NORTHERN TRUST

MARRIAGE AND REMARRIAGE: NAVIGATING THE UNCERTAINTIES

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An engagement is traditionally filled with positive, idyllic hopes for a future life together. Couples often spend this time dreaming, planning and laying the foundation for their marriage. Most people do not want to damper this time with uncomfortable financial discussions or thoughts of what might happen if the "wheels come off" and the relationship deteriorates irreparably. Others may not be keen on disclosing family or individual wealth or may be uncertain as to how to approach retaining separate assets (if that is the intention) and engaging in premarital planning both individually and/or with their future spouse. The default often is inaction. However, individuals who are proactive about educating themselves and engaging in premarital planning, both independently and as a couple, are better equipped to understand the implications of all stages of property acquisition, ownership and retention before and during marriage. They are also better armed with the knowledge that any action or inaction in this regard mirrors their intentions.

While perhaps the most well-known marital planning instrument is the premarital agreement (also referred to as an "ante-nuptial agreement," "prenuptial agreement" or a "prenup"), there are planning tools in the realms of estate planning and financial planning as well. It pays to be aware of and carefully consider all of these options when a couple is engaged. This article examines premarital agreements, premarital planning without an agreement, and postmarital agreements. One key theme emanates throughout: knowledge is power.

PREMARITAL AGREEMENTS

What is a premarital agreement?

A premarital agreement is a contract entered into between two people who intend to marry.[1] The agreement governs certain rights and obligations of the couple during their marriage and in the event of divorce, which most state statutes refer to as "dissolution of marriage." While state courts generally refused to enforce premarital agreements 40 to 50 years ago, all 50 states in the U.S. and the District of Columbia now recognize premarital agreements.[2] However, marriages and dissolution of marriages are governed by state law, and each jurisdiction has different laws governing the substance, validity and enforceability of premarital agreements.

In 1983, in an effort to bring clarity and consistency to the legal treatment of premarital agreements across the differing states, the National Conference of Commissioners on Uniform State Laws drafted the Uniform Premarital Agreement Act (the Act).[3] Since then, twenty-six states and the District of Columbia have enacted the Act, albeit with myriad variations.[4]

What are the permissible subjects that a couple may include in their premarital agreement?

The Act attempts to answer this question delineating the substantive terms for which a couple may contract.[5] Section 3(a) of the Act says that parties to a premarital agreement may contract with regard to:

1. The rights and obligations of each of the parties in their property;
2. The right to buy, sell, use, transfer, exchange, abandon, lease, consume, expend, assign, create a security interest in, mortgage, encumber, dispose of or otherwise manage and control property;
3. The disposition of property upon separation, marital dissolution, death and/or the occurrence/nonoccurence of any other event;
4. The modification or elimination of spousal support (commonly known as "alimony" or "maintenance")[6];
5. The making of a will, trust or other arrangement to carry out the provisions of the agreement;
6. The ownership rights in and disposition of the death benefit from a life insurance policy;
7. The choice of law governing the construction of the agreement; and
8. Any other matter, including their personal rights and obligations, not in violation of public policy or a statute imposing a criminal penalty.

Of the jurisdictions that have adopted the Act, some have adopted Section 3(a) in its entirety, while others have chosen to eliminate or modify it. For instance, both Iowa and South Dakota have eliminated the provision that allows a couple to contract with regard to the modification or elimination of spousal support.[7] Iowa has taken this a step further by affirmatively providing that the right to spousal support will not be adversely affected by a premarital agreement.[8] The remaining 23 states that have not adopted the Uniform Laws have their own statutory authority and common law to specify the substantive areas in which parties may contract in a premarital agreement; again, most of the laws vary significantly from state to state.

Of note, Section 3(a) of the Act is not intended to be an exhaustive list of all things that may be included in a premarital agreement. Number 8 in the list above serves as a "catch-all" for other provisions that a couple may want to include. The only caveat is that the agreement cannot violate public policy or criminal laws. While the Act does not define what is against public policy, states have developed their own specific laws in this area. Examples of provisions that may not be enforceable include:

PROVISIONS IN PREMARITAL AGREEMENTS THAT MAY VIOLATE PUBLIC POLICY	
A provision that adversely affects a child's right to support.	A provision that promotes divorce or stimulates a party to initiate a court proceeding for dissolution of marriage.
A provision regarding child custody or visitation.	A provision that penalizes a party for initiating a court proceeding for dissolution of marriage.
A provision that limits or restricts a victim of domestic violence from relief.	A provision that requires a party to raise a child in a certain religion or faith.

Given the rules about what may and may not be included in a premarital agreement, it is imperative that individuals consult with and retain reputable family law attorneys well-versed in the law of their state if they are considering a premarital agreement. It is advisable to meet as early as possible during the couple's engagement to allow sufficient time for each individual to meet with independent counsel, to educate themselves on the law, and to move forward with the negotiation, drafting and execution of a premarital agreement, if desirable.

How does a person know if he or she needs a premarital agreement?

Many individuals ask this question and the answer truly varies on the circumstances of the couple and their relationship. Attorneys and advisors would be hard-pressed to answer this question without a thorough understanding of each individual's financial situation. There are no specific guidelines to follow. Instead, each individual needs to learn as much as he or she can about premarital agreements. It can be helpful to meet with both a family law attorney and an estate planning attorney early in the engagement to discuss all considerations. Best practice is to have a blended team of expertise. An estate planning attorney can advise clients on short- and long-term wealth planning, while a family law attorney can advise on a client's state-specific rights and obligations after the marriage and can provide insight on how a valid premarital agreement can affect these rights. And, a financial advisor can run the numbers and bring planning scenarios to life. Without a premarital agreement, the law of the state in which the couple is domiciled largely will govern their property rights during their marriage; however, if a couple wishes to modify these property rights provided under state law, a premarital agreement may provide a way to do so. The following section highlights the different ways that states deal with property and income when a marriage ends. It also illustrates how a premarital agreement may change these default outcomes.

