

Estate Planning for the Modern Couple

*An Estate Planner's Guide to Advising
In anticipation of Divorce and Re-Marriage*

Presented by:

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Ethical Considerations

- Confidentiality of Information: IRPC 1.6
 - Joint Representation (Majority)
 - All communications between either husband and wife to the attorney are confidential as to the outside world but not confidential as between husband and wife
 - Separate Representation (Minority)
 - Each client is a separate client and entitled to the confidentiality of unilateral communications to the lawyer by either spouse if the communicating spouse does not wish to impart them to the other spouse

Confidentiality of Information

- **IRPC 1.6 – Confidentiality of Information (Con't)**

- When a lawyer receives communications from one spouse, the lawyer should consider the **relevance and significance** of the information and decide upon the appropriate manner in which to proceed.
- Potential courses of action:
 1. Take no action with respect to communications regarding irrelevant (or trivial) matters;
 2. Encouraging the communicating client to provide information to other client or to allow the lawyer to do so; or
 3. Withdraw from the representation if the communication reflects serious adversity between the parties
 - See IRPC 1.6 [Cmt.16]

CONFIDENTIALITY OF INFORMATION

- **Sampling of State Decisions**
 - Florida: Advisory Opinion 95-4 (May 1997)
 - Attorney may not reveal confidential information to non-communicating spouse;
 - Attorney must withdraw from representation due to the conflict
 - New Jersey: (*A v. B v. Hill Wallack*, 726 A.2d 924 (1999))
 - Attorney must disclose the existence of child born out of wedlock, but not the identity
 - Attorney had joint representation letter, waiving conflicts
 - Court held husband's lack of disclosure constituted fraud on the wife
 - See IRPC 1.6, cmt 16 - Attorney must withdraw if to continue would be to assist in a fraud

CONFLICT OF INTEREST

- **IRPC 1.7 –Conflict of Interest: Current Clients**
 - Conflict exists if
 - The representation of one client will be **directly adverse** to another client; or
 - There is a **significant risk** that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer

CONFLICT OF INTEREST

- **IRPC 1.7 –Conflict of Interest: Current Clients**
 - However, a lawyer may represent the client if:
 - The lawyer **reasonably believes** that the lawyer can provide competent and diligent representation to each affected client;
 - The representation is not prohibited by law
 - The representation does not involve the **assertion of a claim** by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
 - Each client gives informed consent in writing (following authorization from the other client to make any required disclosures)

CONFLICT OF INTEREST

- **Current representation**
 - Can a lawyer continue to represent both spouses once a confidence has been shared to the detriment of the other spouse?
- **Continuing representation**
 - May a lawyer represent either spouse (or both spouses) following the divorce?
- **Attorney-Client Relationship**
 - When the estate planning attorney has represented both spouses, the attorney-client relationship runs to both

WAIVER OF CONFLICTS

- **Waiving Conflicts**

- It may be possible to represent one of the former spouses, but only if the **other party consents in writing** to the representation and **waives**:
 - Any harm that might arise out of the use of information gained while the attorney was representing both spouses;
 - Any conflict of interest that may follow; and
 - The rule prohibiting representation adverse to a client or former client
- Attorney must **clearly warn of all possible consequences** that might follow from representing other spouse.
 - Waiver must fully disclose that the waiving party understands and knowingly waives the right.

ATRO

- **Automatic Temporary Restraining Orders (“ATRO”)**
 - When a divorce action is filed and served, it will likely include an ATRO
 - ATROs are mutual court orders that prohibit either spouse from:
 - Selling, transferring or borrowing against property;
 - Borrowing or selling insurance held for the other spouse;
 - Modifying beneficiaries on policies (health insurance, life insurance, retirement accounts, wills, etc.);
 - Changing bank accounts; or
 - Destroying or hiding assets

PRE-FILING CONSIDERATIONS

- Prior to filing for a divorce, client must consider the following:
 - Terminating joint tenancies and IRA beneficiary designations;
 - The need for a new will while divorce is pending;
 - Revocation of living trusts and retransfer of the property to the parties;
 - Designation of new fiduciaries;
 - Life insurance and estate tax

