Trusts vs. Prenups – Why Trusts Provide Better Asset Protection feat. Joseph Armstrong
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Danielle Friedman: Welcome to Trust Us Estate Planning Wisdom, the podcast where we unravel the complexities of estates and trust to empower you with the knowledge needed for effective estate planning.

Max McCauley: This podcast is hosted by seasoned estates and trust attorneys, Daniel Friedman, Herb Feinberg, and Charles Max McCauley.

Herb Fineburg: This podcast is your guide to the intricate landscapes of estate planning, including wills, trusts, and probate.

Danielle Friedman: Thank you for joining us and we hope you find the discussion informative. But remember, when it comes to legal matters, always consult with a qualified attorney regarding your specific case.

Danielle Friedman: Hi guys. For today's episode, we will be talking about prenuptial agreements and how trust can avoid the need for prenups and why trust can even be stronger than a prenuptial agreement. Inevitably, we often get the call from our clients a week before their children's wedding asking us, do my kids need a prenup?

Danielle Friedman: Do you recommend a prenup? And to answer those questions, we have a special guest today, Joe Armstrong, an attorney that we work with frequently. Joe, can you tell us a little bit more about yourself?

Joseph Armstrong: Thank you, Danielle. It's nice to be with you folks today. Appreciate you having me. So I've been practicing for 26 years now.

Joseph Armstrong: It's hard to believe that. I began my career as a litigator. I consider myself a reformed litigator now. My practice focuses on high net worth individuals, business owners, and professional athletes. where I like to help them with their business overall, act as a quarterback for the legal needs, and then combine that with the long term estate trust and tax planning for the whole family.

Danielle Friedman: So Joe, for our clients who have Trusts, whether they are irrevocable trusts that are funded during our client's lifetimes or revocable trusts that contain dynasty provisions after a client dies, do you typically recommend prenuptial agreements to protect that client's assets when a child gets married??

Joseph Armstrong: Well, in an ideal situation, you're always going to have a prenuptial agreement in addition to the trust as more of a belt and suspenders, full level of protection.

Joseph Armstrong: But reality is this is about to be the happiest day of the lives of your child and their fiance. And the last thing they want to hear about is a prenuptial agreement. They don't want to have the discussion with the fiancé, and they're often offended that their parents would even interrupt their busy wedding planning and happiness with the concept of a prenup.

Joseph Armstrong: So, we don't really recommend Annoying the child as their wedding day approaches with the concept of a pre dump, and we have our trust designed so that the assets of the parent that will pass, as you noted, will be protected in the event of a divorce. Provisions that really do that are those that Do not entitle the child to any distribution of income or principal and leaves that entitlement to the discretion of the trustee.

Joseph Armstrong: Once you take the control of the asset away from the child, very often you have taken control of that asset away from a divorce court is when the divorce court is looking at the assets of parties. The first thing they look at on a questionable asset is to what extent. Is the spouse entitled to the asset or have the ability to control the asset and cause it to be used for their benefit.

Joseph Armstrong: And when that is left solely to the discretion of the trustee, it is much more favorable and a stronger position to take in the divorce.

Herb Fineburg: So talking about a stronger position to take, what is the difference between the terms of a trust. being attacked by a soon to be ex spouse and the terms of a prenuptial agreement to be attacked by an ex spouse.

Joseph Armstrong: Great question, Herb. So let's, let's start with the prenuptial agreement. So when you have the prenuptial agreement, both of the spouses are getting together and they are disclosing in full. All of the assets that they have, all of the income generating ability that they have, also their liabilities, things like life insurance would be included.

Joseph Armstrong: And the name of the game there is to be a complete open book with your fiance. And then come to an agreement on how those items will be handled in the event of a divorce.

Herb Fineburg: So there's a list that is attached to the agreement of everything?

Joseph Armstrong: Everything. You're going to have a schedule of all of the assets of the husband, all of the assets of the wife, and then sometimes you have additional schedules that will give more detail uh, on specific assets that will be treated in a different way.

Herb Fineburg: So the assets of the husband and, uh, and wife are listed on the schedule. Should anything else be listed on the schedule, Danielle?

