NFLR NEVADA FAMILY LAW REPORT

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Rethinking Relocation

by Kathryn E. Stryker, Jolley, Urga, Wirth & Woodbury, Las Vegas

Today's family law practitioners are all too familiar with the problems facing our family court as the result of increased litigation between spouses. Family court caseloads are exploding, and custody and visitation issues constitute a large part of that caseload. In today's increasingly mobile society, it is not unusual to see custodial parents move from state to state, taking their children with them and necessarily impacting non-custodial parents' ability to have regular and frequent contact with their children.

In 1987, the Nevada Legislature followed the lead of numerous other states by enacting a statute which came to be known as Nevada's "anti-removal statute". *See* NRS 125A.350. Four years later, the Nevada Supreme Court interpreted NRS 125A.350 in *Schwartz v. Schwartz*, 107 Nev. 378, 812 P.2d 1268 (1991). Following the leading case out of New Jersey, *D'Onofrio v. D'Onofrio*, 365 A.2d 27 (N.J. Super. Ct. Ch. Div. 1976), the Nevada Supreme Court held that in determining the issue of removal, the trial courts must first determine whether the custodial parent has demonstrated that an actual advantage will be realized by both the children and the

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Estate Gift and Income Tax Consequences of Premarital Agreements

by Todd L. Torvinen

Do prenuptial agreements carry tax consequences? Most definitely. Under current law, pre-marriage transfers of property pursuant to premarital agreements may produce both Gift Tax and Income Tax consequences. Post-death obligations for payments to a surviving spouse created by premarital agreements may carry Estate Tax consequences.

GIFT TAX
THIS ISSUE: IS THERE A GIFT?

Since the creation of the Unlimited Marital Deduction under IRC § 2523 for lifetime transfers of property between spouses, such transfers, if pursuant to a premarital agreement, do not generally carry Gift Tax consequences. However, the issue of a Taxable Gift may still arise if: (1) the premarital agreement requires a *pre-marriage* transfer, which by definition would not qualify for the marital deduction under IRC § 2523; or (2) the premarital agreement requires the post-marriage transfer of property in trust to a spouse, where the terms of the trust provide that the spouse has an income interest which can terminate upon an event earlier than death

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From the Chairman

by Marshal Willick, Chairman

This Chair's column is written after the annual meeting at Tonopah. There are a few things all Section members should be thinking about, and a host of changes, challenges, and opportunities that will present themselves in the next year or so.

NEVADA LEGISLATURE

For pending projects, it is about time for the Section to prepare and present its second child support report to the Nevada Legislature. The Board of Bar Governors, after lengthy deliberation of potential problems ranging from proper use of Bar dues to the Separation of Powers Doctrine, consented to allow the Family Law Section to honor the statutory language in NRS 125B.070(2) and submit the quadrennial report on Nevada's child support laws. The only catch was we have to use our own budget for the process, which the Family Law Section Executive Council did not see as a problem. The Executive Council explicitly re-appointed the prior committee, all members of whom agreed to do the work required for this review, and the Committee has started its work.

The 1996 Report is to be given to the Legislature by January, 1997. We will be preparing model legislation to carry into effect the recommendations made. Any domestic relations practitioners with input to add to the Committee's review should contact me, or one of the following: Cassandra Campbell, Mary Anne Decaria, Peter B. Jaquette, Israel I. Kunin, Rhonda L. Mushkin, or Bruce I. Shapiro, with any information or suggestions.

Another major item on the table affecting the Legislature is the proposal, now being examined by the Council, of suggesting guidelines for temporary spousal support, and/or post-divorce alimony. At least three different models are in use in this state (for temporary spousal support, at least), and many other judges are using standards known only to themselves. This is the area of least predictability, and therefore greatest contentiousness, in current family law practice, and I think we could come up with guidelines that all concerned would believe provided our family court judges with a starting point in analyzing alimony claims.

As a final legislative matter, the recent writ of prohibition issued by the Nevada Supreme Court in *Flaherty v. Paluzzi*, No. 24962 (May 1, 1996) appears to restrict the jurisdiction of the Family Courts, and thus raises the question of what jurisdiction those courts *should* have. Presumably, the Section should take some position as to what cases should be assigned to the Family Courts. Please contact an Executive Council member with any opinions.

SPECIALIZATION PLAN

The Section, at its meeting in Tonopah, approved the proposed Certification of Specialization plan, and I will be submitting the plan to the Bar's committee on the subject, requesting Board of Governors approval and submission to the Nevada Supreme Court for institutionalization of a program.

UIFSA

Turning to the feds, things are also dynamic. It is quite likely that the federal government will mandate *verbatim* adoption of UIFSA to replace URESA, which will alter that practice somewhat. There are various other mandates that are quite likely to show up soon relating to child support enforcement, although it looks as if the push to a uniform national child support guideline, and a federal initiative relating to custody and visitation presumptions (both of which were floated for the past several years) are out of the picture for the time being.

BOUNDS OF ADVOCACY

There has been some question about the Bounds of Advocacy, since the Nevada Supreme Court declined to adopt them as even aspirational goals, indicating they did not want to differentiate among different fields of law, but had already approved the Bounds as aspirational goals for attorneys in Clark County under EDCR 5.04. The short answer: no one knows for sure.

We can be a little more sure about the

proposal for mandatory pro bono work. It looks as if the prior mandatory provisions have been replaced with strictly aspirational language. Since all that started out as a judicial and bench response to the problems created by the loose cannon "independent paralegals" that routinely careen around in the unauthorized practice of law doing truly amazing things to people, it remains to be seen whether the proposed solution addresses the perceived problem.

