

LOVING UNION, LEGAL CONTRACT

Tying the knot: What do you and your children need to know about protecting wealth?

Legal information cited below was contributed by Patricia Saint James, chair of the family law department at Looney & Grossman, LLP.

Hope, optimism, well-wishes and the family's blessings. Despite all the best intentions that accompany a new marriage, the rate of divorce and the number of second, or third, marriages in our society force us to face the reality that many marriages may not last a lifetime. Although no happily engaged couple wishes this to be the case, there are many "what if" scenarios that make it prudent to consider protecting both prenuptial and postnuptial assets.

A variety of tools are available to assist with wealth protection, whether the assets to be protected are those acquired by a spouse's individual efforts, inheritance, gifts, family businesses or beneficial interests in trusts. Before choosing a particular path or entering into a prenuptial or postnuptial agreement, it's important to consult with your financial advisor and family or estate planning attorney to determine which vehicle is best for your family's needs.

The Prenup as a Planning Tool

For the couple planning marriage, the focus is often on the union itself and not the meshing of financial assets, rights and obligations. Far from being a disgraceful exit strategy, the prenuptial agreement can be a helpful planning tool for families. It is used with increasing frequency in a time where many couples are entering into marriage later in life, have children and other financial responsibilities from a previous marriage or have considerable assets that they want to safeguard.

A prenuptial agreement is a contract between two individuals who intend to marry, which typically lays out their respective rights in the event of death or divorce. "Prenuptial agreements are particularly helpful in cases where one person has a much higher level of assets or income than the other, where one has the expectation or possibility of accumulating significant assets, either by gift or family inheritance, or where one wants to segregate a particular asset, such as a family business, from what would otherwise be considered marital property," says Patricia Saint James, the chair of the family law department at the law firm of Looney & Grossman, LLP, in Boston.

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A "fair disclosure rule" requires each person to fully and accurately disclose to the other his or her financial situation, which may make the couple and their family members uncomfortable about entering into a prenuptial agreement.

Prenuptial agreements are recognized and accepted in most states; 27 have enacted the Uniform Premarital Agreement Act (UPAA). In the states that have not adopted the UPAA, prenuptial agreements are permitted and governed by statutory and case law. According to Saint James, the UPAA allows marrying couples to contract with respect to a number of areas including, but not limited to: the rights and obligations of each person in any of the property of the other, the disposition of property upon separation or marital dissolution, the modification or elimination of spousal support, the making of a will or trust and various other matters, provided the agreement is not in violation of public policy or any statute imposing a criminal penalty. For example, a child's right to support cannot be affected in a prenuptial agreement, because public policy prevents parents from bargaining away the rights of their children.

In order to be enforceable under the UPAA, a prenuptial agreement must have been entered into voluntarily and must not have been "unconscionable" at the time of signing. The issue of whether an agreement is "unconscionable" is decided by the court as a matter of law. Some state statutes are even more stringent than the UPAA with regard to the validity and enforceability of prenuptial agreements. In Massachusetts, for example, the courts have established a "fair disclosure rule" under which each person must fully and accurately disclose to the other his or her financial situation prior to executing a prenuptial agreement. In practice, this has meant putting everything on the table—assets, income and liabilities. Disclosure of income, cash and investment accounts, retirement assets, real estate holdings, trust information, and any expected amounts and sources of inheritances, may make some people uncomfortable about entering into such an agreement.

"One person may be the beneficiary of trusts established by his or her family, have an interest in a family business or real estate holdings, or have an expectation of a substantial inheritance under a will," says Saint James. "In that case, it would require disclosing the nature and magnitude of those interests, which could result in resistance from parents or grandparents, many of whom would prefer not to have the details of their estate disclosed to their future son-in-law or daughter-in-law. In many instances, they haven't disclosed such information to their own children. The tension between full disclosure and asset protection under a prenuptial agreement must be resolved prior to executing it."

In determining whether an agreement is fair and reasonable at the time of execution, the courts will look to whether the individuals are fully aware of the rights to which they would have been entitled under state law without such an agreement. In other words, they must sufficiently understand their marital rights and how they are altering them by entering into the agreement.

Certain states, such as Colorado and New York, impose standards for validity or enforceability of a prenuptial agreement both at the time of its execution and at the time of a divorce. This so-called "second-look" approach ensures that a judge would have the authority to deviate from the terms of an agreement where, for example, one spouse is stripped of all indicia of marriage. "That kind of agreement goes beyond being merely one-sided," says Saint James.

Because the standards for the validity and enforceability of prenuptial agreements vary so widely from state to state, it's critical to consult with a financial advisor and an attorney familiar with the particular state law that governs the agreement.

