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Estate Planning for Blended Families - Let Me Count The Ways

By Richard M. Morgan & Loraine M. DiSalvo

As we are all aware, divorce is common in the modern U.S. One frequently cited statistic is that about 50% of all marriages will end in divorce. Many divorces involve couples who have children. Many of these divorced parents subsequently remarry or enter other long-term relationships, which results in "blended" families. Blended families are ones in which one or both members of a couple have children from prior relationships.

One of the most difficult issues faced by couples with blended families is figuring out how assets should pass at their deaths. Many couples with children want to ensure that the surviving member of the couple will be financially okay, and that assets remaining after both members of the couple have died will benefit their children. In a non-blended family situation, these goals can often be met fairly easily. However, where the children are not all children of both members of the couple, meeting both of these goals can be more difficult. Even if a couple with a blended family believes they know what they want to see happen under their estate planning, and both of them agree to the overall goals, it is not always easy or even possible to ensure that things happen exactly the way they envision.

For our October 2012 newsletter, we wanted to discuss some common blended family situations and the planning options which have often been used by blended families in our many years of estate planning practice. While each family is unique, we hope that the options discussed in this Newsletter will help couples with blended families consider their own situations and come up with some ideas which might work well for them.

Please note that, in this discussion, we refer to "children." However, the actual situation could be that only one member of a couple has children, and the other member wants to benefit his or her other family members or friends, or that beneficiaries beyond just children are intended, such as grandchildren, siblings, nieces or nephews, or parents. When reading this newsletter, please don't forget that children might not be the only desired beneficiaries. However, we believe most of the situations discussed will work the same way even if the intended beneficiaries include people other than children on one or both sides of a couple.

Overall Intent 1 - My Kids Get My Assets; Your Kids Get Your Assets: One or both members of the couple had children from a prior relationship. The couple may or may not have had children together. The members of the couple may each have brought significant wealth into the relationship, or they may have brought widely different amounts of wealth to the relationship. However, at least one member of the couple wishes to eventually leave his or her own wealth to his or her own children, with the other member's pre-relationship children receiving only whatever assets that member brought to the relationship.

With this type of intent, the couple needs to be very careful to keep their assets separate during their lifetimes, and not to hold assets jointly. Each member of the couple will have estate planning documents

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prepared essentially as if he or she were a single person with children, so that all of each member's assets will pass to his or her own children at his or her death, without regard to whether the other member of the couple is then living. This can be a relatively simple plan to draft and implement, as long as the spouses remember that jointly owned assets will create potential problems, and as long as the surviving member of the couple knows he or she may need to move shortly after one member's death if their primary residence is owned by the first person to die.

Overall Intent 1A: Basically the same as Situation 1, except that one or both members of the couple wants to leave some assets to the surviving member of the couple, either outright or through a trust. Many of these couples come to their estate planning consultations saying that they want the first spouse to be provided for, but that they eventually want their own children to be the ultimate beneficiaries of their work, not all of the combined children.

If one or both of the members of a couple with a blended family wants to leave some assets to the surviving member at the first member's death, the desired result can be accomplished in several different ways, depending on exactly what is desired.

If the intent is for the surviving member of the couple to receive certain assets or a certain amount or share at the death of the first member of the couple, and the benefits for the surviving member are intended to pass to him or her outright, this can be handled through the estate planning documents. In other words, the primary estate planning documents (Wills or revocable living trusts) can make a specific bequest to the surviving member of the couple. This can help reduce the possibility that the surviving member of the couple may try to challenge the plan, but it also can result in the surviving member of the couple and the deceased member's children having to deal with each other for a long time after one member's death. It is also fairly simple to plan for an outright bequest to the survivor under the estate planning documents.

However, if the desire is for the surviving member of the couple to have more immediate outright access to some or all of the assets he or she is intended to receive, and the survivor is intended to receive the benefits outright, then joint ownership with rights of survivorship (either as "joint tenants" in Georgia and most other states, or as "tenants by the entirety" for married couples in Florida and certain other states), "payable on death" ("POD") or "transfer on death" ("TOD") designations, and other beneficiary designations (on assets such as IRAs, 401(k) accounts, and life insurance policies) can be used.

