



# WRMarketplace

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## **TOPIC: Legacy Planning Before and During a Divorce – What You Can and Can't Do.**

**MARKET TREND:** Divorce rates have been on the rise nationally over the past several years. Accordingly, it should play a larger role in legacy management.

**SYNOPSIS:** Divorce related legacy planning is critical. Spousal inheritance rights continue to exist until the divorce is final. Merely filing a divorce petition may not terminate provisions for a spouse under existing legacy planning documents or sever survivorship interests in marital or joint tenancy assets. To ensure a client's assets pass to intended beneficiaries, it is critical that the client amend his legacy plan (or create one) to adapt to the changed circumstances. Although clients have the most leeway to change their plans before proceedings are initiated, there are still actions the client can and should take after proceedings commence.

**TAKE AWAYS:** Before a divorce petition is filed, clients can execute new wills, amend, revoke, or create and fund revocable and irrevocable trusts, execute new powers of attorney and beneficiary designations, and make other legacy planning changes in anticipation of the divorce. After divorce proceedings begin, clients can still freely execute new wills and powers of attorney, but may need to notify the spouse, obtain the spouse's consent, or secure a court order before implementing more extensive changes. State laws differ as to what a client is authorized to change and transfers that can be made during a divorce. Clients and their advisors must work closely with divorce counsel to determine the exact planning actions that can and can't be taken once a petition for divorce is filed.

Divorce is one of the most difficult events clients can go through, and as they are already facing significant emotional stress and major life decisions, these clients often put off updating their legacy plans. Divorce proceedings, however, can drag on for years and the failure to address planning matters up front can result in the soon to be ex-spouse controlling the client's assets.

The typical legacy plan for a married couple gives most or all of the deceased spouse's assets to the surviving spouse, either outright or in trust. Spouses also typically appoint each other as executors, successor trustees, and agents under their respective legacy planning documents. While a final divorce decree generally revokes provisions for the ex-spouse in the client's will or revocable trust and severs survivorship rights in joint property, filing a petition for dissolution of the marriage does not. The parties remain married until the divorce is final. Until then, each spouse continues to have all the rights and benefits provided by law – including rights upon the incapacity or death of a spouse. Unless the client changes his legacy plan, the existing documents remain in force and the assets will pass to or for the benefit of the spouse. Further, if the client doesn't have a legacy plan in place, the spouse will have priority to serve as the client's guardian or conservator if the client becomes incapacitated and will inherit part, or possibly all, of the client's assets under state intestate succession laws should the client die prior to the divorce being finalized.

Example: H and W were married in 1980 and have three adult children. They resided in California for the entirety of their marriage, and all their assets are community property. Neither spouse executed a will or any other legacy planning documents during the marriage. In 2014, H filed for a divorce. Before the divorce is finalized, W is killed in an automobile accident. Under California's intestate succession laws, all W's assets (that is, her one-half interest in the community property) pass outright to H and her children receive nothing.

## **BEFORE: PRE-DIVORCE LEGACY PLANNING OPTIONS**

The best time to initiate changes to the client's legacy plan is before a petition for dissolution is filed. Once a petition is filed, automatic temporary restraining orders ("TROs") are imposed on both parties to maintain the financial status quo and protect the rights of each spouse. TROs restrict the ability of the client to transfer property, revoke or change beneficiary designations, and amend or revoke the client's revocable trust without notice to, or the consent of, the client's spouse or securing a court order. TROs generally remain in place until the divorce is final (or the petition is dismissed). Accordingly, TROs can potentially be in place for years. Changing the client's legacy plan before the petition is filed provides the most leeway for modifications.

### **Steps to Consider**

Pre-divorce legacy planning requires a careful review of the client's assets and existing legacy planning documents (if any) to determine the spouse's rights and benefits and assess the client's power to change his legacy plan without the spouse's involvement. If the client does

not have a will or other legacy planning documents in place, that analysis also should determine the inheritance rights and other authority granted by law to the spouse in the event of the client's death. After the client and advisors have reviewed the client's existing legacy plan (or lack thereof), they should take steps to change or create a plan before filing the divorce petition.

