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Ten Tips for Estate Planners Who Draft Prenuptial Agreements

Focus on financial matters and consider the effects of applicable state law when identifying provisions to include in prenuptial agreements.

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An increasing number of couples are entering into prenuptial agreements prior to marriage. Through prenuptial agreements, prospective spouses can establish the property rights and financial responsibilities of each party during the marriage and predetermine how property will be distributed in the event of divorce or death. Since prenuptial agreements generally deal with both the possibility of divorce and the eventuality of death, both matrimonial lawyers and estate planning lawyers draft and negotiate these agreements. For estate planners who do not routinely handle matrimonial matters (and for matrimonial lawyers who do not routinely handle estate matters), this can be a tricky proposition. What are the top ten things estate planners should know when drafting prenuptial agreements?

1. Overriding statutory provisions

In general, a prenuptial agreement can override statutory and common law provisions with respect to spousal support, property division, inheritance, and other rights and obligations. Like any contract, a prenuptial agreement is subject to challenge for fraud, duress, overreaching, and undue influence. The agreement must be executed voluntarily and with full financial disclosure (or an appropriate waiver of such disclosure).

It is strongly recommended that each party engage separate and independent counsel in connection with the negotiation of the prenuptial agreement and that each party provide comprehensive financial disclosure. It is also a prudent practice to begin negotiating the prenuptial agreement as far in advance of the wedding date as possible to provide adequate time for thoughtful negotiation.

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2. Opting out of state framework for property division upon divorce

One of the key reasons for a prenuptial agreement is to determine how property will be divided in the event of a divorce and to opt out of the applicable statutory framework for property division. Therefore, when negotiating a prenuptial agreement, it is essential to understand the relevant state's system for dividing property upon divorce.

Most states employ a dual property system, meaning that they recognize a distinction between "marital property" and "separate property." In general, marital property, in simple terms, is property earned or acquired by employment or self-employment during the marriage, while separate property basically is property acquired by either party

before the marriage, as well as inherited property, gifts received by a party from a third party, and passive appreciation on premarital assets.

In community property states, each spouse owns a one-half interest in community—or marital—property. The community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. Alaska also has a community property system, but the parties can elect to opt out of it.

The agreement can provide that any court-awarded support be limited in amount or duration, or that the payor's separate property not be considered in arriving at the award.

In non-community property states, property is divided on an equitable, but not necessarily equal, basis upon divorce. Generally, the court will consider multiple factors in making an equitable distribution. For example, in New York, where the authors practice, Paragraph 5.d. of section 236-B of the Domestic Relations Law directs the court to consider the following factors:

1. The income and property of each party at the time of marriage, and at the time of the commencement of the action.
2. The duration of the marriage and the age and health of both parties.
3. The need of a custodial parent to occupy or own the marital residence and to use or own its household effects.
4. The loss of inheritance and pension rights upon dissolution of the marriage as of the date of dissolution.
5. The loss of health insurance benefits upon dissolution of the marriage.
6. Any award of maintenance under the statute.
7. Any equitable claim to, interest in, or direct or indirect contribution made to the acquisition of such marital property by the party not having title, including joint efforts or expenditures and contributions and services as a spouse, parent, wage earner, and homemaker, and to the career or career potential of the other party.
8. The liquid or non-liquid character of all marital property.
9. The probable future financial circumstances of each party.
10. The impossibility or difficulty of evaluating any component asset or any interest in a business, corporation or profession, and the economic desirability of retaining such asset or interest intact and free from any claim or interference by the other party.
11. The tax consequences to each party.
12. The wasteful dissipation of assets by either spouse.
13. Any transfer or encumbrance made in contemplation of a matrimonial action without fair consideration.
14. Any other factor which the court shall expressly find to be just and proper.

In many non-community property states, the division is of only marital property, but in a number of states, sometimes called "all property" or "kitchen sink" states, separate property also can be divided upon divorce. Some states are hybrid states, in which separate property can be divided if necessary in the discretion of the court.