Assets which pass to the surviving member of the couple under a right of survivorship should be immediately available to him or her. Assets which pass to the surviving member under a payable on death or transfer on death designation or any other beneficiary designation may not be immediately available but should be available more quickly than assets which have to pass through the deceased person's probate estate would be.

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If the intent is for the surviving member of the couple to receive assets through a trust, which may be done to ensure that any remaining assets pass back to the first member's family but can also have protective benefits for the surviving member during his or her lifetime, then generally there must be some specific provisions in the estate planning documents, even if beneficiary designation planning is also involved. For example, if a significant portion of one member's assets are held in tax-deferred accounts, the couple might decide to have a trust for the survivor serve as beneficiary of the tax-deferred accounts, so that the survivor is not able to designate a new beneficiary for the accounts and have any remaining assets pass to his or her own desired beneficiaries, but the survivor can still benefit from a portion or all of the tax-deferred assets during his or her lifetime.

In this case, the trust would need to be created under the estate planning documents done by the couple, and the beneficiary designation on the tax-deferred accounts would also need to be carefully crafted so that the desired portion of the account assets end up payable to the trust after the original account owner's death. As a simpler alternative where there are sufficient non-tax-deferred assets, the first member's estate planning documents can simply provide for a certain portion of his or her assets to be put into a trust for the benefit of the surviving member.

One additional issue which should be considered is if the surviving member of a couple is intended to receive tax-deferred assets (whether outright or through a trust), such as an IRA or 401(k) account, is that the survivor's benefit will be reduced to the extent he or she must pay income taxes on amounts withdrawn from the account after the first member's death. If this income tax impact is not considered, the survivor could end up receiving significantly less real benefit than anticipated.

Overall Intent 2 - Take Care of the Surviving Member of the Couple, Then Take Care of Our Combined Children: One or both members of the couple have children from prior relationships, they may or may not have children together. They want the surviving member of the couple to be able to use and benefit from most of their combined assets after the first member's death, but they want to ensure that the first member's children from his or her prior relationship receive something at some point in time (either after his or her death or after the death of the survivor). Members of the couple may have brought similar or widely different amounts of wealth into the relationship.

Couples who generally want the surviving member of the couple to have the benefit of a significant portion of their combined assets after the first member's death tend to use the widest variety of plans. Factors which will heavily influence the plan include how much control they want the surviving member of the couple to have and how they want assets to pass after they are both deceased.

Some of the couples with this intent decide to make some specific bequests to the first member's children at his or her death (either outright or to trusts), and to have the rest of the first member's assets pass to the surviving member of the couple outright. This type of plan is fairly simple to structure, assuming that each member of the couple is likely to have enough assets available to fund the bequests if he or she dies first. Some of these couples also have their plans set up so that, in each person's documents, similar specific

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bequests will be made to the surviving spouse's children, and the rest of the assets remaining at the surviving member's death will be divided among all of the combined children.

However, couples who have assets pass to the surviving member of the couple outright must always be aware that the survivor will be completely free to change his or her plan after the first person's death, and that he or she may decide to cut the first person's children out. Couples who select this type of plan should be happy with the specific bequests provided for the first member's children under their documents, even if that ends up being all those children ever receive. In addition, asset ownership and beneficiary designations are particularly critical in this type of plan, since if all assets pass to the surviving member of the couple through rights of survivorship and/or beneficiary designations, there will be no assets available to fund the bequests at the first person's death, and his or her children may receive nothing at all.

Other couples who want to allow the surviving member to benefit from the assets left by the first member, but who want to help ensure that some assets will eventually pass to the first member's children decide to have assets pass from the first member to the survivor through a trust, rather than outright. These couples may or may not also include specific bequests to be made to each member's pre-relationship children at their deaths.

The trust for the surviving member of the couple is often set up so that he or she is the only beneficiary as long as he or she is still living, although some or all of the children may also be permissible beneficiaries. At the death of the surviving member of the couple, assets which remain in the trust created by the first member can then pass as the first member intended - to his or her own pre-relationship children, to all the combined children, or to some other combination. The surviving member of the couple may do what he or she likes with his or her own assets, but usually is not given the ability to modify what happens to the trust's assets.

