

**THE MANY FACES OF
THE PRENUPTIAL AGREEMENT:
LEGAL & PSYCHOLOGICAL ASPECTS AND
HOW TO AVOID PITFALLS**

Family and Divorce Mediation Council of Greater New York
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I. When To Get a Prenuptial Agreement (“Prenup”)

A. Common Reasons People Get a Prenup

1. People are marrying later in life and entering into the marriage with significant assets
2. Family wealth / Family business
3. Protect children of a prior marriage
4. Second (or third) marriage
5. Child of divorce or experienced hearing from others about contentious divorce battles

B. Divorce Statistics

1. Approximately 82% of all Americans over the age of 25 will marry at least once in their lifetime.¹
2. 40% of all first marriages, 60% percent of all second marriages and 73% percent of all third marriages will ultimately end in divorce.²

II. Formalities and Bulletproofing the Prenuptial Agreement

- A. A prenuptial agreement is a written, acknowledged agreement entered into by a couple in anticipation of their forthcoming marriage.
- B. Public policy favors individuals reaching their own agreements through contracts, and so duly executed prenuptial agreements are presumed valid and are generally upheld. *See Stawski v. Stawski*, 43 A.D.3d 776 (1st Dep't 2007); *Darrin v. Darrin*, 40 A.D.3d 1391 (3rd Dept. 2007).
- C. There are limited situations where a prenuptial agreement can be set aside, such as for fraud, coercion, overreaching, duress and unconscionability. *See Cioffi-Petrakis v. Petrakis*, 103 A.D.3d 766 (2nd Dept. 2013).
 1. A threat not to marry without a prenuptial agreement, even if the threatened party is pregnant, is not duress. *See Cohen v. Cohen*, 93 A.D.3d 506 (1st Dep't 2012) (*finding that a prenuptial agreement was valid and enforceable even though, at the time of its execution, the wife was pregnant, not represented by counsel, and the husband threatened to cancel the wedding if she did not sign it*); *Colello v. Colello*, 9 A.D.3d 855

¹ U.S Bureau of the Census. 2009. See Table 57 available at <http://www.census.gov>.

² See <http://www.census.gov/compendia/statab/2011/tables/11s0058.pdf>.

(4th Dep't 2004) (*upholding the prenuptial agreement and finding that a husband's alleged threat to cancel the wedding if the wife refused to execute the prenuptial agreement did not constitute duress*). A hard bargain is not duress. Appel v. Ford Motor Co., 490 N.Y.S.2d 228 (2nd Dept. 1985).

2. Courts will not set aside a prenuptial agreement based on unconscionability simply because in retrospect the agreement proves to be improvident or one-sided. See Barocas v. Barocas, 94 A.D.3d 551 (1st Dep't 2012) (*declining to set aside a prenuptial agreement despite a party's claim that she believed there would be no wedding if she did not sign the prenup, that the wedding plans had already been made when the prenup was signed, and that the prenup was signed only two weeks before the wedding*). "An unconscionable bargain is one which no person in his or her senses and not under delusion would make on the one hand, and no honest and fair person would accept on the other, the inequality being so strong and manifest as to shock the conscience and confound the judgment of any person of common sense" Morad v. Morad, 27 A.D.3d 626, 627 (2006).

D. Bulletproofing a Prenuptial Agreement.

1. Lead Time Before the Wedding

It is strongly recommended to begin negotiating the prenuptial agreement as far in advance of the wedding date as possible, or even before the wedding date is set, in order to provide ample time for its negotiation. A common misconception is that a prenuptial agreement will be set aside based on duress if it is entered into in close proximity to the wedding or because a party may have threatened to cancel the wedding if a prenuptial agreement is not signed. This is not necessarily the case. However, it is still best practice to leave as much time as possible between the execution of the prenuptial agreement and the wedding date.

2. Separate and Independent Counsel

Each party should be represented by separate and competent counsel. The agreement must be entered into voluntarily with both parties having an understanding of his or her rights and the extent to which he or she is waiving those rights.

3. Full Financial Disclosure of Assets and Liabilities

Each party should provide full and fair disclosure of his/her assets and liabilities. This does not necessarily require disclosure of each and every asset, but each party must be given a clear idea of the nature, extent and value of the other party's assets.

E. Formalities

1. Must be in writing and signed by both parties
2. Must be acknowledged in the manner required to entitle a deed to be recorded
3. The marriage can serve as consideration for the contract

F. Benefits of Getting a Prenup

1. As a negotiated contract, a prenup can cover a wide variety of issues, including property division, spousal support, and death benefits.

A prenup can also provide how premarital and post-marital debts will be paid. For example, will a parties spousal maintenance payments to a prior spouse or child support obligations be payable from his or her separate property or from marital property?

