What CPAs Need to Know about Tying and Untying the Knot

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In Brief

Even the most romantic decision has monetary implications, and CPAs can help individuals weigh the financial consequences of their decision to get married. This article describes important provisions of prenuptial agreements, as well as postnuptial agreements and other marriage-related financial planning considerations.

Many CPAs enjoy a close, trusting relationship with their clients and their families. As a result, they are in a unique position to help clients (as well as their children and parents) who are entering into or ending a marriage. The following is a discussion of the various ways that CPAs can assist individuals before, during, and after marriage.

Why Get a Prenup?

Approximately 40% to 50% of first marriages and more than half of second marriages end in divorce. Prenuptial agreements allow couples, when they are in a more reasonable and amicable mindset, to limit the issues that can arise in the event of a divorce.

Public policy favors individuals reaching their own agreements through contracts. Therefore, in New York, properly executed prenuptial agreements are typically upheld.

Prenuptial agreements may clarify or override statutory provisions that govern what happens to a couple's financial assets in the event of death or divorce. Through such agreements, couples may tailor the law to meet their individual needs and goals. They also have the opportunity to prescribe terms regarding property division upon divorce, financial responsibilities during marriage, spousal support, and estate rights upon death, among other issues.

Who Should Get a Prenup?

Prenuptial agreements are no longer reserved for the rich and famous. Rather, they have a much broader appeal. ***(Editor's note:** As the definition of marriage broadens, advisors should also consider the circumstances that apply to same-sex marriages. For a discussion of the tax considerations for these couples, see "Federal Tax Implications of* Windsor: *Major Issues Confront Same-Sex Married Couples," by Scott Ahroni and Benjamin Rue Silliman,* The CPA Journal*, July 2014, p. 58.*)

The average age of men and women marrying for the first time has substantially increased. As couples are marrying later in life, it is more common to enter into the marriage with assets, such as a home, a 401(k) plan, or stock options. If the couple does not have assets, they may have business or professional prospects; if the couple has no assets or prospects, they may have student loans or credit card debts.

In the midst of a significant intergenerational transfer of wealth, a growing number of people enter into prenuptial agreements to protect their current or prospective inheritances. In addition, individuals (or their relatives) might strive to keep family businesses in the immediate family and out of the hands of in-laws.

Divorce touches many people, whether firsthand as a participant, or as a child, a close friend, or a family member. Consequently, individuals may decide to minimize the chances of an acrimonious and contentious divorce by entering into a prenuptial agreement, which provides important protections for traditional clients of CPAs. They are beneficial for high-net-worth individuals who are striving to protect their assets, as well as for older couples with children from prior marriages, by serving as an estate planning mechanism to fairly allocate assets between a new spouse and children from a previous relationship.

With an upcoming wedding, individuals are often starry-eyed in love, with divorce far off their radar. It is often prudent for CPAs to raise the possibility of a prenuptial agreement for a client's long-term protection. Advice from a professional advisor is often perceived as neutral and objective; thus, it can be more effective than advice from a family member. At a minimum, it may be advantageous to encourage engaged clients to consult with a lawyer to find out the potential benefits that may be derived from a prenuptial agreement.

Bulletproofing a Prenup

Don't wait until the last minute. Prenuptial agreements should be drafted, negotiated, and finalized as far in advance of the wedding date as possible. Although signing a prenuptial agreement a few days before the wedding does not render it invalid, agreements should be executed at least 30 to 60 days prior to the wedding date. Ideally, a prenuptial agreement should be finalized before a public engagement announcement or before the wedding invitations are mailed.

Separate and independent counsel. Prenuptial agreements have far-reaching implications. A couple has adverse interests with respect to the agreement, so they should not be represented by the same attorney. Instead, to demonstrate that each party entered into the agreement voluntarily and knowingly, and thus to buttress the validity of the agreement, each party should be represented by separate and independent counsel, selected by each party.

Financial disclosure. In matrimonial matters, parties are entitled to broad financial disclosure. Although this right may be waived, both parties should be advised to provide full financial disclosure before entering into a prenuptial agreement. The disclosure should accurately set forth each party's assets, liabilities, and income. An expectation of a material gift or inheritance also may be disclosed, as well as the terms of any trusts to which a party is a beneficiary. Typically, the disclosure is set forth on a schedule that is referenced in the prenuptial agreement and annexed as an exhibit. CPAs can participate in the disclosure process to help ensure that full and accurate information is provided.

Postnuptial Agreements

Similar in intent to a prenuptial agreement, a postnuptial agreement is entered into after the marriage has taken place, not before. Unlike a separation agreement, which is entered into in contemplation of divorce, a postnuptial agreement is entered into in contemplation of an ongoing marriage. Common reasons people enter postnuptial agreements include insufficient time to finalize a prenuptial agreement before marriage, modification of a prenuptial agreement, a significant change in net worth, or the presence of marital difficulties and an ensuing reconciliation.

