When the Honeymoon is Over . . . Estate Planning Before and After the Divorce

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I. ***Introduction.***

Most attorneys focus their attention on one particular area of expertise. Two of the most common areas of practice are (i) Family Law and (ii) Trusts and Estates/Estate Planning. It is rather uncommon to find attorneys who focus on both areas. However, there is a significant amount of cross-over in these two areas of practice. The authors find it surprising that so few family law attorneys know so little about estate planning, and that so few estate planning attorneys know so little about family law.

This program is intended to identify several issues which family lawyers and divorce planners should be prepared to handle at all stages of a marriage. We have broken down this outline to focus on four different stages of a marriage: (i) issues prior to the marriage; (ii) issues to focus on when the marriage is "going south", but before the filing of a divorce complaint; (iii) issues which arise during a divorce proceeding; and (iv) matters to consider following the divorce. Undoubtedly, this program cannot cover the infinite number of issues that may arise in every marital relationship, but it is intended to be a resource to rely upon at all stages of a client's married life.

II. ***Prior to the Marriage***

A. Prenuptial Agreements

- In the United States, prenuptial agreements are recognized in all fifty states and the District of Columbia.

- In most jurisdictions, five elements are required for a valid prenuptial agreement:

  1. The agreement must be in writing (oral prenups are always prohibited);

2. The agreement must be executed voluntarily (not a product of fraud or duress);
3. There must be full and/or fair disclosure of all finances at the time of execution;
4. The agreement cannot be unconscionable;
5. Sufficient opportunity must be allowed to consider the provisions of the agreement and obtain separate legal advice before signing; and
6. The agreement must be executed by both parties (not their attorneys) "in the manner required for a deed to be recorded", known as an acknowledgment, before a notary public.

- Twenty-five states and the District of Columbia have adopted the Uniform Premarital Agreement Act.

- Events to address in a prenuptial agreement:

1. Most common issues to address in a prenuptial agreement:
    - *Protection of premarital assets*
    - *Limiting or avoiding alimony and spousal support payments*
    - *Waiver of spousal survivorship rights/elective share waiver*
    - *Life insurance*
2. *Less common* issues to address in prenuptial agreement:
    - *Treatment of earned income as separate (not joint) asset*
    - *Prevention of unearned income from being considered joint asset*
    - *Definition of income for marital support*
    - *Vacating marital residence*
    - *Waiver of spousal rights in retirement plans*
    - *Confidentiality*
    - *Waiver of rights to serve as administrator of estate*
    - *Acknowledgement that agreement applies regardless of disability or change in health or financial status*

- *Treatment of marital gifts*
- *Use of Federal gift tax exemption (e.g. split gifts)*
- *Use of QTIP trust for inheritance*
- *Treatment of contribution to joint assets – specifically, contribution to down payment on marital residence*
- *Agreement as to religious decisions with respect to the children*
- *Agreement as to guardians of the children in event of both spouse's death*
- *Choice of law (what state's laws will apply)*
- *Treatment of marital debts*
- *Tax obligations/contributions*

3. Issues never addressed in a prenuptial agreement, and not enforceable if addressed:

- *Child custody* -- This is always decided based upon what is in a child's best interests and cannot be decided in advance.

- Grounds upon which prenuptial agreements may not be enforced

1. Lack of voluntariness - *Where the agreement is found to have been entered into through duress or undue influence, it is unlikely that it will be upheld in court.*

2. Unconscionable - *Generally, the test for unconscionability is whether there was sufficient protection against overreaching, concealment and manipulation by one spouse.*

    - When is "unconscionability" measured? At the time of execution of the agreement or at the time of enforcement.

      California: Any provision in a premarital agreement regarding spousal support, including, but not limited to, a waiver of it, is not enforceable . . . if the provision regarding spousal support is unconscionable at the time of enforcement. *California Family Code Section 1612*.

South Carolina: Premarital provisions which waived alimony and attorney fees were enforceable, even though wife's health had deteriorated and she was unable to work; wife did not sign the agreement under fraud or duress, both parties were represented by counsel, the clauses waiving alimony and attorney fees were not unconscionable when entered, and facts and circumstances had not changed such that enforcement of the agreement was unfair. Hardee v. Hardee, 558 S.E.2d 264 (S.C. Ct. App. 2001).

Arizona: Written premarital agreements that are signed by both parties are enforceable . . . The person against whom enforcement is sought proves either of the following: 1. The person did not execute the agreement voluntarily. 2. The agreement was unconscionable when it was executed . . . *Ariz. Rev. Stat.* § 25-202(A), (C).

