# I DO, ROUND TWO:
# SECOND MARRIAGE ESTATE PLANNING

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Families don't remain stagnant—they change and grow, and estate planners must be prepared to help with the growing pains. Divorce and second (or third or fourth...) marriages are an inevitable aspect of preparing an estate plan. It's estimated that more than half of Americans either have been or will be included in a blended family in their lifetime.

Approximately 75% of people who divorce choose to marry again. As a result, almost half of all marriages today are at least the second marriage for at least one spouse. And, approximately 65% of remarriages involve children from a prior marriage.

With multiple marriages comes the opportunity for stepsiblings to have different economic circumstances and face different inheritances. These divergent situations can often cause friction within a blended family. Adding an age disparity or wealth disparity between the spouses puts fuel on the fire. In general, the greater the wealth disparity between spouses, the more potential there is for animosity between the less wealthy spouse and his or her stepchildren.

Without proper planning, children from multiple relationships may not be treated as intended and the interests of surviving spouses may be in direct conflict with those children, detrimentally affecting the family dynamic.

## Prenups, Postnups, and Prenup Alternatives

### Situation #1 – Best Practices for Prenup or Postnup Agreements

Future-husband and Future-wife both have successful careers, and each has their own income. They plan to continue to keep their bank accounts separate. Neither has any desire for spousal support from the other in the event of divorce. So, they don't believe there is any need for a prenuptial or postnuptial agreement (a "prenup" or "postnup").

*Solution*: They couldn't be more wrong. With the grim statistic that about 60% of remarriages end in divorce, prenups for second marriages are even more important than for first marriages.

Individuals entering into second marriages (or third or...) have often had several years to establish a career and accumulate personal assets and thus have more to lose financially in the event of divorce.

And, a prenup serves to clearly identify the separate property assets each party brings into the marriage, which can be especially critical if either spouse comes into the marriage with children.

The prenup can help reduce the risk of later disputes between those children and a surviving spouse.

> All assets benefitting a Texas married person fall into one of two categories: marital property and non-marital property.
>
> Within the category of marital property, there are two sub-categories: community property and separate property.
>
> - Separate property consists of assets owned before marriage or acquired during marriage by inheritance or gift.
> - All of a spouse's other assets, including income received from separate property, are community property. There is a presumption that all assets are community property, barring clear and convincing evidence that an asset is separate property.
>
> When separate and community properties are commingled, the commingling generally results in the assets becoming community.
>
> When a family court divides community property, it doesn't necessarily divide it 50/50. The court can make a "just and right" division and award more than one-half to a spouse, taking into consideration equitable factors. One of the factors that a court can weigh is whether one of the spouses has more separate property than the other.
>
> Even though separate property cannot be awarded to the other spouse, it is still on the table for consideration and can impact the way a court divides the community property. On the other hand, non-marital property is not on the table for consideration in a divorce settlement.
>
> Assets owned by a carefully drafted irrevocable trust are non-marital property. Furthermore, assets owned inside an entity, including income earned but undistributed, aren't divisible upon divorce. Although a spouse's outside ownership interest in the entity is marital property, assets inside the entity are not.

Our Future-husband and Future-wife can enter into a prenup to declare that income earned on separate property will be separate. They can also agree that wages earned by a spouse are that spouse's separate property. In effect, they can create a "community-free" marriage.

When entering into a prenup, certain practices should be followed for the agreement to have a greater likelihood of enforceability.

- Start the prenup process early, long before the wedding day, and complete the process well in advance of the wedding.
- Each party is well-advised by his or her own attorney.
- Let the lawyers do as much of the talking directly with each other as possible.
- Provide a full disclosure of each party's finances and comprehensive plan for handling finances going forward, including the following:
    - Identify assets each brings into the marriage.
    - How income from each party's separate property will be characterized.
    - How wages, salary, or other compensation will be characterized.
    - The disposition of retirement plans, especially those that are separate property prior to marriage but which may be funded with community property wages during marriage.

    - The treatment of debts—those existing prior to marriage and any incurred during the marriage.
    - The filing of income tax returns.
    - The division of assets upon death or divorce and the issue of spousal support upon divorce.
- A comprehensive and forward-thinking agreement could also assign certain financial responsibilities like housing costs or schooling expenditures or even address non-financial matters that are important to the relationship such as childrearing, the religious upbringing of future children, and even the division of household and other tasks.

## Situation #2 – Prenup Alternatives

Future-husband has substantial separate property assets but would rather not start down the road of discussing a prenup.

