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Subject: James Kane: Trusts, Divorce & *Gibson v. Gibson* - No More Confidential Relationship Doctrine?

"Although this commentary centers on a recent Georgia supreme court opinion, it is of interest to practitioners in many other states. The issues the Georgia court addressed are virtually universal hurdles in any litigation when a trust becomes the focus of alimony or property division in a divorce. This Georgia opinion also speaks to both the common law doctrine of the confidential relationship for a married couple and the application of fraudulent transfer law. This doctrine and the body of fraudulent law should be routine checklist items for generally all practitioners involved in both planning and dispute aspects of trusts. The core issue with one spouse's creation of a trust during marriage is whether that trust can later be shielded from the couple's divorce for purposes of an equitable division of the couple's marital assets."

LISI presents members with commentary from **James M. Kane** in Atlanta about a recent Georgia Supreme Court opinion in which two trusts totaling $3.2 million that one spouse created and funded during marriage were excluded from equitable division in the couple's subsequent divorce.

James M. Kane is a tax lawyer with his Atlanta law firm **Kane Law LLC**. He is licensed in Georgia, North Carolina and New York. James's practice includes (i) trusts & estates controversies and litigation (tax and non-tax matters and disputes), and (ii) trusts & estates tax and asset protection planning. In addition to his law degree from Emory University Law School, James has undergraduate finance and graduate Masters of Taxation degrees. Before attending law school, James was an IRS Revenue Agent (in the Atlanta Large Case Examination Division). James maintains a legal blog. Google: James Kane Legal Blog. James has practiced law in Atlanta for 20-plus years, previously with Chamberlain,

Hrdlicka, White, Williams & Aughtry (including work with David Aughtry in the tax controversy arena) and Sutherland, Asbill & Brennan. James won the 2016 Heckerling Tax Court Brief writing contest. This was a contest **Richard Covey** (who is with the New York law firm **Carter, Ledyard & Milburn, LLP** and a founding member of Heckerling) presented to the 2016 Heckerling participants. See Estate Planning Newsletter #2474 (November 2, 2016).

Here is his commentary:

COMMENT:

Although this commentary centers on a recent Georgia supreme court opinion, it is of interest to practitioners in many other states. The issues the Georgia court addressed are virtually universal hurdles in any litigation when a trust becomes the focus of alimony or property division in a divorce. This Georgia opinion also speaks to both the common law doctrine of the confidential relationship for a married couple and the application of fraudulent transfer law. This doctrine and the body of fraudulent law should be routine checklist items for generally all practitioners involved in both planning and dispute aspects of trusts.

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General Observations

The recent Georgia opinion in Gibson v. Gibson, ____ Ga. ____, 2017 WL 2417057 (June 5, 2017), suggests a *possible* move by the Georgia courts to a fraudulent transfer analysis in a divorce-trust dispute, away from the confidential relationship doctrine.

The *Gibson* case centered on the husband's creation and funding of two trusts totaling $3.2 million, with trust document terms that included his wife, daughter, and daughter's descendants as beneficiaries. The husband was not named as a beneficiary. The husband's mother was the trustee. The trust provisions provided that the wife's rights and interests in the trust terminated if the couple legally separated or divorced. The wife was not

aware of the trusts until she later filed divorce. [See below my "Smoke and Mirrors Trust Planning" heading.]

The Gibson couple married in 1993; the husband created the two trusts in 2008; the wife filed for divorce in 2014. Between 2010 and 2013 the husband transferred $3.2 million to the two trusts of various assets, including bank and brokerage accounts, life insurance policies, and an ownership interest in an LLC.

The lower trial court in *Gibson* (a bench trial) excluded the $3.2 million trusts from equitable division in the divorce. By contrast, $2.2 million of other non-trust assets were subject to equitable division.

The trial count relied on evidence of the couple's "rocky marriage" to conclude there was no confidential relationship as to their respective financial circumstances. This was an error. The Georgia supreme court stated the trial court erred in its analysis in this regard. However, the supreme court went on to say this error did not warrant reversal in view of the trial court having made a fraudulent transfer law analysis to conclude the husband did not fund the $3.2 million trusts with intent to defraud his wife.

Sidestepping the Confidential Relationship Doctrine

The confidential relationship doctrine for a married couple under Georgia law is that each spouse – as a matter of law -- enjoys repose and trust in the other spouse. This confidential relationship generally requires no withholding of material facts from the other spouse to his or her detriment.[i]

Arguably, with its *Gibson* opinion sidestepping application of the confidential relationship doctrine, the Georgia supreme court will have the opportunity later to apply the doctrine to another divorce-trust case; possibly, for example, where the trial court is not persuaded by "rocky marriage" factors.

