Premarital Agreements: A Practical Guide for Estate Planners

by Brooke C. Tansill, Esq.
of Frederick J. Tansill & Associates, LLC
in McLean, Virginia

For some trusts and estates lawyers, negotiating and drafting Premarital Agreements is a significant portion of their practice. Such agreements are an effective estate planning tool and it is the experience of the lawyers at our firm that their use and popularity have grown in recent years. There are several socio-economic factors which have likely contributed to this trend. Millennials are getting married later in life and are therefore more likely to have built and acquired significant separate assets which they want to protect. Additionally, the increase in the rate of divorce, coupled with the increase in the number of blended families, has created complexity in the context of estate planning. Second spouses and children from prior marriages have competing interests and there is heightened sensitivity to the division of assets in the event of divorce and the disposition of assets at death. And finally, as we approach what will be the largest wealth transfer in history, those transferring the wealth and those receiving the wealth will be increasingly focused on protecting gifted and inherited assets. This article will provide a broad overview of Premarital Agreements, discuss some important planning concepts, focusing on some uniquely complicated assets that merit special consideration, highlight recent changes in the tax law that affect this area of planning, and describe alternative planning techniques available to clients who neglected to use, or refuse to use, Premarital Agreements.

Overview of Premarital Agreements: Statutory Requirements and Best Practices

Premarital Agreements in Virginia are governed by the Virginia Premarital Agreement Act, Title 20, Chapter 8 of the Code of Virginia. A Premarital Agreement is defined as "an agreement between prospective spouses made in contemplation of marriage and to be effective upon marriage."[1] In order to be valid, the Agreement must be in writing and signed by both parties, and the agreement becomes effective once the parties get married.[2] To be enforceable, the Agreement must be voluntarily executed, the Agreement must not be "unconscionable" when executed, and each party must make a fair and reasonable disclosure of his or her property and financial obligations prior to its execution, or if there was not disclosure, the party who did not receive disclosure must voluntarily and in writing waive the right to disclosure.[3] The issue of unconscionability hinges on the intrinsic fairness of the terms of the Agreement. It is worth noting that Virginia is a very contract friendly state and Premarital Agreements are rarely overturned as unenforceable.

Parties to a Premarital Agreement may contract with respect to any of the following: (1) the rights and obligations of each in the property of either or both of them whenever and wherever acquired or located; (2) the right to manage and control property; (3) the disposition of property upon separation, marital dissolution, death, or any other event, (4) spousal support, i.e. alimony, (5) making a will, trust, or other agreement; (6) ownership rights in and disposition of the death

[1] Va. Code § 20-148.
[2] Va. Code § 20-149.
[3] Va. Code §20-151.

benefit from a life insurance policy; (7) choice of law; and (8) any other matter that is not in violation of public policy or criminal statute.[4] Stated more broadly, Premarital Agreements address what happens when a marriage ends, either because of divorce or death. Importantly, parties to a Premarital Agreement <u>may not</u> contract to any terms addressing child custody or child support. Such issues are always under the jurisdiction of the Court and are subject to modification.

In addition to these statutory requirements and allowances, there are also some best practices that lawyers should adhere to when assisting clients with Premarital Agreements. Both parties should have independent counsel and the Agreement should recite the names of the respective attorneys. If the economically disadvantaged spouse cannot afford counsel or does not want to pay for counsel, perhaps the advantaged spouse should pay. In the rare circumstance in which one party refuses to obtain independent counsel, the Agreement should expressly state that both parties are entering the Agreement freely and voluntarily and the Agreement should expressly recite that one party, after thoughtful consideration, has declined to be represented by counsel. On the issue of financial disclosure, err on the side of over-disclosure. When in doubt, list the asset. When one of the parties has an expectancy of an inheritance, it should be listed with a best estimate. If one of the parties is the beneficiary of an irrevocable trust, list the type of interest and its approximate value. If one of the parties owns a closely-held business interest, thoughtful consideration should be given as to how to estimate its value. An appraisal, while not necessary, can be provided, or the owner might list the gross revenue of the business or compensation received. Some attorneys, as a matter or regular practice and to ensure that the financial disclosure requirement is met, have clients attach their tax returns to the Agreement. Finally, the timing of the negotiation and signing of a Premarital Agreement is important. There is no hard and fast rule but certainly the optics are better if an Agreement is signed well in advance of a wedding. The appearance of duress increases as the wedding date approaches. As a matter of practice, when a client of our firm executes a Premarital Agreement near the wedding date, we include language in the Agreement expressly stating that the parties acknowledge that the date of marriage is imminent and reaffirming that both parties are signing the Agreement voluntarily and free of duress.