*Solution A*: Much of the goal of protecting family assets can be achieved outside of a prenup agreement through a "prenup alternative," such as a carefully drafted irrevocable trust. Assets owned by an irrevocable trust prior to marriage are non-marital property.

Single adults who have already accumulated assets in their own name can transfer assets to certain "self-settled" non-Texas trusts or can sell assets to a 678 Trust. When assets are transferred to a self-settled non-Texas trust or sold to a 678 Trust before marriage, the assets in the trust will continue to be non-marital property, even as they grow. If the assets were sold for a promissory note, the note will be separate property. However, the note will be frozen in value and is the type of asset not susceptible to being commingled.

For those wishing to take an extra measure of precaution, there are additional steps estate planners can take in drafting irrevocable trusts. First, consider avoiding the use of ascertainable standards and instead provide for a trust protector (or special trustee) to have authority to amend the trust and direct or veto distributions. Second, give a special power of appointment ("SPOA")—or the power to create an SPOA—to a third party who can move assets to another trust with similar (but more appealing) provisions. Finally, in some cases, it may be prudent to include a forfeiture provision that requires a beneficiary's interest to terminate in the event such beneficiary is named as a defendant in a lawsuit or is a party to a divorce proceeding.

It's important to note that a trust should be created and funded as far in advance of the wedding date as possible.

Irrevocable trusts are far less likely than prenups to be subjected to legal challenge. Legal precedent tends to favor respecting the integrity of the trust.

Furthermore, the future spouse plays no role with the trust and needn't sign anything with respect to the trust.

*Solution B*: Another prenup alternative is to contribute assets to an entity, such as a limited liability company or limited partnership, before marriage. In Texas, the growth of assets owned in a partnership, as well as income earned on such assets but undistributed, aren't divisible upon divorce. Contrast this with income earned on separate property that was not contributed to an

entity. Income earned on a Texas spouse's separate property is community, whereas income accumulated in the entity is non-marital property.

### Situation #3 – What Prenup Alternatives Can't Do

Future-husband has read about prenup alternatives and thinks everything can be accomplished without a prenup. He resists his attorney's advice to enter into a prenup.

*Solution*: There are certain protections that still require a prenup, but perhaps it could be a scaled-back prenup.

Those entering into second marriages may need to address obligations to former spouses. A child from a prior relationship requires special planning to diminish the risk of later friction between the child and stepparent.

If a spouse is in a high-liability-risk profession, a prenup can provide an added layer of protection for the other spouse's property.

A prenup can also specify how assets will be divided when a marriage ends, whether by divorce or by a spouse's death, which cannot fully be achieved with only a prenup alternative.

In addition, if assets were transferred before marriage to an entity, distributions from the entity are generally treated as community property. A prenup can override that treatment and characterize those distributions as separate property.

If the primary goal is to only protect certain family legacy assets, sufficient protection can often be achieved by prenup alternatives. However, many couples do both a prenup and a prenup alternative (sort of a belt and suspenders approach).

## Planning to Avoid Painful Situations Common with Blended Families

### Situation #4 – Waiting on Stepparent to Die Before Receiving Inheritance

Husband's estate plan provides for the creation of a trust to benefit Wife for her life with the remainder beneficiaries being his children from a prior marriage.

After Husband's death, his children from the prior marriage have to wait for their stepmother to die in order to receive their inheritance.

This is particularly problematic if the surviving spouse is significantly younger than the predeceasing spouse. This waiting period may stretch into decades.

*Solution A:* Consider "carving out" a portion of Husband's estate for Wife sufficient to ensure she will be able to maintain her lifestyle (or appropriately supplement a lifestyle afforded by her own estate). If this amount goes to a QTIP trust for Wife, the advantage is that the undistributed portion remaining at Wife's death passes to Husband's children. The disadvantage is that Husband's

children may be looking over Wife's shoulder scrutinizing what she spends from the QTIP trust. Consider instead an outright bequest to Wife.

When Husband dies, there will have to be a determination of what is Husband's Separate Property, what is Wife's Separate Property, and what is their Community Property. The only assets passing from Husband are his Separate Property and his half of their Community Property as the rest is already owned by Wife. Unless Husband's entire estate passes to Wife, there could be challenges to the characterization of assets, leading to a burdensome tracing of assets. It is critical to provide clarity on asset characterization in either a marital property agreement and/or thorough, careful record keeping.