Danielle Friedman: Well, sometimes if the child knows that they are a beneficiary of a trust, if a trust, for example, was funded for the child during the parent's lifetime.

Danielle Friedman: Then over disclosure is always better than under disclosing. You don't ever want to give opposing counsel a reason to poke holes in the prenup by saying, Oh, well, we didn't know about this asset, therefore the prenup is invalid. So, if a prenup is going to be put in place, the existence of a trust should be disclosed.

Danielle Friedman: And if the trust doesn't permit distributions to the child outside of the trustee's discretion, I think that can be disclosed as well. That way you foreclose any arguments that the trust belongs to the child.

Max McCauley: So, if I'm understanding correctly, when mom and dad come to us and Ask us, do I need to have my son or daughter sign a prenup in advance of the wedding?

Max McCauley: If we've properly planned and they have an irrevocable trust in place, the answer to that question would be to mom and dad. Strictly speaking, they don't need their children beside a prenup. However, if the son or daughter that is getting married had substantial assets, the son or daughter might actually want still to have a prenup.

Joseph Armstrong: Absolutely. Now, when Danielle was talking about our typical scenario that we see with our high net worth clients, perhaps business owner clients, that call comes in a week before the wedding. And when they ask Should we get a prenup? Should we have our daughter or our son try to get a prenup before the wedding?

Joseph Armstrong: The answer is don't bother. Because at that point in the game, one week before the wedding, the prenup's going to be unenforceable in every state. There are a few ways to attack a prenup. First way to attack a prenup is you had assets that you failed to disclose and put on the schedules that we talked about before.

Joseph Armstrong: Second way, Is that you force the prenup upon the spouse without sufficient time for them to consider the ramifications of that agreement. You put a prenup in place for a young couple getting married, they could govern their relationship for 50, 60, 100 years for all we know. So if you try to put that document in front of somebody at the altar, so to speak.

Joseph Armstrong: There's no way that the courts are going to enforce that. It has to be full and complete disclosure. Adequate time to review everything and understand its import and to consult with counsel, choose it.

Max McCauley: But does the child that's getting married, do they have other options to protect their assets other than the prenup before they get married?

Joseph Armstrong: If the child has substantial assets themselves, and you know, that can often be the case. They may have funds that they've inherited from say grandparents that were not put into trust that went directly to the child. Those assets can be exposed in a way in connection with the divorce. Typically, when you enter into a marriage, your inherited property remains your separate property in the event of a divorce.

Joseph Armstrong: However, the increase in value of those assets during the course of the marriage remains subject to the court's powers of equitable distribution. So you can utilize a trust in lieu of a prenup on your own. Delaware is one state, for instance, where you can have a self settled asset protection trust. And you remove your control over your own assets by placing them in this trust with a Delaware trustee that is independent.

Joseph Armstrong: And you set the terms of the trust that you are not entitled to distributions of the income or principal. That will remain within the discretion of the trustee.

Max McCauley: This has to be done before the wedding.

Joseph Armstrong: Absolutely. It has to be done before the wedding. And it can be done.

Max McCauley: Can it be done a minute before the wedding? A day

Joseph Armstrong: A minute before the wedding, court of competent jurisdiction for a divorce does not get jurisdiction over the assets of the parties until they're married. So if those assets are put into the asset protection trust and you have no rights to distributions of income principle, a minute before the wedding.

Joseph Armstrong: You're going to be okay with that trust. It's going to give you very solid protection. Can't guarantee any result in any court. A judge could always go AWOL and, and come up with a decision that really makes no sense.

Max McCauley: And again, we're talking about the child that's getting married to ' mom and dad.

Joseph Armstrong: Mom and dad's assets should be protected in, in trust as part of their overall estate plan. And for our clients, you know, that's not a worry. The way we design their trust, they're already protected. They don't even need to worry about it. The child themselves though, if they want to have protection without raising the issue of a prenup, then they want to look at a, a self settled asset protection trust.

Danielle Friedman: That's a really interesting alternative because even And if you have the time to have a valid prenup put in place, perhaps the child or the marrying child with the assets doesn't want to raise that conversation with their fiance for a number of reasons. So they privately established this asset protection trust and obviate the need for a prenuptial agreement. I like that. I like that option.