The Usefulness of Premarital Agreements and Some Planning Considerations

A Premarital Agreement is a useful estate planning tool for a variety of client circumstances. If there is a large discrepancy in income or net worth between the parties, the economically-advantaged party wants to limit or eliminate spousal claims in the event of divorce. If one party owns a particularly valuable asset such as a closely-held business or a piece of real property, she wants to maintain her ownership of that asset in the event of divorce. Similarly, if one party anticipates receiving a significant gift or inheritance during her life, she wants to protect that asset in the event of divorce and may want to leave inherited assets back to her own family members at death, circumventing the spousal share requirements at death under state law. If the parties are of similar economic means, a Premarital Agreement can also be useful. The parties may have built their wealth prior to marriage and they both want to ensure that their pre-marital assets remain separate property. One or both of the parties may have children from a prior marriage for whom they wish to provide. A Premarital Agreement will allow both parties to limit obligations to their spouse at death to an amount less than the spousal share as required under

[4] Va. Code §20-150.

state law, i.e. the elective share in Virginia.[5] Both parties can also waive their spousal rights guaranteed under federal law to receive certain types of retirement plans so that each party can leave these assets directly to their own children. Another prime reason that parties seek Premarital Agreements is to limit legal fees, court costs, and the stress involved in negotiating a divorce settlement. They want to clarify what is separate property and what is marital property, especially untitled tangible personal property, and they want to determine what happens to those categories of assets in the event of divorce or death without subjecting such division to Court supervision and without incurring substantial legal fees.

Let us consider the jumping off point in negotiating Premarital Agreements, i.e. the vanilla Premarital Agreement. The basic concept is "what's yours is yours and what's mine is mine. If we get divorced, we have no obligation to each other. I walk away with my separate property and you walk away with your separate property. Any joint or marital property will be divided equally between us. At death, neither of us has any obligation to the other. Both of us are free to do whatever we like with our separate property, and any joint or marital property will pass to the survivor by right of survivorship." For some clients, this Agreement is sufficient. It allows the parties, through a title-controls regime, to resolve the division and disposition of assets. For most other clients, Premarital Agreements are highly customized with tailored provisions which reflect the unique financial and family circumstances of the parties. A thorough and detailed discussion of potential terms of a Premarital Agreement is beyond the scope of this Article but it is worth highlighting a few important considerations.[6]

On the issue of financial obligations to a spouse at divorce, if serving as counsel to the wealthier party, of course the goal is to eliminate any exposure to a claim for alimony or spousal support. As a note to estate planners, if there is a family law (divorce) lawyer as opposing counsel, expect resistance on the waiver of alimony. The author has heard many family law lawyers argue that the comprehensive waiver of alimony is fundamentally unfair to the economically disadvantaged party because the future is uncertain and there may be facts and circumstances at the time of divorce that warrant a claim of spousal support, i.e. one party has abandoned the other, or one party has given up her career to raise children. It is also worth noting that family law lawyers are skilled at negotiating divorce settlements in litigated divorces, and they are paid hourly for the time expended when negotiating such settlements. If one or both of the parties insist on some type of payment in the event of divorce, it may be preferable to negotiate a lump sum payment or an installment payment, perhaps even based on the length of the marriage. This allows for a defined payment and there is no room for argument as to what the payment terms are. Both parties benefit from certainty and both parties want to reduce the legal fees and court costs necessary to determine alimony in the future. Furthermore, as discussed below, some of the tax benefits of alimony have been eliminated through recent tax legislation. Of course, there are also risks to a pre-determined lump sum payment, for example if the payor party experiences a significant loss in income or net worth which would inhibit his or her ability to meet the obligations of the payment. Negotiations on this topic require careful consideration.