NEVADA FAMILY PRACTICE MANUAL

On the good news front, the Nevada Family Practice Manual looks like it is finally taking shape and will be published this year. I hope that it will prove to be a valuable tool for new and experienced attorneys alike. Also, I think we *finally* got the 1994 balloon ride refund situation straightened out. If anyone out there thinks they are still owed a refund, please call me.

As always, if any Section member thinks the Section ought to be doing something that it is not doing, please contact me or any other member of the Executive Council and tell us about it.

Editor's Column

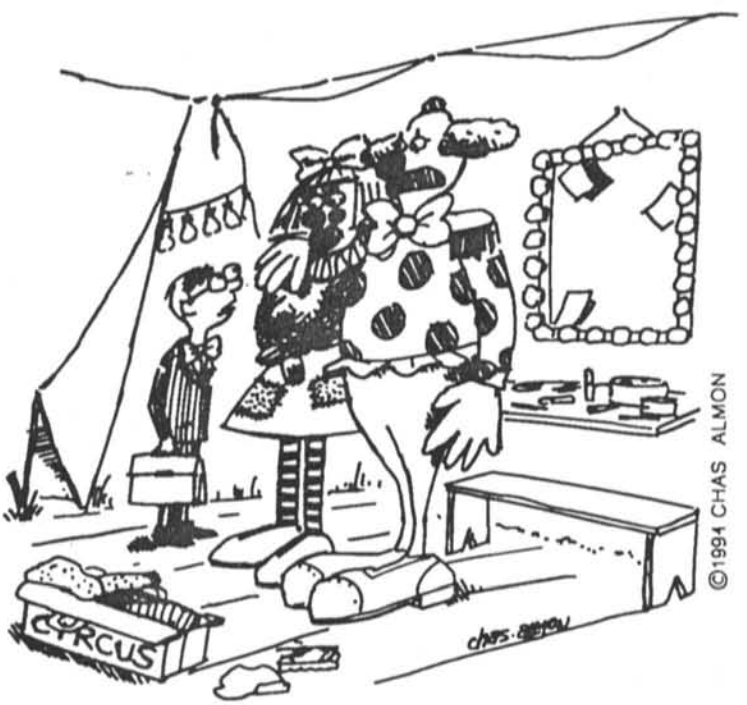
by Mary Rose Zingale, Editor

I am finally writing a short Editor's column after strong requests from fellow members of the Family Law Section. This will be a short, sweet and to the point column.

We need your input! I have printed a NFLR Judgment, Order and Settlement Report Form in this issue on page 11. This form was sent out by the section years ago. It was hoped that we could have a version of Tonopah "roundtables/networking" by providing information to each other via these forms throughout the year. I believe the printing of some of these in the NFLR, is an excellent opportunity for us to share our hard earned knowledge on a trial level. Let's face it - most of us never make it to the supreme court level - our clients in general do not have the money to appeal. Knowing who's who on the trial level and what is to be "expected" of us and the courts is helpful. Think about submitting these reports to me for printing.

Having articles to print also comes in quite handy! Once again think about submitting an article - one you have written or someone else has written. We are all intelligent, prolific people. Let's get it written down and published.

As usual, if you have any topics of interest you would like reviewed, if you have any suggestions as to the NFLR, I am all ears.



"I'm running away and joining an investment banking firm."

Articles, Case Summaries Wanted for NFLR

The Nevada Family Law Report seeks to provide interesting and substantive family law material to educate both the bench and the bar. NFLR needs articles for upcoming issues. If you are interested in writing critiques of pertinent cases, reports/opinions of family law legislation or discussions of family law trends and issues, please request authors guidelines from Editor Mary Rose Zingale, 528 Commercial St., Elko, NV 89801.

Articles published in the NFLR are eligible for continuing legal education credits. Contact the MCLE Board, 329-4443, for applications.

The Section's publication needs your input and contributions. Please contact an editor to discuss any article topic, critique or book review.

Relocation con't

custodial parent as the result of the proposed move, and if so, weigh additional factors to determine whether the move should be permitted.

Until recently, the outcome of a relocation case was typically difficult to predict. Trial courts often found that the best interests of the child mandated that the child not be relocated, even if relocation might be in the custodial parent's best interests. This changed abruptly following the Supreme Court's decision in *Trent v. Trent*, where the Court noted that NRS 125A.350 is "primarily a notice statute intended to prevent one parent from in effect 'stealing' the children away from the other parent by moving them away to another state and attempting to sever contact", and that the statute "should not be used to prevent the custodial parent from freely pursuing a life outside of Nevada when reasonable alternative visitation is possible."

PRE-TRENT DECISIONS

NRS 125A.350, Nevada's "removal statute", provides that

> If custody has been established and the custodial parent or a parent having joint custody intends to move his residence to a place outside of this state and to take the child with him, he must, as soon as possible and before the planned move, attempt to obtain the written consent of the other parent to move the child from the state. If the noncustodial parent or other parent having joint custody refuses to give that consent, the parent planning the move shall, before he leaves the state with the child, petition the court for permission to move the child. The failure of a parent to comply with the provisions of this section may be considered as a factor if a change of custody is requested by the noncustodial parent or other parent having joint custody.

Four years after this statute was enacted, the Supreme Court gave trial courts and practitioners guidance in its interpretation in *Schwartz v. Schwartz*, 107 Nev. 378, 812 P.2d 1268 (1991). No further decisions issued from the Supreme Court regarding the issue of relocation until late 1994.

