



Measuring the Value of Trust Interests in Dissolution of Marriage Proceedings

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A spouse's trust interest in an irrevocable trust may be characterized as separate property in a dissolution of marriage proceeding, but the increase in the interest's value during marriage is marital property. This article considers the relevant time period for measuring the increase in value of common trust interests under current Colorado authority.

Parents and grandparents have long provided for future generations by placing assets in various types of trusts. Some trust beneficiaries bring their trust interests into marriages, while others obtain their interests during the marriage. A trust interest remains the beneficiary's separate property, but the increase in value of the interest during the marriage is marital property that must be calculated in a dissolution of marriage proceeding. The type and design of a trust interest affects the nature of the interest as property. It also determines the starting date for measuring the interest's increase in value during the marriage, which can drastically impact the overall division of marital property.

In Colorado, the *In re Marriage of Balanson* line of cases¹ has given rise to several issues concerning how to value the interests of parties who are beneficiaries of irrevocable trusts that could be considered property in a dissolution of marriage proceeding. The *Balanson* cases and the Colorado legislature's enactment of CRS § 14-10-113(7)(b) in 2002 in response to *In re Marriage of Gorman*² have resulted in different opinions among experts on issues related to trust interests as property, such as:

- how various types of powers of appointment affect the treatment of a remainder interest in an irrevocable trust as property or an economic circumstance under CRS § 14-10-113(7)(b),³
- how to analyze a remainder interest as property when an irrevocable trust is decanted,⁴

- whether and when a remainder interest in an irrevocable qualified personal residence trust or an irrevocable grantor retained annuity trust should be treated as property or an economic circumstance, and
- the relevant time period for measuring the increase in value of a trust interest and how an outright distribution from a trust impacts this issue.

This article addresses the last issue, regarding when to start measuring the increase in value of a trust interest for division of marital property purposes. It focuses on interests in irrevocable trusts.

Dividing Marital Property in Colorado

In a Colorado dissolution of marriage proceeding, the court must set apart to each spouse his or her separate property and divide the marital property after considering all relevant factors.⁵ The relevant factors concerning the division of marital property include, but are not limited to, "[t]he value of the property set apart to each spouse," "[a]ny increases or decreases in the value of the separate property of the spouse during the marriage," and "[t]he economic circumstances of each spouse at the time the division of property is to become effective."⁶

A three-step process governs the characterization of property in a dissolution of marriage proceeding. First, courts must determine whether a property interest exists.⁷ Second, if there is a property interest, courts must determine whether that interest is separate or marital.⁸

Notably, a spouse's separate property includes property acquired before the marriage or acquired by "gift, bequest, devise, or descent" during the marriage.⁹ Third, if there is a separate property interest, courts must calculate the portion of that interest's increase in value that is marital property, beginning at the time of marriage or at the time of acquisition if acquisition occurred after the marriage.¹⁰ This analysis for a trust interest frequently requires the assistance of a trust and estate attorney to provide expertise on the legal aspects of the issues, and a valuation expert, usually an accountant, to calculate the increase in value of the trust interest.

Types of Trust Interests

A grantor of a revocable trust reserves the right to amend or revoke the trust without the consent of a trustee or a person holding an adverse interest.¹¹ If a trust agreement executed after August 7, 2013, does not expressly provide that the trust is irrevocable, that trust is revocable.¹² Even for trusts that are deemed irrevocable, a number of approaches are available under Colorado law to change that trust's terms and operation.¹³

Colorado appellate cases involving trusts in dissolution of marriage proceedings address three main types of irrevocable trust interests: a mandatory income interest, a discretionary interest to income and/or principal (which is subject to the trustee's discretion), and a remainder interest. One beneficiary may have multiple types of interests in the same trust.

A beneficiary who holds a mandatory income interest is generally entitled to receive the net income generated from the trust assets.¹⁴ The trust agreement usually states how frequently the distributions of income must occur, which is typically monthly, quarterly, semiannually, or annually. Many trusts give the trustee discretion to determine the allocation of investments in the trust between fixed income and assets likely to appreciate. The asset allocation can significantly impact the amount of trust income generated.

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income and/or principal to the beneficiary. When the holder of a discretionary interest dies or another trust-specified event occurs (e.g., expiration of a term of years), the discretionary interest terminates and the beneficiary has no further interest in the trust.

Lastly, a beneficiary who holds a remainder interest receives the trust's assets when the trust is distributed on termination. For example, when a trust terminates after the final expenses of the trust's administration have been paid or put into a reserve, a beneficiary with a one-fourth remainder interest would receive one-fourth of the trust's remaining assets, usually contingent on the beneficiary's survivorship.

Treatment of Interests in Irrevocable Trusts

Each type of interest in an irrevocable trust is treated differently, as described below.