The *Gibson* opinion, also arguably, leaves open and unanswered whether, and when, the confidential relationship doctrine will apply in another divorce-trust case. And, whether or not the doctrine applies has a material effect on the burden-of-proof posture of the parties in the divorce proceeding.

Assuming the confidential relationship doctrine no longer applies in a divorce-trust setting, the result is a fundamental shift in the burden of proof. That is, under a fraudulent transfer analysis the objecting spouse who challenges the other spouse's efforts to keep the trust out of the equitable division arena will bear the burden of proving intent-to-defraud by the spouse who created the trust.

By contrast, if a court can apply a confidential relationship doctrine analysis, and assuming one spouse is blindsided later by the existence of the other spouse's trust, arguably the spouse who created the trust has the burden of proof to show that he or she did not intend to defraud the other spouse *by not disclosing* the funding and existence of the trust.

The Court's *Dictum* as to the Confidential Relationship Doctrine

Although the Georgia supreme court in *Gibson* acknowledges the lower trial court did not apply a confidential relationship doctrine analysis, the supreme court in *dictum* suggests a narrowing of the doctrine in two ways.

First, the supreme court states that an analysis of whether, and when, the confidential relationship doctrine applies to a married couple *cannot* be based on case-by-case factors, such as the physical intimacy of the couple, whether or not the couple maintained joint accounts, whether they shared the same bedroom, etc. The court indicates these are not relevant factors in determining whether the doctrine applies. But, the court at this point in its *Gibson* opinion stops short with no indication of when, or under what circumstances, the doctrine will apply.

Second, and going directly to the disclosure-of-material-fact element under the confidential relationship doctrine, the *Gibson* opinion sets up the following question:

> To say that spouses generally enjoy a confidential relationship that entitles one to trust the other does not answer the question of what exactly one spouse is required to disclose to the other.
>
> *Gibson*, 2017 WL 2417057 at 4*.

In the context of the above question, the *Gibson* opinion goes on to state the following universal point for married couples:

> But we [the court] have never said that a person must gain the consent of or even inform his or her spouse before undertaking *every* financial transaction, whether a moderate lunch bill, a generous holiday gift to a friend, or a $50 charitable contribution.
>
> Of course, this case is not about a $50 charitable contribution. . . .
>
> *Gibson*, 2017 WL 2417057 at 4*.

As to the above excerpt, the *Gibson* opinion informs us that there is no requirement for 100% disclosure of every financial transaction in a marriage under the confidential relationship doctrine. In my view, this is an appropriate, practical, progressive view of marriage. Each spouse can (and should) retain an element of independence and autonomy in a marriage.

But, after making the above "not every financial transaction" observation, the *Gibson dictum* stops short as to whether, or how, to bridge the gulf between a $50 charitable contribution and a $3.2 million trust funding (which was about 60% of the total assets in the divorce addressed by the trial court in *Gibson*).

Three Other Take-Away Points from the *Gibson* Opinion

One. The *Gibson* case illustrates, realistically and as a practical matter, how the court system and the laws simply cannot legislate many aspects of marriage. How the relationship of marriage exists between spouses varies as abundantly as the stars in the night sky. There is a great deal of self-responsibility for each unique couple to maintain their relationship with trust, honesty, and candor, especially when financial matters are at play. The courts cannot mandate (or easily mandate) these relationship factors.

Two. For individuals who wish to use protective trusts for their own property in a marriage, the optimal planning is to create and fund the trusts *before getting married*. This pre-marriage trust planning can be completely

unilateral without concern about disclosure to the other soon-to-become spouse. This pre-marriage trust planning also is a much stronger option than using a prenuptial agreement, which requires a negotiated, bilateral written agreement between both soon-to-be spouses.

Three. The pre-marriage Point Two approach above, in my view, can be an attractive option for second marriages, especially where each soon-to-become spouse's children are grown, etc.

Smoke and Mirrors Trust Planning

I have not seen the trust documents in the *Gibson* case and my knowledge is limited only to what is in the *Gibson* supreme court opinion. My following comments are not directed at the Gibsons, neither of whom I have ever met; but directed generally at divorce-trust situations. Below are some key points to consider when examining a trust document in a divorce setting.

- **Purposely Stealth Trust Design**

  A crafty lawyer can purposely design stealth trust documents that include written trust powers effectively *to later add* individuals to the trust as beneficiaries, who are not beneficiaries when the trust is first created. In a divorce setting, substantively this stealth trust design enables the spouse who ostensibly is not at the onset a beneficiary of the trust to be added later as a beneficiary after the smoke clears.