In *Schwartz*, the custodial father filed a motion for permission to relocate from Nevada to Pennsylvania following the parties' divorce. During the marriage, the mother was hospitalized twice for depression; she had also attempted suicide on one occasion. Following the divorce, the father worked as a casino floorman, earning approximately $35,000 annually; the mother worked as a cocktail waitress, earning minimum wage plus tips.

During post-divorce custody proceedings, the mother accused the father (or alternatively, a babysitter), of sexually abusing one of the two children. Eventually, polygraphs revealed that the mother was being untruthful, and as a result, the decree was modified to limit the mother's visitation to supervised visits. As the result of the parties' work schedules, the children began spending as many as 10 hours per day in day care.

In support of his petition to relocate, the father presented evidence that his mother owned a 4-bedroom home in Pennsylvania where the family would reside, and which would accommodate a bedroom for each child. An extended family lived in the area, and the paternal grandmother was willing and able to assist with caring for the children. The father would save $440 per month in child care expenses, and would live with his mother rent-free. At the time of the petition, the father did not have definite employment lined up in Pennsylvania, but the court noted that he had a college degree and that he had received training as a stockbroker and real estate agent previously.

The trial court granted the father's petition, and the Supreme Court affirmed. The Supreme Court began its analysis by noting that

> [r]emoval of minor children from Nevada by the custodial parent is a separate and distinct issue from the custody of the children. However, some of the same factual and policy considerations may overlap. In custody matters, the polestar for judicial decision is the best interests of the child. *See* NRS 125.480. In removing a child from the jurisdiction where the child currently lives, the best

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by *Schwartz*. Pursuant to *Jones*, if the custodial parent shows a sensible, good faith reason for the move, the district court should then evaluate the other factors enumerated in *Schwartz*, focusing on whether reasonable, alternative visitation is possible. If reasonable, alternative visitation is possible, the burden then shifts to the noncustodial parent to show that the move is *not* in the best interests of the child. Such a showing must consist of concrete, material reasons why the move is inimical to the child's best interests.

The *Jones* decision is significant because it clearly shifted the burden of proof from the parent seeking permission to relocate to the parent opposing the request once the initial showing of good faith is made and a reasonable alternative visitation schedule is suggested. However, the decision reaffirmed the necessity for the weighing of the various factors set forth in the *Schwartz* decision, and did not radically depart from the underlying philosophy of *Schwartz*, i.e., that the trial court must carefully consider the request for relocation and the impact of the relocation on the child's relationship with the non-custodial parent. The Court was, however, setting the stage for just such a radical departure, which came in the form of the *Trent* decision.

THE *JONES* DECISION IS SIGNIFICANT BECAUSE IT CLEARLY SHIFTED THE BURDEN OF PROOF FROM THE PARENT SEEKING PERMISSION TO RELOCATE TO THE PARENT OPPOSING THE REQUEST ONCE THE INITIAL SHOWING OF GOOD FAITH IS MADE AND A REASONABLE ALTERNATIVE VISITATION SCHEDULE IS SUGGESTED.

TRENT V. TRENT

The Supreme Court began its opinion in *Trent v. Trent*, 111 Nev. 309, 890 P.2d 1309 (1995) by reciting the underlying facts of the case. Christi and Kenneth Trent (hereafter "Christi" and "Kenneth", respectively) separated in March 1991, and divorced in August, 1992. At the time of their divorce, their only son, Corey, was 2-1/2 years old. Christi was awarded primary physical custody, with specific visitation awarded to Kenneth. At the time of Christi's petition, Christi was caring for Corey on Monday, Tuesday, and Wednesday, and working on Thursday, Friday, and Saturday. On Thursday and Friday, Kenneth's sister cared for Corey until approximately 3:00 p.m., when Kenneth finished work and picked Corey up for the remainder of the day. Kenneth also had Corey with him on alternating weekends (including Friday nights) and some additional Saturdays and Saturday nights, while Christi worked.

The opinion then turned to a discussion of NRS 125A.350 and the guidelines set forth in *Schwartz*. The Court then stated,

> We find it disturbing that despite our decision in *Schwartz*, many district courts are using NRS 125A.350 as a means to chain custodial parents, most often women, to the state of Nevada. NRS 125A.350 is primarily a notice statute intended to prevent one parent from in effect "stealing" the children away from the other parent by moving them away to another state and attempting to sever contact (footnote omitted). Given the legislative purpose behind NRS 125A.350, it should not be used to prevent the custodial parent from freely pursuing a life outside of Nevada when reasonable alternative visitation is possible.

The Court concluded that because the record demonstrated that the mother had met the threshold under *Schwartz* of an actual advantage relating to the proposed move, and that reasonable, alternative visitation was possible, that the petition for removal should have been granted.

The *Trent* decision is significant for several reasons. The facts were such that the question of whether relocation should be allowed was a very close one, yet the Supreme Court made it clear that removal should have been allowed, simply because an actual advantage relating to the move had been shown, and because "reasonable, alternative visitation" was possible. The decision also offers an interesting interpretation of NRS 125B.350 as a "notice statute".