Mandatory Income Interests

Under *In re Marriage of Guinn*, when a non-trustee beneficiary holds only a mandatory income interest, that interest is not property.¹⁵ Specifically, the *Guinn* Court held that absent some "ownership" interest in the principal itself, a non-trustee spouse's mandatory right to unrealized future discretionary allocations of income did not constitute property.¹⁶ *Guinn* did not address whether a mandatory income interest was an "economic circumstance" because the parties in that case apparently did not raise that issue.

Discretionary Interests

In many instances, an interest in an irrevocable trust subject to the trustee's discretion to distribute income and/or principal is not property.¹⁷ However, a discretionary interest in an irrevocable trust is an economic circumstance to be considered by the court in its division of marital property.¹⁸

Remainder Interests

Colorado courts generally consider a remainder interest in an irrevocable trust to be property in a Colorado dissolution of marriage proceeding.¹⁹ The initial value of this interest is separate property, but the increase in value is marital property.²⁰ In the published Colorado appellate cases involving a remainder interest in an irrevocable trust, each trust at issue existed when the dissolution of marriage proceeding commenced.²¹ No published Colorado appellate case has analyzed the treatment of *trust*

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distributions to a trust remainder beneficiary during the term of the trust or upon termination.

The Effect of CRS § 14-10-113(7)(b)

In 2001, the Colorado Court of Appeals held in *Gorman* that a remainder interest in a third-party trust that was revocable or amendable was property for dissolution of marriage purposes.²² After *Gorman*, a combined committee of family law and trust and estate attorneys proposed legislation to preclude the categorization of certain interests in trusts as property in a dissolution of marriage proceeding.

In response to *Gorman*, in 2002 the Colorado legislature enacted CRS § 14-10-113(7)(b), which excludes from the definition of both “property” and “economic circumstance” 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. . . .” In 2003, the Colorado Court of Appeals in *In re Marriage of Dale* concluded that CRS § 14-10-113(7)(b)(1) was enacted in response to *Gorman*, (2) did not overturn the holding in *Balanson II* that a remainder interest in an irrevocable trust was property, and (3) was not intended to alter the treatment of remainder interests in irrevocable trusts as property.²³ As discussed in a previous *Colorado Lawyer* article, different approaches have been used to assess the impact of CRS § 14-10-113(7)(b) on irrevocable trusts that grant powers of appointment to third parties.²⁴

Starting Date for Measuring Increase in Value

The starting date for measuring the increase in value of a trust interest varies depending on the type of trust interest. The type of trust interest also determines how to calculate the increase in value that is marital property.

Remainder Interest in a Revocable Trust

Any interest in a third-party revocable trust is not property so long as the grantor is alive and has capacity to revoke or amend the instrument under CRS § 14-10-113(7)(b). A revocable trust typically becomes irrevocable upon the death of the grantor, so any remainder interest becomes property as of the grantor’s death because CRS § 14-10-113(7)(b) no longer applies.²⁵

In most situations, the relevant period for measuring the increase in value of a remainder interest in a revocable trust begins on the later of the date the trust became irrevocable (usually the grantor’s death) or the date of marriage.²⁶

Mandatory Income Interest in an Irrevocable Trust

When a non-trustee beneficiary holds only a mandatory income interest, that interest is not usually considered property.²⁷ However, when a non-beneficiary trustee makes a mandatory outright distribution of income to a non-remainder beneficiary, the distribution becomes separate property at that time.²⁸

Assuming that the distribution can be traced, any increase in value from the time

of distribution generally is considered marital property.²⁹ If the distribution cannot be traced, the distribution might still impact the marital property division if it can be shown that the assets distributed contributed to the acquisition of existing marital assets.³⁰

Discretionary Interest in an Irrevocable Trust

An interest in an irrevocable trust subject to the discretion of a trustee who is not the spouse is usually not considered property.³¹ However, when such a trustee makes an outright distribution from an irrevocable trust to the spouse pursuant to that trustee’s discretionary power to distribute trust income and/or principal, that distribution then becomes separate property.³²

Assuming that the distribution can be traced, the increase in value is measured from the time of distribution.³³ If the distribution cannot be traced, a contribution argument may be available.³⁴

Remainder Interest in an Irrevocable Trust that Has Not Terminated

Published Colorado appellate cases address a remainder interest in an irrevocable trust that has not terminated, as opposed to a distribution to a remainder beneficiary after the trust termination.³⁵ The case law in this area evolved from early decisions involving interests in assets that are generally difficult to quantify or subject to contingencies.

