-spouses-the-taxman-and-disgruntled-business-partners/?sh=5d2cbd7f5994>.

<sup>104</sup> *Id.*

ing the eponymous 180-foot Marie, complete with a baby grand piano.<sup>105</sup>

Ed's lawyers claimed that neither Ed nor Marie were the owners of any of those properties, properties that had served as marital homes and that the couple had used and enjoyed over the years. The South Dakota trust company was the true owner. Bosarge even had a million-dollar necklace he had given Marie repossessed, stating in his depositions: "That wasn't a gift; that was specifically bought by the trust. It was a specific investment."<sup>106</sup>

South Dakota rules for DAPTs worked in Ed's favor, both during the marriage and at divorce. Marie claimed that she never received trust accountings in her capacity as a trust beneficiary; moreover, she was not notified when she was removed as a beneficiary from the trust. Moreover, during the divorce, "a South Dakota court turned down [Marie's] attempt to get discovery of key trust documents."<sup>107</sup> South Dakota trust privacy rules enabled all these various forms of secrecy and fostered, in this case, a complete lack of transparency that made Marie's quest to prove that a large portion of the trust assets were community property even more daunting. One trust lawyer stated in an article about the divorce: "South Dakota is almost bulletproof,"<sup>108</sup> and another article about the case observed that "[s]everal divorce attorneys and others familiar with trust law said they know of no precedent in which an aggrieved spouse has successfully accessed the assets in a South Dakota trust in a court-ordered divorce settlement."<sup>109</sup> Marie Bosarge likely walked away from her divorce a rich woman; nevertheless on account of her husband's use of DAPTs, she also likely received significantly less than she would have had he owned the assets outright.

Only one case has worked its way through the courts in which DAPTs have worked as marital agreements in a way that replicates the more contractual and consensual characteristics of

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<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> Candace Taylor, *A High-Stakes Divorce Illustrates How the Rich Play Real-Estate Tug of War*, WALL ST. J., Apr. 9, 2020, <https://www.wsj.com/articles/a-high-stakes-divorce-illustrates-how-the-rich-play-real-estate-tug-of-war-11586458598>.

<sup>108</sup> Helman, *supra* note 103.

<sup>109</sup> Taylor, *supra* note 107.

a standard pre- or post-nuptial agreement. The 2017 case from Nevada, *Klabacka v. Nelson*, involved spouses, Eric and Lynita Nelson, who married in 1983 and ten years into the marriage signed a separate property agreement (SPA) that transmuted their community assets into separate property. After almost another decade, in 2001, the spouses each funded their own DAPT with separate property.<sup>110</sup> Both spouses named the same independent trustee and both spouses retained the right to veto any distribution made from the discretionary spendthrift trusts. From the inception of the trust until Eric filed for divorce in 2009, the spouses made a number of gifts from one trust to the other.

Upon filing for divorce in 2009, however, Eric claimed “the SPA and trust agreements were signed in an effort to protect the parties’ assets from creditors and that much of the property contained within the trusts was community property.”<sup>111</sup> The district court found that “the testimony of the parties clearly established that the intent of creating the spendthrift trusts was to provide maximum protection from creditors and was not intended to be a property settlement in the event that the parties divorced.”<sup>112</sup> Moreover, the district court noted that they could have invalidated either or both of the trusts “under theories of constructive trust or unjust enrichment.”<sup>113</sup> Consequently, the district court ordered an equalization of \$8.7 million in total trust assets and ordered both lump-sum spousal support and child support arrearages to be paid from Eric’s trust.

On appeal, the Nevada Supreme Court wholly disagreed. At the outset of its analysis, the Nevada Supreme Court swiftly concluded that the SPA was valid because “[b]oth parties were apprised of the legal consequences of the agreement by their attorney. Additionally, Lynita had her own outside counsel review the agreement prior to signing and provide additional legal advice regarding the consequences of the SPA.”<sup>114</sup> Moreover, the trusts were also valid because they had been executed according to all relevant formalities and the intention of each spouse had

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<sup>110</sup> *Klabacka v. Nelson*, 394 P.3d 940, 943 (Nev. 2017).

<sup>111</sup> *Id.* at 944.

<sup>112</sup> *Id.*

<sup>113</sup> *Id.* at 944.

<sup>114</sup> *Id.* at 947.

been clear.<sup>115</sup> Because both trusts were valid and because there was no evidence that either trust contained community property, the court concluded that the district court had erred in ordering an equalization payment between trusts, stating that such a payment would contravene the discretionary nature of the trust and “would require the trustee to make a distribution outside the scope of the trust agreement and, perhaps more importantly, would run afoul of [the Nevada code] which prohibits payments made pursuant to or by virtue of any legal process.”<sup>116</sup> For similar reasons, the court concluded that the district court erred in ordering spousal support and child support arrears to come out of Eric’s trust and reiterated that “Nevada’s statutory framework explicitly protects spendthrift trust assets from the personal obligations of beneficiaries.”<sup>117</sup>

Ultimately, then, the trusts worked as intended and by design, allowing Eric and Lynita to each protect their assets, even at divorce; the difference here is that the trusts were created with intention, with transparency between spouses, and with attentiveness to the nature of the property being put into trust. In this way, these trusts looked like a postnuptial agreement as opposed to the “secret” or “stealth” premarital trusts recommended by trust companies and wealth managers.

### III. What Harms Arise from Premarital Trusts?

The questions that ultimately arise from this phenomenon of family trusts and DAPTs being used as a replacement for pre- and postnuptial agreements is whether they are creating harms within marriage and, if so, who is bearing the burden of these harms. The answer to the first question – whether the use of these trusts creates harms to spouses – is likely affirmative, as the cases show. Traditional asset protection trusts still work to keep family wealth from a divorcing spouse at divorce while DAPTs,

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<sup>115</sup> *Id.* at 949. “Here, both Eric’s Trust and Lynita’s Trust are valid Nevada SSSTs with plain, unambiguous language indicating a clear intent to create a spendthrift trust.” The court did however conclude that “the district court erred by not tracing the assets contained within the trusts . . . if community property exists within the trusts, the district court shall make an equal distribution of that community property.” *Id.*

<sup>116</sup> *Id.* at 950.

<sup>117</sup> *Id.* at 952.

marketed and sold as substitutes for marital agreements and contracts, are being used to decrease transparency in marital wealth planning, strip spouses of marital wealth that would otherwise be subject to distribution at divorce, and safeguard one spouse's money from the other's support claims. DAPTs, then, by design contravene principles of marital and economic partnership without providing any true assurance that this manner of regulating marital wealth has been ratified by both spouses.

The question of who bears the harms, however, may be more complicated. As the *Klabacka* case demonstrates, there are cases in which concern may be minimal, if both spouses are parties to the planning and enter into a trust-based marital arrangement with full counsel and consent. Cases in which both parties use trusts to protect their own wealth, earned or obtained before marriage, certainly generate less cause for concern. This kind of planning tends to arise particularly in second and third marriages, when spouses enter into marriage with their own wealth and are looking not only to protect their assets but also provide for children from previous marriages.<sup>118</sup> In these scenarios, concerns about transparency and communication might arise but concerns about wealth and power asymmetries as well as trusts being used to strip one spouse of marital wealth accumulated over the life of a long-term marriage may be less acute. The cases that are beginning to trickle into divorce courts around the country evidence however that the harms of these trusts are being born by women in long-term, high-wealth marriages defined by a great degree of specialized household labor and significant wealth asymmetry.

To begin with, at least in the current context of gender and marriage, the harms of these trusts are more likely to fall on women at divorce because trusts are more likely to be created by men – that is to say, those individuals with wealth to protect, access to sophisticated estate planning advice, and the financial capacity to forgo full rights to the assets by placing them in an

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<sup>118</sup> See, for example, HIS, HERS, OR OURS? – ESTATE PLANNING FOR BLENDED FAMILIES, <https://www.sterlingandtucker.com/ealert/estate-planning-blended-families/> and ESTATE PLANNING FOR BLENDED FAMILIES, <https://modernwealthlaw.com/estate-planning-basics-101/estate-planning-blended-families/>.

irrevocable trust.<sup>119</sup> As the cases reviewed in the previous parts of this article confirm, it is much more common to see men taking steps to protecting their wealth before or during marriage than women. Women in general possess less wealth than men, at all points on the wealth spectrum. Single women are, in fact, the lowest wealth-holders and within that group the level of wealth varies according to race and ethnicity.<sup>120</sup> Whereas the median wealth for single white women is \$41,500, the median wealth for single black and Hispanic women is \$100 and \$120 respectively.<sup>121</sup> Married women, overall, possess more wealth than single women and this is attributable to the fact that their wealth is generally measured by couple: “Married households are significantly wealthier than non-married households . . . . Never-married women’s median net worth is just \$2,500 compared to the

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<sup>119</sup> Because we do not have data on who creates trusts, we are reliant on legal disputes to bring the trust claims to light and reveal what kinds of trusts are being created with what kinds of governing terms. Certainly, women also create trusts and, as women gain more wealth, perhaps marketing will be more directed at women. Nevertheless, the trust companies in their current marketing are targeting men, which maps on to the cases that are coming into court.

