Estate Plan Implications in Divorce

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It's essential that family law practitioners consult with estate planning attorneys as they guide their clients through a marital breakup. Here's what to keep in mind.

Estate plans create difficult, unusual issues in divorce proceedings. These can vary significantly depending, among much else, on the type of plan that's in place; whether one party is the beneficiary of the plan; and whether one or both parties created the plan. Family law attorneys may also find themselves wading into unfamiliar waters without proper knowledge or training. Nowhere is this truer than in estate planning.

Such plans can be complex, of course. And although family law and estate planning often intersect, estate planning attorneys frequently know about clients' potential options and pitfalls of which family law practitioners are simply unaware. Consulting with a qualified estate planning attorney can help protect your client's interests during and after a divorce.

Considerations Before Marriage

Parties entering into a premarital agreement — also known as a prenuptial agreement or antenuptial agreement — will likely include both divorce and death provisions. The family law attorney should be careful to make sure that both areas are appropriately addressed. Further, once the premarital agreement is completed, the couple's estate plans should provide for at least what the agreement covers.

Considerations During Divorce

Estate planning issues commonly arise in family law when one party is either the beneficiary of a trust or seeks to place their assets in trust after dissolution.

Assets held in trust, owned by trust: In general, assets held in a trust are not owned by either party but by the trust. A court does not have jurisdiction to award assets of a third party to one of the two parties in a divorce proceeding, particularly if there's a spendthrift provision in the trust that limits a creditor's ability to come after the trust's assets, or if the trust is not named as a party in the proceeding. Even if it is, a court may still be limited in what it can award if there's a spendthrift provision.

The practitioner should become familiar with the laws in their jurisdiction regarding what authority a court has to invade a trust as part of a divorce proceeding. Often, a court's ability to fashion relief with respect to assets in a trust is quite limited, though state laws vary.

Parties may also be limited in what they can agree to regarding assets in a trust. For instance, a trust beneficiary may not be able to agree to award the other party any of the trust's assets — again, particularly if there's a spendthrift provision.

Trust distributions and support issues: Spousal maintenance (also known as alimony) and child support are determined based on the income of both parties. When one party is a beneficiary of a trust, a common issue is whether distributions can be used to calculate child support and/or alimony.

Whether trust distributions can be considered part of an obligor's ability to pay child support or alimony will likely turn largely on the nature and history of the distributions in question. Depending on the type of trust, distributions can consist of income, principal or both. Distributions of any kind are then considered periodic payments if the amounts are consistently received. Frequently, the distribution will have to be formally received before the court can make an award with respect to it.

Recipients of trust income generally receive a form K-1 each year showing the amount and character of distributions. The parties' tax returns and the trust document itself will be essential in arguing whether these distributions are consistent enough to be considered available for determining alimony or child support. A qualified estate planning attorney may be useful in analyzing more-complex trust documents.

Trust income and individuals with special needs: Another consideration for family law practitioners is whether their client would benefit from a special-needs trust, which enables a physically or mentally disabled or chronically ill person to receive trust income while preserving their eligibility for need-based government benefits such as Medicaid and Supplemental Security Income. Because the client does not own the underlying assets, he or she can still be eligible for a benefits program with asset limitations. Distributions from the trust can then supplement a client's income without jeopardizing their access to government assistance.

Transferring assets into trust: Finally, if a client intends to transfer assets into trust following dissolution, family law practitioners should consider working directly with estate planning attorneys to draft the final decree. Unlike most family law attorneys, estate planning lawyers know what language is needed to put the client's estate plan into effect. Collaboration with an estate planning lawyer early in the process can save a family law practitioner from having to amend the decree — or, worse, their client being unable to distribute their assets as intended.

Considerations After Divorce

There's still estate planning work to be done once the divorce has been finalized.

Updating beneficiary designations: State laws generally hold that once a couple is divorced, the ex-spouse loses all property rights by operation of law. Pensions, however, are governed by federal law, formally known as the Employment Retirement Income Security Act of 1974 (ERISA); state laws do not apply. If practitioners fail to update their client's beneficiary designations, the ex-spouse could still inherit the asset.

Unfortunately, pension plans are not the only asset people tend to forget about in divorce proceedings. Bank accounts, retirement accounts, annuities and life insurance policies all have beneficiary designations that, if not carefully managed, could easily end up in the hands of an ex-spouse.

Updating fiduciary appointments: Another reason to revise a client's estate plan is to remove an ex-spouse from a fiduciary role. People getting divorced typically do not want their former spouse administering their estate. Updating executors, trustees and guardians may be critical to effectuating your client's estate plan.

Clients will likewise want to remove their ex-spouse as an agent under their power of attorney. If a client loses capacity, particularly when a divorce is pending, they will need a trusted person who can continue the proceeding on their behalf.

Finally, those who don't want their ex-spouse making medical decisions for them will likely need to revise their medical power of attorney or health care proxy. Depending on one's state laws, medical powers of attorney may not be automatically revoked upon divorce. One can easily imagine a situation in which a client is involved in a terrible accident where life-and-death decisions need to be made. More likely than not, your client would not want their ex-spouse dictating their medical care.

Conclusion

Family law attorneys who undertake this process alone can easily overlook important factors, leading to negative outcomes for their clients. Given the complexity of these issues, it's important to consult with a qualified estate planning attorney throughout the dissolution proceeding.

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Practice Areas

Family Law