New Jersey*:* Jacobitti v. Jacobitti, any prenuptial agreement that would leave one spouse wealthy and the other without means of support is unconscionable and therefore unenforceable under New Jersey divorce law. Ms. Jacobitti was wheelchair bound and suffering from multiple sclerosis in a progressively deteriorating condition. The Court found that the circumstances clearly made the enforcement of the agreement unconscionable; a finding that is also consistent with the definition of unconscionable within the context of *N.J.S.A.* 37:2-32(c) provides that an "'[u]nconscionable premarital . . . agreement means an agreement, either due to a lack of property or unemployability which would (1) render a spouse . . . without a means of reasonable support; (2)

would make a spouse . . . a public charge; or (3) would provide a standard of living far below that which was enjoyed before the marriage . . ..”

3. Failure to fully disclose – *A prenuptial agreement can be unenforceable if the party seeking to enforce the agreement failed to adequately disclose the party’s assets at the time of entering into the agreement.*

4. Public policy – *A prenuptial agreement, the terms of which a court determines violate public policy concerns, may not be enforceable.*

Survey of a sample of prenuptial cases

- ***New York****:* “Considering all the provisions of the pre-nuptial agreement, the court also cannot say that it is so unfair ‘as to shock the conscience and confound the judgment of any [person] of common sense.’” Crowther v. Crowther, 27 Misc.3d 1211(A), 910 N.Y.S.2d 404 (Table) (N.Y. Sup. 2010).
- ***Connecticut:*** Enforceability of a prenuptial agreement is dependent upon the results of a three-prong test:
  (1) the agreement was validly entered into
  (2) the agreement terms do not violate statue or public policy and
  (3) the circumstances of the parties at the time the marriage is dissolved are not so beyond the contemplation of the parties at the time the agreement was entered into as to cause its enforcement to work injustice. See McHugh v. McHugh, 181 Conn. 482, 485-486 (1980)

B. Domestic Asset Protection Trusts

1. What is Domestic Asset Protection Trust (“DAPT”)? – When we refer to a DAPT, we are typically referring to a self-settled trust established in one of the 51 (50 states and D.C.) jurisdictions in the United States. The intent is to remove assets that belong to the grantor from the reach of the grantor’s creditors.
    - A DAPT is similar to a spendthrift trust that a third party would establish for a beneficiary.
    - The terms of the DAPT typically provides a third-party trustee with the independent power to make distributions from the trust for beneficiaries, which will include the grantor.
    - In other words, the grantor will have so parted with dominion and control over the trust that it will be beyond the reach of his creditors, but the grantor may still enjoy the benefit of distributions from the trust with the trustee’s consent.
    - Until relatively recently, a self-settled trust in the United States where the grantor is a discretionary beneficiary, would be ineffective to remove the trust assets from the reach of creditors.
    - Prior to 1999, in order to create an effective self-settled trust beyond the reach of creditors, the trust would need to be established in one of several off-shore jurisdictions (e.g. the Cook Islands, Nevis, the Channel Islands, etc.).
    - Alaska became the first US jurisdiction to enact laws allowing protection for self-settled trusts (in 1997) and was shortly thereafter followed by Delaware, Nevada, South Dakota and a few others.

2. How can a DAPT be used as a protective vehicle in advance of a marriage?

- Prior to the marriage, the grantor may consider moving premarital assets into a DAPT to prevent the assets from becoming subject to equitable distribution, or available for alimony or child support.
- Most states provide that premarital assets that are not comingled with marital assets are generally exempt from equitable distribution.
- A DAPT will typically result in protection from equitable distribution since the assets in the trust are, by the very nature of the trust, separated from marital assets (assuming that marital assets are not also contributed to the trust).
- Do any jurisdictions protect a DAPT from support claims in a divorce?
    - Nevada – appears to provide protection from alimony and child support claims
    - Alaska – appears to provide protection from alimony. Not subject to claims for child support if assets were not transferred when grantor was 30 days or more in default.
    - Delaware – provides no protection from alimony and child support claims
    - South Dakota – no protection from alimony claims if spouses were married on or before the date of transfer. Provides no protection from claims for child support.

III. Planning During the Marriage (*when the Honeymoon is looking like it's over*)

A. Postnuptial Agreements

- Prepared, negotiated and executed after the marriage has already commenced.
- Can provide for an agreement as to property distribution in the event of divorce or death and set reasonable limits on alimony or spousal support.
- Like a prenuptial agreement, cannot fix child support or determine child custody.
- Not always limited to situations in which a marriage is already rocky.

- Postnups are widely used in community property states where assets acquired by either spouse during a marriage are considered owned by both spouses.
- They are demanded by businesses, since there is concern that a partner's divorce could jeopardize assets. Hedge funds and private equity investors have been among those demanding postnups from partners.
- May be appropriate if financial circumstances in a marriage change, such as when one spouse suddenly obtains vast wealth.