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determining whether they constituted property.³⁶ For example, the Colorado Supreme Court addressed whether pensions were property.³⁷ Similar to irrevocable trust interests, pensions are subject to contingencies that make them difficult to value. The Court in *Grubb* began focusing on the economic realities of the interest at issue in holding that difficult-to-value unmaturing pension benefits were property rather than a mere “expectancy.”³⁸ Shortly after *Grubb*, the Court in *Gallo* again acknowledged that hard to value interests can qualify as property by noting that “this court has joined other courts in stating that contingencies should be taken into account when the court disposes of marital property between the parties, not when determining which assets belong in the marital estate.”³⁹

The Court’s holding in *Balanson II* that a remainder interest in an irrevocable trust was property⁴⁰ continued the trend of decisions recognizing that uncertain financial interests that were hard to value and/or subject to contingencies should be considered property because this results in a more equitable division of financial assets between the parties. In *Balanson II*, the Court concluded that while contingencies do not negate the treatment of a trust interest as property, they do affect the value of that trust interest.⁴¹ The Court acknowledged the difficulties in valuing the spouse’s trust interest but nevertheless determined that the spouse possessed a separate property interest in the

trust.⁴² The opinion provided trial courts with guidance when determining the increase in value of remainder interests that are separate property by citing the approach of valuing pensions that take into account contingencies such as survivorship.⁴³ The Colorado Court of Appeals expanded on this guidance, stating that for purposes of valuation, the court can consider additional contingencies, including the delay in a spouse receiving the spouse’s interest or the risk of forfeiture.⁴⁴

For a remainder interest in an irrevocable trust that has not terminated, the relevant period for measuring the increase in value logically begins at the later of the funding date of the trust or the date of marriage.⁴⁵

Remainder Interest in an Irrevocable Trust that has Been Distributed Outright

No published Colorado appellate cases address a remainder interest in an irrevocable trust that has been terminated or otherwise distributed outright. But two approaches may be used to determine the appropriate starting date for measuring the increase in value of a remainder interest in an irrevocable trust that has been distributed outright.

First, the increase in value may arguably be measured from the date the trust assets are distributed to a remainder beneficiary. This approach assumes that upon outright distribution of a trust, the nature of the beneficial



interest fundamentally changes such that a new property interest is created at that point in time. This interest is similar to an inheritance, which debatably warrants the same treatment as if the trust were revocable or amendable, because the beneficiary has control over how to manage the property.

However, the Court of Appeals in *Dale* rejected the argument that under CRS § 14-10-113(4), the “time of acquisition” means the date trust assets are distributed to a remainder beneficiary. The spouse in *Dale* argued that the other spouse’s remainder interest was not acquired until it became an “actual possessory interest,”⁴⁶ but the Court was unpersuaded. Further, the practical effect of treating a remainder interest as not constituting property until it becomes an actual possessory interest would be contrary to the policy adopted in *Balanson II*, so that the mere exercise of a discretionary distribution power or a trust termination power does not defeat treatment of hard-to-value assets as property. Under the first approach, a trustee would only have to exercise a discretionary distribution power, in whole or in part, or a trust termination power to avoid treatment of the spouse’s remainder interest in an irrevocable trust as property under CRS § 14-10-113(4).

Under a second approach, when a remainder beneficiary receives assets by virtue of an outright distribution during trust administration or upon trust termination, the increase in value would be measured from the later of the funding date of the trust or the date of marriage. This approach recognizes that the value of the remainder interest when there are contingencies or variables affecting the value (i.e., before assets are distributed outright) increases when there are no contingencies or variables affecting the value (i.e., after assets are distributed outright). The sole effect of no longer having contingencies or variables would be to increase the value of the remainder interest, whether distributed or not.

The Colorado appellate courts that have addressed the effect of contingencies or variables have taken the position that contingencies or variables can be quantified before trust distribution.⁴⁷ In 2014, the Colorado Supreme Court in *In re Marriage of Cardona and Castro* reaffirmed *Balanson II* by citing it for the specific

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proposition that a spouse’s remainder interest in an irrevocable trust constituted property: “Although the value of the spouse’s remainder interest in that case was uncertain, that uncertainty did not convert the spouse’s interest into a mere expectancy.”⁴⁸

The second approach, under which the increase in value is measured from the later of the funding date of the trust or the date of marriage, is most consistent with current Colorado appellate decisions.⁴⁹ The distribution from the trust is logically traced from a preexisting trust interest rather than construed as the disappearance of one asset and the creation of an entirely new asset.

