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# Estate and Tax Issues in Connection with Prenuptial Agreements and Following a Divorce

## By: Gary R. Botwinick, Esq.

I. *Introduction.*

This program is intended to identify several issues which attorneys, accountants, financial advisors and related professionals should be prepared to handle at two specific stages of a marriage that often do not get an abundance of attention. I've prepared outlines, and presented seminars on the subject of estate planning and tax matters arising during a divorce. However, this program is focused upon (i) tax and estate issues to be addressed in advance of the marriage (including the use of a prenuptial agreement), and (ii) tax and estate issues following the divorce. Undoubtedly, this program cannot cover the infinite number of issues that may arise in every marital relationship, but it is intended to be a resource to rely upon at all stages of a client's married life.

II. *Tax and Estate Issues to be Aware of in Advance of a Marriage*

A. *Marital Rights Under Federal and New Jersey Law* – simply marrying another individual grants certain rights to the spouses. While there are too many to list here, some of them include:

1. Inheritance rights – see NJSA 3B:8-1 New Jersey Elective Share Statute, reflecting minimum inheritance rights of a surviving spouse
2. Spousal Support and Alimony -- see NJSA 2A:34-23
3. Tenants by the Entirety Property Interests – see NJSA 3-17.2
4. Joint Filing Status for Tax Returns – see 26 USC 6013
5. Retirement Survivorship Rights – see 29 USC 1055
6. Treatment of Gifts (Split Gifting) – see 26 USC 2513
7. Deceased Spousal Unused Exclusion Amount ("DSUE") – see 26 USC 2010(c)(4)

B. Prenuptial Agreements – also referred to as antenuptial agreements or premarital agreements

1. New Jersey adopted the Uniform Premarital Agreement Act in 1985 – see NJSA 37:2-31 et seq. – now referred to as The New Jersey Uniform Premarital and Pre-Civil Union Agreement Act

- Requirements -- Agreement must be in writing, with a statement of assets annexed thereto, signed by both parties, and it is enforceable without consideration. NJSA 37:2-33.

- **Contents** – NJSA 37:2-34 specifically sets forth subjects that **may** be addressed in a premarital agreement:
    i. Rights of the parties with respect to property;
    ii. Rights to buy, use, sell assign mortgage, or otherwise dispose of property;
    iii. Specific provisions with respect to the disposition of property upon separation, marital dissolution, termination of a civil union, death, or any other event;
    iv. Modification or elimination of spousal (or civil union) support obligations;
    v. Making of a will, trust or other arrangements to carry out provisions of the agreement;
    vi. Ownership rights and disposition of a death benefit from a life insurance policy;
    vii. Choice of law; and
    viii. *Any other matter, including their personal rights and obligations, not in violation of public policy.*

2. Significantly consequential amendment in 2013 (effective June 27, 2013) dealing with the enforceability of premarital agreements, addressing primarily when an agreement is **unconscionable** and therefore, not enforceable.

- Under New Jersey's old law, ***unconscionability*** was determined at the time of enforcement:
    i. See Jacobitti v. Jacobitti, 135 N.J. 571 (1994), any prenuptial agreement that would leave one spouse wealthy and the other without means of support is unconscionable and therefore unenforceable under New Jersey divorce law. Ms. Jacobitti was wheelchair bound and suffering from multiple sclerosis in a progressively deteriorating condition. The Court found that the circumstances clearly made the enforcement of the agreement unconscionable; a finding that is also consistent with the definition of unconscionable within the context of N.J.S.A. 37:2-32(c) which provides that an "'[u]nconscionable premarital . . . agreement' means an agreement, either due to a lack of property or unemployability: (1) Which would render a spouse . . . without a means of reasonable support; (2) Which would make a spouse . . . a public charge; or (3) Which would provide a standard of living far below that which was enjoyed before the marriage . . .."
- Under New Jersey's post June 27, 2013 revised law, ***unconscionability*** is determined at the time of the execution of the agreement rather than at the time of enforcement.
    i. The law now provides that a premarital agreement **could not be deemed unconscionable unless** the agreement was

unconscionable when executed **because** the party seeking to set aside the agreement:

a. was not provided full and fair disclosure of the earnings, property, and financial obligations of the other party;

b. did not voluntarily and expressly waive, in writing, any right to disclosure of the property or financial obligations of the other party beyond the disclosure provided;

c. did not have, or reasonably could not have had, an adequate knowledge of the property or financial obligations of the other party; or

d. did not consult with independent legal counsel and did not voluntarily and expressly waive, in writing, the opportunity to consult with independent legal counsel.

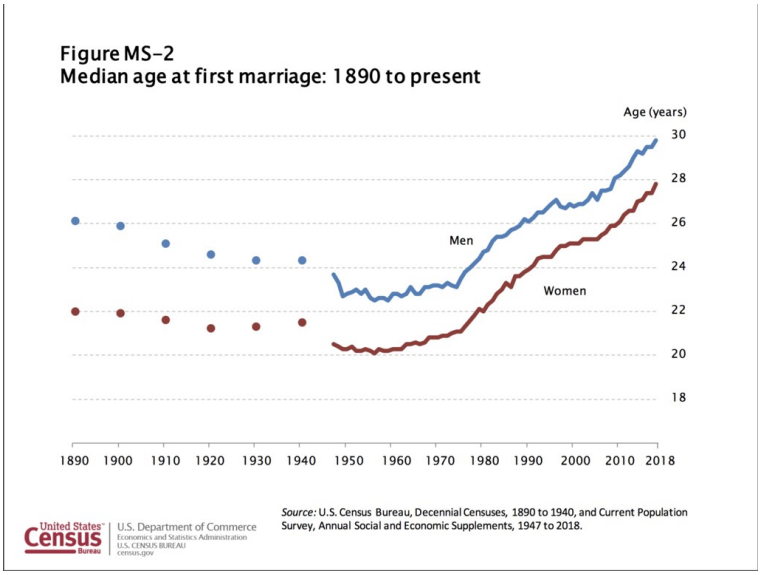
ii. Importantly, these factors are now considered as **the sole factors** that determine whether or not an agreement is deemed unconscionable.

