Philanthropy ALERT

A Publication of the Jewish Community Foundation for Charitable Gift Planning Professionals

THE FOUNDATION

May, 2002

Caveat Estate Planning Lawyer: Death & Divorce Hand in Hand

by Stacy D. Phillips

Death and divorce are sobering subjects to us all. They are inexorably linked as occasions we wish we did not have to consider, much less confront. But face them we must and the better prepared we are to cope with all the ramifications of both – be they legal, monetary or familial – the survivors of these life experiences will be far better off.

Statistically speaking, everyone dies. At the same time – depending on which statistics are believed – one-third to one-half of all marriages in California end in divorce. Pretty compelling numbers. Equally compelling is the fact that the bodies of law that impact our mortality and broken marriages are intertwined in myriad ways. Family law and estate and trust issues have a common foundation in community property law.

It is therefore extremely important that estate-planning attorneys understand the repercussions of divorce among their clients, particularly if property has been re-characterized for estate planning purposes. If it has, the action has significant family law repercussions. It is therefore critical that an estate-planning lawyer have certain family law knowledge because when a marriage ends by divorce rather than death, the spouse who has gifted away property may have regrets. And the spouse who thought he or she received property by gift from the other spouse may soon realize that the gift was not exactly what it was supposed to be.

Estate planning attorneys, if only to preserve client relationships, need to know the consequences of divorce because they will often be the target of blame if gifted assets become mere memories. The five most common mistakes estate planning attorneys make are:

1. Where there has been dual representation, the attorney's failure to have clients sign a waiver of conflicts and confidentiality.
2. Ignoring the effect of Family Code §2640 when transmuting property in prenuptial agreements, trusts, deeds and other documents.
3. Having life insurance that is required as part of a divorce settlement to secure spousal support and child support or a property payout owned by the payor rather than the recipient.
4. Drafting a Prenuptial Agreement with transfers that are to take effect on death without the condition that the parties are still married and not separated.
5. Violating the Automatic Restraining Orders (ATROS) that go into immediate effect upon filing/service of a divorce; legal separation or nullity petition by transferring property during a divorce. A violation would be allowing or helping the client change an IRA or life insurance beneficiaries, or funding a living trust while the ATROS are in effect.

An ATRO specifically forbids a spouse from removing a minor child or children of the parties from the state without prior written consent of the other spouse or the court. It also delineates prohibitions regarding changing or canceling insurance of all kinds (but the restraining order does not require payment of the premiums!) and any duplicitous property maneuvers. The court and other spouse must be notified of any extraordinary expenses five days prior to incurring them once the restraining order is effective. On the positive side, however, community or quasi-community property may be used to pay an attorney or help defray court costs.

While either party is free to change their will, if property is held in a living trust, it should be revoked and the assets retitled in the names of the spouses. This is rather sensitive since one party can revoke most living trusts, but retitling the assets needs the approval of both parties. If title to properties remains in the trust until the marriage is dissolved, it could delay the division of assets at the end of the divorce case. Also, if a client dies during the divorce proceedings and if the trust is not revoked, the trust undoubtedly will leave virtually all the assets – both separate and community – to the surviving spouse. If, however, the trust is revoked and the assets are not

Continued on page 2

Stacy D. Phillips is a founding partner of Phillips, Lerner & Lauzon, L.L.P., and a certified family law specialist by the State Bar of California, Board of Legal Specialization. Having practiced family law exclusively for the past 17 years, she is an experienced litigator and mediator in the field. Ms. Phillips has lectured frequently to numerous professional and academic institutions on family law and mediation matters, and has been widely quoted in both legal publications and the general media.

Continued from page 1

retitled then there will be a probate proceeding which is exactly what the living trust was designed to avoid. Leaving assets to an estranged spouse or even a probate proceeding is certainly not what the deceased client had envisioned for his or her children or other family members. Likewise, it is extremely important that beneficiary designations are always up to date.

