Love, Death & Divorce: Integrating Trusts & Estates, Matrimonial Law and Financial Planning

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I. How Promises in a Divorce Agreement to Spouse #1 May Impact Spouse #2 1

II. Divorce and Your Estate Plan (Including Beneficiary Designations on Retirement Plans, Bank Accounts and Life Insurance) 2

III. The Role of Life Insurance in Prenuptial Agreements and Divorces 5

IV. Can an Irrevocable Trust be up for Grabs in a Divorce Case? 7

V. Immigration Issues Associated with Prenuptial Agreements and Divorce 8

VI. Transfer Tax Issues When Your Spouse is not a U.S. Citizen 10

VII. When To Get a Prenup 13

VIII. Self-Settled Spendthrift Trusts as a Prenup Alternative 15

IX. Investing and Insurance Planning in a Divorce 18

X. Why Every Divorce Client Needs Estate Planning 22

XI. Separating Physical Custody of Children and Financial Control of Property in an Estate Plan 24

XII. When a Will and a Divorce Agreement (or Prenup) Don't Match Up 25

XIII. Portability and Prenups 25

XIV. Social Security Benefits & Divorce 28

XV. Smart Structuring of Child Support and Childcare can Save Tax Dollars 29

XVI. Tax Issues that Arise with regard to Spousal Support and Equitable Distribution . 30

XVII. What's Mine is Mine (or My Child's) 30

XVIII. When To Get a Postnup 32

XIX. Prenups, Divorces, and Business Owners 33

XX. Why Your Matrimonial Lawyer, Estate Lawyer, Financial Planner and Accountant Need to Talk To Each Other 34

XXI. Offshore Accounts and Divorce 34

XXII. Divorce, Prenups, and Social Media 34

XXIII. Educating the "Less Wealthy Spouse" After a Divorce 36

XXIV. How To Protect Children From a Prior Marriage in a Prenup 36

I. How Promises in a Divorce Agreement to Spouse #1 May Impact Spouse #2

A. Child Support & Maintenance Payable to Spouse #1

1. Generally, in the event of a divorce, Spouse #2 does not get a credit for child support or maintenance paid to Spouse #1. *See, for e.g.,* Johnson v. Chapin, 12 N.Y.3d 461 (2009*) (holding that the wife was not entitled to a 50% credit for money the husband paid to his first wife for child support and maintenance);* Mahoney-Buntzman v. Buntzman, 12 N.Y.3d 415 (2009) *(holding that, in calculating the award of equitable distribution, the wife was not entitled to a credit for maintenance the husband paid to his first wife).*

2. In a prenuptial agreement, the parties can opt out of the general law.

   a. A prenuptial agreement may provide that child support and/or maintenance owed to Spouse #1 will be paid from separate property.

   b. Alternatively, a prenuptial agreement may provide that, in the event of a divorce, Spouse #2 will get a 50% credit for amounts paid for child support and/or maintenance to Spouse #1.

B. Duration of Maintenance

1. Divorce agreements typically provide that maintenance is to be paid for a specified duration and may be terminated sooner if certain events occur, such as cohabitation with an unrelated person or the payee's remarriage.

2. Therefore, in the event of the payee's remarriage, his/her maintenance may be cut short and irreversibly terminated. Notably, it has been held that in the event of divorce from Spouse #2, the former payee cannot recoup from Spouse #2 the maintenance lost by virtue of remarriage. *See, for e.g.,* Cohn v. Cohn, 80 A.D. 3d 319 (1st Dep't 2011) *(holding that the wife was not entitled to recoup the spousal maintenance that she lost by virtue of her remarriage).*

C. Modification Proceedings

1. Pursuant to New York's Domestic Relations Law ("DRL") §236B(9)(b), modifications to child support agreements may be made if: (a) more than three years have passed since the agreement was either signed, modified or adjusted; or (b) there is more than a 15% change in either parent's income since the support agreement was signed, modified or adjusted. Either party may request a modification of the child support provisions. Alternatively, DRL §236B(9)(b) allows parties to

voluntarily opt out of these two basis for modifying child support in a validly executed agreement.

2. Spouse #2 may play a role in a modification proceeding, i.e. involving child support. Financial disclosure may need to be provided by Spouse #2, as the financial information statement includes a request regarding income information for other people residing in the same household as the payor parent.

D. Bad divorce from Spouse #1 may impact the terms of a prenuptial agreement with Spouse #2.

E. Limitations on estate planning

1. Important to understand whether the estate planning client is under any contractual obligation to make a testamentary disposition.

2. Always request copies of prior prenups, postnups, and divorce agreements because they often contain provisions about death and need to be coordinated with the estate plan.

3. If the estate plan does not conform to contractual obligations, the estate may be subject to a claim by a former spouse or children of a prior marriage.

II. Divorce and Your Estate Plan (Including Beneficiary Designations on Retirement Plans, Bank Accounts and Life Insurance)

A. Revocation of Provisions for a Former Spouse

1. Section 5-1.4 of the New York Estates, Powers and Trusts Law ("EPTL"), as revised in 2008, revokes dispositions to a former spouse under a Will as well as under lifetime revocable trusts, Totten trust accounts, life insurance beneficiary designations and joint tenants with rights of survivorship. EPTL §5-1.4 also revokes the appointment of a former spouse as a fiduciary or representative – executor, trustee, guardian, agent or attorney-in-fact.

a. Retirement plan designations are revoked only to the extent permitted by law (federal ERISA law can preempt). Note that under the Uniform Probate Code ("UPC") there is an attempt to circumvent ERISA. UPC §2-804(h)(2) provides that if federal law preempts the revocation of a disposition then the recipient is obligated to return the property or is personally liable for the amount of the payment to the person who would have been entitled to the property if there were no preemption.

b. It is still essential to fill out new beneficiary designations and change account titles following a divorce. Written notification of the divorce should be given to the insurance company or financial institution. Under EPTL §5-1.4, "a payor or other third party is not liable for having made a payment or transferred an item of property or any other benefit to a beneficiary (including a former spouse) designated in a governing instrument affected by a divorce, annulment, or remarriage, or for having taken any other action in good faith reliance on the validity of the governing instrument, before the payor or other third party received written notice of the divorce, annulment, or remarriage."

c. EPTL §5-1.4 only applies if there is a divorce, judicial separation or annulment. These provisions are not automatically revoked upon divorce commencement.

d. Automatic restraints under DRL §236, Part B, Section 2 and the Uniform Rules of the Trial Courts prevent either party to a divorce action from taking certain actions with respect to property during the pendency of the action without consent of the other party or of the court.

   i. Cannot transfer, encumber, assign, remove, withdraw or in any way dispose of, any property, including bank and brokerage accounts in individual or joint name (except for customary and usual household expenses or for reasonable attorney's fees in the divorce action).

   ii. Cannot transfer, encumber, assign, remove, withdraw or in any way dispose of retirement accounts.

   iii. Cannot change the beneficiaries of any existing life insurance policies and must maintain existing policies in full force and effect.

e. Even if Will is changed, surviving spouse retains right to claim elective share under EPTL §5-1.1-A during pendency of divorce proceeding unless disqualified a "surviving spouse" under EPTL §5-1.2, which provides for disqualification if:

   i. A final decree or judgment of divorce, of annulment or declaring the nullity of a marriage or dissolving such marriage on the ground of absence, recognized as valid under the law of this state, was in effect when the deceased spouse died.

   ii. The marriage was void as incestuous under section five of the domestic relations law, bigamous under section six thereof, or a prohibited remarriage under section eight thereof.

iii. The spouse had procured outside of this state a final decree or judgment of divorce from the deceased spouse, of annulment or declaring the nullity of the marriage with the deceased spouse or dissolving such marriage on the ground of absence, not recognized as valid under the law of this state.

iv. A final decree or judgment of separation, recognized as valid under the law of this state, was rendered against the spouse, and such decree or judgment was in effect when the deceased spouse died.

v. The spouse abandoned the deceased spouse, and such abandonment continued until the time of death.

vi. A spouse who, having the duty to support the other spouse, failed or refused to provide for such spouse though he or she had the means or ability to do so, unless such marital duty was resumed and continued until the death of the spouse having the need of support.

2. In New York, designation of a former spouse under a health care proxy [Pub. Health Law §2985] and designation to control disposition of remains [Pub. Health Law §4201] are also revoked.

3. Under prior version of EPTL §5-1.4 divorce automatically revoked dispositions to a former spouse under a Will, but not under non-testamentary documents (except expanded in 2005 to revoke dispositions of securities in TOD form).

