When Your Children Wed: Protecting Family Wealth

Complications may arise when children marry.

You've worked hard your whole life and you've enjoyed considerable success. Your net worth is measured in the millions. You've been prudent in handling your money, and you've raised your children to be responsible about it too—to spend it wisely and to be charitable. But now your 25-year-old daughter announces she is going to marry a young man who seems likeable enough, but whom in fact you barely know. You're worried. What if he doesn't share your values about money? If the marriage lasts, will this young man preserve and protect the funds you'd hoped would ensure security for your daughter and grandchildren? And what if the marriage doesn't last? Will this young man end up with millions of your hard-earned dollars?

This worrisome scenario is replicating itself like a computer virus among affluent parents across the country.

Estate planning attorneys say the issue of protecting family wealth against an ill-advised or ill-fated marriage has exploded as a concern among people with substantial assets in the last 10 years.

"Ten years ago, we talked about it occasionally, but infrequently," says Matthew G. Perlow, an estate planning attorney with Blackwell Sanders Peper Martin in St. Louis who has been named one of the Best Lawyers in America for the last three years. "Now it comes up almost all the time."

And the more family wealth, the more of a concern it is, he and other attorneys say. One million dollars or more in investable assets appears to be a kind of threshold for concern. From that point on, the concern just grows more common and more intense.

Behind the Trend

What's driving the upsurge? Observers point to several forces:

- The huge intergenerational transfer of wealth now under way in America, as the Baby Boom generation ages. A report by the Center on Wealth and Philanthropy at Boston College estimated that at least $41 trillion—and quite possibly double or triple that amount—will change hands by 2052. More than six million estates of $1 million and more will be settled.[1]

- The divorce rate. Despite a modest decline since the early 1980s, the American divorce rate is still nearly twice that of 1960, according to the National Marriage Project at Rutgers University. For the average couple marrying today, the lifetime probability of divorce or separation is between 40 and 50 percent. The chances of divorce fall dramatically if the two parties are more than 25 years old, have college educations and religious affiliations, and come from intact families, the Marriage Project reports. But it's not clear that these mitigating facts are widely appreciated. Regardless, divorce is clearly more of a threat than it was before 1960.[2]

- The decision by Congress and the Bush Administration in 2001 to raise the exemption on federal estate taxes. That issue had been agenda item No. 1 for estate tax lawyers, Perlow says. When that issue became less important for some people, other issues naturally surfaced.

- And finally, with the annual gift tax exclusion set at $12,000 per year—$24,000 per married couple—many parents have given their children a significant sum by the time they turn 21, notes Albert Rose, a tax and estate planning attorney with Lewis, Rice & Fingersh, also in St. Louis. Assuming that money has been invested, it can easily amount to more than $1 million in the child's name by the time he or she reaches their early 20s. This situation can create an additional worry for parents who fear they will have no control whatever over what happens to those funds.

What Can Parents Do?

All of which raises the question, what can parents do about it?

Experts say there are at least five main strategies that parents can evaluate before choosing which one or ones are best for them. The five are:

- Worry, agonize and do…nothing, for fear of stirring resentment by interfering with your child's life.
- Advise your children to keep any gifts you provide separate from marital property, which is frequently divided in half in the event of divorce.
- Hold your grip—keep full or partial control of your wealth in your own hands.
- Push for a prenuptial agreement.
- Establish a trust.

[1] Center on Wealth and Philanthropy, January 6, 2003; http://www.bc.edu/research/swri/features/wealth
[2] National Marriage Project, "The State of Our Unions, 2005"; http://marriage.rutgers.edu/Publications/SOOU/SOOU2005.pdf

The first strategy—worry but do nothing—is adopted by quite a few parents, says Randall Kessler, a prominent family law attorney in Atlanta who serves as the Family Courts Committee Chair for the American Bar Association's Family Law Section. The parents may feel their intervention or counsel would poison their relationship with either their child or their prospective new daughter-in-law or son-in-law. They may feel that the child is an adult and needs to be left to make his or her own decisions. They may feel that the best course is simply to trust that everything will work out for the best.

But parents need to realize that "their concerns are legitimate," Kessler asserts. After all, they did earn or preserve the money, and they are entitled to try to exercise some control over what happens to it. And it goes without saying, he adds, that doing nothing offers no protection.

Counseling children to keep gifts separate represents the next lowest level of parental intervention. The rationale behind the strategy rests on the fact that it's common in divorces for property acquired by either of the parties during the marriage to be divided equally or at least equitably, if it has been commingled and thereby become marital property. But non-commingled assets may pass undiminished to their recipient in a divorce. For example, if a parent gives his 25-year-old married daughter $20,000, and the daughter then holds the funds in her own personal account, with other funds that she brought herself to the marriage, that money may be deemed entirely hers in the event of divorce. Likewise, if a parent or grandparent gives a son $500,000 to buy a house, and the son then titles the property in his name only, the house can be considered separate from marital property.

