

Estate Planning Through Premarital Agreements

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Planning for the end of a marriage before the marriage vows are exchanged can be disconcerting. However, with divorce rates topping 50% nationwide, the failure to engage in such planning by executing a premarital agreement may have disastrous consequences. A premarital agreement is especially critical where one or both parties have children from a prior marriage, one or both parties are bringing significant assets into the marriage (or will receive them by inheritance), or one or both parties have closely-held business interests (or will

receive them by inheritance). Premarital agreements should deal with the consequences of the marriage's ending either by death of a spouse or by separation and divorce.

Rights Accruing by Reason of Death of a Spouse

In the absence of a contrary agreement, a surviving spouse has certain rights with regard to a deceased spouse's estate. As an initial matter, if a person dies intestate (without a Will), the surviving spouse has the primary right to serve as administrator of the deceased spouse's estate. This point is not of critical importance, however, since you can resolve this issue simply by preparing a valid Will and naming whomever you like as your executor.

More importantly, in the absence of a valid premarital agreement, a surviving spouse is entitled to receive a minimum share of a deceased spouse's estate. The size of minimum share differs depending upon the length of the marriage. For example, if you married without a premarital agreement and died after 15 years of marriage, your wife would be entitled to a minimum of one half of your estate.

A premarital agreement may modify these property rights in any way desired, including a complete waiver of the right to share in one another's estates. Such a complete waiver would not prohibit either of you from making provision for the other in your Will, but would simply mean that you would have the right to choose how much is left to your spouse and in what manner. Alternatively, instead of a complete waiver, you could provide for some lesser minimum share of the estate or you could specify that the minimum share could be satisfied with a gift in trust, rather than an outright transfer (which would enable you to control the ultimate disposition of the trust assets after the spouse's death). Including such provision in a premarital agreement ensures that your assets pass to your children and grandchildren and that family real estate and business assets remain in the family.

Rights Accruing by Reason of Separation and Divorce

There are three issues that arise in connection with a separation or divorce that may be addressed by a premarital agreement. First is the issue of postseparation support and alimony. Postseparation support

provides a dependent spouse with financial assistance during the period of litigation. Alimony provides the dependent spouse with longer-term financial assistance and may be awarded for a fixed period of time or until the recipient remarries, engages in cohabitation, or dies. In North Carolina, the Court examines a number of factors to determine whether alimony is appropriate in a particular situation and, if appropriate, the amount and duration of the payments. Frequently, a premarital agreement includes a complete waiver of the right to claim alimony or any other type of support payment, although such rights could also be modified rather than completely waived.

Second is the issue of claims by one spouse against a third party for interference with the marriage contract. For example, if one spouse has an affair which leads to the dissolution of the marriage, the other spouse may have a claim against the third party involved in the affair for damages relating to the "alienation of affections." For many years, it was considered highly unlikely that any such claim would be successful, but in recent years there have been some highly publicized successful claims. The premarital agreement could include a waiver by each party of the right to bring a claim for alienation of affections against a third party. While it may be unlikely that any such claim would be successful, the threat of such a claim is often used as a bargaining tool in separation and divorce negotiations.

The third and most important issue addressed by premarital agreements in connection with separation or divorce is the division of property. In general terms, the North Carolina Equitable Distribution Act defines assets as being either "separate property" or "marital property." Separate property is not subject to division, while marital property must be equitably divided (under the statute, "equitably divided" generally means "equally divided") between the two spouses.

Determining what assets are "separate property" and what assets are "marital property" is not a simple matter of determining the legal title to the property. Marital property can include property which is titled in the name of only one spouse if the property was acquired during the course of the marriage. Furthermore, a particular asset may have both a separate property component and a marital property component. For example, your ownership interest in a business would generally be considered separate property if you owned it prior to marriage. However, any increase in the value of that asset during the course of the marriage may be considered marital property because it occurred by virtue of your efforts on behalf of the dealership during the time you were married.

One of the most important aspects of a premarital agreement is defining these terms "separate property" and "marital property" in a way that reflects the parties' intent and is reasonably capable of application without requiring additional litigation. One option is to define the status of property by tracing the source of the funds used to acquire the property. For example, if your separate funds were used to acquire a particular asset (e.g., a vacation residence), that asset would be considered your separate property regardless of the actual title of the property. While this tracing procedure is likely to result in the most accurate and equitable division of assets, it is, as you can imagine, often difficult to apply and can itself lead to extensive litigation. Accordingly, some clients prefer to adopt a "bright line" test which, although less accurate, is easier to apply. For example, the premarital agreement might specify that the division is determined solely by the title to the property, such that any property held in individual names is separate property, regardless of the source of funds, and any property held in joint names is automatically marital property. While easy to apply, this type of test requires tremendous vigilance and care in the titling of assets during the course of the marriage.

Conclusion

Naturally, it may be awkward to raise these issues with one's prospective spouse or one's child who is contemplating marriage. However, if separation or divorce occurs without a premarital agreement, your family assets are put at risk, your financial lifestyle may be jeopardized, and the time and expense of the legal

proceedings will increase substantially. In contrast, the negotiation of a premarital agreement affords the parties an opportunity to address these issues in a non-confrontational setting. Accordingly, the execution of a well-drafted premarital agreement is a critical component of a comprehensive estate plan.

For further information regarding the issues described above, please contact a member of the Trusts & Estates practice.

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