See N.J.S.A. §37:2-38

3. Issues to Address in Prenuptial Agreement

- Protection of premarital assets

i. Very common in second marriages and becoming more important in first marriages with marriages happening later in life




ii. It is imperative that the agreement identify all of the premarital assets.

iii. The agreement should also specifically identify the assets that are considered marital assets (or joint assets) which will be subject to division at divorce or subject to inheritance at death.

iv. The agreement should also have protective language to include assets that were inadvertently left off as separate, premarital assets.

v. Agreement should specifically include in the definition of separate, premarital assets, specific language addressing appreciation and return on investment of such assets. We typically include language like the following:

> *The terms Premarital Property and Separate, Premarital Property shall also include (i) any and all passive and/or active increases in value of such Property, whether or not such appreciation is due in whole or in part to the active contributions or efforts of the other party to this Agreement, economic conditions or due to any other reason, (ii) any and all return on investment of such Separate, Premarital Property, (iii) Property acquired in exchange for such Separate, Premarital Property, (iv) Property acquired as a result of the ownership of Separate, Premarital Property (e.g. dividends, interests in spun-off companies, interests in merged companies, etc.), (v) any and all interest, income or appreciation earned thereon, whether or not the same is due in whole or in part to the contributions or efforts of the other party to this Agreement, economic conditions or due to any other reason, (vi) any and all proceeds from any sale of such Separate, Premarital Property and (vii) any Property acquired with any and all proceeds from any sale or exchange of such Separate, Premarital Property.*

- Alimony and spousal support payments;

i. Depending upon which party you are representing, you may or may not want to allow for alimony. Or, you may want to predetermine what the alimony will be in the event of a divorce.

ii. Keep in mind that in 2014, New Jersey changed its alimony/spousal support statute

- Under the old law, courts had greater latitude to award alimony.
- Under new law, "permanent alimony" was replaced with "open duration alimony." This does not necessarily mean that it is for a fixed number of years.
- Alimony payer has a right to retire. Under the new law there is a rebuttable presumption that alimony can be ended or reduced when the payer reaches retirement age, provided that he or she actually retires at that age.

- For marriages that lasted fewer than 20 years, the length of alimony payouts cannot exceed the length of the marriage unless there are exceptional circumstances.

iii. Consider the possibility of predetermining how alimony will be resolved in the event of divorce, such as by inserting a formula. For example, *if the parties are married between 2 to 5 years, then . . .*

- Waiver of spousal survivorship rights/elective share waiver;

i. NJSA 3B:8-1 et seq. provides that a surviving spouse is entitled to an "elective share" or a required inheritance for the surviving spouse.

ii. Assets that might be acquired from a family inheritance or from a first marriage, which are intended to go to the surviving children of the first marriage and not the surviving spouse, would not be excluded from the definition of the "augmented estate" and would thus be factored in for the purpose of determining the forced inheritance by the surviving spouse.

iii. A prenuptial agreement should include a waiver of the elective share (as permitted by NJSA 3B:8-10.

iv. Does not prohibit either spouse from providing a greater inheritance than would be required under the prenuptial agreement.

v. Often, life insurance is required as a "make-up" for the lost inheritance and to care for the surviving spouse.

- Right to treat gifts as split gifts

i. Pursuant to 26 USC 2503(b)(1) , each year, each donor can make a gift of $15,000 (adjusted for inflation) to any number of recipients.

ii. Pursuant to 26 USC 2505, each individual is entitled to a credit for gift tax in the amount of $11,400,000 (adjusted for inflation), which is referred to as the "gift tax exemption."

iii. Pursuant to 26 USC 2513, gifts made by one spouse to any person other than the other spouse, shall be treated as made one-half by the donor spouse and one-half by the other spouse so long as (i) at the time of the gift the other spouse is a US Citizen, (ii) the spouses are married to each other at the time of the gift and does not remarry before the end of the year of the gift, and (iii) the spouses make an election to treat such gifts accordingly. These are usually referred to as "split gifts."

iv. **Important** – if one party intends to make annual exclusion gifts on a regular basis, and that spouse (as a result of the marriage) wishes to double that gift by having the other spouse consent to the split gift, the prenuptial agreement should include a provision requiring the other spouse to join in making that election.

v. **Important** – if one party wishes to make gifts in excess of his or her gift tax exemption during his or her lifetime, the marriage will allow that spouse to use the other spouse's exemption, provided that he or she is required to make a split gift election. The prenuptial agreement should include that.

vi. **Important** – if you represent the non-moneyed spouse who is being asked to join in the split-gift election, it would be prudent to get something in exchange for this consent, as the value to the other spouse of the full use of the exemption is more than $4,500,000.

vii. **Important** – If you represent the consenting spouse, build in protection for that client by requiring the gifting spouse to indemnify your client for any deficiencies on any gift tax return.

