

Electing for Uncertainty

Maryland decision erodes the ability to control and dispose of estates.



BY J. MAX BARGER

What's in a probate estate? After a new Maryland case, the answer for certain purposes apparently now includes assets previously excluded. Unless it is changed, this ruling could trip up the many Maryland residents who use Transfer on Death designations on investment accounts to simplify their estate plans.

The issue arises under a long-established public policy that discourages people from disinheriting their spouses. The common law gave a forced interest in a deceased spouse's estate to the surviving spouse. That approach has given way to the modern statutory model of the elective share, which lets a surviving spouse take a share of his or her predeceasing spouse's estate, regardless of what was written in the spouse's will. The elective share is set by state statute and varies anywhere from one-third to three-quarters of the estate, depending on the jurisdiction and on which family members survive.

A fundamental question in applying the elective share is what constitutes the "estate" from which the elective share is taken. In Maryland and the District, this "estate" is defined as the "net estate"—traditionally a probate concept.

On Dec. 11, the Maryland Court of Special Appeals changed Maryland law on what assets make up the net estate. In *Schoukroun v. Karsenty* (2007), the intermediate state appellate court expanded the size of the "net estate" from which the surviving spouse's elective share may be taken. This expansion erodes the ability of the decedent to control and dispose of his estate.

The court's decision challenged and, in fact, changed conventional practice by suggesting that standard probate avoidance tools such as a Transfer on Death instruction, beneficiary designations, and revocable trusts may be

included in one's net estate. If this case is not changed legislatively or on appeal, the result invites uncertainty.

FRAUD ON THE MARRIAGE

In *Schoukroun*, the decedent left life insurance proceeds to his wife and some brokerage accounts and his revocable trust assets to his daughter. Circumstances similar to these—a second wife and a minor child from a previous marriage, with an estate not large enough for the estate tax—are common.

This tidy and seemingly simple design was derailed by Schoukroun's widow. She claimed that her husband defrauded her by transferring assets to his revocable trust during his life and using a TOD beneficiary form that did not name her.

The reason for her claim was that previous case law in Maryland had exposed nonprobate assets to an election on the theory that such assets were fraudulently placed outside the reach of the election. A claim of fraud on the marriage was the necessary element for the widow to bootstrap the revocable trust and TOD property into the probate net estate. The *Schoukroun* court concluded, however, that fraud need not be proved, but rather can be found as a matter of law.

The gist of the *Schoukroun* opinion (at the risk of oversimplification) is that if you make anyone other than your spouse the beneficiary of an asset over which you retain "dominion and control," you are committing fraud on the marriage as a matter of law.

Your estate plan then can be unraveled to some degree by your surviving spouse (or your domestic partner in the District, if D.C. law follows the Maryland law in this case). "The [decedent's] intent is simply of no consequence," according to the court.

What is more remarkable, and what reflects the inequities created by this evolving area of the law, is that the net estate is seemingly not increased by assets the surviving

spouse may receive through nonprobate transfers. This permits surviving spouses to take a second bite of the apple by accepting all the nonprobate transfers intended for them but then also reaching for parts of the probate and nonprobate transfers intended for others. This result differs substantially from the traditional probate example where if an election against the will is made, a surviving spouse gives up what he or she would have received under the will.

In contrast, Virginia law is more certain. In Virginia, the augmented estate, modeled after the Uniform Probate Code, includes, roughly, the net probate estate (but not excluding transfer taxes), plus gifts the decedent made to the surviving spouse, gifts the decedent made to others during the marriage, property transferred during the marriage in which the decedent retained certain rights, and gifts the surviving spouse made to others that are derived from the decedent.

In Maryland, however, the absence of a statutorily defined augmented estate leads to considerable uncertainty. The case-by-case implementation of a pseudo-augmented estate has left Marylanders to navigate through the uncertainty created by an ad hoc concept of the net estate and the resulting elective share.

Moreover, the legal uncertainty in Maryland extends to the inclusion of separate property. In Virginia, property that a wife inherits from her parents and would be considered separate property in a divorce is considered separate property (and therefore not "reachable") under Virginia's augmented estate. In Maryland, however, it appears that as long as a Maryland wife retained dominion and control over the inherited assets, upon her death such inherited assets would be included in her net estate and would increase her surviving husband's elective share.

ADVISING IN THE AFTERMATH

One of the absolutes we can take from *Schoukroun* is that when representing a surviving spouse in an estate administration context in Maryland, particularly where there are other beneficiaries such as stepchildren, electing against the will is important to consider. Even if the spouse has received substantial nonprobate assets, election against the will of the deceased spouse will likely benefit the surviving spouse.

In this situation, the surviving spouse who is also the personal representative (the executor) of the estate must have separate counsel advise her about her elective-share claim against the estate. The same lawyer is likely unable to represent both the estate and the spouse, given their conflicting interests.

Although it is clear that an election against the will may be beneficial for the surviving spouse, advising the personal representative may be more problematic during the time period in which the surviving spouse may elect. The *Schoukroun* decision effectively stalls administration of the estate because of the lack of clarity regarding what will be included in the net estate where there is a potential election.

As a result of *Schoukroun*, it is as important to discuss prenuptial and marital agreements with clients as it is to discuss wills and powers of attorney. With a prenuptial or marital agreement that would specify that the spouses agree

to forego an elective share, the client can try to insulate his or her estate plan from an election against the will.

Additionally, carefully worded language in the will and beneficiary designations that ties a surviving spouse's portion to the lack of an election against the predeceasing spouse's is important to consider.

For parents planning to leave wealth to their children, long-term ("dynasty") trusts should be considered. Placing assets in trust for the lifetime benefit of a child would likely insulate such assets from an election against the child's will at the child's death by the child's surviving spouse. Including such tools in parents' wills effectively serves as a prophylactic "parental prenuptial" keeping family assets out of Maryland's net estate and Virginia's augmented estate. (Note, however, that although Virginia's augmented estate excludes assets the decedent received as a gift or an inheritance, once those assets are commingled with marital assets they lose their separate nature and become part of the augmented estate.)

FINDING A FIX

The recent ruling may also have an effect on long-standing laws relating to contracts (such as life insurance, IRAs, and annuities) and the Uniform Transfer-On-Death Security Registration Act.

For example, a financial institution that distributes assets to a named nonspouse beneficiary before the passing of the statutory time to file the election against the will may risk being named as a defendant in a claim of fraud on the marriage. Obtaining a waiver of the right to file the elective share by the surviving spouse would reduce delays and allow financial institutions and personal representatives to proceed with both distributions and administration.

Opponents of the augmented estate have pointed to this issue, claiming that the threat of an election against the augmented estate could drag financial institutions into the same murky waters. Yet for nearly two decades, the augmented estate has been a part of Virginia law. Although it is not perfect, it seems less likely to generate litigation and uncertainty because it takes a broader view of what comprises the decedent's assets and what should be included when calculating the elective share.

As a result of the uncertainty created in Maryland by *Schoukroun*, legislative intervention is needed (if the decision is not reversed on appeal).

Although the Maryland State Bar Section Council on Estate and Trust Law has repeatedly brought proposed augmented estate legislation to the attention of the legislature, Maryland lawmakers have not seriously taken up the matter.

The consequence is that a system of planning is threatened by piecemeal decisions that do not adequately or equitably address the many facets of this issue. Clearly, as even the *Schoukroun* opinion called for, legislative intervention would add certainty and give control back to individuals planning their estates.

J. Max Barger is an associate with Paley Rothman in Bethesda, Md., who concentrates in estate planning. He can be contacted at mbarger@paleyrothman.com.