- What is the problem with postnups?
    - There is little case law on the enforceability of these agreements.
    - Some states are more restrictive in the enforceability of post-nuptial agreements than they are for prenuptial agreements.
        - **New York** -- Compare N.Y. Dom. Rel. Law §236(B)(3) (McKinney 2006) ("An agreement by the parties, made before or during the marriage, shall be valid and enforceable in a matrimonial action if such agreement is in writing, subscribed by the parties, and acknowledged or proven in the manner required to entitle a deed to be recorded."), with <u>Zagari v. Zagari</u>, 746 N.Y.S.2d 235, 238 (N.Y. Sup. Ct. 2002) (holding that remaining in the marriage was sufficient consideration), and <u>Whitmore v. Whitmore</u>, 778 N.Y.S.2d 73, 75 (N.Y. App. Div. 2004) (holding that remaining in the marriage was not sufficient consideration).
        - **New Jersey**—*N.J.S.A.* 37:2-32(c) provides that an "[u]nconscionable premarital agreement means an agreement, either due to a lack of property or unemployability . . . [w]hich would provide a standard of living far below that which was enjoyed before the marriage"), with <u>Pacelli v. Pacelli</u>, 725 A.2d 56, 62–63 (N.J. Super. Ct. App. Div. 1999) (imposing signing-time

and enforcement-time fairness review on postnuptial agreements).

- **Connecticut** – Bedrick v. Bedrick, 300 Conn. 691, 17 A.3d 17 (2011) held that "[b]ecause of the nature of the marital relationship, the spouses to a postnuptial agreement may not be as cautious in contracting with one another as they would be with prospective spouses, and they are certainly less cautious than they would be with an ordinary contracting party. With lessened caution comes greater potential for one spouse to take advantage of the other. This leads us to conclude that postnuptial agreements require stricter scrutiny than prenuptial agreements. In applying special scrutiny, a court may enforce a postnuptial agreement only if it complies with applicable contract principles, and the terms of the agreement are both fair and equitable at the time of execution and not unconscionable at the time of dissolution."

- Some states use the same standard for post-nups and pre-nups
  - **Pennsylvania** -- Stoner v. Stoner, 572 Pa. 665 (2003) held that "the principles applicable to antenuptial agreements are equally applicable to postnuptial agreements."
  - **Kentucky** -- Edwardson v. Edwardson, 798 S.W.2d 941, 945 (Ky. 1990) requiring "full disclosure" and that the prenuptial "agreement must not be unconscionable at the time enforcement is sought" and Rice v. Rice, No. 2003-CA-00409-MR, 2004 WL 362289, at *2 (Ky. Ct. App. Feb. 27, 2004) (applying a prenuptial standard to a postnuptial contract).

B. Gifts and Establishment of Trusts During the Marriage

- Can one spouse make gifts of marital assets without the participation of the other spouse?
- Unilateral dissipation
  - Among the factors considered in making equitable distribution of property is the "contribution of each party to the . . . dissipation . . . in the amount or value of the marital property ... See *N.J.S.A.* §2A:34-23.1(i).
  - **New Jersey:** Monte v. Monte, 212 N.J. Super. 557 (App. Div. 1986) – held that the "intentional dissipation" of assets by one party "is no more than a fraud on the marital rights" to the detriment of the other spouse. The Court thus held that such dissipation is chargeable to the dissipating spouse.
  - **Arizona:** Hrudka v. Hrudka, 186 Ariz. 84, 93, 919 P.2d 179 (Ct.App.1995)- the trial court may compensate nondissipating spouse when apportioning community property, and governing statute contains no temporal restriction on court's consideration of dissipation.
  - **Colorado:** In re Marriage of Paulsen, 677 P.2d 1389, 1390 (Colo. App. 1984) trial court properly considered whether preseparation actions constituted dissipation.
  - **District of Columbia:** Herron v. Johnson, 714 A.2d 783, 785 (D.C. 1998)- requiring that dissipation occurs "at a time when the marriage is undergoing an irreconcilable breakdown which need not coincide with formal separation or initiation of legal proceedings.
  - **Illinois:** In re Marriage of Rai, 189 Ill.App.3d 559, 565, 136 Ill.Dec. 922, 545 N.E.2d 446 (1989) - "[a] party can be found guilty of dissipation even though the act occurred prior to separation or prior to the commencement of the dissolution proceedings."
  - **Missouri:** Dove v. Dove, 773 S.W.2d 871, 873 (Mo.App.1989) - although not using the term dissipation, the trial court properly considered wife's unilateral withdrawals

from joint accounts and loans to her children, during parties' marriage, in awarding wife only 4 to 9.5 percent of marital estate.

