

## PRENUPTIAL PLANNING: KNOW YOUR OPTIONS

Learn the value of prenuptial agreements



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It's a commonly-held belief that the mention of a "prenup" is a surefire way of suggesting that a couple will eventually get divorced. It sounds selfish, uncomfortable and scary. Why would someone want to get a prenup? Why think about divorce before even being married? But the value of prenuptial agreements extends beyond divorce or death scenarios. It can help prepare a soon-to-be married couple with a financial plan for their lives together by providing a transparent, balanced and healthy view of their marital estate.

### WHAT, EXACTLY, IS A PRENUPTIAL AGREEMENT?

A prenuptial agreement (ante-nuptial, pre-marital or "prenup" for short) is an agreement between two people made *before* their marriage (nuptial). The agreement is a binding contract governing support rights and property rights when divorce or death occurs. Historically, states favored premarital agreements about *death* but not about divorce. State legislators thought, like many uninformed couples today, that a contract about property rights at divorce always creates economic incentives to end the marriage. They were wrong. A prenup can allow you to set expectations that bring both of you onto the same page regarding the economics of your marriage. A well-crafted prenup can be a reflection of a strong relationship foundational to marriage rather than a conflicted relationship symptomatic of divorce.

### SHOULD YOU CONSIDER GETTING A PRENUP?

A prenup allows you to explore and discuss the future economics and future expectations in light of evolving state and federal. Many states (Florida, for example) require completion of pre-marital counseling that hopefully covers finances. But pre-marital counseling by itself will not create a binding permanent record of individual assets and shared goals. A prenup serves as that written record. That is why the legal requirement for separate representation by "counselors at law" (attorneys) is essential to all prenuptial agreements. Only lawyers can definitively provide the invaluable information about the legal consequences of your new life together. Couples with children from a prior marriage could especially benefit from legal advice on the effect of a new marriage on past family relationships. At its core marriage is simply a promise and a prenuptial agreement will help clarify exactly what your side of the promise looks like. At the end of the process of premarital financial planning and prenup negotiation, you may even have jumpstarted your lifelong wealth planning as a wedded couple.

#### What are the basic rules to create a valid prenup?

1. *Capacity*: Both parties must possess adult capacity to contract *voluntarily*
2. *Disclosure*: A prenup must provide full and adequate disclosure of all relevant information
3. *Representation*: Each individual must be represented by competent and independent attorneys familiar with spousal rights under state law

### WHAT ARE THE "MUST HAVES" IN PRENUP NEGOTIATION?

The shocking reality of prenuptial agreements is how enforceable they are even when the circumstances of the marriage seem to make the agreement unfair to one of the parties. Yes, you can amend or revoke the prenuptial agreement after marriage<sup>1</sup>. However, if a spouse intentionally took advantage of an economically weaker spouse *before* marriage there is little



incentive for that spouse to revoke or amend the unfair document *after* marriage. And remember, without the written agreement of *both* spouses, a valid but “unfair” prenup is 100% enforceable.

Not sure how to broach the topic of setting up a prenuptial agreement with your future spouse? Check out our piece on [Financial Etiquette](#) to get some tips.

The biggest “must have” in a prenuptial discussion is the knowledge of what you are giving up. This means you must have a fair understanding of your partner’s assets. But more importantly, it means that you “must have” knowledge of what you are giving up under state law. And the relevant state law could be that of a state where the both of you take up permanent residence *in the future*. Waiving your state-specific legal right to one year of income after your spouse’s death is not much to give up. Waiving a state community property right to ½ of *all* property and income accumulated after the marriage is a much bigger sacrifice.

### PREPARING FOR THE AGREEMENT

The reason prenuptial agreements are rarely overturned by the state court is that it is viewed like a business contract. The state assumes that a couple enters into the contract voluntarily (without coercion, duress or undue influence) with fair and full disclosure and with competent counsel. Generally, a court will not second guess the “fairness” of a contract even when the circumstances of the parties change in unforeseeable ways. Consequently, even a dramatic change in marital circumstances may not be enough to change the enforceability of the contract.