Max McCauley: And would that protect not only the inherited asset prior to the wedding, but it would also protect any appreciation and value of that inherited asset?

Joseph Armstrong: It would because those assets are not really the assets of the spouse. That's, that's the key concept. They do not have direct control or entitlement to the assets.

Herb Fineburg: So we have clients who have previously entered into or provided with trust, which provide for distributions at certain ages, maybe 30, 35, and 40. How does that impact a couple that gets divorced? Let's say they get divorced before they have the right to distributions.

Joseph Armstrong: Mm hmm.

Joseph Armstrong: Well. It can still impact, because once, once you have established that that child is going to have a right to a distribution at a certain point in time, and you can quantify it, that right then can be considered by the divorce court in equitable distribution and in setting spousal support and even setting child support.

Joseph Armstrong: They, they all work together. So just to use your example, Herb, let's say that someone is 30 years old and they've been married for 30 years. 5 years and they're entitled to get a substantial distribution at age 35 in 5 more years, but they're getting divorced now. The court could look at that entitlement to get that distribution 5 years down the road and could consider that as a factor in determining how it will divide the marital assets among the spouses and how it will provide for alimony if there will be any.

Joseph Armstrong: And that is because. Those assets that will be coming out as a matter of entitlement, they can count as income and they can also count as an asset that will produce income in the future. So it's, it's factored into the calculations.

Max McCauley: No, with that problem in mind, Danielle, when you draft trust for our clients, do they contain provisions like that, that there's a right to distributions at 35 and 40?

Danielle Friedman: No, usually it's. It's purely discretionary at the decision of the trustee, very, very, very rarely do we ever have trusts where there is a mandatory distribution at a certain age. And that typically only happens when the client is just adamant that they want their child to get the money and at a certain point, but we always warn them that if they want that language in there.

Danielle Friedman: Those assets are going to be subject to the claims of creditors, including divorcing spouses. So we really try to discourage our clients from having that type of language in their, in their trust documents.

Max McCauley: When you review for a new client, when you review their existing trust, how often do you see a distribution provision like that that's problematic

Danielle Friedman: all the time today I was reviewing a trust document for a client and there's 10 million of life insurance in this trust that passes out right to the client's children at age 30. And those kids are already beyond 30. All of them are married. And who knows if they're going to get divorced or not, and that's a lot of money.

Danielle Friedman: One, it's just a lot of money to give to your kids outright, and then to potentially have that subject to the claims of, of a ex son or daughter in law. That's not what the client had intended when they funded that trust, but it's an unintended consequence of having that type of language in the trust.

Max McCauley: Can you deal with that problem?

Danielle Friedman: Yeah, there, there are ways to set up new trusts and move assets from an existing irrevocable trust to another irrevocable trust, it all depends on the jurisdiction and what the terms of the existing trust instrument say, but there are workarounds to doing that. It's really fact specific.

Danielle Friedman: The other thing I often see is clients come to us sort of in the reverse situation and they say, I don't want to do the trust. I'm just going to do Prina. I don't need the trust, both my, my child and, and their fiance, they, they've agreed to do the prenup. Everyone's on board. So I don't need the trust. I don't need this quote, unquote, complicated planning.

Danielle Friedman: And I like to remind them that that's fine now, but the prenup is a contract between the child and their spouse, and they can rip that up if one party or rather if they both agree. Hey. We've been married for 20 years. We don't need this prenup anymore. Let's get rid of it. They can do that. And mom and dad have no say as to whether that prenup continues in effect for the duration of the marriage.

Danielle Friedman: On the contrary, if mom and dad engage in trust planning, They are fully in control and whether the, what those trusts say, how long they last, if distributions are made, that's all up to mom and dad and the married children don't have any say as to what happens in the trust.

Max McCauley: And can the, can the children or the spouse change the terms of their revocable trust?

Danielle Friedman: No, not without significant effort.

Herb Fineburg: But you said they could change the terms of the prenup or even revoke the prenup.

Danielle Friedman: Yeah Prenup is just like any other contract If you have two willing parties who enter into an agreement and then they wish to modify the agreement They can go ahead and do that so if if down the road They decide they don't want to be parties to the prenup and both husband and wife are on the same page Then they can tear it up or they can change the terms of it.