- **Connecticut:** Finan v. Finan, 949 A.2d 468 (Conn. 2008) - a trial court is permitted to consider whether a spouse's actions that occurred prior to the spouses' physical separation constitute the dissipation of marital assets. In order for claims involving pre-separation dissipation to be heard, however, the Connecticut Supreme Court determined that the actions constituting dissipation must occur either: 1) in contemplation of divorce or separation; or 2) when the marriage is in serious jeopardy or undergoing an irretrievable breakdown.
- **Massachusetts:** Kittredge v. Kittredge, 441 Mass. 28, 803 N.E. 2nd 306 (Mass. Dist. Ct. 2004) - Wife complained that her Husband engaged in legal and illegal gambling for the entirety of their marriage and that but for his gambling (and his losses), they would have more assets to their credit for division at divorce. The court in Kittredge refused to credit or refund assets to the Wife for conduct that occurred without complaint during the marriage but it was willing to address gambling losses that continued to occur when the Husband knew the marriage was coming to an end, or had been served with the Complaint for Divorce. Two elements must be proven to support a finding of dissipation or that assets were dissipated: (a.) timing (referring to the time period after it becomes evident that the marriage will not last) and (b.) intent (that the expenditure is made for the purpose of thwarting the other spouse's rights to share of the estate in the impending divorce).

- Are all occurrences of unilateral gifting considered a unilateral dissipation?

  - **New Jersey:** In Kothari v. Kothari, 255 N.J. Super. 500 (App. Div. 1992) - the husband, an immigrant from India, sent large sums of money to his parents in India in accordance with Indian custom. The trial court held that the wife was entitled to equitable distribution equal to one-half of the monies sent to the husband's parents. Considering whether the husband "dissipated" the assets, the Court noted that the Legislature, when adopting *N.J.S.A.* §2A:34-23.1(i), did not define the word "dissipation." The Court stated that "[i]t is clear, however, that the concept is a plastic one, suited to fit the demands of the individual case." The Court cited the following factors in making a determination that the husband unilaterally dissipated marital assets: (i) the proximity of the expenditure to the parties' separation; (ii) whether the expenditure was typical of expenditures made by the parties prior to the breakdown of the marriage; (iii) whether the expenditure benefitted the joint marital enterprise or was for the benefit of one spouse to the exclusion of the other; and (iv) the need for, and amount of, the expenditure.

- ***QUERY:*** Assume the husband in a marriage is an alcoholic who refuses to receive treatment, refuses to work, and has a tendency to incur debt for unreasonable purposes. He drives an automobile while intoxicated, exposing himself to unimaginable liabilities. The wife works hard, has built a business of her own, and has amassed individually titled assets, which would be subject to equitable distribution. The marriage has disintegrated, but the spouses are still living together for the sake of their minor children. The wife is concerned about preserving the wealth that she or they have amassed. They have children to support and educate, and it is clear to her that she will continue to have that financial responsibility. She establishes an irrevocable trust for the benefit of their two children and begins to make sizable contributions to the trust, without the consent or knowledge of her husband. These contributions go on for a period of three years and total $1,000,000 (but not filing split gift tax returns). The wife, after feeling confident that her hard earned money is "protected" as a result of the funding of this trust, files a complaint for divorce.

      - Can the husband claim that these assets were unilaterally dissipated and should, therefore, be charged against the wife's share of equitable distribution?
      - Considering the factors set forth in Kothari: (i) the gifts might have been in close proximity to the filing of the complaint; (ii) providing for the children might qualify as the type of expenditures which the parties made prior to the marital breakdown; (iii) the gifts clearly appear to be of the type that benefit the joint marital enterprise – that being the improvement of the children's lives.

- Gifts to 529 Plans
  - If a spouse is considering a divorce, and is quite confident that he or she will be "on-the-hook" for higher education expenses, should he or she consider establishing 529 plans for each child?
  - Should the accounts be "front-loaded" -- §529(c)(2)(B) of the Internal Revenue Code provides that contributions to a 529 Plan in excess of the gift tax annual exclusion amount (currently $13,000) can be treated as having been made ratably over the 5-year period beginning in the year of the contribution. This means that a couple can make gifts of $130,000 to a 529 plan for each child without any gift tax consequence.
  - The funding of a college expense being in furtherance of the marital enterprise, this should not be considered a unilateral dissipation.

C. Life Insurance

1. Changing the beneficiary of the life insurance policy
   a. The owner of a life insurance policy may designate whomever he/she wants as the beneficiary
   b. Are there any legal restrictions to changing the beneficiary of a life insurance policy prior to filing a complaint for divorce?
      - N.J.Ct. Rule 5:4-2(f) provides that the first pleading in a divorce action must include an affidavit of insurance

coverage which must specify whether any insurance coverage was modified within the 90-day period preceding the complaint.

2. If the life insurance policy is owned by an irrevocable life insurance trust ("ILIT"), can the beneficiary be changed
    a. In most case, the grantor of an ILIT is the insured.
    b. The insured, when establishing the ILIT, must surrender ownership as well as incidents of ownership over the policy
    c. The insured is typically not the trustee of the ILIT
    d. Since the trust owns the policy, the only person who can change the beneficiary of the policy is the trustee
    e. If the trustee changes the beneficiary of the policy in such a way as to eliminate the surviving spouse's interest, the trustee may be subjecting himself to a charge of break of fiduciary duty.
    f. Keep in mind that the final order may require one party to provide life insurance for the benefit of the other.