PRE-FILING CONSIDERATIONS

- **Joint Tenancies**

- Consider:

- The effect of the right of survivorship (i.e., that the entire asset passes to the other spouse on death);
- The likelihood of the death of either party prior to the conclusion of the case; and
- Whether the joint tenancies should be severed

PRE-FILING CONSIDERATIONS

- **Wills**
 - **I.C. § 15-2-508 – Revocation by Divorce**
 - While a judgment dissolving the marriage revokes an existing will as to the former spouse, separating or filing a divorce petition does not
 - During divorce, the parties remain married and have all the benefits provided to a spouse by law in the event of death
 - Additionally, all of the fiduciary appointments (i.e., Durable Powers of Attorney for Property Management and Health Care) remain in place

PRE-FILING CONSIDERATIONS

- **Living Trusts**
 - Trust should be revoked and title transferred back into the name of the spouses
 - Generally, revocation must be:
 - In writing,
 - Signed by the settlor,
 - Acknowledged by a notary public, and
 - Delivered to the trustee

PRE-FILING CONSIDERATIONS

- **Fiduciary Roles**

- Durable Power of Attorney for Property Management (“DPA PM”)
 - In the context of divorce, should the client become incapacitated or disabled, the DPA PM would allow the agent to continue representing the client in the context of the dissolution and to direct the transfer of property divided in the divorce
- Durable Power of Attorney for Health Care (“DPA HC”)
 - In the absence of a DPA HC, the estranged spouse would have the right to make medical decisions for the client and have access to medical records
 - This document could also control who is named the client’s guardian in the event of incapacity
- Guardian for Minor Children
- Trustee of Trusts for Minor Children

PRE-FILING CONSIDERATIONS

- **Community Property Agreements**
 - How can the client revoke?
 - By filing divorce?
 - By obtaining divorce decree?
 - Unilateral rescission?

PRE-FILING CONSIDERATIONS

- **Retirement Account Death Benefits**
 - ERISA Plans
 - Governed by Federal Law
 - Can be changed by:
 - Termination of marriage and award of plan; or
 - Qualified Domestic Relations Order (“QDRO”) has been entered by court and approved by plan administrator
 - Non-ERISA Plans
 - Can revoke designation (would pass to Estate)
 - Adverse income tax consequences
 - May not change designation
 - Could violate ATRO

PRE-FILING CONSIDERATIONS

- **Life Insurance and Estate Tax**

- Problem: A divorce settlement may require one party to maintain insurance for the benefit of the other party or the children.
 - Adverse consequences:
 - The former spouse or children will receive the policy proceeds
 - The decedent's executor must include the policy proceeds in the decedent's taxable estate on the estate tax return;
 - The decedent's estate must pay the tax, at rates up to 40%; and
 - The executor must try to collect a pro rata share of the estate tax from the recipient of the proceeds
 - Solutions: Spouse may want to irrevocably assign all incidents of ownership in the policy to the former spouse or transfer the policy into an Irrevocable Life Insurance Trust

PRE-FILING CONSIDERATIONS

- **Medical Insurance**

- If former spouse participates in an employee group health plan that is subject to COBRA, the plan has obligations to make COBRA health care continuation coverage available to non-worker spouse, as a qualified beneficiary, if there is a divorce.
 - Continued coverage is for 36 months.
 - Non-worker spouse required to pay for the same (even if spouse discontinued coverage while the divorce was pending)

TAX IMPLICATIONS OF DIVORCE

- **Income Tax**

- Alimony Support Provisions: Deductible to Payor and Includible to Payee if “qualified”.
 - Required under Agreement
 - Cash only (not goods and services)
 - Required to end at death of recipient spouse (not tied to child issues)
 - Living in separate households.
- Can elect to treat qualifying payments as not qualifying (but not the other way around).
- Child Support Provisions: Not deductible

TAX IMPLICATIONS OF DIVORCE

- **Income Tax**

- Dependency Exemptions. Parties can agree, but exemption generally goes to the spouse who has legal custody. For planning purposes, want it to go to the parent with the greater tax benefit.
- Property Settlement. No basis adjustment (thus, no immediate tax benefit).
- Residence. Want to make sure that proper language is inserted to protect the exclusion for the spouse who moves out.