- Deceased Spousal Unused Exclusion (DSUE)

i. Prior to 2010, in order for a married couple to use both of their Federal estate tax exemptions, practitioners typically established a trust at the death of the first deceased spouse – commonly referred to as the "credit shelter trust." This trust would be for the benefit of the surviving spouse and the children of the marriage and it "*captured*" the exemption of the first deceased spouse and be non-taxable at the first spouse's death. Importantly, that trust would not be included in the taxable estate of the surviving spouse at the second death. Thus, ensuring the use of both spouse's exemptions.

ii. Starting in 2010, Federal tax law was revised to allow the surviving spouse to inherit the unused portion of the first deceased spouse's exemption. This amount is referred to as the Deceased Spousal Unused Exclusion (DSUE). This would allow the surviving spouse, after the death of the first spouse in 2019, to have the equivalent of a $22,800,000 Federal estate tax exemption in 2019.

iii. **Important** – In order for the surviving spouse to inherit the DSUE, the estate of the first deceased spouse must make an election on a Federal estate tax return. If that election is not made, then the surviving spouse only has his or her own exemption.

iv. **Important** – If one spouse needs the exemption (because she has an estate of over $11.4 Million), then she should ensure that the prenuptial agreement binds the estate/executor of the deceased spouse to make that election.

v. **Important** – As in the gift tax exemption, this DSUE has significant value to the estate of the surviving spouse. The non-moneyed spouse may want to use this agreement to make the DSUE election as a bargaining chip for something else under the agreement.

- Who can terminate a marriage?
    i. NJSA 2A:34-14 provides that "A parent or guardian shall not be precluded by the provisions of this chapter from prosecuting or defending any action respecting the marriage or civil union status or relation of his minor child or ward."

    ii. Accordingly, a guardian can bring an action for divorce on behalf of an incapacitated spouse.

    iii. In Zelman v. Zelman, 175 So. 3d 871 (Fla. Dist. Ct. of App, 4th Dist. 2015), Martin Zelman was married to Lois Zelman. Prior to entering into the marriage, Lois and Martin entered into a prenuptial agreement. Pursuant to the prenuptial agreement, Lois was entitled to receive more from Martin's estate as his widow than she would if they were divorced. As Martin declined into increasingly severe levels of dementia, his children, being aware of the differing results to Lois in the prenuptial agreement as an ex-spouse or as a widow, brought an action for the appointment of one of his children as Martin's guardian. For no apparent understandable reason, the Court allowed the guardianship proceeding to continue without making Lois a necessary party. Martin's son, Robert, was appointed as the guardian and he commenced a divorce proceeding. Ultimately, the guardianship action was appealed and overturned on the grounds that Lois was denied her due process rights as an interested party to participate in the guardianship action.

    iv. As a result of the Zelman decision, all prenuptial agreements should address whether an action for termination of the marriage can be commenced by a guardian or agent.

    v. Alternatively, where there is a difference in the treatment of a spouse as an ex-spouse vs. as a widow(er), a prenuptial agreement should consider this possibility. One way to address this issue is that if a marriage is terminated after a spouse is determined to be incapacitated, should the ex-spouse receive the share of the estate he/she would've received had he/she been a widow(er).

- Waiver of spousal benefits in ERISA governed plans
    i. The disposition of qualified retirement benefits upon a participant's death or divorce is governed by Federal law under the Employee Retirement Income Security Act of 1974 (ERISA) amended by the Retirement Equity Act of 1984 (REA).

    ii. In the absence of an effective waiver or consent, the surviving spouse is entitled to a survivor annuity/accrued benefits from the

spouse's retirement plan. Often, such a waiver/consent is a bargained for concession in a prenuptial agreement.

iii. **Important** – be aware that a premarital waiver is ineffective. The waiver must occur subsequent to the official marriage. Prenuptial agreements should have a written waiver required immediately subsequent to the marriage.

- Suggested Language for Post December 31, 2018 Prenuptial Agreements:

i. This Agreement has been executed subsequent to the effective date of the Tax Cuts & Jobs Act of 2017 ("TCJA"), with the mutual understanding of the parties that the periodic payments provided by this paragraph shall be neither taxable to the recipient as alimony nor tax-deductible to the payor. If, prior to the expiration of the payor's obligation, the alimony tax deduction should be restored to its pre-TCJA form by a change in the governing law or its authoritative interpretation, the parties agree that they shall designate the periodic payments as taxable to the recipient and deductible to the payor; as they would have been entitled to do under section 71(b)(1)(B).

