# INTERESTS IN TRUSTS AS PROPERTY IN DISSOLUTION OF MARRIAGE: IDENTIFICATION AND VALUATION

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*Editors' Synopsis: When a trust is included as part of the divisible assets of a divorce, many complex issues associated with division and valuation of the trust arise. As the author discusses, such a division and valuation may be contrary to the settlor's intent and may require input from family members. This Article discusses the division of interests in trusts and the valuation of those interests, with the primary focus by way of example on the relevant Colorado law. Estate and gift tax valuation concepts also are discussed, and the author suggests that these concepts might be useful in valuing the interests of trusts at the dissolution of marriage. The Article concludes with a discussion of selected tax consequences of the division and valuation of a trust at the dissolution of marriage.*

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## I. INTRODUCTION

A trust can be defined as a "legal device[ ] by which one person is enabled to deal with property for the benefit of another person."[1] The simplicity of the definition belies the complexity to which trusts have evolved. The ability to create concurrent and successive equitable interests and powers in property is unique to trusts.[2] Trusts have proliferated for this reason and also as a consequence of the increase in wealth in recent

[1] RESTATEMENT (THIRD) OF TRUSTS pt. 1, ch. 1, introductory note (2003).

[2] [C]rucial to the development of the trust as a device for the flexible, long-term settlement of family property has been the partially parallel evolution of an Anglo-American law of future interests. Peculiar to that body of law is a tolerance for time-divided ownership that permits a variety of legal (as well as equitable) present and future interests, even in potential, unborn beneficiaries and including conditions and powers of appointment, that would surprise most lawyers familiar only with other legal systems.

*Id.*

decades, the asset protection that a trust may provide,[3] and the income, estate, gift, and generation-skipping transfer tax advantages of trusts.

The high rate of divorce in recent decades is indisputable,[4] with the obvious consequence of courts making an increasing number of property divisions. Another indisputable trend is that the courts are including new types of property and interests in the pool of assets to be divided. Retirement benefits, intellectual ideas, employment perquisites, professional degrees and licenses, and a variety of other assets have been included in that pool and divided by the courts.[5] "Twenty-plus years ago, many jurisdictions ignored pensions as mere contingencies and not deferred wages. Pensions were typically excluded from property settlements."[6] Today, every state considers equitable division of pensions.[7]

A trust can constitute a complex package of present and future rights, powers, and interests, which are not necessarily fixed. If a trust is included in the pool of divisible assets on divorce, the trust instrument must be interpreted, its various interests quantified, and the value divided. Although the process and division may reflect the concept of marriage as a shared enterprise or partnership, this process and division likely will be counter to the intent of the trust's settlor and perhaps will require the participation of the family members of a beneficiary spouse in the proceedings. Those family members are likely to view the process as an unjustified appropriation of a family's wealth.

The body of law regarding division of trusts on dissolution of marriage is, in the author's opinion, too indistinct to say that the law of any one state represents a general rule or an emerging trend. However, Colorado law and, in particular, recent developments in Colorado law illustrate the struggle courts have with such divisions and the lack of a stable framework for dealing with such divisions. Divorce courts and family-law

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[3] *Id.* § 58(1) states that "if the terms of a trust provide that a beneficial interest shall not be transferable by the beneficiary or subject to claims of the beneficiary's creditors [and except as to a beneficial interest retained by the settlor of a trust], the restraint on voluntary and involuntary alienation of the interest is valid."

[4] "[O]ne-half of all new marriages are expected to end in divorce." LENORE J. WEITZMAN, THE DIVORCE REVOLUTION, at ix (1985). Although the ascent of the divorce rate "has moderated somewhat, [the rate] remains imposingly high." Carl E. Schneider, *Family Law in the Age of Distrust*, 33 FAM. L.Q. 447, 450 (1999).

[5] *See* R. FEDER, VALUATION STRATEGIES IN DIVORCE (4th ed. 1997 & Supp. 2004).

[6] GARY A. SHULMAN & DAVID I. KELLEY, DIVIDING PENSIONS IN DIVORCE § 1.1 (2d ed. 1999).

[7] *See id.*

practitioners will require assistance in deciphering trust instruments and valuing temporal interests in property. Trust and estate practitioners therefore will be called upon to assist with these tasks.

This Article first discusses the division of interests in trusts on the dissolution of marriage under Colorado law. The Article then discusses the valuation of interests in trust on the dissolution of marriage, with primary emphasis on Colorado law. Next, the Article considers analogous estate and gift tax valuation concepts and how they might be useful in the valuation of such interests. Finally, the Article considers selected tax consequences that may be relevant in a division and valuation of interests in trusts on the dissolution of marriage.

## II. INTERESTS IN TRUSTS AS PROPERTY: COLORADO LAW

The development of the law regarding the treatment of interests in trusts as divisible property on the dissolution of marriage has been diverse.[8] Some decisions treat interests in trusts as divisible, regardless of whether the interest is vested, unvested, contingent, or remote.[9] Yet some courts have held that an interest in trust is not considered property until the interest becomes possessory (the beneficiary has received or has a present right to withdraw the trust property).[10] Colorado law falls between these two extremes.

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[8] *See generally* Michael Diehl, Note, *The Trust in Marital Law: Divisibility of a Beneficiary Spouse's Interests on Divorce*, 64 TEXAS L.REV. 1301 (1986); Sonja A. Soehnel, Annotation, *Divorce Property Distribution: Treatment and Method of Valuation of Future Interest in Real Estate or Trust Property Not Realized During Marriage*, 62 A.L.R.4th 107 (1988); Sonja A. Soehnel, Annotation, *Divorce Property Distribution: Real Estate or Trust Property in Which Interest Vested Before Marriage and Was Realized During Marriage*, 60 A.L.R.4th 218 (1988).

[9] *See, e.g.*, *In re* Marriage of Bentson, 656 P.2d 395, 396 (Or. Ct. App. 1983); Comins v. Comins, 595 N.E.2d 804, 805-06 (Mass. App. Ct. 1992). In *Comins,* the marital estate included wife's interest in a trust settled by her father. A bank, in its discretion as trustee, was to pay to wife income and principal for wife's "comfort, welfare, support, travel and happiness." *Comins*, 595 N.E.2d at 806. Wife held a power to appoint the trust principal at her death and if the power was not exercised, the remainder was to be distributed by representation to her heirs. *Id.* at 806 n.4. The opinion does not state whether the power of appointment was a general or special power.

[10] *See, e.g.*, Frank G. W. v. Carol M.W., 457 A.2d 715, 727 (Del. Super. Ct. 1983); Solomon v. Solomon, 611 A.2d 686, 691 (Pa. 1992), *superseded by statute as stated in* Budnick v. Budnick, 615 A.2d 80, 82 (Pa. Super. Ct. 1992); Storm v. Storm, 470 P.2d 367, 371 (Wyo. 1970).

A. The Enabling Statute

Colorado Revised Statutes Annotated ("C.R.S.A.") provides, in part:

> In a proceeding for dissolution of marriage or . . . for legal separation . . . the court . . . shall set apart to each spouse his or her property and shall divide the marital property . . . in such proportions as the court deems just after considering all relevant factors including:
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> (a) The contribution of each spouse to the acquisition of the marital property, including the contribution of a spouse as homemaker;
> (b) The value of the property set apart to each spouse;
> (c) The economic circumstances of each spouse at the time the division of property is to become effective . . .; and
> (d) Any increases or decreases in the value of the separate property of the spouse during the marriage or the depletion of the separate property for marital purposes.[11]

C.R.S.A. defines marital property as:

> [A]ll property acquired by either spouse subsequent to the marriage except:
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> (a) Property acquired by gift, bequest, devise, or descent;
> (b) Property acquired in exchange for property acquired prior to the marriage or in exchange for property acquired by gift, bequest, devise, or descent;
> (c) Property acquired by a spouse after a decree of legal separation; and
> (d) Property excluded by valid agreement of the parties.[12]

As discussed *infra*, Part II.J, the Colorado statute also provides that:

> "[P]roperty" and "an asset of a spouse" shall not include any interest a party may have as an heir at law of a living person or any interest under any donative third party instrument which is amendable or revocable, including but not limited to third-party wills, revocable trusts, life insurance, and retirement benefit in-

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[11] COLO. REV. STAT. ANN. § 14-10-113(1) (LEXIS 2003).
[12] *Id.* § 14-10-113(2).

> struments, nor shall any such interests be considered as an economic circumstance or other factor.[13]

When making a property division, a court must determine first whether an interest constitutes property, and if it does, a court then must determine if the property is separate or marital.[14] Increases in the value of separate property and income from separate property constitute marital property.[15] The Colorado statute creates a rebuttable presumption that all property acquired subsequent to the marriage, regardless of titling, is marital property.[16] The presumption in favor of marital property is rebuttable even if an asset is titled jointly.[17] After determining whether an interest constitutes marital property, and setting aside the separate property of the spouses, the enabling statute requires the court to divide the marital property in a manner the court determines to be just, which does not necessarily mean an equal division between the spouses.[18]

B. *In re* Marriage of Balanson

*In re Marriage of Balanson*[19] ("*Balanson II*") concerned the determination of whether a wife's remainder interest in a trust constituted property for purposes of property division in a dissolution of marriage. Wife's parents created a joint revocable trust, which at the death of wife's mother divided into two irrevocable trusts.[20] The settlors intended the "A" trust to be a combined trust consisting of the surviving father's assets and the deceased mother's assets, which would have qualified the trust for the federal estate tax marital deduction at the mother's death.[21] The settlors intended the "B" trust to be a credit shelter trust, with the intent that it

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[13] *Id.* § 14-10-113(7)(b).

[14] *See In re* Marriage of Hunt, 909 P.2d 525, 529 (Colo. 1995).

[15] *See* COLO. REV. STAT. ANN. § 14-10-113(4); *In re* Marriage of Foottit, 903 P.2d 1209 (Colo. Ct. App. 1995).