Another pitfall is drafting prenuptial agreements with transfers that are to take effect on death without the condition that the parties are still married and not separated. Gifts on death should be conditioned on the parties being married, with no dissolution pending and language that protects against being separated prior to the dissolution action being filed at the time of the client's death. Temporary absences like illness, however, should be excluded because complications could occur if one of the spouses is "merely" in the hospital or on vacation.

It is fairly common in a divorce settlement for one party to be ordered to maintain life insurance naming the spouse and/or children as beneficiaries. If the policy is owned by the payor, the proceeds will be included in the estate at death, but the proceeds will be paid directly to the surviving spouse. Since the parties will no longer be married it is unclear whether an estate tax deduction will be available. If not, the proceeds will be taxable which neither party presumably desires. The best solution is having the former spouse be the owner of the policy, although many lawyers representing the payor spouse want control of the policy and will not let the former spouse be the owner.

Ignoring the effects of Family Code §2640 can be "death" to an estate attorney, who needs to know about it; must talk to clients about it; state clearly in transmutation documents whether it applies or not; and write a confirming letter about discussing the code with the client and affirming the client's decision.

It is fairly common for happily married spouses to transmute their principal residence which one of them acquired prior to the marriage from that spouse's separate property to community property. Most people are unaware of the result. Assume the following: George and Barbara are getting married. George promises Barbara that on their first wedding anniversary that he will transmute his separate property residence that he owns free and clear to the community as a "gift". One year later, at the time of the transmutation, the residence is worth $4,000,000 with no debt.

The estate planning attorney prepares a deed and an agreement transmuting George's separate property residence to community property pursuant to Family Code §850-52 which provides that separate property may be transmuted to community property, and vice versa, by a written agreement. Five years later, George and Barbara are getting a divorce and the residence is worth $5,000,000. What does Barbara receive? The answer is Barbara receives $500,000. She didn't receive $2,500,000 because George did not sign a written document waiving his right to Family Code §2640 reimbursement claims. The increase in the value of the residence of $1,000,000 is community property, i.e. $500,000 to George and $500,000 to Barbara and George gets his $4,000,000 back.

Thus, it is crucial that a waiver of a party's §2640 contribution **be in writing.**

The majority of estate planning attorneys represents both spouses. That situation becomes dicey if the clients are getting divorced, making the odds likely the attorney will have to be rescued from representing either party on estate planning issues. The only recourse is to send an identical letter to both clients advising them to seek separate counsel and suggesting they get advice about receiving and revising each estate plan, paying close attention to preparing a new will, dealing with trusts and other ticklish issues.

Although it is technically possible to represent one of the former clients during divorce, it is acceptable only if the other party consents in writing and agrees to waive a laundry list of conditions. The written waiver must warn the client of all the possible consequences of representing one former client and not the other, while spelling out the litany of horrid possible scenarios – an almost impossible task. But even with a very tightly written conflict waiver, the estate-planning attorney who had represented both spouses will need abundant skills and good fortune to successfully navigate some treacherous waters.

It is incumbent on estate planning attorneys to be vigilant of family law issues. Marriages can explode without warning and the only way to master the challenges inherent in divorce proceedings is to be prepared. While it is not inevitable that estate planning and divorce will collide, my best counsel is to believe they will. ✡

PHILANTHROPY ALERT
is published by the Jewish Community Foundation as a service to professionals involved in charitable gift planning.

May, 2002

Chairman
Mark Lainer

President and CEO
Marvin I. Schotland

Chief Operating Officer
Simone Savlov

Vice President, Charitable Gift Planning
Elliot B. Kristal

Professional Advisory Committee Chairpersons
Leah Bishop
Paul Frimmer

THE FOUNDATION
JEWISH COMMUNITY FOUNDATION
6505 Wilshire Boulevard, Suite 1200, Los Angeles, CA 90048
TEL. (323) 761-8700 • FAX (323) 761-8720
www.jewishfoundationla.org

© 2002 Jewish Community Foundation. No portion of this publication may be reproduced or used without permission.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is provided with the understanding that the publisher, editor and contributors are not engaged in rendering legal, accounting or other professional services. Therefore, the contents should not be applied as legal or financial advice.