  This beneficiary add-back often is with the use of a written trust power called a "limited power of appointment"; or in some cases the designation in the trust document of certain powers for a friendly "trust protector", including the trust protector's ability to create limited powers of appointment and make distributions in further trust.

  One initial, potential red-flag when examining a trust in a divorce setting is when the trust document does not show the spouse as the named settlor (or creator) of the trust. This "settlor" naming can be purposely misleading by design. And in most cases the settlor or grantor's name in the trust document has no substantive effect. It could almost be "Santa Claus" without much difference.

Here is a relatively simple example of a stealth trust design, with a spouse named Jane who creates the trust during her marriage:

> Jane is not a beneficiary; Her name appears nowhere within the trust document. But, Jane, with later transfer documents, funds the trust. Jane's father is ostensibly named in the trust document as the settlor. Tom Smith, a longtime family friend, is the trustee. Jane's mother (thus, the settlor's spouse) under the terms of the trust document has a limited power of appointment that includes the settlor's descendants as the class of appointees. Without being naming specifically in this class definition, Jane is a member of the potential appointees. Jane's children also hold similar limited powers of appointment that kick in upon Jane's mother's death.

Don't simply accept your first impression and the surface terms of a written trust document in these divorce situations. Dig much deeper. Use adequate discovery to find trusts that the divorcing spouse *funded*, regardless of whose names appear within the trust document. Ferret out who hired the lawyer that prepared the trust document. Who is the client on the engagement letter? Did the divorcing spouse use the same lawyer in the past for other matters? Did the divorcing spouse discuss the design of the trust with the drafting lawyer?

Did that lawyer assist the divorcing spouse with funding the trust? Who paid the lawyer? Press hard to get copies of the lawyer's correspondence and file documents. Force a detailed privilege log, at a minimum.

- **Target Your Discovery Requests in the Divorce Litigation**

In line with the preceding paragraph, your discovery requests in a divorce should include a request for any trusts where the spouse *transferred* property to the trust. Often discovery requests are too narrow, such as "Provide copies of all trusts you created", or "copies of all trusts for which you are the settlor." As stated above, regardless of the named "settlor", a critical factor during discovery is who transferred the property to the trust?

- **A Practical Reality**

My experience in divorce situations indicates that most spouses, when involved during marriage in this unilateral trust planning, as a matter of practical reality will not fund the trust with the financial door closed-off completely against later being able to benefit from the trust. This is especially the case when the spouse who creates the trust is, for example, is his or her mid-40s with younger children. Therefore, these demographic factors often point to a very high likelihood the trust planning includes stealth design features.

- **Finally, for Tax Practitioners**

A stealth trust typically triggers numerous tax factors that are extremely important, and that are sometimes overlooked *as part of the design and administration of the trust*. This involves income, gift and estate tax.

For example, in many trust planning situations (particularly with stealth features) the attorney drafting the trust will include tax-law provisions in the trust document to make the trust an incomplete gift. In addition, the trust design often will be an intentionally defective trust for income tax purposes. I purposely do not go into the detail of these design factors for this newsletter.

My point, however, is also to focus your discovery requests in a divorce proceeding on finding out how the trust is being *treated for tax purposes*, especially for income and gift tax compliance and reporting purposes. These tax features can help shed light on a clearer pathway for identifying the stealth design of a trust.

Finally, here is an important technical point related to the above stealth discussion. The federal tax regulations look at who transferred property to the trust, rather than simply the name that appears in the trust document as the "settlor". *See, for example,* Treas. Reg. §1.671-(2)(e)(1) ("a person who creates a trust but makes no gratuitous transfers to the trust is not treated as an owner of any portion of the trust under sections 671 through 677 or 679.").

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

James M. Kane

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CITES:

Gibson v. Gibson, ____ Ga. ____, 2017 WL 2417057, (Ga. June 5, 2017).

CITATIONS:

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[i] Georgia cases applying the confidential relationship doctrine to a married couple include: *Murray v. Murray*, 299 Ga. 703, 705, 791 S.E.2d 816 (2016)(post-nuptial agreement unenforceable because husband falsely promised wife he would tear up the agreement); *Beller v. Tilbrook*, 275 Ga. 762, 762-763 (3), 571 S.E.2d 735 (2002) (affirming award of damages on personal injury claim filed in connection with divorce for husband's non-disclosure to his wife of his genital herpes); *Adair v. Adair*, 220 Ga. 852, 855 (1),142 S.E.2d 251 (1965)(divorce decree set aside based on husband's omissions and misrepresentations prompting his wife to sign divorce-related papers); *See also Mallen v. Mallen*, 280 Ga. 43, 622 S.E.2d 812 (2005)(confidential relationship doctrine not applicable to a prenuptial agreement when the couple was not married at the time they entered into the prenuptial agreement).