Some couples want the surviving member of the couple to have the benefit of their combined assets, and are less concerned about eventually ensuring that children receive any benefits. Where estate taxes and protection from creditors and predators are not a concern, many of these couples simply have all the first member's assets pass to the survivor outright. Generally, each member of the couple will have an estate plan which provides that, at the death of the survivor, assets will be distributed among their combined children in a particular way. However, each member also knows and is comfortable with the possibility that the survivor may change this plan after the first death, leaving less to the first person's children than originally planned or cutting them out entirely.

Overall Intent 2A - Benefitting the Children After Both Deaths: In any plan where the desire is for assets to pass to the couple's combined children after the surviving member's death, the couple must decide how the children are to benefit. One decision is whether the children will receive their shares outright or in trust. Often the more difficult decision, however, is whether all children will receive an equal share, essentially as if they were all mutual children of the couple, or whether different children will receive different shares.

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Many couples want to essentially end up with a distribution which has the assets each member brought to the relationship passing to his or her own children. If these couples use a trust for the benefit of the surviving member under the first member's estate planning documents, this result can be more easily achieved. The first member's plan can benefit only his or her children after the survivor's death, and the survivor can then benefit his or her own children in his or her own estate planning documents.

However, some couples want the simplicity of an outright bequest to the surviving spouse, and are less concerned with absolutely ensuring this result. Many of those couples attempt to approximate having each member's own assets pass to his or her children by determining the relative percentages of their combined wealth which each of them brought to the relationship, and then dividing the property left at the survivor's death accordingly. For example, if one person brought approximately 70% of the combined assets to the relationship, and the other person brought approximately 30% of the combined assets, their plans could provide that, after both deaths, the remaining assets would be distributed 70% to the one person's children and 30% to the other person's children. A similar plan can be used in a trust for the survivor, if desired.

A smaller number of blended family couples decide that they want to benefit all of their children equally, as if all of the children were children of both members of the couple. This plan is more commonly found in situations where the couple has one or more mutual children, or where the couple's relationship has been long and stable and relationships with all of the children are particularly strong and close for both members. This type of distribution plan can also be used with either a trust for the surviving member or in an all-outright-to-the-survivor plan.

Issues to Consider in any Blended Family Situation

Be Very, Very Careful When Using Joint Ownership and Beneficiary Designations. A couple who decides to use joint ownership with rights of survivorship, POD and/or TOD designations, and other beneficiary designations to transfer assets to the survivor (or to any other beneficiary or beneficiaries) at one member's death must do so very carefully, to avoid unintentionally providing more or less benefits than desired. Joint ownership should be very carefully created and monitored, to ensure that only the assets intended to pass by rights of survivorship are actually subject to rights of survivorship. Assets subject to beneficiary designations, POD designations, and TOD designations should also be monitored and adjustments made as needed. For example, if the intent is for one member of the couple to carry life insurance which will be payable to the surviving member of the couple, with the insured member's children receiving all of his other assets, and the insured member of the couple allows the insurance policy to lapse, the surviving member of the couple will not receive any insurance proceeds.

This can be a particular risk if the insurance is a term policy, which will become increasingly expensive as the insured ages. As another example, if a couple opens a joint bank account which is primarily intended for use in paying regular daily living expenses, but the account ends up holding a significant amount of "excess" assets, the joint bank account will pass to the surviving member of the couple in its entirety, without regard to whether the account holds $2,000 at the first person's death or whether it holds $200,000. Therefore, it

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would be important that the couple make sure that the balance in the joint account is never in excess of the amount intended to pass to the survivor automatically.

Remember, Any Time Assets Pass to the Surviving Member of a Couple Outright, That Person Is Free to Do With Them As He Or She Wishes, Even If Both Members Originally Agreed to a Different Plan For After Both Deaths. This is always an issue which should be carefully considered. If you don't think you would be happy if your spouse or partner changes the overall plan after your death, then you should generally consider using trusts as part of your plan. If you think you wouldn't mind if your spouse or partner changed your plan after your death, even if that meant your own children received nothing, then you might be fine having assets pass to the surviving spouse or partner outright.