[16] COLO. REV. STAT. ANN. § 14-10-113(3).

[17] *See, e.g.*, Rhoades v. Rhoades, 535 P.2d 1122, 1124 (Colo. 1975).

[18] *See In re* Marriage of Goldin, 923 P.2d 376, 381 (Colo. Ct. App. 1996); *In re* Marriage of Posinoff, 683 P.2d 377, 378 (Colo. Ct. App. 1984).

[19] 25 P.3d 28 (Colo. 2001), *appeal after remand*, 2004 Colo. Ap. LEXIS 1716 (Colo. Ct. App. Sept. 23, 2004).

[20] *See In re* Marriage of Balanson, No. 03CA0765, 2004 Colo. App. LEXIS 1716 (Colo. Ct. App. Sept. 23, 2004) ("*Balanson III*") discussed *infra*.

[21] In *Balanson III*, the court stated that all the assets of both trusts were contributed by the wife's father. *Id.*

would not be subject to estate tax at the surviving father's death.[22] Both trusts provided wife's father with a mandatory income interest and the power, as the trustee, to distribute principal to himself for his support, care, and maintenance. At father's death, the A trust would be distributed in accordance with father's general power of appointment exercisable by will and if not exercised, then in accordance with the B trust. The B trust was to be divided at father's death into as many equal shares as there were living children of the mother and father. Wife and her brother were the only living children of wife's parents. Wife's father was the trustee of both trusts and the trust instrument designated wife's brother as the successor trustee at the death of wife's father.

The issue in *Balanson II* was whether wife's remainder interest in the B trust constituted property under C.R.S.A. section 14-10-113. In reversing the Colorado Court of Appeals' holding in *Balanson I* that wife's interest was an expectancy that did not rise to the level of a property interest,[23] the Colorado Supreme Court determined that wife had a "future, vested interest not within the discretion of the trustee to withhold"[24] and held that wife's interest in the B trust constituted property, as opposed to a mere expectancy.[25] The court reached this conclusion despite the father's income interest and right to invade the principal. According to the court, "[t]hese factors render the value of wife's remainder interest uncertain, but

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[22] *See also In re* Marriage of Balanson, 996 P.2d 213, 220 (Colo. Ct. App. 1999) ("*Balanson I*"), *aff'd in part & rev'd in part*, 25 P.3d 28 (Colo. 2001), *remanded to* 2004 Colo. App. LEXIS 1716 (Colo. Ct. App. Sept. 23, 2004). Property passing from the deceased mother to the trust would have qualified for the estate tax marital deduction pursuant to section 2056(b)(5) of the Internal Revenue Code ("Code") of 1986 as amended. Such a trust also will be included in the surviving spouse's gross estate for estate tax purposes by reason of Code section 2041 (2000). A trust created for the purpose of holding a decedent's remaining applicable exclusion amount, as defined in Code section 2010, is often referred to as a credit shelter trust, by-pass trust, or credit equivalent trust.

[23] *See Balanson I*, 996 P.2d at 222.

[24] *Balanson II*, 25 P.3d at 41.

[25] The court in *Balanson II* stated that it previously had reached the same holding with respect to a trust interest similar to the wife's interest in *In re Question Submitted by the United States Court of Appeals for the Tenth Circuit,* 553 P.2d 382, 384 (Colo. 1976). Although the trusts were similar in some respects, the *Balanson II* opinion ignored the fact that the beneficial interest reviewed in *In re Question* was not subject to a currently existing income interest and power of invasion of a principal for the benefit of the life tenant. In *In re Question,* the surviving spouse of the settlor exercised her right to take an elective share of the estate, which eliminated her beneficial interest in the trust. The only remaining condition subsequent for the beneficiary's interest to become possessory was for the beneficiary to survive the spouse of decedent who had elected against the will. *Id.* at 384.

do not convert her interest into a mere expectancy."[26] The remainder interest constituted wife's separate property, and the appreciation in the value of her separate property constituted marital property under the statute.[27]

C. Power of Appointment

The Colorado Supreme Court in *Balanson II* did not address whether wife held a property interest in the A trust. The parties apparently did not disagree in any of the appellate proceedings that wife's interest in the A trust did not constitute property for purposes of the division. The court of appeals, however, observed in *Balanson I* that wife's interest in the A trust was "merely an expectancy."[28] The court of appeals found it significant that "wife's father was given a power of appointment to pass the entire remaining corpus of trust A through his last will, without any limitation as to the beneficiaries who could be designated in such will."[29]

*1. General Power of Appointment*

At least by way of dicta, Colorado authority suggests that a general power of appointment,[30] which may defeat a spouse's interest in a trust, will render such interest a contingency. A general power of appointment marital trust, sometimes referred to as a "(b)(5) trust,"[31] will grant a surviving spouse the type of general power held by wife's father over the A trust in *Balanson*, and it would seem that such trusts should not be included in the pool of divisible assets.

*2. Special Power of Appointment*

Whether a special power of appointment should cause the same result is less certain. For both practical and tax reasons, many settlors give trust

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[26] *Balanson II*, 25 P.3d at 41.

[27] *Id.* at 42.

[28] *Balanson I*, 996 P.2d at 221.

[29] *Id.* On remand after *Balanson II*, the court reiterated that the wife's interest in the A trust constituted an expectancy. *See Balanson III*, 2004 Colo. App. LEXIS 1716.

[30] A general power of appointment is a power exercisable in favor of the donee, the donee's estate, the donee's creditors, or the creditors of the donee's estate. A special or limited power of appointment is any power which is not a general power of appointment. I.R.C. §§ 2041, 2514 (2000); COLO. REV. STAT. ANN. § 15-2-103(1), (2) (LEXIS 2003).

[31] Such trusts qualify for the estate tax marital deduction pursuant to Code section 2056(b)(5). A marital trust, such as a qualified terminable interest property ("QTIP") trust, need not provide a surviving spouse with a power of appointment. *See* I.R.C. § 2056(b)(7).

beneficiaries special powers of appointment. If wife's father in *Balanson* had held a special power of appointment over the B trust, would the result have been the same?

If the test in *Balanson II* is that vested interests, even those subject to complete defeasance, constitute property interests, one can argue that the result would have been the same.[32] If this position is correct, a trial court would be faced with the choice of completely ignoring the power of appointment in valuing the interest or determining a reduction in the value of the interest attributable to the power of appointment. Such a determination necessarily would require a trial court to weigh subjective criteria and calculate a risk factor as to whether and to what extent a power will be exercised.

D. *In re* Marriage of Beadle

Other state courts have considered trusts in which a spouse's equitable interest has been vested but is subject to defeasance by reason of a power of appointment. *In re Marriage of Beadle*[33] concerned a trust similar in design to the *Balanson* B trust, except husband's mother held a special testamentary power of appointment exercisable in favor of descendants. The trial court held that the remainder interest, though initially vested, no longer was vested by virtue of the mother's execution of a codicil to her will that would have defeated husband's interest.[34] The Montana Supreme Court affirmed, but instead reasoned that husband's remainder could not be vested until the power holder's death. In the author's opinion, this logic is flawed and a consequence of attempting to reconcile the law of future interests with equitable property divisions. A more logical rationale is that, vested or not, some interests are simply too uncertain to constitute property.

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[32] "When a vested remainder is so limited that it may be wholly divested by an executory interest, *power of appointment* or power of termination, it is said to be vested subject to complete defeasance." LEWIS M. SIMES, HANDBOOK OF THE LAW OF FUTURE INTERESTS 20 (2d ed. 1966) (emphasis supplied).

[33] 1998 MT 225, 968 P.2d 698 (1998).

[34] *Id.* at ¶ 5, 968 P.2d at 700. As noted in *Beadle*, the power cannot be exercised until the power holder's death when her will becomes effective.

E. Massachusetts Law

In *S.L. v. R.L.*,[35] the court considered whether five trusts would be included in the marital estate for property division purposes.[36] One of the trusts was a marital trust in which wife's mother held a general power of appointment exercisable by will. The court held that the trust should not have been included in the marital estate because wife's remainder interest was "susceptible of complete divestment upon the wife's mother's exercise of the power."[37] Under this logic, whether the power was general or special and whether the trust was or was not a marital trust is irrelevant.

The court reached an opposite conclusion as to wife's interests in the other trusts, one of which was almost identical in design to the *Balanson* B trust. The distinction drawn by the court was that wife's interest in the nonmarital trusts "[was] subject only to her surviving her [then living] mother, a condition [that Massachusetts precedent] considered not to bar inclusion within the marital estate."[38]

Similarly, in *D.L. v. G.L.*,[39] the marital estate did not include husband's vested remainder interest in a trust, subject to divestment, because the interest "was susceptible of complete divestment upon the [husband's father's] exercise"[40] of a testamentary special power of appointment, and as a consequence, "the equivalent of an expectancy under a will."[41] Husband's grandmother created a trust that would be distributed to the husband and others upon the death of the father in default of the exercise of the power of appointment. Until final distribution, the trustee had the power to spray distributions of income and principal among a broad class of trust beneficiaries.

F. Is *Balanson II* a Bright Line Test?

If *Balanson II* is the bright line test that vested remainders, though subject to divestment, constitute property, unexpected and unusual results

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[35] 774 N.E.2d 1179 (Mass. App. Ct. 2002).

[36] Massachusetts law empowers the court to make an equitable division of all the spouse's property, whether separate or marital.

[37] *S.L.*,774 N.E.2d at 1182.

[38] *Id.* See Davidson v. Davidson, 474 N.E.2d 1137 (Mass. App. Ct. 1985) for the precedent cited by the court in *S.L.*

[39] 811 N.E.2d 1013 (Mass. App. Ct. 2004).

[40] *Id.* at 1028 (quoting *S.L.*, 774 N.E.2d at 1182).