D. Powers of Attorney

1. Often, during the course of a marriage, spouses will execute powers of attorney in favor of each other.
2. Powers are often "general powers of attorney", which means that the agent has all of the powers of the principal.
3. Anyone acting upon authority of a power of attorney is indemnified for any such actions, unless he/she has actual knowledge that the power of attorney has been revoked.
4. How to revoke a power of attorney:
    a. Written notice to all custodians of financial accounts will prevent the agent from accessing such accounts
    b. Physical destruction of each and every original power of attorney as well as every copy if the original power authorized acceptance of a copy.

E. Review of Shareholder Agreements and Buy/Sell Agreements

1. Whenever a divorcing party owns an interest in a business, the business' shareholder and buy/sell agreements should be reviewed prior to filing.
2. Consideration should be given to consequences, if any, as a result of the divorce.
3. How does a divorce impact on the relationship between the shareholders/partners of the business?
4. Can the divorce filing be a triggering event requiring a sale of an interest in the business? Is such a provision enforceable?
5. Can an agreement provide that any transfer to a spouse in a divorce triggers a required sale by the spouse awarded such shareholder interest?
6. If a married party is entering into a buy/sell agreement with triggering events upon divorce, spousal consent should be obtained when the agreement is executed.

F. Gift Tax Exemption

1. In 2011 and 2012, each U.S. citizen or resident is entitled to pass $5,000,000 of wealth to any other person or persons during their lifetime, or upon their death (in the aggregate), without the imposition of federal estate or gift taxes. It is unclear what will happen in 2013.

   a. Thus, a husband and wife together can transfer $10,000,000 without the imposition of a tax.
   b. §2513 of the Internal Revenue Code further provides that a gift from one spouse can be treated as made one-half (1/2) from each spouse if an appropriate election is made and the spouses are married to each other at the time of the gift and the non-contributing spouse does not remarry during the year of the gift.
   c. <u>Query</u>. Should you counsel your client to stay in the marriage long enough to utilize the credit of the other spouse which otherwise might be wasted?

- Example: Herman is married to Wilma but is considering filing a complaint for divorce. Herman has children from a prior marriage and Wilma has no children. Herman has wealth of about $8,000,000 consisting predominantly of a closely held business, most of which is not subject to equitable distribution. Wilma has insignificant assets and is unlikely to receive any significant assets after the divorce. Herman wishes to make gifts of minority interests in his business to his children worth $3,000,000. However, if Herman has only his $5,000,000 estate tax exemption, his estate will likely have to pay an estate tax at his death. With Wilma's consent, however, Herman can "split" any gifts made by him and take advantage of Wilma's $5,000,000 credit which otherwise might be wasted. Thus, this will permit Herman to transfer $3,000,000 of value to his children without the imposition of a gift tax, and he will only use $1,500,000 of exemption, thus saving $1,500,000 of exemption that he would otherwise be required to use. And if he transfers to his children would that be deemed dissipation and counted in marital estate in the event of a divorce?

d. In addition to the $5,000,000 credit discussed above, each individual is entitled to make annual gifts of $13,000 to any other individual without being subject to federal gift tax. Moreover, these so-called "annual exclusion" gifts do not reduce the $5,000,000 credit otherwise available to each U.S. citizen or resident. As discussed above, 26 U.S.C. §2513 permits a married couple to treat any gift made by one spouse as made one-half by each spouse. Thus, prior to a divorce, a spouse can double the annual exclusion gifts he or she could otherwise make if the soon-to-be-ex-spouse consents.

2. The ability to utilize the $5,000,000 credit belonging to the soon-to-be-ex-spouse, and his or her annual exclusion gift rights, can have

significant value. Thus, a spouse anticipating a divorce may wish to consider delaying the filing of a complaint to utilize this opportunity. Likewise, for the spouse whose credits will be utilized not for his or her benefit, this may provide a significant bargaining chip in a divorce action, as this credit may have significantly more value to the other spouse, which he or she may be willing to pay for with a larger share of equitable distribution.

G. ***THE BIG QUESTION*** – *Should an unhappy spouse file a complaint for divorce, or wait and see if the other spouse dies first?* Is the spouse better off divorced or as a surviving spouse?

1. The Elective Share -- The "elective share" is the share of a deceased spouse's estate which a surviving spouse may claim in place of what they were left in the decedent's will. In other words, it is the minimum that a surviving spouse must inherit.
    - It may also be called a widow's share, statutory share, election against the will, or forced share.
    - The amount to be reserved for a spouse is determined by the law of the state where the decedent's estate is located.
    - In most states, the elective share is between ⅓ and ½ of all the property in the estate, although many states require the marriage to have lasted a certain number of years for the elective share to be claimed, or adjust the share based on the length of the marriage, and the presence of minor children.
    - Some states also reduce the elective share if the surviving spouse is independently wealthy.
    - Some states eliminate the elective share based upon circumstances in the marriage at the time of death.