<sup>120</sup> See Asset Funders, [https://assetfunders.org/wp-content/uploads/Women\\_Wealth\\_Insights\\_Grantmakers\\_brief\\_15.pdf](https://assetfunders.org/wp-content/uploads/Women_Wealth_Insights_Grantmakers_brief_15.pdf), *Gender Economic Inequality*, <https://inequality.org/facts/gender-inequality/>, and *America Doesn’t Just Have a Gender Pay Gap, It Has a Gender Wealth Gap*, WASH POST, Apr. 2, 2019, <https://www.washingtonpost.com/outlook/2019/04/02/america-doesnt-just-have-gender-pay-gap-it-has-gender-wealth-gap/>

<sup>121</sup> Mariko Chang, *Lifting as We Climb*, INSIGHT CTR. COMMUNITY ECON. DEV. (2010), [https://static1.squarespace.com/static/5c50b84131d4df5265e7392d/t/5c5c7801ec212d4fd499ba39/1549563907681/Lifting\\_As\\_We\\_Climb\\_InsightCED\\_2010.pdf](https://static1.squarespace.com/static/5c50b84131d4df5265e7392d/t/5c5c7801ec212d4fd499ba39/1549563907681/Lifting_As_We_Climb_InsightCED_2010.pdf). This statistic points to another likelihood, which is that even among men, men of color are less likely than white men to create trusts because of the differences in wealth and the racial wealth gap. From the outset, white families are more likely to inherit than their black counterparts and among those families receiving inheritances, black families receive less: “Blacks received 8 cents of inheritance for every dollar inherited by whites.” Cedric Herring & Loren Henderson, *Wealth Inequality in Black and White: Cultural and Structural Sources of the Racial Wealth Gap*, 8 RACE & SOC. PROBS. 4, 8 (2016) (quoting T. SHAPIRO, THE HIDDEN COST OF BEING AFRICAN AMERICAN: HOW WEALTH PERPETUATES INEQUALITY 69 (2004)). Even in the upper echelons of wealth: “The 99th percentile black family is worth a mere \$1,574,000 while the 99th percentile white family is worth over 12 million dollars.” William Darity Jr. et al., *What We Get Wrong About Closing the Racial Wealth Gap*, INSIGHT CTR. COMMUNITY ECON. DEV. 2 (2018), [https://socialequity.duke.edu/sites/socialequity.duke.edu/files/site-images/FINAL%20COMPLETE%20REPORT\\_.pdf](https://socialequity.duke.edu/sites/socialequity.duke.edu/files/site-images/FINAL%20COMPLETE%20REPORT_.pdf).

\$148,700 median net worth of married individuals.”<sup>122</sup> Even at the very top levels of wealth, women experience the gender wealth gap and on the 2021 Forbes billionaire list, out of 2,755 billionaires, only 328 (12%) were women, and the majority of those women inherited at least a portion of their wealth, usually from a father.<sup>123</sup>

Pressing on the question of who holds the wealth within marriage, recent studies conclude that in most cases marital wealth derives primarily from the husband, at least in different-sex marriages.<sup>124</sup> This is especially true in high-wealth families, the same ones who tend to use trusts in their financial planning. In these high-wealth, “1%” families,

married households rarely qualify for one percent status based on women’s income alone. In 2016, women’s income was sufficient for one percent status in only 1 in 20 elite households . . . . [and] women’s income is not necessary for the vast majority of married households to meet the one percent threshold.<sup>125</sup>

This is not only because women tend to own less wealth than men but also because, despite some changes in the conventional pattern, women tend to marry men with higher incomes than their own.<sup>126</sup> What these studies as a whole suggest, then, is “a persistent male dominance of income resources in elite families.”<sup>127</sup> Based on these gendered patterns of wealth-holding within marriage, Lily Kahng suggests that women are the ones in a marriage who are “less likely to benefit from spousal transfer provisions such as the marital deduction, gift splitting, or QTIP trusts, simply because they have less wealth to transfer.”<sup>128</sup> By

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<sup>122</sup> Karuna Jaggar, *The Race and Gender Wealth Gap*, 15 RACE & REGIONALISM (2008).

<sup>123</sup> *Billionaires: The Richest People in the World*, FORBES (last visited Aug. 17, 2021) <https://www.forbes.com/billionaires/>.

<sup>124</sup> There is less data on patterns of wealth-holding in same-sex marriages and what inequalities exist there.

<sup>125</sup> Jill E. Yavorsky et al., *Women in the One Percent: Gender Dynamics in Top Income Positions*, AM. SOC. REV. (2019), <https://journals.sagepub.com/doi/full/10.1177/0003122418820702>.

<sup>126</sup> *Better-Educated Women Still Prefer Higher-Earning Husbands*, INST. FAM. STUD. (Nov. 7, 2016), <https://ifstudies.org/blog/better-educated-women-still-prefer-higher-earning-husbands>.

<sup>127</sup> Yavorsky et al., *supra* note 125.

<sup>128</sup> Lily Kahng, *The Not-so-Merry Wives of Windsor: The Taxation of Women in Same-Sex Marriages*, 101 CORNELL L. REV. 325, 351 (2016).

the same logic, women are also less likely to establish DAPTs and use premarital trusts as a part of their wealth management and financial planning. As Kahng also suggests, women may tend to use these kinds of asset protection trusts less than men even when they do hold wealth because “trusts are used predominantly by wealthy husbands and appear to reflect a ‘deeply patriarchal outlook.’”<sup>129</sup>

The financial harm these women experience at divorce is compounded because women in high-wealth marriages are also more likely to specialize household labor and work at home rather than in the paid labor market, thereby exacerbating their lack of individual wealth. Drawing again on recent studies: “When a man is the primary breadwinner, 70 percent of women in elite households don’t participate in the labor force . . . . When a woman’s income is enough to put the household in the top 1 percent, men stay home about 22 percent of the time.”<sup>130</sup> Another report found “that 46 percent of the mothers whose husbands earned at least \$250,000 a year don’t work for pay.”<sup>131</sup> Accordingly, the women in high-wealth marriages – whose marital wealth is more likely to be structured by marital trusts – are also more likely to have marriages that follow extremely conventional and gendered scripts for marital roles. Their marriages are “gender-full.”<sup>132</sup> These women are more likely to focus their full time and attention on running the household and caretaking, and therefore rely heavily on a court to equalize marital wealth at divorce, compensating them for indirect contributions to the marital wealth. In these marriages, women, many of them with

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<sup>129</sup> *Id.* at 353.

<sup>130</sup> Andrew Van Dam, *Among 1-Percent Earners, Where Area All the Women?*, WASH. POST, Feb. 18, 2019, <https://www.washingtonpost.com/us-policy/2019/02/13/glass-ceiling-is-even-higher-penthouse-women-percenters-are-rare/>.

<sup>131</sup> Robert VerBruggen & Wendy Wang, *The Real Housewives of America: Dad’s Income and Mom’s Work*, INST. FAM. STUD. (Jan. 23, 2019), <https://if-studies.org/blog/the-real-housewives-of-america-dads-income-and-moms-work>. Also, just over a third of mothers married to men earning less than \$25,000 a year are not in the workforce. *Id.*

<sup>132</sup> Abbie E. Goldberg, “*Doing*” and “*Undoing*” Gender: *The Meaning and Division of Housework in Same-Sex Couples*, 5 J. FAM. THEORY & REV. 85, 88 (2013).

advanced, professional degrees and work experience,<sup>133</sup> have depended on modern legal understandings of marital partnership as a safeguard to allow them to opt out of paid labor. The migration of marital wealth into asset protection trusts, however, has the capacity to undermine any implied bargains made between spouses about the division of household labor.

Ultimately, then, because of sizeable gender and racial wealth gaps – which predict that white couples are more likely to hold wealth and that within that set of predominantly white couples the man is more likely to be the wealthy spouse – the particular harm wrought by DAPTs in marriage planning falls primarily on white women.<sup>134</sup> These women are privileged within marriage and even at divorce they retain and benefit from more than a modicum of privilege in both economic and social terms. Consequently, it may seem as if the problems that plague these women, revealed in part by the use of asset protection trusts, are remote from larger social concerns, involving as they do only a small and circumscribed group of privileged actors. Looking at the effects through a broad frame, however, it is possible to suggest that these concerns have more generalizable implications that can amplify the effects. One troubling dimension of the use of these trusts is what this trend might reveal about social understandings or acceptance of marital partnership and shifts away from transparency – a value that prenuptial agreements instantiate and work to actualize. Another reason we might care about the use of these trusts is the relationship between premarital trusts and wealth inequality. The use of asset protection trusts in marital planning provides a critical look into the legal mechanisms that intensify gender and racial wealth gaps over time.

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<sup>133</sup> See JUNE CARBONE & NAOMI CAHN, *MARRIAGE MARKETS: HOW INEQUALITY IS REMAKING THE AMERICAN FAMILY* (2014).

<sup>134</sup> Women in same-sex marriages are less likely, as Kahng points out, to be in high-wealth marriages based on their own incomes (although there are certainly exceptions, see *United States v. Windsor*, 570 U.S. 744 (2013). Add cite And there is little data about men in same-sex marriages, although speculatively they are less likely to specialize in household labor and be egalitarian within marriage, particularly if there are no children in the home. With an increasing number of children in these marriages and households, however, high-wealth same-sex marriages may begin to look more like different-sex marriages than they do presently – that is to say they may become more gender-full. For more on this, see Allison Tait, *Divorce Equality*, 90 WASH. L. REV. 1245 (2015).

Trust settlors – mostly, at least for now, white men in different-sex marriages – are using trusts to solidify their wealth at the expense of other parties. These trust settlors already benefit from privilege in creating wealth and the trust laws around asset protection trusts let these individuals consolidate and entrench their wealth. Moreover, this entrenchment comes at the potential expense of their spouses and, ultimately, perhaps even at the expense the larger social collective that supports these ex-spouses and their children when a husband's asset are locked away in trust, unavailable for distribution. Accordingly, the role of premarital asset protection trusts in regulating household economies produces inequality within the household, and it may also produce inequality in the larger context. For all these reasons, it may be beneficial to inquire more deeply into what level of tolerance trust law maintains with respect to premarital trusts.