A prenuptial agreement is generally preferable to a postnuptial agreement. It is more difficult for a party to waive rights after they have vested. Postnuptial agreements also tend to languish without a deadline, whereas a wedding date creates momentum for prenuptial agreements. Because married couples are fiduciaries in New York, postnuptial agreements may be held to a higher standard than prenuptial agreements. Despite these drawbacks, postnuptial agreements can serve an important function, and CPAs should keep them in mind as an option when appropriate.

Breaking Up *Is* Hard to Do: How CPAs Can Help

Prepare net worth statements. Net worth statements are one of the most significant discovery devices in a divorce case.

This is especially true because, during marriage, one spouse may control the majority of the assets while the other spouse is left largely in the dark.

On a net-worth statement, each party sets forth all monthly expenses, assets, income, and liabilities. CPAs can assist in preparing or reviewing net worth statements, which can help avoid omissions and errors. The document is sworn to before a notary public, so it is important for it to be complete and accurate.

Perform a marital lifestyle analysis. Forensic accountants may perform a marital lifestyle analysis, which involves examining the income and expenses of the parties during the marriage. Unlike net-worth statements, which reflect expenses and assets as of a specific date, a lifestyle analysis assesses financial activity over the course of a longer period of time. Typically, it involves a review of financial activity over the three or five years prior to the beginning of divorce proceedings.

A lifestyle analysis may be used to help establish the marital standard of living, determine each party's spending habits, and quantify a spouse's support needs. During the lifestyle analysis, a forensic accountant may discover the dissipation or concealment of assets. An analysis also may reveal additional sources of income, for example, when the alleged income is insufficient to have met the expenses during marriage. This may be significant, as matrimonial judges are not bound by income that is reported on tax returns, and may impute income to a party in determining child or spousal support.

Assist with appraisals. In order to effectuate an equitable distribution of marital property, the value of all relevant assets must be ascertained. CPAs and other financial professionals are routinely called upon to value businesses and other assets. They also may be called upon to perform tracings to quantify a separate property component of an asset.

Consider tax consequences. Upon divorce, each asset may not simply be divided down the middle. Rather, marital assets may be offset against each other in order to arrive at an overall equitable distribution. In New York, tax consequences are an express statutory factor to be considered in determining equitable distribution. CPAs serve an important role in helping to ensure that the tax implications are properly calculated and considered in dividing property upon divorce.

Estimate support needs. In cases in which there is a disparity in the income of the parties, the monied spouse might be obligated to pay spousal support to the less monied spouse. The amount and duration of support are determined on a case-by-case basis. CPAs can assist clients and matrimonial practitioners in determining how much support a party requires to subsist after divorce, and for how long. In addition, CPAs can formulate a budget for postdivorce spending.

Secure life insurance. Life insurance generally is obtained to help secure obligations required under a divorce agreement, such as child support, spousal support, and any future property distributions. As financial obligations lessen over time, a divorce agreement may provide that the amount of life insurance might be reduced to reflect the actual amount owed. CPAs can assist in selecting the proper type of life insurance, as well as calculating an appropriate amount of life insurance that should be maintained post-divorce.

To-Dos for CPAs after a Client's Divorce

Review financial terms. It is instructive to review the financial terms of a client's divorce agreement in order to formulate a planning and investment strategy. The divorce agreement also may specify that asset transfers take place within a specified time period. CPAs can oversee asset transfers and make sure that they are carried out in a timely matter.

Earmark funds to pay taxes. Postdivorce spousal support typically is taxable to the payee spouse and tax deductible by the payor spouse. Sometimes, for the recipient of support, it marks the first time—or the first time in years—that she assumes responsibility to file her own tax returns and pay taxes. It is important that such an individual have sufficient assets set aside to timely make tax payments and for budget accordingly throughout the year. CPAs should be mindful that individuals have widely varying financial knowledge, and some may need assistance in the basics.

Manage investments. CPAs play a key role in overseeing the management of investments. Income and assets that had been used to support one household are stretched to support two after a divorce. In certain cases—for example, when a spouse has been out of the workforce for a long period of time and it is unlikely that he will return to work—the financial settlement derived from a divorce may be a primary nest egg or even the sole source of funds during retirement. As a result, it is especially important for CPAs to make sure that an individual is investing wisely to maximize these assets.

CPAs can broach the topic of prenuptial agreements before a marriage begins in order to help preserve their clients' assets.

Providing Advice before and after a Marriage

CPAs can broach the topic of prenuptial agreements before a marriage begins in order to help preserve their clients' assets. During divorce, they can play an important role in providing advice on tax consequences, structuring settlements, and obtaining a clear understanding of their clients' current and prospective financial situations. After divorce, CPAs can formulate short- and long-term plans so that individuals will be well positioned for the next stage of their lives. ❑

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