B. Former Spouse's Relatives

1. EPTL §5-1.4 does not apply to disposition or appointment of former spouse's relatives. *See, e.g.*, <u>In re Estate of Lewis</u>, 114 A.D.3d 203 (4th Dep't 2014) *(holding that will provision nominating the father of the testator's ex-husband, as alternate executor and alternate beneficiary was not revoked under New York law by virtue of the divorce)*.

2. In contrast, UPC §2-804 does revoke bequests to relatives of former spouse who, after the divorce, are not related to the divorced individual by blood, adoption or affinity.

C. Important to remind clients to update their estate planning documents if they are involved in a divorce. Communication between advisors is key, and accountants often have regular contact with clients and can make sure that everyone is on the same page.

III. The Role of Life Insurance in Prenuptial Agreements and Divorces

A. Life Insurance Provisions in Prenuptial Agreements

1. Life insurance can be a mechanism required under a prenuptial agreement in order to secure a death benefit.

2. If there are children from a prior marriage, there are potential benefits of providing Spouse #2 with life insurance rather than leaving Spouse #2 a portion of the estate.

B. Divorce and Life Insurance

1. Life insurance can secure financial obligations stemming from a divorce, such as child support, maintenance, and property distribution.

2. If the parties are able to reach an amicable settlement, the requirement of maintaining life insurance can be set forth in a divorce agreement.

   a. A divorce agreement can provide that the amount of life insurance can be reduced over time in order to reflect a party's actual outstanding financial obligations.

   b. In order to help ensure compliance, the divorce agreement may require a periodic showing of proof that the life insurance is being maintained and/or may give authorization to the beneficiary to directly obtain proof from the insurance company that the life insurance is in effect. Additionally, the requirement for maintaining life insurance can be set forth in the judgment of divorce and/or a qualified life insurance order, which can be served on the insurance company.

3. Pursuant to statute and the applicable case law, courts have the authority to require a spouse to maintain life insurance in order to secure financial obligations. *See* DRL §236(B)(8)(a); <u>Hymowitz v. Hymowitz</u>, 119 A.D. 3d 736 (2d Dep't 2014) *(holding the lower court erred in failing to direct the husband to maintain life insurance with the wife as its beneficiary to secure his maintenance obligation and a distributive award);* <u>Martin v. Martin</u>, 115 A.D.3d 1315 (4th Dep't 2014) *(upholding the lower court's requirement of a husband to maintain a life insurance policy in order to secure his child support and maintenance obligations)*; <u>Alleva v. Alleva</u>, 112 A.D.3d 567 (2d Dep't 2013) *(holding that the husband should have*

been required to maintain life insurance on behalf of the wife to secure his maintenance obligation).

4. When funding an obligation that is payable upon the insured death's regardless of when that death occurs (i.e., a death benefit for children of the terminated marriage), term insurance, which is only effective for a fixed term of years, may not be the most efficient product. Permanent insurance may be more appropriate as the death benefit is guaranteed, assuming all required premium payments are made.

C. Estate Planning & Life Insurance Trusts

1. Irrevocable life insurance trusts ("ILITs") are a tax efficient vehicle for the insured. In a properly structured and maintained ILIT, the death benefit can pass to the designated beneficiaries outside of the insured's taxable estate.

2. A life insurance trust can be drafted to mirror obligations under a divorce agreement. For example, if a divorce agreement requires life insurance to be maintained for the children of the marriage with a declining death benefit as those children age, then a two pot trust can be created with share #1 for children of the first marriage depleting over time and share #2 for all children (taking into account potential future children) gradually increasing.

<u>Sample Language</u>:

(A) The Trustees shall administer any property to be administered in accordance with the provisions of this paragraph as follows:

(1) The Trustees shall divide such property into two (2) shares to be known, respectively, as "Share A" and "Share B."

(a) Share A shall consist of the sum of (i) One Million Dollars if the Grantor's death occurs in 2015; (ii) Nine Hundred Fifty Thousand Dollars if the Grantor's death occurs in 2016; (iii) Nine Hundred Thousand Dollars if the Grantor's death occurs in 2017; (iv) Eight Hundred Fifty Thousand Dollars if the Grantor's death occurs in 2018; and so forth with a reduction of Fifty Thousand Dollars for each subsequent year.

(b) Share B shall consist of the balance of such property.

3. A life insurance trust and the policies held by the trustees should be reviewed on a regular basis. Trustees should continually consider available options for the policy (such as continuing to hold the policy,

converting the policy, allowing the policy to lapse, borrowing cash to pay premiums, etc.) and should monitor performance of the life insurance policies owned by the ILIT. Trustees also have to take care to make sure that all policy premiums are paid and that Crummey notices are properly administered. See Hattleburg v. Norwest Bank Wisconsin, 2005 WL 1574958 (2005) *(ILIT trustee was held liable for estate tax incurred where trustee knew that ILIT did not contain Crummey provisions and still encouraged the donor to make gifts to the trust)*; Sanders v. Citizens National Bank, 585 S.2d 1064 (Fl. Ct. Appeals 1991) *(ILIT trustee accepted gifts but failed to pay policy premiums)*.

IV. Can an Irrevocable Trust be up for Grabs in a Divorce Case?

A. Maybe - answers vary according to state law.

B. While we may know our client lives in NY, we shouldn't assume that the client's children also live in NY. They may live in another state or move to another jurisdiction down the road.

C. Often trust and estate practitioners and other financial advisors tell clients that putting funds in a trust for a child will protect against divorce. In practice, may not be so clear cut. Putting funds in trust for children is more protective than giving it to them outright, but it should not be assumed that the assets will be fully protected in the event of divorce.

D. Third party trusts (set up by parents, grandparents, etc.)

1. Property division

a. In NY, there is equitable distribution of marital property upon divorce. Inheritances and lifetime gifts made to one party are considered separate property, and are not subject to equitable distribution.

b. This is not true in all states. For example, CT is an "all property" state and separate property can be subject to division upon divorce.

c. If funds are actually distributed from a trust and commingled with marital assets, then they can be up for grabs.

2. Child support & spousal maintenance

a. Income is broadly defined under the applicable statute [DRL §236(5-a)(b)(4) and DRL §240(1-b)(b)(5)].

b. Trust income may be included in calculating child support and maintenance.

c. In awarding support, the court can take into account historical distributions to the beneficiary from the trust.

E. Third party trust set up by a spouse for someone else (i.e. children)

1. When a trust is formed in advance of a divorce action and both parties are informed about the trust it is difficult to pierce.

2. Under certain circumstances, it is possible to pierce the trust or the non-grantor spouse may receive a greater percentage of non-trust assets.

F. Prenuptial agreements

1. Provide extra protection of trust assets and distributions.

2. Helpful to alleviate or minimize issues that may arise by virtue of a trust beneficiary moving to another jurisdiction.

G. Self-Settled Trusts

1. A self-settled trust is a trust created by a party who is also a beneficiary.

2. Statutes vary by state regarding whether self-settled trusts provide protection from claims of support and/or equitable distribution.

V. Immigration Issues Associated with Prenuptial Agreements and Divorce

A. In the U.S., immigration has increased significantly in the past few decades

1. From 1980 to 2010, the foreign born population in the U.S. increased from 14.1 million to 40 million. One out of five married couple households in the U.S. has at least one foreign born spouse.[1]

2. A foreign national may obtain lawful permanent resident status in the U.S. in a number of ways, such as employment or a visa lottery. However, the most popular manner of obtaining permanent residency in the U.S. is through a family-based sponsorship, especially through marriage to a U.S. citizen.[2]

[1] *See* Luke J. Larsen & Nathan P. Walters, "Married-Couple Households by Nativity Status: 2011," American Community Survey Briefs, U.S. Department of Commerce, U.S. Census Bureau (Sept. 2013), http://www.census.gov/prod/2013pubs/acsbr11-16.pdf.

[2] *See* Randall Monger & James Yankay, "U.S. Lawful Permanent Residents: 2013," Annual Flow Report, Office of Immigration Statistics (May 2014), http://ww.dhs/gov/sites/default/files/publications/ois_lpr_fr_2013.pdf).

B. Prenuptial Agreements

1. When a U.S. citizen is in a relationship with a non-citizen, the parties may rush to the altar sooner than they otherwise would have gotten married. For example, the marriage could be accelerated due to an expiring visa or the non-citizen having become out of status.

2. If the parties are getting married too quickly for a prenuptial agreement to be executed, they may opt instead for a postnuptial agreement. However, it is often difficult to bring both parties to the table for a postnuptial agreement because they are already married and bargaining power is lost.