Whose Property Is It?

A key issue in protecting wealth during marriage is determining whether a particular type of property will be considered part of a marital estate upon divorce, and thus subject to division. “The defining of marital property is complex and varies from state to state,” notes Christine Lucero, CFP®, Atlantic Trust vice president and wealth strategist.

In “community property” states, each spouse shares joint ownership of property earned by either party during the marriage, regardless of how title is held. In contrast, according to Patricia Saint James, chair of the family law department at Looney & Grossman, LLP, each spouse generally retains separate ownership of property acquired before the marriage. Even within that seemingly “bright-line” distinction between property acquired prior to the marriage and community property acquired during the marriage, there are variations among the community property states. In “equitable distribution” states, the courts may have the jurisdiction to divide all of the parties’ property interests upon divorce, regardless of when or how acquired. Lucero says, “Given the complexities involved in what makes up marital property, it’s wise to talk with an advisor about the various definitions of property rights before marriage.”

“It’s also important to understand the interplay between a prenuptial agreement and a testamentary instrument in defining what the surviving spouse is entitled to in the event of death,” says Paulina Mejia, Atlantic Trust managing director and wealth strategist.

You’re Married. Do You Still Need an Agreement?

Another trend in the area of wealth protection is the use of postnuptial agreements. These contracts typically define people’s rights and obligations in case of divorce or death.

The American Law Institute defines a postnuptial or marital agreement as an “agreement between spouses who plan to continue their marriage, which alters or confirms the legal rights and obligations that would otherwise arise under the law governing marital dissolution.”

Several states, such as Alabama, Louisiana, New York and Texas, have enacted statutes that permit the enforcement of marital agreements. Other states, such as Illinois and Massachusetts, have not enacted such statutes but have found, through case law, that such agreements should be enforced, if applicable criteria are met. Many states have not addressed the issue at all.

A postnuptial or marital agreement stands on different footing from a prenuptial agreement. As Saint James points out, “In the stage of life where a prenuptial agreement is applicable, each person is free to reject unsatisfactory terms of the contract by choosing not to marry. Once the couple is married, however, new concerns arise.” The person initiating the agreement may be doing so having already decided to divorce, but he or she may misrepresent an intention to stay in the marriage in order to induce the other spouse to sign the agreement. The fear of divorce may compel one spouse to agree to the postnuptial agreement in an attempt to save the marriage, thus giving the other a bargaining advantage. As a result of such concerns, a number of states, Connecticut, New Jersey and Utah among them, require a stricter scrutiny of marital agreements to ensure that both people knowingly entered into the agreement without fraud or coercion. Some states go so far as to require that each person be represented by independent counsel. In many states, it is the spouse seeking to enforce the postnuptial agreement who has the burden of proving its enforceability.

A marital agreement can be a useful tool if one person receives a large bequest, gift or inheritance from their family of origin during the marriage and wants to segregate that property from the marital estate in the event of divorce or death. “Each party should carefully consider what they are exchanging or giving up as part of the agreement,” notes Mejia. “In the case of postnuptials, because the parties are already married, even more delicate negotiation may be required.” In states that allow postnuptial agreements as not contrary to public policy, a postnuptial agreement, similar to a prenuptial agreement, does not have to provide for an equal division of assets or income. It is for the court to determine whether the postnuptial agreement meets the state requirements for validity and enforceability of the contract.

The Impact of Trusts on Wealth Protection

Trusts afford clients broad flexibility in the structuring and management of their assets, help reduce administrative costs and delays at death and can produce substantial estate and gift tax savings. Both the donor and the beneficiaries should be aware that courts

may consider trust assets as marital property subject to division at the time of a divorce, depending on the way a trust is structured and the applicable law of the state governing the trust.

Consider the following example: A mother creates an irrevocable trust for the benefit of her child, which provides that distributions to the child may be made at the discretion of an independent trustee. Before and during the child's marriage, she has received distributions from the trust. Upon a divorce, will the trust assets be considered "marital property" and taken into consideration in the division of property between the child and her husband?

The answer will vary depending upon several factors, including the state where the couple resides, the terms of the trust agreement and the history of trust distributions. The trust assets themselves will remain in trust and continue to be subject to the terms of distribution that the mother set forth in the trust agreement. A decree of divorce will not force a dissolution or invasion of an irrevocable trust or a division of the assets while they remain subject to the trust terms. However, if the distributions that the child was receiving are deemed by a court to have been a part of the financial fabric of the marriage (for instance, if trust distributions were used to buy the family home or pay for children's education), the trust may be included as a part of the marital estate and taken into account in the division of other, non-trust, assets. Alternatively, future distributions may be subject to division between the spouses. For example, if the trust agreement provides that the trust assets are to be distributed outright to the child upon attaining a certain age, a court may determine that the future distribution, when received, is subject to a division between the child and her ex-husband.