[41] *Id.*

likely will follow.[42] A different interpretation, however, is possible. *Balanson II* may, and in this author's opinion should be, interpreted as a more limited holding. The vested remainder interest in the B trust, which was subject only to conditions of survivorship and the invasion of trust principal for the care and maintenance of the beneficiary with the then current interest, constituted property under the facts and circumstances of that case. Under this interpretation, the type, number, and extent of the contingencies, both under the instrument and under the facts and circumstances of each case could result in a determination that the interest, even though vested, is too susceptible to complete divestment to constitute property (whether by reason of a power of appointment, trustee power, or the needs of the current beneficiaries). If this more limited interpretation is correct, the corollary is that not every vested remainder interest in a trust is property for purposes of C.R.S.A. Section 14-10-113.

This suggested facts and circumstances approach will require the trial court to consider the contingencies to which interests in trusts are subject and the facts and circumstances surrounding the trust and its beneficiaries. At some point, a court appropriately may say the contingencies render the interest too uncertain, remote, or speculative to constitute property. The court then could avoid the issues and difficulties that otherwise would ensue when quantifying those contingencies and predicting the likelihood of an exercise of powers. *Balanson II* then would be viewed as a marker on one end of the spectrum. Vesting would not serve as a talisman and to the extent this bright line rule now exists, it would be dimmed. More than one court has said that "the concept of vesting should probably find no significant place in the developing law of equitable distribution."[43]

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[42] The court stated in *Balanson II* that "[w]e have previously held that a trust interest similar to that of Wife's in this case constitutes a *vested interest* ." *Balanson II*, 25 P.3d at 41 (emphasis added). That *Balanson* has been interpreted as equating a vested interest to a property interest subject to C.R.S.A. section 14-10-113 is easy to see. The court of appeals in *In re Marriage of Gorman*, 36 P.3d 211 (Colo. Ct. App. 2001), *superseded by statute as stated in In re* Marriage of Guinn, 93 P.3d 568, 571 (Colo. Ct. App. 2004), *cert. denied*, No. 04SC188, 2004 WL 1615237 (Colo. July 19, 2004), discussed *infra*, adopted this interpretation when it held that a spouse's remainder interest in a parent's revocable trust constituted property for purposes of C.R.S.A. section 14-10-113.

[43] Stern v. Stern, 331 A.2d 257, 262 (N.J. 1975); *see Davidson*, 474 N.E.2d at 1137. The *Davidson* court noted the rejection in Massachusetts "of the notion that the content of the estates of divorcing parties ought to be determined by the wooden application of technical rules of the law of property." *Id.* at 1144. *See also D.L.*, 811 N.E.2d at 1020 ("[T]he judge is not bound by traditional concepts of title or property."). More recently, the Colorado Court of Appeals in *Balanson III* has apparently criticized the notion that vesting

G. *In re* Marriage of Jones and *In re* Marriage of Rosenblum

In arriving at its decision in *Balanson II*, the court distinguished its prior decision in *In re Marriage of Jones*.[44] In *Jones* wife became a beneficiary of a trust created by the mother's will during the marriage. A bank and wife's father, as trustees, "had [the] uncontrolled discretion to distribute income and principal from the trust to [the father], the wife, or to the wife's descendants for expenses that the trustees determined to be necessary for their 'health, welfare, comfort, support, maintenance and education.'"[45] The trust was to terminate upon the death of both the wife's father and wife, at which time the trust assets were to be distributed to wife's descendants and if there were no descendants, to the mother's heirs.

Husband argued that the trust was the separate property of his wife and that the increase in the value of the trust principal was marital property. The court held that wife's rights in the trusts were "merely an expectancy and [did] not rise to the level of property."[46]

The court provided three distinct and inconsistent rationales for its holding. First, the trust was "completely discretionary"[47] and wife "could not force the trustee to pay income or principal unless she could establish fraud or abuse."[48] This rationale raises the question of whether the result would differ if the trustee were required to distribute the trust property for wife's reasonable needs. Second, the court stated that the interest in the trust was "not assignable and [could not] be reached by [the beneficiary's] creditors."[49] Spendthrift provisions typically are included in trust instruments, and the existence of those provisions has been irrelevant in the analysis of whether beneficial interests in trusts constitute property.[50] If the result turns on whether a trust instrument contains a spendthrift clause,

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should drive the result, and this seems to indicate a change of direction for that court. 2004 Colo. App. LEXIS 1716. Less than one year before, another division of that court stated: "*In re Marriage of Balanson* . . . holds that the appreciation in a vested remainder interest in an irrevocable trust during the course of the marriage constitutes marital property under § 14-10-113(4)." *In re* Marriage of Dale, 87 P.3d 219, 225 (Colo. Ct. App. 2003).

[44] 812 P.2d 1152 (Colo. 1991).

[45] *Id.*

[46] *Id.* at 1155 (quoting *In re* Marriage of Rosenblum*, 602 P.2d 892, 894 (Colo. Ct. App. 1979)).*

[47] *Id.* at 1156.

[48] *Id.*

[49] *Id.*

[50] Spendthrift clauses have not barred the inclusion of trusts in the pool of divisible assets. See Lauricella v. Lauricella, 565 N.E.2d 436, 439 (Mass. 1991).

very few trusts would be included in the pool of divisible assets. Third, the court distinguished "a discretionary trust from those trusts that grant the beneficiary some future, vested benefit not within the discretion of the trustee to withhold, but whose value may be uncertain at the dissolution of the marriage."[51] The distinction drawn by the court does not, in the author's opinion, require that vested beneficial interests necessarily constitute property.[52]

The *Jones* court cited with approval the Colorado Court of Appeals' decision in *Rosenblum*,[53] which held that an interest in a trust was not property for purposes of a division.[54] In *Rosenblum* husband's mother created an irrevocable trust and designated husband and his sister as the co-trustees with authority "in their absolute discretion to distribute 'all, none or any part' of the net income and principal to any of the beneficiaries [husband and his descendants], to make unequal distributions, or to withhold all income from 'one or more or all.'"[55] The trust instrument stated that "no beneficiary shall have any right or power to enforce the payment of principal or income to himself or any other person."[56] At husband's death, the trust assets were to be divided and held in trust for the benefit of his children (or descendants of a deceased child).[57]

*Jones* may be viewed narrowly as holding that discretionary trusts, with designs similar to the trusts reviewed in *Jones* and *Rosenblum*, are not property for purposes of C.R.S.A. section 14-10-113 and constitute mere expectancies. Yet *Jones* may be viewed expansively as holding that an interest in trust must be vested in a property law sense for a court to consider whether the interest constitutes property within the meaning of the statute. At this point in time, both interpretations are possible. However, if the concept of vesting is disregarded as to avoid automatic inclusion of an interest in the pool of divisible assets, disregarding the concept to avoid a rule of automatic exclusion of an interest seems equally valid.

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[51] *Jones*, 812 P.2d at 1157.

[52] The *Jones* court specifically declined to address whether vested interests subject to divestment constitute property and did not consider the issue until ten years later in *Balanson II*. *See id.* at n.4.

[53] 602 P.2d at 892.

[54] *Jones*, 812 P.2d at 1154-56, 1158.

[55] *Rosenblum*, 602 P.2d at 893. While the husband was a trustee, distributions to him could not be made "in excess of that necessary for his 'health, education, support or maintenance.'" *Id.*

[56] *Id.*

[57] *Id.*

Consider the following trust disposition:

> The will of husband's mother created a trust that designated the husband as the sole trustee with the power to designate and remove successor trustees. The trust agreement states that the trustee shall distribute to husband such amounts of the trust income or principal as the trustee determines necessary or desirable for husband's health, maintenance, and support. At husband's death, the trust property shall be distributed in accordance with a power of appointment exercisable by husband in his will. The power is exercisable in favor of any person or persons except his estate, his creditors, or the creditors of his estate. To the extent such power is not exercised, the trust shall be distributed at husband's death to his descendants by representation. The trust agreement states that the needs, comfort, and welfare of husband are of primary concern to the trustee, and the interests of all other beneficiaries are secondary. The trustee may, pursuant to such guideline, exhaust the entire trust for the benefit of husband to the exclusion of all other beneficiaries. In addition, the trustee may, but need not, consider other resources available to husband when making distributions to him. As trustee, husband has distributed all the income of the trust and substantial amounts of the principal to himself. No other beneficiary has received any trust distributions.

Does *Jones* require that the trust be excluded as property for purposes of C.R.S.A. section 14-10-113?[58]

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[58] In one instance, a bundle of rights and powers in a discretionary trust was so substantial that the court determined it constituted an interest in property under Colorado law for another purpose. In *United States v. Delano*, 182 F. Supp. 2d 1020 (D. Colo. 2001), the United States commenced a civil action against the trustees of a trust to foreclose a tax lien on a beneficiary's interest in a trust created under the will of the beneficiary's mother. *Id.* at 1021. The court distinguished *Jones* and *Rosenblum* and held that, under Colorado law, the beneficiary's interest in trust constituted a property right to which the tax lien attached. *Id.* at 1022, 1024. The beneficiary was the current sole beneficiary of the trust and had the discretion to terminate the trust and retain the assets, though the court did not elaborate on the terms and conditions of the power of termination. *Id.* at 1023. In addition, the trust instrument provided that the "trustee shall pay to or apply for the benefit of [the beneficiary] . . . income or principal, or both, as [the] trustee in its sole and absolute discretion shall deem necessary or advisable for [the beneficiary's] maintenance, health, education, comfort and welfare." *Id.* at 1022. The beneficiary and another individual were the initial co-trustees. The beneficiary exercised his power to remove the other co-trustee and replaced the co-trustee with the beneficiary's son. *Id.* at 1021 n.1.