## **Conclusion**

The use of trusts in marriage planning is a traditional practice in high-wealth families, both historically and presently. Trusts have been the preferred mechanism because they offer asset protection that safeguards the family fortune from multiple kinds of creditors, including divorcing spouses. Moreover, unlike prenuptial contracts – the premarital trust's recently arrived competitor – the trust does not necessarily require any form of asset disclosure, independent review by the other spouse, or even notice to the other spouse. This is especially true of the new generation of asset protection trusts that are being specifically marketed as alternatives to the prenuptial agreement. These trusts expand the population that can establish premarital trusts by allowing individuals to place their own assets in trust and receive protection rather than depending on a third party to create such a trust. While conventional trusts still consistently and successfully protect family wealth, as caselaw demonstrates, cases involving DAPTs are just beginning to work their way onto divorce court dockets. As the use of these trusts increases and more states consider adopting them, however, it may be useful to press on the question of effects and interrogate more fully the gendered harms and equality harms that result from the use of these trusts – and asset protection trusts more generally – in marriage planning. Upon further inquiry, tolerance for these trusts

may decrease as their role in disrupting economic partnership, diminishing marital transparency, and entrenching gendered forms of wealth inequality becomes increasingly well-defined.

Comment,  
**MONEY LEFT ON THE TABLE: VALUING  
THE SURVIVOR ANNUITY AT DIVORCE**

**I. Introduction**

When employees retire, they have the option to reduce their monthly retired pay by a specified amount so their spouse may receive survivor annuity payments should the employee (the “participant”) spouse dies first. But what happens if, after the participant elects for the survivor annuity, the marriage fails?

The valuation of survivor annuity benefits during a divorce will likely have a considerable effect on a former couple’s marital or community property analysis. Further, if certain family law practitioners fail to address this asset in divorce proceedings they may prevent their client from leveraging hundreds, if not thousands, of dollars of assets when the marital or community property is divided. Take the below hypothetical for example.

Jane and John Doe are getting divorced. Suppose 65-year-old John is retired and, after electing for a survivor annuity benefit, his retired pay is \$2,000 a month. If 55-year-old Jane were to outlive John, she would receive \$1,100 a month for the rest of her life. During the divorce proceedings, Jane insists on retaining her survivor benefits.

All too often, family law practitioners acting as the participant’s attorney in this situation have not done their research and will not know how to move forward leveraging the value of the survivor benefit against the non-participant. Most attorneys would immediately resort to hiring an outside expert—like an actuary, economist, or CPA—to find the present value of that benefit. If their client cannot afford an expert, the value of the survivor annuity may be left on the table and the participant spouse may receive less than his or her fair share of the former couple’s marital or community property. But what if, instead of spending the time and money to hire an expert, attorneys were able to compute the value of the benefit with relative ease. In Jane and John’s case, the calculation would look like this:

According to the National Center for Health Statistics in the United States, a 65-year-old man has a life expectancy of 18.1

years while a 55-year-old women's life expectancy is 29 years.<sup>1</sup> This leaves an 11-year age gap between Jane and John's life expectancies. Jane's benefit from the survivor annuity, separate from the value of her portion of the overall pension benefits, would then be a total of 11 (years) x 12 (months) x \$1,100. This amounts to over \$145,000 for the value of just the series of survivor annuity payments over time. The total would then be discounted to find the present value and, even if that reduced the amount by 50%, it would still leave a present value of over \$72,000. Assuming all of these calculations, John's attorney will be able to leverage that \$72,000 and negotiate for Jane to transfer an equivalent amount of marital property to John to offset this marital asset's value.

This Comment will first discuss survivor annuities as divisible property during divorce, and examine their statutory origins. Part III will offer a step-by-step guide for family law practitioners faced with representing a client in a divorce where a survivor annuity is involved, including how, without the help of an expert, the asset can be valued.

## **II. Survivor Annuities as Divisible Property**

An annuity is a financial tool, used primarily by retirees, that accrues interest on a tax-deferred basis and protects against market and longevity risks.<sup>2</sup> Because annuities offer many benefits, retirees use them to create predictable cash flow for the present, future, and, in the case of a survivor annuity, after their death.<sup>3</sup>

Retirement annuities with some form of a death-benefit or survivor annuity provision allow the participant spouse to designate a beneficiary to receive a fixed amount after the participant's death.<sup>4</sup> With private pension plans, for example, the amount of the survivor annuity is the greater of either all the remaining money or a guaranteed minimum for the rest of the

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<sup>1</sup> Jiaquan Xu, *Mortality in the United States*, NCHS DATA BRIEF, <https://www.cdc.gov/nchs/data/databriefs/db355-h.pdf> (last visited Aug. 15, 2021).

<sup>2</sup> *What Is an Annuity?*, ANNUITY.ORG, <https://www.annuity.org/annuities/> (last visited Aug. 15, 2021).

<sup>3</sup> *Annuity Beneficiaries: Death Benefits & Payout Options*, ANNUITY.ORG, <https://www.annuity.org/annuities/beneficiaries/> (last visited Aug. 20, 2021).

<sup>4</sup> *Id.*

beneficiary's life.<sup>5</sup> The cost of this election is generally funded by a reduction in the monthly amount of the participant's retirement benefits.<sup>6</sup>

Although typical, a shared pension is not necessarily required for a survivor annuity to be in play. One example is with military Survivor Benefit Plans.<sup>7</sup> The military retirement scheme does not officially include a death benefit provision for qualified survivor annuitants.<sup>8</sup> Instead, service members may participate in the Survivor Benefit Plan, which is a separate but closely affiliated program that provides benefits in the form of an inflation-adjusted annuity payable to a designated beneficiary upon the death of the participant.<sup>9</sup> While it is not technically part of a shared pension plan, the benefit is paid for by a reduction in the participant's gross retirement pay.<sup>10</sup>

Like real property, such as the marital home, personal property, and bank accounts, retirement pensions and survivor annuities are capable of valuation and division at divorce.<sup>11</sup> As is the case with all types of assets up for division during divorce proceedings, courts attain the ability to classify survivor annuities as divisible property from different authorities. For pension plans and the benefits associated with those plans, the authority from

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<sup>5</sup> *Id.*

<sup>6</sup> Implicit in federal regulations governing spousal division of federal pensions is the assumption that the former spouse's share of the participant's annuity is calculated after reduction for survivor annuity benefits. 5 C.F.R. §§ 838.103, 838.306; *Johnson v. Johnson*, 627 N.W.2d 359, 364 (Minn. Ct. App. 2001). See also Donald Bell & Avy Graham, *Surviving Spouse's Benefits in Private Pension Plans*, MONTHLY LABOR REV. (Apr. 1984), <https://www.bls.gov/mlr/1984/04/art3full.pdf>.

<sup>7</sup> *Survivor Benefit Plan Overview*, MILITARYPAY.DEFENSE.GOV, <https://militarypay.defense.gov/Benefits/Survivor-Benefit-Program/Overview/> (last visited Sept. 14, 2021).

<sup>8</sup> *Id.*

<sup>9</sup> 10 U.S.C.A. § 1448 (2021).

<sup>10</sup> 10 U.S.C.A. § 1452 (2017).

<sup>11</sup> See *Irwin v. Irwin*, 910 P.2d 342, 347 (N.M. Ct. App. 1995) ("a community interest in a pension plan containing a survivor's benefit provision constitutes a valuable portion of the community assets, and the survivor's benefit provision should be considered in valuing and distributing the community interest in the retirement plan."); Lina Gillien, *Dividing a 401(k) and Other Retirement Accounts in Divorce*, DIVORCE NET <https://www.divorcenet.com/resources/divorce/marital-property-division/is-my-spouse-entitled-my-401k>, (last visited Aug. 20, 2021).

which courts derive their ability to divide the assets differs based on the type of employer.

The Employee Retirement Income Security Act (ERISA) was enacted in 1974 to regulate pension plans and benefits provided by private employers to retirees.<sup>12</sup> ERISA applies to pension plans as well as welfare plans, including medical disability, life insurance, and severance plans.<sup>13</sup>

A decade later, Congress amended ERISA by enacting the Retirement Equity Act of 1984 (REACT) with the intention of providing financial security for widows, widowers, and divorcees.<sup>14</sup> Under REACT, specific types of pensions are required to provide joint and survivor annuity benefits for the participant's spouse or former spouse.<sup>15</sup>

ERISA and REACT together provide that any benefit payable under an ERISA-regulated benefit plan—including survivor annuities—may be divided at divorce.<sup>16</sup> State courts also generally have the power to divide all forms of survivor benefits during divorce proceedings.<sup>17</sup> Because of this statutory support, survivor annuities associated with a private pension plan should be considered divisible assets capable of valuation at divorce.<sup>18</sup>

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<sup>12</sup> Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (codified as amended at 29 U.S.C. §§ 1001-1461 (1978)).

<sup>13</sup> ERISA § 3(2); 29 U.S.C. § 1002(2) (2000) (defining pension plans as arrangements that provide retirement income to employees or result in the deferral of income by employees for periods extending to the termination of covered employment, with some exceptions around severance plan arrangements).

<sup>14</sup> Retirement Equity Act of 1984, Pub. L. No. 98-397, 98 Stat. 1426 (codified in sections of 26 U.S.C. and 29 U.S.C. (1984)).

<sup>15</sup> *Id.*; Susan J. Prather, *Characterization, Valuation, and Distribution of Pensions at Divorce*, 15 J. AM. ACAD. MATRIM. LAW. 443 (1998).