3. Marriage comes with certain rights and obligations, including rights to marital property and the possibility of spousal support. Prenuptial agreements can be helpful to define financial rights and obligations upon a divorce. A couple can tailor the otherwise applicable divorce laws in a prenuptial agreement, so that it comports with their needs.

4. A "sham" marriage is a marriage entered into for the sole purpose of obtaining immigration benefits. While prenuptial agreements can be a powerful tool in a bona fide marriage, including if there is more opportunism that the U.S. citizen may have initialized realized, they can be invalidated in a "sham" marriage as void against public policy. *See, for e.g.,* Heilbut v. Heilbut, 297 A.D.2d 233 (1st Dep't 2002) (*where the parties had a "sham" marriage, the Court upheld the invalidation of a prenuptial agreement because it was based upon a "scheme to circumvent immigration laws in the United States" and thus violated public policy*).

5. There may be increased exposure to a prenuptial agreement being set aside based on duress when the parties are rushing to get married due to immigration issues.

C. Divorce

1. A U.S. citizen may endeavor to use a green card for the non-citizen as a bargaining chip in a divorce. However, this tactic may be met with disapproval by a court and can backfire. *See, for e.g.,* Rocano v. Rocano, 12 Misc.3d 1169(A) (N.Y. Sup. Ct. Kings County, April 12, 2006) (*In Rocano, the husband obtained a green card for himself and his daughter, but deliberately did not get a green card for his wife. This became a factor in the court awarding the wife non-durational spousal support and more than half of the marital assets*).

2. If representing the non-citizen spouse who is going through a divorce, it is likely helpful to retain an immigration lawyer.

VI. Transfer Tax Issues When Your Spouse is not a U.S. Citizen

A. Definitions

1. "Alien" means a person who is not a citizen of the United States.

2. "Non-resident alien" means a person who is neither a "resident" nor a citizen of the United States.

3. "Resident alien" means an alien who is a resident of the United States.

4. While the Internal Revenue Code provides a clear, objective test under Section 7701(b) for determining if an individual is a resident alien for income tax purposes, there is no such guidance for determining if an individual is a resident or non-resident alien for transfer tax purposes. Rather, for transfer tax purposes, is a subjective test of "domicile."

   a. "A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such change unless accompanied by actual removal." Treas. Reg. §20.0-1(b).

   b. An individual in the United States on a non-immigrant visa that requires an agreement to leave the United States upon expiration of the visa term can still form the requisite intent to establish domicile in the United States. *See* Elkins v. Moreno, 435 U.S. 647 (1978); Rev. Rul. 80-363, 1980-2 C.B. 249.

B. The United States has estate and/or gift tax treaties with 16 countries: Australia, Austria, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, the Netherlands, Norway, South Africa, Switzerland and the United Kingdom. The rules discussed below are subject to contrary provisions in any applicable treaty.

C. U.S. Gift Tax

1. Donor

   a. Gifts by non-resident aliens of real property and tangible personal property located in the United States are subject to U.S. gift tax, while gifts of foreign situs property or intangible property are not subject to U.S. gift tax. Internal Revenue Code §2511(a).

   b. Resident aliens and U.S. citizens are subject to U.S. gift tax on all gifts, regardless of the situs or character of the property.

2. Donee

   a. Unlimited tax free gifts can be made between spouses who are both U.S. citizens. Internal Revenue Code §2523.

   b. In contrast, in 2015, annual tax free gifts from a U.S. citizen to a non-citizen spouse are limited to $147,000 under Section 2523(i) of the Code.

   c. Gifts in excess of $147,000 to a non-citizen spouse utilize the donor spouse's unified credit.

3. Joint Tenancies

   a. The Technical and Miscellaneous Revenue Act of 1988 ("TAMRA")[3] reenacted the rules of §§2515 and 2515A of the 1954 Code in determining whether and to what extent the creation and termination of a joint tenancy in real and personal property between spouses constitute a taxable gift, where the donee spouse is not a U.S. citizen.

   b. Real property

      i. The creation of a spousal joint tenancy or tenancy by the entirety in real property is not treated as a taxable gift. Treas. Reg. 25.2523(i)-2(b)(1).

      ii. However, upon the termination of the joint tenancy, other than by death of one of the spouses, there is a taxable gift from one spouse to the other to the extent that the non-citizen spouse receives an amount greater than the value of the property at the termination date multiplied by the percentage of the consideration furnished by such spouse. Internal Revenue Code §2523(i)(3).

   c. Personal property

      Upon the creation of a joint tenancy in personal property each spouse is treated as having retained a one-half interest in the property. Internal Revenue Code §2523(i).

   d. Joint bank accounts

      i. If donor spouse can regain the entire account without the donee spouse's consent, there is no gift on creation of the account. A gift occurs when the donee spouse draws on the

[3] Pub. L. 100-647 (1988).

account in excess of his or her contributions. Treas. Reg. 25.2511-1(h)(4).

ii. If creation of the account creates a joint tenancy and each spouse receives an alienable one-half interest in the account, a gift may occur on creation of the account. Treas. Reg. 25.2511-1(h)(5).

iii. Section 675(a) of the New York State Banking Law provides that "[w]hen a deposit of cash, securities, or other property has been made . . . in the name of such depositor or shareholder and another person and in form to be paid or delivered to either, or the survivor of them, such deposit or shares and any additions thereto made, by either of such persons, after the making thereof, shall become the property of such persons as joint tenants and the same, together with all additions and accruals thereon, shall be held for the exclusive use of the persons so named, and may be paid or delivered to either during the lifetime of both or to the survivor after the death of one of them . . . "

D. U.S. Estate Tax

1. U.S. citizens and U.S. resident aliens are subject to estate tax on their worldwide assets. Internal Revenue Code §§2031, 2033.

2. Non-resident aliens are subject to U.S. estate tax on that portion of the gross estate situated in the United States. Internal Revenue Code §2103. The estate tax rates are the same as for U.S. citizens and resident aliens; however, since non-resident aliens have an estate tax exemption of $60,000 (unless the individual is a domiciliary of an estate and gift tax treaty country in which case the treaty rules apply), not annually adjusted for inflation, rather than the $5,430,000 available to U.S. citizens and resident aliens, the effective rate is higher. Internal Revenue Code §2102(b).

3. If a decedent's surviving spouse is a U.S. citizen spouse, the estate tax marital deduction is unlimited. Internal Revenue Code §2056.

4. A decedent can transfer $5,430,000 (in 2015) to a non-citizen spouse free of U.S. estate tax. Above that, the marital deduction is only available for transfers to a non-citizen spouse (even if he or she is a permanent resident) if either: (a) the surviving spouse becomes a U.S. citizen before the estate tax return is filed and has been a U.S. resident since the decedent's death, or (b) the property passes to a Qualified Domestic Trust ("QDOT").

5. The rules regarding portability for the estate of a non-resident alien and for a non-citizen surviving spouse are highly complicated and are beyond the scope of this outline, except as briefly discussed below.

   a. QDOTs: The amount of DSUE cannot be calculated until all QDOT property has been subjected to U.S. estate tax – generally, upon the occurrence of the final QDOT distribution or other final event on which tax under 2056A is imposed (i.e., the surviving spouse's death). Treas. Reg. §20.2010-2T(c)(4). As a result, the DSUE is generally available to the surviving non-citizen spouse only for estate tax purposes and not for gift tax purposes during the surviving spouse's lifetime.

   b. Estates of non-resident aliens cannot make a portability election unless the decedent was a domiciliary of a country with an estate and gift tax treaty that permits a portability election. Treas. Reg. §§20.2010-2T(a)(5), 20.2010-3T(e) and 25.2505-2T(f).

E. Prenuptial Agreements

1. There may be fewer options for structuring a prenuptial agreement if one of the parties is a non-citizen.

2. For example, in some cases, a couple may agree to fund an account during the marriage for the less wealthy spouse or the wealthier spouse may agree to give a fixed sum to the less wealthy spouse after a certain number of years of marriage. This can become problematic if the less wealthy spouse is a non-citizen because of the annual gift tax limitations.

3. On the death side, outright bequests can present an issue due to the restrictions on the marital deduction.

VII. When To Get a Prenup

A. A prenuptial agreement is a written, acknowledged, agreement entered into a couple in anticipation of their forthcoming marriage.