*Solution B*: Utilize life insurance to provide an inheritance for Husband's children from his prior marriage. If life insurance is used for the children's entire inheritance, Husband's entire estate can pass to Wife outright. If instead Husband's estate passes in trust for Wife with the remainder to Husband's children at Wife's death, the life insurance provides some upfront inheritance so the children don't have to wait until their stepmother dies to receive something.

## Situation #5 – My Stepmother is Draining My Inheritance

Husband has children from a prior marriage.

At Husband's death, his estate plan provides for the creation of a traditional bypass trust to benefit Wife for her lifetime and his children from a prior marriage as remainder beneficiaries. Wife is entitled to discretionary distributions of income and principal from the bypass trust under a Health, Education, Maintenance, and Support ("HEMS") standard.

Husband's children from his prior marriage, as remainder beneficiaries, constantly challenge Wife's entitlement to distributions from the bypass trust. They want the highest amount possible of trust assets to be remaining in the trust when Wife dies.

*Solution A*: Carve out a portion of the estate for Wife and a separate portion (and/or life insurance) for the children from the first marriage, as discussed above.

*Solution B*: Utilize an independent trustee for the bypass trust rather than the surviving spouse. Also consider giving the independent trustee the ability to make distributions in addition to those under a HEMS standard in order to avoid having to demonstrate a "need" each time a distribution is made. As a result, Wife will still be entitled to distributions under a HEMS standard, but the independent trustee will not have to justify "close call" distributions since it will have broad discretion to make distributions for any reason.

*Solution C:* Rather than using a discretionary distribution standard for distributions of income, consider making annual income distributions mandatory. Principal distributions will still be discretionary. Having an independent trustee make investment decisions would insulate Wife from attacks that she is weighting investments to income-producing assets in order to pump up the amount of income.

## Situation #6 – My Spouse Would Never Cut Out My Kids (Or Would She?)

Husband and Wife both have children from prior marriages. They want their estates to benefit the surviving spouse for the spouse's lifetime and then all of their children.

Husband's and Wife's estate plans are the same. At the first death, assets pass to a trust for the survivor. The trust gives the survivor a global special power of appointment among anyone other than the survivor or creditors. At the second death, the second-to-die's estate will pass to all of their children, divided equally.

Husband dies first. Wife changes the estate plan to leave her estate to just her biological children and exercises the power of appointment over the trust to cut out Husband's children.

*Solution A*: Either remove the special power of appointment from the trust or restrict it so it can only be exercised in a way that keeps an equal inheritance passing to all the children. Although Wife can still cut out Husband's children from her estate, assets remaining in the trust at Wife's death will benefit all the children.

*Solution B*: Husband and Wife could establish an Irrevocable Life Insurance Trust ("ILIT") for the benefit of all of their children and provide for the ILIT to purchase a joint and survivor policy. The children could be given Crummey withdrawal rights exercisable over Husband's and Wife's contributions to the ILIT (to facilitate premium payments) to minimize the use of Husband's and Wife's gift tax exemptions on contributions. The insurance proceeds payable at the surviving spouse's death would be divided equally among separate dynasty trusts for the children.

To the extent Husband and Wife allocate their GST tax exemption amounts to their contributions to the ILIT, a child's dynasty trust created thereunder (and subsequent trusts created for the next generations) would be forever exempt from transfer taxes.

The ILIT locks in an inheritance that benefits all the children equally, even if the surviving spouse disrupts the passage of the rest of the estate.

## Situation #7 – Concern Child May Challenge My Capacity

Husband is considerably older than Wife. They do not have any children together. Husband has a child from a prior marriage.

Husband's estate plan leaves most of his estate to Wife and a small portion to his child.

Husband believes that the child will be unhappy with the distribution of Husband's estate and file suit, alleging that Husband did not have capacity at the time the estate plan was created.

*Solution*: Around the time that Husband signs his estate planning documents, Husband gives the child a significant gift. If the child accepts the gift and doesn't bring up capacity, the child must believe Husband has the capacity to make decisions at that time.

## Situation #8 – Naming Child as Trustee for Stepsiblings

Husband and Wife both have children from prior marriages. They die and leave their estate to trusts for the children, naming one of the children as trustee.

A stepsibling beneficiary is unhappy with the distribution decisions the stepsibling-trustee is making.

