Retirement Education

Family Conversations: Estate planning for blended family couples

Estate planning can be difficult for any couple, but it can be even more difficult for blended family couples – couples with children from current and/or previous marriages. Clients with blended families may be concerned about choosing between spouses and children. Balancing the interest of the spouse and the interests of the children is like walking a tightrope between potentially competing loyalties. This article will look at four challenges that blended family couples may face when embarking on estate planning.

1 Joint ownership with right of survivorship

How property is titled can be an area of conflict between partners. Married couples in non-community property states often tend to title their property as joint ownership with right of survivorship. Joint ownership with right of survivorship means that the joint tenants have an undivided right to the enjoyment of the property and, upon death, the deceased joint owner's interest passes automatically to the other joint tenant outside of probate. This form of ownership of property may not be appropriate in blended family situations. If either of the partners want to protect children from a previous marriage, this form of ownership may result in inadvertently choosing the partner over the children. The surviving partner would own the property and would control its ultimate disposition. In community property states, each spouse owns an undivided one-half interest in community property and are free to transfer their one-half interest in the property at death as desired.

2 Waiver of spousal rights in ERISA retirement plans

Some of the largest assets owned by individuals can be their qualified plans. Pension plans are subject to automatic survivor benefit rules for surviving spouses. Profit-sharing plans, including 401(k) plans, are not subject to these rules if the plan provides that the vested account balance of the plan is payable in full to the surviving spouse unless the surviving spouse consents to a different designated beneficiary. These spousal rights can be waived under certain conditions. Unfortunately, they cannot be waived until after the marriage takes place. Thus, a prenuptial agreement in which the non-participant spouse agrees to waive the spousal agreement is not effective by itself. The non-participant spouse does not have that right until the marriage occurs and cannot waive it ahead of time. The most that the prenuptial agreement can do is provide that the waiver be executed after the marriage.

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3 Use of trusts to protect children

Individuals facing potential estate taxes at either the federal or the state level may decide to use trusts to minimize estate taxes. A credit shelter trust or bypass trust is designed to hold assets equal to the estate tax exemption amount in trust upon the death of the first spouse. Generally, it provides income for the surviving spouse while maintaining trust assets for remainder beneficiaries. Likewise, a qualified terminal interest (QTIP) trust is a marital trust that provides an income interest to the surviving spouse but that also allows the deceased spouse to determine the remainder beneficiaries. The combination of these two trusts can help minimize estate taxes at the first death and allow deceased spouses to provide for their surviving spouses while protecting remainder interests for the children. Today, the credit shelter or bypass trust may also be used by individuals who do not have an estate tax issue but want to use the structure to provide for children in blended families.

4 Spouse's right to elect against the will

Under state law, a surviving spouse has a right to elect to take against the will. Generally, the amount the surviving spouse is entitled to is the amount that would be awarded under the state's intestacy statutes (as if there was no will). The surviving spouse might consider this if the statutory share is greater than the property left to the spouse under the will. Many states have adopted the "augmented estate" concept. This is extremely relevant today when most property can and often does pass outside of probate, e.g., by contract, by transfer or payable on death, or by trust. If the state allows the surviving spouse's election against the augmented estate, the statutory share is applied against the decedent's probate and non-probate assets. This spousal right can be waived by agreement.

Action steps

As can be seen, these can be difficult conversations between any couple, let alone between blended family couples. A few blended family couples may have already had these difficult conversations and have a prenuptial agreement. A recent Harris Poll found 15% of Americans who were married or engaged reported they had signed one. That percentage increased to 40% of those married or engaged between 18 and 34, but the percentages were much lower for those between 45 and 54 (13%) and even lower for those 55 and above (below 5%).[1]

For those couples who have yet to begin planning for what happens to their loved ones and their property upon their death, the time for these difficult conversations is past due. None of us know what the future will hold, but by taking action now blended family couples can help ensure that their families will be taken care of and disagreements and discord and maybe even court battles will be avoided.

[1] Michael Waters, "Prenups aren't just for rich people anymore," *The New Yorker*, https://www.newyorker.com/news/us-journal/prenups-arent-just-for-rich-people-anymore, July 12, 2022.

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