AREAS IN WHICH STATE LAW VARIES:

1 Treatment of Property in Equitable Distribution States vs. Community Property States

States may treat property as marital and nonmarital property or as community property and separate property. It is imperative for a person to know whether he or she lives in an equitable distribution state or a community property state. Most states are equitable distribution states, largely because of the influence of the Uniform Marriage and Divorce Act in the 1970s and 1980s. However, there are currently nine community property states in the United States: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Some states, like Alaska, also allow couples to "opt in" to community property treatment.

Community Property Jurisdictions. States that use community property law treat a married couple as one economic unit, the marital community. All earnings and property acquired during the marriage are presumed to be part of the marital community, and each individual is considered a one-half owner of the entire marital community both during the marriage and at death or dissolution of marriage. That said, each state implements this general rule differently. Property acquired through gift, inheritance or prior to the marriage generally is separate property.

Equitable Distribution States. While equitable distribution states also classify marital property as any property acquired during the marriage, both individuals are considered joint owners of the property during the marriage. Upon dissolution of marriage, instead of dividing marital property equally, like in a community property state, in an equitable distribution state the court likely will divide the property equitably, which may not result in a fifty-fifty split. There are many factors that determine the allocation formula in an equitable distribution state, including the couple's respective ages, health, educational backgrounds, work histories, monetary and non-monetary contributions to the marriage, future ability to earn income and acquire assets, custodial provisions for any children, special needs of any of the children, nonmarital property of either individual, tax consequences of the property division and the length of the marriage. As such, a property division could range from 0% to 100% of marital property allocated to either spouse; however, most equitable divisions fall somewhere in between.

A good family law attorney can help an engaged couple understand state law on property classification and division of assets and liabilities. From there, the couple can decide whether they want to use a premarital agreement to modify that state law.

EXAMPLE

Domiciled in California

CA If the couple lives in California, which is a community property state, they may decide to be more intentional about the creation of community property. If the couple is planning to purchase a home after the marriage, they may decide to opt-out of community property treatment if they plan to make disparate contributions toward the purchase of the home. If Spouse #1 will contribute 40% of the funds to purchase the home and Spouse #2 will contribute the remaining 60%, the couple may decide to include language in their premarital agreement that would result in sixty-forty ownership, rather than fifty-fifty ownership.

Domiciled in Illinois

IL A couple who lives in Illinois, which is an equitable distribution state, is engaged to marry. This is the second marriage for each person and they are looking to retire to Arizona, a community property state, within the next five years. The couple may decide to include language in their premarital agreement that rejects the creation of community property, regardless of the couple's future state of domicile.

Regardless of whether a couple is in a community property state or an equitable distribution state, they may decide to include general language in their premarital agreement prohibiting the unintentional creation of marital or community property. In many states, nonmarital or separate property can lose its character and can unintentionally become marital or community property if it is commingled with other funds or if it appreciates because of one spouse's personal efforts, for example:

EXAMPLE

Creation of Community Property

A couple may decide to include terms in their premarital agreement providing that marital or community property will only be created if title to future-acquired assets is held in the names of both individuals. If the couple has this language in their premarital agreement, both individuals will need to be mindful of all asset titling and funding during the course of the marriage. A couple also may decide to include a provision that all personal effort by either spouse will not be considered a marital or community contribution to nonmarital or separate property, so that separate property is more likely to stay separate.

The law regarding commingling of assets and transmutation of property is highly nuanced and state-specific, so individuals should seek the advice of an experienced lawyer. Regardless of whether a couple signs a premarital agreement, the rules around commingling highlight one of the many reasons it makes sense to get good advice before marriage. It is important to be fully aware of all the implications of actions related to property disposition during the marriage. (The concept of unintentional transmutation is discussed further below under "Premarital Planning Without a Premarital Agreement.")

2 Treatment of Income in Equitable Distribution States vs. Community Property States

Most equitable and community property states treat income a bit differently. While both generally classify wages earned during the marriage as marital or community property, some community property states classify income earned after a couple's separation but prior to entry of a judgment for dissolution of marriage (also known as a divorce decree) as separate property. By contrast, equitable distribution states generally say that all this income remains marital until the entry of a judgment. Each state also varies on the classification of unearned income and income earned from nonmarital or separate property.

This highlights another key area that couples should discuss with their attorneys and a potential area to contract about in a premarital agreement.

EXAMPLE

Defining Income

A couple may choose to define "income" for purposes of their premarital agreement as excluding income earned from salary or wages if they agree to each keep their employment earnings separate. The couple may choose to include or exclude other types of income (for example, taxable interest, dividends, capital gains, IRA distributions, pension or annuity distributions, Schedule C business income, distributions from Schedule E entities and other forms of income as the couple may agree) from being included in the definition of "income" for purposes of defining marital or community property.

An experienced attorney also can provide significant guidance to clients on alimony, which is commonly referred to as spousal support or maintenance. While some states such as Iowa do not allow parties to a premarital agreement to contract regarding spousal support, many other statutes do allow parties to modify or eliminate rights to receive and obligations to pay spousal support.[9] It is wise to learn what state law says about spousal support, the factors a court uses to determine the amount and duration of such awards. Again, knowledge is power and before either individual considers modifying or waiving his or her right to spousal support, both should understand the potential range of outcomes under applicable state law in the absence of a premarital agreement.

EXAMPLES

Waiver of Spousal Support

Two spouses similarly situated with income and property may agree to a mutual waiver of spousal support. A couple may also decide that a waiver of spousal support becomes null and void if a working spouse resigns from employment in order to raise their child(ren); these types of provisions are commonly referred to as "sunset clauses."

Property Settlement

For a couple where one spouse is a high-wage earner and the other spouse does not work outside the home, they may agree on a property settlement (with the amount varying on a sliding scale based on the duration of the marriage) to the non-working spouse in lieu of a spousal support award. A premarital agreement could provide certainty and protection to both individuals without the emotional and financial toll of protracted litigation in the event their marriage ends in divorce.