Whether a bundle of rights and powers in a discretionary trust, though technically not equating to a vested interest, might, in the aggregate, amount to a property interest subject to division is undetermined at this time. As discussed, some courts apparently have moved in that direction,[59] but the author believes it is too early to predict that such a view represents a growing trend in the law.

H. Trust as Economic Circumstance and Trust Income as Gift

*Jones* also held that wife's interest, though not property, should be considered as an "economic circumstance."[60] As discussed *infra* Part II.J., the enabling statute provides that:

> "[P]roperty" and an "asset of a spouse" shall not include any interest a party may have as an heir at law of a living person or any interest under any donative third party instrument which is amendable or revocable, including but not limited to third-party wills, revocable trusts, life insurance, and retirement benefit instruments, *nor shall any such interests be considered as an economic circumstance or other factor*.[61]

*Jones* may be the basis of a dichotomy regarding economic circumstance. If the trust is not amendable or revocable, the trust may be considered as an economic circumstance, but if amendable or revocable, the trust cannot be considered as an economic circumstance. The statute does not define the terms "amendable or revocable" and, as discussed *infra* Part II.J., a beneficiary's power of appointment or a trustee's amendment power possibly could render the trust amendable or revocable. If this is the case, the statute may have overruled legislatively the portion of the *Jones* court's holding that required the trust to be considered an economic circumstance.

Finally, *Jones* can be cited for the proposition that income distributed

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[59] See, e.g., *Comins*, 595 N.E.2d at 807, in which the court determined a spouse had a present, enforceable, equitable right to use the trust property of a discretionary trust and included the trust in the marital estate. More recently, in *D.L.*, the court stated that a judge is not necessarily precluded from including a discretionary trust in the marital estate; rather, "the trust instrument and other relevant evidence must be examined closely to determine whether that party's interest is too remote." 811 N.E.2d at 1023.

[60] *Jones*, 812 P.2d at 1158. C.R.S.A. section 14-10-113(1)(c) provides that the relevant factors for a court to consider in dividing property include the economic circumstances of each spouse at the time the division of property is to become effective.

[61] COLO. REV. STAT. ANN. § 14-10-113(7)(b) (emphasis added).

from a discretionary trust is a "gift" within the meaning of C.R.S.A. section 14-10-113(2).[62]

## I. *In re* Marriage of Guinn

*In re Marriage of Guinn*[63] held that property for purposes of C.R.S.A. section 14-10-113 should not include a spouse's income interest in an irrevocable trust. In *Guinn*, husband's parents created an irrevocable generation-skipping trust.[64] Husband was entitled to the net income from the trust, which was to be distributed at least annually. Discretionary distributions of trust principal to husband were permitted if such payments were reasonably necessary for husband's health, maintenance, support, and education. Upon husband's death, the principal was to remain in trust for the benefit of husband's descendants. Husband had no power of appointment with respect to the trust. Husband's parents were the trustees of the trust. Specifically, the trust instrument allowed the trustee to determine, in the trustee's reasonable discretion, what was principal and what was income of the trust. The trust instrument allowed the trustee to allocate capital gains to income. Testimony established that capital gains had been allocated to the principal, and interest and dividend income had been allocated to the income interest during the entire term of the trust.[65]

Wife contended that husband's income interest in the trust constituted property under C.R.S.A. section 14-10-113.[66] The court of appeals decided otherwise and held that husband's income interest in the trust was not property under the statute.[67] The court stated that "when the beneficiary has no interest in the corpus, and no right to control how the corpus is invested, . . . the income is a mere gratuity deriving from the beneficence of the settlors."[68]

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[62] *Jones*, 812 P.2d at 1158.

[63] 93 P.3d at 568, 572.

[64] *Id.* at 570.

[65] *See id.*

[66] The court noted the trial court's finding (and that the wife did not dispute such finding) that the husband had no property interest in the trust principal for purposes of C.R.S.A. section 14-10-113 as a consequence of the trustee's power to distribute principal to him for his health, maintenance, support, and education. Solely at issue was whether the income interest constituted property. *Id.* at 570-71.

[67] *See id.* at 572.

[68] *Id.*

J. C.R.S.A. section 14-10-113(7)(b)

In *In re Marriage of Gorman*,[69] husband's living mother created a typical revocable trust in which she retained all the income from the trust, the right to receive distributions of principal for her benefit, and the power to revoke or amend the trust. Upon the mother's death, the trust was to be distributed to the husband and his siblings.

The trial court held that husband did not possess a property interest with respect to the trust, but only a mere expectancy.[70] The court of appeals reversed and held that husband's vested remainder interest had to be treated in the same manner as the vested remainder interest considered in *Balanson II*.[71] The court acknowledged the difficulty in valuing such an interest and suggested that the property division could be delayed until husband came into actual possession of the interest.[72]

In response to *Gorman*, the Colorado legislature revised C.R.S.A. section 14-10-113, effective July 1, 2002.[73] The revised statute states, in pertinent part:

> "[P]roperty" and "an asset of a spouse" shall not include any interest a party may have as an heir at law of a living person or any interest under any donative third party instrument which is amendable or revocable, including but not limited to third-party wills, revocable trusts, life insurance, and retirement benefit instruments, nor shall any such interests be considered as an economic circumstance or other factor.[74]

The statute does not define the terms "amendable" and "revocable," and the meaning of those terms will be fertile ground for controversy and

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[69] 36 P.3d at 212.
[70] *Id.*
[71] *Id.* at 212-13.
[72] *Id.* at 213.
[73] C.R.S.A. section 14-10-113(7)(c) generally provides that the new provision applies to all causes of action filed on or after July 1, 2002, and causes of action filed before such date in which a "final property disposition order" was not entered prior to July 1, 2002. In March of 2003, the trial court, on remand from *Balanson II*, did not consider C.R.S.A. section 14-10-113(7)(b) and included in the wife's remainder interest in the B trust that portion of the appreciation attributable to the period of time when the trust was revocable by the joint settlors. The court of appeals in *Balanson III* found that a final order had not been entered in the matter and that the trial court erred by failing to consider C.R.S.A. section 14-10-113(7)(b) and (c).
[74] *Id.* § 14-10-113(7)(b).

litigation. Many trust instruments grant powers of appointment, both inter vivos and testamentary, for persons who are typically, but not necessarily, beneficiaries of the trust. The practical effect of exercising a power of appointment on the beneficial interest of a divorcing spouse is no different than if a settlor of a revocable trust amended or revoked the terms of the trust altering or eliminating the beneficial interest. Similarly, a trustee's or trust protector's power also might be considered substantial enough to render the beneficial interest amendable or revocable.[75]

Even if a court determined that a power of appointment or other power rendered the interest in trust too remote to constitute property, a remaining issue is whether the beneficial interest may be considered as an "economic circumstance or other factor."[76] As previously discussed, *Jones* held that an interest in a trust that was deemed to be a mere expectancy and not property should be considered as an economic circumstance under C.R.S.A. section 14-10-113(1)(c).[77] The extent to which C.R.S.A. section 14-10-113(7)(b) overrules that holding is unknown at this time.

*Dale*[78] held that wife's remainder interest in an irrevocable trust created by her grandfather constituted property within the meaning of C.R.S.A. section 14-10-113. The court determined that wife's interest was indistinguishable from the remainder interest in *Balanson*.[79]

Wife contended that she held the remainder interest by virtue of being an "heir at law"[80] of her living father. Because C.R.S.A. section 14-10-113(7)(b) excludes "any interest a party may have as an heir at law of a living person,"[81] the remainder interest, according to wife, was not property. The court noted that the definition of an "heir" is "a person who, under the laws of intestacy, is entitled to receive an intestate decedent's property."[82] The court reasoned that wife held her remainder interest in the trust not as an heir at law under the laws of intestacy, but as a vested

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[75] For example, intentionally defective grantor trusts often are drafted to allow a non-adverse party to add beneficiaries of the trust, which creates grantor trust status under Code section 674 without causing the trust to be included in the grantor's gross estate for federal estate tax purposes.

[76] COLO. REV. STAT. ANN. § 14-10-113(7)(b).

[77] 812 P.2d at 1157.

[78] 87 P.3d at 224.

[79] *Id.* at 225.

[80] *Id.* at 223.

[81] *Id.* at 222-23 (quoting COLO. REV. STAT. ANN. § 14-10-113(7)(b)).

[82] *Id.* at 223 (quoting BLACK'S LAW DICTIONARY 727 (7th ed. 1999)).

beneficiary of an irrevocable trust.[83]

Although the court stated that it need not consider any other interpretive aids, the opinion then added:

> The legislative history shows that § 14-10-113(7)(b) was adopted to overturn the holding in *In re Marriage of Gorman*, *supra*, that a vested remainder interest in a revocable or modifiable trust is a property interest subject to division. Speakers on behalf of the bill specifically referenced the *Gorman* decision and explained that subsection (7)(b) was drafted as a noncompromise measure to accomplish a complete reversal of that holding. The speakers also clearly advised that the statutory change did not address the holding in *In re Marriage of Balanson*, *supra*, and was not intended to change the classification of remainder interests in irrevocable trusts as property subject to division. . . . Hearings on S.B. 02-160 before the Senate Judiciary Committee and the House Judiciary Committee, 63rd General Assembly, Second Regular Session (Jan. 9, 2002).[84]

Perhaps C.R.S.A. section 14-10-113(7)(b) could have been more explicit, but in this author's opinion, criticism of the statutory revision is undeserved. The amendment overruled the *Gorman* decision that was, in the author's opinion, clearly wrong. The amendment succeeded in its primary objective, and any uncertainty created by the statute is minor relative to the problem that it cured.

## III. THE PENSION ANALOGY

To view the development of the law regarding pensions and interests in trusts as parallel and analogous is tempting and, indeed, the analogy may be appropriate in some respects. For example, interests in pensions and trusts may be vested or unvested, and the enjoyment of the benefits may be defeated by the death of the participant or beneficiary.[85] However,

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[83] *See id.*

[84] *Id.* at 224.