C. Alternatives to a Prenuptial Agreement

1. Asset Protection Trusts

- What is Domestic Asset Protection Trust ("DAPT")? – When we refer to a DAPT, we are typically referring to a self-settled trust established in one of the state jurisdictions in the United States that provides creditor protection to the grantor even though he is also a beneficiary of the trust. The intent is to remove assets that belong to the grantor from the reach of the grantor's creditors.

i. A DAPT is similar to a spendthrift trust that a third party would establish for a beneficiary, except that the trust is self-settled.

ii. The terms of the DAPT typically provide a third-party trustee or a distribution committee with the independent power to make distributions from the trust for beneficiaries, which will include the grantor.

iii. In other words, the grantor will have so parted with dominion and control over the trust that it will be beyond the reach of his creditors, but the grantor may still enjoy the benefit of distributions from the trust with the trustee's consent.

iv. Until relatively recently, a self-settled trust in the United States where the grantor was a discretionary beneficiary, would have been ineffective in removing the trust assets from the reach of the grantor's creditors.

v. Prior to 1997, in order to create an effective self-settled trust beyond the reach of creditors, the trust would need to be established in one of several off-shore jurisdictions (e.g. the Cook Islands, Nevis, the Channel Islands, etc.).

vi. Alaska became the first US jurisdiction to enact laws allowing protection for self-settled trusts (in 1997) and was shortly

thereafter followed by Delaware, Nevada, South Dakota and now several other states.

- How can a DAPT be used as a protective vehicle in advance of a marriage? *Belt and Suspenders*

  i. Prior to the marriage, the grantor may consider moving premarital assets into a DAPT to prevent the assets from becoming subject to equitable distribution, or available for alimony or child support.

  ii. Even without the DAPT, most states provide that premarital assets that are not comingled with marital assets are generally exempt from equitable distribution.

  iii. A DAPT will typically result in protection from equitable distribution since the assets in the trust are, by the very nature of the trust, separated from marital assets (assuming that marital assets are not also contributed to the trust).

  iv. Do any jurisdictions protect a DAPT from support claims in a divorce? Are these claims considered the claims of "exception creditors"?

    i. Nevada – Appears to provide protection from alimony and child support claims

    ii. Alaska – Appears to provide protection from alimony. Trust assets should not subject to claims for child support if assets were not transferred when grantor was 30 days or more in default.

    iii. Delaware – provides no protection from alimony and child support claims, but appears to provide protection if the trust is established and funded prior to the marriage.

    iv. South Dakota – no protection from alimony claims if spouses were married on or before the date of transfer. Provides no protection from claims for child support.

2. Revocable Trust with Memorialization of Premarital Assets

- It has become rather common for a potential client to determine that a prenuptial agreement is appropriate to protect premarital assets but only decides to reach out to a lawyer ON THE EVE OF THE MARRIAGE.

- As a matter of course, my office will not prepare or represent a client in a prenuptial agreement when the wedding date is imminent for fear of a challenge on the basis of duress.

- In those cases, we often recommend domestic asset protection trusts, but they are not appropriate for everybody.

- A new suggestion is to move all premarital assets that can be transferred into a revocable living trust, referred to as the "John Smith Premarital Revocable Trust". We then create a physical binder and digital file with copies of all brokerage statements, tax returns and valuation reports of all assets that exist at the time of the marriage, so as to establish a baseline value of premarital assets as they exist at the time of the marriage. Clients are advised not to fund the revocable trust after marriage with any marital assets.

- While this does not create any real asset protection, it at least provides a starting point for purposes of determining the identity and valuation of the assets that existed prior to the marriage, and the establishment of the revocable trust creates a mechanism to avoid unintentionally comingling the premarital assets with marital assets.

3. What about Postnuptial Agreements?

- Prepared, negotiated and executed after the marriage has already commenced.

- Can provide for an agreement as to property distribution in the event of divorce or death and set reasonable limits on alimony or spousal support.

- Like a prenup, cannot fix child support or determine child custody.

- Not always limited to situations in which a marriage is already rocky.

- Postnups are widely used in community property states where assets acquired by either spouse during a marriage are considered owned by both spouses.

- May be appropriate if financial circumstances in a marriage change, such as when one spouse suddenly obtains vast wealth.

- What is the problem with postnups?

    i. There is little case law on the enforceability of these agreements.

    ii. The New Jersey Uniform Premarital and Pre-Civil Union Agreement Act (N.J.S.A. §37:2-32 et seq.) specifically applies to "premarital agreements" and makes no mention of "post-nuptial agreements".

    iii. Pacelli v. Pacelli, 319 N.J. Super. 185 (App. Div. 1999) -- The leading case on mid-marriage agreements in New Jersey. In Pacelli, the Appellate Division refused to enforce a mid-marriage agreement, finding that it was unfair in 1986 when it was signed as well as in 1994 when enforcement was sought. The Court was specifically concerned about the potential for coercion inherent in a mid-marriage agreement because one party can use the threat of dissolution of marriage to "bargain themselves into a position of advantage." The Court indicated that it did not need not decide whether all such agreements are so inherently and unduly coercive that they should not be enforced. Rather, the Court stated that such agreements must, at the very least, be closely scrutinized and carefully evaluated.

iv. The Pacelli court indicated that such agreements must be fair and equitable, both at time of execution and implementation. Query? Would that still apply in light of the changes to N.J.S.A. §37:2-38.

- It is clear that, at a minimum, for post-nuptial or mid-marriage agreements to be enforceable, the agreement should satisfy all of the requirements found in N.J.S.A. §37:2-38. But what if the agreement is unconscionable at the time of enforcement?

i. In an unreported opinion, Gallagher v. Gallagher, Docket No. A-1261-09T3 (2010), the Court stated "[g]enerally, mid-marriage agreements are unenforceable as they are 'inherently coercive' entered into 'before [a] marriage los[es]all of its vitality and when at least one of the parties, without reservation, wanted the marriage to survive'". Citing Pacelli.

ii. What about reconciliation agreements?

