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## Divorce Requires an Affirmative Review of an Estate Plan

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LIFE CHANGING EVENTS SUCH AS DIVORCE require a review of one's estate plan. While New York's "revocation on divorce" statute provides some protection for those who do not affirmatively act to change their estate plans, relying on the statute can result in adverse and unintended consequences. This article explains the shortcomings of the New York statute and addresses other estate planning issues to consider in the context of divorce.

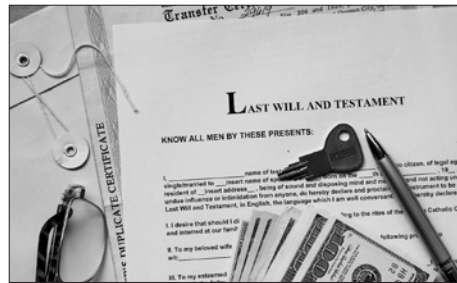
EPTL 5-1.4 provides that a divorce or judicial separation revokes any revocable disposition of property to a former spouse and any provision appointing a former spouse as a fiduciary. This includes the removal of a former spouse in one's will as a beneficiary and as an executor and trustee.

The statute also revokes the appointment of a former spouse as an agent under a power of attorney and health care proxy. It also covers the revocation of a former spouse under a beneficiary designation on transfer on death (TOD) accounts, life insurance policies and certain retirement assets.

One important shortcoming of the statute is that it does not revoke a disposition to or an appointment of a former spouse's relative.

For example, an individual may appoint a former spouse's sibling as trustee of a trust created for the individual's children under his or her will or as a guardian of one's minor children. The sibling may also be designated as a contingent beneficiary under the individual's will or pursuant to a beneficiary designation form of a life insurance policy.

Without affirmatively changing one's estate plan, the former in-law might end up receiving a portion of the individual's assets. The



same sibling could also find himself or herself in a position of controlling assets passing to children or raising the children as guardian if both parents are not alive. The same holds true for appointments under one's power of attorney and health care directive. Clearly, the last thing one would want during a difficult time such as a divorce would be for a former spouse's relative to be in a position to make financial or health care decisions on one's behalf.

Another major shortcoming of the statute is that it does not revoke dispositions or appointments under irrevocable trusts, such as gifting or insurance trusts created during one's lifetime. A former spouse named as a beneficiary under the trust would still be entitled to benefit from the trust assets and could still control the assets as trustee without appropriate language included in the trust that would revoke the former spouse's rights as a trustee and beneficiary.

With the recent change in tax legislation that provides for a temporary \$5 million lifetime gift exclusion in 2011 and 2012, more individuals are implementing gifting strategies in connection with life insurance trusts and gifting trusts to reduce their taxable estates. As a result, now more than ever, it is imperative that such irrevocable trusts contain proper provisions to deal with relationship changes in the future.

### Analyze and Review

For situations where an existing irrevocable trust itself does not provide a mechanism to deal with relationship changes, the

trust should be analyzed to determine if the assets of the trust can be transferred or sold back to the grantor, an intended beneficiary or a new trust to prevent the unjust enrichment of a divorced spouse or the divorced spouse's relative.

The New York statute also does not cover the period of time between a couple's separation and the date when the divorce is finalized. While it may be difficult for an individual to devote time and energy to review one's estate plan in great detail during such a period, it is strongly recommended to at least prepare new estate planning documents and to coordinate beneficiary designation forms of non-probate assets, such as life insurance, IRA and pension asset, as a stop gap measure to remove a soon-to-be former spouse and his or her relatives as beneficiaries and fiduciaries. Otherwise, an unforeseen situation can result in the spouse or his or her relative receiving assets or serving as a fiduciary. If a stop gap approach is utilized, the individual can revisit his or her estate plan in more detail once the divorce is finalized when he or she can focus on the plan.

In this context, it should be noted that the complete removal of the spouse as a beneficiary prior to a divorce being finalized could trigger the New York elective share statutes if the spouse omitting the other spouse as a beneficiary dies prior to the final judgment of divorce.

In general, the elective share rules in New York (EPTL 5-1.1-A) provide the surviving spouse the right to elect to receive the greater of \$50,000 or one-third of the decedent's net estate. If the spouse abandoned the decedent spouse and such abandonment continued until the decedent's death, or if a spouse, having a duty to support the decedent spouse, failed or refused to provide for such decedent spouse, then said spouse would be disqualified as a surviving spouse (even though there was no formal divorce), and he or she would not be entitled to an elective share.

The important point to highlight here is that in most instances, if a spouse dies during the pendency of his or her divorce action, changing one's estate plan so that the surviving spouse receives only his or her elective share as opposed to the entire estate of the decedent spouse is a better result.