POST-TRENT DECISIONS

Following the *Trent* decision, the Supreme Court has considered three additional removal cases, two of which were consolidated on appeal (*Gandee v. Gandee* and *Montelione v. Montelione*, 111 Nev. 754, 895 P.2d 1295 (May 25, 1995)). In *Gandee*, the Supreme Court again reversed the trial courts' decisions denying the requests to relocate. The Supreme Court discussed its recent decisions, noting that:

> This line of cases establishes that the custodial parent wishing to remove the child from the state must make a threshold showing of "a sensible, good faith reason for the move." *Trent*, 111 Nev. at 312, 890 P.2d at 1313. "A `good faith' reason means one that is not designed to frustrate the visitation rights of the noncustodial parent." *Jones*, 110 Nev. at 1261, 885 P.2d at 569 (1994). . . . If, as in this case, the custodial parent meets this threshold requirement, the district court is then bound to consider other factors, as enumerated in *Schwartz*.

After stating the specific factors as set forth in *Schwartz*, the Supreme Court stated that "[i]n particular, a district court should focus `on the availability of adequate, alternate visitation', citing *Trent*.

Finally, in the most recent decision of *Cook v. Cook*, 111 Nev. 822, 898 P.2d 702 (1995), the Supreme Court stated that:

> We recently refined our *Schwartz* decision, summarizing the standard for removal as follows: " [A] custodial parent seeking removal does not

need to show a significant economic or other tangible benefit to meet the threshold 'actual advantage' showing. If the custodial parent shows a sensible, good faith reason for the move, the district court should evaluate the other factors enumerated in *Schwartz*, focusing on whether reasonable, alternative visitation is possible. If reasonable, alternative visitation is possible, the burden shifts to the noncustodial parent to show that the move is inimical to the children's best interests. . . .

We feel that this allocation of burdens is consistent with the evaluation process enunciated in *Schwartz* and is the most equitable way of balancing the interests of the children and the noncustodial parent, while giving the custodial parent the right to reasonable freedom to pursue his or her life. *Jones v. Jones*, 110 Nev. 1253, 1266, 885 P.2d 563, 572 (1994)."

Cook, 111 Nev. at _____, 898 P.2d at 705.

Thus, it is clear that the standard for removal can be easily met, as long as the custodial parent is not blatantly attempting to deny the non-custodial parent his or her visitation rights.

CONCLUSION

What was once an unpredictable issue in the family courts has now become a relatively straight-forward matter. If a custodial parent desires to relocate, for virtually any good-faith reason, he or she should be allowed to do so as long as reasonable, alternative visitation can be put in to place. One possible means of successfully opposing relocation may be to file a countermotion for a change of custody based upon the changed circumstances created by the proposed relocation. However, it seems unlikely that such a tactic would be allowed by the Supreme Court, given the strong directive toward allowing relocation as stated in *Trent* and its progenies.

Premarital con't

(typically, divorce or remarriage) and the remainder of the trust goes to someone other than the spouse.[1]

THE LEADING SUPREME COURT CASES

The leading cases with regard to the Gift Tax and premarital agreements are: *Commissioner v. Wemyss, 324 U.S. 303, 65 S.Ct. 652, 89 L.Ed 958 (1945)* and *Merrill v. Fahs, 324 U.S. 308, 65 S.Ct. 655, 89 L.Ed 963 (1945).*

In *Commissioner v. Wemyss*, the taxpayer and his fiance executed a premarital agreement. Under the terms of the agreement, the taxpayer transferred a certain number of shares of stock to his fiance. The transfer was in exchange for the income the fiance would lose from two trusts for her benefit established under the will of her deceased first husband. The transfers took place prior to the marriage, and the parties married within a month. The Commissioner found a gift and assessed a deficiency on the transfer.

The United States Supreme Court cited the predecessor to Treasury Reg. § 25.2512-8 and determined that there was no consideration for the transfer of the shares under the premarital agreement.[2] Further, the Court noted that while the loss of the trust income to the fiance may be consideration for contract purposes, it is not adequate and full consideration in money or money's worth for Gift Tax purposes. Accordingly, the Supreme Court found a gift and upheld the deficiency assessment.

The companion case to *Commissioner v. Wemyss*, is, *Merrill v. Fahs, supra.* In *Merrill*, the taxpayer and his fiance executed a prenuptial agreement. The terms of the prenuptial required that after the marriage, the taxpayer was to transfer $300,000 in trust to the fiance under terms which conformed with the fiance's wishes. In return for the trust, the fiance released all rights that she might acquire as a wife or a widow in the taxpayer's property, except the right to maintenance and support. The transfer occurred prior to the enactment of the Unlimited Marital Deduction for lifetime and testamentary transfers between spouses. The Commissioner assessed a deficiency on the post-marriage transfer.[3]

The Supreme Court held in *Merrill v. Fahs, at 324 U. S. 311*, that the Gift Tax and Estate Tax are "peri materia and must be construed together". The Supreme Court read the provisions of the Estate Tax Code which denied adequate and full consideration treatment of released marital property rights into the Gift Tax Code. As a result, the transfer to the fiance was not supported by adequate and full consideration and was subject to Gift Tax.[4]

CURRENT STATUTORY SCHEME

IRC § 2512(b) provides that a taxable gift occurs when a transfer of property during the year is made for less than adequate and full consideration in money or money's worth. Under IRC § 2043(b)(1), the relinquishment or promised relinquishment of dower or courtesy or statutory estate created in lieu of dower or courtesy or of other marital rights in the decedent's property or estate shall not be consideration in money or money's worth and such a relinquishment results in a gift.[5] However, the release of spousal support rights is consideration in money or money's worth.[6]

GIFT TAX - WAIVER OF SPOUSAL SUPPORT AS CONSIDERATION FOR PREMARITAL TRANSFERS

In the case of *Ellis v. Commissioner, 437 F.2d 442 (9th Cir. 1971)*, a future husband and wife executed a prenuptial agreement. Under the terms of the prenuptial agreement, the wife waived all alimony and support rights in the event of legal separation or divorce in exchange for a trust which was established for the benefit of the wife. The agreement was executed and the trust was established prior to the marriage of the parties.