A prenup can provide for ownership and use of the marital residence and vacation residences in the event of a divorce.

2. A prenup is very flexible and can be tailored to the couple's individual needs. It can override what would otherwise be the applicable law governing issues such as equitable distribution, spousal support, payment of counsel fees in divorce, and inheritances.
3. Prenups can help assets retain their separate property character and avoid or minimize issues of commingling.

G. Escalator and Sunset Clauses

1. Escalator clauses provide for increasing payouts on divorce or death the longer the marriage lasts.
2. Sunset clauses provide that the agreement will expire automatically after the passage of a certain period of time.

H. Common misconception: Prenups are "unromantic" and "jinx the marriage."

Actually: A prenup helps a couple speak about money issues up front and helps start the marriage with full disclosure and an understanding of the other party's views on money – which is one of the most frequent causes of divorce and disputes within a marriage.

III. Protecting Children From a Prior Relationship in a Prenup

A. Divorce Provisions:

1. Limiting amount passing to new spouse.
2. Opting out of "equitable distribution."

B. Death Provisions:

1. Limiting amount that must pass to new spouse or future children.
2. Providing for disposition to new spouse in trust to insure property passes to children upon spouse's later death.
3. Opting out of "elective share." The elective share is the portion of the estate that a surviving spouse is entitled to claim in lieu of what he/she receives under the deceased spouse's Will (or testamentary substitutes). In New York, the elective share, as provided in Section 5-1.1-A of the New York Estates, Powers and Trusts Law, is one-third (1/3) of the net estate.
4. Providing for life insurance for new spouse to keep existing estate assets available for children.

C. Separate Property in New York

1. Inheritances, gifts made to one party, and pre-marital assets are separate property.
2. The presumption is that property is marital property – have to prove property is separate property.
3. Beware: Laws regarding the treatment of gifts and inheritances in the event of divorce vary by state. There are 9 non-community property states (including Connecticut and Massachusetts) that do not distinguish between separate and marital property. In these “all property” or “kitchen sink” states, gifts and inheritances may be subject to division in a divorce.

D. How Prenups Can Help Protect Separate Property

1. In a prenup, the parties can opt out of unfavorable state law.
2. A prenup can provide greater protection for separate property. For example, a prenup may contain provisions that gifts, inheritances and pre-marital assets will constitute a party's separate property even if they are commingled with marital assets.

Practice Pointer: As a practical matter, regardless of whether there is a prenup, it is strongly advisable to keep separate property in separate accounts in sole name and to maintain good records.

3. A prenup can assist in keeping an inheritance within the family and away from in-laws in the event of death. For example, a prenup may provide the parties must leave each other at least the elective share, but in defining the estate carve out inheritances, such as a family business interest.

E. In-law Proofing Your Estate Plan

1. Leave property to children and more remote descendants in trust rather than outright.
2. Lifetime trusts vs. mandatory distributions at fixed ages.
3. Have the "prenup talk" with your children.

IV. Can an Irrevocable Trust be up for Grabs in a Divorce Case?

- A. Maybe - answers vary according to state law.
- B. While we may know our client lives in NY, we shouldn't assume that the client's children also live in NY. They may live in another state or move to another jurisdiction down the road.
- C. Often trust and estate practitioners and other financial advisors tell clients that putting funds in a trust for a child will protect against divorce. In practice, may not be so clear cut. Putting funds in trust for children is more protective than giving it to them outright, but it should not be assumed that the assets will be fully protected in the event of divorce.
- D. Third party trusts (set up by parents, grandparents, etc.)
 1. Property division
 - a. In NY, there is equitable distribution of marital property upon divorce. Inheritances and lifetime gifts made to one party are considered separate property, and are not subject to equitable distribution. This is not true in all states.
 - b. If funds are actually distributed from a trust and commingled with marital assets, then they can be up for grabs.
 2. Child support and spousal maintenance
 - a. Income is broadly defined under the applicable statute [DRL §236(5-a)(b)(4) and DRL §240(1-b)(b)(5)].

- b. Trust income may be included in calculating child support and maintenance.
 - c. In awarding support, the court can take into account historical distributions to the beneficiary from the trust.
- E. Prenuptial agreements
 - 1. Provide extra protection of trust assets and distributions.
 - 2. Helpful to alleviate or minimize issues that may arise by virtue of a trust beneficiary moving to another jurisdiction.
- F. Self-Settled Trusts
 - 1. A self-settled trust is a trust created by a party who is also a beneficiary.
 - 2. Statutes vary by state regarding whether self-settled trusts provide protection from claims of support and/or equitable distribution.