Spousal Support Omission

The couple may well decide that there is simply too much unpredictability based on their family situation, careers and other goals and therefore voluntarily choose for their premarital agreement to remain silent on the topic of spousal support.

It is imperative that couples looking to modify their rights to spousal support in a premarital agreement thoroughly discuss this matter with their respective attorneys as the law is constantly evolving. While the Act and the majority of state statutes provide that agreements should not be unconscionable at the time of execution (discussed more fully below under "What constitutes a balanced and valid agreement?"), many states, such as California, have modified their law to provide for a "second look" with regard to spousal support modifications.[10] This "second look" provision requires the court to examine unconscionability at the time of execution and at the time of enforcement.[11]

A well-seasoned attorney also will be able to advise on the allocation of debts and expenses, life insurance to secure support obligations, tax-related matters, payment of attorneys' fees and other ancillary matters that arise in the context of marriage and divorce. And, the more knowledge a person can gather the better prepared they will be to engage in meaningful and productive negotiations that conclude with a balanced and valid premarital agreement.

What constitutes a balanced and valid agreement?

While premarital agreements are generally favored under the law, it is important for a couple to be aware of all the specific procedural prerequisites to confirm they are creating and entering into an enforceable agreement. The Act provides for specific formalities and requirements which must occur while the premarital agreement is being drafted, negotiated and executed. A summary of the key provisions is as follows: [12]

1. **The agreement must be in writing and signed by both parties to the agreement.** Oral contracts are not sufficient and unexecuted agreements are not binding in most jurisdictions. Some states have specific requirements for the execution and notarization of premarital agreements, while others merely require signatures. A couple should be certain that they are following all the procedural requirements for the execution of their agreement.
2. **The agreement is enforceable without consideration.** Generally, for a contract to be enforceable there must be a valid offer, acceptance and sufficient consideration to support the agreement. But, that is not necessarily the case for a premarital agreement.
3. **The agreement must be executed voluntarily.** Each individual must execute the agreement voluntarily. This is often defined as a making a conscious choice to enter into the contract, free from duress, coercion, undue influence or any other matter that would somehow deprive someone of the ability to make a conscious decision. The best practices listed below will help a couple meet the voluntariness requirement:

WHAT IS CONSIDERATION?

Consideration is a bargained-for exchange of promises or performance. Utilizing a home purchase as a simple example, a buyer submits a valid offer to purchase the home and the seller accepts the offer. The consideration is the monetary value the seller receives in exchange for the home, along with all of the parties' other promises and conditions as contained in the real estate contract. Applying this example to a premarital agreement, if an individual offers to give her home to her soon-to-be-spouse in the event of a future divorce, there would not need to be valid consideration to support this agreement. This distinguishes premarital agreements from standard contracts.

SPOTLIGHT ON BEST PRACTICES

BEST PRACTICES TO VALIDATE THE VOLUNTARY EXECUTION OF A PREMARITAL AGREEMENT	
Both parties should be represented by independent counsel throughout the process, beginning with retention of attorneys and continuing through the execution of the agreement.	Neither party should be under the influence of any prescription medication or any other substance that would impair his or her comprehension during the execution of the agreement.
Each party should have their respective counsel fully explain their rights under the law and all provisions of the agreement. Neither party should execute the agreement until they fully understand all provisions.	Counsel for both parties should be present at the execution ceremony and should question each party regarding his or her voluntary execution of the agreement. The execution ceremony may be recorded via a court reporter or video.
The premarital agreement should be executed well in advance of the wedding ceremony. Couples should plan to execute the agreement several weeks to several months in advance of the wedding, where possible.	Neither party should be forced or coerced to sign the agreement.

4. **The agreement must not be unconscionable at the time of execution.** Unconscionability has both procedural and substantive elements.

   Procedural Unconscionability. An agreement is procedurally unconscionable if the process of negotiation and signing deprives an individual of the ability to make a meaningful choice. Factors that affect procedural unconscionability generally include whether the parties to the agreement were represented by independent counsel, the length of time over which the agreement was negotiated, the negotiation process itself, and the length of time between the execution of the agreement and the wedding, among other factors. One of these factors alone may not be enough to create procedural unconscionability, but taken together, the outcome may be different.

   Substantive unconscionability. This type of unconscionability is based on the actual terms of the parties' agreement and can be found where a provision or the agreement as a whole is so unreasonably favorable or one-sided as to "shock the conscience." But, substantive unconscionability is not synonymous with fairness.

5. **The disclosure requirements must be met.** Both individuals must make a fair and reasonable disclosure of their property and financial obligations. Alternatively, the parties may waive their respective rights to disclosure in most jurisdictions.[13]

As expected, different states have modified these requirements and tailored them to their own specific state statutes, and state law on disclosure can vary significantly from state to state. Some states do not allow parties to waive the disclosure requirement at all; others require a "full disclosure" as opposed to just

a "fair and reasonable disclosure."[14] Similarly, each state has its own law governing what constitutes voluntary execution of the agreement. While some states provide nothing more than a blanket requirement of voluntariness, other states have very specific requirements in their statutes.

Does a person have to be represented by independent counsel to enter into a premarital agreement?

Many may be surprised to learn that most states do not require each individual to be represented by independent counsel in order for a couple's premarital agreement to be valid. California deviates from this standard. Its version of the Act provides that in order to meet the voluntariness requirement, each individual must be represented by independent legal counsel at the time the agreement is executed.[15] The California statute requiring independent counsel is part of a growing movement both nationally and internationally to require parties who enter into a premarital agreement to be represented by independent legal counsel.