*Solution:* Stepsiblings may have no emotional relationship and readily bring suit against a stepsibling trustee. Estate planners should urge caution to avoid having one stepsibling act as a trustee for another. This puts the fiduciary in a difficult position. (Our firm is currently handling three litigation cases involving an unhappy beneficiary challenging the stepsibling-trustee, alleging the trustee is acting in their own best interest to the detriment of the unhappy beneficiary.)

Instead of one of the children serving as the successor trustee, name a corporate trustee or other third-party independent trustee.

## Situation #9 – The "Get Along Shirt" Doesn't Work


Husband and Wife both have children from prior marriages. The two sets of children often do not get along with each other.

In an effort to "force" them to get along, Husband and Wife name the oldest child from each group as co-executors of both Husband's and Wife's estates.

*Solution*: Appointing stepsiblings who do not get along as co-executors of an estate is a recipe for disaster. Rather than uniting the stepsiblings, it more commonly serves as a source of additional strife.

Instead, engage in activities with all the children during life to foster and grow a family bond between children groups. And, name an independent third party as executor!

## Situation #10 – Choose: IRA Stretch-Out or Control of Final Disposition of Assets

Husband and Wife both have children from prior relationships. They have no children together. Husband wants his retirement account to benefit Wife and then, at Wife's death, pass to his children from his prior relationship.

Naming Wife as the beneficiary of the retirement plan allows Wife to do an IRA spousal rollover and take distributions over Wife's lifetime.

But, Wife will also be able to designate a beneficiary for the account and thus could choose for the account to ultimately pass to beneficiaries other than to Husband's children from his prior marriage.

*Solution:* Name a QTIP trust as the beneficiary of the retirement plan.

The QTIP trust would benefit Wife for her lifetime and could then benefit Husband's children from his first marriage.

The trade-off of naming the QTIP as beneficiary is that the entire IRA will have to be paid out within 10 years of Husband's death, rather than over Wife's life expectancy.

Husband has to decide which is more important to him:

(i) Getting the stretch-out of more than 10 years; or
(ii) Being able to definitively control who the remainder beneficiaries are.

> Remember that the SECURE Act (Setting Every Community Up for Retirement Enhancement Act of 2019) changed the manner of distributions following the plan participant's death.
>
> For most beneficiaries, the life expectancy payout has been replaced by a 10-year payout rule, and there is no requirement of periodical distributions—just that the account balance is distributed at the end of ten years.
>
> For "eligible designated beneficiaries," the payout can be "stretched out" over a life expectancy period. "Eligible designated beneficiaries" are:
>
> - the surviving spouse;
> - disabled or chronically ill individuals;
> - individuals who are not more than 10 years younger than the participant; and
> - a minor child of the participant. (When the minor child reaches the age of majority, their eligible designated beneficiary status ceases and the 10-year period begins).

## Situation #11 – Equal or Equitable

Husband has adult children from his first marriage and young children from his second marriage. He wants the inheritances his children will receive at Wife's death to be "equitable," which is different from equal.

Providing for all of his children to share equally in his estate may not be "fair" if the adult children from his first marriage have already received significant financial support from him. For example, if Husband has already paid for his older children to attend college or set aside money in a 529 Plan, it may make sense for his younger children from the second marriage to receive a larger share of his estate.

*Solution A:* Husband provides for his children from his second marriage to receive larger shares of his estate to account for college expenses or other financial support previously given to the children from his prior marriage.

Note that it is advisable for Husband to include language explaining the reasons for the disparity in the treatment between the sets of children.

*Solution B:* Husband provide for "equalization" gifts to the younger children now, such as creating 529 Plans for each of them, so that Husband's estate can be divided equally among all the children.

*Solution C:* Husband leaves part of his estate to a "pot trust" to be used to educate his younger children, and when the youngest child reaches a set age when education should be complete (perhaps age 25?), the balance of the pot trust is distributed equally to all the children.

## Situation #12 – Portability DSUE Planning for Second Marriage

Wife's first Husband died when the lifetime gift and estate tax exemption was $5 million. He left his entire estate outright to Wife. The executor of Husband #1's estate filed an estate tax return to elect portability, "porting" over his unused $5 million lifetime exemption (the Deceased Spouse Unused Exemption amount or "DSUE" amount) to Wife.

Wife is now remarried to Husband #2 who has already fully-used his lifetime exemption.

An important aspect of portability is that a surviving spouse can only use the DSUE amount of their "last deceased spouse."

Husband #2's health is failing. At his death, Wife stands to forfeit the $5 million DSUE amount from Husband #1.

