

## Managing Prosperity: Estate and Retirement Planning for All Ages Love, Marriage, and Divorce

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The rights of spouses in property play an important role in any estate plan. "Property" as used in this publication refers to all property, including real property (land, buildings, fixtures, etc.) and personal property (stocks, bonds, furniture, etc.). The two situations that merit special attention with respect to spousal rights in property are death and divorce. The rights of spouses in property is different in each of these situations. Therefore, when you plan your estate you must plan differently for these two situations.



This publication will present an overview of the rights of spouses in property upon divorce. Divorces occur at a high rate in the United States. In 1998, there were approximately 2,244,000 marriages and 1,135,000 divorces.\*\* Divorce can easily destroy an estate plan that does not consider the possibility. In addition, divorce can destroy the family farm or business by splitting the assets among warring factions or forcing sale of the farm or business. The following will discuss some options for considering the possibility of divorce in your estate plan.

(This publication will not discuss the rights of the surviving spouse in the estate of the deceased spouse. Instead, the reader should refer to VCE Publication 448-079, *Rights of Surviving Spouses and Children*. In addition, this publication will not discuss other issues arising in divorce, such as child support and spousal support. Persons engaged in estate planning should keep in mind that when a divorce occurs, the husband, wife, and children are all financially worse off than when the couple was married. Two living quarters must be maintained and other shared costs are increased. These factors also contribute to difficulties. For example, a former spouse attempting to purchase the marital home often will have less cash flow to make payments.)

### Separate Property and Marital Property

Upon divorce, the property of the former couple must be divided between the two parties. If the parties can agree on a division of property, that division governs.

\*\* Centers for Disease Control and Prevention. National Center for Health Statistics. National Vital Statistics Reports, Vol. 47, No. 1 to Present. "Births, Marriages, Divorces, and Deaths: Provisional Data for 1998. Vol 47, No. 21.

In Virginia, the local Circuit Courts hold the power to determine ownership of the property of divorcing persons if those persons cannot agree on a division of the property. The rules under which the court determines the division of property between spouses is called equitable distribution. Parties going through divorce should be aware of the rules by which the Virginia courts divide property of divorcing parties. These rules inform negotiations on property divisions.

Note that the rules for property division vary from state to state. Alabama, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin use the community property rule. In community property states, husband and wife are treated as equal partners and each owns a one-half interest in all property. Upon divorce, the property is divided in half with each party receiving an equal share. If divorcing parties acquired or owned property in a community property state prior to residing in Virginia, community property laws may dictate the ownership of that property. Therefore, divorcing parties must carefully consider this factor when dividing property.

Virginia law distinguishes between separate property and marital property. Separate property is property owned by one of the spouses and not the other. Separate property remains the property of the spouse in whose name the property is titled. Marital property is property in which both parties own an interest; regardless of in whose name the property is held. Marital property must be divided between the parties.

Virginia law further defines separate property as:

- all property acquired by either party before the marriage;
- all property acquired during the marriage by inheritance, will, survivorship or gift from a source other than the other party;
- all property acquired during the marriage from the proceeds of sale of separate property;
- income received from separate property during the marriage, if not attributable to the personal effort of either party
- increase in value of separate property during the mar-

riage, unless marital property or the personal efforts of either party have contributed to such increases; and,

- other property as determined by the court.

Personal effort means labor, effort, inventiveness, physical or intellectual skill, creativity, or managerial, promotional or marketing activity applied directly to the separate property of either party.

Marital property may be described further as:

- all property titled in the names of both parties;
- other property as determined by the court; and
- all other property acquired by each party during the marriage which is not separate property.

All property acquired by either spouse during the marriage is presumed to be marital property.

Property may be part marital property and part separate property. This allocation must be made where income from separate property during the marriage is attributable to the personal efforts of either party. For example, if the husband inherits cash from his parents and invests the money in real estate chosen by his wife, the income from this real estate and any increase in value may be attributable to the personal efforts of the wife and thus part separate property and part marital property. If the increase in value and income is

attributable to an upturn in the real estate market generally and/or the wife has no particular real estate expertise, the increase in value and income likely remains separate property.

However, if the wife shows that, by using her real estate expertise, she was able to purchase property for below market value and manage the property to increase normal income, the income and increase in value becomes part separate and part marital property. In addition, when separate property is mixed with marital property (as in depositing separate property funds into a marital account), the property may be part marital and part separate if the properties can be traced. If the properties cannot be traced, the entire account (in this example) becomes marital property. Special rules apply to pensions, profit-sharing, or deferred compensation and personal injury or workers' compensation recoveries.