4. What about a post-marriage waiver of elective share?

- N.J.S.A. 3B:8-10. The right of election of a surviving spouse or domestic partner and the rights of the surviving spouse or domestic partner may be waived, wholly or partially, before **or after marriage** before, on or after May 28, 1980, by a written contract, agreement or waiver, signed by the party waiving **after fair disclosure**.

## III. *Estate and Tax Issues After Divorce*

### A. Revocation by Operation of Law

1. NJSA 3B:3-14 provides that the divorce or annulment of a marriage of a testator revokes any dispositions or appointments made by the will to the former spouse, including any power of appointment on the spouse and any nomination of the former spouse as a fiduciary or guardian, unless the will expressly provides otherwise.

- Since 2005, the revocation provisions of NJSA 3B:3-14 was expanded to include the automatic revocation any dispositions made by a *governing instrument* to the former spouse and any *disposition or appointment created by law or in a governing instrument to a relative of the divorced individual's spouse* who is not also a relative of the testator.

- The 2005 amendments also clearly apply to joint accounts and property held as tenants by the entirety. The result is that such accounts are then owned as tenants in common.

- The 2005 amendments apply retroactively to revoke designations occurring before the enactment of the revisions. Moreover, the amendments even apply to revoke dispositions where the divorce occurred before 2005, but the designations were not updated. See Hadfield v. The Prudential Insurance Company, 408 N.J. Super. 48 (App. Div. 2009).

i. On June 11, 2018, the U.S. Supreme Court decided Sveen v. Melin, 138 S.Ct. 1815 (2018), holding that the retroactive application of a Minnesota statute that revokes spousal beneficiary designations in insurance policies upon the spouses' divorce

does not violate the Contracts Clause of the United States Constitution.

- Where the deceased spouse was required to name the former spouse as the beneficiary under the policy pursuant to the Judgment of Divorce, the provisions of NJSA 3B:3-14 would not apply. See Thomas v. Thomas, No. A-2388-11T2, 2013 N.J. Super. Unpub. WL 2395040 (N.J. Super. Ct. Ch. Div. June 4, 2013). There is no requirement to complete a new beneficiary designation to keep the former spouse as the beneficiary where the designation of the former spouse was required by the judgment of divorce.

2. NJSA 3B:3-14 vs. Federal Law with respect to Federal life insurance plans

- Under the Supremacy Clause of the US Constitution, Federal law will preempt NJSA 3B:3-14 where the application of both New Jersey and Federal law provides different results.

- In Calmon-Hess v. Harner, 904 F. Supp. 2d 388 (D.N.J. 2012), a former spouse was entitled to death benefits under a Federal Servicemembers' Group Life Insurance Act (SGLIA) policy, notwithstanding the divorce and notwithstanding the provisions of NJSA 3B:3-14, where the deceased spouse failed to update his beneficiary designation after divorce.

3. The Impact of NJSA 3B:3-14 on Retirement Benefits

- Retirement benefit plans including pensions, 401(k)'s and Individual Retirement Accounts (IRAs) all utilize beneficiary designations to specify who receives the benefits of such plans at the participant's death.

- NJSA 3B:1-1 specifically includes in the definition of a "governing instrument" a "pension, profit-sharing, retirement or similar benefit plan." Thus, a designation of a former spouse as the beneficiary of such a retirement plan would appear to be revoked. However, this revocation only applies to such plans that are governed by New Jersey law. Any plan governed by Federal law would be subject to the Federal laws.

  i. Many, if not most, employer-sponsored retirement plans are governed by ERISA and REA (as specified above in Section II).

  ii. NJSA 3B:3-14 is pre-empted for any ERISA/REA governed plan. See Kennedy v. Plan Administrator for DuPont Sav. & Inv. Plan, 555 U.S. 285 (2009) and Egelhoff v. Egelhoff, 532 U.S. 141 (2001).

  iii. In such plans, though the parties are divorced, if the former spouse is still listed as the beneficiary designated in the last filed beneficiary designation form, the former spouse is entitled to the benefits, notwithstanding the provisions of NJSA 3B:3-14, which is pre-empted. See Juno v. Verizon Communications, Inc., No. 10-1288, 2011 U.S. Dist. Unpub. WL 1321683 (D.N.J. Mar. 31, 2011).

  iv. **Important** – where a former spouse is entitled to the death benefit of an ERISA plan due to the deceased spouse's failure to change the designation, if the surviving former spouse waived his/her

rights under the plan pursuant to a property settlement agreement during the divorce, the decedent's estate can bring a claim for breach of contract to recover the proceeds. See Estate of Kensinger v. URL Pharma, Inc., 674 F. 3d 131 (3rd Cir. 2012) ("once the benefits were distributed to the designated beneficiary in accordance with the plan documents, ERISA was no longer implicated.").

B. Qualified Domestic Relations Order ("QDRO")

1. It is common in a divorce proceeding for a final resolution to include an assignment of certain rights to an employer-sponsored retirement plan to the former spouse of the participant. These rights are ensured to the participant's spouse pursuant to REA (discussed above).

2. In order to effectuate an assignment or vesting of these rights in the former spouse, the plan sponsor must receive a Qualified Domestic Relations Order (a "QDRO").