*Solution:* While Husband #2 is still alive, Wife makes a $5 million gift to a trust for her children. The $5 million gift eats up Wife's DSUE amount from Husband #1. When Husband #2 dies, Wife can receive another DSUE amount from his estate (if Husband #2's estate has any unused exemption) without having wasted the first DSUE amount.

The Lesson: Be sure to use the DSUE amount from your first deceased spouse before killing off your second spouse.

## Situation #13 – Who Bears Cost of Making DSUE Election?

Husband and Wife both have children from prior marriages. Husband dies. His Will provides for his estate to pass to his children. His taxable estate is well under his available lifetime exemption, so no estate tax return is required to be filed.

Wife, as executor, files an estate tax return solely for the purpose of electing portability to preserve Husband's DSUE amount.

The fees and expenses associated with the tax return are expenses of Husband's estate and reduce the amount of assets passing to Husband's children. But, the portability election only benefits Wife's estate, reducing the estate tax at her later death and thereby passing more to her children.

Should Wife have to reimburse Husband's children the cost of filing the return? Equitably, arguably yes, but legally no.

*Similar:* Husband and Wife both have children from prior marriages. Husband dies. His Will provides for his estate to pass to his children. His taxable estate is well under his available lifetime exemption so no estate tax return is required to be filed.

Husband's oldest child, as executor, decides that he will not file an estate tax return to elect portability. Wife offers to pay all costs associated with the preparation of the tax return but to no avail.

Does Wife have any recourse?

*Solution A*: Husband and Wife include a provision in their Wills or Living Trust requiring the executor to file an estate tax return and elect portability upon request by the surviving spouse.

The surviving spouse could be required to reimburse the estate for any expenses of filing the estate tax return that would not otherwise have been incurred.

*Solution B*: Husband and Wife enter into an agreement that upon death, the executor is required to elect portability upon request of the surviving spouse with the requestor bearing the cost. Such a provision could be included in a prenup or postnup agreement.

The potential DSUE could be a bargaining chip for the less wealthy spouse.

## Situation #14 – Gift-Splitting Must Be 50/50

Husband has children from a prior marriage. Husband wants to create a trust to benefit his children and fund it with $10 million of his separate property assets.

However, Husband only has $2 million of lifetime exemption remaining. Wife has her full $12 million lifetime exemption available.

*Not a Solution*: Can Husband gift $10 million worth of his separate property assets to the trust and gift-split the gift such that 20% ($2 million) is from him and 80% ($8 million) is from Wife? No, split gifts are deemed to have been made one-half by each spouse.

Also, remember that if the election is made to gift-split, it's "all or nothing." All separate property gifts made by both spouses during the year are split 50/50. You cannot pick and choose what you want to gift-split and what you don't want to gift-split.

*Solution*: Husband creates the trust and funds it with $2 million of Husband's separate property, using all of his lifetime exemption.

Husband also gifts $8 million of assets to Wife.

LATER, Wife gifts the $8 million of her new separate property assets to the trust. There needs to be enough time between the gift to Wife and Wife contributing the assets to the trust that Wife has the opportunity to do what she wants with the assets. She could even file for divorce and keep her new separate property assets.

Otherwise, you will run into the situation of the recent Smaldino case (*Smaldino v. Commissioner*, T.C. Memo. 2021-127).

In the Smaldino case, the wife held the assets for just one day before contributing them to a trust for the benefit of the husband's children from a prior marriage. The Tax Court opined that the wife never had an opportunity to exercise any ownership rights with respect to the assets and as such the husband gifted the assets directly to the trust, resulting in the husband owing gift tax.

Our Husband would file a gift tax return reporting a $2 million gift. Wife would file a gift tax return reporting an $8 million gift. Neither elects to gift-split.

## Situation #15 – You Can Make the Gift, But You Cannot Use My Exemption

Husband and Wife have children together, and Husband has children from a prior marriage. Husband and Wife have substantial community property assets. Neither has much separate property assets.

Husband wants to create and fund a trust for his older children. Wife is agreeable to gifting community property assets to the trust but does not want to use any of her lifetime exemption for the gift.

*Solution:* Husband and Wife enter into a marital property agreement in which they agree to convert a portion of their community property into two separate property halves.

Husband will then have separate property to make the gift, and Wife will not have to use any of her lifetime exemption for the gift.

## Situation #16 – Homestead Occupancy Rights

Husband and Wife both have children from prior marriages, and they have a child together.