In a sense, prenuptial agreements are a sort of “buyers beware” transaction and so many advisors emphasize the need to “beware” of your future partner hiding or devaluing assets. And that is something to watch out for. However, the bigger issue is not assessing current wealth, but visualizing the economic impact of future marital events. The ability to imagine unlikely but possible adverse marital circumstances is the real prerequisite for evaluating the fairness of the agreement. For example, a prenup provision for each spouse to pay their own healthcare costs during and after the marriage may sound reasonable for two wealthy individuals planning marriage. But if one spouse develops bankrupting medical expenses indirectly caused by the divorcing spouse, the original agreement might seem quite unfair. Visualizing and negotiating for possibilities like these is the real key to preparing for the premarital agreement. A well-crafted prenuptial should be able to build in an automatic amendment and/or revocation provisions for certain kinds of unforeseeable events.

Bear in mind that certain courts will generally consider invalidating a prenuptial only when its terms “shock the conscience.”<sup>ii</sup> Therefore, a key preparation is to visualize circumstances that would “shock” your sensibilities and then make sure that you eliminate that result.

Remember that gathering the relevant information, choosing and then meeting with one or more attorneys, CPAs, and wealth advisors will take significant time. Most importantly, you need to leave time for your future spouse to react and respond to the planning process. Ideally

you should have the prenuptial done long before the wedding deadline so that no one feels pressure to sign something that is not fully understood.

### ***Specific Cautions for Certain Retirement Benefits***

A major asset of many working individuals is their retirement account. The Employment Retirement Income Security Act of 1974 (ERISA) creates vested rights for surviving spouses to receive survivor or death benefits. These rights may not be waived through a prenuptial agreement because only a spouse of a participant can waive. In classic legal interpretation, a pre-marital waiver of certain ERISA plan rights is invalid until you actually become a spouse after the marriage.<sup>iii</sup> A post-marital waiver would be effective but not a premarital waiver. The point to remember is that while retirement benefits may be a common source of marital wealth, they can be an uncommonly complex asset to help implement your agreed upon intent.

### ***Provision for Financial Support for Children***

No contract can take away a court's right to award support for a minor child upon separation or divorce. This includes any premarital agreement. Every parent has a common law and state statutory requirement to provide basic subsistence support to her or his minor child. This means that any agreement that requires you to do less than or equal to what the law requires is generally irrelevant to courts that will be enforcing the rights of the child. But state support requirements of married couples for their children generally end at the age of majority/adulthood<sup>iv</sup>.

Wealthy couples contemplating college and post-graduate education of children may have prenuptial provisions that provide for educational costs of children and step-children after they reach the age of majority. Prenuptial provisions for adult children are usually enforceable under most states' laws because there is statutory obligation for support. Likewise when an individual agrees to an overly generous provision to provide money to adult children or step-children in a prenup, generally, the courts will enforce the provision *even if it causes unanticipated financial hardship*. Here again the ability of the parties to visualize detrimental changes in circumstances is as much or more important than assessing current financial capability.

### ***Know Your Reasons***

Critics of the American pre-marital dating practices for spouse selection have jokingly quipped that our dating system is based on "intentional deception" and "temporary insanity". But it is no joking matter to be deceived or temporarily confused about where you are headed in the economics of your upcoming marriage. Dispel your negative preconceptions of a prenuptial agreement. Instead, look at a prenup as creating a financial map for your new journey together. Premarital financial planning that includes a prenuptial can help assure you that there is enough fuel to make it to your destination.

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<sup>i</sup> The Uniform Premarital Agreement Act (UPAA), adopted in whole or in part by 20 states, specifically provides that a written amendment or revocation must be in writing and signed by both parties in order to revoke an agreement.

<sup>ii</sup> The UPAA legal term is “unconscionable”.

<sup>iii</sup> A contractual waiver of survivor or death benefits is effective only if the participant takes the additional steps required by ERISA. Specifically, the participant must obtain a post-marital consent from the spouse and must then file the consent with the plan administrator along with a beneficiary designation naming the beneficiary of his or her choice. If the participant fails to request the spouse to sign a consent, the spouse does not sign a consent, or the participant fails to file the consent with the plan administrator, the surviving spouse will be entitled to receive the benefits from the plan, notwithstanding a marital agreement under which the spouse waived his or her rights. *Kennedy v. Plan Administrator*, [129 S. Ct. 865](#); *Greenbaum Doll & McDonald PLLC v. Sandler*, unpub. opin., 256 Fed. Appx. 765 (6th Cir. 12/3/07). As cited in BNA Tax Portfolio Ravdin, 849-2nd T.M., *Marital Agreements*

<sup>iv</sup> The age of majority is 18 in every state except Alabama (19), Mississippi (“age of majority” defined as 21 but 18 for contract capacity) or Nebraska (19 or upon marriage).