In a prenuptial agreement, not only can the parties determine what property will be treated as "separate" and what property will be treated as "marital," but also the parties can provide how marital property will be divided in the event of a divorce and whether one party should be compensated, and in what amount or percentage, if it is anticipated that there will not be adequate marital property to provide an acceptable award.

3. Waiving or setting parameters for spousal support and counsel fees

In most states, a prenuptial agreement can define the parameters of spousal support in the event of a divorce or waive such support entirely. Some states, however, do not permit a waiver of spousal support.

Section 3(a)(4) of the Uniform Premarital Agreement Act (UPAA), which has been adopted by 25 states and the District of Columbia, expressly allows parties to contract for the modification or elimination of spousal support. Note, however, that while New Mexico and South Dakota enacted the UPAA, they did so without section 3(a)(4) and do not permit the waiver of spousal support. California's version of the UPAA replaced section 3(a)(4) with stricter provisions for the modification or elimination of spousal support. Thus, practitioners need to be aware of applicable state law with regard to modification or waiver of spousal support.

In general, a modification or waiver of support in a prenuptial agreement cannot violate public policy, cannot be unconscionable, and must be executed voluntarily and with full financial disclosure

(or an appropriate waiver of such disclosure). In New York, for example, section 236-B of the Domestic Relations Law provides that an agreement with regard to maintenance must be "fair and reasonable at the time of the making of the agreement" and "not unconscionable at the time of entry of final judgment."

In situations where it is just too difficult to anticipate whether support would be warranted or to arrive at an equitable formula, an agreement can remain silent with regard to spousal support or provide that a party can seek a court award of support, with or without limitations. For example, the agreement can provide that an application to a court can be made only if certain conditions are met, such as if one party has been out of the work force for a number of years or if there is a specified differential in income between the parties. The agreement also can provide that any court-awarded support be limited in amount or duration, or that the payor's separate property not be considered in arriving at the award.

The practitioner should keep in mind the interrelationship between spousal support and equitable distribution. Where the prenuptial agreement anticipates a significant accumulation of marital property and an equal split of the same upon divorce or where the agreement provides for a substantial lump-sum equitable distribution payment to the "less wealthy" spouse upon divorce, the need for spousal support will be reduced.

Finally, the practitioner should be mindful of statutes that provide for the payment of counsel fees in a matrimonial matter by the wealthier spouse and the ability to waive or limit the payment of such fees in a prenuptial agreement.

4. Waiving qualified retirement plan benefits

Qualified plan survivor benefits are governed by the federal Employee Retirement Income Security Act (ERISA). Qualified plans include most company-sponsored defined benefit, profit sharing, 401(k), and Keogh plans for self-employed individuals. Individual retirement accounts (IRAs) are not governed by ERISA.

ERISA requires qualified plans to provide that a surviving spouse receive at least half, and in many cases, all of the deceased participant's accrued benefits. A participant may waive these rights with the spouse's acknowledged consent during applicable election periods. Prenuptial agreements, which are written before marriage, are not effective to waive qualified plan survivor benefits as the parties are not spouses at the time of execution. IRA survivor benefits, however, can be waived in a prenuptial agreement.

It is a prudent practice to attach applicable waiver forms to the prenuptial agreement as exhibits so they are readily available to be signed soon after marriage. The prenuptial agreement should provide that the waivers will be executed promptly after marriage. Practitioners should follow up with their clients after marriage to make sure such forms are signed and notarized.

Penalty clauses may be inserted in a prenuptial agreement to ensure that other assets that otherwise would pass to the surviving spouse will be reduced if the surviving spouse either did not sign the benefit waivers or otherwise received qualified plan benefits that had been waived in the prenuptial agreement.

It is important for the practitioner to understand that ERISA waiver rules govern death benefits only and that such rules apply whether retirement assets are acquired prior to or during marriage. It is important also to understand that the ERISA waiver rules do not apply to divorce benefits, and thus a prenuptial agreement may provide for the waiver of retirement benefits, whether acquired prior to or during the marriage, in the event of a divorce.

