EISNERAMPER
WEALTH MANAGEMENT
CORPORATE BENEFITS

Prenuptial Agreements (part 2 of 2)

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Prenuptial Agreements Part 2 of 2

Tax considerations

Income tax

Executing a prenuptial agreement does not usually result in any immediate tax consequences. Tax consequences do arise, however, after one of two events--divorce or death--activates the terms of the contract. To properly plan for your desired tax consequences, you should be aware of the tax ramifications of all property transfers you made before signing the agreement. These not only include transfers made upon divorce or the death of you or your spouse but also transfers made at the time the agreement is executed and during marriage.

Tip: Since tax laws are constantly changing, you should have your agreement examined periodically to ensure that it accurately reflects the wishes of you and your spouse.

Filing joint tax returns

If you choose to file as married filing jointly, both you and your spouse should be entitled to receive copies of the return and supporting documents each year. By doing so, you will avoid future problems in the event of divorce negotiations, if either you or your spouse cannot access necessary tax records.

Gift tax

Generally, property transfers made before marriage may have adverse gift tax consequences, whereas transfers made during marriage are not subject to gift or income tax. When drawing up a prenuptial agreement, therefore, you should stipulate that any transfer of property occur after the wedding.

Clarify tax responsibilities within the agreement

A prenuptial agreement should clarify who will pay to defend a tax audit, if necessary, as well as who will pay any assessed taxes, interest, and penalties. Some agreements stipulate that the couple will file as married filing separately so that the tax problems of one spouse will not affect the other--even though the couple will end up paying more taxes that way.

Tip: Even when spouses file their taxes as married filing jointly, one spouse may be protected against the actions of the other under innocent spouse rules, which were revised by the IRS Restructuring and Reform Act of 1998. Under these rules, although each spouse who signs a joint return is fully responsible for the accuracy of the return as well as the payment of tax, if one spouse failed to report income or reported deductions or other items improperly, the other spouse can sometimes be relieved of the tax, interest, and penalties related to these items.

Estate tax

When a prenuptial agreement takes effect due to the death of a spouse, assets passing from the deceased spouse to the surviving spouse under the terms of the agreement may qualify for the estate tax marital deduction. The deduction cannot exceed the value of the adjusted gross estate, however, and only certain assets qualify for it. For a complete list of property that qualifies for the estate tax marital deduction, see Schedule M (Bequests, etc., to Surviving Spouse) of Form 706.

Frequently asked Questions & Answers

- ***Does a prenuptial agreement mean that the prospective spouses don't trust each other?***
  Perhaps, but a prenuptial agreement is generally grounded in realism rather than a lack of trust. For instance, an older couple marrying for the second time may simply want to protect the inheritances of their children. Some younger couples, on the other hand, might feel that they will save money in the future if the marriage doesn't work out.
- ***Can a domestic partner agreement that you had drawn up when you decided to live together be converted to a prenuptial agreement?*** Yes, by following these steps:
  Review your domestic partner agreement and make any changes and updates that you have both agreed upon. Rewrite the contract and call it a prenuptial agreement. Be sure to state that the agreement is in contemplation of marriage and does not take effect until you marry. Since there is no good self-help resource for writing a prenuptial agreement, have your agreement reviewed by an attorney. Even a small mistake on your part can invalidate your agreement. Lastly, sign your new agreement in front of a notary.
- ***Is it possible to write an ironclad prenuptial agreement?***
  Although you may have done everything correctly, you may still find yourself without an ironclad prenuptial agreement. In New York State, for example, anyone who signs a prenuptial agreement has six years from the time the agreement was signed to contest its contents.
- ***Can a prospective spouse waive his or her right to retirement plan benefits in a prenuptial agreement?***
  In general, if the retirement plan is covered by the Employee Retirement Income Security Act of 1974 (ERISA), an individual can not agree to waive his or her statutory right to benefits under the plan as part of a prenuptial agreement. While ERISA allows a spouse to waive his or her right to plan benefits (for example, a spouse can waive the right to receive a qualified joint and survivor annuity), only an actual spouse (not a prospective spouse) can exercise those waiver rights. In addition, the waiver must comply with specific statutory procedures. However, it may be possible for a prenuptial agreement to provide that the prospective spouse agrees to waive his or her rights once the marriage is consummated. Consult a qualified attorney if protection of retirement plan benefits is important to you.