TAX IMPLICATIONS OF DIVORCE

- **Income Tax**

- Individual Retirement Account ("IRA").

- Care must be taken to avoid unfavorable tax consequences re splitting an IRA.
 - Problem: If an IRA owner were to cash out his IRA and then pay his ex-spouse her share as stipulated in a divorce decree, the transaction could be treated as a taxable distribution (possibly triggering penalties), for which the IRA owner would be solely responsible.
 - Solution: money can be transferred tax-free from one spouse's IRA to the other spouse's IRA in a trustee-to-trustee transfer, as long as it is required by a divorce decree or separation agreement.
 - Must not take place before the divorce is final, or it may be taxable distributions

TAX IMPLICATIONS OF DIVORCE

- **Gift Tax**

- **I.R.C. Section 2516** – no gift tax treatment where there is a property settlement agreement and the divorce occurs within a 3 year period beginning on the date one year before the agreement is entered.
 - No need for agreement to be approved by judicial decree
- **I.R.C. Section 1041** –transfers between spouses incident to divorce are not a taxable event.

DOMA

- **DOMA**

- The U.S. Supreme Court struck down section 3 of the federal Defense of Marriage Act (DOMA) in the *Windsor* case. 111 AFTR2d 2013-2385 (S.Ct. 2013).
- This decision eliminates the federal definition of marriage as limited to one man and one woman, and excluding same-sex couples who are legally married under applicable state law. The Court's opinion requires that federal law treat persons who are legally married under applicable state law as being legally married for purposes of federal law.
- *Windsor* is important with respect to the taxation of same-sex married couples.

DOMA

- **Washington's Definition of Marriage**
 - In 2012, same sex marriage became legal in the state of Washington;
 - From 2007-2012, Washington allowed for Registered Domestic Partners(RCW ch. 26.60) for same-sex couples

UNIQUE ISSUES FOR ESTATE PLANNING FOLLOWING WINDSOR

- Providing for children
 - Are both parents legal parents of child?
 - Power of Attorney provision
 - Guardian of Minor provision
- Joint Accounts (Community Property Issues)

PREPARING FOR THE SECOND (OR HIGHER) MARRIAGE

- MARITAL AGREEMENTS
 - Prenuptial Agreements
 - Agreement prior to marriage regarding character and status of property
 - PostNuptial Agreements
 - Agreement after marriage regarding status of property
 - Community Property Agreements
 - Agreement as to character of property and how it passes at death
- CO HABITATION AGREEMENTS
 - Agreement without marriage regarding the character and status of property

PREPARING FOR THE SECOND (OR HIGHER) MARRIAGE

- Prenuptial Agreements –
 - Contracts between people who intend to marry and for which the mutual promises and the marriage itself are consideration
 - Favored in Washington
 - Tests for Validity
 - Substantive Fairness; or
 - Procedure Fairness
 - Burden of Proof on the person attempting to prove the agreement

PREPARING FOR THE SECOND (OR HIGHER) MARRIAGE

- Substantive Fairness
 - Is the Agreement fair and reasonable to the person not seeking enforcement
 - If the Agreement is deemed to be substantively fair, the inquiry stops;
 - If the Agreement is deemed to be substantively unfair, the Agreement may still stand if it is deemed to be procedurally fair

PREPARING FOR THE SECOND (OR HIGHER) MARRIAGE

- Procedural Fairness
 - Did the spouses make a full disclosure of the amount, character and value of the property involved;
 - Was the agreement freely entered into on independent advice from counsel with full knowledge by both spouses of their rights

QUESTIONS???

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