[85] In recent years, courts have been willing to divide unvested pension rights. See Bender v. Bender, 785 A.2d 197 (Conn. 2001) and Hansen v. Hansen, 836 A.2d 1288 (Conn. App. Ct. 2003), which stated that the court is not precluded from awarding a spouse a portion of retirement benefits earned by the former spouse subsequent to the date of dissolution. In Colorado, unvested military pensions have been divided by the court. *See Hunt*, 909 P.2d 525. Military pensions do not partially vest, and if twenty years of service is not attained, the entire pension is forfeited. *Id.* at 530.

pensions and interests in trusts can be incongruous in other respects. Some interests in trusts, though vested, may be decreased or eliminated by powers of appointment, distributions to other beneficiaries, and payment of death taxes due upon the death of a current beneficiary of the trust. Other interests, though not vested, may give the beneficiary such a degree of control and enjoyment of the trust property that, when considered as a whole, the bundle of powers and rights is the practical equivalent of ownership of the trust property.

As discussed *infra* Part IV.B, the dissenting opinion in *Jones* suggested that interests in trusts may be valued similarly to prospective pension payments. Courts in other states have made the same analogy.[86]

A. Net Present Value Method

Colorado recognizes three methods of distribution to divide a pension upon dissolution—the "net present value" method, the "deferred distribution" method, and the "reserve jurisdiction" method.[87] The net present value method, also referred to as the "immediate offset" method, results in immediate distribution to the non-employee spouse. The *Hunt* court noted: "If using this method, the trial court, guided by actuarial data, values the future benefit, considers a number of different factors, including certain risks . . ., and accords a present value to the future benefit."[88] The lump sum that represents the present value is offset by the value of other marital property.

Applying the net present value method to trusts presents special issues. A frequent uncertainty in the valuation of an interest in a trust arises as a consequence of a right of a current beneficiary (other than the beneficiary spouse) to receive discretionary distributions from the trust. Many trusts are drafted with, and the tax law encourages, the creation of discretionary interests in trusts for the benefit of an older generation because it allows flexible access to trust property without subjecting the trust property to estate tax at the older generation. A preceding invasionary right can produce a range of outcomes, depending on the circumstances. At one end of the spectrum, the invasionary right might be ignored, but at the other

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[86] *See, e.g.*, *Davidson*, 474 N.E.2d at 1145 n.12 ("[G]uidance in crafting creative judgments may be found in cases dealing with pension interests.").

[87] *See Hunt*, 909 P.2d at 525. *See also* Elizabeth Barker Brandt, *Valuation, Allocation, and Distribution of Retirement Plans at Divorce: Where are We?*, 35 FAM. L.Q. 469 (2001); Marvin Snyder, *Challenges in Valuing Pension Plans*, 35 FAM. L.Q. 235 (2001).

[88] 909 P.2d at 531.

end, the invasionary right might render a divorcing spouse's interest in the trust too uncertain and speculative to be quantified.

Present value calculations involving pensions have been the source of significant litigation, which have required expert testimony, and the resulting calculations can vary significantly.[89] The potential for experts to disagree will be even greater in valuing interests in trusts. The terms of trust instruments will vary more significantly than those of retirement plans. Trusts will involve more subjective valuation factors and perhaps multiple measuring lives. In addition, actuaries and accountants may be ill-equipped to decipher trust instruments and their estate, gift, and generation-skipping transfer tax consequences. Finally, as with pension assets, the offsetting assets may not be sufficient to equal the share awarded to the non-beneficiary spouse.

B. Deferred Distribution and Reserve Jurisdiction Methods

Under the deferred distribution and reserve jurisdiction methods, the latter of which also is referred to as the "wait and see" method, the non-employee spouse does not receive any benefits until they actually are paid to the employee spouse or the employee spouse becomes eligible to receive benefits. The deferred distribution method requires the court to predetermine the non-employee spouse's percentage of the pension stream that the non-employee spouse will be eligible to receive, once the pension is both vested and matured. In *Hunt* the court observed: "If the court reserves jurisdiction, the non-employee spouse's percentage share is calculated later at the time when the pension has vested and matured."[90]

To date, the Colorado appellate courts have not reviewed the application of the deferred distribution or reserve jurisdiction methods in the context of a trust, but courts of other jurisdictions have.[91]

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[89] In *In re Marriage of James*, 950 P.2d 624 (Colo. Ct. App. 1997), the parties' respective experts valued the marital component of a pension plan at $50,000 and $190,000. *See also* Brandt, *supra* note 87, at 483.

[90] 909 P.2d at 531.

[91] At least one court has held that a court cannot use the reserve jurisdiction method or retain jurisdiction to enforce a deferred distribution order. In *Smith v. Smith*, 752 A.2d 1023 (Conn. 1999), the Connecticut Supreme Court reviewed a trial court's order that it would retain jurisdiction to divide the trust if a subsequent determination was made that the husband had an interest in the trust. Husband simply disclosed that he was a remainder beneficiary of a family trust, but provided no other information regarding the interest. The Connecticut Supreme Court held that the Connecticut enabling statute did not permit the trial court to retain continuing jurisdiction to divide interests in trusts that were "expected

## IV. VALUATION OF INTERESTS IN TRUSTS

Once a court has determined that an interest in trust constitutes property for purposes of property division, another more complex analysis may be involved in determining the value of the interest. Trusts are designed to accomplish a variety of purposes, and the design of dispositive trust provisions are almost unlimited. Courts will be required to analyze not only the interests of the trust beneficiaries, but also the powers, duties, discretions, and guidelines of the trustee. The task will be challenging for a court in its review of a well-drawn trust instrument. Unfortunately, not all trust instruments are well-drawn, and a court may be required first to construe the meaning of an ambiguous document before assigning a value. In addition, valuation of interests in trusts may require a trial court to consider matters extrinsic to the trust instrument and the marriage that typically are not considered in a proceeding for a dissolution of marriage or legal separation.

### A. Colorado Law

To date, the Colorado decisions have provided only general guidance as to methods of valuing interests in trusts. As discussed below, the appellate decisions do, however, vest broad discretion in the trial court to determine appropriate valuation methods.

### B. *Jones* and *Balanson*

As previously discussed, *Jones*[92] held that a beneficiary's interest in the principal of the trust did not constitute the separate property of a spouse for purposes of division under C.R.S.A. section 14-10-113. In the dissenting opinion in *Jones*, one justice stated that he would have treated the increase in the value of the trust assets during the marriage as marital property.[93] Acknowledging that apportioning the increase in the value of a trust may be difficult, the dissenting opinion stated that trial courts are faced with valuation difficulties every day. The dissent stated:

> As in the case of valuing prospective pension payments, a court can employ any of several alternatives. One alternative might [be] to place a value on [the beneficiary's] interest in the increased value of the trust corpus by utilizing a table similar to that for

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or unvested interests, or to interests that the court has not quantified." *Id*. at 1030.

[92] 812 P.2d 1152.

[93] *Id.* at 1159 (Quinn, J., dissenting).

> valuing a remainder interest for purposes of estate taxes. Another alternative might consist of ordering a percentage of future funds received by the beneficiary to be paid over to the other spouse. Other alternative methods can be employed, based upon a trial court's "experience, insight and knowledge."[94]

*Balanson II* provided trial courts with similar but less specific guidance in valuing interests:

> Other courts that have addressed the valuation of similar interests have suggested an approach similar to that taken when valuing pensions. Under this approach, we conclude that the trial court may consider a variety of circumstances when determining the present value of the trust, including actuarial information concerning the life expectancy of [the beneficiary holding the current possessory interest in the trust] and information concerning the probability and extent to which [the beneficiary holding the current possessory interest] will need to invade principal for [the beneficiary's] maintenance.[95]

In the author's opinion, *Balanson II* and the dissent in *Jones* provide trial courts with the following guidance in valuation:

1. A trial court may value beneficial interests in trusts in the same actuarial manner utilized for federal transfer tax purposes.[96]
2. A trial court may order that a percentage of trust distributions received by the beneficiary's spouse subsequent to a legal separation or dissolution of the marriage be paid to the non-beneficiary spouse.[97]
3. A trial court may utilize other unspecified valuation methods based upon the court's "experience, insight and knowledge."[98]
4. A trial court may consider a variety of circumstances, including actuarial information, concerning the life expectancy of

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[94] *Id.* at 1160 (citations omitted).

[95] *Balanson II*, 25 P.3d at 43 n.6 (citations omitted).

[96] The *Jones* dissent suggested the application of estate tax principles. *See Jones*, 812 P.2d at 1160 (Quinn, J., dissenting). Presumably, federal gift tax principles also would apply. The term "transfer tax" refers to the federal estate, gift, and generation-skipping transfer taxes.

[97] *See Balanson II*, 25 P.3d at 42.

[98] *Jones*, 812 P.2d at 1160 (Quinn, J., dissenting).

> other beneficiaries of the trust, and the extent to which other beneficiaries of the trust eligible for distributions may require principal distributions.[99] Impliedly, an invasion power exercisable in favor of a non-spouse beneficiary may be quantified in the calculation of the beneficiary spouse's interest.

C. *In re* Marriage of Mohrlang

*In re Marriage of Mohrlang*[100] concerned husband's interest in an irrevocable trust that was "not modifiable."[101] The trust principal consisted of stock in a closely-held corporation, which had appreciated since the date of the marriage.[102] Income of the trust was required to be distributed to husband at least quarterly, and principal distributions to husband could be made to him for his health, maintenance, support, and education, within the discretion of the trustee. Husband's interest would terminate if he predeceased his parents, in which case his share would be divided among his children and the descendants of any of his deceased children. Apparently, the trust principal would be distributed to husband upon his parents' deaths. No other person held an interest in the trust that preceded or existed concurrently with husband's interest in the trust.[103]

The trial court did not discount to present value husband's interest in the trust. At issue on appeal was whether the trial court erred in failing to discount the interest to its present value.[104] The court of appeals held that the trial court "should have considered actuarial information concerning the life expectancy of husband's parents and . . . the likelihood that the

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[99] *Balanson II*, 25 P.3d at 43 n.6.