B. Public policy favors individuals reaching their own agreements through contracts, and so duly executed prenuptial agreements are presumed valid and generally upheld. *See* Stawski v. Stawski, 43 A.D.3d 776 (1st Dep't 2007); Darrin v. Darrin, 40 A.D.3d 1391 (3rd Dept. 2007). There are limited situations where a prenuptial agreement can be set aside, including fraud, overreaching, duress, and unconscionability. Courts will not set aside a prenuptial agreement based on unconscionability simply because in retrospect the agreement proves to be improvident or one-sided. *See* Barocas v. Barocas, *94 A.D.3d 551 (1st Dep't 2012) (declining to set aside a prenuptial agreement despite a party's claim that she* *believed there would be no wedding if she did not sign the prenup, that the wedding plans had already been made when the prenup was signed, and that the prenup was signed only two weeks before the wedding).*

C. It is strongly recommenced to begin negotiating the prenuptial agreement as far in advance of the wedding date as possible, or even before the wedding date is set, in order to provide ample time for its negotiation. A common misconception is that a prenuptial agreement will be set aside based on duress if it is entered into in close proximity to the wedding or because a party may have threatened to cancel the wedding if a prenuptial agreement is not signed. This is not necessarily the case. *See, for e.g.,* Cohen v. Cohen, *93 A.D.3d 506 (1st Dep't 2012) (finding that a prenuptial agreement was valid and enforceable even though, at the time of its execution, the wife was pregnant, not represented by counsel, and the husband threatened to cancel the wedding if she did not sign it);* Colello v. Colello, 9 A.D.3d 855 (4th Dep't 2004) *(upholding the prenuptial agreement and finding that a husband's alleged threat to cancel the wedding if the wife refused to execute the prenuptial agreement did not constitute duress).* However, it is still best practice to leave as much time as possible between the execution of the prenuptial agreement and the wedding date.

D. Common Reasons People Get Prenups

1. Entering into the marriage with significant assets.

2. Family wealth.

3. Protect children of a prior marriage.

4. Family business.

5. Second marriage.

6. Child of divorce or close about experience hearing from others contentious divorce battles, which he/she would like to avoid.

7. Marriage later in life.

E. Divorce Statistics:

1. Approximately 82% of all Americans over the age of 25 will marry at least once in their lifetime.[4]

2. 40% of all first marriages, 60% percent of all second marriages and 73% percent of all third marriages will ultimately end in divorce.[5]

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[4] U.S Bureau of the Census. 2009. See Table 57 available at http://www.census.gov.

[5] *See* http://www.census.gov/compendia/statab/2011/tables/11s0058.pdf.

F. Benefits of Getting a Prenup

1. As a negotiated contract, a prenup can cover a wide variety of issues, including property division, spousal support, and death benefits.

2. A prenup is very flexible and can be tailored to the couple's individual needs. It can override what would otherwise be the applicable law governing issues such as equitable distribution, spousal support, payment of counsel fees in divorce, and inheritances.

3. Prenups can help assets retain their separate property character and avoid or minimize issues of commingling.

G. Common misconception: Prenups are "unromantic" and "jinx the marriage."

Actually: A prenup helps a couple speak about money issues up front and helps start the marriage with full disclosure and an understanding of the other party's views on money – which is one of the most frequent causes of divorce and disputes within a marriage.

VIII. Self-Settled Spendthrift Trusts as a Prenup Alternative

A. A prenuptial agreement is the most comprehensive way to protect assets against divorce. A prenuptial agreement can override statutory and common law provisions with respect to spousal support, property division, inheritance and other rights and obligations.

1. While a prenuptial agreement, like any contract, is subject to challenge for fraud, duress, overreaching and undue influence, in New York "there is a heavy presumption that a deliberately prepared and executed written instrument manifests the true intention of the parties." *See* Brassey v. Brassey, 154 AD2d 293, 295 (1st Dep't 1989).

2. The agreement must be executed voluntarily and with full financial disclosure (or an appropriate waiver of such disclosure).

3. It is strongly recommended that each party engage separate and independent counsel. It is also a prudent practice to begin negotiating the prenuptial agreement as far in advance of the wedding date as possible to provide adequate time for thoughtful negotiation.

B. Why might a prenuptial agreement be impracticable or even impossible?

1. One party will not agree.

2. Discomfort with the requisite financial disclosures.

3. Cultural and religious taboos.

4. Social taboos ("jinx").

C. How might a trust work in conjunction with a prenuptial agreement or in place of a prenuptial agreement if one is not possible

1. New York, like many states, employs a dual property system, recognizing a distinction between "marital property" and "separate property." In simple terms, marital property is property earned or acquired by employment or self-employment during the marriage, while separate property is property acquired by either party before the marriage, as well as inherited property, gifts received by a party from a third party and passive appreciation on premarital assets. Thus, separate property placed into trust – whether by a third party as a gift or inheritance or by a spouse retains its separate property character and a trust can be a good means of avoiding commingling of assets and providing a clear means of tracking title.

2. Third Party Trusts

a. <u>Spendthrift trusts</u>: General rule is that when a trust is a spendthrift trust a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary.

i. In New York, a trust is a spendthrift trust unless the trust instrument confers a power of transfer on the beneficiary. EPTL §7-1.5(a); CPLR §5205(c).

ii. The rules restricting access by creditors to spendthrift trusts do not apply to spousal maintenance and child support obligations. *See* <u>Matter of Chusid</u>, 60 Misc.2d 462 (Surr. Ct. Kings Co. 1969).

b. <u>Discretionary trusts</u>: Today, most trusts are drafted as discretionary trusts, meaning that distributions to the beneficiary are wholly within the discretion of the trustee (and generally without regard to any standard). A beneficiary's interest in a discretionary trust is so tenuous that it does not equate to a property right that can be subject to attachment by creditors.

c. Interests in trusts <u>can</u> be taken into account by a court when awarding spousal maintenance and child support. DRL §236B(6)(a); DRL §240(1-b)(b)(5)(iv); <u>Alvares-Correa v. Alvares-Correa</u>, 285 AD2d 123, 26 NYS2d 668 (1^{st} Dep't 2001).

3. Domestic Asset Protection Trusts (DAPTs):

a. Most states do not afford protection to assets placed in trust by an individual for his or her own benefit (commonly referred to as "self-settled trusts"). The "self-settled" trust has traditionally been an exception to the creditor protection afforded to spendthrift and discretionary trusts. An increasing number of states ("DAPT states") do have some form of domestic asset protection legislation for self-settled trusts.

b. New York

i. In New York, EPTL §7-3.1 expressly provides that an individual cannot create a spendthrift trust for his or her own benefit.

ii. A New Yorker can establish a trust governed by the law of another state. EPTL Section 7-1.10 provides that "[w]henever a person, not domiciled in this state, creates a trust which provides that it shall be governed by the laws of this state, such provision shall be given effect in determining the validity, effect and interpretation of the disposition in such trust . . ." Although the statute does not expressly provide New York domiciliaries with the express ability to create a valid trust governed by the laws of another state, existing case law supports such a right. *See* <u>In re New York Trust Co.</u>, 87 N.Y.S.2d 787, 792 (N.Y. Sup. Ct. 1949) *("It is inconceivable that a statue committed to [the policy of EPTL § 7-1.10] would deny its own residents the corresponding right to establish trusts in other states . . . [U]nder the law of this state, a New York resident may choose another state as the situs of a trust as freely as a non-resident may create a trust in New York.")*

iii. However, if a New York State resident creates a self-settled trust in a DAPT state there is a risk that a New York court might refuse to recognize the DAPT state's protections. *See* <u>In re Huber</u>, 2013 WL 2154218, Bkrtcy.W.D. Wash (2013) *(Washington state court held that Washington law applied where the settler was a Washington domiciliary who created a self-settled trust in Alaska)*; <u>Rush University Medical Center v. Roger Sessions et. al.</u>, 980 N.E.2d 45 (Ill. 2012) *(all self-settled trusts are void as to creditors under Illinois law regardless of where the trusts are created)*.

c. DAPT States

i. The sixeen (16) states with DAPT legislation are Alaska, Colorado, Delaware, Hawaii, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, and Wyoming.

ii. In some DAPT states an ex-spouse can still reach a self-settled trust to satisfy claims for spousal maintenance, property settlements and/or child support. A comparison chart of the 16 DAPT trust statutes can be found on the American College of Trusts and Estates Counsel (ACTEC) website.[6]

iii. Trust should be established before marriage. In some states they can be created during the marriage, but not in anticipation of a divorce.

IX. Investing and Insurance Planning in a Divorce

A. Investing

1. The cost of a divorce can be a financial burden on both parties, and thus impact their contributions toward investing. The cost of a divorce can vary widely as can the complexity and contentiousness of the divorce itself. Whatever your experience, this limits the financial resources available to invest as well as the focus that may be needed to invest properly. The distraction of a divorce can also have a negative impact on income, especially if one of the parties operates and owns a business.