3. In general, ERISA and the Internal Revenue Code do not permit a participant to assign or alienate the participant's interest in a retirement plan to another person. These "anti-assignment and alienation" rules are intended to ensure that a participant's retirement benefits are actually available to provide financial support during the participant's retirement years. A limited exception to the anti-assignment and alienation rules is provided for assignments of retirement benefits through qualified domestic relations orders (QDROs). Under the QDRO exception, a domestic relations order may assign some or all of a participant's retirement benefits to a spouse, former spouse, child, or other dependent to satisfy family support or marital property obligations if and only if the order is a "qualified domestic relations order." ERISA requires that each retirement plan pay benefits in accordance with the applicable requirements of any "qualified domestic relations order" that has been submitted to the plan administrator. The plan administrator's determinations on whether a domestic relations order is a QDRO, therefore, have significant implications for both the parties to a domestic relations proceeding and the plan. The following questions and answers are intended to provide an overview of the Federal requirements a domestic relations order must satisfy to be considered a QDRO. See https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/publications/qdros.pdf

4. QDROs must contain the following information:

- the name and last known mailing address of the participant and each alternate payee;
- the name of each plan to which the order applies;
- the dollar amount or percentage (or the method of determining the amount or percentage) of the benefit to be paid to the alternate payee;
- and the number of payments or time period to which the order applies.

5. Perez v. Tapanes, No. A-4421-17T1, 2019 Sup. Ct. App. Div WL 2225009 (May 23, 2019). The parties entered into a divorce agreement in 1993 that provided for equitable distribution of the marital portion of the pension. The parties did not procure a Qualified Domestic Relations Order ("QDRO") to distribute the marital

portion of the pension following their divorce. The former husband retired in 2010 and began collecting his benefits. He did not alert the State of New Jersey that his former wife was entitled to a share of his benefits. By the time the wife began collecting her share of the benefits in 2017, over $70,000 of arrears had accrued. Ultimately, a QDRO was obtained over the former husband's objection.

6. Seavey v. Long, 303 N.J. Super. 153 (App. Div. 1997) -- Decedent's first wife sought to recover portion of widow's pension benefits from decedent's second wife. The Superior Court, Chancery Division, Middlesex County, imposed constructive trust on 70% of widow's benefits in favor of first wife. Second wife appealed. Appellate Division, held that widow's benefits were vested solely in second wife.

7. Use of a QDRO to Satisfy Obligations – Orlowski v. Orlowski, 459 N.J. Super. 95 (App. Div. 2019)

   - In this case the ex-wife sought a QDRO against an ex-husband for reimbursement of their common child's college tuition, forensic accountant's fees, and counsel fees.

   - Appellate Division determined that, notwithstanding the anti-alienation provisions in ERISA governed employee benefit plans, such arrearages could be satisfied through the issuance of a QDRO against the former husband's benefits.

   - ERISA's anti-alienation provisions reflect a policy "to safeguard a stream of income for pensioners (and their dependents, who may be, and who usually are blameless) even if that decision prevents others from securing relief for wrongs done to them." Citing Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365 (1990). Nevertheless, the Court held that there are two exceptions, one of which is that payments can be made from an ERISA governed plan pursuant to a QDRO directing payment to an "alternate payee".

   - An "alternate payee" is defined as "any spouse, former spouse, child, or other dependent of a participant who is recognized by a domestic relations order as having a right to receive all, or a portion of, the benefits payable under a plan with respect to such participant."

   - The Appellate Division determined that failure to pay the college tuition constituted child support arrearages, and could, therefore, be satisfied through a QDRO, notwithstanding the anti-alienation provisions of ERISA. Moreover, "child support" is defined to include attorney's fees and related costs. Thus, they too could be paid through the issuance of a QDRO.

   - Query – What are the income tax consequences of the distributions from the plan pursuant to the QDRO and to whom are the distributions taxed?

C. Post-Divorce Life Insurance and QDRO Problems

1. The final entry of the judgment of divorce is not the end of the process. It is merely a shift to the next phase – the post-divorce administrative task process. Unfortunately, it is somewhat common for problems to occur at this time.

2. Woytas v. Greenwood Tree Experts, Inc., 237 NJ 501 (2019) -- Timothy Woytas entered a marital settlement agreement with Christina Woytas, which required him to provide child support and alimony for 12 years among other financial obligations. To secure these obligations, the MSA required that Timothy obtain a life insurance policy during the alimony period naming Christina as beneficiary and another policy during the child support period naming their children as co-equal beneficiaries. The MSA further stated that failure to maintain life insurance would require the breaching party's estate to be liable for any outstanding obligations.

   - Timothy obtained life insurance policies that included a "suicide exclusion," which limited the death benefit to premiums plus interest if Timothy committed suicide within two years of the effective date of the policy.

   - After his divorce from Christina, Timothy married plaintiff, Sandra Woytas. Pursuant to an oral agreement which Timothy had with Sandra, he obtained another life insurance policy naming her as beneficiary, as Sandra had sacrificed an alimony payment that she was receiving from a prior divorce.

   - Less than two years after his divorce from Christina, Timothy committed suicide. The insurance companies denied payments of death benefits on all of Timothy's life insurance policies, due to the suicide exclusion provisions of the policies.

   - Christina and plaintiff filed claims against Timothy's estate for the value of the policies. Sandra also made a claim that she was entitled to the value of the policy that designated her as the beneficiary from the estate.

