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Insights

Avoid Leaving an Inheritance to Someone You've Never Met

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Over their lifetimes, and at death, parents make gifts to children under the assumption that those gifts will be the property of that child for life, no matter what. Those gifts are intended to benefit the child and no one else. Unfortunately, the laws in Indiana on the division of marital property in the event of divorce may thwart that assumption. The gifts a parent makes today or the inheritance that parent leaves in the future, even in trust, are at risk of being included in the marital pot in a divorce, or at least considered in the division of that marital pot, resulting in the gift assets ending up in the hands of a former spouse or additional, other assets in that former spouse's hands in lieu of the gift assets and, eventually, in the hands of someone that parent may never meet.

Indiana is an "equitable property division state." In a divorce proceeding, the Court will divide property in the manner it deems most fair, not necessarily equally. Under?Indiana Code 31-15-7-4, unless the property is protected by a?prenuptial agreement, any assets acquired by either party, before or after marriage, are considered marital property and are included in the "marital pot" for division and distribution, including assets in the name of only one spouse and including gifts and inheritances. The entire marital pot is then subject to equitable division. Ind. Code 31-15-7 et seq. Contrary to what most assume, gifts and inheritance made to a child are included in that marital pot and subject to that equitable division. The fact that certain assets are from a gift or inheritance is only one of many factors considered by the Court in an equitable division of the marital pot. The question, therefore, becomes one of how to leave an inheritance or make a gift to a child and avoid the unintended consequence of having those assets in the hands of the ex-spouse or excess assets in the hands of the ex-spouse because of the gifts or inheritance in the child's hands; a "distinction without a difference."

The law is relatively clear that property owned by the child or expectancy in gifts and inheritance can be protected by a prenuptial agreement. Under a prenuptial agreement, by contract, prospective spouses can agree that assets owned by each will stay their separate property in the event of divorce or even at death. Prenuptial agreements need to be clear, however, that the assets are excluded from claims of the divorcing spouse but also should be excluded from the marital pot as well as excluded from consideration in the equitable division of marital property in a divorce. Thereafter, the gifts received by lifetime gift or by inheritance need to stay segregated as once assets are commingled with the spouse, those assets are hard to argue back out of the marital pot.

Gifts and inheritances left in trust for a child provide protection against the assets being commingled, but not necessarily from being included or considered in the marital pot and its division. Over the years, the law has eroded the conclusion that assets held in trust for one spouse are not to be considered in dividing assets in divorce. Even though the divorcing spouse may not get direct access to the trust assets, the value of the trust

can be included in the marital pot and considered in the equitable division. This is especially true if the beneficiary of the trust has been withdrawing from the trust and using the assets to increase the lifestyle of the divorcing spouse. Even if the trust is not "broken" and distributed in part to a divorcing spouse, the equitable division of other assets may be altered by the fact that the trust was providing for a standard of living for both spouses. The division of marital assets, therefore, could result in the divorcing spouse receiving more of the marital pot because of the trust; again, a distinction without a difference.

The language of a trust should be clear in protecting from this result. That language should clearly state that distributions are made only to or for the benefit of the child. The trust should also contain "spendthrift" protective language so that the assets are not subject to the child's divorce proceedings (or other creditors). One step further, the trust could also include a requirement that the child and spouse execute a postnuptial agreement (if already married) or a prenuptial agreement (if marriage occurs after the trust is in place) before any distributions can be made from the trust. That agreement should provide that the divorcing spouse will not seek to have the trust assets treated as part of the marital pot or even considered in the equitable division of assets in divorce. If the beneficiary and/or spouse refuse to sign such an agreement, then the assets stay in trust until the marriage ends (by divorce or death) or, once the beneficiary dies, the assets will then pay out to other family members. Requiring such an agreement before distributions may seem extreme, however, without such a requirement, the assets of the trust or the child's other assets outside of the trust are in jeopardy.

Prenuptial agreements and postnuptial agreements are the first line of defense in protecting against family assets passing to a divorcing spouse. Placing gifts in trust are the next line of defense, however, parents should consider the "belt and suspender" approach of having assets in trust and then also requiring a prenuptial or postnuptial agreement before the child can receive any benefit from the trust. With proper planning, assets given to a child can stay with the child as intended, even after divorce. Without proper protection, however, family assets may end up in the hands of a divorcing spouse and then down the line to a subsequent spouse and others the parents may never know.

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