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Protecting Separate Property During **Marriage** and **Divorce**

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It is common knowledge that one in every two marriages ends in divorce, and it follows that it is becoming equally common for those with assets contemplating marriage to consider viable options available to protect assets in the event marital bliss turns sour and ends in divorce.

While discussing a prenuptial agreement in the same breath as choosing a centerpiece arrangement for the wedding reception may be awkward, prenuptial agreements serve to prevent undesirable divisions of property in divorce and death. With respect to the latter, they also play an important role in estate planning. But they are not the only tools used in such planning. Trusts, which can be drafted with myriad terms and conditions tailored to suit a variety of situations, should be considered as a valuable supplement to the prenuptial agreement.

Prenuptial Agreement Basics

Public policy favors individuals deciding conflicts on their own; prenuptial agreements are valid contracts that, when properly drafted, withstand challenges when a marriage fails. In New York, strong public policy sup-

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ports the idea that individuals decide their own interests through contractual arrangements, including prenuptial agreements. See *In re Fizzinoglia*, 118 A.D.3d 994, 988 N.Y.S.2d 648, 649 (2d Dep't 2014). Parties are given wide latitude with respect to the content of prenuptial agreements. The agreement may include provisions dictating asset distribution in the event of death or divorce, the burden of satisfying debts, and waiver of statutory marital rights during life and death.

There are multiple factors to consider in preparing an enforceable prenuptial agreement. See *Matter of Buzen*, N.Y.L.J., April 2, 1999 (Sur. Ct. Nas. Co.). It is critical, for example, that the agreement contain full, current and complete disclosure of assets and debts. Where disclosure is deemed inadequate, a court may be less inclined to enforce the agreement and more inclined to scrutinize the facts surrounding execution of the agreement. In the absence of a showing of an attempt to conceal or misrepresent the nature or extent of assets, however, a mere failure to disclose financial matters, by itself, may not be sufficient to undermine a prenuptial agreement. *Cohen v. Cohen*, 93 A.D.3d 506, 507, 940 N.Y.S.2d 250, 251 (1st Dep't 2012); *Strong v. Dubin*, 48 A.D.3d 232, 233, 851 N.Y.S.2d 428, 430 (1st Dep't 2008).

The court also considers whether the parties were represented by their own attorneys to ensure that they understood the agreement. The mere absence of legal representation, without more, however, does not necessarily establish overreaching or require an automatic nullification of the agreement. See *In re Barabash*, 84 A.D.3d 1363, 1364, 924 N.Y.S.2d 544, 545 (2d Dep't 2011); *Forsberg v. Forsberg*, 219 A.D.2d 615, 616, 631 N.Y.S.2d 709, 710 (2d Dep't 1995). Even where a party is represented by counsel, the agreement may still be invalidated by the court where there is sufficient proof of duress. See *Chait v. Chait*, 256 A.D.2d 121, 681 N.Y.S.2d 269 (1st Dep't 1998) (finding of duress despite husband's representation by attorney supported by evidence that wife repeatedly threatened to take parties' child).

The timing of the execution of the agreement in relation to the marriage ceremony is another compelling consideration in evaluating whether a prenuptial agreement will be enforced. There is a correlation between enforceability and the length of time of presentation and execution, with a shorter time leading to charges of duress. See *Barocas v. Barocas*, 94 A.D.3d 551, 942 N.Y.S.2d 491 (1st Dep't 2012) (wife threat of no wedding on eve of wedding insufficient to demonstrate duress rendering agreement unconscionable); Cf. *E.C.-P. v. P.P.*, 2011 WL 6155727 (Sup. Ct. Nas. Co. 2011) (husband's presentation of the agreement shortly before the wedding date found to be calculated and agreement fraudulently induced).

In New York, strong public policy supports the idea that **individuals decide their own interests through contractual arrangements**, including prenuptial agreements.

Courts also scrutinize the agreement's fairness. New York's courts will invalidate prenuptial agreements deemed products of fraud, duress or inequitable conduct. See *Cioffi-Petrakis v. Petrakis*, 103 A.D.3d 766, 960 N.Y.S.2d 152 (2d Dep't 2013). Absent proof of fraud, duress, overreaching, or unconscionability, however, if the prenuptial agreement is fair on its face, it should be enforced according to its terms. See *Herr v. Herr*, 97 A.D.3d 961, 962, 949 N.Y.S.2d 786, 788 (3d Dep't 2012).

For all of these reasons, prenuptial agreements must be written with care and deliberation and with due regard to the factors cited above to achieve an enforceable agreement. Given that there may be scrutiny at the time of the marriage's and alternatives that exist to safeguard assets prior to entering into marriage should be examined.

Estate Planning Considerations

Under New York law, a surviving spouse who died after Sept. 1, 1992 has a right to the greater of $50,000 or one-third of the net estate. See EPTL 5-1.1-A(a)(2); *Matter of Richardson*, N.Y.L.J., July 3, 2008, at 40, col. 4, 2008 N.Y. Misc. (Sur. Ct. Richmond County). The net estate for purposes of the elective share consists of the decedent's probate assets (property passing under Will) and "testamentary substitutes," less certain deductions. Testamentary substitutes include certain gifts and trusts, accounts in the decedent's name and payable on death to another, jointly owned property, retirement plans, and transfers in which the decedent retained certain rights. The elective share cannot be satisfied with a Trust for the surviving spouse. The elective share cannot be satisfied with a Trust for the surviving spouse. In addition to an elective share right, a surviving spouse is entitled to certain property and one-half of the estate and to serve as the decedent's administrator in the event of intestacy.