   - The Chancery Division concluded that Timothy had breached the MSA and ruled that his outstanding child support obligation had to be paid before any other claims. The Chancery Division therefore ordered plaintiff, as administratrix, to pay the balance of Timothy's estate to Christina and children since outstanding child support exceeded the value of Timothy's estate.

   - The Appellate Division affirmed, rejecting plaintiff's contention that Timothy's children should **only be entitled to child support payments over time**.

   - The New Jersey Supreme Court affirmed, ruling that Timothy had **breached the marital settlement agreement by failing to "maintain" life insurance to secure his child support obligations**. The Supreme Court further ruled that because these obligations clearly exceeded the value of Timothy's estate, precise calculation of outstanding child support was unnecessary.

   - **Query** – Would the result have been different if the amount of sacrificed death benefit exceeded the value of the estate?

3. Konczyk v. Konczyk, 367 N.J. Super. 512, 513-14, 843 A.2d 1167 (App. Div. 2004) -- Upon a failure of a life insurance policy as security, how are damages measured?

   - Defendant, Jerome Konczyk, pursuant to a judgment of divorce (issued on April 8, 1996), was required to pay alimony to plaintiff, Patricia Konczyk, until she reached the age of sixty-five. Defendant was also obliged to maintain $15,000 in life insurance for plaintiff's benefit. The relevant provisions of the JOD provide as follows:

i. Defendant shall pay alimony to the plaintiff directly, as follows: $200.00 per month for five years, upon the signing of the Final Judgment of Divorce, and thereafter, $100.00 per month until such time as the plaintiff reaches the age of 65 years. In the event that plaintiff remarries, defendant's obligation as to alimony shall cease.

ii. The plaintiff shall retain the life insurance policies in her possession and defendant hereby waives his interest in same. Defendant agrees that within 90 days from the signing of this Final Judgment of Divorce, he shall produce proof of $20,000 worth of life insurance, or its equivalent, for the plaintiff's benefit to remain in effect until defendant's death.

iii. When defendant's obligation to pay alimony decreases to $100 per month, after five years from the date of this Judgment, defendant's alimony protection shall be reduced to $15,000 in life insurance. In the event that the defendant's obligation as to alimony ceases, the defendant's obligation to produce said proof of life insurance, or its equivalent, shall also cease.

- Defendant died on December 5, 2002. Prior to his death and without plaintiff's knowledge, defendant removed plaintiff as the beneficiary of his life insurance policy, and designated his two daughters as beneficiaries.

- Plaintiff sought the full $15,000 in life insurance proceeds that defendant was required to maintain.

- The Court determined that the life insurance was clearly and unequivocally designed to secure plaintiff's alimony obligation. Indeed, defendant's obligation to maintain life insurance was co-terminus with his obligation to pay alimony. Since, at the time of defendant's death, plaintiff was only entitled to $2,000, the "protection" that plaintiff was entitled to is only that amount and not the lost $15,000 death benefit.

4. If life insurance is required as security for alimony or child support, who should own the policy?

- If the insured is the owner, he could change the beneficiary without the knowledge of the other spouse.

- If the ex-spouse of the insured is the owner, the insured could not change the beneficiary.

i. **Important** – Prior to the Tax Cuts and Jobs Act of 2017 ("TCJA"), premium payments by the insured to the insurance company were deemed alimony, and thus taxable to the other spouse. After TCJA, alimony is no longer deductible by the payor, nor includable in the income of the recipient. Thus, this becomes a more viable option.

- Consider the use of a trust as the owner of the policy with an independent trustee. The trust could provide identical terms for payouts to the marital settlement agreement, including a required reversion of the policy to the insured when the obligation to maintain the policy expires.

5. Ross v. Ross, 308 N.J.Super. 132 (App. Div. 1998) -- Following husband's death, former wife sought to enforce property settlement agreement by requesting the entry of qualified domestic relations orders (QDROs) entitling her to survivor benefits under husband's pension plans and annuity contract. Husband's widow objected. The Superior Court, Chancery Division, Morris County, entered QDROs authorizing distribution of proceeds of pension plans and annuity contract to former wife. Widow appealed. The Appellate Division held that: (1) trial court's failure to join widow as indispensable party did not deprive trial court of jurisdiction to adjudicate the matter; (2) widow effectively intervened, despite absence of formal motion to do so, and was consequently bound by trial court's decision; (3) property settlement agreement was a QDRO, for ERISA purposes, with regard to pension plan from company that was specifically named in agreement; (4) property settlement agreement was not a QDRO, for ERISA purposes, with regard to annuity contract and pension plan which were not referred to at all in the agreement; and (5) QDROs that were entered after husband's death were not valid for purpose of allowing alienation of plan proceeds under ERISA.

6. Seavey v. Long, 303 N.J. Super. 153, 696 A.2d 102 (App. Div. 1997) -- Vesting widow's pension benefits solely in decedent-husband's second wife, as widow's benefits were only available because husband remarried following his divorce from first wife; refusing to place benefits into constructive trust for benefit of first wife who was entitled to death benefits pursuant to property settlement agreement.

IV. How The Tax Cuts and Jobs Act of 2017 (TCJA) Affects Divorce

A. **The State and Local Tax (SALT) Deduction** is limited to $10,000 per year. That deduction is not doubled for a married couple. In other words, the limit for a couple filing a joint tax return is $10,000. Likewise, the limit for an individual filing a single return is also entitled to a $10,000 deduction. So after a divorce, there will be 2 separate $10,000 deductions permitted.

