Protecting an Estate During and After Divorce

As you help your clients create their next chapter, it's important to understand the ramifications of their financial and estate documents.

By Heather Locus, CPA, CFP®, CDFA™

Going through a divorce is likely the most challenging experience your clients will ever live through. They will have to make countless life-impacting decisions during an emotionally chaotic time. And while some might wish their spouse would literally get hit by a bus, estate-planning matters often get overlooked during the divorce process. If any estate planning has been done in the past, their spouse is most likely listed as their successor trustee, executor, agent designated in powers of attorney, and primary or contingent beneficiary. It is unlikely your client will want their spouse in any of these roles going forward, which makes it important to discuss with him or her and their estate planning attorney what can be done to protect their assets in the event they pass away before the divorce is final.

Who Gets What: The Basic Rules of Trust, Probate, and Estate Law

Every state has its own laws that direct what happens to property when someone dies. Generally, only spouses, registered domestic partners, children, and blood relatives inherit under intestate succession laws when there is not an executed will or trust; unmarried partners, friends, and charities typically get nothing. While the exact amount varies by state, if the deceased person was still legally married, the surviving spouse usually receives a large share with the remaining going to any children. If there are no children, the surviving spouse often receives all the property; more distant relatives inherit only if there are no surviving spouse or children. In the rare event that no relatives can be found, the state takes the assets.

Although there are ways to limit the assets a spouse would receive at death with strategic use of account registrations, beneficiary designations, and trusts, most states have laws that enable a current spouse to receive at least some probate assets. For example, in Illinois there is an "elective share" statute entitling a spouse to one-third of assets distributed through a will if there are kids and one-half if there are no kids. If someone dies without a will or trust (intestate succession) in Illinois, their spouse will receive one-half of the probate estate if they have kids, and all of the estate if they do not have kids. Note: the "elective share" does not include assets passing via joint tenancy, beneficiary designations, or a trust as they avoid probate.

Wills and Trusts

Married individuals typically designate their spouse as executor of their estate in their will and the successor trustee of their trusts.

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They often name in-laws to important positions as well. Depending how their assets are titled, and whether they have a prenuptial agreement or any court orders restricting transfers or revisions to estate-planning documents, updating wills and trusts can be challenging during the divorce process. It is important to at least make sure your client understands their options.

Other Beneficiary Designations

Proceeds of life insurance and retirement plans are distributed according to beneficiary designations, which override wills and trusts. Beneficiaries are easy to change for insurance and IRAs, but spousal consent is required for 401ks and other "qualified plans." There is no statute in Illinois prohibiting an ex-spouse from receiving retirement assets or life insurance proceeds if beneficiary designations are not updated after the divorce is final, as there is with wills and trusts. Therefore, it is critical for clients to update beneficiary designations as appropriate right after the divorce if they choose not to during the process.

Powers of Attorney

If your client has durable powers of attorney for property and health care designating their spouse as their agent, they should consider revoking them immediately to prevent their estranged spouse from having unlimited access to bank accounts, financial assets, and making health-care decisions on their behalf should they become incapacitated. These forms are very easy to update.

Guardians of Minor Children

Your client's will should designate an alternate guardian. In most cases, the law automatically deems a surviving parent the guardian – but if the ex-spouse passes away after your client and while their children are still minors without designating a guardian, then the court would look to your client's will.

Additional Considerations

In Illinois, an ex-spouse is considered to have predeceased the decedent for purposes of their will or revocable trust – but there is no similar Illinois law provision for terminating an ex-spouse's rights in an irrevocable trust. Even if a married individual with some foresight deposits inherited assets into his or her own individual account to keep them non-marital, that account is now part of the probate estate at death. If your client passes away before the divorce is final, the surviving spouse can contest the estate to receive his or her "elective share" of assets held in the individual account – including the inherited assets, even though they would have been non-marital for divorce purposes. Therefore, you should encourage clients to ask anyone they may anticipate inheriting assets from to distribute them to a trust rather than outright to your client. This strategy can protect clients from other creditors as well.

I recently had this issue with one of my clients whose mother had cancer. Her mother updated her estate-planning documents during my client's divorce to have her daughter's inheritance go into a trust while her sons' assets were distributed outright to them. Unfortunately, my client's mother did pass away during the divorce, but her assets went into trust and will not be subject to the "elective share" in the unlikely event my client passes away before the divorce is final.

As you help your clients create their next chapter, it's important to understand the ramifications of their financial and estate documents given their evolving family dynamics. A divorce attorney recently told me a tragic story about one of her clients who suddenly became ill and had not updated her estate-planning documents. The client's soon-to-be ex-spouse was called to make the client's life-support decisions, and he received all of her assets with none going to their children. Given that the client's husband had an additional child with his new girlfriend, the attorney is confident her client would have wanted her children to make her medical decisions and receive all of her assets rather than her husband. Don't let this happen to your clients! Work with their financial advisor and estate planning attorney to ensure their wishes are followed regardless of any outcome. ■

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