[100] 85 P.3d 561 (Colo. Ct. App. 2003), *cert. denied*, No. 03SC701, 2004 WL 423111 (Colo. Mar. 8, 2004).

[101] *Id.* at 562.

[102] Husband's expert valued the trust assets (the stock) on an income approach using a capitalization rate of 33% and a present value discount rate of 4% (for an unspecified number of years) because husband's interest in the trust would not become possessory until his parents died. Wife's expert valued the stock, and the trial court agreed, on the basis of the corporation's net assets. *See id.*

[103] *Id.*

[104] *Id.* at 563. Because the husband had a mandatory income interest, a right to distributions of principal within the trustee's discretion, and the children of the marriage would receive the assets if husband died, the trial court determined that present value discounting was not warranted. The court of appeals determined that the trial court erred by rejecting any discount because husband's interest would go to his children if he predeceased them. *Id.*

trustee would invade the trust corpus in the future."[105] The trial court was reversed and the case was remanded to "reconsider whether the value of husband's trust interest . . . should be discounted by an appropriate rate because of the delay in husband's receiving his interest, the possibility of forfeiture, and other contingencies."[106]

*Mohrlang* raises the following questions:

1. How is an appropriate discount rate determined?[107]
2. What tables are used in determining life expectancy of a measuring life?
3. Should the analysis be limited to actuarial tables or should other factors such as the actual health of a measuring life (e.g., the parents of husband) be considered?
4. Does the possibility of husband's death prior to his parents' death reduce the value of the interest in the trust?[108]
5. Assuming the trust instrument allows for discretionary distributions, how might a history of discretionary distributions of principal affect valuation?
6. What are the "other contingencies" mentioned in *Mohrlang* for a trial court to consider?[109]

As many questions as *Mohrlang* raises, it may provide one bright line rule. Regardless of whether the beneficiary is entitled to mandatory income distributions and discretionary distributions of principal, the trial court at least must consider if the interest in the trust should be discounted to its present value for the period of time until the interest becomes possessory.

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[105] *Id.*

[106] *Id.*

[107] The court noted *In re Marriage of Grubb*, 745 P.2d 661 (Colo. 1987), which applied a 7% discount rate in connection with valuation of a pension. *Mohrlang*, 85 P.3d at 563.

[108] For example, the additional life expectancy of a sixty-four year old under mortality table 90CM, the most recent mortality table for determining the gift and estate tax values of various component interests in property, is approximately seventeen years. The probability of a forty year old dying within seventeen years is 7.5%. It would seem that the calculation suggested by *Mohrlang* could reduce the present value of the trust assets by 7.5% to account for the risk that the beneficiary might not survive until the distribution date.

[109] *Mohrlang*, 85 P.3d at 563.

D. *In re* Marriage of Dale

In *Dale* the Colorado Court of Appeals affirmed the trial court's valuation of a remainder interest that was, according to the court, similar to the remainder interest of the B trust in *Balanson II*.[110] The trial court valued the marital appreciation in wife's interest at $313,962 and awarded husband $120,867.50 of that amount. One-half of the amount was to be paid within sixty days after the death of wife's father (the current beneficiary), and the other half was to be paid after the death of wife's mother.[111] The trial court discounted the interest to present value by applying a six percent discount rate.[112] The court based the term of the present value calculation on the mortality table in C.R.S.A. section 13-25-103.[113]

Wife argued that the valuation was defective because the valuation was not based on expert testimony, no rationale for the discount rate was provided, and the discount rate did not account sufficiently for the mother's usufructuary interest, trustee fees, tax liabilities, market changes in the value of trust principal, or capital gains tax due on trust distribution. The court rejected those arguments and held that the trial court's calculations were reasonable based on the limited information from which the trial court could determine value.[114]

E. Extrinsic Matters

Depending upon the terms of the trust instrument, potential matters subject to discovery include the trust assets, prior trust distributions, accountings and tax returns of the trust, and the age, health, and financial resources (including other trusts) of beneficiaries of the trust who possess

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[110] 87 P.3d 219.

[111] Wife's grandparents created and funded the trust, and wife's eighty-three year old father was the current trust beneficiary. The value of the trust at the time of hearing was $6,647,781. The trust income was distributed to wife's father, but the father had not taken any distributions of principal since 1953. One-half of the trust principal was to be distributed at the father's death to wife and her three siblings, and the balance was to be similarly distributed upon the death of wife's mother who held (or might hold) a beneficial interest in the trust for life as a result of the father's exercise of a power of appointment. *Id.* at 223.

[112] *Id.* at 225. Husband submitted the discount rate, but the court did not mention another rationale for the selection of the rate.

[113] *Id.* C.R.S.A. section 13-25-102 provides, in part, that "[i]n . . . civil actions . . . when it is necessary to establish the expectancy of continued life of any person . . . the table [of] section 13-25-103 shall be received as evidence, together with other evidence as to health, constitution, habits, and occupation of such person of such expectancy."

[114] *Dale*, 87 P.3d at 225-26.

beneficial interests that precede or exist concurrently with the beneficial interest of the divorcing or separating spouse. A more subjective analysis may be involved when the holder of a power of appointment, trustee power, or trust protector power could exercise such power to the detriment of a divorcing or separating spouse, assuming that such a power does not render the interest too remote to constitute property.

F. Other Jurisdictions

Other states have addressed valuation of interests in trusts, and the methods of valuation have been diverse and, in some instances, not well reasoned. The following discussion is a sample of methods employed by various jurisdictions.

In *McCain v. McCain*,[115] husband possessed remainder interests in two tracts of farmland subject to life estates of one aunt for one tract and another aunt for the second tract. The court valued husband's remainder interest as it would have been valued for federal estate tax purposes, which is a present value calculation.[116]

In *In re Marriage of Von Ofenheim*,[117] the court of appeals accepted the trial court's calculation of the present value of husband's interests in three trusts and wife's award of the marital assets was determined to be a sum secured by husband's interest in the trusts.[118] The award was to be paid on the date one of the trusts was to terminate, with interest to accrue until payment.[119]

The Montana Supreme Court in *Buxbaum v. Buxbaum*[120] reviewed the valuation of a trust beneficiary's vested remainder interest subject to defeasance by a power of invasion for the benefit of the beneficiary's living mother. After first concluding that the remainder interest should be in-

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[115] 549 P.2d 896 (Kan. 1976). The Quinn dissenting opinion in *Jones* cited *McCain* as authority that estate tax valuation principles are applicable in valuation of interests. *Jones*, 812 P.2d at 1160 (Quinn, J., dissenting).

[116] The court used the table set forth in Treasury Regulation section 20.2031-10(f), which applied to transfers prior to May 1989. For transfers after April 1989, the method required by Code section 7520, discussed *infra* Part IV, will apply.

[117] 596 P.2d 1007 (Or. Ct. App. 1979).

[118] *Id.* at 1009. The court directed husband to execute an assignment of his interests as security for payment of the judgment. *Id.* at 1010. The opinion does not indicate if the trust instrument contained a spendthrift or anti-alienation provision, but does indicate that husband's interest in the trust was pledged to the repayment of a loan he obtained.

[119] *Id.* at 1010.

[120] 692 P.2d 411 (Mont. 1984).

cluded in the marital estate, the court affirmed the trial court's valuation of the remainder using the undiscounted appraised value of the trust assets. Rejecting the beneficiary spouse's contention that the discounted present value of the interest be used, the court reasoned that the current value of the remainder interest was used as collateral by a corporation of which the trust was a thirty-five percent shareholder.[121]

In *Fox v. Fox*,[122] the Supreme Court of North Dakota considered the value of wife's interest in an irrevocable life insurance trust that held life insurance policies insuring husband's life. The policies had a cash value of $290,000, and wife was the trustee of the trust. Wife was entitled to all the trust income from its inception and after husband's death. Wife, during any calendar year, also could withdraw the greater of $5,000 or five percent of the trust principal. In determining the value of wife's interest in the trust, the trial court agreed with the approach propounded by wife's expert, who provided several different scenarios.[123]

The expert calculated the value of wife's interest in the following manner:

1. The cash values of the life insurance policies were determined.
2. A payment stream of the income until husband's projected date of death was calculated using an assumed interest rate.[124]
3. The trust income for wife's remaining life expectancy after the husband's projected date of death was calculated in addition to the greater of $5,000 or five percent of the trust principal per year.
4. The sum of the income and withdrawn principal was discounted to its present value.[125]

The North Dakota Supreme Court upheld the trial court's determination as

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[121] *Id.* at 413-14.

[122] 2001 ND 88, 626 N.W.2d 660 (2001). *See also* Fox v. Fox, 1999 ND 68, 592 N.W.2d 541 (N.D. 1999).

[123] *Fox*, 2001 ND 88 at ¶ 10, 626 N.W.2d at 662-63. The different scenarios altered the projected dates of death of husband and wife. In contrast, husband's expert determined wife's interest in the trust to have a much higher value, based in part on the death benefit of the policies and no reduction of the interest to its present value. *Id.* at ¶ 6, 626 N.W.2d at 662.

[124] In Colorado, the mandatory income interest would not have been considered as property. See *Guinn*, 93 P.3d at 568, discussed *supra*.

[125] *Fox*, 2001 ND 88 at ¶¶4-5, 626 N.W.2d at 661.

being within the range of its discretion.[126]

In *Fox* the income beneficiary's interest was valued for purposes of a property division.[127] It appears, however, that the analysis would have been applicable for the valuation of the remainder interest in the irrevocable life insurance trust. If the court sought a valuation of the remainder interest, the interest would have been the current value of the trust assets reduced by the present value of the income beneficiary's interest.