The Ninth Circuit held that, because under Arizona law antenuptial agreements waiving support were void, there were no rights to waive. Accordingly, because there were no rights to waive, no consideration was given by the trust beneficiary; therefore the trust corpus was deemed a gift to the future wife.

This case strongly suggests that in the Ninth Circuit, if a State law was such that

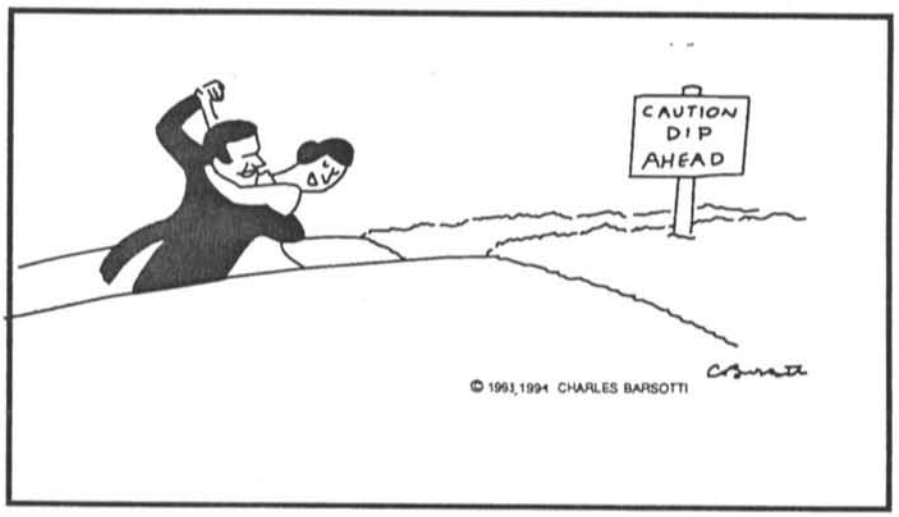
a party to a premarital agreement could waive the right to alimony or spousal support legally, then such a waiver could be deemed at least partial consideration in money or money's worth. In Nevada, under NRS 123A.050(1)(d), a premarital agreement may provide for "modification or elimination of alimony or support or maintenance of the spouse". Accordingly, under the standard provided by the case of *Ellis v. Commissioner, supra,* in Nevada, at least such a waiver of support rights by a spouse may qualify as consideration in money or money's worth and there is a position to avoid taxation of a pre-marriage property transfer.[7]

VALUATION OF EXCHANGED SUPPORT RIGHTS

An interesting question is how to value the exchanged support rights. The Internal Revenue Service would probably take the position that the released support rights must be valued, on an actuarial basis and, to the extent that the property transferred exceeds the value of the support rights released, there is a gift.[8] However, there is authority for the position that a bargained for exchange is deemed equal in value without more. In the case of *Estate of O'nan v. Commissioner, 47 T.C. 648 (1967),* a husband and wife executed a post nuptial contract settling marital rights. A written property settlement agreement was produced after lengthy negotiations where the wife exchanged support rights and the husband transferred a farm to the wife giving her a remainder interest and retaining a life estate for himself. There was no exact way to value the support rights given up by the wife. The Tax Court held that the exchange was assumed to be equal because the parties, through their respective counsel, acted in arms length and actively bargained. Therefore the marital rights exchanged were equal in value to the property which was exchanged. Applying this holding to the premarital context, assuming both parties were represented by counsel; and there were active negotiations and arms-length bargaining between lawyers and parties, equality of consideration may be found.[9]

DATE TRANSFERS DEEMED TO OCCUR

Another issue for Gift Tax purposes is when the transfer takes place. In the case of *Commissioner v. Coply's Estate, 194 F.2d 364 (7th Cir. 1952),* the court held that for most premarital agreements where the obligation for any transfers is contingent upon marriage, then obligation is triggered by the actual marriage and cannot occur any sooner than the marriage date. See also Revenue Ruling 69-347, 1969-1 C.B. 227.



ESTATE TAX: THE ISSUES

With regard to prenuptial agreements and Estate Tax, there are two main issues: 1) whether a post-marriage transfer pursuant to a prenuptial agreement where the transferor retains an interest (IRC § 2036-2038) will be included in Gross Estate upon the death of transferor the property; and 2) whether obligations created pursuant to a premarital agreement are deductible on the Estate Tax return of the deceased obligor spouse.

INCLUSION IN GROSS ESTATE OF RETAINED INTERESTS: IN GENERAL

Under IRC § 2036, transfers where the decedent retains a life interest are included in Gross Estate, except in the case of a sale for adequate and full consideration in money or money's worth. Under IRC § 2037, the value of Gross Estate includes all property to the extent the decedent retains a reversionary interest greater than five percent (5%) of the value of such property unless the interest was created in a sale for adequate and full consideration in money and money's worth. Finally, under IRC § 2038, revocable transfers are included in Gross Estate, except in the case of a bonifide sale for adequate and full consideration in money or money's worth. Accordingly, for a transfer with some sort of retained interest or reversion, the question is whether the transfer was made for adequate and full consideration in money or money's worth. IRC § 2043(b)(1) provides that the relinquishment or promised relinquishment of dower, courtesy or statutory estate created in lieu thereof, or other marital rights in the decedent's property of estate, shall not be considered to any extent a consideration "in money or money's worth".