5. Using estate tax portability

The concept of "portability" or allowing spouses to share their federal estate tax exclusions initially was introduced in 2010 and was made permanent by the enactment of the American Taxpayer Relief Act of 2012 (ATRA). Portability creates a potentially valuable asset to be considered by practitioners when preparing prenuptial agreements.

With portability, the applicable exclusion amount is now a combination of (1) an individual's "basic exclusion amount" ($5 million as indexed annually for inflation; $5.43 million in 2015), and (2) if applicable, the unused basic exclusion amount of his or her last deceased spouse (referred to as the deceased spousal unused exclusion amount or "DSUE amount").[1] Thus, portability potentially offers a wealthy individual who outlives his or her "less wealthy" spouse an opportunity to transfer or "port" an additional $5 million-plus to his or her heirs free of federal estate tax. At a top rate of 40%, an additional exemption of $5.43 million saves $2,172,000 of federal estate tax.

In order to effectively port the DSUE amount to one's surviving spouse, a portability election must be made on the federal estate tax return for the decedent's estate. While it is generally necessary to file a federal estate tax return only if the value of the decedent's gross estate (plus any taxable gifts he or she

[1] Section 2010; section 3.33 of Rev. Proc. 2014-61, 2014-47 IRB 860.

made during life) exceeds the basic exclusion amount, a return must be filed to elect portability even if this filing threshold is not met.

The portability election may be made only by the executor if one is appointed. The surviving spouse is not permitted to file an estate tax return to elect portability if there is a duly qualified executor then acting. In preparing a prenuptial agreement, it is important to consider that someone other than the surviving spouse may be the executor of the deceased spouse's estate.

Where the estate of the first spouse to die would not be required to file a federal estate tax return other than to elect portability, the authors suggest leaving the decision as to whether a return shall be filed solely to the surviving spouse and expressly stating so in the prenuptial agreement. If the surviving spouse is not the executor, there must be a mechanism for the surviving spouse to direct the executor to make the election. Because the return is being filed solely for the benefit of the surviving spouse, the beneficiaries of the deceased spouse's estate (who may be different from the beneficiaries of the surviving spouse's estate) should not be responsible for the cost of filing the return, so the prenuptial agreement should provide that the cost of preparing and filing the return be borne by the surviving spouse.

In the event that the estate of the first deceased spouse exceeds the filing threshold such that a federal estate tax return is required regardless of whether a portability election is to be made, there are a number of factors that will affect the availability of the DSUE amount. Some of these are dependent on decisions and elections made by the deceased spouse's executor to use the DSUE amount, such as whether to elect the marital deduction. Therefore, the prenuptial agreement should provide that for estates in excess of the filing threshold, all decisions and elections with respect to the estate tax return, including the decision as to whether to elect portability, should be the responsibility of the decedent's executor. Nevertheless, the practitioner should include a provision requiring the decedent's executor to make a binding portability election to the extent that there is a DSUE amount available and requiring cooperation and sharing of documentation with the surviving spouse.

What if a client who is entering into a marital agreement has a DSUE amount from a prior deceased spouse? The client needs to be aware that the DSUE amount will be lost if he or she remarries and the new spouse predeceases him or her. Under the "last deceased spouse rule," remarriage alone does not affect who will be considered the last deceased spouse, and an individual can use the DSUE amount from his or her last deceased spouse while married to a subsequent spouse. Practitioners should consider whether a client entering into a prenuptial agreement with a DSUE amount from a prior spouse would benefit from lifetime gifting and whether this should be expressly provided in the prenuptial agreement.

6. Covering the marital lifestyle

Clients often request nonfinancial clauses in prenuptial agreements. These clauses govern the behavior of the parties during marriage, and thus they are often referred to as "lifestyle" clauses. These include serious issues such as careers or child rearing, or light issues such as who walks the dogs or who does the dishes. Sometimes the parties want to specify a certain amount of quality time together, how time will be split between a country and a city home, or even the frequency of sex.

