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Why You May Need A Prenup

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If a prospective couple plans to sign a prenuptial agreement, it's wise to design the agreement with an estate plan in mind. Prenups offer several estate planning benefits — but a poorly planned one can trigger unintended tax consequences or even hinder achievement of estate planning goals. This article discusses certain benefits, such as protection from liability for a spouse's separate debts and implementation of estate planning strategies.

Prenups usually become relevant when a couple gets divorced. But they also provide several benefits for successful marriages, including protection from liability for your spouse's separate debts and implementation of estate planning strategies.

Most states give a surviving spouse certain rights to a deceased spouse's property. In community property states, for example, a surviving spouse enjoys a 50% interest in all community property. In most other states, surviving spouses can choose to receive an "elective share" amount — usually between one-third and one-half of the deceased spouse's estate.

These rights supersede the terms of a will, but they can be waived in a prenup, which doesn't necessarily mean that you'll be disinheriting your spouse. Prenups typically preserve a spouse's right to receive a substantial portion of the other spouse's wealth. But by waiving marital property rights, they allow you to specify the manner in which your assets will be distributed and ensure that your estate plan will operate as intended.

Suppose, for example, that you own a closely held business that you run with your children from a previous marriage. Assume further that the business makes up 75% of your net worth and you want your children to inherit it. A prenup can prevent your spouse from acquiring an interest in the business — either through a divorce or spousal inheritance rights — while preserving his or her right to the other 25% of your estate.

How it works

A prenup should work in concert with your estate plan, rather than against it. For example, if you use a premarital transfer, each party must provide "adequate consideration" for the agreement to be legally enforceable. That is, the parties must exchange items or promises of comparable value to create a binding contract. Typically, prenups transfer property rights from one spouse to the other in exchange for the release of certain marital rights. But if the transfer takes place before marriage, it can trigger income and gift taxes.

The best strategy is to make the transfer after the wedding, because transfers between spouses generally are exempt from both income and gift taxes. However, there are exceptions when a non-U.S. citizen spouse is involved.

Maximizing the estate tax exemption

For couples with larger estates, an important goal of estate planning is to maximize the use of each spouse's estate tax exemption ($5.45 million for 2016). Often, this is accomplished by placing assets up to the exemption amount in a credit shelter trust. The excess amount would then be distributed to the surviving spouse, either outright or in a marital trust.

If a prenup distributes too much to the surviving spouse, it can leave the credit shelter trust underfunded, triggering unnecessary estate taxes in the surviving spouse's estate. A prenup should have the flexibility to accommodate this estate planning strategy and adapt to future changes in the exemption amount.

Disposing of the family home

Prenups often provide for the sale or other disposition of the family home, or give the surviving spouse the right to continue living there. The prenup should be drafted so that it doesn't impede your ability to execute home-related estate planning strategies, such as transferring the home to a qualified personal residence trust.

Work with your advisor

A prenup agreement is essential if you are considering marriage. Moreover, a well-drafted agreement can make a huge difference to the welfare of your estate.

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