2. There are nine community property states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin.
    - In these states, most property that a couple obtains during a marriage is classified as "community property."

- When one spouse dies, the other is automatically entitled to their half of all community property. There is nothing a spouse can do in a will to prevent or limit a spouse's claim to this property.

3. Non-community property states

- Florida – Surviving spouse is entitled to 30% of the elective estate. The definition of the elective estate is expansive and includes transfers with retained interests and other gifts made within one year of death. *Fla. Stat*. §732.201 et seq.
- Maryland – Surviving spouse is entitled to "one-third share of the net estate if there is also a surviving issue or one-half of the net estate if there is no surviving issue." The "net estate" is specifically defined to mean property of the decedent passing by testate succession,…" *Md. Est. & Trust* §3-203. Even though Maryland's statutory share provides spousal protection with a percentage of the net probate estate, Maryland case law extends spousal protection beyond the probate estate. See, Schoukroun v. Karsenty, 177 Md. App. 615 (2007) *cert. granted*; Knell v. Price, 318 Md. 501 (1990) - modifying Maryland's statutory share to include non-probate assets to the extent the decedent retained dominion and control over the asset as of his date of death.
- New York – Surviving spouse is entitled to the greater of $50,000 or 1/3 of the augmented estate, which includes both probate and non-probate transfers. *N.Y. EPTL* 5-1.1-A. A surviving spouse can be denied the elective share if the spouse had abandoned the deceased spouse or failed to provide for the deceased spouse, despite a duty and ability to do so. *N.Y. EPTL* 5-1.2.
- New Jersey – The elective share in New Jersey is unique in that to the extent that a surviving spouse is entitled to an elective share, such share is first satisfied from the value of all property, estate or interest therein, owned by the surviving spouse in his

own right at the time of the decedent's death from whatever source acquired, or succeeded to by the surviving spouse as a result of decedent's death. *N.J.S.A.* 3B:8-18. This makes the New Jersey elective share of questionable benefit to a surviving spouse with any means of his or her own.

4. Analysis – When you are trying to determine whether it is in your client's financial best interests to seek a divorce or stay married, you must carefully analyze the anticipated results in both scenarios.

   a. If a client thinks that they will benefit financially upon the spouse's death, they must understand that, at best, all they will be entitled to is a combination of (i) the elective share (if any), (ii) jointly owned assets with rights of survivorship (net of attendant liabilities), and (iii) certain other assets which they have a legally protected right to receive (i.e. ERISA qualified benefits, as discussed above).

   b. In some cases, these death benefits may exceed what the spouse might be entitled to in a divorce action. However, in some cases, they might be better off divorcing the spouse and quantifying each party's respective rights.

IV. Issues to Address During the Divorce Proceeding

A. Preparing and Executing a New Last Will and Testament

1. If a Spouse Dies During the Divorce Proceeding

a. If there is no will, then there is an intestacy – What rights does a surviving spouse have in an intestate estate?

- New Jersey – The surviving spouse receives the entire estate if: (i) no descendant or parent of the decedent survives, or (ii) if all of the decedent's surviving descendants are also the descendants of the surviving spouse and there is no other descendant of the surviving spouse. Otherwise, the surviving spouse receives a percentage of the estate (but not below a minimum). *N.J.S.A.* §3B:5-3.

- New York -- A surviving spouse is entitled to the following: (i) if a decedent is survived by a spouse and issue, $50,000 and one-half of the residue, (ii) if a decedent is survived by a spouse and no issue, the whole to the spouse. *N.Y. E.P.T.L.* §4-1.1.
- Other states have varying intestate benefits to surviving spouses.

b. What if there is a will that provides for the divorcing spouse and one spouse dies during the divorce but before a judgment of divorce has been issued?

- A divorce effectively cuts-off the inheritance rights of a former spouse in an intestacy, and in most jurisdictions, a surviving ex-spouse is treated as "deceased" for purposes of testate succession (meaning a surviving ex-spouse will not inherit under a will executed before the divorce). But what happens if the death of a spouse occurs while the divorce is pending?

- Generally, until a final judgment of divorce, a divorcing spouse is still entitled to inherit under the deceased spouse's will.

c. What happens to a surviving spouse who is disinherited and is not entitled to an elective share?

