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TENSION TAMERS

Here's how to help your clients avert inheritance lawsuits between their kids and a new spouse.

By Ben Mattlin

In 1995, wealthy oil tycoon J. Howard Marshall died at 90. Almost immediately, a spate of lawsuits erupted between his 27-year-old widow—former Playboy playmate and fashion model Anna Nicole Smith—and his children from a previous marriage. The heated litigation continued even after her death, years later.

Less sensational but similar situations are cropping up everywhere—driven in part by the aging population and a concomitant spike in second, third and even fourth marriages. A 2007 study by a pair of Wharton professors found that Americans over 65 are more likely to be married than ever before, primarily because of longer lives and late-in-life marriages. Other studies show that almost half of all weddings in this country are not first-time marriages.

“Prenups need to be drafted so they don't cause more problems than they solve,” says Jason Smolen from SMOLENPLEVY.

While this may be good news for romantics, it's often not so welcome for baby boomers who had counted on big inheritances but find out instead they have to share with interlopers. “I've seen a meaningful increase in acrimony between children and new spouses over inheritance issues,” reports Chris Ure, senior vice president with UBS in Boca Raton, Fla.

But he and other veterans of inheritance wars are arming themselves with techniques they say are proven to head off intrafamily frictions and ensure estates get distributed according to their wealth-holders' wishes. Here is their advice.

The Elective Share

To be sure, all states except Georgia guarantee surviving spouses a percentage of their deceased spouse's estate, regardless of the terms of the will. That percentage—half in some states, a third in others—is called the “elective share.” Needless to say, it doesn't suit everybody equally.

“The elective share is designed so the surviving spouse doesn't end up in the public

charge,” explains Brian Raftery, a partner in trusts and estates at New York law firm Herrick, Feinstein. “But to override that, you need a prenuptial agreement, which is basically just a spousal contract that changes the default rules.”

Though often associated with divorce, prenups can make a family home go 100% to the surviving spouse (who lives there) and not the children (who don’t), or give the family business to the children (who already work there) but not the spouse (who’d rather stay out of it anyway, thank you).

“Most people with significant assets who remarry do enter into prenuptial agreements to effect a waiver of elective-share rights, or at least limit the amount of the estate to which the surviving spouse is entitled,” says Nancy Fax, managing partner at Pasternak & Fidis, a law firm in Bethesda, Md. “In these situations, divorce is not the primary concern. Protecting assets for the children of the first marriage is critical.”

In short, prenups can define what is whose, and what isn’t. They “characterize the individual assets,” says Victoria Kaempf, senior estate planning attorney at San Francisco-based law firm Howard Rice Nemerovski Canady Falk & Rabkin. This can be especially important in community-property states such as California, where surviving spouses are entitled to half of all community property—or all of it, if there is no estate plan. What constitutes “community property,” however, is the crucial question.

“If the surviving spouse claims an asset is community property but the children from a prior marriage claim it’s the decedent’s separate property,” Kaempf explains, the prenup “could determine how the estate is allocated ... and eliminate a court battle.”

Life Insurance

In addition to helping divide an estate, prenups can establish separate financial obligations. One typical example is life insurance to compensate the surviving spouse for giving up the elective share. “Written into the prenup, the insurance policy should pay a sum that’s at least equal to the value of the elective share,” says Raftery.

If your client is unable to keep up the insurance premiums—because of age or disability, say—the prenup should promise to pay an equivalent sum out of the estate.

All in all, says Raftery, the prenup-with-life-insurance technique “gives the children their full inheritance—namely, the assets of their parent’s estate [minus the house, wedding gifts and so forth]—and the spouse a guaranteed amount to live on that comes quickly and hassle-free.” The insurance payout, he adds, is exempt from probate, transfer papers, federal income taxes and, since it’s between spouses, federal estate taxes.

But the prenup solution has its detractors. Emotional distress is the No. 1 complaint. “No one wants to talk about death while planning a wedding,” says Rex Ritchie, a

director at Woodbury Financial Services, a subsidiary of The Hartford Financial Services Group, in Oakdale, Minn. (For more about prenups, see the sidebar.)

Q-TIP Trusts

Another tool to support both your spouse and children after you die is a qualified terminable interest property, or Q-TIP, trust. Here's how it works: The estate goes directly into a trust for the surviving spouse, who receives all the income it earns but has no control over it. When the surviving spouse dies, the trust is dissolved and the money that's left goes to the children of the first spouse or to whomever was originally designated.

Q-TIP trusts are exempt from federal estate taxes, too, because they're passed between spouses. But they can be tricky, if not costly, to maintain. "If the executor makes even a slight error in filing the federal estate tax return, it could invalidate the trust and cost the estate thousands of dollars," cautions Shelley Elder, an estate-planning attorney in Kennesaw, Ga.

Q-TIP trusts may also pit the surviving spouse's financial interests against those of the offspring. "If the stepparent needs income, the trust is probably managed to generate income rather than for growth, while a portfolio for the children would likely have more growth exposure," says Catherine White, founder and president of FinArc, an investment management firm in Needham, Mass.

That problem is made worse still, she says, "if the surviving spouse takes extra money out of the principal." Which is possible, she explains, because Q-TIP trustees are often allowed to distribute from principal if there's a medical emergency or another valid reason. So choose your trustees carefully.