2. A divorce creates two household where previously one existed. This stretches finances for both parties as typically one party is now stretching their income to support two households, and the other household has lost part of the operating family budget. This constraint can impact the two new households as there is less to invest going forward for retirement.

3. There are psychological issues with investing as well. Men and women when married invest in a way that blends their particular preferences. Men are typically more aggressive and women less so and during the marriage they compromise on a middles ground in terms of the risk taken in the portfolio of investments shared. After a divorce, both parties tend to fall back to their comfort zones.[7]

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[6] http://www.actec.org/public/Documents/Studies/Shaftel-Comparison-of-the-Domestic-Asset-Protection-Trust-Statutes-Updated-through-April-2014.pdf

[7] https://.fisher.osu.edu/blogs/efa2011/files/HHF_5_1.pdf

4. Another factor in a post-divorce situation is that one party may have received a lump sum settlement intended to support his or her needs for income and lifestyle, potentially for the rest of his or her life. This puts undue pressure on the assets acquired to create cash flow and perhaps endure through decades of life. If one spouse cannot be reasonably expected to return to work because of lifestyle during the marriage, these funds have to survive market instability, inflation, potential chronic long term health issues and the need for paid care providers and much more. Often, the recipient of a lump sum settlement is female and women are much more likely to be in need of long term care for chronic illnesses than their male peers.[8]

5. Qualified retirement assets that must be divided in divorce are not all classified in the same manner. The procedure to split IRA assets is known as "transfer incident to a divorce" as compared to 403B, 401K and defined benefit account divisions which must follow the Qualified Domestic Relations Order (QDRO) process. Improper labeling of the action may cause a tax consequence for the receiving party as the action may be classified as an early withdrawal with taxes and fees assessed accordingly.[9] It should be noted that QDRO are only required in plans covered by ERISA or the Employee Retirement Income Security Act.

6. Military and government pensions are not covered by either of the classifications listed above. These plans are typically covered by a Court Order Acceptable for Processing (COAP). There are several reasons why these assets are processed differently.[10]

   a. The employee contributions and balance reported by this is not an accurate reflection of the benefit as it does not reflect the value of the Cost of Living Adjustment (COLA) and government contributions which can be in total 2/3 of the actual benefits that will be received. Furthermore, COLA, unless specifically noted, may only be paid to the original plan participant and not the party awarded a division of the benefits.

   b. The participant in these plans is the only party that can designate when these plans start payment and how the benefit is paid out.

B. Health Insurance

1. During the pendency of a divorce action, there are automatic restraints, pursuant to DRL §236(B)(2) and 22 NYCRR §202.16(a), that remain in effect, which include a requirement that: "Neither party shall cause the

[8] www.aaltci.org/long-term-care-insurance/learning-center/for-womem.php
[9] www.investopedia.com/articles/retirement/03/060403.asp
[10] http://vecon.com/federal-pensions-in-divorce-value-for-off-set-or-divide

other party or the children of the marriage to be removed from any existing medical, hospital and dental coverage, and each party shall maintain the existing medical, hospital and dental insurance coverage in full force and effect."

2. Pursuant to DRL §255(1), a court, before the issuance of a judgment of divorce, shall ensure that both parties have been notified that once the judgment is signed, a party may or may not be eligible to be covered under the other party's health insurance plan, depending on the terms of the plan. Further, pursuant to DRL §255(2), if the parties enter into a divorce agreement, the agreement must include a provision relating to the health care coverage of each party; and that "such provision shall either: (a) provide for the future coverage of each party, or (b) state that each party is aware that he or she will no longer be covered by the other party's health insurance plan and that each party shall be responsible for his or her own health insurance coverage, and may be entitled to purchase health insurance on his or her own through a COBRA option, if available."

3. If while married a party receives health coverage through his/her spouse's employment, their children can continue to receive the coverage after divorce but such party may not be eligible to continue to be covered by the insurance. If the employer is notified within a 60 day window after the divorce is finalized, the spouse will be eligible for coverage through COBRA (Consolidated Omnibus Budget Reconciliation Act) for a maximum of 36 months. The cost is typically 102% of the cost that the employer paid for the coverage and depending on the agreement may be covered all or in part by the ex-spouse.[11]

C. Life Insurance

1. Life insurance is often used in divorce planning to ensure that upon the death of the payor spouse (i.e., the person providing spousal maintenance, child care and child support payments) funds will still be available to continue paying the agreed upon obligations.

   a. Often a trust will be established and the trust will own the life insurance policy. If the insurance will not be owned by a trust, it is important that the policy be owned by someone other than the insured. In every insurance contract there are several named parties to the agreement in addition to the insurance company. There is the owner, premium payer, insured and the beneficiary. These named parties can all be separate and distinct persons. In a divorce, if a trust is not the owner and beneficiary of a policy intended to secure obligations under a divorce agreement then it may be appropriate to make the payee spouse the owner, while the

[11] http://www.shrm.org/templatestools/hrqa/pages/howlongdoescobralast.aspx

insured payor spouse remains as the premium payer. The beneficiary can be the payee spouse or someone else, as the parties agree.

b. If the insurance policy is indeed owned by the payee spouse, and the insurance purchased is part of the written judgment of divorce, then the life insurance premiums are considered part of spousal maintenance and as such the premium payments will be tax deductible to the payor spouse and treated as income of the payee spouse.[12]

c. While is standard to order insurance on the party required to make spousal maintenance, child support and child care payments, life insurance should also be considered for the residential spouse (if he or she is the payee spouse) in divorces where there are minor children. The residential spouse's death may cause a financial burden for the other parent who would then have full responsibility for financially supporting the family and may need to employ babysitters and other care providers to help assist in the duties that were covered by the deceased residential parent.

d. Often the insurance purchased is term as it is the cheapest option. The recipient spouse may want the following rider on the contract for added flexibility:

    i. Waiver of disability: this rider ensures that the premium will be paid for the duration of the contract so that in the event of a total disability of the insured, which would have a catastrophic impact on income, this policy would remain in force to provide the funds as needed for the ex-spouse. It should be noted that some contracts, upon validation of the claim of disability, will convert the term policy to an available permanent policy for the duration of the disability.

    ii. Convertibility: This rider allows the owner to convert the policy from term to permanent insurance. It can be part of the negotiations that the recipient spouse has the right before the termination of the contract to convert the contract to permanent if he or she desires (perhaps as a form of retirement supplement). At the insured ex-spouse's death, the survivor would receive an added lump sum. Should the beneficiary spouse predecease the insured, the beneficiary could be the parties' children or grandchildren or however they agree.

[12] www.irs.gov/publications/p17/ch18html

D. Disability Insurance

1. In the case of a divorce agreement, it is standard that under unforeseen and dire circumstance such as the permanent disability of the ex-spouse who is obligated to pay alimony, child care and/or child support the agreement can be modified to reflect the new circumstances and reduced income.

2. The supported residential household or ex-spouse does not have to settle for reduced payments. It can be part of the agreement, assuming the party is insurable, that the ex-spouse can purchase an individual disability policy where upon a qualifying accident or illness, all or part of the benefit can be assigned to the ex-spouse.

E. Long Term Care Insurance

1. It is fast becoming recognized that one of the greatest risks to lifestyle can be the ravaging effects of the cost of long term care on the cash flow of a household. If the ex-spouse is receiving a lump sum payout as part of the divorce agreement, or even a regularly agreed upon monthly amount, rarely is the potential cost of unexpected accident or illness calculated into the amount.

2. A possible solution is when purchasing life insurance for the residential parent, one may be able, depending on the state of residence, to add a rider on the life insurance policy that will allow the death benefit to be accessed before death to pay for qualifying long term care expenses.

F. Property and Casualty Insurance: Just like life insurance premiums, these premiums can be classified as maintenance if it is ordered in the divorce agreement that one party must pay the premiums for the other party.[13]

X. Why Every Divorce Client Needs Estate Planning

A. Need to review and change existing estate planning documents at commencement of divorce and again when divorce is finalized.

1. Will and revocable trust provisions (and other applicable revocations) in favor of the former spouse are only automatically revoked under EPTL §5-1.4 upon divorce, judicial separation or annulment. Commencement of a divorce proceeding does not cause an automatic revocation of such provisions and those changes need to be effectuated in a new Will or revocable trust.

2. If desired, remove provisions in favor of spouse's relatives.

[13] www.irs.gov/publications/p17/ch18html

3. If there are minor children, may wish to provide for someone other than the spouse to serve as guardian of the property of minor children and/or as trustee of trusts for minors.