<sup>16</sup> BRETT R. TURNER, *EQUITABLE DISTRIBUTION OF PROPERTY* § 6.44 (2020); *Lauzonis v. Lauzonis*, 105 A.D.3d 1351, 1353, 964 N.Y.S.2d 796, 799 (4th Dep't 2013) (“[i]t is well settled that employment-based death benefits that accrue during the marriage are marital property subject to equitable distribution.”).

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*; *Palladino v. Palladino*, 713 A.2d 676, 679 (Pa. Super. Ct. 1998) (“[t]he survivor annuity is a vested property interest of wife and it is separate and distinct from husband's pension. Just as husband's marital pension benefits are assessed to him, so too are wife's survivor annuity benefits properly assessed to her in the equitable distribution scheme.”).

In addition to ERISA-regulated pension plans for private employers, there are other plans and statutory programs that define the retirement benefits for other types of non-private employers. Examples include the Federal Employee Retirement System (FERS)<sup>19</sup> and the Civil Service Retirement System (CSRS)<sup>20</sup> for employees who worked in federal civil service; Final Pay, High-36, CSB/REDUX, Blended Retirement System, and Military Disability programs for military personnel;<sup>21</sup> the Central Intelligence Agency Retirement Act<sup>22</sup> for employees who worked in the CIA; and the Railroad Retirement Act (RRA)<sup>23</sup> for former rail industry employees. These various retirement programs are derived from statutes that define how the benefits and assets associated with the program will be distributed at retirement. The programs also specify how deferred benefits in that particular plan will be recognized as community property during divorce.

Even with this support, however, few attorneys consider or are even aware of these assets during divorce. Moreover, if neither spouse says anything about the survivor annuity during divorce proceedings, the value may be completely lost at divorce if the law does not allow the automatic retention of this asset by the former spouse.<sup>24</sup> Because of the extreme potential for loss in this situation, family law practitioners must be aware of and consider these assets when representing clients in divorce proceedings to avoid leaving money on the table.

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<sup>19</sup> Federal Employees' Retirement System Act of 1986, 99 Pub. L. No. 335, 100 Stat. 514 (1986) (codified as amended at 5 U.S.C.A. §§ 8331-8351 (2020)).

<sup>20</sup> Postal Civil Service Retirement System Funding Reform Act of 2003, 108 Pub. L. No. 18, 117 Stat. 624 (2003) (codified as amended at 5 U.S.C. §§ 101-8348).

<sup>21</sup> *Retired Pay*, MILITARYPAY.DEFENSE.GOV, <https://militarypay.defense.gov/Pay/Retirement/> (last visited Aug. 20, 2021).

<sup>22</sup> Central Intelligence Agency Act, 88 Pub. L. No. 643, 78 Stat. 1043 (1964) (codified as amended at 50 U.S.C.A. § 2012 (1992)).

<sup>23</sup> Railroad Retirement Act, 73 Pub. L. No. 485, 48 Stat. 1283 (1934) (codified as amended at 45 U.S.C. § 231).

<sup>24</sup> See *In re Marriage of Hayes*, 208 P.3d 1046, 1053 (Or. Ct. App. 2009) ("to the extent that the [domestic relations order] awarded wife benefits that were not part of the original property division, it erred."); ANNE E. MOSS, *YOUR PENSION RIGHTS AT DIVORCE: WHAT WOMEN NEED TO KNOW* (3d ed. 2006).

### III. Steps for the Family Law Practitioner

For an attorney representing a client in divorce proceedings, there are several steps that should be taken to ensure effective representation of the client's interest, as well as to avoid malpractice. Those steps are illustrated below.

#### A. *Research the Specific Annuity*

The first step in deciding how to address the survivor annuity during divorce proceedings is to research the specific type of annuity at issue and read up on that program. For private plans under ERISA, practitioners should first read the Summary Plan Description (SPD) associated with the specific pension plan in question.<sup>25</sup> The SPD gives a generic description of the retirement plan, its benefits, and how the assets may be allocated upon divorce or plan termination.<sup>26</sup>

The next type of literature the attorney should become familiar with is the participant's Annual Benefit Statement (ABS). The ABS is different from the SPD because, instead of explaining the benefits the plan gives to all individuals associated with that employer, this statement is unique to the participant and gives specifics that will be helpful to the practitioner.<sup>27</sup>

With public plans or programs not governed by ERISA, neither an SPD nor a ABS will be readily available to the attorney. Instead, a family law practitioner dealing with this type of plan or program should start by reading the primary sources, like the underlying statutes setting forth the retirement plan in general. Attorneys should then look to secondary sources, like materials available online or rules published by relevant governing bodies, and tertiary sources, including any type of pamphlet or guide issued by an associated organization.

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<sup>25</sup> *401(k) Resource Guide-Plan Participants-Summary Plan Description*, IRS.GOV, <https://www.irs.gov/retirement-plans/plan-participant-employee/401k-resource-guide-plan-participants-summary-plan-description> (last visited Aug. 20, 2021).

<sup>26</sup> *Id.*

<sup>27</sup> *Pension Benefit Statements - Lifetime Income Illustrations*, DOL.GOV, <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/pension-benefit-statements-lifetime-income-illustrations> (last visited Aug. 20, 2021).

After the attorney has read up on the relevant documents, he or she should be able to determine what applicable deadlines are in play with the client's type of survivor benefit plan. Depending on the type of plan in which the individual is enrolled, there are likely specific rules about when and how the allocation of a survivor annuitant can be made.<sup>28</sup>

Another important fact for a family law practitioner to discover while researching the specific plan involved in the client's divorce proceeding is the impact divorce has on the survivor annuitant election. Survivor benefits under a FERS or CSRS retirement program, for example, are no longer payable to the non-participant if the divorce happens after retirement.<sup>29</sup>

Other questions that should be considered by attorneys during this research phase are: What actions terminate an annuitant's right to the annuity?;<sup>30</sup> Would the allocation of a survivor annuity beneficiary survive a divorce?;<sup>31</sup> What rights would a new spouse have with regard to the annuitant election if the election of the former-spouse still exists?

After family law practitioners understand their client's rights, they will be able to go into divorce discussions prioritizing

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<sup>28</sup> Orders altering survivor benefits under FERS or CSRS, as an example, may only be done in very specific situations. Any court order that awards, increases, reduces, or eliminates a former spouse survivor annuity, or explains, interprets, or clarifies any such order, must be issued prior to: (1) retirement or death of an employee; *or* (2) the first order dividing the marital property of a retiree and former spouse. 5 C.F.R. § 838.806 (2014). *See generally* Marshal S. Willick, *Retirement Benefits for Legal Professionals: A Very Brief Primer* (2015), <https://www.willicklawgroup.com/wp-content/uploads/2016/10/NALS-Retirement-Benefits-10-9-15-00096547x7A582.pdf>.

<sup>29</sup> *What Happens to Your Federal Employee Benefits in Divorce?*, FEDWEEK.COM, <https://www.fedweek.com/reports/divorce-and-federal-employee-benefits/> (last visited Aug. 21, 2021).

<sup>30</sup> Under the Central Intelligence Agency Retirement Act, for example, a former spouse will no longer be entitled to the survivor annuity payments if he or she remarries before age 55, but the entitlement of the former spouse to such a survivor annuity will be restored on the date such remarriage is dissolved by death, annulment, or divorce. 50 U.S.C.S. § 2034(c)(2).

<sup>31</sup> If a participant is already retired and receiving a reduced pension to provide for a survivor benefit for their former spouse under CSRS, the reduction will automatically be eliminated at divorce unless the parties obtain a court order that says a survivor annuity for the participant's former spouse must continue. 66 P.L. 215, 41 Stat. 614, 66 Cong. Ch. 195 (1920).

what outcomes with regard to the survivor annuitant election will be in the best interest of their client.

*B. Register the Decision*

Once the decision is made about who will be the survivor annuity beneficiary, and when the designation must be made, the next step is to determine who needs to know about the decision.

First, the practitioner must find out what entity is in charge of administering the survivor annuity for their specific plan. For example, with retirement plans under the RRA, the Railroad Retirement Board is the entity that accepts applications for and administers benefits to participant and non-participant spouses claiming benefits under its plan.<sup>32</sup>

Next, the attorney must find out what procedures must be followed when notifying that particular entity, which will be different depending upon the type of plan or program. Ordinarily, the procedure would require the participant spouse to obtain a court order specifying whether or not the former-spouse is the survivor annuitant. After a court order is obtained, the order should then be transmitted to the Office of Personnel Management when a public plan is involved is involved<sup>33</sup>; filed with the federal or state government program administrator for private plans; or registered with the Defense Finance and Accounting Services for military programs.<sup>34</sup>

Whether or not the asset will be valued at divorce will depend upon who is left as the designated survivor annuitant after the decision is registered with the proper entity. If the participant spouse is permitted to exclude his or her now ex-spouse from the survivor benefit plan, there would be no need to value that asset as community or marital property at divorce because it would belong exclusively to the participant spouse as separate property. If, however, the allocation is made for the now ex-spouse at the

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<sup>32</sup> *Spouse/Divorced Spouse Annuity*, RRB.GOV, <https://rrb.gov/sites/default/files/2017-05/rb30%5B1%5D.pdf> (last visited Aug. 19, 2021).

<sup>33</sup> *Court-Ordered Benefits for Former Spouses*, OPM.GOV, <https://www.opm.gov/retirement-services/publications-forms/pamphlets/ri84-1.pdf> (last visited Sept. 14, 2021).

<sup>34</sup> *Updating Your SBP Beneficiary Designations*, DFAS.MIL, <https://www.dfas.mil/RetiredMilitary/provide/sbp/maintain/> (last visited Sept. 14, 2021).

time of divorce, family law practitioners should move on to the next step to determine how the asset should be valued during divorce proceedings.

