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Strategies Parents Should Incorporate Into Their Estate Plans to Safeguard a Child's Inheritance

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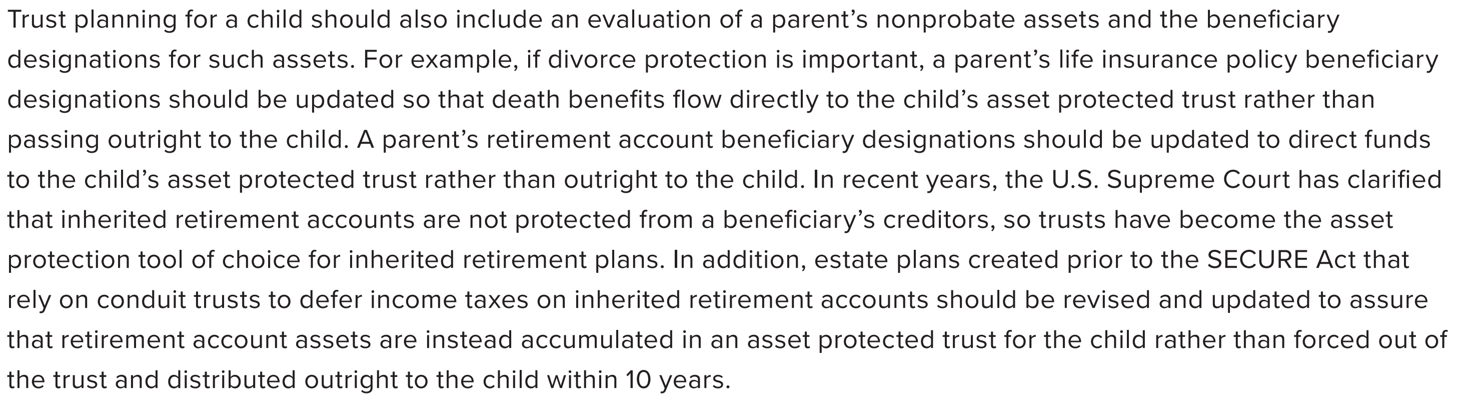
A child's marriage can be one of the most hopeful and joyous occasions for a parent. Marriage can signify to a parent the official end of childhood and the start of adulthood where a mature child has now officially left the "nest." Marriage brings a new member to the family circle, whose values and ideals will hopefully integrate seamlessly with existing family morals. And for many, marriage brings the hope of grandchildren!

Anyone who has ever worked with a family during or after a new marriage knows that a child's marriage may not always be the peaches and cream that the parents had been so hopeful for at the wedding. Family dynamics change, conflicts arise, and a parent's once flowery estate plan that previously placed complete trust and confidence in a child may now need to be changed to assure that the child's spouse may never touch the family fortune in the event of a future divorce. Parents have many estate planning tools and strategies at their disposal that they should be incorporating into their estate plans, either before or after a child's marriage, to safeguard their child, their future grandchildren, and their family legacies in the event of a child's untimely and messy divorce.

Trust Planning

Many clients utilize trusts for their children to protect inherited assets from the child's creditors, such as in the case of divorce. A trust structure is a great first step in safeguarding a child's assets from a divorcing spouse. Trusts may be designed so that the assets of the trust are protected from creditors so long as the assets are held in trust. It is important to note, however, that as soon as the assets are distributed out of the trust, they may become subject to the claims of creditors.

Clients often ask at what point their child's risk of divorce will be eliminated so that assets may ultimately be distributed from the trust to the child. The unfortunate answer is that a child's divorce risk may never be fully eliminated during the child's lifetime—a child may divorce at any age. If protection from the risk of divorce is paramount, a parent should structure a child's trust to provide that inherited assets remain in trust for the duration of the child's lifetime. The trust could be structured to give the trustee broad discretion to make distributions to the child during his or her lifetime, but any time assets are required to be distributed out of a child's trust, the child's assets are potentially exposed to the child's divorcing spouse.



Trust planning for a child should also include an evaluation of a parent's nonprobate assets and the beneficiary designations for such assets. For example, if divorce protection is important, a parent's life insurance policy beneficiary designations should be updated so that death benefits flow directly to the child's asset protected trust rather than passing outright to the child. A parent's retirement account beneficiary designations should be updated to direct funds to the child's asset protected trust rather than outright to the child. In recent years, the U.S. Supreme Court has clarified that inherited retirement accounts are not protected from a beneficiary's creditors, so trusts have become the asset protection tool of choice for inherited retirement plans. In addition, estate plans created prior to the SECURE Act that rely on conduit trusts to defer income taxes on inherited retirement accounts should be revised and updated to assure that retirement account assets are instead accumulated in an asset protected trust for the child rather than forced out of the trust and distributed outright to the child within 10 years.