Danielle Friedman: It's it's not It's no longer in the control of mom and dad,

Herb Fineburg: even though mom and dad asked them to, to have a prenup that it's their it's mom and dad's assets. And they said, we want you to have a prenup. They don't have any control.

Danielle Friedman: No, none. Mom, dad can pay for the prenup. They can beg and plead their children to follow the terms of the prenup.

Danielle Friedman: But at the end of the day, It's up to the married couple, what happens with that prenup.

Max McCauley: In your years of experience, have you seen that prenup be modified or terminated?

Danielle Friedman: Sure. It happens. It doesn't happen often, but it's a possibility. And if you want to eliminate that possibility, the best way to do that is through a trust.

Danielle Friedman: I have a question, which A lot of clients raise cost issues when it comes to setting up trusts and doing proper planning. Do you find that creating a proper prenuptial agreement is more expensive or less expensive than preparing a revocable trust that contains dynasty trusts after the client dies or funding an irrevocable trust during the client's lifetime?

Joseph Armstrong: I would say that much more often than not, it is more expensive to go through the prenup. When you're preparing, say, a revocable living trust that has dynasty trust provisions, you have no adversary. You're working with the family to achieve their goal without opposition. When you're negotiating the prenup, both sides should have independent counsel, and independent counsel, while I may draft what I think is the most wonderful prenup that's ever been made.

Joseph Armstrong: I can assure you counsel on the other side is going to find something that they need to change. They need to earn that fee. They need everybody to know it. So they'll find something to change and there will be back and forth and negotiation, which takes time.

Max McCauley: So you're going to go from paying one lawyer for the estate planning and the trust planning, to on the prenuptial side, paying a minimum of two lawyers and maybe even three lawyers, if mom and dad's lawyer had any say.

Joseph Armstrong: Absolutely. And that's not uncommon that there will be three lawyers involved, you know, you'll have one for husband, one for wife, and then you'll have the, the overriding cause of the need for the prenup, the business owning parents who want to protect it, and then they want to see everything in participation.

Joseph Armstrong: I, I'd even had a prenup agreement where the parents were parties to the prenup.

Danielle Friedman: Huh, how did that work?

Joseph Armstrong: Well, we, we were trying to address the The possibility that you raised where the spouses can just rip it up and parents didn't want that. So they wanted the, the other side to contractually agree with them that they would make no claim to the family business.

Joseph Armstrong: And we specific, we had a separate schedule C to that agreement. And that was family business that. Yeah, it was essentially irrevocable. So while the husband and the wife were free to throw out the prenup to the extent that it applied to them for that one family business line, the parents had the right to enforce it and it couldn't be revoked.

Joseph Armstrong: Now that hasn't been tested. We were being creative there. We'll see how that goes. Hopefully we never need to enforce that provision, but that's an instance where we had three lawyers involved.

Herb Fineburg: So. We've been talking about a prenuptial agreement and how it applies to a divorced children. What happens if a child dies?

Herb Fineburg: Doesn't prenuptial agreements also apply to the event of death? And what happens if you don't have a trust? You didn't do trust planning and everything was left to the child. Even if the prenuptial agreement provides that. The wife will waive any claims or the, the, the husband will waive any claims to the child's interest in the business or, or the inheritance.

Herb Fineburg: I find when they do a will, everything goes to the spouse. And if the spouse is alive, it goes to the children. Does it seem like a prenup is a substitute for trust?

Joseph Armstrong: No, absolutely not.

Danielle Friedman: And oftentimes. What the prenup will say is that the marrying couple waives their right to what's known as the elective share.

Danielle Friedman: So, in most states, you can't disinherit your spouse. By operation of law, a spouse is entitled to something when a first to die spouse passes away. But you can waive those rights and contract out of them. So oftentimes I'll see in prenups that both spouses have said, we do not need to provide anything to each other.

Danielle Friedman: However, that's simply the floor, not the ceiling. So there is nothing preventing the spouses from leaving everything to one another. So even if there's a prenup and there's not a divorce and mom and dad leave everything to their child and then that child dies. And leaves everything to their surviving spouse.

