

Estate planning for blended families

Many professionals have witnessed unintended results when people remarry without making adjustments to their estate plan.

“He died with a very substantial amount in his 401(k) plan. His will left everything to his new wife and the daughter from their marriage.

Unfortunately, when I checked with his employer, it turned out that he had named his first wife as the beneficiary of his account. The designation was very old, but it didn't matter. He never updated it, and his first wife was entitled to it all.”

“It was a May-December marriage. He figured that because his son was much younger than his stepmother, it was easy enough to arrange for his new wife to receive income from some of his assets and the assets themselves to pass to his son after her death. But his son died first. One of his assets was a business that had been in his family for generations. I knew there were other relatives that he would have wanted to continue the business. But his new wife and her family run the business today.”

“They were both financially set when they married. Each had children from earlier marriages. They drafted new wills leaving everything to one another, thinking that each would provide for the other's children when one of them died. That was when things were rosy. It turns out that he grew to actively dislike her children. When she died, it became clear to her children that he had no intention of changing his will in their favor. I had to tell them that there wasn't anything that I could do about it.”

Although anticipating the course of future events is always hard, perhaps more so for blended families, disaster is not inevitable.

Initial steps

As you contemplate how to integrate your new marital status in your estate planning, these steps are particularly important:

Make sure that you have severed all financial connections to your ex-spouse. You may have accomplished much of this at the time of your divorce. Most people recognize the need for a new will upon a change of marital status. But a will only directs how your *probate assets* will pass. Some of your assets pass outside of your will and so require new beneficiaries to be named to receive distributions. Examples of such assets include balances in a company retirement plan or IRA, proceeds from a life insurance policy and accounts with designations that call for payment or transfer on your death.

Protect your own children's inheritance and provide for your new spouse. Advisors strongly recommend against giving your new spouse any discretion in managing or distributing assets that you want your own children to have. No matter how much you trust your new spouse or how strong your belief is that the relationships in your new family are solid, you are leaving the door open to the possibility that your children's inheritances will pass to your spouse's offspring. At the same time, especially if your new spouse is not financially independent, you will want to see to his or her financial well-being too. The tricky part may be finding the right balance.

Implementing your goals

Estate planning specialists have several techniques to help you accomplish these goals.

A premarital agreement. In a blended family situation, these agreements are less in contemplation of divorce, more a way to identify what each spouse brings to the marriage and to whom it's expected each spouse's property will pass. (In community property states, a premarital agreement commonly provides that during marriage, a couple's separate property remains separate.)

A discretionary trust. Many parents in blended families set up this kind of trust because it allows them to choose an unbiased and impartial trustee to oversee a child's inheritance. The trustee may be authorized to pay income from the trust's assets as well as distributions of the assets themselves, according to the standards set out in the trust agreement. You may also be providing a layer of protection for your child's legacy from, say, a child's financial immaturity or the clutches of his or her ex-spouse. You may also set out a

long-term strategy as to who will inherit the assets in the trust should a child predecease you. For example, you can direct that his or her children or your surviving children receive that share.

A qualified terminable interest property (QTIP) trust. This trust allows you to provide for your current spouse for life and your children in the future, at the spouse's death. The typical QTIP trust calls for your new spouse to receive all the income from the trust (paid at least annually). He or she may also have a limited right to receive additional distributions from the trust as well. There's no federal estate tax payable at your death. At your spouse's death what passes to your children will be taxed to the extent that it exceeds the estate tax exemption available at that time.

A life insurance policy. Purchasing a life insurance policy is a way to leave your spouse or children an identifiable amount at your death. The policy proceeds can be used to fund a QTIP or discretionary trust. This approach is often used to satisfy bequests when a spouse and children are close in age. Providing certain conditions are met, setting up a life insurance trust and transferring the policy to the trust may keep the proceeds from being eaten away by estate tax.

A "second to die" life insurance policy. When there's a big difference in age between your spouse and the children that you have together, you might consider a second-to-die life insurance policy. Because the death benefit is not paid until the death of the second insured, premiums are lower than for two policies covering each spouse separately. When the strategy is to delay estate tax until both spouses have died, second-to-die policies offer a source of payment. Again, a life insurance trust may provide a shield from tax on the proceeds.

Put us on your team

If remarriage is on the horizon, we welcome the opportunity to assist you with your estate and trust planning. We will be glad to work with your other advisors to contribute to a smooth blending of your new family now and a secure financial future for you, your new spouse and your children in the years to come.

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Any developments occurring after January 1, 2009, are not reflected in this article.