- *New Jersey* – New Jersey's elective share statute (*N.J.S.A.* §3B:8-1) provides that a surviving spouse is not entitled to a claim if, at the time of death, the decedent and the surviving spouse had been living separate and apart in different habitations or had ceased to cohabit as man and wife, either as the result of judgment of divorce from bed and board or under circumstances, which would have given rise to a cause of action for divorce or nullity of marriage to a decedent prior to his death.
  - Assuming the decedent changed his will to disinherit his wife and she fails the elective share requirements, she would be left with neither an elective share, nor relief in the form of equitable distribution, since the divorce action comes to an end at the death of one party.
  - In Carr v. Carr, 120 N.J. 336 (1990), the New Jersey Supreme Court held that a surviving spouse could continue divorce litigation for the limited purpose of proving that the deceased spouse had diverted marital assets, because equity demanded that the innocent spouse have a forum through which to recover those assets for equitable distribution. Thus, the surviving spouse would be entitled to an equitable remedy.

d. Does a deceased spouse's estate have a right to equitable distribution? What happens in the reverse Carr v. Carr situation, where one spouse dies during the divorce proceeding and the surviving spouse owned a disproportionate amount of marital assets at the time of the death – assets from which the deceased spouse would have been awarded equitable distribution had he survived until the completion of the divorce proceeding?

- New Jersey – The New Jersey Supreme Court recently had the opportunity to address this issue in Kay v. Kay, 200 N.J. 551 (2010). The Court held that when the estate of a spouse who died while an action for divorce is pending presents a claim for equitable relief related to marital property, the court may not refuse to consider the equities arising from the facts of that case solely on the ground that the estate may not assert equitable claims against the marital estate sounding in constructive trust, resulting trust, quasi-contract or unjust enrichment. The Court must consider the equitable claims of the deceased spouse's estate against what would otherwise be the marital estate.
- Pennsylvania – Generally, the death of a spouse during the pendency of a divorce proceeding abates the divorce action and any and all claims for equitable distribution. When the divorce action is abated by the death of one of the spouses prior to the entry of a divorce decree, economic claims are also abated. However, an exception exists when grounds for divorce have already been established, such that the parties' economic rights are determined under equitable distribution principles rather than elective share provisions of the Probate Code. *See* Gerow v. Gerow, 962 A.2d 1206 (Pa. Super. 2008).

2. Reviewing and preparing a new will

a. To avoid any confusion, and to put a client's estate in the best position, a client's existing will should be reviewed as soon as possible in the divorce action – even before the filing of a complaint.

b. A new will should be prepared which should consider a disinheritance of the soon-to-be ex-spouse.

c. The new will should address the manner in which assets are going to be held for any minor children. Consider who should be the trustee of any funds going to minor or immature adult children.

d. The new will should address the client's desires for the guardianship of the children of the marriage in the event that both spouses are deceased.

e. If the other spouse is not a suitable custodial parent for a child, consider naming someone other than the surviving parent as the guardian for the child (specifically stating that it is the client's desire notwithstanding the survival of the other parent). You may also wish to include a mechanism to fund any litigation regarding the guardianship issues to protect the appointed individual from the need to use their own assets.

3. Should the testator consider not disinheriting the surviving spouse?

a. Keeping in mind that a surviving spouse may be entitled to an elective share or a significant award of equitable distribution, a testator may wish to consider leaving a share of the estate equal to the elective share in a QTIP trust.

b. A QTIP trust is a special type of trust that provides the surviving spouse with a distribution of all of the income of the trust, and may provide the surviving spouse with limited access to principal.

c. The trust would continue for the life of the surviving spouse and the remainder (the balance remaining after the surviving spouse's death) would be payable to beneficiaries specified by the deceased spouse.

d. A QTIP trust may be a better alternative to a disinheritance if the testator believes that the surviving spouse will get either an elective share award or an equitable distribution amount.

Assuming the trust satisfies the requirements of what the surviving spouse is entitled to inherit, the trust provides a mechanism to ensure that the ultimate beneficiaries of the share of the estate will be the beneficiaries designated by the testator.

B. Execution of a new health care proxy and power of attorney

1. If a client has a health care proxy while happily married, it is common for the other spouse to be named as the health care agent.
2. Typically, when the marriage is irretrievably broken such that a divorce proceeding commences, it is usually prudent to name someone other than the spouse as the health care agent.
3. A new health care proxy should make it clear that the soon-to-be ex-spouse is not only no longer authorized to make medical decisions, but also that the newly appointed health care agent shall have authority to determine who visits with the infirmed spouse.
4. After revoking any prior power of attorney appointing the soon-to-be ex-spouse as the principal's agent, the principal should sign a new power of attorney authorizing someone else to act as agent.
5. The new agent should be someone who will be able to participate in any ongoing divorce proceeding (e.g. a child from the marriage may not be the best choice).
6. The new power of attorney should also specifically authorize the new agent to continue the divorce proceeding and to resolve any and all marital claims belonging to the principal.