4. Even if the Will is changed, a surviving spouse retains the right to claim an elective share under EPTL §5-1.1-A during the pendency of a divorce proceeding unless he or she is disqualified under EPTL §5-1.2, which provides for disqualification if:

    a. A final decree or judgment of divorce, of annulment or declaring the nullity of a marriage or dissolving such marriage on the ground of absence, recognized as valid under the law of this state, was in effect when the deceased spouse died.

    b. The marriage was void as incestuous under section five of the domestic relations law, bigamous under section six thereof, or a prohibited remarriage under section eight thereof.

    c. The spouse had procured outside of this state a final decree or judgment of divorce from the deceased spouse, of annulment or declaring the nullity of the marriage with the deceased spouse or dissolving such marriage on the ground of absence, not recognized as valid under the law of this state.

    d. A final decree or judgment of separation, recognized as valid under the law of this state, was rendered against the spouse, and such decree or judgment was in effect when the deceased spouse died.

    e. The spouse abandoned the deceased spouse, and such abandonment continued until the time of death.

    f. A spouse who, having the duty to support the other spouse, failed or refused to provide for such spouse though he or she had the means or ability to do so, unless such marital duty was resumed and continued until the death of the spouse having the need of support.

5. Remove spouse as health care agent and as agent under power of attorney.

6. <u>Practice Pointer</u>: Once a divorce proceeding is commenced neither party can change beneficiary designations on life insurance policies, change title of joint accounts or take certain other actions without written consent of the other party or order of the court. These are the "automatic restraints" under DRL Section 236, Part B, Section 2 and the Uniform Rules of the Trial Courts.

B. If there is no Will in place, it is important to sign a Will to avoid intestacy during the pendency of a divorce.

1. Under NY state intestacy law (EPTL §4-1.1), the surviving spouse receives $50,000 + ½ of estate if the decedent has children and 100% of the estate if the decedent has no children.

2. A surviving spouse is only disqualified for intestacy purposes if one of the requirements under EPTL §5-1.2, as discussed above, is satisfied.

XI. Separating Physical Custody of Children and Financial Control of Property in an Estate Plan

A. Guardianship of the person and property of a minor is governed by Article 17 of the Surrogate's Court Procedure Act ("SCPA").

1. The Surrogate's Court is empowered to appoint a guardian of both the person and the property of an infant. In contrast, the Family Court may only appoint a guardian of the person of an infant. *See* Family Court Act §661.

2. Guardianship continues until the minor attains the age of 18 unless the minor consents to the continuation of the guardianship to age 21 or under other certain specified circumstances. SCPA §1707.

B. If an individual has minor children, one of the most difficult issues he or she may face in completing an estate plan is designating a guardian for minor children. Where one parent survives, except if there are extenuating circumstances, the surviving parent will be appointed as the guardian of the person of the minor children.

C. The court may appoint different persons as guardians of a minor's person and a minor's property. SCPA §1707. Therefore, it is possible, however, to name someone other than the surviving parent as the guardian of the minor's property.

1. Furthermore, the court may appoint a guardian to administer a portion of the minor's property and appoint a different person to administer a different portion of the minor's property. In <u>Matter of Cooper-Novack</u>, 177 Misc.2d 643, 676 NYS2d 790 (Surrog. Ct. NY Co. 1998), involving divorced parents, the court appointed the mother as guardian of the property with respect to an inheritance from her family even though the father was already appointed as guardian of the property with respect to an inheritance from his family.

2. If different people are appointed as guardian of the person and as guardian of the property of a minor, the guardian of the person of the minor is not authorized to take the property of the minor into his or her possession.

D. By designating that any property passing to a minor children from the decedent's estate be held in trust during minority (or beyond), the parent can name one or more trustees to essentially fill the role of the property guardian, separating the financial role from the surviving parent's custodial role. This can be beneficial for a number of reasons, including the court's continuing control over a guardian and the requirement of an annual accounting by the property guardian (SCPA §1719) and the court's annual examination of that account (SCPA §1721).

XII. When a Will and a Divorce Agreement (or Prenup) Don't Match Up

A. When a Will and a divorce agreement or prenuptial agreement are in conflict then the spouse or former spouse, as the case may be, has a contract claim against the estate.

B. Always request copies of prior divorce agreements, prenuptial agreements, and other relevant documents because they often contain provisions for dispositions on death and need to be coordinated with the Will.

C. Always ask a client if he/she has a prenuptial agreement or obligations to a prior spouse under a divorce agreement as they may need to be taken into account for estate planning purposes.

XIII. Portability and Prenups

A. Initially introduced by the Tax Relief, Unemployment Reauthorization, and Job Creation Act of 2010 (TRA 2010),[14] and made permanent by the enactment of the American Taxpayer Relief Act of 2012 (ATRA) [15] on January 2, 2013, "portability" allows spouses to share their federal estate tax exclusions with one another, thereby creating a potentially valuable asset to be considered by practitioners when preparing a marital agreement.

1. The applicable exclusion amount is now a combination of (i) an individual's "basic exclusion amount" ($5 million as indexed annually for inflation; $5,430,000 in 2015),[16] and (ii) if applicable, the unused basic exclusion amount of his or her last deceased spouse (referred to as the spousal unused exclusion amount or "DSUE").[17]

2. Individuals may utilize the applicable exclusion amount at death or by making gifts during their lifetime.

3. There is no portability of the generation-skipping transfer tax exemption nor of the New York State estate tax exclusion between spouses.

B. A prenuptial agreement can and should include a provision addressing, among other things, whether a portability election is to be made and who is to bear the expense of filing a federal estate tax return that otherwise would not be required.

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[14] P.L. 111-312 (2010).
[15] P.L. 111-240 (2013).
[16] Internal Revenue Code §2010(c)(3).
[17] Internal Revenue Code §2010(c)(2).

1. DSUE is only available if the decedent's executor makes an affirmative election on a timely filed estate tax return.

2. If an executor is appointed for the decedent's estate, then the portability election may be made only by the executor. If there is no court-appointed executor, then any person in actual or constructive possession of any of the decedent's property may file an estate tax return to elect portability.

3. In preparing a marital agreement, it is important to consider that someone other than the surviving spouse may be the executor of the deceased spouse's estate and that the family dynamics may be such that the surviving spouse does not have the information necessary to file an estate tax return to elect portability. Absent a provision in the prenup, the executor of the deceased spouse's estate may have no obligation to (i) file an estate tax return or (ii) make a DSUE election.

C. In negotiating a prenuptial agreement, the less wealthy spouse has the potential to port DSUE to the wealthier spouse if he or she predeceases.

D. DSUE from a prior deceased spouse?

1. Because of the "Last Deceased Spouse Rule" an individual's DSUE (from a prior spouse) will be lost if he or she remarries and the new spouse predeceases him or her.

   Consider a hypothetical client, Alice, who wants a prenuptial agreement in connection with her upcoming marriage to Bill. Alice is the widow of Charles and she has DSUE of $3 million as a result of Charles' death. If Alice and Bill marry and Bill dies before Alice, she will lose the $3 million of DSUE from Charles because Bill has replaced Charles as Alice's "last deceased spouse."

2. Remarriage alone does not affect who will be considered the last deceased spouse. A surviving spouse can use DSUE from his or her last deceased spouse while married to a subsequent spouse.

3. The identity of the last deceased spouse is not affected by whether the estate of the last deceased spouse elects portability or whether the last deceased spouse has any DSUE available.

4. What can a Prenup do?

In our hypothetical, Charles' executor elected portability and computed a DSUE amount of $3 million. Charles' surviving spouse, Alice, subsequently married Bill. If Alice dies in 2015, is survived by Bill and has neither used any of her basic exclusion nor any of the DSUE from Charles, even though Alice has remarried, her estate has an applicable exclusion amount of $8,430,000 [$5,430,000 + $3,000,000].

