

SPECIAL REPORT

What Blended Families Should Know About Estate Planning

CASE STUDY 1: Simple wills inadequate to protect children from previous marriages

Andy (age 77) and Maureen (age 75) have a long-term second marriage. Andy has two children from a previous marriage, Alexis (age 50) and Kit (age 48). Maureen also has two children from a previous marriage, Lauren (age 45) and Misty (age 44). Andy and Maureen have simple wills that give their entire estate to the surviving spouse with contingent gifts for the four children. After Andy dies, Maureen moves closer to her children and becomes estranged from Alexis and Kit. She changes her will to give her entire estate to Lauren and Misty.

CASE STUDY 2: Delayed inheritance leads to litigation

Andy, a widower (age 56), marries Paris (age 25). Andy has two children, Alexis (age 24) and Lauren (age 21), from his previous marriage to Maureen. Andy wants to provide for his wife but does not wish to disinherit his children. He creates a trust that names his two children as remainder beneficiaries. Andy dies and his children eventually become resentful at having to wait until Paris' death to receive their inheritance. They institute litigation with Paris over extravagant distributions from the trust.

CASE STUDY 3: Long-term-care needs threaten inheritance

Andy and Maureen marry when they are in their 60s. Maureen has significantly more assets than Andy. Both Andy and Maureen have children from previous marriages. Andy's children are Alexis and Kit. Maureen's children are Lauren and Misty. Maureen is concerned that her children's inheritance will be diminished if Andy ever requires long-term care and she has to pay for it with her own funds.

CASE STUDY 4: Child's blended marriage raises estate-planning concerns

Andy and Maureen have a happy first marriage with two children, Alexis and Lauren. Alexis is married to Kit, who has children from a previous marriage and has difficulty keeping a job. Andy and Maureen are concerned that if they leave an inheritance outright to Alexis, Kit will "permanently retire" and live off the inheritance.

WHAT ARE BLENDED FAMILIES?

Blended families take several forms:

- ◆ Married couples in which one or both spouses have children from a previous marriage.
- ◆ Families with children who are in second or subsequent marriages and who have children from previous marriages.
- ◆ Families with children whose spouses have children from previous marriages.

Blended families can face complex estate-planning challenges. Issues can arise between spouses or between children and their spouses. Typically, individuals in blended families want to provide for the spouse as well as the children from the previous marriage. In some cases, they also want to provide for the children from their spouse's previous marriage.

ARE BLENDED FAMILIES COMMON?

Several trends related to divorce have increased the number of blended families.¹

- ◆ Approximately 50% of American marriages end in divorce.
- ◆ Approximately 60% of remarriages end in divorce.
- ◆ Approximately 43% of marriages are remarriages for at least one party.
- ◆ The average duration of these marriages is 7.8 years.
- ◆ There are approximately 1,160,000 new divorces each year.
- ◆ Approximately one million children a year have newly divorced/divorcing parents.
- ◆ 54% of divorced women remarry in five years.

WHAT ESTATE-PLANNING CHALLENGES DO BLENDED FAMILIES FACE?

In a blended family, estate-planning challenges can include:

- ◆ The potential for children to be disinherited.
- ◆ Delays in the children's receipt of inheritance until after the death of their parent's spouse.
- ◆ The need to protect assets from former spouses.
- ◆ Disputes over division of authority or responsibility.

WHAT ESTATE-PLANNING STRATEGIES CAN HELP?

Estate planning for blended families is a form of asset protection. Depending on a family's situation and needs, an estate-planning attorney can help select and execute one of the following strategies.

- ◆ Premarital and Marital Agreements. These agreements should address:
 - The parties' rights and responsibilities during their marriage with regard to living arrangements, division of obligation to pay expenses, and obligation to purchase and maintain long-term-care insurance.
 - The parties' rights and obligations if they divorce.
 - The rights and obligations of the surviving spouse in the estate of the deceased spouse.
- ◆ Spray Spendthrift Trusts. These trusts are designed to benefit the surviving spouse and children. When drafting a Spray Spendthrift Trust, the following should be considered:
 - Distributions. The trustee may be permitted to make distributions to the surviving spouse and designated children.
 - Unitrust distributions. A spouse may be given an annual Unitrust distribution equal to a percentage of the trust. For example, the spouse might receive 4% of the total annual return on assets held in the trust or 4% of the total trust assets as calculated on an annual basis.
 - Trustee selection. A disinterested trustee may be appointed to help avoid conflicts of interest and strained family relationships while permitting distributions for "any appropriate purpose."
 - Death of spouse. The trust may stipulate that, upon your death, the remainder of the trust will be distributed to your children from a previous marriage or to children from both marriages.
 - No contest. Including a "no contest" provision in the trust minimizes the risk that the trust will be challenged.