In 2012, the Uniform Law Commission drafted and approved a new act called the Uniform Premarital and Marital Agreement Act (the "UPMAA").[16] As the title suggests, the UPMAA governs not only premarital agreements, but also marital agreements that are more commonly referred to as "postmarital agreements" or "post-nuptial agreements."[17] (Postmarital agreements are discussed further below.) The UPMAA, unlike the Act, mandates that each party to a premarital agreement must have access to independent legal representation while the agreement is negotiated, drafted and executed.[18] "Access" is defined in the UPMAA as having adequate time to retain an attorney, as well as to receive and consider the advice of counsel, and having the financial ability to retain an attorney.[19] A party also may choose to waive his or her right to independent counsel by signing a waiver with precise and conspicuous language in the agreement.[20]

While the UPMAA was intended to replace the Act, it has only been adopted in two states since its 2012 approval, namely Colorado and North Dakota.[21] Twenty-five states and the District of Columbia continue to adhere to their state-specific versions of the Act.

The Act and the UPMAA both attempted to create uniformity, consistency and predictability in the law governing the validity and enforceability of premarital agreements. To date, these goals remain elusive as each state has its own unique law on premarital agreements. While the effect of the UPMAA is yet to be seen, consultation with an attorney who knows the applicable state law is key. The following list summarizes best practices for couples looking to create an enforceable agreement:

SPOTLIGHT ON BEST PRACTICES

BEST PRACTICES FOR CREATING AN ENFORCEABLE PREMARITAL AGREEMENT	
1	Both parties to the agreement should retain independent legal counsel.
2	The negotiation of the premarital agreement and the drafting process should begin early in the engagement. The couple should allow several months or more for the process to organically progress, beginning with initial attorney consultations and continuing through to the execution of the agreement.
3	Both parties to the agreement should make a full disclosure of all assets, liabilities, income and expenses. This should include not only present ownership interests, but also beneficial and contingent interests. Consult the *Northern Trust Wealth Planning Divorce Checklist* for a delineation of pertinent documents to gather and exchange.
4	The parties should endeavor, through counsel, to reach a balanced agreement so as to avoid any issues with unconscionability in the future.
5	The agreement should be executed well in advance of the wedding date, with a buffer of several weeks or months, as appropriate.
6	Counsel for both parties should attend the execution ceremony and question the parties as to their voluntary execution of the agreement. The execution ceremony may be recorded via video or by court reporter to memorialize what transpired.

PREMARITAL PLANNING WITHOUT A PREMARITAL AGREEMENT

There are many reasons a couple may not enter into a premarital agreement. For these couples, there are still several premarital planning tools available. These tools can help ensure that actions mirror intentions when it comes to the creation and disposition of marital or community property and nonmarital or separate property.

If an individual owns property or has beneficial interests that pre-date the marriage, there may be many reasons to keep this property separate during the marriage, including a desire to keep family wealth within the family or to safeguard property or income during a second or third marriage. The key principle is to be intentional about the creation and maintenance of separate and joint assets and to avoid unintentionally commingling nonmarital/separate property with marital/community property. The following illustrations highlight the importance of these concepts.

EXAMPLE

Jane and Joey are engaged to be married in two weeks. Assume that Jane and Joey are not planning to enter into a premarital agreement and live in an equitable distribution state.

	JANE (AGE 36)	JOEY (AGE 42)
Prior Marriage?	No.	Yes. Ended in divorce.
FINANCIAL SUMMARY PRIOR TO MARRIAGE		
Income	$30,000 per year from employment and nominal interest income.	$300,000 per year from employment and interest income.
Assets and Liabilities	Checking account: $6,000 Savings account: $15,000 Beneficial trust interests: *1. Irrevocable Family Trust No.1:* Corpus of $10 million; Jane is the primary beneficiary. Jane, her spouse, and her descendants may receive discretionary income and principal in the corporate trustee's sole discretion for their health, maintenance, education and support. Upon age 55, Jane has a right to withdraw 10% of the corpus. To date, Jane has not received any distributions of income or principal from the trust. *2. Pending – Irrevocable Family Trust No.2:* Jane's parents are planning to fund an intentionally defective grantor trust with approximately $10 million. Jane will be the primary beneficiary. Jane's parents expect the trust to be funded sometime in the next two years.	Savings account: $150,000 401(k): $350,000 One-third interest in vacation home (value unknown) Child support obligation of $3,500/month to ex-spouse for the benefit of Joey Jr.
Financial Disclosure Prior to Marriage?	Jane disclosed her employment income and her bank accounts. Jane did not disclose her beneficial trust interest.	Yes; Joey disclosed all of the above.

Each individual should keep records showing the value of all assets as close to the date of marriage as possible.

Each individual should engage in a full valuation, whether formally or informally (best practice includes formal appraisals for non-marketable securities), for all of his or her assets as close to the date of marriage as possible. It is best to obtain and retain both paper copies and electronic copies of the records for proper safekeeping. In the event that "the wheels come off" during the marriage, each individual claiming nonmarital/separate property assets will need to prove to the court that these were owned before the marriage and will need to prove the value of each asset.

EXAMPLE

Accurate Records to Reflect Nonmarital Account Values

For his 401(k) account, Joey should retain an account statement dated in the month of his marriage to Jane. While his account will inevitably be commingled during the marriage with marital contributions from his salary, it is important for Joey to have accurate records that reflect the nonmarital value of the account (for example, all property accumulated before his marriage to Jane). In the event of a divorce, the court will be armed with the information it needs to equitably divide only the marital portion of the account.

The couple should keep nonmarital/separate assets separate unless they are intentionally creating marital/community property.

The couple should be intentional about establishing and maintaining individual or joint bank accounts, as the case may be. If they have separate accounts and wish to keep them separate, the owner of the account should be cognizant of all inflows into the account, especially earnings from employment and other income that is marital/community property.

EXAMPLE

Accurate Records to Reflect Nonmarital Account Values

If Joey wants his savings account to remain his nonmarital property, he should continue to maintain this account as a separate account and should not add Jane to the title. Joey also should be very intentional about any deposits or inflows into the account. For instance, if Joey deposits gifts from his parents into his savings account, the account will maintain its nonmarital integrity.

