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ESTATE PLANNING FOR SECOND MARRIAGES

(Estate Planning Advisory No. 6)

This Advisory discusses some of the unique complexities in creating an estate plan for those individuals involved in a second marriage. Couples in a second marriage following a divorce or death of a spouse now account for more than half of a typical estate planning attorney's practice. With children from a prior marriage and children of the second marriage, there are numerous emotional issues and challenges that are presented. This Advisory looks at some of the complexities for those in a second marriage and the available options.

This discussion is neither exhaustive nor tailored to your specific situation, but only intended to give you enough information to discern whether there are options you may want to consider in implementing an estate plan. Our firm representation is only undertaken through a written engagement letter and not by the distribution of this Advisory.

Unresolved Emotional Issues: Issues from a person's previous relationship can negatively affect decisions made during the estate planning process. For many people, their last contact with an attorney may have been in the context of a difficult divorce. The process of meeting in a lawyer's office, discussing the division of assets and struggling over the treatment of children may result in recall of similar agonizing issues raised during a divorce proceeding. If there are concerns on how to apportion an estate among a current spouse and children from a former marriage, the potential to rekindle frustration and animosity can spark conflict between the current spouses. While conflicts are not unusual in making decisions of this nature, it is wise to address them and determine a fair and equitable outcome rather than take no action and leave the surviving spouse with great burdens to solve at great expense.

Dealing with Multiple Sets of Children: Frequently, remarried individuals have children from a previous relationship, as well as one or more children from the current relationship. Discussions over how to devise an equitable plan for all the children can easily become combative. Individuals need to realize that the desire to provide for biological children is strong and does not indicate any current emotional attachment with the previous partner. Complicating this may be a strained bond between a child and a step-parent. Imagine how the strained relationship can be magnified if all of an estate is left to a surviving spouse with the children from the previous marriage having to wait until the step-parent's death before they receive any of their inheritance! This can be even more magnified if the surviving spouse is named as the successor trustee and controls discretionary payments to the children.

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Possible solutions: Solutions include using separate assets or life insurance to fund a separate trust for the children, allowing for an immediate inheritance for the children at the parent's death. Another possibility to ease strained relationships is to name a friend, relative or trust company to act as the trustee when the first spouse passes rather than the surviving spouse. If a child receives the proceeds from a life insurance policy or has a parent's separate property assets available for support or distribution, it is much easier for them to accept the distribution plan rather be concerned that the surviving spouse may spend down the remainder of the estate assets if they are the successor trustee. No one wants to see a situation occur in their family like that of Anna Nicole Smith and her court battle to challenge her husband's trust that left the bulk of his estate to his children! A well thought out plan and open discussions with a spouse and children can go a long way to alleviating decades of anger and resentment after your death among the people you love most.

QTIP Trust: One common tool for second-marriage couples is the creation of a QTIP (Qualified Terminable Interest Property) Trust. This allows a person to control how their share of the marital assets is used after their death. Assets placed in a QTIP Trust allow for income to be distributed to the surviving spouse during his or her lifetime and qualifies for the unlimited marital deduction, so no estate taxes are assessed at the first spouse's death. After the first spouse's death, the principal is held for the benefit of the children of that deceased spouse, but they have to be patient and wait for the death of their step-parent before receiving it. This method preserves the principal of the trust for the children and allows the spouse to have the income from trust assets for the remainder of his or her lifetime, leaving the beneficiaries to wait until assets are divided after the surviving spouse's death. A surviving spouse may be given authority to withdraw principal if needed under certain circumstances (i.e. for medical purposes), but creates the potential that the surviving spouse may pull out too much principal if they are the trustee and have unlimited discretion to withdraw funds. Restrictions on the amount of principal that can be withdrawn can be set out in the trust provisions, but enforcement may be challenging, requiring children to file court actions against a step-parent. If a trust company or third party is named as the successor trustee, a spouse may become resentful if the successor trustee has discretion to make decisions about distributions instead of the spouse. These are touchy issues to discuss and resolve at the drafting stage of the trust.

Prenuptial Agreements: Complications can arise in a marriage where the parties signed a premarital agreement and after marriage decide to implement an estate plan that varies from the provisions in the agreement. The potential conflicts may require amending the premarital agreement, which requires the parties to obtain separate counsel for an amendment to be valid. For example, a premarital agreement may include a waiver of each party's rights to the other's retirement plans, but a pre-marital waiver of spousal benefits for certain retirement plans may not be effective because applicable Treasury Regulations require the parties to be married at the time

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of signing the waiver. If the premarital agreement purports to waive spousal rights to retirement plan assets, it may be necessary to obtain new waivers.

