

the *Matrimonial* **STRATEGIST**

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Financial Planning Tips

MARITAL ASSETS

Estate Strategy During A Divorce Proceeding

By Eli Uncyk

WHEN DEALING with estate planning, we generally concentrate on carrying out the wishes of the client. As lawyers, we point out that some modifications of the simple expressions of a testator's wishes can result in saving estate taxes for the benefit of the beneficiaries of a decedent.

In divorce situations, estate planning has other objectives as well. A client might say, "She doesn't want to give me a divorce...she's just waiting for me to die." If a spouse dies before a divorce is consummated or a settlement signed, the surviving spouse will have certain rights in, and to inherit, assets of the decedent. On the death of one of the parties to a divorce proceeding, the proceedings will be abated (including any claims for equitable distribution), and the surviving spouse will be relegated to the rights of a surviving spouse under the laws of the decedent's last domicile. These estate rights may be greater or smaller than equitable distribution rights.

In order to deal effectively with estate planning during divorce proceedings, a basic knowledge of estate taxes and rights is essential. Estate tax law is generally covered by the federal Internal Revenue Code. State estate taxes are

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Retirement Plans

TAXES

How to Negotiate Survivor Annuities

By Carole Princer Levy

THE SURVIVOR benefits inherent in most retirement plans are important provisions frequently overlooked when a matrimonial attorney negotiates an interest in a retirement plan that is then set forth in a Qualified Domestic Relations Order. Many dollars may be lost if attention is not paid to mandatory provisions of many qualified retirement plans. Although the law does not demonstrate concern for the former spouse with regard to survivor rights, it does allow a former spouse as well as a spouse to obtain them.

Statutory Background

The basis of present-day pension plans, the Employee Retirement Income Security Act of 1974 (ERISA), requires that, subject to certain conditions, in order for a plan to qualify for special tax treatment under the Internal Revenue Code, it must provide an automatic joint and survivor annuity benefit to protect the surviving spouse of a retired participant, or an automatic joint and survivor benefit to the surviving spouse of a participant who dies before retirement. In fact, unless the parties agree to another form of pension benefit, a 50 percent joint and survivor annuity is

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Prudent Estate Planning During Divorce

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usually smaller and often, but not always, follow the consequences of federal taxes. While the federal estate tax threshold is \$600,000 before estate taxes are levied, state estate taxes may start to apply to estates of lesser value.

As a general rule, all assets left outright or in a qualifying trust to a surviving spouse will escape federal estate taxes because of the unlimited marital deduction. Assets that do not escape federal estate taxes are taxed to the extent the assets exceed \$600,000. (Federal estate taxes start at 37 percent.) Accordingly, an estate that is valued at \$700,000 and left to a spouse outright or in a qualifying trust will escape estate taxes entirely.

On the death of the second spouse, however, the calculations start again. If the entire estate of \$700,000 is left to the testator's children, \$100,000 will be taxed at 37 percent, costing the children \$37,000, adjusted for the state estate taxes that may be payable. If the surviving spouse is left \$600,000 outright or in a trust that qualifies for the marital deduction, and the children are left \$100,000, there will be no tax to pay on the bequest to the children, and the surviving spouse (or the trust for her benefit) will receive the \$600,000 free of federal estate taxes. The trust for the spouse's benefit can provide for the remainder to go to the children on the death of the surviving spouse. Thus, it is better to give the surviving spouse something to leave to the children because it will escape or defer

taxes. Of course, when the divorce or separation is concluded, the planning must be altered to take into account the new circumstances. Thorough estate planning is not this simple, and requires a more detailed analysis than is appropriate here. But it is important to understand the basic concepts in order to understand that cutting a spouse out of one's will may cost the children or other beneficiaries money that can be saved with some foresight, planning and cooperation. Despite the animosity that is frequently present during the matrimonial negotiation or litigation process, estate planning must be conducted with a somewhat dispassionate approach.

Spouse's Inheritance Rights

Bear in mind that cutting a spouse out of a will entirely may not work at all in those states where a spouse is entitled to a statutory minimum or a right to elect against a will. All state laws provide that if an individual dies without a will, a fixed portion of the estate will go to the surviving spouse. That fixed portion will vary from state to state, and will depend on whether there are other heirs. (In New York, for instance, a surviving spouse is entitled to receive one-third of a decedent's estate [plus certain marital minimums] if the decedent had two children.) In many states, the surviving spouse's rights can be satisfied by leaving the minimum amount in a certain type of trust for the spouse's benefit, thus protecting the assets for the benefit of the other beneficiaries. In addition, a surviving spouse has the right to elect to disregard a decedent's will if the will does not leave the surviving spouse a certain minimum share. (This is usually called "electing against the will.")

Remember, however, that a spouse who has been abandoned is not required to leave even the statutory minimum to the guilty spouse in most states. Thus, a clause that cuts out a spouse can be drafted that provides that a surviving spouse who has de-

serted the decedent will receive nothing. This type of provision, however, may pit children (who will be presumably the ultimate beneficiaries) against their parent, and the decedent's objectives may be thwarted by guilt or filial loyalty.