Another reason that highlights the need to act affirmatively to review one's estate plan is that EPTL 5-1.4 and other revocation on divorce statutes do not apply to ERISA governed retirement assets, which adds some confusion to this area. Interestingly, only a spouse can waive certain ERISA-governed rights, so an individual may have to wait until the divorce is finalized to change the beneficiary designation of such assets. In this regard, it is worthwhile to note that a court order known as a Qualified Domestic Relations Order (QDRO) is needed to divide a qualified pension plan between divorcing spouses. A settlement agreement is not enough to divide the pension plan.

### Settlement Considerations

While it is clear that an individual should not rely on the revocation on divorce statute, he or she should also consider other estate planning issues in the context of divorce.

To the extent a divorce settlement agreement requires that certain assets pass to a former spouse under a will or in the case of a non-probate asset, by way of beneficiary designation, including a provision in one's will or coordinating the beneficiary designation of such non-probate assets to satisfy such an obligation avoids post-mortem litigation and complex estate administration issues.

It is a recommended approach that the matrimonial lawyer consult with the estate planning attorney to review the provisions of the settlement agreement providing for the former spouse to avoid or at least minimize adverse tax consequences. One typical example is the requirement of maintaining life insurance for the benefit of the former spouse.

In many instances, the settlement agreement will provide that the former spouse must be the beneficiary of a life insurance policy on the life of the other spouse. It may be beneficial from a tax point of view for the spouse to have the life insurance owned by an insurance trust, with the same insurance trust named as beneficiary as well. By the strict terms of the settlement agreement, this may not be permitted, thus invalidating this common approach to the acquisition of life insurance to protect the former spouse in the event of the other spouse's premature death. A properly drafted settlement agreement could

provide that a trust for the benefit of the former spouse, with the former spouse as the sole trustee, shall be permitted as a beneficiary of the life insurance policy.

If a divorce settlement agreement provides for child support payments for the benefit of a special needs child, it is important to consider not having such payments paid directly to the former spouse. Even though the special needs child would not be the direct recipient of such payments, it could potentially jeopardize any government assistance the child may be entitled to receive. To avoid this result, the payments should be made to an appropriate special needs trust for the benefit of such child that is specifically designed to preserve any government assistance he or she may be entitled to receive.

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If an individual wants to appoint a **family member** and his or her **spouse** to serve as **fiduciaries**, language should be included in the estate plan that **revokes the spouse's appointment** if the couple is divorced or legally separated.

If a divorced individual is entering into a second marriage, it is likely that the individual would want to provide some benefit for the second spouse for his or her lifetime while ensuring that the assets ultimately pass to the children of the individual's first marriage at the second spouse's death. If the individual leaves the assets outright to the second spouse, he or she would be under no legal obligation to leave the assets to the individual's children from his or her first marriage at the second spouse's death. This means that the second spouse could omit the individual's children from his or her first marriage as beneficiaries.

To avoid this result, assets can be left to the second spouse in a Qualified Terminable Interest Property (QTIP) trust for the second spouse's benefit. Under this trust, the spouse must be entitled to receive mandatory income distributions.

The trustees can also have the ability to make discretionary principal distributions to the spouse for any reason or no reason at all. Assets may not be distributed to anyone other than the surviving spouse during his or her lifetime. If assets held by the QTIP Trust do not produce income, the surviving spouse must have the right to compel the trustee to convert the assets to other assets that are income producing.

From a tax planning perspective, such a trust is designed to qualify for the marital deduction. This means that any assets left to a spouse subject to the QTIP trust would not incur any estate taxes at the first spouse's death if proper elections are made.

### Relative Changes

In addition to considering planning issues in regard to one's own relationship, consideration should be given to the relationship status of a beneficiary or an appointed fiduciary when preparing an estate plan.

It is prudent to consider making certain fiduciary appointments contingent upon marital status. For example, if an individual wants to appoint a family member and his or her spouse to serve as fiduciaries, either as executors, trustees or guardians, language should be included that revokes the spouse's appointment if the couple is divorced or legally separated. This language would apply to future events and would not necessarily require a change to one's estate planning documents if the relationship of an appointed fiduciary changes.

To protect a child (or other beneficiary) from potential spousal claims in relation to the child's marriage, the parent should consider including language in a will or trust which states that if a child does not enter into an adequate prenuptial or post-nuptial agreement, that child will not receive distributions from his or her trust.

A prenuptial or postnuptial agreement could be deemed adequate under the terms of the trust if it protects assets that one's children receives by gift or inheritance from parents, grandparents or any other family member. The trust can also direct the trustees to hire matrimonial counsel to advise them as to the adequacy of such agreements.

### Conclusion

While the New York legislature provides for very basic protection in the context of divorce, an individual should take affirmative steps to review one's estate plan in the anticipation of divorce, while the divorce is pending and after the divorce is finalized. Failure to do so could result in adverse and unintended consequences.