As mentioned, the trust reviewed in *Fox* was an irrevocable life insurance trust.[128] Irrevocable life insurance trusts are common estate planning devices that are used to make life insurance policy proceeds available to an insured's family without subjecting the proceeds to estate tax at the deaths of the insured or the insured's spouse. With the frequent use of irrevocable life insurance trusts, courts likely will encounter them in identifying and valuing interests in trusts.

In *Trowbridge v. Trowbridge*,[129] husband was entitled to a future distribution of a remainder interest that was subject to husband's mother's income interest, her right to withdraw $5,000 of trust principal in any year, and her right to receive additional amounts of principal as the bank trustee "deem[ed] necessary or advisable for certain purposes."[130] The Wisconsin Supreme Court approved the trial court's decision to award wife thirty percent of whatever accrued to husband.[131] The court further stated that the trial court

> could properly order [husband] to transfer to [wife] or her heirs, legatees, or assigns, 30 per cent of any funds received by [husband] from the trust and could contain other provisions to make that one effective, such as retaining jurisdiction for the purpose of enforcement, enjoining [husband] from attempting to transfer or surrender his interest, or otherwise act to prejudice [wife's] rights, and imposing a lien upon the assets now assigned to [husband] as

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[126] According to the supreme court, the trial court's valuation was dependent upon the evidence presented by the parties and "judges, whether trial or appellate, are not ferrets, obligated to engage in unassisted searches of the record for evidence to support a litigant's position." *Id.* at ¶ 22, 626 N.W.2d at 665.

[127] *Id.* at ¶ 10, 626 N.W.2d at 663.

[128] *Id.* at ¶ 1, 626 N.W.2d at 661.

[129] 114 N.W.2d 129 (Wis. 1962).

[130] *Id.* at 134.

[131] *Id.*

security for the transfer of 30 per cent of the trust proceeds.[132]

In *Zuger v. Zuger*,[133] husband's deceased father created a testamentary trust that was valued at $936,000 at the time of trial. The surviving spouse, husband's mother, possessed a mandatory income interest during her life and a right to withdraw the greater of $5,000 or five percent of the trust principal each calendar year on a noncumulative basis. At the mother's death, the principal was to be distributed equally between husband and his three siblings. Because the principal could be invaded, the trial court concluded that an award to wife of a specific dollar amount would be speculative, and instead ordered that wife receive one-half of husband's share when it became available to him. The North Dakota Supreme Court upheld the percentage and the method of distribution.[134]

Notably, husband's interest in the trust in *Zuger* could have been quantified easily by making a present value calculation.[135] Although the approach in *Zuger* eased the burden of the trial court by eliminating complex analysis, this author believes that courts should rely on such an approach only as a last resort. Otherwise the risk that the divorced spouses, trustees, and other trust beneficiaries will become entangled in controversies regarding the administration of trusts and the exercise of powers and discretions is significant. A court may be tempted to use a method that avoids the current valuation of an interest in a trust, such as when the parties provide little evidence to establish a value; but the failure to quantify an award raises the risk of continuing financial and emotional entanglement of ex-spouses and their families.

## V. ESTATE AND GIFT TAX VALUATION OF TEMPORAL INTERESTS

Determining the value of a future interest in a trust on the basis of

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[132] *Id.* at 136.

[133] 1997 ND 97, ¶ 12, 563 N.W.2d 804, 807 (1997).

[134] *Id.* at ¶ 15, 563 N.W.2d at 807.

[135] Using Tiger Tables Software and estate and gift tax principles, assuming husband's mother's age was seventy-five at the time of trial, the section 7520 rate was 6%, husband or his estate was a one-third remainder beneficiary, and the value of the trust was $936,000, then husband's interest in the trust was $118,706.25. The above calculation reduces the remainder interest by the mother's income interest and her "5 and 5" power. If husband were required to survive to take the interest, a reduction in the value of his remainder interest could be made to account for the risk of husband's death within eleven years (mother's remaining life expectancy). For example, the probability of a forty year old individual dying within eleven years is 3.6% (applying the same mortality tables).

relevant facts and circumstances may require consideration of matters such as the health of beneficiaries, the specific assets held in trust, the past performance of trust investments, the projections for future performance, the prior trust distributions, the identity of the trustees, and a number of other subjective factors. To avoid a facts and circumstances analysis, Congress mandated the use of actuarial valuation tables for certain tax purposes.[136]

Valuation under Code section 7520 is a present value calculation that applies mortality and interest rate factors mandated by the Code.[137] In other present value calculations, the selection of discount rates may vary depending upon market conditions and the specific assets being valued. Similarly, other mortality tables exist that produce values different from that required by Code section 7520.

For interests in trusts to which Code section 7520 would apply, a trial court likely could use those principles within the exercise of its discretion and eliminate considerable uncertainty in valuing future interests in trusts in a property division.[138]

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[136] I.R..C. § 7520(a) (2000) (requiring the application of actuarial tables to value "any annuity, any interest for life or a term of years, or any remainder or reversionary interest"). The tables prescribed under section 7520 apply for valuation purposes to income tax charitable contributions, charitable remainder trusts, estate tax valuation, estate tax charitable deductions, gift tax valuation, gift tax charitable deductions, and generation-skipping transfer tax valuation. *See* Treas. Reg. §§ 1.7520-1(a), 20.7520-1(a), 25.7520-1(a) (2004). Code section 7520 tables do not apply to qualified retirement plans and certain other tax valuations. *See* I.R.C. § 7520(b); Treas. Reg. § 1.7520-3(a).

[137] I.R.C. § 7520(a). The discount rate "is the rate of return, rounded to the nearest two-tenths of one percent, that is equal to 120 percent of the applicable Federal mid-term rate, compounded annually, for purposes of section 1274(d)(i), for the month in which the valuation date falls." Treas. Reg. § 1.7520-1(b)(1)(I). "The mortality component reflects the mortality date most recently available from the United States Census." Treas. Reg. § 1.7520-1(b)(2). The pertinent factors are published in I.R.S. Publications 1457 & 1458 (July 1999). The calculation of such values is typically made using computer software programs.

[138] At least one court has ignored the application of section 7520 valuation when application was clearly applicable for tax purposes. In *Skokos v. Skokos*, 40 S.W.3d 768, 775-76 (Ark. 2001), the trial court valued husband grantor's reversionary interests (and not the grantor's term interests, which were not at issue) in qualified personal residence trusts at more than nine times their values for gift tax purposes. The grantor of a qualified personal residence trust retains the right to live in the residence for a term of years and also may retain a reversion if the grantor dies during the term. The remainder interest constitutes the gift, which is valued in accordance with Code section 7520. *See* Treas. Reg. § 25.2702-5(c). The expert who propounded the higher value was a real estate appraiser. *Stokos*, 40 S.W.2d at 775-76. The expert who propounded the gift tax value for the reversion was a tax lawyer using a computer software program to determine the value. *Id.* In-

In valuing a remainder interest under Code section 7520 for gift tax purposes, the calculation does not take into account the risk that a remainder beneficiary's death may occur prior to trust distribution. In the context of a property division, reducing the value of a beneficiary's interest by a factor attributable to the risk that the beneficiary might not survive until the projected date of distribution (e.g., the death of the current trust beneficiary) may be appropriate. The same mortality tables could be used to determine a reduction in the value of a remainder interest attributable to the possible death of the remainder beneficiary prior to the distribution of the remainder interest.

Some interests in trusts cannot be valued actuarially for tax purposes because of a contingency, power, or other restriction,[139] and if the tables are not applicable, the value for tax purposes is based on all the facts and circumstances.[140] Diversions of income and corpus also may prevent the application of the Code section 7520 tables for tax valuations,[141] as will a terminal illness for a measuring life.[142] If valuation under the tables is not allowed for tax purposes in these situations, logic dictates that valuation by exclusive reliance on the tables for the purposes of a property division is also inappropriate.

Some interests in trusts, though subject to contingencies and diversions, will be certain enough to constitute property for purposes of property division. This category of interests will present the greatest challenge to a trial court. A number of factors may be relevant in valuing these interests, including a review of prior diversions of trust property and the resources of current trust beneficiaries. In those instances, qualitative analysis and creative solutions by trial courts will be required. Complex discovery and the participation of trustees and family members in the pro-

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stead of requiring the distribution of the trust to the grantor on the sale of the residence, which the *Skokos* trusts required, a qualified personal residence trust may be drafted to provide that the trust assets must be converted to a qualified annuity interest upon the sale of the residence. *See* Treas. Reg. § 25.2702-5(c)(8). If the trust instrument did not require distribution of the trust assets to the grantor upon sale, the argument for gift tax valuation would have been more compelling.

[139] Treas. Reg. §§ 20.7520-3(b)(1)(ii), 25.7520-3(b)(1)(ii).

[140] *Id.* §§ 20.7520-3(b)(iii), 25.7520-3(b)(iii).

[141] *Id.* §§ 20.7520-3(b)(2)(B), 25.7520-3(b)(2)(B).

[142] *Id.* §§ 20.7520-3(b)(3), 25.7520-3(b)(3). For this purpose, "an individual who is known to have an incurable illness or other deteriorating physical condition is considered terminally ill if there is at least a 50 percent probability that the individual will die within 1 year." *Id.* §§ 20.7520-3(b)(3), 25.7520-3(b)(3).

ceedings also will be required.

Even in those situations in which contingencies and diversions require a facts and circumstances analysis, tax valuation principles still may be useful to a trial court. For example, if a court determined that a power of invasion in a trust for the support of a divorcing spouse's parent might reduce the value of the trust corpus by as much as one-half, would a Code section 7520 valuation of the spouse's remainder interest utilizing one-half of the value of the trust corpus be beyond the bounds of a trial court's exercise of reasonable discretion? Tax law also may be useful, at least by way of analogy, in instances in which a trial court exercises discretion in quantifying contingencies and diversions.