**Execute a New Will.** At a minimum, the client should execute a new will to remove his spouse as a beneficiary, name new beneficiaries, and appoint new executors. Merely revoking an existing will is insufficient - if the client dies without a will before finalizing the divorce, the spouse will inherit part, perhaps all, of the client's estate under the laws of intestate succession and will have priority for appointment as executor or the right to name an executor.

The will also should appoint guardians of the person for any minor children in the event the spouse predeceases the client, and guardians of the legacy if the client does not want the spouse in charge of the assets a minor child may inherit.

**Amend or Create a Revocable Trust.** If the client has an existing revocable trust, the trust should be amended to remove any provisions for the spouse, including the appointment as successor trustee. In addition, the client should make sure the trust is funded – any assets that are not currently in the trust (other than assets that pass pursuant to a beneficiary designation) should be transferred into the trust prior to filing the petition for divorce.

✓ **Practice Point:** If the client and his spouse established a joint revocable trust, the trust's terms will need to be carefully examined to verify the client's authority to modify or revoke the trust. If the trust agreement requires notice to, or the consent of, the other spouse to amend or revoke the trust, then, unless the divorce is amicable, the client may delay modifying the trust until just before filing for divorce.

If the client does not have a revocable trust or has a joint trust with the spouse, consideration should be given to creating and funding a new revocable trust before initiating divorce proceedings. The ability to transfer assets to a trust will be cut off once those proceedings start.

**Sever Survivorship Interests in Jointly Held Property.** Survivorship rights in assets held jointly by the client and his spouse (such as joint tenancy, tenancy by the entirety, or community property with rights of survivorship) should be severed if possible. In many states, a joint tenancy in real property can be converted to a tenancy in common if the client executes a deed transferring his interest in the property to himself (or to his revocable trust). Assets in a joint bank or other account can be "severed" by withdrawing a portion of the assets. However, the client should be careful not to withdraw more than his proportional contribution to the account.

**Execute General Power of Attorney.** Spouses typically execute general powers of attorney when they establish a legacy plan. The general power of attorney names an agent to manage the client's assets and make financial decisions for the client in the event of incapacity. The

spouse is normally appointed as the initial agent. Even without a general power of attorney, if the client becomes incapacitated, the spouse will still likely make financial decisions and manage his assets. The client should revoke any existing general power of attorney and execute a new power of attorney naming appropriate individuals to manage his assets and financial affairs should he become incapacitated. Copies of the general power of attorney should be given to the client's financial advisors, banks, and other financial institutions.

**Execute Health Care Power of Attorney.** Spouses also typically execute health care powers of attorney as part of their legacy plan, naming each other as agents to make health care decisions. If the client does not have a health care power of attorney and becomes incapacitated, his spouse again is likely to be the person making health care decisions on his behalf. Each client contemplating divorce should execute a new health care power of attorney naming appropriate individuals to make decisions regarding his health care should he become incapacitated. A copy of the new health care power of attorney should be given to each of the client's doctors.

- ✓ **Practice Point:** If the general power of attorney or the health care power of attorney does not nominate a guardian or conservator of the client's estate or person, consideration should be given to executing a separate document to make such nominations and preempt any efforts by the spouse to initiate court proceedings to take control of the client's person or assets should the client become incapacitated.

**Execute New Beneficiary Designations.** It is likely that the client has named his spouse as the primary beneficiary of his life insurance, individual retirement accounts ("IRAs"), annuities, 401k retirement plans, and other accounts or assets that pass pursuant to a beneficiary designation. These accounts and assets should be examined and new beneficiary designations executed naming other beneficiaries, such as the client's new or amended revocable trust.

- ✓ **Practice Point:** If the client lives in a community property state, then absent a pre- or post-marital agreement that provides otherwise, the spouse may have a community property interest in these assets. Execution of new beneficiary designations will not eliminate the spouse's community property interest.
- ✓ **Practice Point:** Qualified pension plans, such as 401k accounts, are governed by ERISA, and a new beneficiary designation will require spousal consent to name someone other than the spouse as the beneficiary.

