



OLD NORTH STATE TRUST, LLC

Defending Inheritance and Gifts from Divorce

Statistics show half of all American marriages end in divorce, which means assets that originally belonged to one spouse may well end up in the other's hands. That's a big reason why we advise using trust arrangements whenever passing on assets to children or grandchildren.

Otherwise, a gift or inheritance might enrich somebody other than the person the giver had in mind. Would you want a divorced ex-in-law to benefit from assets you intended for the benefit of your immediate family member? Probably not, but it's an all-too-common occurrence.

Property laws vary from state to state, of course. "Community property" is the rule in some, meaning everything that either spouse owns is considered to belong to both. And if they split up, it's all divided in half. North Carolina, on the other hand, follows the "equitable distribution" rule, in which the divorce court tries to weigh individual factors in deciding what's a fair way to divvy up assets.

In this state, property will fall under one of three categories.

- **Marital property** is everything that a couple acquired while they were married, with an important exception that will be mentioned in a moment.
- **Separate property** is whatever each spouse owned before the marriage. That exception is anything that either one inherited or got as a gift from someone other than their spouse. This is where a trust agreement is valuable, by helping to ensure that gifts and inheritances remain "separate" and aren't considered "marital."
- The third category is **divisible property**, which can include such things as gains or losses in value of the couple's marital property, or income from that property, that comes after a couple separates. Examples could include market gains, dividends and interest on stocks or mutual funds, or gains in a house's value. If these occur between the separation and the final divorce, they might be divided by a court. By the same token, market losses may be divisible, too!

The equitable property standard can mean a spouse who brought relatively little property to the marriage might end up with the lion's share of the couple's assets, depending on such circumstances as current income, earning potential and child custody. While that might not be a bad thing, it makes much better sense for those directly involved to work out the details, rather than leaving it to battling lawyers and a possibly overworked judge.

But the time to address such things isn't when a marriage is falling apart. Quite the contrary. It should be discussed beforehand, when good will is at its maximum. A prenuptial agreement is how an engaged couple can define what belongs to whom, and what should be considered marital property.

A prenup may seem like the least romantic thing in the world for a starry-eyed couple looking forward to living happily ever after. Nevertheless, not only can it provide important protections to both parties, the process of drafting a prenup can help a couple think about their finances and their future. It still surprises us how many people jump into marriage with hardly a thought about budgets, money management, investments, retirement planning and other essential details for sharing their lives and a household.

The stakes get even higher with second and third marriages. More often than with first marriages, the parties come with significant assets and liabilities, such as the need to provide for children.

Sometimes the status of a couple's property can change in unexpected ways. One common instance is when investments that individual spouses owned before marriage – separate property – are sold and the proceeds used to buy a house. If both names are on the deed, it becomes marital property.

The other important defense, a trust, is up to the third party who makes a gift or leaves an inheritance. Assets held in a trust are generally not exposed to outside parties, especially in combination with a pre-nuptial agreement. These can be done in either order, by the way. A prenup can address existing trusts, but can also specify how to treat any trusts that might be created in the future.

It's worth noting that, in a few states – not yet North Carolina – the law is starting to consider trust assets as marital property. Whether that legal trend will spread, nobody knows. But it's another reason why a prenuptial agreement that explicitly spells out what's separate property and what's marital is an important extra defense.

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