However, if Joey begins to have all or a portion of his salary (which is marital property) deposited directly into the account, he will be commingling marital and nonmarital property. If the extent and duration of the commingling makes it difficult to trace the marital and nonmarital portions, Joey runs the risk that his savings account will become transmuted into marital property.

Individuals should maintain nonmarital/separate assets with nonmarital/separate funds to avoid commingling marital/community property with nonmarital/separate property.

Unless a person plans to gift an asset to the marital/community property estate, he or she should try to use nonmarital/separate funds to maintain nonmarital/separate property. In some states, even personal effort may be considered a marital or community contribution to the nonmarital/separate property. Individuals should seek the advice of an attorney to validate that they are properly maintaining their nonmarital or separate property. The laws in this area are highly nuanced and vary greatly from state to state.

EXAMPLE

Maintain Nonmarital Assets with Nonmarital Funds

Joey should be very careful with his one-third interest in the vacation home if he wants the property to keep its nonmarital classification. First, Joey should have the property appraised as close to the date of marriage as possible. Second, if at all possible, Joey should maintain this nonmarital asset with nonmarital funds. If Joey does not have sufficient nonmarital assets to cover the expenses of maintaining the property, Joey should keep detailed records showing the source and funding of all payments related to the property. For instance, even if Joey uses his salary (marital property) to pay for the real estate taxes, insurance premiums and other maintenance costs, he might still be able to show that the property is nonmarital (assuming he has good records). If the property is nonmarital, then, in the event of a divorce, Joey may have to give Jane a portion of the money he spent to maintain the vacation home but Jane likely would not have any rights to the vacation home itself.

Individuals should obtain records at least annually for all nonmarital/separate property to document all "important" transactions, sources of income, assets and obligations. These records should be retained in perpetuity.

As noted above, individuals should keep account statements reflecting the value of his or her assets as close to the date of marriage as possible. They should continue to obtain and retain year-end financial statements showing the value of all nonmarital/separate property and should confirm that the year-end statements are detailed enough to clearly show the source of each inflow and outflow.

EXAMPLE

Proper Documentation is Critical to Determine Marital and Nonmarital Classification of Commingled Accounts

Assume now that Jane and Joey have been married for 19 years, during which time Joey deposited the following into his savings account: (1) all annual bonuses from his employment (marital property), ranging from $50,000 - $100,000 each year, and (2) annual exclusion gifts from his parents (nonmarital property), which were in the maximum amount of $10,000 from each parent in 1997 (the year of their marriage), and due to indexing increases, totaled $15,000 from each parent in 2018. Joey believes that he received annual exclusion gifts from his parents in most years, but recalls that there were at least three or four years in which he received less than the maximum exclusion amount. Joey also recalls receiving annual exclusion gifts from his aunt during the late 1990s, but cannot recall the specific years or amounts of the gifts. Joey did not retain account statements either via hard copy or electronically because he did not want to be "inundated" with the paper records and he did not see a need to download and retain the electronic statements. Jane now informs Joey that she is planning to file for divorce. In the event that Jane does not agree to give Joey the entire savings account, Joey would need to be able to clearly trace the source of each and every marital and nonmarital deposit to prove the nonmarital value of his account. Over the course of a 19-year marriage, the amount of marital and nonmarital inflows will have been substantial. A court may very well consider the commingling of nonmarital and marital assets into Joey's account to be so significant that it is no longer possible to distinguish the marital and nonmarital components. As such, if Joey does not have proper records to corroborate the cash inflows and the sources, the entire account is in danger of being classified as marital property.

If the account is deemed marital property, Joey may still have the right to all nonmarital funds contributed to the account, but again, without proper documentation, Joey's claim may fail.

Knowing that he has not retained account statements, bonus statements or records from his parents in his own personal files, Joey sets out on a mission to request financial statements from his banks and his employer. However, most financial institutions and employers only retain documents for seven years. Joey begs his attorney to use the subpoena power of the court to seek records dating back even farther, but the same result ensues. Joey therefore only has an incomplete accounting and will be left to the mercy of negotiating with his soon-to-be ex-wife or the court to determine the classification of his savings account. Had Joey maintained proper documentation, he would have been able to save himself the time, expense and uncertainty of attempting to prove the nonmarital nature of his property.

Individuals should meet regularly with their team of advisors (which may include attorneys, accountants, wealth planning and/or trust advisors) to understand which property is marital/community property and which is nonmarital/separate property.

Each individual should meet separately or jointly with his or her spouse, as appropriate, and his or her team of advisors to get an accurate picture of property classification. These meetings should occur regularly. Both individuals should confirm that they are doing what is necessary to achieve their collective goals for the creation and maintenance of marital/community property and nonmarital/separate property.

Individuals should meet with their estate planning attorneys, advisors and family members regarding intentions and planning for family wealth.

If an individual will inherit family wealth outright, through trusts or through family business entities, he or she should meet with professional advisors early and often to discuss strategies for wealth transfer.

EXAMPLE

Considerations for Inheritance Wealth Transfer

While Jane is not currently receiving any distributions of income or principal from Irrevocable Family Trust No. 1, this status may certainly change over time. For future distributions, Jane should decide whether to put the distributions in a nonmarital/separate account or in a marital/community account, depending on her intentions. Jane's attorneys will be able to advise her of the implications of this decision and the characterization of income and principal from the trust once distributed.

With regard to future planning for Irrevocable Family Trust No. 2 (and any additional planning her family may engage in down the road), it would be prudent for her parents' team of advisors to be aware of Jane's situation and upcoming nuptials. This will afford her parents the ability to structure the terms of the trust agreement to allow for distributions only for Jane and her descendants (if they so choose), as opposed to including provisions for her spouse as allowed under Irrevocable Family Trust No. 1. Alternatively, language could be included to define spouse in such a manner as to preclude distributions during the couple's separation or during the pendency of a proceeding for legal separation or dissolution of marriage. In addition, if Jane's parents engage in future gifting to her during the course of her marriage, they should create trusts or other family business structures to safeguard family wealth, if it is their desire to do so. The emphasis should be on the protection of family wealth as opposed to the hiding or nondisclosure of assets.