---

[5] Va. Code §64.2-308.1, *et seq.*

[6] As a resource for trusts and estates lawyers in negotiating and drafting Premarital Agreements, the author highly recommends the 2016 edition of the Virginia practice manual "Negotiating and Drafting Marital Agreements" edited by Richard E. Crouch and published by Virginia CLE Publications.

On the issue of financial obligations to a spouse at death, if the parties have both been previously married and have children from those prior marriages, often waiving spousal inheritance rights in a Premarital Agreement is appropriate. Once that has been addressed, the parties can control the disposition of their assets through the titling of assets. Separate property can pass to the party's intended beneficiaries, oftentimes their own children, and the parties can create marital property to the extent that they want assets to pass to his or her surviving spouse. Thoughtful consideration should be given to ERISA-controlled retirement accounts discussed in more detail below. In the case of blended families, the author has also found that life insurance can be a particularly useful asset in negotiating provisions at death. One party might agree to take out a life insurance policy payable to the other. This might be particularly appealing to the children because it requires the creation of a new asset that benefits the surviving spouse rather than shifting an existing asset away from the children, which would have the effect of reducing their inheritance. Alternatively, if the parties have never been married, do not yet have children, and neither anticipates receiving a significant inheritance, they may wish to provide that if they are married at the time of the first death, they reciprocally agree to leave 100% of their gross estates to the survivor. The lawyers at our firm often encourage such generous provisions. Or the parties may wish to contract to leave 50% (or some other percent) of his or her gross estate to the survivor, either outright or in the form of a Marital Trust (which is particularly useful when one party has significant inherited assets). Of course, keep in mind that a Premarital Agreement is a floor, not a ceiling, and that the parties are free to be more generous with each other than what the Agreement provides. If the parties do waive spousal inheritance rights at death, estate planners might consider including sunset provisions in the Agreement so that this waiver becomes obsolete after the parties have been married for a certain number of years, and the survivor has, in effect, "earned" an inheritance, or a larger one.

Another important consideration in drafting Premarital Agreements is how to characterize income and earnings made by each party during the marriage – as separate property or as marital property. This includes not only income and earnings of each party from employment, from self-employment, or from the performances of services, i.e. wages, salary, and bonuses, but also accumulations and increases in value of investments from passive or investment income. Perhaps the goal is to completely preserve the ability of both parties to keep this property as separate, not subject to any division in the event of divorce and free from the encumbrance of a spousal claim at death. Alternatively, if the parties view marriage as an economic partnership, perhaps they want to characterize all income and earnings during marriage as marital property, which in the event of divorce, would be divided, mirroring how Virginia handles the division of property at divorce under the "equitable distribution" concept. [7]

Retirement Accounts

As referenced above, retirement accounts are a unique asset and merit special consideration when negotiating Premarital Agreements. Federal law, namely the Employee Retirement Income Security Act of 1974 (ERISA), requires that a spouse be named as the beneficiary of a 401(k) plan. Note that most types of IRAs are not governed by ERISA and thus spouses do not have the right to inherit IRAs. If a 401(k) plan-holder wants to name someone other than his or her spouse as the beneficiary, the spouse must waive his or her right to receive the plan assets and must give

[7] Va. Code §20-107.3.

consent to the plan-holder naming someone else as the beneficiary. That waiver and consent must be kept on file with the plan administrator. Consequently, if parties to a Premarital Agreement wish to waive their interests in their spouse's 401(k) plan, the Premarital Agreement must contain the contractual obligation to give his or her consent and sign the waiver. Then, after the marriage, the parties must take steps to actually sign the waiver and give consent. Only a spouse can effectively waive the right to inherit a 401(k) plan so the waiver must be made post-marriage.