V. Portability and Prenups

- A. Initially introduced by the Tax Relief, Unemployment Reauthorization, and Job Creation Act of 2010 (TRA 2010),³ and made permanent by the enactment of the American Taxpayer Relief Act of 2012 (ATRA)⁴ on January 2, 2013, "portability" allows spouses to share their federal estate tax exclusions with one another, thereby creating a potentially valuable asset to be considered by practitioners when preparing a marital agreement.
 - 1. The applicable exclusion amount is now a combination of (i) an individual's "basic exclusion amount" (\$11,180,000 in 2018), and (ii) if applicable, the unused basic exclusion amount of his or her last deceased spouse (referred to as the spousal unused exclusion amount or "DSUE").
 - 2. Individuals may utilize the applicable exclusion amount at death or by making gifts during their lifetime.
 - 3. There is no portability of the generation-skipping transfer tax exemption nor of the New York State estate tax exclusion between spouses.
- B. A prenuptial agreement can and should include a provision addressing, among other things, whether a portability election is to be made and who is to bear the expense of filing a federal estate tax return that otherwise would not be required.
 - 1. DSUE is only available if the decedent's executor makes an affirmative election on a timely filed estate tax return.

³ P.L. 111-312 (2010).

⁴ P.L. 111-240 (2013).

2. If an executor is appointed for the decedent's estate, then the portability election may be made only by the executor. If there is no court-appointed executor, then any person in actual or constructive possession of any of the decedent's property may file an estate tax return to elect portability.
 3. In preparing a marital agreement, it is important to consider that someone other than the surviving spouse may be the executor of the deceased spouse's estate and that the family dynamics may be such that the surviving spouse does not have the information necessary to file an estate tax return to elect portability. Absent a provision in the prenup, the executor of the deceased spouse's estate may have no obligation to (i) file an estate tax return or (ii) make a DSUE election.
- C. In negotiating a prenuptial agreement, the less wealthy spouse has the potential to port DSUE to the wealthier spouse if he or she predeceases.

D. DSUE from a prior deceased spouse?

1. Because of the "Last Deceased Spouse Rule" an individual's DSUE (from a prior spouse) will be lost if he or she remarries and the new spouse predeceases him or her.

Consider a hypothetical client, Alice, who wants a prenuptial agreement in connection with her upcoming marriage to Bill. Alice is the widow of Charles and she has DSUE of \$3 million as a result of Charles' death. If Alice and Bill marry and Bill dies before Alice, she will lose the \$3 million of DSUE from Charles because Bill has replaced Charles as Alice's "last deceased spouse."

2. Remarriage alone does not affect who will be considered the last deceased spouse. A surviving spouse can use DSUE from his or her last deceased spouse while married to a subsequent spouse.
3. The identity of the last deceased spouse is not affected by whether the estate of the last deceased spouse elects portability or whether the last deceased spouse has any DSUE available.
4. What can a Prenup do?

In our hypothetical, Charles' executor elected portability and computed a DSUE amount of \$3 million. Charles' surviving spouse, Alice, subsequently married Bill. If Alice dies in 2018, is survived by Bill and has neither used any of her basic exclusion nor any of the DSUE from Charles, even though Alice has remarried, her estate has an applicable exclusion amount of \$14,180,000 [\$11,180,000 + \$3,000,000].

Assume the same facts as above, except that Bill predeceases Alice. Bill's executors also elect portability on a timely-filed estate tax return;

however, Bill's DSUE amount is computed at \$1,000,000. At Alice's death in 2018, she will have an applicable exclusion amount of \$12,180,000 [\$11,180,000 + \$1,000,000] and will have suffered a loss of \$2 million of the applicable exclusion, or, assuming a federal estate tax rate of 40%, a loss of \$800,000 of estate tax savings. If Bill's executors do not make a portability election, Alice will have an applicable exclusion amount of \$11,180,000. Bill is Alice's last deceased spouse, and she has lost her DSUE from Charles. If there is no portability election, Alice would have suffered a loss of the applicable exclusion of \$3 million resulting in a loss of \$1,200,000 of estate tax savings (assuming a 40% rate). When negotiating Alice's marital agreement with Bill, as part of her negotiation strategy, she should take into consideration the potential loss of her DSUE from Charles.

To avoid the loss of DSUE, it may be beneficial for Alice to make lifetime gifts to utilize the DSUE received from Charles. The Regulations provide that if a surviving spouse who has DSUE makes lifetime taxable gifts, the DSUE is applied first, before using the surviving spouse's own basic exclusion amount.⁵ This is significant because so long as the surviving spouse does not have a new "last deceased spouse," he or she can continue to utilize the DSUE from his or her deceased spouse in connection with lifetime gifting - even if he or she has remarried.