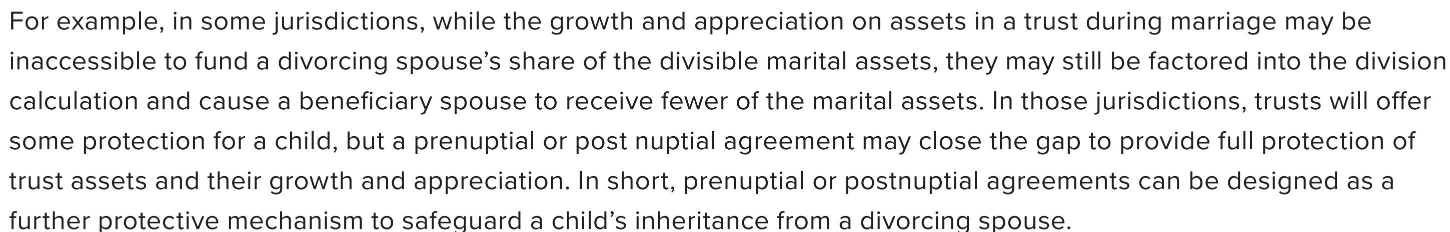
Planning for a Family Business

Often, a family's largest and most precious asset is its family business. When family business interests pass from one generation to the next, proper planning is necessary in order to assure that business interests do not inadvertently become the subject of a child's contentious divorce proceedings. In a divorce, ownership interests in a family business may fracture, the family may inadvertently become partners with a bitter ex-spouse, and business decision making may become more difficult when adverse parties with different motivations each have a say in the direction of the family business.

Before business interests are passed to the next generation, either voluntarily through gifts or through death, the governing documents of the family business should be updated to place restrictions on who may be an owner of the family business, stipulate when an owner may involuntarily give up his or her ownership interest in the family business due to divorce, and define the procedures for buying out divorcing owners who have involuntarily given up their ownership interests. First, a family business can be protected from a child's divorce if the business' governing documents prohibit the spouses of children in the family from owning business interests. If a child's ex-spouse cannot own family business interests, then any transfer of interests to the child's ex-spouse may be deemed void. The child's ex-spouse will therefore be prohibited from participating in the governance, decision making, and profit sharing of the family business. Such transfer restrictions could also be effective in the event that a child-owner dies prior to a divorce so that the child's surviving spouse may not inherit an interest in the family business from the deceased child. Next, if the business' governing documents declare that the divorce of an owner triggers an involuntary transfer of the divorcing owner's interests back to the business, the divorcing owner will no longer own business interests that are subject to division in a divorce. If the governing documents provide procedures to redeem the divorcing owner's interests, the divorcing owner is left with potential cash that could be divisible in a divorce. While the divorcing owner will lose his or her interest in the family business, at least the family business will be protected from the child's ex-spouse.

Prenuptial and Postnuptial Agreements

A prenuptial agreement is a contract between two engaged individuals in anticipation of marriage that may define the rights and obligations of the two parties during the marriage, during a divorce, after a divorce, or upon the death of the parties. A postnuptial agreement is a similar contract, except it is entered into by two individuals after the marriage has already occurred. Prenuptial and postnuptial agreements can be drafted to carve specific assets out of the pool of marital assets that are subject to division in divorce, can define the income and appreciation on separate assets as remaining outside of the pool of marital assets subject to division in divorce, and can limit the scope of what a surviving spouse must inherit upon the death of a spouse.



For example, in some jurisdictions, while the growth and appreciation on assets in a trust during marriage may be inaccessible to fund a divorcing spouse's share of the divisible marital assets, they may still be factored into the division calculation and cause a beneficiary spouse to receive fewer of the marital assets. In those jurisdictions, trusts will offer some protection for a child, but a prenuptial or post nuptial agreement may close the gap to provide full protection of trust assets and their growth and appreciation. In short, prenuptial or postnuptial agreements can be designed as a further protective mechanism to safeguard a child's inheritance from a divorcing spouse.

While a parent cannot force a child to enter into a prenuptial agreement prior to marriage or a postnuptial agreement subsequent to marriage, a parent can apply "parental pressure" during the parent's lifetime to encourage the child to enter into a prenuptial or postnuptial agreement. A parent may also normalize the concept of a prenuptial or postnuptial agreement to the child so that the child may feel less hesitant to enter into such an agreement.

Upon the parent's death, a parent could even draft a child's trust that will be receiving the child's inheritance to require that in order for a married child to receive any distributions from the child's trust, the child must have a prenuptial or postnuptial agreement in place. While such a limitation could impress upon the child the parent's ideals of protection, assure that at least some type of agreement is in place for the child's benefit, and ease the child's eventual hesitation over starting a conversation with his or her spouse-to-be regarding the need to have a prenuptial or postnuptial agreement in place, this type of limitation has the potential to be fraught with risks if the child's agreement is ultimately drafted in a manner inconsistent with the intent of the parent.

Planning strategies that protect a child's inheritance from divorce should be incorporated into every parent's estate plan. Whether the plan utilizes trusts, business organizational documents, or prenuptial or postnuptial agreements, creating an asset protection plan for a child's inheritance will be one of the best gifts a parent can pass along to a child.

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