**Beneficial Interests in Irrevocable Trusts.** The client may be a beneficiary of one or more irrevocable trusts created by his family. Divorce courts are beginning to look at these trusts when determining spousal support, particularly if distributions are authorized for the client's support, even if there are multiple beneficiaries and distributions are solely within the discretion of the trustee. Pre-divorce planning can help protect these trusts from the client's spouse. Planning opportunities include:

- Remove any trustee who is related to the client and appoint a corporate trustee or a third party individual who is unrelated to the client as the trustee.
- Move the situs and administration of the trust to a jurisdiction that provides better protection from beneficiaries' creditors, including protection from spouses.
- Decant the trust to a new trust that is fully discretionary (that is, distributions can be made for any purpose and there are no ascertainable standards) and located in a state that offers better creditor protection for the beneficiaries.
- As a last resort, remove the client as a beneficiary of the trust.

Life Insurance Trust. If the client has established an irrevocable life insurance trust ("ILIT") for the benefit of the spouse (or for the spouse and descendants), the agreement should be reviewed to determine whether the spouse will automatically be removed as a beneficiary when the petition for divorce is filed (a well-drafted ILIT generally will include such a provision). If not, consideration should be given to whether the spouse can otherwise be removed as a beneficiary, the assets decanted to a new trust of which the spouse is not a beneficiary, or the life insurance policy sold to a new trust of which the spouse is not a beneficiary. Note, however, that the trustee of the ILIT has a fiduciary duty to all the ILIT beneficiaries, including the spouse. Removing the spouse as a beneficiary could be a breach of the trustee's fiduciary duties and expose the trustee to liability. In light of this exposure, the trustee may be reluctant to do anything that will remove the spouse as a beneficiary prior to finalization of the divorce. As an alternative, a new ILIT could be created (and funded) for the client's descendants or other intended beneficiaries, with the trustee acquiring new life insurance through the ILIT.

Health, Auto, and Property Insurance. The client should also consider getting new auto and property insurance prior to initiating divorce proceedings. In addition, if the client has health insurance through the spouse's employment, the client should secure a separate health insurance policy.

#### **AFTER: PLANNING OPTIONS AFTER DIVORCE PROCEEDINGS HAVE BEGUN**

All too frequently a client doesn't have the luxury of making pre-divorce changes to his legacy plan, particularly if it is the spouse who filed for divorce. Once proceedings have started and the TROs kick in, the client still has the ability to change parts of his legacy plan. Keeping in mind that the purpose of the TROs is to maintain the financial status quo, the following chart illustrates the legacy planning actions the client is able to freely implement and those actions that may require notice to the spouse, spousal consent, or court approval.

Actions that May Be Taken Without Restriction	Actions that May Require Prior Spousal Notice or Consent or Court Approval
<ul style="list-style-type: none"> <li>• Create or amend a will</li> <li>• Create, but not fund, a new revocable</li> </ul>	<ul style="list-style-type: none"> <li>• Amend or revoke a revocable trust</li> <li>• Fund a revocable or irrevocable trust</li> </ul>

<p>or irrevocable trust</p> <ul style="list-style-type: none"> <li>• Execute a general power of attorney for asset management</li> <li>• Execute a health care power of attorney</li> </ul>	<ul style="list-style-type: none"> <li>• Remove assets from a revocable trust</li> <li>• Sever survivorship interests in marital or joint assets</li> <li>• Change beneficiary designations for life insurance, retirement plans, and other non-probate transfers</li> </ul>
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If the client is a beneficiary of an irrevocable trust, an independent trustee may still be able to take steps after divorce proceedings are initiated to protect trust assets from the client's creditors. Any such action should be taken independently by the trustee and only after consultation with the client's divorce counsel.

- ✓ Practice Point: Each state has its own set of rules regarding actions that can and can't be undertaken once divorce proceedings begin. The client and his advisors will need to work closely with the client's divorce attorney to determine the actions that are allowed and the notices and consents that must be given in the client's particular state.

### TAKE AWAYS

- Before a divorce petition is filed, clients can execute new wills, amend, revoke, or create and fund revocable and irrevocable trusts, execute new powers of attorney and beneficiary designations, and make other legacy planning changes in anticipation of the divorce.
- After divorce proceedings begin, clients can still freely execute new wills and powers of attorney, but may need to notify the spouse, obtain the spouse's consent, or secure a court order before implementing more extensive changes.
- State laws differ as to what a client can change and transfers that can be made during a divorce. Clients and their advisors must work closely with divorce counsel to determine the exact planning actions that can and can't be taken once a petition for divorce is filed.

### DISCLAIMER

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