"Whether and to what extent trust assets may be taken into account in dividing property during a divorce may depend not only on the laws of the state in which the couple resides, but also on other factors such as the terms and distribution patterns of the trust itself," says Rebecca Milliman, Atlantic Trust senior vice president and wealth strategist. "In general, a trust that provides broad discretion in an independent trustee, and where distributions have not been used to support the family, may be less likely to be included as marital property than a trust has been used for the family's support and maintenance."

Properly structured and implemented, trusts can be an important and useful means for protecting wealth throughout generations of a family. It's important for parents and grandparents to consider not only estate tax planning rules, but also family property rules when creating trusts for the benefit of their descendants. Milliman notes, "Always seek guidance from an experienced professional regarding how best to ensure that your wishes are not disrupted by a divorce."

"Planning for a marriage to break up is not the point of either prenuptial or post-nuptial agreements," says Saint James. "But for affluent families, it's important to remember that wealth protection is complex—and a valid concern—for every stage of the family life cycle."

Uniform Premarital Agreement Act

Codified separately in the states that adopted it (i.e., D.C. Code §46-501 to § 46-510, Conn. Gen. Stat. § 46b-36a (2011), etc.)

Massachusetts Materials:

Ansin v. Craven-Ansin, 457 Mass. 283 (2010)

Osborne v. Osborne, 384 Mass. 591 (1981)

DeMatteo v. DeMatteo, 436 Mass. 18 (2002)

Guthrie v. Canty, 315 Mass. 726 (1944)

Ware v. Gulda, 331 Mass. 68 (1954)

S.L. v. R.L., 55 Mass. App. Ct. 880 (2002)

G.L. v. D.L., 61 Mass. App. Ct. 488 (2004)

Matthew Bender, 12 Massachusetts Domestic Relations §12-51 "Prenuptial Agreements/Cohabitation Agreements," (2010)

MCLE, Massachusetts Divorce Law Practice Manual, Vol. I, Chapter 8, Division of Estate (2009)

Massachusetts General Laws Chapter 208, §34

MCLE, Massachusetts Probate Manual, Vol. I, §7.2.5

Law Review Articles / Bar Journals:

"Tax Law: Relationship Dissolution Planning part 1: Nuptial Agreements," 80 Fla. Bar J. 43 (2006)

"Recharacterizing Separate Property at Divorce" 84 U. Det. Mercy L. Rev. 307 (2007)

"Family Law: The Uniform Prenuptial Agreement Act: Taking Casto to a New Level for Prenuptial Agreements", 81 Fla. Bar J. 32 (2007)

"Book Essay: Marriage as a Bad Business Deal: Distribution of Property on Divorce," 17 Fla. St. U.L. Rev. 95 (1989)

"The Perils of Prenuptial Provisions," 48 RI Bar Jnl. 5 (2000)

"Developments in the Law: V. Marriage as Contract and Marriage as Partnership: The Future of Antenuptial Agreement Law," 116 Harv. L. Rev. 2075 (2003)

"Note: The Trust in Marital Law: Divisibility of a Beneficiary Spouse's Interests on Divorce," 64 Tex. L. Rev. 1301 (1986)

"Division of the Pre-Marital Trust or Inheritance," 45 N.H. B.J. 58 (2004)

Matthew Bender, 5-59 Family Law and Practice, § 59.01 (2011) Antenuptial Agreements

ALI-ABA Course of Study Materials, Estate Planning in Depth, Continuing Legal Education for Wisconsin of the University of Wisconsin Law School, June 2010

"Planning and Drafting Premarital Agreements

Statutes:

Official Code of Georgia Annotated (O.C.G.A.) §19-5-13 (2011) Disposition of property in accordance with verdict

O.C.G.A. § 19-3-9 (2011) Each Spouse's Property Separate

Tex. Fam. Code §7.001 (2011) General Rule of Property Division

N.Y. Dom. Rel. Law 236, Part B, § 2, et. seq. (2011)

Illinois Compiled Statutes Annotated, 750 ILCS 5/503 (2011) Disposition of property

Colorado Revised Statutes, C.R.S. 14-2-307 (2011) Enforcement

C.R.S. 14-10-113 (2011) Disposition of Property

Md. Family Law Code Ann. §8-205 (2011) Marital Property Award

D.C. Code § 16-910 (2011) Assignment and Equitable Distribution of Property

Uniform Premarital Agreement Act (UPAA); codified in individual state statutes; See Arizona, California, Connecticut, Delaware, Florida, Illinois, District of Columbia

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