¹Divorce Magazine. <http://www.divorcemag.com/statistics/statsUS.shtml>

- ◆ Bloodline Trusts. These trusts are designed to benefit your child and his or her descendants. With the goal of keeping money in the family, the trust protects assets from the child's creditors, including divorcing spouses, while maintaining maximum control for the child. The trust may include the following provisions:
 - That your child will be the trustee unless he or she is involved in a divorce action or a lawsuit.
 - That your child, acting as trustee, can distribute principal to or for the benefit of himself or herself or to his or her descendants.
 - That there will be a disinterested trustee who can distribute principal for any appropriate purpose.
 - That the trustee will have discretion to distribute income to or for the benefit of the child.
 - That the trust terminates at your child's death and the remaining principal is paid to your child's descendants, not to your son- or daughter-in-law.
 - A Spendthrift provision is a provision that expressly says your child has no right to terminate the trust and protects the assets in the trust from creditors.

- ◆ Irrevocable Life Insurance Trusts (ILITs). An ILIT lets you provide for your children with life insurance and use your remaining estate to provide for your spouse. The trustee of the ILIT purchases a life insurance policy on your life and you pay the premiums. ILITs offer two major advantages. They prevent children from being disinherited because the trust names them as sole beneficiaries of the life insurance policy. And they ensure that children will receive inheritances promptly because the policy will pay the trust immediately upon your death.

There also are some variations on this strategy in which you can:

- Purchase your own life insurance policy and name your children as beneficiaries. The estate-tax consequences of this technique must be considered.
- Have your children from a previous marriage own the policy while you pay the premiums, utilizing your Annual Exclusion gifts.

- ◆ FLPs and LLCs. A Family Limited Partnership (FLP) is an ideal tool for a family that owns real estate. The real estate is transferred to the partnership, which is composed of parents and children. A Limited Liability Company (LLC), comprised of family members, is similar to an FLP. Both arrangements can be used to protect family assets from the claims of spouses and former spouses. FLPs and manager-managed LLCs also can protect family assets from the claims of your children's spouses or former spouses.

- ◆ Life Estates. Often, in a second marriage, one spouse moves into the home of the other. The home is not always retitled jointly - nor should it be. The individual who owns the home often wants the spouse to have the right to live there for his or her lifetime. This can be accomplished by giving the surviving spouse a life estate in the home. Individuals who choose this strategy should attach certain conditions to the life estate, such as an obligation on the part of the surviving spouse to pay the home's taxes, insurance and maintenance expenses. Consideration should be given to requiring an automatic termination of the life estate if the surviving spouse moves out or abandons the property for a certain period of time. And provisions should be made regarding whether the property can be rented or sold and, if so, who is entitled to the rent or proceeds of the sale.

- ◆ Contracts to make a will. When appropriate, a contract to make a will offers a simple estate-planning solution. Often, spouses want their wills to stipulate that everything will be left to the surviving spouse, with remaining assets to be divided on some basis between children from both families upon the death of the second spouse. But, at the death of the first spouse, the will of the surviving spouse typically becomes non-enforceable since it can be changed to disinherit the children of the first spouse. It is possible for the parties to enter into a contract to make a will, which essentially prohibits the surviving spouse from changing his or her will. The disadvantage of this strategy is that the surviving spouse may have valid reason for wishing to change the will, completely unrelated to disinheriting the children of the deceased spouse or delaying their inheritance.

- ◆ Qualified Terminable Interest Property Trusts (QTIPs). With a QTIP, the will or trust of the spouse who dies first gives the surviving spouse the right to income from assets held in the trust. This income interest has the effect of deferring the taxes due at the death of the first spouse. It also is possible to draft a QTIP to include the right for the trustee to make distributions of principal exclusively to the surviving spouse. The surviving spouse has no right to direct payments from the QTIP. Upon his or her death, the trust typically distributes assets to the children of the first spouse. In most cases, a QTIP trust is drafted as part of an overall estate plan, either leaving a portion of the assets outright to the children or leaving those assets to a credit shelter trust for the benefit of the surviving spouse and the children from one or both marriages.
- ◆ Disclaimer Trusts. When assets are left outright to a surviving spouse, he or she may be given the right to "disclaim" them into a Disclaimer Trust. This very popular type of trust should not be used if there is concern that the surviving spouse may disinherit the children of the deceased spouse.

SUMMARY OF ESTATE- PLANNING ALTERNATIVES FOR BLENDED FAMILIES

- ◆ Premarital and Marital Agreements
- ◆ Spray Spendthrift Trusts
- ◆ Bloodline Trusts
- ◆ Irrevocable Life Insurance Trusts
- ◆ Life Insurance Policies Outside Trusts
- ◆ FLPs and LLCs
- ◆ Life Estates
- ◆ Contracts to Make a Will
- ◆ Qualified Terminable Interest Property Trusts
- ◆ Disclaimer Trusts

OAST & HOOK, P.C. www.oasthook.com

521 Middle Street Mall
Portsmouth, Virginia 23704
Tel: (757) 399-7506
Fax: (757) 397-1267

295 Bendix Road, Suite 170
Virginia Beach, Virginia 23452
Tel: (757) 399-7506
Fax: (757) 397-1267