Their residence is Husband's separate property. In Husband's Will, he leaves the house to his older children and leaves other, substantial assets to Wife and the shared child.

Husband plans for his older children to sell the house and split the proceeds as their inheritance.

Husband dies. Wife decides to remain in the house until the youngest child is grown and out of school. Husband's older children cannot sell the residence as long as Wife asserts her homestead occupancy rights.

Husband's older children receive nothing at their father's death and must wait years until the house is sold and they receive the proceeds. Wife receives the substantial other assets left to her.

*Solution A*: They enter into a marital property agreement whereby Wife waives her homestead right. In the agreement, Husband could commit to leaving Wife sufficient funds to find a replacement residence.

This situation is especially notable when there is a large age disparity between spouses. If Wife is not much older than Husband's older children, it may be decades before Wife dies.

*Solution B*: Instead of the residence passing to Husband's older children and other assets passing to Wife, swap them. Plan for Wife to inherit the residence, should she survive Husband, and Husband's children to inherit the other assets.

## Situation #17 – Is the House Paid For?

Add to the previous situation that the house has a mortgage on it. Wife asserts her homestead occupancy rights and stays in the house until she dies.

Husband's older children are responsible for paying the mortgage principal payments and the insurance premiums for the house. Wife is responsible for paying mortgage interest, property taxes, and other maintenance expenses typically imposed on the owner of a legal life estate.

Husband's older children do not have the funds to pay the mortgage or the insurance.

*Solution*: If Husband wants to provide for the residence to pass to his children at Wife's death, leave the residence to a trust.

The trust could also be funded with funds sufficient to cover any future mortgage payments, insurance, property taxes, and other associated expenses.

Husband's children will still have to wait to be able to do what they want with the house, but there won't be issues with funds for maintaining the house.

## Situation #18 – Household Contents Can Be More (Emotionally) Valuable than the House

Adding on to the previous situation, the majority of the house contents are Husband's separate property which he leaves to his older children in his Will. Homestead rights do not cover contents of the house.

Husband's older children come get the furniture and furnishings they've inherited.

Wife, the shared child, and Wife's older children who all live in the house have no furniture.

*Solution:* Household contents need to be addressed in the estate plan. Provisions need to be made for furniture for Wife if the majority of the furnishings are Husband's separate property.

And, the contents need to be addressed with sufficient specificity. Imagine that their premarital agreement provides that Husband's tallboy chest of drawers, framed mirror, and antique chair from his grandfather will remain his separate property but does not provide any further description or photos of the items. Now you have Wife and Husband's children arguing over whether a particular framed mirror was Husband's grandfather's or was purchased by Husband and Wife.

To prevent wars over contents and personal effects, Husband and Wife need to clarify in an agreement which assets are Husband's separate, which assets are Wife's separate, and which are community.

## Bonus: Impact on a Family Legacy Plan

When blended families combine their collective values, experiences, and finances, there is a significant risk that family harmony and the family legacy could be disrupted.

Estate planners should be vigilant in looking out for issues that have the potential to threaten the human capital of the family. Human capital is one of the five key components of a family's wealth (along with intellectual, social, spiritual, and financial capital). Human capital consists of the individuals who make up a family, celebrating each one's personal identity, self-worth, and well-being.

While many feel comfortable guiding clients through the prenup process, too few estate planners take the next step to help guide clients on how to effectively incorporate new family members into the family. Marriage adds a new member to the family, so it instantly impacts the make-up of a family's human capital.

An estate planner has the ultimate goal of maintaining the wealth of a family for generations to come, and accordingly, planners should take an active role in helping clients establish policies that foster good relationships and promote family development and success.

Because entering a new family can be overwhelming, estate planners should coach families to "immediately acculturate new family members, helping them to feel like valued members of the team." Acculturation can be accomplished through two big steps: (1) Sharing information, and (2) Getting involved in the family.

Sharing information is a significant part of making the new family member feel included. Often, a new spouse finds themselves in a predicament in which they appear disinterested if they fail to ask enough questions but appear nosey if they ask too many questions. Granting them a backstage pass to the inner workings of the family will ease anxiety and make them feel like less of an outsider.

There are consultants who can help a family navigate these new relationships. Having an experienced, objective third party serve as the facilitator at a family meeting can moderate the conversation, guide the process, and restore calm when feelings are hurt or tempers flare.