Following are several key principles to consider and adopt, as appropriate, when engaging in premarital planning without a premarital agreement:

SPOTLIGHT ON BEST PRACTICES

BEST PRACTICES FOR PREMARITAL PLANNING WITHOUT A PREMARITAL AGREEMENT	
1	All nonmarital/separate property accounts and assets should be valued or appraised, as appropriate, as close to the date of marriage as possible.
2	Individuals should retain and maintain separate accounts if it is their intention to keep the property separate.
3	Joint accounts and jointly titled assets should only be established and funded intentionally. Individuals should know whether a future inflow is nonmarital/separate property to avoid unintentional commingling.
4	Where possible, nonmarital/separate property assets should be maintained with nonmarital/separate property funds unless the individual intends to gift the asset to the marital/community property estate.
5	Individuals should retain year-end statements for all nonmarital/separate assets, as well as any other relevant documentation relating to transactions that modify property value. They should be certain that the year-end statements are detailed enough to reflect the amount and source of each inflow and outflow. These files should be backed-up regularly.
6	Individuals should retain accurate records of all gifts received from any source, including details like the date of the gift and the type of property received.
7	Individuals should meet regularly with their attorneys, accountants, wealth planning and/or trust advisors and other professional advisors, as appropriate, to gain an accurate understanding of their property classification.
8	Individuals should remain intentional in all actions to be sure that marital/community property and nonmarital/separate property are not commingled.

ALTERNATIVE PLANNING TOOL: ASSET PROTECTION TRUSTS

An alternative form of premarital planning that has been growing in popularity is the asset protection trust. An asset protection trust is an irrevocable self-settled spendthrift trust. There are at least 17 states that currently allow asset protection trusts, most notably Delaware and Nevada.[22] An asset protection trust is funded with a grantor's own assets. Even though the grantor will have a continuing interest in potential distributions of income and principal from the trust, if structured properly, the grantor's creditors will not be able to reach the assets unless they can prove that the funding constituted a fraudulent transfer under applicable state law.

Asset protection trusts are beginning to serve as a substitute for premarital agreements because they do not require negotiation with a soon-to-be spouse. Property held in an asset protection trust is fully shielded from a spouse if the trust is created before the marriage, but may not be fully shielded if the asset protection trust is created and funded during the marriage. For instance, in Delaware, if the couple is legally married when the trust is created and funded, a spouse may later satisfy a claim for unpaid spousal support, child support or his or her respective share of marital property from the asset protection trust.[23] As such, individuals should consider the creation and funding of an asset protection trust before marriage in order to protect their assets to the fullest extent.

The state law governing asset protection trusts does vary from state to state; however, most states generally say that:

1. The trust must be irrevocable;
2. The trust must contain spendthrift language; and
3. The grantor must not serve as the trustee, trust protector, or distribution advisor, or retain the power to direct distributions from the trust or to demand a return of assets transferred to the trust.

There are other state-specific requirements. For example, a Delaware asset protection trust must have a Delaware resident trustee and be governed by Delaware law.

While there are no strict requirements as to funding amounts, it is important not to over-fund an asset protection trust. The best practice is to only fund a portion of a grantor's net worth so that sufficient assets remain outside of the trust in order to satisfy the grantor's ongoing lifestyle expenses.

Asset protection trusts can be valuable and useful premarital planning tools. However, as these trusts are highly specialized, individuals must consult with an experienced attorney to determine whether an asset protection trust is an appropriate part of their premarital planning.

For more information on Asset Protection Trusts, see Delaware Trusts: Safeguarding Personal Wealth, 2018 edition.

POSTMARITAL AGREEMENTS

If a couple does not enter into a premarital agreement, they may have the option to enter into a postmarital agreement after they are married. A postmarital agreement is often referred to as a "post-nuptial agreement." Postmarital agreements are allowed in most states. However, Ohio bans postmarital agreements of any kind in any circumstance.[25] In Minnesota, a postmarital agreement is presumed to be unenforceable if, within two years of its execution, either spouse files for legal separation or dissolution of marriage.[26]

The law governing postmarital agreements is murky at best. While the majority of states maintain specific statutes governing the substance, validity and enforceability of premarital agreements, postmarital agreements largely are governed by each state's common law, meaning there is a patchwork of court cases telling people how a court might view a postmarital agreement. Recognizing the variation and unpredictability of the laws on postmarital agreements, the National Conference of Commissioners on Uniform State Laws tried to bring consistency to this area of law. But, as discussed above in "Premarital Agreements," although the UPMAA was signed in 2012, it has only been enacted in Colorado and North Dakota so far.

While premarital and postmarital agreements tend to cover similar topics, one of the key differences is that most states say that a postmarital agreement must be supported by consideration. (For a discussion on consideration, see "Premarital Agreements" above). This was one of the areas addressed by the UPMAA; but despite efforts to eliminate the consideration requirement for postmarital agreements, consideration still is required by the majority of U.S. states. While some courts have said that forbearance of initiating a proceeding for dissolution of marriage during a time when a marriage is undergoing an irretrievable breakdown does constitute consideration, they have further held that forbearance of bringing an action when the parties are happily married does not suffice as consideration because the parties are merely reiterating a previous promise to be and remain married.[27] Such a reiteration of a prior vow cannot be a bargained-for exchange of promises or performance incident to a postmarital agreement. Other examples where courts have found sufficient consideration to support a postmarital agreement include a mutual release of property rights and an agreement to withdraw a petition for legal separation or dissolution of marriage during a pending proceeding.[28]

Parties to a postmarital agreement should work with an attorney to confirm that any agreement will withstand the applicable validity and enforceability requirements. Of note, the UPMAA's requirements for the validity and enforceability of postmarital agreements are identical to the requirements for premarital agreements. And the common law on postmarital agreements in most states also generally mirrors the rules for premarital agreements. Thus, best practices include the following:

- Parties to the agreement should retain independent legal counsel;
- The agreement should be negotiated and drafted over a long enough period of time to allow both parties the opportunity to seek counsel regarding their rights and obligations;
- Both parties should make a full disclosure of all assets, liabilities, income and expenses (including not only present ownership interests, but also beneficial and contingent interests);
- The parties should try to reach a balanced agreement; and
- The agreement should be properly executed and safeguarded in accordance with the applicable state law and advice of reputable counsel.