As a general rule, if the retained interest pursuant to a premarital agreement is incorporated into a divorce decree, any such transfers with the retained interest qualify under the "court decree exemption." *(See below under Claims Pursuant to Premarital Agreements.)* Therefore, if the spouse with the retained interest created by a prenuptial agreement but merged

into and ordered by a divorce decree, dies, the value of the property will not be included in his Gross Estate.[10]

ESTATE TAX DEDUCTIONS CLAIMS PURSUANT TO PREMARITAL AGREEMENTS

Under IRC § 2053(c)(1)(a), claims against an estate are disallowed to the extent they are not contracted for bonifide and for adequate and full consideration in money and money's worth. Under IRC § 2043(b), the release of dower, curtesy or statutory estate or other marital rights in the decedent's property or estate is not considered to any extent money or money's worth. As a result, claims based on a release of these property rights are not deductible. However, as noted above, the release of marital support rights (alimony) and the release of an obligation for support of minor children are considered to be for adequate and full consideration.[11] The question is: When are claims based on obligations created by premarital agreements deductible? As a general rule, obligations created by premarital agreements are deductible if they are merged into a decree of divorce or are merged into a written property settlement agreement and the parties become divorced one year before or two years after the written property settlement agreement (3-year rule).[12] Therefore, as a practical matter, an estate will have difficulty deducting post-death obligations created by a premarital agreement only when: (1) the parties are married at the date of death, but the premarital agreement requires transfers to the surviving spouse which do not qualify for the Unlimited Marital Deduction under IRC § 2056(a) because they are non-qualified terminable interests under IRC § 2056(b) (typically, a transfer in trust which *terminates* upon the surviving spouse's remarriage), or (2) the parties are divorced but the obligation created by the premarital agreement is not merged into a divorce decree, or the 3-year rule is not applicable. In these cases, the obligation must be supported by adequate and full consideration.

WAIVER OF SUPPORT RIGHTS AS ADEQUATE AND FULL CONSIDERATION

In the *Estate of Ellman v. Commissioner, 59 T.C. 367 (1972)*, under a premarital agreement, the wife waived all statutory property rights and post death widow's support rights in exchange for $500.00 a month from trust for life or sooner remarriage, remainder to husband's children. The Tax Court held that regardless of the enforceability of the claim under state law, the spouse who received the non-qualified terminable interest and waived both dowry and widow's support rights did not transfer adequate consideration in money or money's worth, and a deduction was denied to the estate. The Tax Court distinguished between support rights during marriage and support rights after death for purposes of adequate and full consideration under IRC § 2043(b) and held that the release of widow's support rights was not adequate and full consideration.[13]

What happens if a prenuptial agreement provides that an obligation is created wherein, upon the death of the obligor spouse, the obligee spouse receives terminable interest property that doesn't qualify for the marital deduction, and the prenuptial agreement states that the recited consideration includes both a waiver of marital property rights and intervivos support rights? Is there valid consideration to support a deduction upon the death of the obligor spouse? To some extent it depends upon the Circuit in which the death occurs. As previously stated, the waiver of the right to support which a spouse is entitled before the other spouse's death is consideration in money or money's worth.[14] The Ninth Circuit appears to accept a distinction between the waiver of support rights and property rights.[15] However, the Second Circuit and the Tax Court do not seem to accept the distinction between marital property rights and spousal support rights when both are waived in the same premarital agreement.[16]

For example, suppose a prospective husband and wife execute a premarital agreement. Each party owns real property. They grant each other reciprocal life estates in each other's property, subject, however, to sooner termination if the parties divorce. The remainder of each of the life estates goes to someone other than the grantor or the spouse. Each party, also under the terms of the agreement, waives his or her rights to dowry, curtesy or statutory property rights. One of the parties dies. Is the estate allowed a deduction for the value of the life estate of the survivor? This was the very issue addressed in the *Pollard's Estate v. Commissioner, 52 T.C. 741 (1969)*. In this case, the Tax Court merged the waiver of the life estates which would be consideration into the waiver of statutory property rights. The Tax Court held that under state law the terms of the prenuptial agreement requiring waiver of the statutory property rights had to be read together with the consideration of the reciprocal life estates. Accordingly, the Tax Court found that, if all waivers were construed together, there was no consideration under IRC § 2043(b). The Tax Court disallowed the deduction to the deceased's estate for the value of the life estate.

Similarly, in the case of *Estate of Herbert R. Herrman, et al. v. Commissioner, 1995 RIA T.C. Memo para 95,090*, a husband and wife executed a prenuptial agreement in 1984, prior to marriage. At the time of execution, the husband's net worth was $1.5 million and the wife's was $275,000. Under the terms of the prenuptial agreement, the husband and wife each agreed to waive all support and equitable and testamentary property rights in exchange for wife receiving a $50,000 pension upon the husband's death and also a life estate in his condominium which would be earlier terminated on her remarriage. Subsequent to this, the husband dies. The estate filed an Estate Tax Return and deducted the value of the life estate remaining for the surviving wife. The Commissioner denied the deduction and assessed a deficiency.

The Tax Court held that there was no marital deduction available because the interest was not a qualified terminable interest, in that it would terminate earlier than the life of the surviving spouse if she remarried.[17] The Tax Court also noted that the waiver of testamentary rights does not support an exchange for adequate and full consideration but that a waiver of spousal support does. The Tax Court found, citing *Pollard's Estate v. Commissioner, supra,* that all promises were to be taken together and examined as a single undertaking. Accordingly, the Court held that the waiver of equitable rights in each other's property clearly was not for adequate and full consider-

ation under IRC § 2043(b)(1). The Court hinted that in the proper case they may support an apportionment between a waiver of support rights and a waiver of property rights; however, in this particular case, there was no evidence to support such an apportionment. The Tax Court also noted that the whole transaction looked testamentary.

