MORNINGSTAR

The Challenges of Planning for 'His, Mine, and Ours'

by Sandra L. Atkins and Helen Modly | 12-11-2014

It seems that couples who are still in their original marriage with shared children are becoming somewhat of a rarity. Instead, we are seeing more couples in second or third marriages, with children from previous relationships as well as children in common. To deal with the complexities of "his, mine, and ours" in estate planning, you need to ask sensitive, and often difficult, questions.

Planning for blended families, those with children from prior relationships, is a balancing act. The husband and wife usually want to provide for each other at the time of the first death, but they also want to make sure that their own assets and their share of the marital assets will ultimately pass to their children. The issues differ based on the ages of the couple and their children, the size of estate, the length of marriage, who brought what to the marriage, and so forth.

Educate the Client

Consider this example:

Bud and Rose have been married for several years. This is a second marriage for each of them--Bud has two children from his first marriage, and Rose has three. When they got married, they had an attorney draw up wills with trusts to make sure that each of their children would inherit their parent's share of the estate. During their marriage, they bought a house together and titled it in their joint names. They co-mingled their financial assets and named each other as beneficiaries of their life insurance and 401(k) accounts.

In their tenth year of marriage, when all the children are in high school and college, Rose is killed in an automobile accident. In spite of Rose's intention to protect her assets for her children, everything--cash, life insurance, her share of the house-- transfer to Bud because of the way they were titled. He rolls her 401(k) into an IRA in his own name, and names his children as beneficiaries.

What happens to Rose's children? Presumably they can go live with their birth father, but what about the costs of college that were being covered by Rose and Bud from their joint funds? Will Bud feel any moral obligation to his step-children and continue to help them from Rose's share of their joint assets?

You can see how important it is to educate couples with a blended family on some basic planning issues regarding the titling of assets. They need to know that joint property with right of survivorship will pass to the surviving spouse with no strings attached and that assets with beneficiary designations bypass the provisions set up in a will or trust. A spouse like Rose basically disinherited her children by her lack of understanding.

As for whether or not Bud will feel a moral obligation to Rose's children, it's tempting for couples to say they trust each other to do the "right thing" after the death of the first spouse by making sure the ultimate estate is split between all the children. Unfortunately, there is no guarantee that will happen, especially if Bud should pass away unexpectedly soon after Rose. You need to make sure your clients have fully thought through their wishes and created a scenario that will allow them to be fulfilled.

Inventory the Assets
You can start by helping them put together an inventory of their estate and discuss what they want to do with each asset. There will be several categories:

- Assets they each brought to the marriage, which they may wish to go to their own children
- Joint assets they acquired together with funds earned after their marriage or with equal contributions, such as investment accounts and the marital home
- IRAs and retirement accounts funded both before and after the marriage
- Personal property, such as family furniture, jewelry, and photos

Once the list is complete, the couple needs to envision two situations, considering what they want to happen if the husband or wife dies first. It's critical to identify what income and assets the survivor will need to support his or her lifestyle going forward. This can vary greatly depending on the size of the estate, the age of the survivor and children, and whether or not the deceased was still working or already retired. For a younger family, insurance may be needed to make sure that the spouse can support the children and provide for their education, while a retired couple may need to cover the cost of a pension that has no survivor benefit.

If there is a big age difference between the spouses, special planning may be needed to provide support for the survivor throughout retirement, while also providing for the deceased's children so they don't have to wait so long to receive their inheritance. Life insurance may be advisable in a situation such as this to provide additional funds to meet both goals of providing for the spouse and the children.

Select the Best Documents

Reciprocal wills, or "I love you" wills, won't work in situations with blended families, as they normally leave all the assets to the survivor. With a nuclear family, this is no problem, as both spouses will leave the estate to their shared children. Not so with a blended couple, who have their own children and possibly shared children as well.

At the very least, each spouse should have a will with provisions to fund testamentary trusts. Again, depending on the ages of the couple and their children, at least a portion of the estate should be placed in trust to benefit the surviving spouse during his or her lifetime, with the rest to go to the children as determined by the testator. If there are enough assets, a portion of the trust can also go either directly to children or in trust for their immediate benefit. One thing to remember is that testamentary trusts created under a will almost always require annual court supervision.

A better method is to set up in a revocable living trust that creates the desired trusts at death. When a trust arises from a revocable trust, there normally is no requirement for ongoing court supervision.

If each spouse has a living trust, then joint assets such as investment accounts and even the marital home can be titled as tenants in common with the living trusts as the tenants. This ensures that one half of the value of the marital assets will flow into the trust of the first to die and not become an asset of the surviving spouse.

Divvy Up the Marital Home

The home can create some interesting issues. If only one spouse owns the home, or if the home has substantial value and is a large part of the survivor's estate, the timing of the sale of the home after the first death must be addressed. Clearly, the home should not be owned as joint tenants if the intention is for half of the net value to flow into the estate of the first to die.

It is common for the estate or trust of the owner or co-owner of the home to allow the survivor a period of time to live in the property before it is sold. This prevents the children of the deceased, who are the beneficiaries of the trust, from kicking out the step-parent before a reasonable amount of time.

Act Now

Estate planning is important for all your clients, but especially for those with blended families. They may shy away from having the difficult discussions about how to protect their own children while caring for each other, but don't let them put off the discussion. You can help them frame a plan, maybe by using examples of what other clients have done, and then steer them to a competent estate planning attorney. Once the process is complete, they'll be forever grateful to you.