B. **Qualified Residence Interest** is limited to just the amounts on $750,000 of mortgage principal for a couple filing jointly. For a single individual, the amount is the same -- $750,000. So after divorce, each party can deduct the interest on their respective mortgages up to $750,000.

C. **Old Prenups** which provided for the payment of alimony will have new consequences now that the contemplated alimony is no longer deductible to the payor. **Query** – will a court take that into consideration if a challenge to that payment is made by the payor spouse?

D. **Front loading of alimony payments** is no longer an issue due to the change in the tax treatment of alimony payments.

E. Tax Treatment of Alimony Trusts

1. Alimony trusts have commonly been used to secure a source of alimony payments where there was some concern about the ability of the payor to make such payments in the future.

2. Prior to TCJA, payments received from an alimony trust under 26 USC 682 were taxable as income to the Payee/Recipient spouse under 26 USC 215(d). Any distributions from the Trust to the recipient that were agreed to be support for the benefit of the grantor's minor children would be deemed to be income allocable to the grantor.

3. TCJA repealed Section 682 regarding the treatment alimony trusts.

4. The Internal Revenue Service issued IRS Notice 2018-37, "Guidance in Connection with the Repeal of Section 682," that clarifies the treatment of alimony trusts following the passage of TCJA.

5. IRS Notice 2018-37 states that the Department of the Treasury intends to issue regulations providing clarification of the application of the provisions concerning the repeal of §682. The Notice also states that the future regulations will provide that §682, as in effect prior to December 22, 2017, will continue to apply with regard to trust income payable to a former spouse who was divorced or legally separated under a divorce or separation instrument executed before January 1, 2019. Thus, payments from an alimony trust would continue to be treated as taxable income to the beneficiary under most circumstances for alimony trusts established prior to January 1, 2019.

V. Impact of Prior Estate Planning Techniques by Married Couples After Divorce

A. Irrevocable Life Insurance Trusts

1. Often these trusts include provisions that terminate the rights of a former spouse;

2. What if the divorce agreement relies upon an insurance policy owned by the trust because the divorce attorneys never did due diligence to determine who the rightful owner of the policy is?

3. Can decanting or purchase of the policy from the trust provide certain solutions?

B. Family Limited Partnerships ("FLP") or Family Corporations

1. What if there is an intent to rely upon the assets in the FLP as part of equitable distribution?

2. Must consider the tax consequences of redemption of partnership interest.

3. Should a division of the FLP into two separate entities be considered?

4. Should a Corporation consider a liquidation? A redemption? A division of entity?

5. Maybe the corporation should consider a tax-free reorganization to effectuate a division of assets pursuant to equitable distribution.

6. There are significant tax consequences for each different strategy which must be considered.

C. Intentionally Defective Grantor Trusts ("IDGT")

1. High-net-worth married couples, as part of their estate planning, transfer ownership interests in business entities to trusts for the benefit of family members (typically, their children).

2. Often these trusts are designed as IDGTs to produce significant estate/gift tax benefits.

3. If a divorcing spouse transfers their ownership interests in a business entity to the other spouse, they both will continue to owe the taxes on the income of the IDGT.

4. If a divorcing spouse will no longer have anything to do with that business entity post-divorce, the divorcing couple should consider whether they want to turn off the grantor status of the trust.

D. Treatment of Grantor Trusts (in particular Spousal Lifetime Access Trusts) Where Former Spouse is a Beneficiary

1. 26 USC 677(a) provides that grantor trust status exists if the grantor's spouse may receive income without approval from an adverse party. When a divorce occurs, there is no longer a spouse. But does that mean there is no longer a grantor trust issue?

2. 26 USC 672(e)(1)(A), otherwise known as the Spousal Unity Rule, states that the grantor is considered to hold any power or interest of a spouse, and the grantor's spouse is defined under that section as any individual who was the grantor's spouse at the time of the creation of the trust.

3. A Spousal Lead Access Trust ("SLAT") is an irrevocable trust created during the Grantor's lifetime for the benefit of the Grantor's spouse. The trust is not intended to qualify for the gift or estate tax marital deduction (which would result in inclusion of the trust assets in the spouse's estate); rather, the SLAT is designed to remove the trust assets from both the Grantor and Grantor's spouse's estate.

4. A SLAT, typically provides the Grantor's spouse continued access to the trust funds as the Grantor's spouse can continue to receive distributions for the duration of her lifetime.

5. Because the spouse is a beneficiary, the SLAT is taxed as a Grantor Trust. Consequently, the Grantor must recognize and pay income tax on the trust's income as part of his or her personal income. Pursuant to the Spousal Unity Rule the Grantor is considered to hold any power or interest held by any individual who was the grantor's spouse at the time of the creation of the power or interest.

6. If the former spouse retains rights under the SLAT agreement, even after the divorce, the Grantor (now the former spouse) will still be taxed on the income as the trust will remain a Grantor Trust.

7. Before it was repealed, former 26 USC 682 minimized some of these concerns by taxing the former spouse on any Grantor Trust income payable to that individual. The Grantor was not required to pay taxes on that trust income, regardless of whether spousal trust rights continued to trigger Grantor Trust status post-divorce. As a result of the repeal of 26 USC 682 under the TCJA, the former spouse recipient of distributions is no longer required to pay taxes on that income; the Grantor is now required to pick up that income.