It is important to note that Virginia does have laws that automatically revoke provisions made for a spouse in the event of divorce. Once a marriage is terminated through divorce decree or annulment, provisions made for a former spouse under a Will are revoked.[8] But what about assets that pass by beneficiary designation outside of the Will? The Virginia legislature attempted to address this problem through the enactment of Section 20-111.1(A) which states that beneficiary designations to the former spouse and death benefits payable to the former spouse are revoked upon divorce decree or annulment. But these laws do not trump federal law, and consequently, under the doctrine of preemption, federal government retirement plans that name the former spouse as the beneficiary will pass to the former spouse. A relatively recent Supreme Court case highlights the importance of coordinating beneficiary designations on retirement accounts in the context of divorce. In *Kennedy v. Plan Administrator for DuPont Savings & Investment Plan,*[9] the Supreme Court held that ERISA-covered employee benefit plans must pay death benefits to a participant's properly-named beneficiary under the written plan document, regardless of any state-law claim that the beneficiary had waived his or her right to receive the benefit. In this case, the decedent had named his wife as the beneficiary. The parties subsequently got divorced, thus the divorce decree divested the wife of her interest in the plan, but the decedent did not sign an updated beneficiary designation removing her as the beneficiary. The Executor of the decedent's estate, the decedent's daughter, asked for the plan assets to be distributed to the estate instead, but the Court held that federal supremacy and preemption required them to pay the assets to the named beneficiary.

Closely-Held Business Interests

Business owners are ideal candidates for Premarital Agreements. Absent such an Agreement, they are uniquely exposed to hardship in the event of a spousal claim at divorce or death. While a Court will not award an ownership interest in the business to the spouse, it will likely consider the value of the business in dividing the marital estate. The business owner may have a significant portion of her net worth tied up in the business, and she may be somewhat illiquid, so she may be hard-pressed to make other funds available to satisfy any spousal claim. Additionally, at the business owner's death, if the spouse has not waived his spousal inheritance rights, a spousal claim may disrupt the business continuity plan and thus jeopardize the survival of the business. Counsel representing business owners should encourage their clients to enter into Premarital Agreements that expressly define the business as separate property, any successor business as separate property, and any increases in value derived from the business as separate property, and the Agreement should protect each party's separate property from a claim by the other party in the event of divorce or death. Counsel representing the non-business owner party

[8] Va. Code §64.2-412.

[9] 555 U.S. 285 (2009)

may ask for a financial accommodation in exchange for this waiver, such as the requirement that the business owner make gifts to the other party or transfer financial accounts or real estate to the other party.

There is another potential way in which these Agreements might be useful to business owners in the context of asset protection. If a spouse wishes to be protected from liabilities from the other spouse's business – e.g. from liability on a performance bond in a construction business or from any kind of obligation to co-sign or co-guarantee a business loan, a Premarital or Marital Agreement may assure the spouse freedom from such a liability. These Agreements also may be used to keep the family home free from a business debt-related encumbrance. Having an Agreement in place will often permit the spouse operating the business to secure financing without the other spouse's involvement and/or without pledging the family home as collateral, whereas a bank or lending company will always try to obtain the home as collateral or get the spouse to co-sign.

Recent Changes in the Tax Law That Affect Premarital Agreements

There are two relatively recent changes in the tax law that the author would like to highlight that affect Premarital Agreements: the deductibility of alimony payments and portability of the unused estate tax exemption.

Impact on Alimony Payments Under the Tax Cuts and Jobs Act of 2017

Ever since 1942, there has been an alimony deduction in the tax code. However, under the Tax Cuts and Jobs Act passed on December 22, 2017, for divorces and separation agreements finalized after 2018, spouses paying alimony will no longer be able to take a deduction and spouses receiving alimony will no longer be required to report it as income. Modifications of existing agreements after 2018 will be subject to the new rule if the terms of the agreement expressly subject the modifications to this new rule. Unlike many of the other provisions of the Act, this provision does not sunset after 2025.

Prior to this change in the law, alimony could be beneficial to both parties, alleviating some of the financial stress of divorce by providing tax benefits to the payor of alimony. The recipient of alimony is most often in a lower tax bracket than the payor spouse, so alimony payments allowed for the shifting of income from the higher tax rate of the payor spouse to the lower tax rate of the recipient spouse. Because less money was going to the government in the form of taxes, there was more money available to be divided between the parties. But repeal of the deduction eliminates the tax incentives for the higher-earning payor spouse and reduces the amount of money available to the divorcing parties because taxes are increasing for the payor spouse. What is the effect of this law on these Agreements? Instead of allowing for alimony payments, lawyers might instead negotiate lump sum or installments payments, or might include provisions which require one party to establish a trust for the benefit of the other party that will distribute a certain amount for a certain period.