OTHER PROPERTY AS ADEQUATE AND FULL CONSIDERATION

Suppose an older couple is contemplating marriage. The proposed wife is receiving income from a trust as a result of a prior death of a previous husband. In addition, the income will stop if she remarries. Accordingly, the prenuptial agreement requires that if husband predeceases wife, his estate is to pay her $12,000 a year for her life. She gives him a life estate in the residence in which she lives, in case he survives her. Further assume that the payments of $12,000 a year will cease if the wife remarries (a non-qualified terminable interest that will not support a marital deduction). After that the husband dies, his estate has an obligation to pay the surviving wife the amount of $12,000 a year. Question - is this a deductible claim under IRC § 2053?[18]

The case of the *Estate of Morse v. Commissioner, 69 T.C. 408, aff'd 625 F.2d 133 (6th Cir. 1980)* may provide the answer. In Morse, the court held that the wife's losing trust income was not consideration for the promise to pay her $12,000 a year if she survived. *See also Commissioner v. Wemyss, supra at 324 U.S. 307.* However, the Court stated in dicta that the life estate in the residence which she granted to her husband would have been consideration if it had been bargained for (apparently it was not in *Morse*). Accordingly, *Morse* offers a position for deduction, if the unlimited marital deduction is not available under IRC § 2056.

WAIVER COMMUNITY PROPERTY RIGHTS AS CONSIDERATION

What about the waiver of community property rights? Would such a waiver support an exchange for adequate and full consideration in money and money's worth? Clearly, community property interest is different than the inchoate rights of dower, courtesy or statutory estate. In Nevada, a community property interest is a present vested interest.[19]

Part of the answer may have been provided in the case of *Estate of Carli v. Commissioner, 84 T.C. 649 (1985).* In *Carli*, prospective husband and wife executed a premarital agreement. They were California residents. Under the terms of the premarital agreement, the husband, who had a revocable trust, agreed to amend the terms of the trust to allow a life estate for the wife in the trust assets if she survived him, but which would terminate earlier on her remarriage. The premarital agreement also recited that each of the parties would reciprocally waive support rights against each other and each of the parties waived interest in the other's community earnings. The husband was the only one of the parties to have community earnings. Several years later, the husband died. The husband's estate attempted to deduct the value of the life estate under IRC § 2053. The Commissioner disallowed the deduction.

No marital deduction was available because, under the law, the property was terminable interest property. The Tax Court held that, because the husband had community earnings and the wife waived any interest in those earnings, there was full and adequate consideration in money or money's worth and accordingly allowed the deduction for the estate. The Court essentially recognized the unique nature of community property. In addition, the Court specifically held that the waiver of right to support was not adequate and full consideration in money or money's worth, as it was void against public policy in California at the time.[20] However, the Court noted that, even if the law was changed (it noted that the law regarding the waiver of alimony for support rights was changing and becoming more liberal), the waiver of support rights by each party was not adequate and full consideration because it was reciprocal (versus unilateral) and, therefore, there was no consideration for the decedent's promise to devise a life estate to her.

However, it is difficult to reconcile the holding in the *Carli* case with the case of *Trust Services of America, Inc. v. U.S., 885 F.2d 561 (9th Cir. 1989). Trust Services* holds that the release of community property rights in exchange for an obligation for payment is not (emphasis added) an exchange for adequate and full consideration in money or money's worth. In this case, the Ninth Circuit literally interprets IRC § 2043(b)(1) without recognizing the unique rights married couples have in community property.

Perhaps the *Carli* and *Trust Services* can be reconciled because of the waiver of an interest in community earnings is somewhat measurable and can be forecast in the future if one of the spouses is earning income at the time the premarital agreement is signed; whereas the waiver of an interest in community property is more difficult to forecast as one does not know whether any community property will be acquired. It could be that all the community earnings are used to pay living expenses, which would produce the situation which would not allow for the acquisition of any community property.

Strangely, Fourth Circuit appears to have adopted a different rule with regard to community property. The *Estate of Waters v. C. I. R., 48 F.3d 838 (4th Cir. 1995)* holds that in North Carolina which has adopted a type of quasi community property law, the relinquishment of a community property interest in exchange for an obligation requiring payments is a relinquishment for adequate and full consideration. The Fourth Circuit notes that a relinquishment of community property is indeed different than the relinquishment of dower or courtesy right, as it is a present vested interest.

INCOME TAX CONSEQUENCES

The primary concern from an income tax standpoint for transfers pursuant to premarital agreements arises where, under the terms of premarital agreement, there is a transfer of property from spouse to another in exchange for either support rights or marital property rights. If the transfer occurs prior to the marriage, the transferor or spouse will recognize gain to the extent that the value of the support rights waived, or the value of the marital property rights waived, exceeds the basis of the property transferred.[21] If the transfer occurs after the date of marriage, no gain or loss is recognized because of the requirements of IRC § 1041. The basis to the waiving spouse of the property trans-

ferred pre-marriage in exchange for the marital rights or interest in marital property rights is the fair market value at the time of the transfer and no gain or loss is recognized by the waiving spouse.[22]

CONCLUSION

If a premarital agreement requires premarital transfers of money on property, there are likely Gift Tax consequences and possibly Income Tax consequences. If a premarital agreement provides post-death obligations and payments to a surviving spouse which may terminate upon the remarriage of the surviving spouse, there are likely Estate Tax consequences, regarding the deductibility of such obligations from Gross Estate.