### C. *Value the Asset*

An employer cannot justify the cost of a survivor annuity unless someone is paying for it. Typically, this benefit is paid for by a reduction of the overall retirement annuity.<sup>35</sup> Divorcing parties must decide which spouse will have a responsibility to pay for the cost of this reduction in the annuity at divorce. Depending on which party a family law practitioner represents, the key to effective representation in this situation varies.

If the attorney is representing the non-participant spouse, silence is golden.<sup>36</sup> If neither spouse brings up paying the cost of the survivor annuity during divorce proceedings, the divorce decree may terminate the possibly of the participant spouse later demanding the non-participant give up his or her rights to the benefit.<sup>37</sup> Therefore, unless the participant spouse brings up pay-

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<sup>35</sup> *Johnson*, 627 N.W.2d at 364 (“the former spouse’s share of the pensioner’s annuity is calculated after reduction for survivor annuity benefits.”).

<sup>36</sup> Mark Sullivan, *Defending Against SBP in Divorce*, THE SILENT PARTNER (2020), <https://www.nclamp.gov/publications/silent-partners/defending-against-sbp-in-divorce/>.

<sup>37</sup> *Id.*; *Wallace v. Wallace*, No. 2 CA- CV 2006-0215, 2007 Ariz. App. Unpub. LEXIS 1121 (Ariz. Ct. App. Apr. 19, 2007) (holding that, since the participant spouse’s military Survivor Benefit Plan was not discussed during divorce proceedings, they could not evaluate the effect of later ordering the non-participant spouse to receive the benefit, or what effect valuing that asset would have had on the overall division of property.); *Creech v. Creech*, No. 2008-CA-000592-MR, 2010 WL 743748 (Ken. Ct. App. Mar. 5, 2010) (after a separation agreement was filed with the court, the non-participant spouse filed a motion to receive the survivor benefits and the judge denied her motion. The appellate court upheld the lower court’s order, stating that any interest the non-participant spouse had in the participant’s retirement benefits was “waived in a separation agreement so long as that agreement was not unconscionable.”); *Kazel v. Kazel*, 819 N.E.2d 1036, 1038 (N.Y. Ct. App. 2004) (the failure of the original divorce decree to award survivor benefits to a former spouse meant that the non-participant could not obtain any such death benefit after the participant’s death); *But see Gexler v. Roberts*, 94 N.E.3d 437 (Mass. App. Ct. 2017) (approving the division of the former husband’s pension 14 years after the divorce was finalized because the court found that the division of the pension was neither contemplated during negotiations, nor litigated before the court at the time of the divorce).

ing for the benefit first, it is best for the non-participant to stay silent.

If the attorney is representing the participant spouse, on the other hand, there are three options of how to proceed with valuing the cost of the survivor annuity:

1. *Do Nothing*

In some situations, it may be beneficial to the client if the attorney representing the participant spouse does not insist that the survivor annuity be valued at all. This may be because the participant would like to use the designation of the non-participant as the survivor annuitant as a bargaining chip for a different asset, or for a variety of other valid reasons.

All too often, however, the attorney representing the participant spouse does nothing with the value of the survivor annuity because the attorney has not researched the specific annuity in that case. If the attorney has not done the research as laid out in this Comment above, the attorney is likely to end up in a situation where he or she cannot make a decision at all about the cost of the survivor annuity. This could lead to ineffective representation, and, in some cases, malpractice.<sup>38</sup>

2. *Allocate the Cost*

When the attorney has done ample research with regard to assigning a cost to the survivor annuity at divorce, the attorney will likely realize that the most reasonable approach to this issue would be to allocate the cost of the survivor annuity. This approach involves a shift in the amount of pension percentage each party would receive while the participant spouse is still alive. The guiding principle of this approach is fairness because the existence of the survivor annuity is 100% for the benefit of the non-participant spouse, so the non-participant should theoretically have no responsibility to pay for the reduction in pension amount received by the participant.

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<sup>38</sup> See *Callahan v. Clark*, 901 S.W.2d 842, 848 (Ark. 1995) (affirming a \$120,000 jury award to the client for her attorney's negligent failure to value marital assets); *McCoy v. Fineman*, 785 N.E.2d 714, 721 (N.Y. 2002) (holding that "because [counsel] was negligent in failing to assert plaintiff's claim to preretirement death benefits in the settlement stipulation or judgment, we conclude that plaintiff suffered actionable injury on the day of the stipulation.").

In a situation where the parties to a divorce agree to allocate the cost of the survivor annuity by a reduction in pension payments, the attorneys should make sure they are aware of the procedural steps that should be taken to register this decision. Depending on the type of plan, the decision to change the percentage of pension payments may need to be registered with the entity in charge of allocating the pension at a specific time—like at the time of divorce, or the time of retirement.<sup>39</sup> If an attorney misses one of these deadlines, the attorney could lose the opportunity to carry out the client's decision and, therefore, again be on the hook for malpractice.<sup>40</sup>

### 3. *Value the Entire Asset*

There may be situations where allocating the cost of the asset is not the best option for the participant spouse. He or she might have some reason to demand the entire present value of the survivor annuity from the non-participant spouse. The reasons for this type of decision vary, but it often occurs when the participant spouse would like the ability to allocate a future spouse as the beneficiary of the survivor annuity and wants the non-participant to be as uninvolved in the pension plan as possible. The guiding principle of this approach is, although the asset has value at the time of divorce, the benefit is only realized once the participant spouse dies, so the participant spouse should not have to pay for any portion of it.

If the participant spouse can afford to do so, the attorney could hire an expert to find the present value of the asset. Often, however, hiring an expert may be too expensive and time consuming. In these situations, attorneys can compute a value on their own to get the conversation started with opposing counsel.

There are specific methodologies that may be laid out in statutes or cases in certain jurisdictions which would tell the prac-

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<sup>39</sup> For retirement plans under the Railroad Retirement Act, as an example, pension payments will not be divided between former spouses until a court decree or property settlement is delivered directly to the General Counsel of the Railroad Retirement Board. 20 C.F.R. § 295.3(d).

<sup>40</sup> See *Ziegelheim v. Appollo*, 607 A.2d 1298, 1306 (N.J. 1992) (stating that an attorney's negligent delay in finalizing a settlement agreement may constitute malpractice).

titioner exactly how valuing this asset should be done.<sup>41</sup> If such precedent does not exist in a jurisdiction, however, the steps below can be followed to come up with a present value of the asset:

1. Determine the life expectancies of the participant and the spouse. This information can be found through the National Center for Human Statistics on the Center for Disease Control's website.<sup>42</sup>
2. Assume that the participant dies first; there is no survivor annuity if the participant outlives the spouse/ex-spouse. The survivor annuity will usually last from the death of the participant until the death of the non-participant.
3. Multiply the number of months of payments the non-participant is expected to receive from the death of the participant until the expected death, according to actuarial tables, of the non-participant over time by the amount of payment. The result of this calculation is gross value, or "sum of the payments."
4. The "sum of the payments" is then discounted to find its present value.<sup>43</sup> This discounted rate reflects the concept that if the individual had in hand the present value of the annuity, he or she would be able to invest it and, at that discount rate, earn enough passive income to yield the total gross amount or sum of the payments by the end of the term involved.

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<sup>41</sup> In Pennsylvania, as an example, the Superior Court has found that in post-retirement cases involving an ERISA pension where a joint and survivor option was chosen at retirement, the survivor benefit is a marital asset to be valued using the same present value methodology used in valuing a pension. *Palladino*, 713 A.2d at 679.

<sup>42</sup> National Center for Health Statistics, CDC.GOV, <https://www.cdc.gov/nchs/index.htm> (last visited Aug. 15, 2021).

<sup>43</sup> Present values may be calculated by state statutory tables, online present value calculators, or online present value tables. *See, e.g.*, N.C. GEN. STAT. § 8-47 (present worth of annuities); *Present Value Pension Calculator*, <https://valueyourpension.com/> (last visited Sept. 15, 2021); *Annuity Table for an Ordinary Annuity*, ANNUITY.ORG, <https://www.annuity.org/annuities/rates/table/> (last visited Sept. 15, 2021).

Parties can argue about whether the tables are current and up to date, whether the unisex value should be used,<sup>44</sup> whether any consideration should be given for disabilities,<sup>45</sup> whether the tables are accurate, and which tables are better for one side or the other.<sup>46</sup> These are advocacy issues to be addressed on a case-by-case basis. However, coming up with a simple value takes only a few minutes and can start the discussion about whether or not, at that point, the non-participant spouse would still like to demand the survivor annuity.

The disadvantage of this approach is often the sticker shock associated with the value of the entire asset. If this overall present value is higher than most other assets in that particular divorce, the remaining settlement may not be able to move forward. This would mean the participant would be forced to back down, or the case would be moved to trial. The participant spouse's attorney should discuss with the client about whether this is an outcome the client would favor.

#### D. *Enlist Competent Help*

The final step a family law practitioner should take when addressing the survivor annuity at divorce would be to make sure that they have competent help. Attorneys do not have to go it alone when deciding how to leverage this asset for clients.<sup>47</sup> In fact, the American Bar Association's Model Rules of Professional Conduct states that competent representation includes connecting with an attorney of established competence in the field for assistance if a lawyer is unsure of how to handle an issue.<sup>48</sup>

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<sup>44</sup> Richard A. Booth, *The Economic Case for Gender-Neutral Life Insurance*, 13 CONN. INS. L.J. 267 (2007).

<sup>45</sup> Eliza Grace Lynch, *A Change in Military Pension Division: The End of Court-Adjudicated Indemnification – Howell v. Howell*, 44 MITCHELL HAMLINE L. REV. 1064 (2018).