A successful transfer of wealth from generation to generation is a lofty and admirable goal, but within the estate planning world, there should be more emphasis placed on preservation of the family. Estate planners must seize opportunities presented by second marriages to address the human capital factor and pay a little more attention to the "family" in "family wealth."

## Final Point: CAVEAT Regarding Conflicts of Interest in Representing Both Spouses

Be on guard for potential conflicts of interest. If it appears there could be irreconcilable differences or difficulty achieving a plan that's compatible with both spouses' best interests, don't represent both. If both spouses' consent, choose one and let the other have separate, independent counsel. If the situation appears compatible, have both spouses sign a mutual representation letter and waive any conflicts of interest. Of course, if things go bad, withdraw from representing either spouse.

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- 75% of people who divorce marry again
- In 50% of marriages, at least one spouse has been married before
- 65% of remarriages involve children from prior marriage

# Prenups, Postnups, and Prenup Alternatives

# Situation #1 – Best Practices for Prenup or Postnup Agreements

- Successful careers with own incomes
- Separate bank accounts
- No spousal support if divorce

Solution:

- Prenup!
- "Community-free" marriage

- Start early
- Each party has own attorney
- Let lawyers do the talking
- Disclose assets
- Income from separate property
- Compensation

- Retirement plans
- Debts
- Income tax returns
- Division of assets upon death or divorce
- Spousal support upon divorce

# Situation #2 – Prenup Alternatives

- Future-husband has substantial assets
- Would rather not discuss a prenup

Solution A:

- Irrevocable trust can create non-marital property
- Self-settled non-Texas trust
- Sell assets to 678 trust

Solution B:

- Entity planning
- Limited partnership or LLC
- Assets in the entity (as well as undistributed income) are non-marital property

# Situation #3 – What Prenup Alternatives Can't Do

- Future-husband believes he can accomplish everything without a prenup

Solution:

- Prenup (perhaps scaled-back)
- Obligations to former spouse?
- Child from prior relationship?
- High-liability-risk profession?
- Division of assets if divorce
- Character of distributions from an entity

# Planning to Avoid Painful Situations Common with Blended Families

# Situation #4 – Waiting on Stepparent to Die Before Receiving Inheritance

- Husband has children from prior marriage
- Husband's estate plan: trust benefits Wife for life, then Husband's children

Solution A:

- Separate portion for Wife from portion for Husband's children

Solution B:

- Life insurance for Husband's children

# Situation #5 – My Stepmother is Draining My Inheritance

- Husband dies, leaving children from prior marriage
- Husband's estate plan: bypass trust benefits Wife for life, then Husband's children
- Husband's children constantly challenge Wife's entitlement to HEMS distributions

Solution A:

- Separate portions or life insurance

Solution B:

- Independent trustee
- Distributions outside of HEMS?

Solution C:

- Mandatory distributions

# Situation #6 – My Spouse Would Never Cut Out My Kids (Or Would She?)

- Both have children from prior marriages
- Estate plans: at first death, trust for survivor (trust gives survivor a global special power of appointment); at second death, second-to-die's estate passes to all children equally
- Following Husband's death, Wife changes plan to leave her estate to just her biological children and exercises POA to cut out Husband's children

Solution A:

- Remove POA from trust or restrict it

Solution B:

- Establish an Irrevocable Life Insurance Trust for all children; ILIT purchase joint and survivor policy
- At surviving spouse's death, insurance proceeds divided equally among separate dynasty trusts for children

# Situation #7 – Concern Child May Challenge My Capacity

- Husband considerably older than Wife; no children together; Husband has child from prior marriage
- Husband's estate plan: most to Wife and small portion to his child
- Believe child will be unhappy and challenge capacity

Solution:

- Give child gift around time estate plan signed

# Situation #8 – Naming Child as Trustee for Stepsiblings

- Both have children from prior marriages
- Estate plan: all to trusts for children with one child as trustee
- Stepsibling beneficiary unhappy with distribution decisions

Solution:

- Corporate trustee or other third-party independent trustee

# Situation #9 – The "Get Along Shirt" Doesn't Work

- Both have children from prior marriages; children do not get along with each other
- "Forcing" them to get along by naming oldest child from each set of children as co-executors of both estates

Solution:

- Foster and grow a family bond during life
- Independent third party as executor

# Situation #10 – Choose: IRA Stretch-Out or Control of Final Disposition of Assets

- Both have children from prior relationships; none together
- Husband wants his retirement account to benefit Wife and then his children
- Plans to name Wife as beneficiary, but Wife would be in control of choosing next beneficiary