BEST PRACTICES FOR ASSET MANAGEMENT DURING MARRIAGE

Regardless of the level of legal planning before the marriage, both individuals should be deliberate about their management of income, property, beneficial interests and other financial obligations during the marriage and should be sure that their actions reflect their intentions. While the specific action items for each individual will vary based on the financial and familial circumstances, the following items are representative of some best practices:

1 ***Adhere to Premarital Agreement and Other Agreements, as Applicable.*** If the couple signed a premarital agreement, they both should know where the original agreement is located and should safeguard it. Each spouse also should retain a copy of the agreement in his or her own personal records. Both spouses should adhere to the agreement and implement it by, for example, keeping separate property separate. If either spouse created an asset protection trust, he or she should take all steps necessary maintain the validity of the trust. Finally, the structures outlined in any estate planning documents should be implemented. For example, if the couple establishes a revocable trust, assets should be titled in the name of the trust. If assets are not titled appropriately the planning will be futile.

2 ***Create or Update Existing Estate Plans.*** The couple should create or update their estate plan. They should establish family goals and develop implementation strategies. If the couple has a premarital agreement, they should be certain that their estate planning and their premarital agreement are consistent.

3 ***Avoid Unintentional Commingling of Assets or Transmutation of Property.*** As discussed in "Premarital Planning Without a Premarital Agreement" above, individuals should avoid commingling any nonmarital/separate property with marital/community property if they intend to keep things separate. Gifting to a spouse also can have unintended consequences. While a gift from one spouse to another does not trigger federal gift tax, it does create nonmarital/separate property for the recipient spouse.[29]

4 ***Maintain Records.*** Individuals should maintain accurate and detailed records of all nonmarital/separate property. In the event a marriage dissolves, the owner of nonmarital/separate property will be responsible for tracing the movement of separate assets and proving that they are in fact separate. Even if these assets are classified as nonmarital/separate property in a valid premarital agreement, it is still important to keep records of sales, gifts, transfers and other transactions because this document can corroborate the maintenance of the nonmarital/separate property if challenged by the other spouse.

As this example illustrates, diligent and often times meticulous record-keeping can be essential.

EXAMPLE

Proper Documentation is Critical to Determine Marital and Nonmarital Classification of Commingled Accounts

Returning to our case study with Joey above, in the event that Joey sells his vacation home two weeks after he marries Jane and uses the proceeds to buy stock that is placed in a separate investment account, Joey will want to keep records memorializing the sale tracing the proceeds into his new investment account. Going forward, Joey will want to keep year-end statements for the investment account. If any securities are sold and transferred out of the account, Joey will need to keep a thorough paper trail, following those assets to confirm that they are not commingled with marital assets and, in fact, retain their nonmarital character. If Joey does not maintain good records, he will be left to the mercy of his soon-to-be ex-wife, Jane, who may or may not be willing to stipulate to the characterization of the investment account during the pendency of the divorce proceedings.

The account opening documentation for Joey's investment account will show that it was opened during the marriage, and a court may presume that it is marital property. This presumption can be rebutted, but only with clear documentation.

If the investment account is classified as marital property, it would be subject to equitable division between Jane and Joey, as opposed to being assigned 100% to Joey as his nonmarital property.

5 ***Meet Routinely with Team of Professional Advisors to Engage in Additional Planning, as Appropriate.*** While it may be too late to enter into a premarital agreement, it is never too late to engage in additional estate planning to help make sure that any trusts established for an individual's benefit preserve family wealth in accordance with the family's intentions.

CONCLUSION

Good advisors are able to see things that their advisees may not always see. The financial consequences of marriage and remarriage are real, but with advanced planning those consequences can be positive and constructive, rather than detrimental and contentious. Premarital and postmarital agreements, as well as asset protection trusts, are formal structures that can help give a couple certainty about their individual and collective financial futures. But, formal structures must be supported by conscientious implementation and strong record keeping. In fact, even in the absence of formal planning, thoughtful asset location and income management can offer protection in the event of marital strife. Thoughtful planning and good advice can position you not only for today, but for whatever tomorrow brings.

FOR MORE INFORMATION

As a premier financial firm, Northern Trust specializes in Goals Driven Wealth Management backed by innovative technology and a strong fiduciary heritage. Our Wealth Planning Advisory Services team leverages our collective experience to provide financial planning, family education and governance, philanthropic advisory services, business owner services, tax strategy and wealth transfer services to our clients. It is our privilege to put our expertise and resources to work for you. If you would like to learn more about these and other services offered by Northern Trust, contact a Northern Trust professional at a location near you or visit us at northerntrust.com.

ENDNOTES

1 In the seminal case of *United States v. Windsor,* 570 U.S. 744 (2013), Docket No. 12-307, the Supreme Court of the United States held that the federal definition of marriage as a "legal union between one man and one woman as husband and wife" as elucidated in Section 3 of the Defense of Marriage Act was unconstitutional under the Due Process Clause of the Fifth Amendment. The Supreme Court further held that the federal government must recognize same-sex marriages that have been approved by the states. In 2015, the Supreme Court took this one step further by holding that Section 2 of the Defense of Marriage Act, which allowed states to refuse to accept same-sex marriages, was unenforceable. *Obergefell v. Hodges,* 576 U.S. ____, (2015), Docket No. 14-556. Despite the *Obergefell* decision, some states continue to maintain civil union acts that were enacted pre-*Obergefell;* as such, couples have the option of entering into civil unions or marriages. See Illinois Religious Freedom Protection & Civil Union Act, 750 ILCS 75/1 et seq. (2014).