Impact of Portability

The concept of "portability" became permanent under the American Taxpayer Relief Act of 2012. Portability allows the surviving spouse to inherit the unused portion of the predeceased spouse's estate tax exemption, commonly known as the "DSUE" amount. As a condition of portability, a Federal estate tax return must be filed at the first spouse's death expressly electing portability, even if no federal estate tax return would otherwise be required.

It is easy to imagine that in many cases the surviving spouse who is also named as Executor will forget the requirement to file the federal estate tax return or will conclude that it is too much trouble or too expensive to do so. Or the children of the predeceased spouse, if named as the Executor(s), might not like their step-parent and may resist the request to elect portability out of spite. Including a provision in the Agreement that specifically addresses the DSUE amount will alleviate these risks. For example, the Agreement might provide that the parties agree that the personal representative of the predeceased spouse's estate will, at the request of the surviving spouse within a certain number of days, timely file a portability election for the DSUE amount, and that if the surviving spouse makes this request and if the predeceased spouse would not otherwise be required to file an estate tax return, the surviving spouse will pay for the cost of preparing and filing the estate tax return. The Agreement might also require that the personal representative of the predeceased spouse's estate must fully cooperate with the preparation, execution, and filing of the estate tax return and must promptly furnish all documents and information necessary for that purpose.

The DSUE is an asset and practitioners should consider its potential value to the parties to the Agreement. Consider a situation in which the wealthier spouse has an estate well in excess of the federal estate tax exemption and the less wealthy spouse has assets well under the exemption. If the less wealthy spouse dies first, the DSUE amount would be highly valuable to the wealthier spouse as it would save the wealthier spouse estate tax at his or her death. A practitioner representing the wealthier spouse would negotiate to include a provision requiring that a portability election be made, and a practitioner representing the less wealthy spouse would negotiate for financial provisions favorable to her client in exchange for the agreement to elect portability.

Alternatives to Premarital Agreements: Discipline, Irrevocable Trusts, and (Post) Marital Agreements

It is a universal concern amongst wealthy clients that their children will lose their inheritances in the event of divorce. A Premarital Agreement can alleviate this concern. But what if their inheriting child, or the intended spouse of their inheriting child, refuses to enter into a Premarital Agreement? Tell your wealthy clients to counsel and implore their child to keep inherited assets segregated in his or her own name (or separate revocable trust). Generally, one does not need a Premarital Agreement to protect such assets from a divorce claim. Divorce courts typically do not divide gifted or inherited assets; these are not part of the "marital estate." But if the recipient puts such assets in joint name with a spouse and then gets divorced, the ex-spouse may walk away with 50%. It is important to note that keeping gifted or inherited assets separate is an effective strategy in the event of divorce but not at death. Absent a waiver of spousal inheritance rights in a Premarital Agreement, the surviving spouse has a claim to some portion of the gifted or inherited assets.

Another option available to parents who are concerned about their children losing assets in the event of divorce is to leave assets to their children in lifetime discretionary spendthrift trusts rather than outright. Assets held in an irrevocable discretionary trust by an independent Trustee for the benefit of a child are completely immune for the claims of the child's creditors, the most common creditor being the child's spouse. This arrangement has the added benefit of providing for protection at the child's death because the parent setting up the trust can dictate that any principal remaining at the child's death passes to the child's children, their grandchildren, so the child cannot disrupt this plan by leaving the assets to his or her spouse.

If one party is eager to negotiate a Premarital Agreement but the other party refuses, an option available to the eager party is to set up a self-settled asset protection trust, either domestically or offshore before the marriage. Virginia law now permits self-settled spendthrift trusts.[10] A detailed analysis of the risks and benefits of these vehicles is beyond the scope of this Article, but the author refers readers to the many articles available on her firm's website on the topic of self-settled asset protection trusts in the context of spousal claims.