Solution:

- Name QTIP trust as beneficiary

# Situation #11 – Equal or Equitable

- Husband has adult children from first marriage and young children from second marriage
- Wants inheritances to be "equitable" (different from equal)

Solution A:

- Children from second marriage receive larger shares of estate to account for financial support previously given to children from first marriage

Solution B:

- Make “equalization” gifts to younger children now

Solution C:

- Estate fund a “pot trust” to educate younger children; distribute leftover equally to children

# Situation #12 – Portability DSUE Planning for Second Marriage

- Wife's first husband died
- Wife has $5 million DSUE from first husband
- Husband #2's health failing
- A surviving spouse can only use DSUE amount of last deceased spouse

Solution:

- Wife make $5 million gift to trust for her children while Husband #2 alive

The Lesson: Be sure to use the DSUE amount from your first deceased spouse before killing off your second spouse.

# Situation #13 – Who Bears Cost of Making DSUE Election?

- Husband dies; estate passes to his children from prior marriage
- No estate tax return required
- Wife, as executor, files estate tax return to elect portability
- Should Wife have to reimburse Husband's children the cost of filing the return?

Similar:

- Both have children from prior marriages
- Husband dies; estate passes to his children from prior marriage
- No estate tax return required
- Husband's oldest child, as executor, will not file an estate tax return to elect portability (even with Wife's offer to pay costs)
- Does Wife have any recourse?

Solution A:

- Include in Wills or Living Trust: executor required to file estate tax return and elect portability upon request by surviving spouse
- Could require requestor to reimburse estate for cost

Solution B:

- Include in Prenup or Postnup Agreement

# Situation #14 – Gift-Splitting Must Be 50/50

- Husband has children from prior marriage; Husband wants to create and fund trust with $10 million of separate property assets
- Husband has $2 million of lifetime exemption remaining; Wife has $12 million lifetime exemption available

Not a Solution:

- Husband cannot gift $10 million of separate property and gift-split such that 20% ($2 million) is from him and 80% ($8 million) is from Wife

Solution A:

- Husband fund trust with $2 million separate property
- Husband gifts $8 million of assets to Wife
- LATER, Wife gifts $8 million of assets to trust
- *Smaldino v. Commissioner* (T.C. Memo. 2021-127)

# Situation #15 – You Can Make the Gift, But You Cannot Use My Exemption

- Husband has children from prior marriage; wants to create and fund trust for his older children with community property
- Wife agreeable to gifting assets but does not want to use her lifetime exemption

Solution:

- Partition community property into two separate property halves
- Husband make gift from his separate property half

# Situation #16 – Homestead Occupancy Rights

- Residence is Husband's separate property
- Husband's estate plan: leaves house to his children from prior marriage with plans they'll sell house and split proceeds as their inheritance; leaves other assets to Wife and youngest child
- Husband dies; Wife decides to remain in the house
- Husband's older children must wait years for inheritance; Wife receives assets left to her

Solution A:

- Wife waive homestead right in marital property agreement
- Could leave Wife sufficient funds to find replacement residence

Solution B:

- Plan for Wife to inherit residence, should she survive Husband, and Husband's children to inherit the other assets

# Situation #17 – Is the House Paid For?

- Same as previous situation, except has a mortgage
- Wife asserts homestead occupancy rights and stays in the house
- Husband's older children are required to pay mortgage principal payments and insurance
- Wife is responsible for paying mortgage interest, property taxes, and other maintenance expenses
- Husband's older children lack funds

Solution A:

- Residence pass to a trust
- Fund trust sufficient to cover mortgage payments, insurance, property taxes, and other associated expenses

# Situation #18 – Household Contents Can Be More (Emotionally) Valuable than the House

- Adding on to previous situation, majority of house contents are Husband's separate property
- Husband leaves furniture and furnishings to his older children
- Wife, youngest child, and Wife's older children who all live in the house have no furniture

Solution:

- Address household contents in estate plan
- Make provisions for furniture for Wife
- Address contents with sufficient specificity

# Impact on a Family Legacy Plan

- Watch for issues that have the potential to threaten the human capital of the family
- Incorporate new family members into the family
- Outside consultants

# CAVEAT Regarding Conflicts of Interest in Representing Both Spouses

- Can you advise impartially?
- Can you prepare a plan compatible with both spouses' best interests?
- If so, get written conflict waivers
- If not, each spouse needs separate counsel


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