In the case of Alice and Bill, Alice has an available applicable exclusion amount of \$14,180,000 [\$11,180,000 + \$3,000,000]. Let's assume that Bill intends to leave the overwhelming majority of his fortune to his children, thereby utilizing his entire applicable exclusion amount and leaving no DSUE for Alice if she survives him. If Bill predeceases Alice her applicable exclusion amount would be reduced from \$14,180,000 to \$11,180,000 due to the loss of the DSUE received from Charles (again, this translates into an additional \$1,200,000 of estate tax at Alice's death, assuming a 40% rate). Alice can protect against this loss of applicable exclusion by making lifetime taxable gifts that utilize the DSUE received from Charles. However, this reduction in Alice's net worth as a result of lifetime gifting should be taken into account in negotiating the marital agreement insofar as it might affect the parties' marital lifestyle as well as any negotiated divorce or death benefit.

- E. Multiple Deceased Spouses. It is also important to note that while the DSUE Amount from a prior deceased spouse who is not the "last deceased spouse" cannot be used, the Regulations do permit the use of the DSUE from multiple deceased spouses if the surviving spouse makes taxable gifts utilizing the DSUE from a prior deceased spouse before he or she is predeceased by a subsequent spouse.⁶ In other words, assume Alice makes lifetime gifts of \$3 million using

⁵ Temp. Reg. §25.2505-2T(b)

⁶ Temp. Reg. §20.2010-3T(b)

the DSUE from Charles and is then predeceased by Bill. Assume further that Bill leaves DSUE of \$2 million. Alice can make additional gifts of \$2 million using the DSUE from Bill, while keeping her basic exclusion amount of \$11,180,000 intact.

VI. When To Get a Postnup

- A. A postnuptial agreement is a written agreement that is entered into by a husband and wife after marriage.
- B. Prenups v. Postnups
 - 1. While a postnuptial agreement is entered into after marriage, a prenuptial agreement is an agreement entered into by a couple before marriage.
 - 2. Postnuptial agreements are held to a higher standard than prenuptial agreements because the parties are not fiduciaries, but rather strangers in the eyes of the law. Since a postnuptial agreement is a contract between spouses, it involves a fiduciary relationship requiring the utmost of good faith. *See, for e.g., Petracca v. Petracca*, 101 A.D.3d 695 (2d Dep't 2012). However, the law favoring contracts, results in postnuptial agreements still being held to a high standard in New York and largely upheld.
 - 3. If there is a choice between entering into a prenup or a postnup, when representing the wealthier party, practitioners should encourage prenuptial agreements. There are certain rights and obligations that come with marriage. It is generally easier to waive rights that have not vested yet, rather than those that a party is already entitled to by virtue of marriage. Once the wedding takes place, leverage is lost and it is often very difficult to bring both parties to the bargaining table.
 - 4. It is usually more difficult to get a postnuptial agreement signed than a prenuptial agreement. There is not a deadline for the postnuptial agreement to be executed, whereas with a prenuptial agreement there is the wedding date. Therefore, as a practical matter, many postnuptial agreements linger and do not get signed.
 - 5. Like all other contracts, prenups and postnups require consideration. For a prenuptial agreement, the marriage itself is generally the consideration. There also needs to be consideration for a postnuptial agreement.
- C. Reasons a Married Couple may get a Postnuptial Agreement
 - 1. Not enough time before the wedding to negotiate a prenuptial agreement, so the parties choose to enter into a postnuptial agreement.

2. There was marital strife and they want to move forward with their marriage, but with prescriptions about what would happen in the event of a divorce.
3. Want to revisit the terms of a prenuptial agreement after the passage of time.
4. Change of circumstances.
5. Fixing commingling of separate property.
6. Starting a business.

VII. Divorce, Prenups and Social Media

A. In prenups, there is a trend to include "social media clauses."

1. With the proliferation of social media, non-disclosure clauses have become not just for celebrities. They also now have an appeal for ordinary individuals, such as those who seek to protect their privacy, prevent harm to their reputation, or regulate information pertaining to their business interests.
2. Traditional non-disclosure clauses are being expanded to include restrictions on what can be posted to Facebook, Twitter, Instagram, and other social media outlets.
3. Non-disclosure clauses in a prenuptial agreement can vary substantially in what they prescribe.
 - a. The confidentiality clause may be limited to the content of the prenuptial agreement and its underlying financial information.
 - b. Other individuals might opt for a broader confidentiality provision that extends to non-financial aspects of their relationship, such as limiting what pictures or videos a party can unilaterally post on social media websites.
 - c. The non-disclosure provision can also prohibit the circulation of information that is reasonably likely to have a negative effect on a spouse's career or business.
4. In order to help enforcement of a "social media clause," the prenuptial agreement may provide for certain penalties in the event of a violation, such as injunctive relief and/or payment of counsel fees.