A power of invasion or a contingency over trust principal does not, under tax law, necessarily render actuarial valuation inapplicable. If the possibility of the diversion of principal is negligible or remote, the diversionary right may be ignored. For example, if a gift to charity is dependent upon a condition or power, no estate tax charitable deduction is allowed unless the possibility that the charitable interest would not become effective is so remote as to be negligible.[143] In *Estate of Jack v. Commissioner,*[144] a widow's right to discretionary distributions of trust principal for comfort and support had no value because the widow's property and the income from the trust substantially exceeded her needs, the widow was of advanced age, no distributions of principal were made to the widow, and distributions were allowed only to maintain the widow's standard of living and only if the income of the trust was insufficient. Accordingly, the remainder's passing to charity qualified for the estate tax charitable deduction.[145] In *Estate of De Foucaucourt v. Commissioner*,[146] the ability of an elderly and disabled individual to have or adopt children also was considered so remote as to be negligible and did not disqualify the deduction for the remainder interest's passing to charity.[147] In the context of dividing interests in trust in a property division, this principle would be equally applicable, and the remainder interest of a spouse should be undiminished by the diversionary rights of current trust beneficiaries in some

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[143] *See id.* § 20.2055-2(b).
[144] 6 T.C. 241 (1946).
[145] *Id.*
[146] 62 T.C. 485 (1974).
[147] Prior to the Tax Reform Act of 1969, but not after, an interest in a split interest trust, such as those in *Estate of Jack* and *Estate of De Foucaucourt*, could qualify for the estate tax charitable deduction. Code section 2055(e)(2) now requires that one of three qualifying methods be used.

circumstances.

In *Estate of Gokey v. Commissioner*,[148] the Tax Court valued two remainder interests passing to the decedent's children on the basis of the actuarial tables for estate tax purposes.[149] The remainder interests were subject to the corporate trustee's power to invade income or principal for the benefit of the settlor's spouse if the trustee determined such use necessary for the spouse's care, comfort, support, or welfare.[150] The trust instrument did not require the trustee to consider any of the spouse's other assets. The taxpayer argued that the remainder interests had no value because no one would buy a remainder interest subject to a spendthrift provision and power of invasion.[151] The Seventh Circuit reversed the Tax Court,[152] holding that the tables did not apply and that the value must be determined under the willing buyer and willing seller test because of the power of invasion.[153] The Seventh Circuit also determined that the value of the remainder interest was not reduced by the spendthrift provision because the inability to sell the remainder interests was offset by the inability of creditors to reach the assets.[154] On remand, the Tax Court considered the needs of the spouse for the rest of her life by reviewing her recent expenditures and the value of her other assets.[155] Noting the "inherent uncertainty in any valuation case,"[156] the Tax Court then valued the remainder interests at approximately twenty-four percent of the value of the interests under the tables. The opinion did not disclose how the Tax Court arrived at the values.

One distinction between tax valuation and valuation for property division purposes deserves mention. In effect, the revenue law has one bite at the apple. If a transfer of property is not valued and taxed at the time of the event (e.g., gift or death), the revenue to the government is lost forever. At least in Colorado, the court may have more than one opportunity

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[148] 72 T.C. 721 (1979), *rev'd in part*, 735 F.2d 1367 (7th Cir. 1984) (Table, No. 83-1492, 83-1430), *remanded to* 49 T.C.M. (CCH) 368 (1984).

[149] *Id.* at 728.

[150] *Id.* at 724.

[151] *Id.* at 728.

[152] *Gokey*, 735 F.2d at 1367.

[153] See *Gokey*, 49 T.C.M. (CCH) at 368; *see also* Treas. Reg. §§ 20.2031-1(b), -9.

[154] *See Gokey*, 49 T.C.M. (CCH) at 368-69.

[155] *Id.* at 369. According to the court, "the proper method of analysis is to determine whether the power of invasion is subject to an ascertainable standard, and if so, to determine the remoteness of invasion, or the extent of possible invasion under the standard." *Id.*

[156] *Id.*

to deal with an interest in trust in a property division. If a trial court determines that the interest is too uncertain or remote because of an invasionary right to be considered property, the court still has the discretion to consider the interest as an economic circumstance of a spouse.[157]

## VI. TAX CONSEQUENCES AS A FACTOR IN VALUATION

Should the tax treatment of the trust and the beneficiaries be considered in the valuation of an interest in trust?[158] Consider a trust for which a QTIP election has been made.[159] Assume that deceased father's will established a trust that provides mother with income for her life to be paid at least annually. At mother's death, the trust is to be distributed to wife. Assuming a QTIP election was made with respect to the property and the property qualifies for QTIP treatment, the trust will be included in mother's gross estate for estate tax purposes.[160] Unless mother provides otherwise in her will, the QTIP trust property will be subject to estate tax at the highest marginal rate for mother's estate.[161] For decedents who die in 2005, the estate tax on the QTIP property could be as much as forty-seven percent of the property's value.[162] Thus, valuing wife's remainder interest in the QTIP trust for property division purposes without taking into account its estate tax treatment at the mother's death could result in a gross overstatement of value.

Income tax treatment of the trust and its beneficiaries may be another factor to consider. As a general rule, distributions from trusts are excluded from the beneficiary's gross income[163] but distributions that constitute the income from trust property are not.[164] In-kind distributions will not result in gain or loss or constitute income to a beneficiary, unless the trustee uses

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[157] *See* COLO. REV. STAT. ANN. § 14-10-113(1)(c).

[158] In *Dale*, 87 P.3d at 226, the court stated that "a trial court is not obligated to consider hypothetical tax implications."

[159] If a QTIP election is made pursuant to Code section 2056(b)(7) or Code section 2523(f), the property will qualify for the estate tax marital deduction and gift tax marital deduction, respectively.

[160] *See* I.R.C. § 2044 (2000).

[161] *See id.* § 2207.

[162] *See id.* § 2001(c)(2)(B) (West 2002).

[163] *See id.* § 102(a).

[164] *See id.* § 102(b). The distribution will be carried out in proportionate share to the distributable net income under the rules of Code section 662, unless the amount is paid as a specific sum of money or of specific property and is paid all at once or in not more than three installments. *See id.* § 663(a). If the income is used to satisfy a beneficiary's legal obligation, the income is taxable to the beneficiary. *See* Treas. Reg. § 1.661(a)-2(d) (2004).

appreciated property in satisfaction of a right to receive a specific dollar amount, the distribution is in satisfaction of a right to receive property other than that distributed, or the in-kind distribution is in satisfaction of the right to receive income.[165]

Assuming that an in-kind distribution is excluded from the beneficiary's income, the income tax basis of the assets acquired by the beneficiary will be determined under Code section 1015. Generally, for gain purposes, the beneficiary's basis will be the grantor's basis,[166] unless the rules of Code section 1014 apply (e.g., property is acquired from a decedent).

If the non-beneficiary spouse is awarded offsetting marital property, income tax consequences of a trust distribution or sale of distributed property projected to occur in the future is unlikely to be a significant factor.[167] Yet, if an obligation is due to the non-beneficiary spouse at trust distribution or if the division is deferred, and a compulsory sale of the assets by the beneficiary is anticipated several years after the dissolution of marriage, the income tax payable by the beneficiary spouse may alter the intended economics of the property division. If the property settlement allows the beneficiary spouse to distribute assets in kind to the non-beneficiary spouse, a transfer occurring more than six years after the divorce is not guaranteed to qualify for non-recognition treatment under Code section 1041.[168]

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[165] *See* Treas. Reg. § 1.661(a)-2(f).

[166] *See id.* § 1.1015-2(a)(1). The beneficiary's holding period for the property will include the trust's holding period. I.R.C. § 1223(2).

[167] In valuing pensions, in which distribution lies in the future, one authority stated that "[i]n the common cases of present value, the taxable event lies so far in the future that to attempt to assess a discount for taxes would be mere speculation and not likely to be accepted by the court." FEDER, *supra* note 5, at 273.

[168] Code section 1041(a), (c) provides:

> No gain or loss shall be recognized on a transfer of property from an individual to (or in trust for the benefit of) . . . a spouse, or . . . former spouse, but only if the transfer is "incident to the divorce" . . . . [A] transfer of property is incident to the divorce if such transfer . . . occurs within 1 year after the date on which the marriage ceases, or . . . is related to the cessation of the marriage.

Temporary regulations provide that a transfer is related to cessation of the marriage if the transfer is both pursuant to a divorce or separation instrument and occurs not more than six years after the date on which marriage ceased. *See* Temp. Treas. Reg. § 1.1041-1T(a), Q & A-7 (2004). Transfers that fail the test are presumed to be non-divorce related, but the presumption is rebuttable by showing that the transfer was made to effect the division of property owned by the parties at the time of the divorce. The Treasury Regulations further state that the presumption may be rebutted by showing factors that hampered an earlier transfer of the property, such as legal or business impediments. *See*, *e.g.*, Priv. Ltr. Rul. 92-

## VII. CONCLUSION

Considering the vast amount of wealth held in trusts, the stakes will be high when interests in trusts fall within the pool of divisible assets in a dissolution of marriage. The issues will be technical and the process is likely to spark antagonism and conflict. If any prediction is possible regarding the evolution of the law in this area, the prediction is that change is extremely likely and uniformity among the jurisdictions is unlikely. Needless to say, dividing interests in trusts in a dissolution of marriage will be challenging.

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35-026 (May 29, 1992). Nonetheless, in the absence of a private letter ruling, there can be no certainty as to the outcome of a transaction occurring more than six years after the decree and several questions regarding the temporary regulations remain open. *See* CINDY LYNN WOFFORD, TAX MANAGEMENT PORTFOLIO, DIVORCE AND SEPARATION, No. 515-2nd T.M., § IV.E.3.b (rev. 2004).