An express written and informed document (e.g., one contained in a prenuptial agreement) is required for a waiver of an elective share, rights in intestacy, and a right to serve as fiduciary. Additionally, a prenuptial agreement should address the issue of the necessary documentation the parties agree to execute to change the beneficiary designations on retirement accounts in the event of divorce or waive spousal rights to retirement plan accounts to enable the account holder to name other beneficiaries.

While typically one thinks of young couples with assets as entering into prenuptial agreements, those entering second marriages also achieve important goals with prenuptial agreements. Although the driving force behind a prenuptial agreement in a second marriage is often the disparate resources between the parties, one should not sell short the value of such agreements where the soon-to-be spouses have children from a prior relationship and wish to ensure that those children inherit certain assets upon the death of their respective parent.

Keep Assets in the Family

Increasingly, parents ask their estate planners about how to protect gifts and inheritances given to a child from a spouse about whom they may have

concerns or in the event the child's marriage ends. Grandparents also want to see family assets pass to their grandchildren after their child dies, not the second spouse of the child's widow or widower. The child can enter into a prenuptial agreement to address gifts and inheritance, but it is sometimes easier and less controversial for the parent to give a child a gift or inheritance in trust instead. A prenuptial agreement should still be used to protect a child's outright gift or inheritance from being placed by the child in joint name with his or her spouse. This has the negative effect of making gifted or inherited property, which would have otherwise been separate and not part of marital assets, into a marital asset subject to equitable distribution on divorce. Premarital planning tactics vary depending on whether the assets in question were generated by the spouse or their family. Assets from the family, by way of gifts or inheritance, may be best given or inherited in trust, rather than outright, as income generated by separate property and appreciation in value of the separate property may be considered a marital asset.

Trusts can be drafted in a variety of ways with provisions for distributions and a child's role ranging from liberal to circumscribed. To ensure maximum asset protection, an independent trustee should serve and only that trustee should be authorized to make distributions in his or her sole discretion. How a trust is structured determines the level of protection it affords, and factors to consider include the identity of the trustee, the method for distributions, and the succession plan for the assets at the child's death.

Asset Protection Trusts

Self-settled asset protection trusts (APTs) are touted as supplements or even alternatives to prenuptial agreements. An APT is a trust that seeks to insulate assets from creditors of its creator, including an estranged spouse. APTs are appealing as a form of premarital asset protection planning because their validity does not depend on the same requirements of a valid contract negotiated between two parties, such as disclosure, representation by counsel, timing and fairness. Whereas full and complete disclosure of one's assets is required to ensure the enforceability of a prenuptial agreement, that is not the case with APTs. To the contrary, the settlor of an APT does not have to disclose either his or her intention to form the trust or the assets that will fund it. Nor is the consent of the future spouse required to form the APT. Also, unlike prenuptial agreements that must be executed sufficiently in advance of the wedding in order to avoid being deemed coercive, an APT may be formed at any time.

Certain states (Alaska, Colorado, Delaware, Hawaii, Missouri, Nevada, New Hampshire, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia and Wyoming) authorize the use of APTs. (New York law does not authorize an individual to escape creditors by creating a trust.) States that do authorize APTs provide some or no protection regarding marital claims. Other differences between such states relate to the amount of time the assets must be held in the APT before they are deemed protected from creditors and a cap on the amount of assets that can be insulated. While an individual who creates an APT does not have to live in the state that allows their creation for the trust to be upheld, the factors to be considered will be where the assets are located, the location of the trustee, the individual's access and control over the trust assets.

Asset protection trusts are not without risks, as evidenced by the recent decision of *In re Huber*, 493 B.R. 798 (Bankr. W.D. Wash. 2013). Huber, a Washington resident, finding himself in financial straits and the target of a number of litigations, admittedly set up an Alaska APT. Although an Alaska trust company was trustee and the trust owned an Alaskan corporation funded with assets he contributed, virtually all of the assets were physically located in Washington, the ultimate beneficiaries of the trust were Huber and his children, Huber's creditors were in Washington, and the attorney who prepared the documents was in Washington. The court would not honor the trust provision mandating that Alaska law govern and applied Washington state law, which does not recognize self-settled asset protection trusts. It found that under Washington law, Huber's transfer of assets into the trust were void as transfers made into a self settled trust.

As evidenced by *Huber*, the law regarding the protective nature of such trusts remains in a state of development and it is still unclear how APTs will fare in the face of a spousal challenge, particularly when the trust is created by an individual who is not a resident of the state whose law governs the trust. While asset protection trusts are not bullet proof, they still offer protection in certain situations.

Benefits of Prenups

While trust agreements may seem appealing to avoid the awkward nature of prenuptial agreements, there are certain issues that may be addressed only by a prenuptial agreement.

- To protect one spouse from the other's debts becoming marital debts;
- To pre-determine or waive spousal maintenance or, determine the amount and duration of spousal maintenance;
- To protect income from being considered a marital asset, and to define as separate property any enhanced value of separate property; and
- To set forth the rights and interests of each spouse during the marriage.

Conclusion

Individuals contemplating marriage have an array of estate planning tools available to insulate assets and provide for their distribution, including prenuptial agreements and trusts. Regardless of which estate planning mechanism an individual chooses, however, one conclusion is patently clear: Great care should be given when drafting the instrument or document in question to ensure its survival under judicial scrutiny and to accomplish the objective for which it was designed to achieve. The safest bet may be to combine trusts with prenuptial agreements—a "belts and suspenders" approach. Estate planning lawyers and matrimonial lawyers need to work in tandem to achieve the right result for each situation.

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