

A CAREFUL SEPARATION

Certain estate-planning strategies can make the road to divorce less stressful for everyone involved. BY JUDITH L. POLLER

THE ROAD TO DIVORCE CAN be daunting. There is emotional turmoil. There is extra anxiety if children are involved. And the financial unknowns can be overwhelming. But some element of control can be maintained if there is foresight and planning.

Some of that planning means taking precautionary steps before a divorce action starts. Couples can open separate bank accounts. They can maintain separate credit cards. They can gather financial documents, catalog their tangible personal property and set up separate e-mail and post office addresses that allow them to correspond with their counsel and receive financial documents.

Divorcing couples often forget, however, to review and revise their estate planning documents. And the plans people create when they are married are usually not appropriate when they are parting ways, for obvious reasons. For instance, a plan might still require an individual's entire estate to be passed to his or her (divorced) spouse upon death.

Those plans should not change with a divorce filing. They should be changed before. And it's not just the will (or testamentary substitute) that should be reviewed. It's all the beneficiary designations on a person's retirement plans, life insurance and other assets, along with the form of title on all assets. All these should be reviewed before somebody goes down the divorce path.



KEY ASSUMPTIONS

As advisors assist their clients with a divorce, they should be aware of some key facts:

1. Most states say a person is entitled to a share in his or her deceased spouse's estate—often referred to as the “elective share.” It typically amounts to about one-third of the decedent's estate. Unless the spouse waives the right, he or she retains the right to the spouse's share until a separation or settlement agreement is entered

into or there is a divorce judgment.

2. Once a divorce action is commenced, most states prohibit a spouse from shedding assets, including tax-deferred funds, stocks or assets in retirement accounts such as 401(k)s. Most states also forbid changes in life insurance beneficiaries, and some prohibit revisions in a will once a divorce action has begun.

3. Many assets are owned jointly between spouses. When one spouse dies, these assets automatically pass to the survivor. For

example, it is common for residences to be owned as a “tenancy by the entirety” (a term specific to spouses) or jointly with rights of survivorship. Financial accounts are often held jointly with rights of survivorship as well. While these arrangements may make sense if your marriage is intact, they may not if you’re divorcing. But until the assets are disposed of as part of the divorce process, the assets remain jointly owned.

4. In addition to a will, many people have a health-care proxy that names one spouse as the agent in situations where the other can’t make medical decisions for him-

him to their friends and children. She increased her spending and decided that she was going to drag out the legal process so that Steven would have to continue to support her. She also believed that Steven was involved with another woman. She was determined to not leave the marriage easily.

The environment grew so hostile that the children moved in with Steven because they couldn’t tolerate their mother’s rage.

The couple jointly owned a primary residence, a vacation home and various brokerage and financial accounts. Other than a small checking account, Steven had

assets in his own name. Short of taking full ownership of an account, he could have withdrawn a certain amount and created an account in his name. Both spouses would have had a certain amount of money in each of their names to take advantage of the estate tax exemption amount.

3. If Steven had revised his will and created trusts for his children, he could have then made the trusts, not his wife, the beneficiaries of his IRA.

4. Steven could have transferred the life insurance policy to a trust, naming his children as beneficiaries. The creation of the life insurance trust is a good estate-planning tool, regardless, because it keeps the asset out of the estate tax system. If he was not inclined to create a trust, he could have designated the trust under his will for the benefit of his children as the beneficiary of the life insurance proceeds.

5. Steven could have changed his will to either exclude Susan, forcing her to “elect” against his will, or provide that she merely receive her “elective share” of his assets. Since the couple jointly owned most of their assets, the passage of joint assets to Susan automatically would be factored into the calculation of the elective share amount.

6. Steven could have created custodial accounts or trusts for the children and contributed the annual exclusion amount (currently \$14,000). The exclusion would have had the added benefit of taking money out of the marital pot used for the divorce settlement. Steven could have gifted a larger sum to a trust for the benefit of the children using his lifetime exemption amount (currently \$5 million), but he would have to have done that well before the divorce filing to avoid any claim of a fraudulent conveyance.

Spouses are entitled to inherit non-IRA retirement benefits such as 401(k)s and other pension plans unless they waive their rights in writing.

self. A durable power of attorney is another common document that gives someone the authority to deal with finances in the event of his or her spouse’s medical problem or absence. Again, it is typical to name the healthy spouse as the “financial” agent.

5. Wills or testamentary substitutes leave assets to spouses or create trusts for the spouses’ benefit. People who die intestate (without a will) have their assets pass entirely to their spouses if there are no children. If there are children, the estate is split in half between the children and the spouse. This is certainly not the result one would want during a divorce.

6. Under federal law, you can bequeath an IRA to anyone, but spouses are entitled to inherit non-IRA retirement benefits such as 401(k)s and other pension plans unless they waive their rights in writing.

CASE STUDY

Steven, an investment banker, decided that after 20 years of marriage, he and his wife Susan had grown apart, and while he cared for her, he did not want to grow old with her. They have two children—ages 16 and 18.

Steven filed for divorce, evoking a bitter response from his wife. Susan disparaged

him to their friends and children. He also had several retirement assets that named Susan as the beneficiary, including a 401(k) and an IRA worth several million dollars. He had a life insurance policy with a \$2 million death benefit payable to Susan.

During the divorce proceeding, he suffered a heart attack and died.

Susan, who went from being a divorcee to a widow, inherited all of her husband’s assets. Steven lost the ability to provide separately for his children and to have control over how the money would be managed. This was not what he wanted or intended. Moreover, had he done careful estate planning before commencing a divorce action, the result would have been very different.

No one wants to contemplate the idea he or she could die, but it can always happen. Before filing for divorce, Steven should have reviewed all of his assets. He should have gathered beneficiary designations and been clear about how each asset was titled. And he should have revised his will. Here is how his results could have been different:

1. The house would have remained jointly titled.

2. The financial accounts could have been separated so that Steven had separate

CONCLUSION

Once the divorce process began, Steven could do none of these things. Before he died, he had been a successful businessman who managed to make good investments throughout his marriage. Had he applied some thoughtful planning to his divorce, he would have ensured that his finances were passed on and managed in a way that he would have wanted. *Rw*

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