The trouble with this strategy, lawyers say, is its high risk. For example, even if the son wants to follow his parent's advice, the money may end up getting mixed up with marital property; keeping funds entirely separate can be difficult. And then there's the possibility that the son won't follow the parent's advice. He may feel that he is being

disloyal to his wife if he does so. He may feel that his marriage is safe. He may feel any number of things that keep him from adopting the advice when it's given, or some time later.

Keeping some kind of direct control of family money is therefore a more prudent strategy, attorneys say. They recommend that instead of giving your daughter major gifts of cash, take her on a buying spree and pay yourself for the purchases. Or ensure that your money is well-spent by using it to fund a 529 college savings plan for your grandchildren.

Prenups

A more practical and formal way to protect your family's wealth, attorneys contend, is through the prenuptial agreement.

For many years, prenups were viewed askance by most Americans because they were seen as facilitating divorce, Kessler notes. The general view was that they were more for marriage-hopping Hollywood celebrities. But "in the last 20 years, there's been a shift in favor of prenups," he says. Family attorney Linda Ravdin, who is a partner at Pasternak & Fidis in Bethesda, Md. and who has been named repeatedly by *Washingtonian* magazine as one of the best divorce lawyers in Washington, D.C., says she and her colleagues have noticed a definite trend for more young couples to get them.

Prenups are simply contracts that the two parties enter into before the marriage about how assets will be allocated when the marriage ends through death or divorce. They can cost anywhere from $1,000 to $25,000, depending on the size and complexity of the parties' assets. And advocates like Kessler say they can save all kinds of heartache and money, preventing both a catastrophic loss of wealth and expensive, protracted litigation. Although about half of prenups end up being challenged in court, he says, most cases are settled easily and "the good ones are enforced."

More often than not when young people marry, the impetus for a prenup comes from the wealthy parents, observers say. In most cases, the young person is quite willing to accept the advice, they say. But not always. There can be plenty of pitfalls, both with the wealthy person's son or daughter, and with the prospective in-law.

"Even if you are the initiator of the prenuptial discussion," Ravdin notes, "it can be a painful process because it forces you to contemplate the possibility that the marriage won't work out or you'll die."

And there can be many other difficult issues beyond that. The less-affluent party to the marriage may feel that the request for a prenup reflects a lack of love, distrust in his or her motives, excessive self-protection or unhealthy domination by the prospective father- and mother-in-law. The wealthier party may feel that asking for a prenup is dishonorable and unnecessary.

Every once in a while, prenup discussions will end with the marriage itself being called off, attorneys say. Kessler recalls one case, for instance, where a woman who very much wanted to get married called it off after her prospective husband, who came from a very wealthy family, insisted that under no circumstances would she ever get more than a total of $100,000. The woman decided she had learned something new and unflattering about her prospective mate.

Such cases actually show why prenups are "good for marriages," Kessler contends. "They clear things up. It also sets a pattern for negotiating issues."

Attorneys say there are several best practices to follow in the process of developing a prenup.

"My rule number one," maintains attorney Rose, "is to start the process as early as possible. If you're planning to marry in 12 months, don't wait until four months before. You want the prenup process over with well before the wedding date."

Prenups aren't necessarily for everyone. Nancy Fax, a tax and estate planning lawyer and partner of Ravdin's at Pasternak & Fidis, thinks they're most appropriate for couples where at least one of the parties has or comes from significant wealth, or when the parties are marrying not for the first time and want to ensure that their money passes to their own biological children rather than to their new spouse or his or her children.

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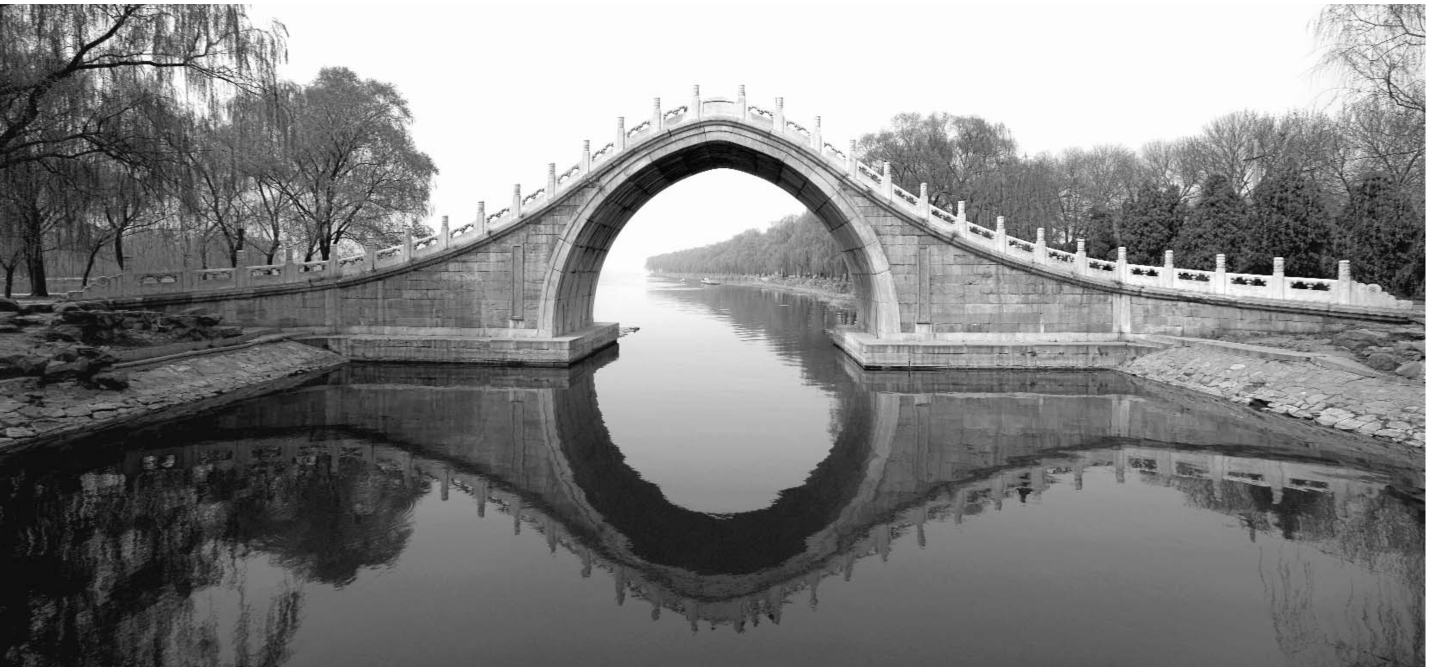
It's also important to recognize that prenups have at least one major vulnerability: They can be ignored by the very people entering into them. Consider, for example, a situation where a couple agrees to a prenup only because the husband was humoring his parents. By the terms of the prenup, the marital home is held in the name of the husband only. But when the time comes to refinance the house, the husband, motivated by any number of reasons, decides to put his wife's name on it too.