<sup>46</sup> Michael A. Stoller, *Estimating the Present Value of Pensions: Why Different Estimators Get Varying Results*, 2 J. LEGAL ECON. 49 (Dec. 1992).

<sup>47</sup> There are many companies that specialize in pension and retirement benefit valuations. JurisPro's Expert Witness Directory, as an example, has an Actuarial Expert Witness database that allows practitioners to find a valuation expert in their jurisdiction. JURISPRO.COM, <https://www.jurispro.com/category/actuary-actuarial-s-563> (last visited Sept. 17, 2021).

<sup>48</sup> MODEL RULES OF PROF'L CONDUCT r. 1.1[2] (2020).

#### **IV. Conclusion**

The takeaway from this Comment should be that the survivor annuity is a hidden asset within the grasp of the family law practitioner. Taking fifteen to twenty minutes to estimate the monthly payment due to the client or opposing party, projecting the interest rate, and considering the differential between the life of the participant and that of the former spouse can yield a quick and reasonable estimate to discuss with opposing counsel.

Although at times it may seem simpler to hire a financial expert, their services may cost thousands of dollars. If settlement discussions become more complex, of course, hiring an expert may be necessary. But, if practitioners first attempt this calculation to value the asset themselves, they will find a less expensive way to address the asset in divorce proceedings before spending too much of the client's money and avoid leaving any money on the table.

Katherine Bourk

Comment,  
THE CHANGING LANDSCAPE OF  
SPOUSAL SUPPORT

**I. Historical Background**

The concept of spousal support has its roots in the English common law system. When people married, the husband would be given control over all of the wife's property and assets that she owned prior to the marriage.<sup>1</sup> Further, the wife would also have to transfer "to her husband her ability to hold real property, sign contracts, and keep any earnings."<sup>2</sup> In exchange for the property rights from a wife, the husband had the duty to financially support her.<sup>3</sup> The duty of a husband to support his wife existed regardless of the wealth with which the wife may have come into the marriage.<sup>4</sup> This created an issue of property ownership when the couple wanted to separate, because the husband retained the property rights to not only the marital property, but also the property that the wife brought into it. The wife therefore needed to be given support in order to survive. During this time, there were two ways in which a married couple could separate.<sup>5</sup> The first, an absolute divorce, was more common among wealthy couples and was the only option to break the marital bond created.<sup>6</sup> The second, known as "divorce from bed and board," was comparable to a current day legal separation.<sup>7</sup> This allowed the couple to live apart from one another, but did not actually sever the marital bond.<sup>8</sup> Due to the marital tie still remaining, the duty of a husband to support his wife did not end with the separation.<sup>9</sup>

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<sup>1</sup> Robert Kirkman Collins, *The Theory of Marital Residuals: Applying an Income Adjustment Calculus to the Enigma of Alimony*, 24 HARV. WOMEN'S L.J. 23, 36 (2001).

<sup>2</sup> Laura Lenzotti Kapalla, Comment, *Some Assembly Required: Why States Should Not Adopt the ALI's System of Presumptive Alimony Awards in Its Current Form*, 2004 MICH. ST. L. REV. 207, 211.

<sup>3</sup> Collins, *supra* note 1, at 29.

<sup>4</sup> Kapalla, *supra* note 2, 211-12.

<sup>5</sup> Collins, *supra* note 1, at 28.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> Kapalla, *supra* note 2.

After bed and board separation, the husband would promise to continue paying for the wife's expenses, giving rise to the concept of spousal support.<sup>10</sup>

Later, the Married Women's Property Acts were passed which allowed for women to keep property after a separation rather than the husband retaining control.<sup>11</sup> This meant that the wife was able to get control over her assets again, which undermined the original rationale behind spousal maintenance. During this time, part of the reasoning behind spousal support appeared to be based on a breach of the marital contract because fault became a determining factor in awarding support. Payment of spousal support resembled a punishment for those who had committed some wrongdoing during their marriage, since it was only awarded to the injured spouse of the relationship.<sup>12</sup>

Beginning in the 1970's the distribution of property between husband and wife at divorce began to change. Equitable distribution became more popular in the courts. It allowed for the spouses to share property at the time of divorce regardless of who held title to it.<sup>13</sup> Additionally, around this same time women started entering the workforce in great numbers.<sup>14</sup> The women who were typically thought to be completely dependent on their husbands were now able to make their own income and support themselves.<sup>15</sup> This was another reminder that the original rationale behind the granting of spousal support was no longer valid.

The 1970's also saw another significant change in divorce law. California passed the first "no-fault" divorce law that allowed a spouse to obtain a divorce without having to allege the misconduct of the other spouse. Most states passed similar laws opting for the no-fault divorce model. This made the rationale that spousal support was used as a compensatory means for

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<sup>10</sup> Larry R. Spain, *The Elimination of Marital Fault in Awarding Spousal Support: The Minnesota Experience*, 28 WM. MITCHELL L. REV. 861, 866 (2001).

<sup>11</sup> June Carbone, *The Futility of Coherence: The ALI's Principles of the Law of Family Dissolution, Compensatory Spousal Payments*, 4 J.L. & FAM. STUD. 43, 49 (2002).

<sup>12</sup> Barbara Bennett Woodhouse, *Sex and Dissipation: The Discourse of Fault in a No-Fault Era*, 82 GEO. L.J. 2525, 2536 (1994).

<sup>13</sup> *Id.*

<sup>14</sup> Jane Rutherford, *Duty in Divorce: Shared Income as a Path to Equality*, 58 FORDHAM L. REV. 539, 549 (1990).

<sup>15</sup> *Id.*

wrongdoing in a marriage inapplicable. Even though the original rationales behind the idea of making one spouse pay spousal support disappeared, courts continued to grant it in many cases, looking for additional rationales.

## II. Purposes of Spousal Maintenance Across the Country

Nationally, there are a variety of models of spousal support, and they differ in their purposes. Because divorce and spousal support is a matter of individual state law there is no universal model of alimony. After parties' divorce, they become subject to what is known as the "Divorce Gap."<sup>16</sup> The divorce gap is the concept that explains that after a divorce, women tend to see about a 20% drop in their income, while men see a rise in their income of about 30%.<sup>17</sup> This discrepancy may be explained by women either stopping work while they raise their children during the marriage, or stopping work post-divorce in order to raise the children.<sup>18</sup> This leads to a conflict with the amount of income they are receiving and their ability to support themselves, putting them in a position to need help from their former spouse to stay afloat.<sup>19</sup> The payment of spousal support is used to help bridge this gap. The most common types of alimony are referred to as permanent alimony, reimbursement alimony, compensatory alimony, and rehabilitative support.

Permanent alimony was the earliest form of support that was granted.<sup>20</sup> This is more often than not used to support a spouse who was a fulltime homemaker in a long-term marriage.<sup>21</sup> The

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<sup>16</sup> Darlena Cunah, *The Divorce Gap*, ATLANTIC (Sept. 20, 2021) <https://www.theatlantic.com/business/archive/2016/04/the-divorce-gap/480333>.

<sup>17</sup> Julia Travers, *It's All About the Divorce Gap: Ending Isolation for Divorcing Women*, PHILANTHOPY WOMEN (Sept. 22, 2019), <https://philanthropywomen.org/feminist-funding/its-all-about-the-divorce-gap-ending-isolation-for-divorcing-women/>.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> Twila B. Larkin, *Guidelines for Alimony: The New Mexico Experiment*, 38 FAM. L.Q. 29 (2004).

<sup>21</sup> Tonya L. Brito, *Spousal Support Takes on the Mommy Track: Why the ALI Proposal Is Good for Working Mothers*, 8 DUKE J. GENDER L. & POL'Y 151, 153 (2001).

amount awarded under permanent alimony was based on “the needs of the receiving spouse and the ability of the paying spouse to pay.”<sup>22</sup> This form of alimony was generally awarded until the spouse receiving the support was either remarried or died.<sup>23</sup> Permanent alimony was often the only way that the divorced wife would be able to stay afloat when the marriage ended, there were children, and she did not possess skills necessary to support herself because of her commitment to homemaking.<sup>24</sup> While it was a safety measure for the payees, the men who were paying the support resisted.<sup>25</sup> If they wished to remarry, it meant that they would still have to support their previous spouse while also trying to support their new spouse.<sup>26</sup> With the rise of no-fault divorces, permanent alimony is much less common due to the financial difficulty it imposes on the paying spouse who is trying to exit the marriage completely.<sup>27</sup>

Reimbursement alimony was based on the idea that one spouse would invest in the other spouse because it would help that spouse’s career and advance their marriage in the long-term.<sup>28</sup> When a divorce interferes with the spouse’s ability to later enjoy the return on the investment, the investing spouse is awarded spousal support in place of the benefit that spouse would have received from the advancement of the other spouse’s career.

Compensatory alimony is a newer model than the others and is based on compensation rather than the need of the spouse.<sup>29</sup> This theory of alimony is based on the idea that one spouse will work outside of the marital home and the other will

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<sup>22</sup> Kelly L. DeGance, Note, “*Savings Alimony*”: *The Struggle for Fairness in Permanent Alimony Awards*, 2 FLA. COASTAL L.J. 317, 318 (2001).

<sup>23</sup> Larkin, *supra* note 20, at 34-35.

<sup>24</sup> Jennifer L. McCoy, *Spousal Support Disorder: An Overview of Problems in Current Alimony Law*, 33 FLA. ST. U.L. REV. 502, 507 (2005).

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> Carolyn J. Frantz & Hanoch Dagan, *Properties of Marriage*, 104 COLUM. L. REV. 75, 99 (2004).

<sup>28</sup> Michelle Murray, *Alimony as an Equalizing Force in Divorce*, 11 J. CONTEMP. LEGAL ISSUES 313, 318 (2000).