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NOTES

[1] In general, if the income interest of a recipient spouse in property transferred by the other spouse will terminate upon an event other than the death of the recipient spouse, and the remainder goes to someone other than the recipient spouse or his or her appointees, then such a transfer is a *non-qualified* terminable interest and is subject to the Gift Tax under IRC § 2523(b). *See also IRC § 2523(e) and 2523 (f).*

[2] Treasury Reg § 25.2512-8 states in part as follows: "...consideration not reducible to a value in money or money's worth, as love and affection, promise of marriage, etc. is to be wholly disregarded, and the entire value of the property transferred constitutes the amount of the gift. Similarly, a relinquishment or promised relinquishment of dower or courtesy, or of a statutory estate created in lieu of dower or courtesy, or of other marital rights in the spouse's property or estate shall not be considered to any extent a consideration 'in money or money's worth....'"

[3] This case was decided prior to the unlimited deduction for gifts to a spouse under IRC § 2523. Today, with the enactment of IRC § 2523 such an unlimited marital deduction would be available and the issue as raised in the case of *Merrill v. Fahs, supra* probably would not arise, unless the transfer was a non-qualified terminable interest under I.R.C. § 2523(b) and (f). *See footnote 1 above.*

[4] Under the current code, a gift occurs where a transfer during a year of property is made for less than "adequate and full consideration in money or money's worth." IRC § 2512(b)

[5] See also Treasury Reg. § 25.2512-8.

[6] *Revenue Rule 68-379, 1968-2 C.B. 414.*

[7] The Nevada premarital statute also provides that a premarital agreement means an agreement between prospective spouses in contemplation of marriage and to be an effective upon marriage. *NRS 123A.030.* Technically, under the statute, an agreement requiring a pre-marriage transfer of property would not be classified as a premarital agreement. However, since such a transfer would seem on its face to be less prejudicial to the spouse waiving the support rights in exchange for the transfer, the public policy of *NRS 123A.050(d)* allowing the elimination of alimony or support or maintenance should apply to such a contract.

[8] See for example *Revenue Ruling 71-67, 1971-1 C.B. 271; Estate of James Harris Scholl v. Commissioner, 88 T.C. 1265 (1987).*

[9] It is also interesting to note, that under *NRS 123A.080,* in order for a premarital agreement to be enforceable there has to be a fair and reasonable disclosure of the property or financial obligations of the party who wants to enforce the agreement. In general, in wont of this the agreement is found to be unenforceable. See also *Sogg v. Nevada State Bank, 108 Nev. 308, 832 P.2d 781 (1992),* which holds that in such a case and where the wife in this case did not have strong business acumen, the wife must have representation of *independent* counsel prior to signing the agreement before it becomes enforceable; as a fiduciary relationship is presumed. Accordingly, under Nevada law arms-length negotiation is probably required in order for the agreement to be enforceable in any event.

[10] *Harris v. Commissioner, 340 U.S. 106, 71 S. Ct. 181, 95 L.Ed 111 (1950); Estate of O'Nan v. Commissioner, 47 T.C. 648 (1967), acq, 1967-2 C.B. 3.*

[11] *Revenue Ruling 71-67, 1971-1 C.B. 271.*

[12] Obligations to pay property settlement, child support and alimony are deductible from Gross Estate if pursuant to a decree of divorce. See *Commissioner v. Converse, 163 F.2d 131, 133 (2d Cir. 1947).* In addition, under IRC § 2043(b)(2) and IRC § 2516 the relinquishment of marital property rights spousal support, and child support in a written property settlement agreement in exchange for obligations of payment and entered into two years before the date of divorce or one year after are *deemed* (emphasis added) for adequate and full consideration, and are deductible.

[13] The Tax Court cited the case of *United States v. Staph, 375 U.S. 118, 84 S. Ct. 248, 11 L.Ed.2d 195 (1963),* where the United States Supreme Court held that just because an obligation is enforceable against an estate under state law does not mean the obligation generates estate tax deductions.

[14] *Revenue Ruling 68-379, 1968-2 C.B. 414.*

[15] *Trust Services of America v. U.S. 885 F.2d 561 (9th Cir. 1989).*

[16] *Adriance v. Higgins, 113 F.2d 1013 (2nd Cir. 1940); Meyers Estate v. Commissioner, 110 F.2d 367 (2nd Cir. 1940), Cert. Denied, 310 U.S. 651, 84 L.Ed. 1416 (1940).*

[17] *See* IRC § 2056(b)(5) and § 2056(b)(7).

[18] A deduction under IRC § 2056 would not be available since the parties were not married at the date of death.

[19] *NRS 123.225.*

[20] See also *Ellis v. Commissioner, 437 F.2d 442 (9th Cir. 1971).*

[21] *United States v. Davis, 370 U.S. 65, 82 S. Ct. 1190, 8 L.Ed 2d 335 (1962).*

[22] *Farid-Farides-Sultaneh v. Commissioner, 160 F.2d 812 (2nd Cir. 1947),* which holds that where a prospective spouse releases marital rights they are presumed to be at least worth the value of the property acquired and that is his or her basis. *See also Revenue Ruling 67-221, 1967-2 C.B. 63.*

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[ ]-Child Support [ ]-Spousal Support/Alimony
[ ]-Property Division [ ]-Other

EXPLANATION/SUMMARY: _____

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