

The Right Steps - When it comes to blended families, estate planning can be a special kind of hell

By **MICHAELA CAVALLARO** APRIL 12, 2009

Families that include children from previous marriages often come with all sorts of complications. Who goes where for the holidays, for instance. Or what roles do step-parents play.

And then there's estate planning. When spouses in blended families sit down to decide who will inherit what, every decision is complicated by the often-difficult and complex emotional bonds among parents, step-parents, half-siblings and other family members.

"The hardest question is what's yours, what's mine and what's ours," says Jerry Chasen, an estate-planning attorney in Miami. Heads of blended families frequently find it more difficult to decide how to distribute their estate, Mr. Chasen says. "The answers have to be explored carefully -- and each partner has to be honest about his or her intentions."

A lack of frankness can have dire consequences -- ranging from the litigious (children from a first marriage sue for a portion of the estate) to the emotional (the estate sows division among family members) to the practical (the estate doesn't provide for a partner or child as intended). Estate planners say it's essential for heads of blended families to communicate openly and honestly about each spouse's priorities. A trusted financial adviser or other counselor may help facilitate those conversations.

After heads of blended families decide what they want, they can draw on an array of tools to ensure that their assets are distributed in accordance with their wishes. What follows is a look at some of those tools, and other steps that spouses can take.



Pre- and Postnuptial Agreements

Prenuptial agreements often are criticized for fostering mistrust and paranoia between couples. But for parents entering a second or third marriage, a prenup can be an efficient way to specify which assets are considered marital property and which are not -- thus offering a way to protect the rights of each spouse's existing children.

In a prenuptial agreement, one partner can waive rights to property, such as a vacation home or family business, that the other partner would like to save for his or her children. Likewise, a couple

may use a prenup to divvy the college savings they've designated for the children they have separately, and to set money aside for children they may have together.

Prenuptial agreements also can specify ownership of future assets, such as inheritances and gifts the couple receives. Say a husband stands to inherit a piece of art from his parents, and would like to pass the painting on to his son from his first marriage. A prenuptial agreement written before his second marriage can designate the painting as individual property, and the husband's will can specifically direct it to the son.

Couples who already have blended their families might consider establishing a postnuptial agreement, which can cover much of the same ground. "Some retirement plans require a spouse's consent in order to give the plan's assets to anyone but that spouse," adds Mr. Chasen. "A postnuptial agreement is a great place to provide that consent in a manner that is legally enforceable."

In either situation, each party should hire an attorney to represent his or her interests, and to ensure that the agreement will be enforceable in the case of divorce or death. "All a pre- or postnuptial agreement means in this situation is that you want to make sure your children from a prior marriage are protected," says Mr. Chasen. "It absolutely does not mean you distrust your spouse."

QTIPs

A qualified terminable interest property trust, or QTIP, provides a way for many blended families to meet dual goals: providing income for a surviving partner while preserving assets for children conceived with a previous partner. Income from the trust must be distributed to the surviving partner at least annually. He or she also may receive additional distributions, depending on how the trust is drafted.

The QTIP also can be beneficial for estate-tax planning purposes. (In 2009, the portion of an estate that exceeds \$3.5 million is subject to estate tax.) Assets in a QTIP are included in the grantor's estate, but are eligible for a full marital deduction so no tax will be due on them at the grantor's death.

However, the trust's assets will also be considered part of the surviving spouse's estate. If the QTIP increases the surviving spouse's estate-tax liability, assets in the trust generally are used to pay those taxes.

Life Insurance

Standard life-insurance policies can be particularly useful for married couples in which one spouse is considerably older than the other. For example, the older spouse might name his or her children from a previous marriage as the beneficiaries of a policy, and leave other assets to his or her current spouse and any children they might have together.

An older spouse who has considerable assets may wish to use an irrevocable life-insurance trust. The trust -- not the individual -- owns the life-insurance policy. As a result, the policy's proceeds are excluded from the individual's taxable estate, as long as the policy is placed in trust three or more years before the death of the grantor.

Beneficiary Information and Wills

Keeping beneficiary information up to date is crucial, and involves more than just wills. A January U.S. Supreme Court decision shows how a beneficiary designated years earlier can come back to haunt.

For example, say Anna and Bill divorce. Bill waives any claim on Anna's retirement-plan assets, but Anna neglects to change the beneficiary from Bill to her new spouse. The Supreme Court has decided that if the oversight is not corrected, Bill will receive the assets upon Anna's death -- contrary to her wishes and even to the terms of Anna and Bill's divorce agreement. In *Kennedy v. Plan Administrator for DuPont Savings and Investment Plan*, the court unanimously ruled that the plan administrator must follow the instructions laid out in its own documents.

"The person on the beneficiary form gets the money," says Dawn Brown, a certified financial planner with L.J. Altfest & Co. in New York. "This decision illustrates how important it is to keep beneficiary designations up to date."

Assuming both partners want to disinherit their former spouses, they should remove them as beneficiaries on life-insurance policies and retirement accounts, as well as from documents establishing ownership of real estate, vehicles and bank accounts. In addition, families should review their will and other estate plans at least every five years, or whenever they experience a significant change such as a birth, death or divorce.

"It's important that people remember to update beneficiary and estate-plan information following any major change in life circumstances," says Ms. Brown. "Otherwise, they risk leaving beloved family members out of their estate."

Family Communication

Estate planners emphasize that the most important element of building and maintaining any estate plan is communication with family members. This step is particularly important -- and can be particularly challenging -- in blended families, where children may be extremely sensitive to what they perceive as inequity in the distribution of assets.

For this reason, Mr. Chasen, the attorney, recommends that blended families speak frankly with their financial advisers about the rationale behind their decisions. "That way, if survivors don't fare as well in the plan as they might like, your adviser can explain why it's structured the way it is, and what your best intentions were," he says.

Couples also should discuss their decisions with their children and step-children. Difficult as the conversation may be, it can prevent serious disagreements in years to come. "People don't want to talk about their estate plans because it means accepting the fact that they're going to die someday," says Ms. Brown. "But it's crucial to communicate goals and intentions related to estate planning very clearly in order to avoid ill will among the survivors."

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