Assume the same facts as above, except that Bill predeceases Alice. Bill's executors also elect portability on a timely-filed estate tax return; however, Bill's DSUE amount is computed at $1,000,000. At Alice's death in 2015, she will have an applicable exclusion amount of $6,430,000 [$5,430,000 + $1,000,000] and will have suffered a loss of $2 million of the applicable exclusion, or, assuming a federal estate tax rate of 40%, a loss of $800,000 of estate tax savings. If Bill's executors do not make a portability election, Alice will have an applicable exclusion amount of $5,250,000. Bill is Alice's last deceased spouse, and she has lost her DSUE from Charles. If there is no portability election, Alice would have suffered a loss of the applicable exclusion of $3 million resulting in a loss of $1,200,000 of estate tax savings (assuming a 40% rate). When negotiating Alice's marital agreement with Bill, as part of her negotiation strategy, she should take into consideration the potential loss of her DSUE from Charles.

a. To avoid the loss of DSUE, it may be beneficial for Alice to make lifetime gifts to utilize the DSUE received from Charles. The Regulations provide that if a surviving spouse who has DSUE makes lifetime taxable gifts, the DSUE is applied first, before using the surviving spouse's own basic exclusion amount.[18] This is significant because so long as the surviving spouse does not have a new "last deceased spouse," he or she can continue to utilize the DSUE from his or her deceased spouse in connection with lifetime gifting - even if he or she has remarried.

b. In the case of Alice and Bill, Alice has an available applicable exclusion amount of $8,430,000 [$5,430,000 + $3,000,000]. Let's assume that Bill intends to leave the overwhelming majority of his fortune to his children, thereby utilizing his entire applicable exclusion amount and leaving no DSUE for Alice if she survives him. If Bill predeceases Alice her applicable exclusion amount would be reduced from $8,430,000 to $5,430,000 due to the loss of the DSUE received from Charles (again, this translates into an additional $1,200,000 of estate tax at Alice's death, assuming a 40% rate). Alice can protect against this loss of applicable

[18] Temp. Reg. §25.2505-2T(b)

exclusion by making lifetime taxable gifts that utilize the DSUE received from Charles. However, this reduction in Alice's net worth as a result of lifetime gifting should be taken into account in negotiating the marital agreement insofar as it might affect the parties' marital lifestyle as well as any negotiated divorce or death benefit.

E. Multiple Deceased Spouses. It is also important to note that while the DSUE Amount from a prior deceased spouse who is not the "last deceased spouse" cannot be used, the Regulations do permit the use of the DSUE from multiple deceased spouses if the surviving spouse makes taxable gifts utilizing the DSUE from a prior deceased spouse before he or she is predeceased by a subsequent spouse.[19] In other words, assume Alice makes lifetime gifts of $3 million using the DSUE from Charles and is then predeceased by Bill. Assume further that Bill leaves DSUE of $2 million. Alice can make additional gifts of $2 million using the DSUE from Bill, while keeping her basic exclusion amount of $5,430,000 intact.

XIV. Social Security Benefits & Divorce

A. If a divorced individual (the "Recipient Spouse") was married to his or her former spouse (the "Former Spouse") for 10 or more years, he or she can receive social security benefits based upon the Former Spouse's employment record (even if the Former Spouse is remarried), provided:

1. The Recipient Spouse is unmarried;

2. The Recipient Spouse is at least 62 years old;

3. The Former Spouse is entitled to or is already receiving Social Security benefits; and

4. The Social Security benefit based on the Former Spouse's record would be greater than the benefit the Recipient Spouse would otherwise be entitled to receive.

B. Keep in mind:

1. The Recipient Spouse's filing status does not in any way impact whether or not the Former Spouse is eligible to receive benefits, nor can it reduce the Former Spouse's benefits as long as the parties have been divorced at least 2 years.

2. Benefits based on a Former Spouse's record are equal to ½ of the Former Spouse's full social security benefits.

[19] Temp. Reg. §20.2010-3T(b)

3. After remarriage, benefits based on a former spouse's employment record cannot be claimed unless the subsequent marriage ends (by death, divorce, or annulment).

   There is an exception when the Recipient Spouse is disabled. In that case, if the Former Spouse dies while the Recipient Spouse is accessing his or her benefits, the Recipient Spouse can continue to receive benefits based on the Former Spouse's record if he or she remarries after age 50.

4. Eligibility to switch benefits

   i. If the Recipient Spouse applies for and receives benefits after reaching full retirement age, then he or she can always switch from the Former Spouse's benefits to his or her own benefit if the anticipated benefit amount will be higher. Thus, this needs to be periodically re-evaluated as circumstances change.

   ii. If the Recipient Spouse applies for and receives benefits before reaching full retirement age based on a Former Spouse's employment record, the Recipient Spouse cannot switch to his or her own benefits at a later date.

5. Delaying collection of benefits until after reaching full retirement age may result in a higher benefit due to delayed retirement credits.

6. A pension based on employment not covered by Social Security (i.e., government or foreign employment) may negatively impact Social Security benefits.

7. Benefits based on a deceased Former Spouse's employment record is the same as widow or widower benefits, provided the marriage lasted at least 10 years.

   a. The Recipient Spouse will continue to be eligible for these benefits even if he or she remarries and is over the age of 60.

   b. If the Recipient Spouse is caring for a child who is under age 16 or is disabled, the 10 year restriction is not applicable if the child is a natural or legally adopted child of the Former Spouse.

XV. Smart Structuring of Child Support and Childcare can Save Tax Dollars

A. Child Support is tax free to the recipient.

B. Maintenance is typically taxable to the recipient.

C. One spouse may be less financially savvy, and get into trouble with the obligations that arise from having to pay taxes on maintenance. One can request tax modeling to illustrate based upon previous years earning how the divorce and the proposed settlement will impact the tax situation of each party.

D. In some cases, may be beneficial in negotiating a divorce agreement to try to obtain a higher amount of child support because it is received tax free.

E. Divorce agreements should include a provision about claiming the children as dependents on their tax returns. Both parents can alternate taking the deduction or one parent can be entitled to claim the deduction every year. If this is left silent in the negotiations, the residential parent will be entitled to take the deduction.

F. Tax deduction associated with paying for childcare.

XVI. Tax Issues that Arise with regard to Spousal Support and Equitable Distribution

A. Tax consequences are taken into account in dividing assets for equitable distribution. Therefore, a dialogue between the matrimonial attorney and accountant is important.

B. Tax refunds and liabilities should be addressed in divorce agreements.

C. Spousal maintenance

1. Tax treatment of maintenance paid during a divorce proceeding varies by court.

2. With post-divorce maintenance, typically it is taxable to the recipient and tax deductible to the payor.

3. Tax consequences of the maintenance payment must be taken into account in order to ensure the recipient is receiving an adequate amount.

4. Less monied spouse may not be involved in handling finances during the marriage, and so it is important to clarify the taxes due on the maintenance payments since there are not withholdings.

XVII. What's Mine is Mine (or My Child's)

A. "Marital property" is defined in DRL §236(B)(1)(c), as follows: "The term 'marital property' shall mean all property acquired by either or both spouses during the marriage and before the execution of a separation agreement or the commencement of a matrimonial action, regardless of the form in which title is held, except as otherwise provided in agreement pursuant to subdivision three of this part. Marital property shall not include separate property as hereinafter defined."

B. "Separate property" is defined in DRL §236(B)(1)(d), as follows: "The term separate property shall mean: (1) property acquired before marriage or property acquired by bequest, devise, or descent, or gift from a party other than the spouse; (2) compensation for personal injuries; (3) property acquired in exchange for or the increase in value of separate property, except to the extent that such appreciation is due in part to the contributions or efforts of the other spouse; (4) property described as separate property by written agreement of the parties pursuant to subdivision three of this part."

C. Burden of Proof

1. In NY, property acquired during the marriage is presumed to be marital property subject to equitable distribution. *See* Clark v. Clark, 117 A.D.3d 668 (2d Dep't 2014); Zufall v. Zufall, 109 A.D.3d 1135 (4th Dep't 2013).

2. The burden is on the party asserting an asset is separate property to prove his/her claim. *See* Hymowitz v. Hymowitz, 119 A.D.3d 736 (2d Dep't 2014); Overton v. Overton, 118 A.D.3d 858 (2d Dep't 2014).

D. Commingling and transmutation

1. Separate property can be transmuted into marital property where the actions of the title spouse demonstrate his/her intent to transform the character of the property from separate to property. For example, the act of depositing separate funds, such as inheritances, gifts, or pre-marital assets, into a joint account creates a presumption of an intent to convert those funds into a marital assets.

2. However, this presumption may be rebutted. The party seeking to have the asset classified as separate has the burden of rebutting the presumption.

E. Significantly, laws regarding what constitutes marital and separate property vary by state. For example, beware that in some states, like CT, inheritances may be subject to equitable distribution upon divorce.

F. How Prenups Can Help

1. In a prenup, the parties can opt out of unfavorable state law.

2. A prenup can provide greater protection for gifts, inheritances and pre-marital assets. For example, a prenup may contain provisions that gifts, inheritances and pre-marital assets will constitute a party's separate property even if they are commingled with marital assets.