Classifications of property in the prenuptial agreements and other provisions are not changed by estate planning unless the parties particularly indicate that result. Normally, the estate plan simply indicates that the property classifications continue until the death of the first spouse.

Dealing with Differences in Ages: Substantial age differences between spouses are not confined to celebrities. These age differences can present problems, and not just because of special rules for computing minimum required retirement plan distributions when the participant is more than 10 years older than the participant's spouse. The children of the elder spouse may resent or distrust the younger spouse. General Chuck Yeager, a famous WW2 combat pilot, married a much younger spouse in 2003 after having his daughter manage his money for years after his first wife's death. After his remarriage, Yeager's attempts to resume management of his finances resulted in resistance by his adult children, who believed their father's new wife had married him solely for his money. Early in 2007, a Nevada County Superior Court judge ordered Yeager's adult daughter to repay almost \$1 million in funds received in the sale of family assets after Yeager filed a lawsuit against his children accusing them of diverting money from his pension fund. This resulted in over two years of court battles, all initially arising out of a remarriage to a younger spouse. This type of situation can be avoided with proper planning and communication.

Dealing with Wealth Disparities in Spouses: Wealth disparities in spouses can create a host of difficult issues. One spouse may not have enough assets to fully fund their own applicable exclusion amount to result in savings in estate taxes after their death. If the wealthier spouse is the survivor, they may reject the idea of transferring assets to fund the amount, knowing that those funds may be inherited by the deceased spouse's children. When both spouses have children, resentment is likely to surface if the wealthier spouse supports his or her children in a more lavish manner than the less-wealthy spouse. Because of societal and gender issues, the tension and potential for conflict may increase when the man is the less-wealthy spouse. To address these issues, knowledge of the likely tension can be helpful, and discovering the disparity as soon as possible in the process will help the estate planning attorney develop options so that a surviving spouse and the children are provided for in a manner that can reduce conflict.

Dealing with Who Pays the Estate Taxes: Estate tax apportionment is complicated because the burden of paying the estate taxes falls on the "rest, residue and remainder" of the estate. If the plan calls for deferring estate taxes until the second spouse's death, which is common, the inheritance of the beneficiaries of the residue after the second spouse's death will

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be diminished by the estate taxes. Essentially, those beneficiaries “pay” the estate taxes and end up with less. In a first-marriage situation, this may not matter because all of the beneficiaries of the first spouse to die are probably the same individuals as those who are the beneficiaries of the surviving spouse and they shoulder the tax burden at some point in time during their parent’s death.

In a second-marriage situation, this may not be the case. Assume Husband and Wife each has two children from prior marriages. Husband’s will may provide for a generous inheritance to his children and Wife may intend to do the same for her children with the expected residue of her estate. If Husband passes first and estate tax is payable at Wife’s death, then Husband’s children may have received their full inheritance while Wife’s children may receive little or nothing after all the taxes on both estates are paid after her death. The issue can also arise when inheritance to children may come from a nonprobate asset such as life insurance or joint tenancy property. These assets may still be includable in the decedent’s gross estate for tax purposes, but the life insurance policy beneficiary gets the proceeds tax-free while the beneficiaries of the residue don’t receive their share until the taxes are paid. Making sure that the allocations are fairly apportioned to all the children is a consideration to be made at the estate planning stage because by the time the first spouse has passed away, the options are few or nonexistent.

Conclusion: Multiple marriage families present special challenges for estate planners and their clients and require increased sensitivity and patience. All of the options can and should be explored and communication should be open between couples and their estate planning attorney. When desires and expectations are discussed and a plan implemented, a couple can spend their remaining years feeling confident that they have left a legacy that will be welcomed and hopefully unchallenged.

As always, you should be sure that additional legislation has not been enacted or that court decisions have been rendered that would change the above advisements. This advisory is neither exhaustive nor is it tailored to your specific situation. If you have questions or concerns, you should discuss your individual situation with us or your own attorney.

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This Advisory is one of a series of business and tax advisories prepared by the attorneys at Buynak, Fauver, Archbald & Spray, LLP. Should you have further questions regarding the information provided in this Advisory, please contact the author listed above.

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