Finally, if a married couple neglected to sign a Premarital Agreement but wishes to negotiate spousal rights after-the-fact, there is another option which the lawyers in our firm have found to be particularly useful as an estate planning tool: Marital Agreements. The Virginia Premarital Agreement Act also allows for agreements between married individuals. The relevant code provision provides that "[m]arried persons may enter into agreements with each other for the purpose of settling the rights and obligations of either or both of them, to the same extent, with the same effect, and subject to the same conditions, as provided in §§ 20-147 through 20-154 for agreements between prospective spouses, except that such marital agreements shall become effective immediately upon their execution."[11]

Consider the following scenario which occurs frequently in our practice: a married couple, both of whom have been previously married and both of whom have a child or children from a prior marriage, want to execute estate planning documents. They do not have a Premarital Agreement. They want simplicity and do not want to employ the use of a Marital Trust for their surviving spouse. They want everything to pass outright to the surviving spouse, and then everything to pass to their collective children in equal or specific percentage shares at the surviving spouse's death. If the parties execute estate planning documents agreeing to this plan, the risk is that after the death of the first party, the survivor will change his or her estate planning documents or make lifetime gifts or retitle financial accounts or change beneficiary designations to favor their own children and disinherit the beneficiaries of the first spouse to die. When we explain this risk to clients and that this simple estate plan is essentially a "hand-shake" agreement between the parties that the survivor will not take any action that has the effect of disinheriting the beneficiaries of the deceased spouse, they are understandably alarmed. A solution for the parties is to sign a relatively simple Marital Agreement in which they contract to this estate plan and agree to not take any action which would disrupt the agreed-upon plan. The Marital Agreement recites the intentions of the parties and outlines what they have agreed to, i.e. that they both agree that whoever dies first will leave all of his or her assets to the surviving spouse, and that whoever

---

[10] Va. Code §64.2-745.1

[11] Va. Code §20-155.

survives will leave all of his or her assets to all their children in the agreed-upon shares. The Agreement should also limit any lifetime gifts so that the surviving competent spouse, or his or her respective children, if acting as agent or successor Trustee, cannot make gifts to themselves or their heirs only which would disrupt the plan to provide for all children of both parties as agreed. When adopting this approach, it is important that if there is a grant of gift-giving power to an agent under a Power of Attorney, or if the Revocable Trust allows for distributions to children or grandchildren during the Settlor's incapacity, that these provisions coordinate with the Marital Agreement.

This approach allows the parties to have a simple estate plan at death, provides comfort to both parties that their wishes will be honored, and has the benefit of providing comfort to the children in knowing that their parents have thoughtfully considered relevant issues and that their interests are protected. It also creates a remedy for the children if either party breaches the contract.

Conclusion

Once a Premarital Agreement has been signed, the parties must work with their estate planning lawyers to prepare and execute estate planning documents which comply with the terms of their Agreement. Careful consideration must also be given to any changes that need to be made to the titling of assets and/or the beneficiary designations. The coordination of assets is vital to the successful implementation of the agreed-upon plan. Consequently, estate planning lawyers should view this as a three-step-process: step one is the negotiating and drafting the Premarital Agreement; step two is the creation and execution of estate planning documents that comply with the terms of the Agreement; and step three is the retitling of assets and the designation of appropriate beneficiaries to coordinate with the estate planning documents.

As a final note, the author encourages civility in negotiating the terms of Premarital Agreements. Strongly advocating for your client's interests in protecting his or her property rights and income does not demand contentious behavior and methods. Clients often feel stressed, fragile, scared, and/or resentful when negotiating such agreements. If their lawyer retains a calm and composed demeanor, working creatively with opposing counsel to find solutions rather than inflaming the situation by adopting an antagonistic and aggressive attitude and approach, the process will be much more pleasant for all parties involved. As trusts and estates lawyers, we are uniquely trained and qualified to work collaboratively with clients and their advisors to find solutions which address their unique family and financial circumstances. We are comfortable navigating delicate situations, assuming the role of a therapist, exercising diplomacy, and seeking fairness. These skills make us well suited to provide tremendous value to clients in the negotiation of such Agreements.