Conclusion

The design of a trust affects whether a trust interest is separate property in a dissolution of marriage. For trust interests that are property,

the impact of an outright distribution to a spouse depends on the nature of the spouse’s trust interest, which also affects the starting date for measuring the increase in the interest’s value. This starting date can significantly impact the division of marital property, so practitioners should pay close attention to the types of trusts and trust interests at issue. ^{CL}



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NOTES

1. *In re Marriage of Balanson*, 996 P.2d 213 (Colo.App. 1999) (*Balanson I*); *In re Marriage of Balanson*, 25 P.3d 28 (Colo. 2001) (*Balanson II*); and *In re Marriage of Balanson*, 107 P.3d 1037 (Colo.App. 2004) (*Balanson III*).
2. *In re Marriage of Gorman*, 36 P.3d 211, 213 (Colo.App. 2001).
3. See Deffenbaugh and Kirch, “How Powers of Appointment Affect Irrevocable Trust Remainder Interests in Dissolution of Marriage Proceedings: Four Approaches,” 48 *Colo. Law.* 48 (Dec. 2019).
4. See Haskell and Chorney, “Decanting in Connection with Divorce: A Case Study,” 48 *Colo. Law.* 62 (Oct. 2019).
5. CRS § 14-10-113(1).
6. CRS § 14-10-113(1)(b), (c), and (d).
7. See CRS § 14-10-113.
8. CRS § 14-10-113(3), (4).
9. CRS § 14-10-113(2)(a).
10. See CRS § 14-10-113(4).
11. CRS §§ 15-5-103(17) and -602.
12. CRS § 15-5-602(1).
13. See Gardner and Wiener, “Is the Irrevocable Trust Really Irrevocable?,” 47 *Colo. Law.* 56 (Oct. 2018).
14. Unitrust or annuity trust interests should be treated differently.
15. See *In re Marriage of Guinn*, 93 P.3d 568, 570-72 (Colo.App. 2004).

16. *Id.* at 572.
17. See *In re Marriage of Jones*, 812 P.2d 1152, 1156-58 (Colo. 1991); *Guinn*, 93 P.3d at 570-72; *In re Marriage of Rosenblum*, 602 P.2d 892, 893-94 (Colo.App. 1979).
18. See *Jones*, 812 P.2d at 1158; *Rosenblum*, 602 P.2d at 894.
19. See *Balanson II*, 25 P.3d at 41; *In re Marriage of Dale*, 87 P.3d 219, 224 (Colo.App. 2003); *In re Marriage of Mohrlang*, 85 P.3d 561, 563 (Colo. App. 2003).
20. CRS § 14-10-113(4).
21. See, e.g., *Balanson II*, 25 P.3d at 41; *Dale*, 87 P.3d at 222; and *Mohrlang*, 85 P.3d at 563.
22. *Gorman*, 36 P.3d at 213.
23. See *Dale*, 87 P.3d at 224 (citing hearings on SB 02-160 before the Senate Judiciary Committee and the House Judiciary Committee, 63rd Gen. Ass., Second Reg. Sess. (Jan. 9, 2002)).
24. See Deffenbaugh and Kirch, *supra* note 3.
25. See *Balanson III*, 107 P.3d at 1047.
26. See CRS § 14-10-113(4), (7)(b).
27. See *Guinn*, 93 P.3d at 570-72.
28. See CRS § 14-10-113(2)(a).
29. See CRS § 14-10-113(4).
30. CRS § 14-10-113(1)(a).
31. See *Jones*, 812 P.2d at 1156-58; *Rosenblum*, 602 P.2d at 893-94.
32. See CRS § 14-10-113(2)(a).
33. See CRS § 14-10-113(4).
34. See CRS § 14-10-113(1)(a).
35. See, e.g., *Balanson II*, 25 P.3d at 41; *Dale*, 87 P.3d at 222; and *Mohrlang*, 85 P.3d at 563.
36. See, e.g., *Ellis v. Ellis*, 552 P.2d 506, 507 (Colo. 1976), *overruled by In re Marriage of Gallo*, 752 P.2d 47 (Colo. 1988).
37. *Gallo*, 752 P.2d at 52 (Colo. 1988); *In re Marriage of Grubb*, 745 P.2d 661, 664-55 (Colo. 1987).
38. See *Grubb*, 745 P.2d at 664-65.
39. *Gallo*, 752 P.2d at 52 (citing *Grubb*, 745 P.2d at 665).
40. See *Balanson II*, 25 P.3d at 41-43.
41. *Id.*
42. *Id.* at 41.
43. *Id.* at 43, n.6.
44. See *Mohrlang*, 85 P.3d at 563.
45. See CRS § 14-10-113(4); *Balanson II*, 25 P.3d at 41; *Dale*, 87 P.3d at 222; and *Mohrlang*, 85 P.3d at 563.
46. *Dale*, 87 P.3d at 224-25.
47. See *Balanson II*, 25 P.3d at 41; *Dale*, 87 P.3d at 224; *Mohrlang*, 85 P.3d at 563.
48. *In re Marriage of Cardona and Castro*, 316 P.3d 626, 633 (Colo. 2014).
49. See CRS § 14-10-113(4); *Dale*, 87 P.3d at 224-25.

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