Danielle Friedman: The prenup has no say as to that. So there needs to be a state planning in effect for the child needs to have an estate plan that says. What happens to those assets and mom and dad don't really have any control over that whereas if mom and dad left the assets and Trust for the child It doesn't matter what what the child will says or what state law says because the trust is going to govern To those assets

Max McCauley: so the trust could ensure The mom and dad's assets stay in the bloodline or that passes to their kids and their grandkids and their great grandkids But the prenup can't do that.

Danielle Friedman: No, the prenup cannot do that.

Herb Fineburg: And most of the cases we've been talking about today are cases where it's the first marriage. Yeah, when your child is married as a Children, your grandchildren still no substitute for a trust that protects the assets for lineage, triple descendants for the, for the bloodline, because you cannot be assured of what kind of prenup will happen years later when that child remarries and marries someone else with that person's own children.

Joseph Armstrong: Absolutely. It's, it's important that when, when you're crafting the trust. You will give your child a limited power of appointment to say where things will go when that child passes, and you can, you can give that limited power in several ways. We always recommend that that power be given to appoint what remains in the trust to the descendants.

Joseph Armstrong: Some practitioners will say, well, I, I think we got to give flexibility because the spouse may want to give something to, to their spouse, you know, out of these funds. While we don't recommend allowing an appointment to a spouse, it's possible that you could have it to a spouse and you could even include charities.

Joseph Armstrong: Uh, but overall, to have the absolute best protection to the assets and assure it goes into the bloodline, we keep that power limit limited to blood descent.

Danielle Friedman: And oftentimes when that conversation happens, and at this point, the children may have been married for many years and the parents may love their son or daughter in law and say, I want them to have this power of appointment to leave at some of the trust assets to their spouse We often have the conversation that that is not the job of the client That is the job of the spouse the spouse's job is to take care of their spouse and leave something to their spouse Mom and dad's job is to take care of their kid And that's it, not to take care of their, and their grandkids and, and whoever else may follow, but not to take care of their son or daughter in law.

Danielle Friedman: That's the job of the, their spouse. So when we have that conversation, something typically clicks where, where they tend to agree with that concept. That's not to say that we don't see children try to work around that, but the best planning What we like to do is to have everything just passed down the bloodline.

Herb Fineburg: I would submit to you that if you have a trust that provides for your child and then for your grandchildren, if your child has passed away or hasn't provided adequately, the fact that the surviving spouse has no responsibility for their children or potentially no responsibility for the children because they've inherited trust from their grandparents is of great benefit to the parent, that they don't have to worry about college education. They don't have to worry about, you know, supporting a child who is dependent. They just have to take care of themselves. And you would hope every adult can take care of themselves.

Joseph Armstrong: There's one issue I hear about a lot from clients when I'm trying to encourage them to go the route of the trust in lieu of the premium.

Joseph Armstrong: And it's, well, I want my kids to be able to enjoy some of this money while they're alive and while they're young. I don't want them to wait until they're 80 years old to enjoy. And that's where they get prompted to say, I want them to be able to get X amount of dollars when they're 30, X amount when they're 40.

Joseph Armstrong: And you need to remind the clients that the trustee, their job is to protect these assets for the benefit of your children. And they have, they have a fiduciary duty to act in the best interest of the child. So if, if the child would like something, they can ask the trustee. And if it's reasonable, the trustee will likely say yes and give the child what they want or what they need.

Joseph Armstrong: So the, the thought that, oh, if I lock it up and trust, my children are never going to get anything is really a misconception that needs to be eliminated.

Danielle Friedman: And the client can be reminded that in the event of a divorce. Not only will your child not be able to enjoy that property, instead, your, your soon to be ex or ex daughter in law or ex son in law is going to be enjoying that property instead of your child.

Danielle Friedman: All right. That was a great conversation, Joe. Thank you so much for joining us. I know I learned a lot today and I hope our listeners did too.

Joseph Armstrong: It was my pleasure. I hope to be able to join you again sometime soon.

Danielle Friedman: Absolutely.

Herb Fineburg: Thank you

Joseph Armstrong: Joe.