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TRUSTS AND ESTATES

CAN'T TOUCH THIS: RECENT CASE, *TANNEN V. TANNEN,* ILLUSTRATES THE IMPORTANCE OF PROTECTING YOUR WEALTH IN A DIVORCE PROCEEDING

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A trust is a flexible estate planning tool that individuals can use to achieve multiple goals, including the management, preservation, and tax-efficient distribution of wealth.

Although many individuals focus on the objective of tax minimization when creating trusts for the benefit of their loved ones, a recent case decided by the New Jersey Supreme Court, *Tannen v. Tannen*, illustrates why individuals should also keep the goal of asset protection at the forefront of their minds. *Tannen* addresses whether, in a divorce proceeding, New Jersey courts will take into account the assets of a trust in which one of the divorcing spouses has a beneficial interest for the purpose of determining alimony.

The History of the Case and the Court's Decision

In *Tannen*, plaintiff Mark Tannen sought divorce from defendant Wendy Tannen after nearly 18 years of marriage. During the marriage, Wendy's parents established an irrevocable trust for her benefit, naming themselves and Wendy as co-trustees. The trust document did not require mandatory payments to Wendy. Instead, the trustees had discretion to make distributions for her health, support, maintenance, education, and general welfare. The trust also instructed the trustees to make distributions only after taking into account other financial resources available to Wendy. Throughout the marriage, the trust paid for certain marital expenses, including real estate taxes on the couple's home.

The trial court held that income generated by the trust was an asset it could consider when computing Mark's alimony obligation. The court imputed $4,000 in monthly income of the trust to Wendy and ordered the trustees to make this monthly payment to her, in addition to the amounts historically distributed by the trust for marital expenses. Taking this income into consideration, the court set Mark's monthly alimony obligation at $4,500.

The Appellate Division reversed the trial court's order, concluding that the trust's income was not an asset held by Wendy for the purpose of determining alimony payments. According to the court, the key inquiry is whether the divorcing spouse can control the income produced by the asset or has "the ability to tap the income source." The terms of the trust document dictate whether the beneficiary spouse has "the ability to tap the income source" of the trust. Thus, the court scrutinized the trust's provisions to determine if Wendy could compel distributions of income from the trust.

The beneficiary of a purely discretionary trust, in which the trustees have unfettered discretion whether or not to distribute trust assets, cannot compel payments from the trust unless the trustees have abused their discretion. Wendy's trust, however, was a so-called discretionary <u>support</u> trust, meaning that the trustees' discretion was governed by a standard related to her maintenance and support. The court grappled with whether this limitation gave Wendy a presently enforceable right to trust income, thus allowing her to control trust assets.

To reach its decision, the court looked at the Restatement (Third) of Trusts and the Restatement (Second) of Trusts, two legal treatises that summarize the general principles of the common law of trusts. According to the court, under the Restatement (Third) of Trusts, a newer formulation of the law, Wendy would be considered to have an enforceable interest in the assets of the trust based on the support standard built into the trust instrument. The court, however, refrained from adopting the approach of the Restatement (Third) of Trusts, concluding that "such a determination would be more appropriately made by our Supreme Court." *Tannen v. Tannen*, 3 A.3d 1229, 1243 (N.J. Super. Ct. App.

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Div. 2010). Instead, the court applied the Restatement (Second) of Trusts and concluded that, under current New Jersey law, the terms of the trust limited Wendy's ability to compel distributions of income from the trust. Therefore, she did not have "the ability to tap the income source" of the trust; accordingly, trust income could not be attributed to her for the purpose of determining alimony.

In a highly anticipated decision, the New Jersey Supreme Court declined the invitation to adopt the approach of the Restatement (Third) of Trusts and affirmed the Appellate Division's opinion without writing a full opinion. Instead, the Supreme Court upheld the Appellate Division's judgment "substantially for the reasons expressed" in the lower court's opinion.

Lessons to Be Learned

Although the Supreme Court did not issue its own opinion in *Tannen*, many lessons can be learned from the Appellate Division's opinion. Primarily, the opinion confirmed that, under current New Jersey law, assets placed in a discretionary trust will not be considered as belonging to the trust's beneficiary for the purpose of calculating alimony. The discretionary trust, therefore, can serve as an invaluable estate planning tool to protect family wealth from the claims of divorcing spouses and other creditors as it passes from one generation to the next.

The opinion also reinforces a well-established tenet of trust law: trust terms really do matter. When creating a trust for the benefit of loved ones, you should ensure that the trust's provisions adequately anticipate and address circumstances that could develop later on down the road. You should also make sure that the attorney drafting your estate planning instruments is sensitive to your needs and has knowledge of the specific facts relevant to your situation and family background. If you are worried about an unintended recipient, such as a divorcing spouse, reaching your assets in the future, you should make sure that the trust has adequate safeguards. Safeguards could include a provision that expressly states your intention that a divorcing spouse never have access to trust funds or a provision that requires trustees to take into account the financial resources available to the beneficiary before making distributions.

Finally, if you already have trust agreements in place, you should review them with the assistance of an attorney to confirm that your assets are not vulnerable to claims from unanticipated recipients. If your trusts do not currently provide sufficient protection, you may be able to amend them or transfer your assets to a more protective trust. If you are interested in creating or modifying your estate plan to take advantage of asset protection strategies, contact any of the attorneys listed.

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