Consider Using Fully Funded Revocable Living Trusts As Part of Your Estate Plans, Instead of Relying On Wills Alone. We would strongly encourage couples with blended families to use fully funded, revocable living trusts ("RLTs") as their primary estate planning documents instead of a Will. Using fully-funded RLTs can help the couple remember not to own assets jointly except where those assets are really intended to pass by rights of survivorship. A fully funded RLT can also help reduce the possibility of a challenge by the surviving member of the couple against the first person's estate plan, or by the first person's pre-relationship children. The anti-challenge effects of a fully funded RLT arise since it is more difficult to challenge a trust than a Will, and since assets in an RLT are not directly subject to a possible year's support claim by a surviving spouse or a surviving minor child. In addition, for couples who are unmarried (or whose marriages are not legally recognized in the state where they live), a fully funded RLT can help protect the surviving member of the couple against the legal heirs of the deceased member of the couple. For example, if the deceased member of an unmarried couple has children from a prior relationship, her children would be her heirs, while her surviving partner would not be her heir. Her children could then attempt to challenge her Will if she made provisions under it for the benefit of her partner.

For Married Couples With Blended Families, Consider Using Well-Drafted Prenuptial or Postnuptial Agreements. We also encourage married couples with blended families to use pre or post-nuptial agreements, which can be used to help specifically describe and limit the rights or interests a surviving spouse will have at the first spouse's death. For example, a prenuptial agreement can have each spouse waive any right to receive a year's support from a deceased spouse's estate. For those couples who may not always have a principal residence in Georgia, a prenuptial agreement may also be able to waive any right a surviving spouse may have to a forced or elective share, or to limit community property rights. In any case, as with any estate plan, it will be critical that the members of the couple pay careful attention to how their assets are owned and how their beneficiary designations are set up.

For Unmarried Couples with Blended Families, Consider Using Well-Drafted Domestic Partner Agreements. Unmarried couples (or those whose marriages are not legally recognized by the state they live in) may be able to enter domestic partnership agreements. Since couples who are not legally married (or legally recognized as married) generally do not have any rights with regard to each other's estates, the domestic partnership agreement does not generally need to waive rights. Instead, it can be used as part of an overall

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estate plan to help give the surviving member of the couple some protection against the legal heirs of the deceased member.

Remember, Trusts Have Many Potential Advantages over Outright Distributions, No Matter What the Situation: As we have mentioned in many prior newsletters, having assets pass to desired beneficiaries in trusts can often provide protections for both the original owner of the assets and the intended beneficiaries. Outright distributions cannot provide these protections. From the original asset owner's perspective, for example, as discussed above, using a trust to allow assets to benefit a surviving spouse or partner can give the original asset owner the ability to provide how the remaining assets will pass at the survivor's death.

The trust can also protect the assets from the survivor's potential problems, such as creditors and predators, including a future new spouse or partner the survivor may have. This creditor and predator protection can also be a good thing from the trust beneficiary's perspective, whether the beneficiary is the surviving member of the couple or a child, as it can help ensure that the assets remain available for the beneficiary even if the beneficiary ends up divorced or with creditor problems such as large uninsured medical costs after an injury or illness. As we have also discussed many times before, the choice of a trustee for any trust can increase the beneficiary's ability to control the trust's assets or increase the protective qualities of the trust, depending on the trustee selected and the structure of the trust itself.

As you can see from the above discussion, what any particular couple with blended family ends up doing in their estate plan will depend on numerous factors. In addition to the factors discussed above, other factors will usually come into play, such as: the respective needs of the intended beneficiaries, the amount of assets which may be available, and the ages of the various desired beneficiaries. The relationships between the members of the family can also be a critical factor. For example, where one member of a couple has a very poor (or no) relationship with his or her pre-relationship children, but has a wonderful relationship with his or her stepchildren, or where the couple has children together, the couple may have less desire for any assets to benefit that member's pre-relationship children. The couple might also want to ensure that any benefits for the member's pre-relationship children are very tightly controlled or defined.

It should be clear from this discussion that planning when a blended family is involved is not "cookie cutter" planning. Couples with blended families need to seek the advice of experienced estate planning attorneys who have worked with many blended families. The couple needs to work carefully with their attorney to ensure that they develop the plan which is right for them. They need to be able to discuss a large number of issues and make a lot of decisions, many of which are tough. The attorney needs to be able to help the couple explore and consider the available options for the couple, so that they can get a plan which truly reflects their needs, their goals, and their desires for their families.

The attorneys at Morgan & DiSalvo have many years of experience working with blended families. If you are part of a blended family, and you want to ensure that your estate plan fits your family situation and your intent, please contact us to schedule an estate planning consultation.