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The court must first divide the property of the couple into: (a) separate; (b) marital; and, (c) part separate, part marital. The court then divides the property between the divorcing spouses. The court may also make a monetary award to a spouse. The law lists factors for the court to consider in making the division of property and/or granting the monetary award. These factors include:

- monetary and non-monetary contributions of each spouse to the well-being of the family;
- monetary and non-monetary contributions of each spouse to the acquisition, care and maintenance of the marital property;
- duration of the marriage;
- ages, physical condition and mental condition of each spouse;
- circumstances and factors which contributed to the ending of the marriage (i.e., was one spouse “at fault?”);
- circumstances under which specific items of marital property were acquired;
- debts and liabilities of each spouse and the circumstances surrounding the debts and liabilities;
- the liquidity of all marital property;
- tax consequences to each spouse; and
- other factors the court may deem necessary or appropriate to determine a fair and equitable monetary award.

## Divorce Planning

The rules just described for the distribution of property among spouses upon divorce are extremely complex, even for lawyers and judges. The authors observe that this complexity often results in a court-ordered split of property “down-the-middle.” Such a division may spell disaster for a family farm or business. At a minimum, the complexity of these rules leads to uncertainty among divorcing parties as to the disposition of property.

The authors realize the delicate nature of “divorce planning” and do not suggest that one enter into a marriage assuming divorce. However, given the high rate of divorce, persons should take steps to minimize the upheaval resulting from divorce. The authors suggest several strategies to cope with the realities of divorce in the United States and consequent uncertainty. The

following should be considered as suggestions only. Each person must consider the risk and practicalities of each situation.

- Separate property should remain separate. Spouses should each maintain a separate bank account, along with a joint bank account. Do not mix separate property with marital property without understanding the consequences. The spouses should make conscious decisions as to what they wish to remain separate and what they wish to transform to marital property. Informed decision making and full disclosure should be the goal.
- Consider the consequences of the titling of real and personal property. These decisions should not be taken lightly. Take time to ponder the options and the consequences of each choice.
- If one spouse enters into a business venture, contemplate the relationship between the role of the other spouse in the business and his or her ownership interest.
- Keep good records of all transactions and of all property owned.
- Consider entering into a marital agreement. (The authors use “marital agreements” to refer to marital or premarital agreements in this publication.)
- Ensure that each spouse acquires some property on his or her own and maintains the property as separate property so that division will be easier in the case of marital discord.

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## Marital Agreements

The most “fool-proof” way to ensure that property is allocated pursuant to the wishes of the parties, as opposed to a judge, is to enter into a premarital agreement. A premarital agreement is “an agreement between prospective spouses made in contemplation of marriage and to be effective upon marriage.” A marital agreement is identical to a premarital agreement, but is entered into during marriage and becomes effective immediately. Therefore, spouses may enter into a marital agreement at any time.

A marital agreement must be in writing and signed by both spouses. Content of a marital agreement may include:

- the rights and obligations in any property;
- the right to buy, sell, use, transfer, exchange, assign, mortgage, encumber, dispose of, manage, control, etc., any property;
- the distribution of property upon separation, divorce, death, etc.;
- spousal support (i.e. payments from the higher income spouse to the lower income spouse to help support the lower income spouse);
- the making of a will, trust, etc., to carry out the provisions of the marital agreement;
- ownership rights in and disposition of the death benefits of a life insurance policy; and,
- any other matter not a violation of public policy or criminal law.

Marital agreements will be enforced so long as they are voluntary, full disclosure was given, and the provisions are not grossly unfair. The authors recommend that the salaries of the parties be noted in the agreement itself. In addition, accurate balance sheets for each spouse should be attached to the agreement. This ensures full disclosure of the financial worth and incomes of the parties as of the date of marriage. If the agreement is later challenged the disclosures can be examined for accuracy. Finally, independent legal counsel must represent each party and the identity of each counsel should be noted in the agreement (some agreements provide for signature by the legal counsel for each party). So long as these precautions are taken, and contrary to impressions in the popular media, post-and-pre-marital agreements should be enforced.

Marital agreements provide certainty in an uncertain arena. However, the personal issues involved in considering a marital agreement may outweigh the benefits they provide. The decision to have or not have a marital agreement is a very personal one, and must be made by each individual after due consideration.

## Conclusion

The consequences of the division of property between spouses upon divorce can be severe to family farm and business operations. The law in this area is complex and this complexity leads to uncertainty. Spouses should be very careful in arranging property ownership, bank accounts and business affairs. No one enters into marriage thinking it will end in divorce. However, in today's complex society, steps must be taken to plan for that contingency. When a family business, second marriage, or other unique circumstances are present, the complexity increases. Planning for possible divorce is a necessity. Spouses should also consider entering into a marital agreement. As always, legal counsel should be consulted when making titling, business, or other decisions in the planning process.

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