A common request by clients is for "bad boy/bad girl" clauses, usually relating to adultery. For example, it was reported that the agreement between Catherine Zeta-Jones and Michael Douglas contained a "fling fee," requiring Michael to pay Catherine $5 million if he cheats on her. Other clauses of such ilk require spouses to forego smoking, drugs, alcohol or gambling, or establish an acceptable weight range during marriage. Frequently clients would like the bad boy/girl to pay more or receive less, as the case may be, if they violate the clauses in their prenuptial agreements.

Practitioners should exercise caution regarding these clauses as they are often vague and difficult to enforce. Since these clauses are morally persuasive, rather than legally binding, it is usually preferable to limit the prenuptial agreement to financial issues and to cover lifestyle issues in a personal letter, if desirable.

7. Preserving confidentiality

The epidemic use of Facebook, Twitter, and other online sites has created a heightened concern regarding confidentiality. The use of confidentiality clauses in prenuptial agreements has spread from celebrities to a wider range of clients who are concerned about privacy and the protection of their business and personal reputations.

A prenuptial agreement must define what information will remain confidential. Sometimes the couple wants to cover only the provisions of the prenuptial document and related financial information. Other times the couple wants to cover all financial and nonfinancial aspects of the relationship. The latter can be challenging as it is important that a confidentiality

clause not be so overbroad as to effectively muzzle the parties.

A prenuptial agreement may provide that no information be disclosed or photographs or videos posted without the prior approval of the other party, or it may specify removal on demand and within a certain time period. Alternatively, the agreement may prohibit the dissemination of information that would reasonably be likely to have an adverse material impact on career or reputation. The agreement also may provide for penalties in the event of a violation, injunctive relief, or payment of counsel fees.

8. Integrating prior obligations

As divorce and remarriage become more prevalent, more clients who are entering into prenuptial agreements already have obligations to a prior spouse or children under a divorce agreement. Practitioners must be aware of these pre-existing obligations and the impact they have on negotiations with the new prospective spouse.

A party might be required under his or her divorce agreement to leave a fixed percentage of his or her estate to a former spouse or children of a prior marriage. Such obligations obviously affect the available death benefit to the new spouse. Also, in such situations, the practitioner should be mindful of how "estate" is defined in the divorce agreement.

In terms of spousal support and child support obligations, the practitioner must be sensitive to the issue of whether such payments during the marriage will be made from marital property or from the separate property of the obligated spouse. If payments are made from marital property, the agreement may provide for a credit to the non-obligated spouse in the event of a divorce. Furthermore, in some jurisdictions, the remarriage can be grounds for a proceeding for modification of a support award based on changed circumstances, and the new spouse's income can be taken into account in an upward adjustment of support.

9. Addressing international elements

As the world becomes increasingly mobile and global, international agreements have increasingly become part and parcel of the prenuptial practice. The key for practitioners is to anticipate as much as possible which countries may be involved, either because property is located there or because the parties may reside there currently or in the future on a part-time or full-time basis. It is not always known whether a prenuptial agreement drafted in one country will be upheld in another. Accordingly, it is helpful if a prenuptial agreement can be drafted at the outset to comply with the law of multiple potential jurisdictions.

In such case, lead counsel would arrange for counsel in other countries to supplement the basic agreement with additional language and schedules so that the prenuptial agreement will be enforceable in all potential jurisdictions. If a party moves permanently to another jurisdiction, it is advisable for the client to consult with counsel in such other country to confirm that the prenuptial agreement is valid and binding, and if necessary, cre-

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ate a postnuptial agreement in accordance with the laws of the new country.