Trusts

Trusts don't have that vulnerability. The "grantor" of a trust—the person who establishes and funds it—can feel confident that its terms will be enforced, attorney Perlow says. That's because the means simply don't exist for the beneficiaries to ignore or override it. Indeed, through trusts, parents and grandparents can make their wealth available under any terms they like—during their lifetimes, and even after they are deceased.



In many cases—for example, when the marrying couple doesn't yet have many assets, but their parents or grandparents do—a trust can be preferable to a prenup, Perlow contends. In other cases—for example, when at least one of the parties to a young marriage has substantial assets and there is family money as well—it often makes sense to establish both a prenup and a trust. In that way, the wealthy young spouse protects his or her own assets, while the parents or grandparents protect theirs.

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Trusts come in many categories. Two of the most basic relate to the lifespan of the grantor. Under a "testamentary trust," wealth is passed on after death. Under a "lifetime trust," parents or grandparents pass on at least some of their wealth while they—the grantors—are still living.

Within these two broad categories, grantors have many options. Parents or grandparents who have faith in their offspring's financial prudence can name the adult child himself or herself as the trustee. In those cases, the grantors have confidence that the adult child will spend the money wisely and not commingle it imprudently with the marital property, during or after the grantor's lifetime.

In contrast, grantors who lack confidence in their beneficiaries' financial judgment may select a third party as trustee or co-trustee, and limit access to the trust funds however they please. For example, they may restrict their children's access to all uses except healthcare and a modest stipend. The rest is thereby preserved for grandchildren.

Parents who fear serial divorces or other upheavals may choose to keep the reins on any trust they establish tight throughout the life of the beneficiary. Others may choose to create a kind of "divorce-insurance" policy for their children to cover the earlier years of their lives. For example, they may create a trust that is tightly restricted until their children are, say, 45. By then, the parents figure, the children will either have their bad first marriage out of the way, or have proved that the marriage is solid. Then the restrictions on the trust can be loosened.

Another strategy involves simply putting certain discrete assets in trust. For example, consider the case of grandparents who want to help a young married couple buy a house. As discussed, giving the couple the money and then letting them put the house in both their names establishes the home as marital property, subject to equal division in the event of a divorce. But if the grandparents buy the house themselves and then place it in a trust established for their grandchild, the house will remain safely in that grandchild's hands, under any circumstances.

Parents and grandparents who want to think beyond their own children may want to consider a "dynasty trust." Developed originally by families like the Rockefellers, Fords and Carnegies in the early 1900s, the dynasty trust is designed to protect descendants of all generations. It enables the "grantor"—the creator of the trust—to distribute income and principal just as he or she would want, long after his or her demise. It also provides for enormous savings in estate taxes.

As with any other trust, the dynasty trust can be written to permit more or less discretion on behalf of the trustee. And by adding a "spendthrift clause," the grantor can also prevent creditors of a beneficiary from attacking trust assets for indebtedness, or prevent the divorcing spouse of a beneficiary from laying claim to trust assets.

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Summary

As parents think about these strategies, lawyers agree, they should realize that they don't—and shouldn't—think in terms of choosing one. For example, in many cases, prenups and trusts are a good idea; they are by no means mutually exclusive.

In any event, parents need to think through the issues carefully, and may want to consult a financial adviser as well as a legal professional to help them. "Most people," Fax notes, "want their money to go to lineal descendants. It's human nature."