3. A prenup can assist in keeping an inheritance within the family and away from in-laws in the event of death. For example, a prenup may provide the parties must leave each other at least the elective share, but in defining the estate carve out inheritances, such as a family business interest.

4. Routine gifts to a spouse may be treated as income for purposes of child support and/or maintenance in a divorce. This can be prevented in a prenuptial agreement.

G. Practice Pointer: As a practical matter, regardless of whether there is a prenup, it is strongly advisable to keep separate property in separate accounts in sole name and to maintain good records.

H. Leave property to children and more remote descendants in trust rather than outright.

I. Lifetime trusts vs. mandatory distributions at fixed ages.

J. Have the "prenup talk" with your children.

XVIII. When To Get a Postnup

A. A postnuptial agreement is a written agreement that is entered into by a husband and wife after marriage.

B. Prenups v. Posnups

1. While a postnuptial agreement is entered into after marriage, a prenuptial agreement is an agreement entered into by a couple before marriage.

2. Prenuptial agreements are held to a higher standard than postnuptial agreement because the parties are not fiduciaries, but rather strangers in the eyes of the law. Since a postnuptial agreement is a contract between spouses, it involves a fiduciary relationship requiring the utmost of good faith. *See, for e.g.,* Petracca v. Petracca, 101 A.D.3d 695 (2d Dep't 2012). However, the law favoring contracts, results in postnuptial agreements still being held to a high standard in New York and largely upheld.

3. If there is a choice between entering into a prenup or a postnup, when representing the wealthier party, practitioners should encourage prenuptial agreements. There are certain rights and obligations that come with marriage. It is generally easier to waive rights that have not vested yet, rather than those that a party is already entitled to by virtue of marriage. Once the wedding takes places, leverage is lost and it is often very difficult to bring both parties to the bargaining table.

4. It is usually more difficult to get a postnuptial agreement signed than a prenuptial agreement. There is not a deadline for the postnuptial agreement to be executed, whereas with a prenuptial agreement there is the wedding date. Therefore, as a practical matter, many postnuptial agreements linger and do not get signed.

5. Like all other contracts, prenups and postnups require consideration. For a prenuptial agreement, the marriage itself is generally the consideration. There also needs to be consideration for a postnuptial agreement.

C. Postnups v. Separation Agreements

1. A postnuptial agreement differs from a separation agreement in that a postnuptial agreement is entered into in contemplation of remaining in the marriage.

2. A separation agreement is entered into by a married couple in contemplation of a legal separation or divorce.

D. Reasons a Married Couple may get a Postnuptial Agreement

1. Not enough time before the wedding to negotiate a prenuptial agreement, so the parties choose to enter into a postnuptial agreement.

2. There was marital strife and they want to move forward with their marriage, but with prescriptions about what would happen in the event of a divorce.

3. Want to revisit the terms of a prenuptial agreement after the passage of time.

4. Change of circumstances.

5. Fixing commingling of separate property.

6. Starting a business.

XIX. Prenups, Divorces, and Business Owners

A. In NY, there is a equitable distribution of marital property upon divorce. Equitable distribution does not necessarily mean equal.

B. Usually, there is not an equal division of the value of businesses in the event of a divorce. The business owner is typically entitled to more than 50% of its value, but the actual allocation is dependent upon the facts and circumstances of each case.

C. Accountants can provide integral assistance in arriving at the value of a business for equitable distribution purposes.

D. In a prenuptial agreement, the parties can contract how to divide businesses started during the marriage and how to handle the appreciation of any pre-marital businesses.

XX. Why Your Matrimonial Lawyer, Estate Lawyer, Financial Planner and Accountant Need to Talk To Each Other

A. Everything is connected so it's important to make sure a client's issues are considered from all perspectives – matrimonial, estate planning, tax and financial planning.

B. Documents prepared in one setting can impact the others, so important to have all advisors involved.

C. In negotiating divorce settlements, matrimonial attorneys should consult with trusts and estates counsel if the agreement will impact the client's future estate plan (for example, by requiring that a percentage of the estate be left for the client's children of the first marriage).

XXI. Offshore Accounts and Divorce

A. There is broad disclosure in divorce cases.

B. Generally, parties need to complete sworn statements of their net worth on which all assets, wherever located, and liabilities are to be included.

C. Assets are required to be listed on the net worth statement whether held by a party or held in the name of a nominee.

D. Tax return is one of the most important documents in a divorce case to help figure out the extent of the assets.

E. If there are foreign assets, disclosure on FBAR forms becomes informative in the event of a divorce.

F. People don't always report their offshore accounts. However, in a divorce scenario if one spouse finds out that the tax return is not accurate he/she may try to use it to his/her advantage. If this may be an issue, should educate clients about amending returns and/or the voluntarily offshore disclosure program.

XXII. Divorce, Prenups, and Social Media

A. In prenups, there is a trend to include "social media clauses."

1. With the proliferation of social media, non-disclosure clauses have become not just for celebrities. They also now have an appeal for ordinary individuals, such as those who seek to protect their privacy, prevent harm to their reputation, or regulate information pertaining to their business interests.

2. Traditional non-disclosure clauses are being expanded to include restrictions on what can be posted to Facebook, Twitter, Instagram, and other social media outlets.

3. Non-disclosure clauses in a prenuptial agreement can vary substantially in what they prescribe.

   a. The confidentiality clause may be limited to the content of the prenuptial agreement and its underlying financial information.

   b. Other individuals might opt for a broader confidentiality provision that extends to non-financial aspects of their relationship, such as limiting what pictures or videos a party can unilaterally post on social media websites.

   c. The non-disclosure provision can also prohibit the circulation of information that is reasonably likely to have a negative effect on a spouse's career or business.

4. In order to help enforcement of a "social media clause," the prenuptial agreement may provide for certain penalties in the event of a violation, such as injunctive relief and/or payment of counsel fees.

5. <u>Sample Non-Disclosure Clause</u>: "The terms and provisions of this Agreement, including, but not limited to Exhibits A and B, shall remain private and confidential. Except to enforce any term or condition of this Agreement or in response to and as required by legal subpoena or court order, neither party shall disclose any of the financial information exchanged by the parties, or any of the terms and provisions of this Agreement, to persons other than their respective families, attorneys, accountants, financial advisors and business advisors whose professional advice or professional assistance will be necessary for the parties to properly satisfy or enforce the terms and conditions of this Agreement. In addition, neither party shall directly or indirectly publish, or cause to be published, any diary, memoir, letter, story, photograph, interview, article, essay, account or description or depiction of any kind whatsoever, whether fictionalized or not, concerning the parties' marriage or any other aspect of their respective personal, business or financial affairs, or assist or provide information to others in connection with the publication or dissemination of any such material or excerpts thereof, if such publication likely would have a detrimental effect on a party's personal, business or financial affairs. As used in the preceding sentence, the terms "publish" and "publication" shall be deemed to include the presentation or reproduction of written, verbal or visual material in any communication medium, including, without limitation, books, magazines, newspapers, records, tapes (audio and video), disks (audio, video and computer), internet, Facebook, Twitter or other social media, phone, video conference, email,

text, computer file or data or any other electronic media, theatrical publications of any kind, movies, television, or radio, in any language and in any jurisdiction."

B. Impact of Social Media in a Divorce Proceeding

1. Divorces can be acrimonious. What is posted on social media is open for public consumption and can be utilized as evidence in a divorce proceeding.

2. For example, in a case involving payment of support, if a party is claiming an inability to pay, postings on Facebook about vacations and on LinkedIn about employment success can be utilized. Likewise, in a custody case, Facebook messages and Instagram pictures can be offered as evidence.

XXIII. Educating the "Less Wealthy Spouse" After a Divorce

A. We are frequently confronted by one spouse having more knowledge and control over the finances than the other party. At times, the less wealthy spouse is left entirely in the dark, having no experience will managing money, bill payment, maintaining a budget, etc.

B. Efforts should be made to involve and educate the less wealthy spouse to prevent or minimize a disparity, and put him/her in a better position if confronted with a divorce scenario.

C. Divorce and new financial responsibilities that go with it can be daunting. It is important to help connect the less wealthy spouse with good advisors in order to help ease the transition.

XXIV. How To Protect Children From a Prior Marriage in a Prenup

A. Divorce Provisions:

1. Limiting amount passing to new spouse.

2. Opting out of "equitable distribution."

B. Death Provisions:

1. Limiting amount that must pass to new spouse or future children.

2. Providing for disposition to new spouse in trust to insure property passes to children upon spouse's later death.

3. Opting out of "elective share."

4. Providing for life insurance for new spouse to keep existing estate assets available for children.