Negotiation Alternatives

In most equitable distribution states, a spouse's estate rights are considered in determining the equitable distribution of marital assets. This, however, may work against the rights of a non-titled spouse in a long marriage who might otherwise be entitled to one-half of the marital assets upon equitable distribution. It has been sound advice to a titled spouse to have a will drafted during divorce negotiations that leaves his or her spouse the statutory minimum in trust, in order to defeat the surviving spouse's right of election against the will, and to encourage the non-titled spouse to reach a settlement before death ends the negotiations. The statutory trust for the benefit of the surviving spouse may also help lessen the federal tax impact on the ultimate beneficiaries, since the statutory trust may not be subject to estate taxes on the death of the first spouse, and may escape estate taxes if the second spouse has an estate that does not exceed the \$600,000 federal statutory exclusion.

But, testamentary substitutes such as "Totten Trusts" (sometimes called "in trust for" accounts), or gifts to third parties within a certain time before death, may not escape a surviving spouse's right of election. The surviving spouse may be able to recover his or her statutory minimum share from these testamentary substitutes, and a careful reading of state law is essential to an analysis.

Life insurance naming a beneficiary other than the estate of the insured or the surviving spouse will not be subject to a right of election, and the beneficiary will receive the proceeds without

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Postmortem Plans

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concern for the surviving spouse's claim. Because life insurance owned or controlled by a decedent will be included in the value of the decedent's estate, however, the estate taxes on the decedent's assets will necessarily be effected. This may increase the estate taxes on the deceased's estate if the will provides for the payment of such taxes from the residuary estate.

Another method of reducing estate taxes and avoiding a surviving spouse's rights would be the creation of a life insurance trust. In such a trust, the spouse transfers life insurance on his or her life into the trust, names the children as the beneficiaries, and contributes, as a gift, enough money to pay the premiums every year. This helps to reduce the taxable estate.

The emotions precipitated by a divorce should not be permitted to run a client's life. Sound judgement, providing for one's beneficiaries — especially infant children — and long-range goals should be paramount in dictating an estate plan, rather than the temporary animosities of the divorce process. Thus, it may be appropriate to leave enough assets to a spouse to ensure that the spouse can adequately care for the parties' children in case of death.

In addition, life insurance should be maintained or purchased as an estate planning tool in order to protect the children, and may also be tailored as a negotiating tool in order to achieve multiple objectives. In most equitable distribution states, courts have the authority to require a supporting parent to obtain and maintain life insurance to ensure the support of minor children or to secure other obligations. As a general rule, in estates of sufficient size, this objective is satisfied with minimal

expense in estate taxes by establishing a life insurance trust that is the owner of the policies into which the insured is required to contribute sums needed to pay the premiums.

This device takes the life insurance out of the estate of the decedent (if the insured lives three years after the date of the transfer of the policy into this trust) and out of the control of the insured spouse during his or her lifetime, so that beneficiaries cannot be changed. Of course, the obligation to contribute money to pay the premiums is still there, but that obligation would exist regardless of the form in which the insurance policy was held.

On occasion, a spouse may demand that the former spouse leave certain assets or other financial benefits to their children or to the former spouse. These provisions, which are equivalent to contracts to make a will, may be

difficult to enforce. As a general rule, security for the obligation is the best mechanism to ensure that a bequest or disposition on death is implemented.

The security can take the form of a joint tenancy with a right of survivorship (with an agreement for use during the lifetime of the original owner), or current transfers into a trust of the assets or funds. The assets left pursuant to such an arrangement will generally be included in the value of the decedent's taxable estate, unless some device is contrived to remove them from the testator's estate.

Estate planning with a spouse during a divorce can result in increased benefits to the parties' heirs.

In addition, creative estate planning can help move negotiations along by having the parties work together to do estate planning for their children's benefits.

Court Rules Against Surrogate Mom, Calls Womb 'Foster Home' to Embryo

A COMPLICATED and well-publicized surrogate scenario has been resolved in favor of the genetic mother by the Orange County Superior Court in Santa Anna, Calif.

In *Johnson v. Calvert*, No. 63-31-90, (Oct. 22,) a childless couple, Mark and Crispira Calvert, had contracted with Anna L. Johnson to bear a child from the implantation of their already fertilized embryo for a fee of \$10,000. A baby boy was delivered from Ms. Johnson Sept. 19. But the relationship between the parties, contractual and otherwise, had deteriorated during the pregnancy, and the surrogate mother sought custody, child-support payments and emotional damages, while the couple asked for enforcement of the custody rights specified in the contract.

No Genetic Contribution

The judge ruled in favor of the genetic mother, analogizing the role played by the gestational surrogate to that of a foster home providing temporary shelter to the growing embryo. He wrote, "Anna Johnson is the gestational carrier of the child, a host in a sense." Here, unlike the much-publicized *Baby M.* case in New Jersey, there had been no genetic contribution by the surrogate mother.

Ms. Johnson filed an appeal Oct. 25.

New Publisher Named

STUART M. WISE has been named publisher of *Leader Publications*, the newsletter division of the New York Law Publishing Co., which publishes *The Matrimonial Strategist*. Mr. Wise, a managing

editor of the division since 1987 and with the company since 1980, also has served as editor-in-chief of *Leader's Product Liability Law & Strategy*. He succeeds Michael E. Lauchheimer, who died of cancer Oct. 4.

Mr. Uncyk is a member of Simon, Uncyk and Borenkind in New York City. This article is adapted from the author's upcoming book, Successful Strategists in Divorce. The writer acknowledges the assistance of Alan Borenkind.