C. Changing beneficiary designations

1. Certain assets do not pass pursuant to the terms of a last will and testament (e.g. life insurance, retirement plans, IRAs). Thus, simply changing the beneficiary under a will is insufficient to dispose of these assets. It is imperative that a divorcing spouse revises all beneficiary designations.
2. What happens if a decedent does not change the beneficiary and the owner dies?

3. Are there certain assets that require the consent of a spouse in order to change the beneficiary designation?

- The Employee Retirement Income Security Act (ERISA) regulates almost all private retirement plans (29 U.S.C. 1001 et seq.).
- ERISA includes an anti-assignment provision that precludes employees from transferring their pension rights to anyone else. 29 U.S.C. 1056(d)(1).
- Congress amended ERISA in 1984 so that the anti-assignment clause does not apply to state court orders that constitute a qualified domestic relations order (QDRO), but otherwise the clause does apply in divorce proceedings. 29 U.S.C. 1056(d)(3)(A).
- The Retirement Equity Act of 1984 (REA) amended ERISA to require that survivor benefits be paid **automatically** to a surviving spouse upon the death of the pension participant, unless the spouse consents in writing to an alternate beneficiary. See 29 U.S.C. 1055(c)(2)(A).
- Because of this mandate and ERISA's anti-assignment provision, a pension participant may not unilaterally designate a non-spouse survivor beneficiary during the pendency of a divorce. *See*, Lefkowitz v. Arcadia Trading Benefits Pension Plan, 996 F.2d 600 (2d Cir. 1993)(absent a specific and effective waiver, a surviving spouse automatically receives death benefits under an ERISA pension plan regardless of the plan participant's designation of a third-party beneficiary); Groh v. Groh, 288 N.J. Super. 321, 672 A.2d 262 (Ch. Div. 1995)(ERISA did not permit any equitable or legal remedy to the deceased spouse's estate to prevent certain retirement plans from being paid to surviving spouse who was divorcing decedent).
- Individual retirement accounts (IRAs) are not covered by the spousal requirements of REA. In the absence of an order prohibiting the changing of a beneficiary designation, or a state

statute of the same import, a spouse is free to change the designated beneficiary of an IRA without spousal consent.

V. Estate Planning Issues After the Divorce

1. Prepare and execute a new will
   a. Address fiduciary issues including who should be the trustee of any funds for minor children, and who should be the guardian for minor children.
   b. Make sure that any obligations set forth in any property settlement agreement are properly covered by the will
2. Prepare a new living will and health care proxy
3. Revise all beneficiary designations, especially those governed by ERISA/REA which could not be changed without spousal consent before the marriage
   a. What happens if the beneficiary of an ERISA/REA plan is not changed after the divorce?
      - Egelhoff v. Egelhoff, 532 U.S. 141 (2001) - David Egelhoff divorced Donna Egelhoff two months before his death, which resulted from an automobile accident. At the time of his death, Mr. Egelhoff had failed to change the beneficiary designation on his 401(k) plan (the "plan"); Mr. Egelhoff had previously named Donna as his beneficiary. The Egelhoffs lived in Washington State. A Washington statute provided that following a divorce, non-probate assets, such as the plan, would pass to a decedent's heirs as if the former spouse had predeceased the decedent.

        Mr. Egelhoff's children from a previous marriage, his heirs, sued Donna Egelhoff in Washington State court to recover the benefits paid to her under the terms of the plan. They argued that pursuant to the terms of the Washington statute, the beneficiary designation in the plan was void and that they should take from Mr. Egelhoff's estate as his natural heirs. At the trial level, the children lost, the court having held that ERISA pre-empted the state statute. The Washington appellate courts reversed the trial court. The U.S. Supreme Court reversed again and upheld the judgment of the trial court. According to the Supreme Court, ERISA pre-empted the Washington statute because the statute had an impermissible connection with ERISA. In short, the Court held that ERISA designated who the recipient of the plan benefits was; plan administrators should be able to rely on a plan's beneficiary designation and should not have to turn to state law to determine the true beneficiary of a plan's benefits. This resulted in Donna Egelhoff, receiving the benefits of Mr. Egelhoff's plan, not his children.

- The Egelhoff case reinforces the importance of executing a new beneficiary designation and a review of all estate planning issues after a divorce.

4. QDROs (Qualified Domestic Relation Order)

- On occasion, the relief of the divorce proceeding ending results in a spouse not following through with 'paperwork'   In the event a final divorce decree gives a spouse a portion of the other spouses defined benefit plan upon death or retirement, it is imperative to have a Court Order (specifically a Qualified Domestic Relations Order) issued and delivered to the employer or former employer.
- The form of these orders must be accepted by the employer before being submitted to the Court
- If the retirement asset to be shared is a defined contribution plan (e.g. a 401k), entry of a QDRO will accomplish this with relative ease. Many times, the employer will have a form that can be used to divide the plan according to the terms of the agreement.