<sup>29</sup> See Christopher D. Nelson, Note, *Toward a Compensatory Model of Alimony in Alaska*, 12 ALASKA L. REV. 101, 120-21 (1995).

work inside the marital home.<sup>30</sup> Compensatory alimony works to account for the fact that the spouse who worked outside of the home is at a market advantage as compared to the spouse who worked inside the home.<sup>31</sup> The courts look to the standard of living that the couple shared, rather than the contribution that each spouse made individually.<sup>32</sup> They use this as a starting point to determine the amount that should be awarded with the idea that each spouse should be granted the opportunity to continue living as if the marriage has not ended.<sup>33</sup>

Rehabilitative support is the most commonly used at the current time.<sup>34</sup> Unlike the other theories for alimony, rehabilitative alimony is not used to compensate the receiving spouse.<sup>35</sup> Instead, it is used to give the spouse the means to obtain some sort of training or education so that he or she can be self-sufficient moving forward.<sup>36</sup> When requesting rehabilitative alimony, the receiving spouse must show a goal of self-sufficiency, have a plan in place to reach that goal, and have calculated what would be necessary to achieve it.<sup>37</sup>

### III. Recent Reforms in Spousal Maintenance

When it comes to the way that spousal support is awarded, it is often inconsistent and unpredictable. Every state has its own set of guidelines that its courts consider in awarding support. Common issues that arise include the duration of the spousal support, the effect of retirement and the formulas that should be used to determine the amount. Over the last several years, there have been substantial reform efforts to try to determine the most effective and predictable method of awarding spousal support. These are discussed below.

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<sup>30</sup> *Id.* at 45.

<sup>31</sup> *Id.* at 120.

<sup>32</sup> Frantz & Dagan, *supra* note 27, at 120.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 119.

<sup>35</sup> *Id.* at 122.

<sup>36</sup> *Id.*

<sup>37</sup> Victoria M. Ho & Jennifer L. Johnson, *Overview of Florida Alimony*, FLA. B.J., Oct. 2004, at 71.

### A. Duration of Support

Many states have taken the approach of attempting to put a durational limit on spousal support. In 2015 Florida attempted to eliminate the concept of permanent alimony. House Bill 943 gave a calculation for alimony that was based on the length of the marriage.<sup>38</sup> This bill established a range for marriages that lasted less than 20 years and a range for marriages that lasted 20 years or longer.<sup>39</sup> The paying spouse in a marriage that lasted less than 20 years would use the formula of “.015 x X x years of marriage,” where X would indicate the difference in the monthly gross incomes of the parties.<sup>40</sup> A paying spouse that was married for 20 years or longer would use the formula of “.020 x X x years of marriage,” with X still representing the difference in the gross incomes of the parties.<sup>41</sup> The proposed Florida bill, was designed to take into consideration the income of the parties, with the lower end being “.25 x X x years of marriage and the high end changing to .75 x X x years of marriage.”<sup>42</sup> Along with the new calculation, this bill also stated that child support payments and alimony combined could not exceed 55% of the paying spouse’s income.<sup>43</sup> On multiple occasions, the proposed legislation died or was vetoed.<sup>44</sup>

In 2010 Florida legislators reformed the law to add an additional type of alimony, referred to as “durational alimony.”<sup>45</sup> This type of support allows for alimony to be awarded on a non-permanent basis and exists for a set period of time for a short or moderate duration marriage. The statute refers to the duration of a marriage by the terms “short term,” “moderate term,” and “long-term.”<sup>46</sup> Short term is used for marriages of less than seven years, moderate is between seven and seventeen years, and long

<sup>38</sup> S. Comm. 943, 2015 Leg., Reg. Sess. (Fla. 2015), <http://www.flsenate.gov/session/Bill/2015/0943>.

<sup>39</sup> Laura W. Morgan, *A Nationwide Review of Alimony Legislation, 2007-2016*, 51 *FAM. L.Q.* 39, , 43 (2017).

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> S. Comm. 668, 2016 Leg., Reg. Sess (Fla. 2015), <http://flsenate.gov/Session/Bill/2016/0668>

<sup>45</sup> FLA. STAT. ANN. § 61.08(1)(2016).

<sup>46</sup> See Morgan, *supra* note 39, at 44.

term is more than seventeen years.<sup>47</sup> In addition, alimony payments are no longer appropriate for short term marriages unless special circumstances exist.<sup>48</sup>

In 2011, Massachusetts also worked to create a durational cap for alimony payments. This statute provided that alimony could not be awarded for a period of time that was greater than 50% of the length of the marriage, if the marriage was five years or less.<sup>49</sup> The statute also mandated those payments could not be awarded for a period longer than 60% if the marriage was ten years or less but more than five, 70% if between ten and fifteen years, and 80% if the marriage was fifteen to twenty years long.<sup>50</sup> This permitted Massachusetts courts to award alimony payments for an “indefinite length of time”<sup>51</sup> for marriages that lasted longer than twenty years.<sup>52</sup>

New Jersey followed suit in 2014 when it amended its alimony statute and took duration into account. This amendment included the limitation that for marriages that lasted less than twenty years alimony would not be awarded for longer than the length of the marriage unless exceptional circumstances existed.<sup>53</sup> Under the statute, exceptional circumstances for this purpose include: (1) The ages of the parties at the time of the marriage and at the time of the award, (2) Duration and degree of dependency, (3) Chronic illness or health condition, (4) Whether one spouse has given up a career or opportunity to support the other, and (5) Share of equitable distribution, among a few others.<sup>54</sup>

Even with this variety of methods these states have used in order to create a durational cap for the payor’s obligation, there is still much unpredictability when it comes to awarding spousal support. Other states have attempted to focus their reforms on methods such as guidelines to calculate the amount that may be awarded, in an attempt to increase predictability.

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<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> FLA. STAT. ANN. § 61.08(4) (2019).

<sup>50</sup> *See Morgan, supra* note 39, at 46.

<sup>51</sup> *Id.*

<sup>52</sup> MASS. GEN. LAWS ch. 208, §§ 48-55 (2012) (codifying the Alimony Reform Act of 2011).

<sup>53</sup> N.J. STAT. ANN. § 2A:34-23(c) (2020).

<sup>54</sup> *Id.*

### B. Amount Awarded

Colorado put a statutory cap on the amount of support that could be awarded by issuing suggested, not mandatory, guidelines in 2013. “The guideline amount is determined by taking 40% of the higher earning party’s monthly adjusted gross income minus 50% of the lower earning party’s monthly adjusted gross income.”<sup>55</sup> The guidelines also put a cap on the amount that can be awarded.<sup>56</sup> This amount should not be more than 40% of the combined monthly gross income of the parties, and if it does it must be reduced to fit into the cap restrictions.<sup>57</sup>

In 2021, Colorado is considering changes to the statute yet again to take into account the new tax change of 2019. The amended statute adds the following provisions: (1) if maintenance is not deductible for income tax of the payor and not taxable to the payee, the amount for parties with a “combined monthly adjusted gross income of ten thousand dollars or less is equal to eighty percent of the amount calculated, and (2) if maintenance is not deductible for income tax of the payor and not taxable to the payee, and the combined gross income of the parties is more than ten thousand but less than twenty thousand, then the awarded amount is equal to seventy five percent of the amount calculated.<sup>58</sup> While this change has not yet been considered final, it illustrates the efforts that states will begin making to offset the tax change that was implemented. By including percentages of the calculated amounts for spousal support obligations, it allows allowing for the additional amount to make up for the tax deductions that would have been given to the payor. It is vital for states to recognize the additional burden the tax change will be putting on those that have an obligation to pay spousal support and to try to help ease the damage this may do moving forward.

Along with the durational limits, Massachusetts attempted to give some predictability to the amount that was awarded. The guidelines mandated that alimony may not exceed the payee’s “needs,” which the guidelines determined to be 30% or 35% of

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<sup>55</sup> *Id.*

<sup>56</sup> *See Morgan, supra* note 39, at 43.

<sup>57</sup> *Id.*

<sup>58</sup> COLO. REV. STAT. § 14-10-114 (2019).

the difference in the gross income of the spouses at the time of their divorce.<sup>59</sup> The committee used the “1/3-1/3-1/3 formula” which is: “alimony payments should be one-third of the total gross income of the payor, plus the recipient spouse’s gross income, minus the recipient spouse’s gross income.”<sup>60</sup>

### C. Retirement Considerations

Throughout alimony reform efforts, states have begun to take retirement into consideration for payors and what that should mean for their obligation to continue paying their spouses. In 2014, New Jersey amended its alimony statute to include a presumption that alimony payments should end at the time of retirement.<sup>61</sup> Under the amendment, payors may look to terminate or modify their obligation to pay spousal support at the onset of actual or “prospective” retirement.<sup>62</sup> This allows the paying spouse to either terminate or modify their support obligation in two situations, either when the payor has actually retired, or when the payor is intending to retire but has not actually done so.<sup>63</sup> The statute does not define the term “prospective” which leaves open the question of how far in advance people can file to modify or terminate their obligation based on retirement.<sup>64</sup> The state has seen this issue come to light and has tried to clarify what “prospective” means for those who want to file. In *Mueller v. Mueller*,<sup>65</sup> the court held that five years prior to an anticipated retirement was too far out to file for a modification or termination of the alimony obligation.<sup>66</sup> The court noted, “the parties’ economic situations, health, and other relevant factors could radically change over such a lengthy period of time, before an actual retirement ever actually takes place.”<sup>67</sup>

<sup>59</sup> MASS. GEN. LAWS ch. 208, §§ 48-55 (2012) (Codifying the Alimony Reform Act of 2011).