2 Unif. Premarital Agreement Act (1983), Prefatory Note.

3 Unif. Premarital Agreement Act (1983).

4 Since 1983, the Act has been enacted in Arizona, Arkansas, California, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Maine, Montana, Nebraska, Nevada, New Jersey, New Mexico, North Carolina, North Dakota, Oregon, Rhode Island, South Dakota, Texas, Utah, Virginia and the District of Columbia. However, in 2013, North Dakota repealed its version of the Act and replaced it with the Uniform Premarital and Marital Agreements Act; see Unif. Premarital and Marital Agreements Act, N.D. Cent. Code §14-03.1 and 14-03.2 et seq. (2013). Colorado, which had never enacted the Act, also enacted the new Uniform Premarital and Marital Agreements Act; see Unif. Premarital and Marital Agreement Act, C.R.S. §14-2-301 et seq. (2014).

5 Unif. Premarital Agreement Act §3.

6 While the Act provides that parties may contract with regard to the elimination or modification of spousal support, it further provides that if such a provision causes one party to the agreement to be eligible for support under a program of public assistance, a court may order the other party to provide support necessary to avoid that eligibility. Unif. Premarital Agreement Act §6(b). Some states have enacted statutes exactly replicating this language, while others have removed the provision (such as Delaware) or expanded upon this provision (such as Illinois). See 13 Del. Code Ann. §326 (1996) and 750 ILCS 10/7(b) (1990).

7 See Iowa Code Ann. §596.5 (1991); see also S.D. Codified Laws §25-2-18 (1989).

8 Iowa Code Ann. §596.5(2).

9 *Id.*

10 CA Fam. Code §1612(c), §1615(a)(2) (2001).

11 *Id.*

12 Unif. Premarital Agreement Act §6(a).

13 In order for a party to successfully rebut the enforceability of a premarital agreement under the Act, the individual most prove that: (1) he or she was not provided with a fair and reasonable disclosure of the property and financial obligations of the other party at the time of execution, (2) he or she did not waive his or her right to further disclosure beyond that which was provided at the time of execution, (3) he or she did not have, or could not have, adequate knowledge of the property and financial obligations of the other party at the time of execution, and (4) the agreement was unconscionable at the time of execution. *Id.* The states are split on the burden of proof regarding the enforceability of the agreement, while the Act makes it clear that the burden falls on the party contesting enforcement. *Id.*

14 See CA Fam. Code §1615(a)(2)(A).

15 In California, the law provides that in order to meet the voluntariness requirement, each individual must be represented by independent legal counsel at the time of execution of the agreement. CA Fam. Code §1615(c)(1). If not, the party must waive representation by an independent attorney after being advised of this right and the terms of the agreement; further, in order for the waiver to be sufficient, the explanation of that party's rights and the agreement must be in a language in which that

party is proficient. *Id.* §1615(c)(1) – (3). (See further §1615(c) for all factors the California state court considers when making a finding of voluntariness.) Additionally, there must be a minimum time period of seven days between the time the individual was first presented with the agreement and advised to seek counsel until the time in which the agreement was executed. *Id.* §1612(c)(2). California also provides additional enforcement provisions in their statute that are not contained in the Act mandating representation by independent counsel when a premarital agreement contains a spousal support waiver. *Id.* §1612(c).

16 Unif. Premarital and Marital Agreement Act (2012).

17 *Id.* The UPMAA specifically does not apply to marital settlement agreements or any other marital agreements that govern parties' marital rights or obligations where a proceeding for dissolution of marriage or legal separation is pending or anticipated. *Id.* §3(c). One of the primary purposes of the UPMAA was to provide consistency with regard to the validity and enforceability of premarital and postmarital agreements. *Id.* Prefatory Note.

18 *Id.* §9.

19 *Id.* §9(b).

20 *Id.* §9(c).

21 See N.D. Cent. Code §14-03.2 et seq. and Colo. Rev. Stat. §14-2-301 et seq.

22 The following states currently allow asset protection trusts: Alaska, Delaware, Hawaii, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia and Wyoming.

23 12 Del. Code Ann. §3573(1) (2014).

24 12 Del. Code Ann. §3570(8), (11) (2017).

25 Ohio Rev. Code Ann. §3103.06 (1953).

26 Minn. Stat. §519.11 (2005). This rebuttable presumption can be overcome if the spouse seeking to enforce the postmarital agreement can establish that the agreement is fair and equitable. *Id.*

27 See *Tabassum v. Younis,* 881 N.E.2d 396 (Ill. App. 2006) (where forbearance of filing for dissolution of marriage was sufficient consideration supporting the postmarital agreement when the parties were having marital difficulties), *Bratton v. Bratton,* 136 S.W.3d 595 (Tenn. 2004) (where a promise to remain in the marriage was not adequate consideration for a postmarital agreement where the parties were not having marital difficulties) and *Whitmore v. Whitmore,* 8 A.D.3d 371 (N.Y. App. 2004) (where continuation of marriage was not adequate consideration to support postmarital agreement).

28 See *Brosseau v. Brosseau,* 531 N.E.2d 158 (Ill. App. 1998) (where mutual release of property rights is sufficient consideration to support a postmarital agreement) and *Tabassum,* 881 N.E.2d 396, citing *Phillips v. Meyers,* 82 Ill. 67 (Ill. 1876); but see *Wiegand v. Wiegand*, 410 Ill. 533 (Ill. 1951) and *Litwin v. Litwin*, 375 Ill. 90 (Ill. 1940) (where the court found wife's promise to dismiss pending divorce actions was not consideration for husband's promise to transfer property).

29 I.R.C. §2523(a).