A final caveat: Q-TIP trusts can be disastrous if "the stepparent is as young as the children, or younger," says Chuck Noparstak, a financial planner with Equitrust Financial Group, in Deerfield, Ill. A young stepparent means the children will likely have to wait a long time for their inheritance—or they may even never see it if the surviving spouse outlives them.

"Offspring aren't happy about waiting until the 'evil stepmother' or 'evil stepfather' dies," observes Charles Avalli, an attorney at Gentile, Horoho & Avalli, in Pittsburgh. Needless to say, this is not exactly conducive to family harmony.

Communication

To ease or even avert this kind of family friction, many financial advisors suggest a strong dose of transparency and communication. "Communication, particularly before a death occurs, helps families prevent these types of issues," says Steve Ciepiela, president and CEO of Charles Stephen & Co., a financial planner in Albuquerque, N.M.

If communicating about such delicate matters seems complicated, the primary

reason for doing so is simple: clarity. “What you really want is to avoid surprises,” says Myra Salzer, founder of the Wealth Conservancy, an independent financial planning firm in Boulder, Colo. Salzer has developed software that lets families exchange vital, personal information online. (For more information, go to executorsresource.com and click on Estate Logic. Annual subscriptions run from \$49.95 to \$189.95.)

Tim Belber, a principal at the Madison Group, an independent wealth-management firm in Greenwood Village, Colo., goes so far as to recommend a “welcoming ceremony” for new spouses—a family dinner or some other gathering to greet them with smiles and handshakes before venturing into weightier matters. “It’s about trying to create a balance between the financial and the personal,” he says. “Then, when you talk about the inheritance concerns, it takes the sting out of it.”

Yet many insist what’s most important is honoring your client’s wishes, not what the kids or other stakeholders want. “It’s always easier to deal with these issues without the children involved,” argues Philip Erickson, an attorney at O’Kelley & Sorohan, in Duluth, Ga. “The parent’s wishes are all that really matter here.”

Granted, zeroing in on what those wishes are can be a challenge. “The advisor must get to know each client’s situation,” says Samuel Shapiro, an estate planning attorney at Mitchell Silberberg & Knupp, in Los Angeles. “Some attorneys focus on estate-tax savings, but to me, truly understanding your client’s needs and values is equally or even more important.”

Of course, this might mean donning the emotional counselor hat. “Advisors must be adept at pointing out the issues without becoming judgmental,” urges attorney Janet Bandera, a consultant for the Moneta Group, in Clayton, Mo. “You have to be sensitive in how you approach these issues, and know when to back off.”

Sometimes that takes a magic touch. “Clearly, members of our profession should be not just wizards of tax and estate law, but careful listeners as well,” says Russell Montgomerie, a CFP at Lawless, Edwards & Warren, in Boca Raton, Fla.

Prenup Pitfalls And Negotiating Tips

Prenups, says David Howard, an attorney at Hoge, Fenton, Jones & Appel, in San Jose, Calif., are “hard to negotiate and hard to make enforceable.”

But others say that this is just the contract’s bad reputation. “People are put off by the idea that their new family is trying to cut them off,” says New York attorney Brian Raftery. “A prenup is actually just a tool to make sure they do get something.” It is not, he stresses, “a ceiling but a floor.” It guarantees a minimum obligation, much like the elective share itself. If the family situation changes later—for example, if one partner’s stock portfolio appreciates dramatically, or if the wealth-owner decides to completely disinherit the ungrateful kids after all—the prenup can always be amended, as long as both parties agree.

Another option is a sunset clause that stipulates, “after 15 years of happy marriage,

say, the agreement no longer applies,” says Raftery.

As prenups become more common, the newly betrothed—especially those entering wealthy families—are less likely to balk. They might even expect them. “Most people just want to know what’s in it, and if it’s good or bad for them,” says Raftery.

Yet Ivan Illan, director of financial planning at Los Angeles-based Michel Financial Group, discourages these contracts. “They can always be fought [in court],” he insists. “They exist only because attorneys love to market them, but there’s no such thing as an ironclad prenup.”

In truth, prenups must meet certain requirements to have any chance of standing up in court. First, each party should employ separate counsel. Otherwise, a judge may rule the agreement invalid. “This tends to invite drawn-out, contentious negotiations and delays,” concedes Theodore “Ted” Kurlowicz, an attorney and professor of taxation and estate planning at the American College in Bryn Mawr, Pa. “But I haven’t had any parties ultimately refuse to sign or get married.”

Second, both sides must disclose all of their assets at the outset. “Many people are reluctant to do this,” says Kurlowicz. “It can get adversarial and messy.” Without it, however, the prenup may not last.

Whatever their pros and cons, one thing is clear. “[Prenups](#) need to be drafted so they don’t cause more problems than they solve,” observes attorney [Jason Smolen](#), of [SMOLENPLEVY](#), a Washington, D.C.-based [estate planner](#).

Dino Tozzi, a certified estate planner and financial consultant with AXA Advisors, in Harrisburg, Pa., says it’s important to remember and remind your client that prenups “can actually preserve family ties rather than strain them.”

And it’s best to get them out of the way as far ahead of the wedding as possible. “Get it done and hope you never have to look at it again,” says Raftery.

Still, it’s never too late. Postnuptial agreements can be just as effective.