<sup>60</sup> See Linda Fidnick, Presentation at the MCLE Family Law Conference, Boston, Massachusetts (Mar. 14, 2008); see also James McCaskey, *Parsing Alimony: Deciphering the 1/3, 1/3, 1/3 Metric*, 5 FAM. MEDIATION Q. 6 (2006).

<sup>61</sup> NEV. REV. STAT. § 125.150(9)(a)-(k).

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> See Morgan, *supra* note 39, at 48.

<sup>65</sup> 144 A.3d 916 (N.J. 2016)

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* at 922.

#### **IV. Effect of the 2019 Tax change**

Prior to January 1, 2019, spousal maintenance was considered taxable income for the spouse that was receiving the payments.<sup>68</sup> Additionally, payors were able to claim the payments as an itemized deduction on their taxes.<sup>69</sup>

After January 1, 2019, things changed for both the payor and payee of spousal maintenance. Alimony and maintenance payments are no longer deductible from the income of the payor and will not be included in the income of the payee if the terms are included in a divorce or separation agreement that was executed after December 31, 2018.<sup>70</sup> Divorce or separation agreements that are modified after this date, as well as those executed after this date, are also affected by this change. There is a caveat for the modification, however, which is that the modification must specifically state that the Tax Cuts and Jobs Act alimony treatments applies.<sup>71</sup>

This new change will continue to have a dramatic effect on people who have to pay their spouse alimony and will likely lead to a shift in the fight over alimony. Because payors are no longer able to deduct these payments, they not only will have to pay out the money to the spouse, but they will additionally still have to pay taxes on the amount paid. Payees no longer have to pay taxes for the amount that they receive, which will inevitably lead to the payee fighting for higher alimony payments. Spousal support payments are inevitably going to be smaller due to the lack of incentives and therefore may not fulfill the purpose that they were meant to serve.<sup>72</sup> In *Mann v. Mann*<sup>73</sup> the court noted that following the tax change on alimony, courts should consider the impact that it may have on the paying spouse.<sup>74</sup> The court found that the economic impact the change will have on the payor will

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<sup>68</sup> Justin T. Miller, *Tax Reform Could Make Divorce a Whole Lot More Taxing*, AMERICAN BAR ASSOCIATION (2019), [https://www.americanbar.org/groups/family\\_law/publications/family-law-quarterly/volume-52/issue-2/tax-reform-could-make-divorce-whole-lot-more-taxing/](https://www.americanbar.org/groups/family_law/publications/family-law-quarterly/volume-52/issue-2/tax-reform-could-make-divorce-whole-lot-more-taxing/).

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> See Cunah, *supra* note 16.

<sup>73</sup> *Mann v. Mann*, 943 N.W.2d 15 (Iowa 2020).

<sup>74</sup> *Id.*

be greater than it has been in the past and this may affect the appropriate percentage of their income to be awarded to the payee.<sup>75</sup> Because this tax change creates a new burden that was not seen before, parties are left with a few options on how to deal with the change. Parties have the opportunity to support their ex-spouses through ways other than the well-known alimony payments.<sup>76</sup> For example, they may wish to exchange other assets throughout time, such as stocks, retirements, or transportation.<sup>77</sup> Parties may also agree to a “tax effect”<sup>78</sup> discount on the amount of alimony that is to be awarded.<sup>79</sup> This would allow for the parties to come to an agreement on an amount that would not be such a burden on the payor, which may allow for less argument about payment of alimony. This would take into account the payee’s tax rate and discount that amount from the total that will be paid.<sup>80</sup> While the change may feel like a small one, it is not hard to see that this is going to lead to more payors fighting to pay a lot less alimony to their spouses as they are receiving no real tax recognition for doing so, and payees will begin wanting much higher payments because they are now receiving free money with no tax consequences to them.

*A. Policy Considerations That Encouraged the Tax Change and Why They May Be Debunked*

According to the America Bar Association, there are four main policy reasons that the tax change on alimony took place, along with some reasons as to why these may not be accurate:

- 1) “The deduction is an unfair tax subsidy that encourages divorce”;<sup>81</sup>
- 2) The ending of the alimony deduction will result in additional tax revenue for the government;<sup>82</sup>

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<sup>75</sup> *Id.*

<sup>76</sup> Bernadette A. Barbee, *Alimony After the TCJA Dystopian Nightmare or Necessary Change? Either Way, It’s Here to Stay*, 41 FAM. ADVOC. 16 (2019).

<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

- 3) The deduction has caused issues because the number of people claiming the deduction and the number of those including it in their income do not match;<sup>83</sup> and
- 4) The burden this poses would discourage people from divorcing and was intended to be “family friendly.”<sup>84</sup>

It is important to look at each policy reason individually to determine how the tax change may or may not have accomplished the reason listed. First, allowing payors to take a deduction was an unfair subsidy that was encouraging divorces across the nation. The ABA argues that it is very unlikely that anyone was going through the emotional and financial burden of getting a divorce solely to take advantage of the tax deduction of paying alimony.<sup>85</sup> Divorce requires a considerable amount of money from both parties and the tax deduction that would be received by the payor is not great enough to make up for the burden that is incurred along the way.

Next, the argument that the U.S government will receive additional tax revenue due to this tax change seems unconvincing. The additional income that the government may receive due to repealing the deduction is outweighed by the cost of the Tax Credit and Jobs Act along with the TCJA’s new code that nearly doubles the estate tax exemption to benefit wealthier families which will increase the federal deficit more each year than the cost of repealing the alimony deduction.<sup>86</sup> This policy concern argues with the other changes that were made with the same Act.

The policy concern that the repealing of the deduction will resolve the issue that there is a mismatch in those people claiming the deduction and those reporting it in their income, seems like an aggressive stretch on how to resolve the issue. The ABA argues that while there is a significant mismatch, about \$2,268,091 worth, the solution was not to get rid of the deduction all together.<sup>87</sup> It notes that this consequently made further work for people who have to keep track of these deductions. This issue specifically comes down to the lack of the enforcement of including these payments in income, and the lack of enforcement is not

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<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

a policy reason for completely eliminating the rules as they are.<sup>88</sup> The idea of matching the payments of alimony and the receiving of it should be simple and if the payees are not reporting the money they are receiving, they should be subject to back taxes, penalties, and interest.<sup>89</sup> This would be a far more practical approach to resolving the issue rather than the elimination of the deduction.

The ABA notes in addition that this tax change creates an additional burden on the Service to determine who is complying and who is not.<sup>90</sup> Prior to the change, the IRS had to match the payments and receipts without much else to consider. With the tax change, the IRS must now determine which rules apply to which payments in accordance with the dates they went into effect.<sup>91</sup> Modification and the dates everything goes into effect has created a harder process to match the payments and receipts and a more unconventional job for those that are in charge of doing so.<sup>92</sup>

The last policy concern was that repealing the alimony deduction was intended to be a “pro-family” approach because it would discourage spouses from divorcing due to the burden that may be put on them post-divorce.<sup>93</sup> The strongest argument against this point is the flipside of the “pro-family” approach which is that it encourages some people to stay in a marriage that is unhappy and unhealthy.<sup>94</sup> Staying in this hostile marriage can have adverse mental and physical effects on those involved, including the children.<sup>95</sup> Psychotherapist Sean Grover states that these hostile marriages are more harmful to the children of the marriage than a divorce would be.<sup>96</sup> The idea that the tax change would support a “pro-family” model is inaccurate in most re-

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<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> Louise Chang, *Unhappy Marriage: Bad for Your Health*, WEBMD (Sept. 20, 2021) <https://www.webmd.com/sex-relationships/news/20051205/unhappy-marriage-bad-for-your-health>.

<sup>96</sup> Sean Grover, *4 Reasons Why Bad Marriages Are Worse for Kids than Divorce*, PSYCHOLOGY TODAY (Sept. 20, 2021), <https://www.psychologytoday.com>.

gards and the arguments against it point to why this would not be beneficial to a family in the long-run.

## **Conclusion**

Over the years, the rationale for spousal support has shifted dramatically. What was once intended to support a wife after her husband took over her property turned into a punishment for wrongdoing during a marriage, and today serves many purposes. Depending on the state that is awarding the support, spousal support can be used for rehabilitative purposes, permanent support, or for compensatory purposes. Due to this lack of consistency, the awarding of spousal support is very unpredictable, and it is difficult to create uniform guidelines.

Many states have attempted reforms throughout the last decade to create a more stable spousal support system. A few of the reoccurring reform themes have been the calculation of support to be awarded, the duration of how long support should last, and whether retirement should be a consideration for spousal support. With each reform came an increase in the predictability of how support would be awarded by the court.

This changed in 2019 when the IRS changed the tax protocol regarding maintenance payments. Prior to this tax change, the payor was able to deduct the payments and the payee was required to include the amount in their taxable income. With the change that began January 1, 2019, the payor is unable to claim a deduction and the payee is not required to include it in their gross income. Moving forward, this change has the potential to have a significant effect on the settlement of divorce cases involving spousal support.

Mackenzie Burch

## Contemporary Issues in the Law of Trusts: An Annotated Bibliography

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This bibliography covers significant issues concerning the use of trusts, with a particular emphasis on issues relevant for family law attorneys. The bibliography covers articles published over the last five years, from 2016 through 2021.

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\_\_\_\_ Enclosed is my check for \$\_\_\_\_\_

\_\_\_\_ Please bill me.

\_\_\_\_ Please send the following back issues of the Journal at  
\$30.00 each: \_\_\_\_\_

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**NOTICE OF CHANGE OF ADDRESS**

Name\_\_\_\_\_

New Address\_\_\_\_\_

Old Address\_\_\_\_\_

Effective Date:\_\_\_\_\_