In addition, the practitioner must be sensitive to the tax issues that arise in the context of international agreements as the tax consequences to noncitizens are not the same as for U.S. citizens. For example, gifts between spouses who are both U.S. citizens and gifts from a foreign national to a U.S. citizen are exempt from federal gift taxation.[2] If the gift is from a U.S. citizen to a spouse who is a foreign national, however, the U.S. citizen can gift only up to $147,000 per year tax free in 2015.[3]

For deaths in 2015, there is an individual exemption up to $5.43 million from federal estate tax taxation. For a surviving spouse, however, there is an unlimited marital deduction, provided, however, the surviving spouse is a U.S. citizen.[4] A noncitizen surviving spouse is ineligible for the unlimited marital deduction. On the other hand, if the foreign national predeceases a U.S. citizen spouse, assets left to the U.S. citizen surviving spouse will be eligible for the unlimited marital deduction.

To ameliorate the estate tax consequences to a noncitizen surviving spouse, a qualified domestic trust (QDOT) may be established for his or her benefit.[5] The inherited assets would be distributed to the QDOT, and the noncitizen can receive the income generated from the QDOT free of estate taxes. He or she may have to pay estate taxes upon distribution of principal of the trust property. If a party is entering into a prenuptial or postnuptial agreement, it may be desirable to provide that the U.S. citizen will set up a QDOT for the benefit of the foreign national.

10. Venturing into postnuptial agreements

It is important to distinguish between postnuptial agreements and prenuptial agreements. A prenuptial agreement is between a prospective bride and groom and is entered into before marriage. A postnuptial agreement is an agreement between a husband and wife and is entered into after marriage. A postnuptial agreement also should be distinguished from a separation agreement insofar as a postnuptial agreement is written in contemplation of an ongoing marriage, while a separation agreement is written in contemplation of a separation or divorce.

There is a growing trend among married couples to enter into postnuptial agreements, which have exploded, perhaps as much as tenfold, in the past five years. A couple may not have had the time or inclination to complete a prenuptial agreement before marriage, or the couple may have married at a time when the discussion of marital contracts was uncommon. Also, a couple may not have felt that they needed a prenuptial agreement prior to marriage, but during marriage have experienced a change of circumstances (e.g., inheritance, birth of a child, career change, illness, or sale of a business) necessitating a postnuptial agreement.

Frequently, couples may want to amend an agreement they entered into before marriage, particularly if there has been a significant change in net worth. Or one or both spouses may have an emotional need for security. Sometime couples use postnuptial agreements if they have had marital difficulties and decide to reconcile.

If there is a choice between a prenuptial and a postnuptial agreement, the practitioner should encourage the creation of a prenuptial agreement. First of all, in a prenuptial agreement, marital rights have not vested, whereas in a postnuptial agreement, they have vested. Clearly, it is much more difficult to waive vested rather than unvested rights. Moreover, there is no deadline for a postnuptial agreement, whereas the wedding is the deadline for a prenuptial agreement. Thus, as a practical matter, many postnuptial agreements simply languish. Moreover, a postnuptial agreement requires consideration, whereas in a prenuptial agreement, the marriage itself is usually the consideration. Finally, in some states, courts scrutinize postnuptial agreements more carefully than prenuptial agreements, sometimes holding them to a higher standard of fairness on the theory that the parties have less leverage in postnuptial agreements than in prenuptial agreements.

Conclusion

In the drafting of wills and other instruments, estate planning attorneys are trained to anticipate a variety of future possible alternative circumstances and scenarios. Such experience provides estate planning attorneys with a valuable skill in drafting prenuptial agreements. However, since prenuptial agreements entail a mix of matrimonial and trusts and estates law, estate planning practitioners who practice in this arena should be proficient in both areas of law. Accordingly, it is very helpful for lawyers in both fields to work in concert, as do the authors, particularly in complex situations. ■

[2] Section 2523(a).

[3] Section 2523(i)(2); section 3.35 of Rev. Proc. 2014-61, *supra* note 1.

[4] Sections 2056(a) and (d).

[5] Section 2056A.