

## Beyond Prenups

When marriages end, sometimes it takes more than a prenuptial agreement to keep assets in the family. BY EARL E. WATSON III AND D. SEAN McDADE

WITH ROUGHLY HALF OF ALL MARRIAGES in the United States ending in divorce, it's no surprise that the prenuptial agreement has become a popular way for individuals to protect their assets in case their one true love should one day become their ex.

But despite the popularity of such agreements, there are no guarantees the prenuptial approach will provide the expected protections. Too often, such agreements don't work because they overlook important assets, are challenged in court as unfair or ignore the impact on children and other family members.

Indeed, those looking for premarital protection may do better by exploring the advantages of asset-protection trusts. These trusts can be used in place of—or in some cases combined with—a prenuptial agreement. In the long run, such trusts often turn out to be cheaper, significantly more effective and less emotionally charged than the typical prenuptial agreement.

Certainly, there are good reasons for seeking premarital protections for the assets you bring into a marriage. State laws vary somewhat on how divorcing couples divide wealth, but it is typically very difficult for either party to successfully argue against the court's bias toward equitable distribution. Things tend to get divided down the middle, and this is generally considered a fair approach to assets accumulated during a marriage.

But what about other types of assets such as inherited wealth, ongoing family enter-



prises or property shared with other family members? A divorce property settlement can wreak havoc in these areas.

Consider what could happen when the assets at stake include something like a closely held operating company. This company may have been in a family for generations, and might even employ hundreds of people whose families rely on the wages paid to them by the company. Even if the divorcing family shareholder doesn't participate in the management or governance of the company, the business might face serious financial instability if the company is part of

the marital property in a divorce proceeding. The company may even have to borrow to buy out the interest in question or seek additional equity capital.

While prenuptial agreements can be designed to address these issues, they come with their own quirks and vagaries. For one thing, there's the expense. When entering into the "this is mine and that is yours" negotiations required for such agreements, each party must have his own attorney. Identifying the items in the "wealth inventory" can be time-consuming and require additional professional assistance, especially when there is significant family wealth involved.

Then, too, people are not necessarily aware of all aspects of their wealth resources. Anything left out, intentionally or otherwise, may taint the agreement or render it less than effective when significant assets are left exposed.

To be considered valid, the prenuptial agreement must be deemed "fair" at the time of execution, and whether it is indeed fair is something that might be determined by a judge and jury years after the fact. As it happens, a significant percentage of prenuptial agreements are discarded by the court for lacking such fairness.

Asset-protection trusts, however, are free of these deficiencies and can be effectively used to provide a clear distinction between marital and individual property. The older generations in a family are the ones who create these mechanisms to circumvent many

of the difficulties involved in prenuptials. In an asset-protection trust, estate distributions and lifetime gifts are made for the benefit of their children instead of being paid to the children outright.

With asset-protection trusts, the distribution of income, and in some cases principal, may be left to the discretion of the trustee (instead of the spouse), and the trustee acts in accordance with the interest of the beneficiary and the objectives of the trust creator.

In addition to protecting family wealth from any dilution created by a divorce settlement, such trusts also protect assets from other sorts of attacks in today's litigious society, such as professional malpractice awards, personal injury claims related to real estate and environmental claims. There are also long-term family advantages. In some states, it is possible to create perpetual asset-protection trusts that continue from one generation to the next so that the trust

will not be included in the taxable estates of those in future generations.

Remember that not all marriages end in divorce. Families may very well wish to include the non-family member in their wealth distribution. Asset-protection trusts can be used to accomplish this and at the same time guarantee that the resource remains within the family whether or not the marriage ultimately survives.

Before contemplating marriage, individuals may also want to consider establishing their own asset-protection trusts. Today, some state laws allow for what is referred to as "self-settled asset-protection trusts." In these states, an individual can create their own trust to protect their investments and business interests, their tangible personal property such as art, their real estate property, and anything else that might be subject to claims made against them, including but not limited to those of divorce settlements.

Prenuptial agreements, meanwhile, can be drawn up to manage and protect economic interests not typically suitable for asset-protection trusts—assets such as qualified retirement plans or perhaps a personal residence one spouse owned before the marriage.

Fairness and equity are desirable objectives when it comes to the division of marital assets in a divorce. While prenuptial agreements are designed to create such fair and equitable distributions, they can be cumbersome and inefficient vehicles, particularly when compared with more flexible and secure planning vehicles such as asset-protection trusts. *EW*

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